

Analysis of the Informal Alcoholic Beverages Market in Mexico

September 2021

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Methodology

Project Objective and Scope

Informal Modalities

- Tax Evasion in Production.
- Contraband Ethanol.
- Finished Product Contraband. Undervalued Parallel Imports.
- Counterfeits, Bottle Refilling, and Adulteration.
- Non-compliant Alcohol.
- Craft Informal Alcohol.
- Alcoholic beverage substitutes not intended for human consumption.

Formal Modalities:

- Legal Cross-Border Purchases.
- Formal Craft Product.

Geographical Scope: Mexico.

Project Background

The Comisión para la Industria de Vinos y Licores, A.C. (CIVyL) represents part of Mexico's effort to research the informal Alcoholic Beverage market in order to better understand the consequences on the formal sector. To this end, this is the fourth study commissioned to Euromonitor International by CIVyL.

Client's Objectives

To determine the volume and value of formal Alcoholic Beverages in Mexico for Fermented and Distilled Products (except Beer).

To determine the volume and value of informal Alcoholic Beverages in Mexico for Fermented and Distilled Products, differentiating the informal market modalities.

To compare the Alcoholic Beverage informal market with the formal market, and its evolution to previous years.

To identify the factors that affect its consumption, its socioeconomic and health impact.

To assess, and, where appropriate, to implement the recommendations to support the enforcement of changes, or regulatory improvements in the federal level in Mexico, from the current and future perspective of the market.

Multi-Source Methodology



Step 1

Secondary Research

- Euromonitor International uses secondary sources including, but not limited to data from the INEGI, the Department of Economy (Secretaría de Economía), the SAT, press releases, and Euromonitor's Alcoholic Beverage database.



Step 2

40 Observation Exercises

- To achieve a holistic perspective, 40 observational visits to retail stores were conducted (e.g., supermarkets, convenience stores, specialty stores *online*, and physical), in Monterrey, Mexico City, Guadalajara, Puebla, and Cuernavaca.



Step 3

45 Interviews

- Interviews were conducted with relevant industry professionals such as: formal alcohol manufacturers, importers, distributors, associations, Government (e.g., Health Department [Secretaría de Salud], and SAT), and customs authorities.



Step 4

Information Review and Validation

- Calculations and estimates are based on rigorously reviewed and validated information.

Value Chain Analysis to avoid double counting

In many cases, informal Alcoholic Beverages can be assigned to more than one modality.

To avoid double counting, Alcoholic Beverages were assigned the first practice with which the product has contact. This allows also for better understanding of each informal alcoholic beverage class.

- For example, if a counterfeit beverage made with contraband ethanol is created, for the purpose of this study, the product is counted as contraband because its informality originates in entering the country without paying taxes, and not during the manufacturing process of the counterfeit beverage.
- The following example helps explain the way Euromonitor assigns categories within the context of this project:



CONTRABAND:

The beverage is classified as contraband because it was at this point where the first contact of informal activity took place (in the domestic territory), within the value chain.

Steps to assess tax loss*

Step 1

Weighted average value of one nine-liter-case of distillates in 2020.

Step 2

VAT and import taxes exemption (if applicable), and Special Tax on Production and Services (STPS) to obtain the price without taxes.

Step 3

Evaded STPS estimation multiplying price without taxes by 53.0%.

Step 4

The estimation of evaded STPS per case is multiplied by those estimated to be informal.

**Note: tax evasion estimation does not consider promotions, free samples, concessions, or other activities that reduce regular retail price.*

Executive Overview

Economic slowdown, and restrictions imposed on alcoholic beverage purchases due to covid-19 promoted an ideal context for informal market growth



Mexican economy has been weakened by the pandemic, which has also affected consumption habits as a result of the restrictions on movement, and access to consumption centers

The Mexican economy and the alcoholic beverage market were affected by the restrictions imposed by the pandemic

- On March 30, 2020, a sanitary emergency was declared**, and the cease of non-essential activities, including, but not limited to, going out to restaurants, bars, non-food product facilities, was decreed. The general lockdown lasted up to May of that same year.
- Some states opened adapting social distancing, schedule changes, and limited capacity measures. As of February 2021, 27 out of the 32 states required the mandatory use of face masks in public places.
- The suspension of activities had a significantly negative impact on unemployment figures, available income, and on other economic indicators.** Millions of Mexicans were forced to adopt different methods of saving. One of these methods consisted of replacing their favorite products, or brands with lower-price options. The Alcoholic Beverage Industry was no exception, since consumers changed from Sparkling Wines to Cider, and from Liquor to low-price distilled agave products.

Mexican economy indicators in 2020	2019	2020	2020 vs. 2019
Available income (MXN million)	18.4m	17.13m	(7%)
Average available household income (MXN)	363.0k	329.0k	(9%)
Average spending on alcoholic beverages (MXN million)	399.0k	394.0k	(1%)
Unemployment rate	3.5%	4.4%	(26%)

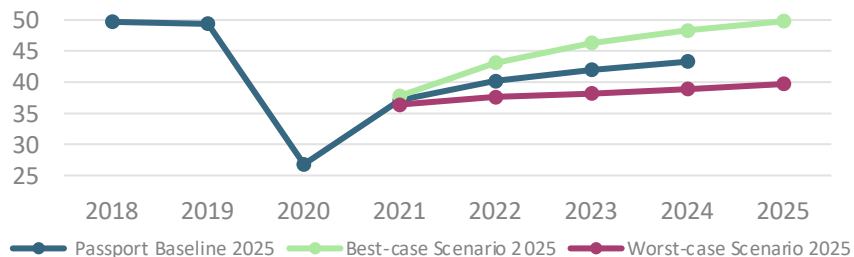
Source: economy, industry and consumers annual Passport Data.

In Mexico, GDP at constant prices declined -8.5% 2020 vs. 2019.

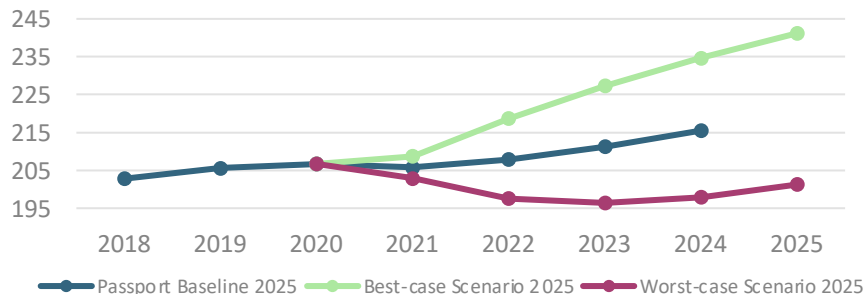
Source: INEGI

Although in 2020 the total consumption of Alcoholic Beverages fell by 7.0%, the *Off-trade* channel rose by 10.9%

Liquor sales volume, Mexico, Millions of liters, 2025
*On-trade**



Liquor sales volume, Mexico, Millions of liters, 2025
*Off-trade***



Despite the restriction on the schedules, *Off-trade* sales of beverages rose due to the drastic closing of *On-trade*

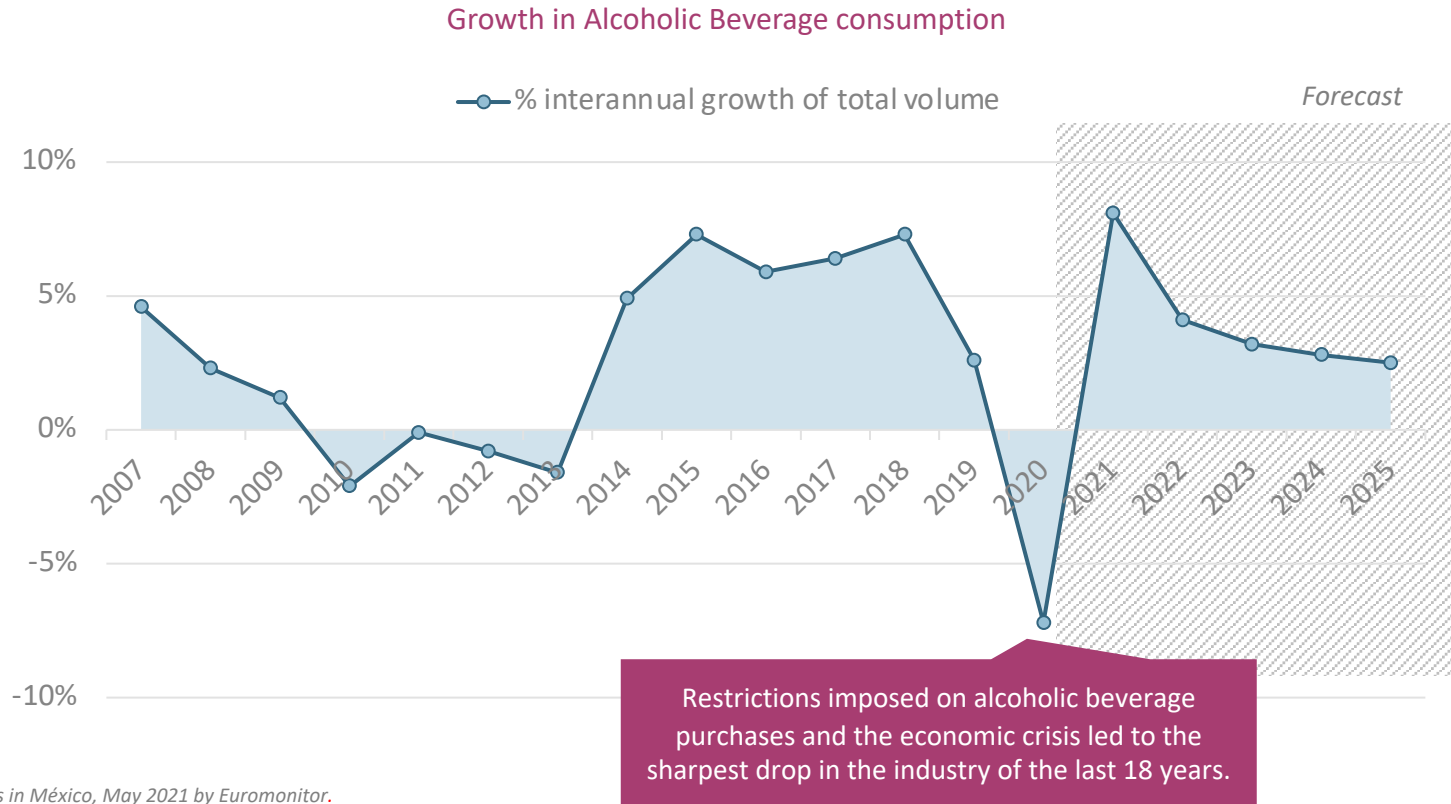
- After a 3% rise in the consumption of Alcoholic Beverages in 2019, during 2020 this figure fell to 7.0% due to the economic crisis, as a consequence of the restrictions imposed by the pandemic.
- One restriction was a limited schedule for the sale of alcoholic beverages (e.g., by November 2020, in CDMX it was forbidden to sell them from Friday 6:00 p.m. to Sunday 11:59 p.m.), this restriction was even sustained by some municipalities until March 2021. As a consequence, some bars decided to close completely for some time.
- Due to these closings, sales On-trade changed from 22.0% in 2019 to 13.0% in 2020, and the ones Off-trade from 78.0% to 87.0%.
- Although a rise is projected in the oncoming years, the On-trade channel will not recover until 2025.

Source: Alcoholic Beverage Projection model by Euromonitor (Bebidas alcohólicas modelo de proyección), Euromonitor Passport.

*On trade: Sales in consumption centers like, bars and restaurants

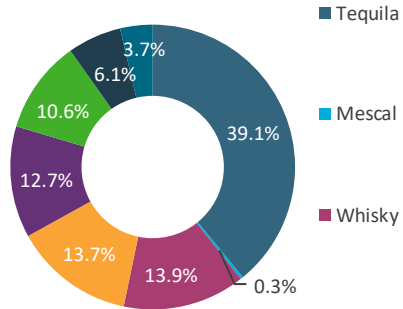
**Off trade: Sales in retail stores, like supermarkets and any corner shop.

An expected rise in the consumption of Alcoholic Beverages of 8.0% and 4.0% for 2021 and 2022 respectively is expected, which will allow for a recovery from the -7.0% drop in 2020



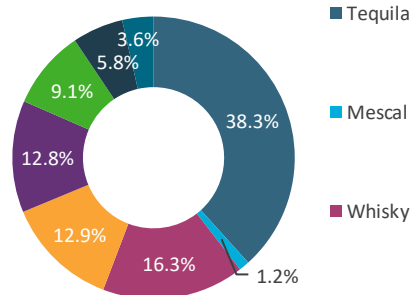
After years of sustained growth, 2020 contraction mainly affected imported beverages like Whisky

Formal market per category,
millions of 9l-cases, 2013



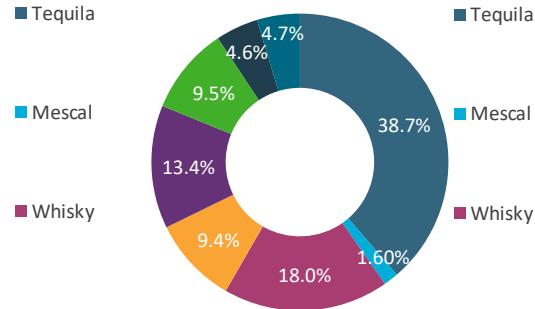
Total volume:
27.4 million 9l-cases.
Total value:
MX\$ 37,648 million.
STPS collection:
MX\$ 9,227 million.

Formal market per category,
millions of 9l-cases, 2015



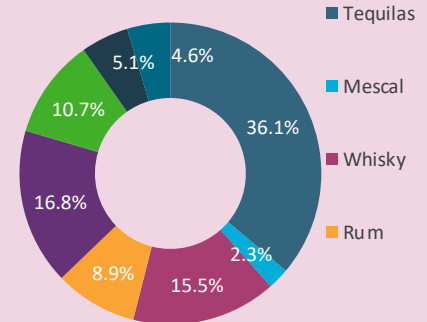
Total volume:
30.1 million 9l-cases.
Total value:
MX\$ 45,749 million.
STPS collection:
MX\$ 11,404 million.

Formal market per category,
millions of 9l-cases, 2017



Total volume:
30.2 million 9l-cases.
Total value:
MX\$ 59,909 million.
STPS collection:
MX\$ 12,825 million.

Formal market per category,
millions of 9l-cases, 2020



Total volume:
26.4 million 9l-cases
Total value:
MX\$ 70,194 million.
STPS collection:
MX\$ 14,879 million.



19,510,622 Informal market in 9L-cases



MX\$ 41,540 Informal market in millions



MX\$ 41,540 Tax loss in millions

The pandemic restrictions and the economic crisis affected not only the formal market, but also promoted the informal market which represented 42.5% of the total of distilled Alcoholic Beverages in nine-liter cases. This figure was triggered, among others, by the purchase of these products in the informal channel (e.g., tianguis), through internet on lightly inspected platforms (like social media), and because of the need to find low-cost alternatives given the loss of purchasing power, and the closing of formal sales channels.

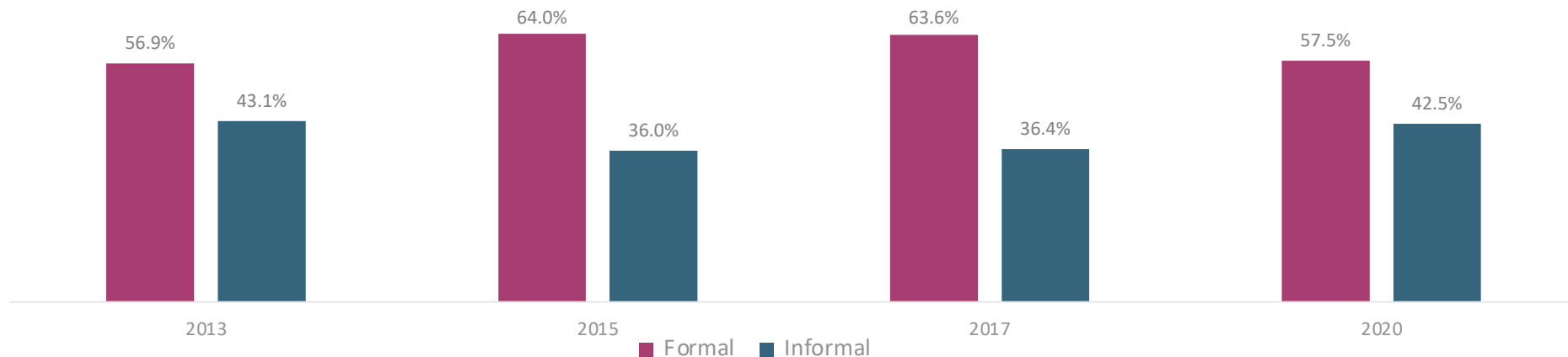
The informal market of distilled alcoholic beverages grew six percentage points during 2017-2020 period partly because of the formal market contraction

Total market, millions of 9l-cases, 2013

Total market, millions of 9l-cases, 2015

Total market, millions of 9l-cases, 2017

Total market, millions of 9l-cases, 2020



Total volume:

48.2 million 9l-cases.

Total value:

MX\$ 57,834 million.

Total volume:

47.0 million 9l-cases.

Total value:

MX\$ 65,179 million.

Total volume:

47.6 million 9l-cases.

Total value:

MX\$ 87,057 million.

Total volume:

45.9 million 9l-cases.

Total value:

MX\$ 123,197 million.

The difficulty to find alcoholic beverages at affordable prices lead consumers and businesses to resource to informal markets like the tianguis

1

More consumers prioritize price over quality of Fermented and Distilled Products

Purchasing power drop per capita (-11.0% 2019-2020) and a Beer shortage due to discontinuation of production in April and May 2020 affected low-income consumers making them more likely to consume low-price Distilled agave products and Distilled liquor (aguardiente), as well as beverages without regulations or falsified.

2

Economic instability and the rise in organized crime adversely affect the *On-trade* channel

Organized crime growth during 2020 (e.g., extortions) affected businesses, especially those of the *On-trade* channel (which contracted from 22.0% to 13.0% that same year and compared to the *Off-trade*) in big cities like CDMX. At the same time, channel closings during the pandemic together with the rise in the prices of formal beverages (+36% from 2017), forced many consumers, bars, restaurants and other points of sale to look for economic products to recover the losses of the months prior to the closings.

3

Alcoholic beverage offer is diversified in tianguis and social media

Historically, in tianguis only Beer was sold (e.g., Micheladas). However, the offer of Fermented and Distilled Products, and prepared beverages like “Mojitos”, or “Clericots” has expanded recently. This trend is also observed in social media like Instagram, Facebook, or Whatsapp groups, where the marketing of non-compliant or contraband alcohol has been identified.

4

The Prohibition Act during the pandemic motivated consumers to look for informal alternatives

Ban on the sales of alcohol during the Prohibition Act enforced during the pandemic at the level of municipalities, caused several negative effects like going back and forth among States looking for alcoholic beverages. There was also an upsurge of informal sales of alcohol in formal (which sold during the prohibition) and informal establishments, as well as on websites like MercadoLibre, where it was sold without authorization.

Informal Alcoholic Beverages are up to 50% cheaper than formal ones, which motivates their consumption, especially when available income drops like in 2020

A wide offer alerts about the informality, but it is also a reason for buying

- The offer of both formal and informal alcoholic beverages which are in their vast majority counterfeit, contraband, non-compliant, or adulterated was detected in the markets.
- It is possible to get informal alcohol bottles in the markets, but, during 2020, the growing selection of informal beverages ready to consume on the spot was noticed. Considering the closings of the formal sales channels like *On-trade* and the purchase limitations during the pandemic, these establishments worked as an open and accessible channel.
- Other sales channels of informal Alcoholic Beverages are the internet (contraband or non-compliant), corner shops (non-compliant or counterfeit) and clandestine bars (refilled or adulterated). In some instances, formal bars and restaurants may sell some kind of informal alcoholic beverages through the illegal operation of the waiters or *bartenders themselves*.

Informal prices by modality, June 2020

	Average prices MXN/ 9l-cases
Contraband Ethanol	\$432
Contraband Beverages	\$1,894
Parallel Imports	\$2,706
Counterfeiting	\$1,488
Tax Evasion in Production	\$2,706
Craft Informal	\$1,488
Non-compliance	\$1,488

This figure shows the offer of prepared beverages available in the tianguis.

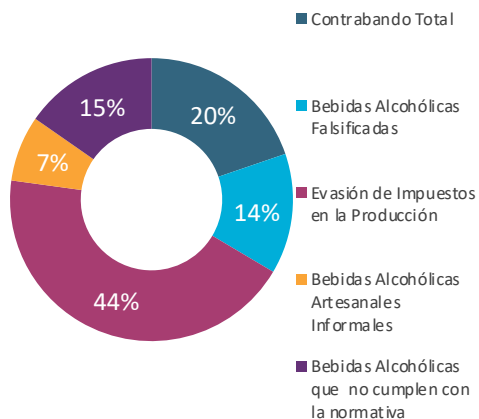


Photograph: Taken in Tepito in CDMX, June 2021.

*Note: Storecheck prices, June 2021.

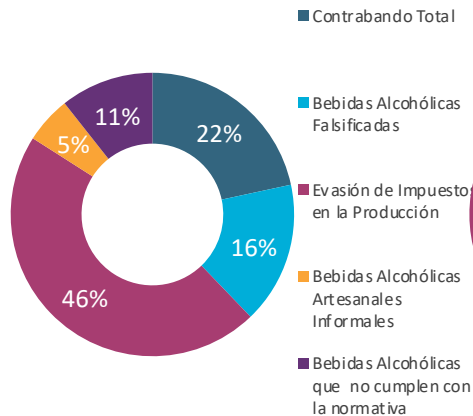
Tax evasion is still the main modality of the informal market, and since 2017 earns 3 p.p. On the other hand, contraband is losing ground

Informal market by modality, millions of 9l-cases, 2013



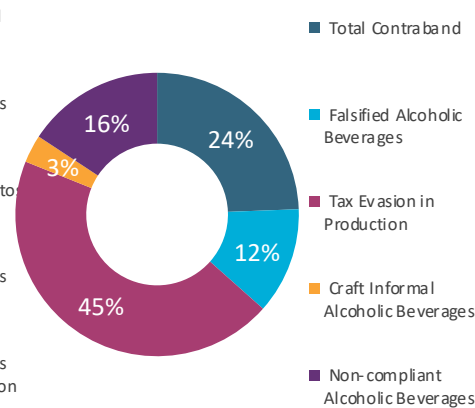
Total volume:
20.8 million 9l-cases.
Total value:
MX\$ 20,186 million.
Tax loss:
MX\$ 6,363 million.

Informal market by modality, millions of 9l-cases, 2015



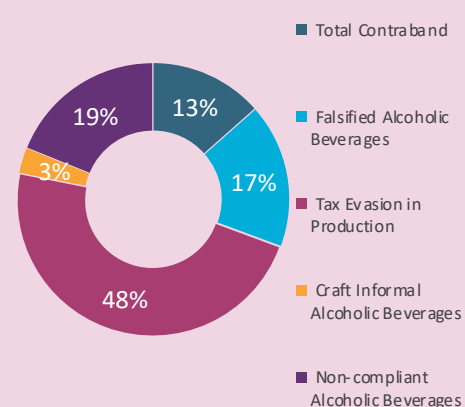
Total volume:
16.9 million 9l-cases.
Total value:
MX\$ 19,430 million.
Tax loss:
MX\$ 6,001 million.

Informal market by modality, millions of 9l-cases, 2017



Total volume:
17.3 million 9l-cases.
Total value:
MX\$ 27,148 million.
Tax loss:
MX\$ 8,745 million.

Informal market by modality, millions of 9l-cases, 2020

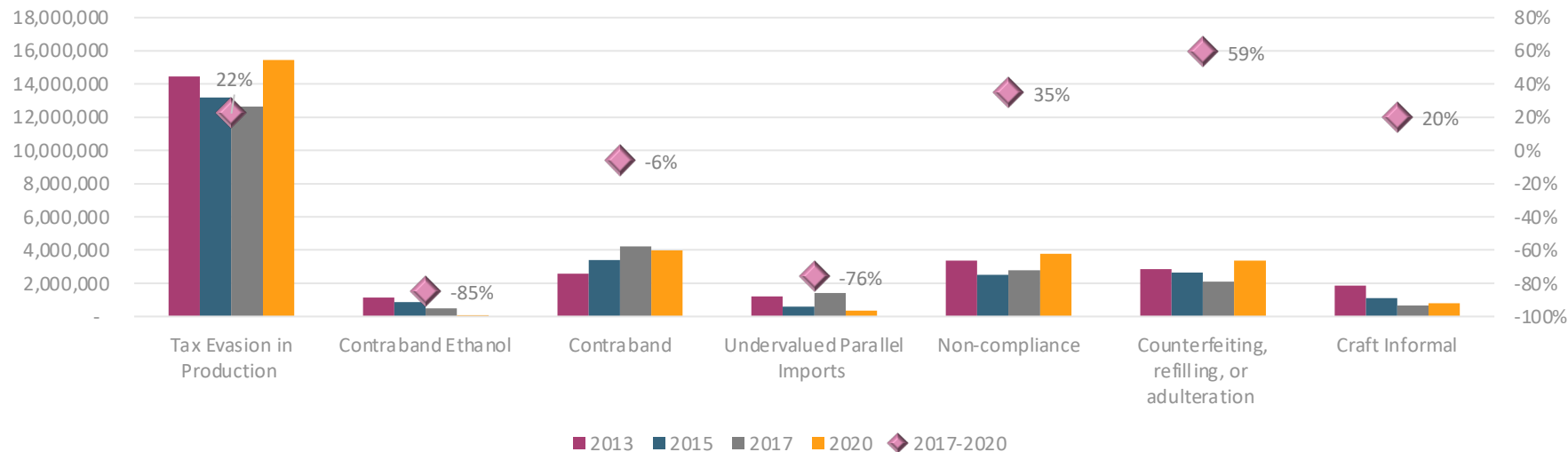


Total volume:
19.5 million 9l-cases.
Total value:
MX\$ 41,540 million.
Tax loss:
MX\$ 11,532 million.

The closing of borders and the reduction of the number of travelers promoted the drop in contraband and parallel imports

Contraband and parallel imports have dropped due to lack of containers caused by the demand of essential consumer goods, and the use of ethanol in the manufacture of alcohol gel. Nevertheless, the hindrance to import alcoholic beverages together with the restrictions imposed by the pandemic, the Prohibition Act, and the closing of the *On-trade* formal channel, promoted the other modalities because of the local nature of their production, (particularly counterfeiting). These modalities are more accessible in the current scenario.

Informal market by modality



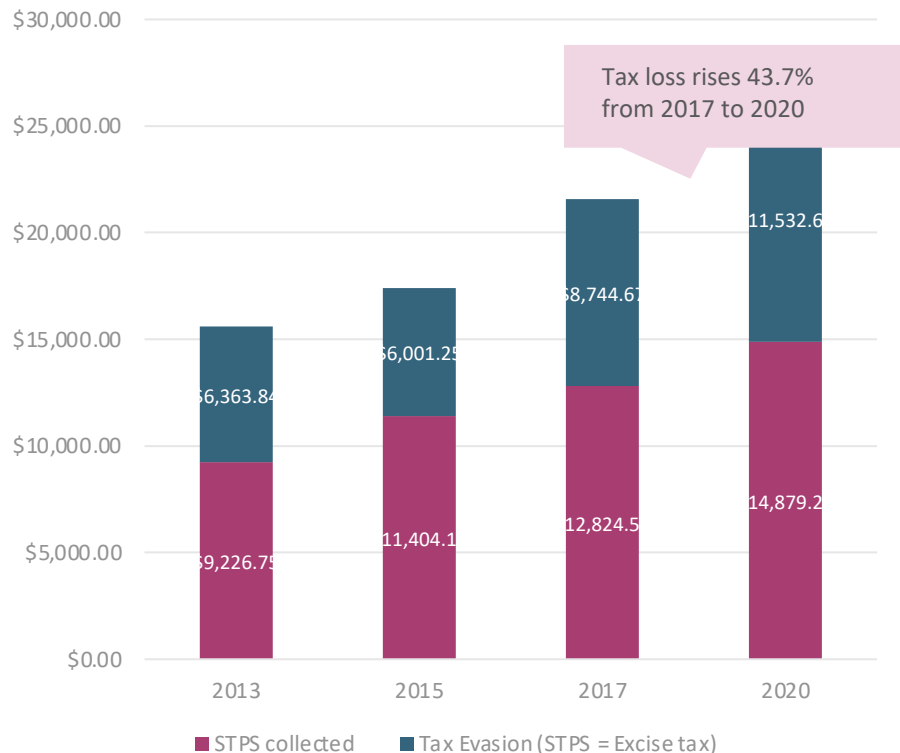
Source: Euromonitor International

The pandemic altered the informal market dynamics observed in previous years, and promoted the growth of informality among locally produced beverages

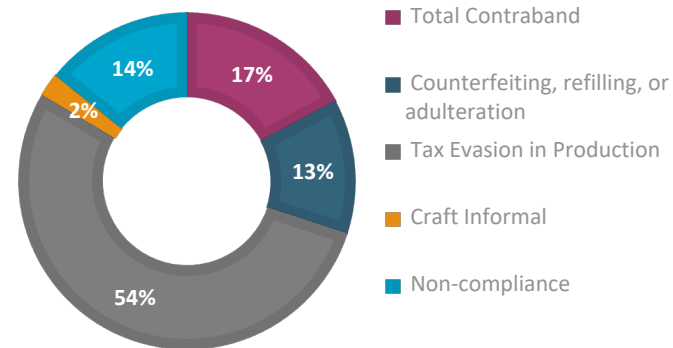
Modality	Variation in millions of 9l-cases, 2017-2020	Findings behind the change
Tax Evasion in Production	+1.56	Tax evasion is rising compared to previous years due to the popularity of local beverages like Mescal or Tequila, where it is observed that it takes several years for informal producers to become legal. Other reasons that encouraged the modality were shortage (temporary) of Beer, economic crisis, purchasing power drop, formal sales channels closings, and accessibility to informal channels.
Counterfeiting, refilling or adulteration	+1.25	The raids undertaken by the health and tax authorities keep many formal establishments under control; however, they haven't been able to implement the same supervision in the tianguis, where most of the growth of these modalities has been detected.
Non-compliance	+0.96	The new sales channels, particularly social media, Marketplaces like MercadoLibre, and tianguis promote the non-compliant sale of alcohol. Young people and low-income consumers are who buy most of these beverages under this modality, as they also spend more time buying on the internet, and social media.
Craft Informal	+0.04	In the Craft Informal category, a growth is observed thanks to the new sales channels, particularly, the internet. Although some platforms like Amazon have implemented control mechanisms (like requesting the seller to submit authorization for the sale of alcoholic beverages), during 2020, informal beverages sales through these channels, and on social media (Facebook, Instagram), grew, partly due to the promotion of craft products.
Contraband Ethanol	(0.43)	Contraband decreased. With an increase in hand hygiene to prevent the COVID-19 transmission, the ethanol intended for the production of antibacterial gel (in USA, and Mexico) saw a rise. The average price of this commodity rose from MXN\$ 15-18 to MXN\$ 80 per liter.
Contraband	(0.47)	The militarization of customs, (more controlled borders), shortage of containers due to worldwide logistics crisis, and the lack of travelers were factors that promoted the contraband drop (6% less than in 2017).
Undervalued Parallel Imports	(0.69)	Parallel importers have been affected by the drop in demand on the On-trade channel, and the hotels, although alcoholic beverages obtained under this modality are also found in other channels, like supermarkets.
Total amount	+2.21	

Tax loss represented 43.7% of the target collection of distilled beverages, growing 31.9% compared to 2017

Target tax collection



Tax loss by informal modality

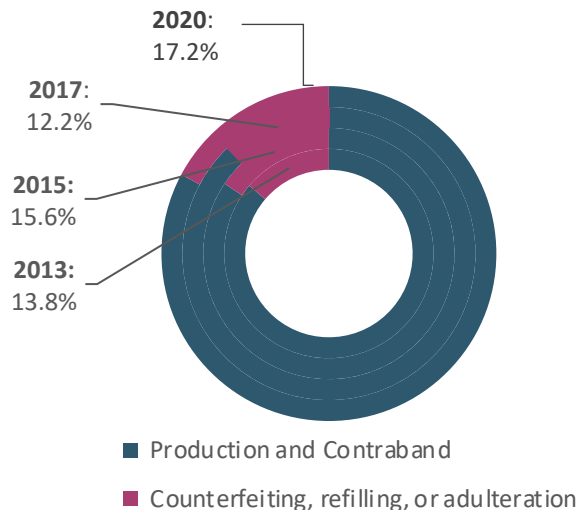


- Tax evasion contributed 54% of the total tax loss. Counterfeiting was the modality that showed the greatest growth (117.0%), with a 13.0% rise in 2020 compared to 8.0% in 2017.
- The increment in tax loss from counterfeiting is proportional to the value of the modality that profited from (like the other practices) the cessation of business of the *On-trade* formal channel, and the limitations in purchases in the *Off-trade channel*.

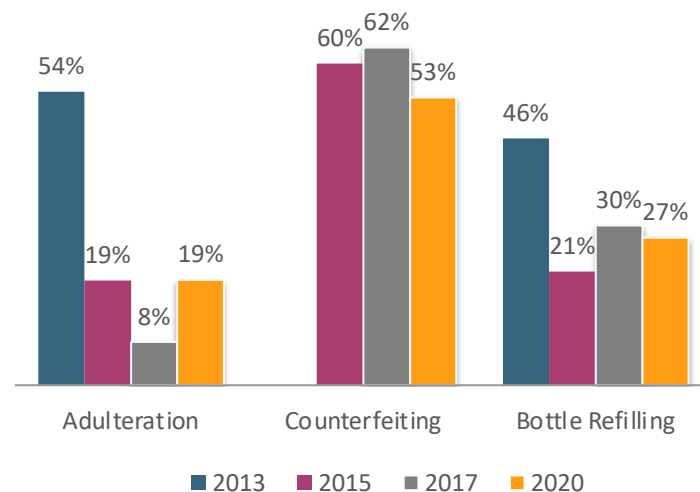
In volume, modalities with a negative impact on public health grew 5 p.p. since 2017, representing more than 17.0% of the market

- The closing of the *On-trade* channel promoted the prepared beverages sales in alternative channels like tianguis, or social media. This kind of beverages, like Mojitos, for example, makes it difficult to distinguish the legitimacy.
- On the other hand, tianguis are not inspected by the department of health, and the supervision of the municipalities is limited, that is why it is not simple for the authorities to detect this practice.

Informal market by modality, millions of 9l-cases, 2013, 2015, 2017, and 2020



Informal market of modalities with direct impact on health, millions of 9l-cases



Conclusions and Recommendations

The search for low prices, and new sales channels due to the pandemic, encouraged informality, which reached its maximum peak since 2013

The economic crisis led consumers to prefer economic products

More than in previous years, during 2020 consumers looked for cheaper Alcoholic Beverages and, in some cases, replaced their favorite ones for more economic versions. In other cases, they bought their preferred beverages at a low price without questioning their origin.

Contraband, one of the main modalities, dropped as a result of the pandemic

The restrictions on the flow of people through the US- Mexican borders, together with the logistics crisis (e.g., shortage of containers), are factors that have affected the decrease of this modality, and that have also impacted the legal market.

There has been an increase in the modalities that affect consumers' health

Prepared Alcoholic Beverages sales through platforms with little supervision like social media, or tianguis, have risen, encouraging modalities like counterfeiting, which are harmful to consumer health and more difficult to distinguish since they are not sealed, or they are mixed with other ingredients.

New informal sales channels have been developed, and existing ones have seen a boost

Restrictions on the sale of Alcoholic Beverages through the formal channel forced producers and consumers to search for alternative channels to buy and sell, with an observed growth in transactions through internet, tianguis, and even, on the street.

Working together with the Government will be crucial to improve inspections and foster awareness among the population

Improving cooperation among Government agencies

Audits are a good tool to fight informal alcohol. However, there is an opportunity to include more controls in informal establishments, improve communication, and to define which authority (e.g., PROFECO, COFEPRIS, Police, SAT, etc.) has jurisdiction in different situations.

Updating tax policies

A tax reform that made formalization more accessible, easy, and fast would discourage the informal channels, considering the *ad quantum* tax, and could help to get small producers (who are in a gray area due to lack of resources) to become legal.

Teaching the population how to detect informal beverages, and foster awareness about the risks they pose to the body

Working together with the Government to design campaigns to foster awareness among the population with the aim of informing about the damages informal Alcoholic Beverages cause to their health, as well as, teaching them how to detect these drinks.

Working together with the Government, and the platforms to inspect online sales

Working hand in hand with the Government, *e-commerce*, and salespeople on social media to keep better track of the cases of Alcoholic Beverages sales without authorization, so that they are held accountable to the authorities.