



MARKET ANALYSIS FOR ILLICIT ALCOHOL IN UGANDA

A custom report compiled by Euromonitor International Consulting
for **Nile Breweries Ltd (NBL)** and related subsidiaries

September 2016



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

- Uganda

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.
- Nile Breweries Ltd (NBL) 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 Uganda, focusing 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 uncover and detail current methodologies used by **official agencies to quantify the illegal alcohol market/track illegal alcohol consumption**.
- To estimate the role that **regulatory measures** might play in this.
- To illustrate the **value chain** for illicit alcoholic beverages by illicit category.
- To provide insights into the informal market and relationship to illicit alcohol

EUROMONITOR APPROACH

Project research methodology

Step-by-Step Process

Secondary Source Review

- Extraction and analysis of **Euromonitor International's Passport data** and reports focusing on Uganda's 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 Uganda, 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.

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.

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.

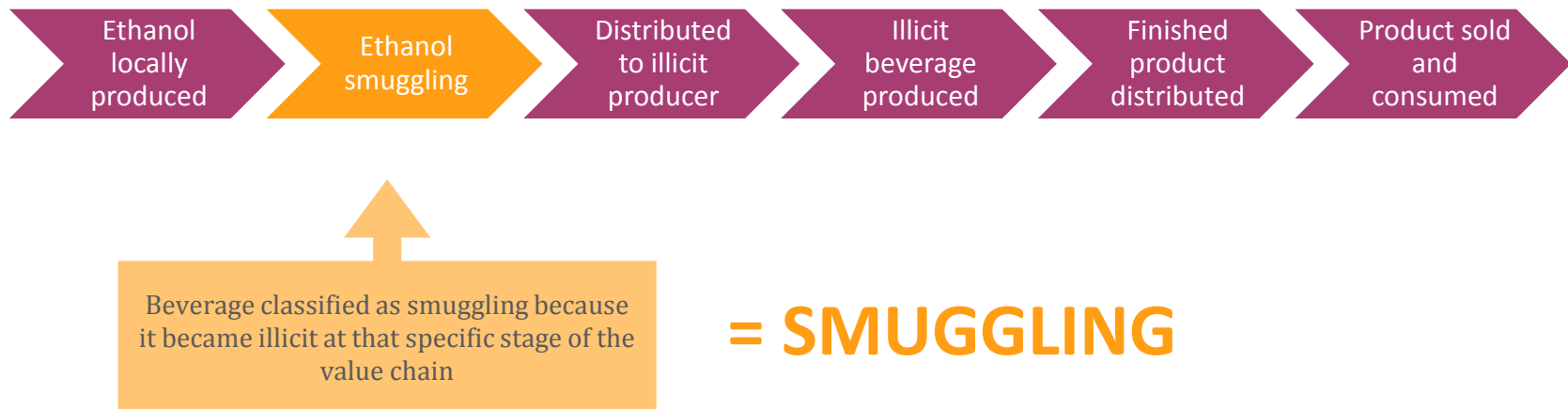
In-depth Trade Interviews

- **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**.

EUROMONITOR APPROACH

Value chain analysis used to avoid double counting

- In many cases illicit alcoholic beverages can fall into more than one category. To **avoid double counting** and to better understand each of these categories, Euromonitor International **designated each product to the category in which it first enters the illicit alcohol market** of any given country.
- For example, if an illicit homebrew beverage is created from smuggling ethanol, then for the purposes of this study it is considered smuggling because the alcohol became illicit the instant it entered the country without paying the due taxes, prior to the homebrew production and distribution process.
- This example (illustrated below) helps explain the **Euromonitor International category classifications for this project**:



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. pharmaceutical alcohol) diverted to the alcoholic beverages market
Tax Leakage	-	Licit alcoholic beverages (locally produced) on which inappropriate or no excise production taxes are paid

MANAGEMENT SUMMARY

Alcoholic Beverages Market Size 2015 in Uganda

1,106,479 HL, LAE

Total Alcohol Market Volume

430,203 HL, LAE

Total Licit Alcohol Market Volume

676,276 HL, LAE

Total Illicit Alcohol Market Volume

US\$2,126 mn

Total Licit Alcohol Market Value RSP

US\$676 mn

Total Illicit Alcohol Market Value in Illicit RSP

US\$172 mn

Total Fiscal Loss

Source: Euromonitor Consulting



Authorities face an enduring battle to regain control of the illicit market

Key Findings

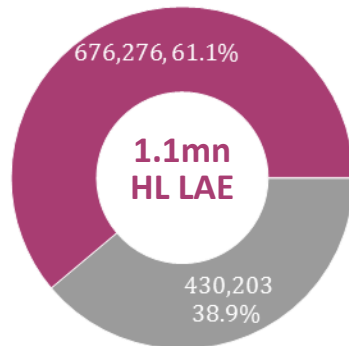
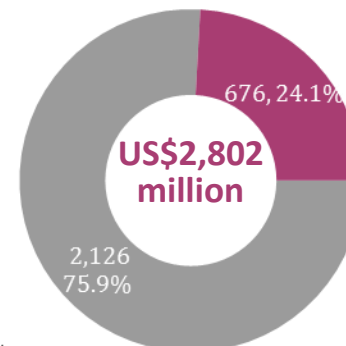


- Illicit alcohol production is now larger than legal production by volume with a **large fiscal loss** to the state. It has spurred the growth of an expanding network of producers, distributors and retailers directly employed in the illicit alcohol marketplace.
- Widespread poverty, **lack of gainful employment** and the long cultural tradition of producing alcohol on a domestic scale has helped illicit production to become the mainstay of household income in both rural and urban settings.
- The correlation between **affordability** and high rates of **unrecorded alcohol** consumption is obvious in Uganda. Illicit alcohol is easily accessed, openly sold and, for the those of low income, it is the only choice available to them.
- **Counterfeiting** of spirits and under declaration of production volumes are central to the illicit alcohol industry. **Ethanol**, as a by-product of sugar or smuggled across the border is a main ingredient of counterfeited spirits. Molasses, also a by-product of the sugar industry feeds into much of the illicit distilled homebrew production.
- Fiscal loss is just **one of many effects** of illicit alcohol and include pervasive addiction and domestic violence, poor mental and physical health outcomes, low productivity, lack of respect and confidence in state institutions and rising criminality and corruption.
- State efforts to influence the development of the market in illicit alcohol are slowly working towards **regularisation** of the marketplace, increasing the tax base, extending the reach of audit trails and applying standards of quality to production.

MANAGEMENT SUMMARY

Illicit production exceeds the legal market in volume terms

Total alcoholic beverages market in 2015

Alcoholic Beverages Market (LAE) 2015**Alcoholic Beverages Market (US\$ million) 2015**

■ Licit Market ■ Illicit Market

Source: Euromonitor Consulting

- In 2015 the total **alcoholic beverages market in Uganda stood at 1,106,479 HL (LAE) in volume terms** and US\$2,802 million in value terms.
- **Illicit alcoholic beverages** accounted for **61.1% of the total market in LAE volume terms** in 2015 and **24.1% in value terms**, while the licit market represented the remaining 38.9% and 75.9% respectively.
- **The illicit alcohol market continues to grow** due to ease of access, high affordability and the uncontrolled production, distribution and sale in both informal and formal channels. High unemployment, poverty and the centrality of illicit production to household income for many families encourages the continuing growth of illicit production.
- **A lack of consistent or proper enforcement**, inspection and registration of traders and transactions has, to this point, allowed illicit production to flourish. Authorities are now focusing on developing greater accountability in the private sector and are slowly reaching out to encompass middle to larger producers of illicit alcohol in an attempt to bring them within the law.

MANAGEMENT SUMMARY

Potential critical point in illicit market development approaching

Market outlook in the Uganda illicit alcohol industry

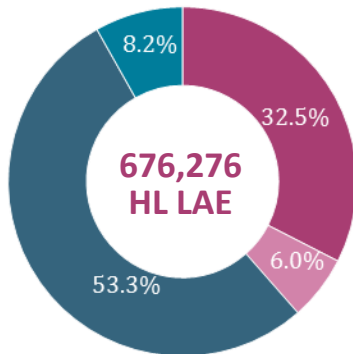
- 1** Pervasive poverty and unemployment forces households to search for alternative sources of income and, in many cases, this becomes illicit alcohol production. The large informal market, widespread counterfeiting, tax avoidance and smuggling helps create an environment where illicit production is seen as a low risk occupation.
- 2** Illicit production is marked by a lack of quality control and stringent hygiene and carries with it an enormous health risk to consumers. It also provides unfair competition to those entities involved in legitimate production of alcohol products, providing large scale employment while working within the law.
- 3** A clear definition of legal and taxable production of fermented and distilled homebrew is required to change the public perception of their legitimacy. Strongly defined legal restrictions, penalties and enforcement regimes backed up by sustained advertising campaigns and exhibitions of enforcement are essential.
- 4** Lower taxes and levies on cheap alcohol in the formal sector must be structured to encourage and welcome the conversion of irregular manufacturers into the legal market. Affordability is critical to convert consumers to legally produced, packaged spirits. Controlled access through restricted licensing and shorter selling hours will also help discourage sales of illicit alcohol.
- 5** Corruption continues to flourish and must be strongly condemned and harshly penalised. Currently, authorities struggle to inspect, audit and enforce quality control on unregulated distillers. Distilled homebrew should be tackled and converted into a taxable product.
- 6** Illicit producers will continue to look for ingredients such as ethanol, either sourced from the by-products of the indigenous sugar processing industry, legal importation or through smuggling. While the dividends of illicit production and distribution are high this is likely to lead to increased smuggling and pressure on border control resources once biofuel production is started.

MANAGEMENT SUMMARY

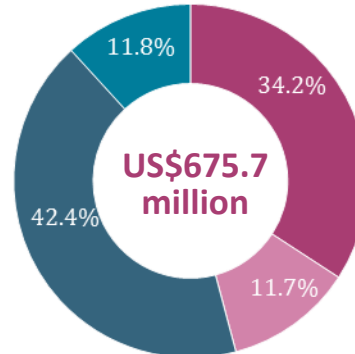
Homebrew remains the largest category in volume and value terms

Illicit alcoholic beverages market in 2015

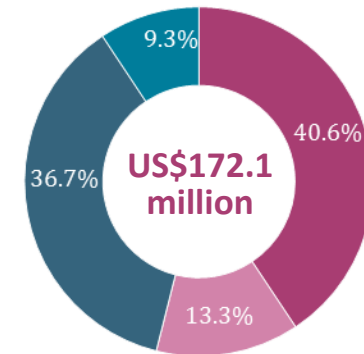
Volume (HL, LAE) 2015



Value (US\$) 2015



Fiscal Loss (US\$) 2015



Source: Euromonitor Consulting

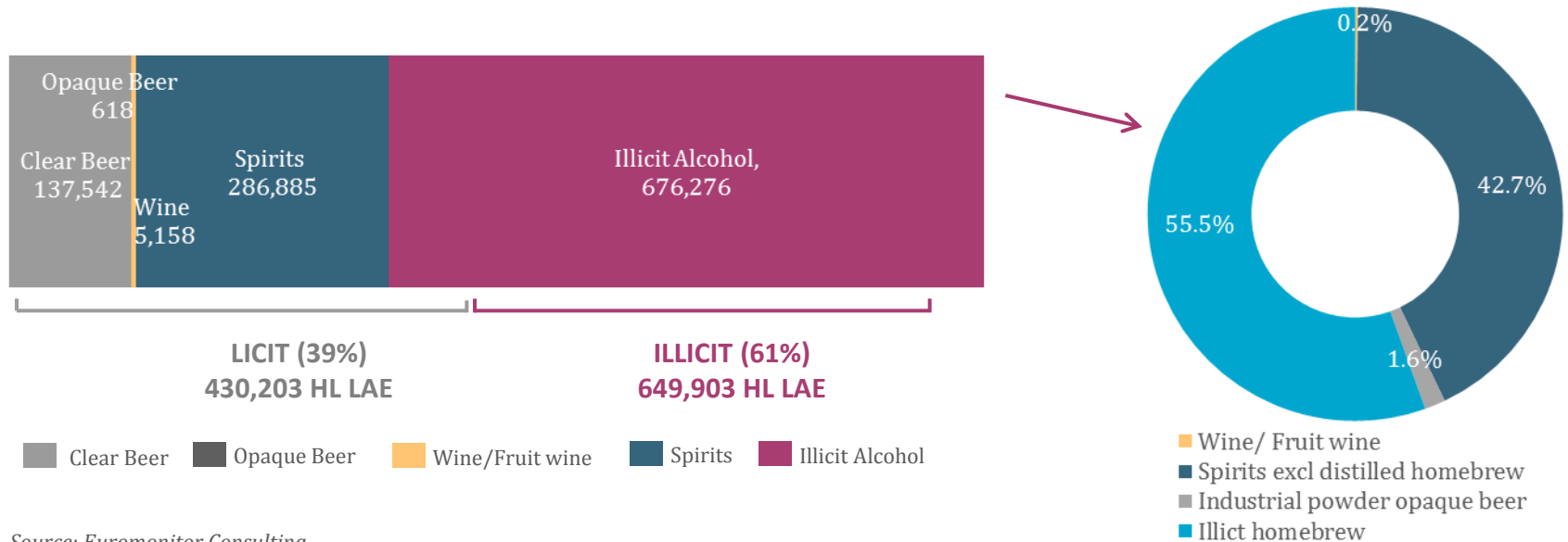
■ Counterfeit
 ■ Smuggling
 ■ Illicit Homebrew
 ■ Tax Leakage

- The total size of the **illicit alcohol beverages market** was **676,276 HL (LAE) by volume** and **US\$675.7 million by value** in 2015.
- **Illicit homebrew** is the **largest form of illicit alcohol** in Uganda, accounting for 42.4% by value and 53.3% by volume of total illicit activities in 2015.
- **Counterfeiting** of legal/illicit alcoholic brands, **the second-largest in volume terms (32.5% of illicit volumes)**, accounted for 34.2% of value sales through illicit unlicensed manufacturers, mainly producing low-cost spirits.
- **Tax leakage and smuggling** are the lowest categories in volume terms, accounting for 8.2% and 6.0% and 11.8% and 11.7% in value terms respectively.
- The **largest category** in terms of **fiscal loss** is **counterfeiting**, which is mainly industrial manufacturing by unregistered distillers, represents **40.6% in value terms** and is followed by illicit homebrew at 36.7%.
- **Surrogate is not present** in Uganda as even the poorest among the population has access to very cheap illicit alcoholic beverages.

MANAGEMENT SUMMARY

Spirits and distilled homebrew dominate illicit LAE volume

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



Source: Euromonitor Consulting

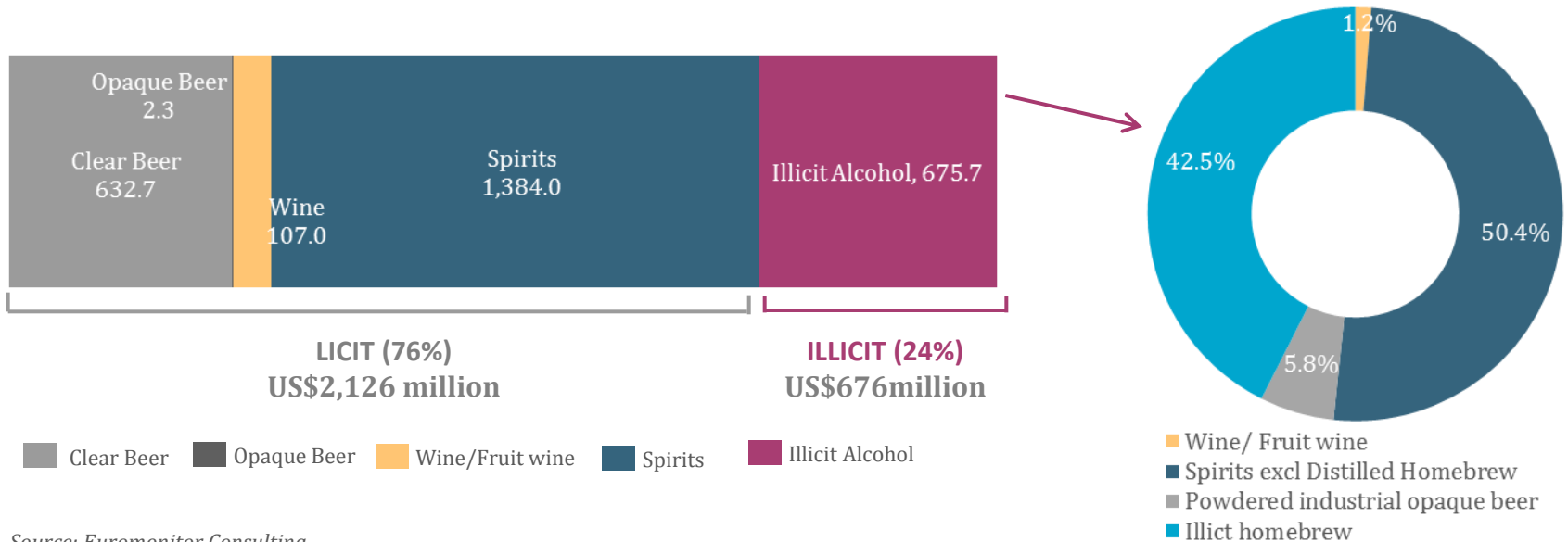
- **Strong liquor, either legal or illicit**, dominates sales in LAE volume terms. Despite the dominance of fermented homebrew in volume terms, its share of the illicit LAE market is under a quarter of total volume produced.
- Spirits, from the illicit production of distilled grain, fruit or molasses or from ethanol based production of spirits, appear widely in the illicit market with consumers preferring the high ABV and value for money of these spirits. **The most common distilled spirit is Waragi, officially banned by law yet widely produced and sold.**
- In the legal market, spirits captures 67% of all LAE volume with beer accounting for 32%.



MANAGEMENT SUMMARY

Homebrew remains the largest part of the illicit market by value

Composition of alcohol market in value terms (US\$m) by type of beverage in 2015



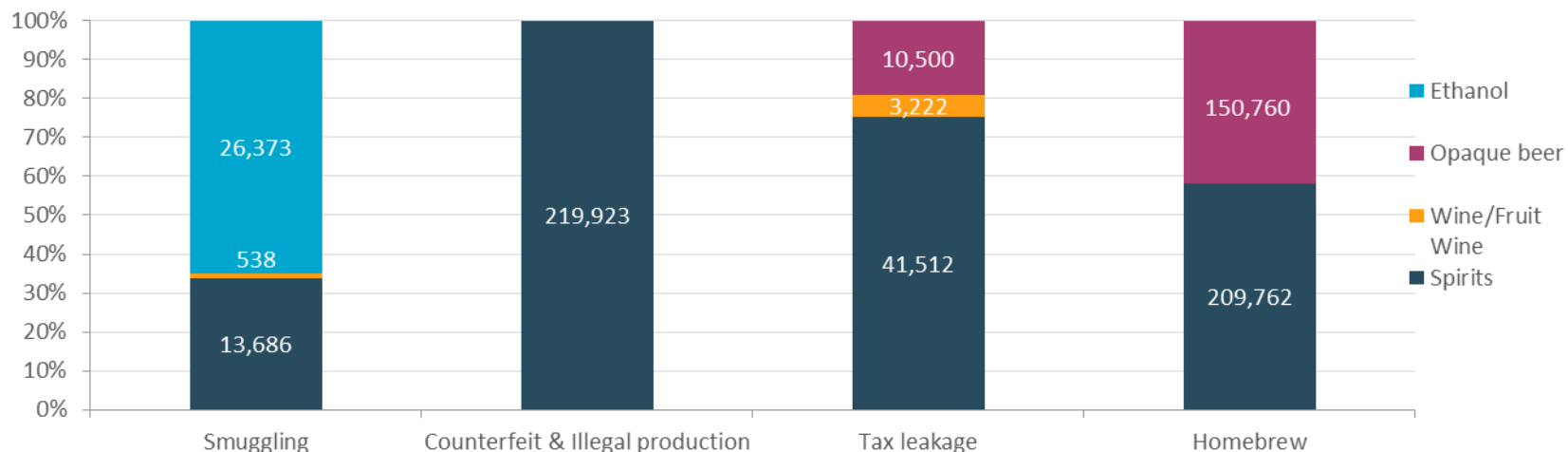
Source: Euromonitor Consulting

- **Clear beer** dominates **legal production** with **opaque beer** offering a cheaper alternative drink for lower income consumers. **Fine wines** are available but expensive and are mainly distributed through upmarket bars, clubs and restaurants. Imported international and locally produced **branded spirits** are available from wholesalers and recognised distributors for sale in established bars and clubs across Uganda.
- Central to illicit alcohol production is **fermented homebrew** which is widely available, for immediate consumption, in the local area of its production. Trade in **distilled homebrew** is strong and growing with organised production, distribution and retailing offering high profitability at all points in the supply chain.
- Undeclared or under-declared production of **spirits** is practised by unscrupulous legal producers and is easily sold in sachets and small bottles in the informal market. **Powdered opaque beer**, an alcohol only when mixed with water, is usually available in local brew bars and local on-premise outlets for which no tax is paid.



Illicit spirits captures the largest volume share of the market

Illicit Alcohol Market by Alcohol Type (HL, LAE) 2015



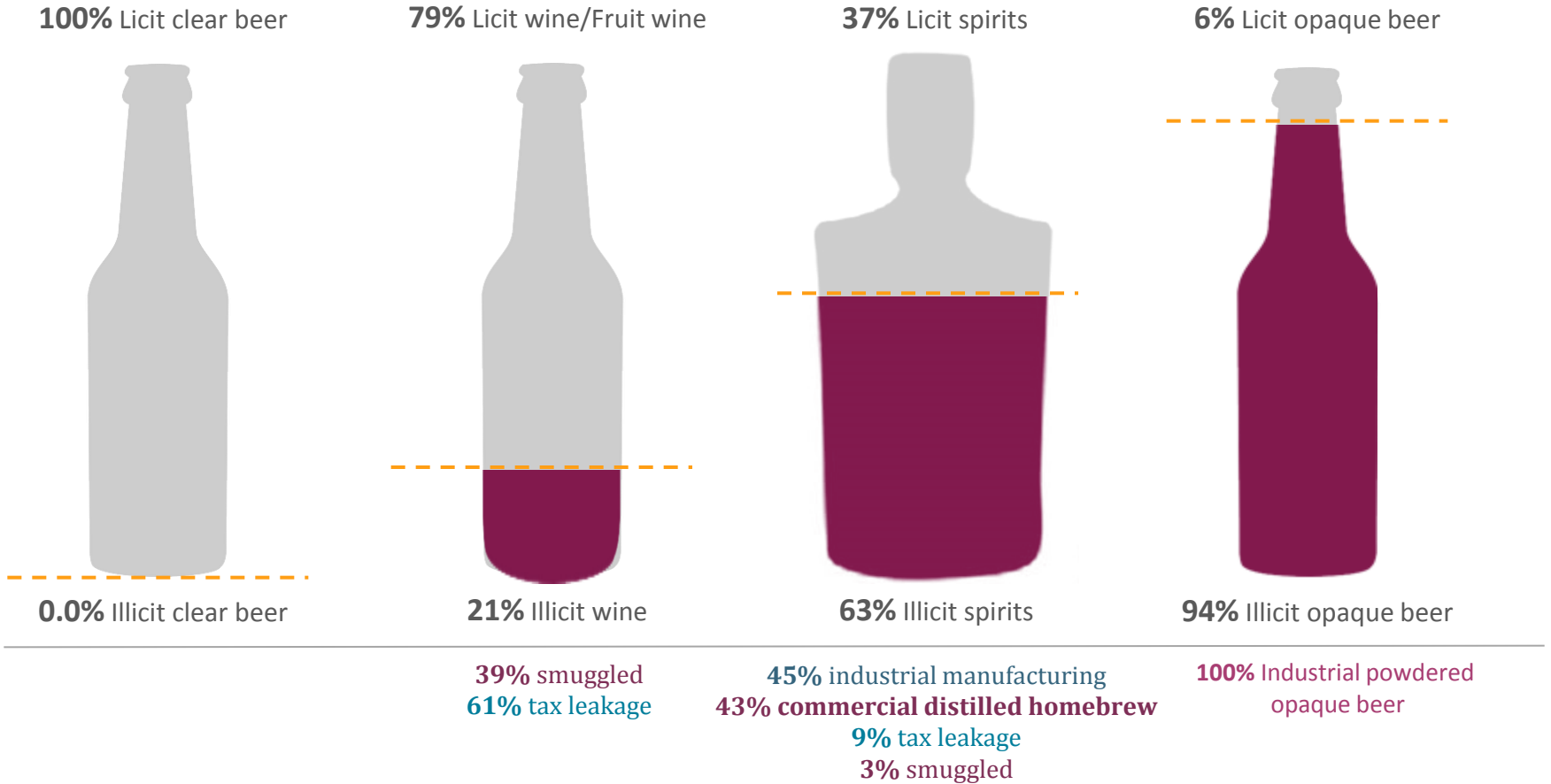
Source: Euromonitor Consulting

- **Homebrew** is the largest segment in the market by volume, mainly of fermented products made on a small scale for local consumption. Fermented homebrew is the cheapest form of alcohol in the market and is particularly consumed in rural areas.
- **Counterfeit and illicit production** is the second largest segment by volume and is focused on the sale of ethanol, grain and fruit based spirits. Ethanol is sourced locally from one distillery in the country or alternatively from legally imported, diverted legal imports or smuggled sources. Molasses is also a by-product of sugar production and is used as a base for much of the illicit spirits made across Uganda, often flavoured with marwa or other fermented homebrew.
- **Tax leakage** comprises mainly of illicit and undeclared production of spirits by registered entities. Under declaration of production levels either from market testing of new products or intentional exclusion of production volumes for profit are the main drivers of tax leakage. **Smuggling** also includes many international brands of whiskey, gins, vodka, brandy and others. Fine wines are also smuggled, often disguised as grape juice from the Middle East or China.

MANAGEMENT SUMMARY

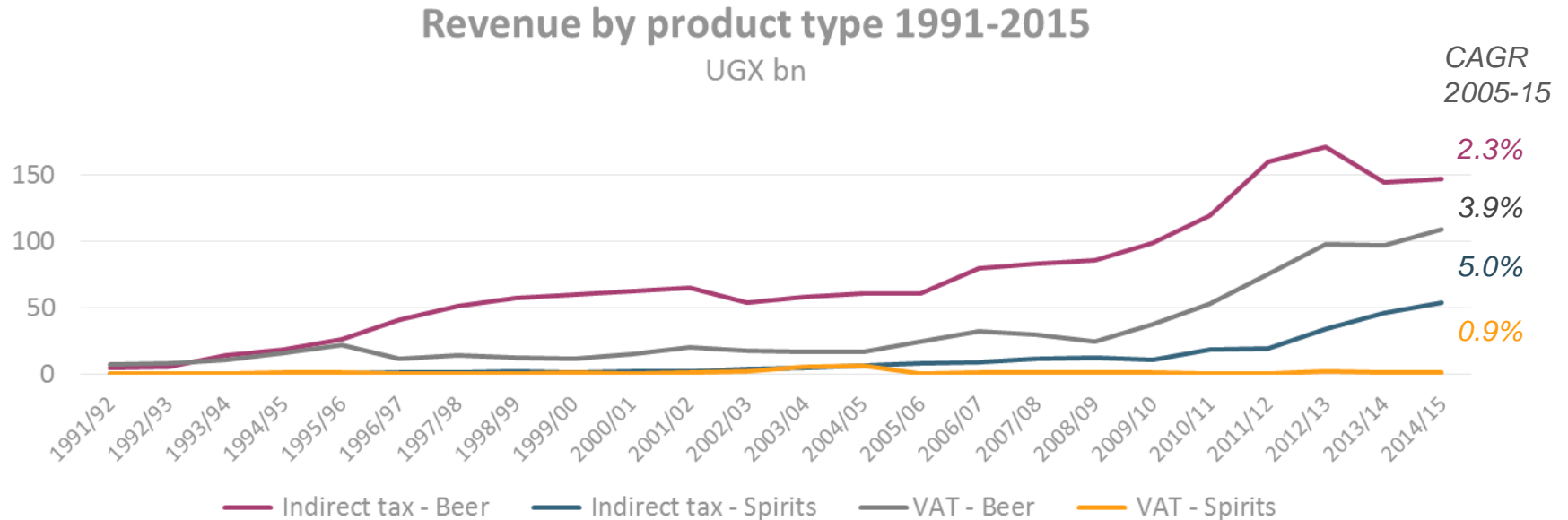
Illicit spirits and powdered opaque beer volumes are larger than legal production

Composition of market volume by beverage – licit vs illicit in 2015



Source: Euromonitor Consulting

Revenue generation improving but revenue from spirit sales particularly slow to grow



Source: URA, UBOS

Beer

- Indirect taxation of beer has generated increasing levels of revenue for the government based both on increased sales and increased taxation rates.
- Preferential rates for locally sourced ingredient based beer products aimed at encouraging a switch to consumption of legitimate affordable beer has been replaced with a higher rate, discouraging further growth of this category of product

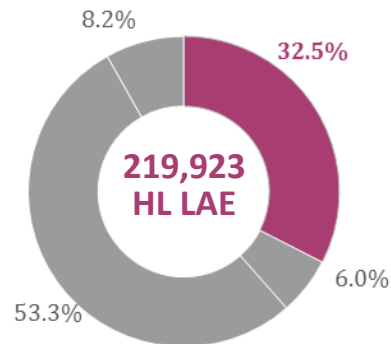
Spirits

- Increasing indirect tax on spirits is a result of a widening tax base as more companies are audited and assessed on their production volumes.
- VAT on consumer sales, however, remains stagnant with little increase in collections despite widespread, increasing availability and sales of waragi in both rural and urban areas

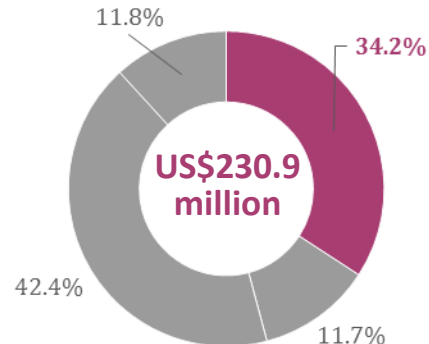
COUNTERFEIT AND ILLICIT BRANDS: MARKET SIZE

Counterfeit & illicit brands is the largest segment of the illicit market

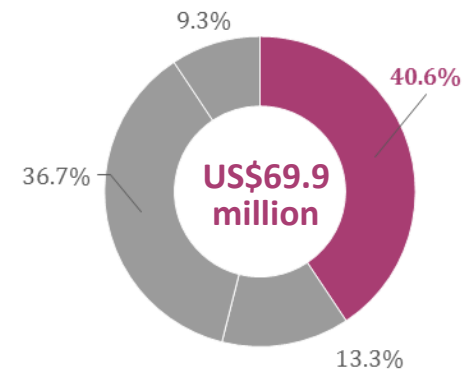
Volume (HL, LAE) 2015



Value (US\$) 2015



Fiscal Loss (US\$) 2015



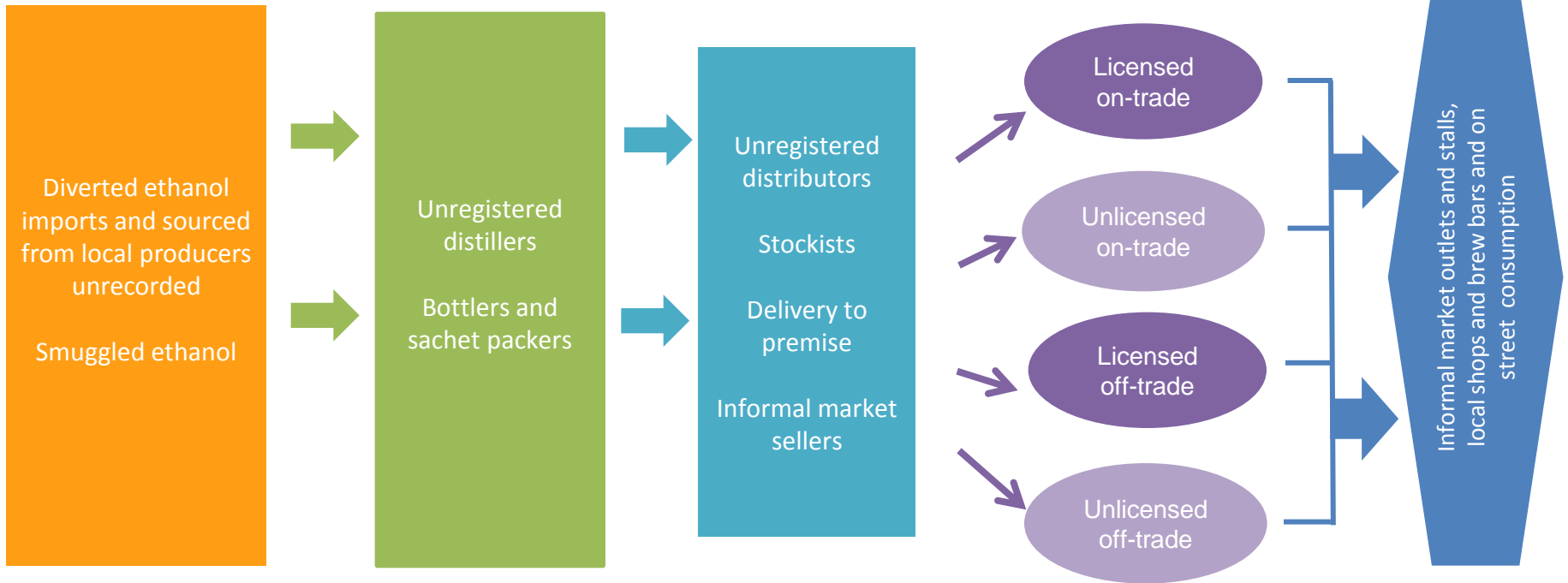
Source: Euromonitor Consulting

■ Counterfeit
 ■ Smuggling
 ■ Illicit Homebrew
 ■ Tax Leakage

- Industrial manufacturing of low grade spirits represents the bulk of the illicit category and is mostly packaged in **sachets** but also in **glass and PET** bottles with original branding or copycat branding of major local brands. It varies hugely in levels of alcohol content, ingredients and quality of production and is often flavoured to suit local tastes and trends.
- Counterfeit production appears in all segments of the market from premium and mid-priced **international imported** brands to mimicking of legally produced, local high quality brands as well as mid-market and budget, **local branded** alcohol.
- The majority of counterfeit premium international alcohol is dependent on access to **correctly moulded bottles**, security closures and high quality printed collateral which are often smuggled across the border. Alternatively, **refilling** of the current stock of bottles with a mixture of licit or illicit alcohol with water is used.
- **Unregistered manufacturers** of alcohol depends on the availability of ethanol or other grain based alcohol for the majority of their produce.
- **Ethanol** can be sourced currently from one distillery in Uganda or can be easily and legitimately imported. Ethanol also comes from the diversion of supplies to the chemical and pharmaceutical industry through reselling to the illicit distillers.

COUNTERFEIT AND ILLICIT BRANDS: VALUE CHAIN

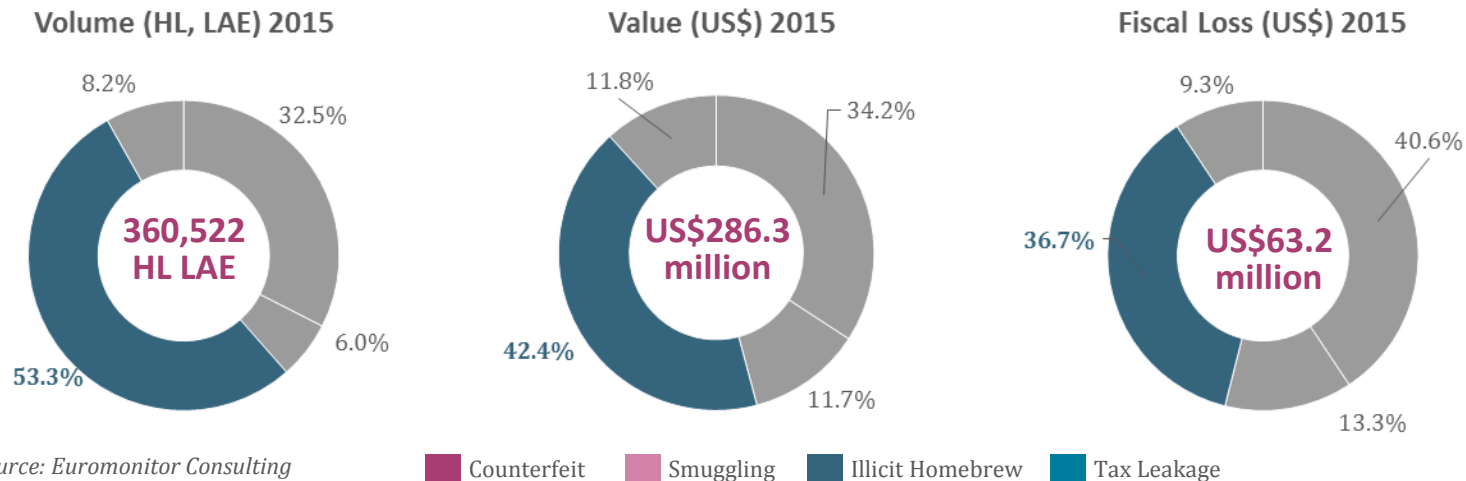
Counterfeit – illegal industrial manufactured spirits value chain



Unfilled = illegal activity/product not present if in this colour

 Colour filled = illegal activity/product present



ILLICIT HOMEBREW: MARKET SIZE**Distilled homebrew achieving higher economies of scale, profitability**

- Illicit homebrew **represents 83% of total illicit alcohol volume** consumed in Uganda in 2015 and 53.3% of total LAE illicit volume. Fermented homebrew outsells distilled by around eight times in volume, however distilled captures 58% of LAE total for homebrew given the very high alcohol content.
- Distilled homebrew made from local ingredients attracts a 60% **excise duty rate** but this is never declared or paid in Uganda. As a result US\$63.2 million was lost to the state in 2015.
- Much of the illicit production of **distilled homebrew** takes place on a small scale, however larger local producers process up to 2,000HL spirits per annum.
- There are also a small but growing number of **industrial scale producers for distilled homebrew** made up of co-operatives of small distillers able to take advantage of bulk buying economies and have the ability to fulfil large and regular orders both inside Uganda and for export to neighbouring countries.
- **Fermented homebrew** is made of readily available ingredients sourced locally including sorghum, maize, beer bananas among others but varies by region. **Brewing** is a self-taught skill with traditional recipes often passed through families over generations. Sales are usually confined to the local area as the product deteriorates rapidly on contact with sunlight.

ILLICIT DISTILLED HOMEBREW: KEY FACTS**Distilled homebrew production becoming more organised and centralised**

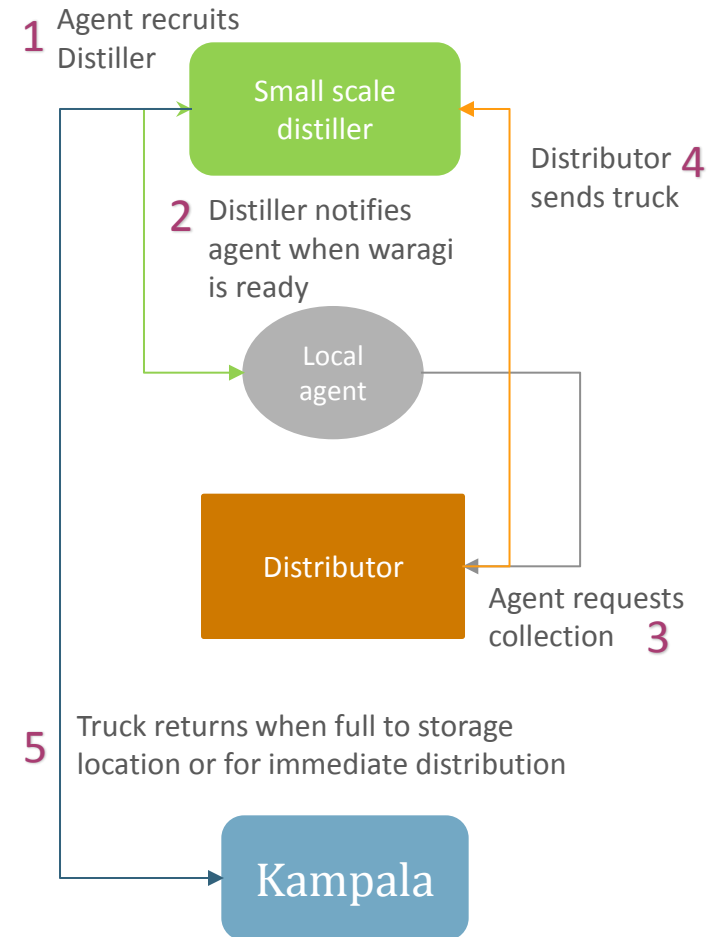
Consumption and distribution of illicit spirits is generally **contained within the region** around production facilities. Few illicit homebrew distillers have enough **capacity to distribute across the country**.

However, there is now a reported increase in **warehousing** of illicit spirits that suggests that larger networks of production and distribution are starting to be established with **pre-purchase** of waragi under contract.

In the west, the distribution loads can be transported openly but in the East and North it is often hidden, reflecting the levels of enforcement and authority activity in the area.

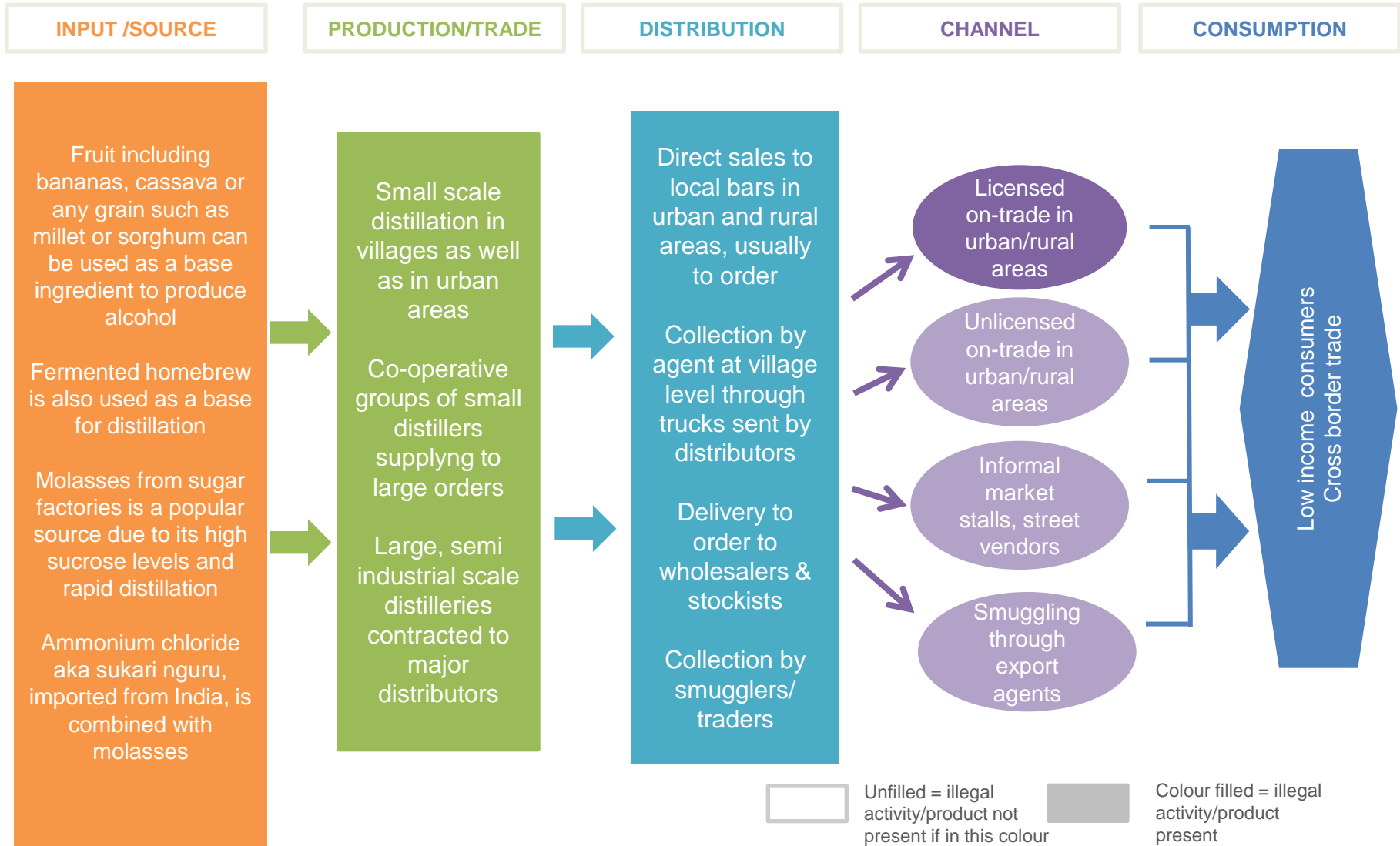
On reaching **Kampala**, the waragi is distributed to dens in low income settlements already well known for selling or are stored in a shack/warehouse for distribution at a later date or for **direct delivery** to bars.

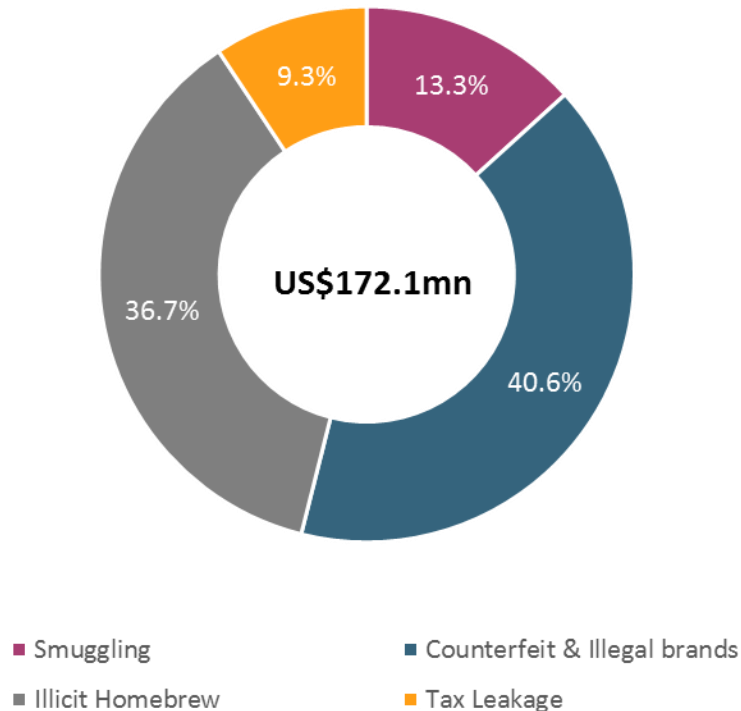
Waragi is also made for export with **Rwanda** and **Tanzania** key destinations for a sweet version of waragi. It is collected by foreign traders with responsibility for smuggling it across the border. For export to **Tanzania**, the waragi is usually smuggled in small quantities, often disguised in milk cartons or in small jerry cans that are loaded on boats of various sizes and undeclared.



ILLICIT DISTILLED HOMEBREW: VALUE CHAIN

Illicit distilled homebrew - value chain



FISCAL LOSS: MARKET SIZE**Fiscal loss to the state for illicit alcohol reached US\$172.1 million****Fiscal Loss Loss of Illicit Alcoholic Beverages Market (US\$)**

- Total fiscal loss reached **US\$172.1 million** in 2015 with counterfeit & illicit production mainly represented by industrial manufacturing the largest contributor to loss (40.6%) followed by distilled homebrew (36.7%) and smuggling (13.3%).
- Import duty is lost on smuggled goods when imported from outside EAC regional countries.
- All other forms of illicit production attract excise duty according to the type of alcoholic beverage.
- Price differentials favour sales of illicit alcohol at a substantial discount on legal alcohol. The overall fiscal loss also reflects the low production and retail costs of illicit alcohol of all types.
- Operating outside the tax net for illicit manufacturers, distributors and sellers is very profitable for distilled products and continues to encourage the expansion of the illicit spirits market.

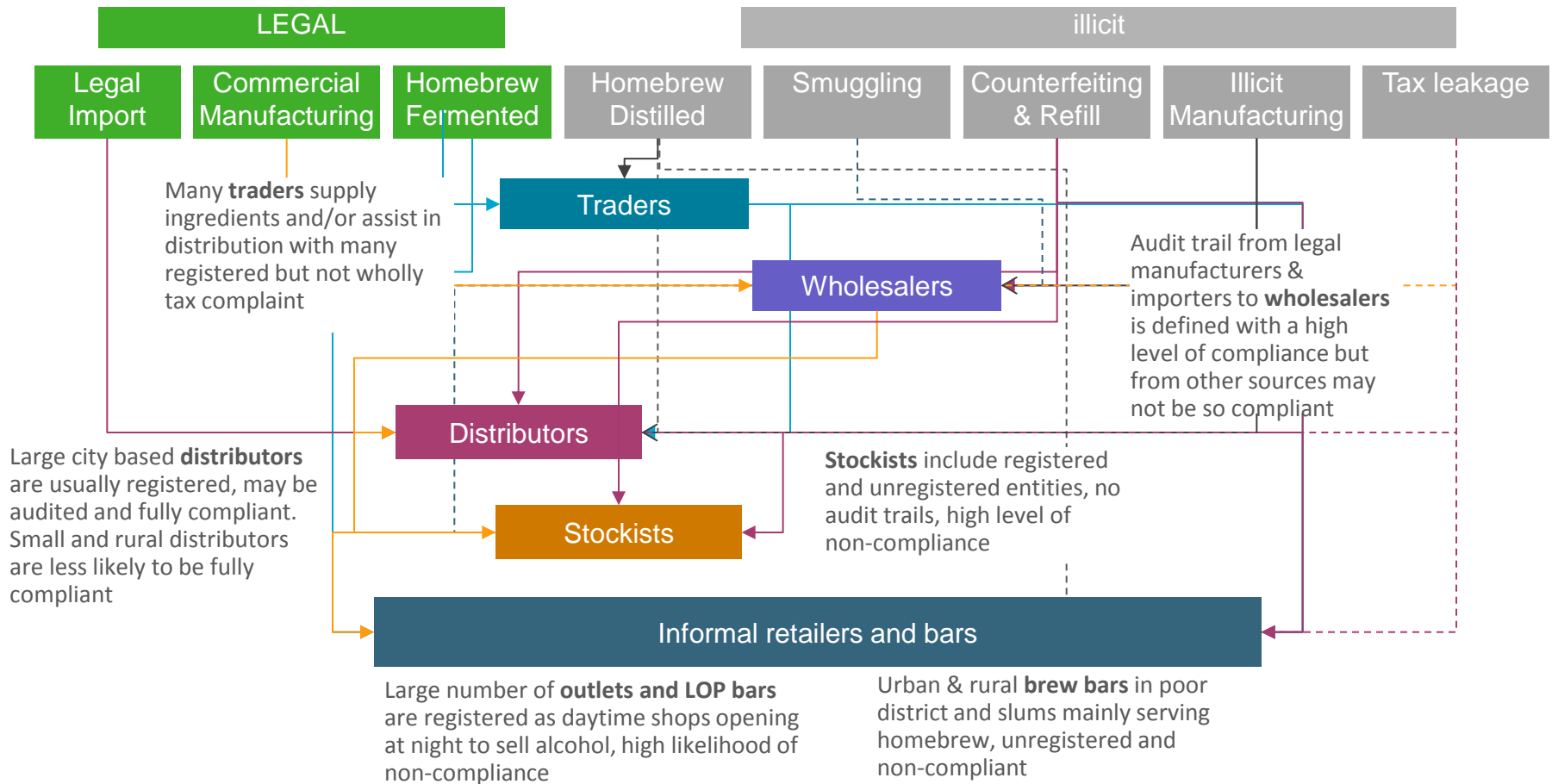
Source: Euromonitor Consulting

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COMPLIANCE

Tax compliance levels vary through the supply chain

URA attention to date has been on **large formal established businesses** that are now fully tax compliant. The focus has been on establishing strong and clear audit trails through the supply chain. Attention is now turning to **medium scale wholesalers, distributors and stockists** where compliance is less complete and the audit trail is less distinguishable. The drive for **receipt issuing and recording** is underway and alongside the TREP registration programmes the URA are slowly achieving better **identification, registration and enrolment** of businesses in the legal tax net



LEVELS OF FORMALITY

Dynamics of informality

