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Background Study

Growth of heat-not-burn tobacco sales and a dramatic decline of cigarettes

Rapid structural change in Japan's domestic tobacco industry

Request by tobacco seller and grower groups in relation to next period's tax increase

To date, the Japan Tobacconist Federation and the Japan Tobacco Growers Association have taken a solid stance against the decision to increase tobacco tax, and in regards to the tax increase to be rolled out in the next period, have made the request of "If tax increase is unavoidable, then minimize impact on the industry," (as reported in a previous July edition of this paper). We (the Editorial Dept.) examined the factors behind the decision to make this painful choice.

Current Situation

A comparison of the estimated total demand in the first year of the tax increase program (FY 2017) and the estimated total demand in the final year of the program (FY 2022) (total of cigarettes, heat-not-burn tobacco, and cigarillos), showed a decrease of 21.6 billion units, or 12.6%, proving that the consecutive tax increases over a 5-year period have had a massive impact on consumption.

A breakdown shows a significant decrease of 52.9 billion cigarettes (36.4%) due to the direct blow from multiple tax increases, and it clear that the trend is tapering off. Meanwhile, despite the taxation method of heat-not-burn tobacco also being revised for 5 consecutive years (real tax increase), sales of heat-not-burn tobacco increased by 26.9 billion or around 2.5 times, and this paper's estimated market share also grew from 14.8 to 35.0% (refer to figure). The result for the most recent FY 2022 quarter (Jan – Mar) was 37.3%. A significant decrease in cigarettes and sudden growth in heat-not-burn tobacco—it is clear to see the structure of Japan's tobacco industry has undergone rapid change in the past 6 years.

Background

In order to minimize the impact on the industry, tobacco seller and grower groups have advocated for taxation reforms on heat-not-burn tobacco as top priority if the proposed tax increase of 3 yen per unit in an appropriate timing from 2024 onwards is unavoidable.

To elaborate on the background to this, firstly there is the issue of the tax burden (tax system). Currently, the tax applied to heat-not-burn tobacco products is around 50 yen less per box and 25 yen less per unit compared to cigarettes, however considering that heat-not-burn tobacco has already become established as a major category occupying one-third of the market, it is reasonable that the tax burden should be the same as that for cigarettes.

Secondly, there is the impact on grower groups. JT (Japan Tobacco Inc.) buys all of Japan’s homegrown tobacco, however heat-not-burn tobacco only uses one-tenth of the amount of domestic grown tobacco leaves that cigarettes do. As such, speeding up the decline in cigarettes through tax hikes (increasing heat-not-burn tobacco consumption) will be a tremendous blow to tobacco farmers.

The third factor is the status of retailers that sell heat-not-burn tobacco. According to a study by the Japan Tobacconist Federation and JT, the ratio of cigarettes vs. heat-not-burn tobacco sold by each convenience store (which account for 38% of all tobacco product retailers) is 62% and 38%, respectively. In contrast, the ratio of cigarettes vs. heat-not-burn tobacco sold by each general tobacco retailers (which account for 42% of all tobacco product retailers) is 86% and 14%, respectively. These figures show that general tobacco retailers still rely heavily on cigarette sales.

Decision

A tax increase on cigarettes at this point in time would further accelerate growth of heat-not-burn tobacco sales and have an enormous impact on small and medium retailers and domestic leaf tobacco. It can be said that both groups made the aforementioned painful decision under the premise that a tax increase in the next period was simply “unavoidable.”