Illicit Trade: Alcoholic Drinks in South Africa in 2020

A custom research report compiled for South African Liquor Brand owners Association (SALBA), Beer Association of South Africa (BASA) and VINPRO

20 May 2021

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The data included in this report is accurate according to Euromonitor International´s market research database, at time of publication: 20 May 2021

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INTRODUCTION

Background

Against a backdrop of various legal alcohol restrictions, key industry stakeholders aim to keep abreast of the illicit alcohol situation in South Africa and understand the impact of the ban on illicit trade. The industry further wants to understand the implications for the licit alcohol market from any foreseen policy changes to be implemented.

Challenge and Question

The dry sales ban has resulted in several developments in the illicit alcohol space. There is a need to understand how the alcohol ban has affected illicit trade during 2020 compared to historical trends, having been tracked since 2012, as well as to further investigate the regulatory environment.

Approach

Euromonitor uses a mixed-methodology approach to reach a consensus view on the Illicit Alcohol Market in South Africa, triangulating inputs from secondary and primary sources as well as in-depth industry engagements.

Answer

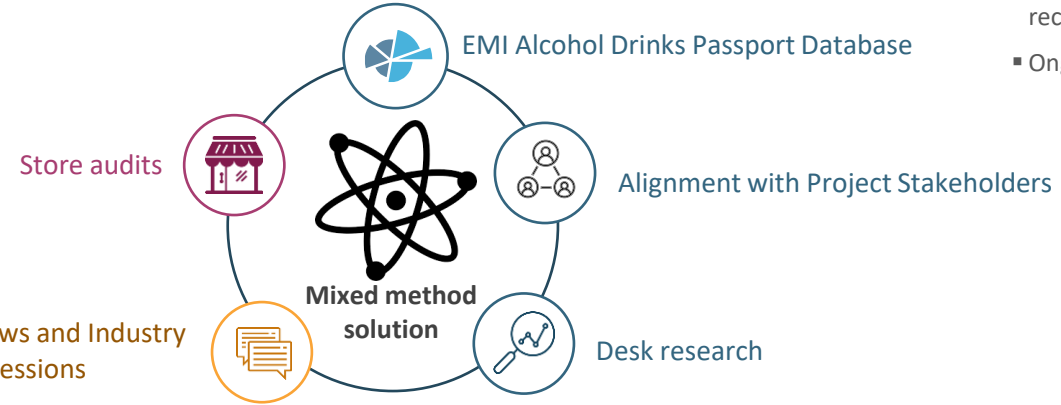
The dry sales ban resulted in an increase in the demand for illicit alcohol, further incentivizing syndicates to take advantage of the depressed legal market for profit making. Indirect consequences saw a rise in homebrew consumption-related deaths as well as an increase in criminal activities. Lack of punitive measures and enforcement further encouraged illicit activity.

Overview of multi-phased approach to sizing the illicit alcohol market

1 Alignment

- Review existing knowledge and hypotheses from 2012 and 2017 study
- Confirm objectives, scope, and definitions
- Alignment key stakeholders

2 Execution and analysis



3 Actionable outcomes

- Final delivery
- Storytelling and key recommendations
- Ongoing support

TRIANGULATION AND VALIDATION Throughout the project-lifecycle, the **findings are rigorously reason-checked against multiple inputs** from trade interviews, store observations, industry engagements and secondary sources.

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Project Research Methodology

SECONDARY RESEARCH

Reference all relevant, **recently published information** on alcohol and illicit alcohol trade in South Africa

Key **data points** used in research:

- **Trade data** – from the DTI
- Licit Alcoholic Drinks Data from EMI **Alcoholic Drinks** data and data from **FTI Consulting**
- **Expertise area specific reports** from GAIN, Genesis Analytics Informal Trade study, South African Medical Research Council and WHO

TRADE INTERVIEWS

Online interviews across the supply chain:

- Alcohol beverage manufacturers; NGOs; trade associates; government organisations
- Online industry engagement sessions with **sales personnel at South African Breweries** in Gauteng, Mpumalanga, Limpopo, Western Cape and KwaZulu-Natal
- Online engagement with **SALBA Illicit Trade Task Team**

FIELD WORK

- **21 in-person store observations** in Gauteng, Western Cape and Free State provinces on illicit alcohol as available
- **Pulse Interviews** (short, informal interviews) with store personnel when available to understand the value chain, distribution and selling points of illicit alcohol

FINALISATION

- Qualitative and quantitative analysis of findings, emphasising the most important **illicit products and trends in 2020** compared to historic trends
- **Validation and finalisation of data** through further engagements
- Reporting on findings and **value chain of illicit alcohol** as available

Note: See appendix for additional information on methodology

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Total size of illicit alcohol and estimation of government fiscal loss revenue

Step 1
Size illicit activity by volume

Each of the main illicit activities are identified as well as the main product categories impacted.

The total volume/value for each product type and by illicit activity is calculated in order to identify how much of this volume/value has been "lost" to tax authorities through customs and excise duties.

Step 2
Apply current tax structure

The appropriate tax rate for the specific year, depending on the product and illicit activity, is applied to the volume.
This is the amount that should have been paid to the government but was not due to illicit trade.

Step 3
Calculate fiscal loss

The total value lost is aggregated across all illicit activities into a single number that represents loss to the government in one year (R million).

Illicit category definitions

Category	Subcategory	Definition
Counterfeit and Illicit Brands	Substitution/refill	Illicit alcohol sold as licit brands or empty bottles of legitimate products refilled with cheaper alcohol.
	Industrial manufacturing of illicit brands	Manufacturing of illicit branded or unbranded alcohol.
Smuggling	Ethanol as raw material	Illicit imports of ethanol as a raw material.
	Finished product	Illicit imports of alcoholic beverages.
Illicit Homebrew	Illicit homebrew (distilled/fermented)	Illicit homebrew refers to home-made alcoholic beverages that are produced for commercial purposes without paying excise taxes. In South Africa, homebrew mainly includes beer made from sorghum or malt (including a wet or dry base ingredient), locally known as Traditional African Beer or Umqombothi. Homebrew can also include other types of fermented homebrew made from fresh produce (eg pineapple beer) or a dry-base (eg Supa Ginja). The production of homebrew is not illegal or illicit. Only once the product is sold without paying the correct excise taxes is it deemed illicit.
Surrogate	-	Alcohol not meant for human consumption as a beverage (eg pharmaceutical alcohol) diverted to the alcoholic beverages market.
Tax Leakage	-	Legally-produced alcohol on which the required taxes have not been paid in the country of production.

Note: The Illicit Alcohol Market in this report excludes sales that could have occurred during the alcohol restriction period that originated from the licit market

COVID-19 and the ban on legal sales resulted in an increase in consumption of illicit alcohol

Restrictions on legal alcohol create higher demand and profit-making incentives for illicit alcohol

The dry sales ban imposed by the South African government amid COVID-19 resulted in **higher demand for illicit substitutes in 2020**. **Opportunities for high profit margins** resulted in **more players entering the illicit market** and an **increase in criminal activities**. Illicit syndicates have become more sophisticated and dynamic, scaling up operations and distribution. **Illicit alcohol infiltrated up-market areas**, especially during the sales ban, as consumers were desperate and willing to pay exorbitant prices. Following the dry ban, illicit traders continued to undercut legal prices to maintain demand and overcome competition.

Illicit alcohol consumption grew by 10% CAGR during 2017-2020, reaching 22% of the total market

Total illicit alcohol consumption increased to **665,431 in HL LAE in 2020,** reaching 22% of total HL LAE volume of licit and illicit alcohol consumption in 2020, compared to 14.5% in 2017 and 13% in 2012. **Smuggling is the largest form of illicit activity in HL LAE volume and witnessed the fastest level of growth** driven by high profit margins associated with under-declaration of imports and diversion of alcohol to the local market without paying excise taxes. **Counterfeiting operations**, particularly production of illicit alcohol, **was scaled-up to satisfy rampant demand for spirits**. Furthermore, **increased homebrew consumption and emergence of fruit fermented homebrew** (such as pineapple beer) was driven by lack of access to legal alcohol sales, combined with easily available ingredients.

Government burdened with health implications of illicit alcohol consumption, while lacking resources to enforce existing regulations

Health implications escalate in relation to availability of illicit alcohol and increased homebrewing

Health risks associated with consumption of illicit alcohol have been **compounded by the prohibition** and increased **experimentation with homebrew and lethal concoctions in 2020**. Restrictions have resulted in a growing number of people engaging in harmful behaviours. This also presents notable health risks, especially in poor communities. **Several people were reported to have lost their lives as a result of consuming homebrew** containing lethal substances such as methanol and methylated spirits.

Lack of enforcement of existing regulations and minimal punitive measures

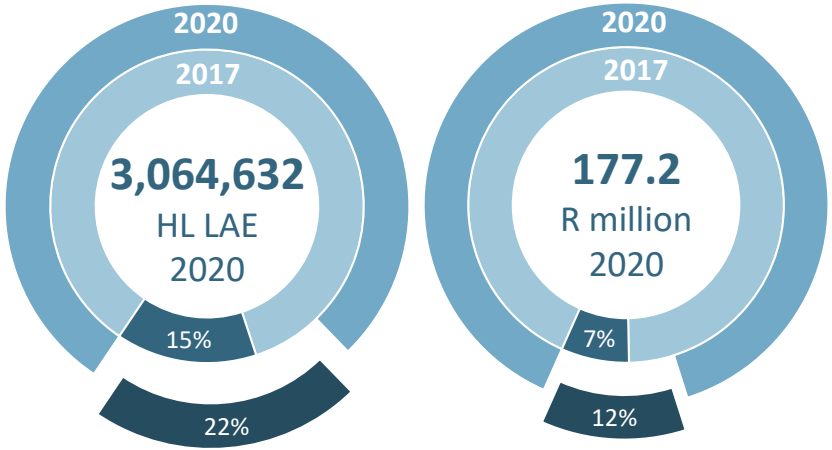
Liquor laws and regulations in South Africa largely aim to control licit alcohol manufacturers and suppliers. Industry sources believe that the country has relatively **sufficient regulations** for the legal market, but minimal **punitive measures** and **lack of enforcement encourages illicit activity**. Many illicit traders that are caught only face a fine and are able to continue operating shortly thereafter. In addition, revenue losses in relation to COVID-19 as well as the ban on alcohol sales further constrained law enforcement's resources.

EXECUTIVE SUMMARY

The illicit alcohol drinks market posted an estimated CAGR of 10% in HL LAE volume terms during 2017-2020, reaching 22% of the total market (licit and illicit alcohol). Illicit alcohol was widely available during the lockdown period in 2020 and has become even more sophisticated through organized criminal syndicates. Overall, the impact of 2020 has ensured more people that would typically not buy illicit alcohol have moved in this direction, while illicit products are finding their way into the formal channel, competing directly against licit brands.

Supply restrictions encourage illicit alcohol market and increase criminal syndicates

Total Alcohol Market Size by Volume and Value 2017/2020



22%

Illicit Alcohol % of Total Market by Volume in 2020

12%

Illicit Alcohol % of Total Market by Value in 2020

Licit Market* Illicit Market

*Note: *Licit market sales reflects the impact of the dry sales ban.*

- South Africa faced some of the **harshest restrictions** in relation to combating COVID-19 including the banning of legal alcohol sales, which had a **severe impact on the licit alcohol market** in terms of revenues and job losses.
- **Total licit market volume in HL LAE declined by 6.5% CAGR during 2017-2020**, with a drop in volumes seen across all categories as a result of the dry sales ban and restrictions within on-trade channels.
- The **wide availability of illicit alcohol** during the sales ban created a **flourishing market**. Total **illicit alcohol in HL LAE volume terms grew by 10% CAGR during 2017-2020**, reaching **22% of the total market in 2020** (illicit + licit volume sales), up from 14.5% in 2017.
- **Economic uncertainties and financial pressures** as a result of the pandemic, coupled with **high profit-making opportunities**, incentivizes individuals to participate in clandestine activities to generate an income.

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ILLICIT ALCOHOL MARKET
AT A GLANCE

Volume

665,431 HL LAE
Total Illicit Market Size

10%
CAGR 2017-2020

22%
% of Total Market*

Value

R20.5 BILLION
Total Illicit Market Size

17%
CAGR 2017-2020

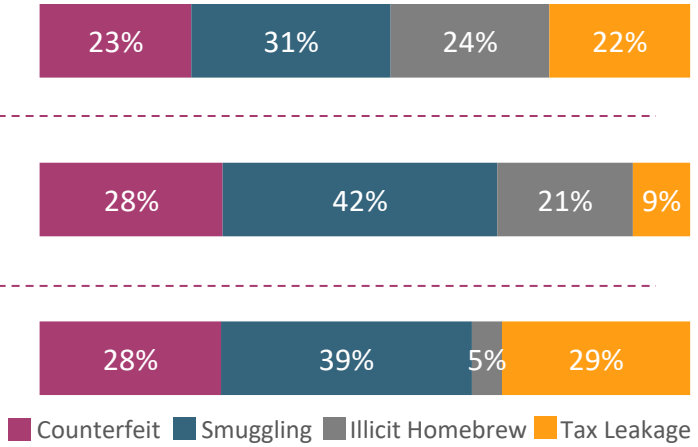
12%
% of Total Market*

Fiscal Loss

R11.3 BILLION
Total Fiscal Loss

20%
CAGR 2017-2020

Share by Illicit Category



*Note: *Total market = Licit + Illicit Alcohol Market.*

COVID-19 and ban on legal sales further entrenched illicit alcohol activity, which may take years to reverse

Key Drivers of Illicit Trade

Historic drivers of illicit trade still hold relevance during 2020

COVID-19 further pitched the **economy into a recession**, shrinking incomes and raising unemployment, which is disproportionately worse for poor households. In turn, **more people are looking for ways to generate an income**, with some **turning to the illicit alcohol market to make a profit**. Consumers were willing to purchase illicit alcohol at high prices during the ban (up to 3-4 times higher), but those who could not afford it turned to more experimentation with homebrews. Enforcement of regulations was even more difficult amid a refocusing of resources to curb COVID-19.

COVID-19-specific Drivers

Supply restrictions meant illicit traders gained further control over the market

Legal sales bans and restrictions

Lack of access to the legal alcohol market created **higher demand for illicit alcohol products and more players entering the market to make a profit**. Illicit traders were able to expand operations under the dry sales ban, through controlling both the supply and price.

Following the ban on alcohol sales, Illicit traders resorted to undercutting licit market prices outside of the legal sales ban to retain demand and beat competition.

The legal sales ban resulted in several unintended consequences, presenting severe health and safety implications

As consumers struggle to deal with the negative impact of COVID-19 as well as the alcohol sales ban, incentives to generate an income through clandestine methods, increased criminal activities and informal trading intensified during 2020. Consumers willing to purchase alcohol without concern for its origin as well as increased experimentation with lethal concoctions resulted in a rise in alcohol-related deaths. Furthermore, industry sources indicate consumers' reporting of illicit activities (in relation to identifying fake alcohol or counterfeit products) was negatively impacted by the ban as consumers did not want to jeopardize their chances of obtaining alcohol.

Livelihoods negatively impacted across value chain

Alcohol-related deaths spike due to lethal concoctions

Consumer reporting of illicit alcohol drops

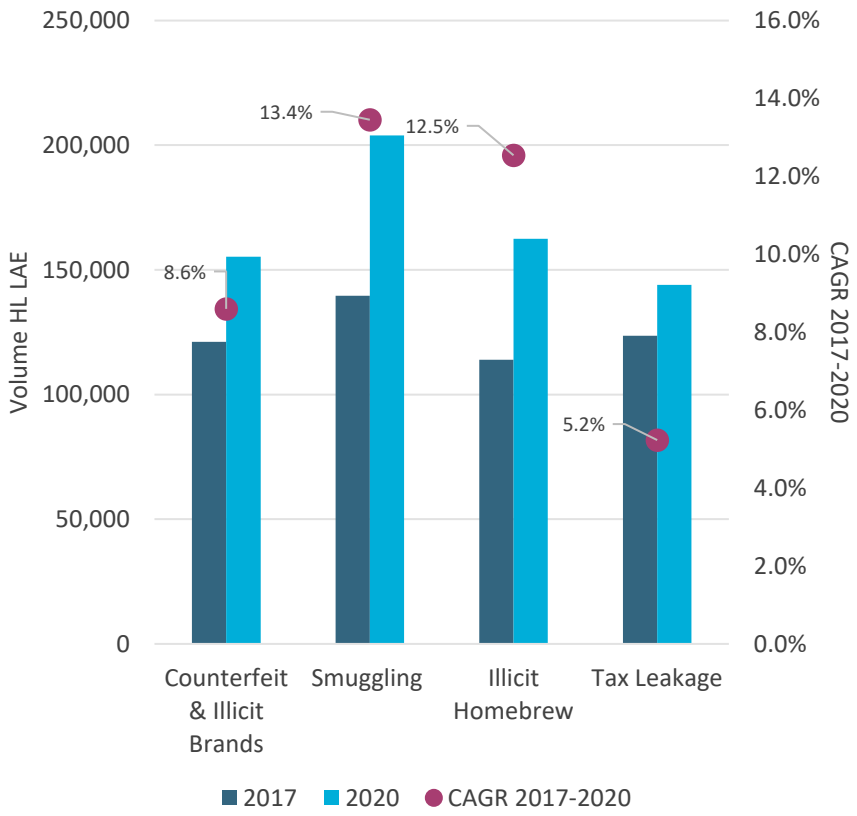
Increased criminal activity of illicit syndicates and looting

Informal sector sees higher activity

Illicit activities experienced growth in all categories

The ban on licit alcohol sales, coupled with pre-existing drivers, resulted in a rise in Illicit activities across all categories measured. Sources indicated smuggling operations was the fastest growing category in HL LAE volume terms in 2020 thanks to high profit margins for spirits, while homebrew saw increases in experimentation as well as selling amid increased demand for alcohol during the dry sales ban. Production of cheap counterfeit brands and unbranded alcohol, especially of spirits, also saw higher demand in 2020.

Illicit Alcohol Market Volume HL LAE 2017/2020



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High profit-making incentives drive smuggling and counterfeiting activities

Smuggling

Smuggling sees the fastest growth among all categories

Smuggled illicit alcohol posted a **CAGR of 13.4% in HL LAE volume terms** during 2017-2020 driven by ease of access to smuggled alcohol (both finished and ethanol) through round-tripping, duty-free channels and movement across porous borders. Smuggled finished products are found in both formal as well as informal markets and tend to mainly include spirits. **Smuggling is highly profitable compared to other categories** due to ease of access and limited inputs required compared to producing counterfeit alcohol.

Counterfeiting

Counterfeiting activities flourished during 2020 amid rampant demand for spirits

Both refilling and industrial manufacturing saw higher levels of activity in 2020 compared to 2017, with counterfeiting posting a **CAGR of 8.6% in HL LAE volume terms**. Cheap raw materials and ease of access to ingredients such as ethanol contributed to the rise in counterfeiting operations. Although ethanol saw shortages in relation to high sanitiser demand, industry sources indicated illicit traders were able to obtain supply through smuggling, leakages from the local industry or using ethanol unfit for human consumption. Other harmful products such as methanol or even hand sanitisers were used in faking alcohol products unbeknown to consumers.

Desperate consumers turn to making their own alcohol, with some selling for a profit

Illicit Homebrew

Increased experimentation with homebrew raises concerns as harmful products are added to raise potency

Illicit homebrew was estimated to have posted a **CAGR of 12.5% in HL LAE volume terms** over the 2017-2020 period. **Rising demand for homebrew during the months of the lockdown, coupled with increased production and selling** contributed to the rise in illicit activities. Although sorghum beer remains the most popular form of illicit homebrew, pineapple beer saw significant popularity in 2020. Informal outlets, as well as private households, are key selling points for illicit homebrew, with prices significantly lower than licit beer. **Homebrews are often not produced in sanitary conditions and in some cases may contain lethal additives to strengthen the alcohol content.**

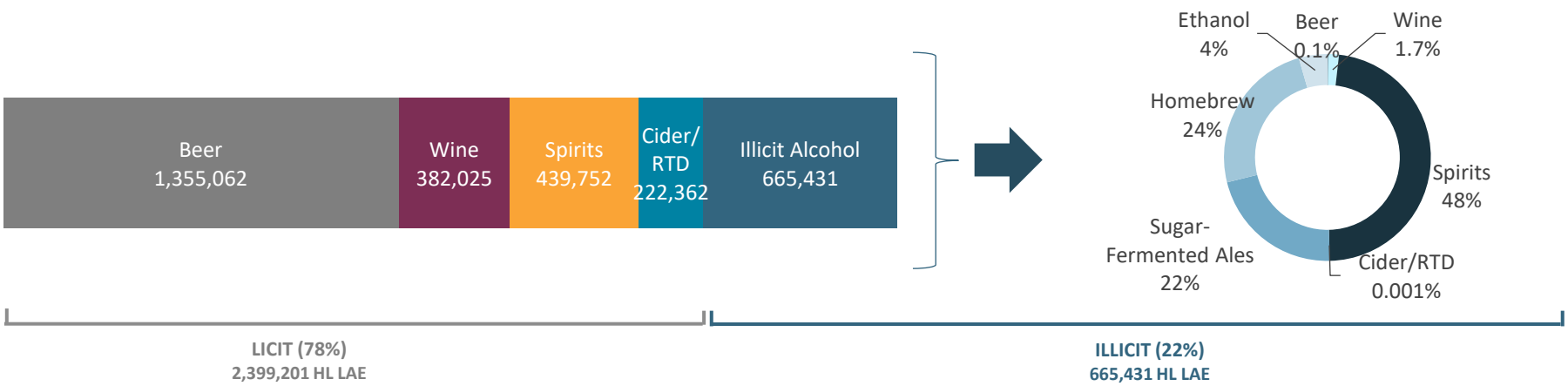
Tax Leakage

Loopholes in the regulatory environment see continued growth in tax leakage

Within tax leakage, **regulatory loopholes within the declaration of sugar-fermented ales remain a key concern**. Producers of sugar-fermented ales mostly comply with regulations around labelling their products but are non-compliant in terms of composition (often containing a higher level of sugar-fermented water +20% than that allowed). In turn, **falsely declaring their products as a fruit-based beverage, or undeclaring production volumes to avoid paying excise duties**, are the key activities within tax leakage. Overall, **tax leakage posted a CAGR of 5.2% in HL LAE volume terms during 2017-2020**. These products are also sold for significantly low prices, driving consumer demand by lower income groups.

While beer is the most consumed licit alcohol type by volume, spirits dominate illicit alcoholic drinks

Licit and Illicit Alcoholic Drinks 2020, HL LAE Volume



Spirits accounted for the largest share of illicit alcohol in volume terms (HL LAE) in 2020, reflecting relevance in both counterfeiting as well as smuggled products. Fermented alcoholic drinks such as beer, wine and cider/RTD accounted for a much smaller share of illicit alcohol types due to lower profit margins and a higher degree of difficulty in producing a reasonable counterfeit. Illicit homebrew accounted for the second largest category in volume terms (HL LAE) as demand for alcohol during the ban drove increased production (including sorghum beer and other types of fruit fermented homebrew such as pineapple). Sugar-fermented ales produced by wine manufacturers accounted for the third largest category by HL LAE volume terms.

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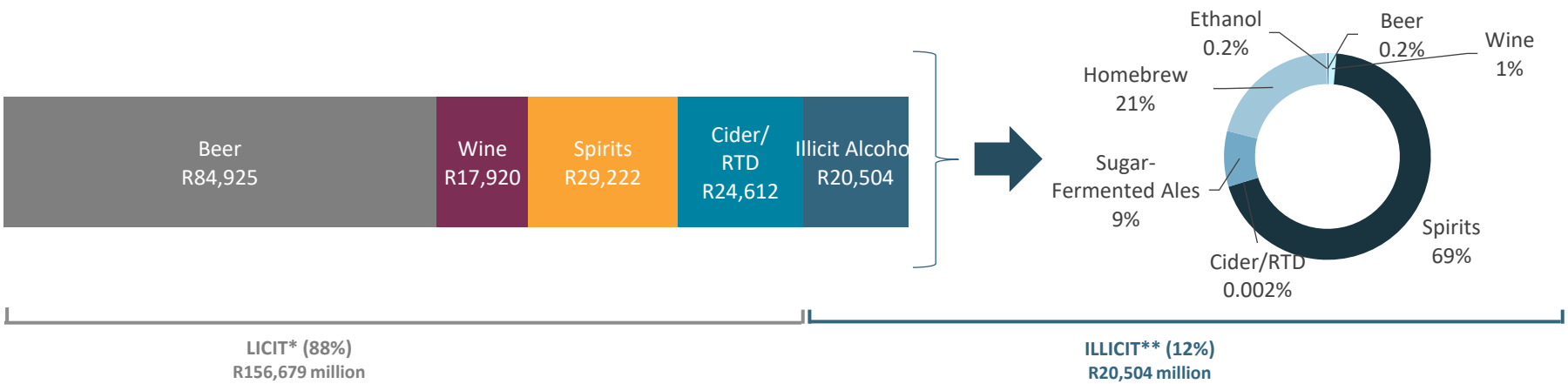
Cheap prices of homebrews and sugar-fermented ales contributes to lower value shares than spirits

Licit and Illicit Alcoholic Drinks 2020, Value R million



Spirits dominate the illicit alcohol market in value at two-thirds of the market thanks to higher prices of R137-R192 per litre compared to fermented drinks. Illicit spirits were popular during the dry sales ban in 2020 thanks to their high alcohol content, which tended to last longer than fermented products such as beer and cider. Illicit homebrew accounts for the second main category in value terms but is still less than a third of the spirits market due to its low price of R10 per litre. Sugar-fermented ales represented the third main category of the illicit alcohol market in value terms, with a price of R15 per litre. Illicit activity in clear beer/lager accounts for a marginal share in both value and volume terms as it is less profitable and more difficult to produce.

*Note: *Licit market prices include on-trade and off-trade ** Illicit prices based on store observations and interviews of pricing during March 2021, adjusted for inflation*

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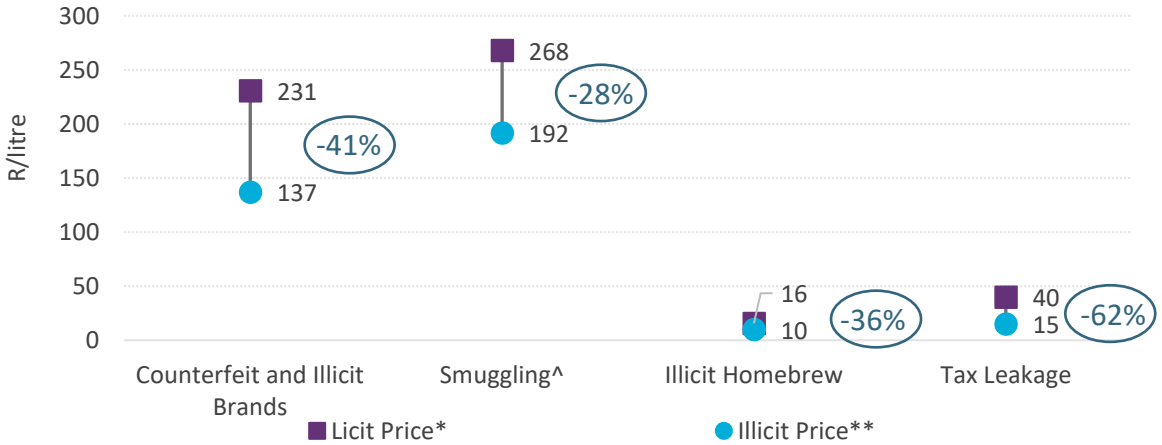
Illicit alcohol prices are almost half those of legal prices outside of the dry sales ban

Average Retail Sales Price (R per litre) 2020



-43%

Illicit prices below licit prices outside of alcohol sales ban, 2020

> *"Illicit traders are finding ways into licensed stores in efforts to maintain demand. Consumers are driven to these stores as they offer lower prices."*
> - Trade Association

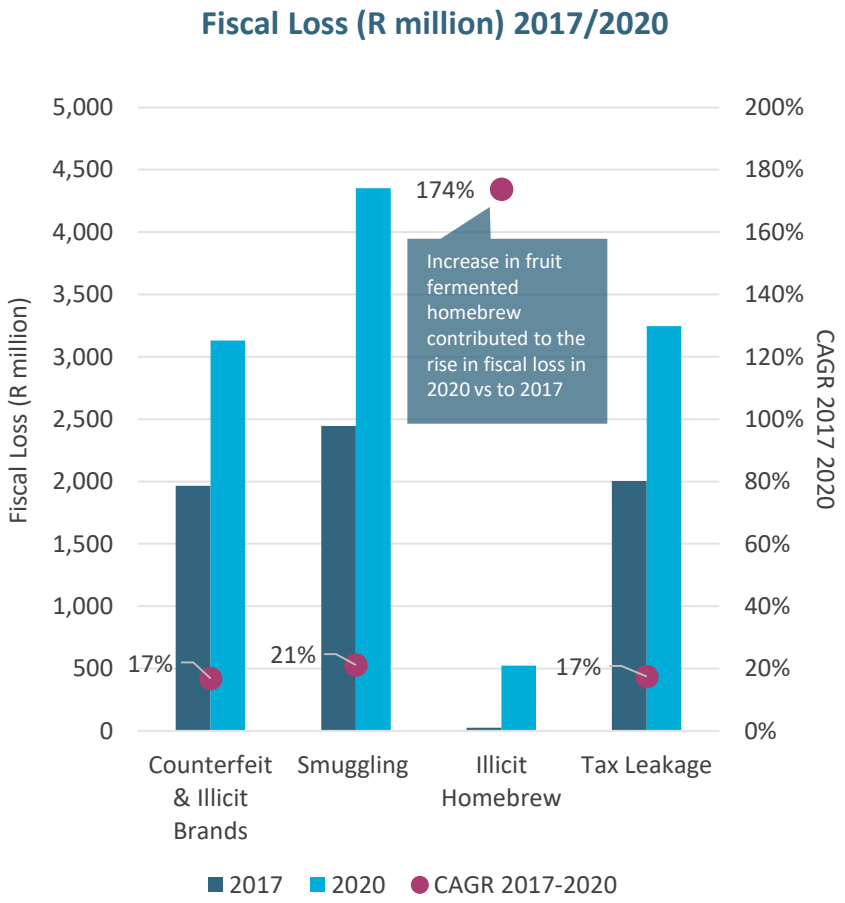
Illicit traders often reduce their prices to below that of the licit market in order to appeal to consumers and undercut competition. Average illicit prices were estimated at 43% below licit prices in 2020 during months outside of the sales ban, compared to 51% in 2017 and 40% in 2012. Price differentials of sugar-fermented ales within the tax leakage category remains the widest as these products largely avoid paying high excise taxes (equivalent to a spirit tax). Smuggled products are often charged at similar prices to legal alcohol, but industry sources indicate traders will offer lower prices when faced with competition from legitimate businesses.

*Note: *Licit market prices include on-trade and off-trade*
*** Illicit prices based on store observations and interviews of pricing during March 2021, adjusted for inflation*
^ Excludes smuggled ethanol price

Fiscal loss increases by 20% CAGR over 2017-2020

Total fiscal loss increased from R6.4 billion in 2017 to **R11.3 billion** in 2020, a CAGR of 20%. The illicit alcohol market not only presents critical challenges for the healthcare sector, but also contributes to fiscal revenue loss for the government. **This mainly stems from unpaid excise and customs duties as illicit syndicates are driven to avoid increases in taxes and ultimately raise profit margins**.

In addition, fiscal revenue losses as a result of the ban, places **additional burden on the state's ability to combat COVID-19, enforce regulations and stimulate an economic recovery going forward.**



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Recommendations

Increased education and reporting on Illicit Alcohol

Raising consumer awareness of the health risks related to consuming illicit alcohol as well as informing consumers of the strategies that illicit traders adopt to mimic licit alcohol is essential. Encouraging anonymous consumer reporting of illicit alcohol could further place pressure on illicit traders and better inform law enforcement.

Collaboration with government to strengthen enforcement and implementation

Targeting laws on capturing illicit traders would be most beneficial. There already has been great improvement since 2017 on this front, but government remains constrained on enforcement. Further strengthening collaboration mechanisms and centralisation of coordination and information sharing between producers, retailers, law enforcement and other government agencies will improve capacity and efficiencies.

Stricter punitive measures

Reducing incentives to partake in illicit activities through stricter punitive measures is cited as a key method to combat illicit trade. Illicit traders typically face a fine, but are able to continue operating shortly after being reprimanded. Raising criminality associated with illicit alcohol trade is key to combating incentives.

ILLICIT CATEGORY ANALYSIS

Smuggling

Smuggling is growing the fastest as high profit margins and open duty-free channels amid the dry sales ban incentivize activity

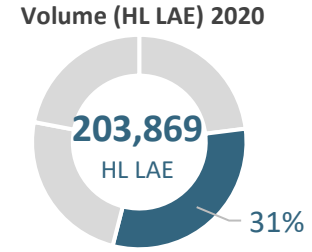
- **Smuggling was the most prevalent activity during 2020**, accounting for **31% in HL LAE volume terms** and **42% in value terms** in 2020.
- **Smuggling occurs mainly with finished products**, particularly **brown spirits** (whiskies and brandy) and **white spirits** (vodka and gin), including more premium products within each category.

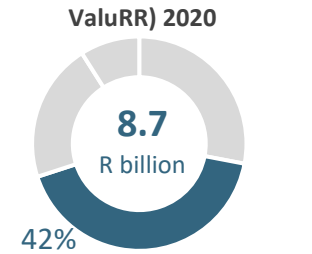
Share of Subcategory Volume (HL LAE)

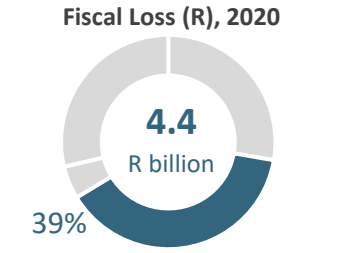
Finished Products **85%**

Ethanol **15%**

- **Closure of export borders** meant that **products destined to being exported** were **returned to local markets** in large quantities during the export ban (also known as **round-tripping**) and sold without the required excise duties. Illicit parallel imports imported from another country without the permission of the official manufacturer and sold within the country also occurred. West Africa (mainly Nigeria and Ghana) is another source of cheap smuggled spirits (particularly sachet packets).
- **Duty-free products** bought by foreign diplomats **are also being resold to local markets without the correct duties paid**, contributing to **high fiscal loss** of smuggled products. SARS reported that R100 million in excise duties are lost per month as a result of duty-free alcohol sales.
- The remaining **15% of smuggled products** in volume terms (HL LAE) **is ethanol used to produce fake alcohol. Ethanol** is being **smuggled, wrongly declared or diverted** with the aim of avoiding excise duties.
- **Fermented products on average see much lower volumes of smuggling** due to lower profit margins than spirits, but some homebrew was cited as smuggled from Zimbabwe.







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Beverages and Brands

- Leading spirit brands (eg Smirnoff, Johnny Walker) are most susceptible to smuggling, while other brands found in the market include whiskies brands Seagram, Braveheart, McDowell's, 8PM and Royal Challenge.
- Smuggled products are often sold at a similar price point as the original product, with consumers less knowledgeable about the product's legality.
- Product labels are sometimes incorrect, or the alcohol content does not conform to South Africa's legal standard (ie 43% ABV and 750ml bottles).

Drivers

- High profit margins continue to drive incentives for smuggling of finished spirits products, linked to high excise taxes. Consumers were also more willing to pay high amounts (some 3-4 times higher prices) for spirit alcohol as a result of the dry sales ban.
- Duty-free sales were open during the dry sales ban, which likely contributed to rampant activity by foreign diplomats, who can purchase up to R250,000 worth of goods.

Where

- Spirits are mainly smuggled from neighbouring countries, with several cheap brands coming from West Africa (largely in the form of sachet packets).
- Duty-free/round-tripping smuggling occurs throughout the country, to a larger degree around major cities.
- Smuggled products are found to be prevalent in foreign-owned stores in both informal and formal channels. COVID-19 meant that more people were consuming products at home.

Effects

- Smuggling continues to grow at a faster rate than counterfeiting thanks to high margins and relative ease of operations.
- Smuggling presents the largest fiscal loss to the government through lost excise duties. These resources are largely needed in other areas, eg the healthcare sector.
- Smuggling creates unfair competition to licit suppliers, while misleading consumers into thinking the product they are buying is genuine.

Smuggling of finished products saw rife activity linked with duty-free sales and round-tripping as stock was diverted to local markets

INPUT/SOURCE

PRODUCTION/TRADE

DISTRIBUTION/CHANNEL

CONSUMPTION

Finished Goods

- **Duty-free - foreign diplomats** purchase cheap liquor and **resell** to local market
- Smuggling typically occurs from neighbouring southern African, Eastern bloc and Asian countries

Raw Ingredients

- Smuggling of ethanol typically transported across **porous land borders** (mainly from neighbouring countries)

- **Duty-free channels**, **round-tripping** and across borders
- **Porous borders** and corrupt officials: land borders are more notorious, but **seaports** cited as key entry points during 2020
- **Production** of illicit spirits from ethanol is **easy**, creating incentives

- Smuggled **finished products include** both **premium** and **cheap spirits**.
- **Premium** products are mainly sold in the **formal** channel, but sold informally during the ban
- **Cheap** smuggled **brands** are predominantly found in informal channels, particularly **unlicensed** channels.

- Consumers of all income ranges buy **smuggled** product as these range from **cheap to premium brands**
- Often consumers are **not aware** a product is smuggled
- During the ban, **more people were willing to purchase illicit products**, and were less concerned about their origins

Impact of Legal Sales Ban

Ethanol easily available through increased supply

Increase in smuggled products to satisfy demand

Online channels to sell and advertise

More consumers willing to purchase **illicit brands**

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A major contributor to rising smuggling was open duty-free trade, while the liquor trade was banned. Plenty of stock was also supposed to be exported or imported for exportation but never left the country.

- Alcohol Manufacturer/Importer

Smugglers have a margin of around R90 per bottle that they can play with due to excise benefits.

- Alcohol Manufacturer

Very often you will see the same price being asked as for the original product. If there is a competing store around the corner, then the product may be priced lower in order to attract purchasers.

- Alcohol Manufacturer/Importer

For every week we have been in lockdown, it has set our investigations back six months to a year, with more and more cases emerging.

- Alcohol Manufacturer

The dry sales ban meant that many were incentivized to divert products to the local market. Sachet packets of smuggled spirits were also found to be popular during 2020 thanks to their relative affordability among low-income consumers. Overall, profit-making incentives drive smuggling operations, especially in relation to the dry ban as margins increased with greater control over the market.

Counterfeit and Illicit Brands

Counterfeiting operations have become more sophisticated, with illicit producers scaling up operations in remote parts of the country

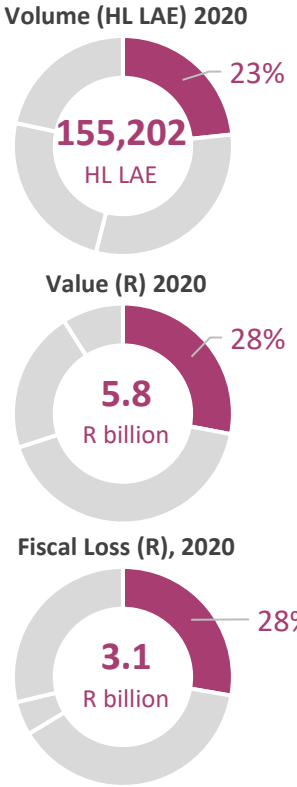
- Counterfeit and illicit brands is the **third largest category of illicit alcohol in HL LAE volume terms** representing **23%,** and the **second largest category in value terms**, accounting for **28% in 2020**.
- Illicit traders took advantage of increased demand for alcohol, **scaling up production** of illicit spirits and **improving counterfeit labels**, making these products difficult to identify.

Share of Subcategory Volume (HL LAE)

Substitution/Refill **48%**

Industrial Manufacturing **52%**

- Ethanol plays a key role in counterfeit brands and is **easily available** through leakages from the local industry or smuggled from neighbouring countries. **Increased supply of ethanol in 2020 resulted in easier access for illicit producers.** Industry sources noted that the special rebate for sanitiser producers using ethanol likely contributed to leakage towards the illicit alcohol market. Other harmful products (eg methanol and sanitiser) were also being used to fake alcohol, unbeknown to consumers.
- **Empty bottles used for refilling** are sourced from **informal retailers** or **stolen from licit producers**, which are then professionally resealed and, in some cases, re-labelled with counterfeit labels. I**ncreased occurrences and degrees of violence associated with criminal activities** were cited, linked to theft of packaging materials (alongside alcoholic drinks).
- **Consumers are not always aware** of fake products, but have in some cases indicated **headaches and poor taste** related to fake brands. **During the various bans, it was cited that consumer reporting on illicit alcohol declined**, especially for fake products, as many feared losing their alcohol source.



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Beverages and Brands

- Spirits are the most counterfeited alcoholic drinks as production is relatively easier compared to fermented alcohol such as beer.
- Spirits such as vodka, whiskies and cane are subject to the greatest level of illicit activities, mostly produced from industrial alcohol, such as ethanol. Brands including Smirnoff Vodka, Johnny Walker Whisky and Gordon's Gin are often counterfeited, while several cheap brands of spirits came to the market in 2020.

Drivers

- Counterfeit brands are usually priced lower than legal ones, driving demand for these products among lower-income groups in South Africa.
- Production costs are minimal, with readily available ingredients.
- Rising prices of legal alcohol in relation to excise taxes incentivise illicit traders, with the ban on sales allowing them to gain more control over the supply chain.
- Lacklustre enforcement and minimal punitive measures further contribute to illicit trade.

Where

- Counterfeit products are mainly produced in remote parts of the country, with KwaZulu-Natal being a hotspot.
- Counterfeits have a strong price advantage over legal alcohol, attracting vulnerable consumers and depriving the government of tax revenue. In turn, these are mainly sold in informal markets.
- Illicit traders are finding ways to enter licensed stores through taking advantage of desperate retailers amid months of shutdown, offering cheaper alcohol and renting the store front.

Effects

- Counterfeit products pose severe health risks given the use of industrial alcohol that is unfit for human consumption, causing violence and cognitive impairment (such as vision and hearing problems).
- Spikes in consumption-related deaths were seen during 2020.
- Health risks and concerns about consumption of illicit counterfeit alcohol are escalating as illicit alcohol-related deaths rise.

Counterfeit production expanding in remote areas of South Africa, with operations becoming even more sophisticated during 2020

INPUT/SOURCE

PRODUCTION/TRADE

DISTRIBUTION/CHANNEL

CONSUMPTION

Industrial Manufacturing

- Smuggled or leaked **ethanol**
- **Stolen/recycled packaging** such as bottles, caps, labels from licensed manufacturers or fake labels printed
- **Cheap** illicit brands

Substitution/ Refill

- Use of licit bottles with or without labels
- Mainly **spirits**, and wine to a lesser extent

- **Hotspot** production areas are in **isolated coastal towns** in KwaZulu-Natal and Eastern Cape
- **Production** mainly by **unlicensed distillers** and bottlers

- Unlicensed bottlers and retailers
- Refilling using fake alcohol or water

- Distributed via vehicles from remote production sites to various areas, including inland
- **Off-trade consumption increases** during ban
- **Found in both informal** and (to a lesser extent) **formal outlets**
- Informal trade reported increases during ban due to outlet closures

- **Cheap prices** attract low-income consumers outside the ban
- Consumers tend to be **unknowledgeable** or unconcerned about the dangers
- **Consumers not typically likely to purchase illicit products** (eg mid-to high-income groups) prone to searching for illicit alcohol during the ban

Impact of Legal Sales Ban

Rise in theft of packaging materials/licit alcohol

Increased production/ illicit actors

Lower quality and safety standards

Increased sophistication of operations

Online channels to sell and advertise

More **consumers willing to purchase illicit brands**

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Prohibition created an untapped market for illicit traders where they were able to gain more control over the supply chain and pricing.

- Trade Association

Counterfeit products prices may be around R100, where if you buy the real product in store, the price will be R140.

- Alcohol Manufacturer

When the ban was reinstated, anonymous consumer reports of counterfeiting activities stopped as they did not want to jeopardise their chances of obtaining alcohol.

- Trade Association

Counterfeit products have genuine labels and genuine closures, but are unsafe to consumers and are mainly sold in the informal channel.

- Alcohol Manufacturer

Illicit syndicates were able to establish larger and more sophisticated counterfeiting operations, which are expected to support further illicit activity in 2021 as past efforts to reign in these operations have been set back. Furthermore, syndicates are able to take advantage of the dire situation retailers faced amid months of shutdown, through offering cheaper alcohol and renting the store front, allowing them to secure some of the pent-up demand among cash-strapped consumers.

Illicit Homebrew

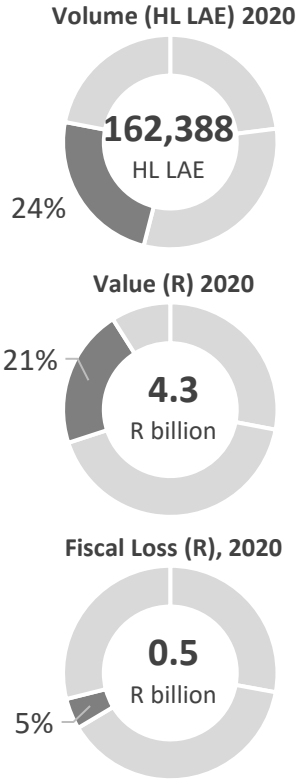
Supply restrictions resulted in more experimentation with homebrew

- **Illicit homebrew** mainly consists of **sorghum or malt homebrew** as well as **fruit fermented homebrew** (eg pineapple).
- **Homebrews saw a rise in demand during the alcohol ban**, with more people making their own homebrew and some selling it to earn an income.

Share of Subcategory Volume (HL LAE)

Sorghum Beer	Other Fermented Beer
86%	14%

- **Pineapple beer soared in popularity** thanks to ease of access to inputs and simple production methods. An online survey of 1,500 consumers by Euromonitor International, fielded during March-May 2020, asking consumers about their use and knowledge of illicit alcohol during the dry sales ban, found that **15% of consumers admitted to making their own alcohol due to the sales ban**. In addition, pineapple beer also became a source of income for some, with private residences brewing for reselling to neighbouring communities.
- Under South African alcohol legislation, the production of homebrew is legal and does not require a permit or license if it is for personal use. Homebrew is, however, **deemed illicit when it is produced to be sold commercially and no excise is paid**. Excise tax on Traditional African Beer is marginal, but often **homebrews**, especially those with **fruit fermented ingredients**, **do not conform to tariff classifications of a Traditional African Beer (sorghum or malt-based homebrew)**. In turn, the excise tax that would be charged for a fruit-based homebrew is equivalent to that of a spirit's tax at ABV of 8%. In turn, **fiscal loss increased to R522 million in 2020, compared to R25 million in 2017.**



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Beverages and Brands

- Homebrew consumption is deeply rooted in cultural traditions. Mainly consumed in informal areas, Homebrew is cheap and easy to make using a dry base (such as sorghum or malt), bread, sugar, yeast and water.
- Harmful substances such as methanol or methylated spirits are sometimes added to increase potency.
- Fruit-based homebrewing became more popular during 2020, as well as dry powder homebrew mixtures such as Super Ginja or King Korn.

Drivers

- Low production costs, readily available and affordable ingredients, and strong cultural habits are key drivers of illicit homebrew consumption, particularly sorghum-based beer.
- Limited accessibility to licit alcohol resulted in an increase in experimentation with fruit fermented homebrew (eg ginger and pineapple beer). Pineapple sales saw a sharp rise in 2020 in relation to homebrewing, with store observations confirming some commercialisation of production by individuals to make a profit.

Where

- Consumers of sorghum-based Traditional African Beer tend to be located in rural, mining and agricultural areas of the country where the population tends to have low levels of education and income, such as parts of KwaZulu-Natal, Limpopo/North West/Mpumalanga, Eastern Cape and Gauteng.
- Other fermented beers such as pineapple beer are found in both urban and rural areas, largely brewed at private houses.

Effects

- Although the product only becomes illicit once sold, homebrew poses severe health risks for vulnerable communities as it often includes harmful substances.
- Homebrew that is made for commercial purposes also has a negative effect on the performance of licit sorghum and other beer brands in the market.

Homebrew ingredients are cheap and accessible, with production relatively simple

INPUT/SOURCE

- **Ingredients** are **easily accessible** and **cheap**: such as sorghum, malt, yeast, fruit and sugar
- **Sorghum beer includes wet and dry** (powder) components
- **Harmful products** such as methanol/methylated spirts in some cases **added**

PRODUCTION/TRADE

- Produced by **informal players** and **small-scale commercial operators**
- Popular in provinces of Gauteng, KwaZulu-Natal, Northwest, Limpopo and Mpumalanga
- **Increased homebrew production** during 2020, compared to pre-ban levels.
- Rise in **pineapple beer** brewing

DISTRIBUTION/CHANNEL

- Distributed to wholesalers and retailers in formal and informal markets
- Found mainly in **unlicensed on-trade stores** or **private homes converted into an informal outlet**, but also present in taverns (licensed outlets)

CONSUMPTION

- **Sorghum-based beer**, known as Umqombothi, is **popular among older generations** (+45 years) and largely entrenched in South Africa's culture
- **Pineapple beer** consumption seen **across income-ranges**

Impact of Legal Sales Ban

Use of **lethal additives in homebrew**

Pineapple beer brewing soars in popularity

Increased production for **reselling** by existing and new producers

Reports of **higher informal activity** as licensed outlets struggle to renew licences

Increased demand for homebrew across income groups as ban on alcohol restricts supply

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The brewed pineapple beer/punch is kept in 20-litre plastic buckets. Customers come with their own containers, and concoctions are sometimes mixed with cheap alcohol like vodka to raise potency.

- Store Observations and Pulse Interviews

The consumer group for homebrew tends to be mostly low-income patrons, male and roughly 35-45 years and upwards.

- Store Observations and Pulse Interviews

Example of illicit homebrew being distributed to outlet in Gauteng

Illicit homebrew grew in popularity in 2020 driven by relatively simple production methods and easily available ingredients amid the ban on legal alcohol. Sorghum-based beer is largely popular in rural communities, consumed on-trade by older generations, while young adults preferred to try other mixtures or fermented products when licit alcohol was not available such as pineapple beer or punch.

Tax Leakage

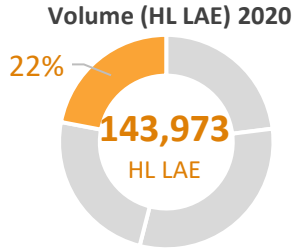
Low prices of sugar-fermented ales through excise tax avoidance drive demand

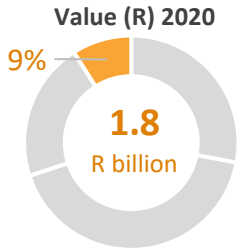
- The majority of tax leakage occurs within **sugar-fermented ales** as these products are **non-compliant** in terms of **tariff classification** of fruit-based beverages. Sugar-fermented ales in this report refers to alcoholic beverages that utilises sugar-fermented water as its base ingredient, combined with colourants and flavourings (to appear similar to a consistency of wine).

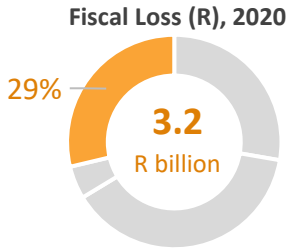
Share of Subcategory Volume (HL LAE)

Low-cost Wine	Sugar-Fermented Ales
1%	99%

- Tax leakage occurs through **wrongful classification of sugar-fermented ales as fruit-based beverages**, resulting in **excise tax avoidance**, as well as under-declaration of production. Rising sales of sugar-fermented ales are driven by **low prices** (R15/litre on average), **strain on consumers' income levels**, and **availability of products in retail stores.**
- Sugar-fermented ales are often **labelled as a "flavoured alcoholic drink"**, posing as wine or a fruit-based beverage and are often placed in close proximity to low-cost wines with in a retail store environment.
- Industry sources indicated that sugar-fermented ale production was not heavily affected as a result of the ban and in fact saw an increase since 2017. Availability of low-priced sugar-fermented ales creates an **unfair competitive advantage** for licit wine producers. The significant gap in sugar-fermented ales versus wine excise tax, R25.6/litre versus only R4.39/ litre, coupled with rising rates each year, are key contributors to the increase in tax leakage. **A smaller proportion** (1% HL LAE) of tax leakage **occurs where producers of low-cost wines under- declare their production volumes** in order to avoid paying tax on the full production volume.







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Beverages and Brands

- Sugar-fermented ales tend to be sold alongside low-cost wines.
- These products are either a **diluted form of wine** mixed with **sugar-fermented water** or are made using sugar-fermented water mixed with **fruit/ flavourings**.
- The level of **fruit-based ingredients varies** drastically from week to week, with **wine only used in cases of excess production** or availability.

Drivers

- Despite improvements in the excise classification system, **lack of enforcement and resource constraints** by the South African Revenue Service (SARS) were cited as some of the main drivers of tax leakage in the ales industry.
- Manufacturers are driven by avoidance of high excise tax rates for sugar ales, and are encouraged by lack of enforcement of tariff structure by SARS.
- Sales are driven by **significantly low prices** and **high ABV of 8-12%**, attracting low-income consumers.

Where

- Sugar-fermented ales are often packed in clear plastic containers (such as those used for cooking oil) or cardboard boxes.
- Sugar-fermented ales can be found in regular licensed liquor stores, as well as informal outlets. The products are typically placed alongside low-cost wines, with consumers usually opting for the cheapest product.
- Sales are concentrated in the provinces of Western, Eastern and Northern Capes, in areas located near vineyards and rural settlements and those displaying high levels of poverty.

Effects

- Producers of sugar-fermented ales do not pay tax or pay only a proportion of tax, leading to government revenue loss, estimated at R3.2 billion.
- Tax leakage presents an unfair competitive advantage to illicit manufacturers, results in damaged reputation of the licit wine industry as well as loss of revenue to licit producers through lost sales.
- Availability of cheap alcohol at high ABV outside of the dry sales ban further reinforces alcohol abuse.

Sugar-fermented ales are largely positioned as low-cost wines, placed in proximity but selling for around 60% cheaper

	INPUT/SOURCE	PRODUCTION/TRADE	DISTRIBUTION/CHANNEL	CONSUMPTION
Wine	• Under-declared production of **low-cost wines** by domestic wineries	• Production of sugar-fermented ales mainly occurs in the provinces of **Western Cape**, and **Eastern Cape** to a lesser extent • Sugar-fermented ales consist mainly of sugar-fermented water and colourants/flavourings to achieve a similar look as wine.	• Distribution by **official and illicit distributors** to wholesalers and retailers in formal and informal markets • Typically found in **off-trade licensed and unlicensed stores**, while diverted towards informal markets during the ban	• **Low-income** farmworkers, those living in rural settlements or with minimal incomes • A 5-litre container of sugar-fermented illicit alcohol can cost as little as R45-60, reinforcing **alcohol abuse** among **vulnerable consumers**
Sugar-Fermented Ales	• Undeclared production of **sugar-fermented ales** • **Misclassification** of sugar-fermented ales as **fruit beverages** due to wrongful tariff classification and labeling			
Impact of Legal Sales Ban	**Minimal impact** on availability of **inputs** such as sugar	**Rise in production** reported during 2020	More "**back-door**" sales were reported as a result of the ban	**Prices remain significantly cheaper** than licit wine prices

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There are clear guidelines for ales, but still the guidelines are not implemented, and cross checked.

- Trade Association

Cheap ales do not meet the correct labelling requirements, positioning themselves as a flavoured alcohol beverage or even wrongfully declaring themselves as a rosé.

- Alcohol Manufacturer/Importer

Given that consumers are severely cash-strapped, there is a real risk of losing more consumers to the illicit ales market if the legal price is increased through higher taxes.

- Trade Association

Sugar-fermented ales are among the cheapest alcoholic drinks in South Africa, available because of the low production costs and wrongful excise tariff classification. The availability of cheap sugar-fermented ale with high ABV reinforces alcohol abuse among lower-income consumers, while also potentially leading to damage to the wine industry's reputation.

Surrogate

Codeine abuse is gaining popularity among the youth in South Africa, driven by social pressures, low prices and easy availability

- Surrogate alcohol refers to the **consumption of pharmacy alcohol** contained in over-the-counter (OTC) medicinal products such as **codeine-based cough syrup**. The **misuse of codeine** in South Africa largely stems from **easy availability** of the product as it **does not require a prescription** to be purchased.
- Industry stakeholders have been **attempting to reduce the misuse of codeine-based cough syrup** in South Africa through **improved tracking of sales** at outlets. Adcock Ingram also **reduced the alcohol content** of its cough mixture, Broncleer, to 0.5% in 2016. However, cough mixture with a higher ABV of 18% is still widely available. **Up-scheduling the drug** was another proposed measure, but this was met with **criticism as it potentially marginalises low-income consumers** without access to health insurance.
- **Total surrogate consumption in volume rose to 10,013 HL in 2020, from 8,690 HL in 2017**, an increase of 4.3% CAGR. In HL LAE terms, **surrogate consumption rose to 1,802 HL LAE in 2020** (0.3% of the total illicit alcohol market), compared to **43 HL LAE in 2017** (0.1% of the total illicit alcohol market), reflecting high ABV in cough mixtures that are abused.
- Nonetheless, **codeine-based cough mixtures are widely available in South Africa** with ABV levels of as high as 18%, with consumers able to purchase them from pharmacies and, in some cases, unlicensed liquor outlets. Prices are relatively low, around R20-35 per 100ml bottle. According to South African Medical Research Council, an estimated 3% of admitted individuals were treated for Codeine addition in 2018, rising to 184 in 2018 compared to 80 in 2017. Codeine abuse amongst teenagers (cited as the main demographic abusing cough mixtures) could be even higher considering not all teenagers are admitted for treatment.
- **Consumers mix cough syrup with non-alcoholic carbonated drinks, commonly referred to as "Lean" once mixed, and is said to mimic the effects of illegal narcotics**. Consumption of codeine-based concoctions has gained popularity among the South African youth, with social challenges such as peer pressure, depression and addiction playing key roles.

THEMATIC ANALYSIS

Livelihoods severely impacted

The alcohol industry creates many jobs across the value chain, and many companies either downscaled or closed completely as they were unable to operate during 2020. This is against a backdrop of already lacklustre economic conditions, with GDP declining by 7% in 2020.

Alcohol-related deaths spike

Illicit alcohol poses a threat to consumers' health as these products are often mixed in unsanitary conditions, using harmful substances. More consumers turned a blind eye to the origins of their alcohol, while also brewing their own, leading to increased deaths.

Fiscal loss to government

Loss of revenue to the government has increased, through higher illicit activities contributing to fiscal loss, while there were likely shortfalls in VAT related to the closure of stores and operations, weighing on essential government revenue.

The ban on alcohol sales has a compounding effect on livelihoods across the value chain

- **Livelihoods negatively impacted across the alcohol value chain**: It is estimated that the ban has put 200,200 South Africans jobs at risk as a result of the first three alcohol bans.
- **Small- to medium-sized firms were more susceptible**: An estimated 800 small- to medium-sized liquor manufacturers faced bankruptcy due to the first ban on alcohol sales, with 30% of breweries forced to shut their doors. An estimated 18 million jobs were lost in the beer sector alone related to the first three bans.
- **Major investment plans cancelled or put on hold:** This will hamper the economic recovery. Glass manufacturer, Consol Holdings, suspended investment of R1.5 billion, while South African Breweries (SAB) halted R5 billion investment and Heineken cancelled R6 billion investment.
- **Related industries felt the pinch**: Glass manufacturers, collectors, small recycling businesses as well as distributors struggled greatly as a result of the ban. With the legal alcohol industry accounting for 85% of sales in the glass packing industry, losses of up to R1.5 billion were recorded, placing 25,000 direct jobs at risk as a result of the ban on alcohol sales.

Coupled with loss of income and livelihoods, more people are desperate to earn an income and are susceptible to resorting to clandestine means. The immediate impact of the ban on sales was felt by several stakeholders in the industry, which can have long-term negative effects on economic recovery and employment.

Health implications of illicit alcohol are compounded by lethal ingredients added

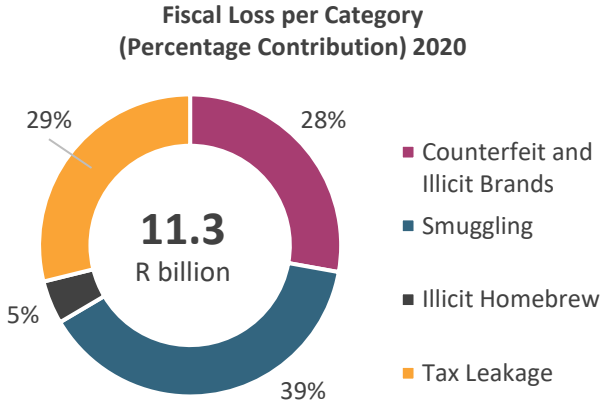
- Faced with prohibition, **homebrewing and distilling became more prevalent** during 2020 among consumers who typically would not have tried this before the prohibition on alcohol.
- Google reported a **surge in searches** of "**how to make home-made alcohol**" and "**how to make pineapple beer**" over the first month of the alcohol ban in South Africa, particularly in Free State, Limpopo, Mpumalanga and North West provinces.
- **Health risks** associated with consumption of illicit alcohol have been **compounded by the prohibition** and increased experimentation with homebrew. Severe restrictions have resulted in a growing number of people engaging in harmful behaviours.
- It was reported in May 2020, that 14 people died after consuming homebrew during the alcohol ban. Additionally, those that survived suffered severe consequences as a result of harmful homebrews
- Harmful products such as methylated spirits and sanitiser were added to homebrew concoctions.

The legal alcohol supply restrictions resulted in increased use of substances unfit for human consumption in homebrew mixtures to raise the alcohol's potency. Consumers of homebrew concoctions can experience intense periods of suffering and, in some cases, lose their lives.

Prohibition and illicit trade reduces much-needed fiscal resources

Total fiscal loss is estimated at **R11.3 billion in 2020**, up from **R6.4 billion in 2017**. **Smuggling represents the main source of fiscal loss, at R4.4 billion in 2020, compared to R2.4 billion in 2017**. Smuggling contributes to fiscal loss through both unpaid excise tax on raw ethanol used as an ingredient in counterfeit products as well as finished products.

Tax leakage is the second largest contributor to fiscal loss at R3.2 billion in 2020, from R2 billion in 2017, mainly due to wrong declaration of sugar-fermented ales as wine due to the wide gap between wine and sugar-fermented ales taxation.



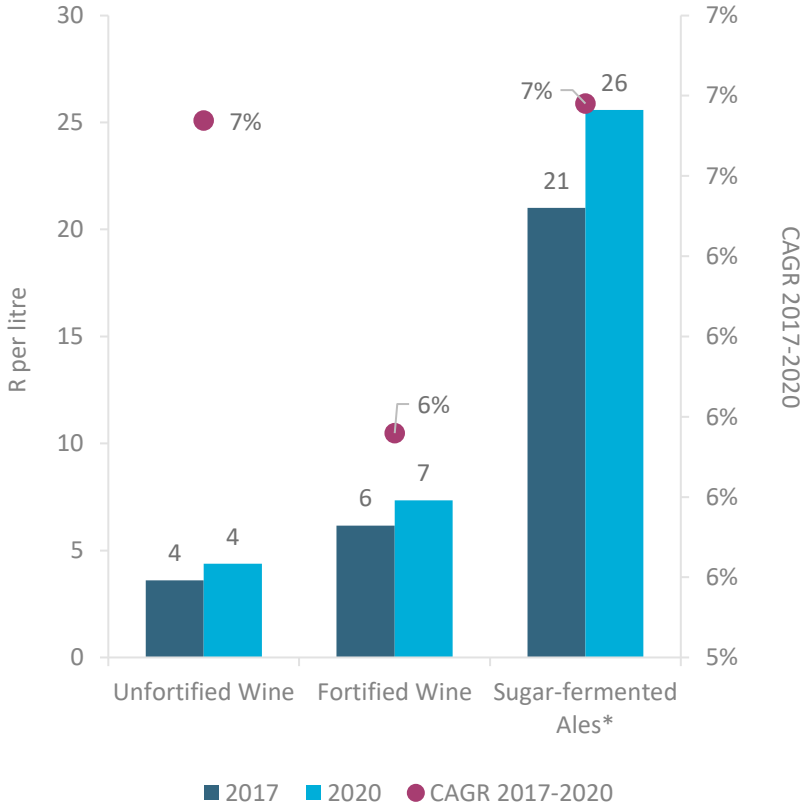
Counterfeit and illicit brands is the third main contributor to fiscal loss through unpaid excise tax duties on illicit alcohol by syndicates, mainly of counterfeited spirits, **amounting to R3.1 billion in 2020, from R2 billion in 2017**.

Illicit homebrew represents the **smallest proportion of fiscal loss** due to **lower levels of excise taxes for Traditional African Beer**. That said, **fruit fermented homebrew** (which does not confirm to the classification for Traditional African Beer or a fruit-based beverage containing 80% fruit) should be taxed the same as a **spirits-based tax** according to its AVB content. This implies a **higher fiscal loss when compared to 2017** in relation to the proliferation of fruit fermented homebrew. Total fiscal loss for illicit homebrew amounted to **R522 million 2020, compared to R25 million in 2017.**

Wide gap in excise tax of wine vs sugar-fermented ales, combined with lack of enforcement contributes to fiscal loss

Sugar-fermented ales are taxed at the highest excise rate at R213 per litre of alcohol equivalent in 2020, translating to R25.58 per litre of an ale of 12% ABV, compared to a rate of R4.39 per litre of unfortified wine. Lack of enforcement, rising excise taxes and the wide gap between wine and sugar-fermented ales have likely fueled the wrong declaration of sugar-fermented ales, or undeclaration altogether, to avoid the steep excise duties.

Excise Tax: Wine vs Sugar-Fermented Ales 2017-2020



*Note: ** Excise tax per litre calculated using ABV 12% of a spirits-based tax on sugar-fermented ales*

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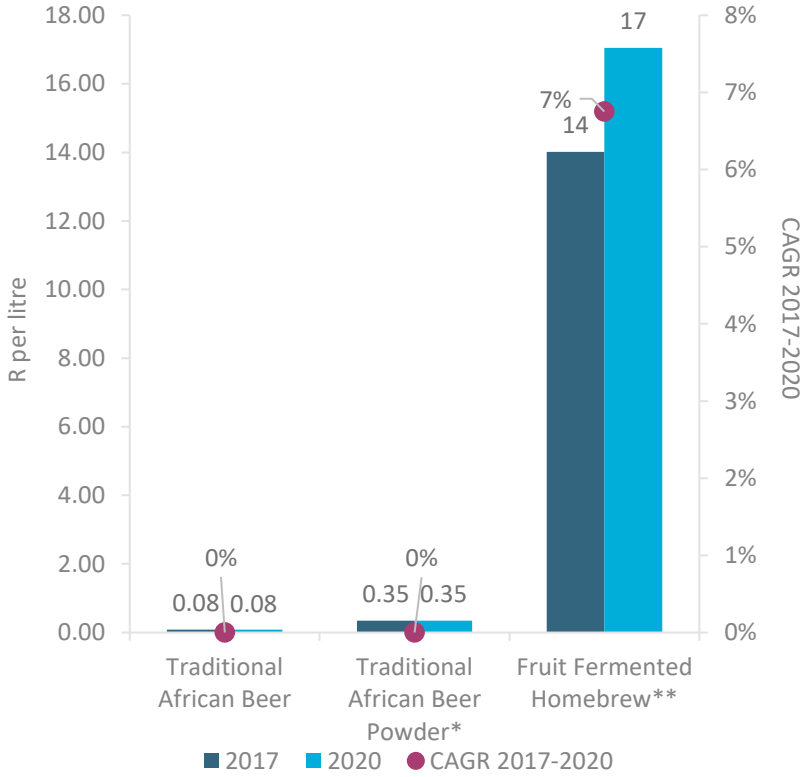
Fruit fermented beer sees greater relevance in fiscal loss

The proliferation of fruit fermented beer during 2020 contributed to a higher excise tax loss for the Illicit homebrew category. Fruit fermented homebrew such as pineapple beer are around 8% in terms of ABV, which includes sugar and yeast to support the fermentation process. According to the tariff classifications, excise tax on a fruit fermented beverage that contains less than 80% fruit (eg a pineapple beer typically contain more sugar to increase fermentation) would be equivalent to a spirits-based tax at R213/Laa, translating to R17 per litre of ABV 8%.

Excise Tax: Traditional African Beer/Powder vs Fruit Fermented Homebrew 2017-2020



*Note: *Traditional African Beer powder calculated per Kilogram*
*** Excise tax per litre calculated using ABV 8% of a spirits-based tax on fruit fermented homebrew that contains less than 80% fruit.*

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REGULATORY ENVIRONMENT

Government burdened with implementation of existing regulations

- Trade sources indicated that the regulatory environment is relatively sufficient but lacks implementation. **Law enforcement is often faced with lack of resources** to fully implement regulations, especially against proactive syndicates. This is exacerbated by **corruption and collusion** among illicit operators.
- The **disconnect between the national, provincial and local government agencies** creates further difficulties in effectively combating illicit traders.
- Through **improved collaboration** between **industry players and regulatory authorities**, there have been several successful cases where **illicit syndicates have been reprimanded**. However, many are **faced with minimal consequences**, often paying a fine. **Weak punitive measures create few disincentives** for illicit operators.

> Currently people have to pay fines or just lose their license when trading illegally. This is not a hard enough penalty to get the word out that these operations should not take place.
>
> - Licit Alcohol Importer/Manufacturer

> The light penalties given to perpetrators are a challenge, as well as the time it takes for court cases to take place. In the interim, a lot of things can happen to manipulate and make things disappear, which then also just leads to cases being thrown out by the courts.
>
> - Trade Association

Liquor Amendment Bill seeks to address long-standing issues, but is met with criticism

Regulatory landscape largely unchanged over the past few years

The Liquor Amendment Bill 2016 aimed to address the socioeconomic impact of liquor, standardise regulations, improve regulatory collaboration and eradicate illicit trade. The Bill, however, has remained unsigned since 2017. Several policy changes have been proposed largely to curb excessive drinking and place more pressure on licit players to take responsibility. Some of the key changes include:

- Raise the legal drinking age from 18 to 21;
- Hold manufacturers, distributors and retailers responsible for products sold in unlicensed outlets;
- Restrict advertising on TV, radio and social media;
- Prohibit manufacturers, distributors and retail sale of alcohol at any location less than 500 metres from certain facilities.

Proposed restrictions are seen as hampering the industry's competitive environment

The government is under pressure to further control the alcohol market in South Africa given alcohol-related harm among the population. However, the **proposed measures have been met with strong criticism from industry stakeholders** as existing regulations remain ineffectively enforced and further controls would add additional burdens on the licit market.

Restrictions in terms of the sale of alcohol in certain areas as well as advertising have been criticised as they **limit new entrants to the liquor market and reduce competition**, particularly for small-sized businesses.

Fast-tracking approval of Liquor Amendment Bill needed to close regulatory loopholes in tariff classifications, in combination with strong enforcement

Liquor Amendment Bill seeks to address loopholes in classification of beer and sugar-fermented beverages

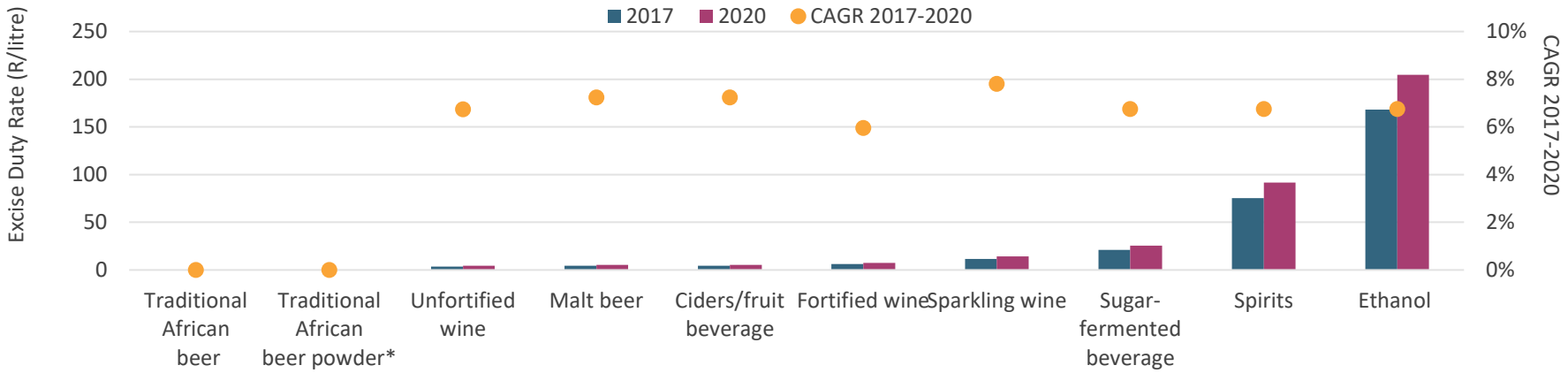
As part of its proposed Liquor Amendment Bill 2016, the government has suggested **minimum regulations on the production and packaging of beer, Traditional African beer and sugar-fermented beverages**, with one of the aim to curb the use of contaminants in homebrews intended for sale. This is the first time the liquor regulations seek to cover Traditional African Beer and other fermented homebrews. However, according to industry sources, the draft Bill has been delayed as traditional African leaders are still considering the inclusion of Traditional African Beer in the legislation.

Tariff determination remains uncertain around fruit fermented alcoholic drinks

There are still loopholes within the tariff classifications of fruit-based alcoholic drinks that lead to wrong classification of a sugar-fermented ales as a wine. Fruit-based beverages are intended to be taxed low in order to stimulate job creation within the agricultural sector. However, sugar-fermented ale producers are taking advantage of loopholes in labeling requirements (labelling their product as a “flavoured alcoholic beverage”) and avoiding the correct tariff determination by altering their composition when being tested. The Department of Agricultural, Land Reform and Rural Development has **increased testing** of these products in order to **identify and remove non-compliant products** from the marketplace, but **further collaboration between government organisations and the industry is needed in order to improve compliance**.

Raising excise taxes without improving enforcement and penalties provides additional incentives to illicit operators

Excise Duty Rate (R/litre) 2017/2020



Source: South African National Treasury

Excise taxes are continuously hiked above inflation, increasing on average by 6% CAGR during 2017-2020. Altering consumer behaviour by **raising prices appears ineffective amid high levels of poverty**, coupled with an **excessive drinking culture** and **easy access to cheap illicit alcohol**. Excise tax as a means to combat excessive drinking places further burden on compliant businesses. **Illicit syndicates, which largely operate in the unlicensed and unregulated sector, will continue to find ways to avoid paying excise tax**.

*Note: *Traditional African Beer powder calculated per Kilogram*

Alternative measures to curb excessive consumption and illicit alcohol met with criticism

Proposed Measure	Implications
Tax Stamps	Tax stamps are easily counterfeited by criminal syndicates (as seen in Mozambique), while generating a cost burden for licit manufacturers. The cost burden on licit manufacturers widens gap of licit and illicit prices further, inadvertently fueling profit incentives and illicit trade.
Minimum Pricing	Minimum pricing imposed on licit alcoholic drinks may have a counter effect in combating illicit trade as illicit syndicates are able to raise the price of illicit alcohol just enough to fall under the radar of authorities, and thus adding to their profit margins.

Tax stamps (such as track and trace) and minimum pricing are some of the measures that aim to combat illicit trade. The feasibility and success of these measures under the South African context is, however, questionable. **Without sufficient enforcement of existing regulations, further controls of the licit market would result in additional loopholes and strains on enforcement.** In both instances, the price of licit alcohol is raised, driving further incentives for profit-making of illicit players.

APPENDIX

Project Research Methodology in-depth

SECONDARY RESEARCH

- Reference all relevant, **recently published information** on alcohol and illicit alcohol trade
- **Ongoing review** of alcohol market, regulations and illicit trade throughout project lifecycle
- Key **data points** used in research:
  - Trade data – from the DTI
  - EMI Alcoholic Drinks data and data from FTI Consulting;
  - Expertise area specific reports from GAIN, Genesis Analytics Informal Trade study, SA medical research council and WHO

TRADE INTERVIEWS

Online interviews, 25+ in South Africa, conducted by Euromonitor analysts and project managers across the supply chain including:

- Alcohol drinks manufacturers; NGOs; trade associates; government organisations
- **Online industry engagement sessions with sales personnel** at **South African Breweries** in Gauteng, Mpumalanga, Limpopo, Western Cape and KwaZulu-Natal
- Online engagement with SALBA Illicit Trade Task Team

FIELD WORK

- **21 in-person store observations** in Gauteng, Western Cape and Free State provinces on illicit alcohol as available
- **Pulse Interviews** (short, informal interviews) with store personnel when available to understand the value chain, distribution and selling points of illicit alcohol

FINALISATION

- Qualitative and quantitative analysis of findings, emphasising the most important **illicit products and trends in 2020** compared to historic trends
- **Validation and finalisation of data** through further engagements.
- Reporting on findings and **value chain of illicit alcohol** as available

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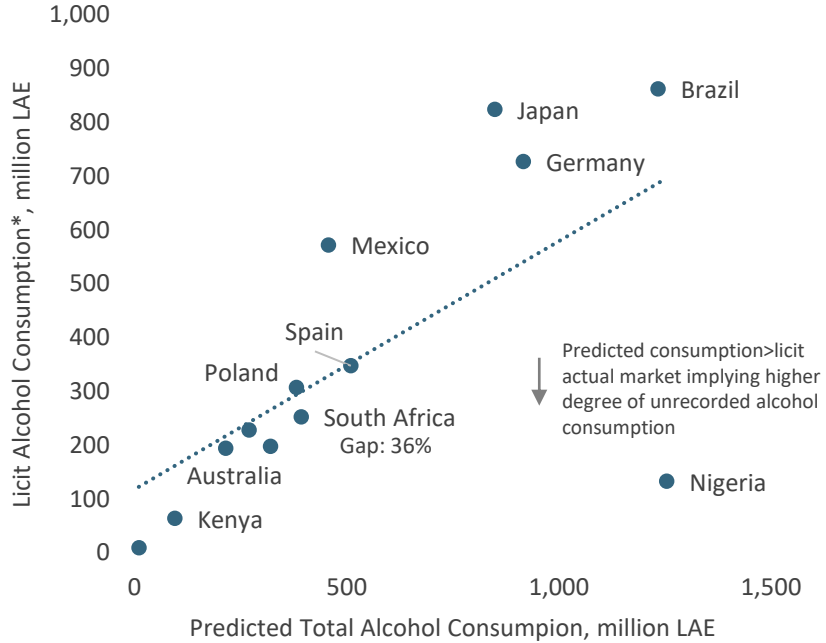
Econometric modelling predicting the level of alcohol per capita consumption in SA using macro-economic variables indicates a 36% unrecorded alcohol incidence

Licit Alcohol Consumption vs Predicted Alcohol Consumption, 2020



Note: The analysis of predicted alcohol consumption in this regression does not take into considering the ban on legal sales, as well as COVID-19 and the inclusion of these factors could have an impact on the results.

** Based on IWSR data for selected countries updated May 2020*

Fixed Effects panel model was used across 22 developed and developing countries with the following variables:

Total Alcohol Consumption Per Drinking Population (based on lifetime abstinence rate of population above 15 years^) = *ƒ* (FixedEffect_Country; GDP; Labour_Force_Participation)

Predictive modelling provides a top-down view on alcohol consumption per capita, considering the relationship of economic development and labour force participation with alcohol consumption globally across an array of developed and developing markets. Whilst predictive modelling cannot be used as a final measure of actual total alcohol consumption; it is an indicative view of a top-down macro input to evaluate the robustness of results derived from detailed bottom-up illicit trade quantification as per the methodology followed in this study. Based on the analysis, total predicted alcohol consumption (including recorded and unrecorded alcohol) in South Africa is estimated at 392 million LAE in 2020. Compared to recorded alcohol consumption in 2020 (estimated at 252 million LAE*), this implies an unrecorded incidence of 36% of the total market (recorded and unrecorded).

Supply chain analysis identifies where the illicit activity first takes place and the route to market of illicit products and recommendations for tackling illicit trade

Step 1
Overall description of the supply chain

Main purpose is to understand how the products are being sold, in which step of the supply chain they become illicit and which players are involved.
Results: Supply chain diagram (see following slide for details on the illicit value chain).

Step 2
Deep dive in each step of the chain

Main purpose to answer questions related to:
- Local production of illicit products: Suppliers of raw materials, packaging, labels etc through criminal activities or procurement;
- Distribution channels: Where are illicit products found, relevance of online stores, on-/off- premises, etc?
- Who is buying and prices paid?

Step 3
Recommendations

Existing and proposed strategies to tackle illicit trade based on findings.

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EMI Illicit Methodology Approach:

- Euromonitor has developed a holistic illicit trade research framework, with consistent definitions and metrics, applicable to any industry, allowing cross-country comparisons.
- Euromonitor's illicit methodology categorization allows for more granular understanding across individual illicit categories in determining the nature, size in value and volume terms, illicit category drivers, fiscal revenue loss, illicit alcohol drinks type impacted and how the illicit types can be addressed specifically. Each illicit category can be tackled strategically to try curb its growth.
- Euromonitor combines existing sources with mixed methods for stronger data, deeper insights and actionable recommendations. The research methodology combines secondary and primary research. Primary research includes trade and expert interviews with various source contacts, which focus on collecting rich content and specific views across various value chain touchpoints with respective alcoholic drinks industry actors.

Value chain analysis used to avoid double counting

In many cases, illicit alcoholic drinks can fall into more than one category. To avoid double counting and to better understand each of these categories, Euromonitor International has designated each product to the category in which it first enters the illicit alcohol market of the country.

For example, if an illicit homebrew is created from smuggling ethanol, then for the purposes of this study it is considered smuggling because the alcohol became illicit the instant it entered the country without paying the due taxes, prior to the homebrew production and distribution process.

This example (illustrated below) helps explain the Euromonitor International category classifications for this project:

Total size of illicit alcohol and estimation of government fiscal loss revenue

Step 1
Size illicit activity by volume

Each of the main illicit activities are identified as well as the main product categories impacted.

The total volume/value for each product type and by illicit activity is calculated in order to identify how much of this volume/value has been "lost" to tax authorities through customs and excise duties.

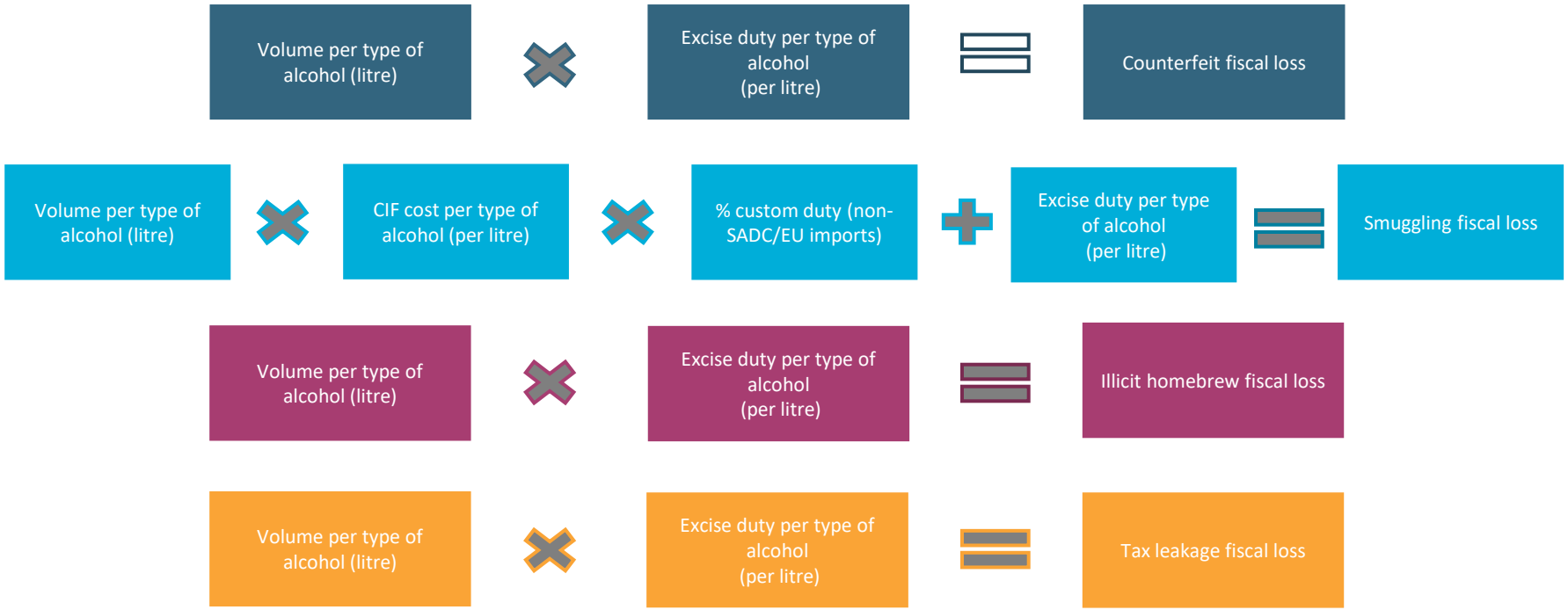
Step 2
Apply current tax structure

The appropriate tax rate for the specific year, depending on the product and illicit activity, is applied to the volume.
This is the amount that should have been paid to the government but was not due to illicit trade.

Step 3
Calculate fiscal loss

The total value lost is aggregated across all illicit activities into a single number that represents loss to the government in one year (USD million).

Fiscal loss based on excise tax and import duty (where applicable) are calculated using the following method for each relevant category:



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Alcohol market definitions

Category	Definition
Licit Alcohol	Alcoholic drinks that are legally tax compliant in terms of paying the correct excise and other duties as required by the country in which the beverages are sold. Actual licit alcohol data in 2020 (including the impact of the ban on sales) were used to calculate the illicit trade market in this study.
Illicit Alcohol	The non-payment of relevant excise and other duties to be fully tax compliant. Illicit alcohol can also lack other official requirements within a specific market. Some of the most important requirements that may be lacking include necessary health permits, and compliance with the local laws and norms applicable to the alcoholic drinks production process, including ingredients.
Informal Alcohol	Alcohol sold through informal channels mainly via premises which are unlicensed, unregulated (on-/off-trade) and with fewer amenities, primarily targeted towards lower-income and unemployed patrons in both urban and rural regions. Examples include open market stalls, kiosks, bars and shebeens. In emerging markets, the informal distribution segment is very significant across categories; this is therefore a major focus of this study. Within informal distribution, both licit and illicit alcoholic drinks can be sold; this study will analyse only the distribution of illicit alcohol.

Abbreviations:

HL - Hectolitre

LAE - Litres of alcohol equivalent

Illicit category methodology (1)

Category	Methodology
Counterfeit and illicit brands	
Substitution/refill	Sum of total licit sales (volume) of alcoholic beverages by channel (on-/off- trade) multiply x% of substitution/refill estimated per type of beverage = total substitution/refill market size Conversion to LAE = substitution/refill alcohol market size multiply x% of pure alcohol type.
Industrial manufacturing of illicit/unbranded alcohol	Average of three approaches: **Approach1:** Bottom-up approach based on rural and urban drinking (15+) population (below national poverty threshold) multiply x% likely to consume illicit spirits per week multiply average yearly per capita consumption of spirits = total illicit industrial manufacturing market size. **Approach 2:** Licit spirit volume sales multiply (used as a benchmark figure) x% relative size of counterfeit sales = total illicit industrial manufacturing counterfeit spirits market size. **Approach 3:** Residual approach analysing the local production of ethanol plus imports minus exports to determine the amount of ethanol available for local consumption. Ethanol leakage from licit producers and customers as well as ethanol round-tripping using export data was then analysed. Illicit smuggled ethanol plus leaked/diverted ethanol converted to finished product = total illicit industrial manufacturing market size using illicit ethanol.
Smuggling	
Smuggling of the finished product	Total licit imports of alcohol subcategory multiply x% licit imports not recorded (smuggled) = total smuggled alcohol per subcategory. Conversion to LAE = smuggling market size multiply x% of pure alcohol type per alcohol subcategory.
Smuggling of ethanol	Total licit imports of ethanol (raw material) multiply x% illicit imports not recorded (smuggled) = total smuggled ethanol (raw material) market size. Converted to finished product = smuggled distilled finished product market size. Conversion to LAE = smuggling market size multiply x% of pure alcohol type.

Illicit category methodology (2)

Category	Methodology
Illicit homebrew alcohol	
Illicit homebrew	Combination of 5 Approaches below **Approach 1:** Based on apparent consumption of sorghum: Total consumption of sorghum multiply x% used in brewing multiply conversion rate multiply volume sold = total illicit sorghum beer volume. Conversion to LAE = illicit homebrew market size multiply x% of pure alcohol type. **Approach 2:** Based on pineapple sales: Total pineapple sales multiply x% used in homebrewing multiply by conversion = total pineapple homebrew market size. Conversion to LAE = illicit homebrew market size multiply x% of pure alcohol type. **Approach 3:** Homebrew volume estimates based on unlicensed and licensed outlet production: Bottom-up approach based on number of licensed and unlicensed alcohol outlets multiply x% that make use of fermented sorghum beer as well as other homebrew (including for example pineapple, ginger and marula beer) multiply production volumes per year multiply x% volume sold = total illicit homebrew market size. **Approach 4:** Based on consumption of homebrew among typical consumers: Bottom-up approach based on rural and urban drinking (15+) population (below national poverty threshold) multiply x% likely to consume homebrew per week multiply average yearly per capita consumption of homebrew multiply x% volume sold = total illicit homebrew market size. **Approach 5:** Pineapple beer sales based on excess yeast sales: Total yeast sales above normal usage in 2020 multiply x% used in homebrewing multiply by conversion = total pineapple homebrew market size Conversion to LAE = illicit homebrew market size multiply x% of pure alcohol type.

Illicit category methodology (3)

Category	Methodology
Tax leakage	
Tax leakage	Average of various approaches: **Approach 1:** Total production of sugar-fermented ales multiply x% undeclared plus total production of sugar-fermented ales multiply x% misclassified as wines = total sugar-fermented ales tax leakage market size. **Approach 2:** Licit wine volume sales (used as a benchmark figure) multiply x% relative size of low-cost wines sales multiply x% under-declared = total low-cost wines tax leakage market size. Licit wine volume sales (used as a benchmark figure) multiply x% relative size of sugar-fermented ales sales multiply x% undeclared plus relative size of sugar-fermented ales sales multiply x% misclassified as wines = total sugar-fermented ales tax leakage market size. **Approach 3:** Total licit economy beer volume sales (used as a comparison market) multiply x% proportion of national economy beer consumed in Western, Northern and Eastern Capes (as a proxy to highest consumption areas for sugar-fermented ales multiply x% undeclared production of sugar-fermented ales sales multiply x% misclassified as wines = total sugar-fermented ales tax leakage market size. Conversion to LAE = low-cost wines/sugar-fermented ales tax leakage market size multiply x% of pure alcohol type.
Surrogate	
Surrogate	General consumers of surrogate figure is based on population statistics. A surrogate consumer group was quantified and average consumption per capita of surrogate was applied. The typical surrogate user is between 15-18 years of age, male or female, all races, employed or unemployed. Cough syrup which is popular was used as a baseline for the valuation as this is typically mixed with a soft drink. Consumers tend to be those living in both rural and urban areas, and tend to be situated in Gauteng, North West, Mpumalanga and Limpopo provinces based on trade interviews and engagements. The proportion of population that fits into the most typical surrogate consumer group multiply by x% of teenagers that tend to have a codeine addiction, multiply the volume and use of cough syrup annually. Conversion to LAE = total surrogate market size multiply x% of pure alcohol type.

Sources

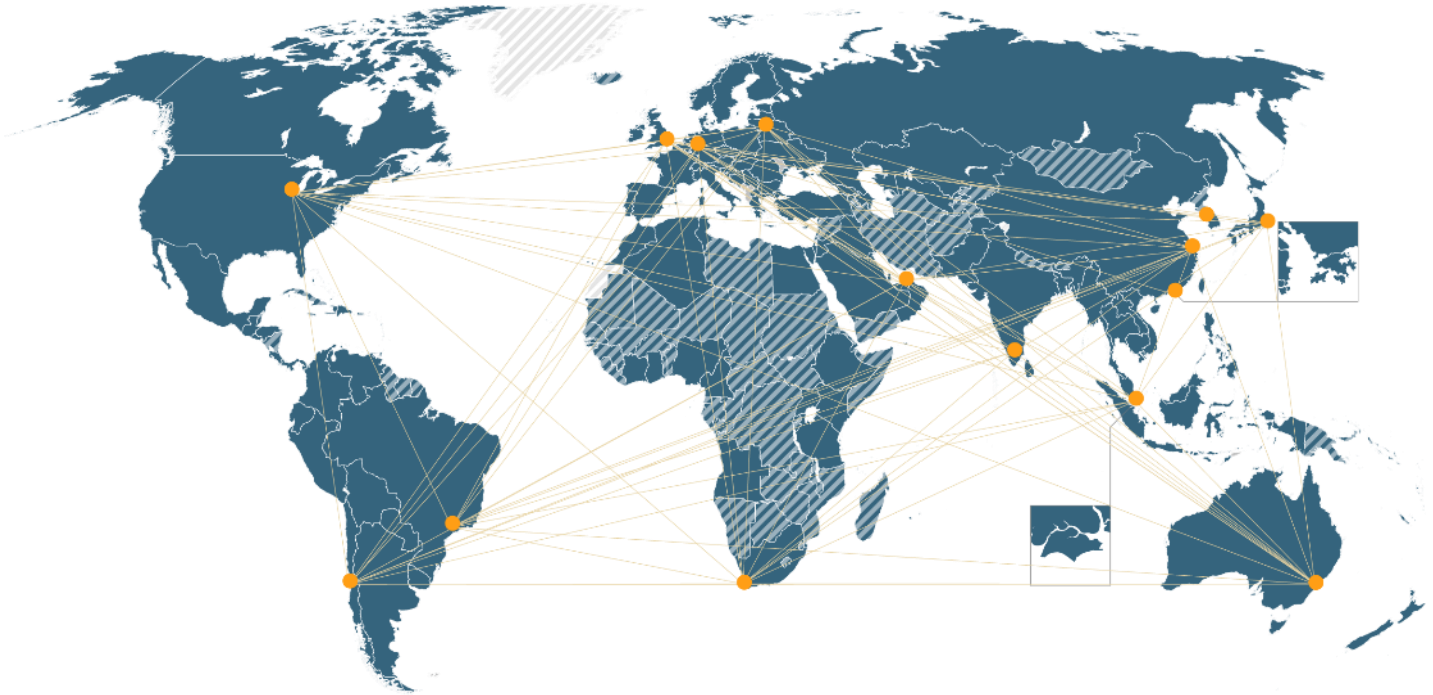
Key Primary Sources	
Source Type	Source
Alcoholic Beverage Manufacturer	Diageo plc
Alcoholic Beverage Manufacturer	Devil's Peak Brewing Company
Alcoholic Beverage Manufacturer	Distell
Alcoholic Beverage Manufacturer	Distillique Beverages
Alcoholic Beverage Manufacturer	Orange River Cellars
Alcoholic Beverage Manufacturer	Pernod Ricard South Africa (Pty) Ltd
Alcoholic Beverage Manufacturer	South African Breweries
Alcoholic Beverage Manufacturer	Southern Cape Vineyards
Alcoholic Beverage Manufacturer	Stellenbosch Vineyards
Alcoholic Beverage Manufacturer	Strandveld Vineyards
Alcoholic Beverage Manufacturer	Distillers Union
Ethanol Association	Ethanol Producers Association of Southern Africa
Ethanol Manufacturer	NCP Alcohols (Pty) Ltd
Government	Department of Agriculture, Land Reform and Rural Development
Government	Gauteng Liquor Board
Government	Western Cape Liquor Authority

Sources

Key Primary Sources	
Source Type	Source
Other	Anchor Yeast
Other	Brand Compliance
Other	FTI Consulting
Trade Association	Consumer Goods Council of South Africa
Trade Association	SALBA Illicit Trade Task Team
Trade Association	South African Liquor Brand owners Association (SALBA)
Trade Association	South African Wine Industry Information Systems (SAWIS)
Trade Association	Transnational Alliance to Combat Illicit Trade (TRACIT)

Key Secondary Sources	
Source Type	Source
Government	National Treasury
Government	South African Revenue Services
Government	South African Medical Research Council
Trade Association	Department of Trade and Industry
Trade Association	World Health Organisation: Alcohol Report 2016: South Africa
Other	Genesis Analytics Evaluating the economic, health and social impacts of the proposed Liquor Amendment Bill, 2017
Other	Global Agricultural Information Network May 2020, Sorghum production in SA
Other	Global Data

Euromonitor International network and coverage



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Execute

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- Inform product/service development
- Set or refine go-to-market strategy

Measure and track results

- Measure and track sales/share
- Understand performance
- Set benchmarks

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