Industry Study

The South African Liquor Industry

Final Report, June 2005

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1. Introduction

The South African liquor industry, comprising beer, wine and spirit segments, is characterised by high levels of concentration where virtually the entire market is served by a mere handful of companies. Current industry dynamics have their roots in developments that took place almost three decades ago, where the country's political isolation together with the then government's tolerance of market concentration and the presence of vested interests saw the emergence of a small number of key players that controlled the market.

Today, ownership in the sector is not dissimilar to what it was in the 1970s and 1980s. In the beer segment, South Africa's incumbent operator has in a short space of time become the world's second largest brewer. Wine producers like KWV continue to play an important role, while the spirits sector is still dominated – to a significant extent – by SFW and Distillers Corporation in its present-day guise as Distell.

However, transformation in the sector has become a key objective of the government, which is hoping not only to increase market opportunities to historically disadvantaged groups, but also to break up what it perceives to be anti-competitive conduct by some of the sector. New liquor legislation was recently promulgated, which seeks to increase government control in virtually every faced of the liquor value chain, from production to distribution and retail.

While the sector has, overall, performed well in recent years, it is increasingly being challenged by other sectors for a share of consumers' disposable income. At the same time, the current government has made it a key objective to reduce the widespread abuse of alcohol, and related social and medical consequences. Black economic empowerment (BEE) is also starting to take place in the sector, with a number of notable transactions having taken place in the recent past. Also, BEE charters and related industry 'scorecards' are currently being developed in a widely consultative process. Transformation remains one of the key challenges for the sector, especially in the context of the liquor industry's unique characteristics and dynamics, and the country's existing demographics and ownership patterns.

This industry report looks broadly at the sector's segmentation, sales and international trade performance, industry concentration and key products, employment characteristics, BEE, competition and regulation, the potential for SMMEs as well as some of the key challenges facing the sector going forward.

2. Brief overview of the South African liquor industry

The South African liquor industry can be broadly classified to include the manufacture, marketing and distribution of wine, spirits and beer. For the purposes of this report, the primary emphasis is on the “manufacturing” stage, rather than upstream production (for example wine growing) or downstream retailing.

The South African liquor industry today has to a large extent been shaped by the domestic environment in which it operated over the past few decades, and more recently, by global influences and opportunities. Past regulation and even political considerations led to a sector that is in part highly concentrated, for example in the beer and spirits industry. This means that a small number of firms control a large part of the market. While it can be argued that certain global dynamics and economies of scale require this, a prime example of this not necessarily being the case is Germany, where besides national and international brands almost every town has its own commercially viable brewery. In South Africa, a single company controls virtually the entire market.

In the spirits segment, a small number of firms are responsible for most of the production, marketing and distribution of liquor. While South Africa boasts a significant number of “home-grown” brands, for example *Amarula Cream Liqueur* or *Cape to Rio* cane spirit, many spirits are produced locally under international license.

The wine industry has far lower levels of industry concentration, with more than 500 active wine producers. While some of the large established spirits and wine companies own key producers in the sector, a large number of independent wine estates and co-operatives likewise play an important role.

Table 1. SA Wine industry at a glance (2003 / 2004)

South Africa's world ranking as a wine producer	9th in 2003
Producers' Income	R 2,6 billion
Number of wine growers	4,400
Number of wine producers (cellars / co-ops)	544
Employment	44,000 (primary agriculture) 22,000 (processing, incl. 3,500 wine cellar personnel) 43,000 (services e.g. wholesale, retail) 109,000 **total**
Land under vines	110,000 hectares 55% white, 45% red varietals
Number of vines	321 million
Leading wine growing regions	Worcester, Paarl, Stellenbosch, Robertson
Volume of production	885 million litres
Total exports	266 million litres 53% white, 47% red wine
Liquor consumption in South Africa (2003)	349 million litres
State revenue from wine products	R 1,082 million (Excise duty) R 940 million (VAT) R 2,022 million **total**

Source: SAWIS

A number of challenges face the South African liquor industry today, including issues around global competitiveness in the current climate of increasingly "free trade" in line with WTO principles. Black Economic Empowerment (BEE) is a key issue currently debated within the sector, and relevant industry charters are at an advanced stage of being concluded. At the same time, the liquor industry faces increasing competition from other sectors for a share of consumers' disposable income.

Despite the fact that there has been volume growth in the liquor industry, the sector today attracts a smaller *share* of discretionary disposable income than was previously the case. Data by research company AC Nielsen calculates that in 2004, spending on liquor accounted for approximately 13% of total discretionary spend, compared with 23.7% in 1996 and 16.4% in 2000. Relative 'spending share' was taken away mainly by the communications sector, including the cell phone, internet and digital satellite television categories. Nevertheless, higher income levels and greater disposable income mean that overall disposable income on consumables has also grown.

3. Key statistics of the liquor industry

3.1 Industry sales

The South African liquor industry is part of the general beverages sector, and can be broadly segmented into beer production / breweries and wine and spirits. The wine and spirits component can be further sub-divided along its sub-categories, for example still and sparkling wine, liqueurs, white and brown spirits, flavoured alcoholic beverages (FABs) and so forth.

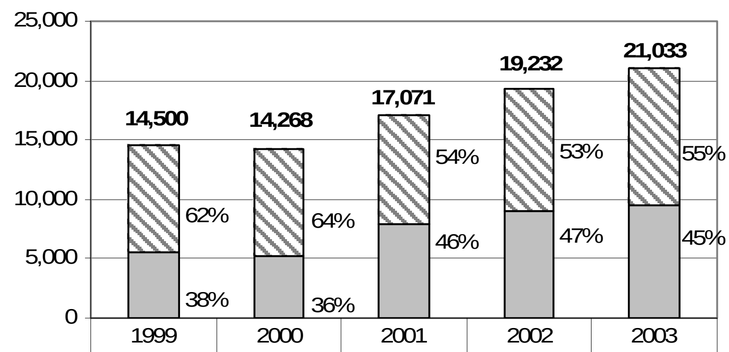
The liquor industry has in recent years recorded robust growth in sales value terms, which increased from R 14,5bn in 1999 to approximately R 21bn in 2003. This represents a nominal aggregate change of almost 50%. More recently, 2002 – 2003 year-on-year growth between was 9% in value terms. Soft drinks and mineral water, being the third component to make up the beverages sector, contributed a further R 9bn to beverage industry sales in 2003. While not forming a part of this study, this would make it roughly the size of the wine and spirits sector.

The split between sales of the beer market on the one hand, and wine and spirits on the other, was approximately 55% to 45% in 2003, the most recent year for which data was available from Statistics SA at the time of writing. In relative terms, the contribution to sales by the beer sector has declined over the period under review, although there has been a stabilisation over the past three years. National beer sales have increased by 28% to R 11,5bn between 1999 and 2003, while wine and spirits sales grew by 72% to R 9,6bn over the same period. According to recent industry reports (for example, by *AC Nielsen* and as contained in the financial statements of leading liquor producer and marketing company *Distell*), beer, FABs and brandy present three of the strongest growth categories of recent times.

Fig. 1. Value of sales through off-consumption outlets

(excluding bars, restaurants and other drinking establishments)

1999-2003, Rmn



	1999	2000	2001	2002	2003
Breweries and Sorghum Beer Breweries	8,960	9,118	9,183	10,279	11,482
Distilleries and Wineries	5,540	5,150	7,888	8,952	9,551

Source: Statistics SA

In the clear beer (as opposed to traditional African beer) market segment, South Africa's dominant producer (SABMiller) holds approximately 95% of the market share. The company's global annual sales (as at 31 March 2004) were valued at US$ 12,6bn (approximately R75bn), to which the South African beer operations contributed almost US$ 2bn (approximately R12bn). This excludes income from the company's equity holdings in the soft drinks industry, Appletiser South Africa and the Distell Group. Overall, 2003/4 data suggests that beer's share of the total liquor market rose to approximately 60% (in absolute alcohol share) in 2004, according to research published by AC Nielsen. Beer's market share was gained mainly from spirit-based companies, with the exception of the FAB segment. Even here SAB competes successfully with a number of products, most notably with *Redd's*.

SABMiller's dominant market position is further highlighted by the fact that South Africa's 6 top-selling liquor brands are all produced by the company. These are, in order of market share, *Carling Black Label*, *Castle, Hansa, Castle Milk Stout, Amstel* and *Castle Lite*. (The other four making up the top 10 are *Smirnoff* vodka, *Hunter's*, *Klipdrift* brandy, *Bell's* whisky and *Redd's* (FAB). Boosted by a strong upswing in demand for premium beers, Brandhouse beer labels such as *Windhoek* and *Heineken* have however seen strong growth in its relevant market segment.

Stakeholders falling into the “distilleries and wineries” category recorded R 9,5bn worth of sales in 2003, according to Statistics SA. Producers’ sales amounted to R2,6 billion in 2003. In volume terms, more recent data by SAWIS shows that in 2004 domestic sales and exports of natural wine amounted to 574 million litres, of which 308 million litres were domestic sales (54%) and 266 million litres (46%) were exports. The wine component of alcoholic fruit beverages was almost 10 million litres in 2004, equivalent to roughly 3% of the volume of domestic wine sales. Average nominal income per ton of grapes was R2,105 in 2003, up almost 60% from an average of R1,329 in 2003.

3.2 International trade performance

South Africa is a net exporter of liquor, with total beer, wine and spirit trade valued at almost R5bn in 2003. To this exports contributed with almost R3.9bn, while imports were valued at almost R1.1bn. Whereas total import grew by 51% in nominal terms in the six-year period 1999 to 2004, exports recorded a 156% gain. The most spectacular growth took place in the period 2000 – 2002, when the strengthening Rand mitigated somewhat against further strong export growth as experienced in previous years. But as is always the case when interpreting data, the choice of start and end date can play a major role with regard to an overall assessment of trade performance.

Table 2. Recent trade data for beer, wine, other fermented beverages and spirits (Rmn)

HS Classification	**HS 22.03**		**HS 22.04**		**HS 22.06**		**HS 22.08**		**Aggregate Total**	
Description	**Beer**		**Wine**		**Other fermented beverages (e.g. cider)**		**Spirits**		**Total beer, wine, spirits**	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
1999	137	40	1,221	82	22	0.6	149	581	1,529	704
2000	105	32	1,689	51	23	3.1	160	483	1,977	570
2001	247	20	1,971	44	33	1.1	304	601	2,555	665
2002	300	17	3,002	80	62	0.7	267	742	3,630	840
2003	401	102	3,151	88	36	0.9	222	716	3,809	907
2004	249	85	3,437	57	22	0.5	205	919	3,913	1,062
% change 1999-2004	+82%	+112%	181%	-30%	0%	-17%	+38%	+58%	+156%	+51%
Share of Exports 2004	6%		88%		1%		5%		100%	

Source: DTI database

South Africa’s key liquor export is wine which accounts for almost 90% of *total* liquor exports. This is followed by beer (6%), spirits (5%) and ‘other fermented beverages’ (1%).

Beer exports are small in comparison with wine, as beer is generally brewed by breweries (often SABMiller-owned) in neighbouring countries, where applicable. More than 75% of South Africa's recorded beer exports went to Angola, although it must be remembered that trade flows within the Southern African Customs Union (SACU), including Namibia, Lesotho, Swaziland and Lesotho, are not readily captured by the data. Notably, imports of beer have risen dramatically in the period 2002/2003, with 82% of recorded imports coming from the Netherlands and United Kingdom. They have since moderated to levels last seen in 2000 and 2001, although this co-incided with a period of substantial currency depreciation and thus more "expensive" imports. The same *caveat* with regard to SACU applies. It is evident however that Namibian Breweries-Heineken-Diageo's joint venture "Brandhouse" (more about this later) is increasingly competing at the premium end of the market. Its beer products include the Windhoek range, Becks and Heineken.

The relatively high value of spirit imports can be explained by the particular dynamics of this market segment, where global brands are either produced locally under license or are imported in full (for example Scotch whisky). Spirit exports have in fact declined in recent years, while imports have remained relatively stable. In 2004, exports of South African spirits were widely dispersed, although primary destinations included Angola (a new destination), Canada, Germany, Mozambique and the United States. Imports were mostly from the UK, home to the world's leading spirits producers and marketers (as the analysis later will show). Significant imports were also sourced from the United States and Jamaica.

Key Export and Import Markets: Spirits (HS 22.08)

Spirits: key export markets (2004)	**Spirits: key sources of imports (2004)**
Angola (16% of total)	United Kingdom (67% of total)
Canada (11% of total)	United States (13%)
Germany (7%)	Jamaica (6%)
Mozambique (10%)	Ireland (2%)
United States (6%)	Canada (2%)
Rest: 50%	*Rest: 10%*

Source: Department of Customs and Excise

The wine segment, which accounts for most of South Africa's liquor trade, has shown some resilience in the face of a strengthening local currency. In fact, exports of wine have achieved good year-on-year growth between 1999 and 2004, especially in the 2001/2002 period of Rand weakness. A stronger Rand appears – from the trade data – to have had little impact on the overall *value* of wine exports. According to various industry sources and media reports, margins have however been under severe pressure, with some wines (especially at the upper end of the market) being re-positioned from the export market back to the local market.

The majority (72% in 2004) of South Africa's wine exports are shipped as bottled wine, while 28% goes out as bulk wine for re-packaging in the destination market. Within this category, white wine varietals (including Rosé wine) (with a weighted average in 2004 of 32%) showed a far higher bulk export component than red wine varietals (weighted average 23% in 2004). Exports as a percentage of total "drinkwine" production have risen substantially in recent years, climbing from 21.7% in 1999 to 33.6% in 2003 (Source of data: SAWIS).

Key Export and Import Markets: Wine (HS 22.04)

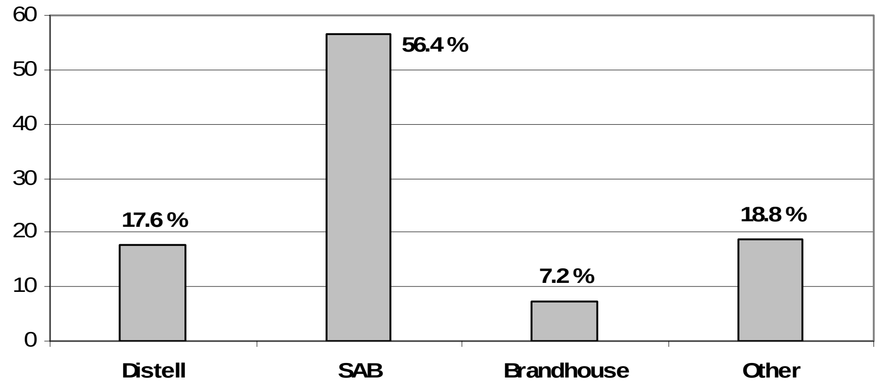
Wine: key export markets (2004)	**Wine: key sources of imports (2004)**
United Kingdom (37% of total)	France (57%)
Netherlands (15%)	Portugal (15%)
Germany (9%)	Italy (9%)
Sweden (7%)	United Kingdom (4%)
United States (5%)	Netherlands (3% of total)
Rest: 27%	*Rest: 12%*

Source: Department of Customs and Excise

3.3 Number of firms within the industry and key products

As outlined later, the structure today of the South African liquor industry (essentially encompassing beer, spirits and spirit-based drinks, and wine) has its roots in the strong regulatory regime of the 1970s and 1980s. As a result, a small number of firms control the liquor industry. In addition, the capital-intensive nature of liquor production, distribution and marketing means that a fair amount of consolidation around key brands and companies has taken place. Particularly in the spirits market, a large number of global brand names are in existence, reaching well into the South African market (usually manufactured and distributed locally under license). The exception is the wine industry, despite the existence of certain multi-brand owners and distributors. This segment differs significantly from the beer and spirits segments in that a far larger number of independent producers operate in this market.

Fig. 2. Key players' market share of SA liquor industry (Oct.-Nov. 2004)



Source: Distell, AC Nielsen

In the beer segment, London-based **SABMiller** (formerly *South African Breweries*) is the leading producer of (malt) beer in South Africa, holding a 95% share of the market in this segment. It is today one of the largest beer companies in the world, following rapid expansion in key international markets, mainly through mergers and acquisitions. The key merger between South African Breweries and US company Millers took place in 2002. The company owns over 150 beer brands. Key beer brands produced and marketed in South Africa include *Castle*, *Carling Black Label* and *Amstel* (produced under license), while the company's more than 150 international brands include *Pilesener Urquell*, *Millers and Holsten*.

The formal sorghum beer industry, which is referred to as "traditional African beer", is dominated by **United National Breweries (SA)** (UNB). This Indian-owned company is the successor to National Sorghum Breweries (NSB), and took management control of that company in 1996. In 2000, UNB also took over *Traditional Beer Investments,* the sorghum division of then SA Breweries. The company holds a 90% share of the local market, producing around 400mn litres per annum. However, this performance must be seen in the context that in South Africa more than three quarters of traditional African beer is brewed at home, the rest being industrial production. Also, the size of UNB's brewing volume (0,4bn litres) is substantially smaller than that of SABMiller's South African operations (2,5bn litres).

The company owns 9 breweries (5 coastal, 4 inland), and has some ownership control over both its distribution network as well as raw material sourcing through its Isithebe (KZN)-based malt plant. Brands include *Chibuku* and *Ijuba Special*. It plans to broaden its reach to the “home” market by producing a powder version of traditional African beer. A small number of other companies currently compete in this segment, including notably King Foods, a division of Tiger Brands.

In the clear beer market – and specifically at the premium end – SABMiller’s main rival is **Brandhouse**, the local joint venture referred to earlier between Namibian Breweries, Heineken and global beverages company Diageo, which was launched in July 2004. The formation of 'Brandhouse' follows the purchase of an effective 28.9% stake in Namibia Breweries by Diageo and Heineken. Brandhouse effectively replaced Guiness UDV (SA), the South African subsidiary of multinational spirit producer Diageo. Guiness UDV had the largest South African market share in whisky (through for example *Bells* brand) and vodka (through Smirnoff), as well as smaller shares in the brandy, gin and FAB markets.

Brandhouse sells and markets products including *Heineken*, *Windhoek Kilkenny, Becks* and *Guinness* beer, *J&B*, *Dimple* and *Johnnie Walker* whisky, *Smirnoff Vodka*, and FABs such as *Archers Aqua and Smirnoff Spin*. Further competition for local players will also be in the liqueur, brandy and gin categories through brands *Cape Velvet Cream*, *VO Brandy* and *Gilbey’s Gin*. Although this venture holds a threat to certain of SABMiller’s product categories, most notably in the premium beer market, it poses little threat to the overall market position of the incumbent firm.

As a result, the South African malt beer industry is dominated by SABMiller, while in the sorghum-beer / traditional African beer category United Breweries (SA) dominates the ‘formal’ sector. A number of smaller micro-breweries also exist alongside SABMiller, focusing in most respects on very small local niche markets, or the premium label market. Examples include **Mitchells** Brewery in Knysna (established 1983), and Midrand-based **Bavaria Brau**, recently taken over by its Dutch (but previously unrelated) namesake Bavaria NV.

Table 3. Key players in the SA beer market segment

Name of company	Selected examples of brands produced and / or marketed and distributed in South Africa
SABMiller	*Castle, Carling Black Label, Amstel, Pilesener Urquell, Millers, Sterling*
United National Breweries (SA)	*Chibuku, Ijuba Special, Leopard Special, Tlokwe*
Brandhouse (Namibian Breweries, Heineken, Diageo venture)	*Heineken, Windhoek, Kilkenny, Becks, Guinness, Tafel*
NMK Schulz (distribution)	*Boddingtons, Corona, Grolsch, Stella Artois, Zambezi*

Source: Company websites

In the spirits segment, a small number of companies control the market. **Distell**, which is 30% equity-owned by SABMiller, produces and distributes spirits and wines under various well-known trademarks. Distell was formed following the merger between Distillers Corporation and Stellenbosch Farmers Winery group (SFW) (see section on Competition). These include (among others) *Grants* and *Scottish Leader* whisky*, Romanoff vodka, Klipdrift, Oude Meester, Viceroy,* and *Van Ryn's* brandy*, Gordon's* gin*, Bacardi* rum*, Amarula* liqueur and FABs such as *Klipdrift & Cola* and *Bacardi Breezer.* As shown in Figure **2** above, Distell's share of the South African liqueur market currently stands at approximately 17.6%.

Other key competitors in the spirits segment include **DGB**, **Edward Snell & Co, NMK Schulz** and **Pernod-Ricard**.

DGB was formally formed in 1991 from the merged Douglas Green and Bellingham. According to DGB's company website, it is today South Africa's "largest independent producer and distributor of wine and spirits", with spirit brands including *Kahlua*, *Red Heart Rum*, *Zappa Sambuca*, *Remy Martin* and *Ballentine's* whisky. Wine brands (production and / or distribution) include *Graham Beck*, *Douglas Green, Bellingham* and *Veuve Clicquot* champagne.

Edward Snell & Co is a South African family-owned company, and is involved in the production and marketing of various spirits. Its headquarters are in Durban, with production facilities in various centres. The company produces and / or markets and distributes brands that include *Wellington* brandy, *Glen Eagle* whisky, *Russian Bear* vodka, *Cape to Rio* cane spirit, among others. It is also responsible for the distribution of brands including *Absolut* vodka, *Jack Daniels* whisky and *Moët & Chandon* champagne. *Jack Daniels* and *Southern Comfort* are global brands that E. Snell distributes locally on behalf of The Really Great Brand Company, which in turn is the local presence of US brand owners Brown-Forman. While Distell and now Brandhouse (whose products were previously distributed by GUDV, the South African subsidiary established out of the merged Guiness and Grand Metropolitan, owned by multinational Diageo) compete mainly in the proprietary and premium end of the market, Edward Snell is active mainly in lower priced, value-for-money market segment.

NMK Schulz are agents, importers, wholesalers and local distributors of alcoholic beverages, serving mainly the premium end of the spirits (as well as the wine and beer) segment. They are located in Johannesburg, but have regional representation through depots in most major centres of South Africa. Some of the company's spirit (and other) brands include *Stroh* rum and *Störtebecker* schnapps, *Jim Beam* whisky, *Frangelico* liqueur, *Corona*, *Zambezi* and *Stella Artois* beers.

Pernot-Ricard, the French-based company, is according to its website one of the world's three leading wine and spirits operators. Its products include well-known brands that include *Chivas Regal* and Jameson, *Olmeca* tequila, wine brands including Australian *Jacob's Creek*, *Martell* brandy and various FABs. It is represented in South Africa through its subsidiary, Pernod Ricard South Africa. Seagrams, a further competitor active in the South African market, was bought out by Pernod-Ricard.

A number of much smaller liquor manufacturers are also active in this market segment, for example Cape Town-based SLD Liquor Manufacturers, or George-based Mahers Beverages. They compete mainly at the lower end of the market with generic products, for example in the liqueur, 'sours', sambuca and tequila categories. Many producers and marketers of spirits (both large and small) source their raw materials (vodka, gin, cane spirit etc.) from NCP Alcohols, a Durban-based manufacturer and leading South African producer of ethanol for the alcoholic beverages industry. Another supplier is sugar producer Illovo through its Merebank (Durban) and Glendale (KZN North Coast) distilleries.

Table 4. Key players in the SA spirits market segment

Name of company	Selected examples of brands produced and / or marketed and distributed in South Africa
Distell	*Grants, Scottish Leader, Romanoff, Klipdrift, Oude Meester, Viceroy, Van Ryn's, Gordon's, Bacardi, Amarula*
Brandhouse	*J&B, Dimple, Johnnie Walker, Smirnoff, Cape Velvet Cream, VO, Gilbey's*
DGB	*Kahlua, Red Heart, Zappa Sambuca, Remy Martin, Ballentine's*
Edward Snell and Co.	*Wellington, Glen Eagle, Russian Bear, Cape to Rio, Absolut, Jack Daniels*
NMK Schulz	*Stroh, Störtebecker, Jim Beam, Frangelico, Corona, Zambezi, Stella Artois.*
Pernod-Ricard	*Chivas Regal, Jameson, Olmeca*
NCP Alcohols, Illovo etc.	Production and supply of "raw" alcohols (e.g. gin, vodka, cane) to local manufacturers and marketers

Source: Company websites

Unlike the beer and wine industries, the high industry concentration levels found in the beer and spirits segment are not replicated in the wine industry, where a far larger number of market participants are active. This segment of the liquor industry is located predominantly in the Western Cape province, and to a smaller extent in the Northern Cape. The Worcester region is the leading producer in terms of vines planted, followed by Paarl, Stellenbosch and Robertson.

According to SAWIS, the wine industry's statistics authority, an estimated 4,401 *primary* wine producers (i.e. growers of grapes) supply approximately 550 wine cellars and wine co-operatives. As can be seen in the table below, the majority of wine producers are private cellars with a capacity of 1-500 tons[1]. A further 48 private wine cellars could in 2003 be classified as medium (500-1000 tons), while 50 wine cellars crushed between 1000 and 5000 tons of grapes. Co-operatives, which are mostly jointly owned by a number of primary wine producers, were mostly responsible for a crushed tonnage of over 10,000 tons, in other words more than 20 times more than the average size of a private wine cellar. In fact, 6.3% of total white varietals, and 60.9% of total red varietals, were crushed by co-operatives during 2003. In terms of total industry output, therefore, they play a key role.

[1] Note that disaggregated data from SAWIS was only available for 2003 at the time of writing; however, recently updated 2004 totals *were* available and are provided at the end of the table

Table 5. Structure of the SA wine industry (2003)

(2004 aggregate at bottom)

Capacity category (tons of grapes crushed in 2003)	**2003 Number of Wine Cellars**			
	Producing wholesalers	**Private wine cellars**	**Co-ops**	**TOTAL**
1 - 100	5	219	-	224
> 100 - 500	1	106	-	107
> 500 - 1000	1	48	1	50
> 1000 - 5000	5	50	14	69
> 5000 - 10000	-	-	19	19
> 10000	4	-	32	36
Total (2003)	16	423	66	505
	2004 Number of Wine Cellars			
	Producing wholesalers	**Private wine cellars**	**Co-ops**	**TOTAL**
Total (2004)	**18**	**460**	**66**	**544**

Source: SAWIS

The large number of wine producers means, and subsequently low concentration levels, mean that the industry consists of a few large marketers and distributors of wine competing with a large number of "independents". Key producers and distributors in terms of volume and brand include Distell (which has interests across the board in spirits, FABs, liqueurs and wine, among others), KWV and DGB (also with brands in different liquor segments).

Table 6 Key players in the SA wine segment

Name of company	**Selected examples of brands marketed and distributed**
Distell	*Fleur du Cap, Chateau Libertas, Drostdy Hof, Durbanville Hills, Nederburg, Zonnebloem, JC le Roux, Pongrasz, 5th Avenue, Graca, Tassenberg, Witzenberg* as well as numerous premium brands managed through subsidiary 'Cape Legends' (e.g. Allesverloren, Alto, Neethlingshof, Uitkyk)
DGB	*Bellingham, Douglas Green, Graham Beck, Culemborg, St. Augustine,*
KWV	*KWV, Groot Constantia, Beyerskloof, Kanonkop, Boschendal, Slanghoek, De Wetshof, Seidelberg, Laborie*
Other leading brands:	*Hamilton Russel, Jordan, Vergelegen, Warwick, Fairview, Rustenberg, Meerlust, Simonsig, Delheim, Neil Ellis, Mulderbosch, L'Ormarins, Morgenhof, Middelvlei, Zevenwacht etc.*

Source: Company websites

3.4 Value to the South African economy

The liquor industry makes a significant contribution to the South African economy, not only in terms of its contribution to GDP, but through its payment of taxes such as company tax, VAT and excise duties, provider of employment, supplier and user of a variety of goods and service, role player in the tourism industry and so forth.

The wide reach of the liquor industry across the primary, secondary and tertiary sectors of the economy, from agriculture (grapes, malt, hops, sugar cane) to manufacturing (wine making, distilling, brewing) to marketing, distribution and retail mean that the sector's contribution to GDP is difficult to quantify.

Compounding this problem is the fact that the national statistics agency, Statistics South Africa, does not provide regular disaggregated GDP statistics showing the contribution to GDP by the liquor, wine and spirits sector. The beverages sector, *within* the broader manufacturing sector, is often lumped together with tobacco, while the contribution of the liquor sector's reach into the primary (agriculture) and tertiary (marketing services, transportation etc.) sectors is difficult to quantify.

According to research by ABSA Bank' economics division, the manufacturing sector's contribution to overall GDP is 32.2%. The beverages sector accounts for 4% of GDP, although this includes both alcoholic and non-alcoholic beverages. Agriculture contributes 3.8%.

Since most of the wine industry is located in the Western Cape, its contribution to the region's gross geographic product (GGP) is significant. The spirits segment, with its own dynamic mix of local production and / or distribution of international brands, is spread a little more evenly throughout South Africa, although even here the largest players are located in the Western Cape (for example Distell, Brandhouse, KWV). In the beer industry, the production and distribution network is spread out nationally, with at least seven SABMiller breweries alone operating in various centres.

3.5 Employment characteristics of the industry

The liquor industry is an important source of employment opportunities in South Africa. Unfortunately, few reliable employment statistics covering recent years appear to be available, due in part to seasonal variations (for example the wine industry) and the overlap between certain manufacturing processes with other industries (for example certain distillation of ethyl alcohols).

For the wine industry, a recent report by Conningarth Economists estimates the total number of direct employees to be 109,000. Of these, only 22,000 are involved in the processing of wine (refining, manufacturing, cellar personnel), while 44,000 are employed on the primary production side (wine growers). A further 43,000 are employed on the distribution, which includes the wholesale, retail and transportation sectors. In addition, 7,000 tourism-related jobs are said to be directly attributable to the wine industry.

In the beer industry, SABMiller – with 95% market share – directly employed 5,200 employees as of March 2004. According to a now outdated estimate by SAB, as contained in the DTI's 1997 liquor policy paper, a large number of jobs are created in dependent and related industries, as well as the informal sector. It estimates that up to 14,000 beer-related jobs were in the packaging sector, 20,000 in agriculture (barley, hops), 95,000 in the formal retail sector and a staggering 230,000 in the informal retail sector. Presumably, this would include the many informal brewing operations found predominantly in rural areas, and often serving domestic or very localised areas.

No reliable data is available for the spirits industry. Key players include Distell, Brandhouse, DGB, E.Snell, KWV, Pernod Ricard, NMK Schulz and upstream producers (of cane spirit, rum, vodka etc.) NCP Alcohols and Illovo. A number of wine producers are also active in the spirits segment, for example through the distillation of brandy and flavoured liqueurs. The sugar cane industry in Kwazulu-Natal, and the resulting presence of cane-based alcohol producers around Durban (NCP Alcohols etc.), serve as an important driver for the location of various smaller spirit marketers and re-sellers. These operate mainly at the lower end of the market, but nonetheless provide significant local competition to large brand-name companies like Distell.

4. Industry profile

4.1 Segmentation within the industry

As is evident from the preceding sections, the South African liquor industry can be broadly segmented into beer, spirits and wine sectors. Despite the inter-relatedness of these segments, for instance their dependence on disposable income and the substitutability of some of the products, the dynamics within each sector are nevertheless fairly unique.

Beer captures by far the largest share of the market, and consists of clear and more traditional varieties. The clear beer market is approximately twice the size of the sorghum beer market, although the data does not capture traditional home-brewing. The industry is dominated by SABMiller, the formerly South African company which has grown into an international leader in the beer sector.

Table 7. Overview of broad market share (in percent) according to liquor category (1995-2003)

YEAR	Alc. fruit beverages (FABs)	Beer*	Trad. African beer*	Natural wine	Brandy	Other spirits	Whisky	Fortified wine	Sparkling wine	TOTAL %
1995	1.7	41.6	26.5	12.8	7.2	4.5	3.1	2.3	0.3	100.0
1996	2.0	41.2	24.6	13.9	7.7	4.6	3.3	2.4	0.3	100.0
1997	2.3	41.4	24.2	13.9	7.7	4.6	3.2	2.4	0.3	100.0
1998	2.5	43.2	23.7	13.6	6.6	4.9	3.0	2.2	0.3	100.0
1999	2.7	44.3	23.3	13.7	6.0	4.9	2.7	2.0	0.4	100.0
2000	3.2	42.8	24.3	13.9	5.7	5.1	2.8	1.9	0.3	100.0
2001	3.3	42.6	24.1	14.0	6.0	4.9	2.8	2.0	0.3	100.0
2002	3.2	43.1	23.9	14.0	6.1	4.7	2.6	2.1	0.3	100.0
2003	3.2	44.6	23.7	12.3	6.3	4.7	2.6	2.3	0.3	100.0

Source: SAWIS

** Note: The market share implied by these figures does not appear to be consistent with output data by SABMiller / United National Breweries, unless the assumption is made that approximately 75% of traditional beer production and consumption is self-made and thus not captured by official statistics*

The spirits industry, broadly classified, accounts for approximately 15% of the liquor industry market share, and can be further segmented into white spirits (for example gin, vodka), brown spirits (for example brandy and rum), whisky and spirit-based drinks (or FABs). Brandy captures by far the largest share of the market (46% of spirits sector), with South Africa being one of the leading producers of Brandy worldwide. The sector is dominated by a small number of multi-brand companies, who are often subsidiaries of global brand-name manufacturers or at least have long-term distribution agreements.

The wine industry, which as indicated earlier has the lowest levels of industry concentration within the liquor industry, covers still wine, fortified wine and sparkling wine categories. Together, these account for approximately 15% of the liquor market. Wine production is split approximately 68% to 32% in favour of white varietals, with only Stellenbosch, Paarl and Malmesbury wine regions crushing more red than white varietals. An increasing focus on the noble cultivars is evident, notably Sauvignon Blanc, Chardonnay, Cabernet Sauvignon, Pinotage, Merlot and Shiraz, as measured by these cultivars' percentage of total plantings. For example, the area distribution of Cabernet Sauvignon has more than doubled since 1996, for Shiraz has grown from 1.1% to 7.7%, Merlot from 1.6% to 6%, and Pinotage from 3.3% to 6.1%.

Table 8. Overview of broad market share within liquor market segments (1995-2003)

Category	**Sub-Category**	**Domestic Market Share (%) within given Category** ***2003 data***	
Beer	'Clear' Beer	65	
	Sorghum / Traditional African beer	35	
Wine	Natural Wine	88.4	Red: 32 %
			White: 68 %
	Fortified	9.5	
	Sparkling	2.2	
Spirits	Brandy	45.8	
	Whisky	18.9	
	Other Spirits	35.3	

Source: SAWIS

4.2 Black economic empowerment (BEE)

According to the current wine industry charter, black economic empowerment is defined as "an integrated and coherent economic process that directly contributes to the economic transformation of South Africa, and brings about the economic empowerment of all black people, including women, youth, people with disabilities, and people living in rural areas." A black empowerment enterprise is one that is "at least 25.1% owned by black persons and where there is substantial management control".

On the whole, the South African liquor is currently still predominantly white-owned, owing to a large extent to the fact that its past regulatory regime has lead to a highly concentrated ownership patterns and subsequently high barriers to entry. For example, leading wine and spirits company Distell, which was formed out of the merger between Distillers Corporation and Stellenbosch Farmers Wineries (SFW), is still largely owned by large corporates Rembrandt – KWV Investments, and SAB (now SABMiller). However, press reports from February 2005 state that Distell has made substantial progress in structuring a BEE transaction, which would dilute the tightly held shareholding and is predicted to be completed within the next few months. DGB, another leading wine and spirits company, has 10% black ownership. However, the first major BEE deal in the wine and spirits sector came about towards the end of 2004, when KWV Limited finalised the sale of a 25.1% stake in the group to BEE consortium Phetogo Investments.

In the beer segment, SABMiller is a public listed company with limited black shareholding, although the company focuses strongly on increasing BEE mainly through its supply and distribution channels. In the wine industry, various empowerment ventures have led to black ownership and / or management of wine-producing land, although mostly in partnership with incumbent operators.

Moves are currently underway to introduce BEE more formally into the industry, with the development of both a liquor industry and wine industry charter. Up until recently, BEE initiatives have been largely ad-hoc in nature and without a clear overall strategy. A ‘Consultative Conference on Black Economic Empowerment in the South African wine industry’ was held in 2003 by the South African Wine Industry Trust (SAWIT) together with the South African Wine and Brandy Company (SAWB). Black ownership in the wine industry is estimated to be less than 1%.

SAWIT represents both government and industry, with a budget of over R360mn over a 10-year period “to effect promotion and transformation in the wine industry”. SAWB is the relevant industry partner. The abovementioned conference mandated SAWIT and SAWB to draft a Wine BEE Charter and Industry Scorecard, covering farming, wine manufacturing and trade. The purpose of these was to “facilitate the vision and the achievement of the goals and to align and focus all sectors of the wine industry value chain into coherent strategic activities This was to tie in and complement existing BEE strategies, namely the agricultural sector’s Agri-BEE Charter as well as the Liquor Manufacturers and Wholesalers’ Charter and Scorecard.

The wine industry charter, for which SAWB is taking responsibility on a technical management level, is currently in its 7th draft version (published in February 2005). The paper contextualises BEE with reference to the following key issues that need to be recognised and dealt with:

- A highly skewed ownership regime, which still rests largely in white hands;
- A history of problematic labour relations;

- The need for economically viable and market driven BEE;
- The importance for the industry to become more closely integrated into its entire value chain;
- The need to support human social capital development;
- The importance of a shared and united vision and goals in the wine industry.

In recognition of these issues, the industry has drawn up its objectives for BEE. One of the key objectives emerging out of the above issues is the establishment of industry benchmarks in order to “ (a) lower access barriers to resources and support services in favour of new entrants from historically disadvantaged groups or individuals”, and “(b) establish incentives for effective partnerships, mentorships and ventures between existing operators and new entrants”.

With respect to point (b) above, the wine industry is already characterised by a number of joint ventures and or mentorships in pursuit of BEE. The first black-owned wine producing farm in South Africa was the “*New Beginnings*” venture, involving *Nelson’s Creek* wine farm. This BEE transaction, which took place in 1997 and involved farm workers using their government housing subsidies to replant vineyards allocated to them by the farm’s owner, formed a model for a number of subsequent similar transactions.

Table 9. Selected BEE ventures in the wine industry

Name of venture	Year	Land reform type	Number Beneficiaries
New Beginnings	1997	Black estate	16
Gelukshoop	2002	Black estate	43
Biz Africa	2002	Black estate	73
Winola Park	2003	Black estate	47
Papkuilsfontein	1998	Joint venture (51%)	n/a
Thandi	1996	Joint venture (33.3%)	150
Carpe Diem	2000	Joint venture (50%)	99
Bouwland	2003	Joint venture (74%)	60
Van Loveren BEE venture	exp. 05/2005	Joint venture (40%)	n/a

Source: WOSA; N. Tregurtha

In the beer segment, SABMiller – now one of the world’s leading international beer companies with headquarters in London – is making progress towards BEE mainly through its network of suppliers and distributors. In 2004, for example, the company spent over R

700mn with 1,500 BEE suppliers in South Africa, representing an increase of 21% over the previous year. Growth for the 2005 financial year is envisaged to be similar. On the distribution side, already over half of the company's South African distributors are BEE individuals or companies, having been assisted my substantial financial commitments by BEE.

4.3 Competition

The structure of the South African liquor industry, essentially encompassing beer, spirits and spirit-based drinks, and wine, has its roots in the strong regulatory regime of the 1970s and 1980s. Market power rested with a few large conglomerates (especially in the beer market, and to a lesser extent in spirits), although some segments (wine) contained a much larger number of enterprises. Despite interventions by South Africa's competition authorities, most notably with regard to the market for spirits following the Distillers Corporation and Stellenbosch Farmers Winery group (SFW) merger in 2000, a small number of companies currently control a large bulk of the South African liquor industry. These include SABMiller, Distillers and Brandhouse.

A lessening of competition in the SA liquor industry took place as early as 1918, when according to the Competition Tribunal's background assessment of the recent SFW-Distillers merger

> *…"a so-called 'gentlemen's agreement' was entered into by the KWV and the wine merchants under which the KWV would refrain from competing with the merchants it supplied. Specifically, the KWV, as a quid pro quo for the co-operation of private entrepreneurs, undertook not to compete with the existing interested parties in the trade in or distillation or manufacture of wines and spirits in Africa south of the equator."*

Many decades later, in 1979, a market sharing arrangement resulted from the restructuring of parts of the South African liquor industry, which secured SAB's (now SABMiller) beer monopoly and the Rembrandt Group's dominant position in the spirits and particularly brandy market. As a result, Rembrandt was to stay out of the beer market, while SAB was not to directly compete in the spirits industry. At that stage, SAB had owned SFW as well as spirits company Henry Tayler and Ries.

This restructuring led to the South African Competition Board to recommend, in 1982, that the vertical integration and resulting lowering of competition as a result of this transaction be reversed, the government at that stage rejected this recommendation. However, six years later, a partial reversal of the restructuring was effected through the separate listing on the Johannesburg Stock Exchange of SFW and a new entity called Distillers Corporation SA Limited. Twelve years later, in 2000, Distillers and SFW once again merged to form Distell, giving the merged entity dominant market share in the gin, sparkling wine, fortified wine, FABs and brandy categories. Distell's share of the South African liquor market (including beer) immediately after the merger was just under 20%. The company also has interests in the regional market, for example a stake in African Distilleries in Zimbabwe, Drinks and Beverage Co in Mauritius, as well as Tanzania Distilleries Limited.

Due to the "lessening of competition" in various categories following the merger, most notably in the premium spirits category (interestingly, the Competition Tribunal interpreted market share more according to price categories rather than the classic "white spirits", "brown spirits" etc. differentiation), the Tribunal went on to require Distell to divest itself of brand interests. These included some brandy categories (Martell) as well as its distribution rights of KWV brands. However, as KWV still partly owns Distell, a potential conflict of interest with regard to competition nevertheless remains.

Significant competition in the premium spirits market also comes from newly formed Brandhouse, which is consolidating its position in the industry together with heavyweights Diageo (the leading global spirits company) and Namibian Breweries. Others, such as E Snell, DGB and Pernod-Ricard. Nevertheless, market share (and market power) within this sector rests largely with a small number of companies. Entry barriers are high, not so much as a result of production challenges but rather the vast resources required to gain market share through marketing and advertising.

In the wine industry, competition is intense, exacerbated by the fact that the strengthening Rand has forced many export-geared producers to re-evaluate he local market. 2004 in particular was signified by vast surpluses, applying downward pressure on prices and necessitating market practices that can sometimes be interpreted as being anti-competitive. For example, producers are increasingly forced to enter into arrangements with retailers and especially the restaurant sector to ensure "shelf space" or a listing on the menu, often to the exclusion of competing brands. Nevertheless, competition remains healthy in this sector.

The South African beer industry is a classic case displaying market dominance by a single operator. With the exception of the premium beer market, where rival Namibian Breweries (through the Brandhouse venture) competes, SABMiller virtually owns the market. While

SABMiller is not a true monopoly in that despite its market share it does not charge monopolistic prices nor are other operators prevented from entering the market, it nevertheless wields substantial market power. The company has grown from being a national company with interests in liquor, retail and manufacturing, to the world's second largest brewer with brewing interests across the globe especially in key emerging markets. In South Africa, a number of small micro-breweries exist alongside SABMiller, although these mostly serve only a very small local market.

4.4 SMME potential

According to the National Small Business Act of 1996, small, medium and micro enterprises (SMMEs) can be classified as such according to a number of criteria. These include number of employees, annual turnover and gross asset value (excluding fixed property).

Type	Number of employees	Annual turnover	Gross asset value
Micro	< 5	< R 0,15 million	< R 0,1 million
Small	< 50	< R 5 million	< R 2 million
Medium	< 200	< R 10 million	< R 5 million

Due to the widely varying segments within the broader liquor industry, a generalisation with respect to he sector's SMME potential is not possible. The beer sector in particular is highly capital intensive, and entry barriers or insufficient returns as a result of SABMillers dominance of the local market have seen many smaller breweries fail. This notwithstanding, a number of microbreweries (usually targeting a confined geographic area) operate in various parts of South Africa. The large and mostly unrecorded number of small-scale operations brewing traditional (or sorghum) beer are mostly small private ventures, and usually serve domestic purposes (own consumption) or very localised areas. These typically fall outside the effective reach of South Africa's regulatory regime.

The wine industry consists of a number of co-operatives and large wine estates on the one hand, and on the other hand a fairly sizeable number of smaller producers competing for market share in across all market segments. Almost half (219) of all private wine estates crushed less than 100 tons of grapes in 2003. Nevertheless, the wine industry is mostly capital intensive and would thus not easily be classified as typical SMME-type firms. This assertion however applies mainly to wine *estates*. A recent trend has been the emergence of a number of small-scale wine producers, who either grow and harvest their own grapes off very small tracts of land, or buy in grapes from various producers and undertake only the making of wine. *“Garagiste”* wine makers refers to small-scale producers, often using rented facilities, who make small batches of wine either privately or for small-scale marketing and distribution. The award-wining status of a number of these wines bears testimony of the potential for success of these small-scale producers, and in effect the potential for SME-sized enterprises within this sector. Internationally, this trend has existed for a number of years already.

In the spirits segment, a small number of large firms own most of the market share. This notwithstanding, a number of small-scale producers exist alongside it, competing for market share especially at the bottom end of the market. This is particularly the case in Kwazulu-Natal, due to the presence of South Africa’s sugar industry (a by-product of which is the distillation of “extra neutral potable ethanol” for the alcoholic beverages industry – essentially vodka, gin, cane spirit). With the alcohol “material” across different vodka or gin brands being largely a homogenous product, the role of various brand manufacturers is essentially one of product differentiation through marketing. What this means in the context of potential for SME operators is that entry barriers from a technical perspective are far less of a deterrent as are the barriers from a branding and marketing perspective. Herein lies the greatest challenge for potential SME stakeholders.

4.5 Industry regulation

The core legislation pertaining to the South African liquor industry is the Liquor Act of 2003 (Act 59 of 2003), which was promulgated by Government Gazette in April 2004. Related legislation are the National Liquor Regulations, 2004, which relate to the procedures for registration of liquor entities and other related matters as required under the Liquor Act of 2003. The National Department of Agriculture’s Draft Liquor Products Amendment Bill, which deals with issues such as geographical indications, inspection of premises etc., has not yet been promulgated.

Unlike the 1989 Liquor Act, which dealt with all liquor-related aspects including manufacture, distribution and retail sales of liquor in South Africa, the 2003 National Liquor Act covers predominantly manufacturing and distribution aspects. Owing to powers vested in the provinces by South Africa’s constitution, the responsibility for regulating the liquor industry rests jointly with national and provincial governments. Retail licensing, for example, was found by the Constitutional Court (before which initial versions of the proposed liquor legislation were brought) to be of exclusive provincial jurisdiction. The Constitutional Court ruling[2] found that the country's national government enjoys the "power to regulate liquor trade in all respects other than liquor licensing", thus rejecting its attempts to "prescribe detailed mechanisms to provincial legislatures for the establishment of retail licensing mechanisms".

The two key objectives of the national legislation are to restructure the liquor industry and to address the social-economic costs of alcohol abuse. To restructure the industry, government is seeking greater control over the sector at all levels, while also to deal with potentially anti-competitive conduct by dominant industry players, and to facilitate greater participation in the sector especially by historically disadvantaged groups.

Earlier draft versions of the liquor legislation envisaged a three-tier system consisting of manufacturing, distribution and retail. This would have sought to achieve a certain amount of de-coupling of certain aspects of the high degree of vertical integration found in the liquor industry, for example where spirits manufacturers also own major liquor retail outlets (as was until mid-2002 the case with Distell and Western Province Cellars), or where manufacturers have substantial control over their distribution network (for example SABMiller with respect to beer). It was argued that control over manufacture *and* distribution would in many instances foreclose new market entrants, thus also hampering greater participation by businesses owned by historically disadvantaged groups.

The new legislation requires manufacturers and distributors to become registered in terms of the Act. These registrations had to be completed by no later than November 2004, although they were in most respects a mere conversion from the old licensing system to the new. Officially, conditions for registration include commitments made by the applicant in terms of BEE. In practice, however, these conditions currently apply only to new market entrants, until such time that the necessary registration criteria have been formally drawn up by the relevant authorities. According to the National Liquor Authority, it is envisaged that this system will be in place by late 2005, to tie in with the expected completion of BEE charters for the greater liquor industry. From then on, registration conditions will also place a far greater emphasis on the applicant's commitment to combating alcohol abuse, for example whether the applicant subscribes to any industry code of conduct approved by the Minister.

[2] Reference: *Case No CCT 12/99, with respect to the Liquor Bill 2000*

Further, applications are to be adjudicated based on whether the proposed registration will materially restrict or promote –

- new entrants to the liquor industry
- job creation within the industry
- diversity of ownership
- efficiency of operation within the industry
- exports or
- competition.

A less restrictive dispensation relates to so-called micro-manufacturers, which are classified as those not exceeding the following threshold volumes –

- for manufacturers of beer, 100 million litres per year
- for manufacturers of traditional African beer (sorghum beer), 50 million litres per year
- for manufacturers of wine, 4 million litres per year
- for manufacturers of spirits, 2 million litres per year

Smaller producers and distributors, i.e. those falling below each of the above thresholds, are not required to be formally registered *at a national level* in terms of the new legislation, but must still comply with any registration and licensing requirements set out by the relevant provincial authorities. Regulation of micro-manufacture, retail sale and liquor consumption as well as of methylated spirits, are the responsibility of provincial liquor authorities.

Provincial roll-out of liquor legislation is currently underway in South Africa, having so far been completed in the Eastern Cape and Gauteng. Until such time as when the new legislation has been fully implemented, the relevant provisions of the previous Liquor Act of 1989 continue to prevail.

4.6 Social Issues and Consumer Protection

As outlined in the previous section, the 2003 National Liquor Act covers predominantly manufacturing and distribution aspects. As outlined earlier, the two key objectives of the national legislation are to restructure the liquor industry as well as to address the social-economic costs of alcohol abuse. While the first objective must be seen in the context of a sector having high concentration levels, especially in the beer and spirits segments, the social aspects have been elevated to the current high status owing to South Africa's poor track record especially with respect to the abuse alcohol and its health and social consequences.

One of the methods that the new liquor legislation is using to address the social and health aspects of liquor consumption is by imposing conditions on the registration of liquor license holders (in this case applicants falling above the threshold limits that have been set for compulsory registration). Considering the concentrated nature of the industry, these conditions should, therefore, in practice apply to all key beer and spirits operators. Many wine producers and distributors may however fall below this threshold.

In fulfilling the requirements for registration, the new Liquor Act requires that...

> *… "the applicant's proposed contribution to combating alcohol abuse, including whether the applicant has subscribed to any industry code of conduct approved by the Minister…"*

In practice, these requirements have not been applied to the initial license conversion process, which required existing producers and distributors over the volume threshold to register their activities by November 2004. The conditions for registration did however apply to *new* registrants from this date onwards. It is expected that by the end of 2005 (coinciding with the annual renewal of registrations) these conditions will apply to all firms covered by the legislation.

While the Act is not specific about the exact measures required from industry participants, a voluntary industry organisation has for the past twenty years provided sector participants with guidelines relating to various alcohol-related aspects. The organisation, which is called the Industry Association for Responsible Alcohol Use (ARA), categorises its activities under the following four themes:

- (industry) self regulation
- primary prevention through education and research
- youth development and prevention of under-age consumption
- participation in public policy development

Corporate members include South African Breweries, Distell, E.Snell, DGB, KWV among others, which means that industry coverage within this forum of the broader liquor production and distribution sector is substantial.

ARA members subscribe to a strict Marketing Code, which includes rules on advertising, promotions and media use. In this regard, complaints relating to its members are referred to an independent arbitrator. The ARA has also drawn up a 'Code of Business Practice' relating to legal, moral and ethical obligations, which the organisation claims "thousands of traders" subscribe to. The ARA has taken a number of positions with regard to issues affecting the sector. These relate to advertising, age limits, availability of alcohol, 'moderation and benefits', pregnancy, taxes and warning labels. While a discussion of each of these is beyond the scope of this study, some of the ARA's positions and related issues are summarised below:

Advertising: alcohol advertising does not increase consumption or affect abuse of alcohol; rather, its main purpose is brand building through brand differentiation;

Age Limits: supports 18 years as minimum (unsupervised) drinking age, emphasises importance of decision-making empowerment through education (of youth) as more effective than overly restrictive drinking-age limitations;

Availability: sees no causal link between availability of alcohol (i.e. type of beverage sold by licensee, opening hours, number of licensed outlets), per capita alcohol consumption and alcohol-related problems. Instead feels that focus on risky drinking patterns of individuals or groups holds greater hope for success.

Moderation and Benefits: advocates the importance of moderate drinking, but at the same time takes the position that the message of moderation should run in parallel to the message that moderate consumption has positive health effects;

Pregnancy: advocates the use of caution with respect to the consumption of liquor during pregnancy; actively providing funding for research into FAS (foetal alcohol syndrome);

Taxes: a policy based on high taxes has limited, if any, effect as a means of controlling the consumption of liquor due to unfavourable demand / price elasticity [3]; also believes that increased excise taxes as a means of moderating consumption imposes an excessive and fundamentally unfair burden on responsible drinkers and thus defeats its apparent objective;

[3] Inelastic demand means that a rise in prices leads to a relatively smaller drop in demand

Warning Labels: believes that warning labels would be ineffective in combating irresponsible alcohol use, and sees its ‘voluntary restraint’ of adding positive messages about possible health benefits relating to moderate alcohol consumption as a trade-off against the use of warning labels.

While the ARA’s policy position appears largely based on fully referenced scientific research, it is clear from an analysis of the above that the industry organisation is in effect opposed to any increasing regulation as a means of regulating alcohol consumption. This is perhaps understandable considering the nature of this body, which was formed by industry representatives who clearly have a stake in the sector. While not passing judgment on the validity of the organisation’s positions, it nevertheless remains a fact that a significant proportion of motor vehicle accidents on South African roads are related to the (excessive) consumption of alcohol. Furthermore, a substantial proportion of all trauma cases in hospitals also bear a direct link to the consumption of alcohol. Foetal Alcohol Syndrome (FAS) in South Africa finds one of the highest incidence rates in the world. While causal links to excessive alcohol consumption are not readily proven, it is certain that these are likely to include social, economic, moral and other reasons.

At the same time, it must be recognised that from a social responsibility and health perspective, regulation will necessarily find limited application in the unregulated segment of the industry. For example, home brewing of traditional African beer (sorghum beer) has cultural, economic and other roots, and campaigns to regulate consumption through interventionist policies are likely to be met with limited success. Furthermore, beer powder (the basic ingredient next to water used in the domestic production of traditional African beer) does not in its unfermented form contain alcohol, and would thus not fall within the scope of alcohol regulations.

5. Key challenges facing the industry and prospects for growth

As is clear from the previous analysis, the South African liquor industry is facing many significant challenges going forward. Many of these challenges are directly related to the country’s unique socio-economic landscape. In this context, an understanding of the present-day industry structure is only possible by recognising developments over the past three decades. In particular, the country’s international isolation during the apartheid regime meant that competition within the sector was often directly influenced by economic and political policies of that era.

The South African liquor industry today is market by high levels of industry concentration, especially in the beer and spirits segments. SABMiller controls virtually the entire malt beer market, although in fairness its share of the beer sector when considering the large unregulated component is somewhat smaller. Despite the absence of any specific legislation prohibiting competition in the beer market, entry barriers are in fact very high. Various micro-breweries exist, even more still have closed down, but none are able to capture any significant market share away from the incumbent operator. While this situation is naturally not entirely desirable, especially in the context of achieving broader ownership in the sector and opening it up to further competition, the situation is complicated by a number of key issues. SABMiller does not employ overtly monopolistic pricing behaviour, thus negating the argument that "consumer surplus" – which in economic theory refers to the aggregate additional price over the current average that might have been prepared to pay for beer – is passed to the company. Also, SABMiller operates in a market where size is increasingly key to survival. At the same time, the company is a publicly listed, meaning that despite its grip on the local market, it nevertheless benefits a large range of shareholders. Blindly changing ownership patters in the beer industry to more clearly reflect South African demographics is thus clearly not an easy task.

The spirits industry is also fairly concentrated, with a small number of players dominating this segment. Complicating factors, especially in the context of broadening ownership and making entry more accessible to new market players, include the fact that many of the sector's products are internationally branded goods. Many of these products are manufactured locally under intricate licensing and distribution agreements. The wine industry also faces its own unique set of challenges. Despite strong moves to broaden ownership by increasing BEE, it is said that less than 1% of this sector is black-owned.

Some of the many challenges facing the South African liquor industry therefore include the following –

- Overall ownership in the beer and spirits sector is highly concentrated, in a large part due to historical reasons where this was condoned if not even promoted;

- Entry barriers are extremely high in these segments, and with regard to spirits lie less with technical barriers rather than the substantial resources required to successfully build new brands through marketing and advertising;

- Despite South Africa's competition authorities' ruling that major liquor and wine company Distell dispose of certain of its brands (following the SFW-Distillers merger) to avoid excessively high concentration ratios in certain product segments, the industry remains highly concentrated at the product segment level;

- The dominance of SAB (SABMiller) in the beer industry poses difficulties with regard to broader ownership, as the incumbent operator is apparently not conducting its operations anti-competitively with regard to pricing, and thus does not necessarily warrant intervention to achieve consumer benefit;

- Detaching the currently close relationship between beer manufacture and distribution may be one of the few avenues for broadening broader ownership in this sector, although already more than half of SABMiller's non-owned local distribution is owned by historically disadvantaged groups (it should however be remembered that the company's close relationship with these distributors, often through complex finance arrangements, prevent them from being independent operators);

- Nevertheless, cross-ownership between production and distribution continues to maintain high entry barriers for new players into the liquor industry;

- The wine industry consists of a large number of primary and secondary producers, although entry barriers to new operators remain high considering the substantial capital requirements;

- Alcohol abuse and related medical and social consequences remain a significant problem in South Africa, something that the current legislation is hoping to reduce through stricter controls and penalties. However, this abuse is both a cause and consequence of the country's socio-economic environment, which for example warning labels (as has been proposed) will not simply eradicate;

- A number of BEE initiatives are underway in the wine industry, both at the primary production and processing / distribution stages. The key challenge here is for the process currently underway to lead to sustainable transformation of the industry, based on economic realities, in order to achieve long-term success;

- Another exogenous challenge facing the industry is the exchange rate, although this affects the wine industry the most. Spirits are mostly produced locally (in many cases under license for the South African market), meaning that exports are less of a factor. Beer is generally produced within the market that it serves (for example SABMiller's neighbouring breweries produce for the local market there), and exchange rate fluctuations do not directly affect Namibian Breweries local market presence due to the linked exchange rate. The wine industry however relies on exports to a far greater extent, with the exchange rate at current levels deeming many of South Africa's exports uncompetitive in key international markets;

- The liquor industry is forced to compete for consumers' disposable income with an increasing number of competing sectors, which in South Africa include the communications sector (especially cellular), the lottery and so forth. This is evidenced by the decreasing proportion of disposable income spent on alcohol, although lower taxes and a favourable interest rate climate have probably reduced the negative impact than would otherwise have been the case. Nevertheless, the latest available data from SAWIS indicates that in the wine industry (encompassing natural wine, fortified wine and sparkling wine), volume consumption decreased by 10,2% between 2002 and 2003. Since 1999, there had been virtually no volume growth;

- A number of regulatory challenges remain with regard to the new liquor legislation, for example in the establishment of clear benchmarks and conditions for registration of existing and new market participants.

Growth prospects in the liquor industry to a large extent depend on how the challenges mentioned above will be met by producers, government, representative bodies and consumers alike. Overall, beer (especially premium beer) has shown positive growth, with industry reports showing that it has eroded market share from other liquor categories with the exception of FABs. White spirits in particular bore the brunt from growing beer sales. Both SABMiller and Namibian Breweries gained overall liquor market share.

Growth prospects also depend on growing consumer demand, both in terms of average volume consumption as well as in absolute terms. South Africa has a growing middle class, which bodes well for liquor consumption in both the middle and premium market. A growing switch from for example traditional beer to spirits has been observed of late, and FABs have demonstrated strong volume growth among black consumers. In fact, according to industry sources the strongest growth in demand for certain FABs, for example brandy-based coolers, has been from the growing black middle class. In the presence of general economic upliftment especially among historically disadvantaged groups, and favourable economic conditions (interest rates, disposable income), the prospects for various liquor segments looks promising. Overall, however, intense competition for consumers' disposable income, technological advances and widening product offerings will continue to be important determinants of the growth prospects in the liquor industry.

6. Current policy objectives for the industry

From a government perspective, a number of important issues define its objectives for the South African liquor industry. It is widely recognised that the industry is in effect controlled by a mere handful of companies, who between them probably hold at least 90% market share. These concentration ratios not only have historical reasons, but also describe dynamics in the global liquor industry – especially with respect to spirits.

There are essentially two key objectives for the liquor industry, the one being transformation and encompassing objectives such as black economic empowerment, while the other focuses on combating the widespread abuse of alcohol.

Despite an undeniable need for transformation, relatively little practical evidence exists on how this can be achieved both effectively *and* in an economically sustainable manner. Transformation in this regard implies the broadening of ownership and control in the industry, both through an environment that is conducive to new entrants as well as key transactions that will lead to greater involvement of historically disadvantaged groups in the sector. But the 'wrongs' of the past can not be reversed in one swoop, especially in a sector where market strength is sometimes a key to competitive survival. This means that transformation, while an important policy objective, will remain a substantial challenge to effect in practice. This is especially true since the liquor industry globally is built around large international brands, requiring substantial capital to maintain and indeed further build them. After all – as was stated earlier – product differentiation through advertising and marketing are one of the key ingredients driving the development and growth of liquor brands, despite the apparent content homogeneity within the various spirit categories.

The well documented and widespread abuse of alcohol forms an important policy objective, as evidences by various references to it in the new liquor legislation. The legislation also outlaws the so-called "*dop*" system, whereby farm workers were often supplied with alcohol as part-payment or "bonus" for their work. This created a class of dependents who were vulnerable and stood little chance of upgrading through training and other means. Further evidence driving the emphasis on responsible drinking is the fact that the Western Cape, for example, has one of the highest incidences of foetal alcohol syndrome worldwide. While the abuse of alcohol can certainly not be blamed on the industry alone, but signifies a much wider social problem, the importance of measures to combat it can certainly not be over-estimated.

In this regard, the Liquor Act makes reference to “measures to combat alcohol abuse” as a condition for granting registration to firms active in this sector. There have also been proposals for the introduction of warning labels to be placed on all alcohol packaging, similar to those found on cigarette boxes. However, industry sources have warned that such measures will achieve very little but cost vast sums of money. Rather, some propose, a special tax charge on alcohol could be used to fund a major education drive about responsible alcohol use.

7. Conclusion

This report provides a broad overview of the South African liquor industry, and finds the liquor market to be dominated by a small number of large firms and stakeholders. The beer market is controlled by a single company, the spirits industry by a mere handful, while the wine industry contains much lower concentration ratios with a small number of large producers together with a large number of smaller players.

Current industry dynamics have been shaped both by internal and external influences. Internally, market concentration and tacit (if not active) collusion were tolerated by the government of the day especially in the late 1970s and early 1980s. The country’s international isolation and domestic political dispensation meant that the local business climate was unique. Out of this grew a small number of industry players that today dominate the sector. Subsequent growth following the country’s re-integration into the world economy saw local company SAB consolidate its local market position and grow to become the second largest brewer in the world.

With economic ownership and control within the sector still resting largely in “white” hands, one of the key challenges today is how to sustainably effect transformation in this sector without negatively impacting on its development and growth prospects. Already, a number of empowerment transactions have taken place in the wine and spirits sector. However, even merely in relation to these segments within the broader liquor industry, these transactions represent relatively minor transformation. In the beer industry, “transformation” has thus far taken place predominantly within the incumbent’s sourcing and distribution strategies.

Another pertinent issue relates to alcohol use. Finally, the negative impacts of alcohol abuse have been formally recognised by the sector’s new framework legislation and will hopefully make a real difference towards more responsible alcohol use.

8. Industry stakeholders

Website contact details of selected industry players

Industry Organisations

Industry Association for Responsible Alcohol Use	www.ara.co.za
Wines of South Africa (formerly SA Wine and Spirits Export Association)	www.wosa.co.za
SA Wine and Brandy Company	www.sawb.co.za
SA Wine Industry Information and Systems	www.sawis.co.za
Wine Industry Ethical Trade Association	www.wieta.org.za
SA Brandy Foundation	www.sabrandy.co.za

Beer

SABMiller (named South African Breweries in SA)	www.sabmiller.com

Wine and Spirits

Distell	www.distell.co.za
Brandhouse	www.brandhouse.co.za
DGB	www.dgb.co.za
E.Snell	www.esnell.co.za
KWV	www.kwv-international.com
NMK Schulz	www.nmk.co.za
NCP Alcohols	www.ncpalcohols.com

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