A SMOKESCREEN ECONOMY:
The nature and scale of the township grey market cigarette trade in Delft
A Smokescreen Economy: The nature and scale of the township grey market cigarette trade in Delft

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PREFACE

The Sustainable Livelihoods Foundation seeks to contribute towards the improvement of livelihoods in poor communities. We support the emergence and growth of micro-enterprises. Enterprise development, however, remains hindered by a range of constraints such as crime, skills shortages, and absence of affordable finance. An important obstacle in many small businesses is the policy environment, which presents constraints through barriers such as regulation (and also, in certain cases, the absence of regulation), land use rights and trading restrictions. In order to understand these challenges and provide much needed insights on the informal sector, the Foundation initiated a research and policy engagement project, known as the Formalising Informal Micro-enterprises (FIME) project. The project rationale was not to promote business formalisation in a narrow legalistic sense, but rather through advocating a developmental approach the project has sought to identify ways in which micro-enterprises can be better accommodated within a more inclusive economy.

Under the FIME project, SLF has undertaken extensive field research in eight township communities across South Africa. Through this research, we have developed a unique set of insights into the informal market of fast moving consumer goods (FMCG). In this research, we have identified the important role of ‘grey’ market products in many FMCG businesses, from street vendors to liquor retailers and spaza shops. One of the most widely available grey market products is a cheap cigarette. These are sold through various retail channels including street traders and spaza shops. The presence of grey market tobacco in spaza shops is of particular interest to our research. Our on-going study of spaza shops has identified substantial shifts in the business dynamics within this sector with bigger businesses replacing smaller businesses. This transition has contributed to the demise in many South African shops (typically the smaller businesses) and the emergence of non-South African shopkeepers. One of the cornerstones in the success of the new spaza entrepreneurs is their business networks and ability to access goods directly from producers and / or suppliers with limited distribution in the township.

With this understanding in mind, we sought to investigate the availability of grey market cigarettes in spaza shops in one of the townships we have studied. The research has sought to investigate whether the number of retail points selling grey-market cigarettes had expanded over time and whether the change in spaza business dynamics had an influence on this development.
1. INTRODUCTION

The Sustainable Livelihoods Foundation has been conducting original research on South Africa’s Informal economy since 2010. This research includes an on-going census of township micro-enterprises in Cape Town, Gauteng and Durban. The research identified 9,402 micro-entrepreneurs operating 10,157 enterprise activities in eight sites. We undertook in-depth interviews with 3,384 of these entrepreneurs in the following sectors: liquor retail (taverns, shebeens and house sales), spaza shops, hair salons, educarees, street traders, traditional healers and micro-manufacturers.

In the course of our field research, we encountered the presence of ‘illegal’ cigarettes in all of the township sites. These ‘cheap’ cigarettes were usually sold at street stands and spaza shops. In the initial round of micro-enterprise census studies (spanning the period 2010-2013), we found that of the 1051 spaza shops surveyed, 393 (37%) sold illegal cigarettes. Furthermore, we found that 23% of South African spaza stores that sold illicit cigarettes whereas 51% of immigrants run spaza shops sold illicit cigarettes. This finding contributed to our assessment that non-South African shopkeepers ran bigger businesses and were more effectively linked to ‘grey market’ supply chains through which products such as illegal cigarettes could be obtained. As has been defined by Bucklin (1993), “grey market goods are genuinely branded merchandise distinguished only by their sale through channels unauthorized by the trademark owner.” Liquor and cigarettes are often termed as ‘grey market’ as, unlike ‘black market’ products, they might be legally manufactured but illegally distributed. This may include goods moved by distributors who move products across borders lacking proper licences or not adhering to the government regulation and avoiding duties and taxes (Maltz 1975; Myers & Griffith 1999).

Research conducted by Liedeman (2013) shows the contrasting business models and levels of success between South African and foreign-run spaza shops. It is argued that foreign-run spaza stores were found to have a larger scale of operations and were thus more successful in comparison to the micro ‘survivalist’ structures of South African spaza shops. A key competitive advantage identified for the foreign-run spaza stores (mainly in the case of Somali shopkeepers) was an extensive social network of fellow migrants, which provided beneficial services such as cheap labour and collective procurement of goods. Furthermore, the strength of this network enables shopkeepers to access important spaza products, notably illegal cigarettes, that are often obtained through ‘informal’ procurement processes and not as easily available from ‘legitimate’ wholesale stores, but must be bought through particular social and business networks on the ‘grey market’.
This current study, in Delft South and Eindhoven, seeks to address some of our unanswered questions on the role of grey market cigarettes in the spaza sector. In particular, we sought to understand:

• Whether the availability of grey market cigarettes in the spaza shop sector shifted upward overtime, comparing our earlier results with a site resurvey in 2015?
• Whether both South African and non-South African shopkeepers have equal access to grey market supply channels?
• The importance of grey market cigarettes within the spaza shop product offerings?
• The effectiveness or otherwise of state endeavours to control grey market cigarettes and the resulting policy implications?

In addressing the research questions, the study objective was to collect evidence and pricing data of grey market cigarettes sold ‘loosely’ (sticks). The price of the cigarettes was considered a useful proxy indicator of their grey status. Furthermore, through purchasing cigarettes from individual stores, the research sought to verify the scale of illegally sold cigarettes across the total population of spaza shops, which we had identified through a recent business census.

1.1 Technical Note on Grey / Illegal Cigarettes

From a visual perspective, it is difficult to differentiate between legal and grey market cigarettes. Often the cigarette products in question appear to meet the legal manufacturing requirements of mainstream tobacco brands, such as having health warnings and other mandatory technical information on the packaging as well as embossed markings. In the South Africa context, reports indicate that illegal / grey cigarettes operate within three core markets: i) counterfeit (commonly known as fakes), ii) contraband (commonly referred to as smuggled) and iii) Illicit (these are locally produced, but evade taxes; sometimes known as Illicit Whites) (Joossens & Raw 2011; Gilmore et al., 2014). The counterfeit market involves cigarettes that are branded under legitimate names and sold as the genuine item. The tobacco industry argues that counterfeit cigarettes are of poorer quality and pose heightened health risks (Stevens & Caider, 2005; Pappas et al., 2007). The contraband market may comprise both genuine and counterfeit products smuggled into South Africa to avoid applicable taxes and or duties. Corporates also often link the sale of illicit cigarettes to organised crime such as international drug smuggling, human trafficking and even terrorism, inferring that the former finances the latter. The illicit market usually comprises products that are manufactured with undeclared tobacco leaf. The cigarettes are produced and sold for consumption in South Africa with the product undeclared to SARS and therefore avoiding excise and other taxes. Illicit cigarettes can be manufactured in legitimate cigarette producing factories, or produced in illegal and covert operations. *Illicit Whites*, for example, are legitimately manufactured cigarette brands that are produced for the illicit market either within South Africa or smuggled into the country, thus avoiding taxes and duties.
The grey market trade in cigarettes is reported to have expanded since 2008. As of 2012, TISA (Tobacco Institute of Southern Africa) has estimated that the grey segment enjoys roughly 30% market share and would rank second in the South African market place if it were a ‘legitimate’ company. Reports from legal manufacturers and other tobacco role players state that approximately 8.5 billion illicit cigarettes (or 850 thousand master-cases) were sold in 2012. In the process the South Africa government was said to have lost around R5 billion in unpaid duties in 2012, and up to R12 billion over the past 3 years (TISA 2015). According to TISA CEO, Francois van der Merwe, 60% of illicit cigarettes in South Africa are locally manufactured, 30% are smuggled from Zimbabwe and 10% from other areas of sub-Saharan Africa.

A key strategy used by industry and government in the fight against illegal cigarettes are actions to familiarise the public with the signs of unlawful cigarettes. These efforts have focused largely on cigarette packaging and labelling. This information is intended to enable consumers to discern the legitimacy of the tobacco product. According to TISA’s website, a packet of 20 cigarettes can be considered illegal when i) there is no excise stamp (diamond stamp <SA>), ii) readings of Tar are greater than 12 mg and Nicotine greater than 1.2mg, and iii) the packaging lacks health warnings and the Reduced Ignition Propensity (RIP) embossed on the side of the cigarette box.

Importantly, where consumers pay less than R18 (excise duty alone for a pack of 20’s is R12, 42), the product can be considered illegal and part of the grey market. This means that any cigarette sold loosely for **less than ninety cents** in South Africa is most likely illegal.
2. METHODOLOGY

2.1 CASE STUDY SITE

Our research site is Delft South and Eindhoven. Delft is a diverse formal settlement in Cape Town, South Africa (Map 1), with demographic make-up of ‘coloured’ and ‘black African’ (primarily Xhosa) individuals. It has a population of approximately 152 000 individuals with Delft South consisting of 36 105 individuals and Eindhoven 7081 individuals (StatsSA 2011). Roughly 43% of the population in Delft is unemployed and 69% of the population earn less than R3200 per month (StatsSA 2011). Poverty in Delft is deep and widespread.

Map 1: Location of Delft South in Cape Town.
2.2 OBSERVATION OF AVAILABILITY OF ILICIT CIGARETTES: 2010 /2011 Survey and 2015 Resurvey

SLF collected extensive data on the informal micro-enterprises operating in Delft South / Eindhoven in 2010 and 2011. These data provide a solid baseline against which shifts and trends in grey market cigarette availability can be assessed.

A new wave of the SLF micro-enterprise census was initiated in June 2015 in Delft South. This two month in-depth re-study made use of an updated methodology which built on that used in the previous eight study sites (see Charman, Petersen, Piper, Liedeman and Leg 2015). The research entailed resurveying the specific geographic area of Delft South to identify change in micro-enterprises and to identify developing trends. Towards the conclusion of the wider survey, a specific investigation into informal cigarette sales in the survey area was initiated. Two local experienced researchers conducted the data collection on bicycle and foot over a period of five working days. The researchers approached spaza shops identified in the 2015 survey as customers with the objective to simply purchase the cheapest cigarette available in the store.

The intention was to identify all the spaza shops selling loose cigarettes for less than ninety cents, with the price point used as a proxy indicator of the illegitimate status of the product. The fieldworkers asked the shopkeeper for a ‘cheap or 50cents cigarette’, purchasing whatever cigarettes they were offered. They did not ask for a particular brand. Together with pricing information, researchers also documented the business name, street location, shopkeeper nationality and the brand name of each cigarette purchased. The purchased cigarettes were then placed into individual plastic bank bags and marked with an identification sticker and corresponding data. Each bank bag was then allocated a unique survey number to be used as a tracking tool and to enable subsequent spatial mapping. See figure 1.

Although the 2015 FIME census in Delft South identified 158 grocery retailers (spaza shops), the fieldworkers only succeeded in surveying 128 of the total number of spaza shops. The fieldworkers reported that the remaining spaza shops were not included in the study either because they were closed on the multiple occasions that the researchers visited the store or because the shops could not be found. The limited financial resources available for this study meant that we were unable to devote additional time to tracking down the missing shops outside the five days allocated to the research.

The research data was captured and analysed in Microsoft Excel and grouped into three data categories; i.) Availability, ii.) Trader profile, and iii.) Brand and price availability.
Figure 1: Map of Delft with the purchased cigarettes in the bank bags during the method of mapping the availability of illicit cigarettes (Source: Justin Patrick, Sustainable Livelihoods Foundation, 2015).
3. FINDINGS

3.1 AVAILABILITY

In the 2010/2011 FIME survey, the SLF research identified 129 (82%) spaza shops selling illicit cigarettes and 29 spaza shops not selling illicit cigarettes (Fig. 2). In comparison, in 2015 the resurvey learned that there was an 11% increase in the number of spaza stores selling illicit cigarettes, with 119 (93%) out of 128. See (Fig 2).

![Figure 2: The availability of illicit cigarettes in Delft for 2010 – 2011 (n = 158) and the availability of illicit cigarettes in Delft South and Eindhoven 2015 (n= 128).](image)

In 2010/2011 the researchers noted that cigarettes were commonly sold in house shops; micro-enterprises that are much smaller than spaza shops and, unlike spazas which are located in a dedicated space, are integrated within people’s homes, often sharing fridge space and shelf space in the kitchen. House shops usually sell a limited range of products, including bread, milk, frozen meat, ice-lollies, sweets and chips, paraffin and cigarettes. Interestingly, in the 2015 survey the researchers encountered only on rare occasions the sale of cigarettes in house shops. The disappearance of cigarettes might be attributable to the rise in grey market cigarettes in spaza shops and the corresponding difficulties faced by house shops in accessing the supply chains through which these products are obtainable.
3.2 TRADER PROFILE

Cheap cigarettes were more widely available in the spaza shops operated by foreign entrepreneurs than in the South African run stores. In 2010/2011 in Delft South, 70 (90%) of the foreign entrepreneurs were selling illicit cigarettes and 59 (74%) South African spaza stores were selling illicit cigarettes. Whereas in 2015, 65% of South African spaza stores sold illicit cigarettes and 97% of foreign stores sold illicit cigarettes. See figure 3.

![Figure 3](image)

Figure 3: The % of spaza enterprises divided into nationality and indicating those selling and not selling illicit cigarettes in Delft in 2010/2011 and in Delft South and Eindhoven in 2015.

The majority of the foreign-run stores and also the majority of those trading in illicit cigarettes in both 2010/11 and 2015 (79%) were operated by nationals from Somalia/Ethiopia. See Figure 4 and 5.
Figure 4: The nationality and % of spaza stores trading in illicit cigarettes in Delft in 2010/2011 (n = 129).

Figure 5: The nationality and % of spaza stores trading in illicit cigarettes in Delft South and Eindhoven in 2015 (n=119)
Map 2: Spaza shops by nationality in Delft South and Eindhoven September 2015
Map 2 from the FIME project indicates spatially the overwhelming majority of foreign-run spaza stores in comparison to South African-run stores within Delft South in 2015. Additionally, the even spatial distribution of these spaza stores indicates the ease of availability of cigarettes within short walking distance from most households and areas within Delft.

### 3.3 BRAND AND PRICE AVAILABILITY

50 cents remains the most common price for a loose cigarette sold in spaza stores for both 2010/11 (118 spaza stores) and 2015 (107 spaza stores). A minority of illegal cigarettes are priced up to 80 cents. See figure 6.

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Figure 6: % of spaza stores and their price point (under 90 cents) for illicit in Delft South in 2010/2011 data (n=129) and in Delft South and Eindhoven data 2015 (n=119).
Figure 7: The number of spaza stores selling various brands of loose stick cigarettes within Delft South and Eindhoven in 2015 (n= 119).

Figure 8: The various brands of cigarettes that were purchased at spaza stores in the course of the FIME research (Source: Justin Patrick, Sustainable Livelihoods, 2015).
The specific brand of cigarettes was not recorded in the 2010/2011 surveys but was in the 2015 resurvey. In the course of the 2015 research, the fieldworkers collected and labelled a total of 227 illegally traded cigarettes. The three most commonly available illicit brands found in Delft South spaza shops are 1) Premium Blue, with a presence in at least 44% of the spaza stores, 2) Bastille, available in approximately 33% spaza shops and 3) Pacific, present in about 11% of the businesses (Fig. 7 and Fig. 8). We are not able to verify whether other legitimate brands are available in each of the shops.

Interestingly, it was revealed that even within the illicit trade, particular cigarette brands were being sold at seemingly very low prices. One such example is a brand marketed merely as VIP cigarettes. Information obtained from field research and insider knowledge revealed that at the time of research this brand was being discontinued by its South African manufacturers and had recently been dumped into the Delft market by local distributors for as little as R40 per carton of 200’s; essentially setting spaza shop owners back 20 cents per loose stick. This brand is currently widely available in a number of Western Cape townships, particularly on the Cape Flats, and was being sold for 50 cents in each of the three (foreign-run) Delft spazas it was located in during this study. The sale of this product allows for lucrative profit returns of up to 150%. Regarding brand availability, it is important to note that even though only three spaza shops in the sample stocked the VIP brand, this was certainly not an indication of the brand being less popular. It could be argued that it is more likely that this brand is not easily available through supply chain networks as the consignment of cigarettes was depleted.
4. DISCUSSION

The challenges of eliminating illicit tobacco are immense. Between 2010/11 and 2015 illicit cheap cigarettes have become more widely available. The evidence presented by this case study shows an 11% increase in availability of illicit cigarettes in Delft South within spaza stores. The research highlights the ease of access and availability of illicit cigarettes since spaza stores are within easy walking distance for most households in townships such as Delft.

Further, these illicit cigarettes are more widely sold in foreign-run spaza stores (90% in 2010/11 and 97% in 2015) in comparison to South African spaza stores (74% in 2010/11 and 65% in 2015). This could be attributed to the decrease in South African run spaza stores since 2010 whereby Liedeman (2013) found that in 2010 roughly half of the shops were run by South Africans but in more recent research approximately 80% of the spaza stores are now run by foreigners. Foreign-run spaza stores tend to have extensive social networks and larger scale of operations, possibly contributing to their ability to access supply channels of illicit cigarettes.

These findings have implications for the consumption and regulation of the grey market illicit tobacco trade. It is said that the grey market trade contributes to the growth in organised crime as the profits fund other crimes such as money laundering, corruption, human trafficking and drug dealing. The government is aware that grey market activities have a damaging effect on the economy, society, government and the rule of law (Phiyega, 2014), though strategies to reduce availability are clearly not working. The pervasive availability of the “50 cent” cigarette brings into question the effectiveness of current tobacco policies, legislation and regulatory frameworks which have essentially been designed to stem the flow of these illegal products.

Importantly, it is argued that the availability of cheap cigarettes is encouraging and fuelling the smoking habits of many South Africans, particularly in poorer communities, and consequently increasing the tobacco health related problems (Boshoff 2008; Centre for Regulatory Effectiveness 2011). In the context of widening availability of cheap cigarettes, government efforts to control smoking through increases in excise tax have been undermined (Mohammed 2002). Solutions to overcome increased tobacco related health problems will need to include more stringent policing of illicit cigarettes manufacture, smuggling and sale in various retail outlets.
4. REFERENCES


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