

# The location of job creation and job destruction in multinational companies across the EU

## The British American Tobacco Case Study

ERM Analytical Report

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### Abstract

*British American Tobacco (BAT) has gone forward in the last five years to an extensive restructuring of its production activities. The motivation for this strategy included factors both from the demand side (a decrease in the consumption of tobacco products in Western countries and an increase in low- and middle-income countries), as well as from the supply side (reduction in overcapacity in Europe and manufacture of products close to the countries where they are consumed). The radical spatial restructuring of BAT's production activities appears to have coincided with important increases in profitability and in the dividends the company pays to its shareholders.*

### *1. Basic facts*

**Name of the company or group:**

British American Tobacco (BAT).

**Nationality of the company or group:**

BAT has headquarters in London (United Kingdom). It is listed on the London Stock Exchange. Based on the FTSE 100 index, BAT was in 9<sup>th</sup> place in 2007 on the London Stock Exchange, in terms of capitalisation.

**The countries in which the company is represented (the main ones if there are many):**

BAT is active on all five continents. More specifically, BAT has offices in over 180 countries, where it is involved in the commercial marketing and promotion of its products. In 2007, BAT owned 47 units of production in a total of 40 countries.

**The sectors (NACE 3-digit) in which the company operates (please specify if they differ between countries):**

C12.0. - Manufacture of tobacco products (47 countries).

G46.3.5 - Wholesale of tobacco products (180 countries).

**The number employed in the company in the different countries (approximate figures are sufficient):**

The figures below refer to broader geographical areas (end of 2007):

- North America – Pacific (USA-Canada-Japan): 1,844 employees.
- Latin America (including South America, Mexico, Central America and Caribbean): 15,009 employees.
- Europe (including over 40 countries): 18,913 employees.
- Africa and Middle East: 7,807 employees.
- Asia – Pacific: 10,334 employees.
- Total employees: 53,907.

It is interesting to note that in 2007, BAT bought a total of 460,000 tons of tobacco from 280,000 farmers. Eighty per cent of that tobacco was obtained from farms and suppliers in developing countries.

The number employed in different sectors and/or broad activities in each country (please give an approximate percentage breakdown)

There are not sufficient data on the spatial structure of the company's individual activities (trading and manufacture of products).

## *2. Changes in the location of employment*

**How has the number employed changed over the period considered in the different countries in which the company or group is located? (Please give broad percentage changes)**

Changes in employment are directly associated with a range of broader structural factors affecting the tobacco industry. First, the public anti-smoking campaigns in Western societies have contributed to a drastic reduction in smoking over the last two decades. For example, in Australia, it has been estimated that smoking will have been eliminated by 2030. By contrast, the developing countries present a huge potential for the tobacco industries. Smokers today represent approximately 23% of the world's population, and one out of two smokers lives in Asia. This has led the multinational tobacco industries to seek out new markets. Secondly, (1) market liberalisation under the aegis of the World Trade Organisation (2) political changes in the states of Central and Eastern Europe as well as (3) the rapid economic growth of developing countries in Asia have fostered the further internationalisation of the production and trade activities of the global tobacco industry. The closure of several of BAT's units in Europe and the company's increasing interest in investing both in states of Eastern Europe and also in developing countries appear to confirm the above-mentioned potential. In the table below we give some of the most important instances of restructuring of BAT in Europe (and in Canada) between 2003 and 2007.

### BAT Restructuring in Europe (2003-2007)

	Year	Region	Unit	Job reduction	Caused
<b>Italy</b>	2007-04-19	Provincia Autonoma Trento	Rovereto	147	n.d
	2004-10-12		Bologna, Scafati	238	End of production on behalf of Phillip Morris.
<b>Germany</b>	2006-06-06	Bayern – Oberfranken	Bayreuth, Hamburg, Bremen	800	Decline in sales due to tobacco tax increases. n.d
	2004-12-03	Nordrhein – Westfalen; Dusseldorf	Dusseldorf, Ratingen	483	
<b>Netherlands</b>	2006-06-01	Oost – Nederland; Gelderland	Zevenaar	570	Increase of productivity and elimination of overcapacity
<b>United Kingdom</b>	2005-06-01	South East- Hampshire – Isle of Wight	Southampton	660	Production costs Benefits of localisation in the Far East (Singapore and Korea) in terms of distance from the destination markets. Cost cutting / Improvement of productivity.
	2003-12-01	North East; Tees Valley and Durham.	Darlington	500	n.d
<b>Canada</b>	2005-10-21	Ontario	Guelph	555	Decline in sales (since 2000 the company's volume have declined 38 per cent)
<b>Cyprus</b>	2006-03-31	Nicosia	Nicosia	89	Loss in exports High production costs

Source: Processing of BAT and ERM data

The geographical reorientation of BAT activities towards middle- and low-income countries is confirmed by the following investments (data were taken from BAT press releases and articles in the international financial press).

### Sample of BAT investments in middle- and low-income countries (2001-2008)

Turkey	2008-02-22. BAT acquired state-owned Tekel, increasing its market share from 7 to 36%. Turkey is the world's 8 <sup>th</sup> biggest market for cigarettes. Thirty-eight per cent of the adult population is smokers. Tekel operates a total of six factories. BAT had penetrated the Turkish market in 2002, when it acquired a factory in Tire-Izmir.
South Korea	2001-09-08. BAT announced construction of a factory in one of the most important markets in the world. The new factory will be built in Gyeongnamdo Province. Company officials said there is increased demand for the company's locally produced international brands. It is estimated that the creation of the factory will be the key to success in the Korean market, in which BAT has been doing business since 1988.
Serbia & Croatia	2003-08-04. BAT acquired the state tobacco industry Duvanska Industrija Vranje (DIV). Around 50% of Serbia's adult population are smokers. BAT already had a 13% share of the Serbian market. The acquisition of the Serbian company was aiming at relieving BAT of the obligation to pay import duties. It is estimated that the factory is also an ideal base for exports to neighbouring countries, since such countries conclude free trade agreements among themselves. In 2002, DIV employed 570 people. It is worth noting that four years earlier, BAT had acquired the Croatian tobacco industry Tvornica Duhana Zadar, with the objective of penetrating the local market and increasing sales in neighbouring countries.
Peru	2003-04-03. Acquisition of Tabacalera Nacional S.A.A. BAT is market leader in Latin America, with 55% of market share. In 2003, BAT was also the market leader in Brazil, Chile, Venezuela, Central America and the Caribbean.
Nigeria	2001-09-24. BAT announced the creation of a cigarette factory in Ibadan, Nigeria. This investment was expected to create 1000 jobs. According to the company itself, the economic and social environment had improved, making a large investment in the production and distribution of cigarettes feasible.

The cases above indicate that three factors have converged to cause BAT relocations:

- Less demand in the industrial countries and overcapacity in European units of production.
- Increased demand from countries with middle and low incomes (Eastern Europe and developing countries). Transfer of units of production closer to end customers.
- Utilisation of the opportunities presented by market liberalisation and direct foreign investment. Entry into joint ventures with local tobacco industries. Creation of jobs on the local level as a vehicle for the development of business activities.
- Weak anti-smoking legislative framework. Many developing countries do not require that cigarette packets bear warning messages regarding the effects of smoking on health.

These same countries take a favourable view of the colossal short-term income from taxation of smoking, ignoring the long-term effects in terms of public health.

Finally, it should be noted that the above list of acquisitions is not an exhaustive one. Important acquisitions have also taken place in recent years in Italy – the second-largest European market for tobacco products – with acquisitions of the state-run enterprise Ente Tabacchi Italiani as well as in Scandinavian countries (acquisition of Skandinavisk Tobakskompagni A/S) and Japan.

**How far do the changes in employment reflect shifts in the location of production of particular goods or services between countries as opposed to the location of the production of a new product in one country rather than in another (or others)?**

There are no data indicating a correlation between the spatial structure of the company's activities and the features of products.

**Have the changes in employment been associated with a reorganisation of the company's activities, such as concentrating manufacturing in a particular place (or places) and administrative or management functions in another (or others)? If so, please give details**

An analysis of various company documents (annual reports, press releases, etc.) and articles in the international financial press has shown a trend towards relocation of BAT's production activities (1) to countries with lower labour costs, and (2) to countries that are closer to the developing markets. The developing countries meet both these criteria, a fact which explains the investments made in countries such as Nigeria, Turkey, South Korea, Russia and Serbia. In the industrialised countries, restructurings and closure of units of production are aimed at eliminating the overcapacity that appeared with the decrease in smoking (in the 1990-1997 period consumption of cigarettes fell by 10.9% in Europe and 7.6% in North America). But by and large in those countries, jobs involving the marketing and distribution of products were saved.

**Have there been any changes in the location of employment between regions within countries over the period considered, such as, for example, the concentration of production in a particular location? If so, please give summary details**

Based on data from ERM, BAT Germany decided to locate the activities of its factory in Dusseldorf (Brinkmann Niemeyer). No further data are given, however, that would clarify the motivation for this decision. By and large, however, no other cases have been recorded involving the transfer of jobs between regions (of the same country). The changes noted have taken place either within the EU or on a global scale.

**Is there any evidence that observable trends in the location of the company's activities have changed over the period examined? For example, has a shift towards expanding operations in one or more of the new Member States been replaced by an expansion in other locations either in the EU or outside?**

Overall, three distinct trends can be seen regarding the spatial structure of the company's activities:

- First, the number of units of production in the countries of the EU-15 is shrinking, and the activities of some factories are being relocated to certain EU countries (e.g. Germany/Poland), at the expense of others (e.g. Zevenaar unit in the Netherlands). The same appears to be true of the transfer of production from Romania to the factories in Poland (Augustow) and Germany (Bayreuth) for the purpose of meeting the increased demand from the Bulgarian market after Bulgaria entered the EU. This latter case appears to be connected to the fact that BAT tried in 2005 to enter into a joint venture with the Bulgarian public enterprise Bulgatabak but without success. According to the managing director of BAT Bulgaria, the German and Polish factories have a greater capacity, and help meet the demand of the Bulgarian market.
- Second, new investments are being made in countries outside the EU (Serbia, Croatia and Turkey). BAT also has a total of three factories in Russia (BAT-Yava in Moscow, BAT-SPb in St. Petersburg and BAT-STF in Saratov), i.e. the fourth largest cigarette market in the world. In 2007 BAT had around a 20-25% share in this market.
- Third, investments are being made in low-labour-cost countries outside the EU, which are at the same time rapidly developing markets for the tobacco industry (e.g. South Korea, Nigeria, Kazakhstan, etc.). These investments appear to be of major importance for the company: according to the BAT's chief executive (2007 Annual Report), the group's profitability is expected to increase substantially in the next five years, due to increased consumption of higher-quality products, i.e. premium-priced brands, mainly in the developing markets.

**Factors underlying locational decisions. What were the main reasons for the company's decisions?**

The combination of (a) low labour costs, (b) high demand (c) creation of a local centre for exports to developing neighbouring countries has determined the company's investment policy. It is worth noting that during the five years between 2002 and 2007 BAT's productivity profits amounted to around GDP1 billion. Overall, it is estimated that the restructuring carried out involved over half the company's worldwide capacity. Despite the particularly spectacular increase in profitability, the company announced in its 2007 Annual Report that it was aiming to cut back expenses by more than GDP800 million over the next five years, without making it clear what the effects of this policy would be in terms of employment and production.

**What part if any did a concern to produce in, or be close to, the market to be served play in the decisions of where to locate?**

As stated before, proximity to targeted markets has played a primary part, since transport costs, delivery delays and export duties are minimised, while the company as an employer acquires social prestige and political clout on the local level.

**Have the main factors underlying locational decisions changed over the period considered (for example, have low labour costs become a more or less important factor)?**

Lowering labour costs has undoubtedly played an important part in the locational decisions for the company's activities, in combination however with the penetration of rapidly growing markets for tobacco products.

## **Commentary**

The relationship between restructuring (as a means of minimising production costs), employment levels and the importance acquired nowadays by the maximisation of shareholder value in companies' strategic choices is in need of further investigation. In view of the importance being acquired by institutional investors in the global economy, BAT, like most listed enterprises, appears to attach increased importance to the creation of shareholder value: what is more, the company's shareholder dividends have increased considerably in recent years. As the company's 2007 Annual Report states, "over the past five years, we have delivered significant shareholder value with a total return of 294 per cent, compared to 89 per cent for the FTSE 100 as a whole". In parallel, the company's profits increased by approximately 7.66% on average in the three years from 2005 to 2007, and all the forecasts confirm that this trend will continue in the years to come. Even though the company has a good reputation for the generosity and consistency of its social schemes when it carries out restructurings (an assessment confirmed in the Cyprus restructuring), the case of BAT, like that of other companies, causes concern regarding social impacts of globalisation.

The question that arises is to what extent a globalised economy, operating almost exclusively with the objective of shareholder value, is sustainable in the long term, from the social point of view. Whereas there is no doubt that liberalisation of commercial transactions and direct foreign investments have had an overall positive effect in increasing the productivity and performance of multinational companies, it is unclear to what extent the same dynamic is a factor for social well-being:

- First, because the constant demand for higher profits and lower production costs seems to exert pressures on workers (pay, working hours, etc.). In this instance, the danger of relocation acts as a means of putting constant pressure on workers.
- Second, because the lack of regulation of the global economy is often accused of calling into question social and employment rights in Western countries, thus creating conditions of social as well as tax and environmental dumping.
- Third, because it is generally realised that it is very difficult for workers who have lost their jobs due to relocation to find another satisfactory job, due to their inability to adapt to different production and workplace practices in the tertiary sector (causing cases of social exclusion to appear). In parallel, jobs in the tertiary sector are often considered to be less secure than in industry.
- Fourth, because productivity gains are likely to be first shared with the company's shareholders in the form of generous dividends, a fact that does not contribute to a fairer allocation of the benefits of globalisation. This development entails significant dangers both on the macroeconomic level (decreased demand,

productive investment and employment) and also on the social level (increased social inequalities).

These developments are also facilitated by the weakening of the regulatory role of the state, the system of collective bargaining and the trade union organisations. In the face of the above key-issues (in need of further investigation), the creation of a framework for the regulation of the globalised productive, trade and financial system is considered to become an ever greater necessity.

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