MARKET ANALYSIS FOR ILLICIT ALCOHOL IN MALAWI

A custom report compiled by Euromonitor International Consulting
for Chibuku Products Limited

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INTRODUCTION

Project objectives and scope

Category Coverage

- Counterfeited and illegal brands
  - Substitution/refill
  - Industrial manufacturing of illicit/unbranded
- Smuggling
  - Smuggling of ethanol
  - Smuggling of the finished product
- Homebrew artisanal alcohol
  - Illicit homebrew
- Tax leakage
- Surrogate

Alcohol Type Coverage

- Distilled
- Fermented

Country Coverage

- Malawi

Project Background

- Illicit alcohol trade poses a substantial health threat to consumers, whilst the economic consequences for alcoholic drinks companies and governments are equally considerable.
- Chibuku Products Limited and related subsidiaries are aware of the damage being done to its business by illegality. To combat this more efficiently the company wants to gain additional knowledge regarding the details and volumes of illegal trade.

Client Objectives

The main objective of this project is to **understand the shape of all types of illegal alcohol markets in Malawi, focussing on 2015**. Key points to be researched during this study include:

- To examine the current **trends of the illicit alcohol** landscape.
- To **size the total market for illicit alcohol** and **illicit alcohol categories**.
- To understand **consumer purchase motivation**.
- To estimate the role that **regulatory measures** might play in this.
- To illustrate the **value chain** for illicit alcoholic beverages by illicit category.

Project research methodology

Step-by-Step Process

Secondary Source Review

- Extraction and analysis of **Euromonitor International's Passport data** and reports focusing on Malawi alcoholic drinks industry.
- Review of **secondary sources** that may be available in the public domain on the **size of the legal market** for alcoholic beverages in Malawi, the **scale and main illicit activities in the market** and key trends.

Industry Specialisation

- **In-depth conversations** with Euromonitor industry managers and country analysts.
- Compilation of **industry contacts**, and **insights on trends** and direction for future research.

Store/tavern Observations

- **Store visits** to try to understand **what illicit activities are taking place** as a result of the commercial (bad) practice by retailers/informal traders and tavern/bar owners.

In-depth Trade Interviews

- **In-depth, semi-structured interviews** with **relevant government officials** responsible for monitoring the sale and licensing of alcoholic beverages, **NGOs**, **trade associations**, **importers**, **breweries/distilleries**, **distributors**, **retailers**, **industry consultants**, and **other players in the supply chain**.

Analysis and Reporting

- Data **review**, **interpretation** and **assessment** to build a **composite view of the illicit alcohol market** in both volume and value terms.
- **Validation** and **cross-checking** of all project findings and associated data.
- Preparation of a dynamic **PowerPoint delivery report**.
- Results **presentation** and discussion.

DEFINITIONS

Project definitions

Category	Subcategory	Definition
Counterfeited and Illegal Brands	Substitution/refill	Illicit alcohol sold as licit brands or empty bottles of legitimate products refilled with cheaper alcohol
	Industrial manufacturing of illicit brands or unbranded beverage alcohol	Manufacturing of illicit branded or unbranded alcohol
Smuggling	Smuggling of ethanol	Illicit imports of ethanol as a raw material
	Smuggling of the finished product	Illicit imports of packaged alcoholic beverages
Homebrew Artisanal Alcohol	Illicit homebrew	Illicit homebrew alcoholic beverages made for commercial purposes
	Licit homebrew	Beverage alcohol produced as part of long-standing traditional and/or cultural practices. Includes home production for personal use; excludes home production for sale
Surrogate	-	Alcohol not meant for human consumption (e.g. to be used to produce pharmaceutical and paint products etc.) diverted to the alcoholic beverages market
Tax Leakage	-	Licit alcoholic beverages (locally produced) on which inappropriate or no excise production taxes are paid

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MANAGEMENT SUMMARY

Alcoholic beverages market size 2015 in Malawi

160,003 HL, LAE

Total Alcohol Market Volume

62,380 HL, LAE

Total Licit Alcohol Market Volume

97,623 HL, LAE

Total Illicit Alcohol Market Volume

US$105mn

Total Licit Alcohol Market Value RSP

US$62mn

Total Illicit Alcohol Market Value in Illicit RSP

US$80mn

Total Fiscal Loss

Source: Euromonitor Consulting

Abbreviations:

HL - Hectolitre

LAE - Litres of alcohol equivalent

High alcohol consumption and large illicit alcohol market

1 Malawi has a strong alcohol culture

According to the World Health Organization in 2010, consumption of alcohol per capita was 12.8. Prevalence of heavy episodic drinking occurred in 40.8% of drinkers

2 Urban youth & rural poor are the largest consumers

Although alcohol consumption in Malawi is universal, the largest category of consumers are the rural poor and urban youth. Price and availability of illicit alcohol is driving this trend

3 Tax leakage is the largest contributor to illicit trade in Malawi

It is estimated that around 70% of the production from ~20 main registered manufacturers is under-declared in terms of production tax. Distilled spirits account for the majority of the illicit volume and value

4 Surrogate accounts for the second largest illicit volume HL LAE

Denatured alcohol from domestic producers and an even larger quantity which is imported, provides alcohol manufacturers with raw ingredient which was destined for other industrial uses

5 Smuggling providing competitive price advantage

Competitive price advantage and changing lifestyles in Malawi are the primary drivers of the illicit smuggling trade. Smuggled alcohol is universally consumed in Malawi and consumption is stable to increasing as evidenced by availability

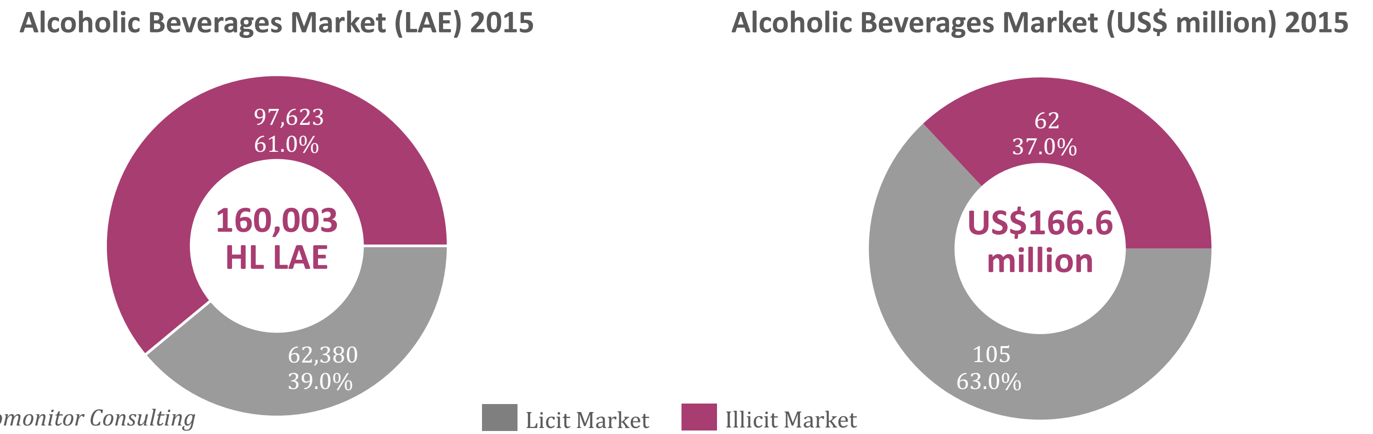
6 Lack of visibility means enforcement is a challenge

Authorities and enforcers are under-resourced. Lack of visibility of operations and lack of technology to monitor product content means illicit activity is on-going

MANAGEMENT SUMMARY

Low income rural population and youth target for growing illicit alcohol market

Total alcoholic beverages market in 2015



Source: Euromonitor Consulting

- In 2015 the total **alcoholic beverages market in Malawi stood at 160,003 HL (LAE) in volume terms** and US$166.6 million in value terms
- **Illicit alcoholic beverages** accounted for **61.0% of the total market in LAE volume terms** in 2015 and **37.0% in value terms**, while the licit market represented the remaining 39.0% and 63.0% respectively
- The **Malawi Confederation of Chambers of Commerce and Industry** (MCCCI, 2016) observed that the illicit trade, especially in distilled spirits targeting the low income population and youth will have a long term customer base
- **Some factors for illicit growth** include enforcement of laws and regulations by government agencies, department and Ministries remains a challenge. The major reasons are capacity and financial resources
- Legal, locally produced alcohol that does not pay its excise is the number one driver for illicit alcohol activity in terms or volume, value, and fiscal loss
- Most illegal production of distilled alcoholic and fermented alcoholic beverages are produced in urban areas and distributed to rural areas. Malawi also has a vast informal sector for distributing alcohol that includes "shanty towns," market stalls, street kiosks and unlicensed bars, which increases availability and ease of purchase

Illicit trade growing amidst temporary economic uncertainty

Market outlook in the Malawi illicit alcohol industry

1. In 2015, buffeted by weather and policy shocks, Malawi's **real GDP growth was estimated at 2.9%, down from 5.7% in 2014**. In 2016, **economic growth is projected to rebound to 4%,** with agriculture as the main driver. The growth outlook is premised on favourable weather conditions, macroeconomic stability, consistency in policy implementation and renewed private-sector confidence

2. **Consumption is generally universal –** meaning that both the rich and poor, urban and rural consume alcoholic beverages. **Consumer expenditure on alcohol is expected to grow**, however with increasing licit alcohol prices and greater excise on alcoholic beverages there will be **a tendency to trade down to cheaper or illicit brands** within a specific category, such as opaque beer and economy spirits

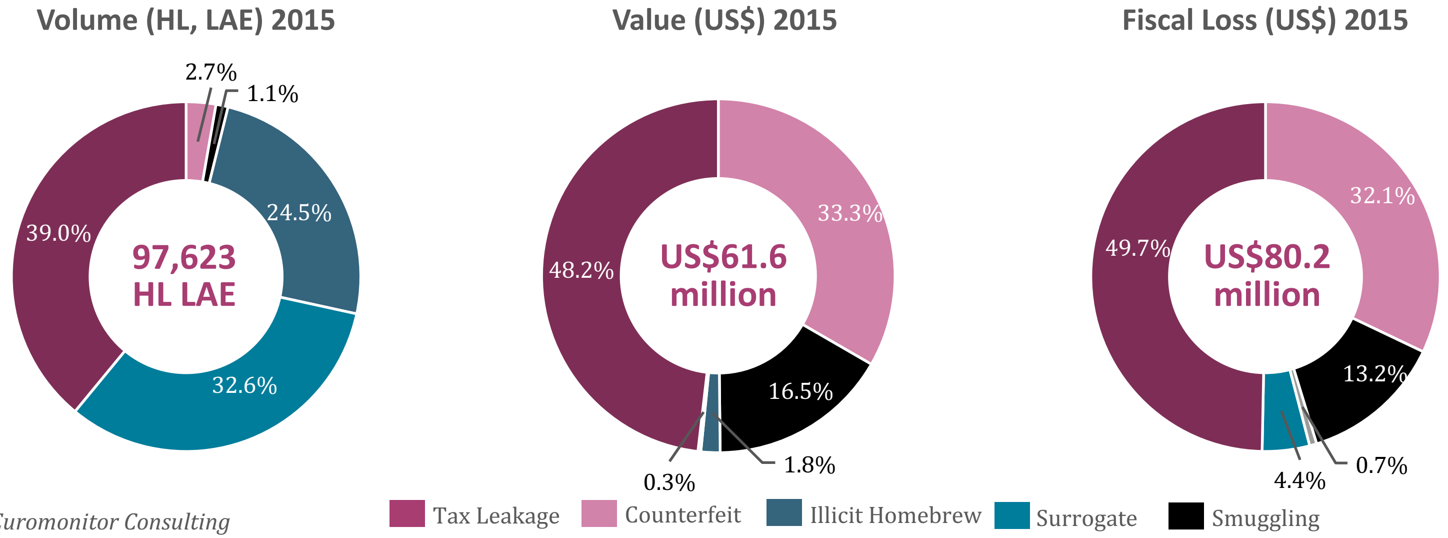
3. **The illicit alcohol trade in Malawi is growing**, especially in distilled spirits targeting the low income population and youth which will provide a long term customer base. **Tax leakage is the primary driver of illicit distilled spirits.** The second largest contributor is counterfeit alcohol, with substitute beer driving the illicit trade

4. The 2013 "***ban on use of sachets***" has **not reduced the consumption patterns but merely rearranged the distribution modes** into drums, plastic bottles, and refills. Now the manufacturers are packaging in plastic bottle formats in 200 ml, 5, 10 and 20 litres. The larger sizes are purchased and then split and sold informally in smaller batches. This has yet again given a volume advantage for the manufacturers and exposed the final consumer even more with the risks associated with informal market refills

5. **Smuggling of premium products is expected to remain a major impediment to the licit market unless the government shows a firm commitment to tightening border controls** and enforcement. Enforcement of laws and regulations by government agencies, department and Ministries remains a challenge. The major reasons are capacity and financial resources. This is applicable mostly to City Councils, Ministry of Industry, Trade and Tourism, and to a smaller extend, Malawi Bureau of Standards

Illicit alcohol activities driven by Tax Leakage

Illicit alcoholic beverages market in 2015

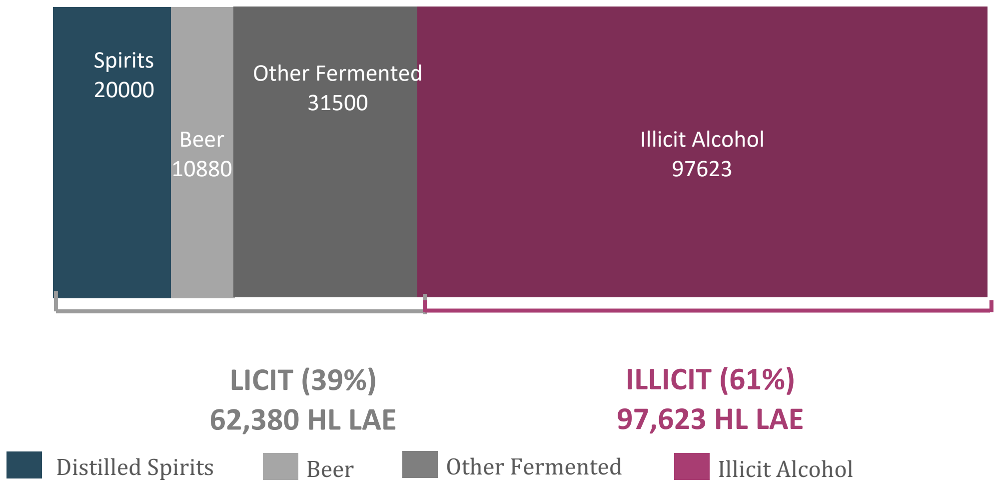


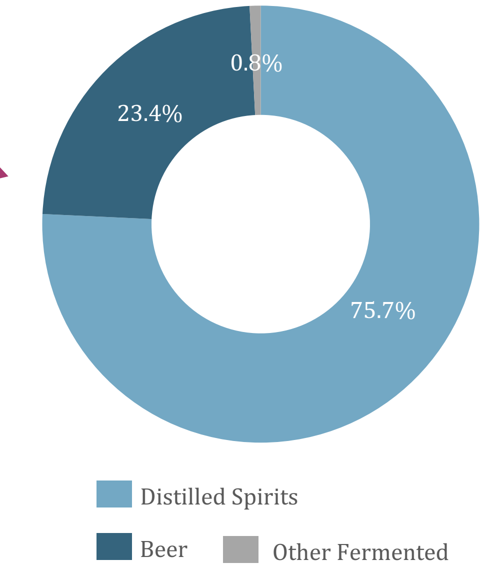
Source: Euromonitor Consulting

- The total size of the **illicit alcohol beverages market was 97,623 HL, LAE by volume** and **US$61.6 million by value** in 2015
- **Tax Leakage** is the **largest illicit activity** in Malawi, accounting for 48.2% by value, 39.0% by volume of total illicit activities in 2015. Most importantly, it **accounted for nearly half (49.7%)of the total fiscal loss**
- **Surrogate** alcoholic production is **the second-largest in volume terms (32.6% of illicit volumes) but it** accounted for **the lowest of value sales.** Low value is due to it being an ingredient as opposed to finished product
- **Smuggling were the lowest categories in volume terms**, accounting for 1.1% but accounted for the **third highest amount of value sales at 16.5%**
- The **other significant drivers of fiscal loss** were **illicit counterfeit alcohol and smuggled finished alcohol,** (mostly fermented**) which represented 32.1% and 13.2% of the fiscal loss respectively**
- Although illicit homebrew and surrogate accounted for a significant portion of the total market volume of illicit alcohol, their low production costs means that total value and fiscal loss is relatively low

Illicit volumes are predominantly made up of distilled spirits

Composition of alcohol market in volume terms (HL LAE) by type of beverage in 2015



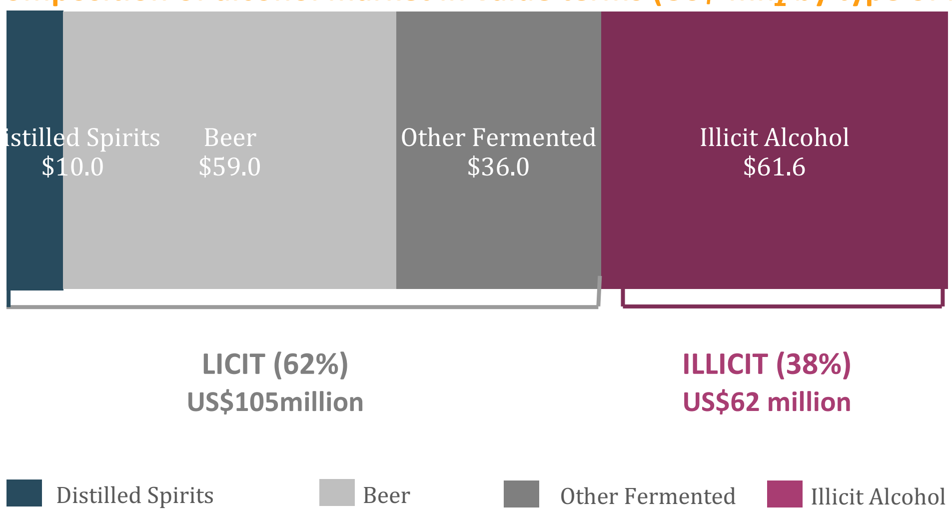


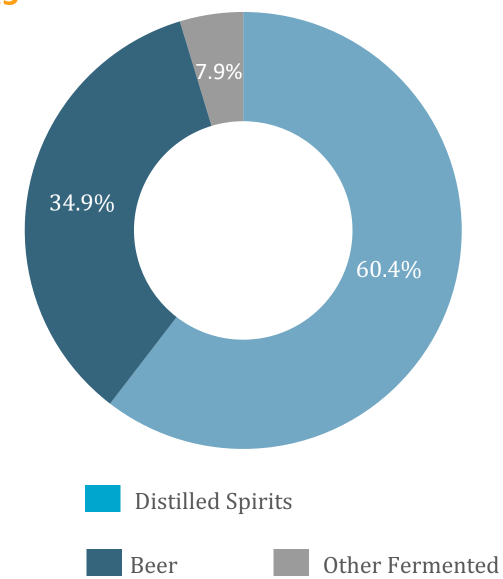
Source: Euromonitor Consulting

- In Malawi, distilled spirits **dominates the licit alcoholic beverages market with 75.7% in LAE volume** terms in 2015, followed by **beer with 23.4%**
- **Distilled Spirits** accounted for the majority share of 75.7% of **illicit** alcohol in LAE volume terms, mainly due to the high alcohol content, supply and availability of the product. Tax Leakage and distilled surrogates were the largest drivers of this category
- **Illicit beer** accounted for **23.4%** of illicit homebrew market volume, was the largest category in terms of total volume
- Other fermented alcohol such as **wine** and c**ider** were the least affected by illicit alcohol activities, representing **0.8%** of the total illicit alcohol HL LAE volume

Beer dominates licit and tax leakage spirits the illicit market value

Composition of alcohol market in value terms (US$'mn) by type of beverage in 2015



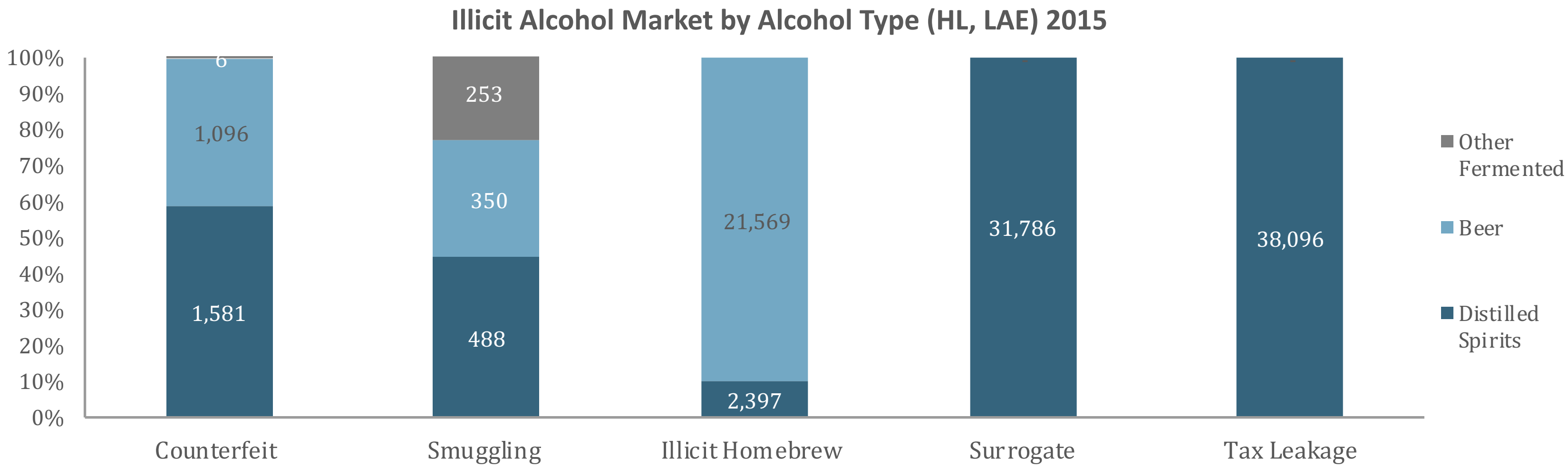


Source: Euromonitor Consulting

- In the **illicit alcohol** market, distilled spirits led with 60.4% in terms of value, which was driven primarily by **tax leakage comprised solely of illicit distilled spirits**
- **Beer** followed at **34.9% of the total illicit alcohol market.** Two drivers accounted for this; counterfeit substitute beer and smuggled beer which represents 33.3% and 16.5% of the total illicit alcohol market value
- **Other fermented alcohol** follows with 7.9% of the illicit alcohol market. Smuggled cider accounts for the majority of this market value

Illicit spirits constitute the bulk of illicit activity categories in volume terms

Composition of market volume – alcohol type in 2015



Source: Euromonitor Consulting

- **Tax leakage is the largest illicit category**, driven entirely by distilled spirits. Tax leakage occurs via local legal spirit producers who produce low priced-spirits. There is a **mismatch of excise-paid revenue based on production recorded spirit volumes to the availability of low-priced alcohol inventory** distributed or found across formal and informal retail outlets
- **Surrogate alcohol is the second largest** illicit category, and it too is driven entirely by distilled spirits. However the extremely low price **of illegal ethanol marginalized** its total **fiscal loss impact**. The majority of the surrogate volume comes through importation in secrecy from the authorities
- Illicit homebrew is the third largest illicit category, driven by fermented homebrew beer. This category of alcohol consumption is sometimes brewed and consumed on-premises and both urban “shanty town” and rural locations and consumed by rural poor and urban poor driven by low prices
- Counterfeited & illegal brands represent only **2.7% of total illicit volumes**. Counterfeit brands consist of two sub-categories, substitution/refill which is driven by beer, and manufactured illicit or unbranded alcohol, driven by distilled products. The high volume of counterfeit refill beer drives the low HL LAE total volume and accounts for the majority of the value and fiscal loss
- Smuggling of premium spirits, beer, cider and wine is popular, conducted along Malawi’s borders to South Africa and Mozambique. Smugglers are well connected, with good knowledge of import procedures

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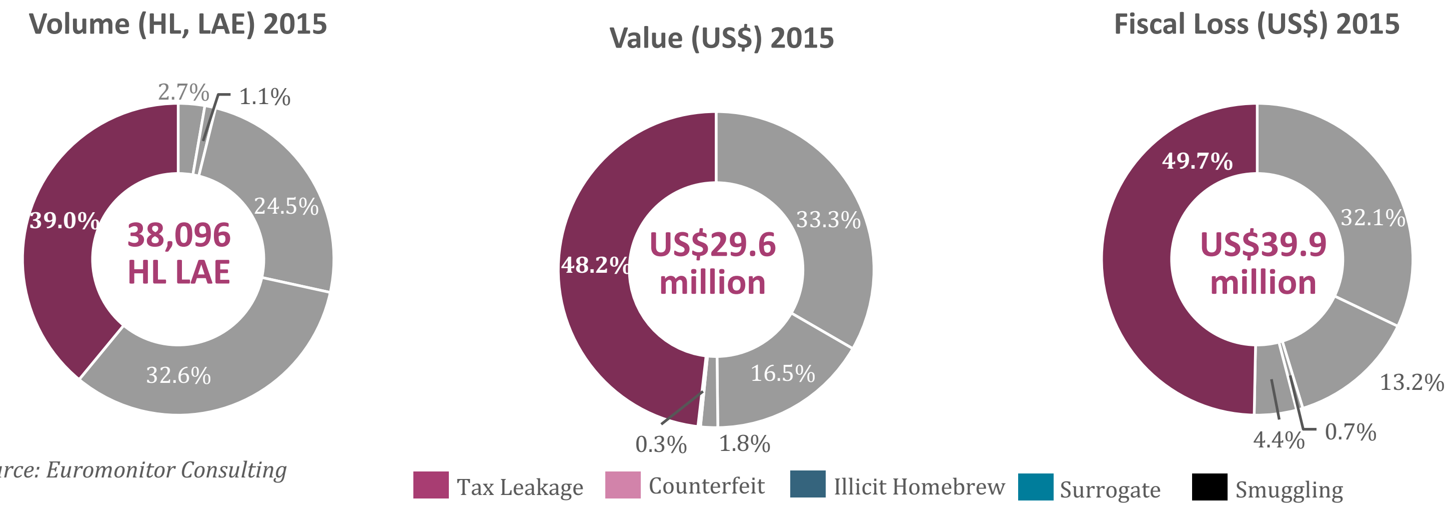
TAX LEAKAGE: MARKET SIZE

Tax leakage is the largest contributor to illicit trade in Malawi



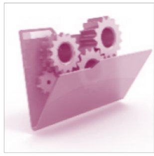
Source: Euromonitor Consulting

Tax leakage is set to continue growth and sustain its position as the largest illicit alcohol category in Malawi

- The tax leakage category is the largest contributor to illicit HL LAE (39%), value (48.2%) and fiscal loss (49.7%)
- The majority of the illicit alcohol trade in Malawi is derived from approximately 20 manufacturers who are registered entities
- Typically these entities are small and medium sized, relatively new and unknown business both to the general public and some government departments or agencies
- It is estimated that around 70% of the production from these manufacturers is under declared in terms of production tax
- It is estimated that this category is set to continue its growth trajectory into the foreseeable future

Strong demand for cheap alcohol is filled by tax leakage manufacturers

Drivers and general overview



Strong drivers contribute to the huge demand in production from tax leakage manufacturers

- Two manufacturers are said to make up the lion's share of tax leakage production
- Low disposable income of the consumer base is the biggest driver to this category
- Consumers are able to easily access extremely cheap alcohol products with high alcohol content; there is no such brand loyalty to prevent simply switching to the cheapest alternative
- Informal production and distribution structures also means that government are unable to properly monitor precise production and hence are unable to implement stronger taxation

Supply chain

An extremely agile and intricate supply chain is employed

- The supply chain used is said to be agile and expansive
- Ethanol is a the key raw ingredient which is both imported and sourced domestically in Malawi
- Main sources of local supply are Ethanol company of Malawi, Presscane and Illovo Sugar
- Imports of ethanol come through South Africa and Swaziland passing through the porous borders of Dedza and Mwanza
- Major local and international transporters with tanks of around 35,000 litres are essential to the supply chain
- A medium sized manufacturer on average would take around 2 truck deliveries per week
- Plastic sachet formats orders are said to be produced over night to avoid detection and these are sold through Mobile vendors/Kiosk
- Distribution of the finished product is done by own fleet (around 3 – 10 ton trucks on average per manufacturer) and also using local transporters where a per job fee is negotiated meaning no fixed transport costs like labour, insurance and maintenance
- Some manufacturers establish regional warehouses and/ or sales representatives who then act as a wholesaler to the retail level

Tax Leakage targets distilled spirits brands

Types and brands

Plastic bottle formats and to some degree sachets are prevalent

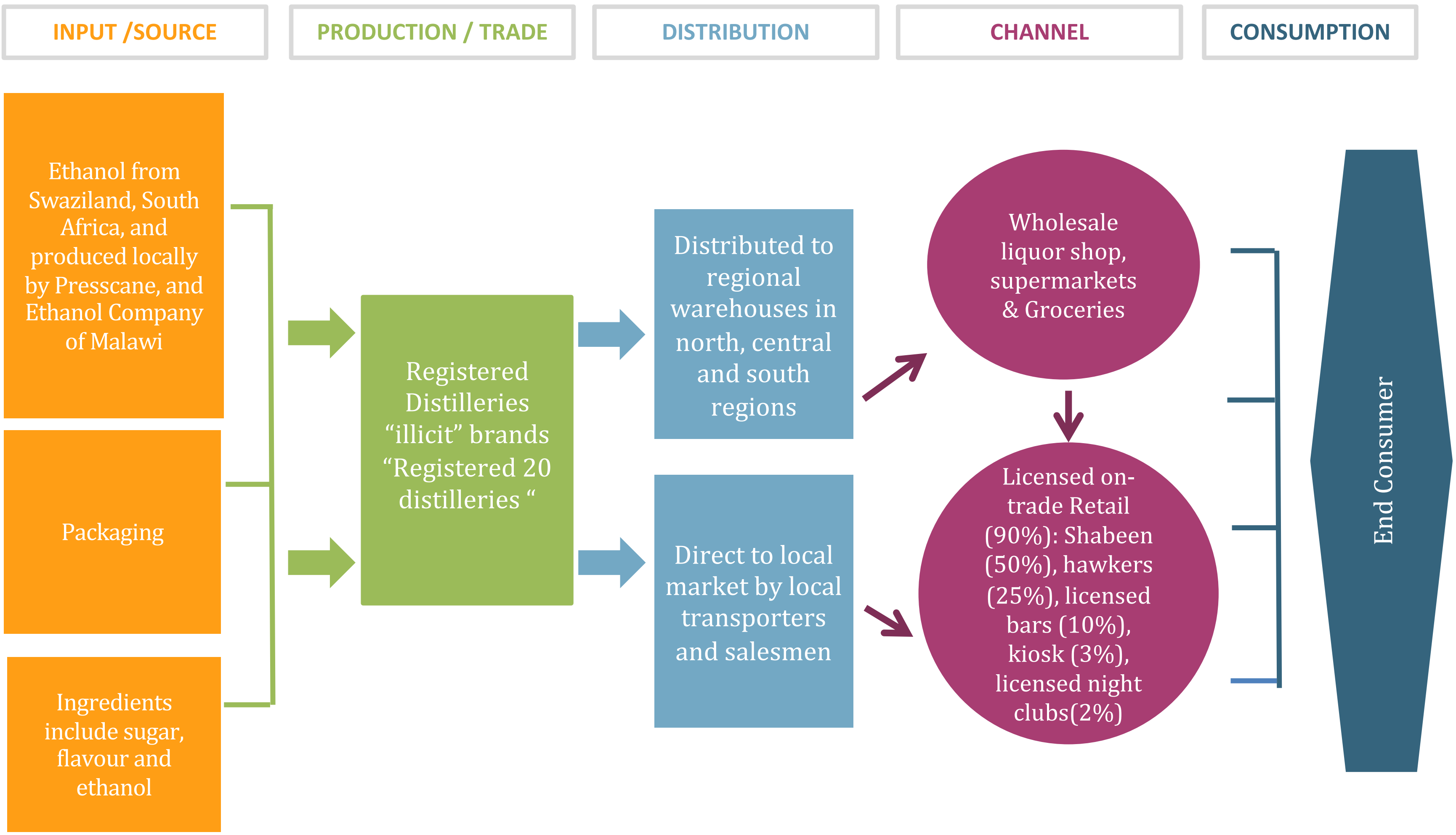
- Spirits is the sole contributor to this category
- Plastic bottle formats are most popular and seen across brands such as Win, Charger, Rider, Bobo and other branded and unbranded spirits
- The impact of this category is most felt by manufacturers complying with glass bottle formats like Malawi Gin, Powers No 1 as well as opaque beer like Chibuku and Chimera
- Illicit distilled spirits are so cheap that they also compete with fermented categories
- Sachet production is estimated to make up around 25% of production and consists of both branded and unbranded types

Consumption

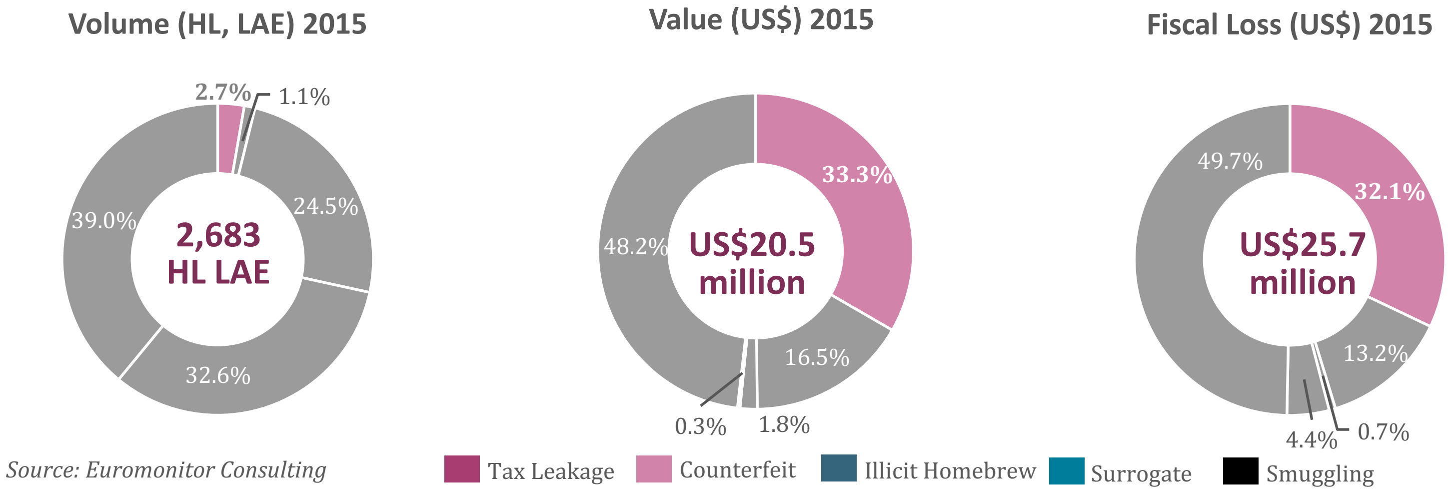
Urban poor and rural youth are targeted market segments

- These spirits are consumed off-trade both in rural and urban areas – especially sub-urbans and rural trading centres where some economic activities were taking place. The targeting is that of urban poor and rural youth
- The market is more profitable in urban/semi-urban areas (60%) where casual labourers and formal employees have stronger relative buying power and the rest of rural districts (40%) with farmers, youth plying their trade as bike pushers and casual labourers

Tax Leakage – 20 or so manufacturers are key to this category



Counterfeit & Illegal brands: small on HL LAE volume, large on fiscal impact



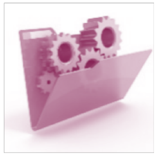
Source: Euromonitor Consulting

Substitution/ refill of fermented products dominates the category

- Counterfeit manufacturing and refills represents only **2.7% of illicit volumes however accounts for 33.3% of value**, and represents the second largest fiscal loss of US$25.7 million
- Counterfeit brands consist of two sub-categories, substitution/refill which is driven by beer, and manufactured illicit or unbranded alcohol, driven by distilled products. The high volume of counterfeit refill beer drives the low HL LAE total volume and accounts for the majority of the value and fiscal loss
- Counterfeit and illicit brands comprise 11.2% of the illicit alcohol market by volume in Malawi. Substitution/refill is carried out by non-registered distilleries and driven primarily by on-trade activity, while manufactured production is demand driven
- The potential for continued growth of counterfeit and illegal brands is high in the foreseeable future

The substitution/ refill market is the key subcategory

Drivers and general overview



Beer drives the substitution/refill market, distilled products dominates the manufacturing sub-category

- Refill of beer is practiced mainly in on-trade establishments including licensed bars, restaurants and clubs and mainly impacts on popular categories of beer
- On-trade premises provide a great opportunity to practice refill/substitution as the consumer may not be able to view the dispensing of the alcohol or the opening of the bottle
- Under the manufacturing of illicit branded or unbranded alcohol sub-category, the main driver was the distilled category by volume 2,061 HL and 837 HL, LAE representing 97% of the total fiscal loss
- The demand for lower priced distilled alcohol is the primary driver of the manufacturing of the illicit distilled spirits. A high price differential between legal and illegal spirits represents an attractive draw for consumers
- A lack of enforcement and detection is enabling production of banned branded or unbranded sachets and bottle formats

Supply chain

Illicit activity is customer driven at the retail and wholesale level

- Illicit manufacturers can purchase raw materials from local ethanol factories or imported ethanol from South Africa and Swaziland not meant for distilled or fermented alcohol production
- The main transporters of local or imported ethanol use 30,000 to 38,000 litre tankers to transport to factories
- The illicit activity starts from the manufacturer where processing is done continuously and mostly overnight in accordance to their market networks – where customers place orders and they manufacture for delivery to wholesalers or retailers
- The illicit manufacturing takes place when a particular retailer or wholesaler knowingly asks manufacturers to produce a particular brand or unbranded spirit. Orders usually come from wholesaler's who often lack licences
- In terms of distribution from the factory to shops, the customer handles movement of such kinds of illicit products. They often bribe their way to their local shops or warehouses for under-ground distribution. These are sold through kiosks, hawkers and around popular drinking places and consumed off-trade

Illegal manufacturing targets mostly low income urban poor and rural youth

Types and brands

Beer accounts for the majority of substitution/refill volume, manufactures of illicit branded or unbranded alcohol produce mostly distilled spirits

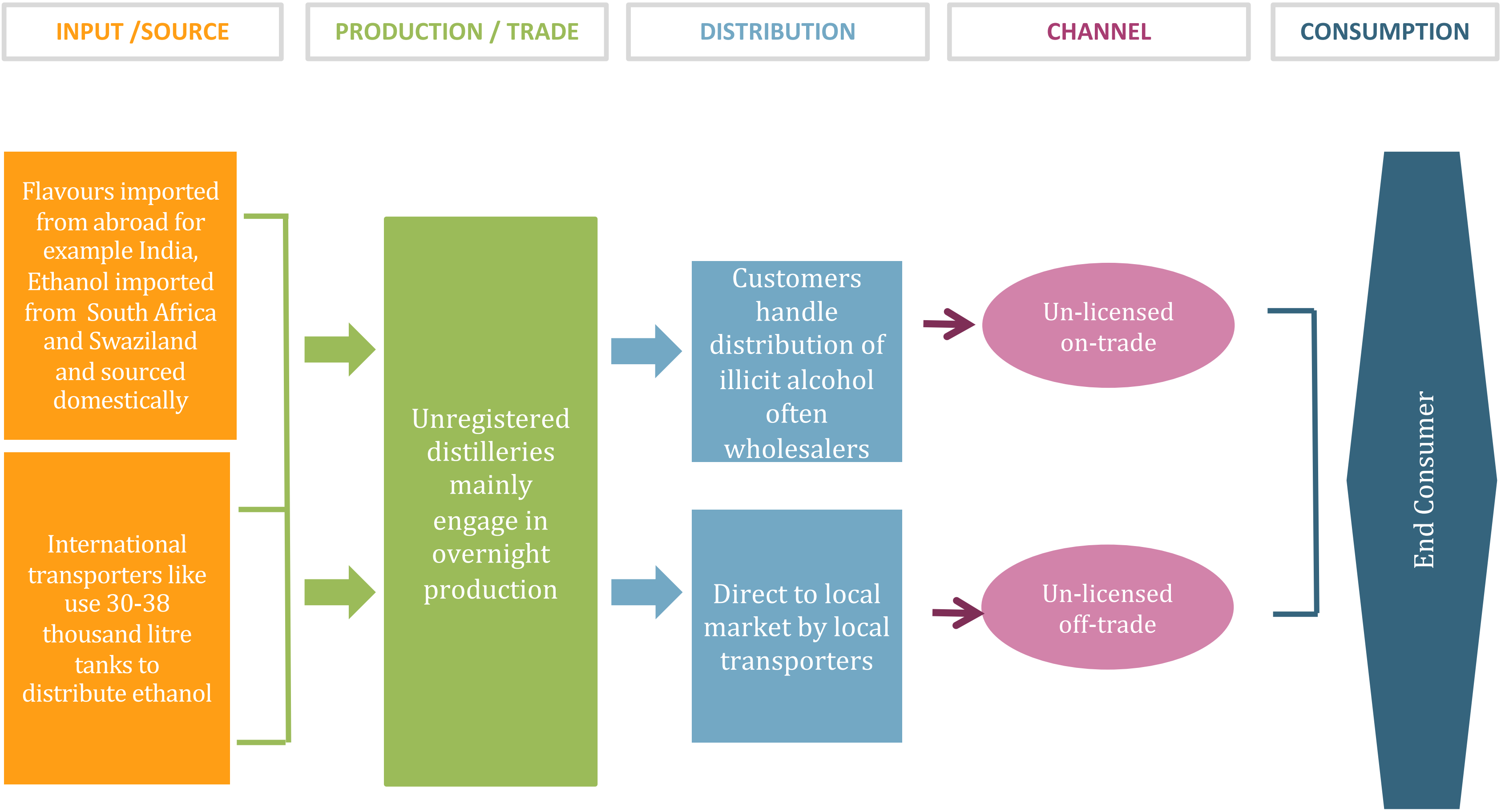
- The main driver of volume under substitution/refill was beer 23,664 HL by volume 1,091 HL, LAE
- Under the manufacturing of illicit alcohol, the main driver was the distilled category by volume 2,061 HL and 837 HL, representing 97.0% of the total volume produced by this sub-category

Consumption

Urban poor and rural youth are targeted market segments

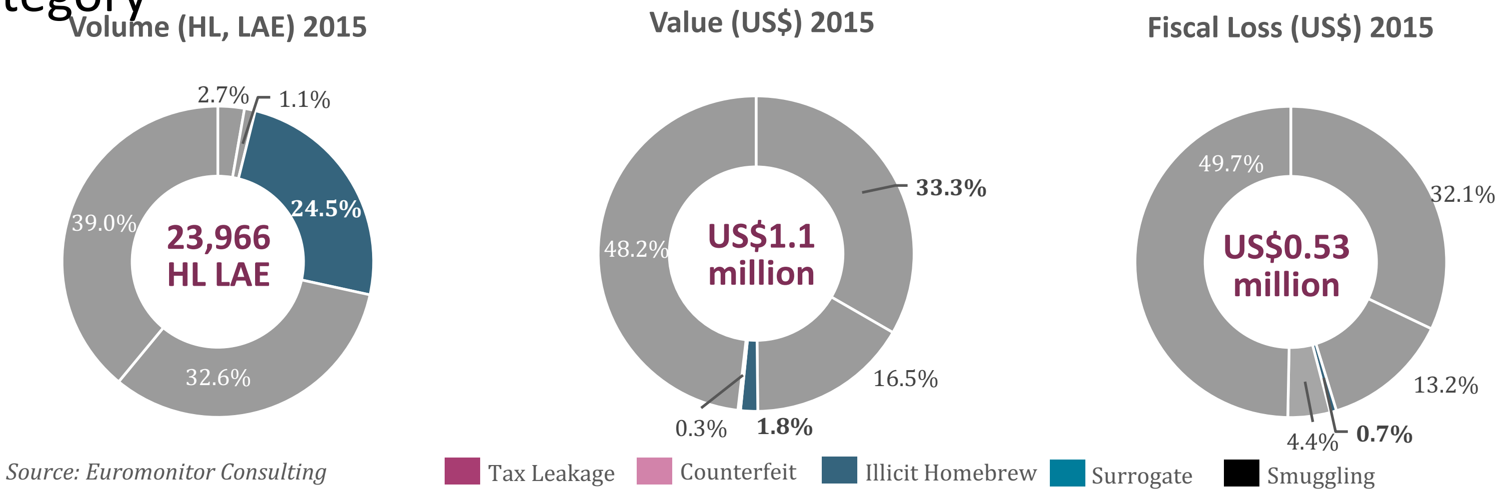
- Substitution/refill beer consumption is driven mainly by on-trade premises such as hotels and nightclubs, where urban and rural youth are the primary targets for consumption
- Illicit distilled beverages are undoubtedly increasing at a fast rate relatively and somewhat targets youth and the poor. The main driver is the supply and availability of the product

Counterfeit – illegal industrial manufactured spirits value chain



ILLICIT HOMEBREW: MARKET SIZE

Traditional beer drives the high volume of this declining illicit alcohol category



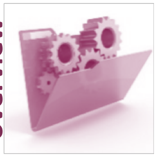
Source: Euromonitor Consulting

Homebrew beer – masese - dominates the category

- Illegal homebrew accounts for **24.5% of illicit alcohol volumes however account for only 1.8% of value**, equivalent to **US$1.1 million** in 2015. The fiscal loss of counterfeit illicit activities amounts to a fiscal loss of US$0.53 million
- The largest component of illicit homebrew was traditional beer accounting for 90.0% of total LAE volume and 67.0% of fiscal loss
- Homebrew or artisanal production of alcohol also known as kachasu is widely practiced in both rural and urban communities while being consumed mainly by low income and unemployed people
- Homebrew is locally manufactured from local raw materials including maize, millet, yeast and sugar. With this chemical composition, the fermentation period is short and instantaneous
- The women in this business operate in local markets and pay local council market fee/tax
- This category remains small and on the decline with the availability of several other cheap illicit alcohol substitutes

Illicit homebrew's competitive advantage is its price & regional appeal

Drivers and general overview



Supply and availability are the primary drivers for homebrew

- **Regionally produced**, with local ingredients and quick manufacturing time, homebrew production and consumption is driven by regional tastes and demands
- There is competition with industrial manufacturers of the illicit distilled spirits because they have a good network. However, the **competitive advantage** of the home brew is that they are area specific. **The supply and availability** of locally produced alcohol drives the consumption of homebrew
- The alcohol content is estimated at 28.9% or above making a perfect match to other unbranded beverage alcohol

Supply chain

Supply chain dominated by regional influences, access to market becoming difficult

- **Distilled homebrew** is produced by illegal distillate producers. Due to the high prices of spirits and other alcohol, illegal production of distilled homebrew is a profitable business
- **Fermented homebrew is made mostly by females**, mainly from various base ingredients for own consumption or sharing communally, and is also sold amongst the community
- The channel of distribution includes local markets, hawkers and locally grass thatched fences (shabeens) which are unlicensed outlets
- Local officials impose **daily levy's** to oversee the marketplace
- It is often a challenge for sellers to access space to trade, depending on the volume of trade at any given point
- A provisional market fee is chargeable whenever illicit homebrew is sold at a market place

Illicit homebrew remains appeals to urban and rural poor

Types and brands

Masese and Kachasu main homebrew products

- The largest component of homebrew production was beer (masese), followed by distilled spirit (Kachasu).

Consumption

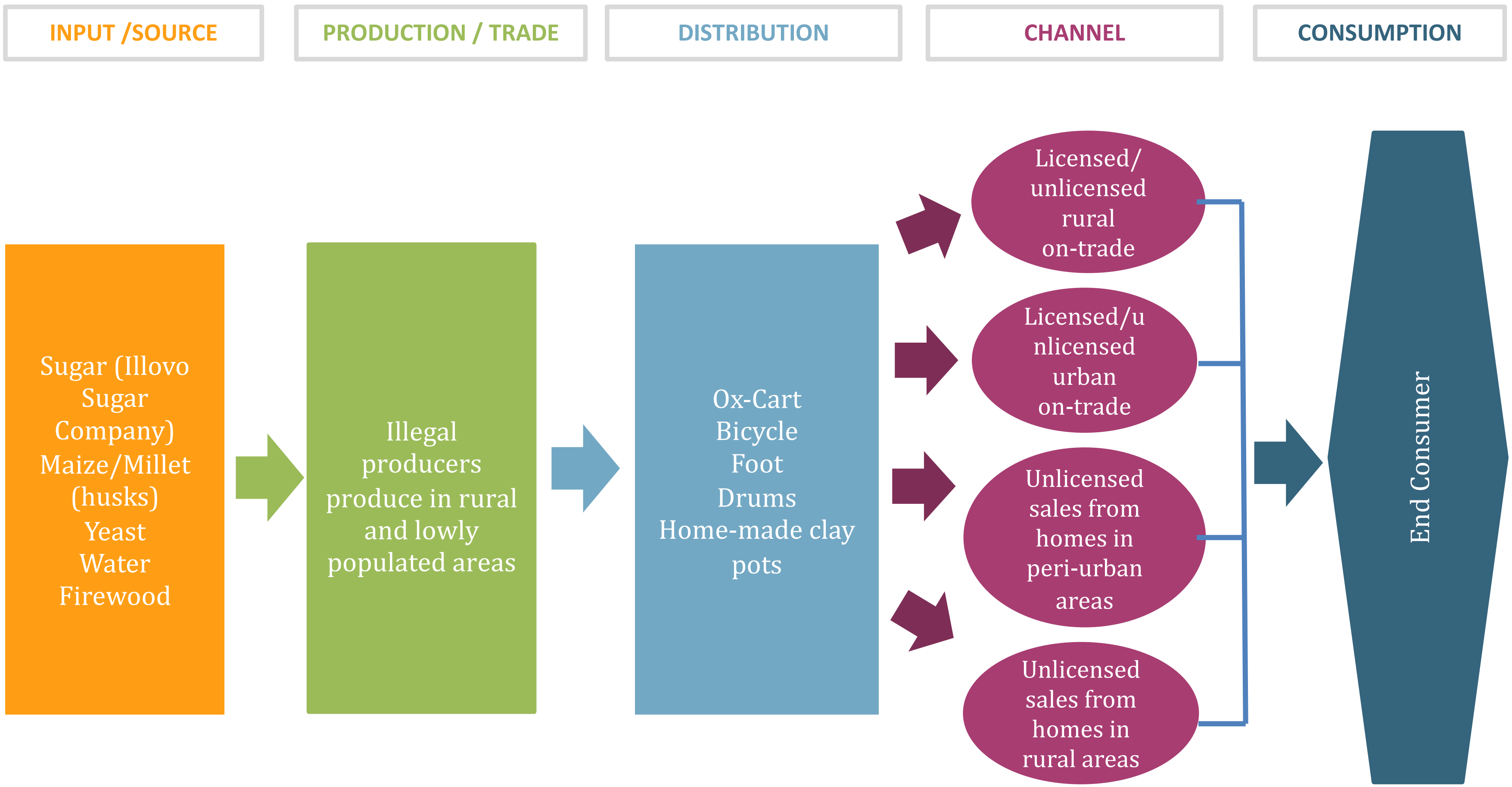
Urban and rural poor are targeted market segments

- This category of alcohol consumption is sometimes brewed and consumed **on-premises and both urban "shanty town" and rural locations** and consumed by rural poor and urban poor **driven by low prices**.

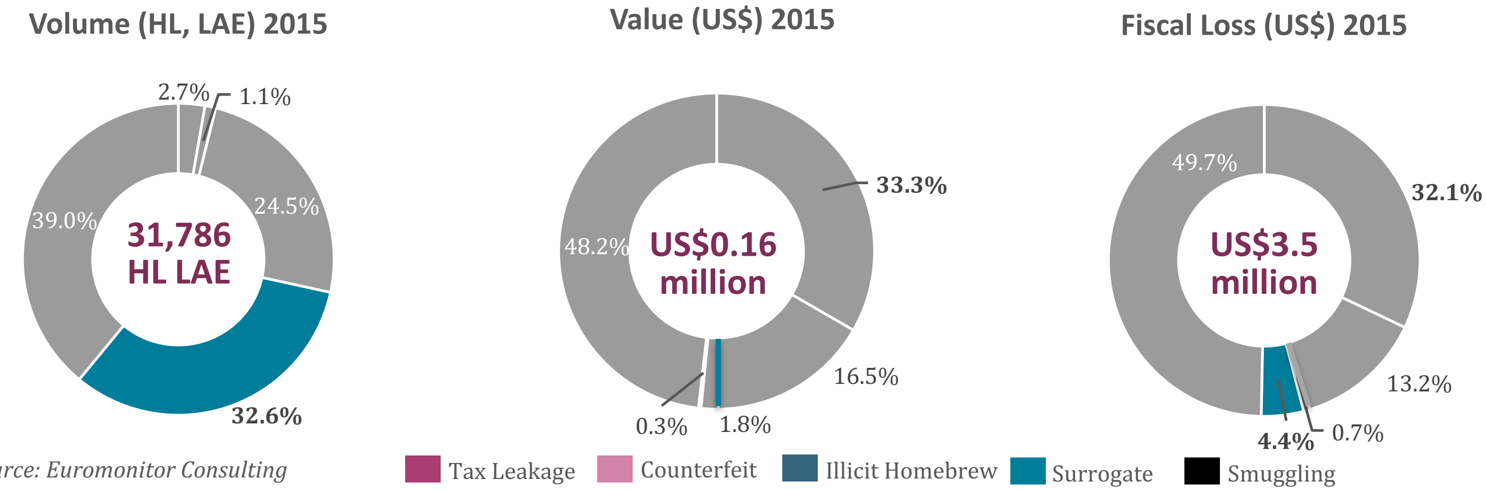
- There is a likelihood that illicit homebrew distilled spirit (Kachasu) has **been impacted negatively by the illicit industrial manufactured spirits**

ILLICIT HOMEBREW: VALUE CHAIN

Illicit homebrew – value chain



Surrogate: significant driver of illicit volume, marginal in fiscal impact



Source: Euromonitor Consulting

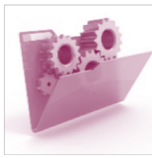
Industrial production of distilled products dominates the category

- Surrogate alcohol stems from use of ethanol as a raw ingredient which was intended for use in other industries for example paint production or pharmaceuticals; it is often unfit for human consumption
- Driven exclusively by distilled products, the Surrogate category represents **32.6% of illicit volumes however accounts for only 1.8% of value**, and amounts to a fiscal loss of US$3.5 million
- Surrogate was the second largest category HL LAE volume. The low fiscal loss impact reflects that ethanol is a raw ingredient input into the process rather than a finished product
- The volumes for this category mainly come from imported denatured alcohol as well as locally produced. There are two main suppliers of denatured alcohol but a larger portion is imported. This ethanol is used to manufacture spirits which results in questionable safety
- Importation of ethanol is on the increase to support the growing demand of the spirits by the youth and low income earners. Although surrogate consumption has not reached serious levels, it is a growing concern for the Malawi government and NGOs due to its high potential to be detrimental to consumer health

SURROGATE: KEY FACTS

Middlemen key to supply chain for surrogate production

Drivers and general overview



Demand for cheap spirits by youth and rural poor drive ethanol imports not fit for human consumption

- The surrogate category depends upon both domestic and imported supply; the 95.0% proof ethanol is mixed with water (5.5:4.5 ratio) to produce illicit alcohol. Research indicates that excess importation of ethanol is linked to official imports under HS 2207 Un-denatured ethyl-alcohol of an alcoholic strength by volume of 80 percent volume or higher
- Volumes are driven by the fact that lower importation tax is paid on denatured ethanol using the relevant HS tariff code. Purchase price for denatured ethanol as a raw material is also much lower than ethanol produced for alcohol production making for a very low overall cost base for the manufacturers
- Importation of ethanol not fit for human consumption is on the increase to support the growing demand for spirits by youth and low income earners. Malawi Bureau of Standards and other NGOs are attempting to fight the rise of this activity. There no major medical cases linked to this problem for now, however, there are clear and visible features among youth of swollen bodies especially the face, skin turns light over time and general social concern on health risks

Supply chain

Disconnected supply chain managed by middle men to accommodate illegal supply of ethanol

- Sources for the ethanol are both local and foreign. A large portion of the denatured ethanol used to produce surrogate alcohol is imported. Some of the illegal (undeclared) ethanol largely enters Malawi via Dedza and Mwanza control border points in 30,000 – 38,000 litres capacity tankers (trucks)
- A smaller portion is locally produced
- Majority of the production of surrogate is carried out by illicit importers who operate and manufacture in secrecy from the authorities. Generally, these companies have no sign posts, and have very strict requirements for secrecy and restricted access to their premises. They develop very strong networks such that they do not sell to any person or business before they establish the identity and motive of the buyer
- These illicit importers do not own large fleet of trucks or vans for delivery of raw materials and final products. They sub-contract in real-time and often hire small vans to distribute directly to kiosks, bars, and market places irrespective of the legality of the establishment. Their distribution networks often include foreign-owned wholesalers to act as warehouse “middlemen” to distribute in a local area. This strategy significantly reduces their operating costs

SURROGATE: KEY FACTS

Off-trade consumption driven by low income consumers with easy access to surrogate products

Types and brands

Illegal manufacturing targets mostly low-cost hard liquor sold in plastic sachets

- Distilled alcohol is most severely impacted by surrogate production, impacted brands include: Premier Brandy, Malawi Gin, Zappa, Malawi Vodka, Amarula Gold, Powers No 1, Premier Brandy (Small) and Powers No 1 (small)
- Ethanol is used to produce, among many other branded or unbranded spirits, Shooter (bottled), Black Ponda Rum, Zero ananas gin, Black Ponda Rum, Chikoka, Galaxy, Red deer Whisky, Rider(bottled), Black Ponda Rum, Breezer Pina Colander, Mafumu, Bwana, Maya, Rider (bottled), Black knight, Bobo, Win, Wow pine apple, and Cheers whose market is increasing

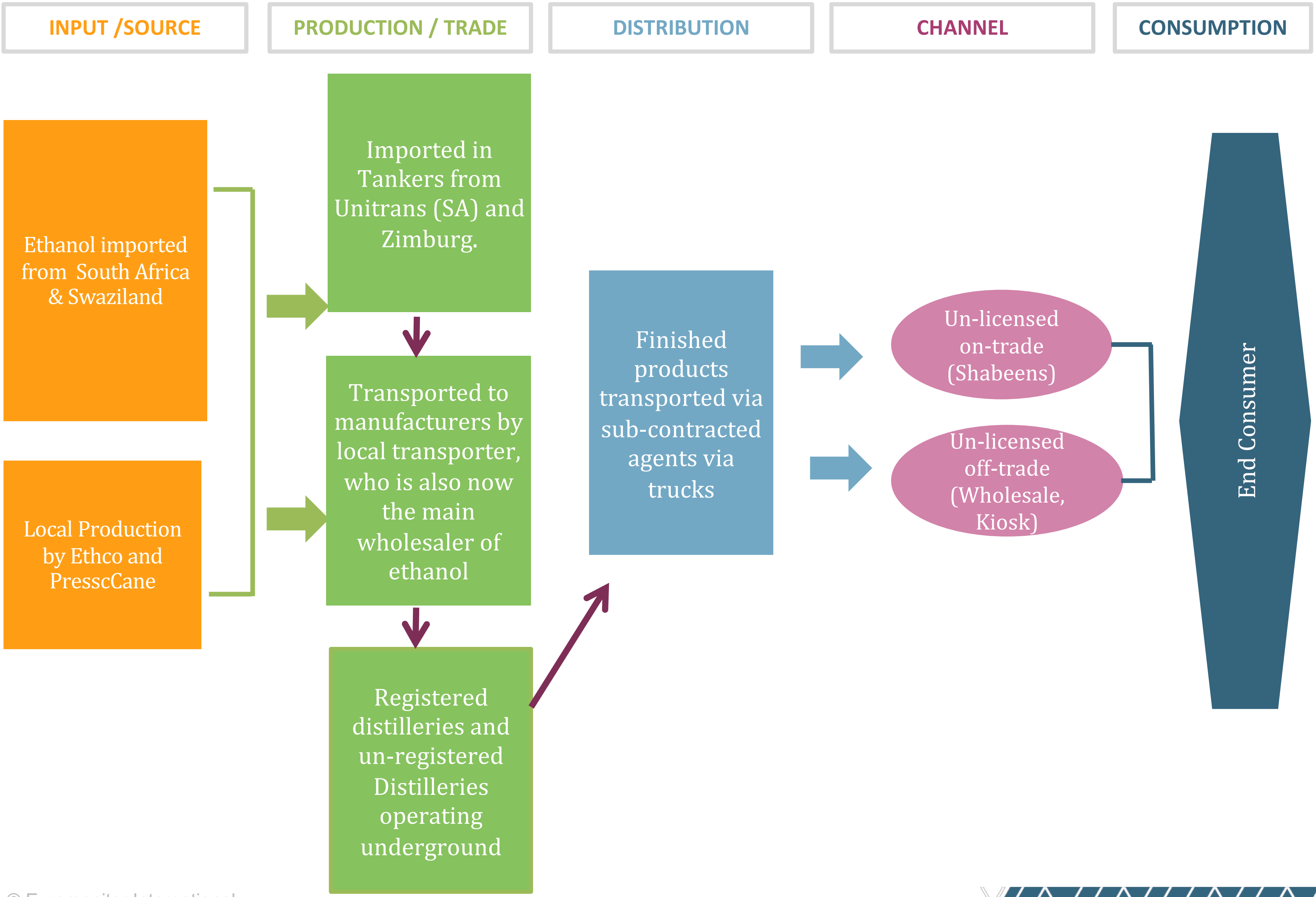
Consumption

Urban & rural poor are targeted market segments

- On-trade is not so prevalent because illicit alcohol consumption is often part of a normal working day – at times these spirits are taken in between meals
- These spirituous products – made from smuggled and at times legal alcohol is used to disguise themselves from law enforcers – are consumed everywhere in rural and urban areas, hawkers, kiosks and shabeens – often close to major drinking places
- They can also be carried home and work places because they are often potable
- The consumption is mostly by the poor in both rural and urban owing to inexpensive prices and ease of getting drunk. The consumption of all spirits drink is increasing and the main contributing factor is low income and accessibility

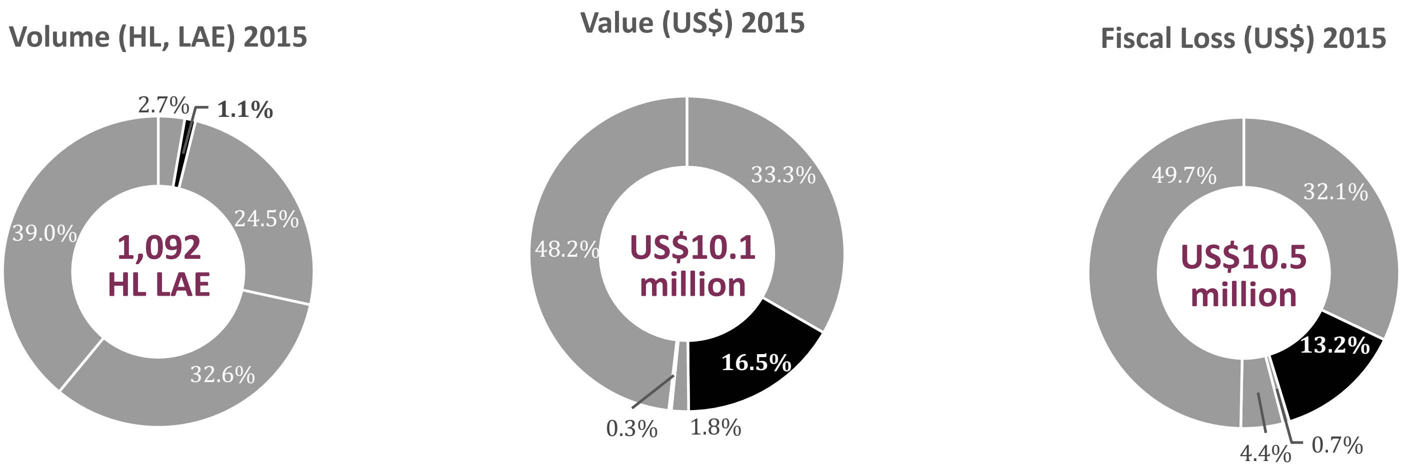
SURROGATE: VALUE CHAIN

Surrogate - illegal industrial manufactured spirits value chain



SMUGGLING: MARKET SIZE

Smuggling is smallest category in volume, but represents significant fiscal loss



Source: Euromonitor Consulting

Tax Leakage · Counterfeit · Illicit Homebrew · Surrogate · Smuggling

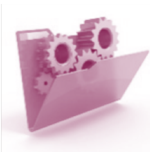
Spirits is the most popular smuggled alcohol type in volume terms, fermented alcohol drives value

- Smuggling is the smallest category in HL LAE volume at 1.1% of the total illicit market, but represents the third largest value share at 16.5% and accounts for $10.5 million in fiscal loss
- Smuggling consists of two sub-categories: raw ingredients, where the total actual smuggling of illicit imports of ethanol as a raw material was computed to fall under the surrogate category, and the second is finished products
- Finished spirits lead the smuggling category with 488 HL LAE volume, $3.1 million in fiscal loss, while smuggled beer led in overall fiscal loss at $4.8 million, with a volume of 350 HL LAE. Other smuggled fermented products such as wine and cider contributed $2.6 million in fiscal loss
- Smuggled illicit alcohol arrives primarily from South Africa via small trucks and shipping containers, and is distributed to wholesalers and supermarkets, then to various retails outlets – fuel stations, restaurants/hotels, hawkers, kiosks, bars and to individuals – by the smuggling networks
- Competitive price advantage and changing lifestyles in Malawi are the primary drivers of the illicit smuggling trade. Smuggled alcohol is universally consumed in Malawi and consumption is stable to increasing as evidenced by availability

SMUGGLING: KEY FACTS

Competitive pricing and poor border enforcement enables smuggling in Malawi

Drivers and general overview



Smuggling providing a competitive price advantage for illegal importers

- Since taxes for locally produced and formally distributed alcoholic products are increasing with time, the constant tax increase pushes the prices up for alcoholic beverages which makes smuggled products relatively cheaper
- For those retailers and outlets who procure locally, legally and pay taxes, often face poor sales and no growth at all
- Smuggling of finished products is the mainstay for major wholesalers and distributors and other small scale cross-border illegal importers who are capable of pushing the prices substantially lower per unit
- A high number of foreign nationals and refugees maintain shops in areas such as Blantyre and Lilongwe markets where they sell a significant amount of smuggled wines and vodkas

Supply chain

Poor border controls permitting continued smuggling of illicit alcohol

- Retailers acquire alcohol in South Africa at set times when liquor products are on promotion or near expiry. Local contacts provide opportunities for low cost purchases
- Once alcohol is acquired, experienced transporters (smugglers) from Malawi or South Africa are retained for transport
- For small scale business, trucks with existing cargo is used to hide the illicit alcohol, for larger established businesses, shipping containers are hired to transport the alcohol
- Owners of the businesses arrange passage for the goods at the Malawi-South Africa border through under-declaring the amount of alcohol they are importing and other means

SMUGGLING: KEY FACTS

Smuggling is a clear response to local pricing and taxation hikes

Types and brands

45.0% of all beer imports and 48.5% of all cider imports are smuggled into Malawi

- Main alcoholic products targeted for smuggling are beer (lagers and ciders), spirits (including brandy, whisky and rum) and wines which affect mainly popular Malawian brands like green, chill, Malawi Gin and Vodka, Stout and Kuche kuche although to a very small magnitude
- The negatively affected beer is local opaque/cloudy Chibuku and Malawi Gin. However, the plastic packaging and decanting option available to competitors renders prices effectively much lower than (un)branded spirits

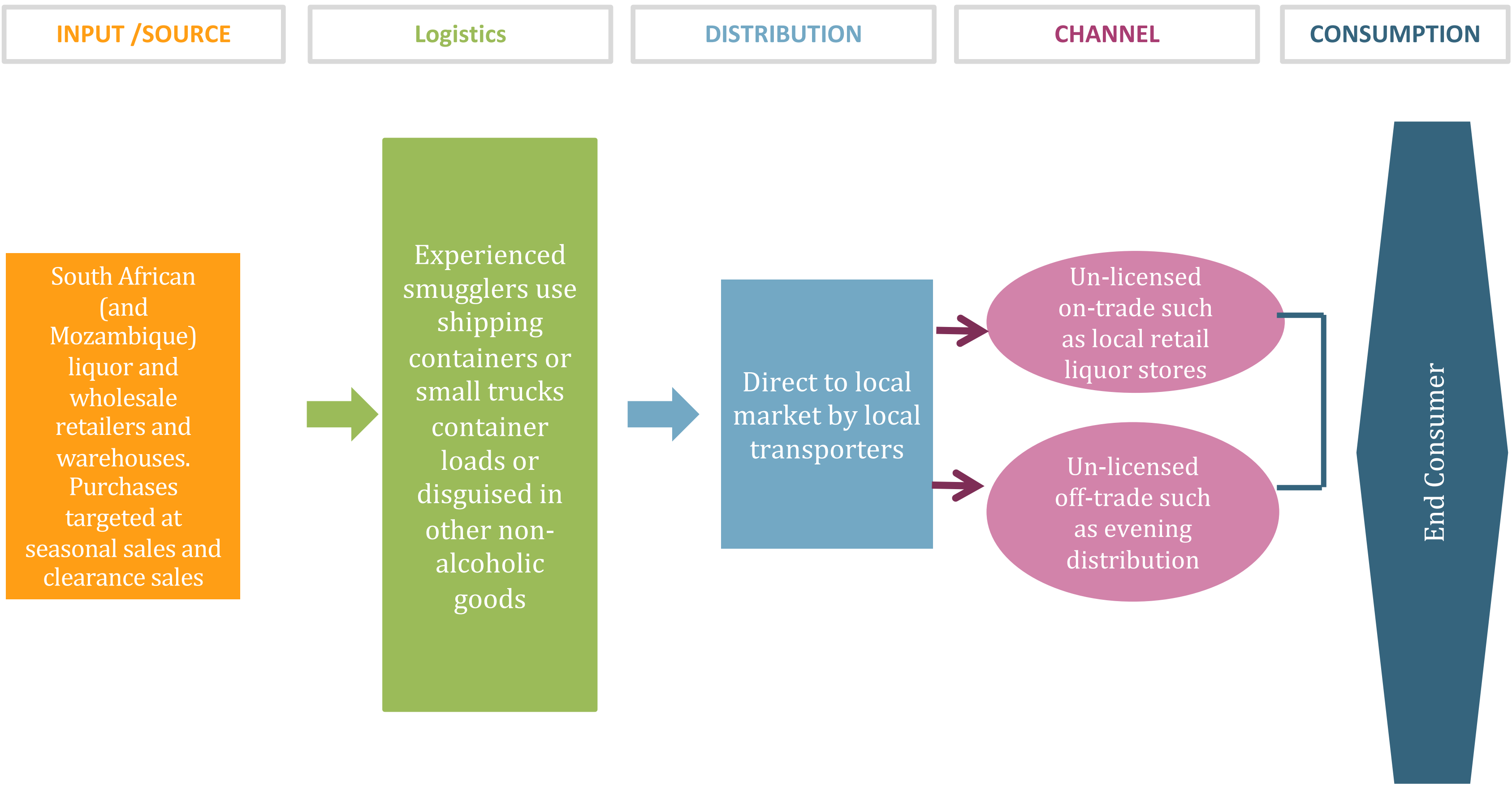
Consumption

Changing lifestyles, increased socialization and status, driving increased smuggling

- The other drivers of increased smuggling are changing urban lifestyles – increasing socialization and changing preferences amongst men and women, low alcohol content (can be consumed mid-week), following urban elites and experts
- Despite the smaller market share (of ciders) compared to popular beer and spirit brands, the other fermented beers category is growing
- These products are consumed both on-trade and off-trade predominately urban "shanty town" locations
- In terms of the social status, it is universally consumed and consumption is stable to increasing as evidenced by wide availability. Changing lifestyles – including drinking beer in-between meals habits

SMUGGLING: VALUE CHAIN

Smuggling of illicit alcohol – supply value chain



Euromonitor Consulting

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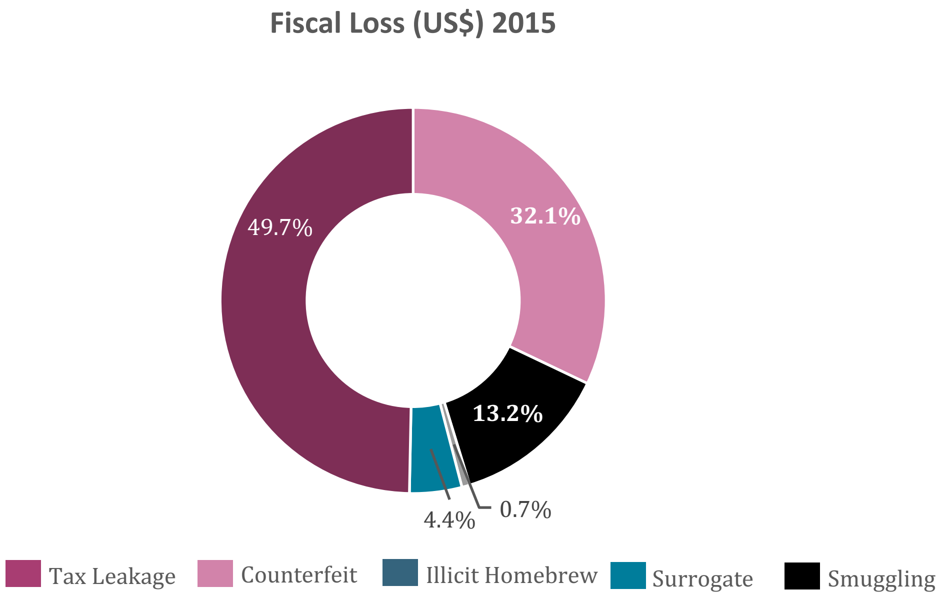
SIZE AND SHAPE OF FISCAL LOSS OF ILLICIT ALCOHOL IN THE MARKET

Fiscal loss amounts to US$80.2 million in Malawi



Source: Euromonitor Consulting

Fiscal loss mainly originates from tax leakage followed by counterfeit

- In total, fiscal loss reached US$80.2 million in 2015. Tax Leakage was the main source of fiscal loss, accounting for a 49.7% share, or US$39.8 million. Counterfeit brands, mainly beer, is the second-largest contributor to fiscal loss at an 32.1% share, or US$25.7 million
- The issue which is more specific to the alcoholic beverages is to do with more established and visible businesses versus small and invisible (due to their size and business model) which has exposed the weaknesses in tax regulatory enforcement
- There is no certainty as to whether some players in the industry are paying taxes in full or not paying at all
- There are about twenty small and medium companies that have been adversely affected with the new regulations famously known as the "***ban on use of sachets***" which the government instituted 2013 – pushing production in glass bottles instead. However, this ban has pushed manufacturers and consumers to adapt though a process name 'decantation' whereby larger containers are separated into smaller ones; as a result there has not been a decline in production or consumption of this type
- Other key players driving fiscal loss are those that operate underground with informal operations
- Smuggling of alcoholic goods occurs at a high rate due to porous country borders and inadequate checking equipment

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Key primary sources

Source Type	Name
Government Ministry	Ministry of Industry, Trade and Tourism
Government Ministry	Malawi Bureau of Standards
Government Ministry	Malawi Revenue Authority
Government Ministry	Malawi Chambers of Commerce
Home Brewer	Pachikapu Shabeen
Home Brewer	Chiphazi
Importer/Distributor/Wholesaler	Liberty Wholesalers
Importer/Distributor/Wholesaler	Importer of AREA 18B
Manufacturer	Carlsberg Malawi Ltd
Manufacturer	Malawi Distilleries Ltd
Bottle/ Packaging manufacturer	Polypack (packaging) Ltd
Manufacturer	Bwenzi Group Ltd - Lilongwe
Manufacturer	Linga Winery
Manufacturer	Chibuku Products Limited
Retailer	Chipiku Shops
Retailer	Sunbird Lilongwe Hotel
Retailer	Peoples
Retailer	SEIGE Pub - (Area 49 Gulliver)
Retailer - Kiosk	Fred Sangwenti
Trade Association	MCCCI

On-trade/off-trade outlet observation conducted at:

Chipiku
Sidat Drinking Pub
"Pachikapu"
Funani Shop
Velvet Bar
No name - Mobile vendors/Kiosk outside Bwandilo
Mbowe BP Station shop
OSIB Beverages Centre (Rwandan Shop)
Napozo Shop

Liberty Liquor Shop
Pa Squency
Kampha Shabeen, Khoswe Bar and Bottle store
Alex whole sale & others (Global Beverage distributors, Miami Liquor distributors, pa Mandambwe)
Shoprite
Wishes Leisure Park Pub
Ryalls - 21 Grill

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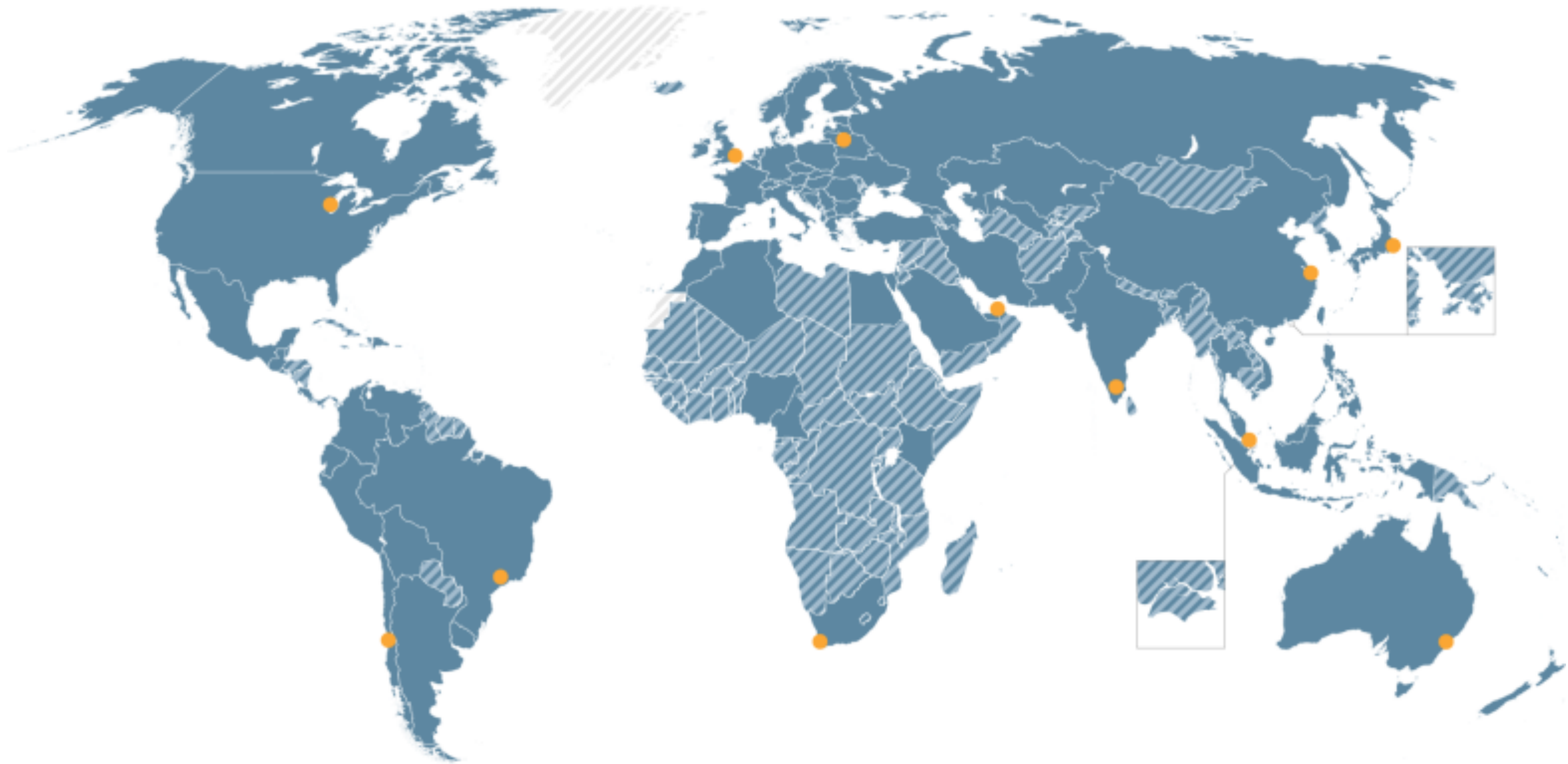
ABOUT EUROMONITOR INTERNATIONAL

Euromonitor International network and coverage



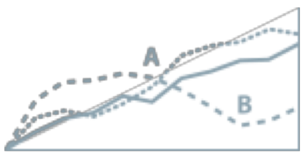
12 OFFICE LOCATIONS
London, Chicago, Singapore, Shanghai, Vilnius, Santiago, Dubai, Cape Town, Tokyo, Sydney, Bangalore, and São Paulo

80 COUNTRIES
in-depth analysis on consumer goods and service industries

210 COUNTRIES
demographic, macro- and socio-economic data on consumers and economies

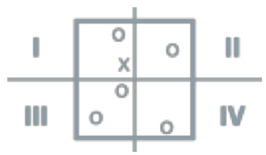
ABOUT EUROMONITOR INTERNATIONAL

Custom solutions and capabilities



Category evaluation

Sizes, shares, growth
Segmentation
Market entry strategy

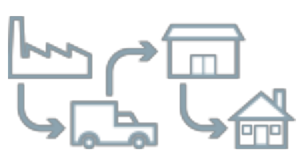


Competitive intelligence

Profiling
Benchmarking
Partner evaluation

Innovation

NPD business case
Consumer insights
Product claims

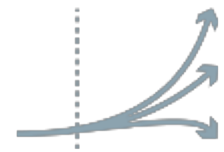


Route to market

Production, imports, exports
Supply and value chain
B2B and B2C channels

Macro

Opportunity frameworks
PEST
Quarterly tracking

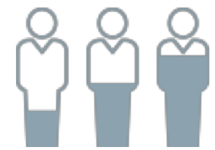


Forecasting

Launch, sales, demand, lifecycle
Success / failure probabilities
Determine risk exposure

Scenario analysis

Market simulations
Portfolio analysis
Test business cases



Consumer analytics

Customer profiling
Income distribution models
Purchasing behaviour

Marketing analytics

Marketing effectiveness
Substitutes and complements
Price and channel strategy

Visualisation

Discovery, sharing, communication
Market attractiveness planners
Performance monitoring

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