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# *The Financial Management of the Illicit Tobacco Trade in the UK*

## *Introduction*

Over the last two decades official and media discourses have paid increasing attention to the proceeds of ‘organised crime’. In the main, these accounts portray crime-money as a corruptive force, a threat to social life and the stability of national and global financial systems (for a critique see van Duyne & Levi, 2005; Reuter, 2013). In the UK alone, for example, the Home Office (2007) estimates the annual revenue derived from organised crime at more than £11 billion, while the attendant economic and social costs are close to £25 billion. However, despite the apocalyptic tone of these discourses, which are primarily based on estimations of crime-money constructed by using dubious methodologies and extrapolations from economic models (see van Duyne, 1994), as well as the fact that asset recovery has become a priority for policy-makers and law enforcement agencies internationally (Levi and Osofsky, 1995; Brown *et al.*, 2012; FATF, 2012; NCA, 2015), research on the financial management in illegal markets and other manifestations of ‘organised crime’ is limited (see Levitt and Venkatesh, 2000), with the drug market in specific contexts being perhaps the exception (see Reuter *et al.*, 1990; Naylor, 2004; Brå, 2007; Skinnari, 2010). Although there is a relatively sound understanding of finance-related issues in the drug markets, with an emphasis on prices, costs of doing business (Caulkins *et al.*, 1999; Moeller, 2012), investments and money laundering, not much is known about other illegal markets (cf. Reuter, 1985; Moneyval, 2005; Petrunov, 2011; Soudijn and Zhang, 2013) apart from estimations of their proceeds.<sup>1</sup> This view is also shared by law enforcement agencies. In a recent event held at the Dutch Ministry of Security and Justice, for example, even the Head of Europol’s Financial Intelligence unit noted that “very little is known about the financial management of organised crime...” (Navarrete, 2015).

The contemporary trade in illicit tobacco in the UK is a large and an extremely dynamic market, which has an impact not only on British law enforcement authorities, but, because countries such as the Netherlands, Belgium and Germany act as transit points for tobacco products destined for the UK, also on their continental European counterparts (van Duyne & Antonopoulos, 2009). It is a market that has been identified in media and other discourses with threatening, foreign organised crime structures that incur huge financial costs for national economies. According to the BBC (2009), for example, *"for criminal gangs from the Mafia to the Triads, cigarette smuggling is the new 'cash cow'... In the UK, the cost of tobacco smuggling to the exchequer was estimated by HMRC to run to £2.6bn... while losses for retailers, wholesalers and distributors are thought to run to £230m annually and £191m for the manufacturers"*. However, thus far, apart from pricing and networking at different levels of the market (see Hornsby and Hobbs, 2007), the financial aspects of the trade have been neglected by researchers. Drawing on a diverse set of original empirical data, including interviews with active criminal entrepreneurs involved in the trade, this article provides an account of the financial management of the illicit tobacco business in the UK. The study has two main objectives. First, to increase knowledge on the financial management of ‘organised crime’ by using the illegal tobacco trade in the UK as a case study, and, second, to further knowledge of the trade’s social organisation.

This article is organised into four sections. The first offers a discussion of the methods employed in the data collection. The second section offers a general yet concise overview of the illicit

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<sup>1</sup> See, for example, the special issue of the journal *Global Crime* (Savona, 2014) dedicated to estimating the proceeds of crime and ‘mafia’ revenues in Italy.

tobacco trade, including a discussion of the characteristics and key actors of the market in the UK. This overview is based on our own research and that of others (see von Lampe, 2006; Hornsby and Hobbs, 2007; L’Hoiry, 2013). The third focuses on the financial aspects of the market in terms of sources of financing, settlement of payments, costs of doing business, profits and investment. The article ends with a discussion of our findings, which suggest a critical departure from the discourses on ‘organised crime’ and crime-money.

### *Methods and data*

The methodological approach for the study includes the collection and use of a diverse set of data. Primarily, the research benefited from in-depth interviews with a range of actors who have expert knowledge of the trade. These included ten customs officials and the intelligence team of HM Revenue and Customs (HMRC) working in the area of tobacco smuggling, one UK Border Force officer, five investigative journalists and independent researchers with experience exploring the phenomenon, and the lead of a multinational tobacco manufacturer’s illicit trade intelligence unit in the UK. In addition, interviews were conducted with eleven *active* criminal entrepreneurs and two money couriers specialising in the illegal tobacco trade. The eleven entrepreneurs, some of whom were interviewed on numerous occasions, operated at all levels of the trade (upper/importation and wholesale, middle, and lower/retail, see von Lampe, 2005)<sup>2</sup> and belonged to eight unconnected schemes located in various parts of the UK. The two money couriers interviewed worked as part of the same scheme and were associated with one of the entrepreneurs. Criminal entrepreneurs and money couriers were identified in the following ways: seven criminal entrepreneurs were identified after the first author became immersed in the field, and specifically in locations in the North of England and London with larger markets in illegal tobacco products. Some of these locations were suggested by HMRC officers. One entrepreneur was introduced to the first author by a common acquaintance, and introductions to three business partners followed. Both money couriers were introduced to the first author by the criminal entrepreneur they worked for who had previously been interviewed for the study. The interviews with three entrepreneurs and one money courier were tape-recorded. The rest of the interviews with entrepreneurs and with one money courier were informal in which questions were asked and usable data was received. The interviewer was given time to take detailed notes during the interviews.

Most of these interviews, which are part of an ongoing ethnographic research project that the first author has been conducting on the illegal tobacco market in the UK including observation in venues where tobacco products are stored and sold (‘fag houses’/ ‘tab houses’, legal retail shops, pubs etc.), were conducted from December 2013 to February 2014 and from October 2014 to March 2015. Finally, a range of open sources were consulted, including media accounts, government documents, national and international law enforcement reports, and reports by professional associations and tobacco manufacturers. Many of these reports were found online.

At this point the aforementioned sources’ limitations should be pointed out. Official data, including data derived from interviews with members of the authorities, is the result of law enforcement activity, which in turn depends upon resource restrictions, the competency of agents, organisational priorities and broader political agendas. In addition, official accounts often limit the scope of social scientific analyses by stereotyping the identity of individuals involved in ‘organised crime’ activities as one-dimensional ‘criminals’ drained of cultural context; something that might impose limitations on the analysis of the actors and social dynamics that constitute the business and how it is financed (Hobbs and Antonopoulos, 2014).

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<sup>2</sup> The names of the interviewees provided in the article are fictional in order for anonymity to be preserved.

Furthermore, as acknowledged by a significant number of researchers who have conducted interviews with ‘organised criminals’ (e.g. Zhang and Chin, 2004), the interview method has numerous limitations. There are issues of generalisability and one can never be certain about validity; although ‘cross-checking’ and ‘member checking’ significantly contribute towards eliminating some of the more dubious accounts. In addition, there is the issue of the representativeness of the sample. As mentioned, in some instances we used a method of snowball sampling to identify illegal entrepreneurs and money couriers, thus limiting the sample to the researcher’s own personal network and the subsequent networks of the entrepreneurs interviewed. As a result, we were not able to interview entrepreneurs involved in the illegal *production* of tobacco products and, perhaps most importantly, we were not able to obtain primary data on the financial management of *legal* tobacco manufacturers who have been implicated in the *illegal* tobacco business (Joossens and Raw, 1998).

Finally, although a wide range of open sources were utilised to collect technical information about ‘organised crime’, these should be treated with caution for a variety of reasons. Firstly, they refer to cases in which the authorities have been successful, thus ignoring cases and/or schemes that continue unseen and uninterrupted. Secondly, they tend to present the issues relating to the actors of organised crime and the activity itself in a sensational and morally-charged manner, which is of limited analytical value. Nevertheless, we think that the methodological triangulation throughout the study, and the consultation of both official and ‘unofficial’ sources of information, has created a net that has captured at least some of the important aspects of financial management in the UK illicit tobacco market and the networks involved in its operation.

### *An Overview of the UK Illicit Tobacco Market*

The illicit tobacco market in Britain has undergone a series of transformations since the late 1980s, when tobacco smuggling became a more serious concern for the authorities. This was indicated by an increase in the number of seizures from 1999 onwards, which has since stabilised (Transcrime, 2013). The most significant changes to the market relate to the composition of the merchandise available (genuine UK brands, non-UK brands, and counterfeit products), underpinned by the following variations that have occurred in specific periods of time:

- From the late 1980s and up until the beginning of the 2000s a number of legal tobacco manufacturers were involved in the smuggling of billions of packs of their own brands. Gallagher (as they were known then), BAT, Philip Morris, and RJ Reynolds became major actors in the global illicit tobacco business (Joossens and Raw, 1998). They created an illegal market for their own brand of cigarettes in the UK by facilitating the exportation and re-importation of cigarettes into the country. During that time, the UK became the central hub for contraband cigarettes (see van Duyne and Antonopoulos, 2009).
- In the mid-2000s, counterfeit cigarettes from China (Shen *et al.*, 2010; von Lampe *et al.*, 2012) and Eastern Europe (predominantly Ukraine and Poland) became the major source of illegally traded tobacco. In 2004 it was estimated that over one million counterfeit cigarettes were seized every day in the UK (HMRC, 2004). More recently, the authorities have dismantled a number of illegal factories producing counterfeit tobacco products in various UK localities, such as Grimsby, Glasgow, Aberdeen and Chesterfield (Transcrime, 2013).
- From 2007 onwards, illicit or ‘cheap’ whites started appearing in the UK market. Illicit whites represent the market in legally produced yet illegally supplied tobacco products manufactured in the free zones of Eastern Europe, UAE, and Thailand, which are readily available to illegal marketers. The most known case in the European market is ‘Jin Ling’, a brand lawfully manufactured in the free zone of Kaliningrad (Russia), yet destined for illegal markets in the

EU. In 2012, the UK was estimated to have the highest consumption levels of illicit whites in the EU (1 billion cigarettes), presenting an annual increase of 49% (KPMG, 2013; Edwards and Jeffray, 2014).

- From 2008 onwards counterfeit hand-rolling tobacco (HRT) manufactured in the UK began to appear in Britain (National Audit Office, 2013). In this context it is important to point out that although cigarette seizures have been stable since the mid-2000s, the seizures of HRT have been steadily increasing (TMA, 2014).

UK tobacco prices are the highest in the EU, mainly because, on average, the tax burden accounts for 88% of the product price (TMA, 2014). The relatively reduced affordability of tobacco products in the country (Blecher & van Walbeek, 2008) has opened up opportunities for illegal traders cashing in on an environment constituted by what Mackenzie (2014) has characterised as a ‘condition for guilt-free consumption’. However, while the high taxation rate and resulting price have produced great incentives for those involved in smuggling tobacco products, there are additional factors to consider, such as the presence of illegal trading networks, the low likelihood of detection and arrest and relatively light punishments (Joossens & Raw, 2012), as well as a culture of accepting tobacco smuggling as a ‘service’ to the public (Wiltshire *et al.*, 2001; see also Ruggiero, 1997). In 2013, the percentage of contraband and counterfeit tobacco products consumed in the UK constituted 16.4% of the overall tobacco market (KPMG, 2013). However, this figure needs to be treated with caution. Illegal markets involve economic activities that are intended to go unnoticed and thus unrecorded in the official and trade statistics. Therefore, the figure above may reflect the intensity and the successes or failures of law enforcement operations, or the weakness of the methods adopted to collect data.

Geographically, the market reach for illicit tobacco products extends across the UK, although formal variations can be distinguished at national level and at the level of the borough (Williams & Williams, 2002). At the national level, according to data provided by the TMA (2014), there appears to be a high percentage of illegally traded cigarettes in the overall markets of London, East Midlands, Yorkshire & the Humber, South East England, South West England and West Midlands. Northern Ireland, Wales and Scotland show the smallest percentages in the UK. In the context of HRT, however, the pattern changes dramatically, with the market in London showing the lowest levels of non-UK duty paid consumption (TMA, 2014). It is also interesting to note that in specific locations there is a concentration of packs from specific countries. For example, a relatively recent study in South London showed that 20% of the packs collected and analysed were Polish, highlighting direct illicit supply routes from Eastern Europe into specific London areas (Power, 2013).

#### *Market characteristics and actors*

There seems to be a range of ‘entities’ involved in tobacco smuggling that can be placed on a continuum. Large, hierarchical, rigid and stable group structures are rare. The smuggling of cigarettes seems to be conducted by fluid and constantly reconfiguring networks of individuals operating on a relatively small scale. Some of these individuals are often driven by the price disparities between the UK and a number of other countries, and include British holidaymakers traveling abroad in the summer period, truck drivers on jobs to continental Europe, university students, and Eastern European migrants making trips to their country of origin before returning to the UK with a quantity of tobacco products that exceeds customs regulations (otherwise known as ‘bootlegging’).

On other occasions small-scale smuggling schemes involve a group of people funded by a single investor. In these instances, the individual members (‘runners’) visit neighbouring countries

(e.g. France) to buy a permitted quantity of cigarettes that they declare for personal consumption<sup>3</sup> and, once in the UK, the investor collects the merchandise (see Hornsby and Hobbs, 2007; L’Hoiry, 2013). Groups trading in illicit tobacco are sometimes clustered around a small core of individuals who retain an ongoing presence, around whom more transitional individuals become involved as and when opportunities arise. This description is true of a smuggling operation we came across where one individual – ‘Big George’ – organised several tobacco bootlegging operations over a long period of time. While his involvement was constant over this period, the vast majority of those involved in his operations were involved for short periods. Indeed, some individuals were involved for a single bootlegging operation. ‘Big George’ has been active in the illicit tobacco trade for a number of years. A retired truck driver, he regularly visits major road arteries connecting the South and North of the UK and Bed and Breakfast establishments in areas near the border that are used by truck drivers to rest for the night. He befriends drivers, pays for their dinner, drinks and, occasionally, their accommodation and asks them to buy a number of cigarettes during their work trip to continental Europe. He pays them for the cigarettes as well as £1,000-£2,000 depending on the difficulty of the trip and the quantity of the product they transport.

However, large-scale smuggling involves *networks*, i.e. fluid and dynamic social systems that consist of shifting patterns of relationships among actors (see Wasserman and Faust, 1994; von Lampe, 2006), which constantly adapt to shifting opportunities, operational environments and forms of social control. Large-scale smuggling usually demands the importation of containers from Eastern Europe (Poland, Ukraine, Russia, Lithuania, etc.), China, or the Middle East and, therefore, requires greater sophistication, planning and financing. These networks may convene for a prolonged period or for single instances. These instances involve what is also known in the Customs vernacular as ‘Kamikaze runs’: one off operations, usually a truckload of cigarettes, often carried out by a driver who has no criminal record. Alternatively, these loose networks and groups of individuals may attempt to maintain longer involvement. Within all networks the importance of *brokers* - actors who bring together two or more disconnected parts of the network - and the service they offer was emphasised on a number of occasions during our research interviews. As ‘Tom’, a tobacco entrepreneur, revealed: *“Knowledge is everything. Without brokerage nothing happens, nothing is going to function. I would not know where to get so many cigarettes from... I have no information, I haven’t got a clue”*.

Individuals may become involved in tobacco smuggling via family or neighbourhood contacts. Prisons and pubs were also mentioned as key environments for contacts and knowledge about schemes. Finally, legal business environments offer the context in which the formation and consolidation of relationships between individuals and groups involved in the illicit tobacco trade can take place. Therefore, legal businesses operate as the context in which relationships (employer-employee and among partners) are transformed into criminal business relationships, where levels of trust, dependability and reputation can be assessed by actors before the business relationship is established (see von Lampe and Johansen, 2004). As ‘David’, a tobacco entrepreneur suggested:

*“Trust is an important part, you have to trust people... You have to be business-minded, because it has to run as a business... The legal business context is very important in meeting people and appearing dependable, someone who can do the job”*.

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<sup>3</sup> Although, in theory, there are no limits to the quantity of tobacco one can bring into the UK from EU countries, one is more likely to be asked questions if they have more than 800 cigarettes (40 packs or 4 sleeves), 200 cigars, 400 cigarillos or 1kg of tobacco. For those arriving from outside the EU, the following quantities are permitted: 200 cigarettes (10 packs or 1 sleeve), 100 cigarillos, 50 cigars, or 250g tobacco (HMRC, 2015).

Groups of ‘organised’ career criminals coming together to undertake systematic tobacco smuggling activities have some presence in the trade. However, they are the exception rather than the rule. ‘Jack’, a customs officer, explained “*Everyone thinks that there is a Mr. Big who will finance criminal activities. And, yes, it will happen but in the majority of cases it’s people throwing their money in to get a profit...*”.

Our research found a range of associations existing between the illicit tobacco market and legal businesses in the UK (and elsewhere, see Antonopoulos, 2008; van Duyne and Antonopoulos, 2009). For example, tobacco smugglers often use legal businesses to transport and store their illicit goods. In such cases, the active involvement of individuals from the legitimate sphere can be viewed on a sliding scale of illegality – at one end actors know explicitly that their activities are illegal and, at the other end, others are unaware of their involvement in criminal activity. The role played by tobacco manufacturers is also very interesting in this context, where tobacco smuggling can be viewed as another field of enquiry that exemplifies the blurred distinction between the ‘underworld’ and the ‘upperworld’ (Ruggiero *et al.*, 1998; van Duyne, 2003). First, there is a ‘systemic synergy’ (Passas, 2003) between the tobacco industry and the cigarette-smuggling business. As von Lampe (2005: 31, 34) suggests, over an extended period of time, “large-scale smuggling would not be possible without at least the tacit connivance of the cigarette manufacturers”. In order to increase their share of a shrinking national market,<sup>4</sup> it is suggested that large tobacco companies sometimes encourage tobacco smuggling as a way to stimulate consumption, compete with domestic producers (Schapiro, 2002) and displace competitors from specific contexts (see Collin *et al.*, 2004). In addition, in a bid to pressure governments into freezing or reducing the taxation on tobacco products, tobacco companies have been known to ‘exploit’ the issue of tobacco smuggling as a lobbying method (Joossens and Raw, 1998).

### *Financial management of the trade*

#### *Sources of capital for initiating and sustaining operations*

Start-up capital is required for someone to enter the illicit trade in tobacco. The specific amount usually depends on the quantity of merchandise being traded. We found that a wide range of sources are used for initiating tobacco smuggling operations. The first concerns small funds from legitimate work and savings, which are used to finance small-scale smuggling/bootlegging operations. It is in this context that virtually anyone with a small amount of capital can become involved in the business, from holidaymakers and immigrants, to students and those working across international borders, as one opportunistic tobacco entrepreneur, ‘Sol’, reveals:

*“I went on holidays in Majorca in the summer of 2004 for the first time and of course, one of the first things I noticed was the price of cigarettes. Something like €2-2.50 for Benson and Hedges, Silk Cut, Marlboro, stuff that you would buy back home for double that price or even more. I was ‘loaded’ in Spain because I was supposed to stay for 2 weeks in Majorca with the savings of a year-and-a-half. I decided not to spend all my money on booze and instead I bought a couple of suitcases of cigarettes which I got back with me when I got home. I sold the cigarettes to my friends and people I knew and some of the sleeves I sold in the cafés and the pubs that I manage”.*

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<sup>4</sup> This has become particularly apparent in the UK in the context of the Smoke Free law, which was passed in 2007 (TMA, 2014).

Our research suggests that small amounts of money are invested in the illegal tobacco market for the following reasons. Firstly, many entrepreneurs have access to relatively small markets, which was highlighted in the data by the case of two foreign students in a university in the north of England supplying cigarettes and tobacco to the foreign students of the same nationality studying in another university. Secondly, traders often intentionally invest small amounts of capital and operate at this level as a ‘detection avoidance tactic’, in order to circumvent the interests of the authorities and local extortionists:

*“... I got a little bigger than in the beginning. But I would not like to be big! ... If you are big, the lights are on you. People see you, there is gossip about your business. Next thing you get is a ‘tax man’ asking for money [means an extortionist]. It is better if you have a small business and you know everyone you sell to. You feel safe”* (interview with ‘George’, tobacco entrepreneur).

The second source that was identified in our study was funding from legal businesses that illicit tobacco entrepreneurs own or manage. This was the most straightforward case of funding and the one that tends to be present in the majority of the cases at the level of importation and wholesale. In a large number of cases legitimate businessmen or owners of large pieces of land (e.g. on both sides of the border in N. Ireland) invest funds in what is called a ‘conglomerate’, in which legal businessmen are asked whether they would be interested in investing £10,000-£20,000 in an importation scheme. Some investors continue operations as part of a ‘conglomerate’ for a prolonged period of time, some are active for a few importations, and others are involved in ‘one off’ importations. What is usually the case is that there is a core of investors who know each other through their involvement in various other legal (and occasionally illegal) projects become better-positioned in a specific scheme because they come to know brokers and other strategic individuals involved in the whole process. As the scheme gains momentum, influential entrepreneurs ‘trim down’ the investments of other actors in order to enjoy better returns on their own investments.

Other similar conglomerates are facilitated by ethnicity. One example from our data is that of a Kurdish businessman - ‘Aras’<sup>5</sup> - who was involved in a large-scale scheme importing cigarettes with his Polish brother-in-law and his Lithuanian friend. He asked an additional three entrepreneurs based in a northeast locality - all of whom were Kurdish and owned food stores, kebab shops and car-washing businesses - to contribute towards the importation of a container of cigarettes. They invested £20,000 each and, after the successful importation of the merchandise, decided to do it once every month. Individuals investing funds from their legal businesses in the UK illegal tobacco market are not necessarily businessmen owning UK-based businesses. In our interviews we came across a large scheme importing cigarettes from Eastern Europe, which involved two major financiers; a Russian businessman and a Hungarian businessman based in Germany who financed a German wholesaler and expected a return without being involved in the actual smuggling of tobacco. The German wholesaler was linked to a Sheffield-based importer in the UK via an Irish broker.

What should be included in this category of ‘sources of capital’, however, are illegal profits from legal businesses. ‘Aras’ is an interesting case study. When he was in the process of collecting money to support a small importation scheme from Poland, he ‘skimmed’ (evaded taxes) in his legal retail business: in other words he simply did not provide receipts for a significant part of his transactions. In addition, according to his estimation, for every five customers with a total expenditure of £10 or more, he would overcharge each individual by £2. Given that no analytic receipt is ever provided in his shop, as well as the fact that it is, as he mentioned, extremely rare that a customer

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<sup>5</sup> ‘Aras’ is a pseudonym.



notices they have been overcharged, this provides a profit of at least £500 per month. He then invests the money in his tobacco importation business.

Thirdly, an important source of funds for the illicit tobacco business are those stemming from other illegal activities and businesses. During our research, we came across individuals heavily involved in cannabis cultivation and drug dealing deciding to slowly move into the tobacco trade because the risks were comparatively low. In the opinion of 'Steve', a customs officer: "...*the tobacco business is like a playground for them...*". It is also not unusual for criminals to invest a small amount of money into someone else's illegal tobacco scheme. This is usually the case in small localities in which everyone is familiar with one another and information about successful and profitable schemes flows. Occasionally, these local criminals extort their way into a tobacco smuggling scheme in something that could be described as a 'forced investment'. As 'Steve', reveals:

*"Hard men from the local community hear about a successful business in the pub and decide that they want to put a little bit of money instead of extort. This makes them feel like 'businessmen', you know, and not like some kind of gorillas..."*

Finally, entrepreneurs noted multiple funding sources (see Junninen, 2006), which amalgamate some of the sources that are mentioned above, or include other quite ingenious ways of making money. For example, one illegal entrepreneur we interviewed revealed that in his effort to secure the start-up capital for a bootlegging scheme he set up a raffle (a small-scale gambling competition using numbered tickets) with 19 friends from the Traveller community. Each of the initiators of the raffle contributed £50 each in order to buy a second-hand white van, which was used as the prize for the raffle. 300 tickets were sold for £20 each. The profit was £6,000 (£300 per person). The interviewee used the £300 profit as the start-up capital to enter the illegal tobacco trade. The rest of the start-up capital needed was borrowed from one of his sons whom around that time 'taxed' a couple of low level drug dealers in a neighbouring locality and was involved in bare knuckle fighting bets. This amounted to £700, which was added to the initial £300.

As mentioned earlier, trust is an integral part of collaboration in the trade. In cases from large-scale importation through to small-scale bootlegging we found that investor's shares are ensured by trust. We found that business relationships and trust were primarily forged in current and former legal and illegal business operations. In one interview 'George', a tobacco entrepreneur, emphasised that:

*"You have to have a massive element of trust. They have to trust you, like they must love me, you know, because every penny I made, I showed them, I told them the truth, they got back. They never lost a penny because of me, the times when there was a loss... and you had to prove what had gone wrong so that's what I did, had to show them what had gone wrong..."*

However, trust is central but it is not the only way of establishing business relationships. We also found evidence of investors or 'consortia' of investors using threats of violence to force their way into the market (see Winlow, 2001), where shares were often entrusted through fear of extortion or use of violence, as 'Jack', a customs officer, reveals:

*"These guys are unpredictable and they are not the best partners in the world as they do not really know how to do business. They are known for their capacity and willingness to use violence more than anything else. But if they want to get involved in the business, in your business, what do you do? What can you do? Can you say 'no'? At least if they are part of it, they won't 'tax' you. In this case you, as an investor [in tobacco smuggling] want to make sure that they get their share"*

## *Settlement of Payments*

The source of merchandise and the number of suppliers an illegal entrepreneur can connect with depend on the scale of the smuggling scheme and the effectiveness of brokers, who form links with wholesalers (and financiers) in other countries. Usually small-scale smugglers/bootleggers tend to buy products from a number of legal suppliers, including duty-free shops and legal retailers in countries with lower-priced cigarettes and tobacco. Occasionally a bootlegger will have a number of suppliers who straddle the border between the legal and the illegal. For instance, one of our interviewees obtained their merchandise from a number of legal retailers in various Spanish towns, as well as an illegal wholesaler who operated from a warehouse outside Athens. Irrespective of the type of legal supplier, there were no special arrangements with regards to payment. Cash was almost always given up-front, which suggests that 'trust' extends only so far and exists mainly as an indicator of functional dependability and discreetness.

Earlier we mentioned that small-scale smuggling schemes are often organised by small groups of people travelling into neighbouring countries to buy a legal quantity of cigarettes, which they claim is for personal consumption ('runners'). Similar to other small-scale schemes, these operations tend to have a number of legal retail outlets as their suppliers. There are a number of ways in which a person who funds the 'runs' makes sure that the 'runner' does not steal the money without bringing back the merchandise. Firstly, the 'runners' are recruited from the organiser's local community and are often members of his/her immediate social circle. Secondly, organisers befriend prospective 'runners' involved. One example of this is the case of 'Big George'. The drivers involved in his schemes revealed information about their place of origin, residence, family and place of work during the recruitment phase. This information could then be used in case something went wrong. This information would be obtained and checked for authenticity before he asked them to participate in the scheme.

Credit is rare in the illegal tobacco business. It is only present at the higher importation/wholesale level ("*...I was so far up the chain.... I would have got credit*", as 'David', a tobacco entrepreneur noted), and only at the *initiation* of an importation/wholesale level scheme. Once the first smuggling operation is complete, there is available funding to lubricate additional cycles of the business. The provision of credit is facilitated by trust among actors involved and, more specifically, the broker who may be able to vouch for the trustworthiness of the entrepreneur receiving the merchandise on credit. In the case of the absence of a broker, credit is facilitated by trust between the supplier and the buyer at the wholesale level.

If merchandise is obtained on credit, there are agreements with regards to settlement of payments to offer a level of security in case a load is lost, damaged or confiscated by the authorities. As the experience of 'David', a tobacco entrepreneur, reveals

*"They [Lithuanian wholesalers] were alright with me because when the stuff went missing it was their loss because we had an agreement before we started. I said 'right listen, if it taken or customs get involved, I've got no connection and it's your loss and end of load...'"*

In wholesale/importation schemes a number of people act as 'payment facilitators'. They operate as specialist brokers bringing together two or more disconnected parts of the scheme. For example, our data highlighted importations made in Northern Ireland, where people of Irish origin who live and work in China facilitated the payment process between Chinese wholesalers and manufacturers. These Irish brokers have lived in China for many years, they speak the language, and they have previously conducted business with the Chinese. Financially speaking it is a simple process; the brokers are paid

for their knowledge. They are paid in accordance with the upper/wholesale level of the business, and their payment can amount to thousands of pounds per importation, or in the case of large deals, they can be paid 1% or more of the profit made by the UK importer. Unfortunately, because of the fragmented nature of the business and because brokers tend to operate on the international level, more detailed information on their payment patterns is not available and requires further research.

With regards to settlement of payments at the retail level, cash is given up front in return for the merchandise. As 'Sol' emphatically noted, "*I always got cash for the cigarettes. Nobody got credit off me, they paid for them or they didn't get the goods. Simple as that*". Generally, there are usually no meticulous records for the settlement of payments at national or international levels, apart from those cases in which legal tobacco manufacturers are involved. However, according to customs officers interviewed, during HMRC raids, basic lists with orders for tobacco products have been found.

### *Costs of doing business*

The costs of doing business depend on a variety of factors: the scale of the scheme and its logistical complexities, the country of supply, the legality, the number of different suppliers per scheme, the number of actors involved, and a number of 'unforeseen expenses' all contribute to the cost. The first set of costs is associated with *buying the merchandise*. Occasionally, larger schemes obtain their merchandise through illegal suppliers. However, as mentioned earlier, small-scale smugglers/bootleggers usually buy and sell relatively small quantities of cigarettes and tobacco obtained from legal retailers. Usually, carrying a couple of suitcases from Spain or Greece does not cost anything more than the actual trip, which the bootleggers will have already paid for. The involvement in a scheme is often purely opportunistic. Other small-scale smugglers pay the travelling expenses for their 'runners' plus a small amount for the 'runner's' labour:

*The initial amount I used for my first scheme was £500. But it was part of the holiday, so I am not counting the expenses for the trip itself, accommodation, food and drink and so on. I did not plan to bring cigarettes when I went to Spain that first time. So in the trips after that I planned to spend about £1,000 per trip for cigarettes. There is only so much you can carry with you if you are alone. Later, when people who travelled every now and they were in the job, I needed a little more not only because the amount of cigarettes was bigger but also because we needed money for the flights for these people... With the students flying back to Greece and those going to Spain on holiday even in January sometimes, you needed at least £150 per flight, for about 15 trips a year, then another £30 per person for their trouble to buy the fags. Plus the money for cigarettes, each person buying 16 sleeves [master cases = 10 packs of 20 cigarettes each] ..."* (interview with 'Sol').

When small-scale entrepreneurs buy the merchandise from legal retailers, the price per pack fluctuates between €2-3.50 depending on the brand (€20-35 per master case depending on the brand). When the cigarettes are bought from an illegal wholesaler, sleeves of British consumed brands (Regal, Benson & Hedges, Silk Cut, etc.) are bought for as little as £10 per sleeve/master case. Any changes in the price of cigarettes bought from the legal suppliers were on the basis of the taxation in the country in which cigarettes were to be legally sold. With regards to illegal wholesalers buying from counterfeiters, prices can fluctuate on the basis of variations in production costs. Cigarettes at the wholesale/importation level are bought in British pounds for £1 per pack (£500 per box or 50 sleeves). According to the tobacco entrepreneurs we interviewed, the price has not changed over the last few years, neither has the quantity a wholesaler generally purchases. The reason for the unchanged quantities over time is that the market and demand the particular wholesalers/importers cover does not

seem to be changing and the wholesalers have only a limited capacity to push the merchandise forward into the UK market.

Another set of costs is associated with producing the merchandise. Research studies have shown that illegal cigarette factories have been active for many years in several countries (Shen *et al.*, 2010). Relatively recently, illegal factories have appeared in the UK as an effort by illegal entrepreneurs to cut down the costs associated with importing cigarettes and tobacco from Chinese and Eastern European producers. Our interviews provided examples of illegal factories and costs associated with their establishment and sustenance. For example, one entrepreneur transformed a rented warehouse into an illegal factory in Grimsby, paying £25 rent per week, and bought a cigarette rolling machine online via the online commerce company AliBaba.com for £7,000. This second-hand rolling machine had been previously owned by a major UK legal tobacco manufacturer. There was no detailed information on prices relating to specific items used during the production phase (compressor, cutter, etc.) or the tobacco itself. However, it was known that the whole operation cost approximately £60,000 to initiate:

*“We (Customs) found a cigarette making machine in an old warehouse and the necessary cigarette paper and packaging. They got it from big companies. We went to Imperial and people like that and told them ‘we don’t want you to sell them. We want you to smash them up...you’re shooting yourself in the foot”* (interview with ‘Jack’, customs officer).

Less start-up capital is required in order to establish illicit tobacco factories that simply pack tobacco in Britain, such as one discovered by authorities a few years ago in Glasgow. Our data suggests the expenses for this particular operation were £200-300 per month for the venue, £5,000 to obtain raw tobacco for the initial packaging, £1,000 to buy counterfeit packs and £1,000 a month to employ two Chinese nationals to pack the tobacco.

Transportation costs naturally vary on the basis of the distance covered and the risk of seizures or arrests associated with specific UK entry points. However, it is possible for the transportation fee to be significantly different for an identical distance covered and possible risk. For example, according to OLA (2012), in two separate investigations in the UK, one driver received £1,000 per successful Channel crossing and the other £10,000. Transportation-related expenses also include money for cover loads. In our research a number of low price commodities such as jelly, sand, cattle feed, glass jars and cardboard were identified. Moreover, it should be mentioned that the vulnerability of the transportation industry to tobacco smuggling reduces transportation costs because goods are smuggled by owners of transportation companies, or are planted on their vehicles without their knowledge. For example, one importer we interviewed was also the owner of a transportation company. Drivers working for him during legal international projects were unaware that they were also involved in an illegal tobacco smuggling operation: *“The drivers of the trucks were just given their normal wages, they didn’t know about the job. It was a legal job to them...”* (interview with ‘David’, tobacco entrepreneur).

In another case the owner of a transportation company and his three legal employees travelled to Spain and Greece on legal business, transporting fresh foods, fish and wine. The fuel and other expenses per trip were paid by the company (or association of companies) that commissioned the trip. There were no other expenses because the merchandise was transported by the four individuals. Basically, when the illegal tobacco trader is the owner of a legal transportation company, the illegal business is to a great extent facilitated logistically by his legal business, resulting in insignificant transportation expenses.

Entrepreneurs who invest in the illegal tobacco business must also incur the costs of payments to ‘workers’ and other actors involved in a scheme. These include payments to:

- *‘Runners’*: in cases of small-scale smuggling amounts of £30 per ‘runner’ were identified;

- *Brokers*: for example, in the case of a Kurdish wholesaler we interviewed ('Aras'), his Polish brother-in-law and his Lithuanian contact received a £2,000 brokerage fee each per container imported from Lithuania to the UK;
- *Couriers*: individuals who are trusted with transporting merchandise and/or money. For instance, in our interviews we became aware of a case of transportation of £1,000,000 in tobacco money from the North of England to an individual in London. The courier received £5,000 for the service or 0.5% of the money transported. Unfortunately, we do not possess any information as to whether this is a standard percentage for the couriers in the illicit tobacco business;
- *Retail sellers/street sellers*: here, we refer to those retail sellers who have not invested in the trade, but work for someone who has. They receive a daily fee of £50-100 for their work.

The details above highlight that payments to actors involved in tobacco smuggling can differ enormously, depending on their role and the size and scope of the operation. Finally, there are other non-standard costs in the illegal tobacco trade:

- *Corruption/Bribery costs*: e.g. bribing private security officers primarily at airports and ports to 'turn a blind eye' to the illegal entrepreneurs reclaiming merchandise confiscated by customs (as has been the case in N. Ireland). We were informed that the fee for a corrupt security guard to contact a criminal group by phone when it is safe to obtain confiscated merchandise was £300.
- *Insurance*: Insurance is sometimes bought by illegal manufacturers to protect entrepreneurs if their merchandise is seized or lost. Wholesalers buying the merchandise abroad could pay an extra £50,000 per 10,000,000 cigarettes (the amount of cigarettes in a container) to insure the load.
- *'Informal taxation'/extortion*: we have come across major criminals and 'crime families' in Newcastle who have been known to extort tobacco smugglers.
- *'Decoy' expenses*: Expenses towards diverting the attention of the authorities and/or misleading legal suppliers of tobacco products. It is known that when a passenger flies outside of the EU no tax is applicable to HMRC on tobacco bought from duty free shops. If the passenger flies within the UK or EU the VAT will be accounted for to HMRC by WDF (World Duty Free) on behalf of the customer. In one of the smuggling schemes we came across (interview with Customs officer), a group of 5-6 smugglers booked return flights from London Heathrow to both Switzerland (outside the EU) and Newcastle, England that departed at roughly the same time. The smugglers checked in for both flights, and after the security checks, they provided their boarding passes in order to buy cigarettes at duty free prices. After they bought the cigarettes they flew to Newcastle where they delivered the merchandise, and back to London. The expenses for the flights to Switzerland were what is known as 'decoy' expenses.

### *Profits from the illegal tobacco trade*

The profit margin from the illegal tobacco trade in the UK also depends on a number of variables. Firstly, profit fluctuates in accordance with the type of merchandise being sold (i.e. non-tax paid merchandise produced in the UK or abroad vs. 'illicit whites' vs. counterfeit products). Generally, counterfeit products tend to outweigh profit in all other types of smuggling, mainly because they are very cheap to buy. We found an average mark up of 200% in these cases. Producing the product is also very profitable. The illegal tobacco factory in Grimsby that was mentioned earlier cost £60,000 to set up and before Customs intervened and dismantled the factory (within three weeks) the profits had

reached over £3,000,000 (interview with Customs officer). Tobacco products bought abroad from legal retailers appear to have the smallest profit margin. According to participants, the worst case scenario is that the illegal entrepreneurs will have at least a 75% profit on their investment, something that highlights the lucrateness of the trade. The profit margins increase with the volume of imported merchandise, as one illegal tobacco researcher we interviewed, 'Chris', has found *'If you buy 10,000,000 cigarettes, the costs are going to be lower...the profits higher. It is the same way cash & carry work...'*.

Secondly, profit margins depend on the position of the illegal entrepreneurs in the supply chain, with profits reducing as the merchandise moves down the supply chain. Someone in the retail market will make on average a profit of 50p per pack. In terms of wholesalers' profits, these are shared on the basis of the original investment. For example, if a wholesaler invests 30% of the funds for the importation of a container of tobacco products, they will receive 30% of the profit made after the merchandise moves down the supply chain. In small-scale smuggling schemes, profit sharing is demonstrated according to the status and longevity of the entrepreneur's employment in a bootlegging group. Some actors with only limited involvement are paid a fixed fee for their participation. For example, we found a standard fee of £30, which is similar to that paid to 'runners' in different schemes. Other actors (in small-scale schemes) are paid via a mixture of cash and cigarettes, enabling them to make an additional profit themselves. This opportunity is dependent on ties of trust which are established and consolidated by long term involvement with the main actors.

Thirdly, the profit depends on the accessibility consumers have to illegal retailers: contraband products sold via legal outlets (e.g. the Polish food retailer mentioned earlier) or pubs where locals attend seem to facilitate transactions.

Fourthly, profits can fluctuate depending on the effectiveness of marketing and promotion techniques. On the wholesale level, the marketing technique is the network that connects all trade levels itself. The successful schemes are those that have the ability to promote and push the merchandise to people in 'lower' levels of the supply chain in the UK. On the local, retail level 'fag houses' and known individuals are used to procure cigarettes. Marketing/promotion occurs somewhat organically via word of mouth as the actors' status and reputation within specific locales, pubs or workplaces alerts potential customers to the availability as well as the quality of the merchandise. The longer a bootlegging/smuggling operation is in existence, the lower the need to market the product becomes. The sale of the merchandise via places such as local pubs is often an indication of guaranteed high quality products. On the street, a retailer may offer a pack of cigarettes to a potentially new customer to 'lure' them and establish themselves as 'their' suppliers. It should be noted, however, that the level of demand in many small localities often outstrips supply, rendering the marketing and promotion of the goods unnecessary. In one case we came across, entrepreneurs marketed their products in areas that were outside their usual business radius during outdoor events, for example horse racing events in York and Wetherby, or air shows, and took up the opportunity to sell contraband cigarettes.

Naturally, some profits are re-invested in cycles in the illegal tobacco trade, often with the objective to 'upgrade' the business. However, much of the profit is simply spent on hedonistic pursuits. As a tobacco entrepreneur told one of our interviewees who has researched the illicit tobacco: *"Life as party! Cars, gold... more gold than you can choke a dog with... dining and wining with local celebrities such as footballers"*. Money is spent on holidays or often loaned to family members and friends for a variety of reasons. Profits are also used to pay off debts such as loans or mortgages, cover legal expenses, buy luxury cars and racing bikes, and pay the tax for these items as well as maintain them. A readily identifiable pattern is that spending habits tend to change over time as individuals' biographies evolve. Those illegal tobacco traders who are young, with limited social responsibilities, prefer to spend their profits on hedonistic pursuits (see Hall *et al.*, 2008). As their lives

change and they grow older, some seek to secure their family's future (e.g. one entrepreneur paid for his son's university education in the USA) and invest in legitimate business opportunities, including SMEs. Many illegal tobacco traders invest in establishments in the night-time economy (pubs, bars, clubs) and in property, not only in the UK but also abroad in countries such as Spain and the Republic of Ireland. In one of our cases, money was also invested in property in Iraqi Kurdistan. In this case, the amount was small and the legal banking system was used. We also came across illegal tobacco entrepreneurs investing in the enhancement of their existing legal business, e.g. more and better vehicles, bigger premises, advertising, or in establishing new businesses. Examples include pie and ice-cream factories, pawnbrokers and jewellery shops, Polish foodstuff shops and Polish hair and beauty salons in areas heavily populated by Eastern European diasporic communities.

The areas of investment are linked to the individual actors' own contacts and networks and areas of previous experience and knowledge (see L'Hoiry, 2013). One individual with an existing job in food supply sought to expand his business using his illicit profits. Actors are typically restricted to investing in areas in which they held some prior experience or expertise. Therefore examples of investment in offshore bank accounts were rather atypical cases since most entrepreneurs did not know people who could assist with the practicalities of setting up such an account.

As mentioned earlier, in some cases proceeds of crime were invested in the establishment of legitimate businesses. However, it should be noted that illicit proceeds were not laundered through these legitimate businesses thereafter. The legitimate business or its upgrade was, therefore, the product of the illicit activity. Money laundering on a sophisticated, complex and systematic scale was not evidenced in our research. Illicit profits were used directly to establish licit business interests, which short-circuits the money-laundering operation that becomes part of the mainstream system as it boosts legitimate banks' reserves. However, as mentioned above, illicit proceeds were not subsequently laundered through these legal businesses once they had been established.

## *Discussion*

The findings from this research do not seem to support the image of the illicit tobacco market as a threatening manifestation of stable, hierarchical forms of 'organised crime'. Nor do our findings support the image of crime-money that poses a serious threat to the national and international social order by corrupting political institutions and the financial system. The illegal tobacco trade is a very organic and fragmented business, which does not require a great degree of sophistication and management of finance and resources. Participants in these networks often act in an opportunistic and improvisational mode in a global market system. A number of individuals act as intermediaries who bring together disconnected parts (see Morselli & Roy, 2008) by controlling in a sense all the information asymmetries that make up the networks. However, the core relationship in this field appears to be purely instrumental and economic as individuals or small groups form temporary collaborations in order for their shared objectives to achieve success. Illegal tobacco entrepreneurs are often 'unusual suspects' who do not fit the profile of an archetypal 'smuggler'. The composition of a typical group of tobacco smugglers is better understood in the context of varied and networked relationships of individuals keen on securing a share of the market (L'Hoiry, 2013). Generally, these individuals do not form structured 'organisations' characterised by a sophisticated division of labour. At the core of collaboration between and among these entrepreneurs often lie family, ethnic or kinship relationships, as well as relationships forged within legal businesses (von Lampe and Johansen, 2004).

With respect to finances in particular, these legal businesses are also the terrain upon which the provision of credit is facilitated by trust among actors involved and, specifically, the brokers who may

be able to vouch for the trustworthiness of the entrepreneur receiving the merchandise. Having said that, unlike drug markets in which credit is an integral feature (Matrix 2007; Brå, 2007), credit in the illegal tobacco trade is more prevalent at the importation/wholesale level and only after years of 'frictionless' consolidated collaboration between and among entrepreneurs in *legal* projects. Finally, legal businesses facilitate the transportation and sales of tobacco products, thus reducing the costs for doing business and contributing to a higher profit margin.

Most of the entrepreneurs we interviewed, although they manifested entrepreneurial acumen to a varying extent, did not manage profits in an efficient enough way so as to be considered a 'threat' to social order or the financial system. They either possessed a small piece of the market with modest profits that simply spilled over into the legal economy, or they did not have the capacity to launder bigger profits (as a direct effect of anti-money laundering policy and practice) (Levi, 2013). When money laundering is the case, criminal entrepreneurs are embedded in legitimate businesses which provide for a very convenient extant setting for this type of financial management. The examination of the financial management of the illicit tobacco trade in the UK highlights that legal businesses not only act as a platform upon which *legal* relationships transform into *illegal* ones, but also as platforms for a relatively more efficient management of crime money (see Kleemans and van de Bunt, 2008). In a similar way, as mentioned earlier, the distinction between the 'underworld' and the 'upperworld' is blurred, the common distinction between 'illegal' capital and 'legal' capital is an overstatement. Crime profits are spent in the same way that normal money is spent, and legitimately earned money is often invested in illegitimate enterprises.

The generally unsophisticated financial management practices in the illegal tobacco trade are the result of a number of factors, such as the fragmented and decentralised nature of this particular trade, which in the UK creates an environment where crime-money is widely distributed rather than gathered in the hands of few big players. This supports the results of research based on official data on asset-confiscation, which shows that although a large amount of organised crime-money exists, and irrespective of the type of asset this money is converted into, its distribution is unequal (see van Duyne and Soudjin, 2010; van Duyne *et al.*, 2014). Skinnari (2010: 209) notes that the profits and investments made from drug entrepreneurs in Sweden "were not of socially subversive size, but rather, to enable a middle-class existence...". The same seems to apply to many of the illegal tobacco entrepreneurs in the UK. However, if we possessed more detailed data about the management of crime-money by multinational legal corporations that have been involved in tobacco smuggling, this claim might have been different (see Gounev and Ruggiero, 2012).

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