CASE 3-3
Philip Morris Enters Turkey

Under regulatory and legal fire in the United States, tobacco companies have been staking their financial futures in developing countries. In the seven years since Turkey abolished price controls that had propped up its state-owned tobacco company, Philip Morris has gotten millions of Turks to cast aside local cigarettes in favor of its Marlboro, Parliament, and L&M brands. For Philip Morris—which saw international tobacco profits grow 60 percent to $4.6 billion last year from 1994—nowhere has that push been more successful than in Turkey. In the nation that inspired the phrase "smokes like a Turk," 43 percent of the 62.9 million population smokes, according to government estimates, compared to 25 percent in the United States. Meantime, cigarette consumption in Turkey has increased at an annual rate of about 4.76 percent since 1992, making this one of the fastest-growing markets in the world. Philip Morris has watched its share of the Turkish cigarette market mushroom, to 23 percent in 1997 from 15 percent in 1995, while Tekel, the government-owned tobacco company, has seen its hold drop to 70 percent from 82 percent over the same period, according to figures provided by the Turkish government. Third-ranked R.J. Reynolds, with its Winston and Camel brands, says its share has grown to 7.3 percent from 2.9 percent.

Turkish smokers got their first taste of Philip Morris brands in the 1970s, when smuggled, tax-free American cigarettes began flooding local bazaars. But it wasn't until the early 1980s that the company was allowed to sell cigarettes in Turkey. Eager to raise Turkey's status in the West, then–Prime Minister Turgut Ozal decided to turn his rural country into a model of free enterprise. One of his targets: Tekel, the creaky state monopoly that has held exclusive rights to sell tobacco, salt, and liquor to Turks since the waning days of the Ottoman Empire.

How could Mr. Ozal prod Tekel into the modern age? He announced in 1984 that foreign tobacco merchants would be allowed in Turkey for the first time since the days of the sultans.

But there was a catch: Tekel would continue to price and distribute all cigarettes both foreign and domestic. That advantage came in especially handy when Tekel in 1988 launched Tekel 2000, a cigarette blended with American tobacco leaves that it designed to compete with Marlboro. Priced about 25 cents lower than a standard 20-cigarette pack of Marlboros at the time, Tekel 2000 quickly won a quarter of the market.

Arguing that it couldn't survive in Turkey unless it had the right to price and distribute its own products, Philip Morris leveraged the one thing it had that the government badly wanted: millions of dollars to invest in the country. And it wouldn't invest that money unless Tekel gave up control.

Tekel eventually relented, and in May 1991, Philip Morris got the right to market, price, and distribute its own cigarettes, conditioned on a number of factors, including building its own factory. Philip Morris announced a joint venture with Sabanci Holding Inc., a local company, and poured $100 million to start construction of a factory in the southwestern city of Torballi. The factory opened in 1993; Philip Morris eventually expanded it into a $230 million facility capable of cranking out more than 28 billion cigarettes annually.

Supporting the idea that Philip Morris adjust its cigarette blends is a confidential 1992 report, titled "PM's Global Strategy: Marlboro Product Technology," conducted by researchers at rival B.A.T. Industries PLC's Brown & Williamson unit. "When Marlboro has been introduced into a market there is no evidence that initial offerings may be closer to that market's traditional taste," concludes the report that documents different Marlboro formulations in countries including Brazil, Britain, and Germany. "Over time PM will alter the product and introduce product technology more consistent with an overall Marlboro sensory character."

Philip Morris says it doesn't comment on speculation by competitors. The company says it strives "to ensure that Marlboros are as consistent as possible worldwide," but adds that some variation results from local regulations that limit constituents like tar or require the use of locally grown tobaccos. Beyond the taste difference, Tekel couldn't keep up when Marlboro's prices were cut. Although they still maintain Tekel 2000 was a success, Tekel executives announced that they want to sell the brand to a foreign competitor. Where Philip Morris really bested rivals is in marketing and distribution.