



## ILLICIT ALCOHOL IN RUSSIA

A custom report compiled by Euromonitor International  
for Baltika Breweries

APRIL 2015

# TABLE OF CONTENTS

Section Title	Slides
Introduction	<a href="#"><u>3</u></a>
Project scope and definitions	<a href="#"><u>8</u></a>
Methodology	<a href="#"><u>12</u></a>
Executive summary	<a href="#"><u>20</u></a>
Illicit alcohol market in Russia	<a href="#"><u>36</u></a>
Tax leakage	<a href="#"><u>57</u></a>
Appendix	<a href="#"><u>63</u></a>

**Note:** This PowerPoint presentation may not be suitable for printing purposes



# INTRODUCTION

PROJECT SCOPE AND DEFINITIONS

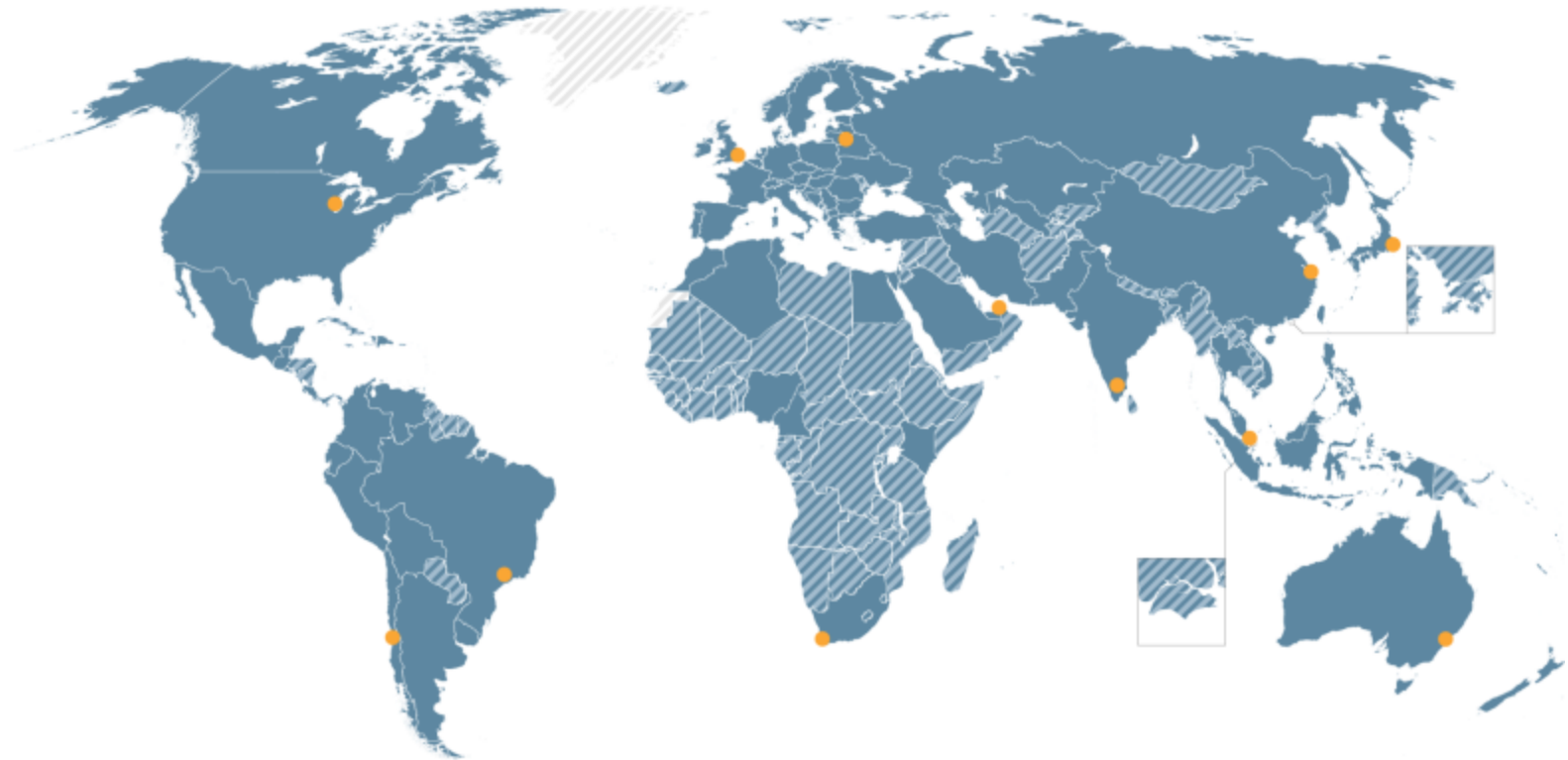
METHODOLOGY

EXECUTIVE SUMMARY

ILLICIT ALCOHOL MARKET IN RUSSIA

TAX LEAKAGE

# 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

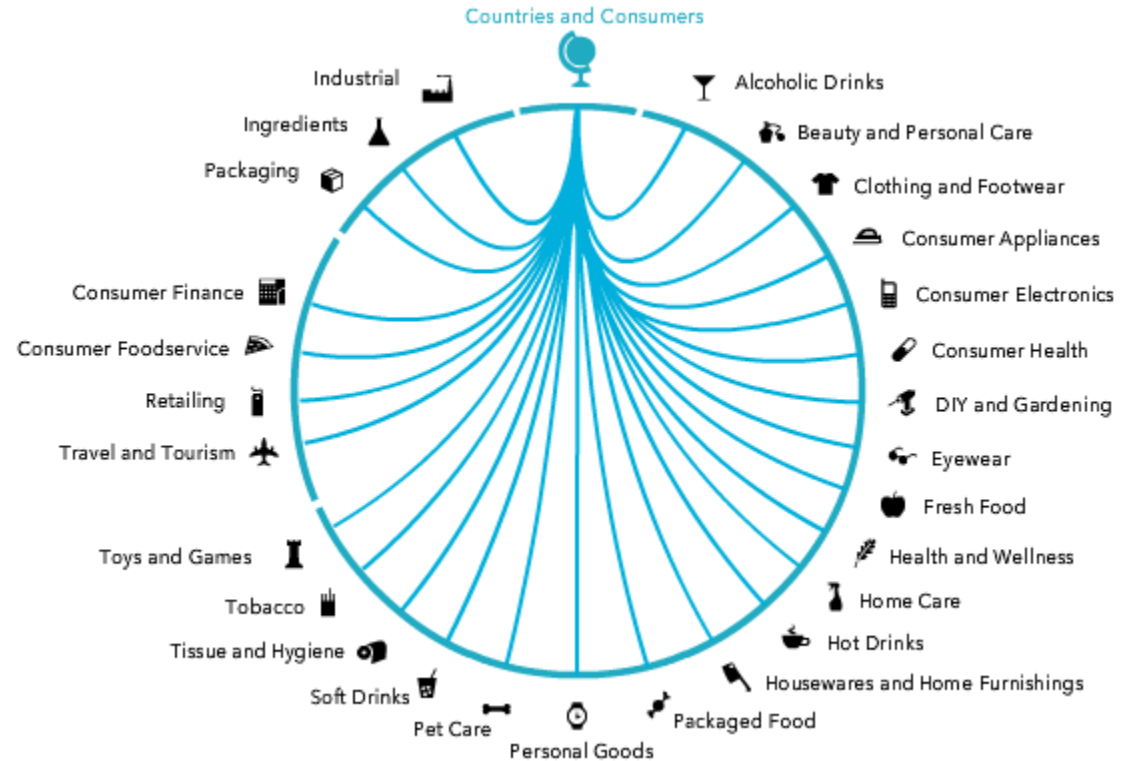
■ + ■ **210 COUNTRIES**

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

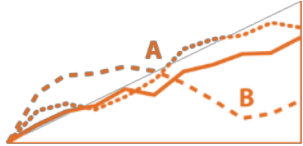
# Countries and consumers

## 360° Perspective

Passport offers subscribers a comprehensive view of their commercial environment, from the product-specific trends tracked within industry databases to the socio-economic insights in Countries and Consumers.

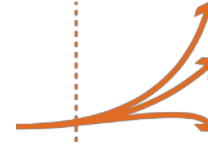


# Custom solutions and capabilities



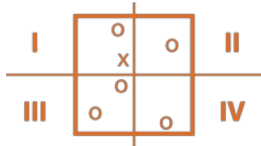
## Category evaluation

Sizes, shares, growth  
Segmentation  
Market entry strategy



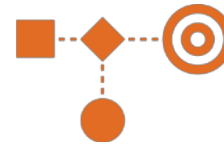
## Forecasting

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



## Competitive intelligence

Profiling  
Benchmarking  
Partner evaluation



## Scenario analysis

Market simulations  
Portfolio analysis  
Test business cases



## Innovation

NPD business case  
Consumer insights  
Product claims



## Consumer analytics

Customer profiling  
Income distribution models  
Purchasing behaviour



## Route to market

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



## Marketing analytics

Marketing effectiveness  
Substitutes and complements  
Price and channel strategy



## Macro

Opportunity frameworks  
PEST  
Quarterly tracking

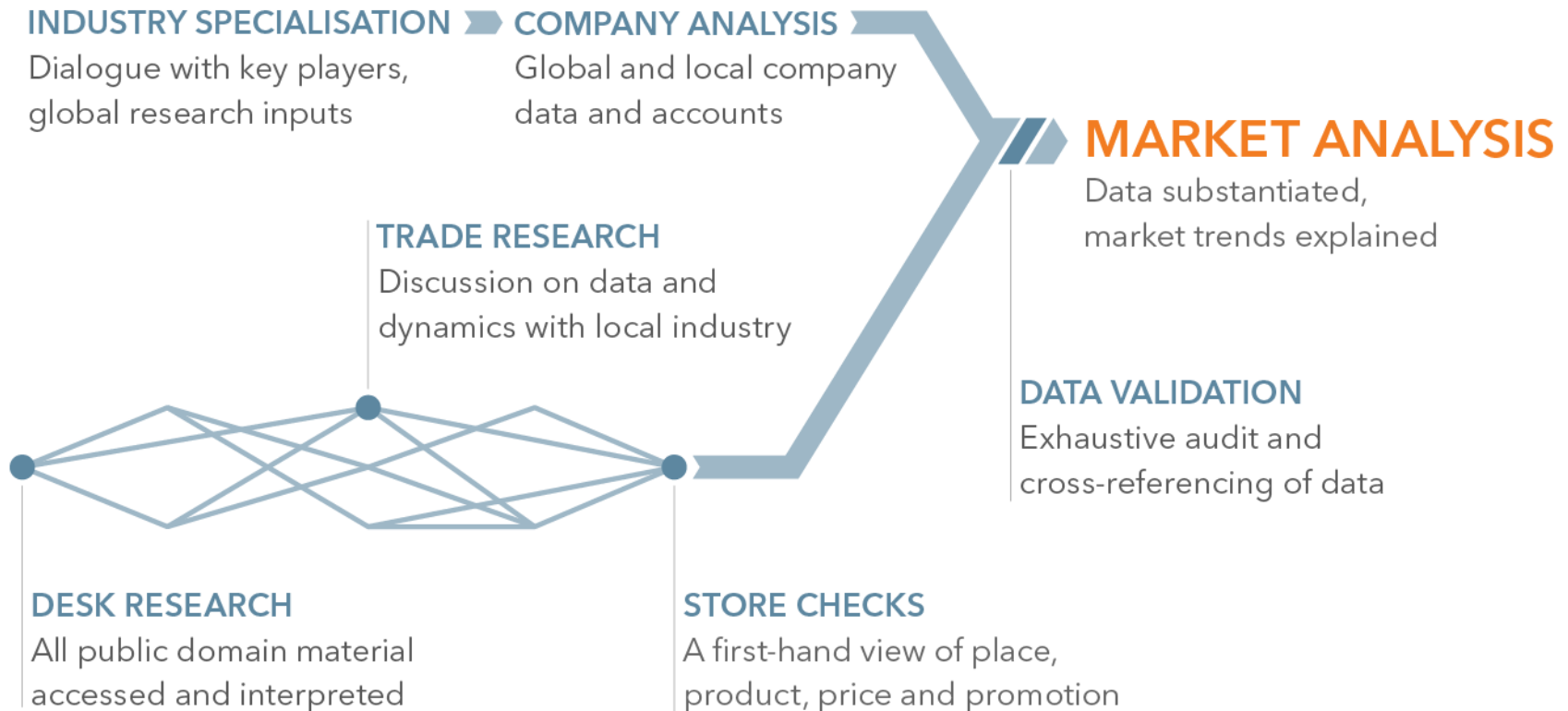


## Visualisation

Discovery, sharing, communication  
Market attractiveness planners  
Performance monitoring

# Research methodology

## GLOBAL INSIGHT



## LOCAL KNOWLEDGE

INTRODUCTION

**PROJECT SCOPE AND DEFINITIONS**

METHODOLOGY

EXECUTIVE SUMMARY

ILLCIT ALCOHOL MARKET IN RUSSIA

TAX LEAKAGE



# Project objectives

## Category Coverage

### Counterfeit & Illegal brands

- Substitution/refill
- Industrial manufacturing of illegal/unbranded

### Contraband

- Contraband of ethanol
- Contraband of the finished product

### Illegal artisanal alcohol

### Surrogate

## Alcohol Type Coverage

### Beer

### Wine

### Vodka

### Liqueur

## Geographic Coverage

### Russian Federation

## Project Objectives

- Examine the current trends in illicit alcohol in Russia
- Size the total market for illicit alcohol by type of alcohol in volume and value terms as well as to estimate the amount of tax revenues lost every year to the illicit trade
- Understand what motivates people to buy illicit alcohol and estimate the role that regulatory measures might play in this
- Qualitatively outline the value chain for illicit alcohol by describing how and where such products are typically produced and how they are then distributed





## Euromonitor International Solution

- Internal interviews with the in-house alcoholic drinks team, as well as with the in-country analysts to gain their insights into trends in illicit trade, efforts to combat them, and what in their view are the critical future trends.
- Analysis of official and semi-official secondary data available in trade sources, including estimates of the size of the illegal trade.
- Storechecks to observe products available in local market.
- Interviews with key local players including with alcohol companies, distributors, retailers, customs officials, national police forces and alcohol associations for their opinions on the size of the trade and trends in the market.
- Our skilled analysts will collate and analyse the above multiple sources to reach our independent conclusions, which we will report transparently and with any relevant estimates and assumption-building factors.

# Project scope and definitions

Category	Sub-category	Alcohol Type	Definition
Counterfeit & illegal brands	Substitution/refill	Beer	When illegal alcohol is sold under legal brands or when empty bottles of legitimate products are refilled with cheaper alcohol
		Wine	
		Vodka	
		Liqueur	
	Industrial manufacturing of illegal brands or unbranded beverage alcohol	Beer	Involves manufacturing of illegally branded or unbranded beverage alcohol
		Wine	
		Vodka	
		Liqueur	
Contraband	Contraband of ethanol	Ethanol	Illegal imports of ethanol as raw material
	Contraband of the finished product	Beer	Illegal imports of alcoholic beverages
		Wine	
		Vodka	
		Liqueur	
Illegal artisanal alcohol	n/a	Beer	Artisanal alcoholic beverages made for commercial purposes, ie samogon, etc.
		Wine	
		Vodka	
		Liqueur	
Surrogate	n/a	n/a	Alcohol not meant for human consumption ie pharmaceutical alcohol, beverages mixed with methanol, etc.
Tax leakage	n/a	n/a	The amount of excise tax revenues the government is losing as a result of illicit alcohol trade. The estimate is based on the assumption that people would buy volumes similar to our market size legally, were the illicit trade not present.

# Project scope and definitions

Alcohol Type	Definition	Alcohol Type Name in Russian as per Rosstat and Russian legislation (171-law)
 <b>Beer</b>	An alcoholic drink brewed from malt, hops, sugar and water and fermented with yeast, without the addition of ethanol.	Пиво и пивные напитки
 <b>Wine</b>	An alcoholic drink containing up to 22% of alcohol by volume (abv) and produced from fermented grapes or other fruit, with or without the addition of ethanol. Includes cider and mead.	Вино, ликерное вино, фруктовое вино, винный напиток, сидр и медовуха
 <b>Vodka</b>	A spirit drink, produced on the basis of ethanol (ethanol produced from food materials) and water, and containing 38-56% abv. Includes drinks, such as vodka and samogon.	Водка
 <b>Liqueur and other spirit drinks</b>	A spirit drink, produced using ethanol, produced from food materials, or spirit-containing foodstuff, and which is not included in the definitions of beer, wine and vodka. Includes drinks, such as whiskies, brandy, cognac and similar.	Другие спиртные напитки, кроме водки, и ликероводочные изделия
<b>Ethanol</b>	Spirit produced from food or non-food materials.	Этиловый спирт

INTRODUCTION

PROJECT SCOPE AND DEFINITIONS

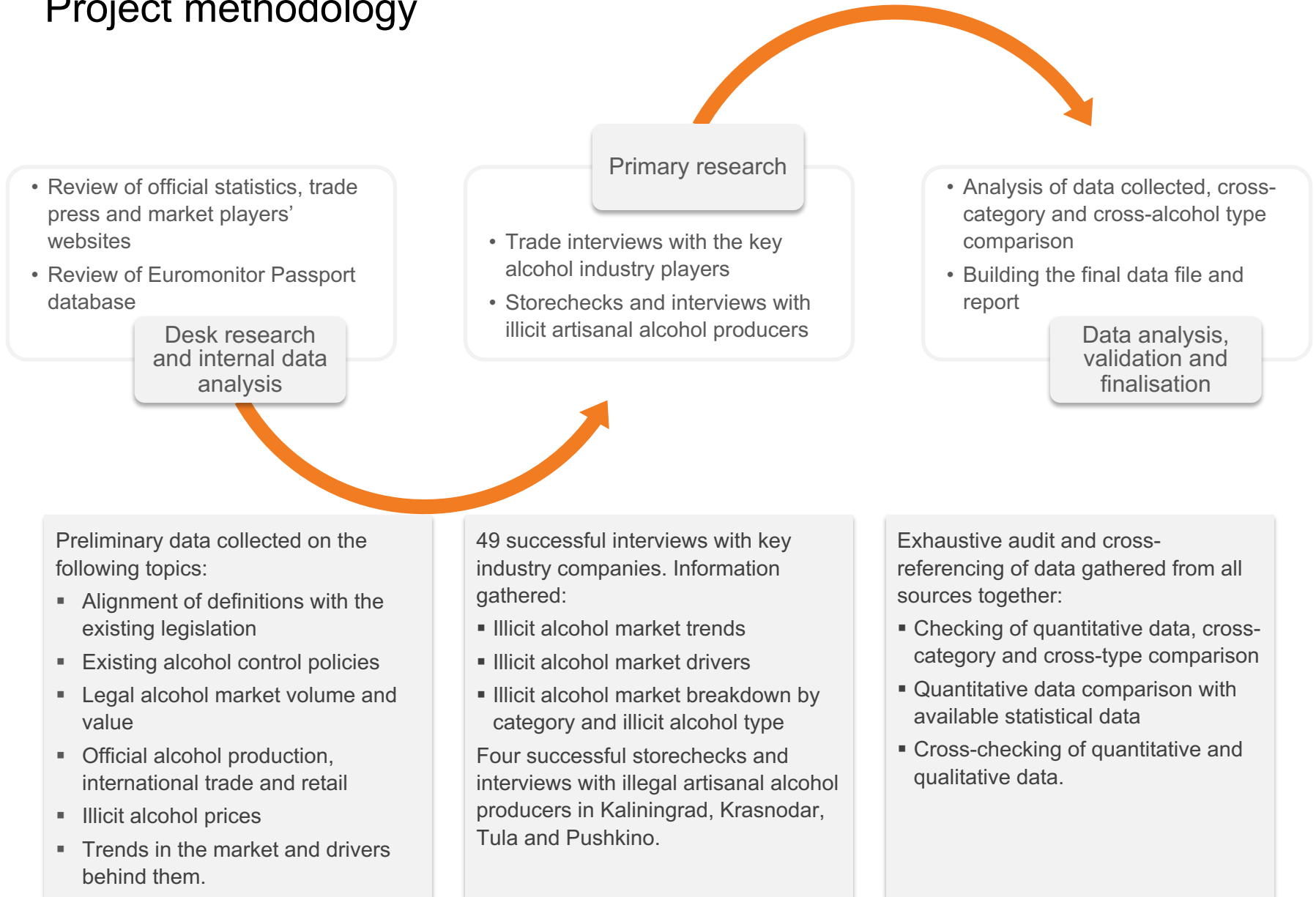
**METHODOLOGY**

EXECUTIVE SUMMARY

ILLCIT ALCOHOL MARKET IN RUSSIA

TAX LEAKAGE

# Project methodology



# Valuation approach - Initial Estimates

Illicit Activity Type		Valuation methodology
Total illicit alcohol - Initial estimates to be used in estimating particular categories	<b>Total illicit alcohol</b>	<p><b>Total illicit alcohol volume</b> = Average volume of the two valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated total illicit volume = An average of illicit alcohol total volume estimates, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of illicit in the total volume = Alcohol market size volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of illicit alcohol volume compared to the alcohol market size volume</p>
	<b>Total illicit volume of a particular alcohol type</b>	<p><b>Total illicit volume of a particular alcohol type</b> = Average of the two approaches</p> <p><b>Approach 1:</b> Based on the estimated total illicit volume = An average of total illicit alcohol volume estimates of a particular alcohol type, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of illicit in the total volume = Market size volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of illicit volume compared to the market size volume of a particular alcohol type</p>

# Valuation approach - Counterfeiting

Illicit Activity Type		Valuation methodology
Counterfeit & Illegal Brands (CIB)	Substitute/Refill (SR)	<p><b>Total substitution/refill volume</b> = Sum of substitution/refill (SR) volumes of the four alcohol types</p> <p><b>SR volume of a particular alcohol type</b> = Average volume of the three valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated SR volume = An average of SR volume estimates of a particular alcohol type, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of the particular alcohol type in the total SR volume = Estimated total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of counterfeit &amp; illegal brands (CIB) alcohol in total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of SR in total CIB alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of a particular alcohol type in total SR volume</p> <p><b>Approach 3:</b> Based on the estimated share of SR in the total CIB volume (for each particular alcohol type) = Estimated total illicit volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of %share estimates, indicated during trade interviews, of CIB in total illicit volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of %share estimates, indicated during trade interviews, of SR in total CIB volume of a particular alcohol type</p>
	Industrial manufacturing of illegal/unbranded (IM)	<p><b>Total industrial manufacturing of illegal/unbranded (IM) volume</b> = Sum of IM volumes of the four alcohol types</p> <p><b>IM volume of a particular alcohol type</b> = Average volume of the three valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated IM volume = An average of IM volume estimates of a particular alcohol type, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of the particular alcohol type in the total IM volume = Estimated total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of counterfeit &amp; illegal brands (CIB) in total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of IM in total CIB volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of a particular alcohol type in total IM volume</p> <p><b>Approach 3:</b> Based on the estimated share of IM in the total CIB volume (for each particular alcohol type) = Estimated total illicit volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of CIB in total illicit volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of IM in total CIB volume of a particular alcohol type</p>

# Valuation approach - Contraband

Illicit Activity Type		Valuation methodology
Contraband	Ethanol	<p>Contraband ethanol volume =</p> <p>Estimated total illicit alcohol volume  <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of contraband in total illicit alcohol volume</p> <p><b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of ethanol in total contraband volume</p>
	Finished product	<p><b>Total contraband volume of finished product</b> = Sum of contraband volumes of the four alcohol types</p> <p><b>Contraband volume of a particular alcohol type</b> = Average volume of the three valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated contraband volume of finished product =                      An average of contraband volume estimates of a particular alcohol type, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of the particular alcohol type in the total contraband volume of finished product =                      Estimated total illicit alcohol volume  <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of contraband in total illicit alcohol volume  <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of finished product in total contraband volume  <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of a particular alcohol type in total contraband volume of finished product</p> <p><b>Approach 3:</b> Based on the estimated share of contraband in the total illicit volume (for each particular alcohol type) =                      Estimated total illicit volume of a particular alcohol type  <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of contraband in total illicit volume of a particular alcohol type</p>



# Valuation approach - Artisanal, Surrogate and Tax leakage

Illicit Activity Type		Valuation methodology
Illegal Artisanal Alcohol	<b>Illegal Artisanal Alcohol</b>	<p><b>Total illegal artisanal alcohol volume</b> = Sum of illegal artisanal volumes of the four alcohol types</p> <p><b>Illegal artisanal volume of a particular alcohol type</b> = Average volume of the three valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated illegal artisanal alcohol volume = An average of illegal artisanal volume estimates of a particular alcohol type, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share of the particular alcohol type in the total illegal artisanal alcohol volume = Estimated total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of illegal artisanal in total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of a particular alcohol type in total illegal artisanal volume</p> <p><b>Approach 3:</b> Based on the estimated share of artisanal in the total illicit volume (for each particular alcohol type) = Estimated total illicit volume of a particular alcohol type <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of artisanal in total illicit volume of a particular alcohol type</p>
Surrogate	<b>Surrogate</b>	<p><b>Surrogate alcohol volume</b> = Average volume of the two valuation approaches</p> <p><b>Approach 1:</b> Based on the estimated surrogate alcohol volume = An average of surrogate alcohol volume estimates, indicated during trade interviews</p> <p><b>Approach 2:</b> Based on the estimated share in the total illicit alcohol volume = Estimated total illicit alcohol volume <b>MULTIPLIED BY</b> An average of % share estimates, indicated during trade interviews, of surrogate in total illicit alcohol volume</p>
Tax Leakage	<b>Tax Leakage</b>	<p><b>Total tax leakage</b> = Sum of tax leakage of the four alcohol types and surrogate</p> <p><b>Tax leakage of the particular item</b> = Total illicit volume of the particular item <b>MULTIPLIED BY</b> Applicable excise tax value <b>MULTIPLIED BY</b> Excise tax application rate (Beer and Wine 100%, Vodka and Surrogate 40%, Liqueur 30%)</p>

# Illicit beer calculation steps

Total substitute/refill estimates: 59.9 litres mn

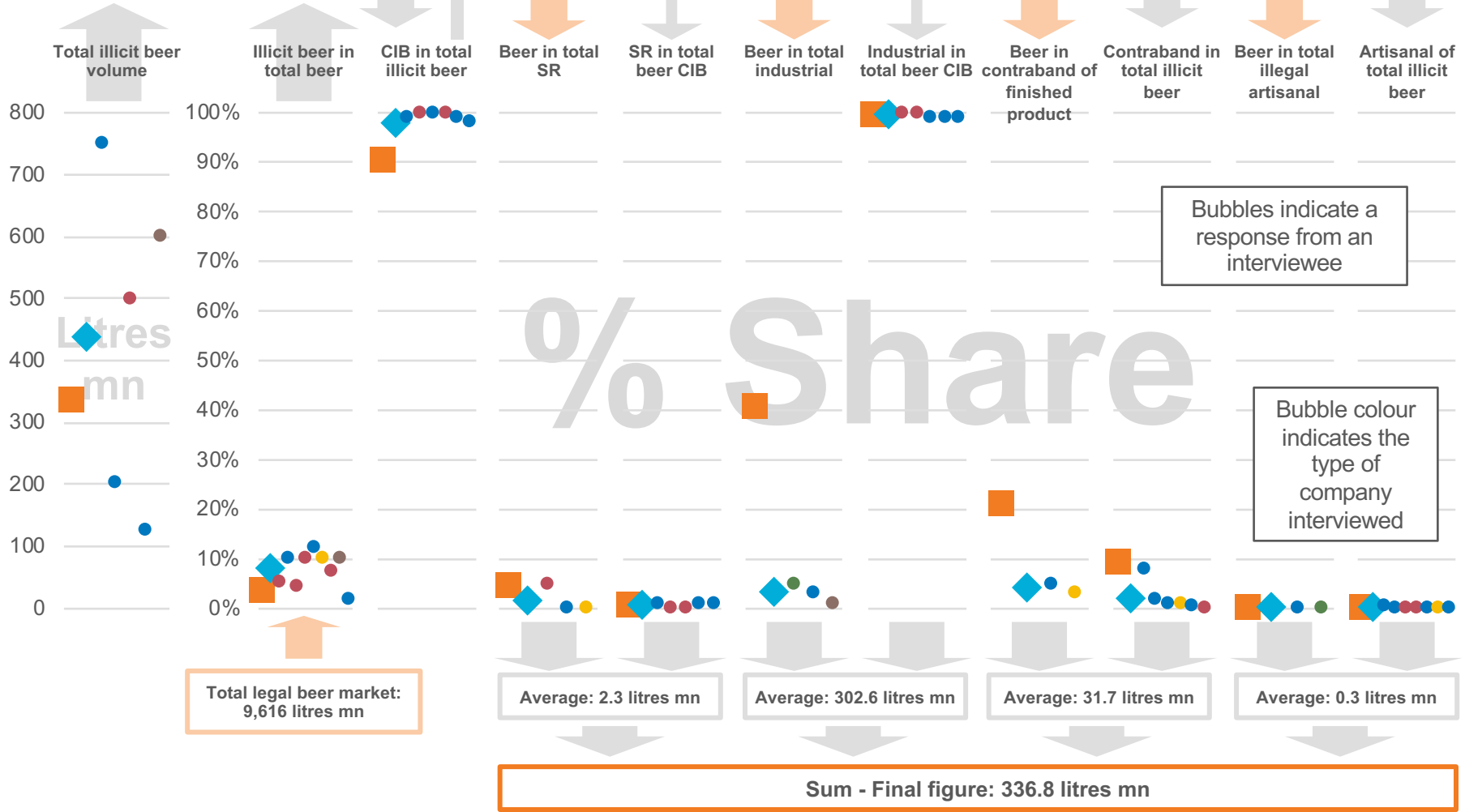
Total industrial estimates: 591.1 litres mn

Total contraband of finished product estimates: 70.6 litres mn

Total illegal artisanal estimates: 264.7 litres mn

Average: 602.6 litres mn

CIB estimate: 589.8 litres mn



Bubbles indicate a response from an interviewee

Bubble colour indicates the type of company interviewed

- Final figure
- ◆ Arithmetic average of responses
- Producer
- Association
- Distributor
- Importer
- Research agency

# Illicit beer calculation steps (cont.)

Data type	Answers of interviewees									Normalised average	Final figure
	750 litres mn	600 litres mn	500 litres mn	205 litres mn	125 litres mn	-	-	-	-		
Total illicit beer volume	750 litres mn	600 litres mn	500 litres mn	205 litres mn	125 litres mn	-	-	-	-	436 litres mn	337 litres mn
Illicit beer in total beer	12.5%	10.0%	10.0%	10.0%	10.0%	7.5%	5.5%	4.5%	2.0%	8.0%	3.5%
CIB in total illicit beer	100.0%	100.0%	99.9%	99.0%	99.0%	98.0%	-	-	-	97.9%	90.5%
Beer in total SR	5.0%	0.0%	0.0%	-	-	-	-	-	-	1.6%	4.4%
SR in total beer CIB	1.0%	1.0%	1.0%	0.0%	0.0%	-	-	-	-	0.6%	0.7%
Beer in total industrial	5.0%	3.0%	1.0%	-	-	-	-	-	-	3.2%	40.5%
Industrial in total beer CIB	100.0%	100.0%	99.0%	99.0%	99.0%	-	-	-	-	99.4%	99.3%
Beer in contraband of finished product	5.0%	3.0%	-	-	-	-	-	-	-	4.0%	21.0%
Contraband in total illicit beer	8.0%	2.0%	1.0%	0.9%	0.5%	0.0%	-	-	-	2.0%	9.4%
Beer in total artisanal	0.0%	0.0%	-	-	-	-	-	-	-	0.0%	0.1%
Artisanal of total illicit beer	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-	0.1%	0.1%

“Illicit beer is produced either behind the counters in medium-sized breweries or ‘openly’ in small breweries, which are not controlled by the state properly. Beer is then either supplied to the retail by distributors who do not know the beer is illicit, or sold as a tap beer to horeca, who understand its origin very well.” **Producer**

“Legal producers brew beer illicitly, then approach their distributors and sell legal beer together with illegal. From this point distributors do not know they sell illicit product, and neither do retailers.” **Association**

“Large part of draft beer is illicit. Here producer can easily avoid paying excise duty.” **Distributor**

“Beer is being imported illegally from Kazakhstan, but as no border exists it is impossible to account for it. At this stage, the laws leave a room for such import and no accounting is present.” **Association**

“The only illicitly produced beer is fully concentrated in this category [Industrial manufacturing of illegal/unbranded]. However, as production of beer is a sophisticated technology, only plants with equipment can produce more than they declare.” **Research agency**

“For beer, it is very small breweries that either have no brand name or reputation to lose. They just produce alcohol behind the counter and sell it either to small shadow horeca as tap beer or through small sellers in street kiosks. Thus, illegal sales are conducted mostly B2B.” **Producer**

“As these are smaller-scale breweries producing most of illicit beer, the main way for them to realize it is through draft/tap beer sale. <...> On a local level the police is supposed to control that, but they are not interested in small-scale crimes.” **Association**

INTRODUCTION

PROJECT SCOPE AND DEFINITIONS

METHODOLOGY

**EXECUTIVE SUMMARY**

ILLICIT ALCOHOL MARKET IN RUSSIA

TAX LEAKAGE



ALCOHOL  
MARKET SIZE  
IN RUSSIA IN 2013

**TOTAL**

**LEGAL**

**ILLICIT**

LPA VOLUME  
(MILLION LITRES)

**1,687.1**

**1,270.3**

**416.8**

LPA LITRES PER  
CAPITA  
(POPULATION 0+)

**11.8**

**8.9**

**2.9**

LPA LITRES PER  
CAPITA  
(POPULATION 15+)

**14.0**

**10.5**

**3.4**

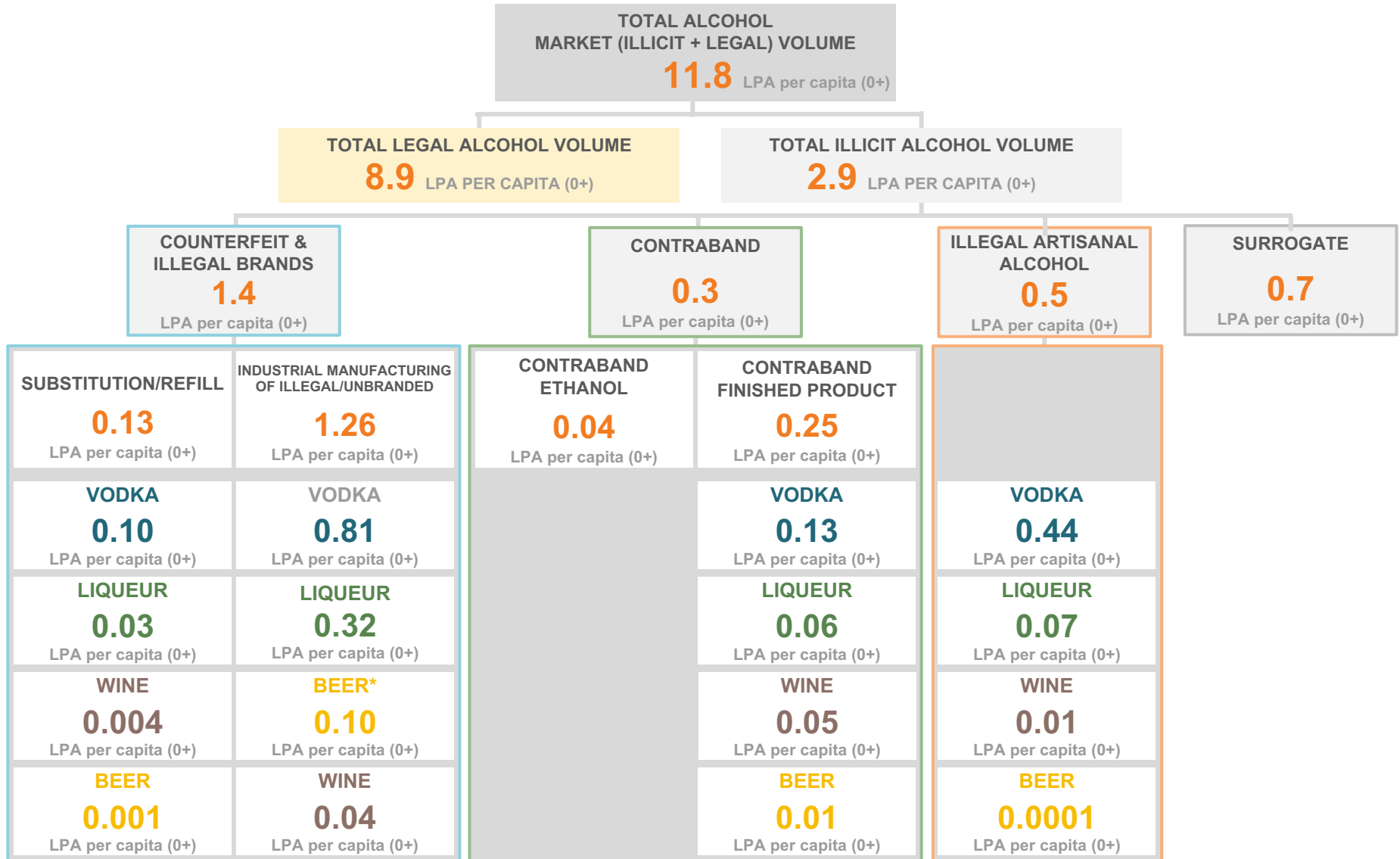




## KEY FINDINGS

- Consumption of legal alcohol is declining due to increasing prices, while consumption of illicit alcohol is growing due to illicit alcohol being a cheaper alternative to the legal one.
- Price sensitivity is the sole most important illicit alcohol consumption driver in Russia. Already high price sensitivity increased further over 2009-2014 due to sharp rises in alcohol excise taxes and establishment of a minimal retail price for alcohol over 28% abv.
- More than half of illicit alcohol in Russia is considered to be industrially manufactured in existing small and medium alcohol plants or former plants, which lost their license.
- Spirits, vodka being the most prominent among them, is the key illicit alcohol type, accounting for 49% of total illicit alcohol in absolute volume and 66% in pure alcohol volume.

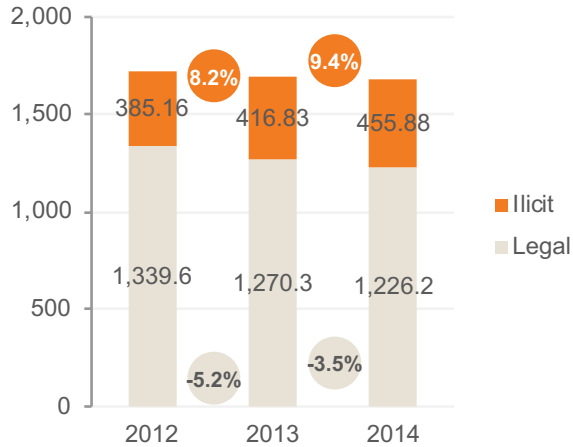
# Illicit alcohol market overview in Russia in LPA per Capita (0+)



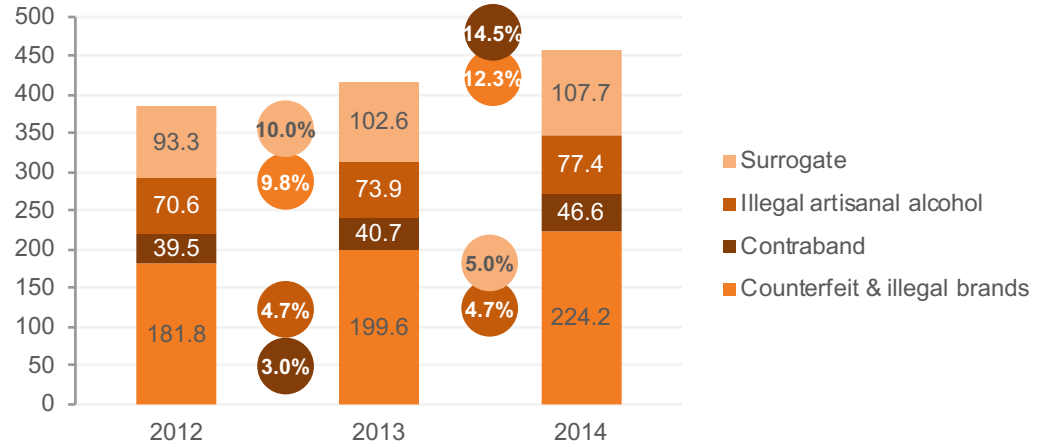
Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

# Illicit alcohol market overview in Russia

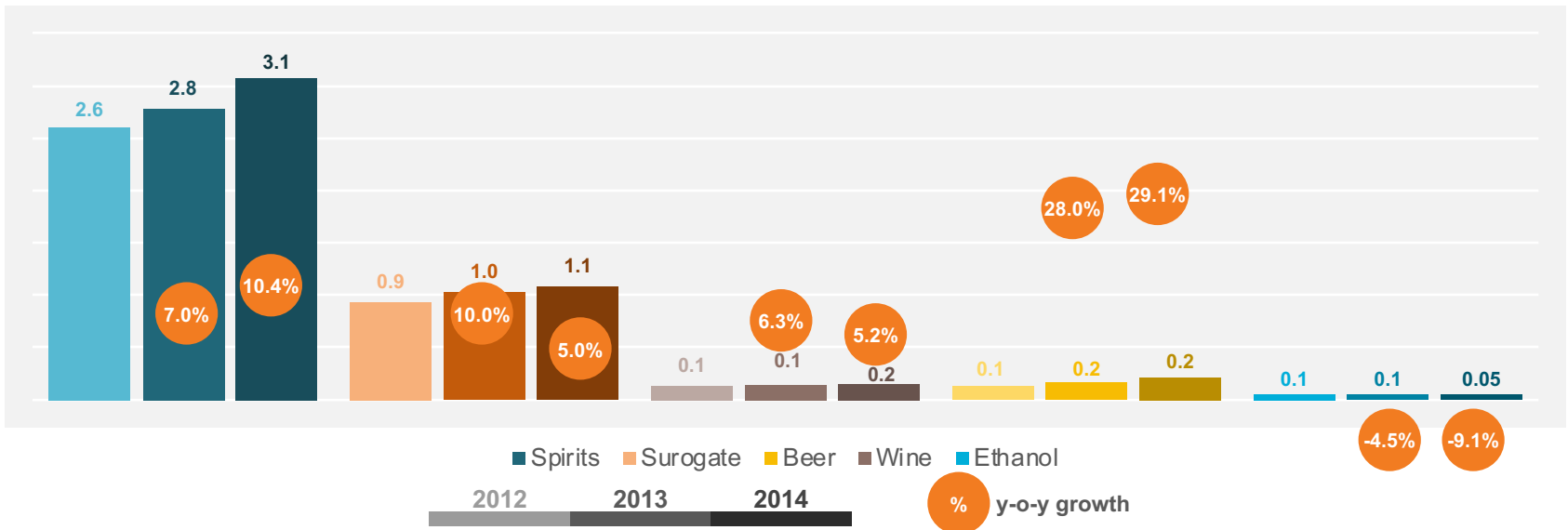
Illicit Alcohol versus Legal Alcohol Market, Volume in mn LPA



Illicit Alcohol Categories by Type of Alcohol, Volume in mn LPA



Total Illicit Alcohol by Type of Alcohol, Volume in bn LPA

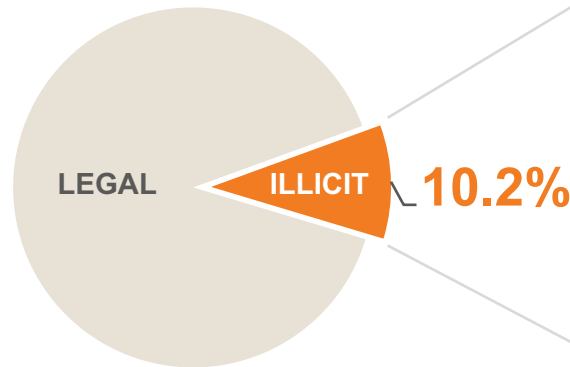




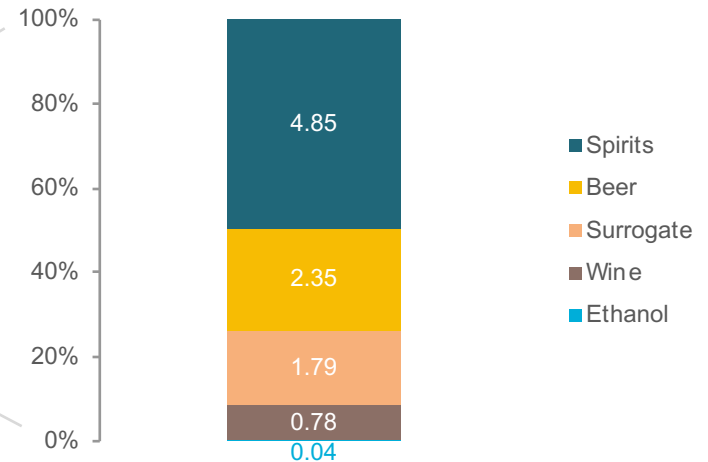
# Market for strong alcohol is more affected by illicit alcohol



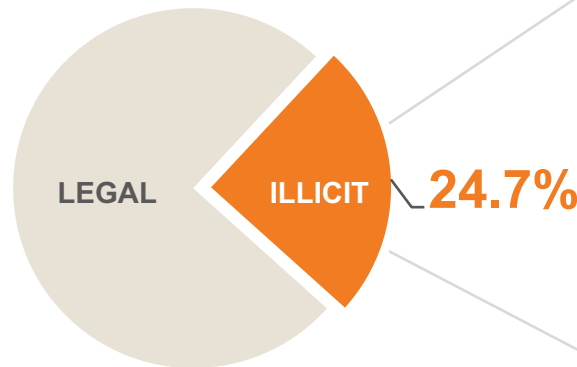
Illicit Alcohol versus Legal Alcohol Market in Litres per Capita (0+)



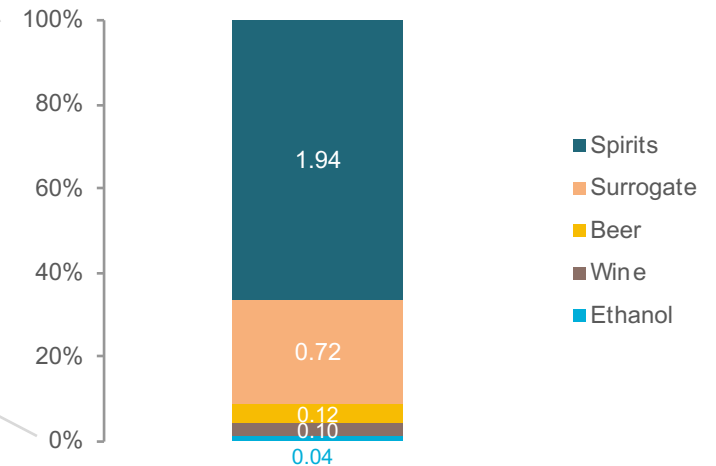
Structure of Total Illicit Alcohol by Type of Alcohol in Litres per Capita (0+)



Illicit Alcohol versus Legal Alcohol Market in LPA per Capita (0+)



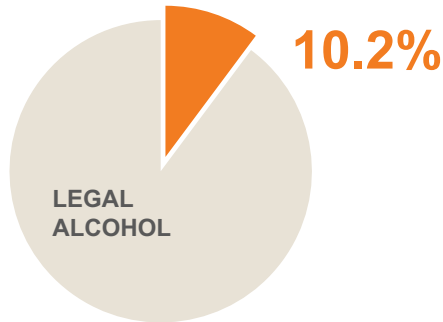
Structure of Total Illicit Alcohol by Type of Alcohol in LPA per Capita (0+)



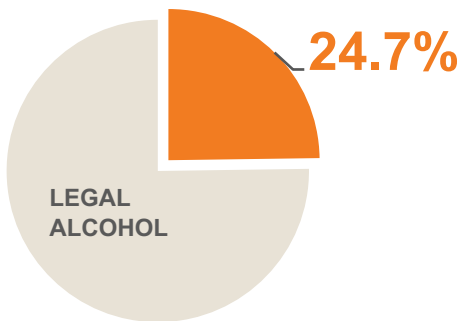
**Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks**

# Market of beer is least affected by illicit alcohol

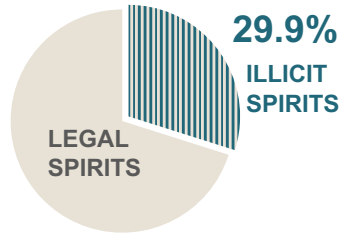
Illicit Alcohol Share in Total Alcohol Market in Actual Volume



Illicit Alcohol Share in Total Alcohol Market in LPA Volume



Illicit Alcohol as a Share of the Total Market by Alcohol Type in Volume (mn litres) and LPA mn, 2013



TOTAL SPIRITS  
**16.2** litres per capita (0+)  
**6.5** LPA per capita (0+)

ILICIT SPIRITS  
**4.8** litres per capita (0+)  
**1.9** LPA per capita (0+)

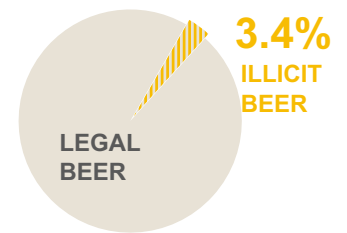
LEGAL SPIRITS  
**11.4** litres per capita (0+)  
**4.5** LPA per capita (0+)



TOTAL WINE  
**8.7** litres per capita (0+)  
**1.1** LPA per capita (0+)

ILICIT WINE  
**0.8** litres per capita (0+)  
**0.1** LPA per capita (0+)

LEGAL WINE  
**7.9** litres per capita (0+)  
**1.0** LPA per capita (0+)



TOTAL BEER  
**69.4** litres per capita (0+)  
**3.4** LPA per capita (0+)

ILICIT BEER  
**2.3** litres per capita (0+)  
**0.12** LPA per capita (0+)

LEGAL BEER  
**67.1** litres per capita (0+)  
**3.3** LPA per capita (0+)

SURROGATE

**1.8** litres per capita (0+)  
**0.72** LPA per capita (0+)

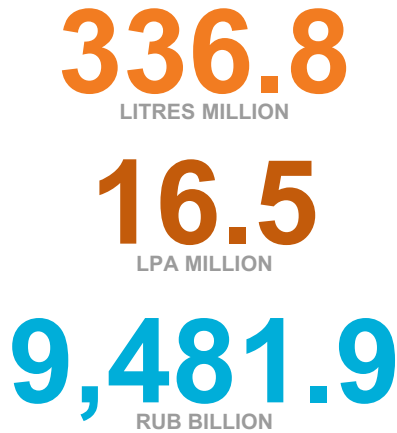
ETHANOL

**0.04** litres per capita (0+)  
**0.04** LPA per capita (0+)

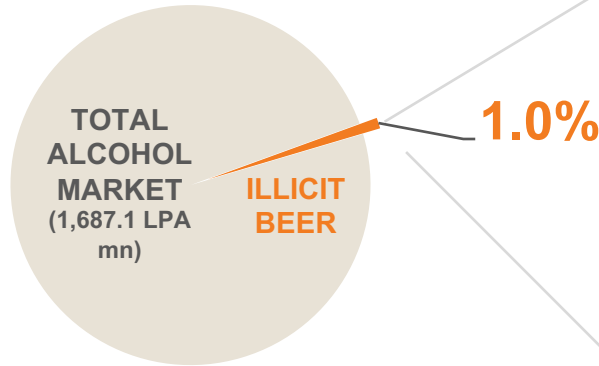
Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

# Beer distributed in kegs rather than bottles to foodservice

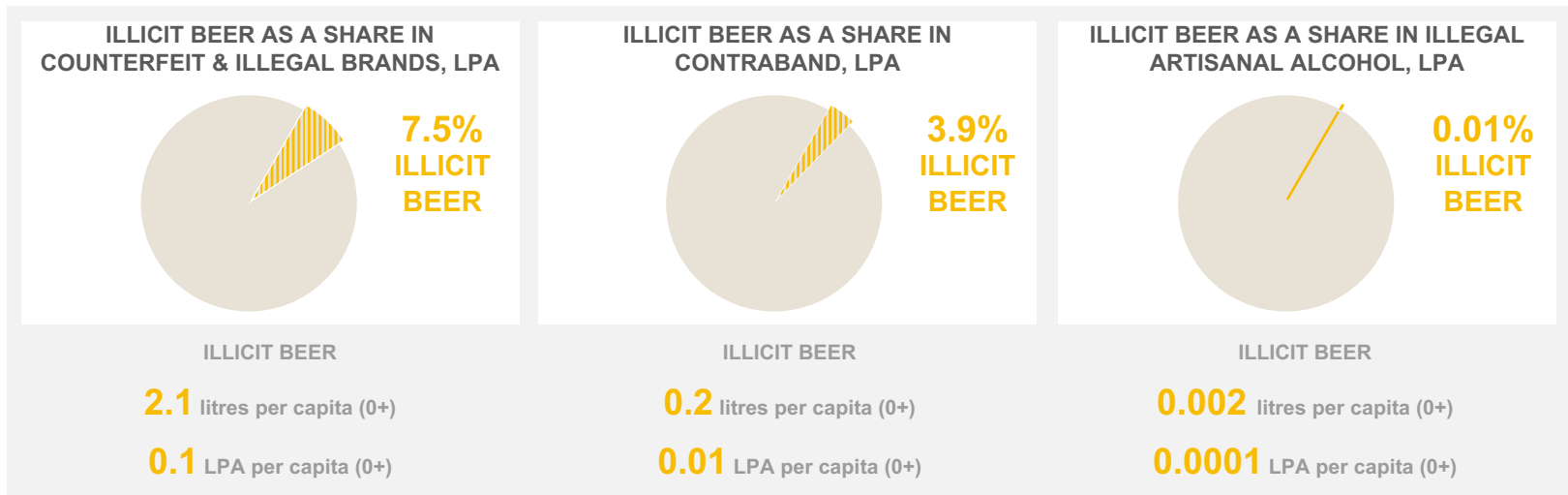
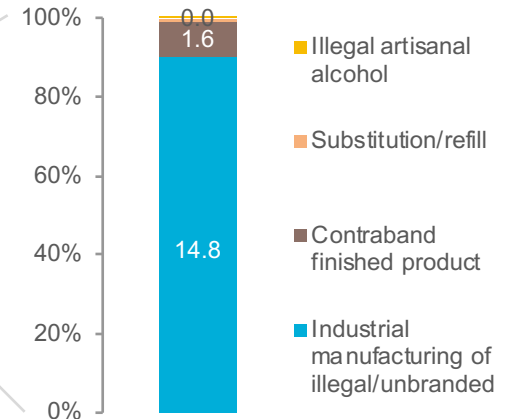
## TOTAL VOLUME AND VALUE OF ILLICIT BEER IN 2013



## Illicit Beer as a Share in Total Alcohol Market, 2013

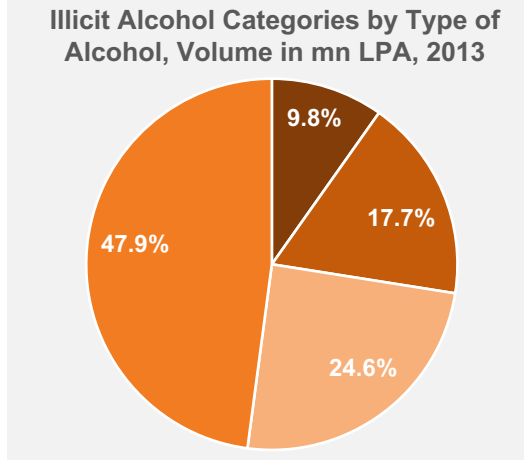
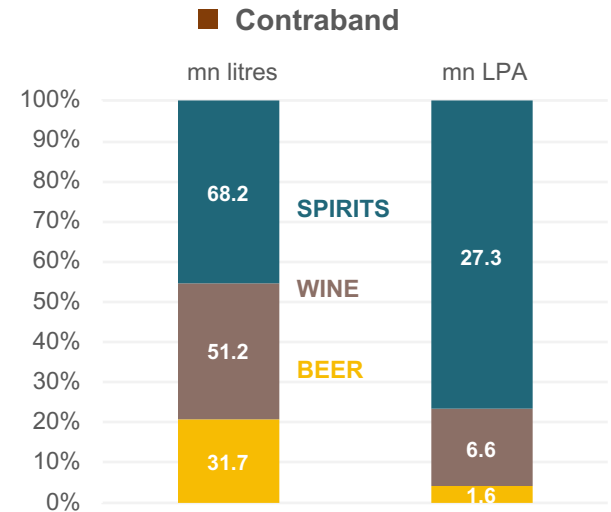
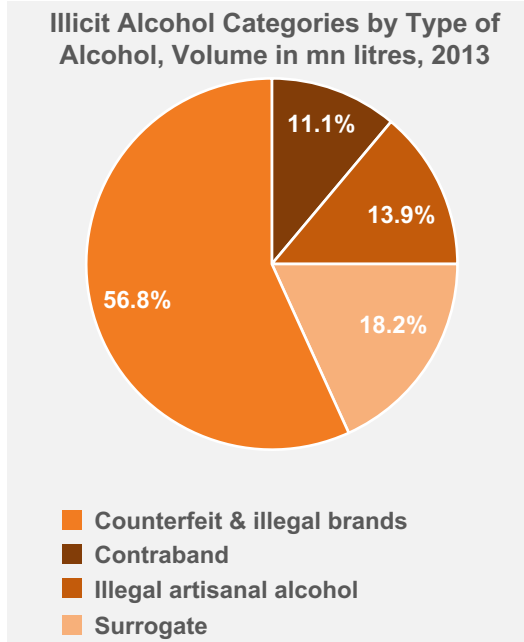
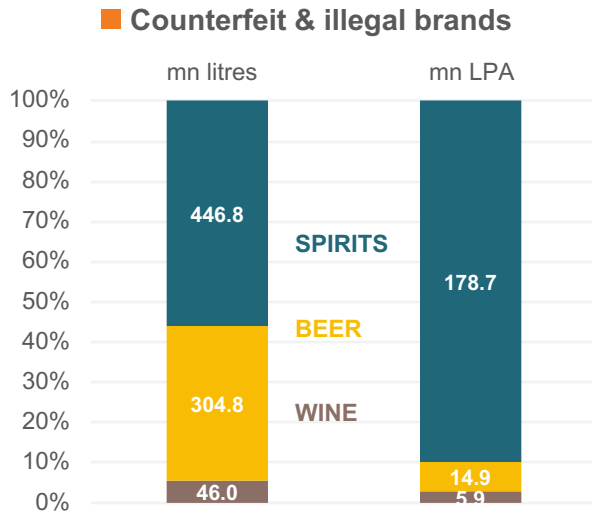


## Structure of Total Illicit Beer by Subcategory, 2013, LPA mn



Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

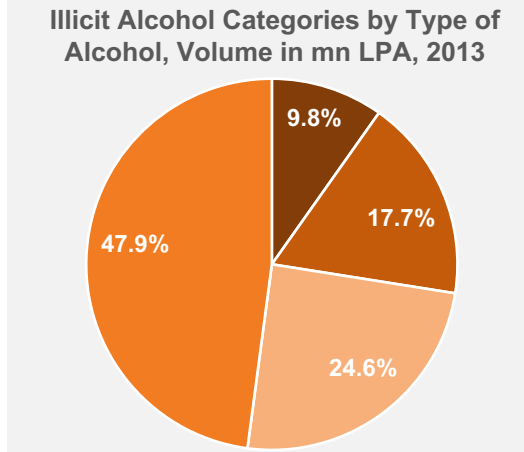
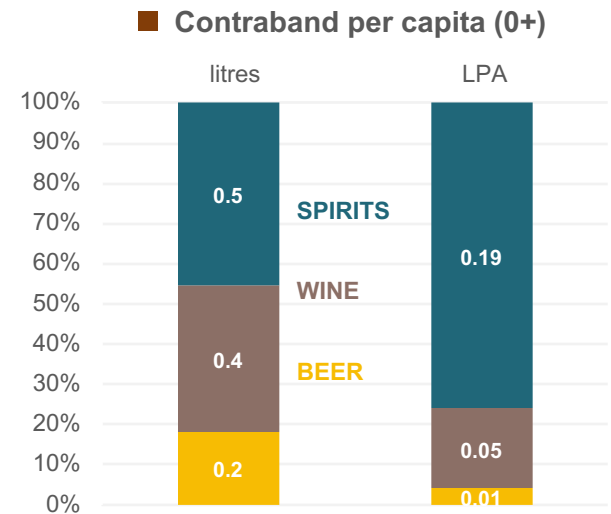
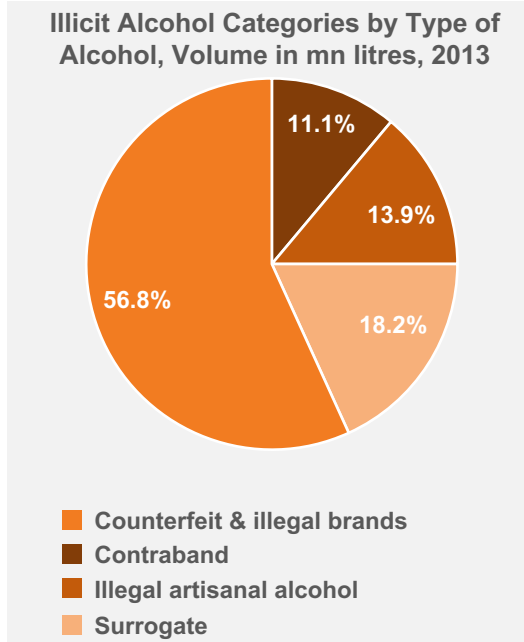
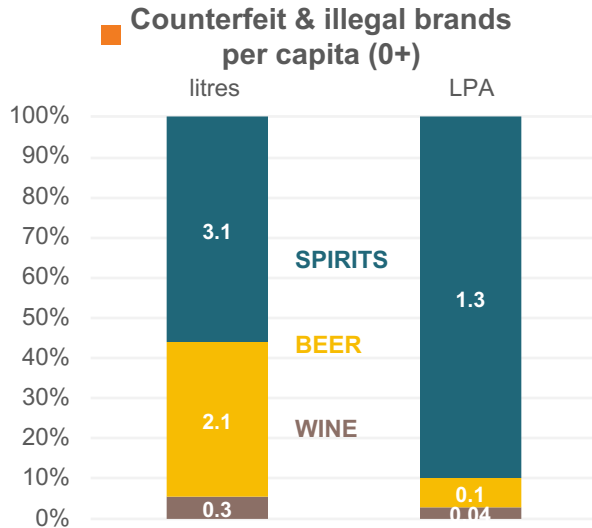
# Illicit alcohol categories by type of alcohol in Russia in 2013



- Surrogate**
- Key types of surrogate**
- Medical tinctures, such as hawthorn tincture
  - Eau de cologne
  - Perfumed water
  - Lotions
  - Bath additives
  - Other fluids containing denatured ethanol

Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

# Illicit alcohol categories by type of alcohol in Russia in 2013



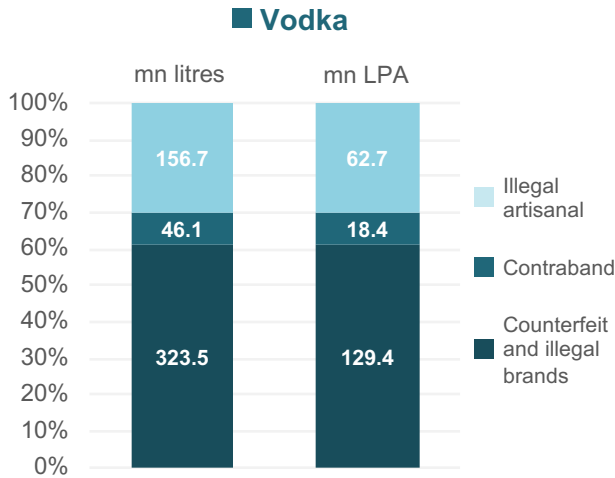
**Surrogate**

**Key types of surrogate**

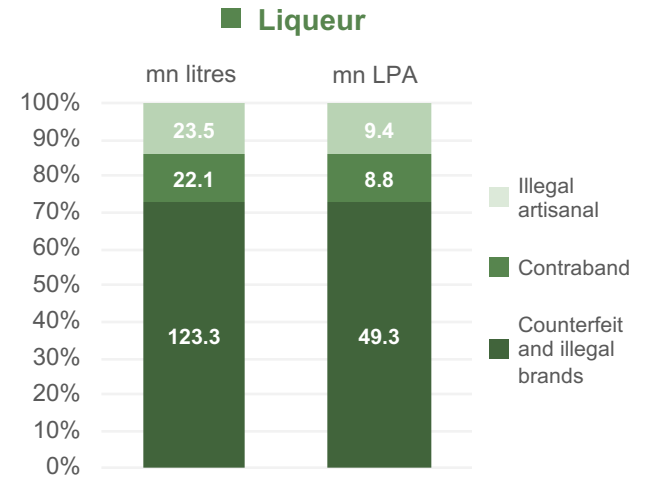
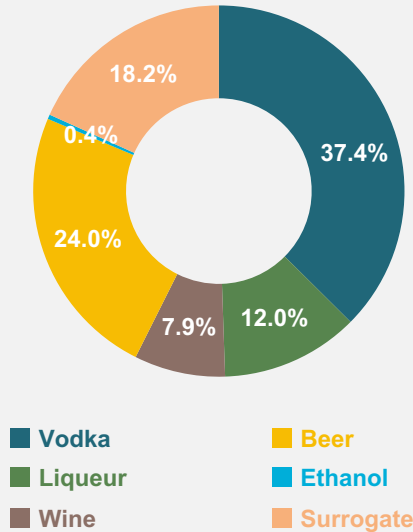
- Medical tinctures, such as hawthorn tincture
- Eau de cologne
- Perfumed water
- Lotions
- Bath additives
- Other fluids containing denatured ethanol

*Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks*

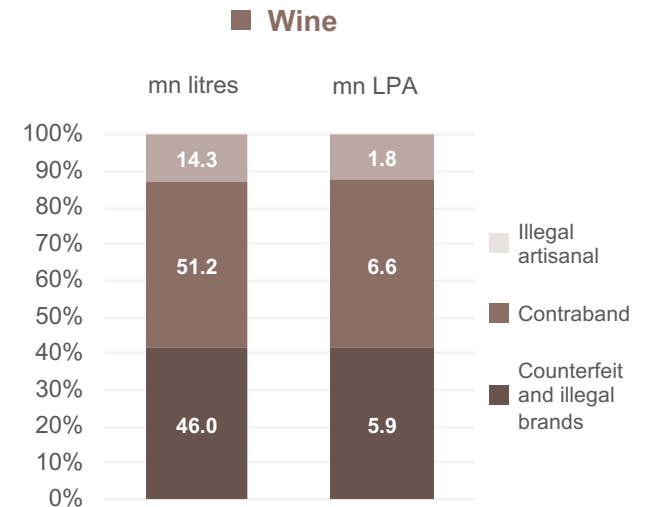
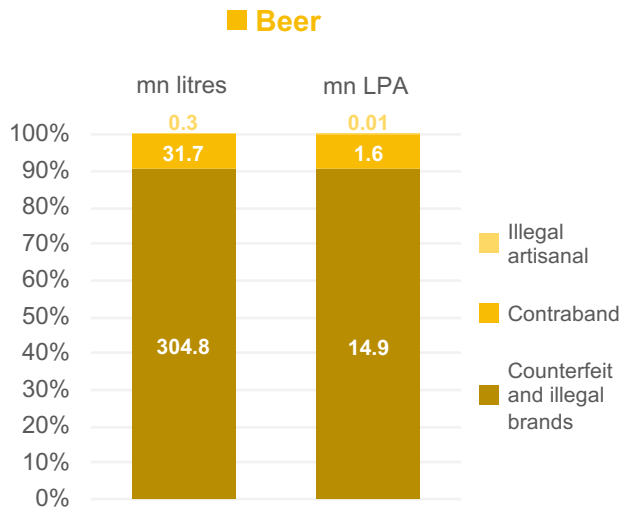
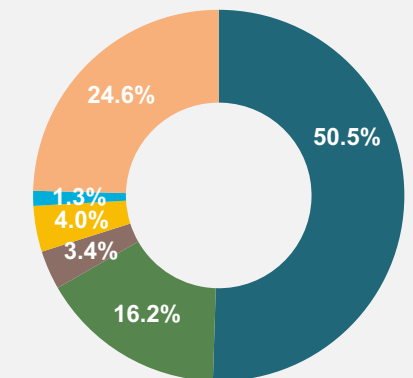
# Counterfeit and illegal brands dominate illicit alcohol



Illicit Alcohol Types by Category, Volume in mn litres, 2013

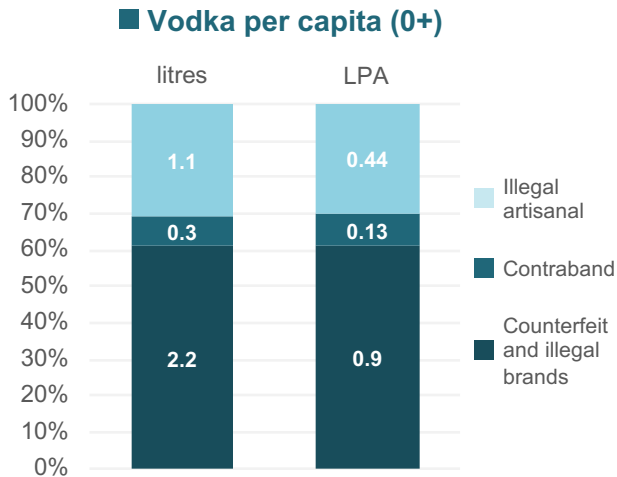


Illicit Alcohol Types by Category, Volume in mn LPA, 2013

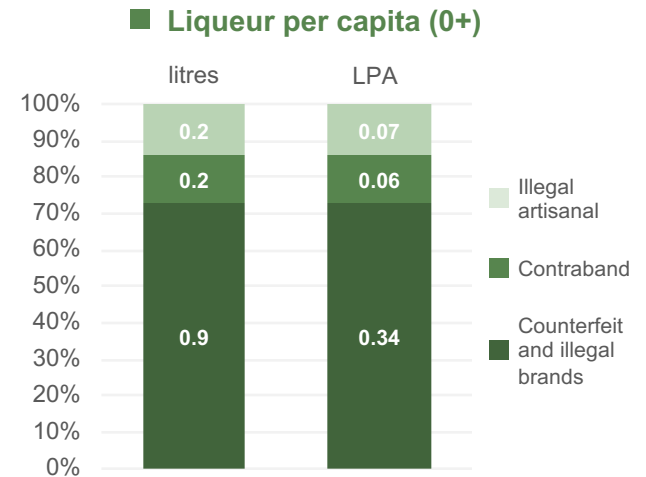
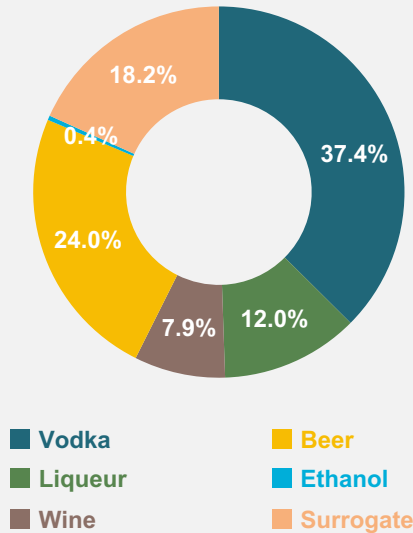


Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

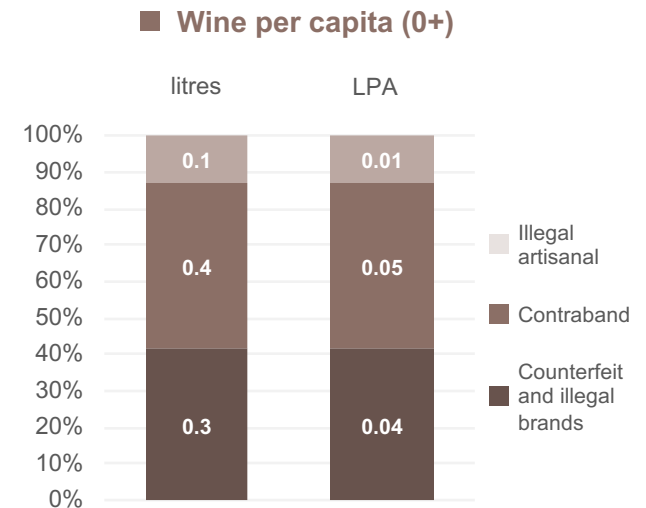
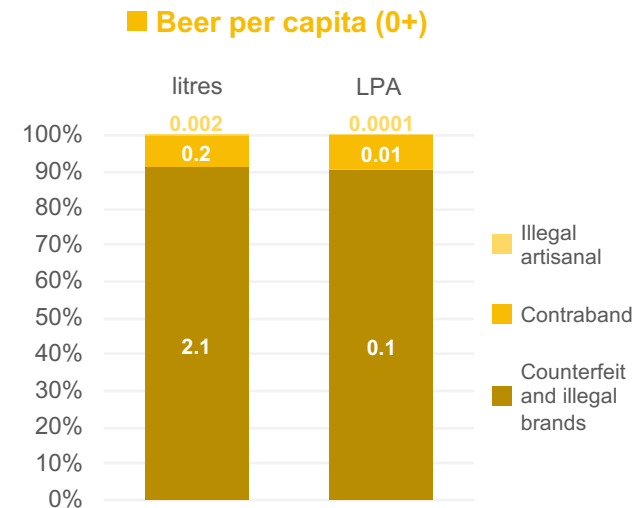
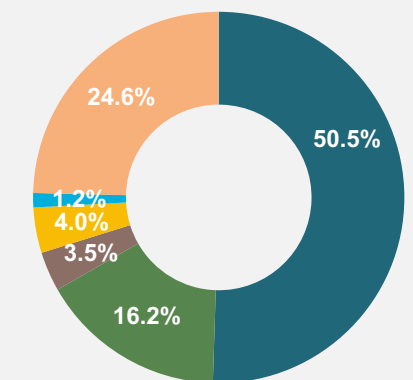
# Counterfeit and illegal brands dominate illicit alcohol



Illicit Alcohol Types by Category, Volume in mn litres, 2013

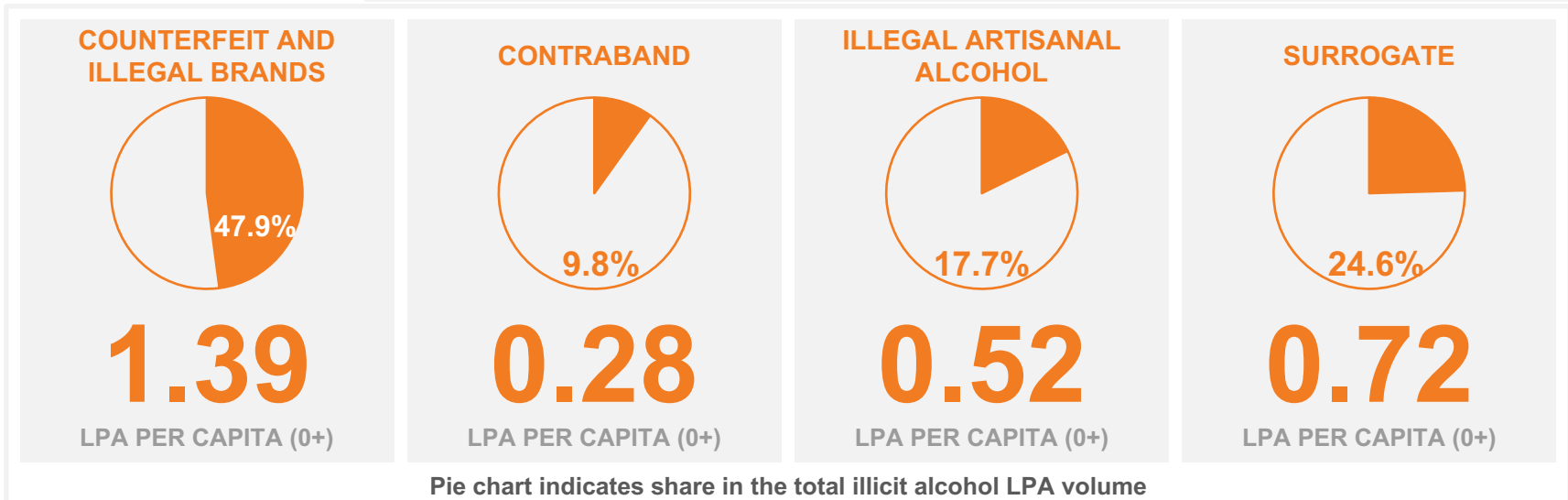
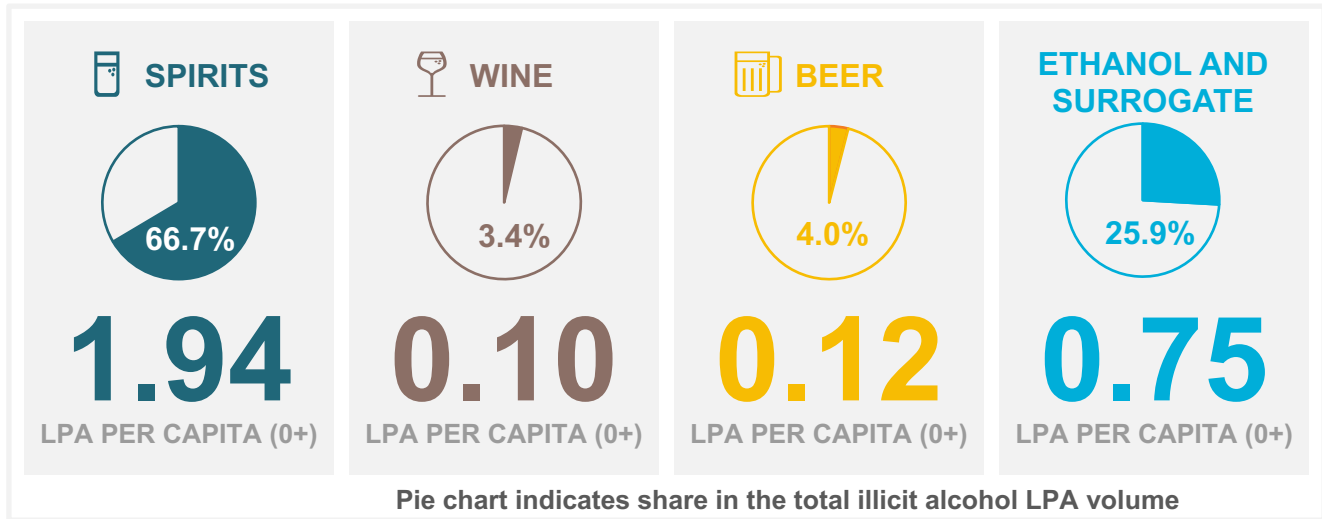


Illicit Alcohol Types by Category, Volume in mn LPA, 2013



Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks

# Illicit alcohol consumption pure alcohol volume per capita 2013



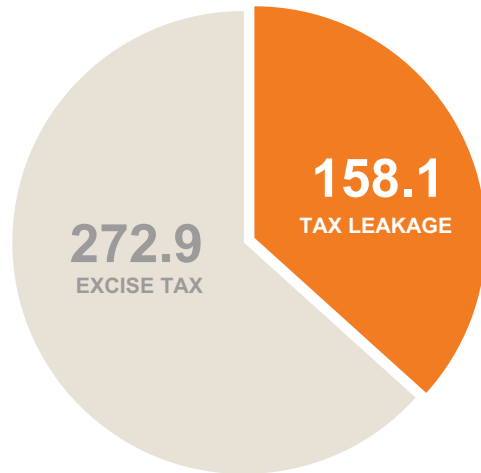
Note: Surrogate accounts for 0.72 LPA per capita and Contraband Ethanol accounts for the remaining 0.04 LPA per capita.

Note: Based on the Federal Service for Alcohol Market Regulation, the dominant share of illicit beer is contributed to RTD drinks recorded as beer drinks



# Stricter alcohol control policy results in increasing tax leakage

Total Tax Leakage Value Compared to Total Received Excise Tax Value (RUB billion) 2013



## 7.0

Times increase in excise tax over 2009-2016 for **BEER**

## 3.8

Times increase in excise tax over 2009-2016 for **WINE**

## 3.5

Times increase in excise tax over 2009-2016 for 40% ABV **SPIRITS**

## 2.3

Times increase in the minimal retail price of **SPIRITS** over 2011-2014

## 2.0-3.2

Times a litre of illicit **VODKA** is cheaper than the minimal retail price in 2014. The price difference equates to

## RUB220-310

- In 2010, the government of the Russian Federation started an active alcohol control campaign aimed at decreasing alcohol consumption, reducing the incidence of alcohol-related illnesses and deaths, and eradicating the illicit alcohol market.
- The policy had the opposite effect from what was intended. While the total legal alcohol market has declined, it is believed that the growing illicit alcohol volume is offsetting the decline in the legal market.
- High price sensitivity is the most important illicit alcohol consumption driver in Russia. Moreover, the rapid increase in alcohol excise tax resulted in manufacturers willing to avoid tax paying and recording products under other alcohol type, e.g. RTD drinks are declared as beer drinks in order to reduce tax duties.
- Total estimated tax leakage of RUB158.1 billion – the value of excise tax revenues the state is losing as a result of illicit alcohol trade – constituted 58% of the total excise tax for alcoholic drinks received into the state budget in 2013.
- Tax leakage is higher for alcohol with higher applicable excise tax, such as spirits.

# Tax leakage calculation

Data	Alcohol Type	Metrics	2012	2013	2014
Total illicit beer volume	Beer	Litres mn	263.2	336.8	434.9
Total illicit wine volume	Wine	Litres mn	104.8	111.5	117.3
Total illicit vodka volume	Vodka	Litres mn	489.7	526.3	579.3
Total illicit liqueur volume	Liqueur	Litres mn	160.2	168.9	188.1
Surrogate	Total	Litres mn	233.2	256.5	269.3



**Illicit alcohol market size multiplying by excise tax per liter of beverage or abv (depending on type of alcohol)**

Excise tax per litre of beverage	Beer	RUB	12.0	15.0	18.0
Excise tax per litre of beverage	Wine	RUB	6.0	7.0	8.0
Excise tax per litre of abv	Vodka	RUB	277.0	400.0	500.0
Excise tax per litre of abv	Liqueur	RUB	277.0	400.0	500.0
Excise tax per litre of abv	Surrogate	RUB	277.0	400.0	500.0



**Total excite tax multiplying by excise tax applicationn rate for each type of alcohol**

Excise tax application rate	Beer	%Rate	100.0%	100.0%	100.0%
Excise tax application rate	Wine	%Rate	100.0%	100.0%	100.0%
Excise tax application rate	Vodka	%Rate	40.0%	40.0%	40.0%
Excise tax application rate	Liqueur	%Rate	40.0%	40.0%	40.0%
Excise tax application rate	Surrogate	%Rate	40.0%	40.0%	40.0%



**Getting the total excise tax which would be paid if alcohol was legal**

Applicable excise tax	Beer	RUB mn	3,158.3	5,052.0	7,828.9
Applicable excise tax	Wine	RUB mn	629.1	780.3	938.1
Applicable excise tax	Vodka	RUB mn	54,260.9	84,208.2	115,850.6
Applicable excise tax	Liqueur	RUB mn	17,749.3	27,029.7	37,617.0
Applicable excise tax	Surrogate	RUB mn	25,837.5	41,041.5	53,867.0

<b>Tax leakage</b>	<b>Total</b>	<b>RUB mn</b>	<b>101,635.0</b>	<b>158,111.8</b>	<b>216,101.6</b>
--------------------	--------------	---------------	------------------	------------------	------------------

# Key trends in alcohol industry in Russia over the next 3-5 years

## ECONOMICS

- With general welfare and economy being key factors influencing illicit alcohol consumption - **declining real wages** leading to decline of purchasing power and **higher unemployment** are expected to stimulate consumption of illegal alcohol.
- **Devaluation of ruble**, and **economic sanctions** are also expected to further stimulate alcohol prices driving decline in official market as people expect to search for cheaper alternatives.

## MARKET PLAYERS

- Decrease in assortment in legal alcohol market is expected with **manufacturers leaving just key product/brand** in each mass, medium and premium segment.
- Decline in purchasing power of consumers is expected to lead to decline in sales and as a result to lower margins enabling **distributors and retailers to consider alternative income** including participation in illegal alcohol distribution and sales guaranteeing higher profitability especially in smaller cities and rural areas.

## PRODUCTS

- **Growth of share of strong alcohol in illegal market** is expected over the next 3-5 years with low-priced and low-quality industrial counterfeit vodka gaining share over samogon.
- Imported counterfeit alcohol is expected to be substituted by **local counterfeit production**.
- With more people searching for cheaper options switch to illegal vodka, surrogates or fortified wine is expected as most tinctures, eau de cologne and technical spirits are broadly available and cheap.

## BEER MARKET

- In **legal beer industry** there is expected **continuous decline in consumption** especially economy segment as people are switching to spirits.
- Market experts believe that if the government continues raising excises and takes no educational measures, **consumption of beer-like products** will flood the market as market players will search ways to avoid tax payment.

INTRODUCTION

PROJECT SCOPE AND DEFINITIONS

METHODOLOGY

EXECUTIVE SUMMARY

**ILLICIT ALCOHOL MARKET IN RUSSIA**

TAX LEAKAGE

# Decreasing legal alcohol market is offset by growing illicit one

## TOTAL ILLICIT ALCOHOL 2013

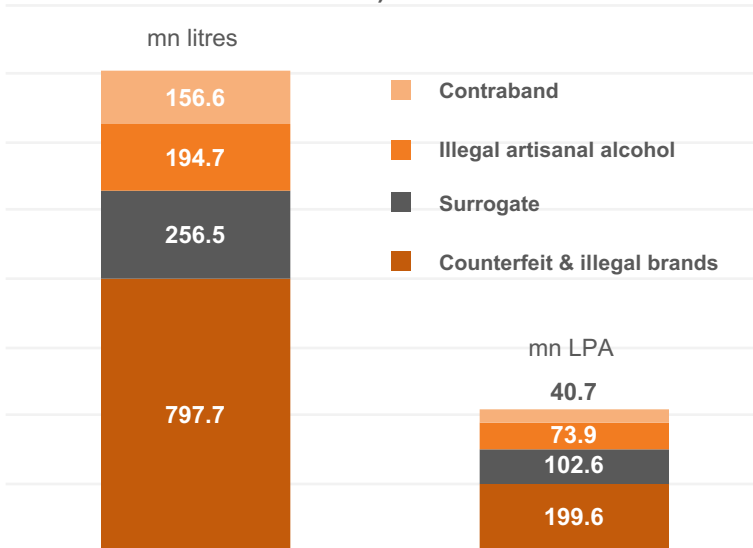
**1,405.9**  
MILLION LITRES

**416.8**  
MILLION LPA

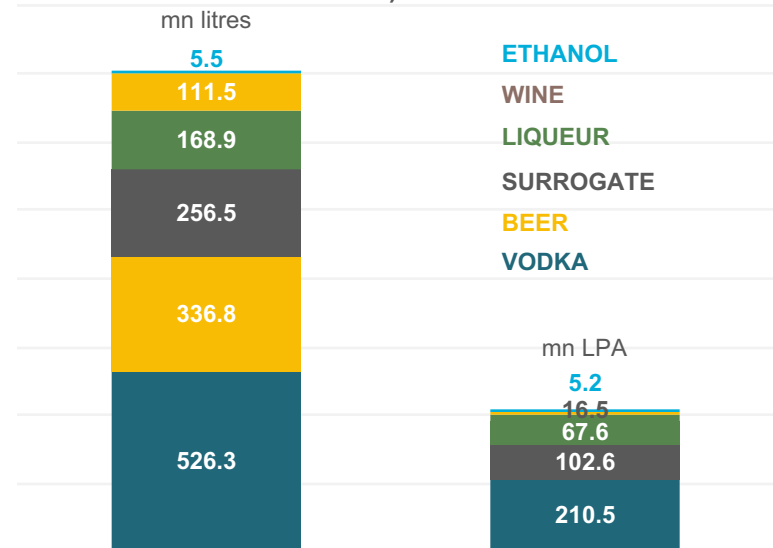
**192.4**  
RUB BILLION

- Consumption of legal alcohol in Russia is declining due to its increasing alcohol prices. Total legal alcohol sales declined by 5% from 2012 to 2013. Rise in excise taxes and establishment of the minimal retail price are considered to account for the decline.
- Consumption of illicit alcohol, on the other hand, increased 8% from 2012 to 2013 in LPA terms, due to illicit alcohol being a cheaper alternative than increasingly more expensive legal.
- Consumers are often indifferent as to whether alcohol is legal or illicit, as long as the quality difference is indistinguishable or sufficient.

Total Illicit Alcohol by Category (million litres and LPA) 2013



Total Illicit Alcohol by Alcohol Type (million litres and LPA) 2013



# Price is the key purchase consideration for illicit alcohol

## GENERAL DRIVERS

### High price sensitivity

- High price sensitivity is the most important illicit alcohol consumption driver in Russia. Many alcohol consumers have comparatively low purchasing power and cannot afford legal alcohol. Illicit alcohol costs less than legal alcohol, as its price does not include alcohol excise tax.

### Indifference to alcohol taste and its harmful features

- Indifference to alcohol taste and its harmful features is often characteristic of the most price-sensitive and alcohol-dependent consumers. This driver is therefore especially relevant for the increasing consumption of surrogate alcohol.

## ALCOHOL POLICY RELATED DRIVERS

### Rapid rise in alcohol excise tax and establishment of the minimal retail price

- Price of legal alcohol increased faster than disposable income over 2011-2013. Increased alcohol excise tax and the introduction of a minimal retail price resulted in further increase of already high consumer price-sensitivity. Many customers offset these price increases by switching to illicit alcohol. Correspondingly, some producers are considered to have switched part or all of their production to illicit trade, to maintain margins in face of declining demand for legally-produced alcohol.

### Prohibition of alcohol retail sales from 11pm to 8am and at certain public places

- Inconvenience created by prohibition and restrictions to purchase alcohol at night or in particular places has prompted customers to seek illicit alcohol options.

# Counterfeit and illegal brands are key to illicit alcohol category

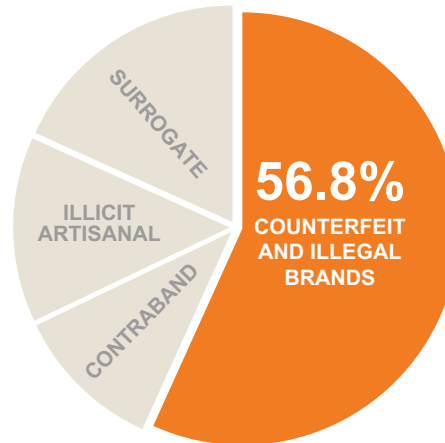
## TOTAL VOLUME OF COUNTERFEIT AND ILLEGAL BRANDS IN 2013

**797.7**  
LITRES MILLION

**199.6**  
MILLION LPA

**110.6**  
RUB BILLION

Counterfeit and Illegal Brands Share in Total Illicit Alcohol Litres (%) 2013



Counterfeit and Illegal Brands Share in Total Illicit Alcohol LPA (%) 2013

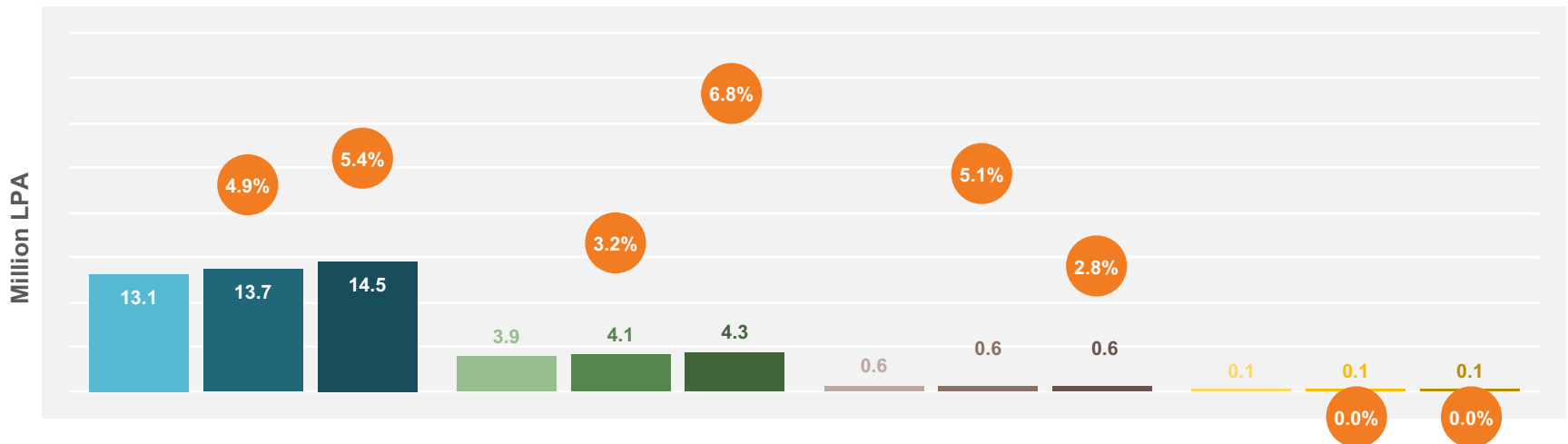
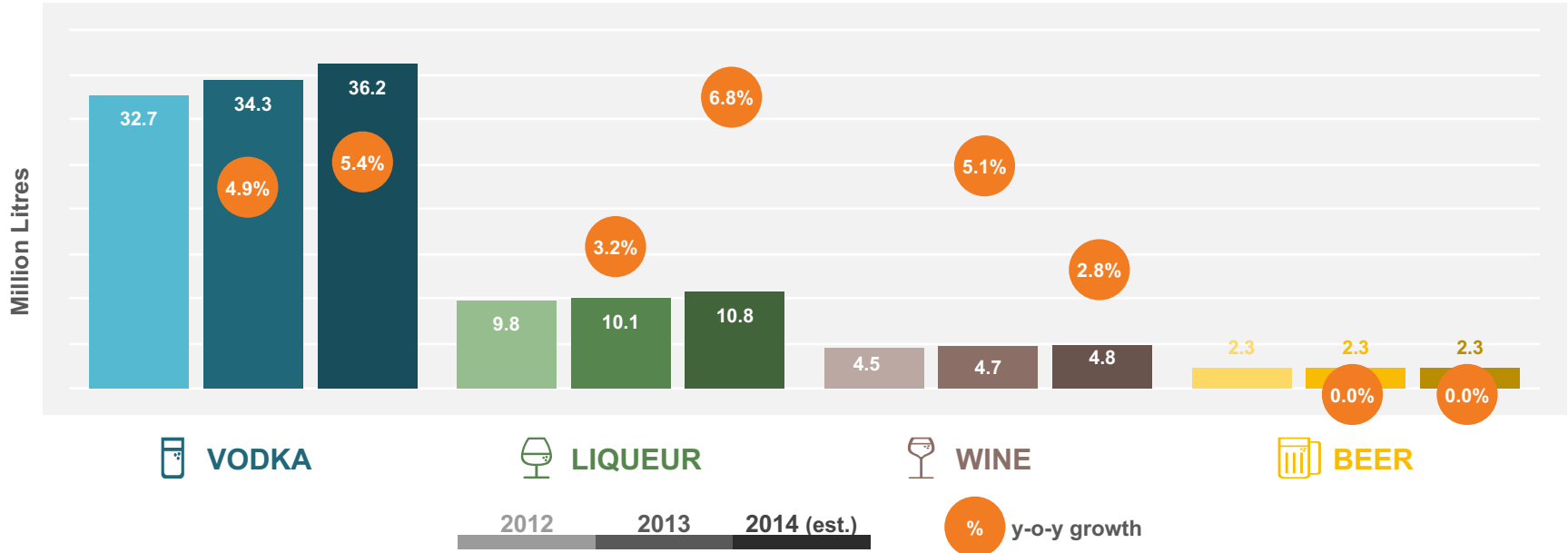


- Sharp increases in alcohol excise tax are the main factor behind a rapid increase in counterfeit and illegal brands' volume, as smaller legal producers switch some of their production to illicit, or close legal production down and begin illicit production altogether. Hence, most of this alcohol is illegally produced in smaller legal alcohol plants or former alcohol plants that have lost their license due to a more stringent alcohol control policy.
- Previously, only smaller companies engaged in illicit production as larger companies value their license more and were able to compete with illicit alcohol due to

- economies of scale. But with excise tax spikes, illicit production is becoming more attractive for medium companies as well. Major companies are considered to avoid any illegal activities to avoid any possible of the risk of losing license and reputation.
- Some counterfeit and illegal brands of alcohol are considered to be sold in legal retail such as small convenience stores, either purportedly as a legal product, or under-the-counter. Consumer often might not know that they are buying illicit alcohol. The product is also sold through such channels as taxi drivers' network.

# Vodka dominates otherwise insignificant substitution/refill alcohol

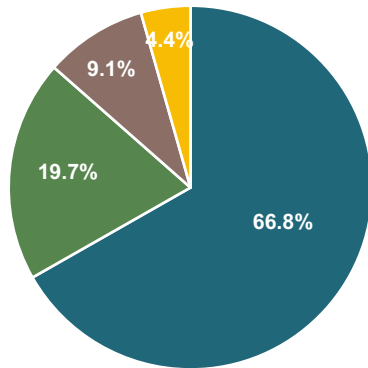
Volume and Year-on-Year Growth of Substitution/Refill Alcohol by Alcohol Type





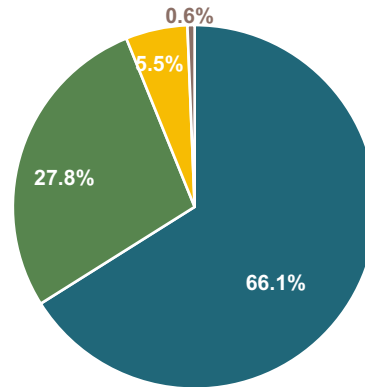
# Expensive and known brands of vodka often substituted/refilled

Breakdown of Alcohol Types  
by Litres (%) 2013



 VODKA

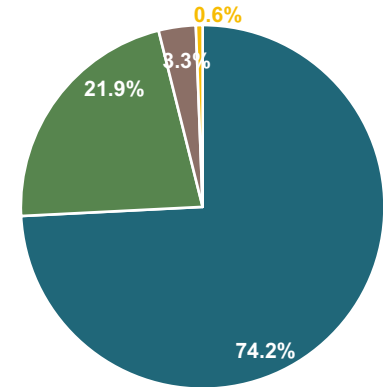
Breakdown of Alcohol Types  
by RSP Value 2013



 LIQUEUR

 WINE

Breakdown of Alcohol Types  
by LPA (%) 2013

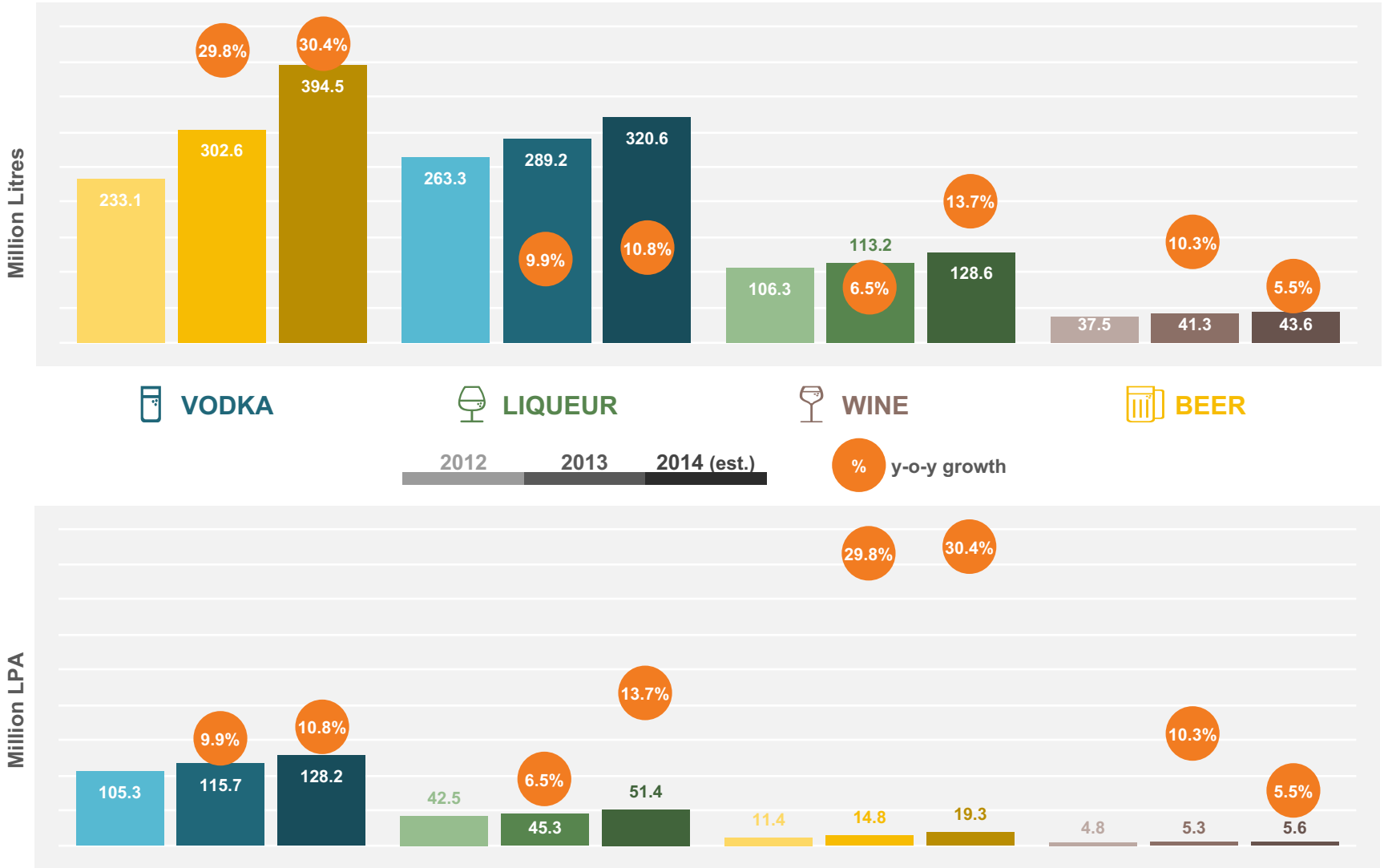


 BEER

- Substitution/refill is not significant in Russia. It accounted for a mere 4% of total illicit alcohol in both actual volumes and LPA terms and 6% of counterfeit and illegal brands' volume (9% of LPA volume) in 2013.
- Simple shape of bottle being most common and high volume of production makes the substitution/refill of vodka easier if compared to other alcohol types.
- More expensive and known brands of vodka and liqueur tend to be substituted/refilled and then offered to consumers as an original brand "at a discount", as consumers are typically more interested in well known brands.
- In wine, the legal market is extremely fragmented which results in lack of a single brand providing sufficient potential for counterfeiting. Only some expensive sparkling wine brands are attractive for substitution with cheaper beverage.
- Substitution/refill is considered to be very complicated for beer and some liqueur due to bottles specifically manufactured to be difficult to counterfeit, or having a unique design and hard to refill via generic equipment. Moreover, substitution/refill is difficult to sell via official channels and in convenience stores, where illicit alcohol is offered more often, but where consumers do not usually buy expensive alcohol.

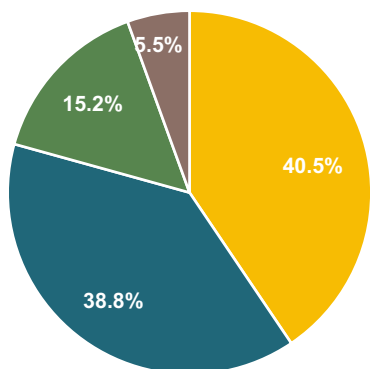
# Industrial manufacturing dominates illicit alcohol

Volume and Year-on-Year Growth of Industrial Manufacturing of Illegal Brands or Unbranded Alcohol by Alcohol Type



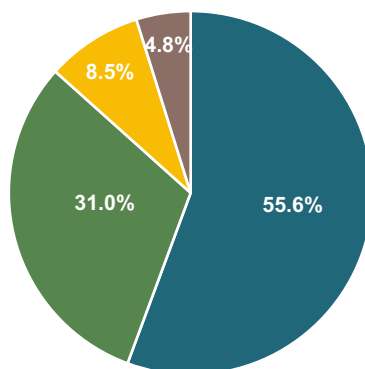
## Illicit alcohol mostly industrially manufactured

Breakdown of Alcohol Types  
by Litres (%) 2013



 **VODKA**

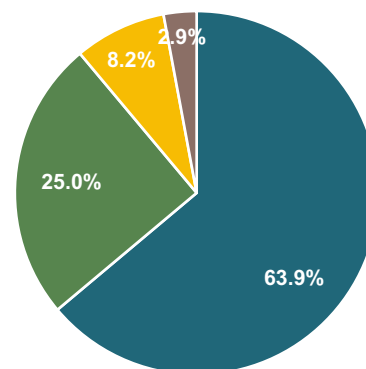
Breakdown of Alcohol Types  
by RSP Value 2013



 **LIQUEUR**

 **WINE**

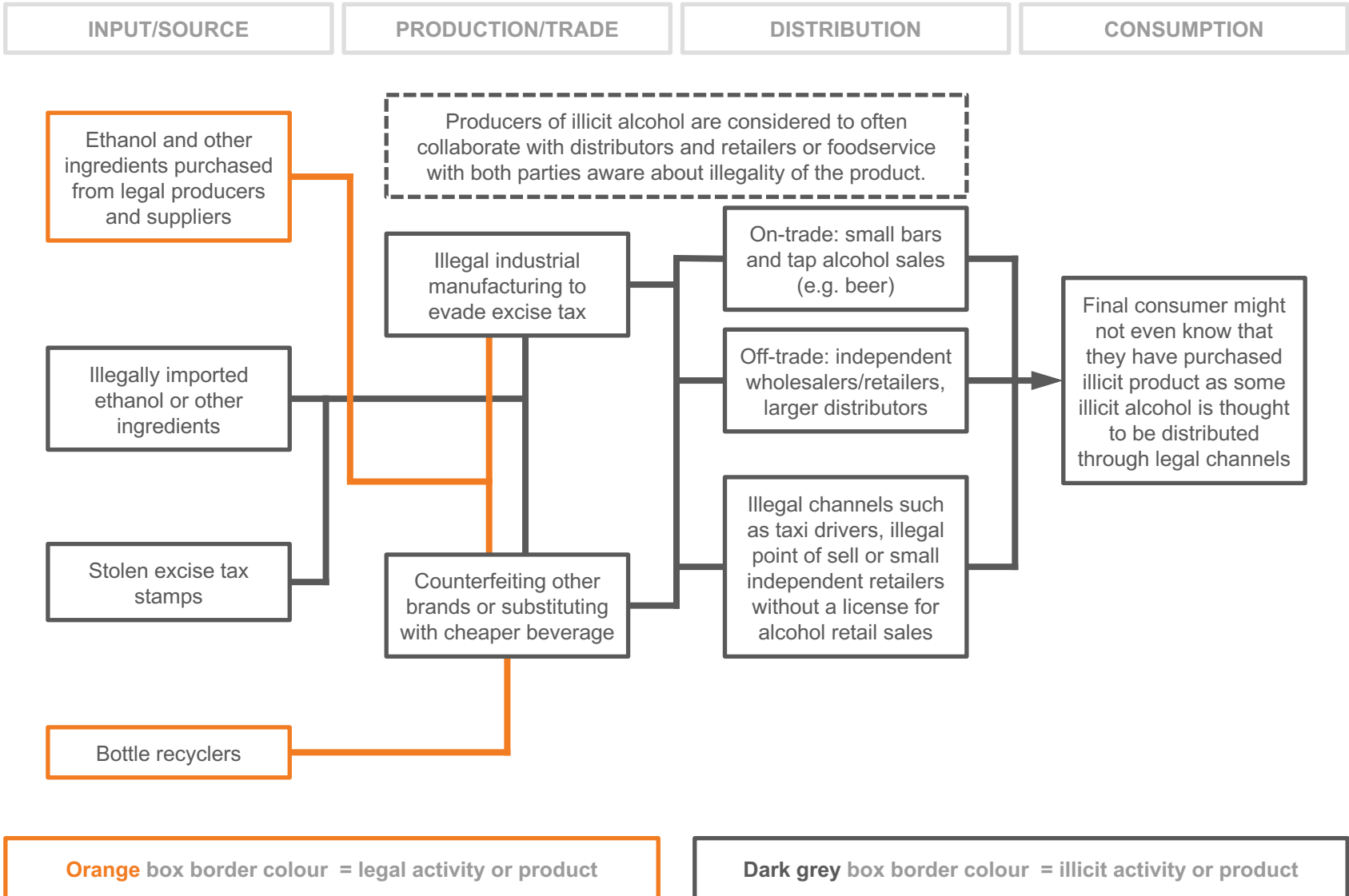
Breakdown of Alcohol Types  
by LPA (%) 2013



 **BEER**

- Industrial manufacturing accounted for 53% of total illicit alcohol volume (44% of LPA volume) and 94% of counterfeit and illegal brands' volume (91% of LPA volume) in 2013.
- Most illicit production takes place in existing or former smaller alcohol plants that have lost their license. Closed down plants have the required equipment and are unlikely to be visited by government authorities as they are not supposed to produce alcohol anymore.
- Reducing product price by the evasion of excise tax is the main goal of the industrial manufacturing of illegal alcohol, especially spirits, which have higher excise tax.
- Illicit beer is mainly industrially manufactured as the process of production is complicated and industrial production is the only way to produce sufficient quantity. Beer does not require an excise tax stamp and it can be distributed to foodservice and retail in kegs rather than bottles.
- In wine, low quality fortified wine - ethanol mixed with grape substance - is most commonly produced illegally. Excise tax applicable to natural wine is comparatively low and does not offer a significant opportunity for illicit production as a means to evade excise tax.

# Counterfeit and illegal brands value chain



# Contraband is mainly constituted from finished products

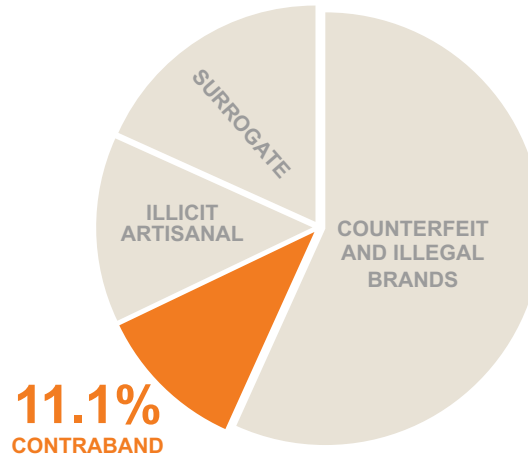
## TOTAL VOLUME AND VALUE OF ALCOHOL CONTRABAND IN 2013

**156.6**  
LITRES MILLION

**40.7**  
MILLION LPA

**25.5**  
RUB BILLION

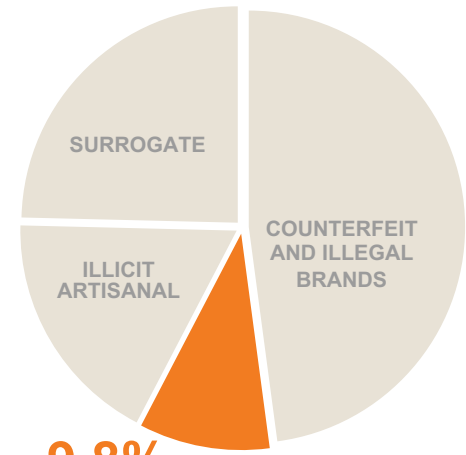
Contraband Share in Total Illicit Alcohol Litres (%) 2013



**11.1%**  
CONTRABAND

ETHANOL REPRESENTS **3.5%** OF ALCOHOL CONTRABAND IN ACTUAL VOLUME

Contraband Share in Total Illicit Alcohol LPA (%) 2013



**9.8%**  
CONTRABAND

ETHANOL REPRESENTS **12.9%** OF ALCOHOL CONTRABAND IN LPA VOLUME

### Ethanol contraband in decline

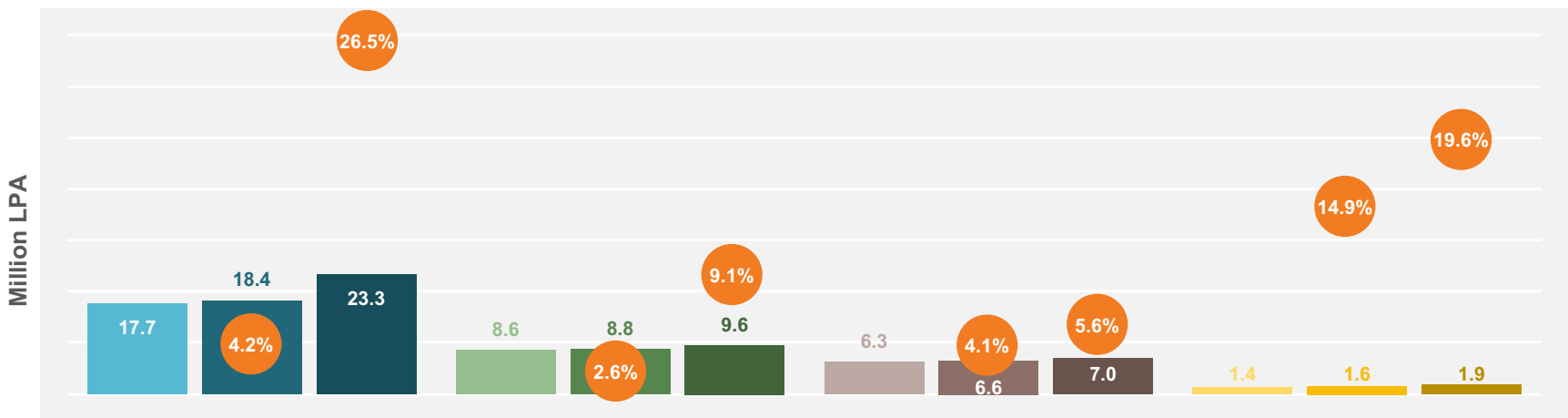
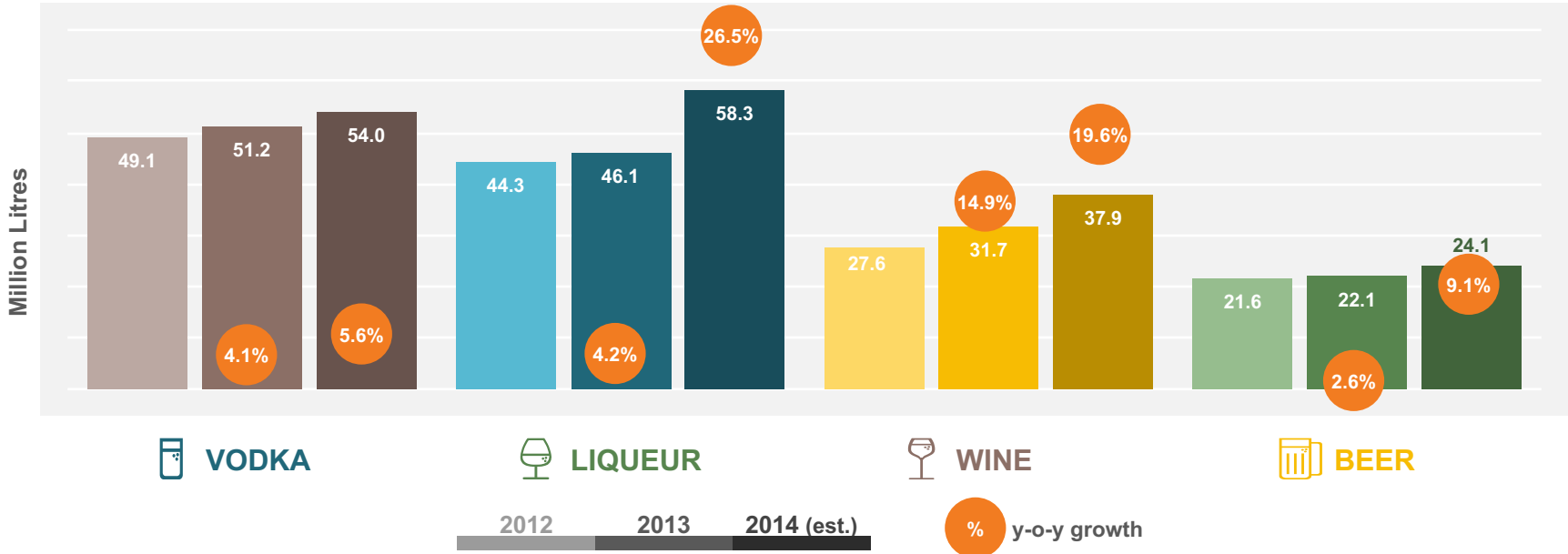
- Ethanol contraband is insignificant in Russia and its volume is declining. It constituted less than 1% of total illicit alcohol volume (1% of LPA volume) and 4% of total contraband volume (13% of LPA volume) in 2013.
- Low profit margins compared to contraband of the finished product and abundance of cheap, locally-produced ethanol, such as rectified or intended for medical use, are considered to be the main reasons why

ethanol contraband is insignificant and further declining.

- China, Belarus and Kazakhstan, due to open borders, are the key countries where ethanol is being smuggled from, due to low prices.
- The most common way to smuggle ethanol is by labeling it for use in the perfume industry.

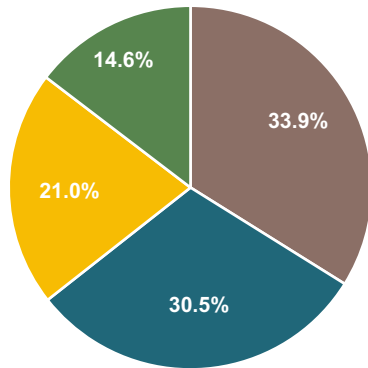
# Difference in excise is the main contraband driver

Volume and Year-on-Year Growth of Contraband of the Finished Product by Alcohol Type



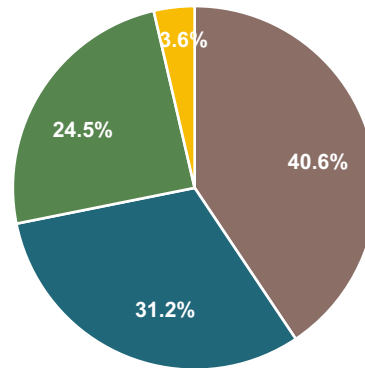
# Kazakhstan considered the key contraband country

Breakdown of Alcohol Types  
by Litres (%) 2013



 **VODKA**

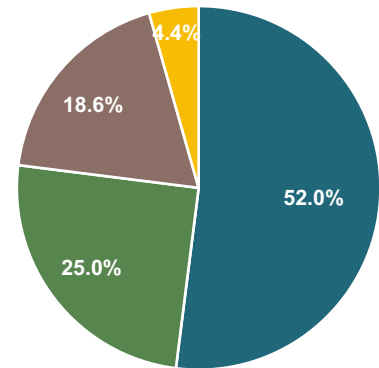
Breakdown of Alcohol Types  
by RSP Value 2013



 **LIQUEUR**

 **WINE**

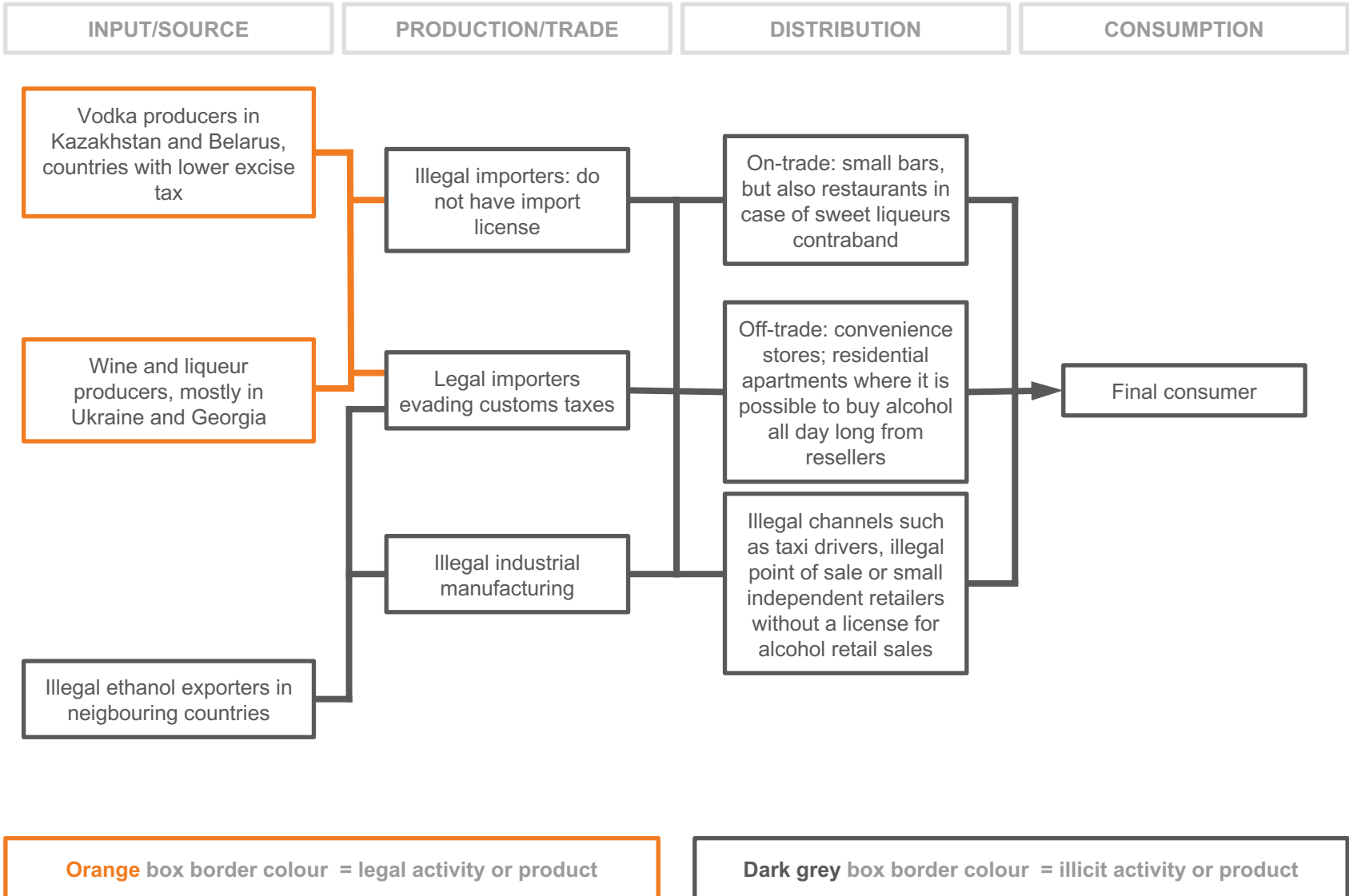
Breakdown of Alcohol Types  
by LPA (%) 2013



 **BEER**

- Increasing excise tax in Russia is considered the main factor behind growing contraband volume. In 2013, the contraband of the finished product constituted 11% of total illicit alcohol volume (9% of LPA volume) and 96% of total contraband volume (87% of LPA volume).
- Vodka from Kazakhstan and Belarus, wine from Georgia and Ukraine and liqueur from all neighboring countries in general are the key contraband products.
- Kazakhstan is considered to be the key contraband country due to much lower excise tax and open borders due to Customs Union.
- Expected harmonisation of excise taxes among the members of Customs Union is expected to curb contraband flows from Kazakhstan and Belarus.
- Low local production of wine in Russia and high production in neighboring southern countries explains both the high legal imports and high contraband volumes.
- Liqueur, especially expensive one and one not produced in Russia, is also a very common contraband good, offering comparatively high profit margins for smugglers.
- Contraband of beer is comparatively low as the price difference with neighboring countries is low and other alcohol types offer better profit opportunities.

# Contraband value chain





# Artisanal alcohol consumption spreading into urban areas

## TOTAL VOLUME AND VALUE OF ILLEGAL ARTISANAL ALCOHOL IN 2013

**194.7**  
LITRES MILLION

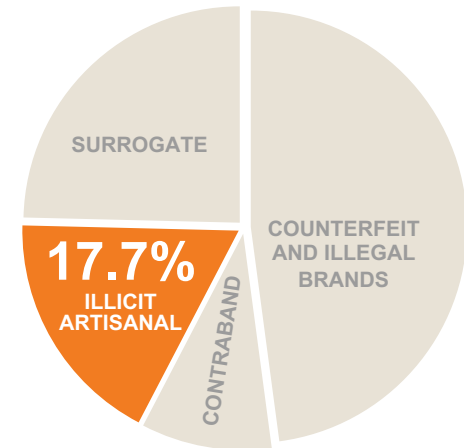
**73.9**  
MILLION LPA

**32.6**  
RUB BILLION

Illegal Artisanal Alcohol Share in Total Illicit Alcohol Litres (%) 2013



Illegal Artisanal Alcohol Share in Total Illicit Alcohol LPA (%) 2013



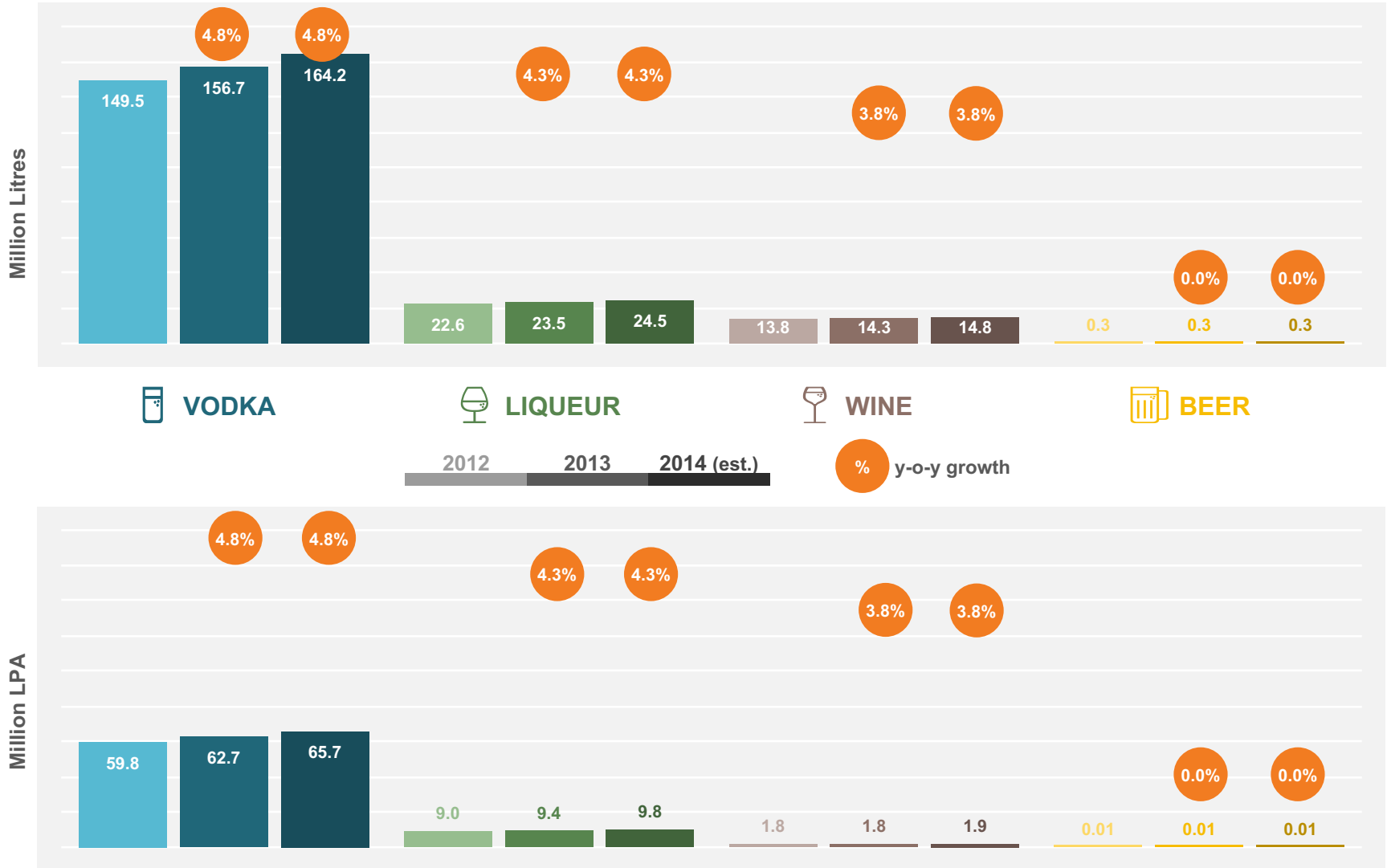
- Increasing legal alcohol prices are increasing demand for the cheaper illegal artisanal alcohol, mostly vodka. This is becoming more common - not only in rural areas, where it is traditionally very common, but also in urban areas, where people brew it in their apartments and sell to their neighbours.
- While for all other illicit alcohol categories the key consumption driver is an opportunity to save, for samogon and illicit artisanal beer and wine it is not the case.
- Samogon is often perceived to be of a better quality than

the cheapest vodka offered in the retail. Samogon is also often believed not to cause hangovers, while artisanal beer is thought to be preservative-free.

- An opportunity to try something new is also a motive to buy artisanal alcohol.
- Illegal artisanal vodka such as ethanol mixed with water is aimed purely for lower income consumers, while samogon may also be purchased by higher income consumers for its perceived quality, as well as novelty.

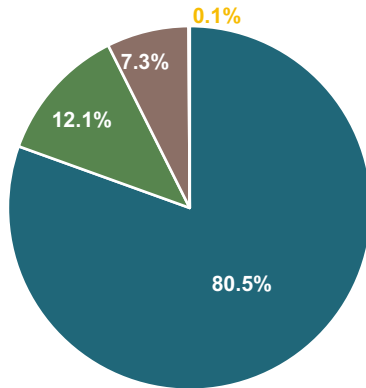
# Illicit artisanal vodka most popular due to very low price

Volume and Year-on-Year Growth of Illegal Artisanal Alcohol by Alcohol Type



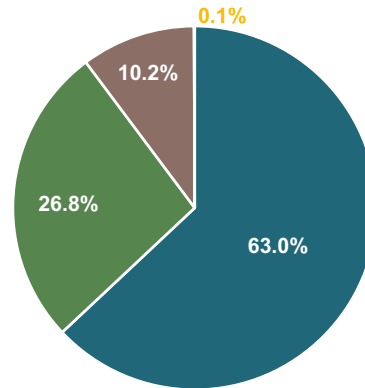
# Illicit artisanal liqueur too expensive

Breakdown of Alcohol Types  
by Litres (%) 2013



 VODKA

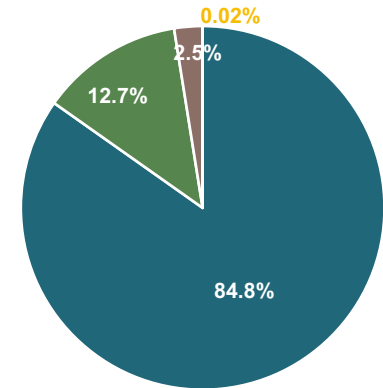
Breakdown of Alcohol Types  
by RSP Value 2013



 LIQUEUR

 WINE

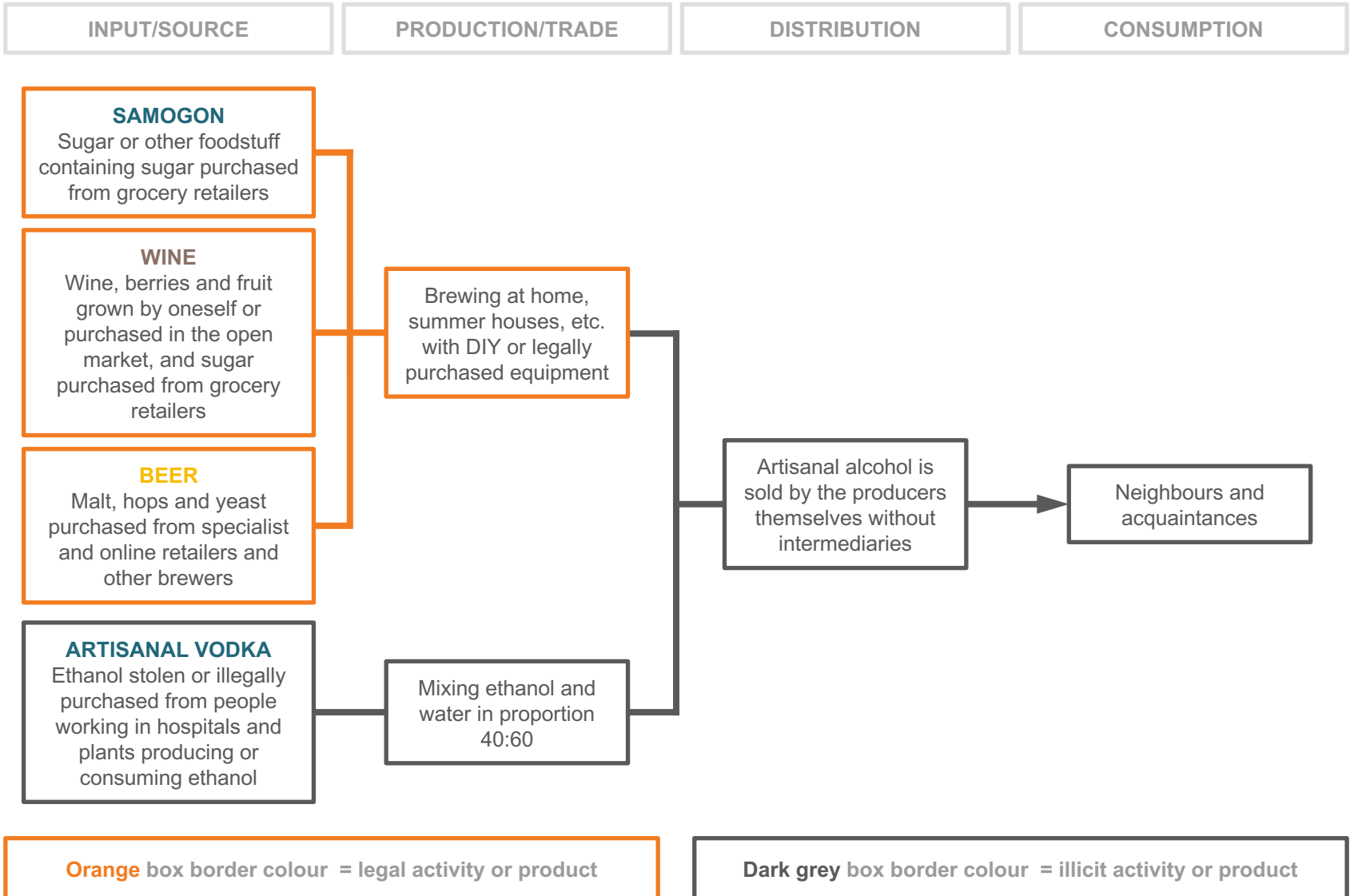
Breakdown of Alcohol Types  
by LPA (%) 2013



 BEER

- Artisanal vodka, which can be either samogon or ethanol mixed with water, dominates illegal artisanal alcohol.
- Very low pricing, compared to other legal and illicit alcohol alternatives, is the main factor behind the strong and increasing popularity of artisanal vodka – ethanol mixed with water. Illicit samogon growth is considered to stagnate.
- While artisanal liqueur is considered to offer better taste for a similar intoxicating effect than artisanal vodka, the comparatively high price of artisanal liqueur curbs its popularity.
- Illegal artisanal wine and beer are not common as their price is high, even compared to legal wine and beer, and thus they do not serve the main function of illicit alcohol: to be a cheaper substitute for legal alcohol.
- Moreover, production process of artisanal wine and beer is complicated, attracting people interested in the process itself rather than selling it and is mostly produced for personal consumption, which is legal in Russia.
- Illicit artisanal wine is mostly produced in southern Russia, where it is made from local grapes, berries and fruits and usually sold to tourists.

# Illegal artisanal alcohol value chain



# Illegal artisanal samogon and vodka\*

## SAMOGON

### PRICE

**RUB120-180 PER LITRE**

### PRODUCER'S MOTIVATION

**MONETARY BENEFIT/  
OWN CONSUMPTION**



- Produced from sugar (or other sugar containing foodstuff such as fruit and berries, starch, rye, wheat, barley and maize), yeast and water. Herbs and other additives may be added for flavour. The final product may be diluted with water to reduce alcohol by volume or just to inflate volume.
- 15-30 litres of output per producer per month - part of this may be for personal consumption.
- 1-1.5 litre PET bottles or glass jars are usually purchased by a consumer per occasion.



**PRODUCER** is typically a 55-60 year old man; addictive behaviour; low or middle income; interested in better quality than of low cost vodka offered in retail.

**CONSUMER** is usually a man over 45 years old with addictive behaviour, low income or unemployed, or a man over 35 years old, middle income, looking for a "natural product" or to try something new.



## VODKA

### PRICE

**RUB80-170 PER LITRE**

### PRODUCER'S MOTIVATION

**MONETARY BENEFIT**



- Produced by mixing undenatured ethanol with water in proportion 40:60. Ethanol in small volumes is usually stolen from or purchased from acquaintances working in hospitals and plants that produce or use ethanol.
- Denatured ethanol sometimes may be used instead of undenatured, which makes the final product dangerous.
- 10-30 litres of output per producer per month. Producers may intentionally keep output volumes low to prevent detection at the ethanol suppliers site.
- 0.5-1 litre PET bottles or glass jars are usually purchased by a consumer per occasion.



**PRODUCER** is invariably a man seeking monetary benefit and intentionally violating the law.

**CONSUMER** is typically a man over 45 years old with addictive behaviour, low income or unemployed.



\*Note: Analysis is based on storechecks done in Kaliningrad, Krasnodar, Tula and Pushkino

# Illegal artisanal wine and beer\*

## WINE

PRICE  
**RUB250 PER LITRE**

PRODUCER'S MOTIVATION  
**OWN CONSUMPTION**



- Production most common in the southern Russian due to a warmer climate and more suitable conditions for growing grapes, the most common artisanal wine ingredient. Berries and fruit such as apples, pears and plums are other common ingredients. Sugar is added for sweetness and for alcohol by volume.
- 20 litres of output per producer per season.
- 1.5 litre PET bottles are usually purchased by a consumer per occasion.



**PRODUCER** is typically a resident of a small town or village, middle and upper income, produces wine as a hobby for own consumption or to gift as a home-made product.

**CONSUMER** is a man over 35 years old, middle income, looking for a “natural product” or to try something new.



## BEER

PRICE  
**RUB80-100 PER LITRE**

PRODUCER'S MOTIVATION  
**OWN CONSUMPTION**



- The same way as a regular beer is produced from malt, hops, yeast and water. Artisanal beer is considered to be healthier and of a better quality than many offered in retail due to absence of preservatives, colourants or other ingredients perceived by consumers to be undesirable.
- 30-50 litres of output per producer per month.
- 1.5-3 litre PET bottles or glass jars are usually purchased by a consumer per occasion.



**PRODUCER** is usually a 35-40 year old man, who produces beer as a hobby for his own consumption and to receive satisfaction from the production process.

**CONSUMER** is a man over 35 years old, middle income, looking for a “natural product” or to try something new.



\*Note: Analysis is based on storechecks done in Kaliningrad, Krasnodar, Tula and Pushkino

# Surrogate consumption increasing

## TOTAL VOLUME AND VALUE OF SURROGATE ALCOHOL

IN 2013

**256.5**  
MN LITRES

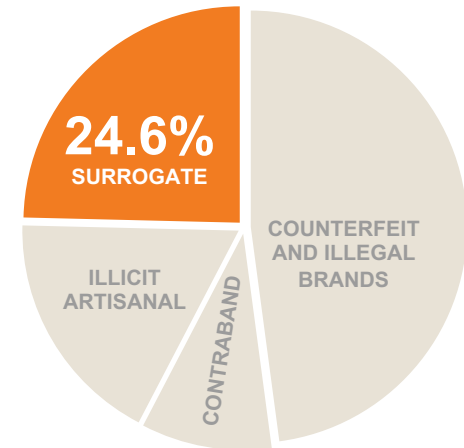
**102.6**  
MN LPA

**23.8**  
RUB BILLION

Surrogate Share in Total Illicit Alcohol Litres (%) 2013



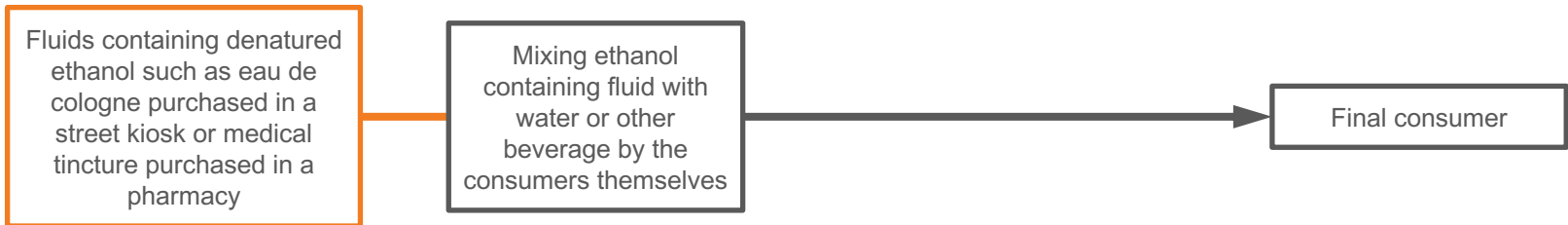
Surrogate Share in Total Illicit Alcohol LPA (%) 2013



- Medical tinctures such as hawthorn tincture, eau de cologne, perfumed water, lotions, bath additives and other fluids containing denatured ethanol are the key types of surrogate.
- Surrogate consumption volume increased over 2011-2013 and is expected to increase further due to a widespread alcohol addiction among the population, and surrogate's low price being the key purchase consideration among addicts. The lowest income population segment can no longer afford even illicit vodka and the only factor they consider important in choosing alcohol is its alcohol content.
- Medical tinctures and other ethanol containing fluids, not

- intended for drinking, are sold at a lower price than legal alcohol due to less sophisticated and regulated production process, absence of applicable excise tax for packaging less than 100ml and absence of the minimal retail price.
- Moreover, surrogate price increases slower than other illicit alcohol types, such as industrially manufactured vodka, the price of which typically follows overall alcohol market dynamics. This makes surrogate more attractive for the most price-sensitive consumers.
- Fluids used as surrogates are also widely available in drugstores and kiosks.

# Surrogate value chain



**Orange box border colour = legal activity or product**

**Dark grey box border colour = illicit activity or product**



INTRODUCTION

PROJECT SCOPE AND DEFINITIONS

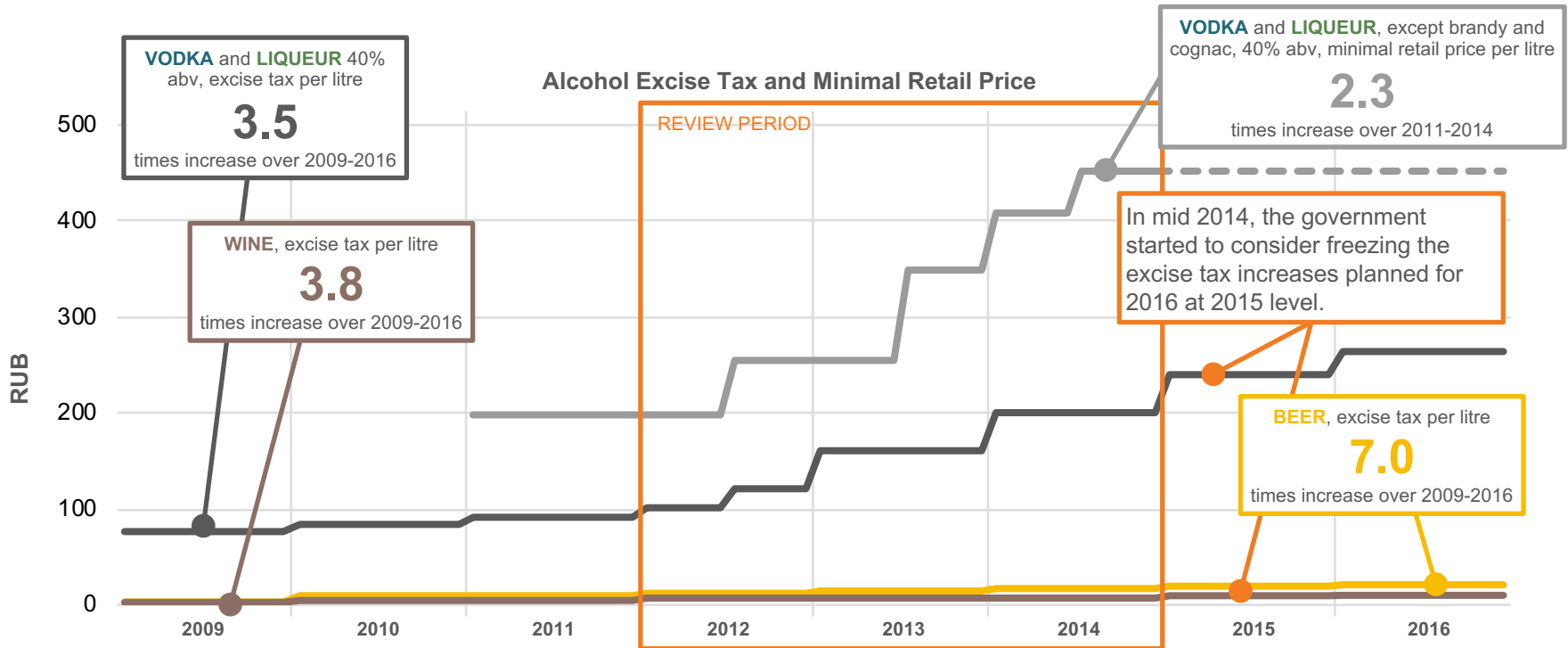
METHODOLOGY

EXECUTIVE SUMMARY

ILLCIT ALCOHOL MARKET IN RUSSIA

**TAX LEAKAGE**

# Stricter alcohol control policy aims to curb alcohol consumption



## Alcohol control policy goals

- Since the adoption of a state alcohol policy conception at the end of 2009, the Government of Russian Federation executes an active alcohol control campaign aimed to decrease alcohol consumption per capita by 55%, reduce the incidence of alcohol-related illness and deaths, and to completely eradicate illicit alcohol sales by 2020.

## Key alcohol control policy measures

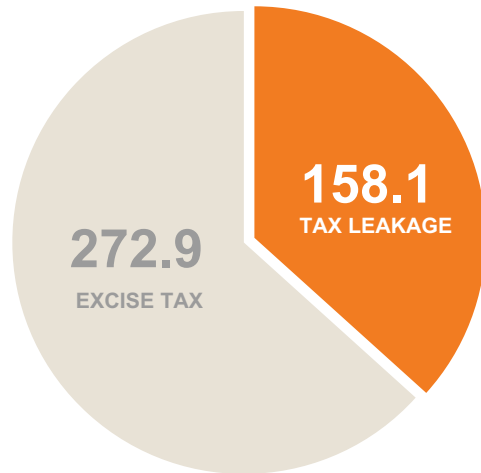
- Increasing alcohol excise tax rate: almost four-fold increase for spirits and wine, and seven-fold increase for beer over 2009-2016.
- Setting the minimal obligatory retail price, which depends on their abv, for all spirits over 28% abv.
- Prohibition of alcohol retail sales

from 11pm to 8am local time.

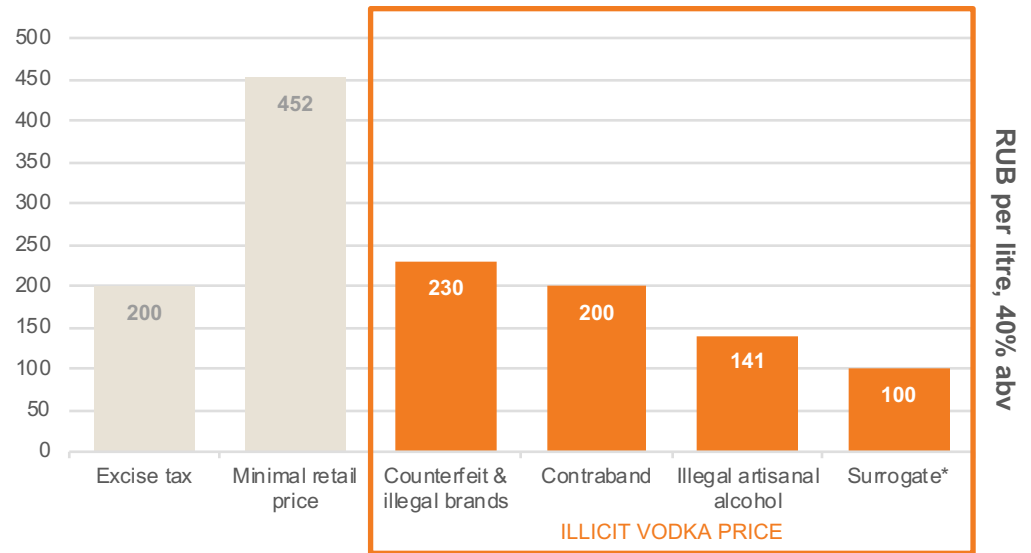
- Prohibition of alcohol retail sales and consumption in particular places, such as petrol stations.
- Restrictions on alcohol advertising.
- Inclusion of beer on the list of alcoholic beverages, eg advertising now restricted.

# Stricter policy results in opposite effect to that intended

Total Tax Leakage Value Compared to Total Received Excise Tax Value (RUB billion) 2013



Difference Between Legal and Illicit Price of Vodka 2014



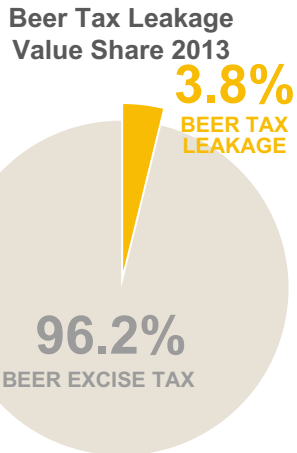
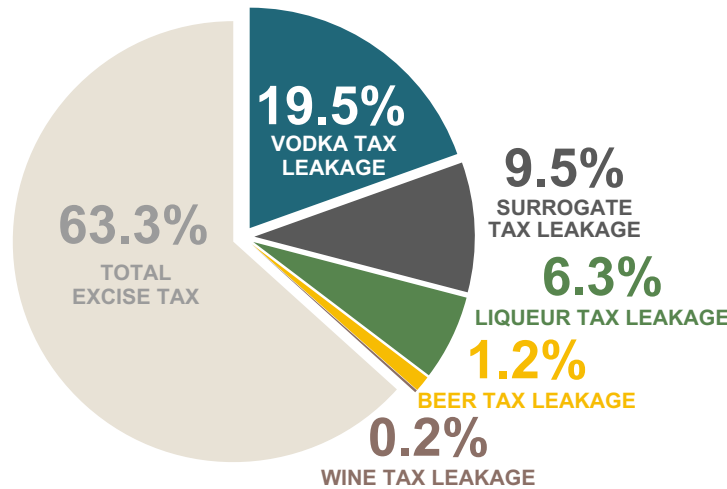
- Contrary to the intended goal of curbing illicit alcohol, the stricter alcohol control policy appears to have facilitated growth of the illicit market.
- High consumer price sensitivity coupled with increasing price difference between illicit and legal alcohol – vodka, for example, was RUB220-310 lower than the minimal obligatory retail price in 2014 – prompted consumers to increasingly choose illicit alcohol instead of legal.
- Tax leakage is the value of excise tax revenues the state is losing as a result of illicit alcohol trade. The estimate is

- based on the assumption that people would buy volumes similar to the legal market size, were the illicit trade absent.
- Total estimated tax leakage of RUB158.1 billion constituted 58% of the total excise tax for alcoholic drinks received into the state budget in 2013. The share increased substantially, from 44% and RUB101.6 billion in 2012.
- Total estimated tax leakage also constituted 82% of the estimated total illicit alcohol market value in 2013.

\*Note: Surrogate price per litre is presented as an example of the cheapest available illicit vodka substitute.

# Tax leakage much higher for alcohol with higher excise tax

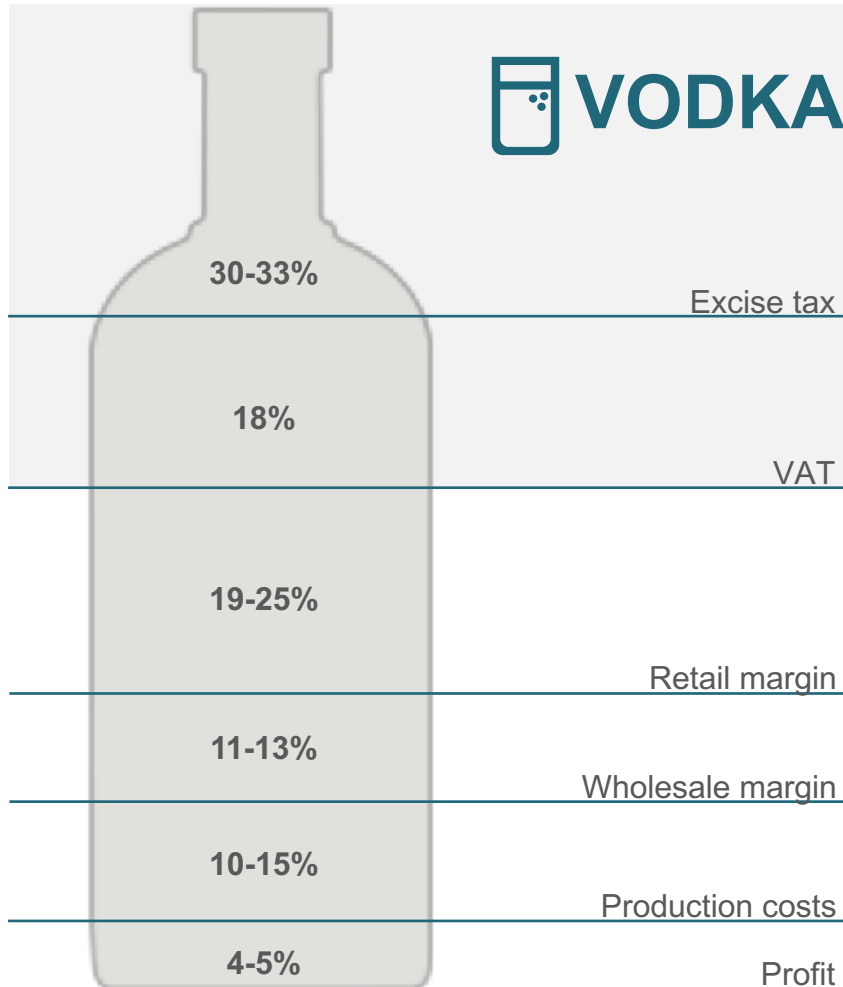
Tax Leakage Value Share by Alcohol Type Compared to Total Excise Tax Value Received 2013



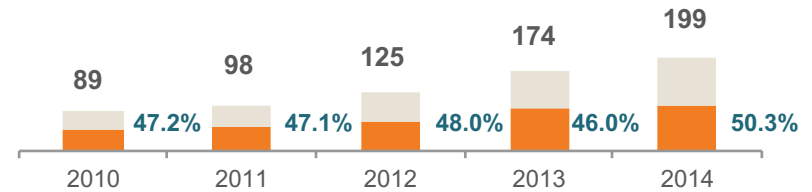
- As consumers buy illicit alcohol to save money, the highest share in total illicit alcohol volume is accounted for by the alcohol types with the highest applicable excise tax: vodka, surrogate (considered as a substitute for vodka) and liqueur.
- Tax leakage value for vodka, surrogate and liqueur in 2013 was higher than the corresponding excise tax – spirits over 9% abv – received into the state budget.
- Tax leakage for beer and wine is much lower, because of the much lower applicable excise tax and the resulting much lower illicit consumption volume.

# Avoiding paying excise tax brings the price down at least twofold

Price Structure\* for Vodka in Russia in 2014, %



Share of Excise Tax in the Minimal Selling Price per Bottle (0,5l), %



### Up to 50% of selling price is paid as excise tax

- Excise tax of RUB500 per liter of pure alcohol in 2014 (an increase by RUB100 from 2013 when it was RUB400) combined with VAT tax of 18% results in up to 50% of the total (minimal selling price) price per bottle.
- As a result, when illegal vodka producers avoid paying taxes the price does down twofold or taking into account skipping some value chain steps like wholesalers and retailers can bring the price threefold lower.

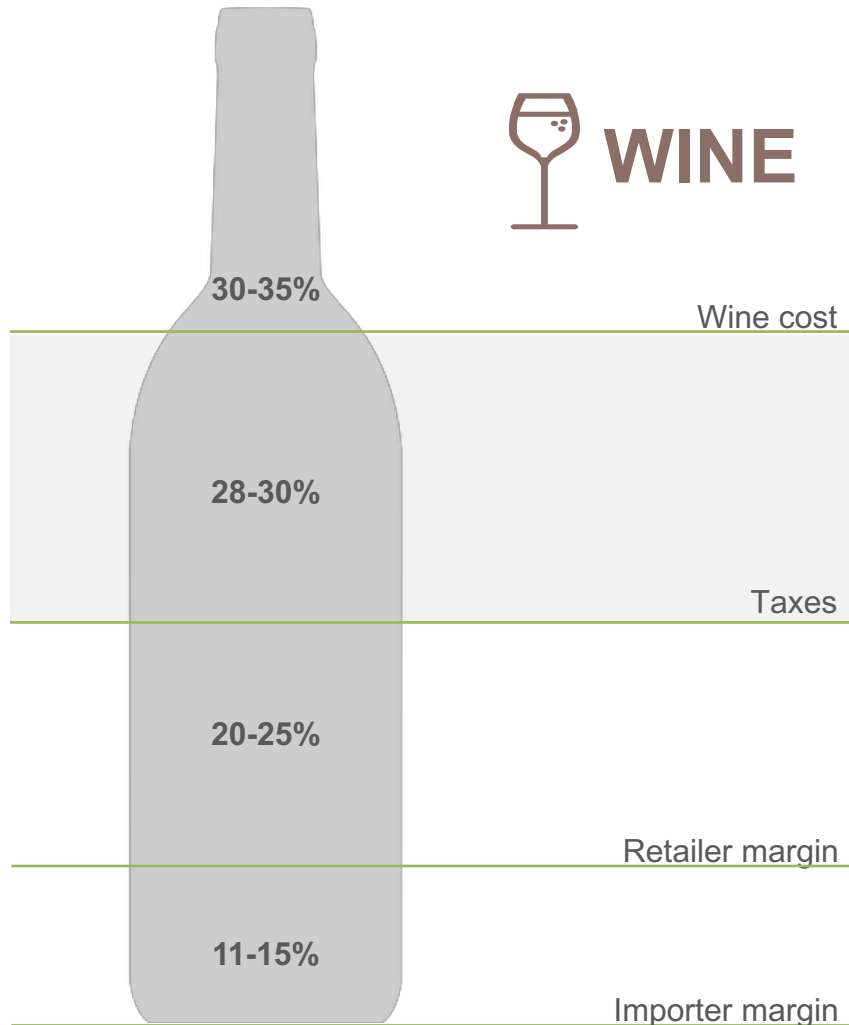
### Production costs:

- |                   |                         |
|-------------------|-------------------------|
| 1. Label – 0.3%   | 5. Bottle – 2.0%        |
| 2. Mark – 0.5%    | 6. Raw materials – 3.0% |
| 3. Royalty – 0.7% | 7. Production – 6.7%    |
| 4. Cap – 1.3%     |                         |

\*Note: Price structure is presented in descending order.

# Almost third part of the price is paid as taxes

Price Structure\* for Wine in Russia in 2014, %



Wine cost:

1. Production – 15%
2. Bottle – 7.5%
3. Label – 1.1%
4. Cork – 7.5%
5. Boxing – 1.2%

**Taxes applied:**

- Excise tax per bottle
- VAT 18%
- Custom duties 20% from wine cost

**Excise tax for different alcohol drinks per liter in 2014:**

- Wine - RUB8
- Sparkling wine – RUB25
- Other (cider, mead, poire) – RUB8

\*Note: Price structure is presented in descending order.



**APPENDIX**



ALCOHOL  
MARKET SIZE  
IN RUSSIA IN 2013

**TOTAL**

**LEGAL**

**ILLICIT**

ACTUAL VOLUME  
(MILLION LITRES)

**13,784.7**

**12,379.2**

**1,405.5**

LITRES PER CAPITA  
(POPULATION 0+)

**86.3**

**96.1**

**9.8**

LITRES PER CAPITA  
(POPULATION 15+)

**102.4**

**114.3**

**11.6**







ALCOHOL  
MARKET SIZE  
IN RUSSIA IN 2013

**TOTAL**

**LEGAL**

**ILLICIT**

TOTAL VALUE  
(BILLION RUBLES)

**2,354.2**

**2,161.7**

**192.5**

RUB PER CAPITA  
(POPULATION 0+)

**16,417.9**

**15,075.7**

**1,342.1**

RUB PER CAPITA  
(POPULATION 15+)

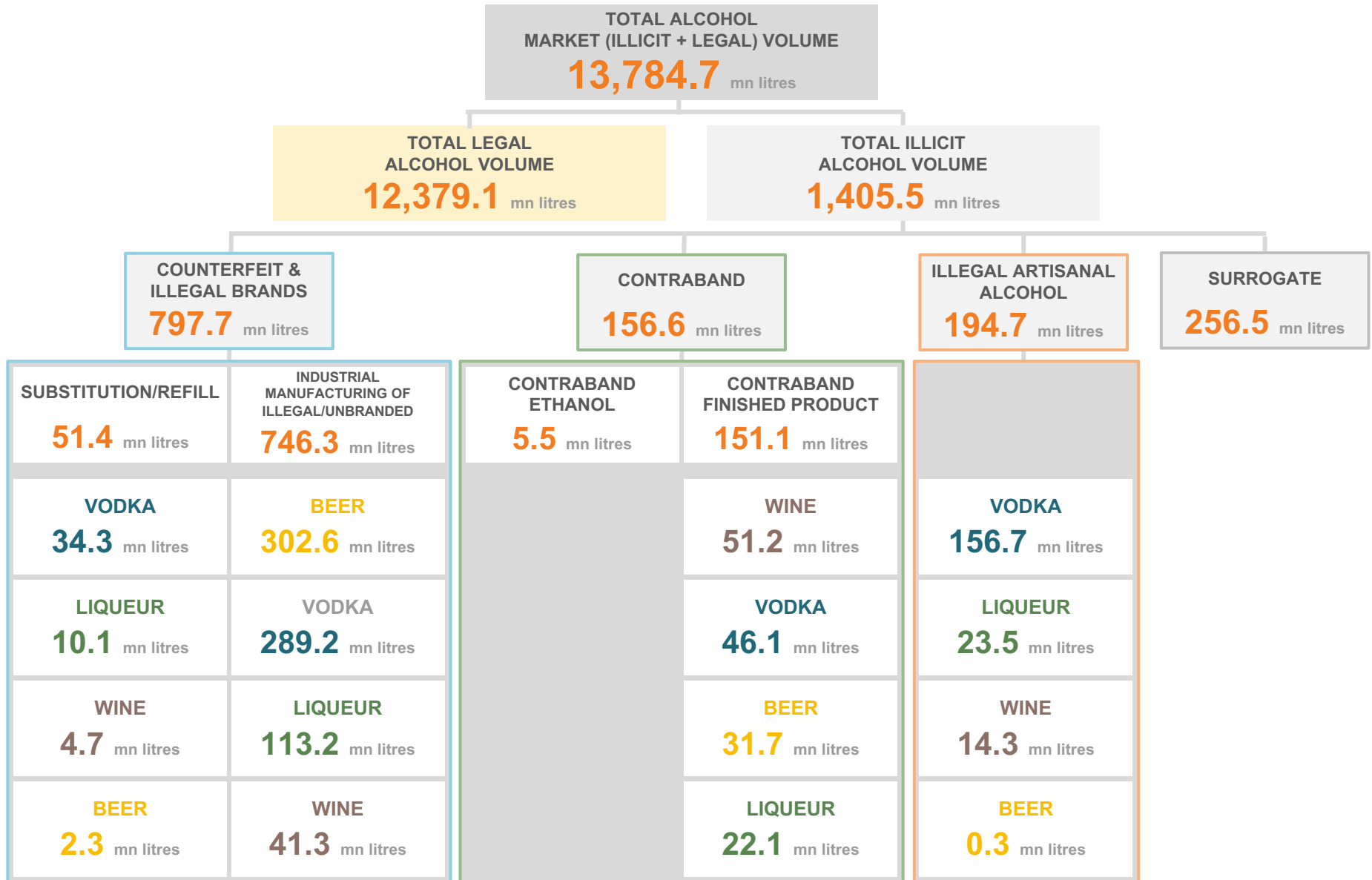
**19,478.3**

**17,886.0**

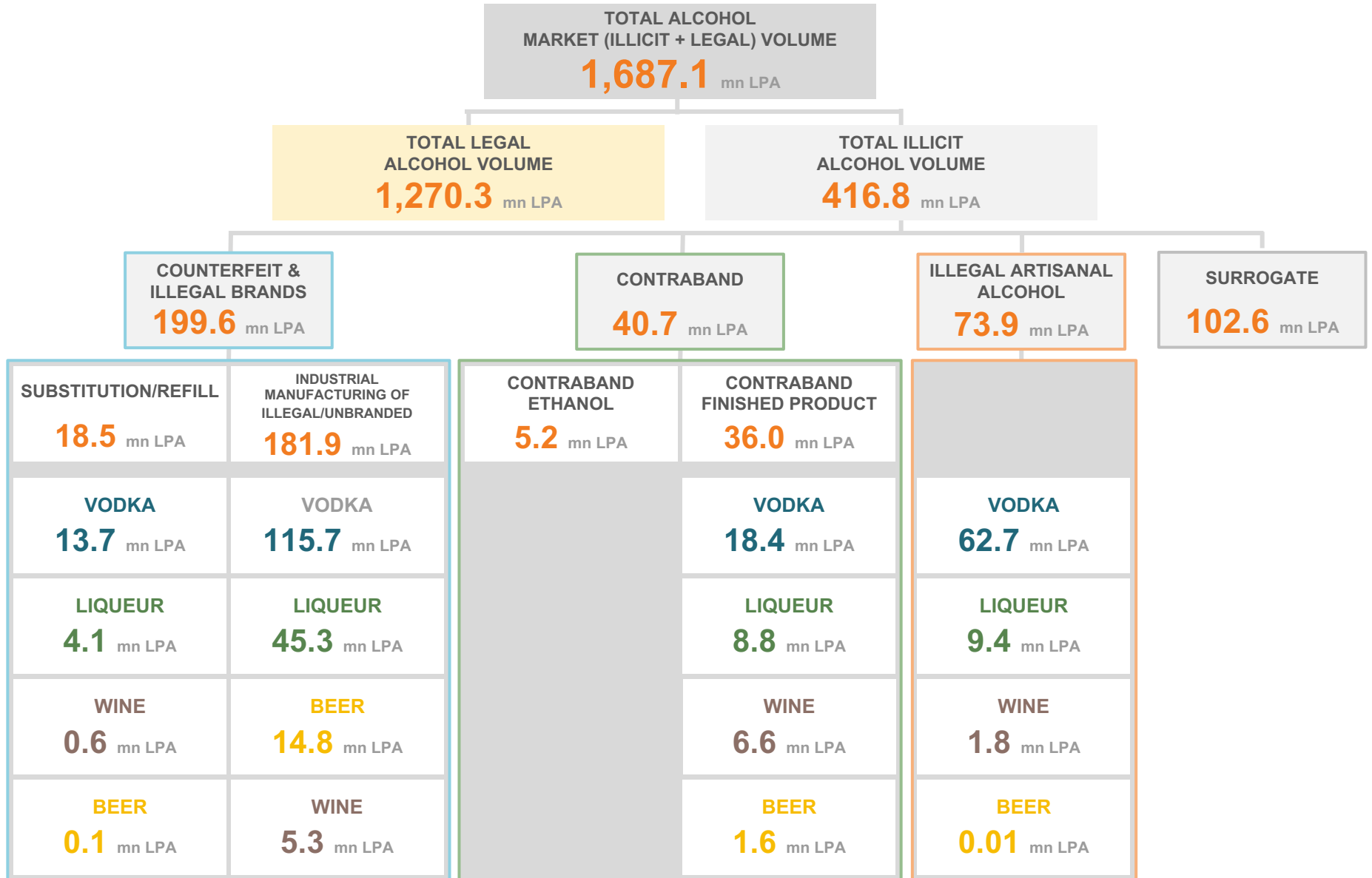
**1,592.3**



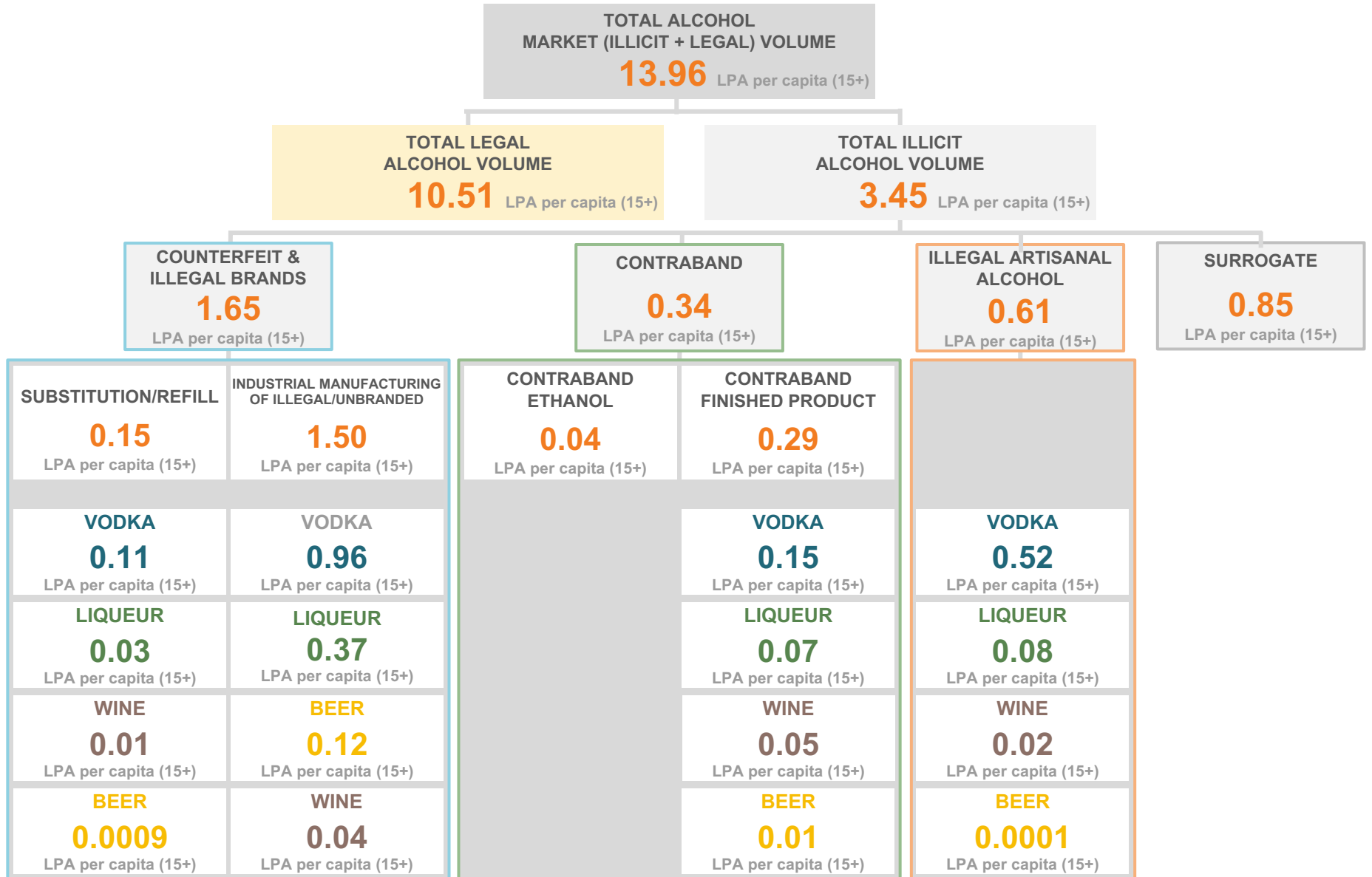
# Illicit alcohol market overview in Russia in actual volume



# Illicit alcohol market overview in Russia in LPA

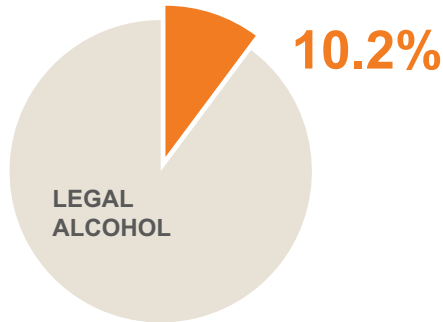


# Illicit alcohol market overview in Russia in LPA per Capita (15+)

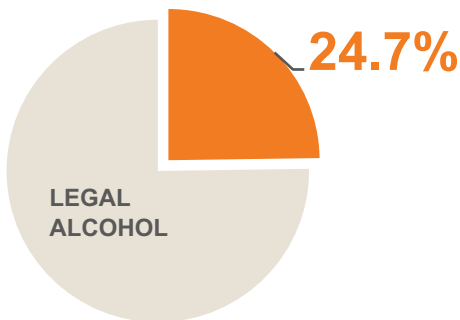


# Market of beer is least affected by illicit alcohol

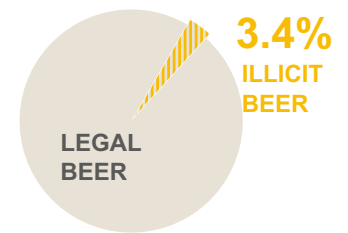
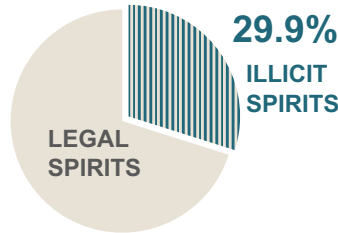
Illicit Alcohol Share in Total Alcohol Market in Actual Volume



Illicit Alcohol Share in Total Alcohol Market in LPA Volume



Illicit Alcohol as a Share of the Total Market by Alcohol Type in Volume (mn litres) and LPA mn, 2013



TOTAL SPIRITS	<b>2,326.2</b> mn litres
	<b>930.1</b> LPA million
ILLICIT SPIRITS	<b>695.2</b> mn litres
	<b>278.1</b> LPA million
LEGAL SPIRITS	<b>1,631.0</b> mn litres
	<b>652.0</b> LPA million

TOTAL WINE	<b>1,243.7</b> mn litres
	<b>160.7</b> LPA million
ILLICIT WINE	<b>111.5</b> mn litres
	<b>14.4</b> LPA million
LEGAL WINE	<b>1,132.2</b> mn litres
	<b>146.3</b> LPA million

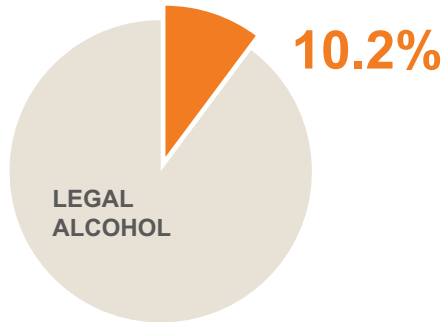
TOTAL BEER	<b>9,952.8</b> mn litres
	<b>488.5</b> LPA million
ILLICIT BEER	<b>336.8</b> mn litres
	<b>16.5</b> LPA million
LEGAL BEER	<b>9,616.0</b> mn litres
	<b>472.0</b> LPA million

SURROGATE	<b>256.5</b> mn litres
	<b>102.6</b> LPA million

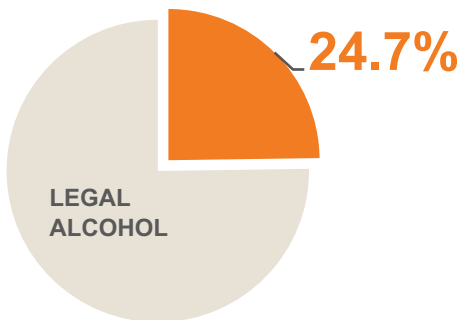
ETHANOL	<b>5.5</b> mn litres
	<b>5.2</b> LPA million

# Market of beer is least affected by illicit alcohol

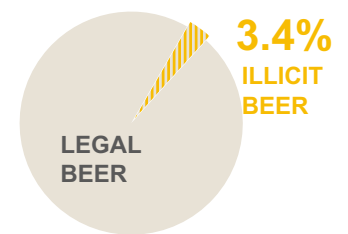
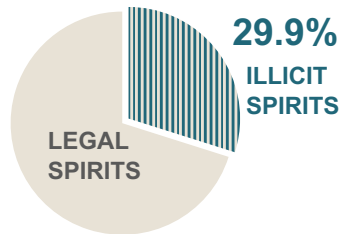
Illicit Alcohol Share in Total Alcohol Market in Actual Volume



Illicit Alcohol Share in Total Alcohol Market in LPA Volume



Illicit Alcohol as a Share of the Total Market by Alcohol Type in Volume (mn litres) and LPA mn, 2013



<b>TOTAL SPIRITS</b>	<b>19.3</b> litres per capita (15+)
	<b>7.7</b> LPA per capita (15+)
<b>ILICIT SPIRITS</b>	<b>5.8</b> litres per capita (15+)
	<b>2.3</b> LPA per capita (15+)
<b>LEGAL SPIRITS</b>	<b>13.5</b> litres per capita (15+)
	<b>5.4</b> LPA per capita (15+)

<b>TOTAL WINE</b>	<b>10.3</b> litres per capita (15+)
	<b>1.3</b> LPA per capita (15+)
<b>ILICIT WINE</b>	<b>0.9</b> litres per capita (15+)
	<b>0.12</b> LPA per capita (15+)
<b>LEGAL WINE</b>	<b>9.4</b> litres per capita (15+)
	<b>1.2</b> LPA per capita (15+)

<b>TOTAL BEER</b>	<b>82.4</b> litres per capita (15+)
	<b>4.0</b> LPA per capita (15+)
<b>ILICIT BEER</b>	<b>2.8</b> litres per capita (15+)
	<b>0.14</b> LPA per capita (15+)
<b>LEGAL BEER</b>	<b>79.6</b> litres per capita (15+)
	<b>3.9</b> LPA per capita (15+)

<b>SURROGATE</b>	<b>2.1</b> litres per capita (15+)
	<b>0.85</b> LPA per capita (15+)

<b>ETHANOL</b>	<b>0.05</b> litres per capita (15+)
	<b>0.04</b> LPA per capita (15+)

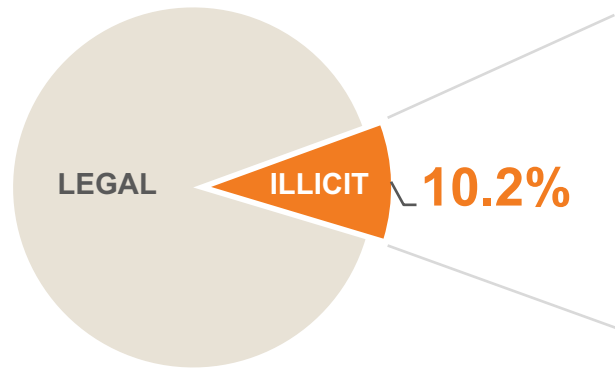
# Market for strong alcohol is more affected by illicit alcohol

Illicit Alcohol versus Legal Alcohol Market in mn Litres Volume

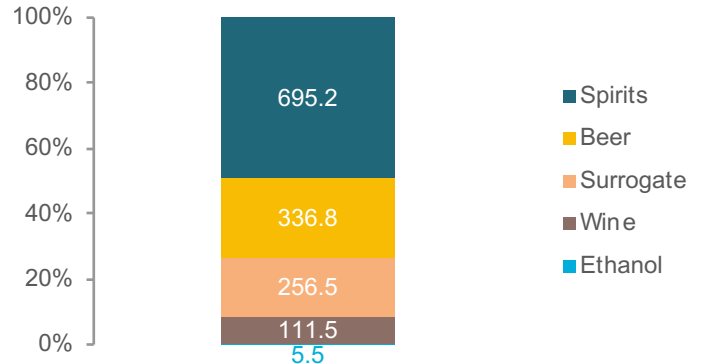
TOTAL ALCOHOL MARKET (ILLICIT + LEGAL) VOLUME  
**13,784.7** mn litres

TOTAL ILLICIT ALCOHOL VOLUME  
**1,405.5** mn litres

TOTAL LEGAL ALCOHOL MARKET VOLUME  
**12,379.2** mn litres



Structure of Total Illicit Alcohol by Type of Alcohol in mn Litres Volume

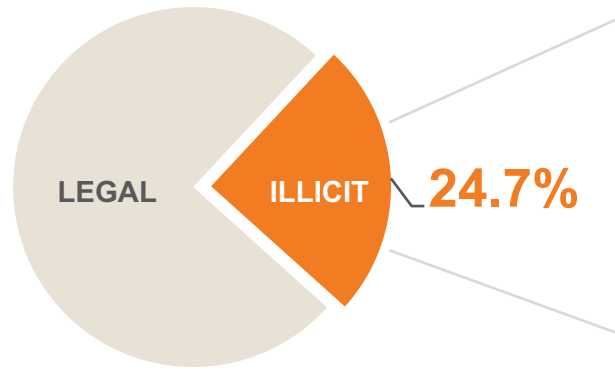


Illicit Alcohol versus Legal Alcohol Market in LPA Volume

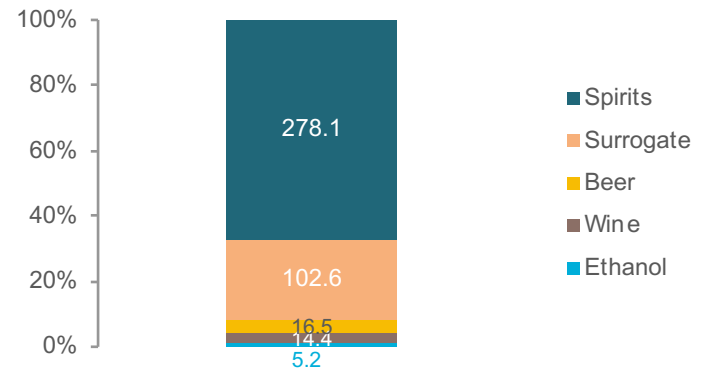
TOTAL ALCOHOL MARKET (ILLICIT + LEGAL) VOLUME  
**1,687.1** mn LPA

TOTAL ILLICIT ALCOHOL VOLUME  
**416.8** mn LPA

TOTAL LEGAL ALCOHOL MARKET VOLUME  
**1,270.3** mn LPA



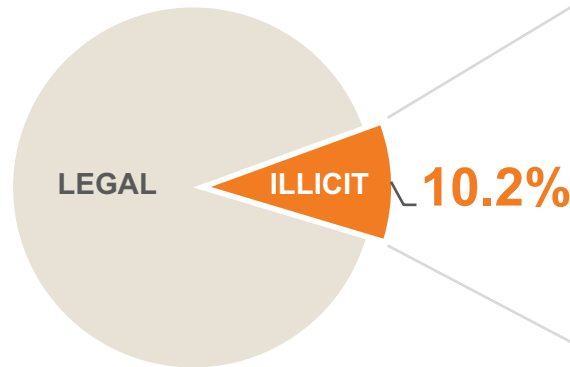
Structure of Total Illicit Alcohol by Type of Alcohol in LPA Volume



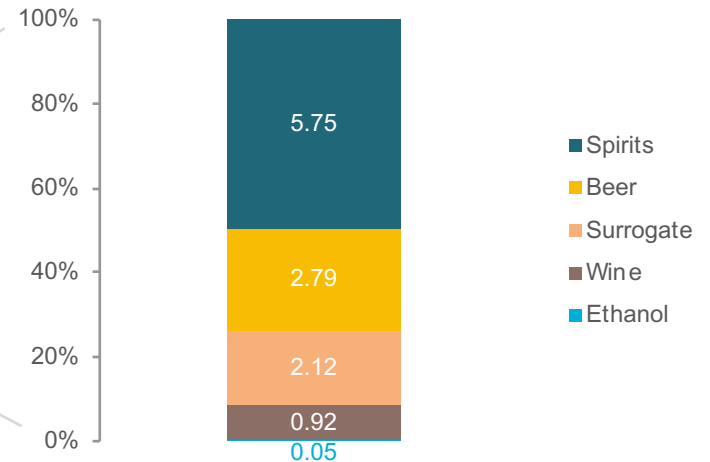
# Market for strong alcohol is more affected by illicit alcohol



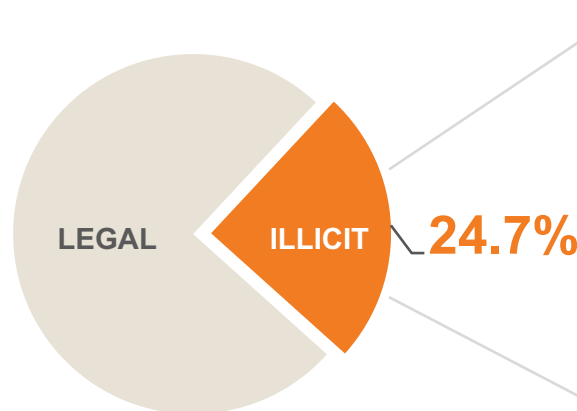
**Illicit Alcohol versus Legal Alcohol Market in Litres per Capita (15+)**



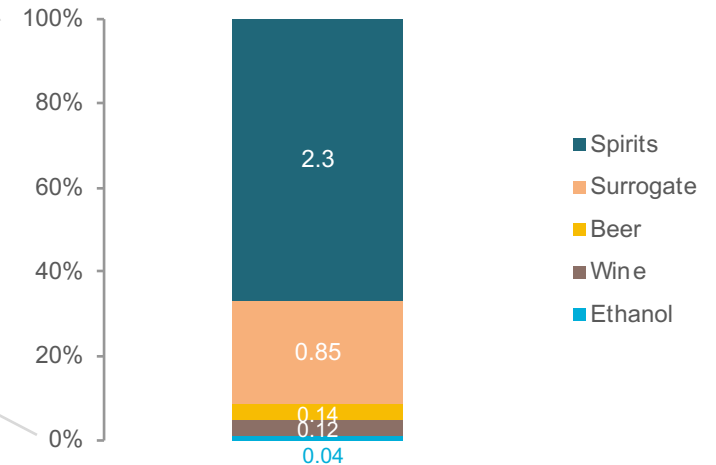
**Structure of Total Illicit Alcohol by Type of Alcohol in Litres per Capita (15+)**



**Illicit Alcohol versus Legal Alcohol Market in LPA per Capita (15+)**



**Structure of Total Illicit Alcohol by Type of Alcohol in LPA per Capita (15+)**





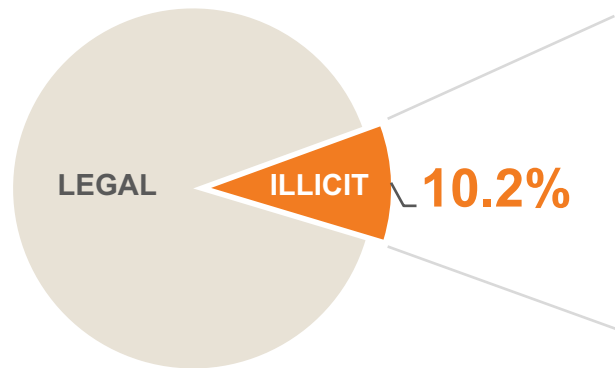
# Market for strong alcohol is more affected by illicit alcohol

Illicit Alcohol versus Legal Alcohol Market in mn Litres Volume

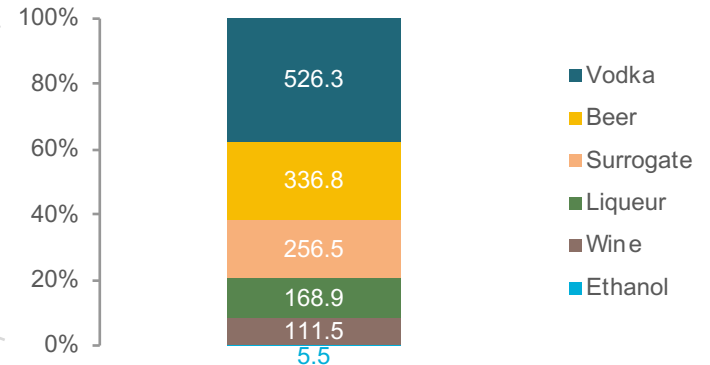
TOTAL ALCOHOL MARKET (ILLICIT + LEGAL) VOLUME  
**13,784.7** mn litres

TOTAL ILLICIT ALCOHOL VOLUME  
**1,405.5** mn litres

TOTAL LEGAL ALCOHOL MARKET VOLUME  
**12,379.2** mn litres



Structure of Total Illicit Alcohol by Type of Alcohol in mn Litres Volume

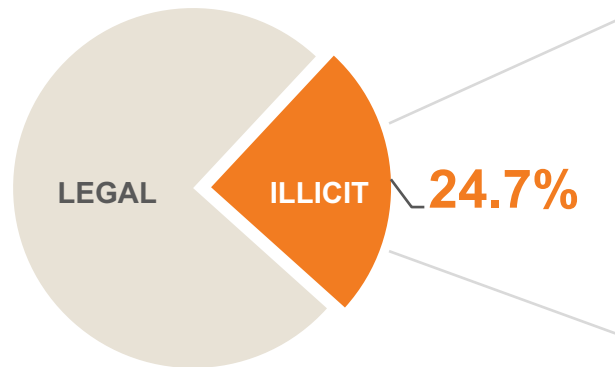


Illicit Alcohol versus Legal Alcohol Market in LPA Volume

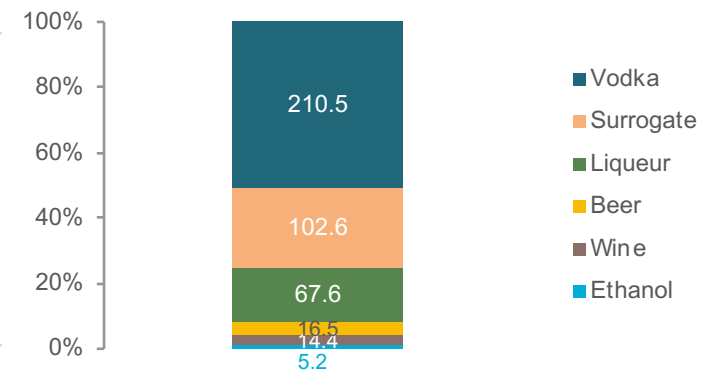
TOTAL ALCOHOL MARKET (ILLICIT + LEGAL) VOLUME  
**1,687.1** mn LPA

TOTAL ILLICIT ALCOHOL VOLUME  
**416.8** mn LPA

TOTAL LEGAL ALCOHOL MARKET VOLUME  
**1,270.3** mn LPA



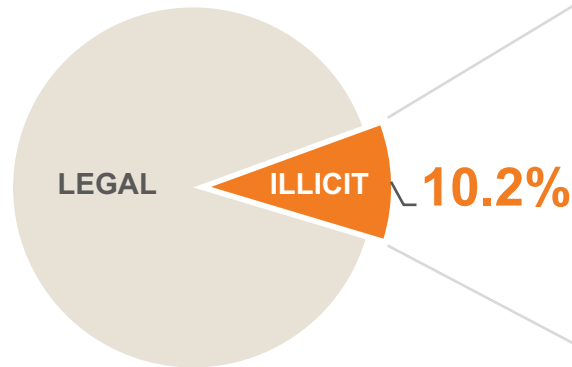
Structure of Total Illicit Alcohol by Type of Alcohol in LPA Volume



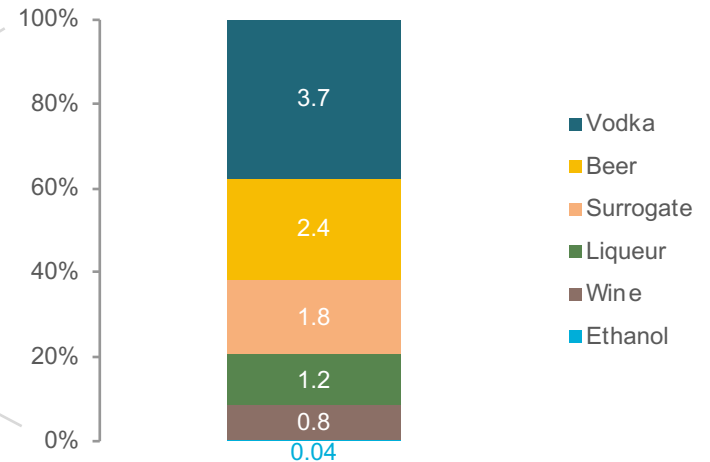
# Market for strong alcohol is more affected by illicit alcohol



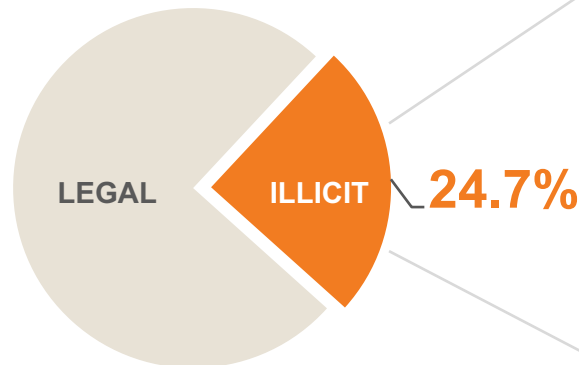
**Illicit Alcohol versus Legal Alcohol Market in Litres per Capita (0+)**



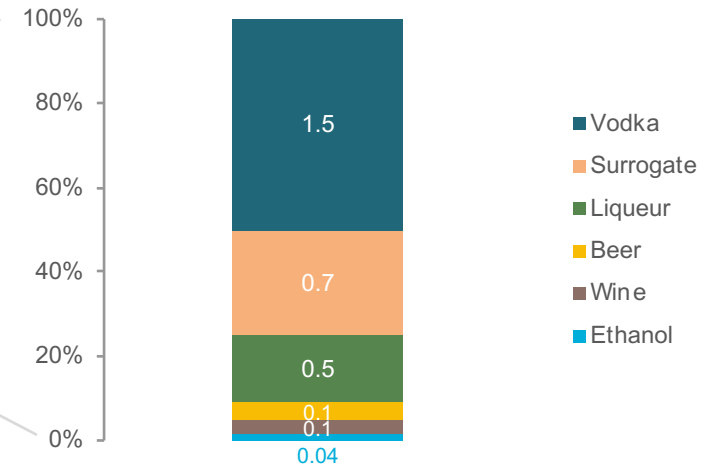
**Structure of Total Illicit Alcohol by Type of Alcohol in Litres per Capita (0+)**



**Illicit Alcohol versus Legal Alcohol Market in LPA per Capita (0+)**



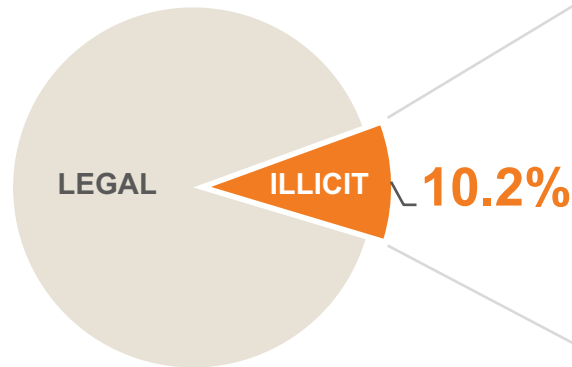
**Structure of Total Illicit Alcohol by Type of Alcohol in LPA per Capita (0+)**



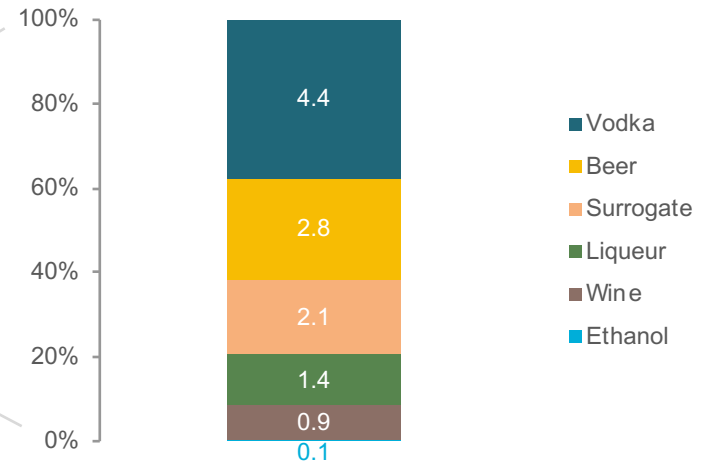
# Market for strong alcohol is more affected by illicit alcohol



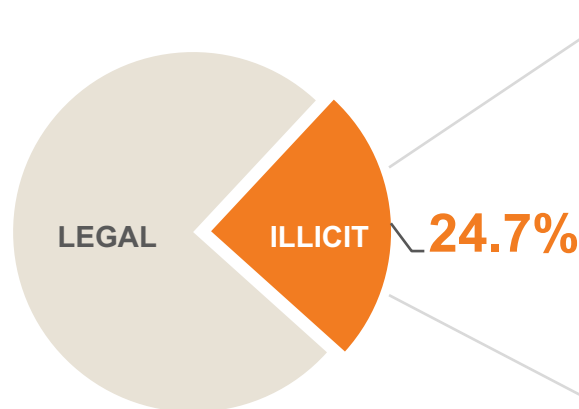
**Illicit Alcohol versus Legal Alcohol Market in Litres per Capita (15+)**



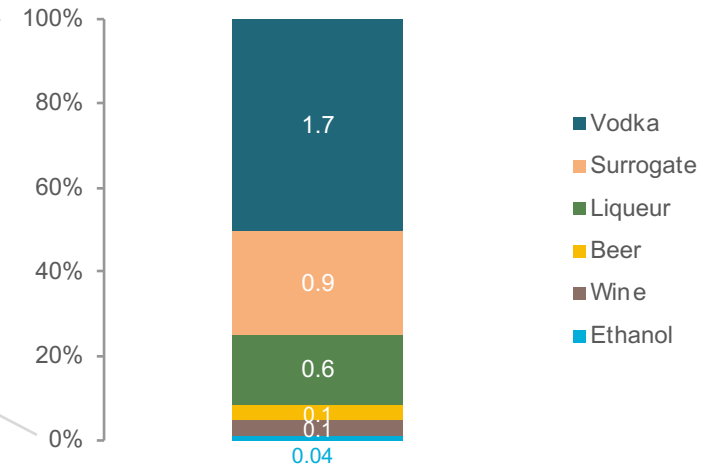
**Structure of Total Illicit Alcohol by Type of Alcohol in Litres per Capita (15+)**



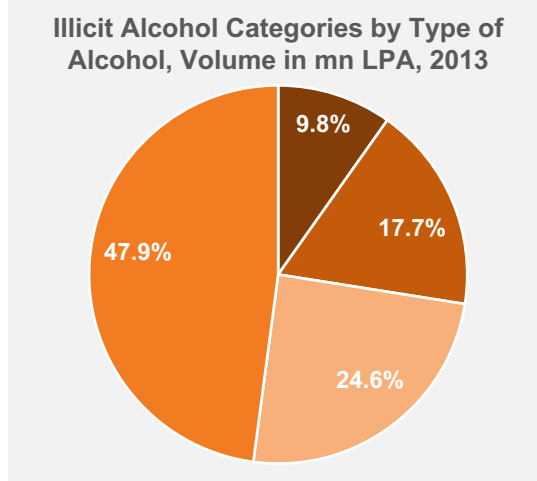
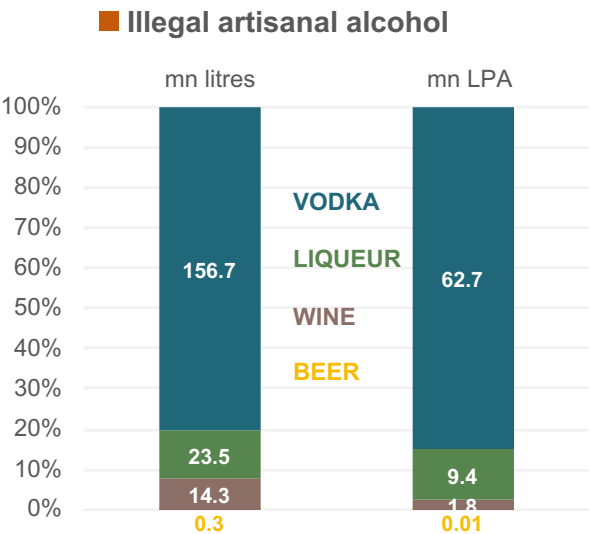
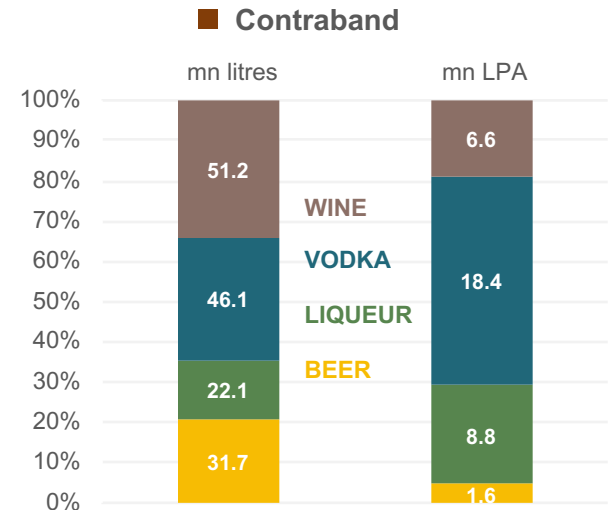
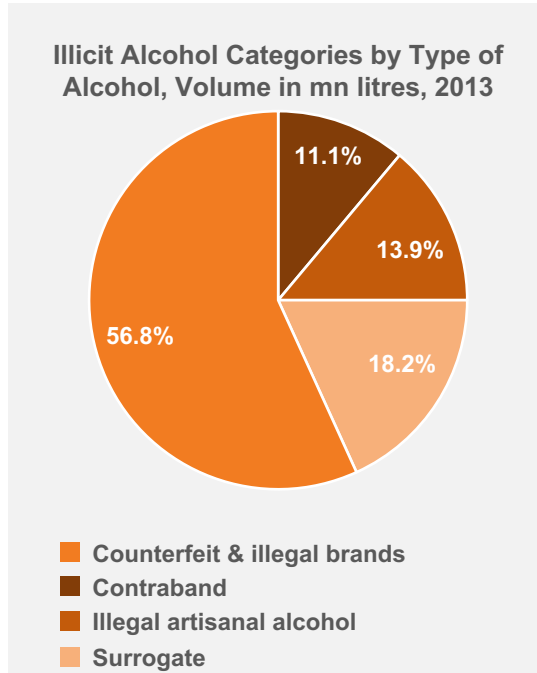
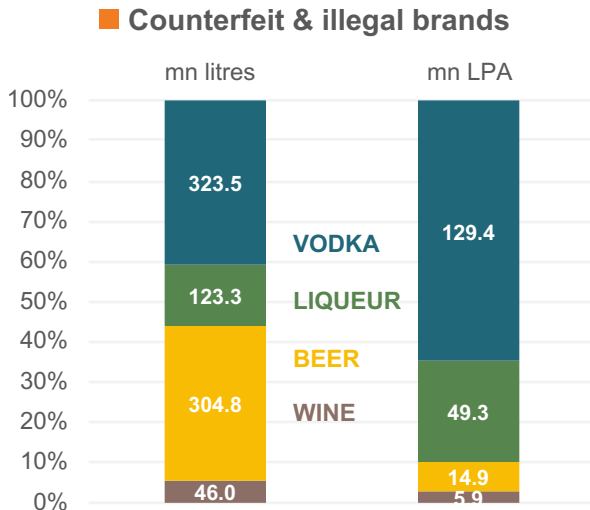
**Illicit Alcohol versus Legal Alcohol Market in LPA per Capita (15+)**



**Structure of Total Illicit Alcohol by Type of Alcohol in LPA per Capita (15+)**

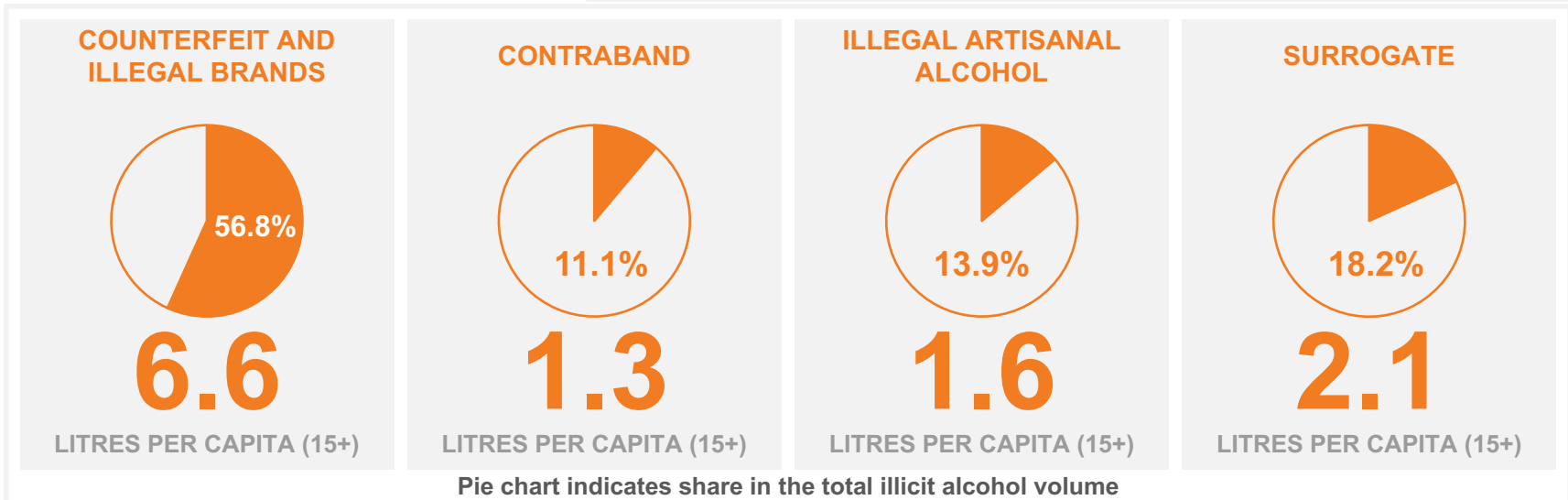
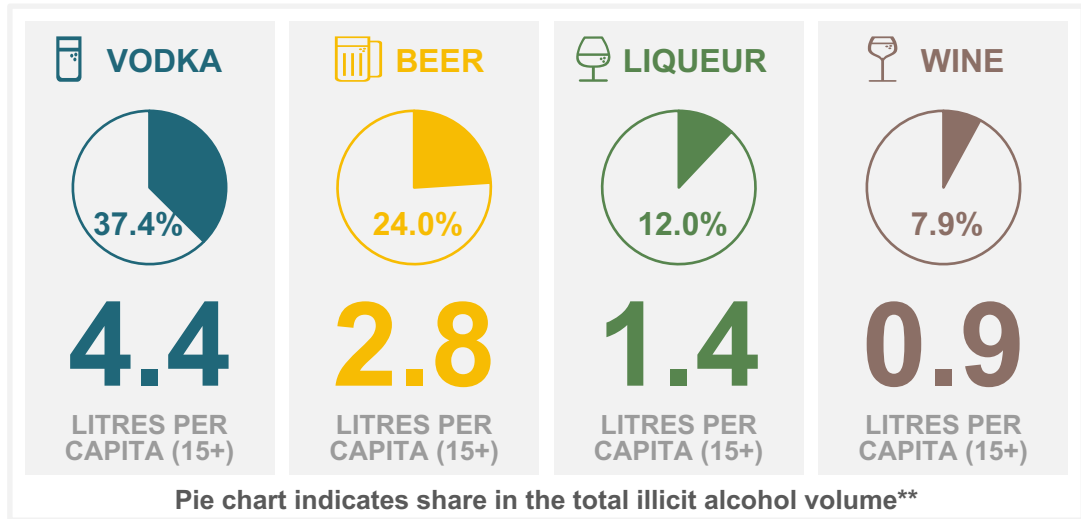
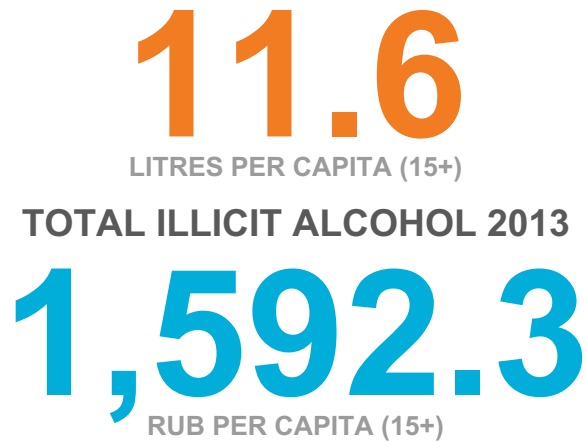


# Illicit alcohol categories by type of alcohol in Russia in 2013



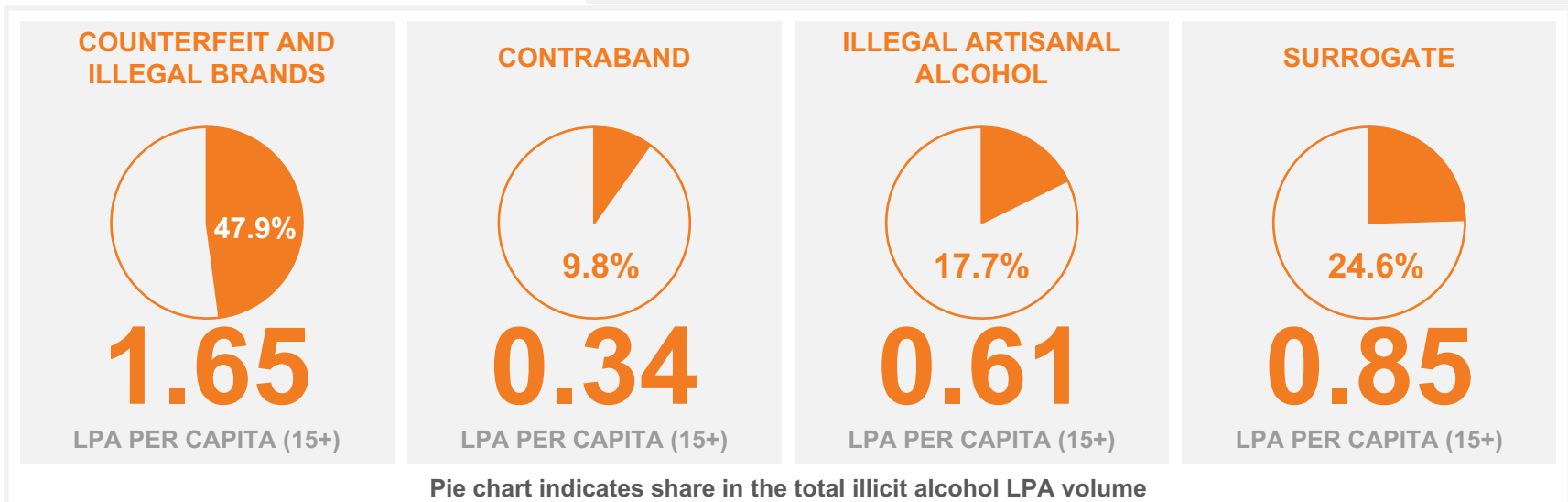
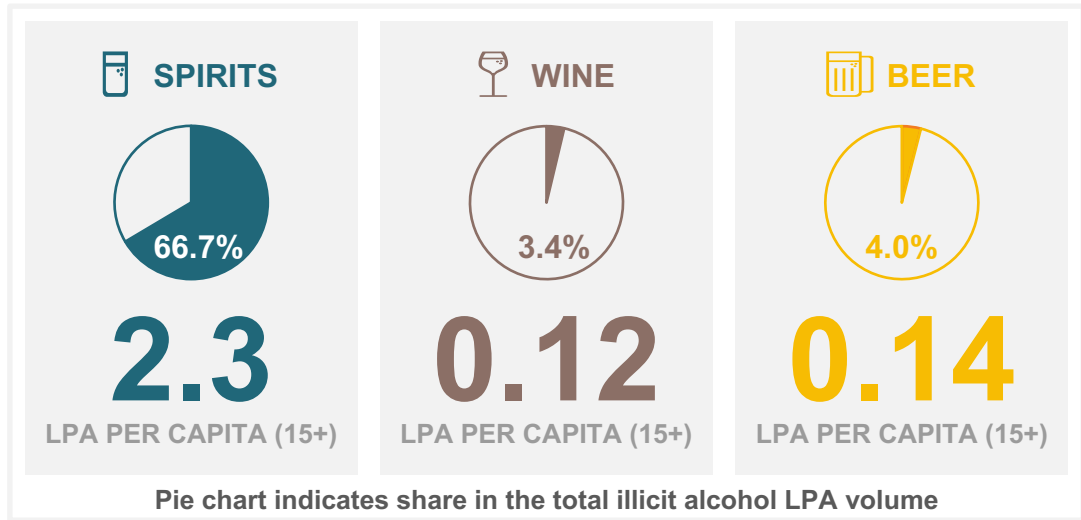
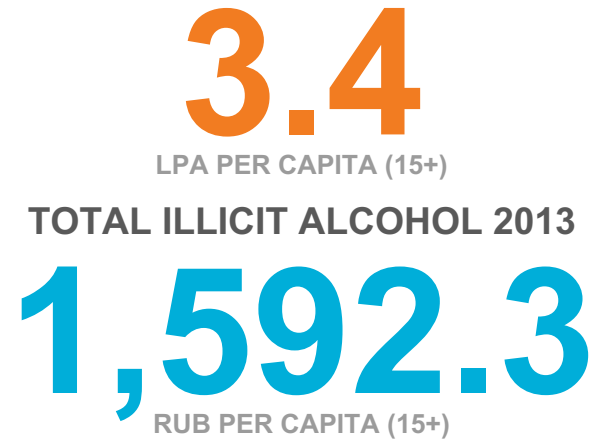
- ### Surrogate
- #### Key types of surrogate
- Medical tinctures, such as hawthorn tincture
  - Eau de cologne
  - Perfumed water
  - Lotions
  - Bath additives
  - Other fluids containing denatured ethanol

# Illicit alcohol consumption volume per capita 2013



Note: Surrogate accounts for 2.1 litres per capita and Contraband Ethanol accounts for the remaining 0.05 litres per capita.

# Illicit alcohol consumption pure alcohol volume per capita\* 2013



Note: Surrogate accounts for 0.85 LPA per capita and Contraband Ethanol accounts for the remaining 0.04 LPA per capita.

## Comparison of statistics and findings

- Euromonitor used statistics as a starting point in illicit market size calculation:
  - Production by type of alcohol + stock + net trade (import – export) - retail sales were calculated in order to see the gap (called difference below in the table) in official data which can potentially be illicit alcohol
- Further the data was validated by trade interviews with market experts – associations, distributors, government bodies, manufacturers, research centers, retailers, suppliers, etc.
- Finally, Euromonitor provided findings based on the analysis of all data received via desk research including statistics and trade press and via trade interviews.



### SPIRITS STATISTICS

Alcohol Type	Category	Metrics	2012	2013
Liquers	Production	Litres mn	30.9	37.0
Liquers	Stock	Litres mn	11.6	16.4
Liquers	Net trade	Litres mn	14.5	14.5
Liquers	Sales	Litres mn	78.7	83.9
<b>Liquers</b>	<b>Difference*</b>	<b>Litres mn</b>	<b>-21.7</b>	<b>-16.1</b>
Vodka	Production	Litres mn	939.3	1,067.1
Vodka	Stock	Litres mn	177.5	171.3
Vodka	Net trade	Litres mn	-29.8	-44.3
Vodka	Sales	Litres mn	1,530.7	1,402.0
<b>Vodka</b>	<b>Difference</b>	<b>Litres mn</b>	<b>-443.7</b>	<b>-207.9</b>
Cognac incl. brandy and calvados	Production	Litres mn	90.9	115.2
Cognac incl. brandy and calvados	Stock	Litres mn	22.7	24.2
Cognac incl. brandy and calvados	Export	Litres mn	117.2	78.5
Cognac incl. brandy and calvados	Sales	Litres mn	125.2	124.1
<b>Cognac incl. brandy and calvados</b>	<b>Difference</b>	<b>Litres mn</b>	<b>-128.7</b>	<b>-63.2</b>

Note: Difference = Production + Stock + Net trade (import-export) - Sales

## Comparison of statistics and findings (cont.)

Whiskey	Production	Litres mn	0.0	0.1
Whiskey	Stock	Litres mn	6.8	10.0
Whiskey	Net trade	Litres mn	79.7	79.6
Whiskey	Sales	Litres mn	46.4	51.1
<b>Whiskey</b>	<b>Difference</b>	<b>Litres mn</b>	<b>40.2</b>	<b>38.5</b>
Liquers	Difference	Litres mn	-21.7	-16.1
Vodka	Difference	Litres mn	-443.7	-207.9
Cognac incl. brandy and calvados	Difference	Litres mn	-128.7	-63.2
Whiskey	Difference	Litres mn	40.2	38.5
<b>Spirits</b>	<b>Difference*</b>	<b>Litres mn</b>	<b>-553.9</b>	<b>-248.7</b>

<http://stat.customs.ru/>

<http://www.fedstat.ru/>



### SPIRITS EUROMONTIOR ANALYSIS

Alcohol Type	Category	Metrics	2012	2013
Spirits	Retail sales as per Passport	Litres mn	1,720.7	1,631.0
Illegal spirits	Substitution/refill	Litres mn	42.5	44.4
Illegal spirits	Industrial manufacturing of illegal/unbranded	Litres mn	369.5	402.4
Illegal spirits	Contraband finished product	Litres mn	65.8	68.2
Illegal spirits	Illegal artisanal alcohol	Litres mn	172.1	180.2
<b>Illegal spirits</b>	<b>Total</b>	<b>Litres mn</b>	<b>649.9</b>	<b>695.2</b>

Note:  $Difference = Production + Stock + Net\ trade\ (import-export) - Sales$



## Comparison of statistics and findings (cont.)

### WINE STATISTICS

Alcohol Type	Category	Metrics	2012	2013
Wine	Production	Litres mn	1,447.8	1,292.2
Wine	Stock	Litres mn	124.1	46.8
Wine	Net trade (import – export)	Litres mn	789.8	815.5
Wine	Retail sales	Litres mn	1,049.0	288.0
<b>Wine</b>	<b>Difference*</b>	<b>Litres mn</b>	<b>1,312.7</b>	<b>1,866.5</b>

<http://stat.customs.ru/>

<http://www.fedstat.ru/>

### WINE EUROMONITOR ANALYSIS

Alcohol Type	Category	Metrics	2012	2013
Legal wine	Retail sales as per Passport	Litres mn	1,171.6	1,132.2
Illegal wine	Substitution/refill	Litres mn	4.5	4.7
Illegal wine	Industrial manufacturing of illegal/unbranded	Litres mn	37.5	41.3
Illegal wine	Contraband finished product	Litres mn	49.1	51.2
Illegal wine	Illegal artisanal alcohol	Litres mn	13.8	14.3
<b>Illegal wine</b>	<b>Total</b>	<b>Litres mn</b>	<b>104.8</b>	<b>111.5</b>

*Note: Difference = Production + Stock + Net trade (import-export) - Sales*

## Comparison of statistics and findings (cont.)

### BEER STATISTICS

Alcohol Type	Category	Metrics	2012	2013
Beer	Production	Litres mn	9,935.9	9,518.2
Beer	Stock	Litres mn	229.3	308.5
Beer	Net trade (import – export)	Litres mn	69.6	26.6
Beer	Retail sales	Litres mn	10,557.0	10,056.1
<b>Beer</b>	<b>Difference*</b>	<b>Litres mn</b>	<b>-322.1</b>	<b>-202.8</b>

<http://stat.customs.ru/>

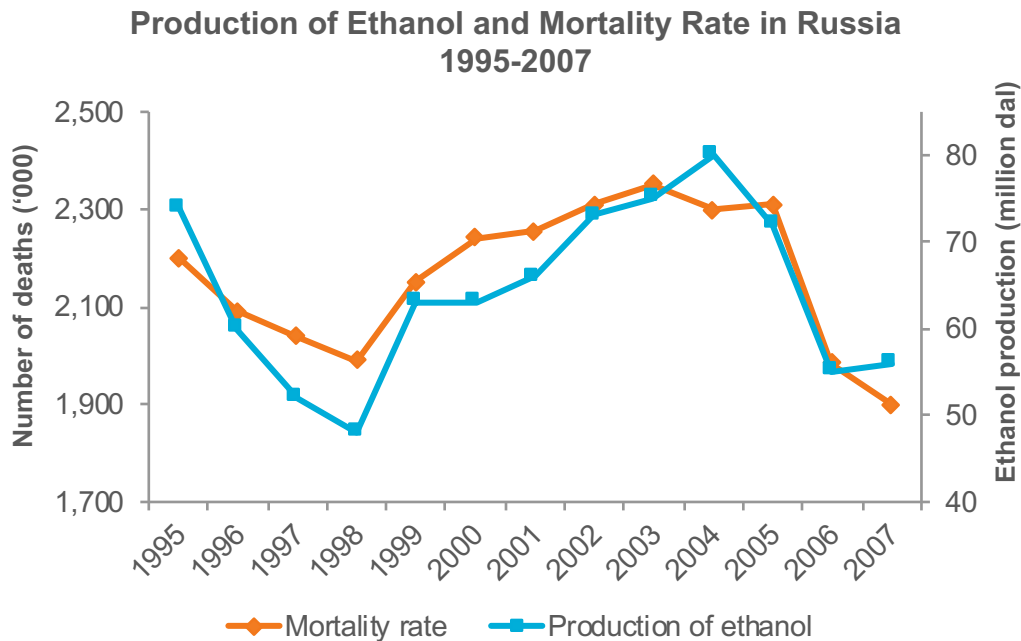
<http://www.fedstat.ru/>

### ILLEGAL BEER EUROMONITOR ANALYSIS

Alcohol Type	Category	Metrics	2012	2013
Legal Beer	Retail sales as per Passport	Litres mn	10,172.0	9,616.0
Illegal Beer	Substitution/refill	Litres mn	2.3	2.3
Illegal Beer	Industrial manufacturing of illegal/unbranded	Litres mn	233.1	302.6
Illegal Beer	Contraband finished product	Litres mn	27.6	31.7
Illegal Beer	Illegal artisanal alcohol	Litres mn	0.3	0.3
<b>Illegal Beer</b>	<b>Total</b>	<b>Litres mn</b>	<b>104.8</b>	<b>111.5</b>

*Note: Difference = Production + Stock + Net trade (import-export) - Sales*

# Every fourth death in Russia is connected to alcohol consumption



*“High cardiovascular mortality in Russia is partly determined by high alcohol consumption. We started the research in 1999 with 25 autopsies, coming to the conclusion that up to 25% of those who died from heart failure had blood alcohol levels incompatible with life - over 4 ppm.”*

**- David Zaridze, Deputy Director of Russian Cancer Research Centre**

- According to National Research University, Russia has made tremendous progress in reducing mortality, which dropped from 2.3 million deaths in 2005 to 1.9 million in 2013.
- Moreover, alcohol poisoning declined from 35,000 to 9,700 over the same period.
- The crude death rate decrease was mainly attributed to an increase in life expectancy, which reached 70.5 years in 2012, up from 65.5 in 2005.
- According to National Research University, the overall decline in mortality was a result of the introduction of anti-

- alcohol measures in 2006, such as price and excise tax rate increases on alcoholic beverages, restrictions on advertising and limits on retail sales by time and place.
- The research has revealed that there is a strong correlation between alcohol manufacturing and mortality rates in Russia. An increase in production (and consumption) of alcohol leads to an immediate increase in mortality.
- As a result, removing the anti-alcohol measures such as minimum prices and excise tax increases on alcoholic beverages as well as time and place restrictions may result in 5.5 million deaths by 2030.



20-YEAR MORTALITY RISKS  
FOR MALE SMOKERS BY  
ALCOHOL CONSUMPTION

35-54  
years

55-74  
years

**Low**

<1 BOTTLE OF VODKA  
PER WEEK

16%

50%

**Medium**

1-3 BOTTLES OF VODKA  
PER WEEK

20%

54%

**High**

≥3 BOTTLES OF VODKA  
PER WEEK

35%

64%

Source: *The Lancet. Alcohol and mortality in Russia: prospective observational study of 151 000 adults, 2014*





## CONTACT DETAILS

**Inga Volyneć**

Associate Consultant

Tel: +370 5 243 1577 ext 4633

[inga.volyneć@euromonitor.lt](mailto:inga.volyneć@euromonitor.lt)

**Jonas Cerneckis**

Senior Consultant

Tel: +370 5 243 1577 ext 4623

[jonas.cerneckis@euromonitor.lt](mailto:jonas.cerneckis@euromonitor.lt)

**Chris York**

Business Development Manager

Tel: +44 (0) 20 7251 8024 ext 3406

[chris.york@euromonitor.com](mailto:chris.york@euromonitor.com)

**Dr. Sarah McArthur**

Business Development, Consulting

Tel: +44 (0) 20 7251 8024 ext 2419

[sarah.mcarthur@euromonitor.com](mailto:sarah.mcarthur@euromonitor.com)