A STUDY ON GLOBALIZATION OF PHILIP MORRIS INC.

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ABSTRACT

A STUDY ON GLOBALIZATION OF PHILIP MORRIS COMPANIES INC.

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With the trend of free trading and opening of the market, market leading multinational tobacco companies are accelerating their moves to take advantageous position in the global tobacco market.

From 1987, after the opening of the Korean cigarette market, all the major cigarette brands of multinational tobacco companies came into the Korean cigarette market and have been competing fiercely. Korean Tobacco and Ginseng Corporation (KT&G) which had enjoyed monopolistic status is losing its market share. In Korea, the cigarette market has matured and there is little room to grow in the domestic market. Outside of Korea, there are many growing tobacco markets in the world, and KT&G's future growth will can only come from international sales.

This study has examined Philip Morris Companies INC's (PM) successful case of globalization in the tobacco industry. From this study, PM's key success factors of successful globalization was found.

This study shows that PM's successful globalization has accomplished by superior tobacco industry knowledge, global Marlboro franchise, strong portfolio of American Heritage Brands, vast manufacturing, sales, and distribution infrastructure.

With these strengths, Philip Morris generates substantial excess free cash flow and is constantly in search of investment vehicles.

For globalization, KT&G has to develop technology and reduce cost for achieving price competitiveness, and it has to do licensing, joint-venturing or strategic alliances in the areas of product development, manufacturing, and marketing outside of Korea.

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CHAPTER 1 INTRODUCTION

1.1 Background and Purpose of the Study

From 1987, after the opening of the Korean cigarette market, all the major cigarette brands of multinational tobacco companies came into the Korean cigarette market and have been competing fiercely. Korean Tobacco and Ginseng Corporation (KT&G) which had enjoyed monopolistic status in the domestic market is losing market share. In Korea, the cigarette market has matured and there is little room to grow in the domestic market. Outside of Korea, there are many growing tobacco markets in the world, and KT&G's future growth can only come from international sales.

Many multinational tobacco companies are successfully doing business in the world cigarette market. In an attempt to compensate for the loss in the domestic market, multinational tobacco companies are pursuing global strategies. An increase of international business activities including M&A, joint-ventures and alliances, precipitated by the growth in competition has also been witnessed over the past decade.

Philip Morris is the leading company among multinational tobacco companies. A study on the global strategy of multinational tobacco company is essential for KT&G's globalization.

In this research, I would like to study the following issues:

- Analyze competition among big multinational tobacco companies.
- Analyze the globalization strategy of Philip Morris.
- Recommend the desirable globalization strategies for KT&G.

1.2 Organization of the Study.

The introductory chapter examines the rationale of global strategy. Chapter 2 discusses the concept, motives and benefits of global strategy. Chapter 3 examines competition among multinational tobacco companies. Chapter 4 focuses on the globalization strategy of Philip Morris. Chapter 5 summarizes the key findings of the research and recommend desirable actions for KT&G.

[Figure 1.1] Overview of the Study

Introduction
∘ Background and Purpose ∘ Organization

↓

Globalization of the Tobacco Industry			
World Cigarette Market	Operating Environment	Company Strategies	Major Companies' Competitive Comparisons

↓

Globalization of Philip Morris Inc.			
Company Profile	Cigarette Product Portfolio	Process of Globalization	Performance Review

↓

Conclusions
∘ Summary of Key Findings ∘ Recommendations

Chapter 2 LITERATURE REVIEW ON GLOBALIZATION

2.1 Concept of Globalization

At its core, globalization is the process by which the world's economy is transformed from a set of national markets into a set of markets that operate without regard to national boundaries.[1]

Today most business activities are global in scope. Finance, technology, research, capital and investment flows, production facilities, and marketing and distribution networks all have global dimensions. Every business must be prepared to compete in an increasingly interdependent global economic environment, and all business people must be aware of the effects of these trends when managing a multinational conglomerate or a domestic company that exports. Even companies that do not operate in the international arena are affected to some degree by the success of the European Community, the export-led growth in South Korea, the revitalized Mexican economy, and the economic changes taking place in China.

It is less and less possible for business to avoid the influence of the internationalization of the U.S. economy, the globalization of the world's markets, and the growth of new emerging markets. As competition for world markets intensifies, the number of companies operating solely in domestic markets will decrease. Many forces are driving companies around the world to globalize — in the sense of expanding their participation in foreign markets. Companies also need to globalize in another sense — that is, integrating their worldwide strategy.

2.2 Motivation of Globalization

Among the earliest motivations that drove companies to invest abroad was the need to secure key supplies especially minerals, energy, and scarce raw material resources.[2] Aluminum producers needed to ensure their supply of bauxite, tire companies went abroad to develop rubber plantations, and oil companies wanted to open up new fields in Canada, the Middle East, and Venezuela. By the early part of this century, Standard

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[1]) J. Fraser, "What's New about Globalization?," The McKinsey Quarterly, 1997.

[2]) Christopher A. Bartlett, Sumantra Ghoshal, "Transnational Management," The McGraw-Hill Companies, Inc., 1995, p. 5.

Oil, Alcoa, Goodyear, Anaconda Copper, and International Nickel were among the largest of the emerging MNCs.

Another strong trigger of globalization could be described as the market-seeking behavior. This motivation was particularly strong in companies that had some intrinsic advantage, typically related to their technology or their brand recognition, that gave them some competitive advantage in offshore markets. Although their initial attitudes were often opportunistic, many companies eventually realized that these additional sales allowed them to exploit economies of scale and scope, thereby providing a source of competitive advantage over their domestic rivals. This was a particularly strong motive for some of the European multinationals whose small home markets were insufficient to support the volume-intensive manufacturing processes that were sweeping through industries from food and tobacco to chemicals and automobiles. Companies like Nestle, Bayer, and Ford expanded internationally primarily in search of new markets.

Another traditional and important trigger of globalization was the desire to access low-cost factors of production. Particularly as tariff barriers declined in the 1960s, many U.S. and European companies for whom labor represented a major cost found that their products were at a competitive disadvantage compared to imports. In response, a number of companies in clothing, electronics, household appliances, watchmaking, and other such industries established offshore sourcing locations for producing components or even complete product lines. Soon it became clear that labor was not the only productive factor that could be sourced more economically overseas. For example, the availability of lower-cost capital (perhaps through a government investment subsidy) also became a strong force for globalization.

2.3 Objectives and Sources of Competitive Advantage

As shown in Exhibit 1-1, there are three categories of objectives pursued by a global firm:[3] (1) achieving efficiency, (2) managing risks, and (3) innovating, learning, and adapting. The key is to create a firm's
competitive advantage by developing and implementing strategies that optimize the firm's achievement of these three categories of objectives.

[3]) Arvined V. Phatak, "International Management: Concepts and Cases," International Thomson Publishing, 1997, p. 14.

EXHIBIT 1-1

Global Strategy: An Organizing Framework

Strategic Objectives	**Sources of Competitive Advantage**		
	National Differences	Scale Economies	Scope Economies
Achieving efficiency in current operations	Benefiting from differences in factor costs — wages and cost of capital	Expanding and exploiting potential scale economies in each activity	Sharing investments and costs across products, markets, and businesses.
Managing risks.	Managing different kinds of risks arising from market-er policy-induced changes in comparative advantage of different countries.	Balancing scale with strategic and operational flexibility	Portfolio diversification of risks and creation of options and sidebets
Innovation, learning, And adapting.	Learning from societal differences in organizational and managerial processes and systems.	Benefiting from experience —cost reduction and innovation.	Sharing learning across organizational components in different products, markets, or businesses.

Source: Sumantra Ghoshal, "Global Strategy: An Organizing Framework," Strategic Management Journal, Vol. 8, 1987, p. 428.

2.4 Three Levels of Globalization

For globalization to be successful, an organization must align its global strategy at all three levels—strategy/structure, corporate culture, and people. Failure to do this has been the single most common reason that organizations have failed in their attempts to go global.[4]

[4]) Stephen H. Rhinesmith, “A Manager's Guide to Globalization,” 1996, p. 7-11.

Level Ⅰ: Strategy/Structure

Strategy/Structure defines the relatvely fixed mix of centralization/decentralization and geographic/functional/business/product structure to be used for best competitive advantage. A global organization must devise a structure that encourages quick decision making. It may relocate some functions to places other than headquarters. A multicentered organization emerges that can serve all parts of the firm anywhere in the world.

Level Ⅱ: Corporate Culture

Corporate culture encompasses the values, norms of behavior, systems, policies, and procedures through which an organization adapts to the complexity of the global arena. The foremost concern of any global corporation is the speed and agility with which it can respond to new developments anywhere in the world. To achieve this, the corporation must create a common vision and value system that provides guidance for decentralized management. It must also constantly scan the environment for new trends and directions.

Successfully developing a global corporate culture involves not only understanding, skill, and the reallocation of resources but also the ability to deal with issues of identity, power, and psychology that are always difficult to overcome in any organizational change.

Level Ⅲ: People

A global organization's people, and especially its global managers, constitute the most critical factor in the organization's ability to survive and grow. People represent an organization's purpose, mission, values, and mindset, which are the generative juices that enables it to respond creatively to the unanticipated. Thus, in a global organization, the human resource challenge is the traditional one of recruitment, selection, training, and succession planning, but on a global scale from global sources. Global and cross-cultural training and career-path planning are fundamental for all global managers, regardless of their domestic or international assignments.

2.5 Global Strategy Levers

Globalization strategy is multidimensional. Setting strategy for a worldwide business requires choices along a number of strategic dimensions. There are five such dimensions:[5]

- Market participation involves the choice of country-markets in which to conduct business and the level of activity, particularly in terms of market share.
- Products/services involves the extent to which a worldwide business offers the same or different products in different countries.
- Location of value-adding activities involves the choice of where to locate each of the activities that comprise the entire value-added chain — from research to production to after sales service.
- Marketing involves the extent to which a worldwide business uses the same brand names, advertising, and other marketing elements in different countries.
- Competitive moves involves the extent to which a worldwide business makes competitive moves in individual countries as part of a global competitive strategy.

For each global strategy dimension or lever, a multilocal strategy seeks to maximize worldwide performance by maximizing local competitive advantage, revenues, or profits, whereas a globalized strategy seeks to maximize worldwide performance through sharing and integration. Intermediate positions are feasible. A business that has a fully globalized strategy would make maximum use of each of the five global strategy levers and would therefore have fully global market participation, global products and services, global location of activities, global marketing, and global competitive moves. But, not every business should use such a strategy.

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[5]) George S. Yip, "Total Global Strategy," Prentice-Hall, Inc., 1995, p. 12-13

2.6 Benefits of Global Strategy

Use of global strategy can achieve one or more of four major categories of potential globalization benefits:[6]

- Cost reduction
- Improved quality of products and programs
- Enhanced customer preference
- Increased competitive leverage

[6]) George S. Yip, op. cit: p. 16

CHAPTER 3 GLOBALIZATION OF THE TOBACCO INDUSTRY

3.1 World Cigarette Market Overview

The world tobacco industry is facing its toughest period to date. In 1997, world cigarette consumption contracted for the first time since 1992 and given the present climate, manufactures are likely to face further difficulties during 1998.[7] Although, the Asian economic crisis and its likely global repercussions remains the biggest threat, other factors, such as the growth in the number and severity of cigarette advertising and marketing restrictions in both the developed and developing world, increased health concerns, more stringent legislation, recent proliferation in the number of health and product liability cases, rising anti-smoking sentiment fuelled by recent adverse publicity and in particular from the thousands of secret documents released during lawsuits, recent tax and price hikes and a surge in contraband sales, have all contributed to the current situation.

However, with sales of around 5.2 trillion pieces per annum, valued at some $284 billion, and some 1.1 billion smokers worldwide, tobacco remains one of the world's major markets. Multinational tobacco companies are continuing to make inroads to an increasing number of markets. In addition, former state monopolies, in an attempt to compensate for the loss of domestic business, have also sought to increase their proportion of sales accounted for by exports. An increase in corporate activity including takeovers, joint-venture partnerships and alliances, precipitated by the growth in competition has also been witnessed over the past few years.

Between 1990 and 1997, world cigarette consumption grew by 1.7%. After reaching a high of 5,216 billion pieces in 1996, the market declined by 0.5% in 1997 when sales were affected by the Asian economic crisis and declines in volume sales in both North America and Western Europe. In 1997, the Asia-Pacific region accounted for 52.8% of global cigarette sales, followed by Eastern Europe at 12.1%. The traditional core cigarette consuming regions - Western Europe and North America, both experienced a further contraction in sales. Western Europe's share of world cigarette sales fell from

[7]) World Tobacco File 1998, Market Tracking International Ltd, 1999, p. 2-11.

12.6% in 1990 to 11.6% in 1997 and North America's share declined from 11.2% to 10.2% over the same period.

[Table 3-1] World Cigarette Volume Sales by Region(1997,% volume)

Asia -Pacific	Eastern Europe	Western Europe	North America	Latin America & the Caribbean	Africa	Middle East
52.8%	12.1%	11.5%	10.2%	5.9%	3.8%	3.7%

Source: National Statistics / Industry sources / USDA / World Tobacco

Between 1990 and 1997, the Middle East experienced the strongest growth in cigarette sales at some 24.3%, followed by Asia-Pacific at 8.6% and Africa at 3.6%. The Latin America and Caribbean region experienced the largest decline in consumption at 16.5% as a result of economic instability, especially during the early part of the 1990s combined with an increase in cross border sales and smuggling due to price disparities and low consumer spending power. Other regions to experience a decline in consumption over the period under review include
North America, Western Europe and Eastern Europe.

[Table 3-2] Trends in Regional Cigarette Consumption (1990-1997, % change by volume)

Asia -Pacific	Eastern Europe	Western Europe	North America	Latin America & the Caribbean	Africa	Middle East
8.6%	-5.0%	-5.9%	-7.6%	-16.5%	3.6%	24.3%

Source: National Statistics / Industry sources / USDA / World Tobacco

China is the largest cigarette market with volume sales totalling some 1,652 billion pieces and accounting for nearly a third of global sales. The second largest market is the US, which accounted for 9.3% of world cigarette sales in 1997, followed by Japan with 6.3% of sales. These three markets, together with Indonesia, Russia, Germany, Brazil, South Korea and India account for nearly 65% of world cigarette sales.

[Table 3-3] Cigarette Consumption by Major World Market (1997, % volume sales)

China	US	Japan	Indonesia	Russia	Germany	Others
31.9%	9.3%	6.3%	4.1%	4.0%	2.7%	41.7%

Source: National Statistics / Industry sources / USDA / World Tobacco

Between 1990 and 1997, the world's top fifteen cigarette markets experienced a 2.7% overall growth in consumption levels. Indonesia, the fourth largest cigarette market in the world, recorded the largest growth rate at 44.1% between 1990 and 1997. Brazil, The world's seventh largest market, experienced a 29.6% fall in cigarette sales as a result of price increase and depressed consumer spending levels. Russia experienced a 16.2% decline as a result of high levels of contraband sales. In China, the world's largest market, consumption levels increased by 6.6% between

[Table 3-4] Cigarette Consumption Growth/Decline in the Worlds Top 10 Markets(1990-1997, % change in consumption)

Brazil	Russia	France	US	Ukraine	Indonesia	Turkey	India	Korea	China
29.6%	16.2%	-13.4%	-8.1%	-6.2%	44.1%	42.2%	32.9%	9.0%	6.6%

Source: National Statistics / Industry sources / USDA / World Tobacco

1990 and 1997 due to growth in consumer demand for manufactured cigarettes and a shift in consumer preference away from traditional forms of tobacco consumption.

3.2 Globalization of the Tobacco Industry

During the first half-century of cigarette promotion in the United States, the formula for success was a relatively simple one: the "Big Six" manufacturers concentrated on inducing hundreds of millions of Americans to smoke their cigarettes. R.J. Reynolds, Philip Morris (PM), Ligget and Mayers, American Tobacco, Brown and Williamson, and Lorillard each promoted a few reliable brands, such as Lucky Strike, Pall Mall,

Camel, and Chesterfield.[8] They succeeded in achieving loyal followings for particular brands which differed little from those of their competitors. Creative promotion schemes, including catchy slogans, baseball cards, coupons, and other lures, enabled the companies to corner their exclusive segments of the growing market.

Tobacco manufacturers today continue their traditions of intense competition and clever advertising. A small number of firms dominate the U.S. cigarette market. Yet, the nature of the six companies has changed profoundly in the last thirty years. As concern about the health effects of smoking swept the country in the 1950s and 1960s, sales growth rates slowed, and the market stagnated. The companies began to look toward new frontiers for profits. With varying degree of aggressiveness, luck, and skill—and amid the general trend toward diversification among American corporations in the 1960s—the cigarette companies used their considerable assets to acquire new companies and new products, even as they continued the battle to have large segments of the domestic tobacco market.[9]

Several of the companies also intensified their efforts to sell cigarettes internationally, first in Europe, and more recently in the developing nations of the third world as a pivotal area for further growth in their cigarette businesses and are working diligently to have a large share of this rapidly growing market.

The biggest multinational cigarette makers are Philip Morris (an estimated 15% world share), B.A.T Industries, British American Tobacco (more than a 10% share), and RJR Nabisco Holdings' R.J Reynolds Tobacco (RJR) and Japan Tobacco (fighting over approximately 10%). Other companies take less than 1% of the market each, including Gallaher Group (UK), Reemtsma (Germany), Tabacalera (Spain), and Imperial Tobacco (UK). Philip Morris makes the world's cigarette of choice, with the Marlboro brand.

3.3 Operating Environment

Tobacco advertising and marketing restrictions are now implemented in many countries across the world. Although Western Europe and North America remain the leading advocates of regulating tobacco advertising, advertising restrictions in other

8) William R. Finger, The Tobacco Industry in Transition, Lexington Books, 1981, p. 159.
9) William R. Finger, op. cit: p. 160.

parts of the world have also become increasingly more stringent. In the Asia-Pacific region, comprehensive anti-tobacco legislation exists in Singapore, Hong-Kong, Australia, New Zealand, South Korea and Malaysia. In China, the world largest market, most forms of tobacco advertising prohibited since 1995. The following year, the authorities established a screening centre so that all tobacco advertisements still allowed would be subject to government approval. China introduced another anti-smoking measure in July 1997. On this occasion, tobacco companies were instructed that they will no longer be allowed to sponsor sports and cultural events in the media from the end of 1999. It is expected that all tobacco advertising will be eliminated by the turn of the next century.[10] Similarly in Eastern Europe, stiffer advertising restrictions have also been recently introduced in Bulgaria, Romania and Latvia. The US remains the most litigious cigarette market with all the major tobacco manufacturers embroiled in a variety of legal proceedings. In the U.S., the major tobacco companies also face hundreds of other lawsuits. Elsewhere in the world, tobacco class-actions have also been filed in Japan, France, Ireland, Spain, the UK, Brazil, Guatemala, Israel, Sri Lanka and Canada.

The majority of countries which do not impose significant restrictions are those in the Middle East, Latin America and Africa. The vast majority of countries nevertheless impose a ban on the sale of cigarettes to anyone under the age of 18 years, prohibit smoking on public transport, cinemas, theatres, public workplaces and healthcare facilities. A number of countries including the Philippines, Jordan, Australia, Nigeria and South Africa have in 1998 activated anti-smoking legislation. There has also been a continued increase in total smoking bans being applied to both domestic and international flights. There also has been a world-wide increase in the number of countries requiring health warnings and constituent listings on cigarette packets. Although labelling regulations remain fairly relaxed in Africa and Latin America, the Asia-Pacific region has witnessed a significant increase in labelling requirements with more countries expected to follow the example already set by China, Singapore, Taiwan and Malaysia.[11]

In most major markets, taxation levels have continued to rise. Given that excise duties and other taxes are an important deterrent to cigarette consumption, higher taxes and the ensuing price rises have contributed to a decline or a reduction in the growth

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[10]) World Tobacco File 1998, op. cit: p. 9.

[11]) World Tobacco File 1998, op. cit: p. 10.

rate of legitimate cigarette sales in a number of countries. The cigarette markets in France, the UK, Sweden, India and Australia have been among some of the worst affected by tax hikes in recent years. Taxation levels have continued to soar in several Western European countries which has often created large disparities in price especially between neighbouring countries. This has contributed to the substantial growth in legal and illegal cross-border sales. In 1997, the estimated loss in tobacco revenue from smuggling within the European amounted to 350 million ECU(£231 million). The recent economic and political instability in Asia has contributed to the region's first fall in legitimate cigarette consumption this decade. The economic crisis has had a negative effect on consumer disposable income which in turn has hindered the recent growth in sales of manufactured cigarettes and particularly of imported American-blend brands. Smuggling and the counterfeit trade are both expected to soar as a result. Over the past three decades, the cigarette industry has been plagued with the long-term decline in adult smoking in most industrialized countries. However, whilst adult smoking experience a marked decline in the 1970s and 1980s, the number of adults smoking has tended to level out in the 1990s due largely to the increase in the smoking prevalence of females most notably in the UK, France, Japan, Belgium/Luxembourg and Norway and a rise in teenage smoking. Meanwhile, in emerging markets, the recent rise in the numbers of young adults and females taken up smoking has been more pronounced due to population growth and the gradual emancipation of women in the Asia-Pacific, Latin American, Midle East and Caribbean regions.[12]

3.4 Company Strategies

A feature of the global cigarette market during the present decade has been the falling demand in the mature markets of North America and Europe, coupled with fast growing demand in other parts of the world, in particular the emerging economies of Eastern Europe, Latin America and East Asia. More recently, leading tobacco companies have increasingly been faced with escalating litigation costs. As a consequence, there has been fierce competition amongst major multinational companies to establish a foothold in markets where cigarette sales are continuing to grow and this has been accompanied by a drive towards internationalized brands. At the same time, there has been an increasing number of state monopolies and former state monopolies

[12]) World Tobacco File 1998, op. cit: p. 11.

entering the market, as market liberalization has opend up many more countries to foreign competition. This has in turn led to major multinationals moving to obtain market share in these newly opened economies, which has led the domestic companies to increase their focus on exports. As sales of traditional domestic brands have declined in countries such as Japan, Korea and Thailand, many companies have reacted by entering into joint-venture agreements with major multinationals.[13]

3.5 Performance Comparisons

During 1999, the top five global companies accounted for over 45% of world cigarette volume. Clearly, assuming that this trend continues, very soon the top five companies are likely to account for over half of the global market. In 1999, Philip Morris and British American Tobacco accounted for nearly one third of world consumption.

Philip Morris is the most profitable tobacco company, generating US$7.7 billion tobacco division operating profit in 1999. British American Tobacco's operating profit amounted to US$2.2 billion, with R.J Reynolds generating US$1.2 billion.

Among the leading companies, Philip Morris recorded the largest increase in sales revenue between 1994 and 1997, with sales growing by 38%. Rothmans International's sales grew by almost 33% during this period, boosted by the inclusion of South Africa from 1996. R.J Reynolds recorded a sales growth of 9%, with British American Tobacco sales growing by 7%.

[Table 3-5] Global Cigarette Sales by Major Company (1997-1999)

Company	1997 volume billions	% world volume share	1998 volume billions	% world volume share	1999 volume billions	% world volume share
Philip Morris	941.7	18.2	944.5	18.1	876.1	16.9
BAT	712.0	13.7	714.0	13.7	753.0	14.5
R.J Reynolds	316.0	6.1	310.5	6.0	296.4	5.7
JapanTobacco	288.3	5.6	272.6	5.2	273.0	5.3
Reemtsma	119.4	2.3	129.0	2.5	130.0	2.5

[13]) World Tobacco File 1998, op. cit: p. 1055.

Others	2811.0	54.1	2,845.4	54.6	2855.5	55.1
Total	5,193.8	100.0	5,216.0	100.0	5,184	100.0

Source: World Tobacco / Company Annual Reports

[Table 3-6] Operating Profits by Major Company (1999)

Company	Operating Profits(US$ million)
Philip Morris Inc	7,675
BAT	2,235
R.J Reynolds	1,275

Source: Company Annual Reports

3.6 Major Companies' Competitive Advantage Comparisons

Of the three largest companies, British American Tobacco has the most brands and is the most international but Philip Morris continues to dominate the global cigarette market principally through its ownership of the Marlboro brand. To an extent, R.J Reynold's success in non-US markets has been achieved in a similar way with the Camel, Winston and Salem brands. Both of the latter two companies have been able to expand international sales on the back of the continuing and growing demand for American-blend cigarettes, of which Marlboro and Camel are two of the best known worldwide.[14] British American Tobacco's most significant regions are Asia Pacific, Latin America & the Caribbean and Africa. The company is also significant in Western Europe, although generally its brands are not placed in the top three, with the exception of Germany where HB holds the number two position. The company's main strength is in the international Virginia-blend sector, with important brands as State Express 555, John Player and Benson & Hedges, with State Express 555 being one of the fastest growing international Virginia-blend cigarettes worldwide. Key brands in the American-blend sector include Kent(excluding the US), Lucky Strike, Barclay, Pall

14) World Tobacco File 1998, op. cit: p. 1062.

Mall, Viceroy and Kool. In Latin America, British American Tobacco owns Belmont and Derby, two of the region's leading cigarette brands. In the US, CPC is a leading discount cigarette brand and through its associate Imperial Tobacco(Canada), the company has Players and du Maurier, the two best-selling cigarette brands in Canada. Since the start of the 1990s, British American Tobacco has become well established in Eastern Europe and the former USSR, with sales in the region now being a significant proportion of total volume. The company leads the Hungarian cigarette market with leading brand Sopianae, is also strong in Africa and has been strengthening its position in the Middle East. Philip Morris is the world's largest tobacco product company and in addition to dominating the US cigarette market, the company has a strong position in many Western European markets as well. In Western Europe, Marlboro is the number one, two and three cigarette brand in many major markets. The company's dominant position was extended in 1996 with the acquisition of a majority share in Tabaqueira, Portugal's former state tobacco monopoly and the Marlboro brand has performed particularly well in other former state monopoly markets such as Italy and Spain. Philip Morris brands have also performed well in the Asia Pacific region, especially in countries where the popularity of American-blend cigarettes has grown. In addition, the company has benefited from the consumer shift towards lighter cigarette blends and low tar and nicotine products. In the US, for example, Marlboro Lights is the leading low tar brand and the brand was extended in 1998 with the launch of Marlboro Ultra Lights. The R.J Reynolds best-selling brands are Camel, Winston and Salem. Salem has gained sales in the Asia-Pacific region and is, in addition, the leading menthol cigarette worldwide. The company is mainly active in the American-blend sector and internationally the company has benefited particularly from the shift towards this type of cigarette, with sales of Camel worldwide rising by 5% in 1997. Whilst volume has declined in the US, R.J Reynolds remains the number two company with a one quarter market share and owns Canada's largest cigarette brand Export ‘A’, through its subsidiary RJR MacDonald. Activity has been increased in Africa and the Midle East and R.J Reynolds was an early entrant into Eastern Europe and the former USSR. In the former USSR and the Baltic states, volume rose by 60% in 1997, with sales growing by 55% in Eastern Europe.[15]

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[15]) World Tobacco File 1998, op. cit: p. 1063.

3.7 Korean Cigarette Market

3.7.1 Scale and Legal Environment

Cigarette manufacturing in Korea is monopoly by law. But the market has been opened to foreign companies since 1987. In 1999, Korean tobacco market recorded sales of 96 billion cigarettes. From 1990 to 1998, the market experienced an annual growth rate of 1.6%. However, due to growing legal and social restrictions on smoking, in addition to increasing health awareness, domestic consumption of tobacco products is expected to either stagnate or slightly drop.

3.7.2 Key Players of the Korean Cigarette Market

The Korea Tobacco & Ginseng Corporation(KT&G) is the dominant player in the market accounting for 93.6% of cigarette volume sales in 1999. The company's market share has been affected by increased sales of imported cigarettes. The brands introduced by the company since the opening of the market in 1987 have proved successful and the company has continued to repackage and update its product offering to compete with the foreign brands on the market. KT&G produces 21 brands in all and this includes two varieties of ‘THIS’(THIS and THIS PLUS) and three varieties of 88(Light, Gold and Menthol). To meet the growing challenge faced by imported brand, KT&G is attempting to improve the quality of its cigarettes by relying less on home grown tobacco and increasing its purchase of good quality foreign leaf as well as through introducing a wide range of new, particularly, light and aromatic brands.

The leading foreign manufacturer in the market is Philip Morris followed by Japan Tobacco. Both companies have gradually begun to increase their share of the market. In 1993, imported cigarettes accounted for 6.7% of volume sales with an increase to 11.1% recorded in 1997. Mild Seven from Japan Tobacco is the leading imported brand

followed by Marlboro and Virginia Slims of Philip Morris.

[Table 3-7]Korea Leading Companies, Market Share by Volume (1992-1999)

	1992	1993	1994	1995	1996	1997	1998	1999
KT&G	94.6	93.	91.1	87.5	89.0	89.9	95.1	93.6
PM	2.3	2.9	3.6	5.0	6.2	6.9	2.3	3.2
JT	1.2	2.0	3.6	5.8	3.0	2.8	1.7	2.4
Others	1.9	1.7	1.7	1.7	1.8	1.4	0.9	0.8
Total	100	100	100	100	100	100	100	100

Source: Korea Tobacco & Ginseng Corporation

3.7.3 Imports

The cigarette market in South Korea has been open to imports since 1987. Between 1992 and 1997, imports rose by 11.0% with imports having increased its proportion of apparent volume consumption from 5.4% to 11.1% over the same period. The U.S. and Japan supply around 94% of all cigarette imports. Other smaller suppliers include the UK, Germany, Sweeden, Switzerland, Hong Kong and the Netherlands. Korea regularly records a large cigarette trade deficit. The total value of imports reached US$300.7 million in 1997 while the value of exports reached US$8.8 million in 1997. The impact of the economic crisis on imported brands has been phenomenal. The market share accounted for by imported brands fell from more than 11% prior to December 1997 to 4.9% in 1998, and 6.4% in 1999.

3.7.4 Exports

Central Asia, U.S., Latin America and the Caribbean, Russia and China are among Korea's largest export markets with smaller quantities delivered to Taiwan, Singapore, New Zealand, Cambodia and Myanmar.
KT&G exported only 2.7% of its total cigarette sales by volume in 1999.

[Table 3-8] Cigarette Trade and Apparent Consumption Trends

(1993 -1999)

Volume million pieces	1993	1994	1995	1996	1997	1998	1999
Production	96,900	90,679	87,509	93,001	96,795	100,987	96,276
Imports	7,309	8,360	12,384	11,903	11,603	5,222	6,089
Exports	800	739	742	1,903	2,029	2,254	2,628
Consum-ption	103,409	98,300	99,151	103,001	104,316	106,561	95,502
Imports as a % of consum-ption	7.1	8.5	12.5	11.6	11.1	4.9	6.4
Exports as a % of production	0.8	0.8	0.8	2.0	2.1	2.2	2.7

Source: Korea Tobacco & Ginseng Corporation

CHAPTER 4 CASE STUDY OF PHILIP MORRIS' GLOBALIZATION

4.1 Company Profile

Philip Morris has its origins in London in 1847 when Philip Morris opened a shop in Bond Street selling Turkish style cigarettes.[16] Philip Morris introduced a number of successful cigarette brands, including Ovali, Cambridge and Oxford Blues and continued as one of the country's leading tobacconists for many years. A small but successful business was also established in the US, where the brands sold primarily on the strength of country image. In 1919, the US company was formed known as Philip Morris & Company Ltd. In 1925, the Marlboro brand was introduced, which was an immediate success and was sold as a cigarette for women, for the wealthy and sophisticated. The company remained a small player, until the introduction in 1933 of Philip Morris English Blend and Philip Morris quickly grew to become the fourth largest US tobacco company by 1939. In the 1950s, the Marlboro brand was repositioned, with the now famous Marlboro Man being used in advertising for the first time. By 1976, Marlboro had become the number one brand in the US and had been the world's best selling cigarette since 1972. From the early 1970s, the company's international business had been expanded to counteract the stagnation in the domestic tobacco market. In common with other tobacco companies, Philip Morris had diversified over the years and in 1988, the company acquired Kraft Foods to complement Miller Brewing which had been purchased in 1970. Today, Philip Morris is the world's largest tobacco company, the second largest food company and the third largest brewer. The company produces around one in six of all cigarettes smoked worldwide.

4.2 Company Structure

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16) World Tobacco File 1998, op. cit: p. 1085-1087

The US tobacco interests are the responsibility of Philip Morris Inc., whilst Philip Morris International Inc. is responsible for business in all other countries.

Philip Morris Inc.

The company is the leading cigarette manufacturer in the US. Marlboro is the best-selling cigarette in the US, with Marlboro Lights being the largest selling low-tar brand. Merit is a leading low-tar brand and within the discount segment, the company's brand, Basic, is the market leader. Other premium brands include Benson & Hedges, Merit, Parliament and Virginia Slims.

Philip Morris International Inc.

Established in 1955, Philip Morris International is responsible for all non-US operations and is the leading US exporter of cigarettes. The company has expanded its business considerably in emerging markets, particularly in Eastern Europe and Asia. Some 98% of the company's international sales consist of American-blend cigarettes, with Marlboro being the main international brand and other important brands include Bond Street, Chesterfield, Dallas, F6, L&M, Lark, Longbeach, Merit, Parliament, Petra, Philip Morris and Virginia Slims.

Kraft

The largest packaged food company in the United States and the second-largest in the world. Kraft's 1999 revenues were $26.7 billion and its operating income was $4.2 billion. Leading brands include Kraft, Oscar Mayer, Post, Maxwell House, Jacobs, Milka, and Philadelphia.

Miller

The second-largest beer company in the United States, with 1999 revenues of $4.3 billion and operating income of $511 million. Leading brands include Miller and Miller Lite.

Capital Corporation

Manages a leasing and structured finance portfolio.

4.3 Product Portfolio

One of Philip Morris's key strengths is the Marlboro brand, which in addition to being the worlds' best-selling cigarette. Marlboro is sold worldwide and accounts for over half of all Philip Morris cigarette sales by volume. One in ten cigarettes smoked around the world is made by Philip Morris and three out of every 10 cigarettes sold in the US are Marlboro. Worldwide, Philip Morris volume sales amounted to 876.1 billion in 1999 and Marlboro, with sales of 319 billion, accounted for 36% of the total. Merit is the company's second largest selling cigarette throughout the world.

U.S. Brands

The major premium brands in the US are Marlboro, Marlboro Lights, Virginia Slims, Merit, Benson & Hedges and Parliament. Principal discount brands are Basic and Cambridge. Other brands include Alpine, Players, Bucks and Bristol. In 1999, US cigarette volume down by 8.5% to reach 208.2 billion units compared with 1998.

International Brands

Philip Morris International's leading brands are Marlboro, L&M, Philip Morris, Bond Street and Chesterfield. Other international brands include Caro, Diana, F6, Klubowe Lark, Longbeach, Multifilter, Muratti, Next, Peter Jackson and Petra. International cigarette volume sales down by 6.8% in 1999 to 667.9 billion units compared with 1998. In terms of volume, Philip Morris is the leading tobacco producer in more countries worldwide than any other company and this includes an impressive share of around 50% in the key US market. In addition, the company is strong in Europe, with Marlboro being the best-selling brand in the EU as a whole. Over the past few years, the brand has grown in strength in former state monopoly makers such as Italy, Portugal and Spain. Philip Morris International has a cigarette market share of at least 15% and in a number of instances, substantially more than 15%, in a total of more than 40 markets. These include Argentina, Australia, Belgium, the Czech Republic, Finland, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, the Philippines, Poland, Portugal, Saudi Arabia, Singapore, Spain, Switzerland and Turkey.

4.4 Process of Globalization

4.4.1 Motivation of Globalization

Until the early 1950's, cigarette sales grew steadily in the United States, with only a few brands to choose from.[17] Because consumers tended to stick to one brand throughout their smoking careers, advertising and marketing strategies were aimed simply at snaring new smokers and keeping them. Nonfiltered cigarettes were the rage, and there was little need for product innovation.

Cigarette promotion became more complicated in the fifties, though. In 1954, Reader's Digest published a series of articles about the health hazards of tobacco. And a decade later, the U.S. surgeon general, in the highly publicized smoking and health report, concluded that "cigarette smoking is a health hazard of sufficient importance in the United States to warrant remedial action."[18] Filter cigarettes, such as Winston and Viceroy, which were presumed to be less hazardous to the smoker's health, surged in popularity; filtered menthol brands also began to flourish. Those firms which responded well to the changing market, by developing and promoting the filter and menthol brands, not only survived this transition in marketing variables but actually prospered in the process. Reynolds, Brown and Williamson, Lorillard, and Philip Morris all enjoyed a substantial boost in sales in the 1950s, while American Tobacco and Liggett and Mayers both fell into depression.

As large numbers of new brands began appearing in the 1960s, the advertising strategy of the industry changed. No longer could companies afford to focus only on winning the loyalties of new smokers. While the new brands usurped the traditional favored position of non-filters, they were also undermining smokers' brand-loyalties in general.[19]

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[17]) William R. Finger, op. cit: p. 161
[18]) William R. Finger, op. cit: p. 161
[19]) William R. Finger, op. cit: p. 162

More important, the furor over health hazards was hurting sales; many smokers were quitting and the number of new smokers was declining. Consequently, advertising became less a matter of attracting new smokers and more a matter of snagging established smokers from competing brands. A cigarette-manufacturing executive explained the new advertising strategy to Business Week in 1969, saying that advertising efforts result mainly in share swapping in a market that is growing only with the population. Even if a company can grab some business at one end, "Someone else is pulling it away from you at the other," said the executive.[20]

The intensely competitive nature of cigarette promotion in this era led to some pretty drastic reactions. In 1969, for instance, one tobacco executive, according to Business week, said that his company "boosted the nicotine" of most of its brands. If cigarette advertising were to be totally banned, perhaps the "need for a smoke," as the executive put it, would keep people hooked.

The rising swell of anti-smoking fever led in 1971 to a ban on cigarette advertising from radio and television. But the effects of the ban were not nearly so catastrophic. The networks were less compelled to run a plethora of anti-smoking spots to refute the cigarette ads, so, indirectly, some pressure was actually taken off the industry. Also, not having to buy television advertising saved the companies hundreds of millions of dollars. Industry experts believed the ban would not immediately damage their business.

After the advertising ban began, sales in the early 1970s once again grew at a moderate but steady pace. The industry helped this growth along with another major marketing innovation—the low-tar, low-nicotine cigarette. What the filters did for the 1950's, the low tars did for the 1970s. Although low-tar cigarettes had been around since the fifties, they had never attracted much attention. In the 1970s, however smokers concerned about their health but not wanting to kick the habit turned to the low-tar brands in rapidly increasing numbers. By 1979, the low-tar, low-nicotine cigarette market accounted for close to 50 percent of cigarette sales in the United States. Philip Morris's Merit ranked ninth among all brands in 1979; its sales grew more than 25

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[20]) William R. Finger, op. cit: p. 162

percent in that year alone. Kent, Vantage, Winston Light, and other low-tar brands have also jumped upward. Although low-tar-and-nicotine sales boosted the cigarette industry in the 1970s, they carry no promise of a long-range growth pattern. Introducing new brands costs staggering sums. Reynolds plunked down $40 million for its "all natural" Real cigarette only to watch it languish on retailers' shelves across the country, and Brown and Williamson is likely to spend $150 million on its new Barclay brand. More important, perhaps, the companies are battling over a market that by 1979 had a growth rate, according to Business Week calculations, of less than 1 percent.[21] The size of the domestic pie is not expanding. It can only be sliced in different ways. Faced with a declining domestic market, Philip Morris pursued a strategy of expansion overseas, in particular into emerging and developing markets.

4.4.2 Globalization Process

Several of the major firms have invested the cash generated by domestic cigarette sales to a booming international cigarette market. Although the overseas market is not new to the U.S. industry. American cigarettes have been exported for decades, particularly to European nations. Since World War Ⅱ, when many Europeans learned to prefer the rich blends and flavor-enhancing additives of U.S. cigarettes over their own brands, export sales have been climbing. U.S. firms quickly became interested in taking advantage of this European fascination with their product, particularly as domestic sales stagnated, but they have had to contend with complex international marketing barriers.

All but a few European countries have state-owned tobacco monopolies which own the tobacco manufacturing facilities and run the distribution systems. Foreign cigarette firms have to market their brands through these state monopolies. For many years, U.S. firms attempted with little success to sell their cigarettes through the state-owned distribution systems. European tariffs on foreign-produced cigarettes remained high, and the monopolies promoted their own brands far more heavily than they did the foreign products.[22]

To overcome these obstacles, Philip Morris devised a fresh approach and negotiated

[21]) William R. Finger, op. cit: p. 163
[22]) William R. Finger, op. cit: p. 167

a series of contracts with the European monopolies. Initially, PM provided technical assistance, allowing the monopolies to continue producing and selling the brands themselves. Then, the company began acquiring and constructing manufacturing facilities abroad. Soon PM was producing cigarettes in the Netherlands, Belgium, Britain, West Germany, and Spain at minimal marketing costs since it turned over its cigarettes to the state monopolies for distribution.

The monopolies receive a high share of the income from Philip Morris sales, reducing the company's royalties below its domestic profit margin. But because of this income, the monopolies have a stronger incentive to promote the Philip Morris brands than to push their own. Meanwhile, Philip Morris has applied its superior marketing skill to the European situation, usually promoting the popular Marlboro along with a single local brand, such as Sweden's Bond Street. And the Marlboro man has proved as enticing a figure in Europe as in the United States.

Other domestic firms have attempted to follow Philip Morris's lead, negotiating their own license agreements and acquiring overseas production capacity. The efforts has proved to be too great for Liggett and Lorillard, which both sold their overseas business in the late 1970s, and for American Brands. By the terms of the 1911 trust dissolution decree, BAT Industries has overseas rights to most of American Brand's cigarettes: to gain access to foreign sales, American bought Britain's Gallaher Limited in 1968, but Gallaher has little market penetration outside Britain. Brown and Williamson markets its popular brands, such as Kool, through its parent, BAT Industries.[23]

Besides Philip Morris, then, only Reynolds is pursuing the international market— but with some difficulty. Winston once had the popular advantage abroad that Marlboro now enjoys, providing Reynolds a solid base. But the company did not begin signing licensing arrangements until the early 1970s, thus achieving slower growth than Philip Morris. Reynolds also made early mistakes that hurt sales: it developed costly excess production capacity in West Germany, did not quickly target local brands such as Philip Morris's Bond Street, and had to revamp its entire Swedish distribution system at great expense. Although it now has numerous licensing arrangements and production facilities overseas, Reynold's sales have not grown to rival those of Philip Morris, BAT Industries, or Rothmans. But Reynolds has at least established itself as a formidable

[23]) William R. Finger, op. cit: p. 168

competitor for future international growth.

Having cut their teeth in Europe, Philip Morris and R.J. Reynolds are now hungrily eyeing the rapidly expanding worldwide market. Several strong incentives have led third-world nations to boost the cigarette industry within their borders. They receive large quantities of tobacco from various foreign-aid programs.[24] They see tobacco as a potentially lucrative cash crop for exportation purposes, and a growing domestic market as an incentive to production. The promise of high tax revenues from cigarette sales holds great appeal to cash-strapped countries. Finally, the major tobacco companies have spent millions on advertising and public relations in third-world nations, increasing their acceptability to the foreign consumer.

The U.S. companies are patterning their advertising pitch in developing nations after their earlier domestic experience; advertising is directed at the youth and at the newly emerging middle classes who aspire to western symbols of success. In most developing countries, the push to develop new consumers is not being offset by anti-smoking policies or regulations.

Prospects appear favorable for a continuing boom in overseas cigarette sales. For Philip Morris these international sales should bring steady growth to its cigarette operations. Also the contacts and marketing network established through this expansion should reap substantial benefits for the other consumer-oriented products of the two tobacco giants.

4.5 Recent Corporate Developments

During 1999, volume sales down by 1.7% compared with 1996 to 876.1 billion units.[25] US volume down by 9.9% to 208.2 billion units and international volume was up by 1.2% during the year at 667.9 billion units. International sales accounted for two thirds of total volume during the year. International sales continued to grow, driven by higher volumes and prices, despite unfavourable currency movements and a difficult business environment in Asia. The US market share rose from 47.6% to 49.6% in 1999. Marlboro remains the largest-selling cigarette brand in the United States, with volume

[24]) William R. Finger, op. cit: p. 169

[25]) Annual Report on Philip Morris Companies Inc. 1999.

sales of 152.8 billion units during the year, down by 2.9% compared with 1996. This equates to 36.4% of the United States market compared with 32.2% in 1996. The company's share of the premium segment was 73.4%, compared with 73.0% in 1998 and premium cigarettes accounted for 88.0% of 1999 volume, compared with 86.4% in 1999. In January 1998, the latest extension to the Marlboro range was introduced, with the US launch of Marlboro Ultra Lights. According to Philip Morris International, its share of the international cigarette market, excluding the US, was 13.9% in 1998, compared with 13.6% in 1997. Overall, unit shipments, including brands acquired through acquisitions have grown at a compound annual growth rate of 11% over the last five years, compared with an overall compound annual industry growth rate of around 1.5% over the same period. Internationally, sales of the Marlboro brand increased by 4.1% in 1999, to 319 billion units, representing more than 6% of the international cigarette market, excluding the US. During 1999, volume grew strongly in Western Europe, led by strong performances in PM,s well-established markets of Italy, France, Portugal, the Benelux and Scandinavian countries, Greece and Austria. In addition, PM gained share in the majority of its key markets, strengthening its leadership position. Volume was essentially flat and share was lower in Germany, reflecting intense competition. In the Asia/Pacific region, 1999 results reflect outstanding volume growth and a record share in Japan, as well as a strong recovery in Thailand, Korea and Malaysia, where PM posted double-digit volume gains. Volume and share advances in the region were driven by the excellent performances of Marlboro, Lark, L&M and Virginia Slims. In Eastern Europe, volume declined significantly, due to the impact of continued economic difficulties.

PM has taken measures to restore growth by implementing strategic pricing actions, by accelerating the move to local production and by further strengthening its infrastructure. In Latin America, Marlboro's leadership position in Mexico was further solidified by record volume and share levels. In Brazil, Marlboro posted double-digit volume growth and gained over half a share point to reach a new record. Other key markets that posted solid volume and share gains include Hungary, the Slovak Republic, Saudi Arabia and Egypt. Share was also up in the Czech

[Table 4-1] Philip Morris International Inc's Estimated Market Shares in the Selected Foreign Markets(1998)

Country	Share	Country	Share
Portugal	88.2%	Czech Republic	79.4%
Finland	74.4%	Argentina	63.5%
Saudi Arabia	62.2%	Hong Kong	61.3%
Italy	59.0%	Slovak Republic	53.8%
Switzerland	46.4%	Singapore	46.0%
Belgium	41.6%	Germany	41.3%
Australia	38.4%	U.A.E.	38.0%
Netherlands	36.1%	Poland	33.5%
France	32.9%	Mexico	32.4%
Hungary	30.5%	Spain	28.7%
Philippines	25.9%	Turkey	23.8%
Japan	18.3%	Egypt	11.4%

Source: Philip Morris Companies Inc. 1999 Fact Book

Republic, and volume grew strongly in Romania.

Since 1990, the company has made a number of acquisitions in Eastern Europe and Russia. The initial acquisition in Hungary has been followed by acquisitions in the Czech Republic, Russia, Lithuania, Kazakhstan, the Ukraine and Poland, where a stake was acquired in the country's largest tobacco company, ZPT Krakow, in 1996. In 1997, capacity was increased and Productivity improved through various acquisitions and capital projects. In January 1997, Philip Morris International acquired a controlling interest in Tabaqueira-Empresa Industrial de Tabacos, S.A., Portugal's formerly state owned tobacco company. Later in the year, the company restructured its interests in the business of Cigarros La Tabacalera Mexicana S.A. de C.V., Mexico's second largest cigarette company, by increasing ownership in the business from 28.8% to 50.0%. The company has now been renamed Philip Morris Mexico SA de CV. Major capital

expenditures undertaken in 1997 include the modernization and expansion of facilities in Germany, the Netherlands, Switzerland, Poland, Russia, Lithuania, the Ukraine, Turkey, Malaysia and Brazil.

[Table 4-1] Philip Morris Inc: Acquisitions and Joint-Ventures 1991-1998

Year	
1991	Eger in Hungary, jointly with Austria Tabak.
1992	Tabak a.s. the dominant company in the Czech Republic
1992	The Samara factory, Russia
1993	Krasnodar Tobacco, Russia
1993	Lietuva, Lithuania.
1993	Alma-Atinskij Tobacco, Kazakhstan
1994	Majority ownership of cigarette factory in the Ukraine.
1996	33% stake in ZTP Krakow, Polan's largest cigarette company
1997	Stake in Mexican company, La Tabacalera Mexicana increased to 50%. Company renamed Philip Morris Mexico SA de CV
1997	Majority control of Portugal's state tobacco monopoly, Tabaqueira.

Source: Trade Press/Annual Report

4-6. Performance Review

Sales for Philip Morris Companies Inc., including duties and taxes and the Kraft Food and Miller brewing business, rose by 5.7% in 1999 to just over US$79 billion, with operating income rose by 30.8% to US$14.8 billion. Since 1993, sales have grown by 19%, with operating income increasing by 40.8% over the same period.

Tobacco sales rose by 29% in 1999 to US$47.1 billion compared with 1996, with international tobacco accounting for 58% of the total. The sales rise was accounted for in the US mainly by volume and price increases and an improved product mix. Internationally, an additional factor was the consolidation of previously unconsolidated and newly acquired subsidiaries. Tobacco operating profit, rose by 18% during the year

[Table 4-2] Philip Morris Inc: Financial Summary 1993-1999

Year Ending 31st December	Operating Revenues	Operating Income	Earnings before Income Taxes	Net Earnings
1993	60,901	7,587	6,196	3,091
1994	65,125	9,449	8,216	4,725
1995	66,071	10,526	9,347	5,450
1996	69,204	11,769	10,683	6,303
1997	72,055	11,663	10,611	6,310
1998	74,391	11,334	9,087	5,372
1999	78,596	14,825	12,695	7,675
% change 1993~1999	29.1	95.4	104.9	148.3

Source: Company Report

to US$9.8 billion. The poor US performance was due primarily to litigation settlement charges, higher marketing, administration and research costs and higher fixed manufacturing costs. These were partially offset by price rises, higher volume and improved product mix. If the impact of litigation settlement charges were exclued, the operating profit for 1997 would have increase by 12.3%. However, Philip Morris International increased operating profit by 12.6% to US$4.6 billion, despite an adverse exchange rate impact of US$400 million. The international operating margin rose from 31.4% in 1996 to 32.8% in 1997.

Operating revenues for 1999 increased $4.2 billion (5.7%) over 1998, due primarily to settlement-related price increases from domestic tobacco operations. The comparison of operating revenues was also affected by incremental year 2000 related revenues of approximately $225 million, as customers purchased additional product in anticipation of business disruptions from the century date change, as well as the divestiture of several international food business. Excluding these items, operating revenues for 1999 increased $4.1 billion (5.6%) over 1998.

Operating income for 1999 increased $3.5 billion (35.2%) over 1998, due largely to 1998 pre-tax charges of 3.4 billion related to domestic tobacco litigation settlement.

In terms of sales, international tobacco is the most significant sector for Philip Morris, accounting for almost 58% of the tobacco total in 1999.

International tobacco is more profitable for Philip Morris than domestic tobacco, with international tobacco accounting for 51% of the total tobacco operating profit in 1999.

Tobacco accounted for 73% of Philip Morris Companies' total operating profit during the year, up from 65% of the total in 1998. The increase in importance was due mainly to the price increase of domestic tobacco. International tobacco continues to increase its relative importance to the group, with sector operating profit rising from 65% of the total in 1998 to 73% in 1999.

[Table 4-3] Consolidated Operating Results (in millions)

	1999	1998	1997	1996
Operating Revenues				
Domestic Tobacco	$19,596	$15,310	$13,584	$12,462
International Tobacco	27,506	27,390	26,240	24,087
North American food	17,546	17,312	16,838	16,447
International food	9,251	9,999	10,852	11,503
Beer	4,342	4,105	4,201	4,327
Financial service	355	275	340	378
Total	$78,596	$74,391	$72,055	$69,204

	1999	1998	1997	1996
Operating Income				
Domestic Tobacco	$4,865	$1,489	$3,287	$4,206
International Tobacco	4,968	5,029	4,572	4,078
North American food	3,107	3,055	2,873	2,628
International food	1,146	1,127	1,326	1,303
Beer	511	451	459	440
Financial service	228	183	297	193
Operating companies income	$14,825	$11,334	$12,814	$12,848
Genaral corporate expenses	(627)	(645)	(479)	(442)
Minority interest	(126)	(128)	(87)	(43)
Amortization of good will	(582)	(584)	(585)	(594)
Operating income	$13,490	$9,977	$11,663	$11,769

Source: Company Report

Chapter 5 CONCLUSIONS

In this study, I reviewed the case of Philip Morris', the leading multinational tobacco company, globalization. I will summarize the key findings of Philip Morris' successful globalization.

First, faced with a declining domestic market, Philip Morris has been successfully pursuing a strategy of expansion overseas for a number of years, in particular into emerging and developing markets. The company has also increased non-domestic cigarette sales. International tobacco is consequently a source of strong profits growth. Whilst the US market has decreased, over the last ten years, Philip Morris's international tobacco business has increased 60%.

Second, scale is the name of the game in the global tobacco industry. Scale continues to be the main driver of consolidation in the global tobacco industry. The increasing competitiveness of the global tobacco industry has resulted in the need for economies of scale to leverage global brand portfolios and manufacturing, distribution, and marketing capabilities.

Third, Philip Morris' strong global position is a result of its portfolio of international brands, which continue to grow. Philip Morris' sustainable competitive avantage is its global Marlboro brand. Marlboro is one of the top-recognized consumer brands throughout the world. This success took several decades, superior marketing and advertising, and a vast manufacturing infrastructure to develop. Internationally, the company aims to deliver continued profit growth through strong volume gains and continuous brand improvements as smokers trade up to higher quality international brands.

Lastly, Philip Morris has superior tobacco industry knowledge, Global Marlboro franchise, strong portfolio of American Heritage Brands, vast manufacturing, sales, and distribution infrastructure. With these strengths, Philip Morris generates substantial cash flow and is constantly in search of new investment opportunities.

Based on the analysis of Philip Morris's globalization, I recommend the following

actions for Korea Tobacco & Ginseng Corporation.

First, globalization of KT&G is essential because the domestic cigarette market has matured and KT&G's market share is decreasing gradually. There is little room in the domestic market to compensate for the loss of market share.

Second, KT&G needs to establish a medium and long term globalization strategy including education of global business personnels and development of international brand. As a small company compared to big MNCs, KT&G needs to pursue a differentiation strategy.

KT&G has to focus on developing countries that may have low incomes now, but have a high prevalence of smoking. Markets that MNCs have avoided because of political, religious, or cultural differences are also good target markets. North Korea is a good base for production for China and Russia. KT&G would have the advantage of relatively cheap North Korean labor and leaf tobacco. KT&G has to try to be the No. 1 player in North Korea. And KT&G has to research about local taste and make cigarettes suitable for local consumers.

Third, big MNCs possess competitive advantage of "low-cost" production over Korea in cigarette production. For globalization, KT&G has to develop new technologies and reduce cost for achieving price competitiveness. Today, KT&G is required to buy all of the locally produced tobacco, regardless of its actual requirement. And this tobacco is higher in cost than imported tobacco. In such an environment it appears difficult for KT&G to achieve price competitiveness. For achieving price competitiveness, KT&G has to reduce the number of tobacco growers and tobacco planting, and enhance production efficiency through improved production capacity and the efficiency of its facilities.

Fourth, today, KT&G is exporting cigarettes mainly through indirect exporting. In the future, KT&G has to engage in licensing, joint-ventures and strategic alliances in the areas of product development, manufacturing, and marketing outside of Korea to become a globally competitive company.

Appendix

Global Features of Philip Morris

Subsidiaries & Affiliates

Country	Company
Argentina	Massalin Particulares
Australia	Philip Morris
Belgium	Weltab
Brazil	Philip Morris Brasileira(Santa Cruz)
Costa Rica	Tabacalera Costarricense
Dominican Republic	Industria de Tabaco Leon Jimez
Ecuador	Tabacalera Andina
El Salvador	Tabacalera de El Salvador
Germany	Philip Morris GmbH
Guatemala	Tabacalera Centroamericana
Hong Kong	Philip Morris
India	Godfrey Phillips India Ltd.
Mexico	Tabacalera Mexicana
Netherlands	Philip Morris
Nigeria	International Tobacco Company
Pakistan	Premier Tobacco Company
Panama	Tabacalera Nacional
Portugal	Philip Morris
Spain	Philip Morris Espana
Switzerland	Fabriques de Tabac Reunies
Turkey	Philip Morris
Uruguay	Abal Hermanos
Venezuela	Tabacalera nacional

Alliance Agreement

Country	Company	Equity Ratio
Canada	Rothmans-Benson & Hedges	29.0
Czech Republic	Tabak(Philip Morris)	77.4
Hungary	Egri Dohanygyar	80.0
Kazakhtan	Almaty Tobacco Kombinat	97.0
Lithuania	Philip Morris Lietuva	65.2
Russia	Krasnodar	49.0
Ukraine	Kharkov	51.0

Source: Tobacco Merchant Association.

Licensing

Country	Company
Austria	Austria Tabakwerke
Bolivia	Compania Industial de Tabacos
Bulgaria	Bulgartobac
Cameroon	Societe Industrie des Tabac de Cameroun
Chile	Pacil
Cyprus	Cassandra
Egypt	Eastern Tabacco
Finland	Amer-Tupakka
Greece	Papastratos
Indonesia	Gudang Garam
Italy	Monoli de Stato
Ivory Coast	Societe Ivorian des Tabacs
Poland	Polish Tobacco Association
Senegal	Manufacture de Tabacs de l'Quest Africain

Source: Tobacco Merchant Association.

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