

Regulation and taxation of consumer products

A growing burden

Nairobi, 11th November 2011



Outline

- Context and definitions
- Drivers of regulation and historic trends
- Anticipated future trends by industry
- A call to action
- Discussion

Context

Product taxation and regulatory interventions are becoming a more and more important to the formulation, manufacturing, sale and marketing of consumer products

- Governments are increasingly acting to intervene in consumer markets to address public health and social concerns – as well as the need to address fiscal deficits
- While the pace and scale of regulatory intervention varies across product categories, the overall trajectory toward a more regulated environment seems clear
- These changes will have profound consequences for the landscape in which many CPG firms operate
- There is a window of opportunity to engage proactively with government to shape the nature of the debate and the shape of the future regulatory environment

Definitions

We see eight key primary types of intervention that are being implemented by governments to change consumer behaviours in the interest of public health, the environment and public finances

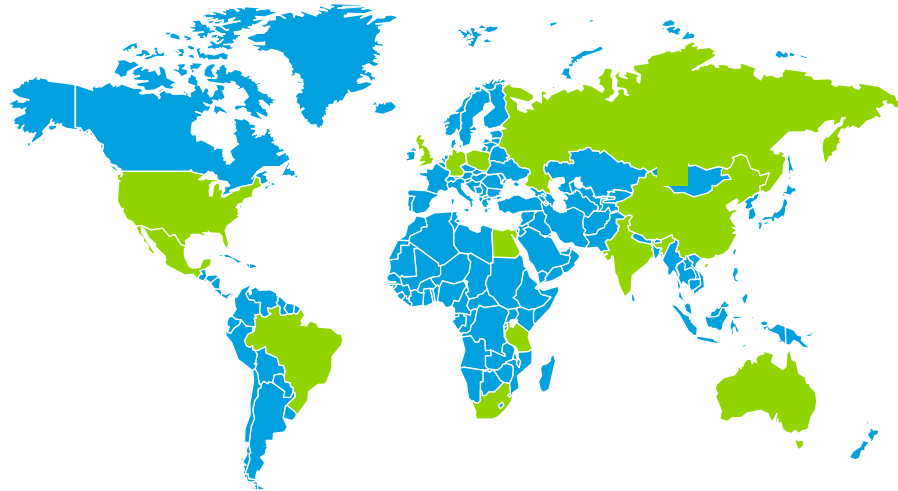
Types of regulation	Tobacco	Alcohol	Food
1. Product content	<ul style="list-style-type: none"> Reduction in permissible levels of tar and nicotine 	<ul style="list-style-type: none"> Limitations around the contents of alcohol 	<ul style="list-style-type: none"> Early restrictions on unnatural, harmful additives
2. Product labelling	<ul style="list-style-type: none"> Move towards plain packaging 	<ul style="list-style-type: none"> Growing use of health warnings 	<ul style="list-style-type: none"> Ingredients labelling and nutritional content
3. On packaging health warning	<ul style="list-style-type: none"> Increasingly explicit health warnings including graphics 	<ul style="list-style-type: none"> Proactive engagement of industry to provide on-pack warnings 	<ul style="list-style-type: none"> Nutritional content displayed as a warning
4. POS information	<ul style="list-style-type: none"> Compulsory warnings around POS and restrictions on advertising 	<ul style="list-style-type: none"> Information about age restrictions, also health warnings 	<ul style="list-style-type: none"> Little sign of POS regulation except in menu labelling
5. Advertising restrictions	<ul style="list-style-type: none"> From limiting advertising to complete ban in most places 	<ul style="list-style-type: none"> Changing restrictions around when and where advertising can appear 	<ul style="list-style-type: none"> Advertising restrictions for certain foods, especially when concerning children
6. Sale and possession	<ul style="list-style-type: none"> Age limits 	<ul style="list-style-type: none"> Changing licensing laws driven by political and economic climate 	<ul style="list-style-type: none"> Vending machine content restrictions in schools
7. Point of consumption	<ul style="list-style-type: none"> Restrictions on where you can smoke and bans in some countries 	<ul style="list-style-type: none"> Restrictions on where you can consume alcohol e.g. transport, work 	<ul style="list-style-type: none"> Move towards stricter guidelines on the content of food served at schools
8. Product taxes	<ul style="list-style-type: none"> Substantial excise duty rises well ahead of inflation used as a key control measure 	<ul style="list-style-type: none"> Excise duties seen as a way to modify consumption behaviours, for example to lower intake of alcohol content beverages 	<ul style="list-style-type: none"> Expecting product taxes to be used to encourage healthier eating and more sustainable consumption choices

Research undertaken

Deloitte has undertaken an in-depth programme of research into the evolving regulatory landscape as it impact the consumer products sector

We identified a representative cross section of markets and regulation types which formed the basis of the study:

13 countries spread across developed, emerging and developing economies



Countries in scope: Australia, Brazil, China, Egypt, Germany, India, Mexico, Poland, Russia, South Africa, Tanzania, UK, USA

Categories in scope: Tobacco, alcoholic beverage, food and beverage

Types of regulation considered:

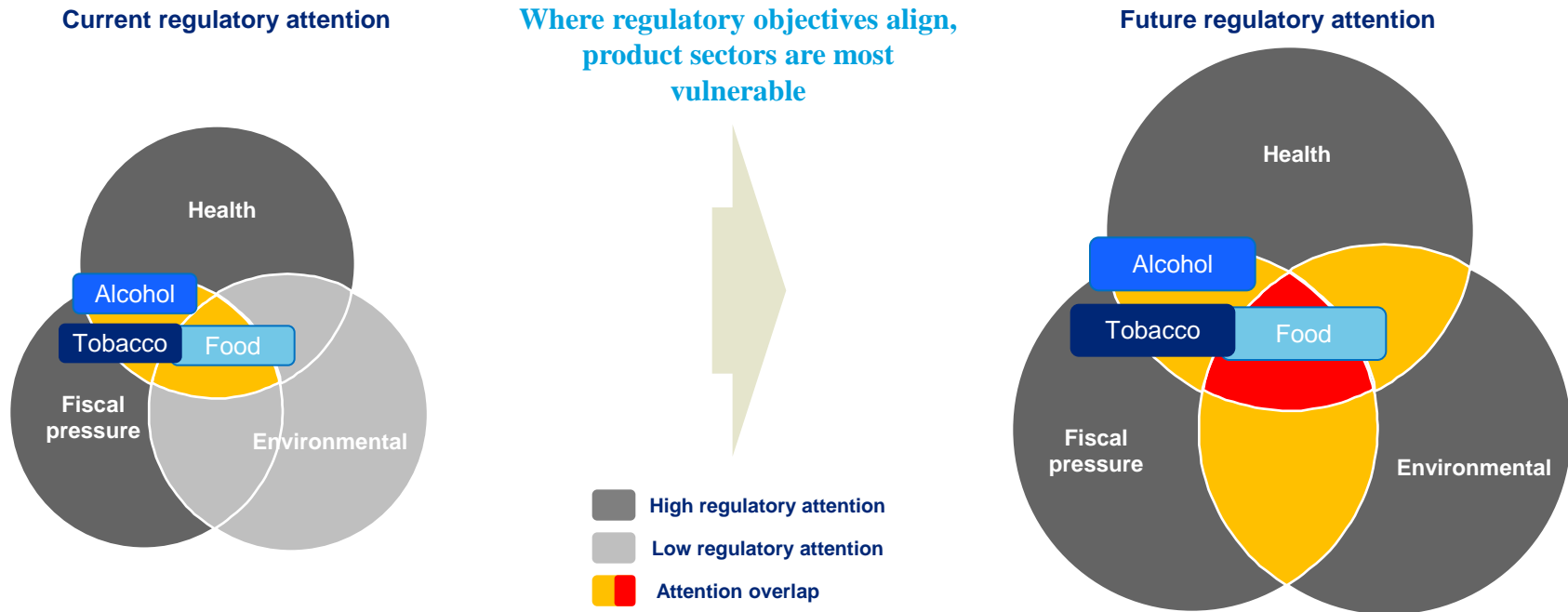
- Point of sale information / warning / visibility
- Product content
- Product labelling
- On pack health warnings
- Other restrictions on sale and possession
- Public consumption restrictions

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Drivers of regulation and product taxation

The key drivers of regulatory intervention and product taxation today are the public health agenda and fiscal deficits, with environmental considerations fast becoming more important



Tobacco industry significantly offsets its cost to society through contribution to fiscal deficit

- Societal health cost has historically provided a strong argument for government taxation
- Healthcare cost of tobacco in the US was \$75.5bn in 1998, however these industries also make a major fiscal contribution.
- Tobacco and alcohol taxes account for between 0.3 and 2.3% of total tax revenues in the UK and the US
- The cost of obesity is rising rapidly (\$147bn in the US, 1998) but its fiscal contribution does not yet match that of tobacco or alcohol.

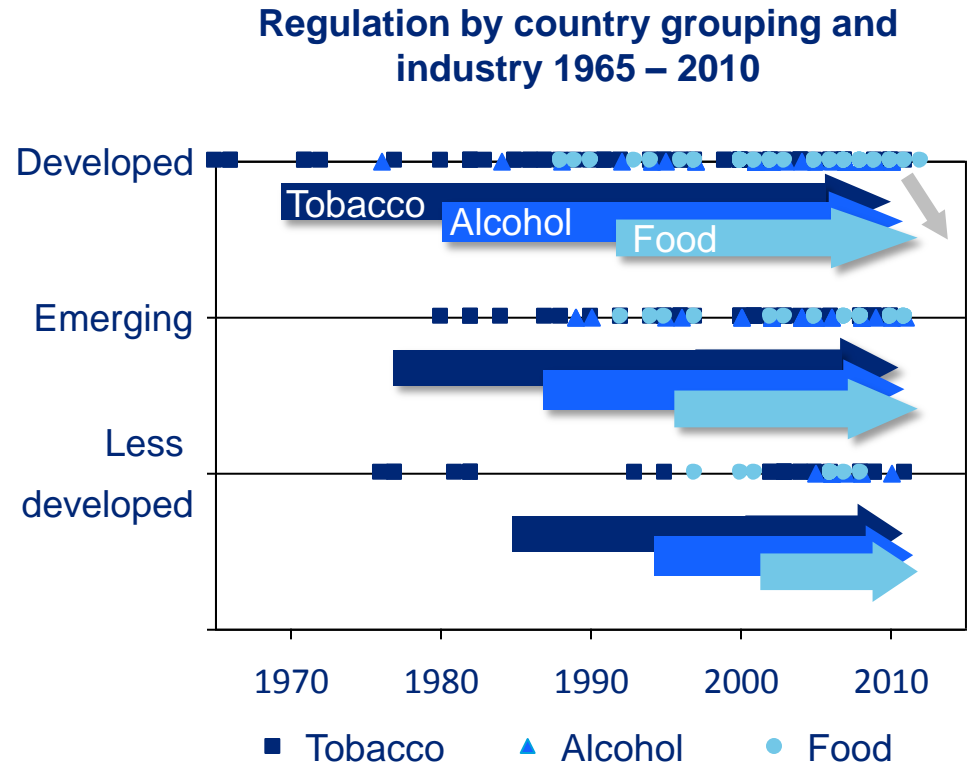
The negative impact of all consumer products on the environment is considered a major cost to society, but has not yet been systematically targeted by governments

- Environmental costs are estimated at 11% of GDP globally
- Current taxation offset is only c.3% of GDP in developed economies and much lower in less developed (however two thirds of the offset in developed economies relates to duty on hydrocarbon oils)

Regulatory trends

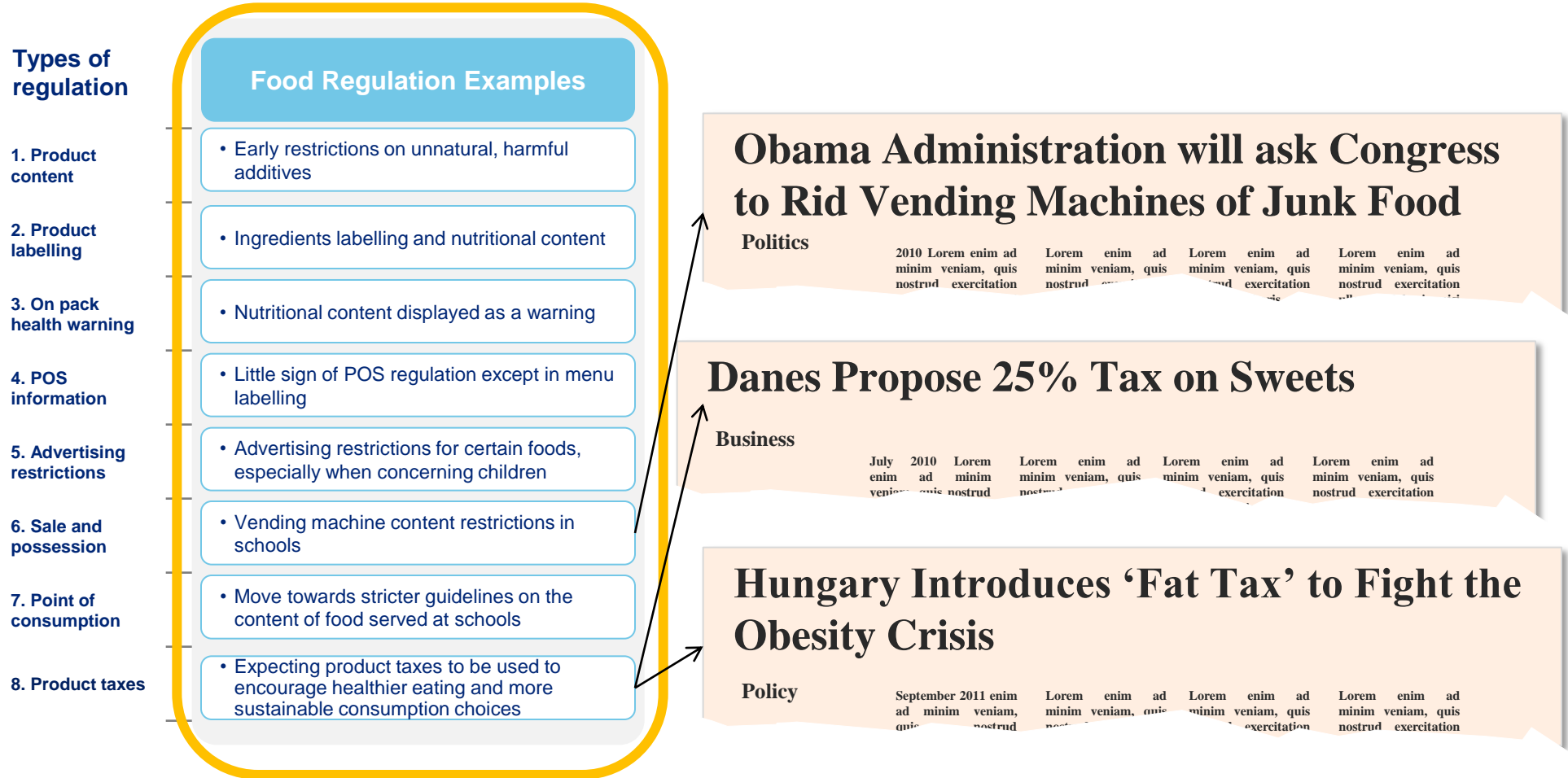
Our research identified clear patterns in the way regulation and product taxation is evolving across product categories and markets

1. There is a clear trend towards greater regulation and higher product taxes across many consumer goods categories
2. There is a clearly identifiable cascade in the regulatory and tax burden from more harmful to less harmful product categories
3. The speed at which regulation cascades between markets and products is increasing.



Regulatory trends (cont')

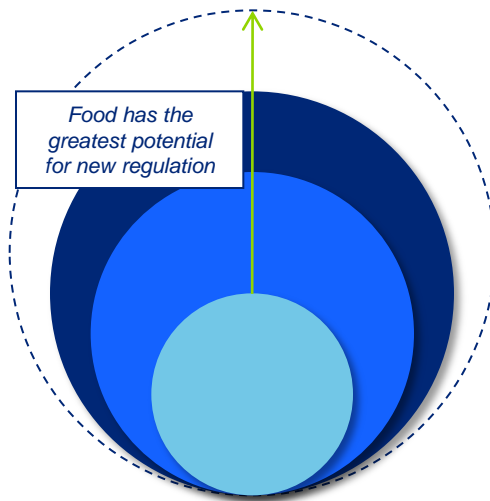
One of the most striking developments concerns the increasing focus around the harmful effects of some food and non-alcoholic drink categories.



Regulatory trends (cont')

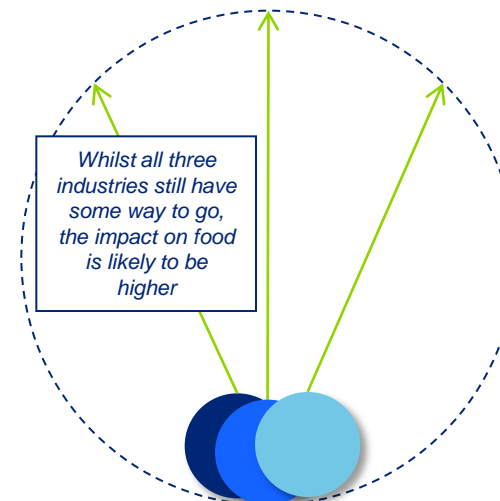
Whilst all three sectors will be increasingly impacted by environmentally driven regulation, the food industry will be particularly sensitive to new public health and environmental interventions

Public health driven regulation (indicative model)

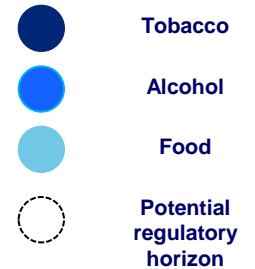


- Tobacco and alcohol are already highly regulated
- In the food industry governments are increasingly looking at more direct measures to discourage the consumption of unhealthy foods, including restricting availability and applying additional product taxes
- This trend is driven by the growing incidence of obesity and metabolic diseases and the increasing health related costs these imply

Environmentally driven regulation (indicative model)



- Relative to public health driven regulation, all industry sectors are further from the likely future regulatory level for environmental regulation
- However, the food sector appears to be particularly exposed to environmental regulation.



Regulatory considerations will increasingly be drivers for innovation in impacted industries

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Future trends by industry

Medium term regulatory changes are likely to differ significantly by industry

Recent historic trends across all industries

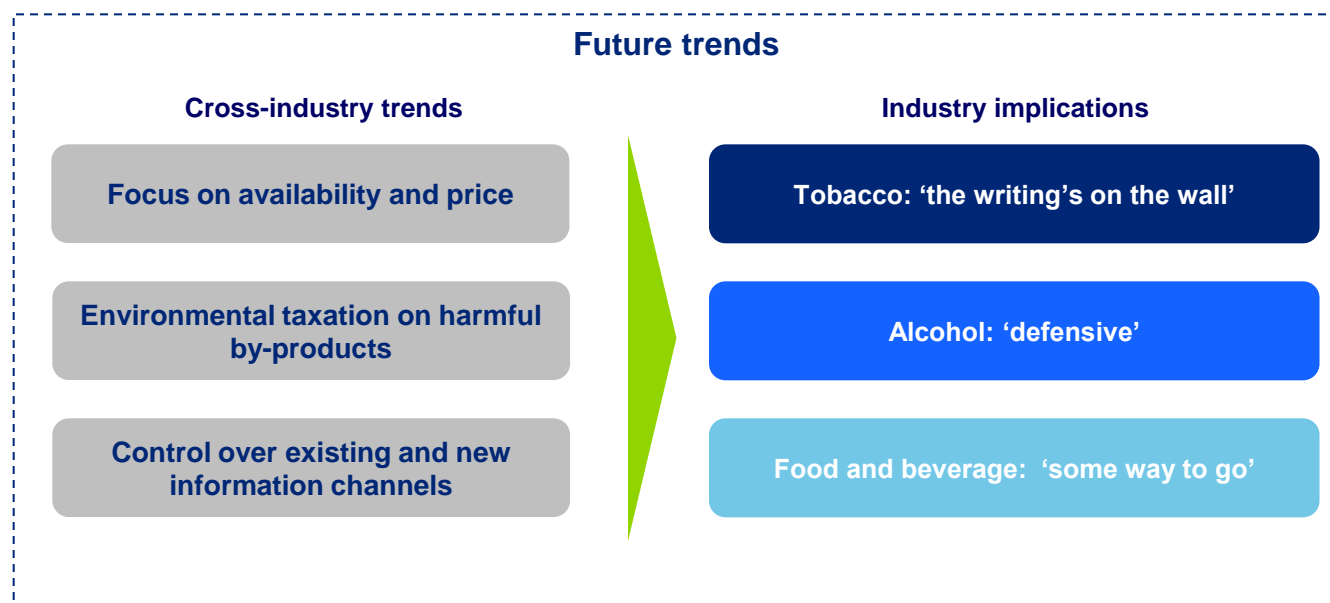
Regulation targets product constituents then targets the information and availability of the product or category

Regulation tries to influence consumer choice through information and then restricts availability

Self-regulation is increasingly being viewed as a method to shape future regulation

There is increasingly stringent regulation in more advanced countries and industries e.g. Tobacco, UK

Across all categories, children are often the subject of regulation as focus shifts to the next generation



Future trends by industry: Tobacco

The direction of travel in tobacco regulation is clear - though there is less certainty over the extent and timing of the most harsh interventions

Under the
counter

Further public
consumption
restrictions

Plain packaging

Ingredients
restrictions

- Across the globe regulations are increasingly targeting the relationship between consumers and the product:
 - PSA
 - PP
 - RDB
- The impact of these changes is debatable but the long-term consequences could be profound and may impact upon production, logistics and consumer dynamics
- The key defence is the unintended consequences “prohibition was not a success”

Future trends by industry: Alcohol

With further taxes and regulations on labelling, advertising and availability of alcohol expected, the industry still has everything to play for in terms of influencing these changes

**Packaging and
point of sale
restrictions**

**Increased
product duties /
taxes**

**Further
advertising
restrictions**

- We see three key issues arising from the next wave of alcohol regulation:
 - The effects of the regulations may differ considerably between different types of alcoholic beverage product and hence different impacts on alcohol producers
 - Because of these differences regulation and product taxation has become a competitive issue rather than a shared cause
 - Some of the more stringent regulations (eg, graphic health warnings) could create social tipping points around acceptability along the lines already seen with tobacco.

Future trends by industry: Food

Of the categories considered, we see the greatest uncertainty about the potential extent and severity of regulation is in food

**Packaging and
advertising**

**Reducing
consumption**

**Addressing
environmental
concerns**

- The manifest social concern around certain types of food consumption is creating increasing momentum for regulatory change - momentum that may be difficult to reverse once it is established.
- However the evidence around the impact of fat taxes and other measures is not yet robust - moreover the regulation of food consumption is closely linked with social issues and so the shape of future policy is difficult to predict.
- There is a window of opportunity for the industry to engage and influence the terms of the debate.

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Key questions

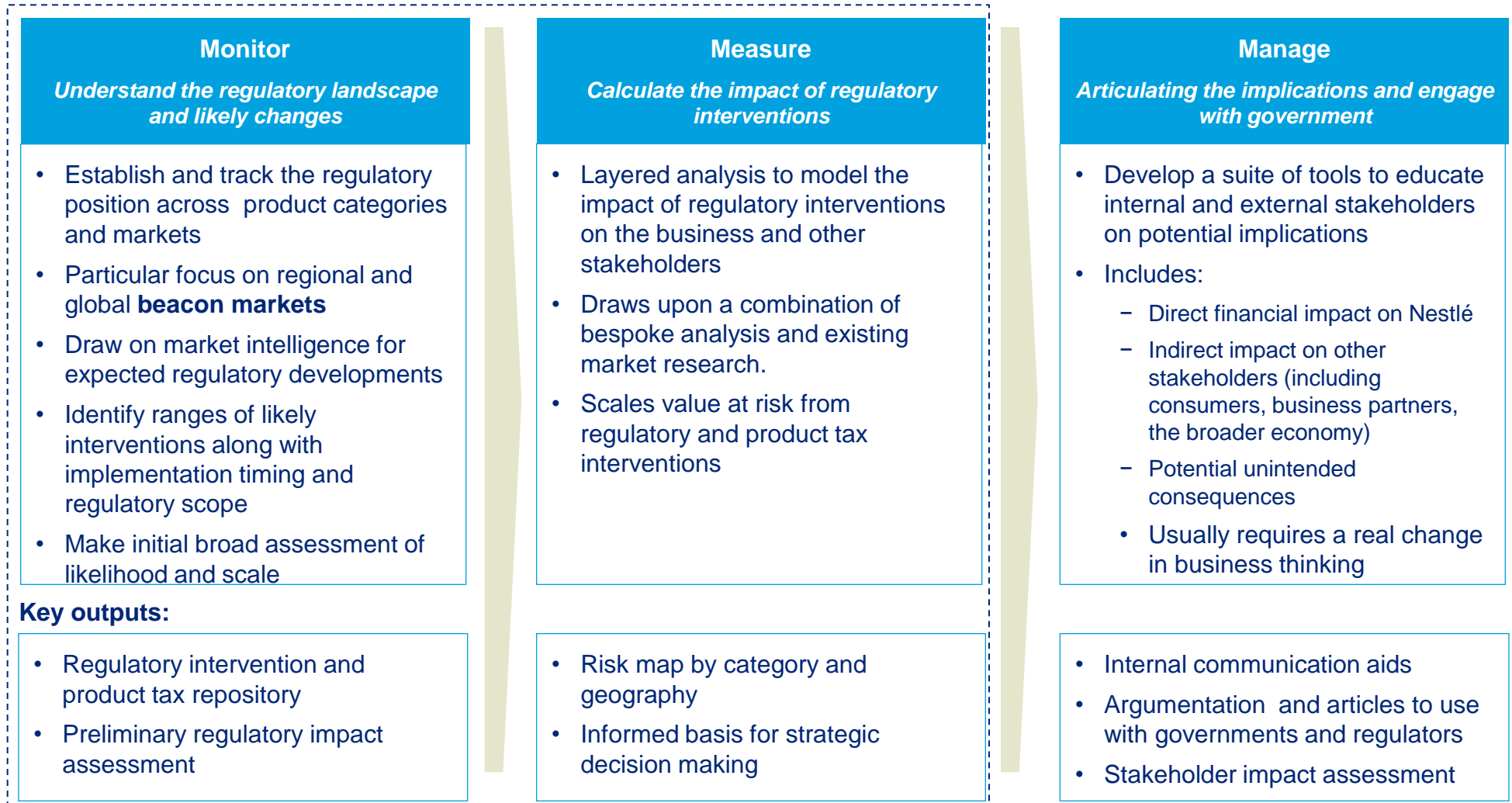
We see 3 key questions that businesses and the industry collectively need to address

1. What does success look like from the perspective of the industry and government, and how might these be aligned?
2. What are the key decision making bodies that influence the policy agenda and how can you most effectively engage with them?
3. What tools and resources do you need to establish to proactively monitor and respond to the changing regulatory environment?

Recommended approach

Tracking and managing the Value at Risk contains three elements, each can be considered independently – we typically recommend an initial focus on Monitor and Measure

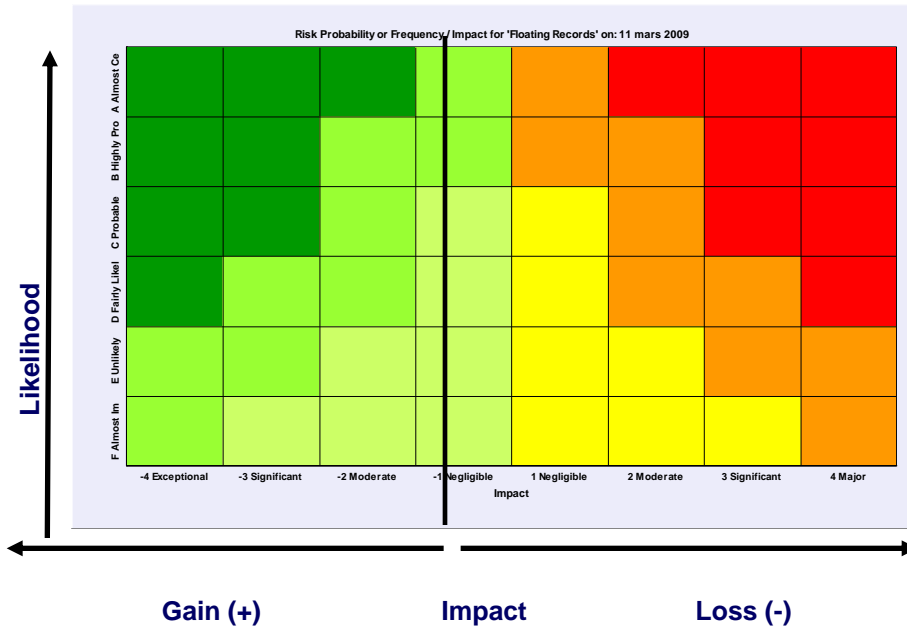
Three Stage Process:



Recommended approach (cont'd)

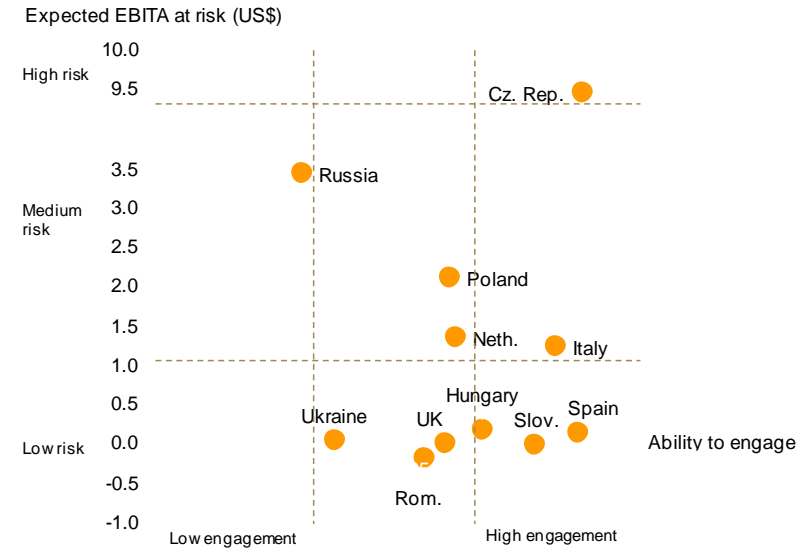
These two steps are best integrated with the wider Enterprise Risk Management (ERM) process based on information about regulatory risk

ERM Output Structure



- ERM outputs are clearly plotted to show severity and likelihood
- This plotting allows for prioritization and categorization for best management and containment of risk

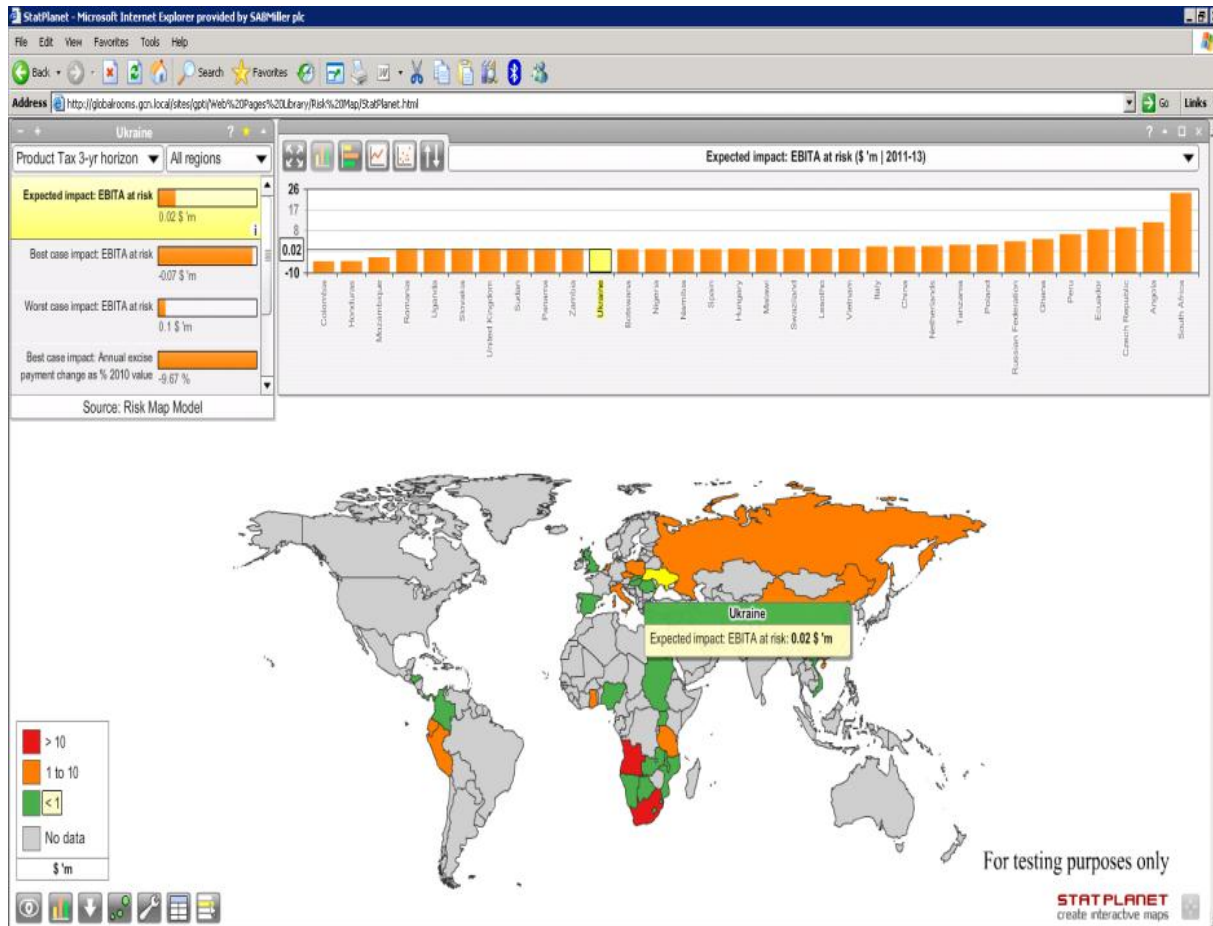
Example Risk Map Output



- Risk mapping for expected regulatory change can be plotted in much the same way
- Risk can be plotted as EBITA in a currency value, as a percentage of a country's turnover or any other meaningful measure for the business
- Risk can be rolled up to regional level and tallied across categories of products

Recommended approach (cont'd)

These two steps are best integrated with the wider Enterprise Risk Management (ERM) process based on information about regulatory risk



- Outputs are typically plotted as a heat map, with thresholds set for red amber and green
- Again, this analysis can be run using a variety of metrics
- Regional analysis is also possible
- This is ideally suited to the ERM process as line management in a country is the best place for ownership

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Questions?

For more information

- Lawrence Hutter
Global Leader – Consumer Business
lhutter@deloitte.co.uk
- John Kiarie
Partner
jkiarie@deloitte.co.ke
- Angela Wainaina
Associate Director
awainaina@deloitte.co.ke



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