



# THE ILLEGAL ALCOHOLIC BEVERAGES MARKET IN SIX LATIN AMERICAN COUNTRIES 2015

Colombia, Ecuador, El Salvador, Honduras, Panama and Peru

Report prepared by Euromonitor International  
for SABMiller

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## Introduction

# Project scope

### Types of illegal alcohol

Counterfeit & illegal brands

Contraband

Illegal artisanal alcohol

Surrogate

Tax leakage

### Country coverage

Colombia

Ecuador

El Salvador

Honduras

Panama

Peru

### Measures

Volume HL LAE

Value US\$ Mn

Fiscal loss US\$ Mn

### Project background

- Over the past four years, SABMiller and Euromonitor International have partnered to perform an in-depth market research with the objective of understanding the illegal alcoholic beverage market in six countries of Latin America.
- This research is based on findings at a national and regional level that will help design a strategic plan to increase government and consumer awareness.

### Client's objectives

- Estimate consumption of illegal alcoholic beverages in six countries in terms of value, volume and fiscal loss.
- Qualitative analysis to describe the production chain and sale of illegal alcoholic beverages in each country.
- Examine current trends in the consumption of illegal alcoholic beverages.
- Understand the drivers that spur consumption of illegal alcoholic beverages among consumers from the industry perspective.

### Euromonitor International's Solution

- Quantify the market of illegal alcoholic beverages with comparative definitions vs. other markets in the region.
- Learn the different forms of distribution of the value chain.
- Deliver conclusions at national and regional level which will help understand the issue in the six countries under study.

## Introduction

## Key definitions

## What is illegal alcohol?



**Illegal alcohol:** includes all the alcoholic beverages, distilled or fermented, that exist outside legal framework due to counterfeiting, contraband of finished product or raw material, illegal artisanal manufacturing, tax leakage at a local level, or surrogate alcohol that is shifted to the alcoholic beverage market.

## Metrics used in the alcohol market

- Volume HL LAE (legal and illegal)
- Value US\$ Mn (legal and illegal)
- Fiscal loss US\$ Mn (illegal)

## The 5 types of illegal alcohol



**Counterfeit/illegal brands:** illegal alcohol sold as legal brands (substitution), empty bottles of legal products refilled with cheaper alcohol (refill) or industrial manufacturing of illegal brands or illegal unbranded alcohol.



**Contraband of raw material or finished product:** illegal imports of ethanol as raw material and illegal imports of alcoholic beverages as finished product.



**Illegal artisanal alcohol:** Illegal artisanal alcoholic beverages manufactured for commercial purposes.



**Surrogate alcohol:** Alcohol not intended for human consumption, such as pharmaceutical alcohol, mouthwash and perfumes/colognes



**Tax leakage:** Legal alcoholic beverages manufactured at local level for which consumption taxes are not paid.

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## Illegal Market Volume 2015 - Region



812,577<sub>HL LAE</sub> | 23%

Market size in volume,  
Share out of total market

US\$2,064<sub>Mn</sub> | 14%

Market size in value,  
Share out of total market

US\$631<sub>Mn</sub>

Fiscal loss



## Which are the main findings for the illegal market in 2015?



### Colombia

- The annual **illegal alcoholic beverage market decreased 6%**, due to a reduction in contraband volume.
- Nonetheless, it **remains the largest one in terms of volume**.
- **Contraband decreased 24%** as a result of the enforcement of the Anti-Contraband Law, the closing of the border with Venezuela, and a higher number of arrests and seizures.
- **Counterfeit alcohol is still the most common type of illegal alcohol**. In the past year, it grew at a rate of 6%.
- According to official figures, spirits taxes dropped more than 40%. It is estimated that **tax leakage from legal manufacturers increased 11%**.



### Ecuador

- The strong economic crisis generated a contraction in the economic activity of the country, reducing the consumption of alcoholic beverages (legal and illegal). **Consumption of legal drinks dropped by 20%, while the illegal market fell 9%**.
- The **illegal supply**, especially of beverages above 35 degrees LAE, **increased its market share**. Proof of this situation is found in the higher consumption of counterfeit alcoholic beverages.
- The sales of **illegal artisanal alcohol continues to encourage the manufacturing of illegal beverages**. This alcohol is used for manufacturing artisanal beverages or for refills on a larger scale.

## Which are the main findings for the illegal market in 2015?



### El Salvador

- **In 2015, the illegal alcohol market grew 2%.** Consumption grew in terms of volume, **but held a smaller share of the total market (22%).**
- **Actions enforced by the authorities were insufficient** to reduce the consumption of illegal alcohol, but they are on the right track to reduce the consumption of surrogate.
- The **difference between taxes applied to potable alcohol** used for alcoholic beverages and to alcohol used for other purposes **encourages the illegal alcohol trade.**
- **Counterfeit and surrogate alcohol remain the main forms of illegality.** Both categories together represent 87% of the total volume of illegal alcohol. However, **surrogate has lost market share, decreasing 8% in 2015.**



### Honduras

- Honduras has the **illegal alcohol market which experienced the highest growth rate in the last year** (31% compared to an average decrease of 5% at the aggregate level).
- The **illegal alcohol market is growing more rapidly than the legal market**, at 31% vs. 18%, respectively.
- **Contraband of ethanol increased 39%** and is still the category that most contributes to the illegal alcohol trade.
- The **alcoholic beverages industry shows no tax leakage from local production.** The rigid tax policy currently in force continues to show its achievements. By reporting tax collection details via the media, greater transparency and control is achieved.



## Which are the main findings for the illegal market in 2015?



Panama

- Panama is still the smallest illegal alcohol market in the region.
- The illegal market decreased 10% in the past year, but maintains its 2% market share.
- Stolen brands of legal alcoholic beverages are marketed at lower prices which encourages consumers to buy them because of their attractive price.
- Areas in the vicinity of **Colón Province, and the Provinces of Veraguas, Herrera and Coclé concentrate the highest levels of consumption** of contraband and illegal artisanal alcohol.



Peru

- The consumption of illegal alcohol continues to show a negative trend.
- Consumption of illegal alcohol shrank 3%, reaching a 27% share of the total market.
- Registration of ethanol users and their purchases and sales statements makes it difficult to sell ethanol illegally. However, the lack of effective control and oversight still leaves leeway for illegal supplying.
- Contraband of ethanol from Bolivia remains a strong source of supply for the illegal market, whereas the contraband of ethanol towards Ecuador has dropped.
- PRODUCE's *Mesa de Trabajo Multisectorial de lucha contra bebidas alcohólicas ilegales* (Multisectoral Work Group in the fight against illegal alcoholic beverages) launched a coordination initiative that **will hopefully bear fruit from 2016 onwards**.

## Which are the main factors that affected the illegal market in 2015?

### These factors facilitated consumption:

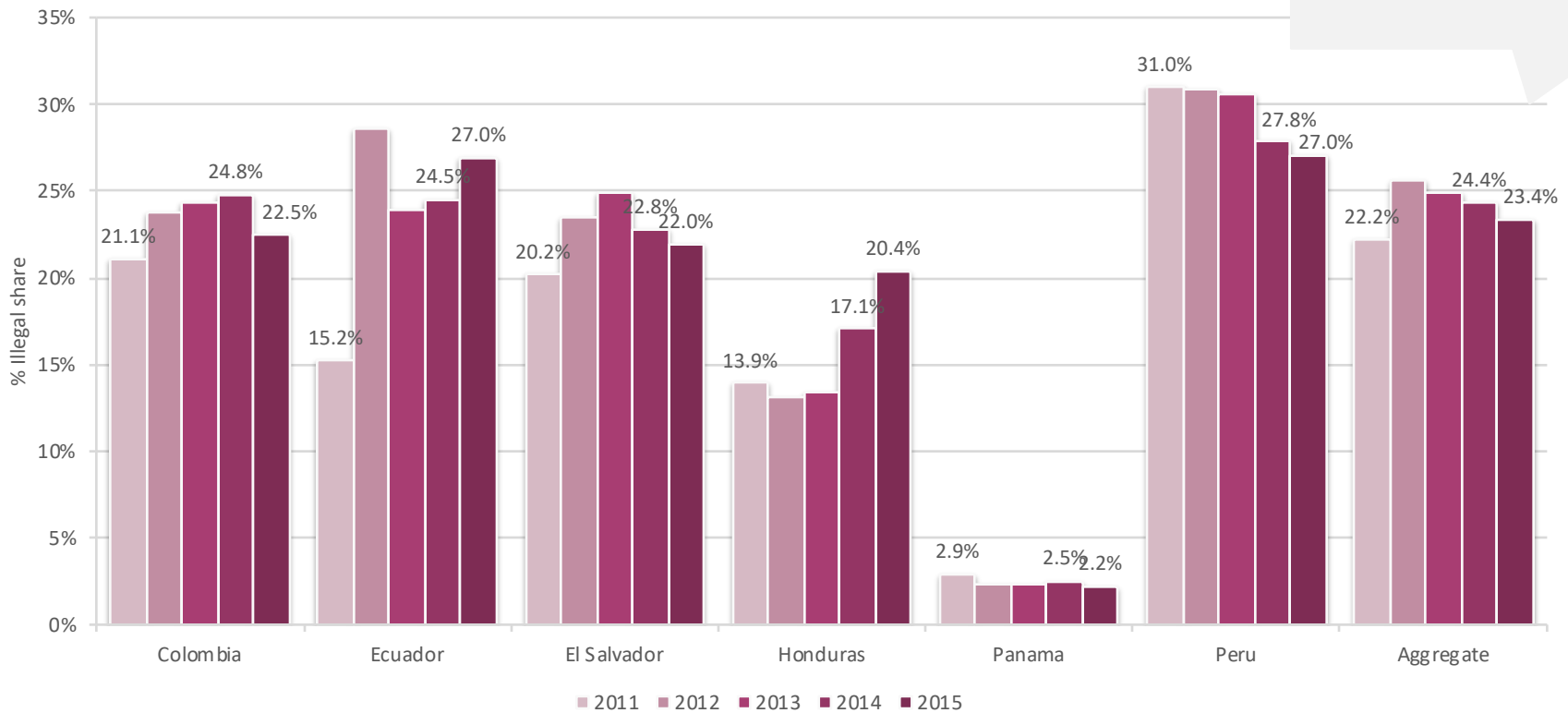
- **Regulation and control of ethanol are still insufficient:** Ethanol continues to be used as raw material for counterfeit products, as it is not required to be denatured.
- **Weak law enforcement and mild penalties:** This includes corruption in Customs, lack of control over sanitary licenses, and lax penalties for offenses related to illegal trade.
- **Greater availability of illegal beverages in new channels:** Sold through free classified ads online (used as a mean of promotion only since transactions take place in person), and independent stores located in neighborhoods outside popular areas in the past.
- **Reduced purchasing power drives demand for low-priced products:** Preference for cheap products regardless of origin or potential health risks.

### These factors weakened consumption:

- **Increased involvement of the authorities:** The number of seizures and apprehensions of illegal product increased, as well as the inspections taking place at points of sale.
- **Improvements in the regulation of ethanol:** Requirement to register the purchase and sale of ethanol, as well as the implementation of import quotas, has halted illegal trade.
- **Increased awareness of authorities and consumers:** Communication strategies about the illegal alcohol issue and its economic impact have increased awareness of this subject.
- **New regulations for contraband:** These include the application of the Anti-Contraband Law in Colombia, and the implementation of fiscal stamps for imported product in Ecuador.
- **Interinstitutional collaboration:** In Peru, the installation of the *Mesa de Trabajo Multisectorial* is expected to have a positive impact in 2016.

# 1 out of every 4 bottles of alcohol is illegal; over the years, this figure has been on a slow downturn

Evolution of the market share of illegal alcoholic beverages, 2011 – 2015 (HL LAE)










The aggregate share of illegal alcohol fell 1 percentage point in 2015

Given that historical variations in certain countries are deemed to be marginal, under the concept of margin *de Minimis* of (+/- 2%), Euromonitor International considers that Colombia, Ecuador, and Honduras are the only markets that experienced relevant changes in 2015.



## In absolute terms, Colombia is still the biggest market and Peru has shown a downward trend in the past few years

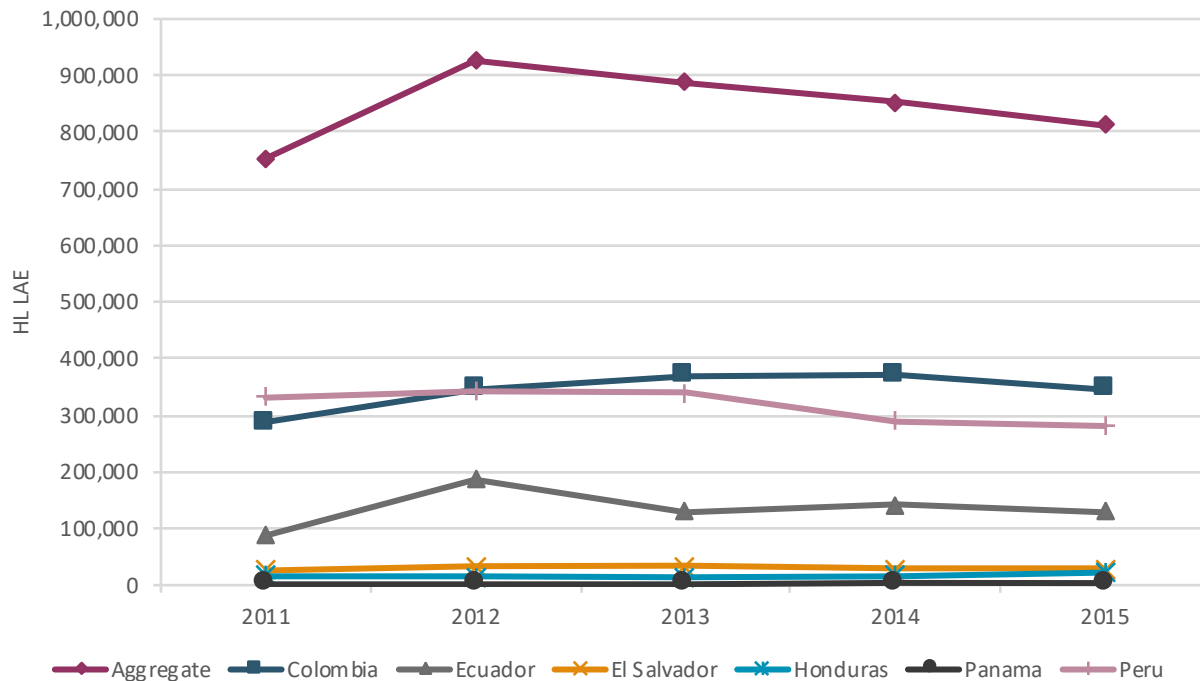
Illegal market HL LAE	2011	2012	2013	2014	2015	Variation 2014-2015
Colombia	288,072	346,181	370,253	371,527	347,601	 -6.4%
Ecuador	87,639	186,326	129,939	142,011	129,540	 -8.8%
El Salvador	25,867	33,478	32,238	28,006	28,432	 1.5%
Honduras	16,407	14,287	13,930	16,981	22,262	 31.1%
Panama	3,787	3,719	3,719	4,048	3,659	 -9.6%
Peru	331,931	342,381	338,752	290,043	281,082	 -3.1%
<b>Aggregate</b>	<b>753,703</b>	<b>926,371</b>	<b>888,831</b>	<b>852,616</b>	<b>812,577</b>	 -4.7%

\*Figures for 2013 in Panama were modeled. Figures for 2011 exclude the tax leakage category.

# Peru and Panama are the two markets that decreased in 2011 - 2015

In aggregate, the illegal market has grown 7.8% in the past 5 years, as a consequence of higher consumption levels, especially in Colombia and Ecuador.

Evolution of the illegal alcoholic beverage market, 2011 – 2015 (HL LAE)

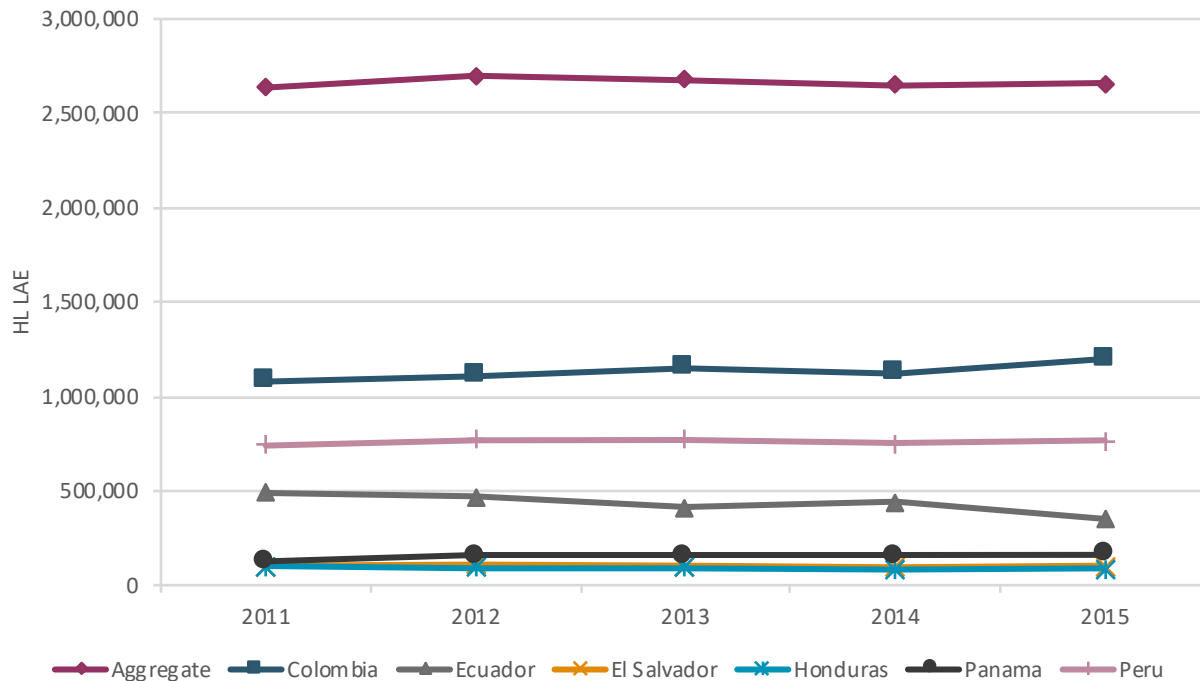


Illegal market HL LAE	Variation 2011-2015
Colombia	↑ 20.7%
Ecuador	↑ 47.8%
El Salvador	↑ 9.9%
Honduras	↑ 35.7%
Panama	↓ -3.4%
Peru	↓ -15.3%
<b>Aggregate</b>	<b>↑ 7.8%</b>

# In the past 5 years, consumption of legal alcoholic beverages has maintained an almost constant level in the region








In aggregate, the legal market has maintained an almost constant level, growing 0.9% between 2011 and 2015. However, Panama and Colombia underwent growth levels above 10%, whereas Ecuador and Honduras decreased.

Evolution of the legal alcoholic beverage market, 2011 – 2015 (HL LAE)



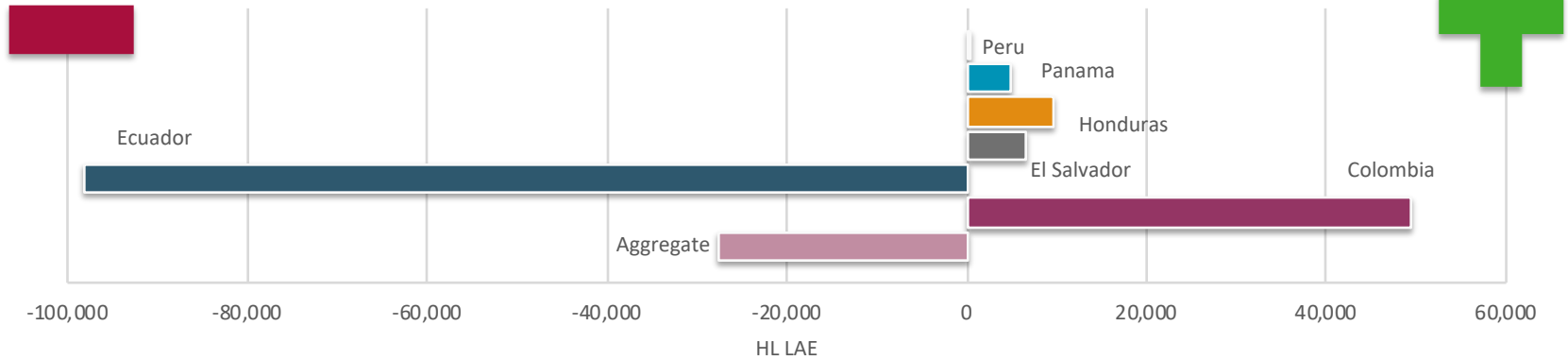
Legal market HL LAE	Variation 2011-2015
Colombia	↑ 11.1%
Ecuador	↓ -28.1%
El Salvador	↓ -1.2%
Honduras	↓ -14.2%
Panama	↑ 27.4%
Peru	↑ 2.9%
<b>Aggregate</b>	<b>↑ 0.9%</b>

## In the past year, consumption decreased only in Ecuador due to a strong economic crisis

Legal market HL LAE	2011	2012	2013	2014	2015	Variation 2014– 2015
Colombia	1,078,647	1,109,741	1,154,884	1,125,420	1,198,691	 6.5%
Ecuador	488,559	464,470	413,690	436,695	351,090	 -19.6%
El Salvador	102,250	109,231	97,353	94,956	101,065	 6.4%
Honduras	101,424	95,089	89,557	82,584	86,981	 5.3%
Panama	126,085	153,080	153,079	155,346	160,647	 3.4%
Peru	739,481	767,678	769,309	752,270	761,285	 1.2%
<b>Aggregate</b>	<b>2,636,447</b>	<b>2,699,289</b>	<b>2,677,872</b>	<b>2,647,270</b>	<b>2,659,759</b>	 0.5%

# In aggregate, illegal consumption dropped in a greater proportion vs. legal consumption

Variation of the total market by country, 2014 - 2015 (HL LAE)



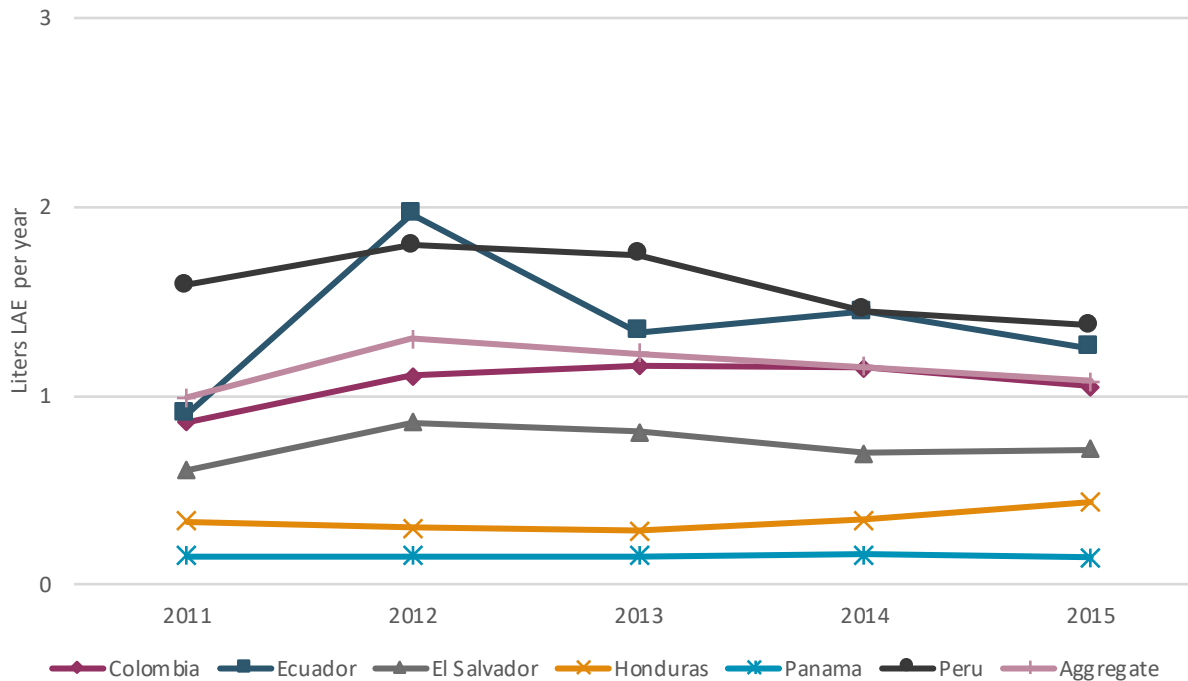
Variation 2014 - 2015 HL LAE	Legal market	Illegal market	Total market
Colombia	73,271	-23,927	49,345
Ecuador	-85,605	-12,471	-98,076
El Salvador	6,109	426	6,535
Honduras	4,398	5,281	9,679
Panama	5,301	-388	4,913
Peru	9,015	-8,960	54
<b>Aggregate</b>	<b>12,489</b>	<b>-40,039</b>	<b>-27,550</b>



# In aggregate, per capita consumption of illegal alcoholic beverages reached 1.1 liters per year in 2015

During the review period of 2011 – 2015, per capita consumption increased 8.6% at an aggregate level. However, in Peru, per capita consumption decreased 13.2% as a result of the actions undertaken by both the industry and government authorities to combat this issue. Ecuador and Honduras experienced increases above 30%.

Evolution of per capita consumption of illegal alcoholic beverages, 2011 – 2015 (Liters LAE)

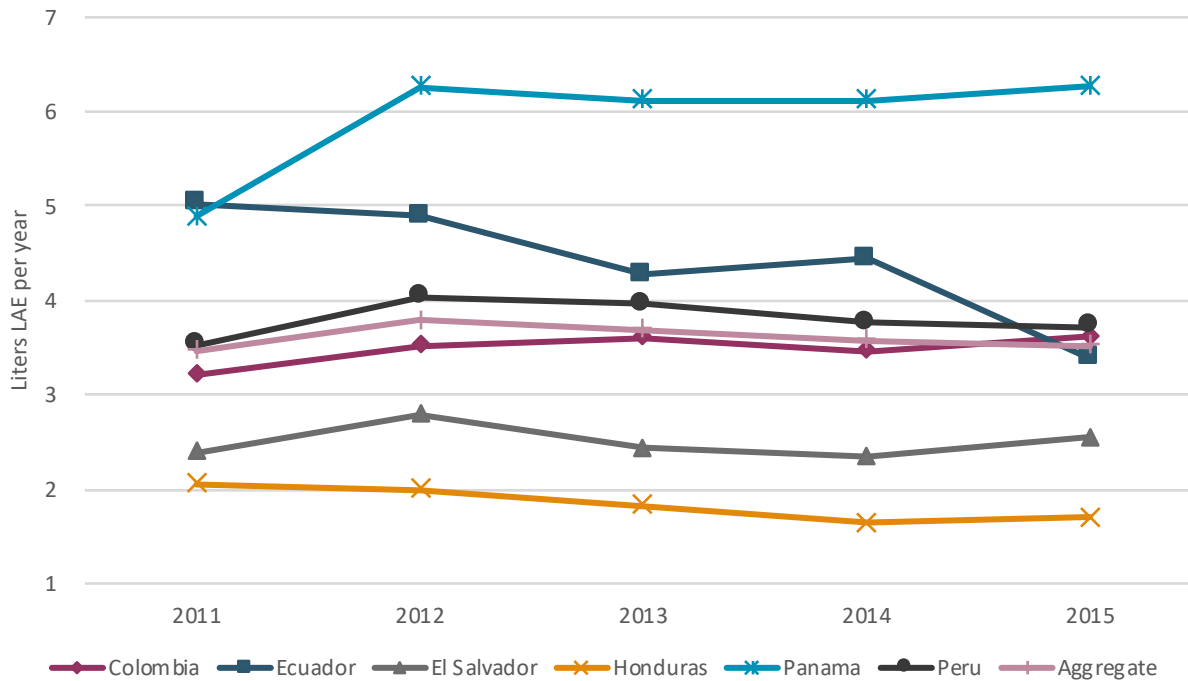


Legal market	Variation 2011-2015
Colombia	↑ 22.4%
Ecuador	↑ 38.7%
El Salvador	↑ 18.7%
Honduras	↑ 31.2%
Panama	↓ -2.8%
Peru	↓ -13.2%
<b>Aggregate</b>	<b>↑ 8.6%</b>

# At an aggregate level, per capita consumption of legal alcoholic beverages amounts to 3.5 liters per year in 2015

During 2011 – 2015, consumption grew 1.6%. However, Ecuador is the country where consumption was most affected, as a result of changes in the structure of taxes for imported alcoholic beverages, higher prices and the economic crisis.

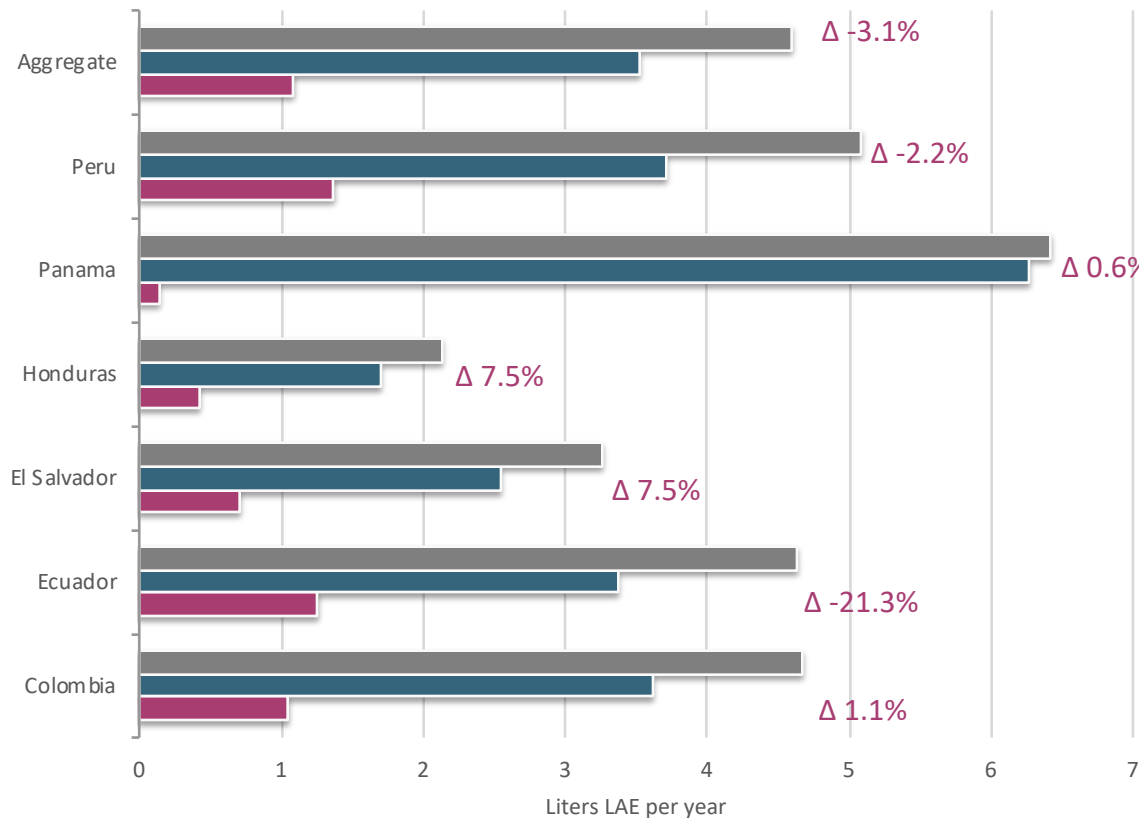
Evolution of per capita consumption of legal alcoholic beverages, 2011 – 2015 (Liters LAE)



Legal market	Variation 2011-2015
Colombia	↑ 12.7%
Ecuador	↓ -32.6%
El Salvador	↑ 6.7%
Honduras	↓ -17.1%
Panama	↑ 28.2%
Peru	↑ 5.5%
<b>Aggregate</b>	<b>↑ 1.6%</b>

## In aggregate, per capita consumption in the total market decreased 3.1% in 2015

Per capita consumption, 2014 – 2015 (Liters LAE)



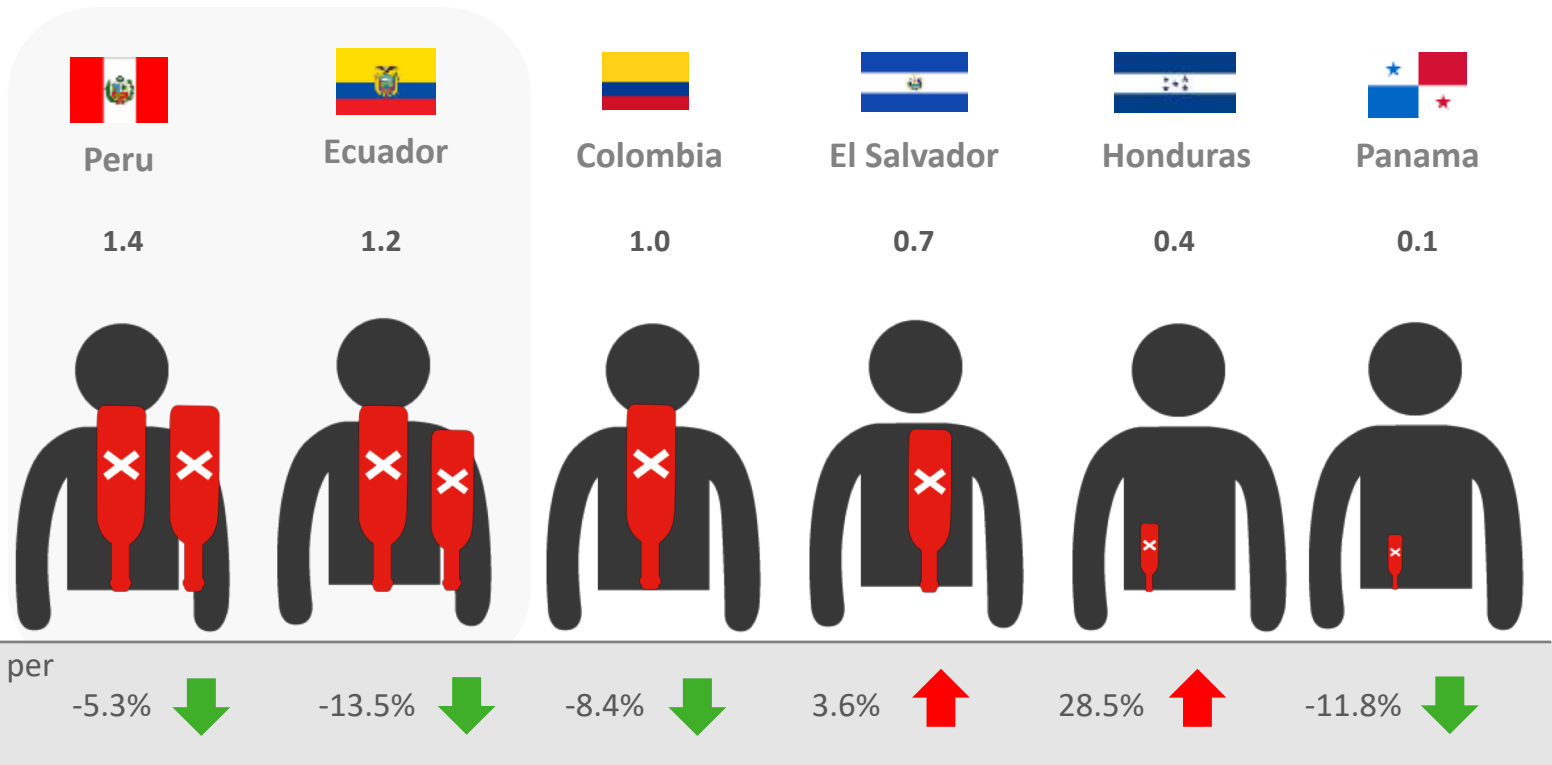
■ Total per capita consumption ■ Legal per capita consumption ■ Illegal per capita consumption  
 ▲ = Variation total per capita consumption 2014 - 2015

- In aggregate, per capita consumption of the total market dropped 3.1% in 2015, to **4.6 liters LAE**. This is due to reduced consumption in both markets, legal and illegal.
- **Ecuador is the country with biggest drop** in per capita consumption at a legal and illegal level (-23.8%, -13.5% respectively).
- **Honduras is the country with biggest growth** in total per capita consumption, due to the increase in consumption at illegal (28.5%) and legal (3.2%) levels.
- **Panama still shows the highest levels of per capita consumption of legal beverages** in the region (6.3 liters LAE).

# The ample availability of illegal alcohol in Ecuador and Peru is reflected in high per capita consumption

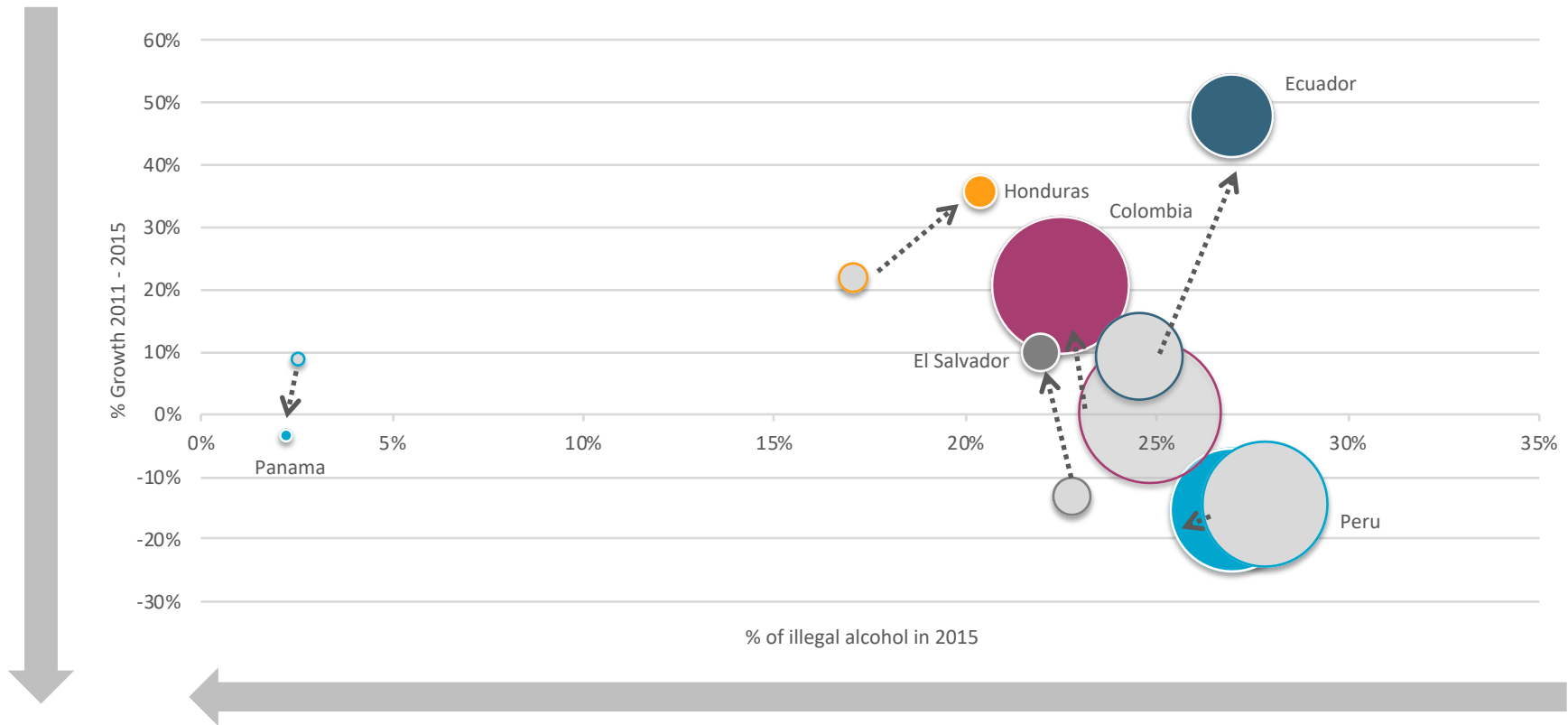
Annual per capita consumption of illegal alcohol, 2015 (liters LAE)

Estimate based on population 15-65 years old



In the past 5 years, Honduras is the country with the highest share in the illegal market, and Ecuador is largest in terms of size

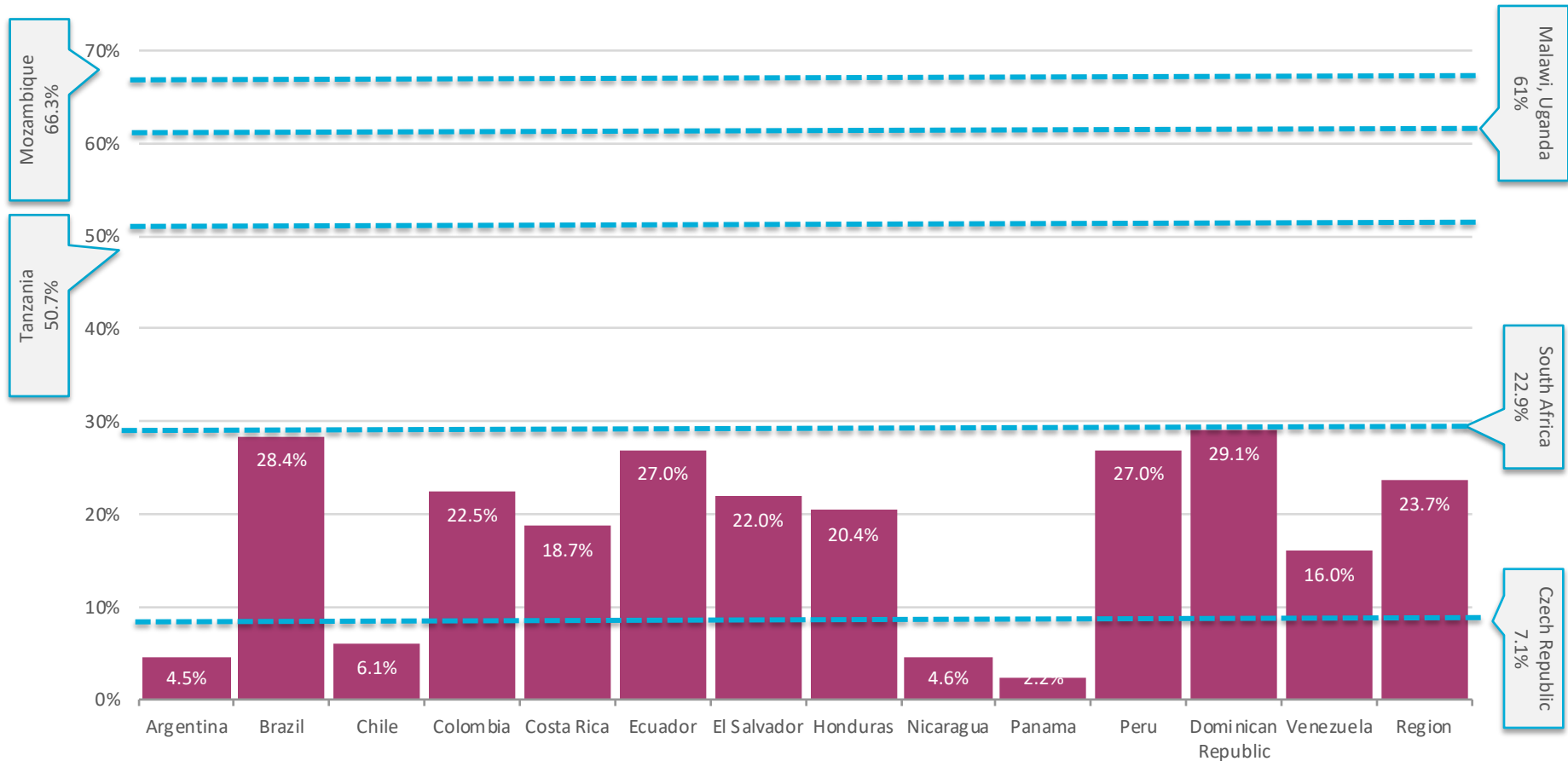
Illegal alcohol market, 2015 (HL LAE)



\*The size of the bubble represents the size of the illegal market in 2015 (HL LAE). The light grey bubbles represent the size of the market in 2014.

# At a regional level, consumption of illegal alcohol is below the rates in African countries

Share of the illegal alcohol market, 2015 (HL LAE)



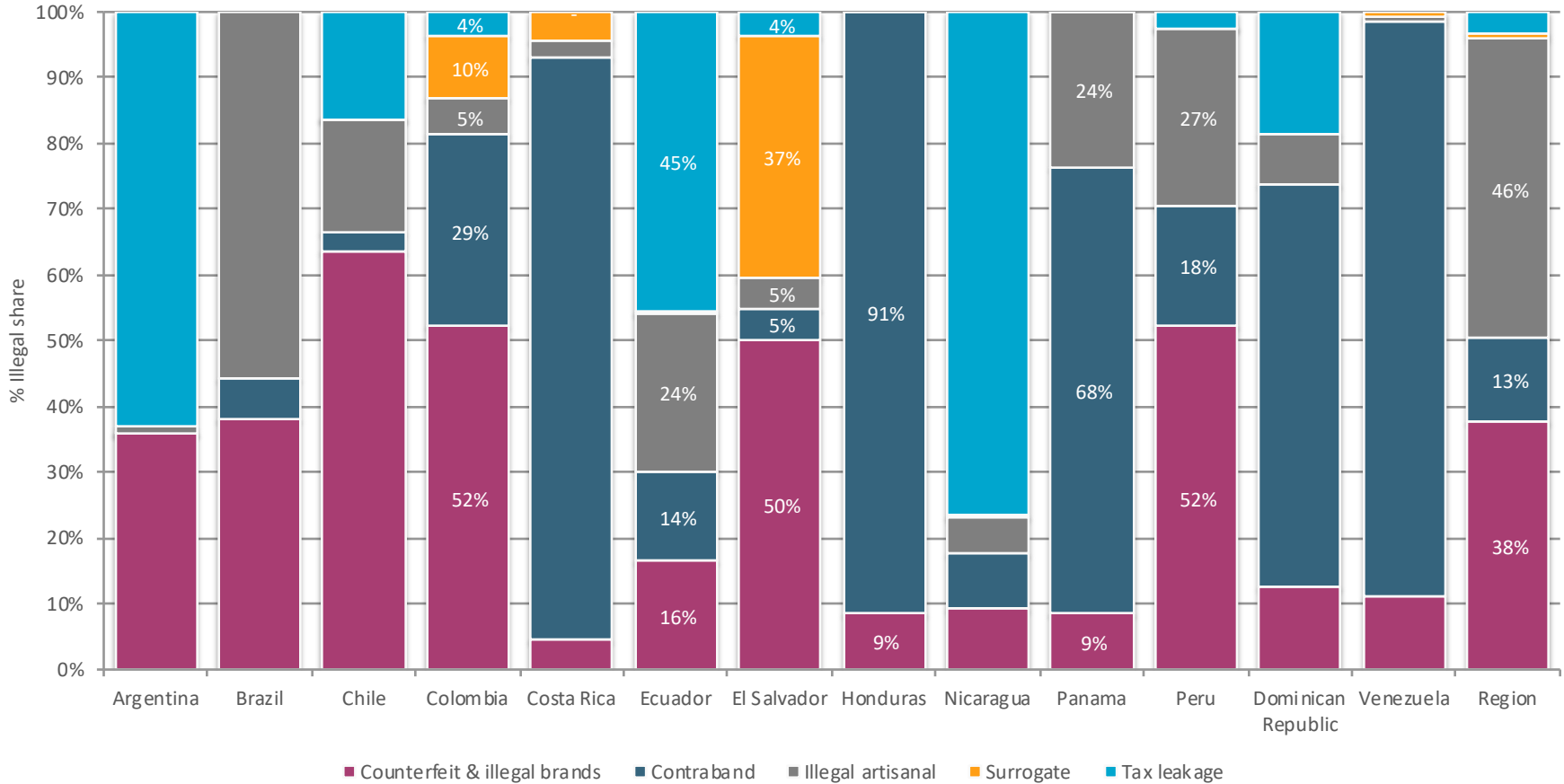
\*Figures for Brazil do not include tax leakage

Brazil, Venezuela = 2011. Nicaragua, South Africa = 2012. Argentina, Chile = 2013. Czech Republic, Mozambique = 2014. Other countries = 2015.

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# In the region, the risk is mostly sanitary, as it represents 83% of the market

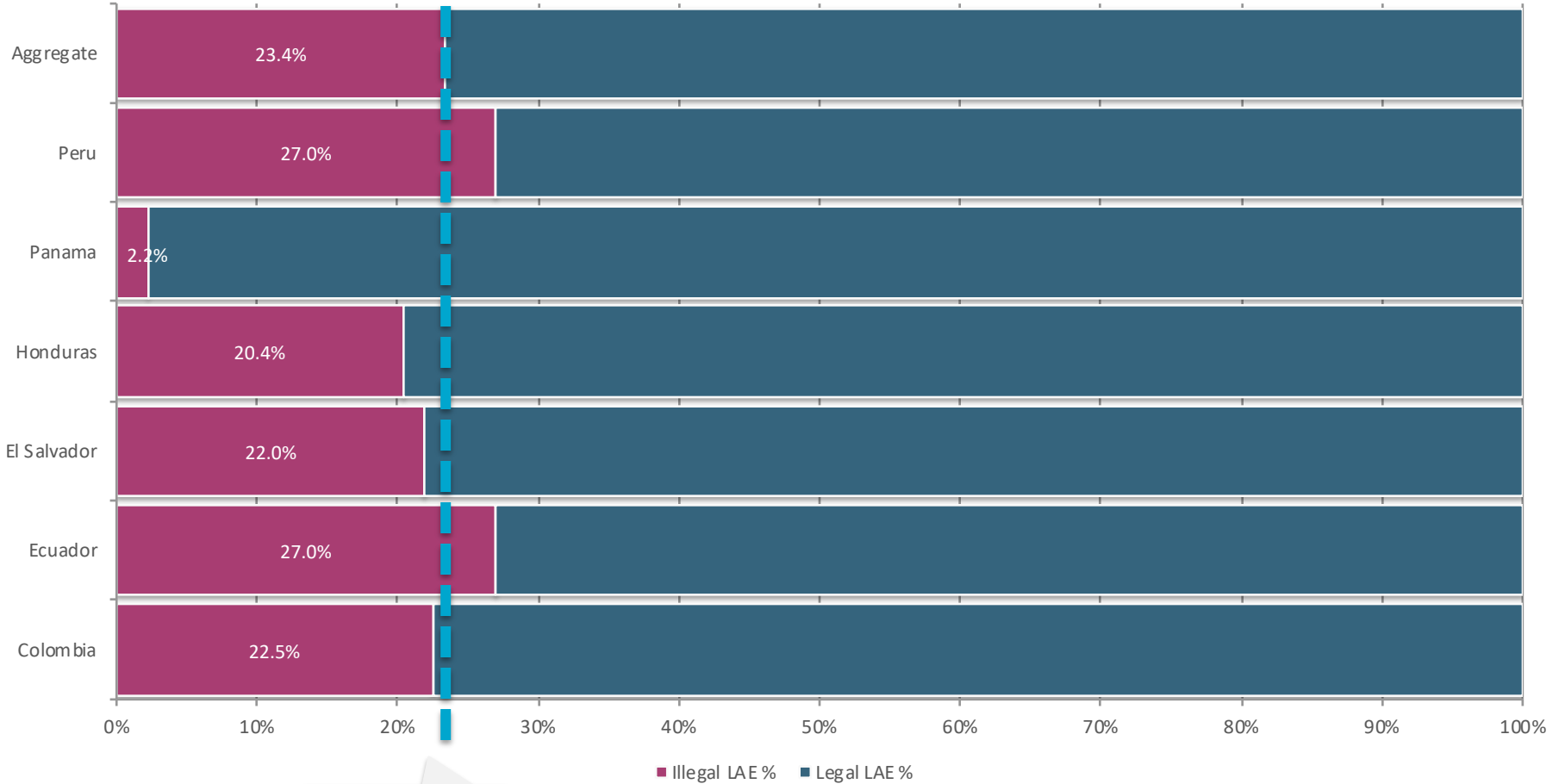
Share of the illegal alcohol market by category, 2015 (HL LAE)



Note: Within sanitary risk is included = counterfeit, artisanal and surrogate alcohol. Within fiscal risk is included = contraband and tax leakage.

# Peru and Ecuador remain above the aggregate's average of illegality

Share of the illegal alcohol market, 2015 (HL LAE)



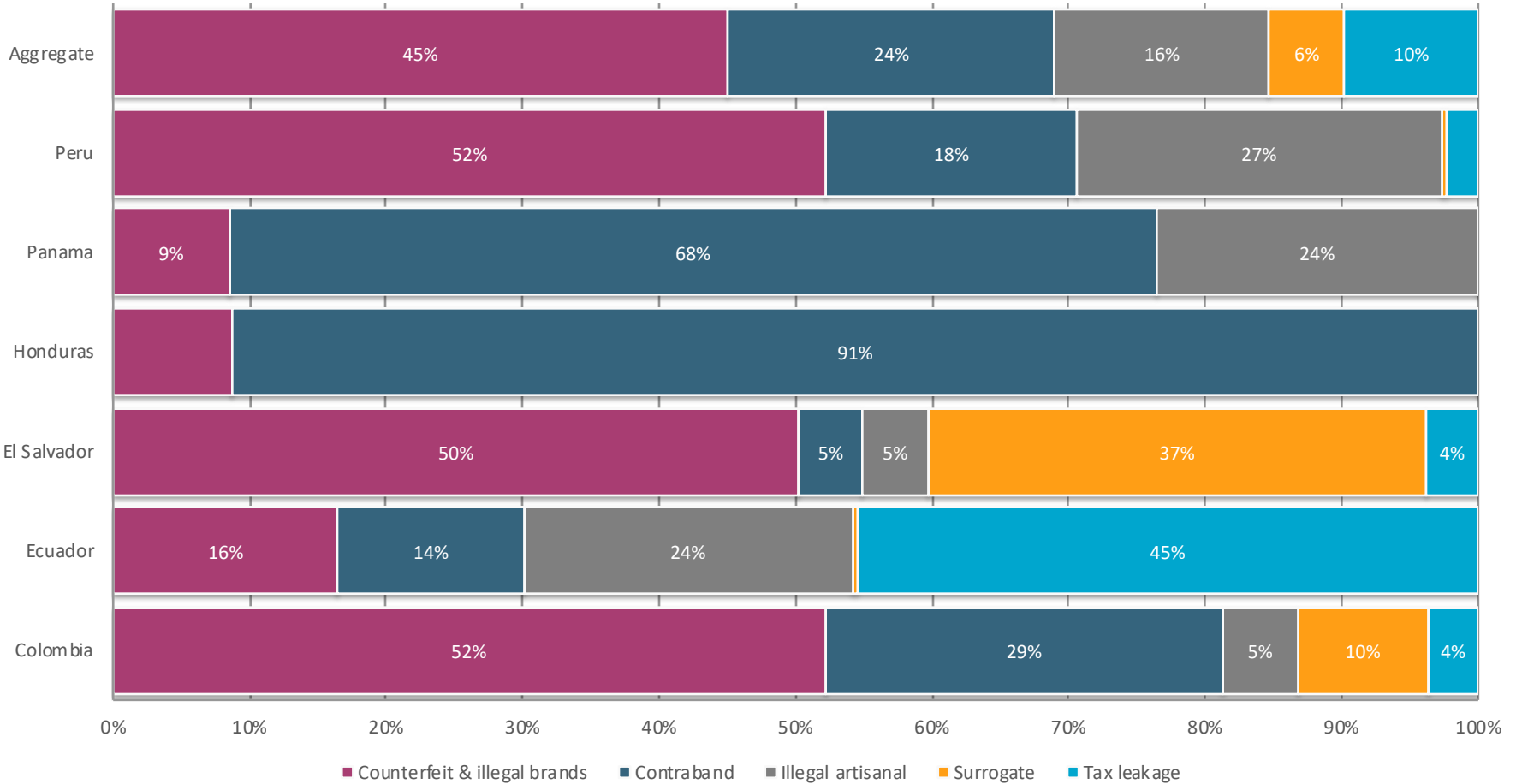
Average Aggregate





# In aggregate, sanitary risk has gained ground, reaching a 67/33 proportion vs. fiscal risk

Share of the illegal alcohol market by category, 2015 (HL LAE)

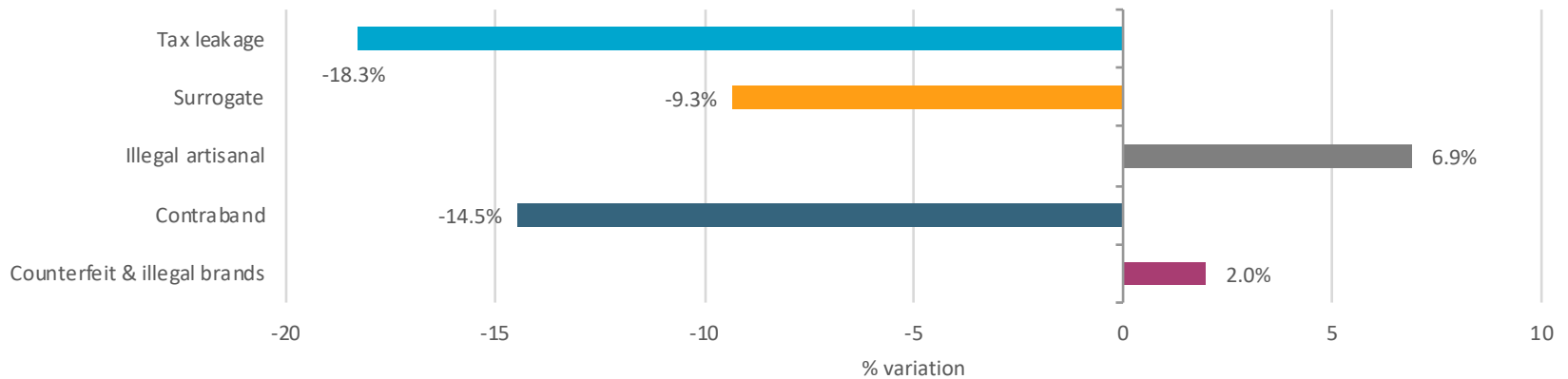


Note: In sanitary risk is included = counterfeit, artisanal and surrogate alcohol. Within fiscal risk is included = contraband and tax leakage.



# In aggregate, counterfeit and illegal artisanal alcohol gain higher market share, which translates into a higher sanitary risk

Variation by category at aggregate level, 2014 – 2015 (HL LAE)



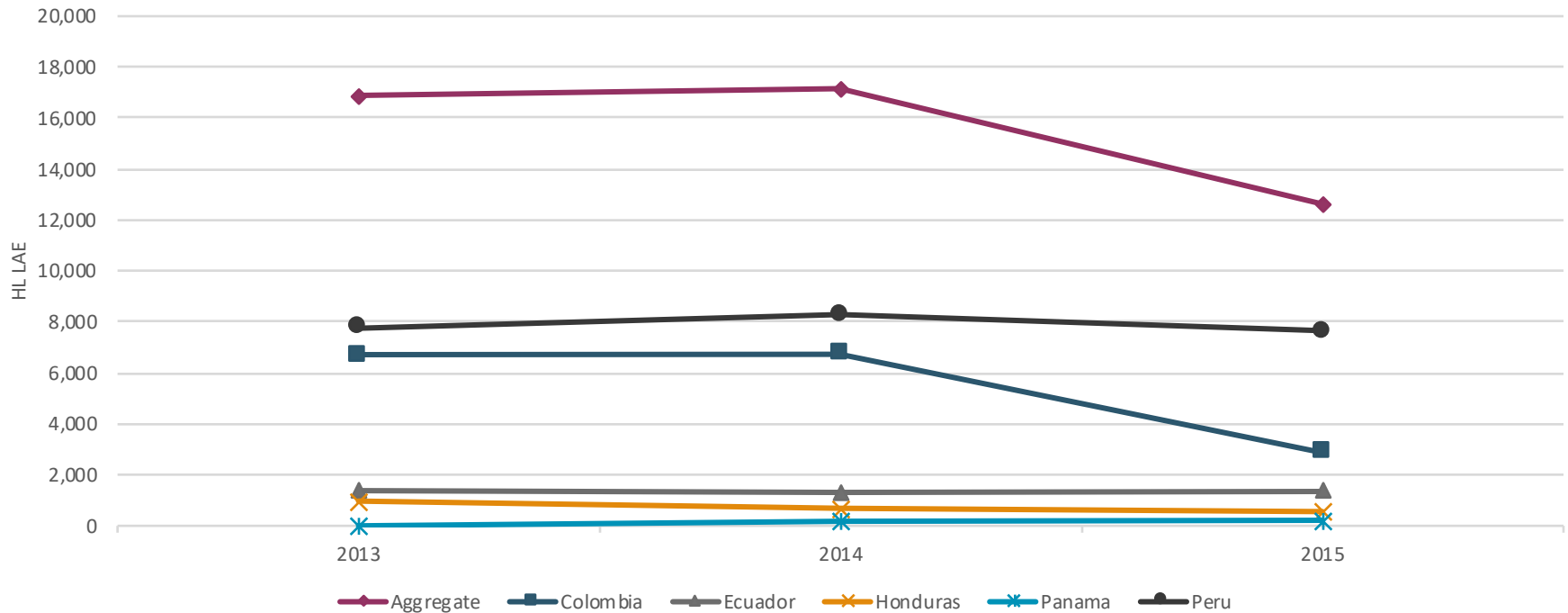
	Counterfeit alcohol	Contraband	Illegal artisanal alcohol	Surrogate alcohol	Tax leakage
Colombia	6.2%	-24.2%	-0.7%	-8.8%	10.8%
Ecuador	10.8%	2.9%	16.3%	-5.0%	-24.8%
El Salvador	4.4%	3.0%	8.2%	-8.3%	139.4%
Honduras	16.1%	32.8%	-20.0%	0.0%	0.0%
Panama	0.0%	15.4%	-3.4%	1.0%	-100.0%
Peru	-4.2%	-11.0%	5.5%	-35.5%	7.5%
Aggregate	<b>2.0%</b>	-14.5%	<b>6.9%</b>	-9.3%	-18.3%



# In aggregate, consumption of illegal beer decreased 26% in the past year

Consumption of illegal beer shows a downward trend; being an affordable alcoholic beverage, many consumers can afford to buy legal brands. In the past three years, illegal consumption has decreased 25%.

Illegal beer market, 2013 - 2015 (HL LAE)



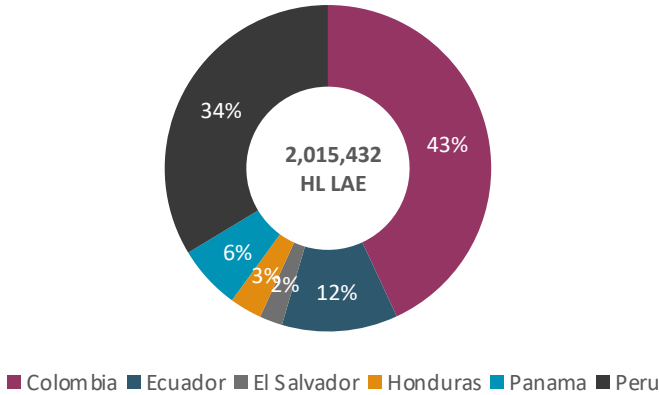
Note: No illegal beer found in El Salvador



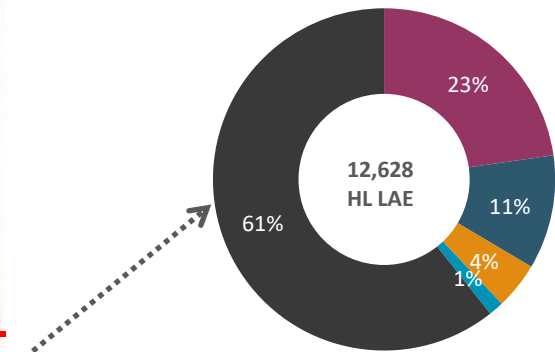
# Illegal beer loses market share; however, counterfeit beer gains ground



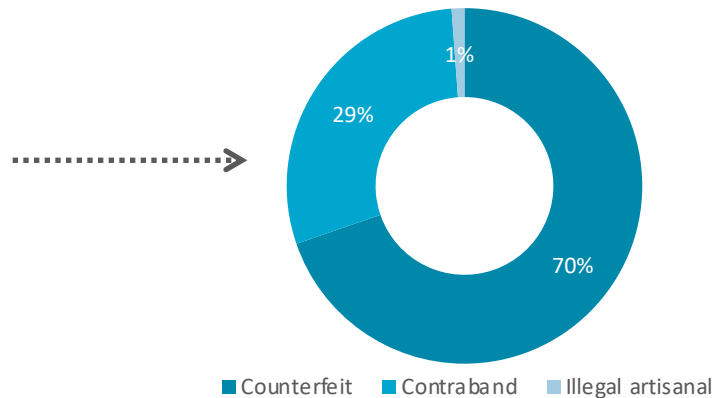
Legal beer market, 2015 (HL LAE)



Illegal beer market, 2015 (HL LAE)



Categories of illegal beer, 2015 (HL LAE)

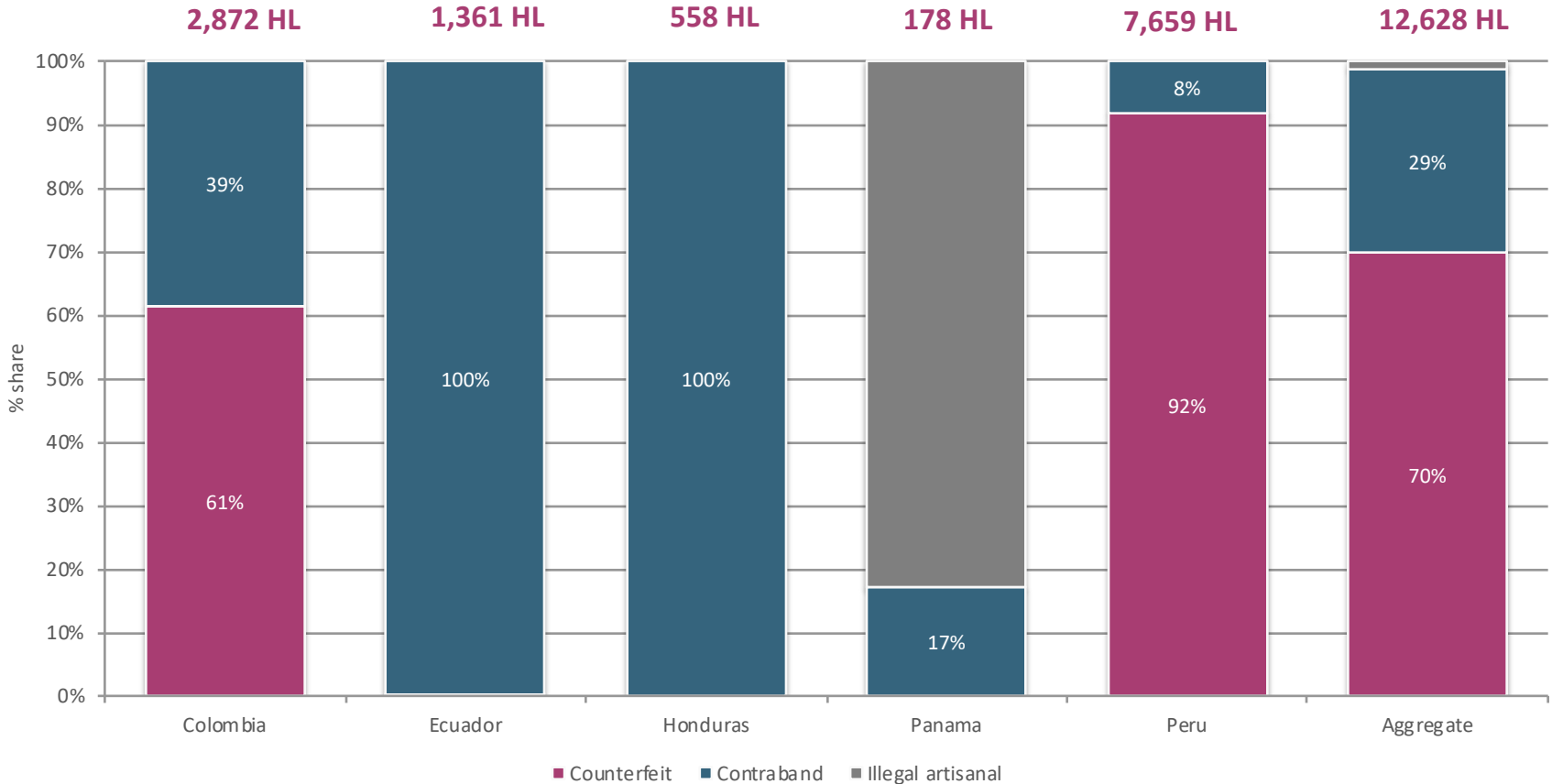


- **Colombia and Peru** remain the countries where beer consumption reaches the highest volume, in legal as well as illegal beer.
- In **Colombia**, however, **illegal beer holds a smaller share of the illegal alcohol market than Peru** (0.8% vs. 2.7%).
- As regards categories, **counterfeit beer is still the most common type**, but there is a growing volume of illegal artisanal beer.



# In aggregate, counterfeit is the most common type of beer; a small volume of illegal artisanal beer was found in Panama

Illegal beer market, 2015 (volume LAE)



Note: No illegal beer found in El Salvador



## Illegal Market Value 2015 - Region



812,577<sup>HL LAE</sup> | 23%

Market size in volume,  
Share out of total market

US\$2,064<sup>Mn</sup> | 14%

Market size in value,  
Share out of total market

US\$631<sup>Mn</sup>

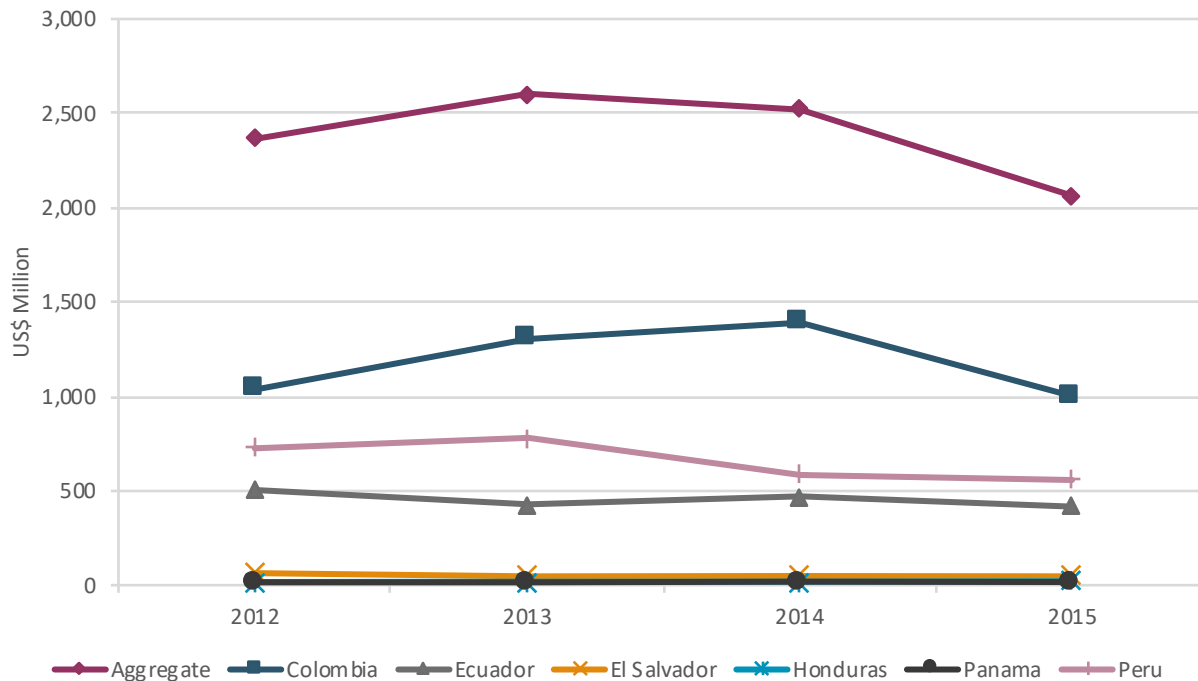
Fiscal loss



## In aggregate, the illegal market also decreased in terms of value

At an aggregate level, the illegal market decreased -12.8% in the past four years, as a result of a reduction in the sales prices of illegal alcoholic beverages. The performance in Honduras and Panama, however, was quite the opposite.

Evolution of the illegal alcoholic beverage market, 2011 – 2015 (US\$ million)

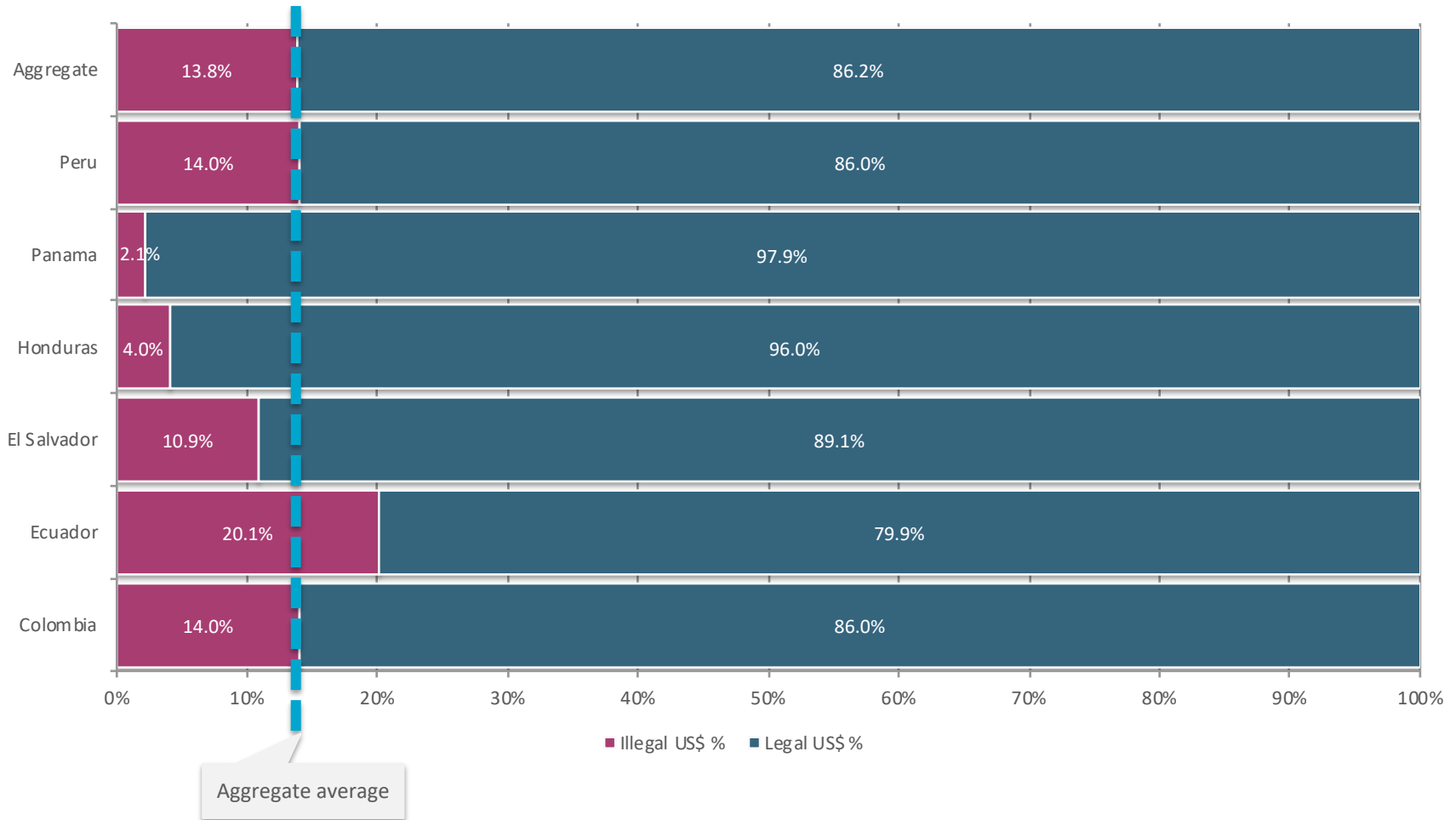


Illegal market US\$ million	Variation 2012-2015
Colombia	↓ -3.8%
Ecuador	↓ -17.5%
El Salvador	↓ -20.1%
Honduras	↑ 23.7%
Panama	↑ 10.4%
Peru	↓ -23.3%
<b>Aggregate</b>	<b>↓ -12.8%</b>

Note: The exchange rate of local currency vs. the US\$ may also influence results in the historical analysis.

# Ecuador is still the country with highest share of the illegal market in terms of value; Peru and Colombia also remain above average

Share in the illegal alcohol market, 2015 (US\$)



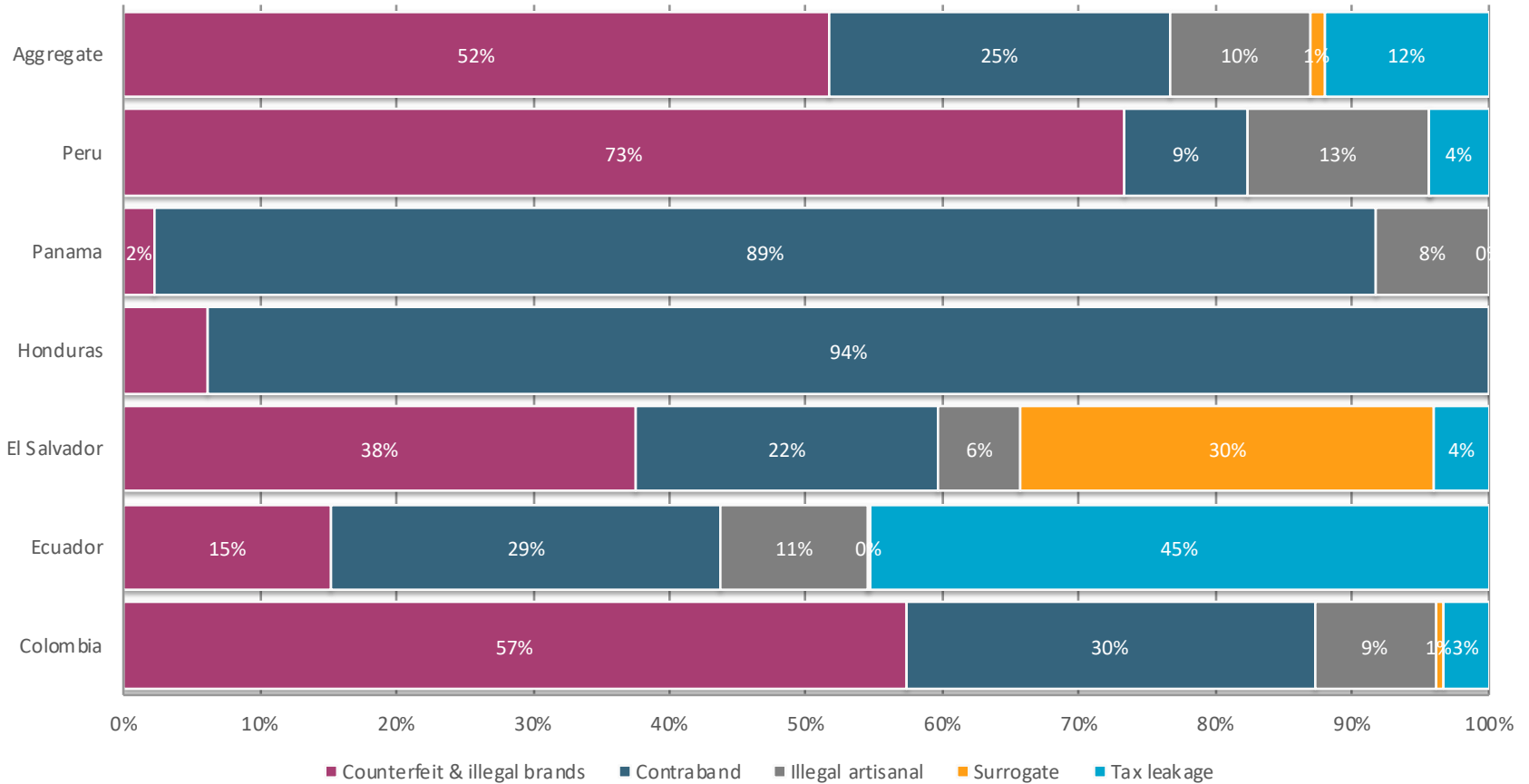
Nota: Value estimated on the basis of illegal end consumer prices





# In aggregate, the biggest loss for the legal industry is generated by the sale of counterfeit alcohol

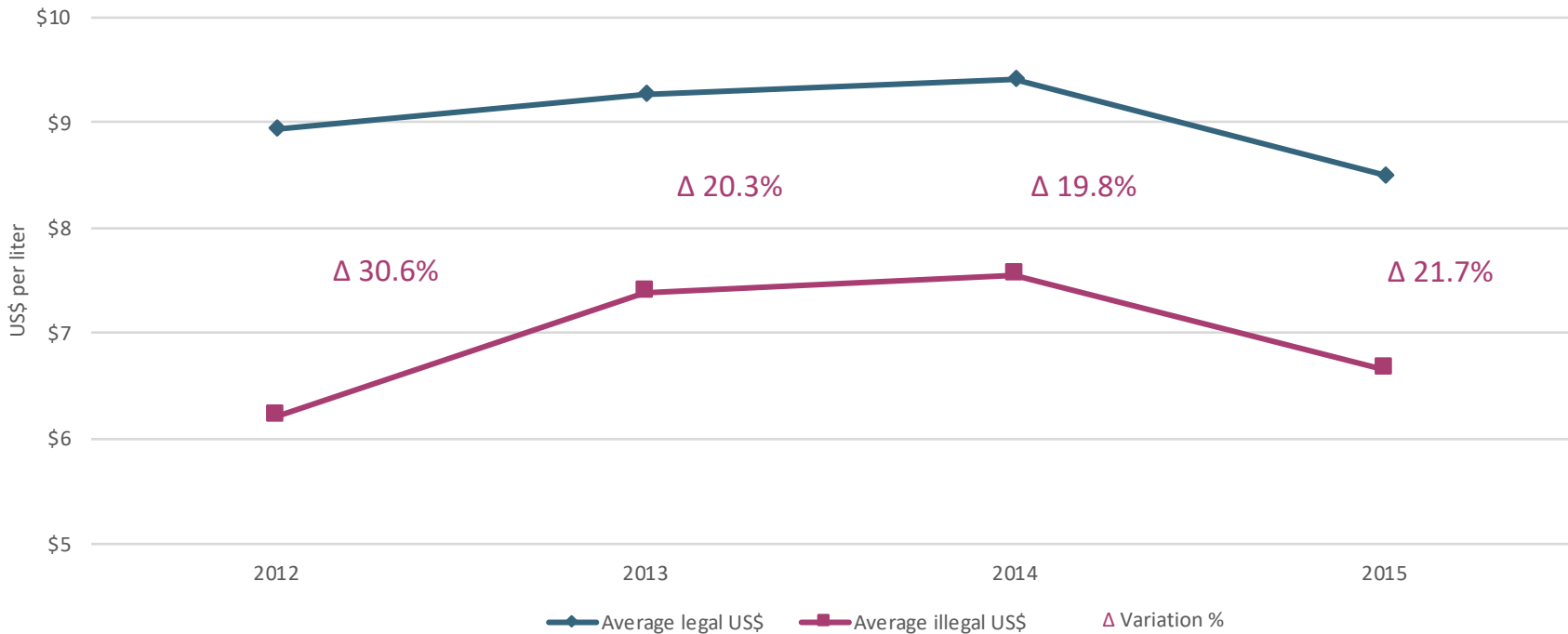
Illegal share by category of alcohol, 2015 (US\$)



# In the past 4 years, the difference between legal and illegal prices has gradually narrowed

The biggest reductions were felt in Colombia, where the difference in prices went from 23% in 2012 to 12% in 2015. In the case of Peru, the difference went from 31% to 22% from 2012 to 2015. However, at the aggregate level in 2015, the difference grew by 1.9 percentage points.

Average consumer prices, 2012 - 2015 (US\$ per liter)



Note: The exchange rate of local currency vs. the US\$ may also influence results in the historical analysis



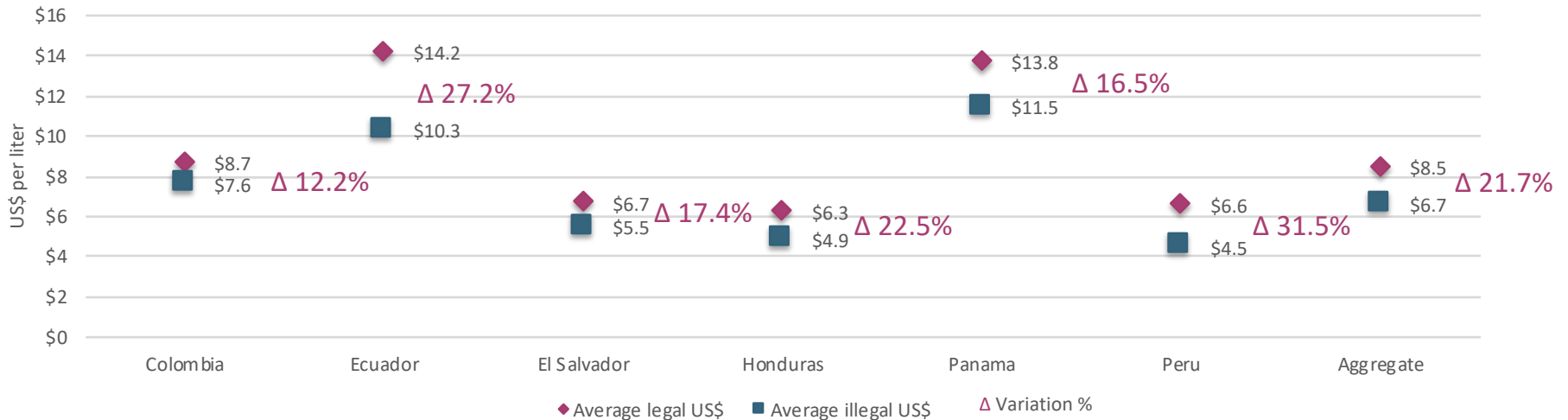
# Colombia presents the narrowest price gap compared to the rest of the countries

Price is among the main drivers behind the purchase of illegal alcohol in the region.  
 From a consumer perspective, Ecuador shows the most appealing price gap, followed by Honduras.  
 However, given the restrictions on the sale of legal alcoholic beverages in Ecuador, in addition to the country's shaky financial situation, total consumption has diminished.

Difference between illegal and legal prices, 2015

# 21.7%

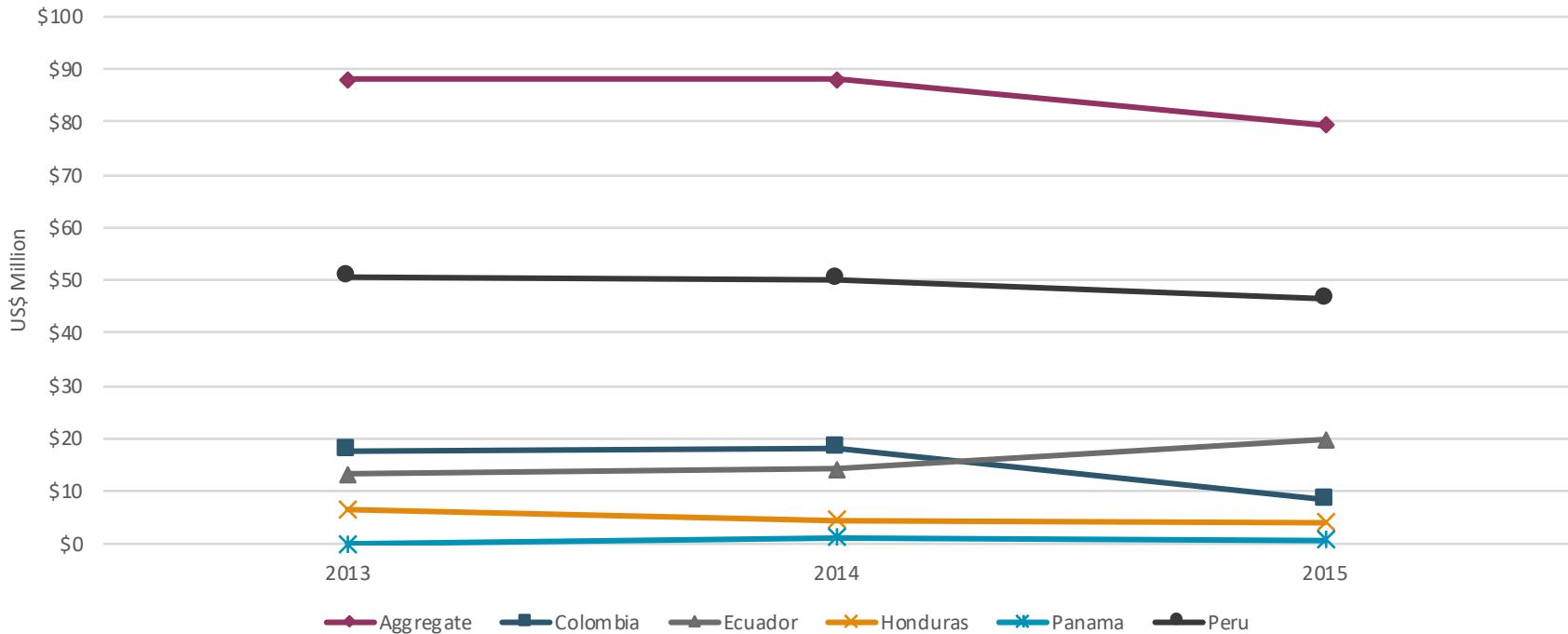
Average consumer prices, 2015 (US\$ per liter)



# In aggregate, consumption of illegal beer decreased 10% in the past three years

The same as observed in volume, consumption of illegal beer in terms of value is also on a downward trend, but with a smaller decrease (10% vs. 25% in volume in 2013 - 2015).

Illegal beer market, 2013 - 2015 (US\$ million)



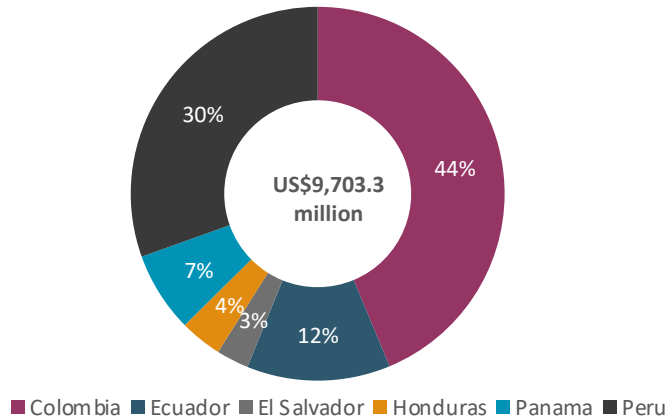
Note: No illegal beer found in El Salvador



# In terms of value, the beer market has fallen to US\$9 million with respect to 2014

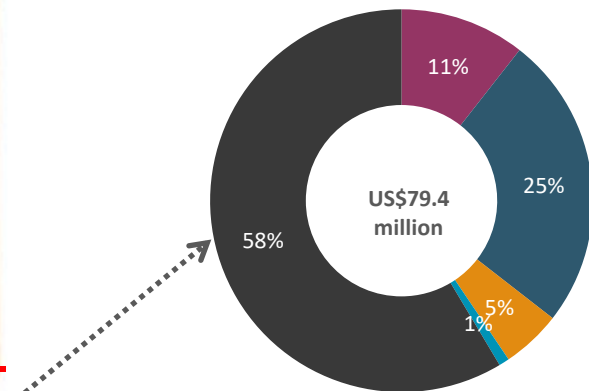


Legal beer market, 2015 (US\$ million)

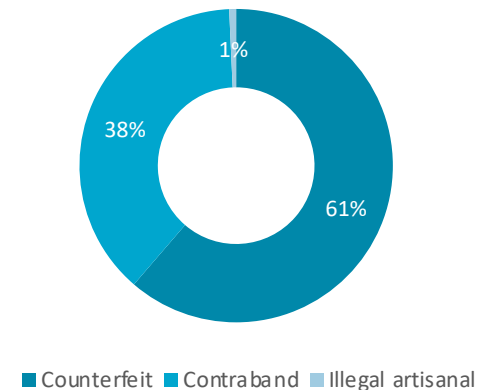


- In 2015, **consumption of legal beer gained share in Colombia** (44% vs. 41% in the previous year), **whereas in Peru it decreased** (35% vs. 30% in 2014).
- In Peru, **illegal beer gained share** (from 49% to 58% in the past year), whereas in **Colombia it dropped drastically** (39% to 11%) thanks to the closing of the border with Venezuela.

Illegal beer market, 2015 (US\$ million)



Categories of illegal beer, 2015 (US\$ million)



# Illegal Market Fiscal Loss 2015 - Region



812,577<sup>HL LAE</sup> | 23%

Market size in volume,  
Share out of total market

US\$2,064<sup>Mn</sup> | 14%

Market size in value,  
Share out of total market

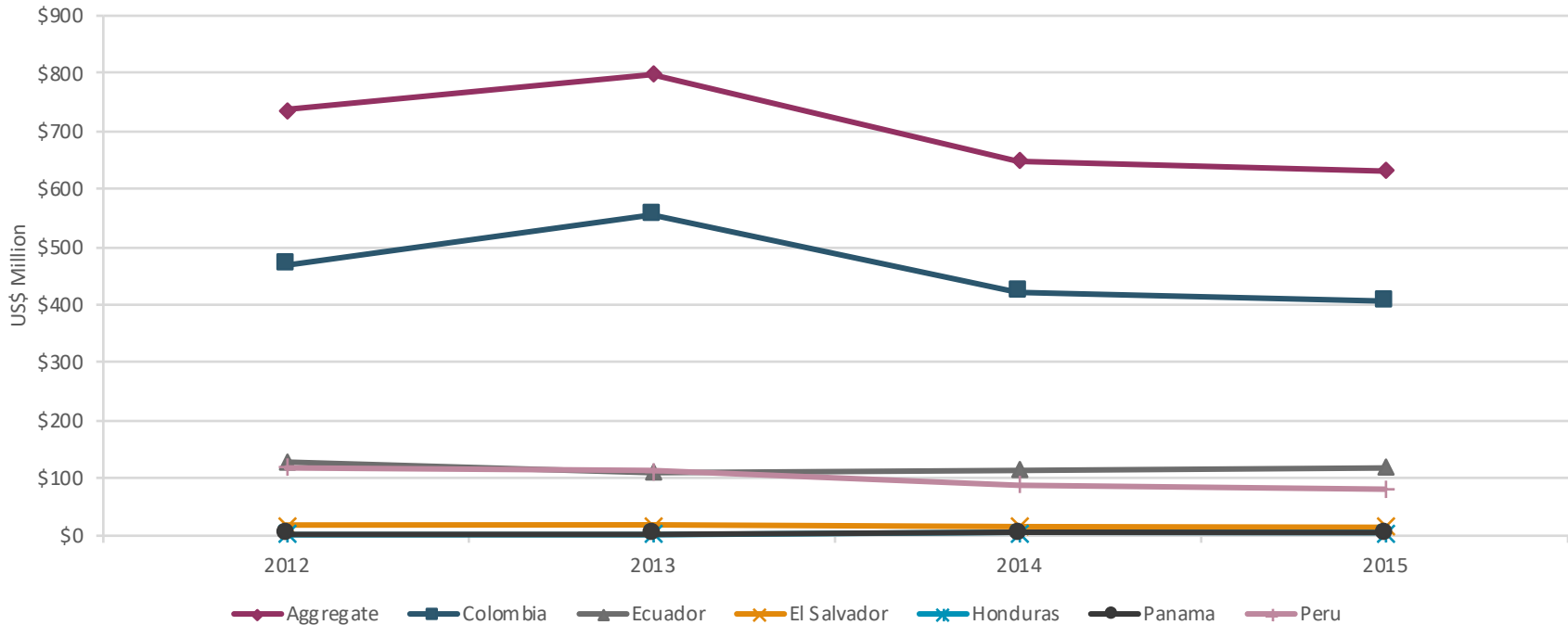
US\$631<sup>Mn</sup>

Fiscal loss



# In aggregate, fiscal loss has decreased in a larger proportion compared to the decrease of the illegal market in terms of volume

Evolution of fiscal loss, 2012 - 2015 (US\$ million)



In 2012 – 2015, fiscal loss decreased 14.3% (from US\$736.3 Mn to US\$631.1 Mn), whereas the size of the illegal market decreased 12.3%, in the same period. However, in 2013, fiscal loss increased due to changes in the tax structures, despite the drop in consumption of illegal alcohol.

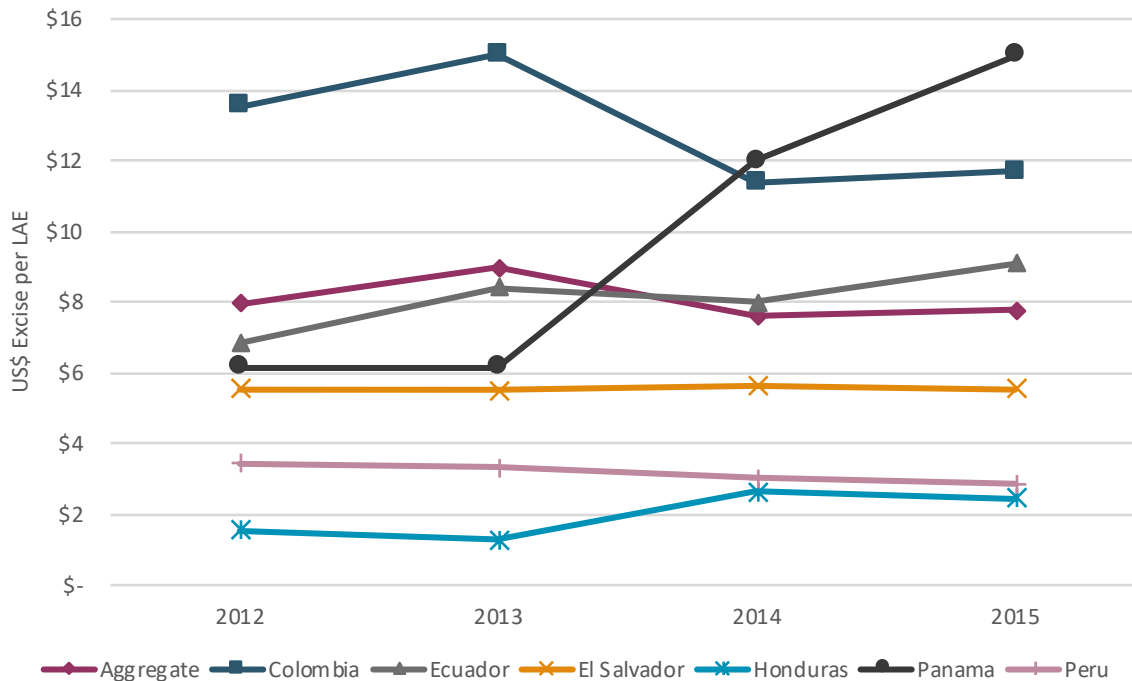
Note: the estimate of fiscal loss includes only import duties and manufacturing and consumption taxes (excise). The exchange rate of local currency vs. the US\$ may also influence results of the historical analysis.



# In aggregate, the excise paid per liter LAE has decreased 2% in the past four years, but Colombia still has the highest excise levels

In Panama, Honduras and Ecuador, the levels of excise per liter LAE increased. In Peru and Colombia, the performance was quite the opposite. In the case of Panama and Ecuador, taxes were increased, but in Honduras, the variation is due to the *ad valorem* composition of the tax.

Evolution of the excise paid per liter LAE, 2011 – 2015 (US\$ million)



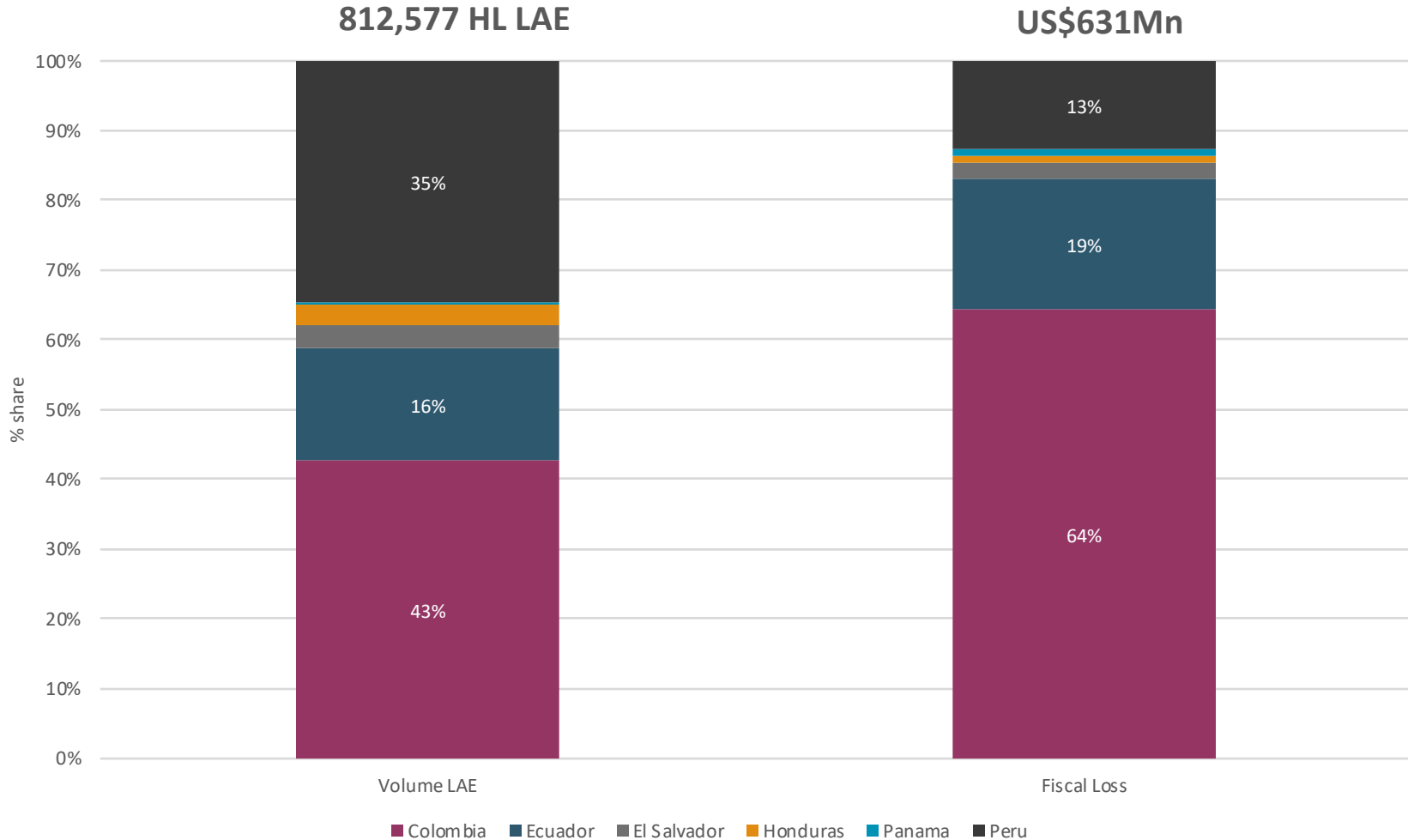
Excise per liter LAE	Variation 2012-2015
Colombia	↓ -13.7%
Ecuador	↑ 32.8%
El Salvador	↑ 0.6%
Honduras	↑ 59.9%
Panama	↑ 143.6%
Peru	↓ -16.4%
<b>Aggregate</b>	<b>↓ -2.3%</b>

Note: the excise paid per liter LAE was estimated on the basis of the total fiscal loss divided by the size of the illegal market in terms of volume. The exchange rate of local currency vs. the US\$ may also influence results in the historical analysis.



# In 2015, Ecuador gained share in total fiscal loss, but Colombia still represents the biggest part

Illegal market in volume (HL LAE) and fiscal loss (US\$ Mn), 2015



## In Colombia, Ecuador and El Salvador, excise levels are above the average aggregate

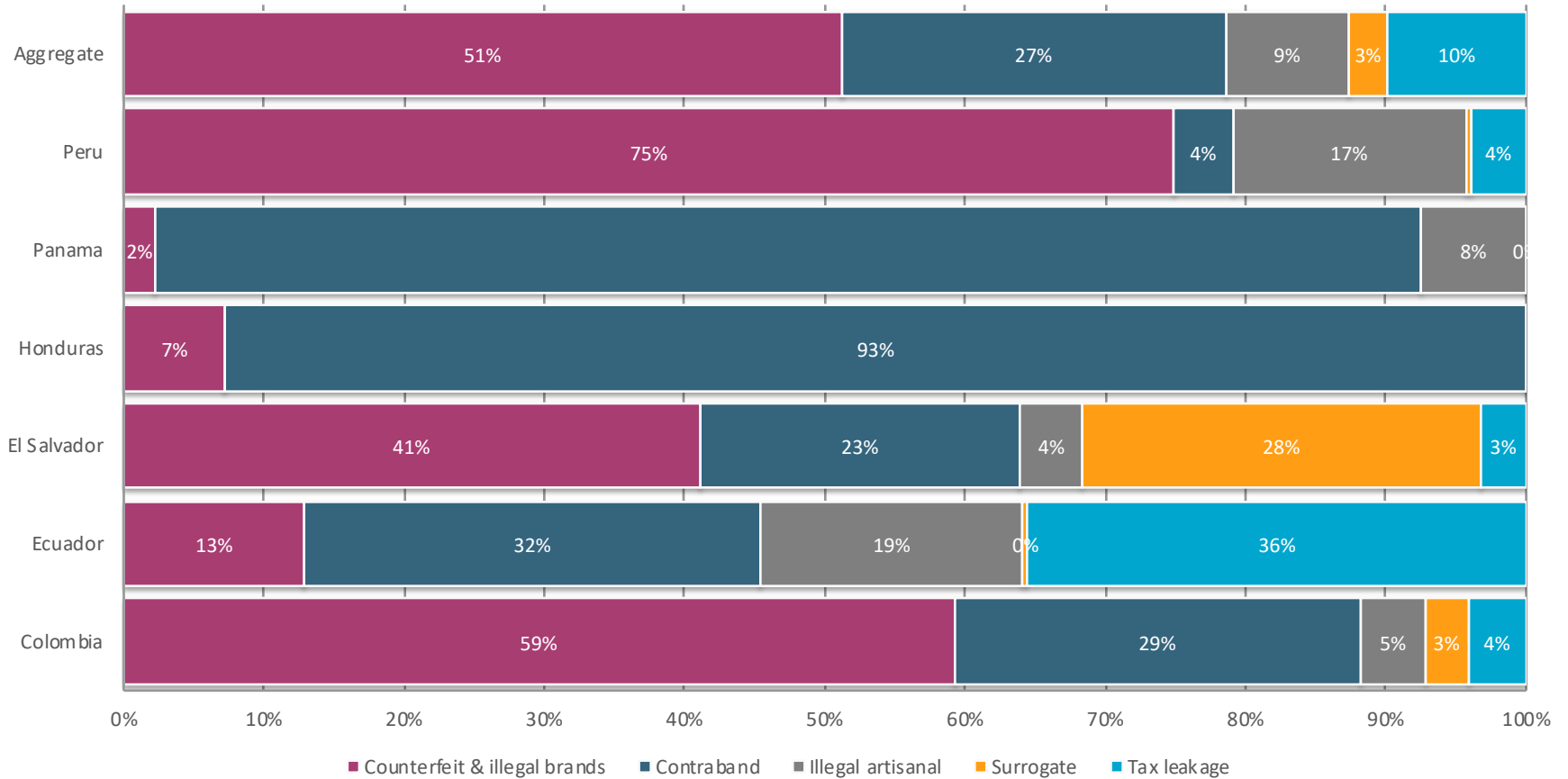
	Excise US\$/LAE		VAT US\$/LAE		Total Excise + VAT US\$/LAE	
	Beer	Spirits	Beer	Spirits	Beer	Spirits
Colombia	8.58	12.36	2.86	0.00	11.45	12.36
Ecuador	7.24	7.24	4.69	4.42	11.93	11.66
El Salvador	11.93	6.32	6.32	2.50	18.25	8.56
Honduras	4.55	2.04	6.36	1.97	10.91	4.01
Panama	4.50	4.50	3.96	1.99	8.46	6.49
Peru	9.20	2.50	5.52	3.04	14.72	5.54
<b>Aggregate (average)</b>	<b>7.67</b>	<b>5.83</b>	<b>4.95</b>	<b>2.32</b>	<b>12.62</b>	<b>8.15</b>

Above average
  Average
  Below average

Source: SABMiller

# Counterfeit is the category that most contributed to fiscal loss in 2015

Fiscal loss by category, 2015 (US\$)



## Panama and Colombia are the two countries with highest loss of excise US\$ per LAE in 2015

	Illegal market size (US\$ mn)	Excise lost (US\$ mn)	Import duties (US\$ mn)	Excise lost per LAE (US\$)	Total fiscal loss (US\$ mn)
Colombia	1,002	394	12.3	11.7	406
Ecuador	416	88	29.9	9.1	118
El Salvador	51	15	1.0	5.6	16
Honduras	21	6	-	2.5	6
Panama	16	3	2.2	14.9	5
Peru	557	80	0.1	2.9	81
<b>Aggregate</b>	<b>2,064</b>	<b>586</b>	<b>45.5</b>	<b>7.7</b>	<b>631</b>

## Based on the 2015 research, Euromonitor identified the following factors which could affect the illegal market in 2016:



- Based on the positive effects observed so far, the enforcement of the **Anti-Contraband Law in Colombia**, and the creation of the **Mesa de Trabajo Multisectorial in Peru**, will continue to help reduce the volume of illegal alcohol consumed in both countries.
- **The coordinated efforts between the public and private sector** in the fight against illegal alcohol will continue to enhance awareness among the population. This situation was made clear in Colombia, Peru, Ecuador and El Salvador.
- The use of **tax stamps in Ecuador** will continue to help identify counterfeit and contraband products.
- **Tougher regulations of ethanol sales** will help weaken the manufacture of counterfeit alcoholic beverages and the consumption of surrogate alcohol.
- Devaluation of local currencies vs. the US dollar will continue to **raise the prices of legal products**, thereby making illegal alcoholic beverages much more appealing.
- The **increase in taxes on legal alcoholic beverages**, especially spirits and imported alcoholic beverages, could spur the sale of contraband and counterfeit products.
- The involvement of **organized crime** along with the **corruption of those responsible for oversight and control** encourage the growth of illegal activities in Latin America.
- The **mild disciplinary actions** towards contraband-related crime and violation of brand proprietary rights, as well as the bureaucratic legal procedures, limit the coercive power of the law.



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## Executive summary

# Illegal alcoholic beverage market in Colombia 2015



**347,601<sub>HL</sub> LAE | 22%**

Market size in volume,  
Share out of total market

**US\$1,002<sub>Mn</sub> | 14%**

Market size in value,  
Share out of total market

**US\$ 406<sub>Mn</sub>**

Fiscal loss



## Executive summary

# Which are the main findings for the illegal market in 2015?

1

### The illegal alcoholic beverage market decreased 6%

- The market fell from 371,527 HL LAE in 2014 to 347,601 HL LAE in 2015.
- The main cause of this reduction was the drop in contraband.

2

### Contraband fell 24%

- Enforcement of the Anti-Contraband Law.
- Higher number of seizures.
- Closing of the border with Venezuela.

3

### Counterfeit alcohol keeps growing, at a rate of 6% in the past year

- Higher consumption of Substitution/Refill, a practice that is currently affecting tequila as well.
- The industrial manufacturing of illegal *aguardiente* and *aperitivos* grew less than the category (2%).

4

### Tax leakage increased 11%

- Unregistered sales of *aguardiente* and *aperitivos* reached 12,686 HL LAE.
- According to official numbers, tax collection for spirits fell by more than 40%.



## Executive summary

# Which are the main factors that affected the illegal market in 2015?

### These factors facilitated consumption:

- Easy access to potable ethanol.
- New channels that sell illegal products outside the *San Andresitos* area.
- Availability of original bottles and labels.
- Limited enforcement of the Anti-Contraband Law in certain regions including the Nariño Department.
- Consumer unawareness of the risk of consuming illegal alcoholic beverages, and how to identify them.
- Organized crime gangs and drug trafficking boosting alcohol contraband.

### These factors weakened consumption:

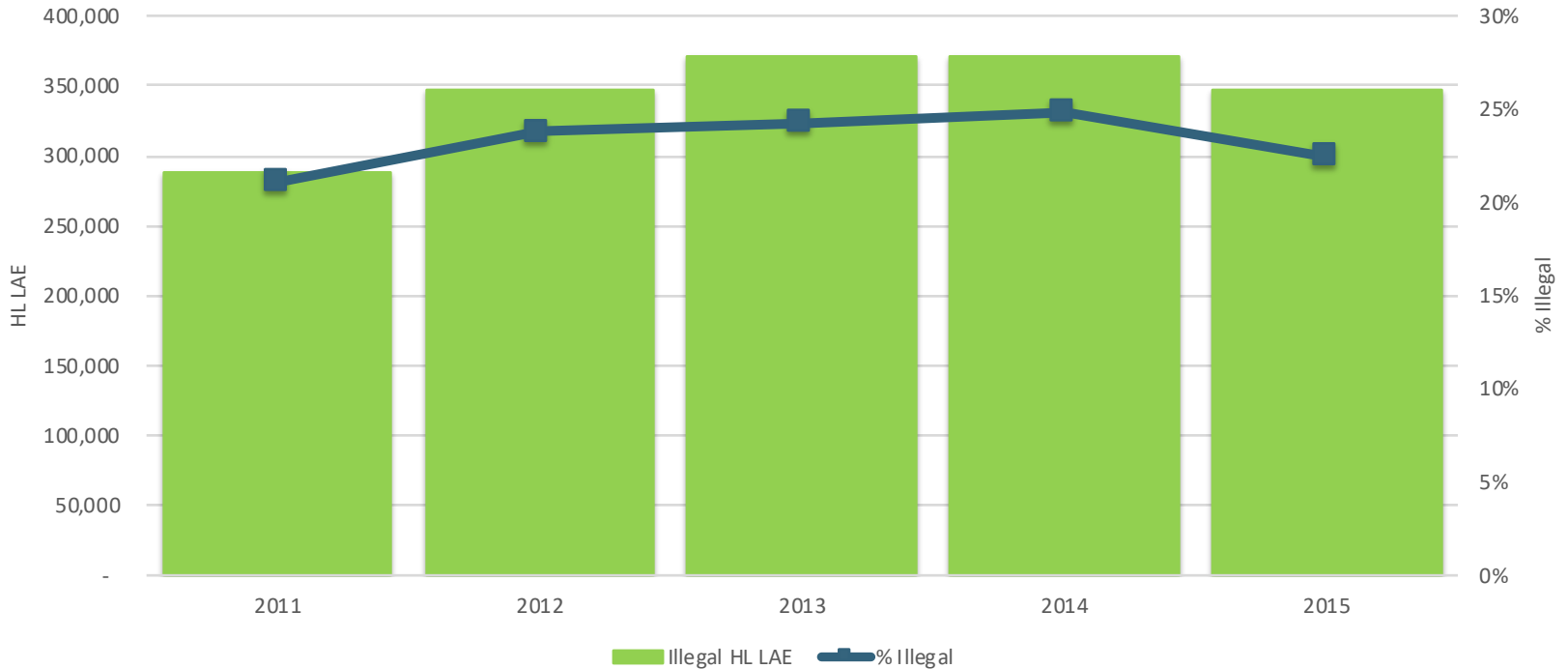
- Enforcement of the Anti-Contraband Law.
- Greater control of the ethanol sold by the *Licorera* of Cundinamarca.
- Closing of the Colombia-Venezuela border.
- The industry's ongoing efforts to increase consumer awareness of this issue.
- Price hikes in the illegal alcoholic beverage market.

**Executive summary**

# Evolution of the illegal market (LAE) in the past 5 years

Between 2011 and 2015, the illegal alcohol market grew 20.7%, from 288,072 HL LAE\* to 347,601 HL LAE. However, in the past year, consumption dropped 6.4%. Illegal alcohol’s share of the total market ranged between 21% and 25%, with a 22% share in 2015.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International  
 \* Excludes the tax leakage category

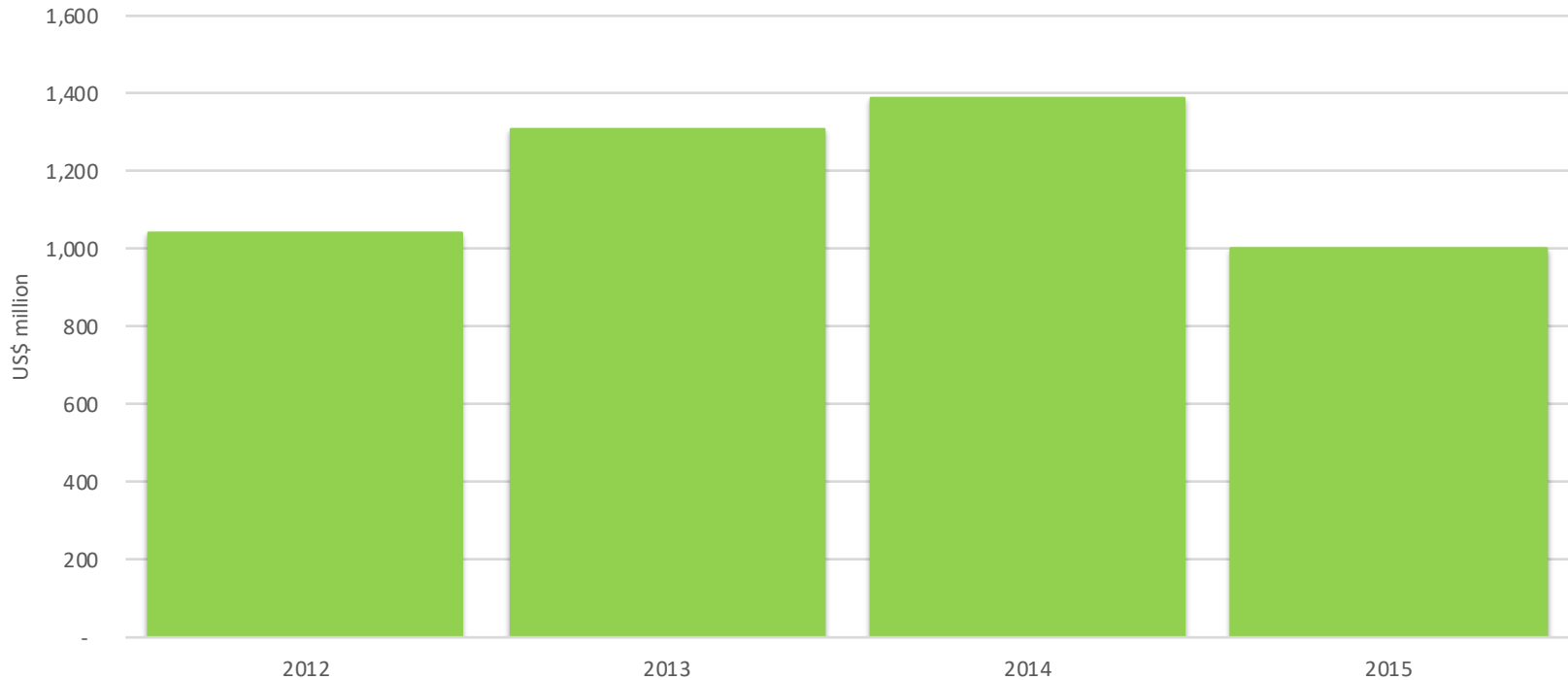


## Executive summary

# Evolution of the illegal market (US\$) in the past 4 years

Between 2012 and 2015, the illegal alcohol market decreased 4%, from US\$1,041 million to US\$1,002 million. In the past year, consumption showed a more drastic reduction of 28%. An important factor to bear in mind is the value of the Colombian peso vs. the US dollar, which dropped more than 50% during that period.

## Evolution of the illegal market (US\$), 2012 - 2015



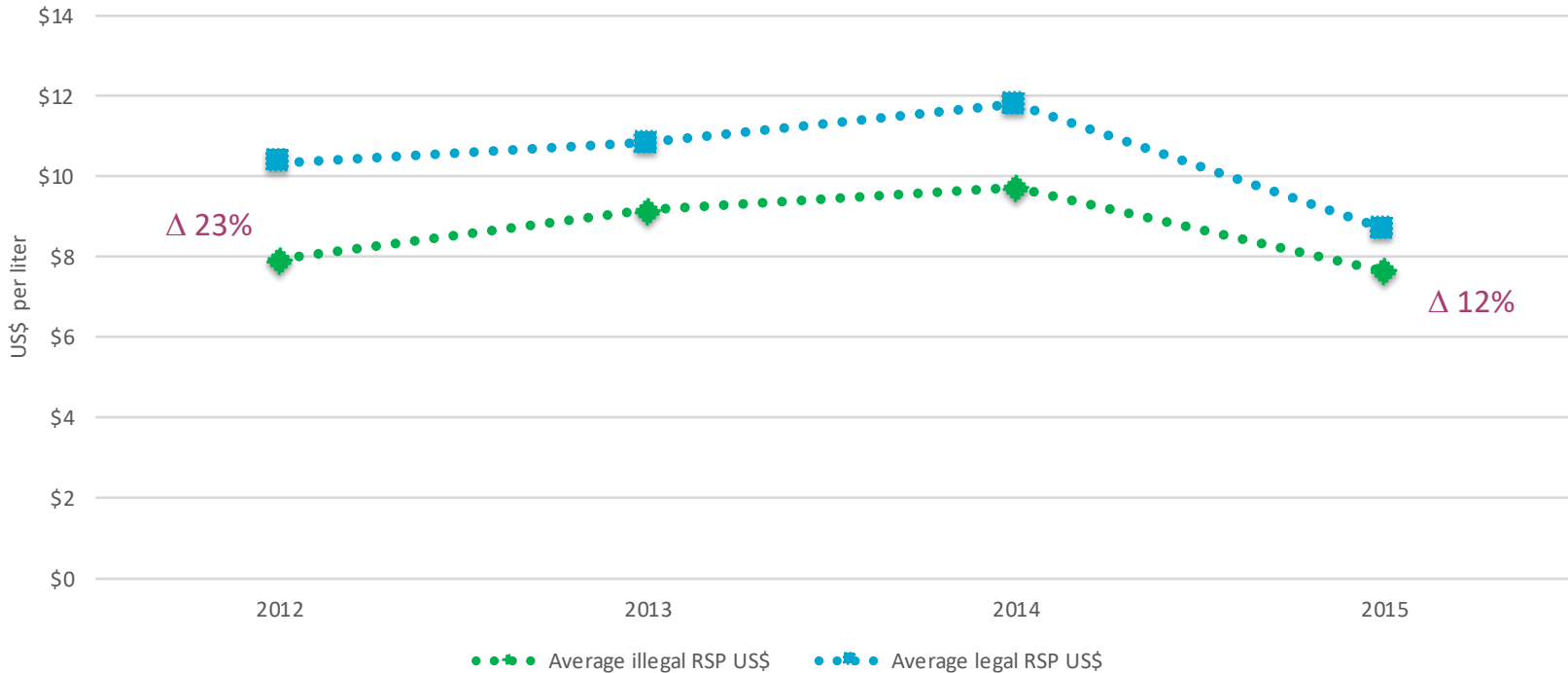
Source: Euromonitor International

**Executive summary**

# Evolution of prices in the illegal market in the past 4 years

Between 2012 and 2015, the difference between legal and illegal prices has gradually lessened. As shown in the chart, the difference in 2012 was 23%, vs. 12% in 2015. When the difference between prices becomes smaller, illegal alcohol loses its appeal among the lower-income segments.

Evolution in average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



Executive summary

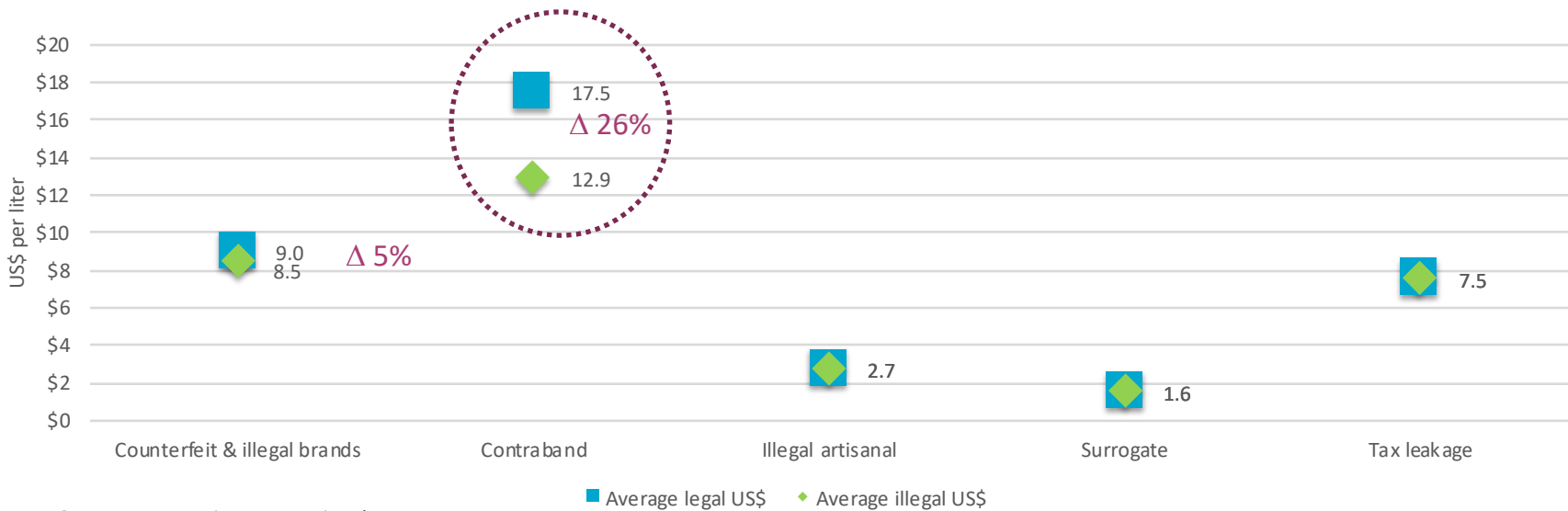
# Price analysis by category

The price of contraband alcohol shows the highest variation (26%) followed by counterfeit alcohol with a variation of 5%. It is increasingly common to sell illegal alcohol at prices similar to legal alcohol, to avoid detection by consumers as well as the authorities; this practice has helped narrow down the difference.

Difference between illegal vs. legal prices, 2015

# 12%

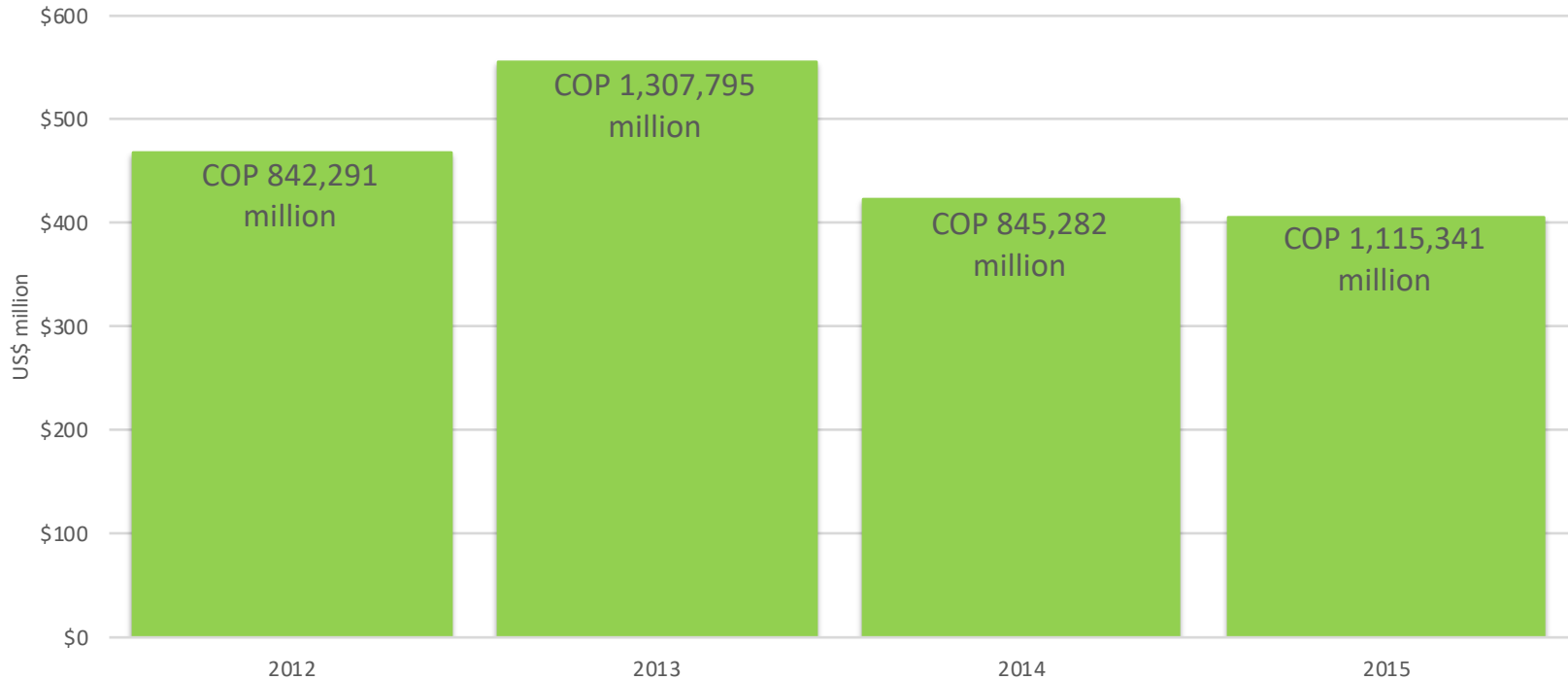
Average prices per liter (US\$), 2015



Source: Euromonitor International

**Executive summary****Evolution of fiscal loss (US\$) in the past 4 years**

Fiscal loss shrank 13% between 2012 and 2015. In 2012 it was estimated at US\$468 million and in 2015 it decreased to US\$406 million. However, the effect of the exchange rate of the Colombian peso vs. the US dollar is eliminated, fiscal loss grew 32% in 2012-2015 and in the past year.

**Evolution of fiscal loss (US\$), 2012 - 2015**

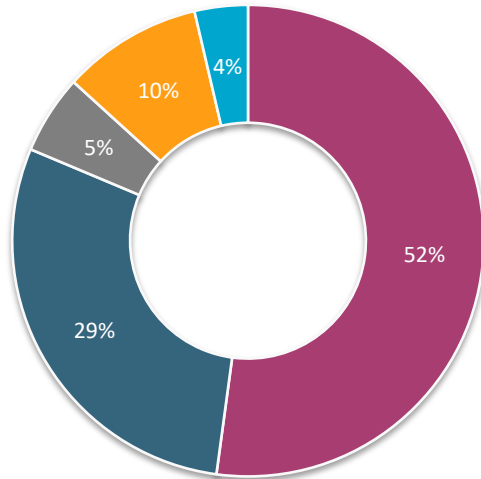
Source: Euromonitor International

\* One should consider the strong devaluation of the Colombian peso vs. the US dollar during that same period: COP 1,798.23 per dollar in 2012 and COP 2,746.47 in 2015.

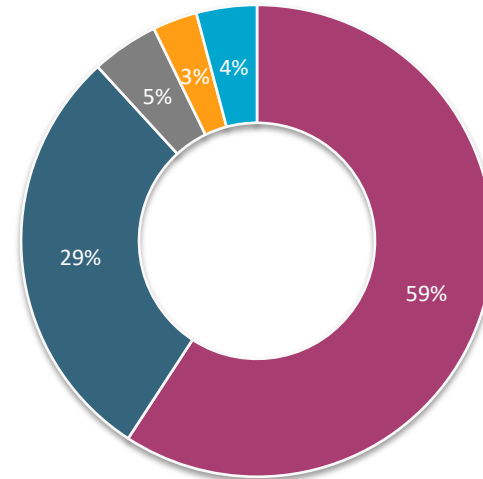
Executive summary

# Analysis of fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category (US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

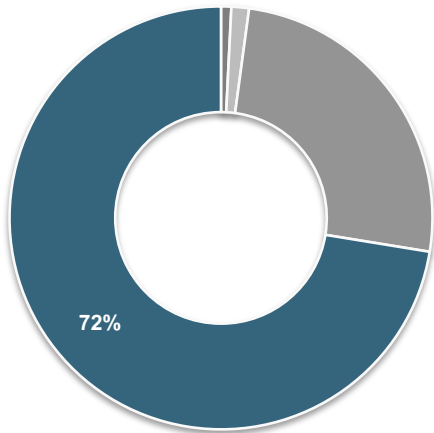
In 2015, counterfeit alcohol/illegal brands became the category mostly responsible for fiscal loss (59%), replacing contraband, which had played that role during the previous year. This is due to an increase in the consumption of counterfeit alcohol and the decrease in contraband.



## Executive summary

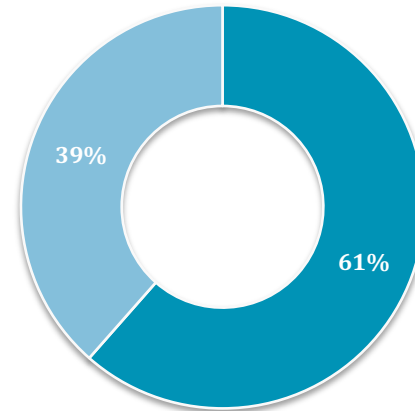
# Analysis for beer

Legal alcoholic beverage market, HL LAE, 2015



■ RTD ■ Wine ■ Spirits ■ Beer

Illegal beer market, HL LAE, 2015



■ Counterfeit ■ Contraband

Source: Euromonitor International

In 2015, consumption of illegal beer decreased 57%, mainly due to the drop of contraband. Closing the border with Venezuela was a decisive factor, as well as the higher number of operations designed to combat illegal beer activities. Contraband decreased in volume 79%; however, “retape” of beer grew 23%.



## Counterfeit alcohol and illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Market share in volume, 2015
<b>181,247</b>	<b>52%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>574</b>	<b>240</b>

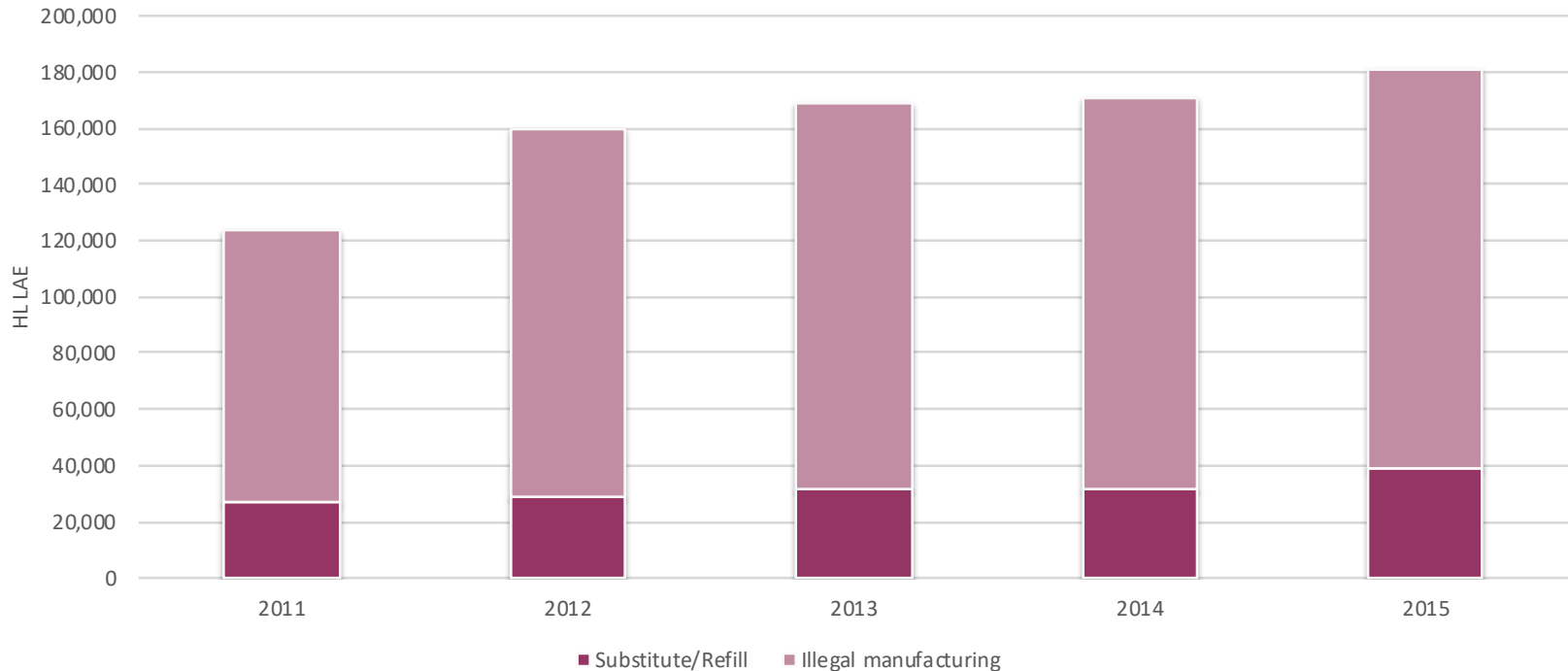
- Volume-wise, counterfeit and illegal brands are the biggest category in the illegal alcohol market.
- Consumption of counterfeit/illegal brands grew 6% in 2015, being the category with highest growth after tax leakage. This is a consequence of having easy access to ethanol as a raw material and other supplies such as bottles and labels.
- The subcategory of industrial manufacturing is still the most important in the counterfeit category. In 2015 it reached 141,891 HL LAE, equivalent to US\$480 million. Substitution/Refill experienced higher growth rate (23% compared to 2%), reaching 39,356 HL LAE, equivalent to US\$94 million.
- The fiscal loss derived from counterfeit alcohol is estimated at US\$240 million for 2015, which represents 59% of the total fiscal loss.

## Counterfeit alcohol and illegal brands

### Evolution of consumption (LAE) in the past 5 years

- During 2011-2015, consumption of counterfeit alcohol increased 46%, from 124,023 HL LAE in 2011 to 181,247 HL LAE in 2015.
- The main subcategory is industrial manufacturing of illegal brands/unbranded, which represents 78% of all the counterfeit alcohol in 2015.

#### Evolution of the counterfeit alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Counterfeit alcohol and illegal brands

### Main factors that influence the category



#### ALCOHOLIC BEVERAGES

- Spirits are the main targets for counterfeiting, especially *aguardiente*, followed by whisky and rum. Operations carried out in recent years revealed the existence of counterfeit tequila as well.
- Antioqueño and Néctar brandy, Old Parr whisky and José Cuervo tequila are among the most common brands.



#### WHERE

- Illegal manufacturing is usually conducted using *alambiques*, although recent seizures show that these procedures have become more complex.
- Substitution/Refills are also found in bars and tobacco stores.
- Andean and Pacific are the regions with highest consumption of counterfeit alcohol.



#### FACTORS

- Raw materials such as ethanol, bottles and labels are easily available.
- Lack of control on the part of the authorities to prevent counterfeiting in bars and tobacco stores.
- The finished product's low cost drives purchase among the different players within the supply chain.



#### EFFECTS

- Illegal alcohol generates huge fiscal loss to the country.
- Illegal alcohol has a negative impact on legal manufacturers that suffer often substantial financial losses.
- Counterfeit alcohol is a health hazard for the population.

## Contraband

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>101,460</b>	<b>29%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>300</b>	<b>118</b>

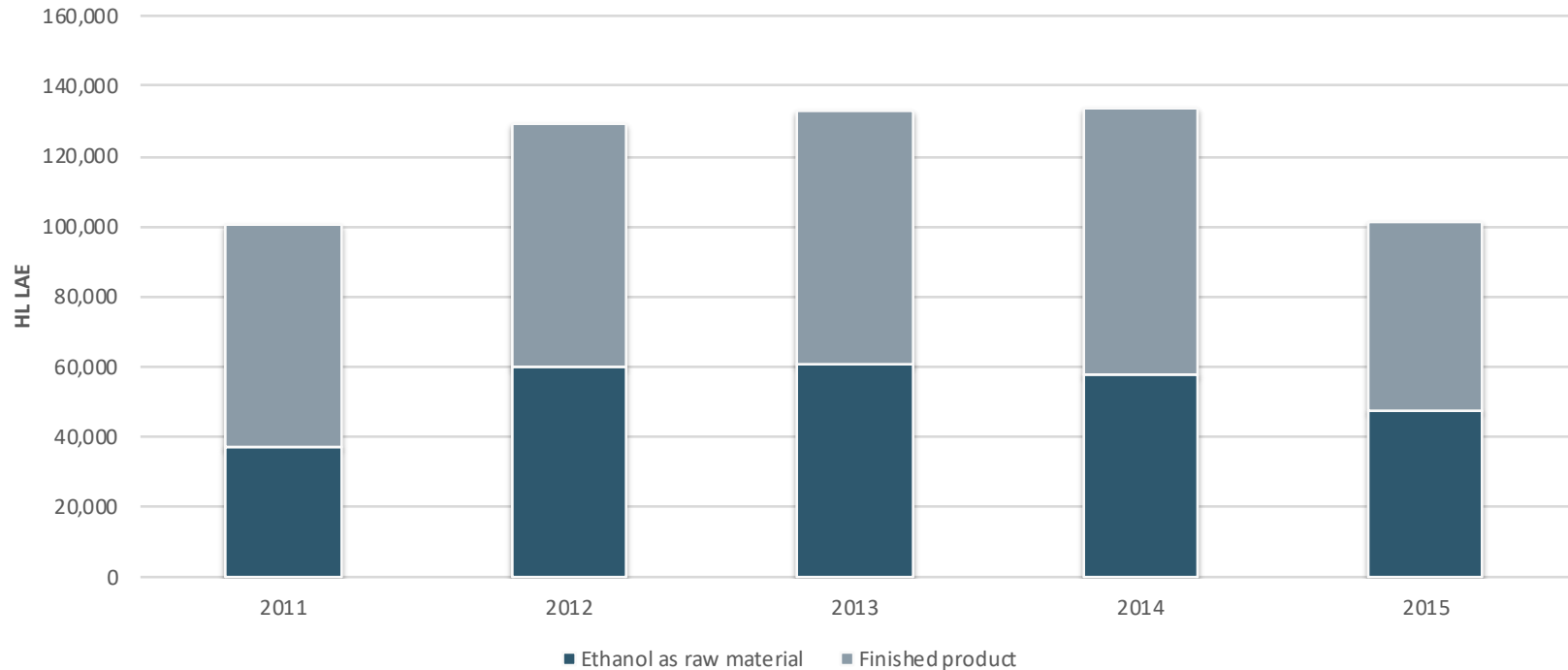
- Volume-wise, contraband is the second category of illegal alcohol consumed in the country, valued at US\$300 million.
- Contraband of finished product leads with a share of 53% (53,999 HL LAE), and contraband of ethanol represents the remaining 47% (47,462 HL LAE).
- Between 2014 and 2015, contraband of ethanol decreased 18%, mainly due to the enforcement of stricter control measures in Customs and the Anti-Contraband Law. During that same period, contraband of finished product suffered a more severe drop (29%) thanks to the closing of the border with Venezuela.
- Fiscal loss originated by contraband is estimated at US\$118 million for 2015, representing 29% of the total fiscal loss.

## Contraband

### Evolution of consumption (LAE) in the past 5 years

- During the review period of 2011-2015, consumption of contraband alcohol maintained extremely stable levels, with only 1% growth. However, in the past year, it decreased by 24%.
- Contrary to the performance of the category, contraband of ethanol grew 28% in that same period. Contraband of finished product has shown an upward trend over the years. As seen in the chart below, volume decreased only in the past year. In general, the decrease during the review period was 14%.

#### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Contraband

### Main factors that influence the category



#### ALCOHOLIC BEVERAGES

- Whisky is the type of alcoholic beverage that enters the country mostly as contraband. Other types are rum, tequila and vodka.
- Among the brands that most commonly enter the country illegally include Old Parr whisky, Buchanan's rum, José Cuervo tequila and Absolut vodka.



#### WHERE

- Contraband brands are mostly sold in tobacco stores and *San Andresitos*.
- Some bars sell brands of both legal and illegal origin.
- In the border towns of *Norte de Santander* and *La Guajira*, beer contraband is a major factor, although it decreased in 2015.
- In the Caribbean region, contraband plays a leading role.



#### FACTORS

- The main factor that encourages contraband is the significant difference in price compared to legal alcohol (26%).
- The contraband of alcohol + other routes of contraband + drug trafficking set up a perfect situation to enable money laundering for criminal gangs.



#### EFFECTS

- Contraband alcohol generates fiscal loss to the country.
- Severe damage to the incomes of importers and manufacturers of legal alcohol products, with subsequent profit drops.
- Unfair competition in the alcohol market.

**Illegal artisanal alcohol****Consumption analysis**

Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>18,830</b>	<b>5%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>89</b>	<b>19</b>

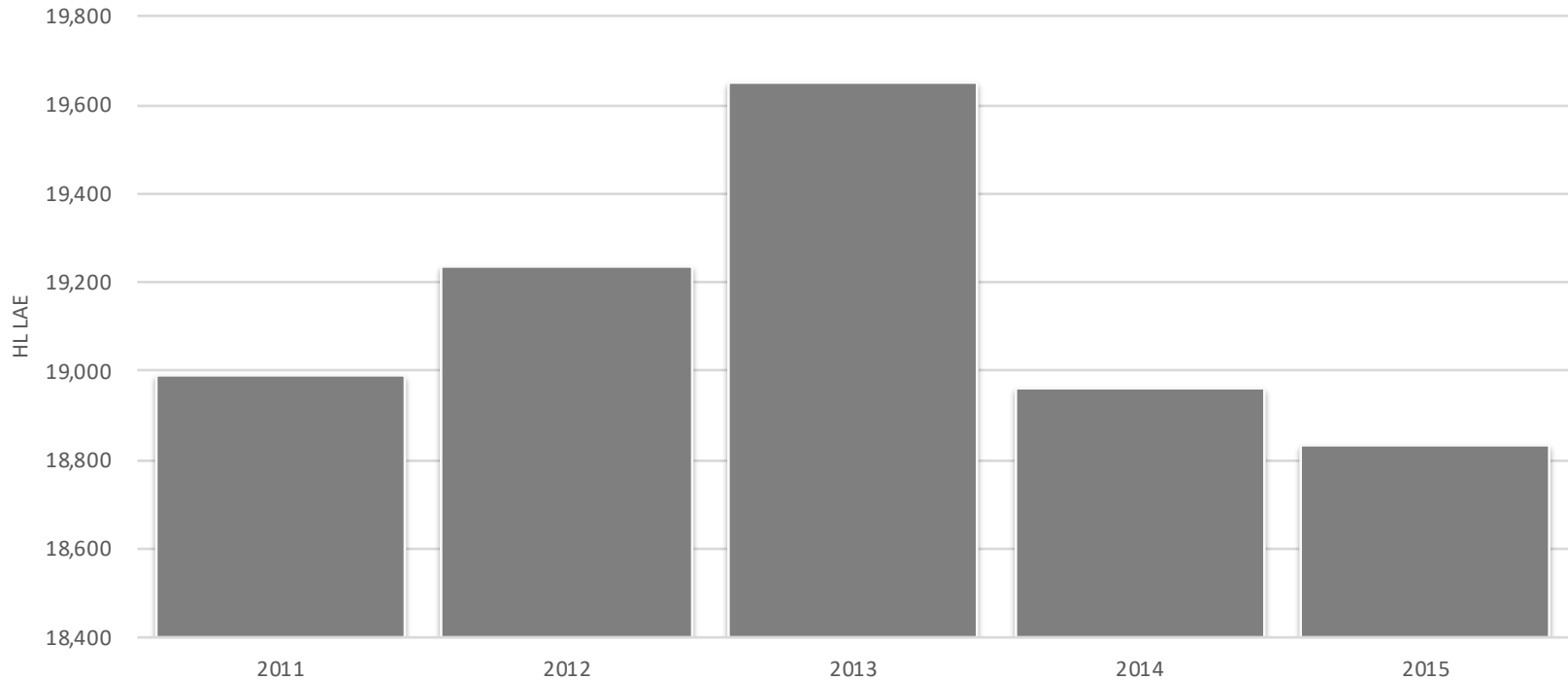
- Illegal artisanal alcoholic beverages held a share of 5% (18,830 HL LAE) in the illegal alcohol market in 2015. The amount spent on purchasing illegal artisanal alcoholic beverages was estimated at US\$89 million.
- Fermented beverages account for 52% of consumption, and distilled beverages make up the remaining percentage.
- The fiscal loss generated by illegal artisanal alcoholic beverages is estimated at US\$19 million for 2015, which represents 5% of total fiscal loss.

## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- Although the consumption of illegal artisanal alcohol peaked in 2013, it decreased less than 1% in 2011 – 2015. Similarly, in the past year, this category dropped 0.7%, as a result of consumption having migrated to low-cost legal alcoholic beverages.
- However, consumption of this type of alcoholic beverages will likely continue, as it is linked to cultural practices that are widely entrenched in several parts of the country.

#### Evolution in the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International



## Illegal artisanal alcohol

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Illegal artisanal alcoholic beverages are mostly based on sugar cane.
- These are among the best known: *viche*, *masato*, *guarapo*, *chirrinchi* and *chicha*.



### WHERE

- This type of beverages are sold at fairs, market squares, stores and some tobacco stores.
- Each region has its own artisanal alcoholic beverage, but the manufacturing and marketing of this type of beverages mostly takes place in the Pacific area.



### FACTORS

- The main reason for consuming illegal artisanal alcoholic beverages is the price, which is affordable for the majority of the population.
- In certain departments such as *El Valle*, these alcoholic beverages are consumed as part of local tradition.



### EFFECTS

- Illegal artisanal alcoholic beverages generate fiscal loss to the country.
- They are a health hazard for the consumers, as they are manufactured without production or quality standards of any kind.

## Surrogate alcohol

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>33,378</b>	<b>10%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>5</b>	<b>12</b>

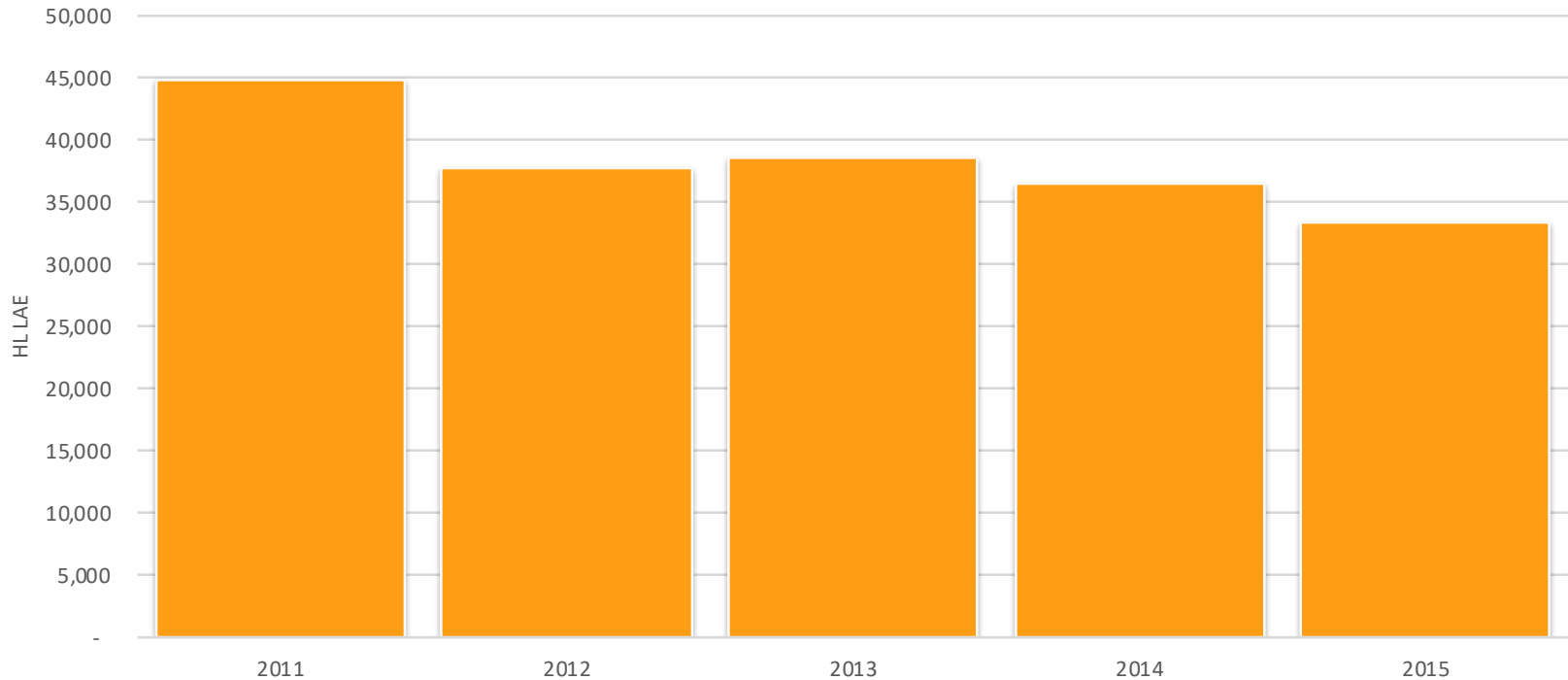
- In 2015, consumption of surrogate alcohol represented 10% in volume LAE of the total illegal alcohol market.
- It is estimated that consumers spent US\$5 million in the purchase of pharmaceutical alcohol to use as substitutes for legal alcoholic beverages.
- The ensuing fiscal loss is estimated at US\$12 million, which represents 3% of the total fiscal loss.

## Surrogate alcohol

# Evolution of consumption (LAE) in the past 5 years

- This category experienced the greatest drop in volume (26%) in the past 5 years. Given that consumption is restricted to a segment of the population that lives in conditions of extreme poverty and is highly prone to alcoholism, statistics show a substantial decrease.
- In 2015, this helped reduce the consumption of surrogate alcohol by 9%.

### Evolution of the surrogate alcohol market(HL LAE), 2011 - 2015



Source: Euromonitor International

## Surrogate

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Pharmaceutical alcohol is used as surrogate for legal alcoholic beverages.



### WHERE

- Alcoholic beverages using pharmaceutical alcohol are mixed by the consumers themselves, as they are easy to make. They only require a sweet beverage to mix with the pharmaceutical alcohol.



### FACTORS

- Consumption of these beverages is common in low socio economical segments, as they are inexpensive compared to other alcoholic beverages.
- To a lesser degree, they are consumed by young people below the legal age to buy alcoholic beverages.



### EFFECTS

- Consumption of pharmaceutical alcohol is a health risk due to the high blood alcohol concentration.
- In addition, it causes fiscal loss to the country.



## Tax leakage

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>12,686</b>	<b>4%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>34</b>	<b>17</b>

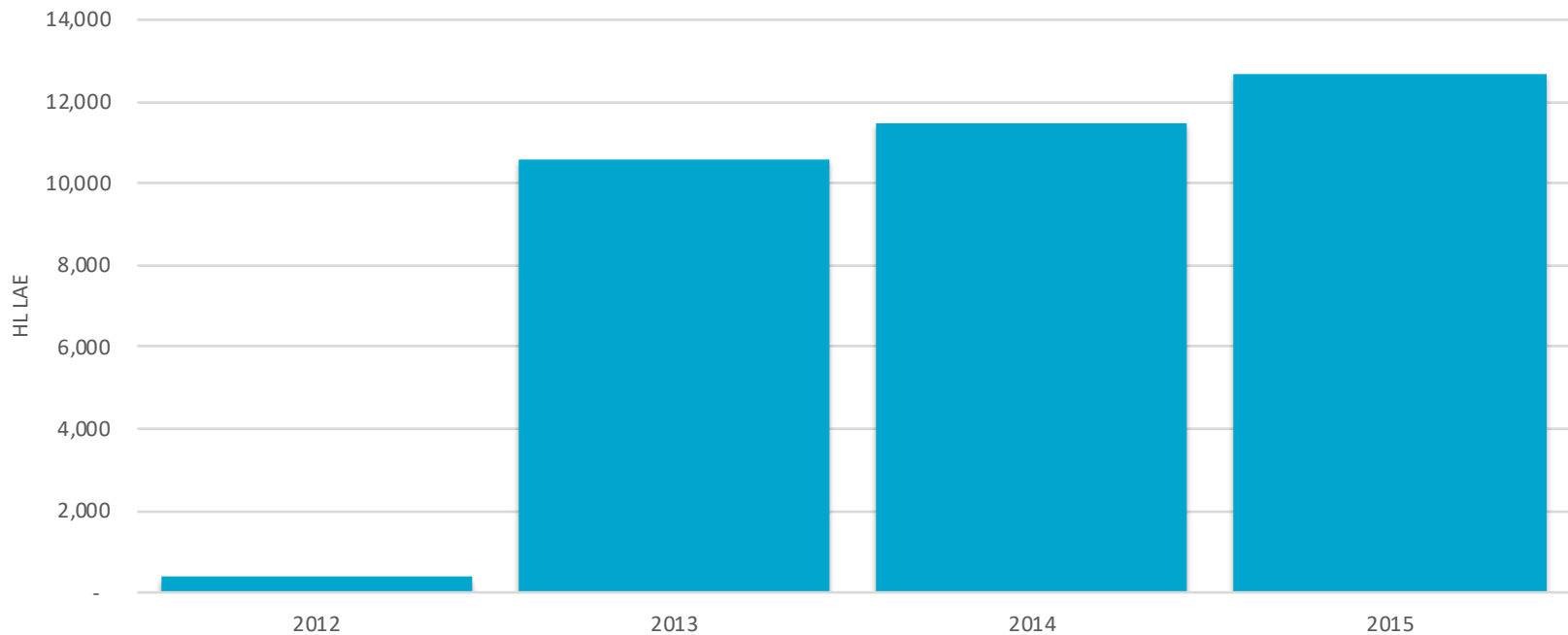
- Although this is the smallest category of the illegal alcohol consumed in the country, tax leakage reached 12,686 HL LAE, equivalent to US\$34 million.
- All the tax leakage is made up of distilled beverages.
- Fiscal loss caused by legal beverages that evade taxes is estimated at US\$17 million for 2015, which represents 4% of the total fiscal loss.

## Tax leakage

# Evolution of consumption (LAE) in the past 5 years

- The lack of strict control measures on the manufacturing and marketing of national brandies, rums and *aperitivos* allow tax leakage levels to grow year after year.
- During 2014-2015, this category grew 11% due to the lack of control measures enacted by the authorities. The manufacturing of legally produced *aperitivos* with alcohol content exceeding allowed levels has become common practice to evade taxes.

### Evolution tax leakage (HL LAE), 2012 - 2015



Source: Euromonitor International

## Tax leakage

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Brandy and rum manufactured at local level.
- *Aperitivos* claiming an alcohol content of 8-9%, but whose real content is close to 19%.

### WHERE

- They are found at small tobacco stores, corner shops, liquor stores, bars or restaurants.

### FACTORS

- Lack of transparency in statistics of the manufacturing and distribution of national spirits.
- *Aperitivos* low price and high alcohol content are quite appealing to consumers.

### EFFECTS

- Tax leakage results in the loss of resources to the regions that are affected.
- Unfair competition against legal players.



## Industry comments

### Key quotes from interviews



Contraband enters mainly through Bogota.

— *Tobacco Store Fabio*



Counterfeit alcohol has the fastest growth rate in the Nariño region.

— *Revenue Department of Nariño*



Contraband is the new form of drug trafficking. The same transport is used to bring in one product and take out another.

— *National Prosecuting Office*



Trucks entering the country with ethanol are milked on the way.

— *Revenue Department of Nariño*



Thanks to the Anti-Contraband Law and control over the sale of ethanol, we were able to improve the revenues generated by legal alcohol in the department.

— *Revenue Department of Cundinamarca*



Contraband in Cúcuta is over.

— *Dislicores*





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Executive summary

# Illegal alcoholic beverage market in Ecuador 2015



**129.540<sub>HL LAE</sub> | 27%**  
Market size in volume,  
Share out of total market

**US\$ 416<sub>Mn</sub> | 20%**  
Market size in value,  
Share out of total market

**US\$ 118<sub>Mn</sub>**  
Fiscal loss



## Executive summary

# Main findings in the illegal market in 2015

1

### Government regulations continue to heavily affect the consumption of alcoholic beverages

- The total market of alcoholic beverages decreased in volume by 13%, whereas consumption of legal alcoholic beverages decreased 20%.

2

### Consumption of illegal whisky and rum grows at greater speed due to the higher alcohol content

- The illegal supply, mainly of alcoholic beverages such as whisky and rum with more than 35 degrees LAE, increases its market share.
- Proof exists of this situation in the growing consumption of counterfeit alcoholic beverages (11%).

3

### Sales of illegal artisanal alcohol continues to encourage the manufacturing of illegal beverages

- Illegal artisanal alcohol is used for manufacturing illegal alcoholic beverages, whether artisanal beverages or refills on a larger scale.
- The most common alcoholic beverages are sugar cane *aguardiente* and flavored *aguardiente*.

4

### Restrictive measures encourage the diversification of illegal trade forms

- Growing popularity of online sales channels.
- Distribution along with groceries.
- Micro-traffic for retail sale and even self-consumption.

## Executive summary

# Main factors that affect the illegal market in 2015



### These factors facilitated consumption:

- Extension of the deadline for safeguard collection (extra duty) of the imported product.
- Diversification of distribution channels for the illegal product (mainly online stores).
- Discretion in the registry of manufacturing cost for the tax *ad valorem*.
- Consumer habits and customs, where price is more important than quality.
- Free distribution and sale of illegal artisanal products in rural and suburban areas.



### These factors weakened consumption:

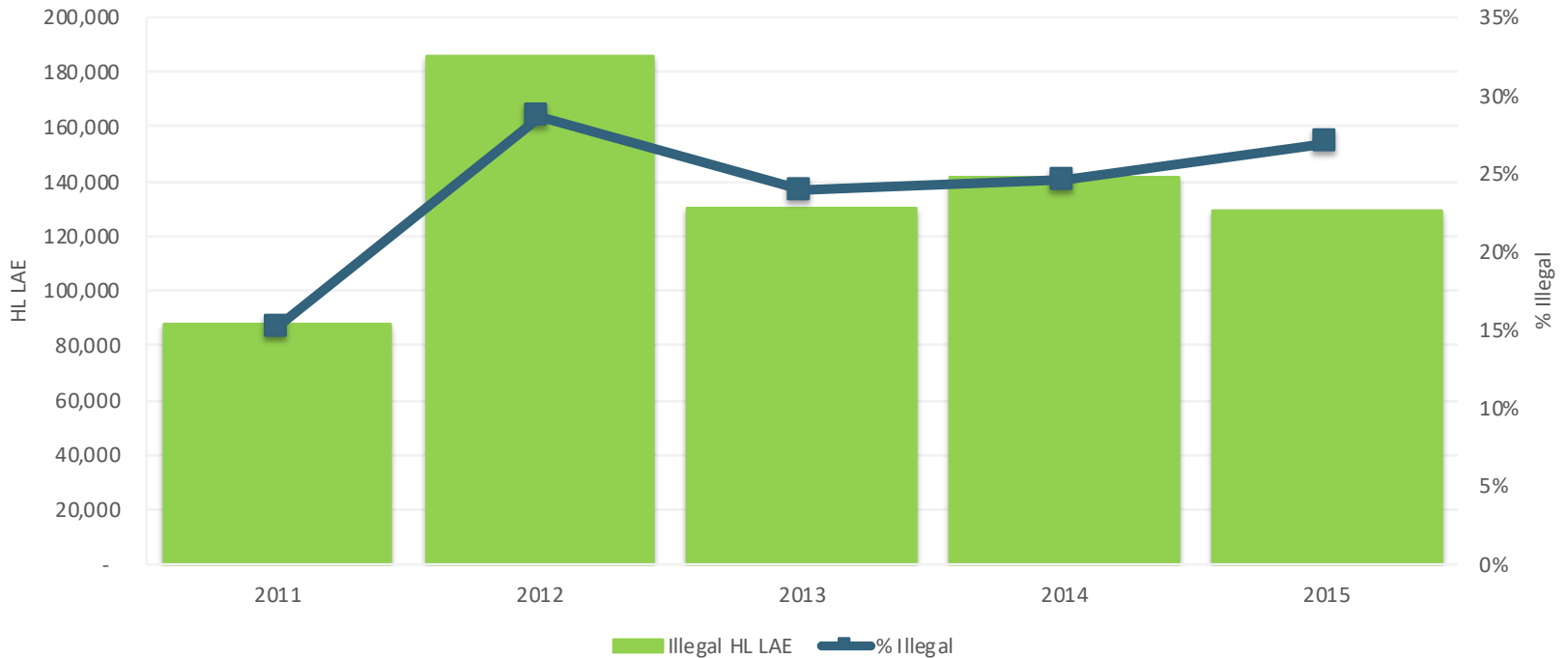
- Lower frequency in the consumption of alcoholic beverages in general, due to consumers tightening their budgets still further.
- Greater collaboration among legal manufacturers of local alcoholic beverages to identify illegal products and combat illegal trade.
- Enforcement of control and follow-up measures specific for certain channels, such as fiscal labels for imported products.
- Reduction in the import of ethanol based on specific quotas per importer.

**Executive summary**

# Evolution of the illegal market (LAE) in the past 5 years

Illegal trade's share of the total market increased in the past three years, reaching 27% in 2015. This trend was driven by the constant increase of the legal product's prices, which made illegal products much more appealing. During the review period of 2011-2015, the illegal market showed 48% growth\*.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International

\* In 2011 is excluded the tax leakage category, which represents the most common form of illegality in Ecuador

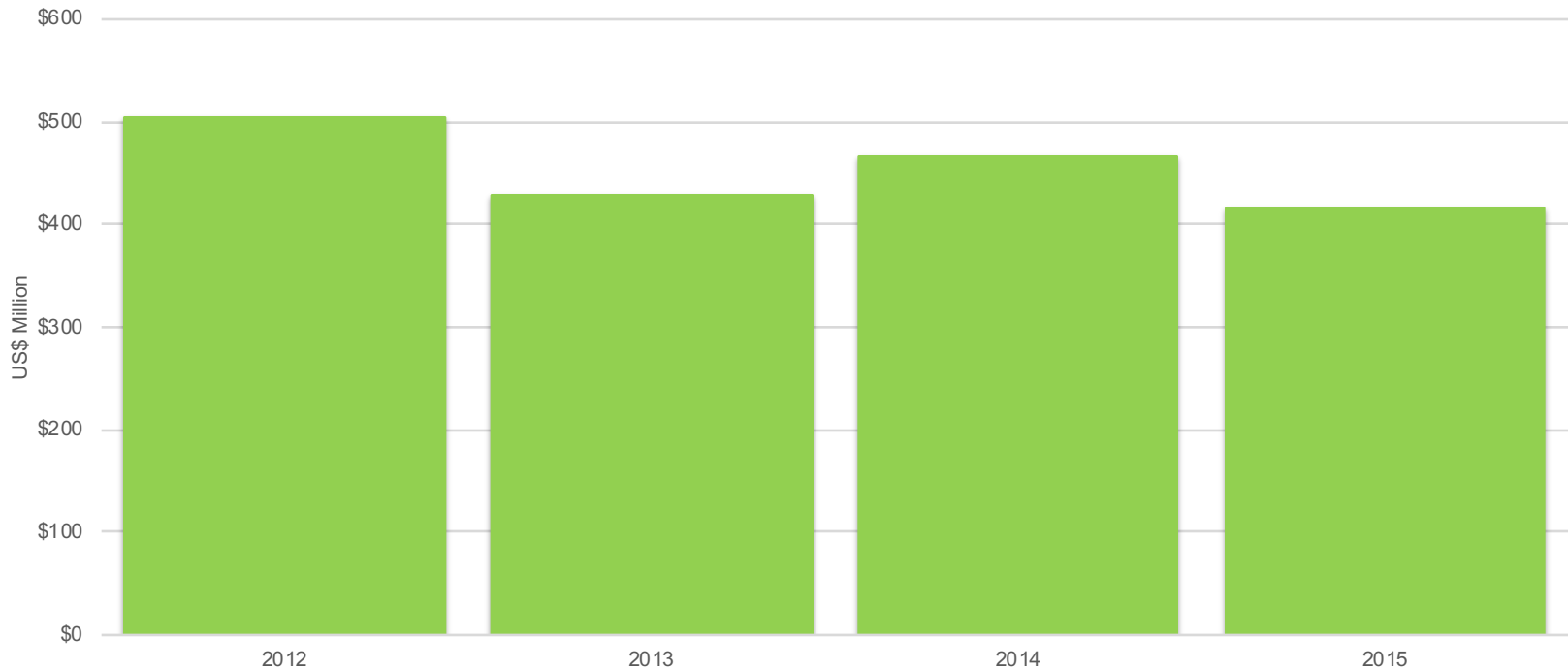


## Executive summary

# Evolution of the illegal market (US\$) in the past 4 years

In value terms, between 2012 and 2015, the illegal alcohol market shrank 17%, from US\$504 million to US\$416 million. In the past year, consumption decreased 11%, as a result of a rise in the price of alcoholic beverages combined with the country's shaky financial situation, which decreased consumer purchasing power.

## Evolution of the illegal market (US\$), 2012 - 2015



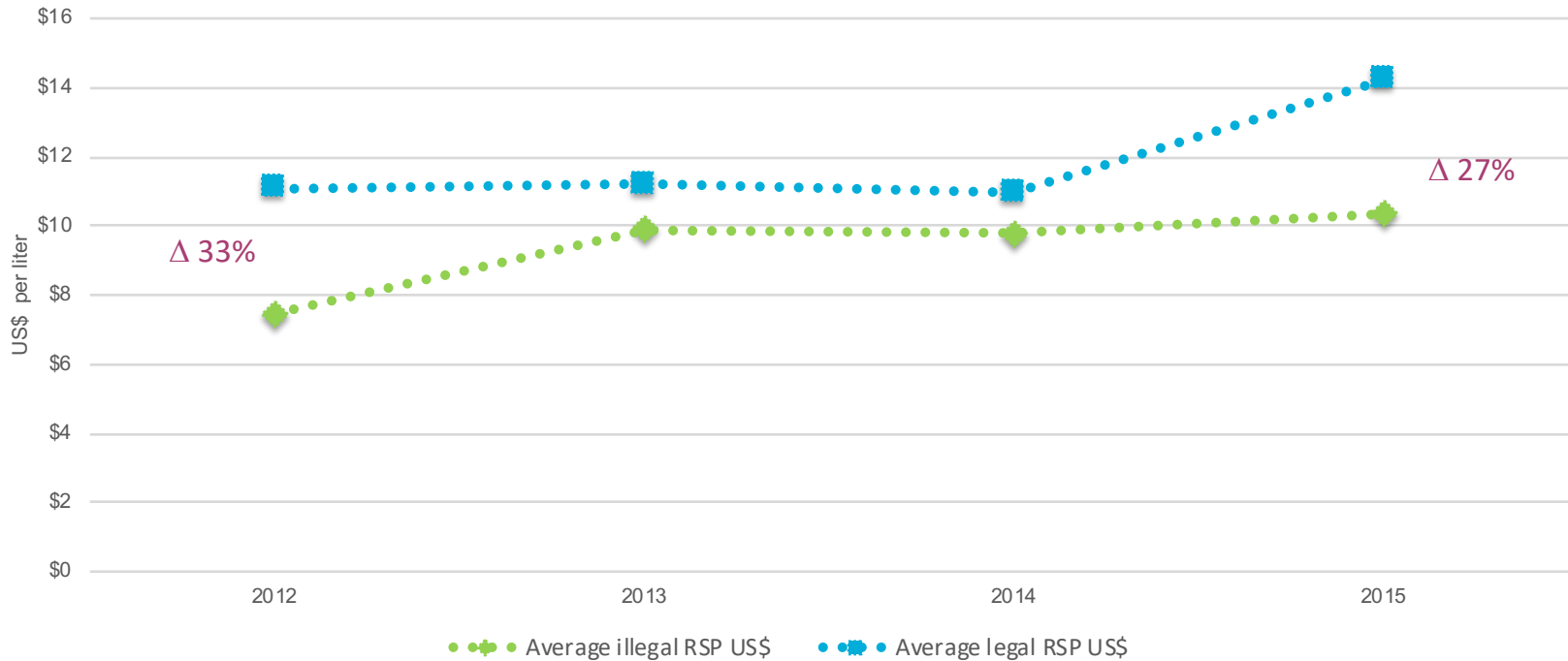
Source: Euromonitor International

**Executive summary**

# Evolution in illegal market prices in the past 4 years

Between 2012 and 2015, the difference between legal and illegal prices had gradually decreased. However, in the past year, the difference grew considerably, due to the price hikes in legal beverages. As seen in the chart below, in 2012, the difference was 33%, whereas in 2013 and 2014, it decreased by 11%.

Evolution in average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



Executive summary

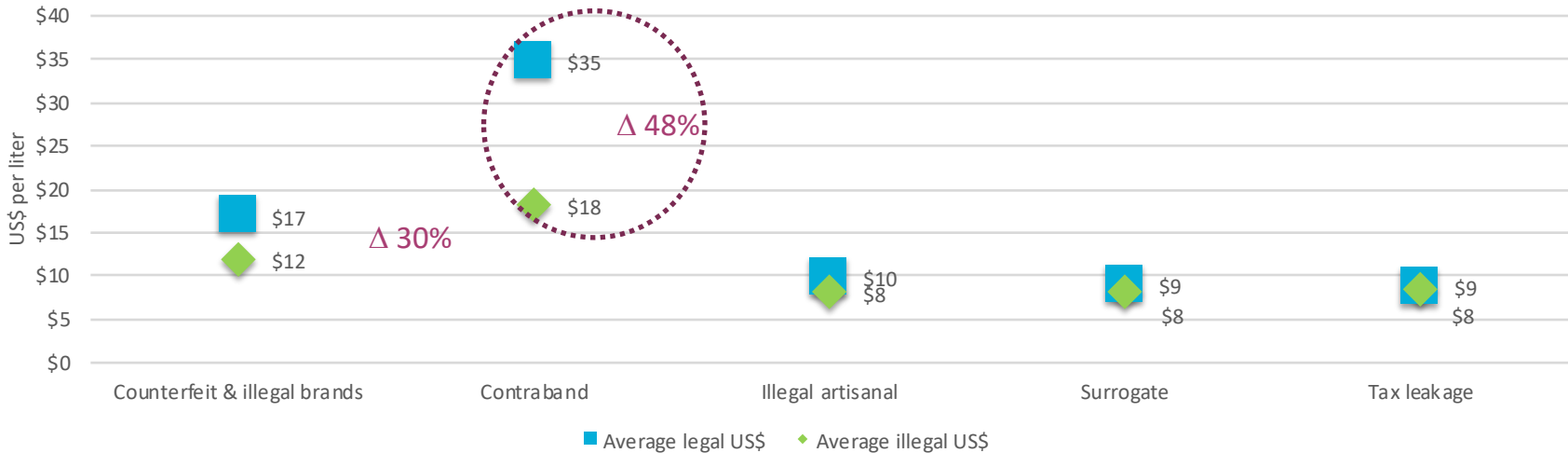
# Price analysis by category

Contraband is the category with highest difference in prices, with brands that are sold at up to half the price of the legal product. The counterfeit and illegal brands category also shows major differences in prices, above all prices in *on premise* channels. Even though the difference in price of legal alcoholic beverages that evade taxes is small given the consumption volume (largest category in volume), the loss remains considerable.

Difference between illegal vs. legal prices, 2015

# 27%

Average prices per liter (US\$), 2015



Source: Euromonitor International

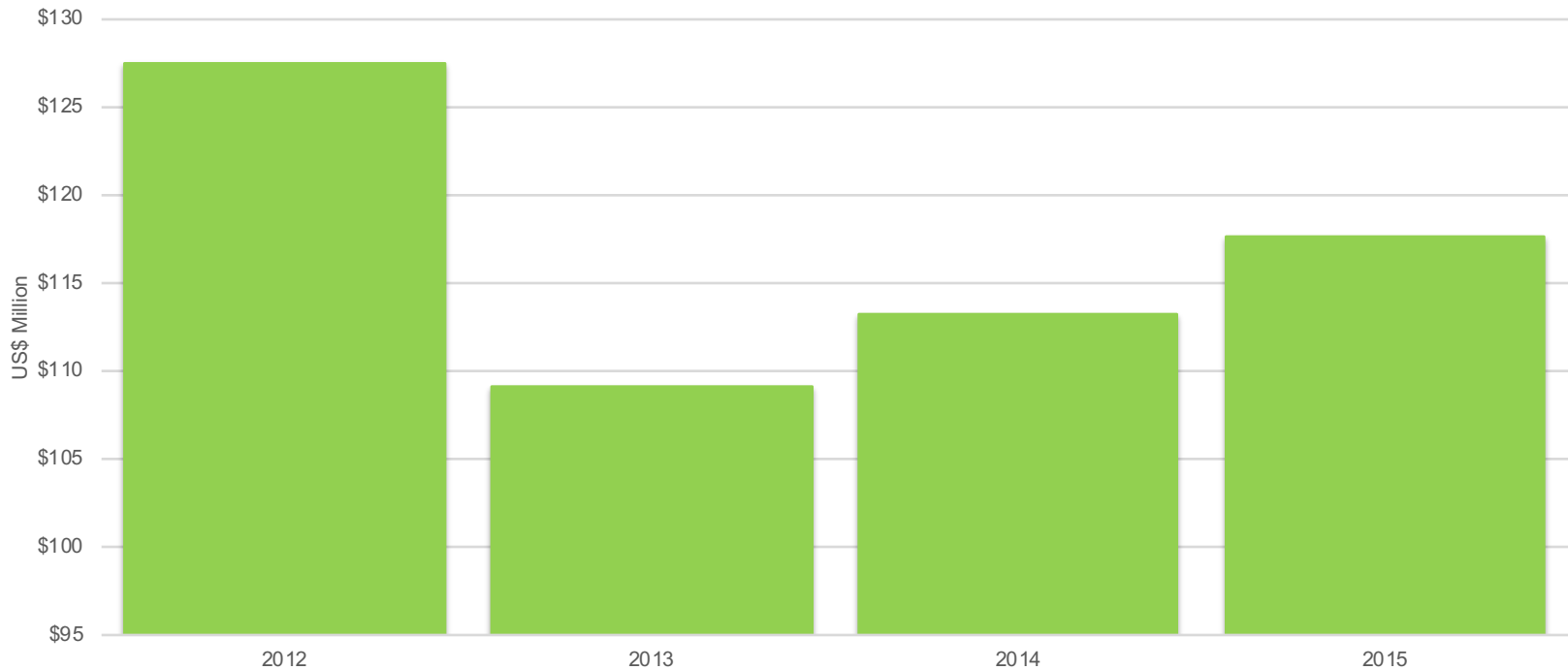


## Executive summary

# Evolution of fiscal loss (US\$) in the past 4 years

Fiscal loss decreased 17% in 2012-2015. In 2012 it was estimated at US\$128 million and in 2015 it fell to US\$118 million. However, in the past year it experienced a remarkable leap (4%) considering the adjustment of taxes paid on imported alcoholic beverages.

## Evolution of fiscal loss (US\$), 2012 - 2015

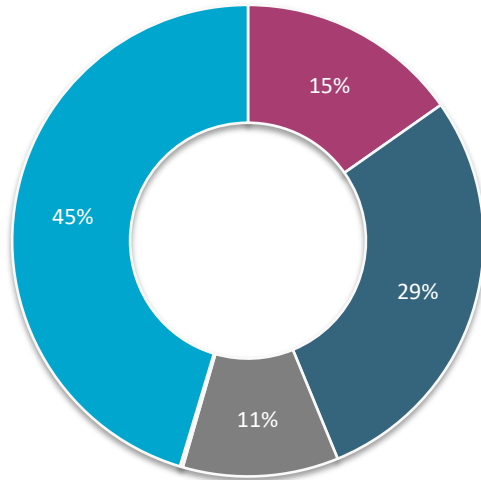


Source: Euromonitor International

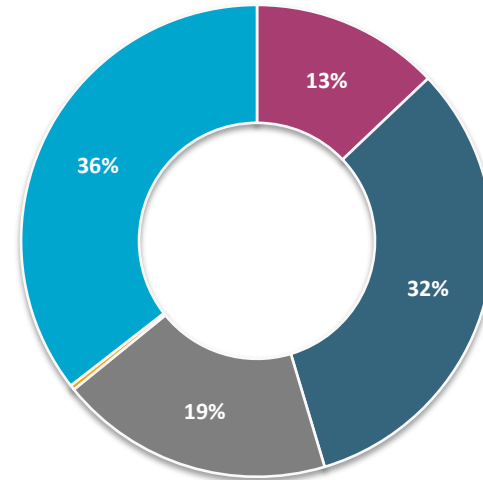
**Executive summary**

# Analysis fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category(US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

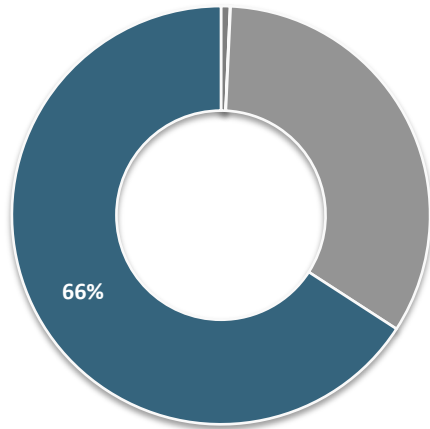
Tax leakage is the most relevant category in terms of consumption in volume as well as in fiscal loss. Contraband is the second category that most contributes to fiscal loss, due to the growing tax burden, which in some cases caused the original selling price to increase up to 100%.



## Executive summary

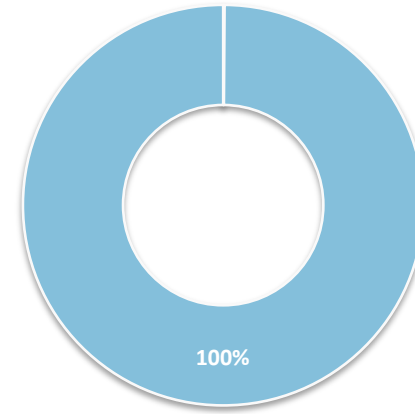
# Analysis for beer

Legal alcoholic beverage market, HL LAE, 2015



■ RTD ■ Wine ■ Spirits ■ Beer

Illegal beer market, HL LAE, 2015



■ Counterfeit ■ Contraband

Source: Euromonitor International

In the alcoholic beverage market, beer is the segment with lowest percentage of illegality. Illegality happens mostly in the contraband coming from Colombia, Peru, Mexico and the US. There is counterfeiting via refill in *on premise* channels such as bars and discos, but it is minimal.

## Counterfeit and illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>21,373</b>	<b>16%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>63</b>	<b>15</b>

- Volume-wise, counterfeit and illegal brands rank third in consumption of illegal alcoholic beverages. Within this category, illegal manufacturing of illegal brands/unbranded prevails with 79% and focuses on spirits (*aguardiente*, rum and whisky).
- Between 2014 and 2015, its market share within the total illegal market grew from 14% to 16% in terms of volume LAE. This was due mostly to the proliferation of alternative counterfeiting processes, such as refills with essences and transferring contents between brands from one bottle to another, using preparations similar to the original product.
- Fiscal loss resulting from the sale of counterfeit product amounted to US\$15 million dollars, representing 13% of the total fiscal loss.

## Counterfeit and illegal brands

# Evolution of consumption (LAE) in the past 5 years

- In 2011-2015, consumption of counterfeit alcohol and illegal brands decreased 55%, reaching 21,373 HL LAE in 2015. Illegal production has been gaining ground over the years, whereas Substitution/Refill volume has dwindled.
- In the past year, consumption increased 11% due to the proliferation of on premise channels, where owners opt to buy illegal alcohol to boost profits, especially due to the rising prices of legal alcoholic beverages.

### Evolution of the counterfeit and illegal brands market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Counterfeit and illegal brands

### Main factors that influence the category



#### ALCOHOLIC BEVERAGES

- The main types of alcoholic beverages involved in this category are Colombian anise-flavored *aguardiente* (such as Paisa), Scotch-type whisky, Oro-type rum and El Cuervo tequila, among others.
- Included in illegal manufacturing are rums, whiskies and fruit-flavored *aguardiente* which are sold without sanitary registration certificate or brand.



#### WHERE

- Mainly in on premise channels such as bars, discos and nightlife entertainment centers in general.
- Off-premise sale takes place in duty-free retail stores.



#### FACTORS

- Counterfeit products usually offer customers similar flavors at a lower price, ensuring higher profit margins for the merchant with prices comparable to those of the legal product.
- Thanks to the lack of or infrequent controls, selling counterfeit and illegal brands is quite easy.



#### EFFECTS

- Health hazard for consumers.
- Lower sales volume of legal alcoholic beverages, especially with corporate clients and purchases for social events.

## Contraband

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>17,610</b>	<b>14%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>119</b>	<b>38</b>

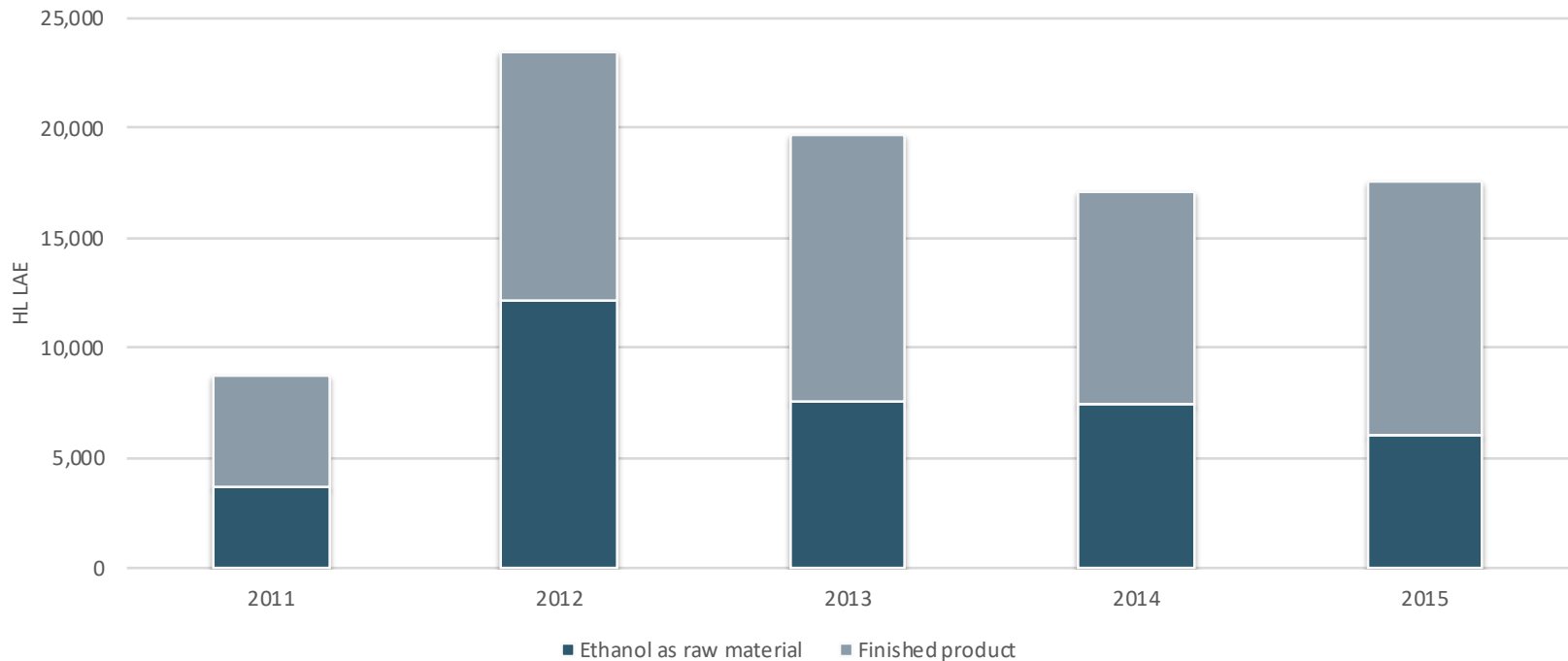
- In terms of volume LAE, contraband ranks fourth in the total illegal market. However, its market value is the second highest (US\$119 million), considering that it includes premium brands of whisky, *aguardiente* and cognac.
- Contraband of ethanol as raw material represents 34% of the category in terms of volume LAE, thus reflecting the relevance of the contraband of premium alcoholic beverages.
- The fiscal loss resulting from contraband is estimated at US\$38 million; it is the second highest, due mainly to the high import rates.

## Contraband

# Evolution of consumption (LAE) in the past 5 years

- In 2011-2015, contraband doubled in volume, mainly due to the ever-higher tax burden. In the past year, growth was 3% in terms of volume.
- The enforcement of requirements, such as fiscal stamps on imported products and import surcharges effective as of 2015, also helped to boost the contraband sale of alcoholic beverages.

### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International



## Contraband

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- The types of alcoholic beverages more frequently involved in contraband are whisky, rum, vodka, and tequila, with brands such as Grant's, Johnnie Walker, Old Parr, Captain Morgan.
- Contraband ethanol is used as an ingredient/raw material for counterfeit beverages.



### WHERE

- Contraband of alcoholic beverages enters mainly through the borders with Colombia and Peru, brought from Panama.
- The most common points of sale are grocery warehouses, small and duty-free liquor stores, and personalized distributors online.
- Contraband ethanol enters through the border with Peru.



### FACTORS

- The main reason for buying contraband products is the price, which is up to 48% cheaper than legal alcoholic beverages.
- The legal product comes with specific fiscal stamp; however, the effects of this security measure seem to have weakened.



### EFFECTS

- Fiscal loss as a result of import and illegal sale.
- Contraband also affects the sales of importers and distributors.

**Illegal artisanal alcohol****Consumption analysis**

Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>31,154</b>	<b>24%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>44</b>	<b>22</b>

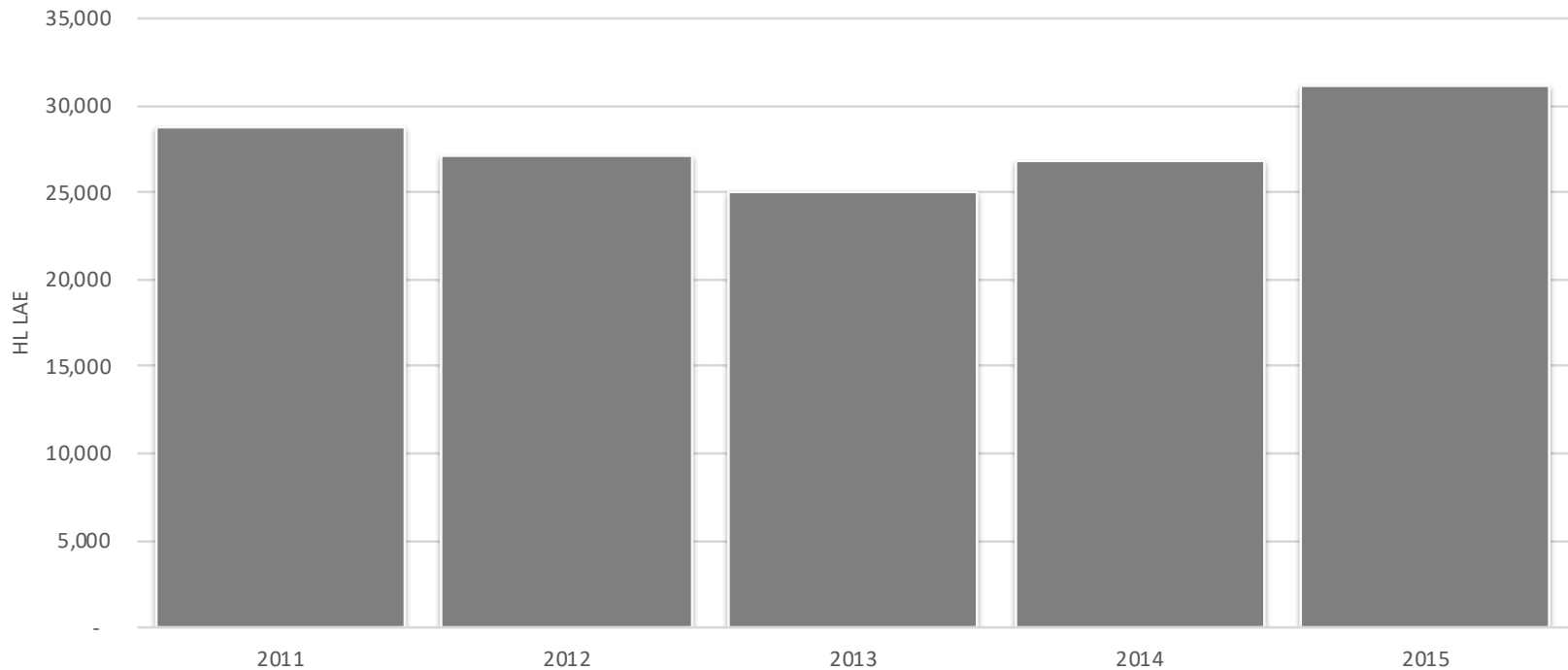
- In terms of volume LAE, illegal artisanal alcoholic beverages rank second in the total illegal beverage market. These alcoholic beverages are manufactured using illegal artisanal ethanol as raw material, which makes their sale much easier.
- Consumption of illegal artisanal alcoholic beverages has become quite mainstream and socially accepted, to the extent that in many places, it is not actually considered an illegal activity, particularly in rural areas.
- In the past year, this category's share of the total market in terms of volume LAE took a significant leap, rising from 19% to 24%.
- Fiscal loss resulting from the sale of illegal artisanal alcoholic beverages is estimated at US\$22 million, which represents 19% of the total fiscal loss.

## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- In 2011-2015, consumption of these alcoholic beverages increased 8%, rising from 28,819 HL LAE in 2011 to 31,154 HL LAE in 2015.
- The illegal artisanal manufacturing of ethanol, which is the main ingredient of these beverages, is the main factor driving consumption. In the past year it saw considerable growth (16%), in turn driving up residual ethanol volume.

#### Evolution of the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Illegal artisanal alcohol

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- The most common illegal artisanal alcoholic beverage is brandy based on sugar cane (known as *puntas*, *guayusa* and *pájaro azul*).
- There are beverages with fruits and herbs that are sold in milder versions and distributed at social events and/or more populated areas.



### WHERE

- These type of beverages are sold in farmers' markets, independent grocery stores, clandestine wine cellars, homes, and *haciendas* that produce farm food products.
- They are sold mostly in rural and suburban areas.



### FACTORS

- Their consumption is rooted in socially accepted cultural habits and customs.
- The availability of these beverages is exclusive, as there are few or no other options.
- Given its low price, it is an affordable product.



### EFFECTS

- They are a health hazard for consumers.
- Growing consumption by young people below the legal age to purchase alcohol.
- They generate fiscal loss to the country.



## Surrogate

# Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>506</b>	<b>0.4%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>1</b>	<b>0.4</b>

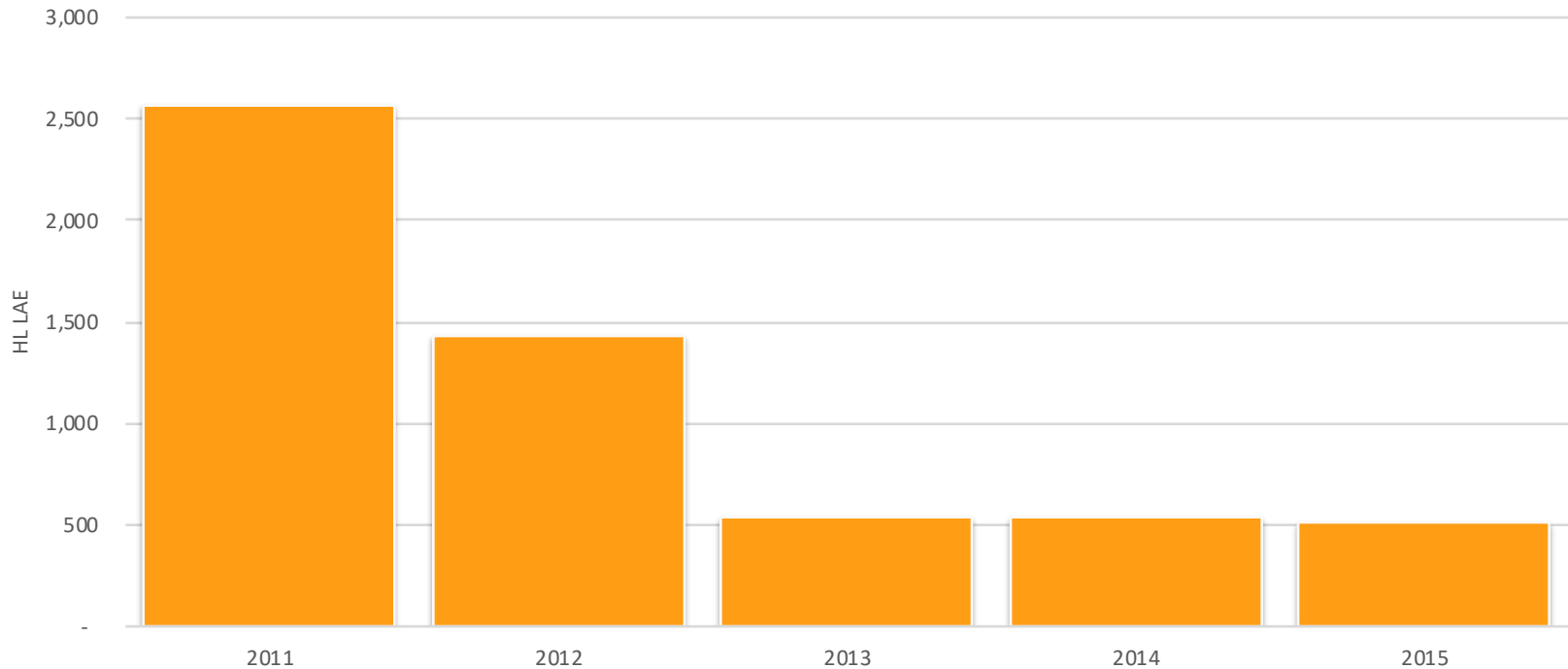
- In terms of volume LAE, the consumption of surrogate alcohol in 2015 represented 0.4% of the total illegal alcohol market.
- This category is the least common in the Ecuadorean market, due to the easy access to illegal artisanal alcohol or legal alcohol that pays no taxes and to the decrease in imports of alcohol for industrial uses.
- It is estimated that consumers spent US\$1 million in the purchase of pharmaceutical alcohol as surrogate of legal alcoholic beverages.
- The resulting fiscal loss is estimated at US\$0.4 million, representing 0.3% of the total fiscal loss.

## Surrogate

# Evolution of consumption (LAE) in the past 5 years

- In the review period of 2011-2015, consumption of surrogate alcohol suffered a remarkable drop, driven by stricter controls in the import of alcohol and greater awareness on the part of the population after the intoxication/poisoning scandal that happened in 2011.
- The category is expected to continue decreasing in the future.

### Evolution of the surrogate alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Surrogate

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- The typical beverages containing surrogate alcohol are pure *aguardientes*, artificial flavored mixes based on sweet wine, illegal artisanal compounds with methanol, and other types of non-ethanol products.



### WHERE

- Sales take place in taverns in extremely low-income areas, vendors in kiosks or tobacco stands, street vendors, and informal sales in urban homes.



### FACTORS

- Substance abuse/addiction.
- Extreme poverty.
- Occasionally, the deception of counterfeit products at a lower price.



### EFFECTS

- Consumption of pharmaceutical alcohol is a health hazard, due to the extremely high blood alcohol concentration they cause quite rapidly.



## Tax leakage

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>58,899</b>	<b>45%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>189</b>	<b>42</b>

- Volume-wise, tax leakage produced by legal alcoholic beverages is the biggest category in the illegal alcohol market, representing 45%.
- The products that most frequently evade taxes are linked to *aguardiente*, wine-based flavored beverages and other types of distilled products similar to rum, with lower prices and targeted at low-income segments.
- Tax leakage is entirely composed of spirits.
- Fiscal loss generated by legal alcoholic beverages that evade taxes is estimated at US\$42 million for 2015, which represents 36% of the total fiscal loss.

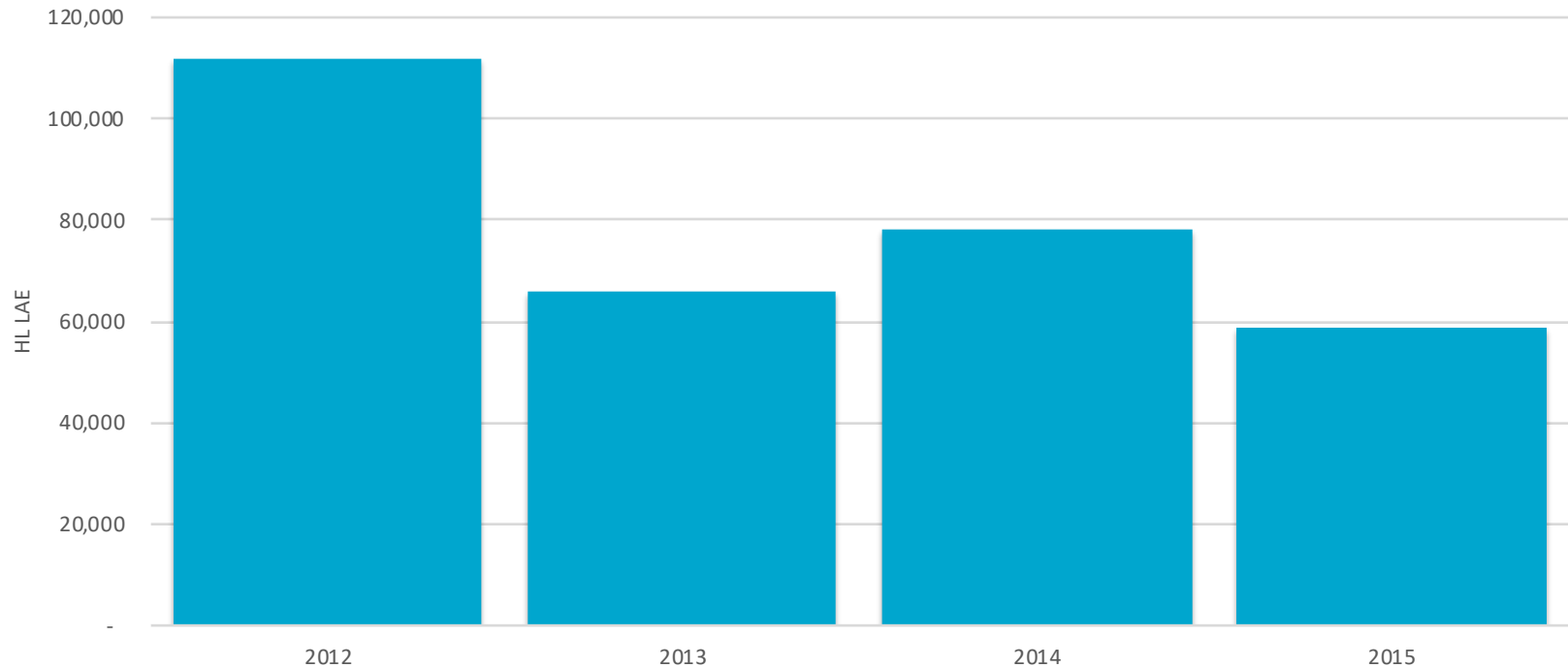


## Tax leakage

# Evolution of consumption (LAE) in the past 4 years

- In 2012 – 2015, consumption of legal alcoholic beverages that produce tax leakage has fallen considerably (47%), from 112,084 HL LAE in 2012 to 58,899 HL LAE in 2015.
- In the past year, tax leakage in terms of volume decreased 25%; this was mostly due to an improvement of controls implemented in the production of alcoholic beverages on the part of small semi-industrial manufacturers.

## Evolution of tax leakage (HL LAE), 2011 - 2015



Source: Euromonitor International

## Tax leakage

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- *Aguardiente* in dry format, flavored beverages presented as wine, and low-quality rum.
- Beverages produced on a small scale by legal manufacturers that leave a part of their production unreported.



### WHERE

- Main points of sale in the provinces of *Cotopaxi*, *Manabí*, *Guayas* and *Los Ríos*, which is where the semi-industrial manufacturing plants operate.
- They reach end consumers through independent liquor stores in low-income areas.



### FACTORS

- Consumption of these products is mainly due to their comparatively low price.
- Higher penetration and availability in places where other legal products are usually absent.



### EFFECTS

- Unfair competition for the local industry that does pay taxes.
- Tax leakage drains the country's resources.



## Industry comments

### Key quotes from interviews



Only eight remain of the initial 33 associated importers; this is the negative consequence of contraband and heavy taxes.

— *Importer of Alcoholic Beverages, Importers Association*



There are many other ways of hiding illegality, which continues to flourish in on premise sales channels.

— *Alcoholic beverages distributor*



Tax leakage is largely due to the discretionary cost categories, relative to the *ad valorem* tax in small-sized producers.

— *Asociación de industriales licoreros AILE*



Illegality stems mostly from the sale of raw material as an artisanal product. And there is also an obvious reduction in general consumption levels.

— *Distillers Association*



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## Executive summary

# Illegal beverage market in El Salvador 2015



**28.432<sub>HL LAE</sub> | 22%**

Market size in volume,  
Share out of total market

**US\$51<sub>Mn</sub> | 11%**

Market size in value,  
Share out of total market

**US\$16<sub>Mn</sub>**

Fiscal loss



## Executive summary

# Main findings in the illegal market in 2015

1

### The illegal alcohol market grew 2% in 2015, but lost share

- Consumption grew in terms of volume, but its share of the total market decreased.
- The illegal alcohol share fell from 23% in 2014 to 22% in 2015.

### Actions enforced by the authorities proved to be insufficient for reducing the consumption of illegal alcohol

2

- The *Dirección Nacional de Medicamentos* (DNM) carried out inspections and seizures of illegal alcohol in pharmacies over the year, this helped decrease the consumption of surrogate.
- The follow-up conducted by the Health Ministry (MINSAL) resulted in higher scores as regards the number of registered companies and the volume of registered alcohol quotas.

3

### Counterfeit alcohol and surrogate continue to be the main forms of illegality, but surrogate consumption is decreasing

- Both categories represent 87% of the total volume of illegal alcohol.
- Counterfeit alcohol grew 4% in volume, whereas surrogate decreased 8%.

### The difference between the taxes on potable alcohol for alcoholic beverages and those used for other purposes spurs the illegal trade

4

- The alcohol used for manufacturing alcoholic beverages is taxed US\$5 per liter, whereas alcohol used for other purposes is only taxed US\$0.10 per liter.
- This difference encourages the refill of popular brands of *aguardiente*, the sale of illegal alcohol such as pharmaceutical alcohol, and unreported tax leakage.

## Executive summary

# Main factors that affect the illegal market in 2015

### These factors facilitated consumption:

- Better performance of the local economy, increasing the amount of consumer income available for the consumption of alcoholic beverages.
- Greater availability of contraband product advertised in the classified ads section online and in some stores.
- Limited inspections in pharmacies, especially in rural areas.
- Insufficient resources allocated to the *Unidad de Alcohol y Tabaco* of the Department of Health to follow up the assigned quota.

### These factors weakened consumption:

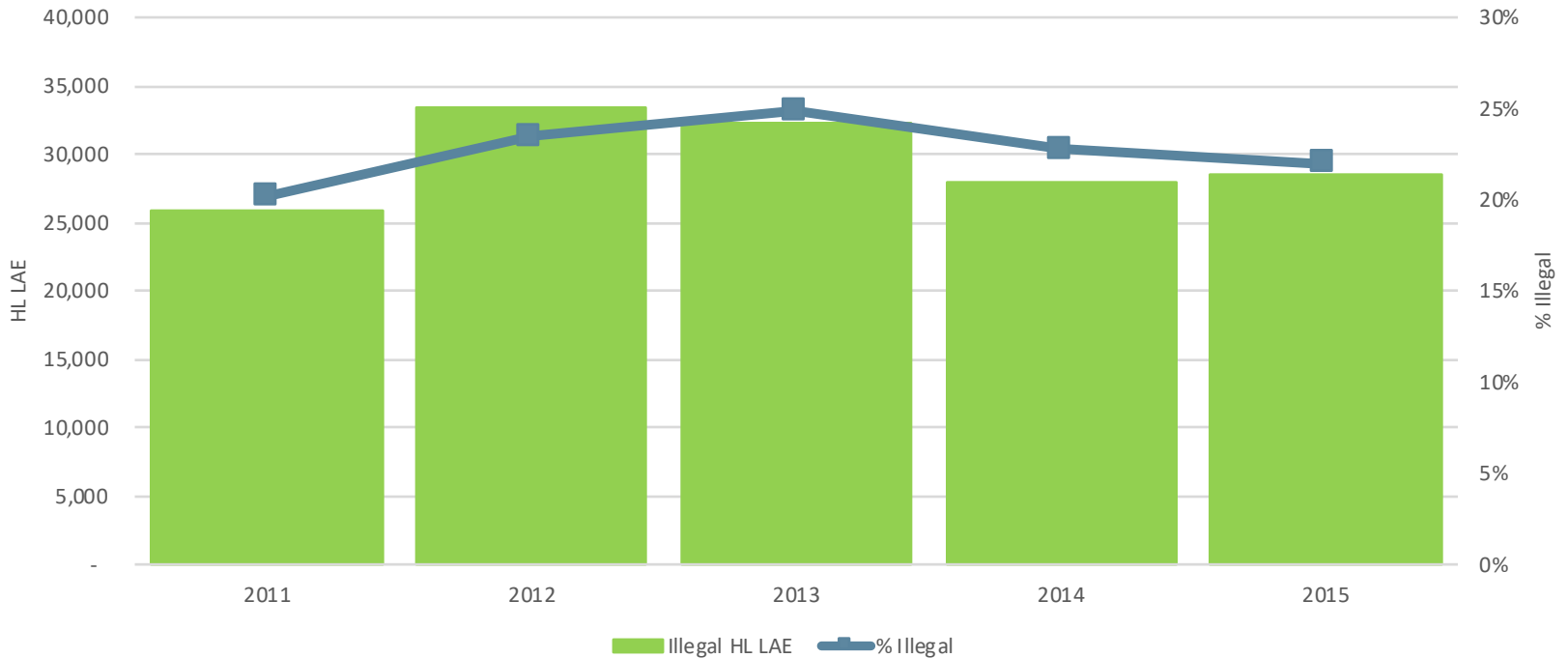
- DNM carried out inspections and seized product in pharmacies focused on the sale of alcohol.
- MINSAL increased the registry and number of companies and the volume of alcohol registered in the quota.
- Actions informing about the problems related to illegal alcohol and the subsequent blow to the economy have generated greater awareness among both authorities and consumers.

**Executive summary**

# Evolution of the market in the past 5 years

In 2011-2015, consumption of illegal alcohol increased 10%, from 25,867 HL LAE to 28,432 HL LAE. In the past year, it showed minimum growth (2%), with a share of the total market estimated at 22%. In 2012, illegal alcohol consumption strongly increased mainly due to higher availability of residual ethanol.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International



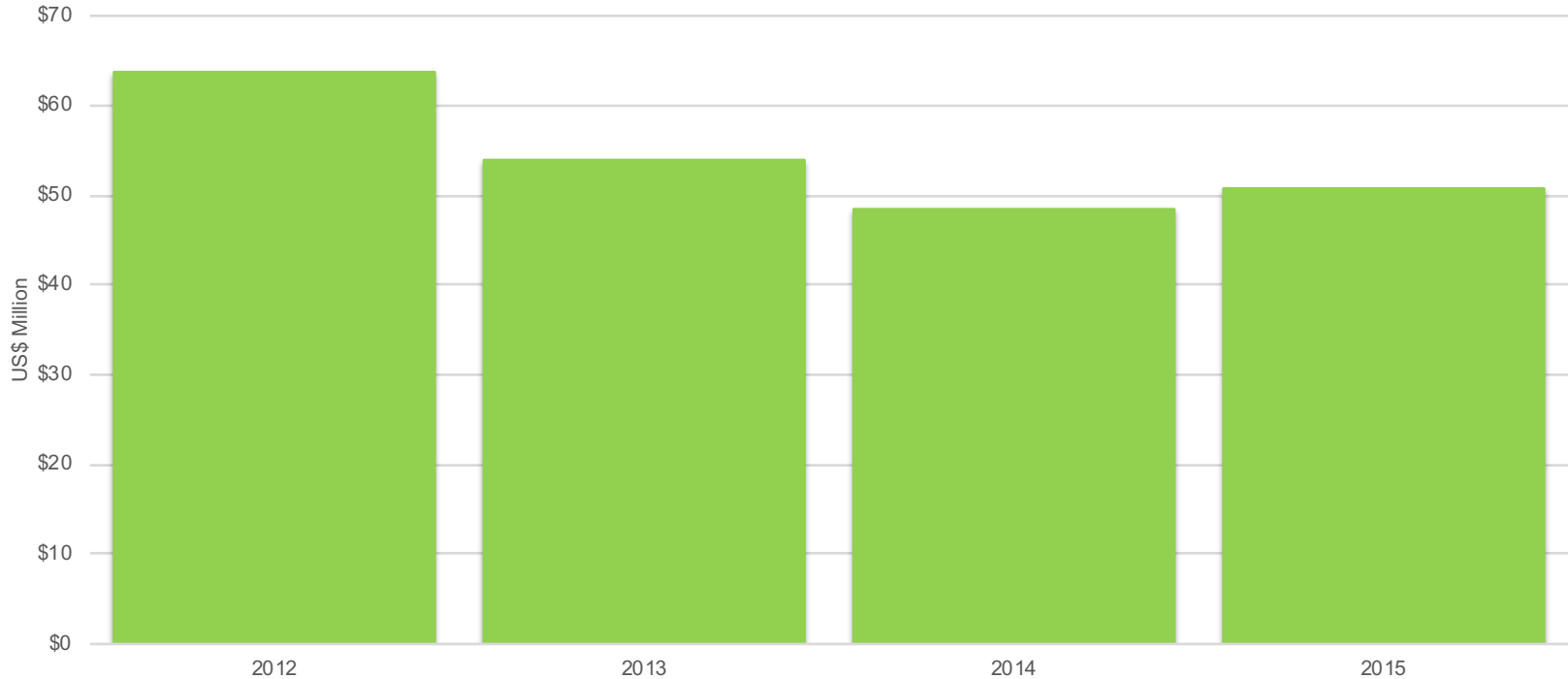


**Executive summary**

## Evolution of the illegal market (US\$) in the past 4 years

Between 2012 and 2015, the illegal alcohol market decreased 20%, from US\$64 million to US\$51 million. In the past year, consumption grew 5%, reflecting the price adjustment that occurred that same year.

### Evolution of the illegal market (US\$), 2012 - 2015



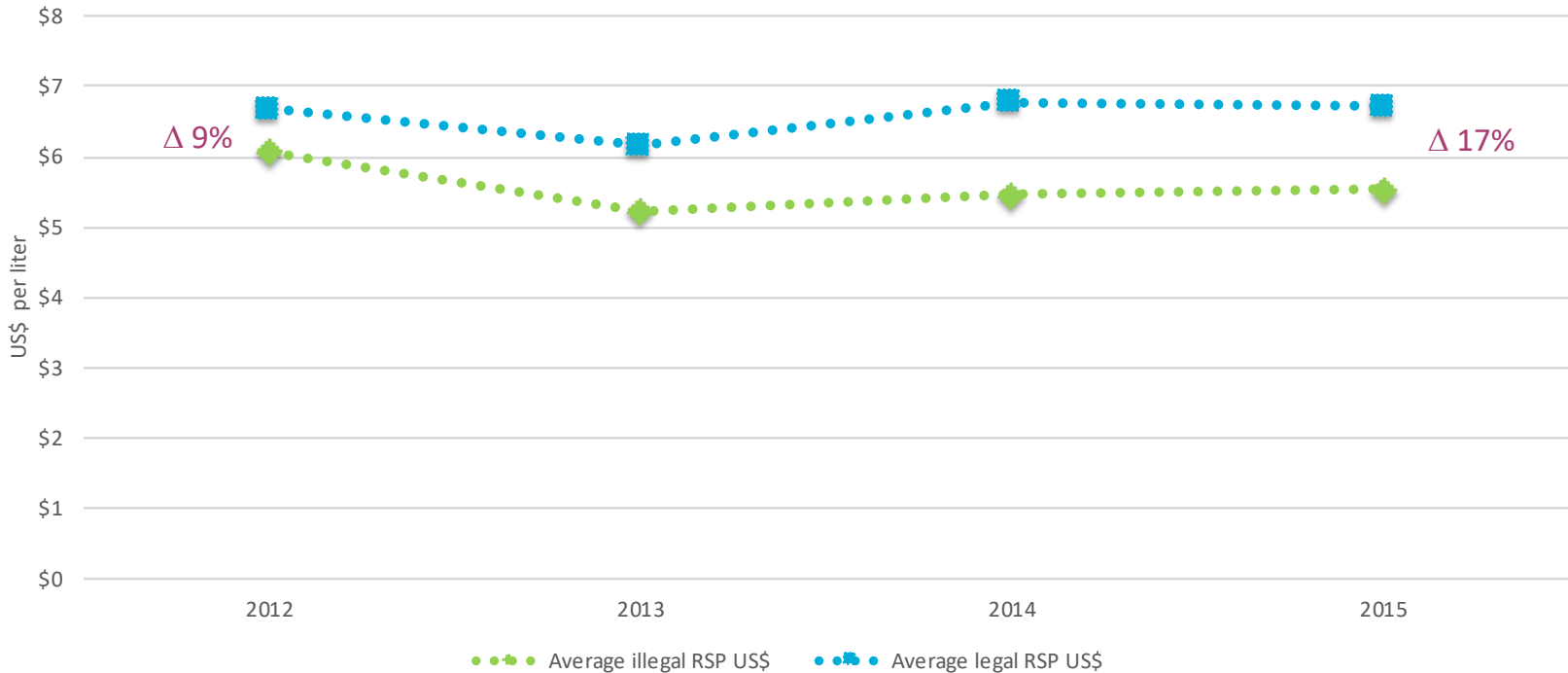
Source: Euromonitor International

**Executive summary**

# Evolution of prices in the illegal market in the past 4 years

In 2012-2015, the difference between legal and illegal prices gradually widened. As shown in the chart below, the difference in 2012 was 8%, whereas in 2015 it was 17%. With a broader difference between prices, illegal alcohol is gaining appeal among the lower-income segments.

Evolution in average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



## Executive summary

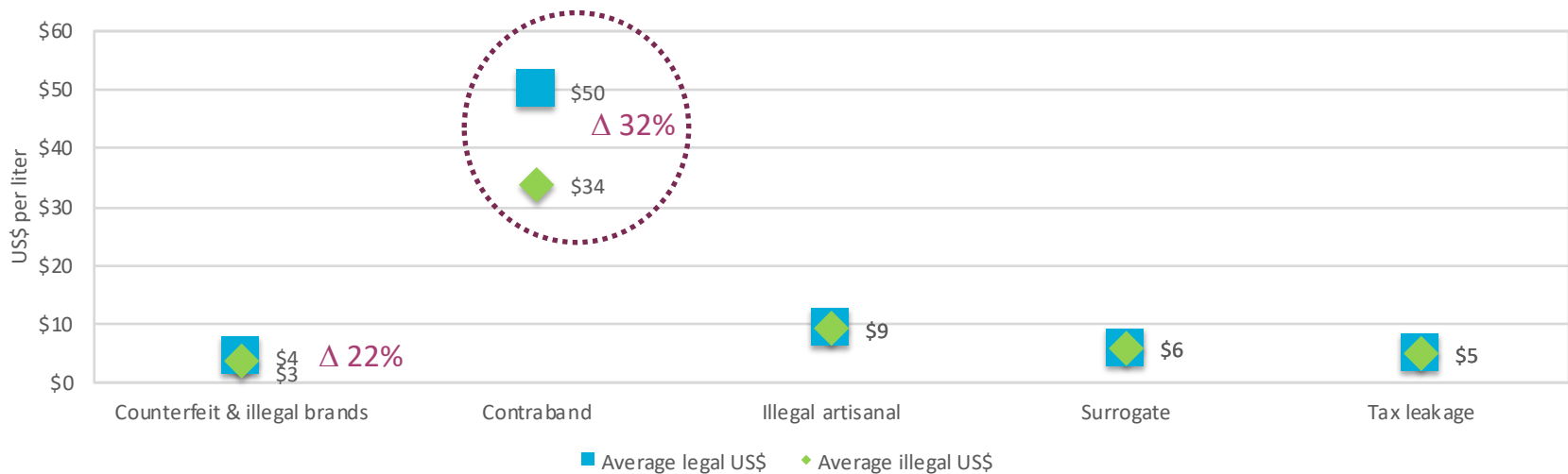
# Price analysis by category

Difference between illegal vs. legal prices, 2015

# 17%

Contraband alcohol has the greatest difference in prices (32%) due to the higher prices of *premium* brands, which are badly hit by this illegal practice.  
 In the case of counterfeit alcohol, the difference is 22%, whereas the remaining categories show no difference.

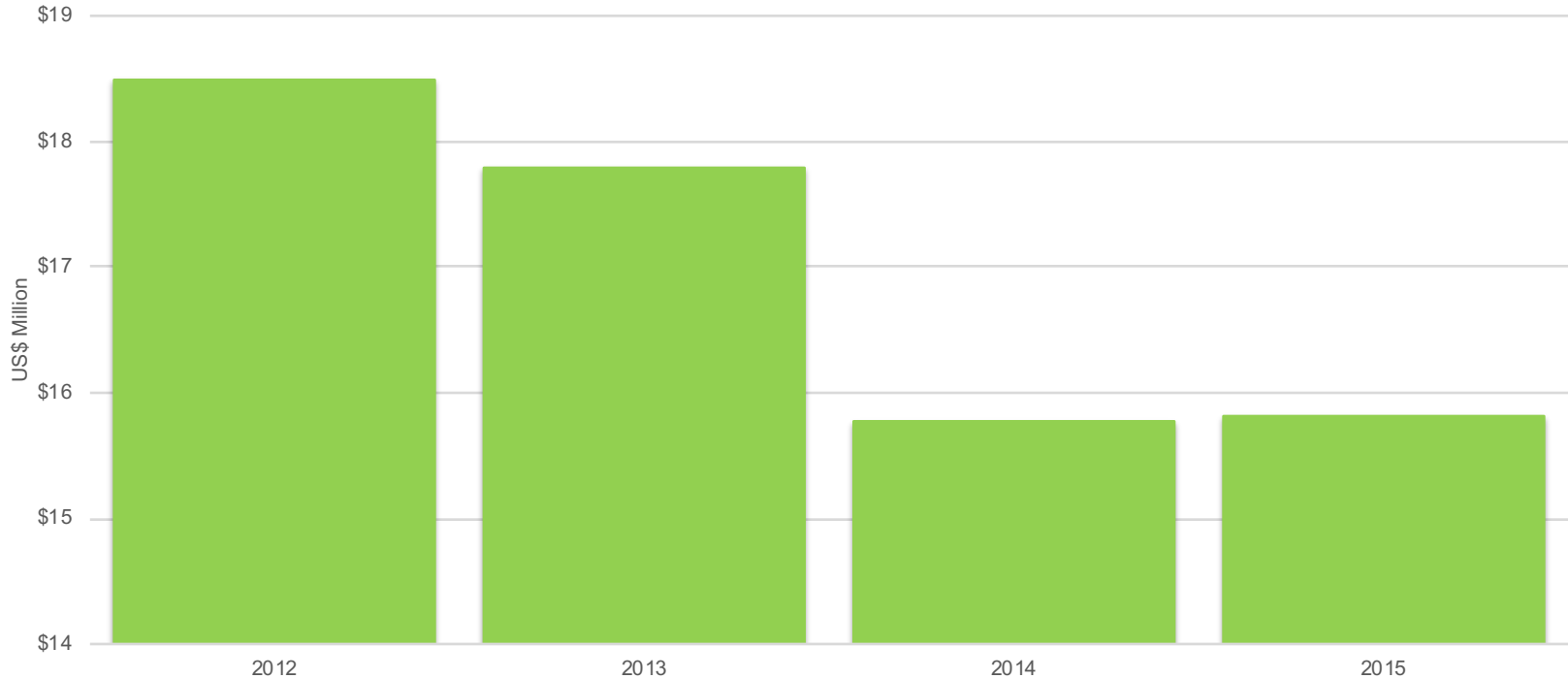
Average prices per liter (US\$), 2015



Source: Euromonitor International

**Executive summary****Evolution of fiscal loss (US\$) in the past 4 years**

Fiscal loss fell 15% in 2012-2015. In 2012 it was estimated at US\$19 million and in 2015 it decreased to US\$16 million.

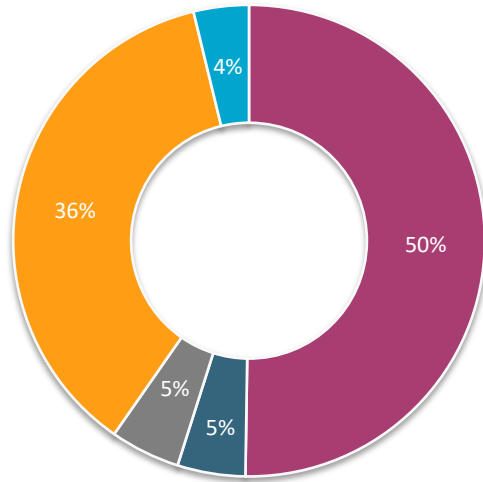
**Evolution of fiscal loss (US\$), 2012 - 2015**

Source: Euromonitor International

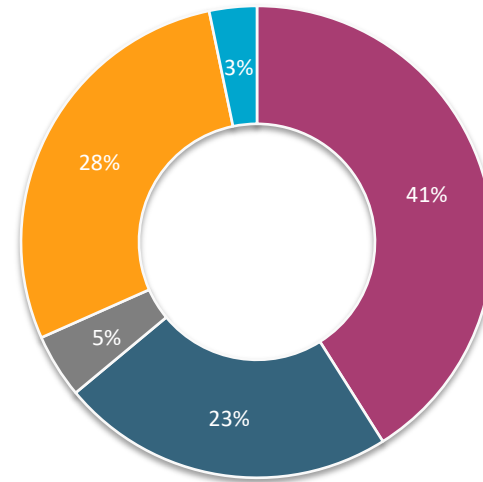
Executive summary

# Analysis of fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category (US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

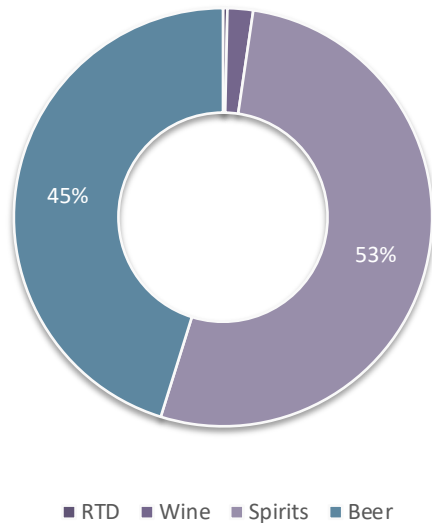
Fiscal loss maintained its level of US\$16 million, similar to 2014. Counterfeit alcohol/illegal brands and surrogate are the two categories that generate the highest fiscal loss, with a combined value of US\$11 million and 87% market share. Likewise, though contraband represents 5% of the market LAE, it generates around 23% of the total fiscal loss. The reason is that contraband involves whisky almost exclusively, which is a premium product with a price significantly higher than *aguardiente*.



## Executive summary

# Analysis for beer

### Legal alcoholic beverage market, HL LAE, 2015



Source: Euromonitor International

Spirits are the most important category in terms of volume LAE with a 53% share in the legal alcoholic beverage market. Beer is in second place, with 45% of volume LAE. During the research process, in interviews and visits to points of sale, no illegal trade of beer was discovered. Given beer's low alcohol content and how it is made, illegal production is not appealing compared to other alcoholic beverages such as *aguardiente*.

## Counterfeit alcohol and illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>14,285</b>	<b>50%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>19</b>	<b>7</b>

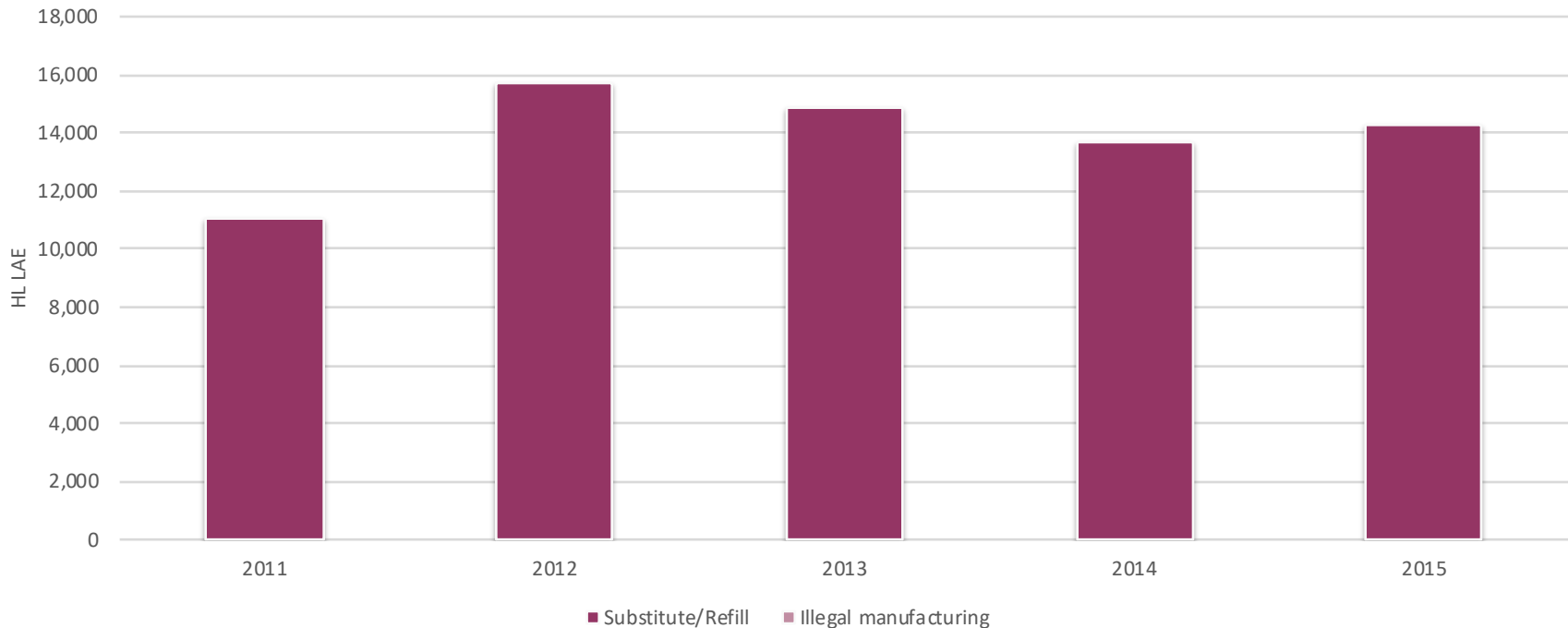
- Volume-wise, counterfeit alcohol/illegal brands top the list in the illegal alcoholic beverage market.
- Within the category, the total volume is made up by spirits.
- Between 2014 and 2015, this category increased 4%, mainly because the higher demand for *aguardiente* sparked the growth of illegal refill of these beverages.
- Fiscal loss generated by counterfeit alcohol/illegal brands is estimated at US\$7 million for 2015, which represents 41% of the total fiscal loss.

## Counterfeit alcohol/illegal brands

### Evolution of consumption (LAE) in the past 5 years

- Within the counterfeit alcohol/illegal brands category, consumption was discovered of refilled alcoholic beverages exclusively. In 2011-2015, consumption increased 30%, from 11,012 HL LAE in 2011 to 14,285 HL LAE in 2015. The lack of action to stop counterfeiting encourages more people to carry out this illegal activity.
- The huge difference between the taxes paid by the legal alcohol used for manufacturing alcoholic beverages and industrial alcohol drives people to switch from the former to the latter.

#### Evolution of the counterfeit alcohol/illegal brands market (HL LAE), 2011 - 2015



Source: Euromonitor International



## Counterfeit alcohol/illegal brands

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Counterfeiting mostly involves spirits; the main ones are *aguardiente* and vodka brands such as *Caña Rica*, *Tropi Caña*, and *Cuscatlán*.
- Garbage collectors sell empty bottles of popular brands to be refilled.



### WHERE

- Counterfeit alcohol is normally sold in taverns and liquor stores, and obtained through street vendors.



### FACTORS

- Easy access, due to the lack of control over the volume of residual ethanol.
- Insufficient control at points of sale.
- Consumers and merchants of alcoholic beverages seek cheaper products.



### EFFECTS

- Counterfeit alcohol is a health hazard for consumers.
- It generates huge fiscal loss to the country.
- Illegal alcohol has a negative impact on legal manufacturers that suffer often substantial losses.



**Contraband****Analysis by category**

Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1,324</b>	<b>5%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>11</b>	<b>4</b>

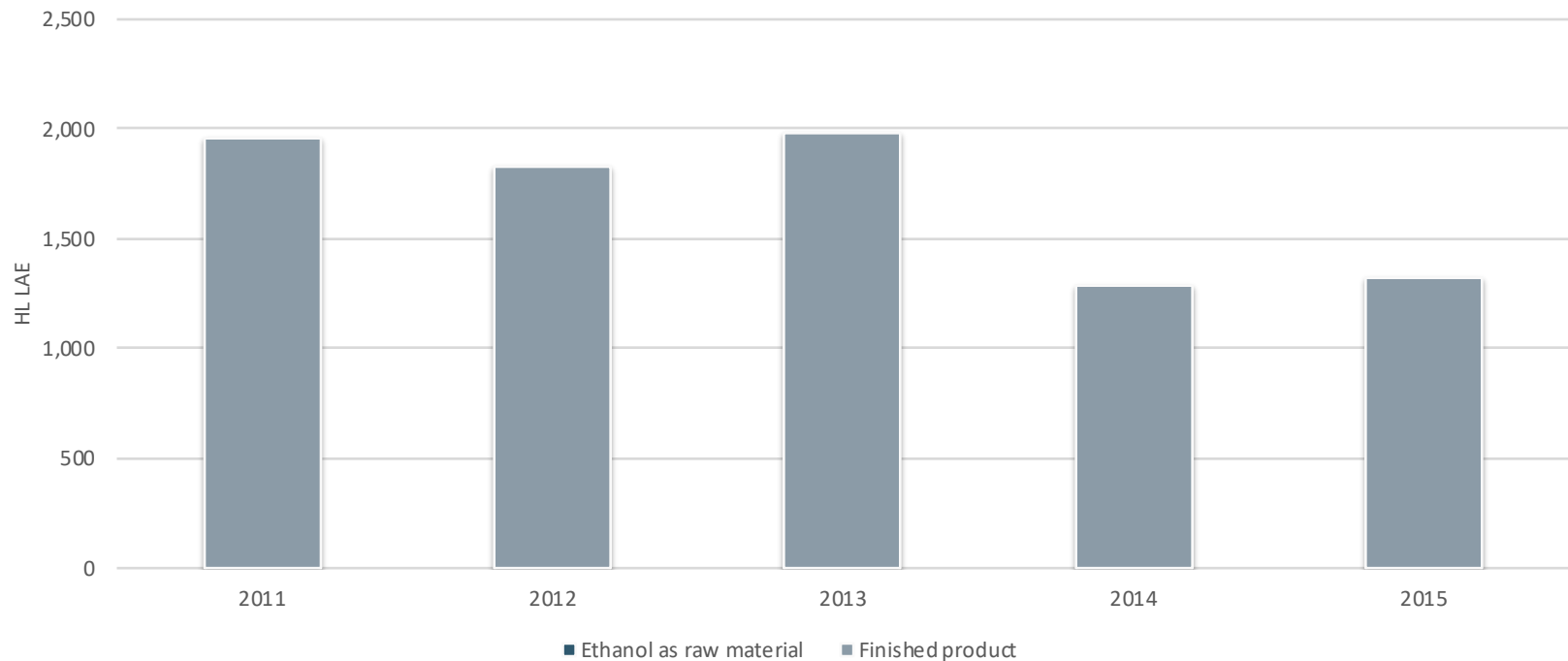
- Volume-wise, the contraband category ranks fourth in the illegal alcoholic beverage market, valued at US\$11 million.
- Within the category, whisky is the most affected by contraband.
- Between 2014 and 2015, contraband grew 3%, due to the higher volume of contraband whisky.
- During the research process, the existence of contraband ethanol could not be confirmed.
- The fiscal loss generated by contraband is estimated at US\$4 million for 2015, which represents 23% of the total fiscal loss.

## Contraband

### Evolution of consumption (LAE) in the past 5 years

- During the review period, consumption decreased 32%, from 1,956 HL LAE in 2011 to 1,324 HL LAE in 2015. As shown in the chart below, consumption of beverages that use ethanol as raw material is nonexistent, and the category is composed only of the finished product.
- However, consumption of the finished product increased 3% between 2014 and 2015, due to the lack of control by the authorities.

#### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Contraband

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Spirits, mainly Johnny Walker, Old Parr and Chivas Regal whiskey, but also Absolut and Grey Goose vodka.



### WHERE

- Normally sold in *on-trade* channels such as restaurants, bars and discos.
- Some duty-free stores also offer these alcoholic beverages to the public.
- They are sold through classified ads online, on sites such as [www.sv.clasificados.st](http://www.sv.clasificados.st) and OLX.



### FACTORS

- Inadequate control at borders and during sales conducted in duty-free shops.
- The higher prices and taxes for these premium beverages promote contraband (the price differential between legal and illegal alcoholic beverages).



### EFFECTS

- Contraband alcohol generates fiscal loss to the country.
- It encourages unfair competition with companies that sell legal alcohol.



## Illegal artisanal alcohol

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1,362</b>	<b>5%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>3</b>	<b>0.7</b>

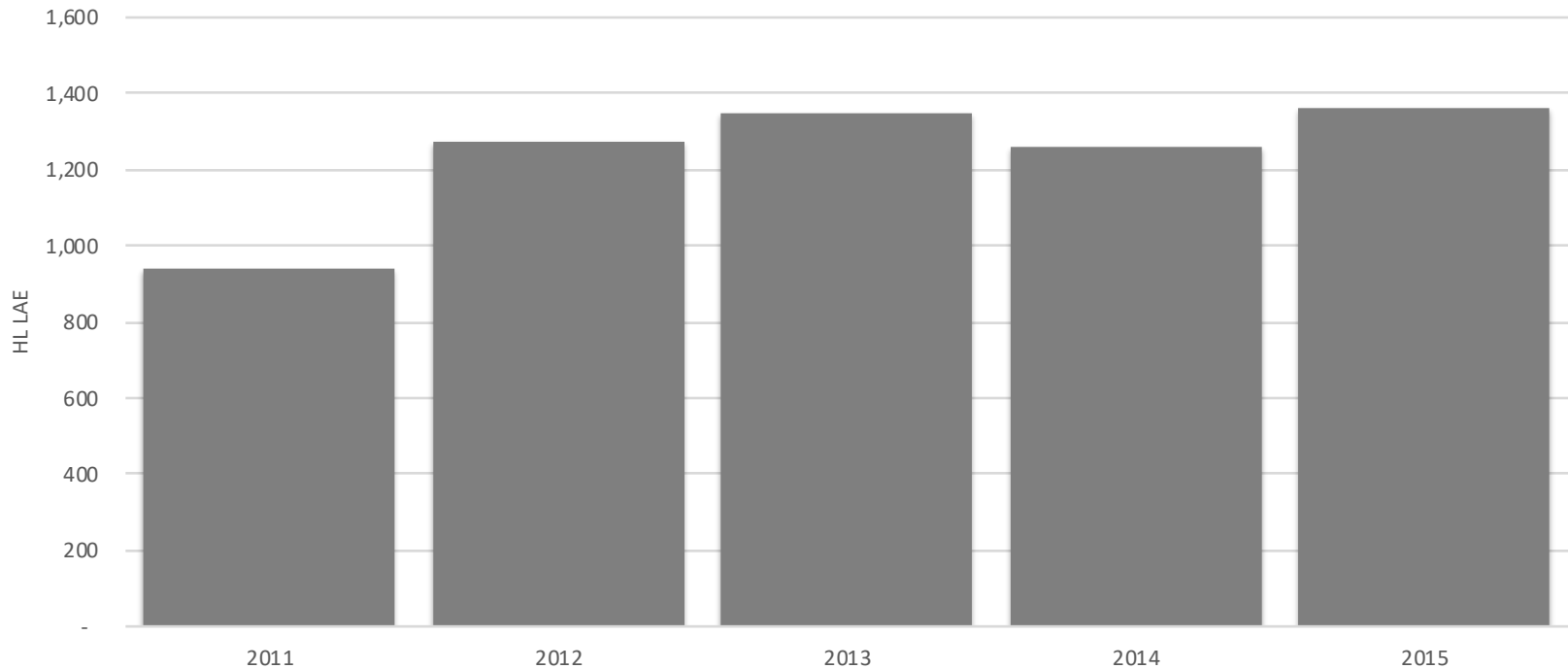
- Illegal artisanal alcoholic beverages held a share of 5% (1,362 HL LAE) in the illegal alcohol market in 2015. The amount spent on their purchase was estimated at US\$3 million.
- *El chaparro* comprises the category's total volume and consumption increased between 2014 and 2015, driven by a greater demand for alcoholic beverages.
- The fiscal loss generated by illegal artisanal alcoholic beverages is estimated at US\$0.7 million for 2015, which represents 4% of the total fiscal loss.

## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- In the review period, consumption of illegal artisanal alcohol increased 45%, from 938 HL LAE in 2011 to 1,362 HL LAE in 2015.
- In the past year, consumption increased 8%, triggered by a higher aggregate demand for alcoholic beverages which in turn was the consequence of improved scores growth and consumer income.

#### Evolution of the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Illegal artisanal alcohol

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- *El Chaparro* is the most popular illegal artisanal beverage.
- It is sold in recycled plastic bottles (PET).



### WHERE

- Consumption of illegal artisanal alcohol concentrates in rural areas, through clandestine businesses that operate in homes, markets and the outskirts of town.
- In small villages small stores operate clandestinely.



### FACTORS

- Consumers in rural areas seek this beverage because of its high alcohol content.
- *El Chaparro* has a more affordable price.
- In rural areas, there is less control over the manufacturing of alcoholic beverages.



### EFFECTS

- The illegal artisanal alcohol business promotes fiscal loss among manufacturers.
- They represent a health hazard for consumers as they are made without production or quality standards of any kind.



## Surrogate

# Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>10,384</b>	<b>37%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>15</b>	<b>5</b>

- Volume-wise, surrogate alcohol holds the second place in the illegal alcoholic beverage market with a share of 37%. The reason is that pharmacies are dedicated almost exclusively to the sale of alcohol, which is neither denatured nor authorized by sanitary registration.
- Consumers spent an estimate US\$15 million in the purchase of pharmaceutical alcohol as surrogate of alcoholic beverages.
- Between 2014 and 2015, consumption of surrogate alcohol fell 8%, mainly due to the higher number of inspections carried out in pharmacies by government authorities.
- The fiscal loss generated by surrogate alcohol is estimated at US\$5 million for 2015, which represents 28% of the total fiscal loss.

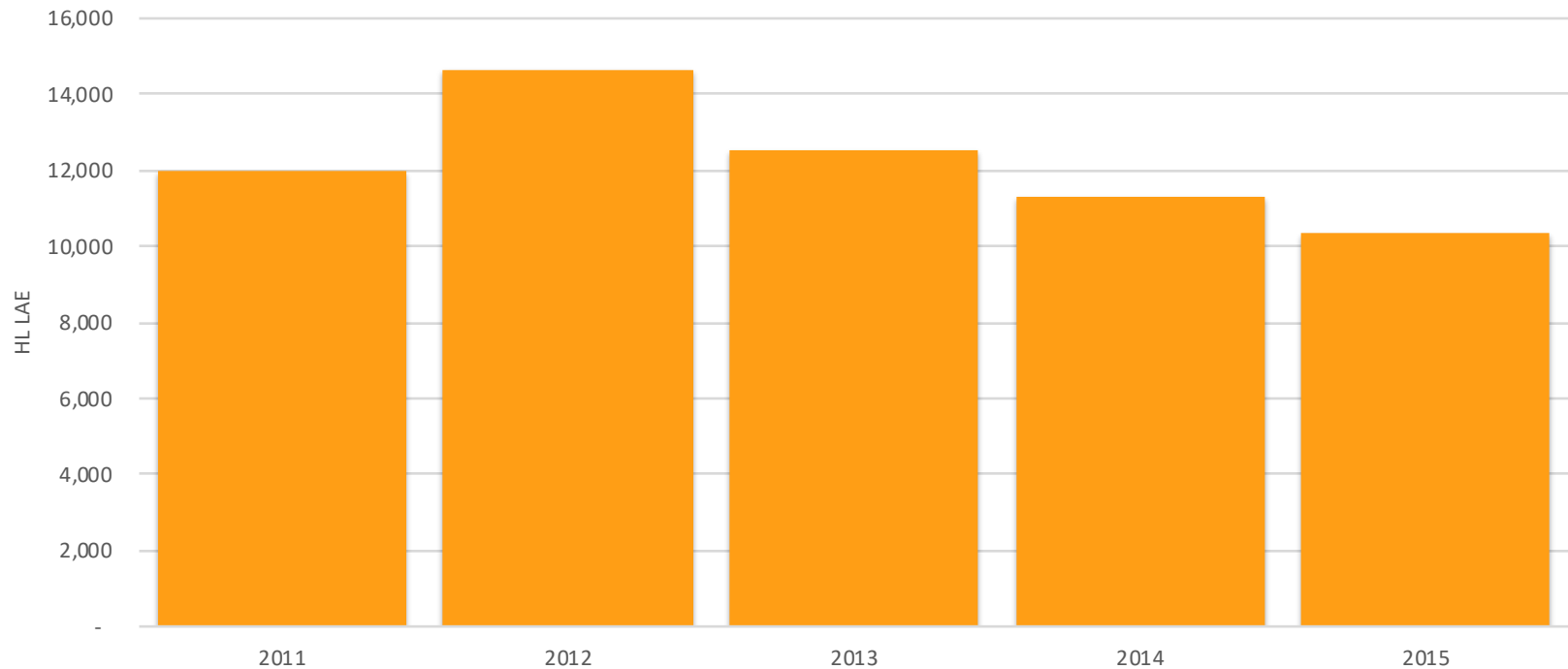


## Surrogate

# Evolution of consumption (LAE) in the past 5 years

- In the review period, consumption of illegal artisanal alcohol fell 3%, from 11,962 HL LAE in 2011 to 10,384 HL LAE in 2015, caused by the greater number of inspections carried out in pharmacies.
- However, these inspections are not altogether effective; beyond checking to see that the alcohol being sold is denatured and has its sanitary registration, there is no real intention to penalize all the pharmacies that do not comply with this regulation, to avoid medicine shortages that could occur if many pharmacies are shut down.

### Evolution of the surrogate alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Surrogate

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Surrogate alcohol derives from the commercialization of outside-quota alcohol, which is distributed as “denatured” alcohol for topical use.



### WHERE

- The main commercialization channels are independent pharmacies that operate in the vicinity of the markets or in rural areas.



### FACTORS

- Controls enforced by government authorities which, even though they helped to cut down the sales in this category, were insufficient to reduce the problem significantly.



### EFFECTS

- Consumption of pharmaceutical alcohol is a health hazard because of the high alcohol concentration levels.
- The alcohol for topical use has lower tax rates and generates fiscal loss to the country.
- High incidence of social behavioral disorders such as violence and crime.



## Tax leakage

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1,077</b>	<b>4%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>2</b>	<b>0.5</b>

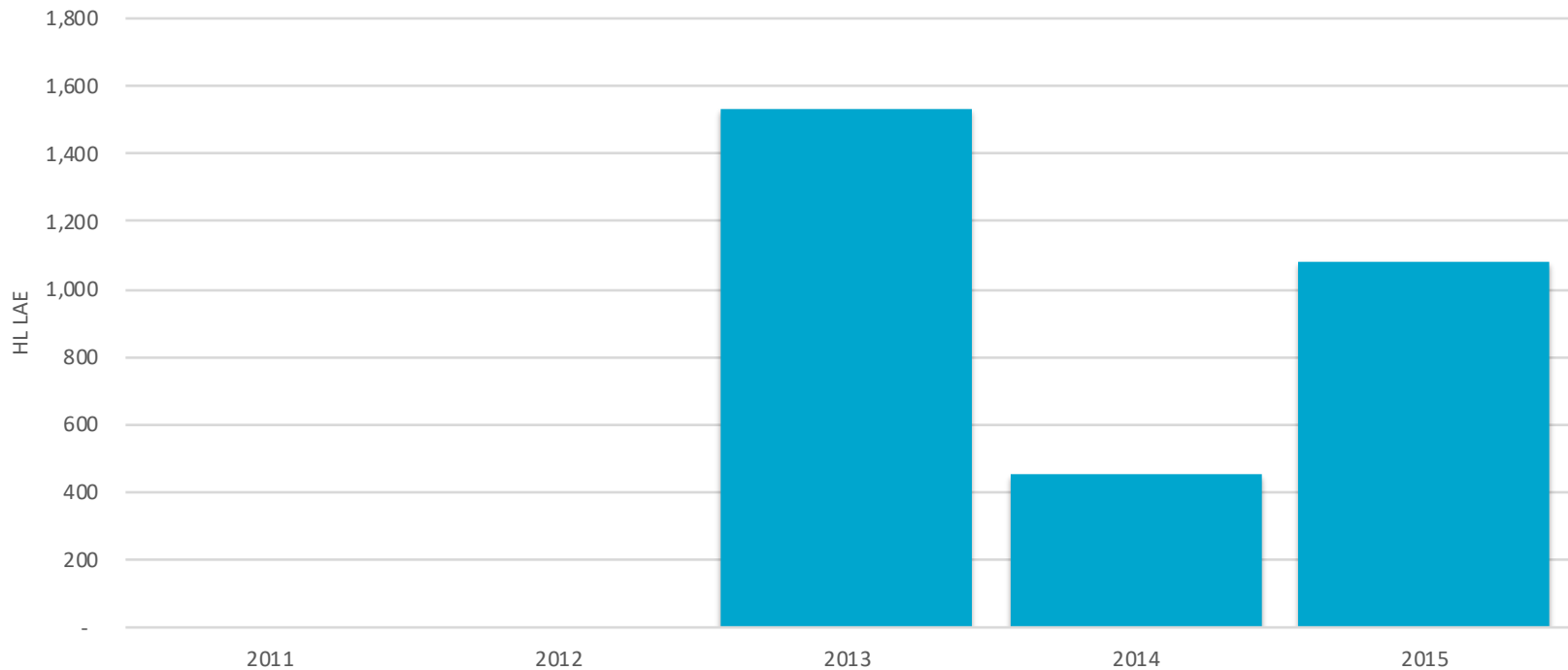
- Tax leakage is the smallest among the categories of illegal alcohol consumed in the country and reached 1,077 HL LAE, equivalent to US\$2 million.
- It is estimated that the difference between the ethanol used in the manufacturing of alcoholic beverages and the one available was 25,000 HL LAE, of which approximately 1,000 HL LAE were used for manufacturing that went unreported.
- The fiscal loss generated by legal alcoholic beverages that evade taxes is estimated at US\$0.5 million for 2015, which represents 3% of the total fiscal loss.

## Tax leakage

# Evolution of consumption (LAE) in the past 5 years

- In 2015 tax leakage grew 139%, from 450 HL LAE in 2014 to 1,077 HL LAE in 2015. Consumption of alcohol that evades taxes is nonexistent for 2011 and 2012.
- The growing number of inspections carried out in pharmacies by the DNM and communication via the media reduced the diverted alcohol, which was redirected for the illegal trade.

### Evolution of tax leakage (HL LAE), 2011 - 2015



Source: Euromonitor International

## Tax leakage

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Tax leakage is fully generated by spirits, *aguardiente* in particular.



### WHERE

- Especially carried out by manufacturers of alcoholic beverages who do not file tax returns for at least part of their production.



### FACTORS

- Lack of control and follow-up in the allotment and usage of alcohol quotas.
- Evasion enables to obtain very high profit margins.
- Greater availability of raw material and lax control over residual ethanol.



### EFFECTS

- Tax leakage results in loss of resources for the regions.
- Unfair competition that impacts the other manufacturers of alcoholic beverages.



## Industry comments

### Key quotes from interviews



Despite the DNM's efforts to control this problem (surrogate alcohol) in pharmacies, the procedure was very specific and short-lived. There should be a specialized unit on the style of the ATF in the US.

— *Salvadorean Distributor*



If we shut down all the pharmacies that are selling alcohol with irregularities, either because the product is not denatured or it lacks registration (false bullet), we would have another problem on our hands, because there would be no more pharmacies left.

— *Dirección Nacional de Medicamentos*



The bottom line is usually a price-tax combination (contraband). In other neighboring countries, these beverages have much lower taxes. In Guatemala for example, tax is 10.6% of the price of spirits, vs. El Salvador, where there are 2 taxes, making prices soar. As a result, even considering transport costs, that same bottle imported illegally to El Salvador (from Guatemala) can be sold at a more convenient price and still be profitable.

—*Liza Group*



All this began with the fiscal reform (counterfeiting spirits). Before, taxes were much lower; now, almost half the price of the product is tax. As a result, prices went up and counterfeiters were in business, as this illegal activity became profitable.

—*Liza Group*



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Executive summary

# Illegal alcoholic beverage market in Honduras 2015



22.262<sub>HL LAE</sub> | 20%

Market size in volume,  
Share out of total market

US\$21<sub>Mn</sub> | 4%

Illegal market size in value,  
Share out of total market

US\$5<sub>Mn</sub>

Fiscal loss\*

\*Fiscal loss refers only to the production and consumption tax. Fiscal loss including sales tax is US\$10.3 million dollars.





## Executive summary

# Main findings in the illegal market in 2015

1

### Contraband of ethanol as raw material increased 39%

- The manufacture of *aguardiente* using ethanol as raw material increased 5% in 2015.
- Imports and national manufacture of ethanol decreased, causing the contraband of ethanol to grow from 13,182 HL LAE in 2014 to 18,369 HL LAE in 2015.

2

### Tax leakage in the alcoholic beverages industry is maintained at zero

- The rigid tax policy currently in force continues to show its achievements. Reporting tax collection details via the media, results in greater transparency and control.
- At a national level, the industry of alcoholic beverages presents no tax leakage.

3

### In 2015, the illegal alcohol market grows more rapidly vs. the legal market

- In 2015, the illegal market grew 31%, whereas the legal market grew 5%.
- The contraband of ethanol as raw material and the clandestine manufacturing of *aguardiente* spurs the illegal market.

4

### Contraband of ethanol as raw material is still the factor that most contributes to the illegal alcohol trade

- Contraband increased its volume by a 33% in 2015, compared to 2014.
- With respect to the illegal market, the category grew from 90% in 2014 to 91% in 2015.

## Executive summary

# Main factors that affect the illegal market in 2015



### These factors facilitated consumption:

- Lack of control by the authorities, stimulates the illegal entry of ethanol via Customs and inland blind spots.
- Limited local manufacturing of ethanol and increase in the manufacturing of *aguardiente*, which encourages illegal imports of ethanol.
- Devaluation of the local currency, which jacked up the price per liter of legal alcohol.
- Increase in the production of *panela* (raw cane sugar) and greater availability of raw material for the clandestine distillation of *aguardiente*.



### These factors weakened consumption:

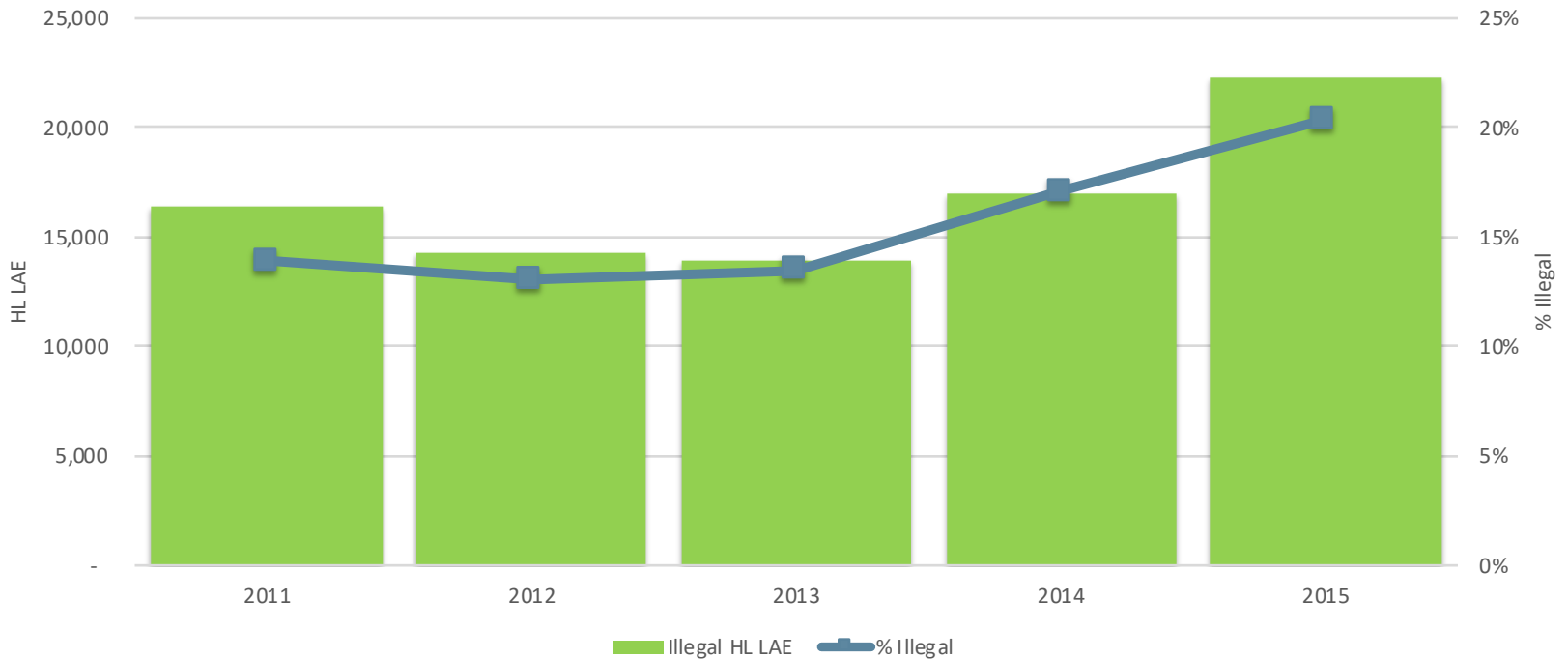
- Industry's ongoing efforts to generate consumer awareness.
- Instructions in newspapers about how to recognize the various security seals of legal brands.
- Greater control of fiscal loss by the authorities.
- *Distintivo Atlántida*, a project launched by the Ministry of Tourism, managed to reduce the number of illegal artisanal alcohol manufacturers.

**Executive summary**

# Evolution of the illegal market (LAE) in the past 5 years

Between 2011 and 2015, the illegal alcohol market grew 36%, from 16,407 HL LAE to 22,262 HL LAE. The upward growth tendency is still positive and has gained momentum in the periods 2013 – 2014 and 2014 – 2015. In HL LAE, growth rates were 22% and 31%, respectively.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International

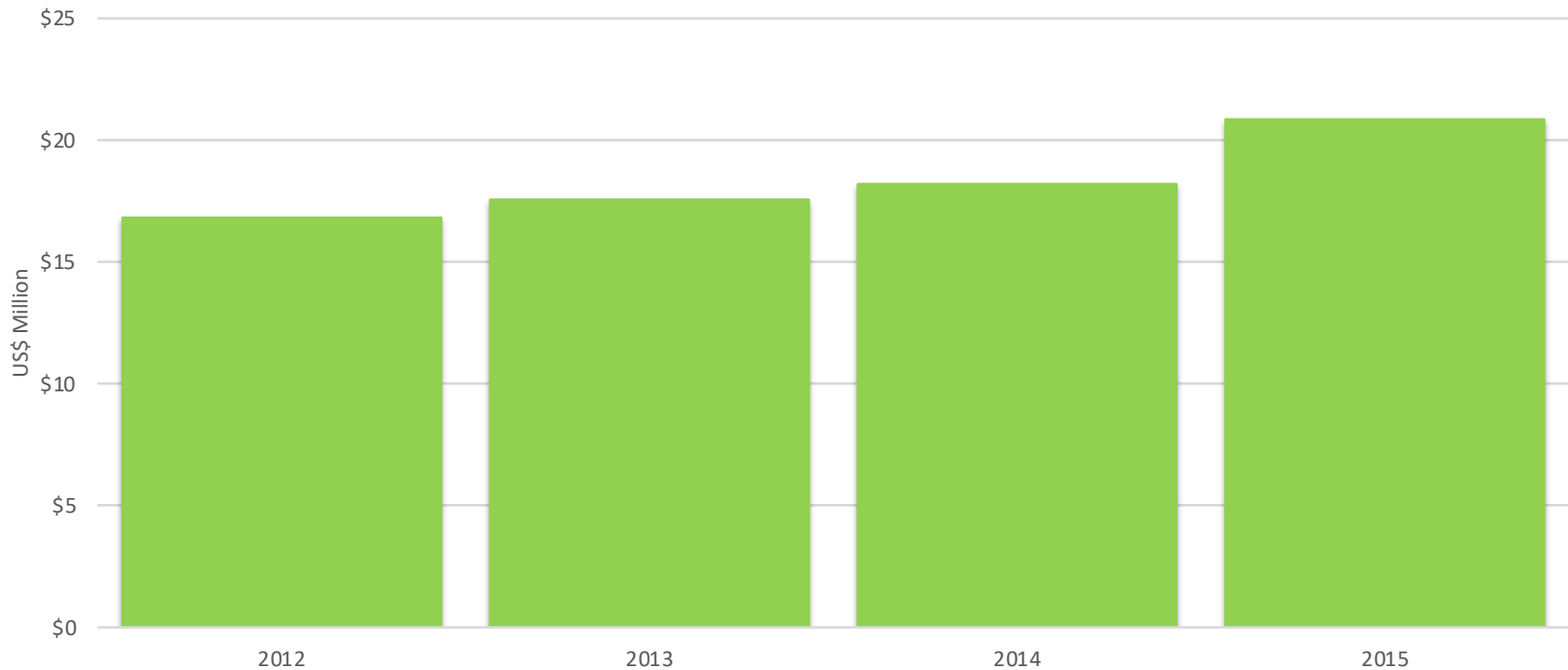


## Executive summary

# Evolution of the illegal market (US\$) in the past 4 years

Between 2012 and 2015, the illegal alcohol market grew 24%, rising from US\$17 million to US\$21 million. The upward growth tendency remains positive and reached its highest level in 2015. In this last year, growth was 15%.

## Evolution of the illegal market (US\$), 2012 - 2015



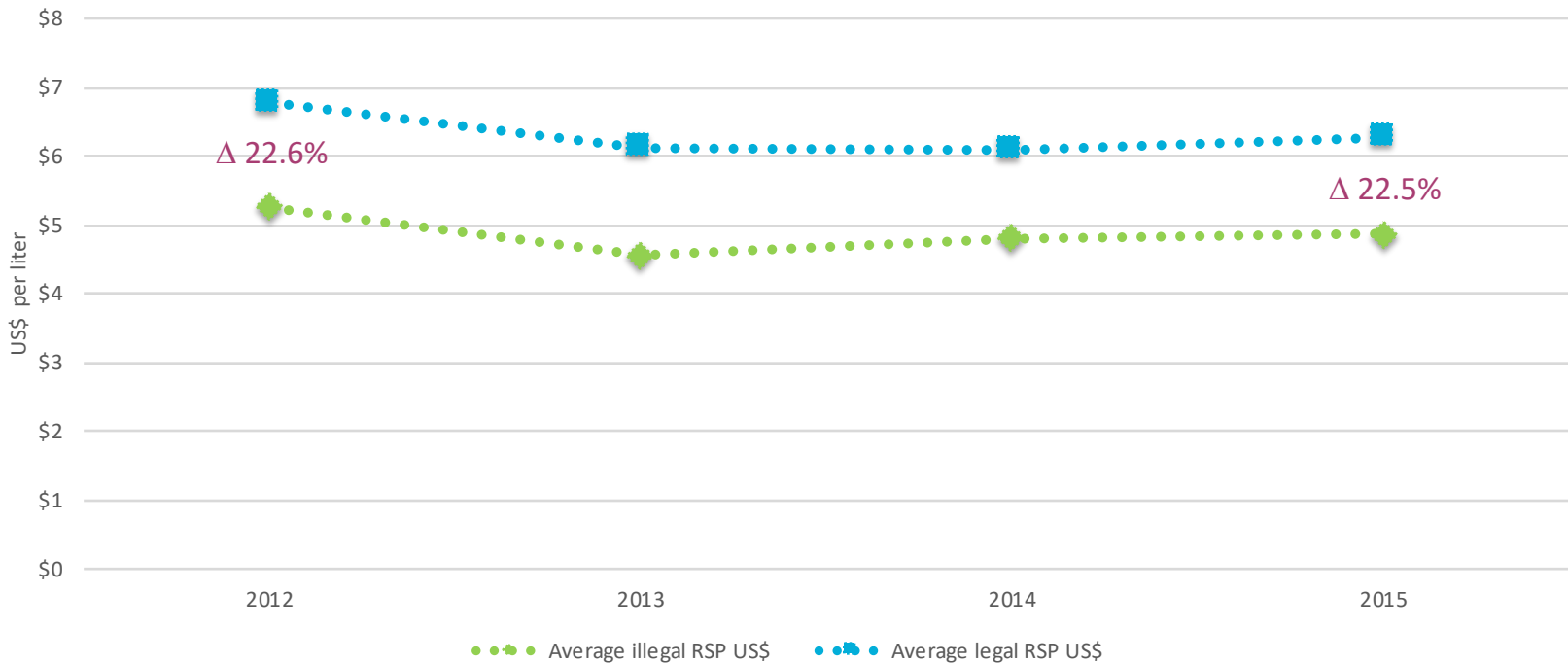
Source: Euromonitor International

**Executive summary**

# Evolution of prices in the illegal market in the past 4 years

Between 2012 and 2015, the difference between legal and illegal prices narrowed slightly. As shown in the chart, in 2012 the difference was 22.6%, whereas in 2015 it was 22.5%.

Evolution in average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



Executive summary

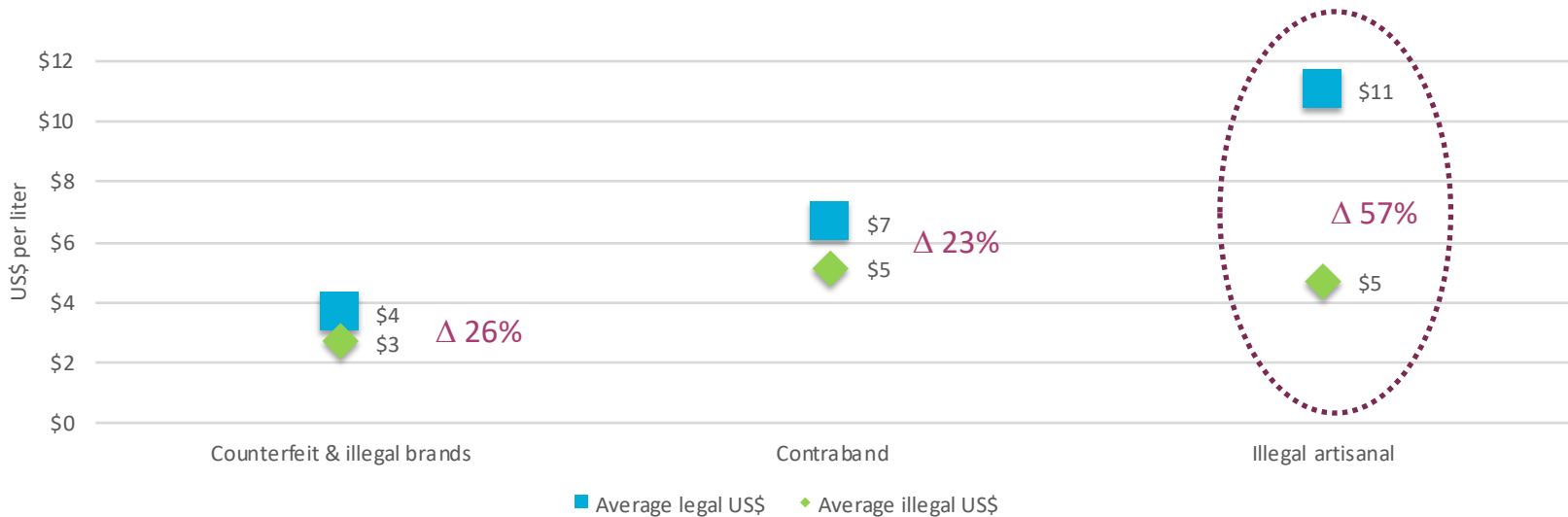
Price analysis by category

The price of illegal artisanal alcohol presents the highest variation (57%), as the illegal *guifiti* is sold at extremely low prices. Counterfeit alcohol has a variation of 26%, especially in the prices of *aguardiente*. Although contraband is last in the list (23%), the contraband of finished products shows big variations, especially tequila.

Difference between illegal vs. legal prices, 2015

22.5%

Average prices per liter (US\$), 2015



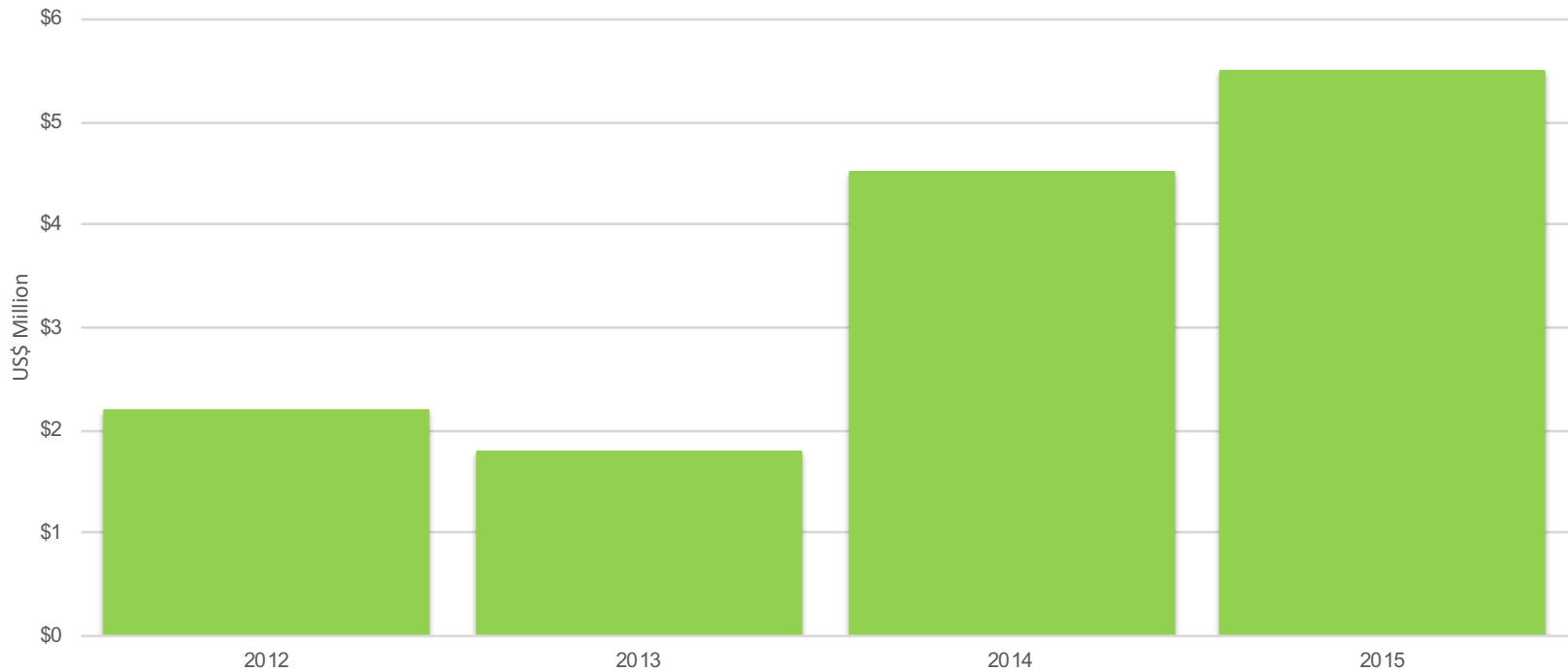
Source: Euromonitor International

## Executive summary

# Evolution of fiscal loss (US\$) in the past 4 years

Fiscal loss increased a 149% between 2012 and 2015. Even though there were no changes at tax level, variations in the prices and volume of illegal alcohol generated this growth. In 2012 it was estimated at US\$2 million and in 2015 it increased to US\$5 million.

## Evolution of fiscal loss (US\$), 2012 - 2015

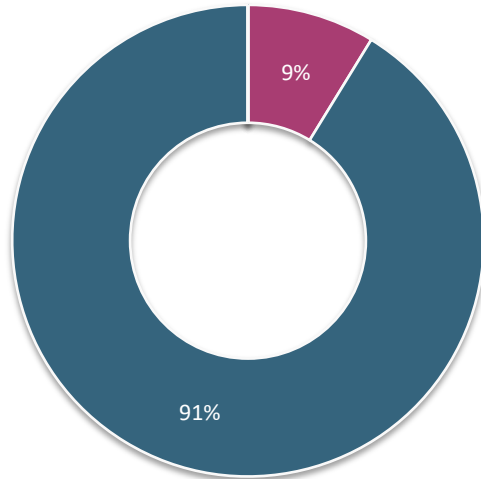


Source: Euromonitor International

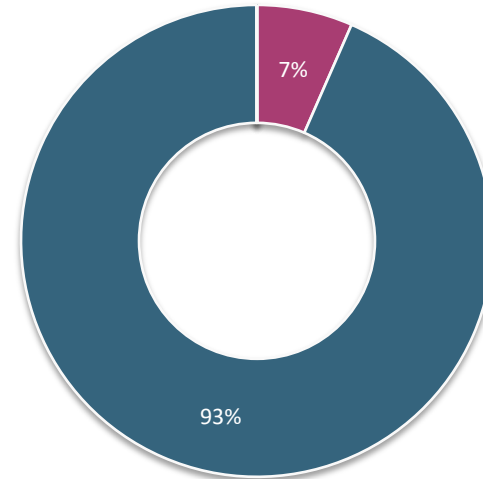
Executive summary

# Analysis of fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category (US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

In 2015, contraband continued to be the category that most contributes to fiscal loss (93%), with 62% that comes from the contraband of ethanol as raw material; it is followed by contraband of finished product, with 31% of the fiscal loss. The illegal manufacturing of *aguardiente* holds a second place, with a 7%.

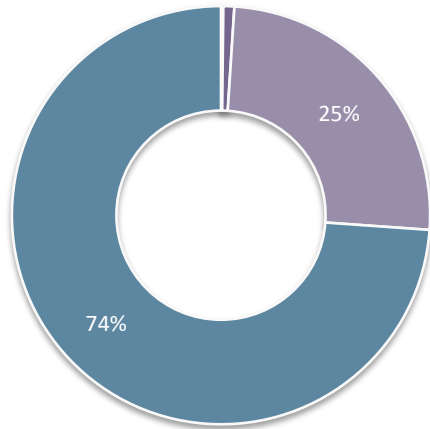




## Executive summary

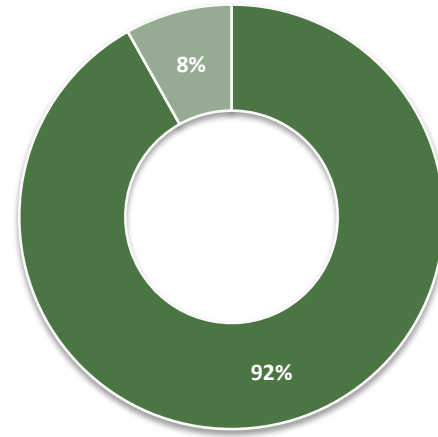
# Analysis for beer

Legal alcoholic beverage market, HL LAE, 2015



■ RTD ■ Wine ■ Spirits ■ Beer

Illegal beer market, HL LAE, 2015



■ Counterfeit ■ Contraband

Source: Euromonitor International

Due to its low alcohol content, beer is usually less weighty in the illegal market in HL LAE, though it enjoys a strong presence in HL. Its contribution to the illegal market in HL LAE is of 3%, focused on the contraband category. Given the absence of illegal manufacturing of beer in the country, it is not present in the other categories of the research. Of the total beer market in HL LAE, 0.9% is illegal.

## Counterfeit alcohol/illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1,950</b>	<b>9%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>1</b>	<b>0.4</b>

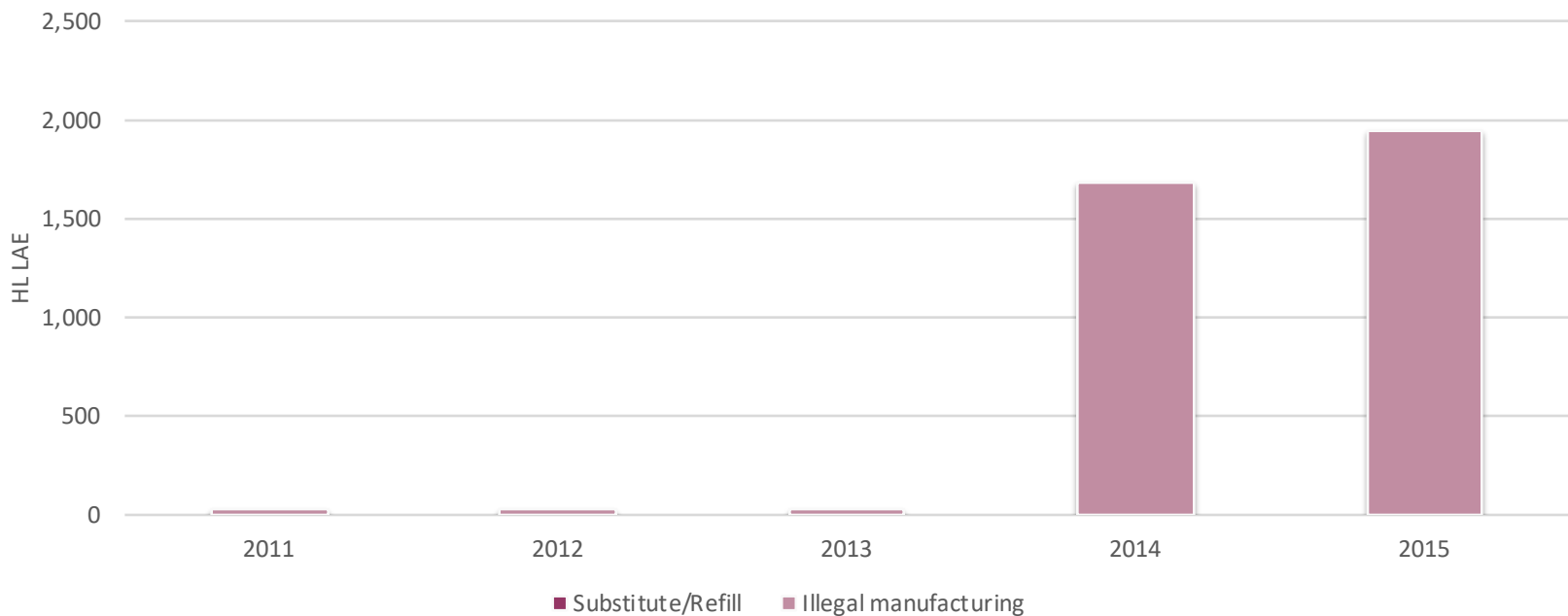
- Volume-wise, the illegal manufacturing of *panela*-based *aguardiente* represents 100% of the category, reaching 1,950 HL LAE. This is equivalent to a share of 9%, which means that counterfeit alcohol occupies the second place in the total illegal market of alcoholic beverages.
- Bottle refilling is considered within the contraband category, as it is done with *aguardiente* made with contraband ethanol. However, refill in Honduras reaches 1,458 HL LAE.
- The illegal industrial manufacturing is favored by the growing production of *panela* in 2015. This goes hand in hand with the coffee production, as *panela* is used as food to pump energy into the workers in the coffee industry.
- The fiscal loss generated by counterfeit alcohol is estimated at US\$0.4 million, which represents 7% of the total fiscal loss.

## Counterfeit alcohol/illegal brands

### Evolution of consumption (LAE) in the past 5 years

- In the review period of 2011-2015, consumption of counterfeit alcohol/illegal brands grew from 34 HL LAE in 2011 to 1,950 HL LAE in 2015. Growth of both the panela production and the contraband of ethanol in 2015 led to a greater availability of raw material for the illegal manufacturing of *aguardiente*.
- During 2011 - 2013, the illegal manufacturing of *aguardiente* was done with artisanal *panela* produced by small manufacturers. Since 2014, one of the bigger manufacturers started selling *panela* that is diverted for illegal manufacturing.

#### Evolution of the Counterfeit alcohol/illegal brands market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Counterfeit alcohol/illegal brands

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Locally manufactured *aguardiente* is the only beverage affected by counterfeiting.
- Brands of the *Licorera Los Ángeles*, *Golazo* and *Catrachito* are among those most used for bottle refills.



### WHERE

- Counterfeit *aguardiente* is found in very small quantities.
- Substitution/Refill takes place in the Northern part of the country, specifically in the city of *San Pedro Sula*, and it is sold in certain small stores or wineries.
- Illegal manufacturing of *aguardiente* takes place mostly in the Center-South region.



### FACTORS

- The end consumer is not aware of the product's illegality and simply prefers lower-priced beverages to get drunk.
- The low price of counterfeit/illegal beverages compared with the original brands is appealing and drives to purchase them.



### EFFECTS

- It represents a health hazard, as the consumer is unaware of its origin and whether it is adequate for human consumption.
- It affects the income as well as the image and reputation of legal alcohol manufacturers.

**Contraband****Consumption analysis**

Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>20,311</b>	<b>91%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>20</b>	<b>5</b>

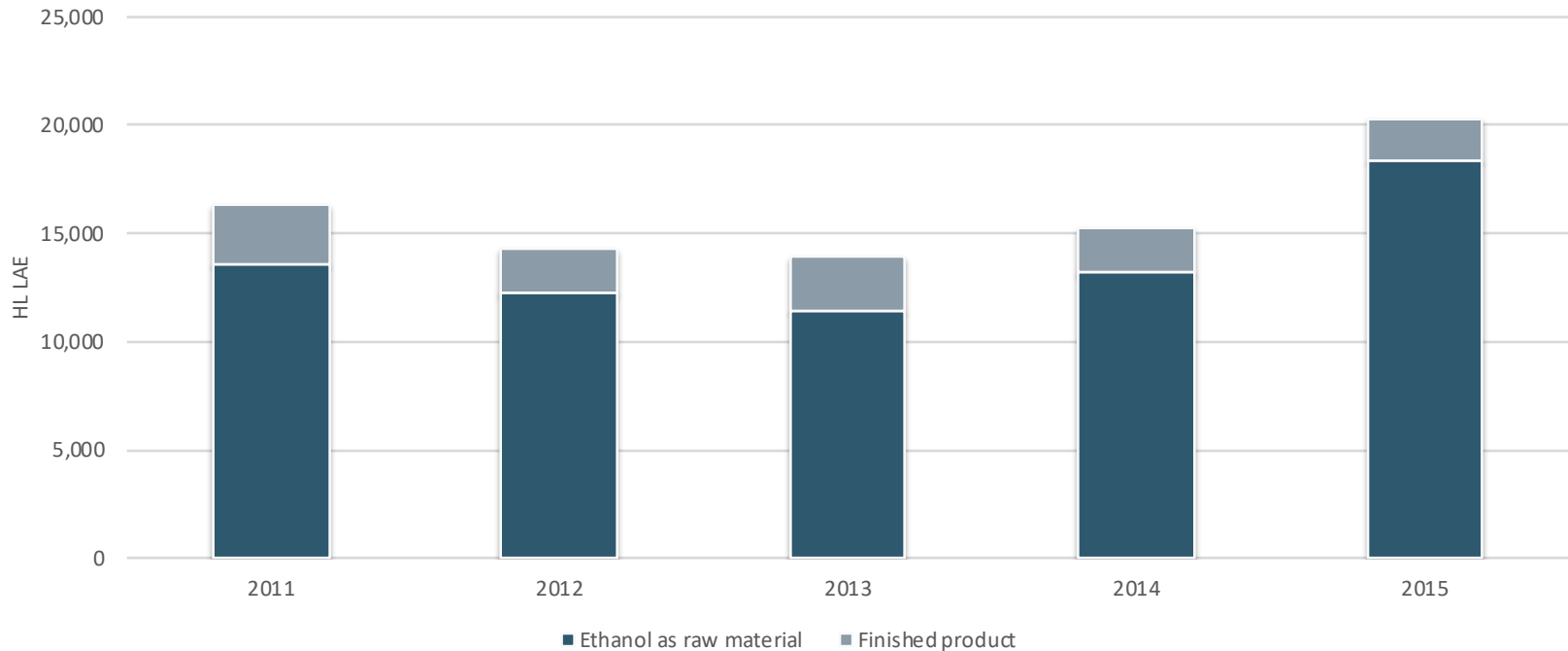
- Volume-wise, contraband represents 91% of the illegal alcoholic beverages consumed in the country, and contraband specifically of ethanol as raw material is 83%.
- Contraband of ethanol as raw material increased a 39% compared to 2014, whereas the finished product one decreased 8%. This is due to the efforts made by legal spirits importers to recover their clients, along with the reduction in the prices of local beer.
- Most of the contraband ethanol is used by the formal industry of alcoholic beverages, and part of it goes to Substitution/Refill. This is due to the lack of national manufacturing of the product and the insufficient ethanol import quotas.
- The brands of spirits in greatest demand are hit by the contraband of finished products due to their lower price. The contraband of beer shrank by a 13%, due to a reduction in the price of local beer.
- The fiscal loss generated by contraband is estimated at US\$5 million, which represents 93% of the total fiscal loss.

## Contraband

# Evolution of consumption (LAE) in the past 5 years

- In the review period of 2011-2015, consumption of contraband increased 24%, from 16,372 HL LAE in 2011 to 20,311 HL LAE in 2015, reaching its highest level in 2015.
- The lack of local production of ethanol and the limit to its import quotas are the main reasons behind the growth of contraband of ethanol as raw material to the country. The drop in contraband of finished products is due to the efforts made by manufacturers and importers of alcoholic beverages to increase awareness and customer loyalty

### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Contraband

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Contraband affects the majority of alcoholic beverages, especially national brands of *aguardiente*.
- Among the brands most involved are whisky Johnny Walker whiskey, José Cuervo tequila, Absolut vodka and Grey Goose vodka.



### WHERE

- Contraband of ethanol as raw material and of finished products enters the country through inland Customs or blind spots at the borders.
- Contraband of beer mainly takes place in the departments of *Ocotepeque* and *Copan*.



### FACTORS

- The difference in prices between legal and contraband products strongly contributes to contraband consumption.



### EFFECTS

- Illegal ethanol, which is used for bottle refilling, is a health hazard for consumers.
- Contraband of finished products directly affects the companies that represent the brands victimized by contraband, reducing sales of the legal alcoholic beverages.



## Illegal artisanal alcohol

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1.7</b>	<b>0.01%</b>
Market size value, 2015 (US\$)	Fiscal loss, 2015 (US\$)
<b>2,200</b>	<b>1,002</b>

- Illegal artisanal alcoholic beverages show a sharp reduction of 20% compared to 2014, from 2.2 HL LAE to 1.7 HL LAE.
- Hopefully, this category will continue to decrease year by year, due to the initiatives of the *Distintivo Atlántida* program, which promotes the legalizing of small artisanal manufacturers of *guifiti* along with the manufacturing and commercialization under the same brand of *Herencia Garifuna*.
- Fiscal loss generated by illegal artisanal alcohol is estimated at US\$1,002 for 2015, which represents less than 1% of the total fiscal loss.

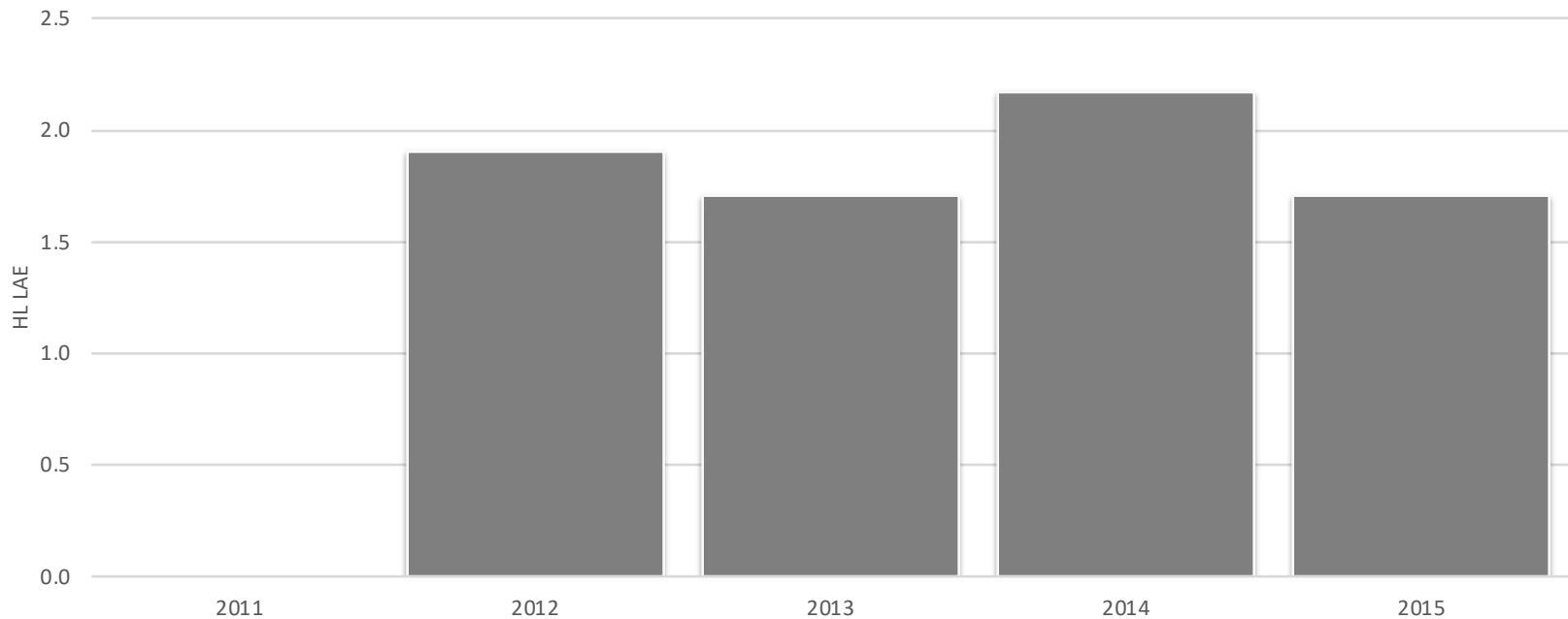


## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- Consumption of illegal artisanal alcohol decreased 9% in 2012 - 2015, from 1.9 HL LAE in 2012 to 1.7 HL LAE in 2015. In 2011, the illegal artisanal alcohol market was nonexistent.
- Consumption of *guifiti* nationwide is limited. This Honduran tradition is disappearing; consequently, the manufacturing of *guifiti* is on a natural decline. Also, the *Distintivo Atlántida* program is encouraging small artisanal manufacturers to become legal and sell their products under a common brand.

#### Evolution of the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Illegal artisanal alcohol

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- *Guifiti* is the only artisanal beverage illegally manufactured and sold in the country, thanks to its presence in areas of flourishing tourism activity.



### WHERE

- It is sold in the North coast and the Bay islands.
- Normally, it is sold in Garifuna villages, in manufacturers' homes, and very rarely in certain grocery stores or neighborhood stores.



### FACTORS

- *Guifiti* is consumed by the Garifuna people as part of an ancestral heritage to cure maladies and health issues, and also at burials, weddings and births.
- Tourists also buy it to take back to their country as a souvenir.



### EFFECTS

- Like all intoxicating beverages, an excess of *guifiti* can have powerful negative effects on one's health.



## Industry comments

### Key quotes from interviews



What most affects the business are the taxes, which went up a few years ago, and the liquid assets we had for reinvesting must now be used for paying the higher taxes.

— *Juan N. Kawas & CIA*



The contraband of alcohol pipes is still going strong. This means that the liter of ethanol comes out much cheaper than the product sold by *Licorera Los Ángeles*, which has to pay all the taxes for its ethanol.

— *Distribuidora Istmania*



Contraband in the country has decreased. Up to 2 years ago they still sold products like Chivas, Johnny Walker, among others, all contraband. I can now say that during all of 2015 and so far this year 2016, nobody has come offering a contraband product.

— *Bar Loca Luna*



Istmania has managed to combat contraband via campaigns, price tightening and controls, among others. In the past few years, contraband of the brands that Istmania manages has dropped 30%.

— *Distribuidora Istmania*



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Executive summary

# Illegal alcoholic beverage market in Panama 2015



3,659<sub>HL LAE</sub> | 2%

Market size in volume,  
Share out of total market

US\$16<sub>Mn</sub> | 2%

Market size in value,  
Share out of total market

US\$5<sub>Mn</sub>

Fiscal loss



## Executive summary

# Main findings in the illegal market in 2015

1

The illegal market decreased 10% in the past year but maintains its share at 2%

- Despite the slump in the consumption of illegal alcohol from 4,048 HL LAE in 2014 to 3,659 HL LAE in 2015, it maintains a share of 2% due to the slight increase of the legal market.
- Panama still represents the smallest illegal alcohol market of the region.

2

The theft of legal products in importers/distributor companies are more frequent

- The brands of stolen legal alcoholic beverages are sold at much lower prices that attract consumers to buy them to save money.

3

In the interior of the country, consumption of illegal alcohol is higher

- Villages in the vicinity of *Colón* province, and the provinces of *Veraguas*, *Herrera* and *Coclé*, are the areas with highest levels of consumption of contraband alcoholic beverages and illegal artisanal alcohol.

4

The downturn in tourism encouraged an increase of the illegal market

- Due to the devaluation taking place in countries such as Brazil and Colombia, the influx of tourists has decreased, thus generating greater pressure to reduce costs in the hotel and restaurant sector.
- Some hotels and restaurants decided to buy contraband alcoholic beverages, which they acquired mainly in the *Colón* Free Trade Zone.

## Executive summary

# Main factors that affect the illegal market in 2015



### These factors facilitated consumption:

- A rise in the prices of spirits and a reduction in import levels boosted the search for lower-priced alternatives.
- A lack of supply of legal alcoholic beverages in the market as a result of the changes carried out in the Panamanian Authority of Food Security (AUPSA).
- The decrease in imports and manufacturing of legal alcohol.



### These factors weaken consumption:

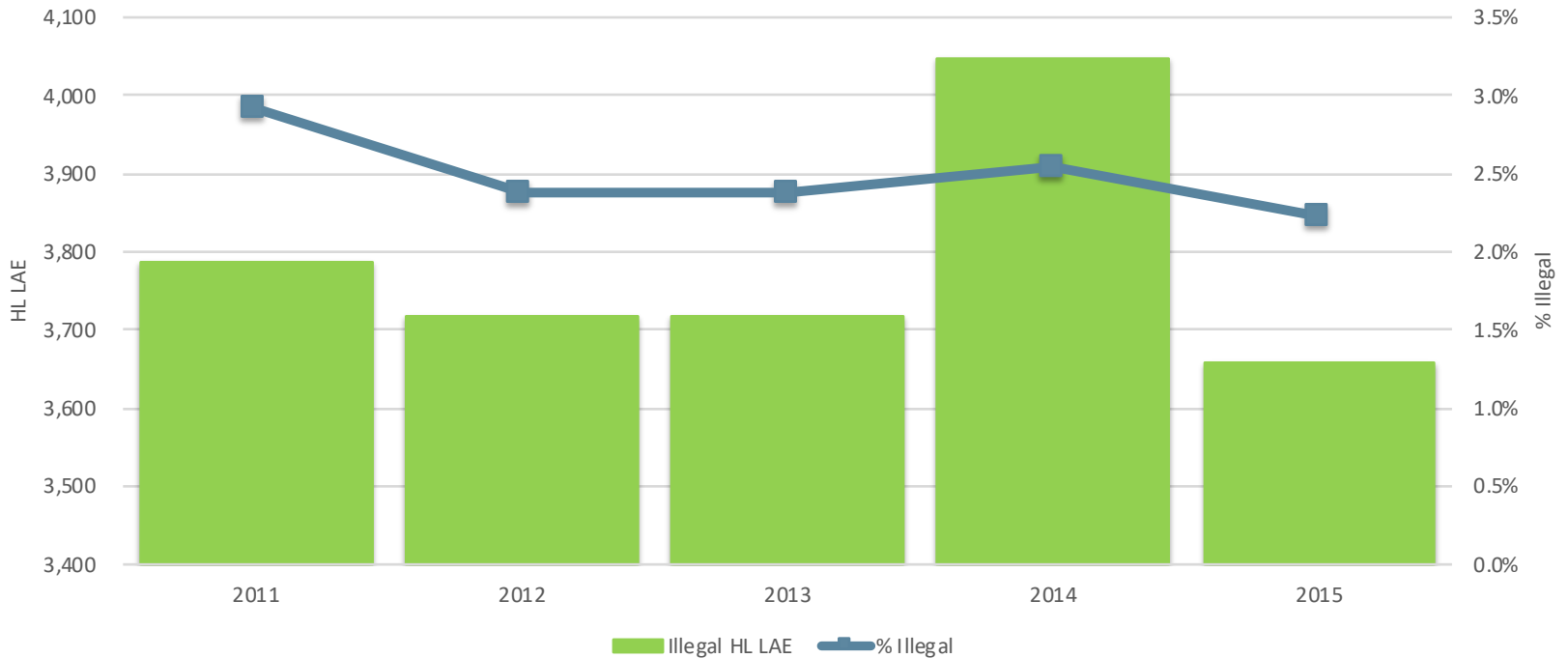
- Inspections at Customs managed to seize around 5% of illegal products.
- The use of plastic strips to seal transport trucks between duty-free areas and checks by Customs agents.
- Migration of consumers of illegal artisanal alcoholic beverages to beer, due to its low price.

**Executive summary**

# Evolution of the illegal market (LAE) in the past 5 years

The illegal alcohol market decreased 3% from 3,787 HL LAE in 2011 to 3,659 HL LAE in 2015. In 2015, consumption fell 10%, the lowest level in the last few years. However, due to the decline of the legal market in the past 5 years as well as the price hikes, contraband has increased.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International



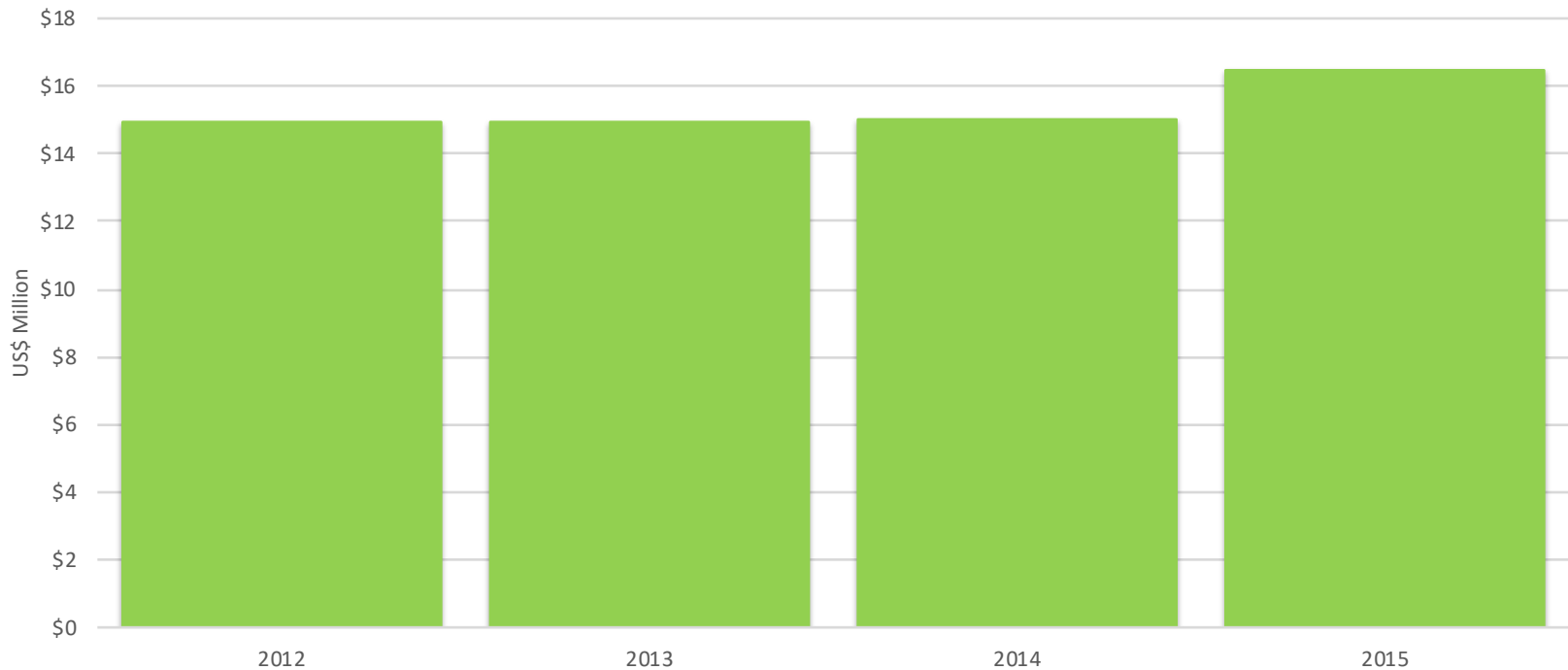


## Executive summary

# Evolution of the illegal market (US\$) in the past 4 years

Between 2012 and 2015, the illegal alcohol market grew 10%, from US\$ 15 million to US\$16 million. As in the period of 2012 - 2014 it maintained a relatively constant level; the biggest change can be observed in the past year, due to the rise in the prices of alcoholic beverages.

## Evolution of the illegal market (US\$), 2012 - 2015



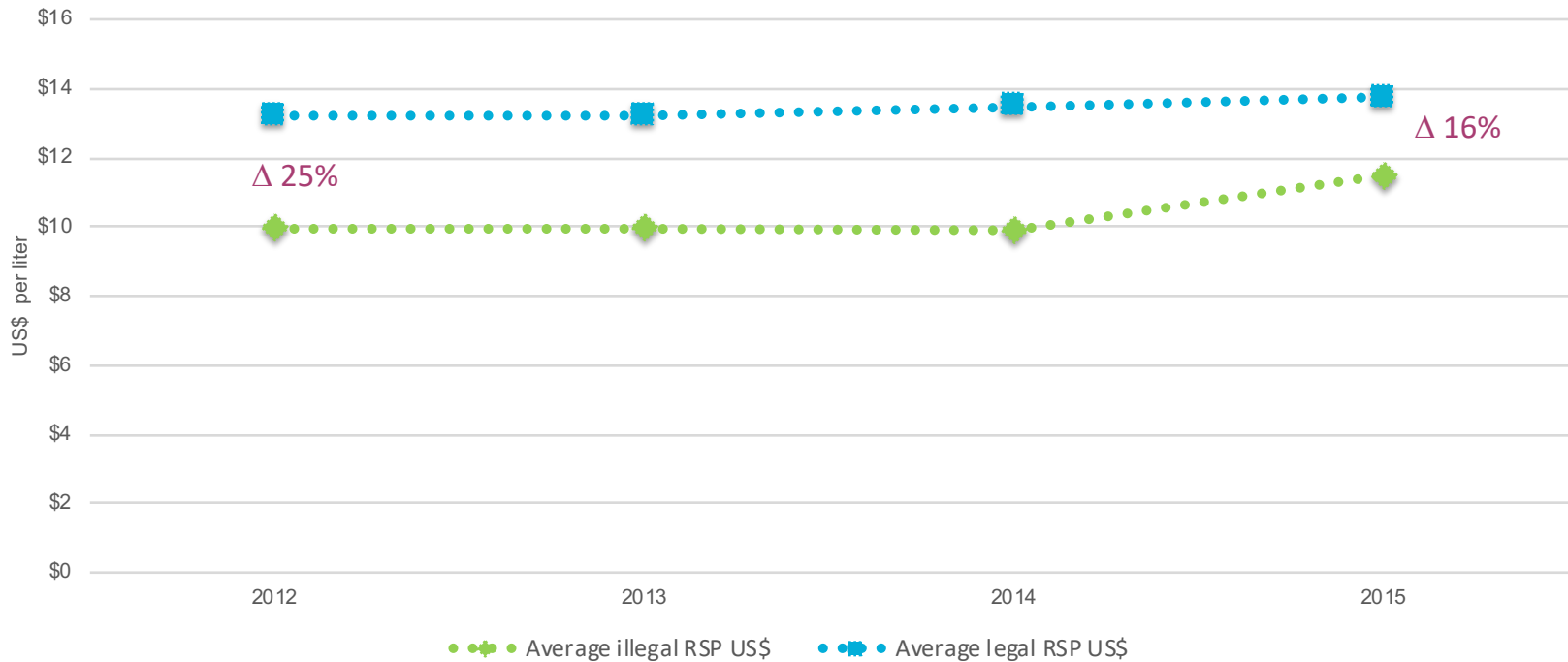
Source: Euromonitor International

**Executive summary**

# Evolution of prices in the illegal market in the past 4 years

Between 2012 and 2015, the difference between legal and illegal prices has grown smaller. As shown in the chart below, in 2012 the difference was 25%, whereas in 2015 it was 16%, considering that illegal alcohol became more expensive.

Evolution in average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



**Executive summary**

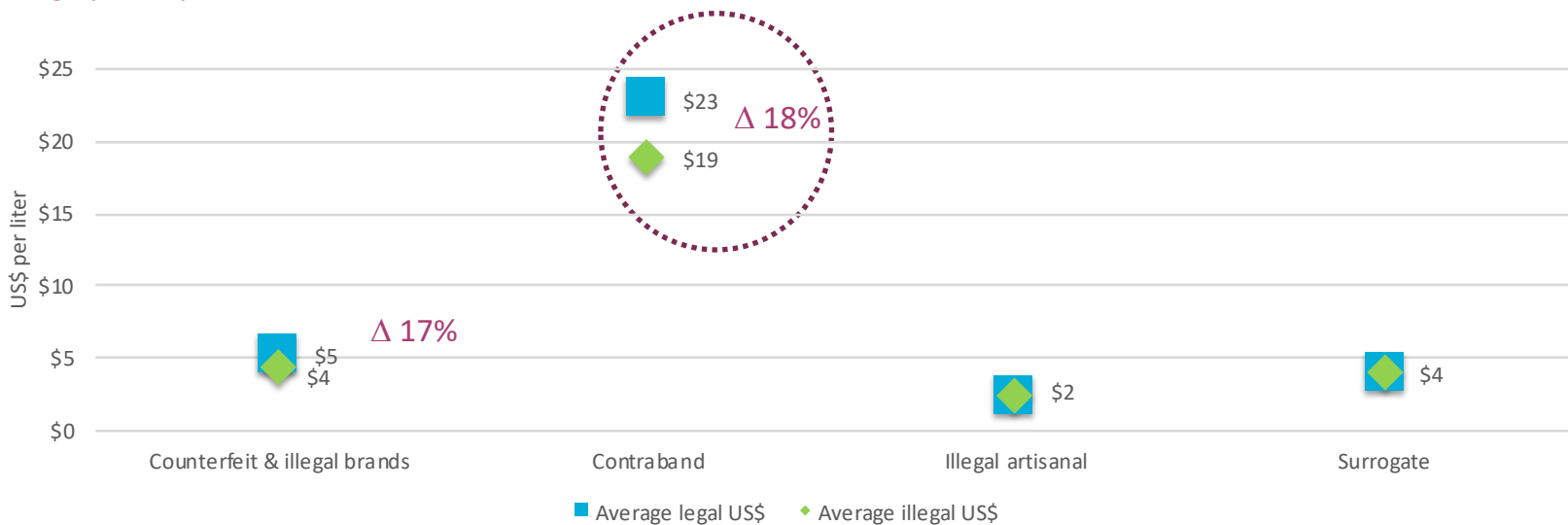
# Price analysis by category

Difference between illegal vs. legal prices, 2015

# 16%

Contraband alcohol is the category with highest price variation (18%) followed by counterfeit & illegal brands (17%). Both have strong consumer appeal as people seek ways of saving money without having to change their regular consumption of alcoholic beverages. In the case of illegal artisanal alcoholic beverages and surrogates, sales prices are the same.

Average prices per liter (US\$), 2015



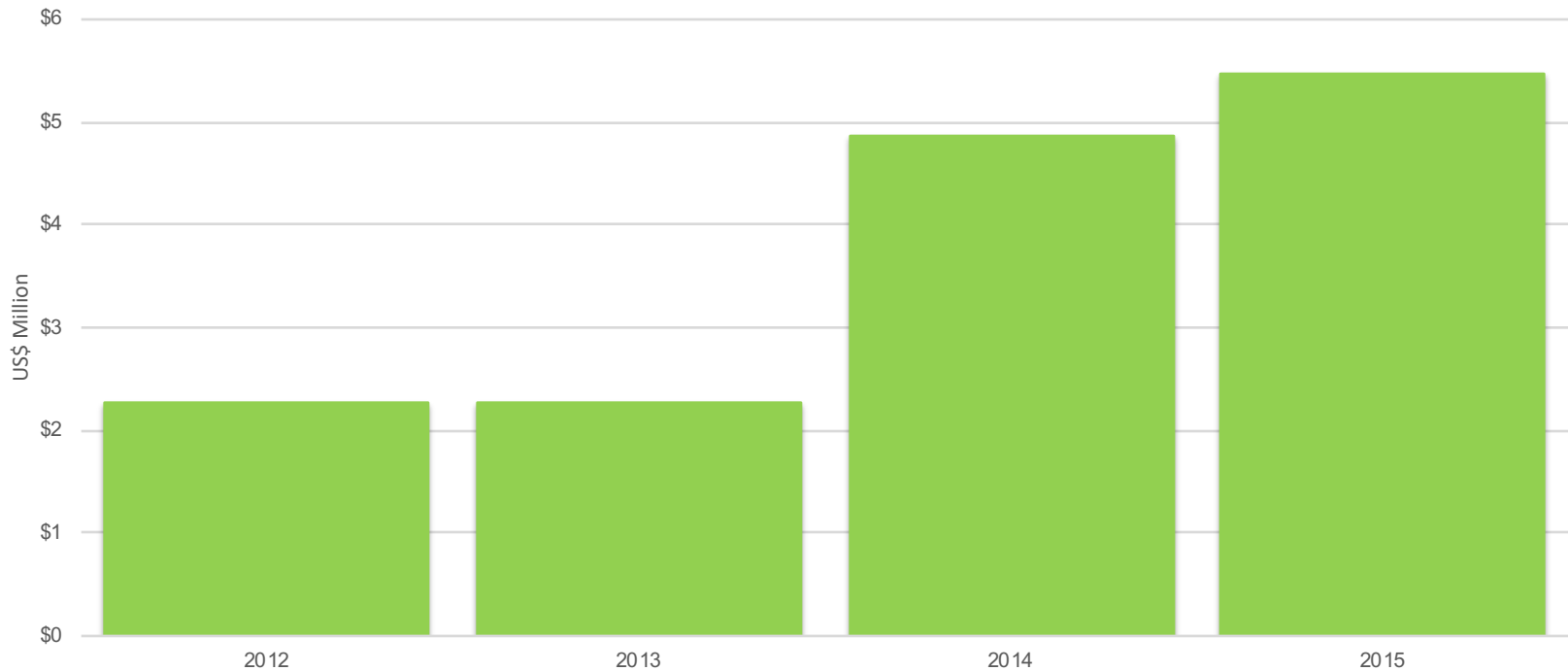
Source: Euromonitor International

## Executive summary

# Evolution of fiscal loss (US\$) in the past 4 years

Fiscal loss grew 140% in 2012-2015. In 2012 it was estimated at US\$2 million and in 2015 it increased to US\$5 million. In 2015 it grew 13%, reaching the highest level observed in the last few years. It is noteworthy that in 2014 taxes increased for spirits manufactured at the local level.

## Evolution of fiscal loss (US\$), 2012 - 2015

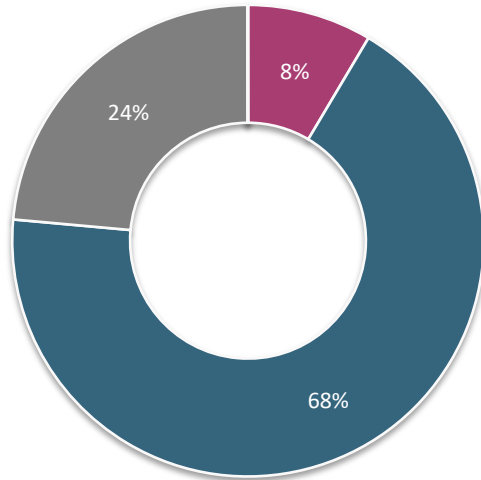


Source: Euromonitor International

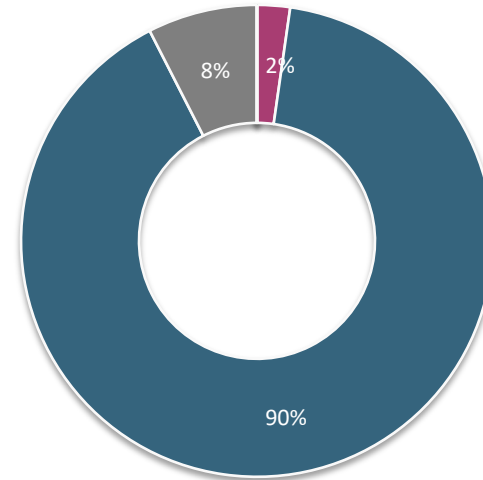
**Executive summary**

# Analysis of fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category (US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

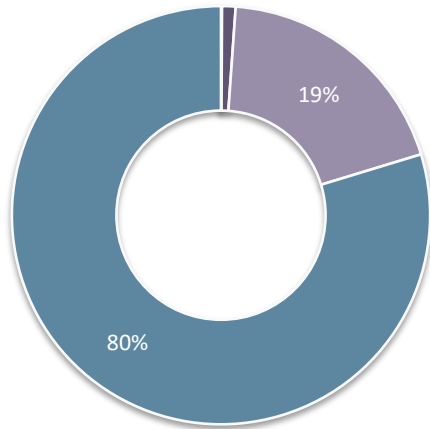
In 2015, contraband was the category that most contributed to fiscal loss (90%). This is due to the higher consumption of contraband alcoholic beverages and to the increase in beer tax.



## Executive summary

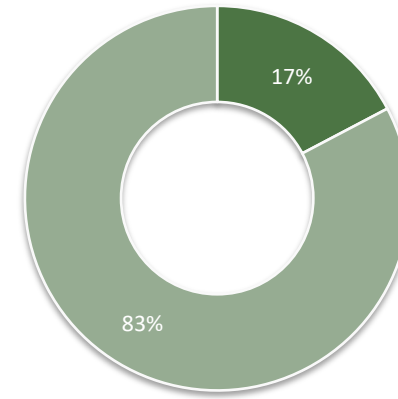
# Analysis for beer

Legal alcoholic beverage market, HL LAE, 2015



■ RTD ■ Wine ■ Spirits ■ Beer

Illegal beer market, HL LAE, 2015



■ Contraband ■ Illegal artisanal

Source: Euromonitor International

In 2015, beer was still the most consumed alcoholic beverage in the country. Within the illegal market, most of the illegal beer is artisanal (83%), and, at a lower percentage, of contraband origin (17%).

These alcoholic beverages are mostly found in high-tourism areas such as San Blas. Provinces including Santiago concentrate the contraband of beer not sold in Panama and that enter through the border with Costa Rica.

## Counterfeit alcohol/illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>312</b>	<b>9%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>0.4</b>	<b>0.1</b>

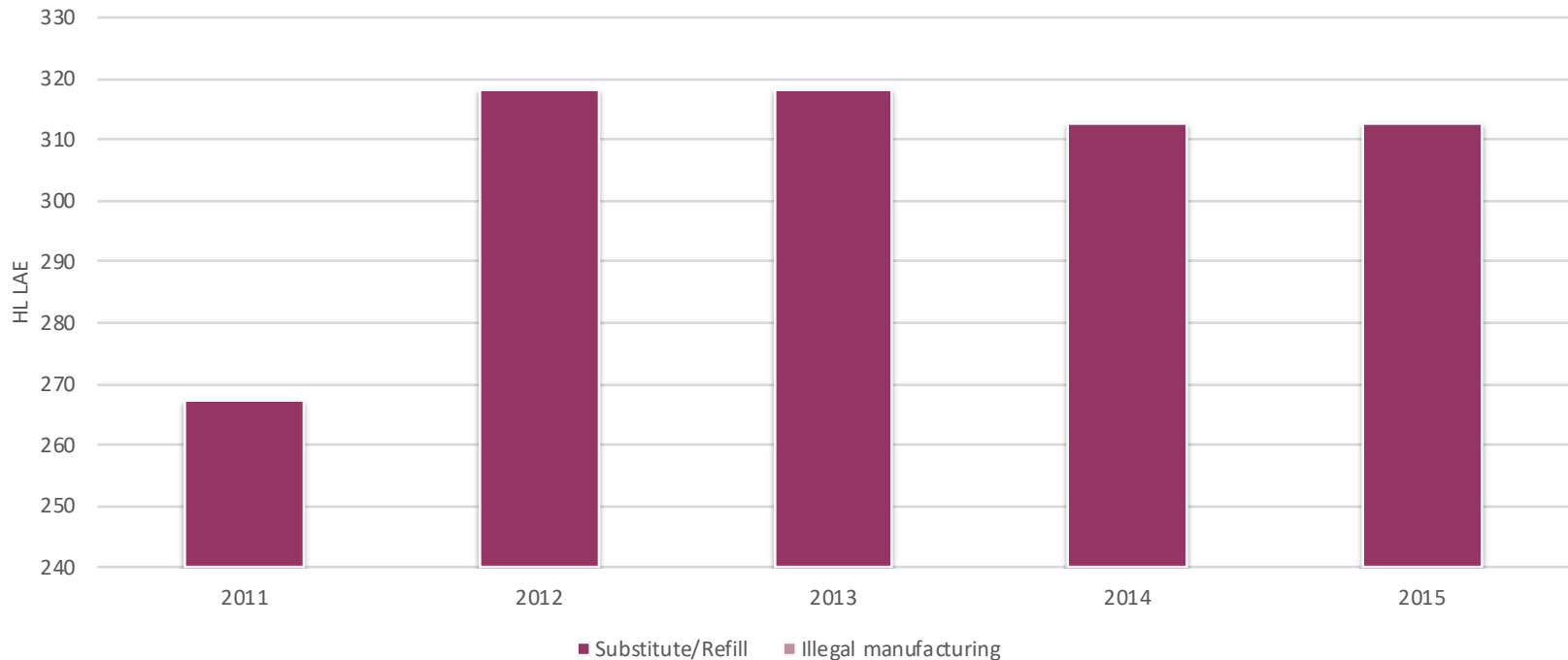
- Volume-wise, this category ranks third in illegal alcoholic beverages.
- There is no industrial manufacturing of illegal brands; the most common practice is Substitution/Refill, which is sold in bars and restaurants in order to reduce costs.
- Substitution/Refill involves only distilled products, not fermented products.
- Between 2014 and 2015, the category maintained its level, with no changes in the number of counterfeiters and no actions to deter those currently active.
- Fiscal loss generated by counterfeit alcohol/illegal brands is estimated at US\$0.1 million for 2015, which represents 2% of the total fiscal loss.

## Counterfeit alcohol/illegal brands

### Evolution of consumption (LAE) in the past 5 years

- In the review period of 2011-2015, consumption of counterfeit alcohol & illegal brands has grown 17%, from 267 HL LAE in 2011 to 312 HL LAE in 2015. In the past year, it remained stable at 312 HL LAE compared with 2014.
- Manufacturers and importers pay little attention to places that go in for Substitution/Refill, as they are usually bars and restaurants in low-income neighborhoods.

#### Evolution of the Counterfeit alcohol/illegal brands market (HL LAE), 2011 - 2015



Source: Euromonitor International



## Counterfeit alcohol/illegal brands

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Alcoholic beverages mainly involved rum, *seco* and gin.
- Among the most affected brands include Abuelo rum, Herrerano *seco*, and Beefeater and Tanqueray gin.



### WHERE

- Sold mainly in bars and taverns in low-income neighborhoods.



### FACTORS

- One brand of alcohol is offered but a cheaper version is used instead, to cut costs.



### EFFECTS

- It discredits brands to be offered but not actually served.
- It affects the sales volume of premium alcoholic beverages, replacing them with cheaper versions.
- Fiscal loss to the government.



## Contraband

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>2,485</b>	<b>68%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>15</b>	<b>5</b>

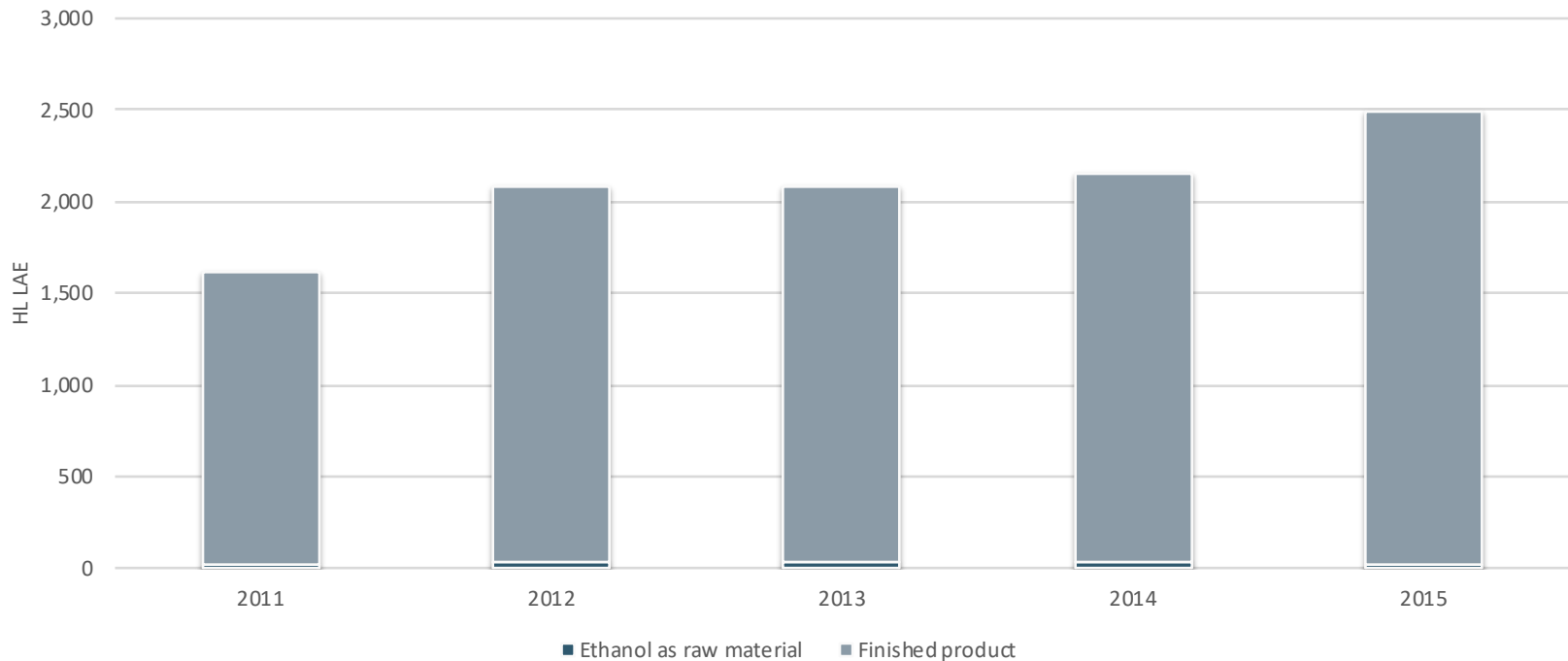
- Contraband is the biggest problem in illegal alcoholic beverages. It tops the list, beating out all other categories, and is valued at US\$15 million.
- Contraband of finished product leads with a vast majority of 99% (2,466 HL LAE) and contraband of ethanol as raw material claims the remaining 1% (18 HL LAE).
- Volume-wise, contraband reached 2,485 HL LAE in 2015, approximately 15% more than in 2014 due to the shortage of spirits in the legal market and their high prices.
- Fiscal loss generated by contraband is estimated at US\$5 million, making it the category with highest fiscal loss (90%) in 2015.

## Contraband

# Evolution of consumption (LAE) in the past 5 years

- During the review period of 2011-2015, consumption of contraband increased 54%. In 2015, consumption grew 15%, the highest level in the past few years as the prices of legal alcohol remained high.
- Despite the decrease in imports and manufacture of alcohol in Panama, consumption of contraband alcohol maintains its positive trend.

### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Contraband

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- The main alcoholic beverages in contraband are whisky, rum, *seco*, vodka and beer.
- Among the brands most involved include Chivas Regal and Buchanan's whisky, Zacapa rum, Grey Goose vodka, and Miller Lite and Corona beer.



### WHERE

- Contraband brands are mainly sold in areas adjacent to the Panama-Colon highway, West Panama and Central provinces.
- Particularly common in cargo trucks that hide a few boxes of alcohol which are sold directly to the target points of sale.



### FACTORS

- The high price of legal alcoholic beverages has driven consumers to seek cheaper alternatives.
- Merchants seek to lower costs and increase their profits.



### EFFECTS

- Consumption of legal alcoholic beverages is falling, given the existence of other cheaper options.
- Merchants are always on the lookout for these alcoholic beverages, as a way of lowering costs.



## Illegal artisanal alcohol

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>861</b>	<b>24%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>1</b>	<b>0.4</b>

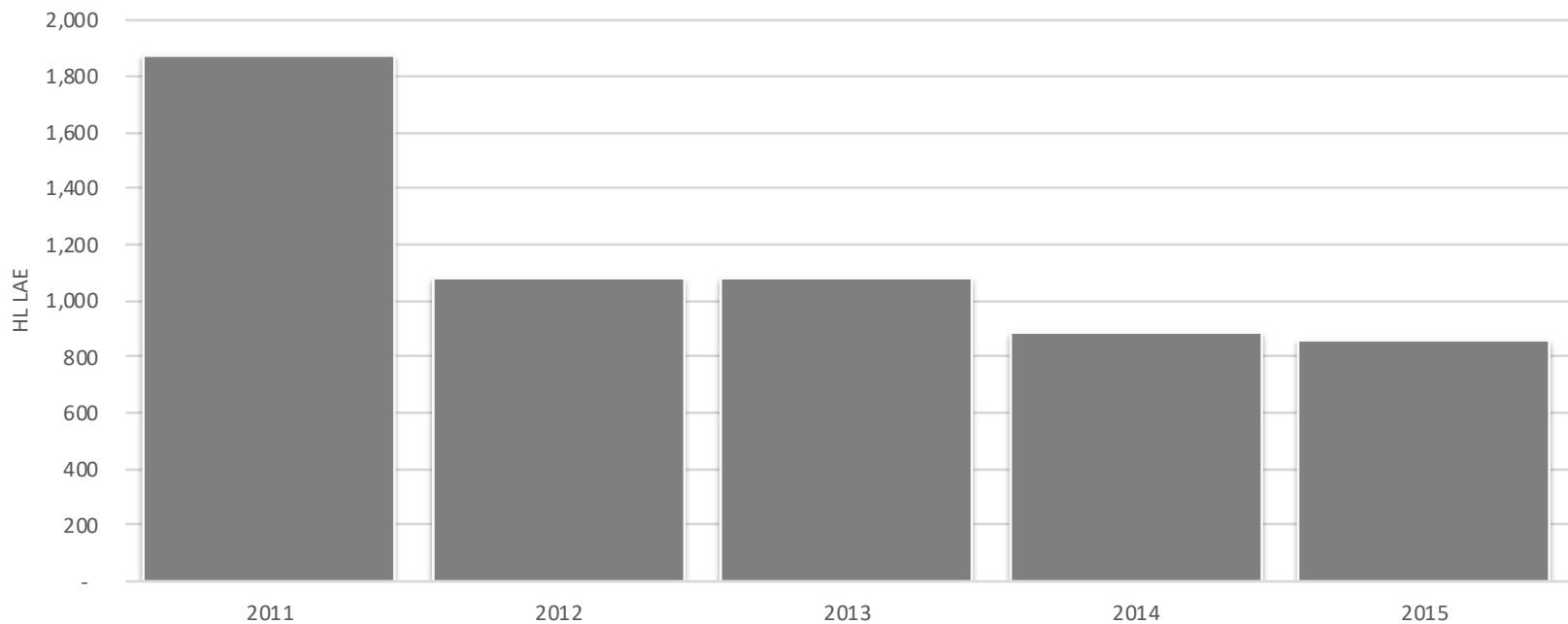
- In 2015, illegal artisanal alcoholic beverages held a share of 24% in the illegal alcohol market. Volume was estimated at 861 HL LAE, 3% less than in 2014.
- The market of illegal artisanal alcoholic beverages represents the second category of the total market and the amount spent on the purchase of these beverages reached US\$1 million in 2015.
- In general terms, this category is not a major problem as it is considered part of the national culture. Still, in the province of *Santiago* it is an issue, as these substances could have harmful effects on health due to the manufacturing process, especially the *chirrisco*.
- The fiscal loss generated by illegal artisanal alcoholic beverages is estimated at US\$0.4 million for 2015, which represents 8% of the total fiscal loss.

## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- Consumption of illegal artisanal alcohol is on a downward trajectory, and in the review period of 2011-2015 it decreased 54%. Similarly, in the past year this category had a 3% drop, as a result of migration toward the consumption of beer.
- *Chirrisco* is being controlled by ongoing search and seizure processes carried out jointly by the National Police and the Town Council of *Santiago de Veraguas*.

#### Evolution of the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Illegal artisanal alcohol

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Among the most popular illegal alcoholic beverages include *chirrisco*, *chicha fuerte* and palm wine.



### WHERE

- *Santiago, Veraguas* is the city most affected by the sale of illegal artisanal alcohol.
- Sold in plastic bottles, or empty bottles of other alcoholic beverages, mostly in manufacturers' homes and on the Inter-American highway.



### FACTORS

- The majority are culturally important beverages that are consumed at parties and special events.
- *Chirrisco*, the only artisanal spirit, is the biggest problem due to its highly primitive manufacturing method using parts from air conditioners, and sometimes battery acid.



### EFFECTS

- Being a substitute of legal alcohol, it severely reduces the sales of legal alcoholic beverages.
- Depending on its preparation method, *chirrisco* can have highly damaging effects on health.



## Surrogate

# Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>1</b>	<b>0.02%</b>
Market size value, 2015 (US\$)	Fiscal loss, 2015 (US\$)
<b>606</b>	<b>197</b>

- Surrogate is not a relevant category in Panama as by law, all alcohol sold to the public must be denatured.
- Those who consume this category of alcohol suffer health issues almost immediately. As intake can lead to death, very few can consume it again.
- Volume-wise in this category, pharmaceutical or denatured alcohol holds the highest scores.
- Between 2014 and 2015, the percentage of surrogate grew 1%. Market value in 2015 was estimated at US\$606. The volume in 2015 was 1 HL LAE, an increase of 1% from 2014, due to the higher import level of denatured alcohol.
- Fiscal loss generated by this category is estimated at US\$197, which represents 0.004% of the total fiscal loss.

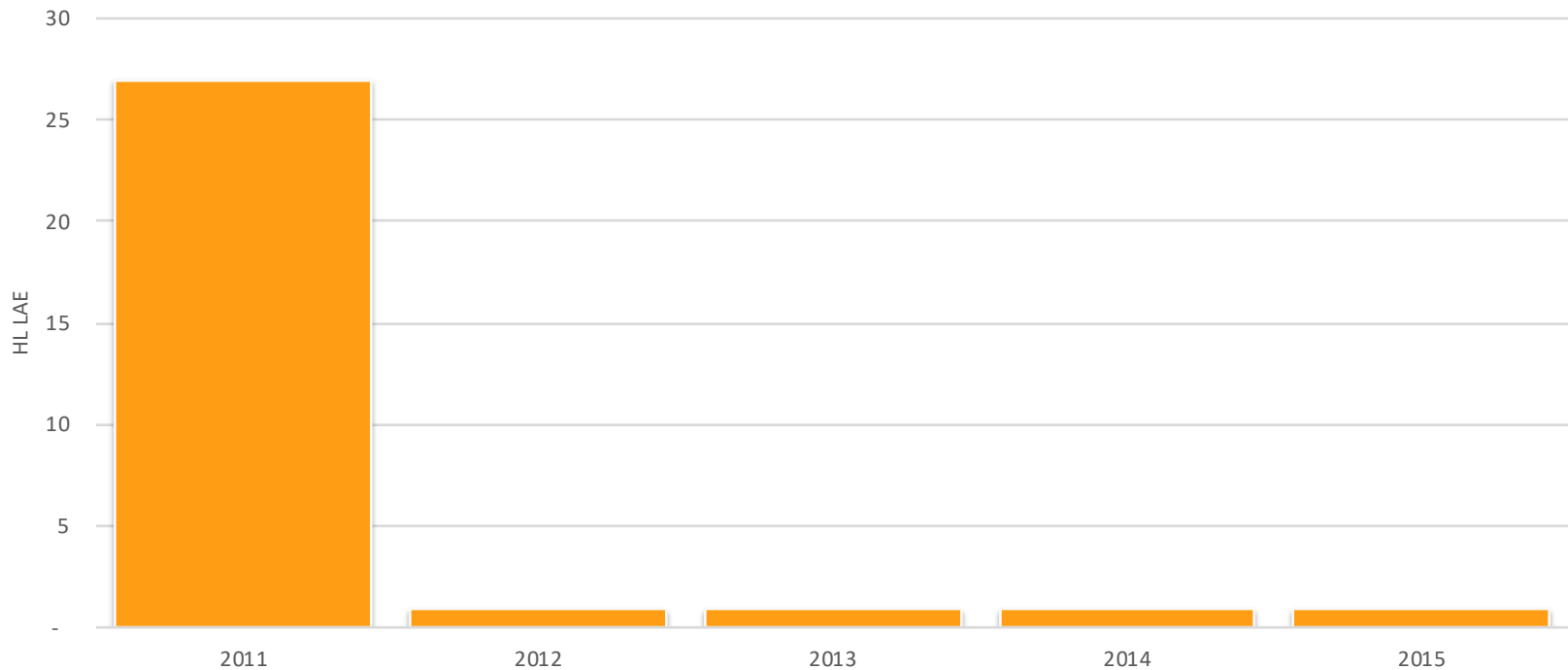


## Surrogate

# Evolution of consumption (LAE) in the past 5 years

- Consumption of this category increased 1% in 2015, due to the growing offer of denatured alcohol in the market.
- However, the intake of surrogate alcohol can cause grave health issues and even death, maintaining consumption at low levels.

## Evolution of the surrogate alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Surrogate

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Primary ones are denatured alcohol and perfumes, as they are used as substitutes of legal alcoholic beverages.

### WHERE

- Denatured alcohol is sold mostly in pharmacies, supermarkets and minimarkets.
- Mainly consumed in low socio economic neighborhoods of Panama City, as they are more affordable to those financially unable to buy alcoholic beverages.



### FACTORS

- Consumers usually suffer serious drinking problems.
- Poverty prompting a moment of despair over the impossibility of buying legal alcoholic beverages sometimes leads people to consume this category of alcohol.



### EFFECTS

- Consumers suffer serious health issues and, in many cases, death.



## Industry comments

### Key quotes from interviews



Currency devaluation in countries like Brazil has caused a drop in sales in the Free Trade Area; these in turn have sought other channels to sell their products, whether illegally in retail or to Panamanian individuals, which is illegal.

— *Varela Hermanos, S.A.*



Customs only controls the merchandise that exits the Customs area. It is not our business to control what exits the Free Trade Area; that problem belongs to the sphere of the Administration of the Free Trade Area.

— *National Customs Authority*



There is an excess supply of hotels in Panama and they seek ways of acquiring cheaper spirits.

— *Spirits & Wine Group*



Our products exit Customs, arrive at our wineries and, when we open the boxes, we realize that in some of them, 1 or 2 bottles are missing. We do not know where these spirits go.

— *Spirits & Wine Group*



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Executive summary

# Illegal alcoholic beverage market in Peru, 2015



281,082<sub>HL LAE</sub> | 27%

Market size in volume,  
Share out of total market

US\$557<sub>Mn</sub> | 14%

Market size in value,  
Share out of total market

US\$81<sub>Mn</sub>

Fiscal loss



## Executive summary

# Main findings in the illegal market in 2015

1

The drop in national manufacturing of ethanol promotes new ways of obtaining the raw material

- Increase of imports and decrease of exports of ethanol to cover the demand.
- The contraband of ethanol from Bolivia is an ongoing source of supply, whereas the contraband of ethanol towards Ecuador decreased.

2

The counterfeiting of whisky has introduced a new form of Substitution/Refill

- Mainly, counterfeiting whisky with ethanol, artificial coloring and flavoring in recycled bottles.
- Substitution/Refill of expensive brand-name whisky with cheap brands and recycled bottles.

3

Registration of ethanol users and their purchase and sales statements makes it difficult to commercialize ethanol illegally.

- Companies are obliged to register and report to PRODUCE, whereas illegal players are unable to do so.
- The lack of effective control and oversight leaves room for illegal supplying. Also, illegality is further encouraged by the fact that purchases of small volumes and for non-controlled uses do not require reporting or supervising.

4

PRODUCE's *Mesa de Trabajo Multisectorial* launched a coordination initiative that will hopefully bear fruit from 2016 onwards.

- It has been actively in operation since December 2015, persuading the authorities and private sector parties to cooperate, and coordinating their participation.
- PRODUCE has established work committees: Preventive (campaigns), Regulatory (Denaturing rules) and Repression (coordinating operations), which have been working on several initiatives to be implemented in 2016 and subsequent years.

## Executive summary

# Main factors that affect the illegal market in 2015

### These factors facilitated consumption:

- Lack of effective control of transport and end use of ethanol.
- Commercialization of potable ethanol for industrial use without denaturing, which is diverted towards the manufacturing of illegal alcoholic beverages.
- Poor physical control of ethanol at Customs.
- Lax control in rural areas and in the detection of informal players.
- Clandestine operators and frequent changes of locations used for counterfeiting.
- Appealing profit margins between prices of illegal vs. legal alcohol.
- Smugglers get support in transit areas, making it hard for the authorities to enforce the law.
- Impunity for criminals that were caught due to lack of evidence and corruption.
- Greater availability of local supplies for the manufacture of illegal artisanal alcoholic beverages.
- Limited enforcement of Law 26932 in local authorities and other institutions.

### These factors weaken consumption:

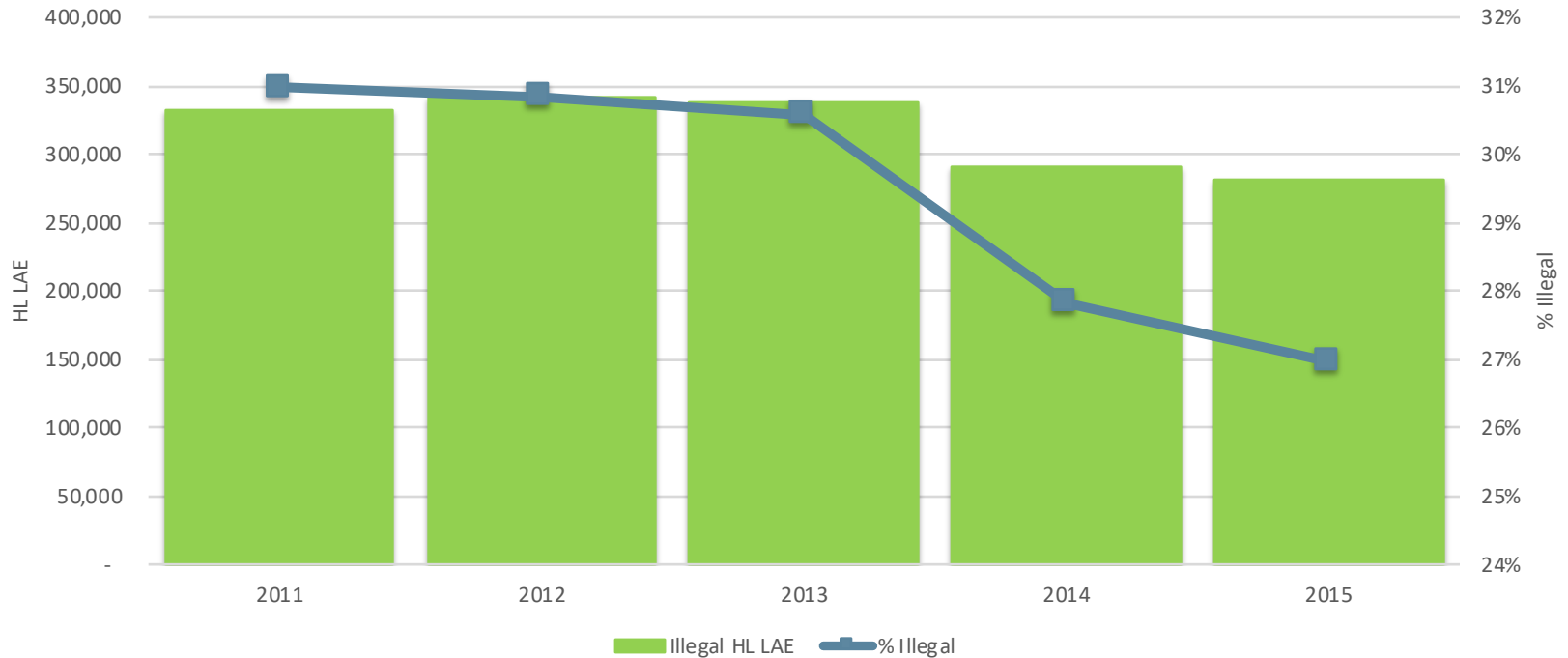
- Lower amount of residual ethanol.
- Mandatory registration of purchase and sale of ethanol hinders illegal sale.
- Greater control at Customs, especially in regards to paperwork.
- More seizures of counterfeit and contraband alcoholic beverages.
- Greater control of beer brands at community events to limit the presence of counterfeit products.
- Tough competition among offers and promotions of imported alcohol in modern channels.
- Growth of modern retailing, as it sells only legal products.
- Greater awareness of the damaging effects on health caused by surrogate alcohol
- Launch of the *Mesa de Trabajo Multisectorial para luchar contra Bebidas Alcohólicas* and its inter-institutional coordination initiative.

**Executive summary**

# Evolution of the illegal market (LAE) in the past 5 years

Between 2011 and 2015, the illegal alcohol market decreased 15%, from 331,931 HL LAE to 281,082 HL LAE. Its market share shrank from 31% to 27% in the same period. In the past year it decreased 3% in terms of volume.

Evolution of the illegal market (HL LAE), 2011 - 2015



Source: Euromonitor International



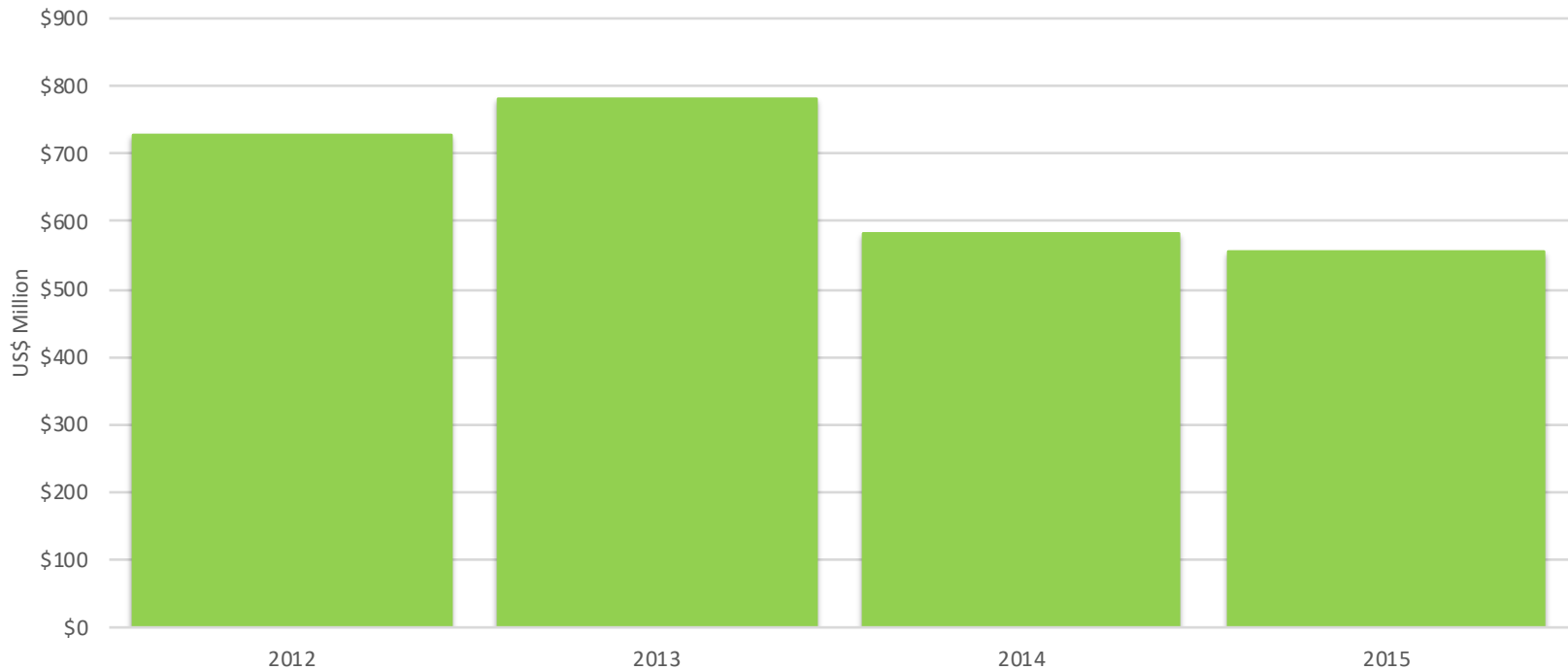


## Executive summary

# Evolution of the illegal market (US\$) in the past 4 years

Between 2012 and 2015, the illegal alcohol market shrank 23%, from US\$722 million in 2012 to US\$557 million in 2015. In the past year consumption also decreased, representing 5%.

## Evolution of the illegal market (US\$), 2012 - 2015



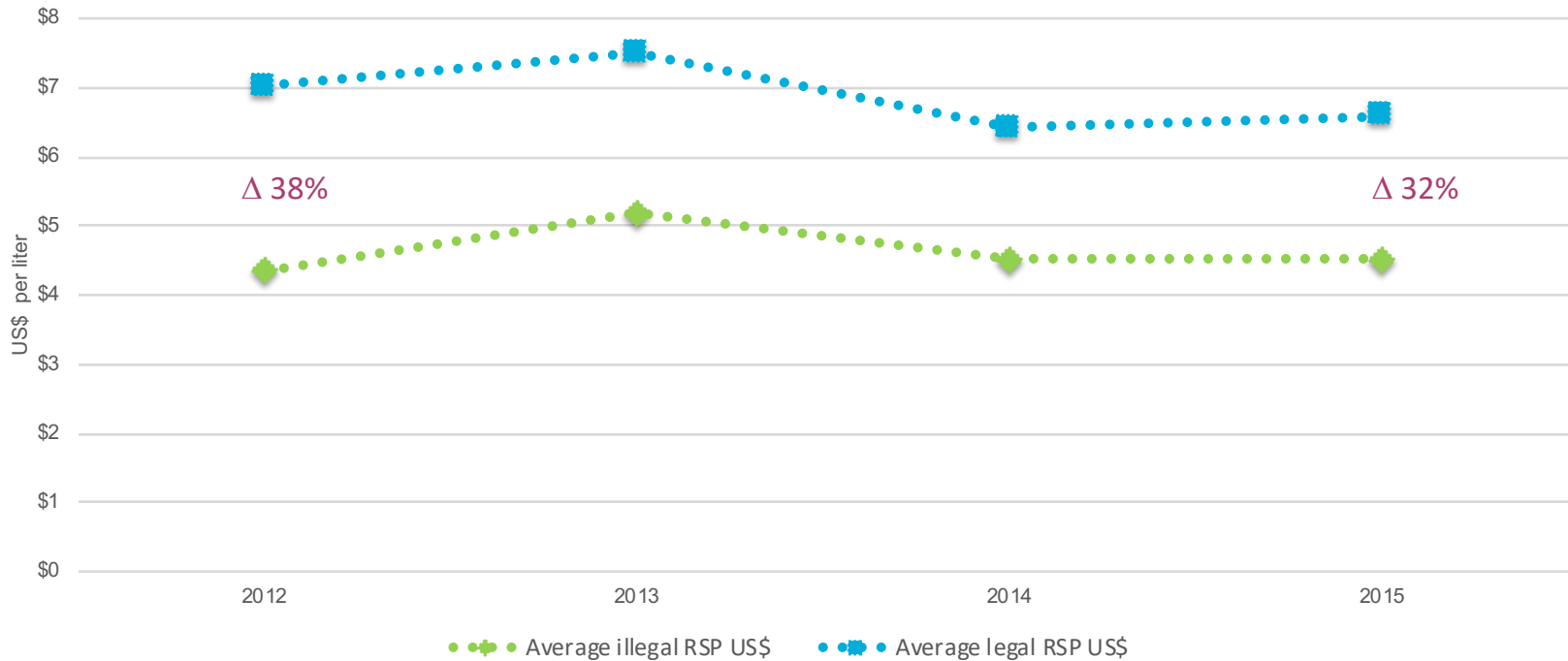
Source: Euromonitor International

**Executive summary**

# Evolution of prices in the illegal market in the past 4 years

Between 2012 and 2015, the difference between legal and illegal prices has gradually narrowed. As shown in the chart below, in 2012 the difference was 38%, vs. 32% in 2015. As the difference between prices decreases, illegal alcohol loses its appeal among the lower-income segments.

Evolution of average prices per liter (US\$), 2012 - 2015



Source: Euromonitor International



## Executive summary

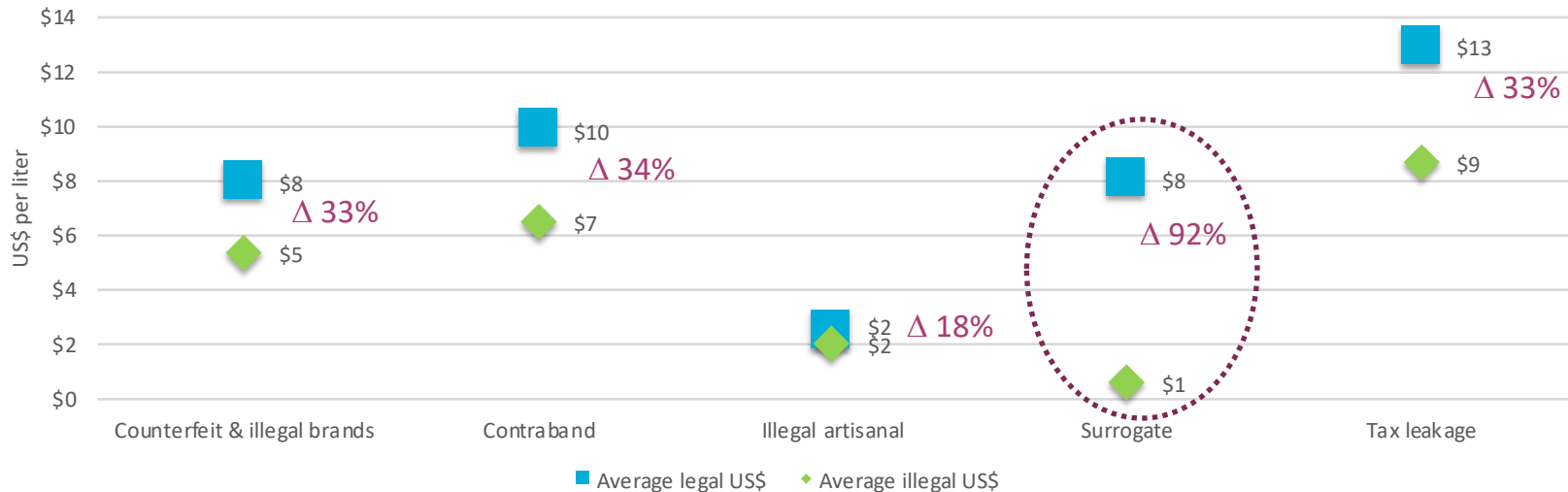
# Price analysis by category

The gap between illegal and legal prices has widened since 2014 (30%). This is due to the devaluation of the local currency (14% compared to 2014) which mainly matched the prices of legal alcoholic beverages. Although all the categories present price variations, surrogate alcohol shows the highest (92%), followed by contraband (34%).

Difference between illegal vs. legal prices, 2015

# 32%

Average prices per liter (US\$), 2015



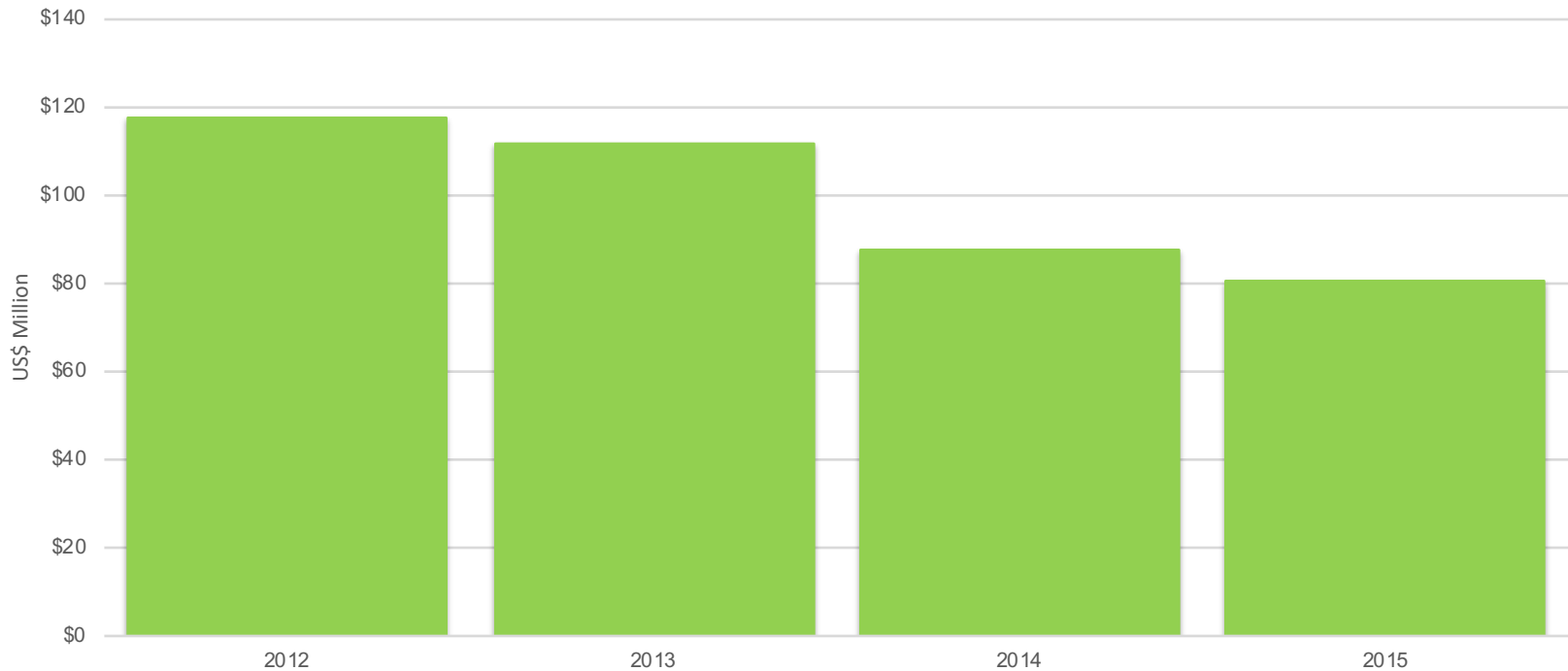
Source: Euromonitor International

**Executive summary**

## Evolution of fiscal loss (US\$) in the past 4 years

Fiscal loss has fallen 31% between 2012 and 2015. In 2012 it was estimated at US\$117 million, and in 2015 it decreased to US\$81 million, the lowest level observed in recent years.

### Evolution of fiscal loss (US\$), 2012 - 2015

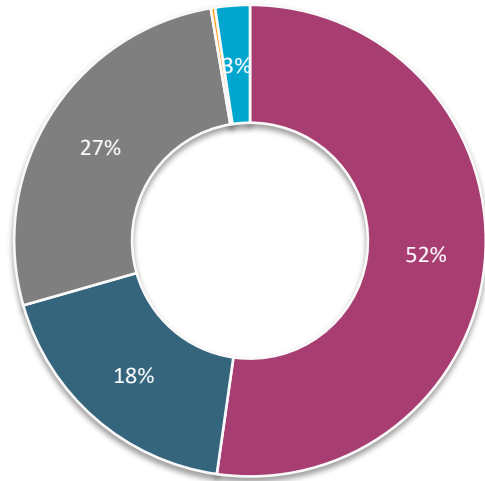


Source: Euromonitor International

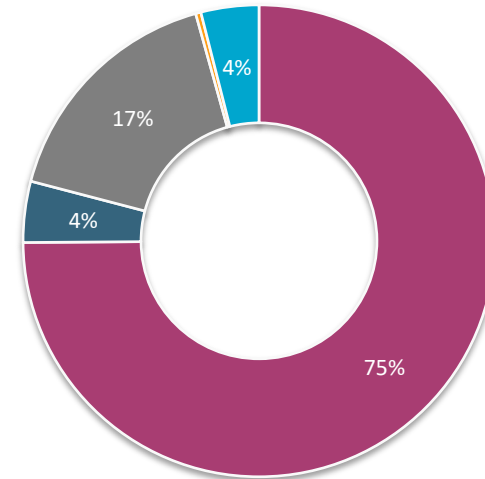
Executive summary

# Analysis of fiscal loss by category

Illegal market by category (HL LAE), 2015



Fiscal loss by category (US\$), 2015



■ Counterfeit & illegal brands 
 ■ Contraband 
 ■ Illegal artisanal alcohol 
 ■ Surrogate 
 ■ Tax leakage

Source: Euromonitor International

Counterfeit alcohol/illegal brands are the leading category in the illegal market, and in 2015 they continue to be the main source of fiscal loss (75%), despite having decreased since 2014.

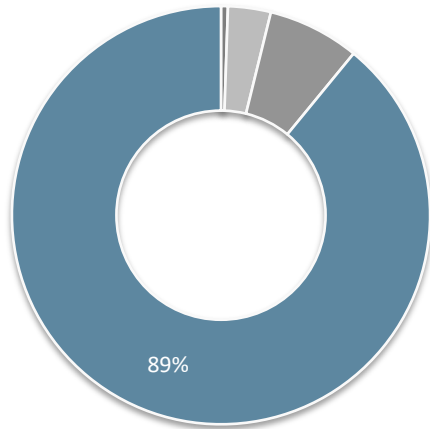
Illegal artisanal alcohol contributed 17% to fiscal loss in 2015, meaning it grew 20% in the past year.



## Executive summary

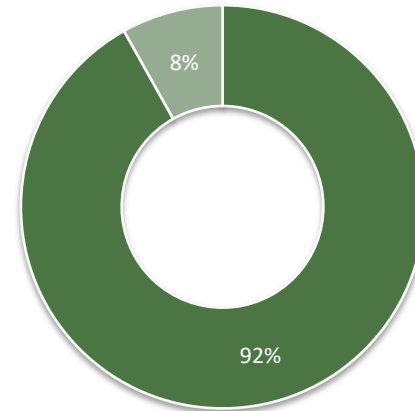
# Analysis for beer

Legal alcoholic beverage market, HL LAE, 2015



■ RTD ■ Wine ■ Spirits ■ Beer

Illegal beer market, HL LAE, 2015



■ Counterfeit ■ Contraband

Source: Euromonitor International

In 2015, consumption of illegal beer decreased 8%; however, beer is still the most consumed legal alcoholic beverage in Peru.

Volume LAE of illegal beer was 7,659 HL in 2015 (1% of the legal beer market). Counterfeit & illegal brands are still the main form of illegality in the beer market (92%), especially by decanting the beverage from bottles of lower-priced brands.

## Counterfeit alcohol/illegal brands

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>146,863</b>	<b>52%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>408</b>	<b>60</b>

- Volume-wise, counterfeit alcohol is still the main category in the illegal alcohol market.
- Within the category, spirits make up most of the volume (95%) as they use ethanol as the main raw material.
- The main form of counterfeit is Substitution/Refill, which represents 67% of the volume in the counterfeit category and in 2015 attained 98,525 HL LAE. Illegal industrial alcohol shrank less than Substitution/Refill with respect to 2014 (1% and 6%, respectively), attaining 48,338 HL LAE.
- With regard to 2014, the counterfeit alcohol/illegal brands category decreased by 4% due to the lower presence of residual ethanol in the market, greater efforts to control the existence of beer brands at events, prevent surreptitious entry, and seizure of counterfeit products.
- The fiscal loss generated by counterfeit alcohol is estimated at US\$60 million for 2015, which represents 75% of the total fiscal loss.

## Counterfeit alcohol/illegal brands

### Evolution of consumption (LAE) in the past 5 years

- In the review period of 2011-2015, consumption of counterfeit alcohol/illegal brands decreased 26%, from 199,652 HL LAE in 2011 to 146,863 in 2015. In the past year, the category fell 4% from 2014.
- The main sub-category is Substitution/Refill, with 67% of total counterfeit alcohol, and also fell 25% in 2011-2015.
- The mandatory registration of potable ethanol hinders its illegal sale, but the lack of effective controls and the fact that there is no obligation to denature industrial alcohol allows counterfeiters to carry out their activity.

#### Evolution of the Counterfeit alcohol/illegal brands market (HL LAE), 2011 - 2015



Source: Euromonitor International



## Counterfeit alcohol/illegal brands

### Main factors that influence the category



#### ALCOHOLIC BEVERAGES

- The alcoholic beverages affected the most are wine, *pisco*, rum, whisky, vodka and the anise-flavored beverage made with ethanol, sold in recycled bottles and with forged labels.
- Wine and *pisco* of little-known brands or lacking registration, along with Substitution/Refill of beer and whisky of well-known brands with cheap brands.



#### WHERE

- In formal channels such as liquor stores, wineries and markets. Also in unlicensed channels such as informal wineries and street markets.
- Normally, in popular areas and outskirts of cities, especially in *Lima, Arequipa, Puno (Juliaca)*, and *Trujillo*.
- The main regions that manufacture *pisco* and wine are *Ica* and *Chincha*.



#### FACTORS

- Lack of effective control of transport, and end use of ethanol.
- Sales of ethanol for industrial use without the denaturing process.
- Criminals operating underground and constantly changing the locations where they carry out their illegal activity.
- Impunity for criminals that were caught due to lack of evidence and corruption.



#### EFFECTS

- Illegal alcohol causes huge fiscal loss to the country.
- Consumption is a very serious health risk to consumers.
- It damages the image of original brands and affects their sales.
- It can even increase violence and crime rates, especially by the mafias involved.

## Contraband

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>51,516</b>	<b>18%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>50</b>	<b>3</b>

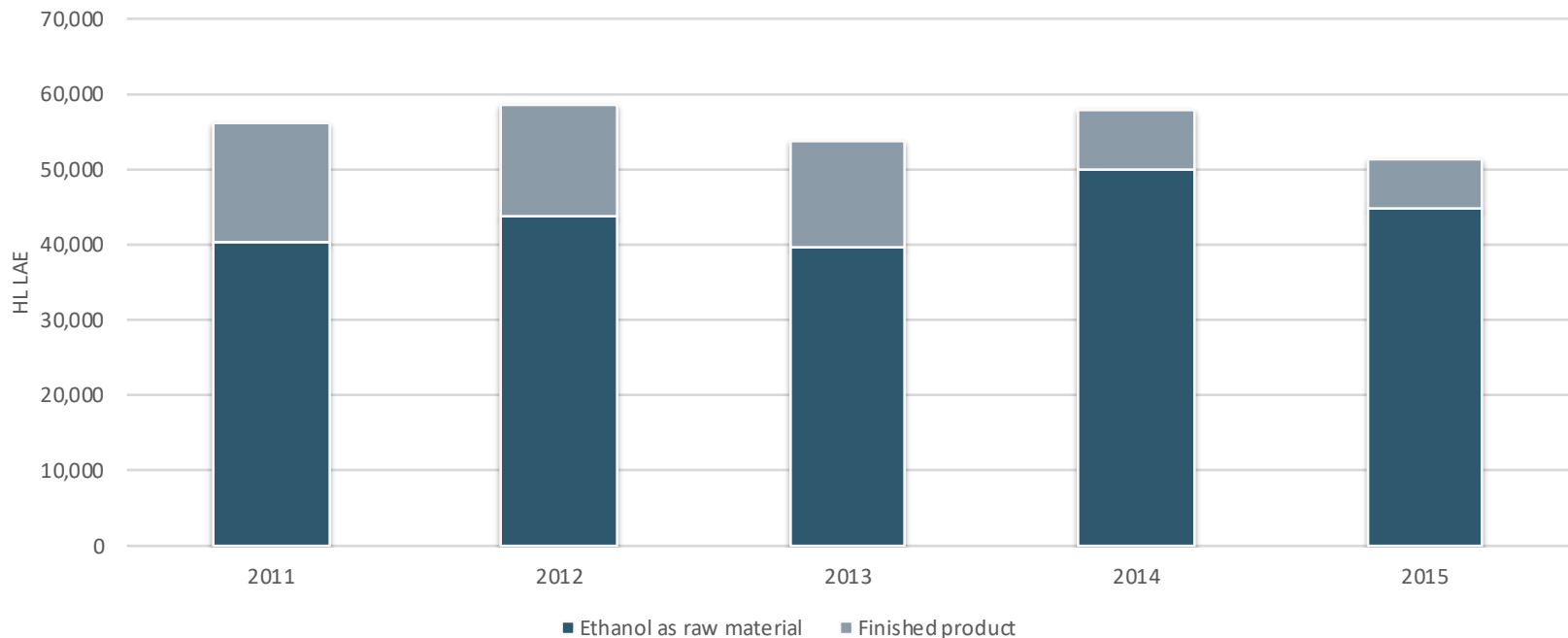
- Volume-wise, contraband represents the third largest category of illegal alcohol consumed in the country, valued at US\$50 million.
- With respect to 2014, the contraband category decreased 11% (from 57,876 HL LAE to 51,516 HL LAE); this was due to stricter Customs controls, especially of finished products, and the competitive supply of imported legal spirits.
- Contraband of ethanol as raw material leads with an 87% share (44,667 HL LAE), and contraband of finished product claims the remaining 13% (6,849 HL LAE).
- The majority of contraband finished products are spirits (85%), especially whisky brands in high demand.
- The fiscal loss generated by contraband is estimated at US\$3 million, which represents 4% of the total fiscal loss.

## Contraband

### Evolution of consumption (LAE) in the past 5 years

- Consumption of contraband decreased 8%, from 57,876 HL LAE in 2011 to 51,516 HL LAE in 2015. 87% of consumption is attributed to the contraband of ethanol as raw material. Consumption fluctuated throughout this period, and, as opposed to the category, grew 11%. The finished product suffered a remarkable drop of 56%.
- Devaluation of the local currency drove up prices of imported legal spirits. However, importers launched a strong competitive strategy of promotions in the modern channel, with the intent of maintaining or increasing sales volume at the expense of profit margins.

#### Evolution of the contraband market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Contraband

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- Whisky, rum and vodka are the main types of alcoholic beverages that enter the country as contraband.
- Contraband of beers and wines also exists, but to a smaller degree.
- Smuggled ethanol is used for manufacturing counterfeit alcoholic beverages in the southern region.



### WHERE

- Contraband of ethanol originates in Bolivia; brands enter legally to *Zofratocna* and are sold without paying the appropriate taxes.
- The contraband of finished products is sold mainly in liquor stores, wineries and markets, alongside the legal products.
- These products are also offered in street markets, on the internet or directly.



### FACTORS

- The absence of effective control of transport and end use of ethanol.
- Impunity penalizing criminals that got caught, due to lack of evidence, and corruption.
- Social support to smugglers in circulation areas, making it hard for the authorities to enforce actions



### EFFECTS

- Contraband alcohol generates fiscal loss to the country.
- Decrease in the sales of legal alcohol and the profits.
- Increase of violence and crime rates, especially by the mafias involved.

## Illegal artisanal alcohol

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>75,219</b>	<b>27%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>74</b>	<b>13</b>

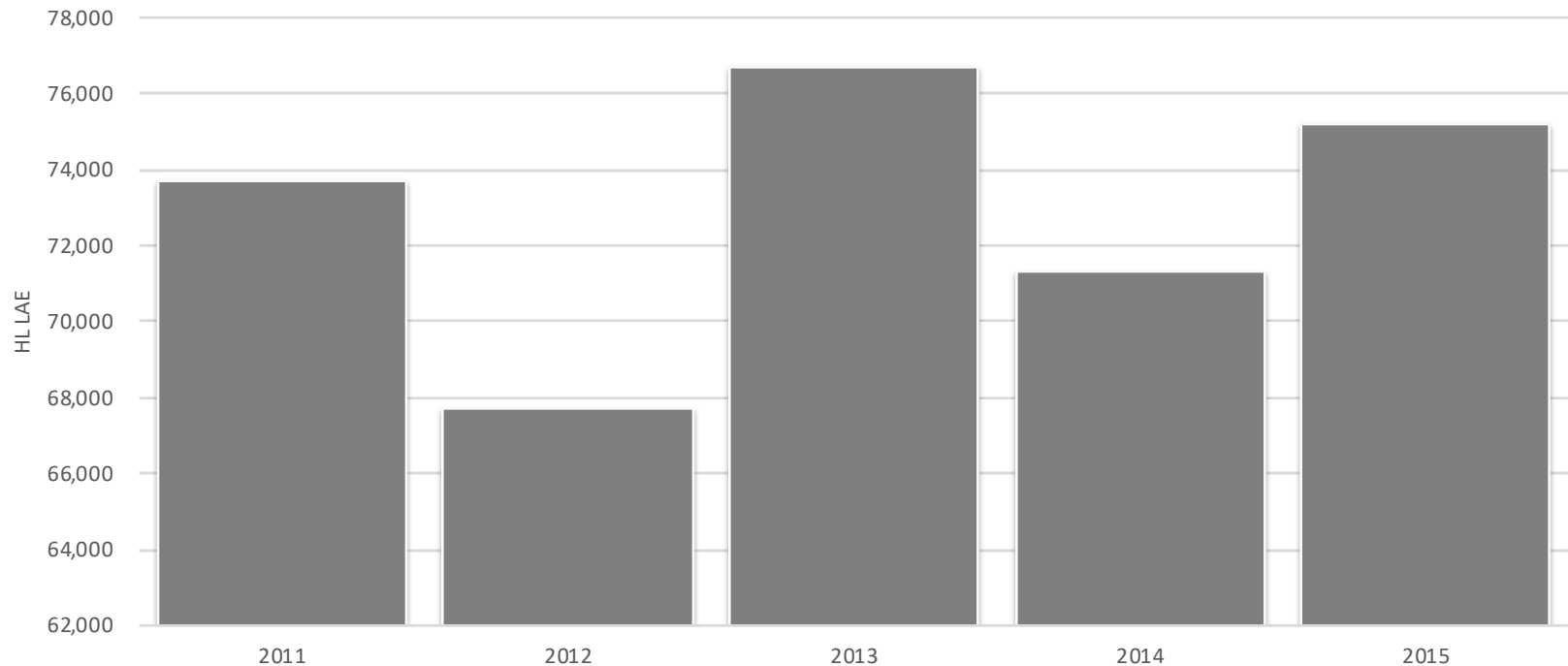
- Volume-wise, illegal artisanal alcoholic beverages are the second category of illegal alcohol consumed in the country, valued at US\$74 million.
- Spirits are the main category (93%), especially because of the artisanal manufacturing of alcohol based on sugar cane, also *pisco* and *aguardientes* out of grapes.
- With respect to 2014, the category grew 6% due to an increase in the production of sugar cane in non-dedicated areas and in the artisanal manufacturing of *pisco*, which was fueled by a greater demand in the local market.
- The fiscal loss generated by illegal artisanal alcoholic beverages is estimated at US\$13 million for 2015, which represents 17% of the total fiscal loss.

## Illegal artisanal alcohol

### Evolution of consumption (LAE) in the past 5 years

- Consumption of illegal artisanal alcohol has fluctuated over the review period of 2011-2015 and grew 2%. In the past year, this category grew 5% due to an increase in the production of low-cost illegal artisanal alcoholic beverages and greater demand for them.
- The higher demand for legal *pisco* also spurred the manufacturing of artisanal *pisco*. These spirits gained appreciation thanks to marketing campaigns and an extensive competition from legal brands.

#### Evolution of the illegal artisanal alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Illegal artisanal alcohol

### Main factors that influence the category



#### ALCOHOLIC BEVERAGES

- The main distilled beverages are *cañazo*, *aguardiente*, *yonque* and *pisco*.
- There is also manufacturing of fruit and root-based mashes, which are sold under regional names such as *RC*, *7 Raíces*, *Chuchuhuasi* and *Uvachado*.
- Among the fermented beverages are wine, *chicha* and *masato*.

#### WHERE

- The areas dedicated to the production of *pisco* and wine are *Ica*, *Chincha*, *Arequipa*, *Moquegua* and *Tacna*.
- *Chicha* is produced in different coastal areas and in the *sierras*.
- These products are sold in liquor stores, wineries and markets.
- They can also be found in informal wine cellars, street markets and private homes, generally in popular areas in the outskirts of cities.

#### FACTORS

- Lower price in comparison with other legal alcoholic beverages.
- Consumption based on cultural tradition, especially in regional festivities.
- High availability of local supplies and the tradition of manufacturing the beverage.
- Consumer perception that artisanal spirits are not illegal.

#### EFFECTS

- Consumption of these alcoholic beverages is a health hazard, especially due to the poor quality and deficient sanitary standards.
- They cause great damage to the image of legal *pisco* and its sales.
- Illegal artisanal alcoholic beverages generate fiscal loss to the country.

## Surrogate

# Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>824</b>	<b>0.3%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>0.2</b>	<b>0.3</b>

- In 2015, consumption of surrogate alcohol represented 0.3% in volume LAE of the total illegal alcohol market.
- At the head of this category we find alcoholic beverages prepared with low-quality ethanol mixed with orange-flavored soft drinks or similar, usually sold underground in disposable soda bottles or served in taverns.
- Consumers spent an estimated US\$0.2 million on the purchase of pharmaceutical alcohol to use as substitute for a legal alcoholic beverages.
- The category of surrogate alcohol decreased 36% in volume LAE from 2014 levels, as a result of greater awareness regarding the high health risk posed by this product.
- The fiscal loss generated is estimated at US\$0.3 million, which represents 0.4% of the total fiscal loss.

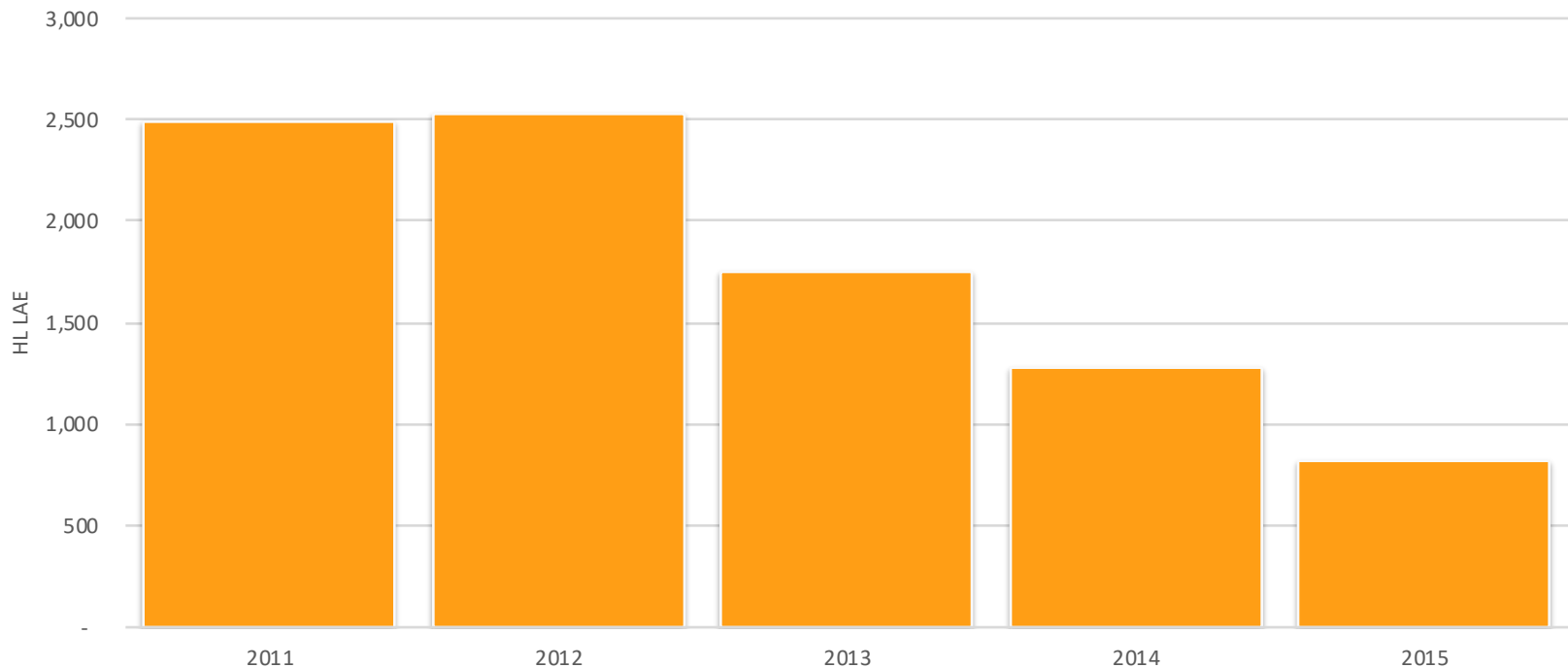


## Surrogate

# Evolution of consumption (LAE) in the past 5 years

- This is the category which suffered the strongest slump in volume (67%) in the past 5 years. This decrease is due to a higher awareness among consumers of the tremendous risk posed by this product.
- In 2015, consumption dropped 36%, reaching the lowest level in the last few years.

## Evolution of the surrogate alcohol market (HL LAE), 2011 - 2015



Source: Euromonitor International

## Surrogate

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- These alcoholic beverages are manufactured with low-quality ethanol mixed with water or orange soft drinks, mixers, or similar products.
- The most common names are *racumín* or *salta pa'atrás* or *calientito* (for products served warm, usually in the *sierra*/mountains).

### WHERE

- They are sold clandestinely in wine cellars, market stands or street vendor stands, especially in slums and the areas surrounding wholesale markets.
- In private homes behind closed doors (to take away or for their own consumption) and are located in popular and peripheral areas.



### FACTORS

- Consumption of these beverages is common in low socio economic neighborhoods, as they are low-priced and affordable products.
- This mainly involves alcohol addicts who lack access to safer types of alcoholic beverages.
- Adjustment for clandestine selling, changing locations when they are discovered.



### EFFECTS

- Consumption of pharmaceutical alcohol represents a health hazard, due to the high level of alcohol concentration.
- Increased violence and crime rates.



## Tax leakage

### Consumption analysis



Market size volume 2015 (HL LAE)	Share in volume, 2015
<b>6,661</b>	<b>2%</b>
Market size value, 2015 (US\$ million)	Fiscal loss, 2015 (US\$ million)
<b>25</b>	<b>3</b>

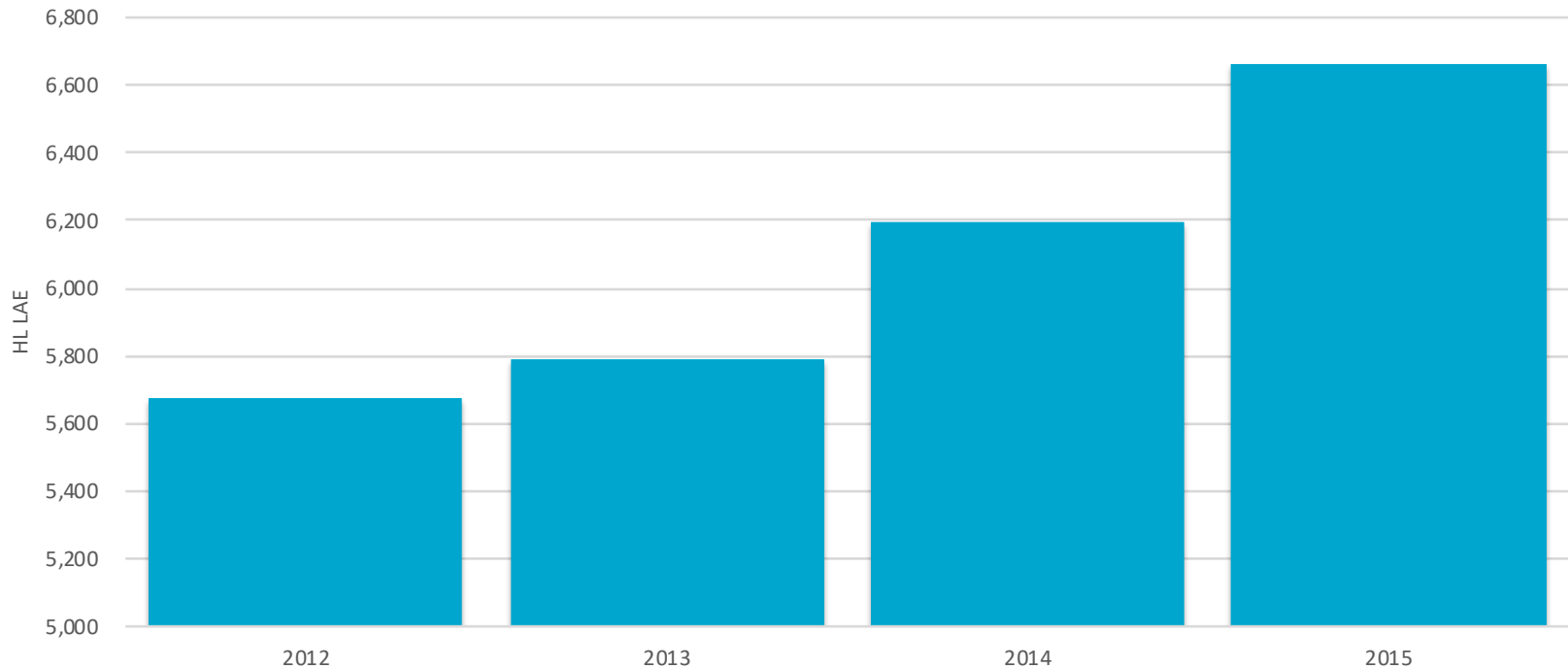
- Volume-wise, tax leakage is the fourth largest category in the illegal alcohol consumed in the country, valued at US\$25 million.
- Tax leakage mostly comprises spirits (70%), especially *pisco* and rum.
- With respect to 2014, this category increased an 8% as a result of greater demand for legal *pisco* and wine, which encouraged manufacturers to sell these products without invoices.
- The fiscal loss generated by tax leakage is estimated at US\$3 million for 2015, which represents 4% of the total fiscal loss.

## Tax leakage

# Evolution of consumption (LAE) in the past 4 years

- In the past few years, tax leakage has increased, as small manufacturers have secretly stopped issuing invoices to their frequent customers, making good use of the tax gap (selective + *IGV*).
- As shown in the chart below, this category grew 8% between 2014 and 2015.

### Evolution tax leakage (HL LAE), 2012 - 2015



Source: Euromonitor International

## Tax leakage

# Main factors that influence the category



### ALCOHOLIC BEVERAGES

- *Pisco*, wine and other legal spirits, with Sanitary Registration, produced by small legal manufacturers.
- They tend to be good-quality products and fairly well-known brands.
- Some supplies, bottles and labels are purchased without invoices being generated.



### WHERE

- Sales are usually carried out on-site at the manufacturer's plant or warehouse, and the transaction is done discreetly, with trustworthy customers.
- Located mainly in the provinces.



### FACTORS

- The low price of these alcoholic beverages is appealing to consumers.
- Lack of control or oversight by the authorities, especially in provinces.



### EFFECTS

- Tax leakage causes fiscal loss.
- Unfair competition against legal players.

## Industry comments

### Key quotes from interviews



We have noticed a higher presence of the counterfeit market because, on the one hand, selling in the southern areas has become much harder for us; and on the other hand, the counterfeit products are on display for everyone to see... Registered companies are presenting their reports on a quarterly basis, they go by the book, yet nobody's crossing the information. And I don't think they're controlling the transport of alcohol as the regulations say. There is no traceability.

— *National manufacturer – Cartavio Rum Company*



The presence of contraband products is still very strong in the southern region, the same as in previous years. In the South, Tacna is the main source of supply of these products... The problem with Tacna is not the free trade area in itself, whose role is to supply all the southern area, but the lack of control in the transport of products to the domestic market.

— *Importer – Pernod Ricard Peru*



We need to do intelligence work with the information provided by registered companies. Some companies are registered for buying ethanol, but at the same time, we detected that with the same RUC, they have the sanitary authorization to manufacture and commercialize wine-industry alcoholic beverages, i.e., *pisco* and wine.

— *Business Association – SNI*



Taking official action is a complicated matter, because one can't always gather enough evidence, and without it no action is possible; normally, counterfeiters operate behind closed doors or in clandestine workshops with little or no observable movement, and soon after, they tend to move. It's possible that by the time you have the judge's search warrant, they are no longer there.

— *Policía Fiscal*



## Industry comments

### Key quotes from interviews



The strictest controls are always for legal products. They make things extremely complicated for those of us who have a legal business. Now, when we bring in merchandise, not one single container gets a green light; we always get the red light because we are all treated as criminals; this means more costs, time, claims, etc.

*Importer – Drokasa Licores*



Now, PRODUCE's control has slightly reduced informality, because now they need to get authorization. The outcome is fewer sales, because there are fewer clients; before, if you had 2,000 clients, you can only sell to 1,000 clients, as half have not gone formal. You do not know why they do not go formal. Some of them have switched to another business field.

*Distributor of ethanol – Comercial de Alcohol Milagros*



The authorities should oversee the manufacturers of alcoholic beverages and check that they're using the right type of alcohol and not industrial alcohol as raw material, because it is forbidden, but rectified alcohol is not forbidden. So, they should control the raw materials being used by the manufacturers of alcoholic beverages. That's where control should be targeted.

*Distributor of ethanol – Alcoholes Destilados SAC*



Contraband has been badly hit by the exchange rate, because in 2014 it was S/. 2.8, and everyone competed in dollars, but in 2015 it climbed to S/. 3.5, and so these S/. 0.70 were eaten up by the importers for the price war, which affected the smugglers who did have to pay that devaluation. And for many clients who used to buy contraband, it was no longer profitable because the small difference didn't justify the risk they were taking.

*Importer – Perufarma*



## Industry comments

### Key quotes from interviews

With the *mesa técnica* the intelligence work has improved; now you can identify the authorities. At a logistics level, we have gained the attention of the pertinent authorities, and in addition, we have workshops: one in March for policing, another one for health-related matters... In all the workshops, the idea is to become acquainted with regulations and jurisdictions, as well as the risks and consequences of not abiding by them. Thanks to the investigations in Tacna, operations were carried out in March (2016).

*PRODUCE – Fight Against Customs Crime and Piracy*

There is an inspection for registered companies that have the authorization (for *pisco*), but sometimes break the law when they manufacture *pisco* but no longer comply with all the requirements. We take different forms of action with those who do not use the right permits: on own account, complaints, campaigns, acting over non-authorized products, etc.

*INDECOPI*

You find this in small stores that get a license for wineries in poor districts of the city outskirts. And they sell these drinks they call *Claro* and *Movistar*; *Claro* means a light-colored drink; it is pure sugar cane *aguardiente*, or ethanol and nothing else; and *Movistar* when it contains *chuchuhuasi* along with the alcohol.

*Town Council of San Martín - Inspections*

Smugglers are implementing new ways of carrying out their criminal activity. If a route is not under very strict control they can use trucks; however, if these are detected they can use station-wagons, or the passengers themselves to carry part of the goods, and then they pull the stock before arriving at the market. The most important area to keep under control is the South of Peru, and we've got further controls under way there. For contraband, the reasons are the expensive Customs duties and taxes.

*SUNAT - Customs*



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## Methodology

# Methodology



### Secondary research

Local analysts gathered published material, including:

- Official statistics regarding manufacture and imports
- Statistics regarding seizures of illegal products
- News
- Industry regulations
- Data on the legal market provided by Passport and other sources



### Interviews with the different market stakeholders

At regional level, **127 interviews** were carried out with Government agencies, media, associations, players in the beverages industry (merchants and manufacturers), and NGOs.



### Visits to stores

At a regional level, there were **111 store visits**. The goal of these store visits was to observe types of beverages, bottles, prices, brands, etc.



### Validation and analysis of findings

The analysis focused on national manufacturing, imports/exports and industrial consumption of raw material to quantify the residual volume that remains in the domestic market and estimate the potential volume that could be shifted to the illegal alcohol market.

## Methodology

# Technical notes

### Scope of studies, 2011 - 2015

	2011	2012	2013-2015
<b>Categories</b>			
Counterfeit alcohol	x	x	x
Contraband	x	x	x
Illegal artisanal alcohol	x	x	x
Surrogate alcohol	x	x	x
Tax leakage	N/D	x	x
<b>Sub-categories</b>			
Distilled (Spirits)	x	x	x
Fermented	x	x	x
Illegal beer	N/D	N/D	x
<b>Metrics</b>			
Volume (HL LAE)	x	x	x
Value (US\$)	N/D	x	x
Fiscal loss (US\$)	N/D	x	x

- The estimated volume of illegal alcohol is included in the stage where they become illegal, in order to avoid double counting.
- Whenever possible, estimation methods as well as the sources have remained constant over the years. In those cases where it was necessary to adjust the estimation method or replace/include a new source, the method that best reflected the market's real situation was chosen.
- Value is estimated on the basis of the illegal market price paid by consumers. It excludes sales tax.
- For conversion to US dollars, the average currency exchange rate of the year the study took place was used.
- Estimate of fiscal loss refers only to taxes on the manufacture and consumption of alcoholic beverages and import duties (in the case of contraband).
- For illegal artisanal beverages and surrogate alcohol, taxes on the country's most popular legal alcoholic beverage, or the one most affected by substitution, are the ones considered.

## Examples of illegal alcoholic beverages

# Pictures of illegal products - Colombia

San Victorino, Bogota



San Victorino, Bogota



## Examples of illegal alcoholic beverages

### Pictures of illegal products - Ecuador

Contraband



Contraband beer



Counterfeit spirits



Counterfeit spirits



Counterfeit spirits



Tax leakage



Illegal artisanal alcohol



Illegal brands



## Examples of illegal alcoholic beverages

### Pictures of illegal products - Panama

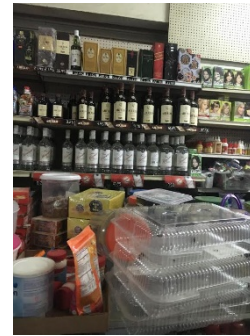
Contraband beer



Contraband spirits



Sale of contraband spirits



Illegal artisanal alcoholic beverages



*Chicha fuerte* ready to be consumed



*Chirrisco* seized in the province of *Santiago*



Contraband beer seized in *Colon*



## Examples of illegal alcoholic beverages

### Pictures of illegal products - Peru

Counterfeit and contraband



Contraband spirits



Counterfeit alcoholic beverages



Artisanal alcoholic beverages



Contraband spirits



Counterfeit alcoholic beverages



Counterfeit alcoholic beverages





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