

Analysis of tobacco industry attractiveness: Case of Croatia

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Abstract

Tobacco industry is one of the most profitable global industries with the steady increase in global demand for tobacco and tobacco related products. Tobacco industry in Croatia has a centuries-old tradition and tobacco is one of the most important non-food agricultural crops produced in Croatia. Moreover, tobacco industry in Croatia is one of the major revenue sources of the government's budget. The aim of this paper is to determine whether tobacco industry in Croatia is attractive enough for a new player willing to enter the market. Paper provides brief overview of the tobacco industry and the impact it has on Croatian economy. Furthermore, paper explains how excise duties and product prices changed over time, shows market consolidation and concentration before and after the EU accession, and in detail depicts forces which determine industry's profitability, i.e. its attractiveness.

Key words: tobacco, market concentration, Five forces framework, Croatia

JEL Classification: L10, L66, M21

1. Introduction

Tobacco industry is one of the most profitable global industries, and despite of numerous scientific studies exposing the various harmful effects of the long-term use of tobacco products on human health, and despite of placing excise duties on tobacco products, the global demand for tobacco products is in constant uprise. In 2018, global cigarette market was estimated at \$888 billion, with the growth forecast of 4% and value of \$1.12 billion till 2024 (Barjković, 2019). Each year around 6.5 billion cigarettes are sold worldwide, with an estimation that there are one billion smokers worldwide. Tobacco market is extremely complex given the many legal regulations it is subject to, given the various issues related to the production, processing, distribution, advertising and sale of tobacco products, and especially given the numerous ethical and social issues, doubts and controversies (Čagalj and Ivanković, 2017).

Tobacco is one of the most important non-food agricultural crops produced in Croatia, with steady increase in production yield, where annual tobacco production is worth about \$18.5 million (Čagalj and Ivanković, 2017). Bičak (2019) states that around 400 Croatian tobacco farmers achieve value equivalent to 62% of Croatia's potato and fruit production, as much as 55% of grape production and 48% of olive oil production. According to Eurostat (2015) 31.1% of the Croatian population are smokers, ie consumers of tobacco products. Therefore, tobacco industry in the Croatia is one of the major revenue sources of the government budget, accounting for about 4% of total annual revenues (Čagalj and Ivanković, 2017). The largest share of the government budget revenue coming from tobacco industry is made by excise duties on cigarettes, which were introduced in 1994 to the Croatian tax system, where taxpayers include manufacturers and importers of tobacco products.

During negotiation to the EU accession, a transitional period until 31 December 2017 was approved for the adjustment of minimum excise duties on cigarettes, as required by EU Directive 2011/64 / EU on the structure and rates of excise duties. The share of total excise duty should be a minimum of 57% of the average weighted retail price of cigarettes placed on the market, and a minimum of €64 per 1,000 cigarettes. From 1 January 2014, excise duty has been increased to at least 60% of the average weighted retail price of products placed on the market and a minimum of € 90 per 1,000 cigarettes (Bajo and Jurinec, 2016).

The aim of this paper is to determine whether tobacco industry in Croatia is attractive enough for a new player willing to enter the market. Paper provides brief overview of the tobacco market and the impact it has on Croatian economy. Furthermore, paper explains how excise duties and product prices changed over time, shows market consolidation and concentration before and after the EU accession, and in detail depicts forces which determine industry's profitability, ie its attractiveness.

2. Overview of tobacco industry in Croatia

The tobacco industry in Croatia has a centuries-old tradition, and over the last centuries there have been several factories for processing of tobacco, with the first recorded planting of tobacco made in the area of the city of Đurđevac as far back as 1571. The production of virginia and burley tobacco has been expanding since 1960 in Podravina, which has geographically become one of the leading regions in the production of these types of tobacco in the Yugoslav market. It was not until the 1990s that consolidation took place on the Croatian tobacco market. (Dundović, 2019). Hrvatski duhani d.d. with its network of around 500 subcontractors is the main company for cultivation and processing of raw tobacco in Croatia. Tobacco purchase is organized in three main purchase centers - in Virovitica, Kutjevo and Pitomača, while the tobacco processing is carried out in Virovitica. Hrvatski duhani d.d. purchase around 80% of the total tobacco production in Croatia, while the rest is made by

Agroduhan Slatina. In 2018, Croatia had 3,131 hectares of planted tobacco fields and produced 7,100 tons of raw tobacco (Dundović, 2019). Around 60% of the domestic grown raw tobacco is purchased by the only one remaining tobacco factory in Croatia, while the rest is exported to the foreign markets, mostly in European Union and to a lesser extent to South America, Africa and Australia (Čagalj and Ivanković, 2017).

From market structure point of view, tobacco industry in Croatia is an example of oligopolistic market where only small number of players operate on the market. However, that also means that even though manufacturers of tobacco products operate independently from one another, most likely there are strong interdependences between them. Moreover, regardless of the small number of players operating on the market, there are still strong entry barriers for potential new market entrant due to the already strong brands being sold on the market with highly loyal customer base. (Čagalj and Ivanković, 2017). Furthermore, demand for tobacco products is somewhat inelastic because demand does not change as much as the price of the cigarettes. In their work, the authors analyzed the tobacco market in Croatia and determined the amount of excise duties on tobacco products, and through the work came to the realization that there was a fall in budget revenues from proportional excise duties, as well as a decrease in the turnover of tobacco products in the Republic of Croatia, which means that an increase in tobacco and excise prices had an impact on demand for it (Bajo and Jurinec, 2016).

Tobacco industry in Croatia is highly regulated by the Act on restrictions on the use of tobacco and related products (NN 45/17, 114/18), and since the Republic of Croatia is a member of the European Union, the EU's Tobacco Products Directive (2014/40/EU) applies, as well. Both Act and Directive regulate the industry with the goal of restricting the use of tobacco and tobacco products, and, deterring young people from smoking. (Brajković, 2019). There are several other regulations and acts which determine the excise duties on tobacco products (NN 106/2018, NN 22/13-115/16, NN 106/2018). Table 1 shows the change in excise duties in the period 2010 - 2017. The amount of specific excise duty is constantly increasing, with the largest increase occurring in 2016 and 2017, by 19.6% and 12.7%, respectively. On the other hand, ad valorem excise duty is decreasing for the last couple of years. The largest change in the amount of the minimum excise duty occurred in 2012, when the minimum excise duty increased by 29.6% from the previous period, while the overall increase in the observed 2010-2017 period was 85.6% or HRK 321.

Table 1. Excise duties on cigarettes (per 1,000 cigarettes) in the period 2010 – 2017 (Ministry of Finance, Customs Administration)

Date	Specific excise duty (HRK)	Change in specific excise duty (%)	Ad valorem excise duty (%)	Change in ad valorem excise duty (%)	Minimum excise duty (HRK)	Change in minimum excise duty (%)
01.01.2010.	180,00		30%		375,00	
01.10.2010.	180,00	0,0%	33%	10,0%	375,00	0,0%
29.11.2012.	180,00	0,0%	36%	9,1%	486,00	29,6%
04.06.2013.	197,00	9,4%	37%	2,8%	567,00	16,7%
06.03.2014.	210,00	6,6%	37%	0,0%	598,50	5,6%
18.04.2015.	230,00	9,5%	38%	2,7%	648,00	8,3%
01.12.2016.	275,00	19,6%	36%	-5,3%	671,00	3,5%

In line with changes in the amount of excise duties over time, retail prices of cigarettes have changed, as well. Minimum excise duties affect the most sensitive products, i.e. the products with the lowest prices, whose retail prices must be adjusted to accommodate to the buying power of consumers on one hand and to the planned sales and profit levels of the producers. High retail prices can lead to consumers switching from more expensive products to the cheaper ones, and even more harmful for the producers, from cheaper products to their substitutes in the illegal market.

Table 2 depicts the changes in the retail prices of several brands which are leaders in their class. Benston - Rothmans represent brands with the lowest retail prices, Walter Wolf the ones with middle price range, while Ronhill - Dunhill the ones that belong to the higher price range. When comparing changes in the amount of minimum excise duties in table 1, and retail prices in table 2, one can easily see the correlation between the two. In 2012 – 2017 period, minimum excise duty increased by 43%, while the retail prices of the cheapest brands increased by 40%. The middle price range increased by 20% and higher price range by 25%. These price increases indicate that producers were not ready to take the full burden of minimum excise duties on themselves and tried to pass them on to the consumers.

Table 2. Retail prices (in HRK) on selected cigarettes in the period 2010 – 2017 (Ministry of Finance, Customs Administration)

Brand	2010	2011	2012	2013	2014	2015	2016	2017
Benston/Rothmans	14,00	15,00	15,00	17,00	19,00	20,00	20,00	21,00
Walter Wolf	17,00	19,00	20,00	20,00	22,00	22,00	23,00	24,00
Ronhill/Dunhill	18,00	19,00	20,00	20,00	23,00	23,00	24,00	25,00

Bajo and Jurinec (2016) analyzed the tobacco market in Croatia and came to the realization that increase in ad valorem excise duties has led to the decline in central government revenues from ad valorem excise duties and to the decrease in the overall turnover of tobacco products in Croatia, meaning that an increase in excise duties, and consequentially of tobacco products prices, had an significant impact on the demand for tobacco products. Table 3 shows sales figures of cigarettes sold in Croatia during 2010 – 2017 period. There was a decline of 1.48 billion cigarettes, or 23.58% in 2010-2015, after which volumes picked back up in 2016 and 2017 reaching close to the quantities realized in 2013 when the Croatia joined the European Union.

Table 3. Quantity of cigarettes sold in retail from 2010 - 2017 (in million) (AC Nielsen Cigarettes (2010 – 2017))

Manufact.	2010	2011	2012	2013	2014	2015	2016	2017
TDR	4,878,199	4,407,470	4,034,140	3,252,230	2,676,350	2,432,820	N/A	N/A
BAT	24,035	68,083	190,320	245,230	199,660	137,940	2,717,498	2,734,833
ITG	16,556	64,224	105,780	139,200	119,330	75,040	50,563	41,158
JTI	23,621	120,687	170,470	179,610	224,780	260,060	267,261	373,399
PMI	1,278,963	1,398,657	1,419,450	1,440,400	1,627,970	1,842,230	1,923,737	1,966,528
Other	2,152	3,815	3,310	4,830	7,720	7,830	11,326	6,181
Total	6,223,526	6,062,936	5,923,550	5,261,500	4,855,810	4,755,970	4,970,385	5,122,098

3. Market concentration of tobacco industry in Croatia, before and after EU accession

Global tobacco industry is a highly concentrated industry both from equity and market share perspectives, where about 90% of the global cigarette production comes from the four largest market players (Philip Morris, British American Tobacco, Imperial Tobacco, and Japan Tobacco), some regional and pan-regional companies, and the remaining from national monopolies, such as in Turkey and China. For example, some of the largest cigarette factories in the world are in China, where China National Tobacco Corporation has approximately 98% of China's tobacco market share. Most of the tobacco industry is made up of the production and sale of final tobacco products, out of which 95% are cigarettes (Croatian Encyclopedia, 2019).

Brjković (2019) states that with nearly \$30 billion in sales in 2018, Philip Morris International (PMI) is a leader among tobacco companies worldwide, where their most recognizable brand is Marlboro. PMI is followed by British American Tobacco (BAT) with \$26.1 billion in sales and major brands Camel and Lucky Strike, Imperial Tobacco with \$20.1 billion in sales with major brands Kool and Winston, Altria Group with sales of \$19.6 billion, Japan Tobacco with sales of \$19.4 billion, ITC with sales of \$8.7 billion, Gudang Garam with sales of \$6.3 billion, and KT&G with sales of \$4.1 billion.

For conducting analysis of the market concentration of the tobacco industry in the Republic of Croatia, we will use AC Nielsen (2012-2019) reports regarding market share and retail sales of the tobacco manufacturers present in the Croatian market, and these are: Tvrnica duhana Rovinj (TDR), Philip Morris (PMI), Japan Tobacco International (JTI), Imperial Tobacco (ITG) and British American Tobacco (BAT). Table 4 shows the quantities of cigarettes sold per manufacturer via retail channel in Croatia from 2010 to 2012, ie the period before the accession of the Republic of Croatia to the European Union.

Table 4. Quantity of cigarettes sold in retail from 2010 - 2012 (in million) (AC Nielsen Cigarettes (2010 – 2012))

Manufacturer	2010	2011	2012
TDR	4,878,199	4,407,470	4,034,140
BAT	24,035	68,083	190,320
ITG	16,556	64,224	105,780
JTI	23,621	120,687	170,470
PMI	1,278,963	1,398,657	1,419,450
Other	2,152	3,815	3,310
TOTAL	6,223,526	6,062,936	5,923,550

Analyzing the total quantities of cigarettes sold in the period 2010-2012, we can see that the total quantities are decreasing and that the quantities sold in 2012 are down by 4.82% compared to 2010. The largest decrease in sold quantities is coming from the market leader TDR, whose quantities decreased by 17.30%, while on the other hand, the quantities of other producers have increased. ITG, JTI, BAT had the most significant increases in quantities, which were increased 5, 6 and 7 times, respectively. The second largest producer on the market - PMI - experienced an increase in sales volumes of almost 11%.

Table 5 shows the market shares of the five leading manufacturers operating on the Croatian tobacco market. Through the observed years we can see that the cumulative share of the two leading manufacturers exceeds 90% of the total market share, meaning that the tobacco market in Croatia during the period 2010-2012 is characterized by a very high market concentration. Moreover, table 2 shows that the local producer - TDR is constantly losing market share. At the end of the observed period, TDR's market share was 68.1%, down by 10.28% from 2010. On the other hand, TDR's main domestic rival PMI has increased its market share by 3.41%. The other three major manufacturers (BAT, JTI, ITG) gradually increased their market shares above 1% in the observed period, where BAT, the third largest market player manage to capture 3.2% of the total market by the end of 2012. It can be observed that in

2010-2012 period all international companies had managed to increase their sale volumes on the expense of the local manufacturer.

Table 5. Market share of cigarettes manufacturers from 2010 – 2012 (AC Nielsen Cigarettes (2010 – 2012))

Manufacturer	2010	Cumulative (2010)	2011	Cumulative (2011)	2012	Cumulative (2012)
TDR	78,4 %	78,4 %	72,7 %	72,7 %	68,1 %	68,1 %
PMI	20,6 %	98,9 %	23,1 %	95,8 %	24,0 %	92,1 %
BAT	0,4 %	99,3 %	1,1 %	96,9 %	3,2 %	95,3 %
JTI	0,4 %	99,7 %	2,0 %	98,9 %	2,9 %	98,2 %
ITG	0,3 %	100,0 %	1,1 %	99,9 %	1,8 %	99,9 %
Other	0,0 %	100,0 %	0,1 %	100,0 %	0,1 %	100,0 %

As stated earlier, Republic of Croatia has undertaken to adjust excise duties on tobacco products so that all tobacco producers operating on Croatian market would have the same excise duty calculation, and in turn provide fair market competition for all the market players. Table 6 shows the market shares of main cigarettes manufacturers in Croatia for the 2013 – 2017 period.

Table 6. Market share of cigarettes manufacturers from 2013 – 2017 (AC Nielsen Cigarettes (2013 – 2017))

Mfr.	2013	Cum. (2013)	2014	Cum. (2014)	2015	Cum. (2015)	2016	Cum. (2016)	2017	Cum. (2017)
TDR	61,8%	61,8%	55,1%	55,1%	51,2%	51,2%		0,0%		0,0%
PMI	27,4%	89,2%	33,5%	88,6%	38,7%	89,9%	38,7%	38,7%	38,4%	38,4%
BAT	4,7%	93,8%	4,1%	92,8%	2,9%	92,8%	54,7%	93,4%	53,4%	91,8%
JTI	3,4%	97,3%	4,6%	97,4%	5,5%	98,3%	5,4%	98,8%	7,3%	99,1%
ITG	2,6%	99,9%	2,5%	99,8%	1,6%	99,8%	1,0%	99,8%	0,8%	99,9%
Other	0,1%	100,0%	0,2%	100,0%	0,2%	100,0%	0,2%	100,0%	0,1%	100,0%

During the observed period, market shares of each player have changed, especially the one of TDR, a local manufacturer, whose market share has fallen by 27.23% from 2010 until 2015 when BAT acquired TDR, which allowed BAT to transform from being a major global player with a small market share on the Croatian market to the market leader. However, the biggest winner during this period is PMI who managed to achieve incredible 40% in organic growth.

4. Attractiveness of tobacco industry in Croatia

In order to better understand wheatear tobacco industry in Croatia is attractive or not, and in what degree, Porter's Five forces framework (Porter, 2008) has been applied as a method for analyzing competition of the business. Five forces framework draws from industrial organization economics to determine the competitive intensity and, therefore, the attractiveness of an industry in terms of its profitability (Thompson, Strickland and Gamble, 2008). Five forces framework helps analyzing the level of competition within a certain industry, where competitiveness does not only come from competitors, but instead the state of competition in an industry depends on five basic forces: threat of new entrants, bargaining power of suppliers, bargaining power of buyers, threat of substitute products or services, and existing industry rivalry. Companies operating in an industry with highly intense five forces do not earn attractive returns on investments, while on the other hand, if the forces are mild there is room for companies to achieve higher returns (Porter, 2008).

4.1. Threat of New Entrants

The most common competitive pressures associated with potential new market entry do not come from outside the industry, but from existing market players who are looking for new opportunities in geographical areas where they are not present (Thompson, Strickland and Gamble, 2008). In some industries, especially in tobacco industry, consumers are loyal to reputable international brands, where attracting consumers to new brands that are already present in the market can be slow, time consuming and usually very expensive process. The entry of new competitors may be even more difficult if the entrenched market players have strong and efficient distribution channels, where the newcomer is required to either establish its own distribution network or penetrate in the already existing ones.

Croatian retail market is highly consolidated since 75% of the retail market share is in hands of few large organizations, while small and medium sized retailers have around 25% of the market. Moreover, tobacco market is not very attractive for new entrants because market is already saturated with various tobacco products and brands, there is a significant distribution cost, and associated brand positioning costs. Moreover, another deterrent is that Croatian tobacco market is highly regulated where regulation prohibits public exposure of tobacco products which in turn makes life very difficult for tobacco products' manufacturers to develop their brands (Krajinović, Bučević and Bosna, 2016).

The new market entry onto Croatian tobacco market occurred in 2010 when JTI (Japan Tobacco International), the third largest producer of tobacco products in the world, entered the market (tportal.hr, 2010). Distribution of JTI brands was taken over by Fibis, with the expected turnover of about \$135 million over the five year period. JTI entered the Croatian market with brands such as: Winston and Camel, which are

one of the best-selling brands in the world. JTI positioned price of Winston in order to compete with Walter Wolf, one of the best-selling TDR brands on the market. It is highly unlikely that there will be any new entrants into the Croatian market after JTI's penetration in 2010, especially considering that there are four largest international manufacturers already present on the market.

4.2. Rivalry Among Industry Firms

Most companies perceive their competitors as a threat and devote their outmost attention to one goal, how to increase the market share relative to the competitors' ones, and although competitors certainly pose a threat to the business viability, sometimes when dealing with the right competitors can even strengthen rather than weaken a firm's competitive position in a particular market (Porter, 2008). There are numerous ways how companies can compete with one another in order to attract consumers and increase their market share, the most common ones are: greater product recognition, better product features, higher quality, higher image and brand appeal, broader portfolio, etc. When companies are willing to give up their share of profits by lowering their prices (price war), it is obvious that they are operating in a market characterizes by very high intensity of rivalry between market players (Carpenter and Sanders, 2009).

Until 2015, the main market players in the Croatian tobacco market were the local manufacturer TDR with its local brands, such as: Ronhill, Benston, York, Walter Wolf and Filter 160, and international company PMI, which had only international brands in its portfolio, the ones like: Marlboro, Chesterfield and Philip Morris. BAT, JTI and ITG were also present on the market with their own international brands. After the acquisition of TDR, BAT managed to consolidate domestic TDR brands to its portfolio of already existing international brands, such as: Lucky Strike, Pall Mall, Dunhill and Rothmans.

After the successful integration of Benston brands under the Rothmans brand, BAT has done the same with Ronhill brands which got integrated under Dunhill brand umbrella, probably the most prestigious of all other BAT brands (Kuksunović 2016). Kuksunović (2016) quoted John Brady, a member of the BAT Adria Board in charge for Marketing: Ronhill has lost more than half of its initial market share, making it clear that consumers are looking for a change that is reflected mostly in increasing consumption of international brands. With this move, BAT has reduced the offering of local brands, out of which only Walter Wolf, Filter 160 and York remained, and in turn strengthened its portfolio to match the portfolio offering from other competitors who only sell international brands on the market. Therefore, the rivalry among existing market players is high and companies are forced to adapt to other competitors' moves in the market.

Although the rivalry among existing competitors is high, there has not been any actions, yet which would imply the possibility of entering into a price war with other players within the tobacco industry in Croatia. However, when looking at the presence of strong rivalry between current market players, one cannot exclude the possibility of price wars occurring in the future. Table 7 presents the retail prices of the main brands from four largest manufacturers where most manufacturers have offers in the same price range.

Table 7. Retail prices by main brands present on Croatian tobacco market in 2017 (Customs Administration)

Manufacturer	Brand	Retail price (in HRK)
BAT	ROTHMANS	22,00
BAT	PALL MALL	23,00
BAT	LUCKY STRIKE	25,00
BAT	DUNHILL	26,00
JTI	LD	22,00
JTI	WINSTON	23,00
JTI	CAMEL	24,00
PMI	MURATTI AMBASSADOR	22,00
PMI	CHESTERFIELD	23,00
PMI	PHILIP MORRIS	24,00
PMI	MARLBORO	28,00
ITG	WEST	24,00
ITG	GAULOISES BLONDES	27,00
ITG	DAVIDOFF	28,00

4.3. Threat of Substitutes

Consumers are usually encouraged in the presence of substitutes to compare products based on their various characteristics, functionality, usability, and maybe most important, on price. Manufacturers of successful substitute products are putting pressures on market players to constantly improve and evolve their products alongside different product characteristics and to fight for every consumer explaining what sets apart that their product and why it is better than substitute one (Thompson, Strickland and Gamble, 2008).

In tobacco industry, one of the main substitutes for cigarettes is fine-cut tobacco, which is attractive to consumers because of its price which is several times lower compared to the average cigarettes. Fine-cut tobacco can be divided into two groups, branded fine-cut tobacco which can be purchased at retail stores and outlets, and

unbranded fine-cut tobacco that consumers purchase on the illegal market. Apart fine-cut tobacco there are several other substitutes, such as: processed tobacco for heating (heated tobacco products), liquids intended for consumption in an electronic cigarette, regardless if contain or not nicotine (e-liquids), and other products that meet the above characteristics and are not heated tobacco products or e-liquids (new tobacco products) which are present on the Croatian market (Carinska uprava, 2019).

According to Kojić and Orlović (2016) there are several criminal activities occurring on Croatian market related to tobacco products, out of which the main ones are: smuggling and contraband of tobacco products, counterfeit tobacco products, illicit whites or cheap whites (cheap manufactured cigarettes), bootlegging, and illegal manufacturing. Unbranded cut tobacco is the largest substitute for cigarettes which is no surprise since traditionally tobacco is grown in many parts of Croatia and large part of production ends up on the illegal market. Kojić and Orlović (2016) state that 7.8% in the total smoking population smoke fine-cut tobacco, while 4.5% smoke unbranded fine-cut tobacco. Moreover, it is estimated that around 1,000 tons of fine-cut tobacco is consumed annually on the black market, for which no excise duty nor VAT have been paid, and which in turn leaves state budget without more than \$115 million (Kojić and Orlović, 2016).

Heated tobacco products are a relatively new substitute products on the market, where main threat comes from two brands: GLO, developed by BAT, and IQOS, developed by PMI (GLO heats heat tobacco sticks at 240°C, while IQOS at 350°C). These heated tobacco sticks cannot be consumed the same way as a classic cigarette, but only via specific heating device developed by their respective manufacturer. In 2008 PMI has begun researching and developing next-generation of smoke-free products, investing over \$6 billion in their flagship product – IQOS. IQOS is a device which heats the tobacco stick and does not release same smoke type like the one found in classic cigarettes, which in turn has significantly lower health risk compared to that of consuming classic cigarette. Following the move by PMI, BAT has made significant investments in new generation of smoke-free products, as well, totaling around \$2.5 billion in research and development of their flag-ship product – GLO. The vapor produced by GLO has 90 to 95% less harmful substances than the ones found in the smoke of the classic cigarette. The development of both brands, IQOS and GLO, took several years and were global projects considering the number of various experts and scientist involved in developing both products (Brajković, 2019).

Considering that legislation concerning tobacco and its products is becoming every year ever more restrictive with a constant pressures on price increase, it is highly likely that consumption of classic tobacco products such as cigarettes will continue with its decline, which in turn will force both consumers and manufacturers to turn to the new generation of tobacco products, the ones like smoke free heated tobacco products (progressive.com.hr, 2019).

4.4. Bargaining Power of Buyers

The relationship between buyers and sellers can represent a weak or a strong competitive force depending firstly, on the number of buyers, their bargaining power, and their capability to obtain preferential pricing arrangements and more favorable terms of sale, and secondly, on the size and competitive importance of strategic partnerships between sellers and buyers in the specific industry (Thompson, Strickland, Gamble 2008). The tobacco industry usually defines its buyers as traders who purchase cigarettes directly or through distributors and sell them to end consumers. With the decline in the market share of the specific manufacturer, the power of customers, traders and retailers, will increase due to the relatively higher financial power of its competitors. Moreover, the bargaining power is also enhanced over time by the illegal and 'dark' markets, which impedes market success of new brands and in turn, further strengthens strong brands (Karjinović, Bučević and Bosna, 2016).

Due to the high rate of consolidation of the Croatian market, customers have a significant influence on manufacturers of tobacco products, which is dependent on their relative market share. Besides large international retail chains, such as: Lidl, Spar and Kaufland, there are several large national retailers operating in Croatia, such as: Konzum and Plodine, and there are several regional ones, who operate either as strategic partnerships or simply as a group of small companies, such as: NTL – Narodni trgovački lanac with more than 1,400 outlets and Ultra gros with more than 1,550 outlets throughout Croatia (table 8). Therefore, by consolidating retail market buyers increase their bargaining power and gain more advantageous position towards the sellers.

Table 8. Market share of top 10 retailers by revenue in 2018 (National competition authority, 2019)

	Retailer	Market share %
1.	KONZUM	20-30
2.	LIDL	10-20
3.	PLODINE	5-10
4.	SPAR	5-10
5.	KAUFLAND	5-10
6.	TOMMY	5-10
7.	STUDENAC	< 5
8.	KTC	< 5
9.	NTL	< 5
10.	MLIN I PEKARE	< 5

Top 10 retailers	> 80%
Other 41 retailers	< 20%

4.5. Bargaining Power of Suppliers

Suppliers have higher bargaining power in those industries characterized by not many global players and where the whole business is undergoing a process of consolidation. On the other hand, when largest global manufacturers are present in the market, especially the one highly concentrated, such as Croatian tobacco market, as a rule suppliers will have a smaller bargaining power since the industry leaders make up a large percentage of the total market share (Thompson, Strickland, & Gamble 2008). Moreover, globally, there is an excess supply of materials required for the production process of cigarettes and other tobacco products which implies a low bargaining power of suppliers (Karjinović, Bučević and Bosna, 2016).

However, the one non-market player which has a significant impact on the tobacco industry in general, is the government, with its discretionary right to impose the amount of excise duties, which in turn, if being too high, lead to high final product prices and therefore stimulate demand for substitutes. The use of tobacco products in Croatia is regulated by the Act on restrictions on the use of tobacco and related products, which is in line with EU directives (the Act). The Act regulates the use of tobacco and related products, as well as what kind of information and in what way can be labeled on the product packaging, what are the preventive measures and who supervises the implementation of these measures stipulated in the Act, all with the aim of reducing the overall consumption of tobacco products (Act on restrictions on the use of tobacco and related products, 2019). Some examples of the regulations are that tobacco products which are flavor enriched and have 3% or higher share in a certain category may be in sale until May 20, 2020, like in case of menthol flavor. Health warning signs and information messages labeled on the products are defined by the Act, where text alerts and photos must be from a photo collection defined in the Act and should cover 65% of the product exterior. Moreover, a pack of cigarettes should consist of a minimum of twenty cigarettes, while a pack of branded fine-cut tobacco of at least 30 grams of tobacco, etc. (Act on restrictions on the use of tobacco and related products, 2019).

5. Conclusion

Croatia historically had a developed tobacco industry until 2006 when only one cigarette factory remained operating. Prior to joining the European Union, Croatian tobacco industry was highly concentrated where two market leaders had over 90% of the overall market share. Following the EU accession, Croatia had to undergo a process of adaptation to EU directives and law harmonization, which impacted the use of tobacco and tobacco related products, , and in turn was reflected in the overall

increase of excise duties. By opening up the tobacco market, consumers quickly shifted their demand towards the international brands, which somewhat weakened the competitive position of the only remaining local manufacturer (TDR) whose market share slowly declined over the years, and finally in 2015 was acquired by BAT. After the acquisition and under the control of BAT, TDR changed their product portfolio from local cigarette brands to mainly international brands which dominate the global market. Nevertheless, TDR under the ownership of BAT remained the dominant market player and one of the largest exporters in the Republic of Croatia.

Implementation of more restrictive EU laws, with high excise duties on tobacco products, affected the sales levels and in turn the overall size of the market. On the other hand, despite that market contracted over the years, the state budget had an increase in the revenue collected from the sale of tobacco products. From 2012, excise duties have continually increased every year reaching the minimal level of €90 per 1,000 cigarettes. Due to the price increase of tobacco and tobacco related products consumers slowly moved towards either illegal market or to the next generation of smoke-free substitute products, which in turned had an impact on the overall industry profitability. Moreover, since tobacco industry is highly regulated, maneuvering capabilities of existing market players is also very limited which makes the industry not so much attractive for a new market entry. Furthermore, potential market entrant in a consolidated market, such as Croatian, would face a major challenge of setting up its own distribution network and retail agreements.

As in any industry, tobacco is no exemption, retailers with their size and turnover always try to get better deals from their suppliers, and suppliers are willing to accommodate such requests depending on the retailer's attractiveness in terms of number of retail units, geographical reach, and client base. Just as there was consolidation process among tobacco product manufacturers, the similar process happened on the distribution and retail side of the market, where many local retailers started grouping up together to increase their bargaining power.

Following the EU accession, Croatian tobacco market remained highly concentrated and consolidated with the presence of large global companies which cumulatively hold 99.88% of the market. Just by looking at the number of market players, their size, organizational capabilities and their market share, Croatian tobacco industry is not very attractive for the new potential market entrant because there are not many companies who would be willing to compete with the largest global players, especially not on the highly regulated market such as Croatian. On the other hand, due to the high consolidation of the market, there is not much rivalry between major players since most of their actions are strictly regulated by the legislator, including labeling and packaging of tobacco products. Although rivalry between existing competitors is moderate and the potential entry of new competitors is unlikely, it can be concluded that tobacco industry in Croatia is not attractive in the long term, and considering all

of the above mentioned market threats, it is even questionable how profitable the industry will be in the future.

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