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Accelerating complexity: Regulatory trends in the consumer goods industry

Introduction

Consumer Products and Retail businesses face a number of trends that will transform the markets in which they operate over the next few years. Each of these trends is in itself significant; the fact that they are increasingly interrelated and the magnitude of the potential combined impact makes the challenges for executives even more complex. They include:

- Dramatic growth in emerging markets; slowing growth in developed ones.
- Consumers who are more mobile, empowered by technology and connected in real-time.
- Focus on cost cutting, liquidity, international growth, and diversification.
- Sharper focus on the responsible sourcing of materials, commodity cost volatility, and sustainability.
- Continuing consolidation across sectors and geographies.
- A changing regulatory environment in which governments are examining increasingly aggressive approaches to the regulation of different categories of consumer goods.

This paper focuses on the last of these trends. Over the past forty years, there has been an identifiable cascade in the regulatory and tax burden from more harmful products, such as tobacco, to less harmful product categories such as food, with accelerating timescales. For consumer products companies, this will require a step change in level of regulatory awareness and engagement.

This report is part of a DTTL program to help executives in the consumer industries address this and other critical global challenges. The program focuses the deep knowledge and experience of practitioners in Deloitte member firms around the world on specific priority issues and solutions to help executives guide their companies. The intention in each case is to provide executives with industry-specific perspective and provide practical guidance that has commercial impact.

I hope you find this study useful and that you will also benefit from our upcoming reports on sustainability, pricing, globalization, and other topics as they become available.

I welcome your ideas and input on this and other topics that you feel are important for your business, and encourage you to contact me or the leaders listed on the back of this report.

Leon Pieters
Consumer Business Propositions Leader
Deloitte Consulting, Netherlands

Regulatory trends in the consumer goods industry – the new imperative

Growing concerns about public health, societal issues and environmental sustainability are encouraging governments to examine increasingly aggressive approaches to the regulation of different categories of consumer goods, as well as introducing – and raising existing – product taxes. Furthermore, unprecedented fiscal deficits are forcing many governments to explore and implement new revenue generating measures – providing further incentive to increase product taxes, legitimized in part by the wider strategic agenda.

This impact can most directly be seen in relation to the traditional "sin" products such as alcohol and tobacco. For example:

- Australia is currently in the process of legislating to remove all branding from tobacco packs, and other countries are expected to follow shortly.
- Iceland is currently considering proposals to make the sale of tobacco illegal except under prescription.
- The Russian Duma recently voted to introduce restrictions on the late night sale of alcohol and to ban its consumption in a variety of public places.
- Thailand has plans to implement graphic health warnings on alcoholic beverages.

However, the effects are also being felt in sectors that have not yet been subjected to regulation of this sort, particularly in food and non-alcoholic beverage. In 2010, for example, the Danish government raised taxes by 25% on 'unhealthy' food and drinks, and in September 2011 the Hungarian government introduced a special tax on foods high in fat, salt, and sugar content.

Taxing less healthy foods and drinks is also being actively discussed in many other countries, including the UK. Proposals are currently under consideration in the U.S. that could add 30% to the cost of an average soft drink. Consumer goods companies are also increasingly concerned about a range of environmental taxes that will make products more expensive.

Deloitte's* experience from working with many leading consumer products companies around the world, reinforced by specific research undertaken, indicates that these changes reflect an accelerating cascade of regulation across different sectors and geographies.

These changes create material value at risk for consumer product companies in terms of the cost of managing the burden of regulation; the loss of brand equity where the ability to market brands is restricted; and reduced sales volume as products become less available and affordable

As some major players in the industry have already recognized, this requires a step change in level of regulatory awareness and engagement. This can be challenging for food and beverage businesses – especially large, multinational organizations which are exposed to a complex array of different regulatory issues across a wide spectrum of geographies and product categories.

However, businesses that are thoroughly prepared with a strategic response to these challenges are likely to be best positioned to mitigate the risks they are exposed to and able to capitalize on the opportunities they present.

* As used in this communication, "Deloitte" means Deloitte Touche Tohmatsu Limited member firms.

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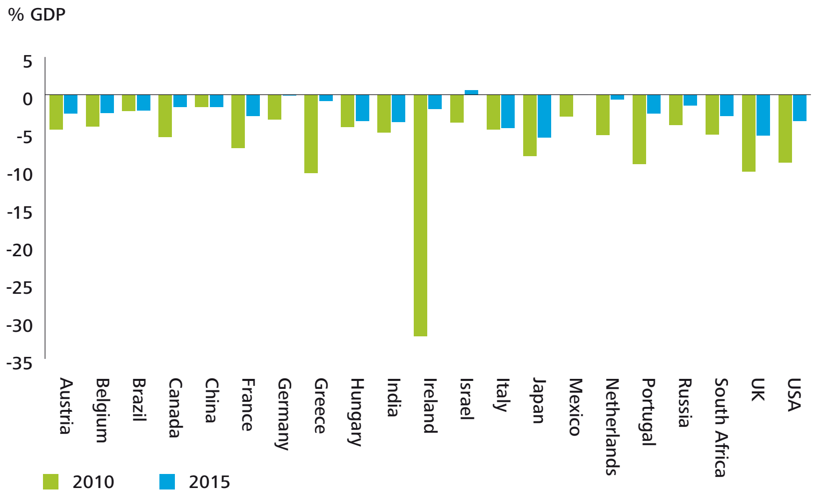
Key drivers of increasing regulation

The changing regulatory landscape will prompt many businesses to consider the potential market impact of increasing product regulation, what it will mean for their own business, and what their strategic response should be. However, before discussing how businesses should respond, we should understand what has driven this unprecedented – and growing – intensity of regulatory intervention. While there are number of factors that influence these regulatory changes, it appears that the key factors are the increasing fiscal pressure on governments; growing willingness to intervene to promote public health and mitigate adverse societal impacts; and a desire to minimize the negative impact of industry on the environment.

Figure 1. Current and target budget balance in OECD, BRIC and South Africa



Source: Economist Intelligence Unit, 2011

Fiscal deficits: A significant driver of product taxation on consumer goods companies will be the need for governments to balance fiscal budgets. Many major economies are facing mounting public debt and governments are seeking ways to get budgets back into balance by increasing revenues and decreasing spending (see Figure 1).

Public health: The cost to society of smoking (estimated to be £5bn in UK in 2009[1]) has historically provided a strong argument for government taxation. A similar argument is put forward for alcohol products. In part as a result of this, tobacco and alcohol taxes constitute a significant source of fiscal income, accounting for 0.66%[2] and 0.23%[3] of total tax revenues in the U.S., respectively. In the UK, tobacco and alcohol taxes represent an even higher percentage of total government tax take, at 2.2%[4] and 2.3%[5], respectively. The cost of obesity in the U.S. is likely to rise to about $344 billion in medical-related expenses by 2018, eating up about 21% of health-care spending.[6] In the UK, NHS spending on obesity was found to have increased seven-fold between 2006 and 2009[7]. However, the fiscal contribution of the food and beverage sectors does not yet compare with that of tobacco or alcohol. The problem is not limited to developed economies, with the World Health Organization (WHO) estimating in 2008 that 1.5 billion adults, 20 and older, were overweight.[8]

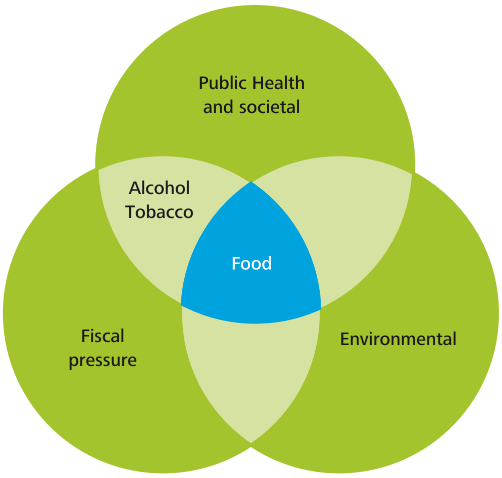
Environment: The negative impact of the manufacturing, distribution, consumption and disposal of consumer products on the environment is considered a major cost to society but has not yet been systematically targeted by governments. The Stern review in 2005 estimated that the total cost of climate change will be equivalent to losing 5-10% of Global Gross Domestic Product every year, given a 5-6 degree increase in average global temperatures.[9] Agricultural processes in food production, clothing manufacture and the raw materials used in consumer technology, among others, have been highlighted as significant contributors to climate change. However environmental taxes accounted for just 8%[10] of total taxes in the UK in 2010, and the level of environmental taxation is generally lower in less developed countries. Governments are increasingly likely to take the view that there is scope for further environmental regulation and taxation to make up for the discrepancy with the cost of environmental damage to GDP.

1 Tobacco Control Journal/British Heart Foundation, 2009
2 Tax Policy Centre, 2010
3 Tax Policy Centre, 2010
4 HMRC, 2011
5 HMRC, 2011
6 Joint report by the United Health Foundation, the American Public Health Association, and Partnership for Prevention, 2009
7 NHS report 2009
8 WHO, 2008
9 Stern Report 2005
10 ONS, 2010

The intersection of regulatory drivers:

The intersection of the three key regulatory drivers leaves the food industry particularly vulnerable to future regulation (see Figure 2). Tobacco and, to a lesser extent, alcohol, have both historically been impacted by the fiscal and public health/societal drivers of regulation in many countries. By contrast, food has been comparatively less regulated, although increasing public health and fiscal concerns put areas of the food industry more firmly within scope for future regulation. Simultaneously, while all three industries will be impacted by environmentally driven regulation, the more resource-intensive nature of the food industry leaves it the most exposed to future regulation.

Figure 2. The intersection of regulatory drivers



Understanding regulatory trends

To more fully understand the historical patterns of regulatory evolution – an important lens to use when considering where future regulation may arise – Deloitte UK undertook a global research exercise to understand how regulation has evolved and how it currently translates across multiple markets and industries. As indicated in figure 3, the 'deep-dive' global research looked at eight types of regulation across 13 countries globally.

Figure 3.

Types of regulation	Tobacco	Alcohol	Food
1. Product content	• Reduction in permissible levels of tar and nicotine	• Limitations around the contents of alcohol	• Early restrictions on unnatural, harmful additives
2. Product labelling	• Move towards plain packaging	• Growing use of health warnings	• Ingredients labelling and nutritional content
3. On packaging health warning	• Increasingly explicit health warnings including graphics	• Proactive engagement of industry to provide on-pack warnings	• Nutritional content displayed as a warning
4. POS information	• Compulsory warnings around POS and restrictions on advertising	• Information about age restrictions, also health warnings	• Little sign of POS regulation except in menu labelling
5. Advertising restrictions	• From limiting advertising to complete ban in most places	• Changing restrictions around when and where advertising can appear	• Advertising restrictions for certain foods, especially when concerning children
6. Sale and possession	• Age limits	• Changing licensing laws driven by political and economic climate	• Vending machine content restrictions in schools
7. Point of consumption	• Restrictions on where you can smoke and bans in some countries	• Restrictions on where you can consume alcohol e.g. transport, work	• Move towards stricter guidelines on the content of food served at schools
8. Product taxes	• Substantial excise duty rises well ahead of inflation used as a key control measure	• Excise duties seen as a way to modify consumption behaviours, for example to lower intake of alcohol content beverages	• Expecting product taxes to be used to encourage healthier eating and more sustainable consumption choices

Regulatory "cascade" – *regulation crossing industries and markets in accelerating timescales*
Over the past forty years, there has clearly been an identifiable cascade in the regulatory and tax burden from more harmful to less harmful product categories such as food, with accelerating timescales.

In tobacco, following decades of increasingly stringent advertising regulations, the most restrictive regulation seen thus far – a total ban of on-pack branding in Australia – is currently passing through the Parliament. Many health professionals anticipate this ban will have a significant impact on tobacco sales, though the unintended consequences such as impact on the illicit market are not fully understood.

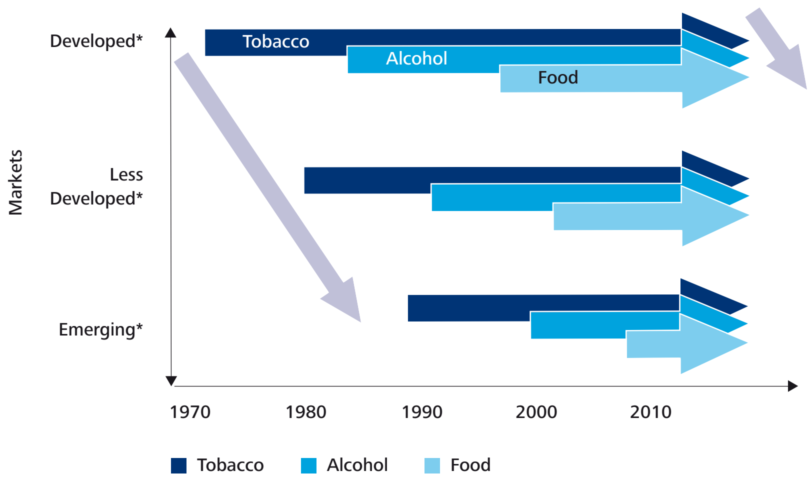
Historically, restrictions around product purchase and consumption have impacted the alcoholic beverage industry (e.g. liquor license laws, age limits, and drunk driving restrictions). Additionally, advertising laws and product taxation have impacted the alcohol industry. The WHO encourages member nations to "influence the price of alcoholic beverages, for instance by taxation". More recently, labeling of alcohol units has been applied by the UK government to encourage consumers to make sensible choices for their health without restricting consumption. The measure has met with mixed reviews, with criticism being leveled that guideline unit amounts are misunderstood by consumers.[11]

Recent guidelines and regulations around food labeling, such as the voluntary display of GDA (Guideline Daily Allowance) information on the front of packaging in the EU, have sought to educate consumers on the dangers of less healthy products. More stringent regulation targeting the less healthy characteristics of particular categories of food products is anticipated.

Deloitte's research also shows that key pieces of regulation in one market are often followed by similar interventions across other markets, Australia was an early adopter of legislation around the display of tobacco products at point-of-sale in 2000, restricting the product to the seller side and not less than 1 meter away from any part of the customer service area. Mexico applied a similar measure in 2008, when it was ruled that cigarettes at point-of-sale must be placed in such a manner that consumers do not have direct access to them.[12]

Increasingly prohibitive – *incremental regulatory advances increase severity of regulatory map*
As demonstrated in the tobacco industry, regulation can often be incremental, increasing in severity over time. For example the early health warnings on cigarettes were typically small and text-based.

Figure 4. Regulatory cascade across markets and industries



Developed: Countries with high GDP per capita and that typically have relatively advanced regulatory bodies to monitor the consumer products industries.

Less developed: Countries with moderate GDP per capita and that typically have relatively less advanced regulatory bodies to monitor the consumer products industries.

Emerging: Countries with low GDP per capita that have little regulation to monitor the consumer products industries.

11 Drinkaware, 2011
12 The International Document Centre, 2011

Over time a number of markets have increased the size of these warnings whilst also introducing increasingly graphic images to accompany the warning. Some countries, such as Australia, are now contemplating a move to plain packaging which would effectively remove all company branding from the pack, replacing it with large graphic health warnings.

Summary – *particular exposure of the food industry to increased regulation*

With the food industry comparatively less regulated in relation to the public health/societal and fiscal drivers than the tobacco and alcoholic beverage industry, the cascade of regulation across sectors suggests that the industry is particularly exposed to increasing severity of regulatory interventions in the future. Additionally, the trend has been for less developed and emerging markets to adopt regulations first introduced in developed markets. Given that such adoption seems to be accelerating it is likely that in the future all three sectors will face increased regulation across both developed and developing markets and that the lag between adoption in more developed markets and developing markets will become ever shorter.

Implications for consumer products companies, governments, and regulators – *shifting from passive acceptance to proactive engagement*

A better understanding of the impact of regulation on business and society can help consumer products companies and governments make well-informed decisions that have a positive and sustainable influence on both patterns of consumption and economic performance – providing a win:win for consumers and business.

The consumer products companies' standpoint – *understanding exposure, prioritizing investment, and engaging with regulators*

Consumer products companies need to develop a good understanding of their exposure to regulatory change in each market but the changing regulatory picture across markets makes this a complicated endeavor.

Chocolate provides a useful example of the way in which several factors can potentially intersect to create a regulatory risk for a consumer goods company. The product is not only linked to rising healthcare costs but its production can also have a negative impact on the environment. Figure 5 below outlines some of the environmental regulations that could increasingly affect chocolate manufacturers.

13 Defra's Green Claims Guidance(2011) provides advice to business for clear, accurate, relevant and substantiated environmental claims on products; Updates to the Polish Code of Ethics in Advertising stated that "In general, claims to be "environmentally friendly" must be substantiated", 2008

14 The most common method of comparing the environmental impact of different consumer products takes into account the carbon emissions of each stage of the product lifecycle, including raw materials, productions, transportation, consumption and disposal

15 Foresight, 'The Future of Food and Farming' (2011); The Government Office for Science, London

Figure 5. Potential exposure of a chocolate bar to environmentally-driven regulation

In our experience the most successful businesses prioritize their investment of time and resources, engaging early on with key regulatory issues, especially in beacon or high-profile markets. Multi-national businesses are particularly challenged in this regard, as they face a global patchwork of regulatory activity and successful engagement requires resources and skills that are often in short supply.

The government standpoint – *effective regulation must benefit the government and consumers*

Governments also face important challenges in this area to ensure that new regulations are appropriately targeted and effective in achieving their objectives. This is particularly the case where governments are attempting to develop new regulations (such as the plain packaging of tobacco) or applying existing regulations to new markets (such as some of the current debate on food regulation).

Much of the regulation in this area is focused on attempting to alter 'voluntary' behavior through the use of a combination of price, education/information, and restricted availability. However the deep-set nature of many consumption patterns means that this can be difficult to achieve in practice, especially in the short-term.

This creates complex policy trade-offs that may be difficult to analyze completely. For example, the cost to business of an advertising ban may be immediate and substantial in terms of reduced commercial freedom, inability to bring new products to market, and so forth. However, the effect of the ban on consumption patterns (presumably the objective of the regulation) may only be realized over the very long-term, making it difficult to assess the efficacy of the policy.

Furthermore, even where regulations are effective in achieving their primary objectives, is should also be recognized that these can drive other economic or social costs. For example, one study found that the annual cost to the economy of federal regulation in the U.S. alone exceeded US$1.7 trillion.[16] Another study found that 19 new regulations had been introduced in the UK in 2007-08, costing UK businesses an additional £1.9bn.[17] A similar study found that more than a quarter of all regulatory proposals were deemed 'not fit for purpose'.[18]

The most effective regulatory frameworks typically recognize the need to understand clearly who benefits and who feels the pinch from the regulation. The ability to quantify these costs and benefits is often an essential step in evaluating the net impact of the policy. In its work with regulators and businesses across the globe to evaluate regulatory impact, Deloitte has found that quantifying the costs and benefits of regulation works most effectively where industry and government engage in ongoing open and constructive dialogue, pooling their common knowledge to generate as accurate a picture as possible about the impacts of a proposed regulation.

Quantifying the costs and benefits of regulation works most effectively where industry and government engage in ongoing open and constructive dialogue.

16 SBA (2010), 'The impact of regulatory costs on small firms'

17 British Chambers of Commerce (2009), 'Cost of regulation on British business rises to £77 billion'

18 British Chambers of Commerce (2011), RPC annual report issued March 8, 2012

Regulatory case studies
By working with leading consumer products companies, Deloitte member firms have had the opportunity to build and refine a set of tools to quantify and manage the impact of regulatory risk on a global scale. There is certainly no 'one-size-fits-all' toolkit for quantifying and managing regulatory risk – drawing on Deloitte's global base of industry knowledge and experience, member firms tailor the toolkit to the individual needs of organizations. The selected case studies below highlight just some of Deloitte's experience in helping member firm clients manage the burden of regulatory risk and identify the opportunities it brings.

Case study 1: a multinational beverage company
Deloitte provided a major multinational beverage company with a comprehensive set of tools to identify and manage regulatory risk. The tools deployed include an intelligence-led early warning system to identify regulatory changes, as well as a robust and transparent risk analytics tool to quantify financial exposure of the firm. Deloitte also supported the development of a comprehensive engagement toolkit for each of the firm's end markets to use to inform their own approach with government. This was supported by an economic impact model that provides quantified evidence to help provide rigor in the arguments being put forward.

Case study 2: international tobacco group
Recognizing the importance of evidence-led engagement with policy makers, British American Tobacco (BAT) commissioned Deloitte UK to undertake an independent evaluation of the effectiveness of graphic health warnings in influencing consumption. The report undertook one of the most comprehensive econometric studies to date, covering 27 markets over 14 years. The findings were produced in a public domain report by Deloitte that BAT is now using actively to support their discussions with governments across the globe.

How do you get started?

As a consumer products company facing a changing global regulatory landscape, here are several key questions to consider:

1. Have you yet made the shift from a reactive to a proactive stance on regulation? Is this embedded in the business culture?

2. Where are you focusing your attention with respect to fiscal, health, societal, and environmentally driven regulation?

3. How visible are future regulatory changes and their potential impact in the different geographic territories in which your organisation operates?

4. Do you have a process to understand, analyze and respond to regulatory changes – including a toolkit to engage regulators effectively across your country operations?

5. Do you have the people, skills and capabilities required to implement effectively the necessary processes to deal with regulatory changes?

Deloitte brings a unique and proven approach that translates a strategic regulatory risk vision into an actionable and comprehensive plan to pool existing resources (for example across the Corporate Affairs, Enterprise Risk, Strategy, and Finance functions) and tools to meet the demands of a changing regulatory landscape. At a high level, this approach:

1. Defines a vision, strategy and role of a regulatory risk management capability and assesses the current position against the required level of capability centrally and in-market.

2. Establishes a regulatory risk capability comprised of policies, procedures, roles, responsibilities and supporting quantitative tools (for example, a predictive model and portfolio risk map).

3. Implements the regulatory risk capability in a phased approach centrally and across markets in a way that effectively embeds the tool in business-as-usual processes.

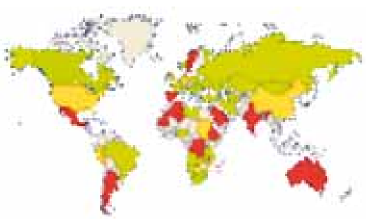
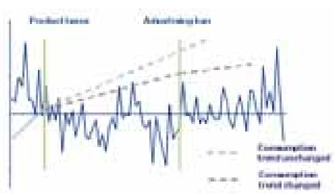
Figure 6. Actionable response to regulatory risk

Prepare			Test	Monitor / Review
Define vision and role of regulatory risk capability	Assess current performance and capabilities	Design and test 'proof of concept' tools	Roll out phase 1: *Proof of concept*	Roll out phase 2: Widespread adoption and embed in BAU
• Understand the wider strategic context. • Perform value at risk analysis. • Confirm stakeholder expectations. • Define vision and role of regulatory risk strategy and management capability.	• Investigate existing models, databases and toolkits to quantify and manage value at risk. • Understand existing capabilities and resources aligned to regulatory risk. • Perform gap analysis to show the current versus required level of capability to quantify and manage regulatory risk.	• Design, develop and test regulatory risk quantification and management tool(s) such as: – predictive quantitative model, portfolio risk map; and – supporting policies, procedures, roles and responsibilities. • Leverage client tools where feasible. • Enhance existing and/or develop new enabling technology, where required.	• Identify primary group of high regulatory risk territories and product categories. • Roll out proof of concept tools to priority territories. • Engage policymakers in conversation regarding strategic regulatory developments. • Capture and consolidate feedback from territories. • Iterate toolkits and processes where required.	• Plan and communicate roll-out to wider set of territories. • Build skills and capabilities to generate energy around regulatory risk to encourage wide scale adoption of tool(s) through: training, guiding teams, best-practice forums. • Embed into BAU: e.g. enable skills transfer into relevant teams, enhance existing reporting process to include measurement and monitoring of regulatory risk.

Representative tools and methodologies

The tools that Deloitte has helped clients to establish have two broad aims: to understand and to manage proactively the value at risk from regulatory changes. Deloitte's ability to help companies develop and deliver such tools rests on the broad strategic, economic, consulting, tax and enterprise risk skill sets that exist across Deloitte member firms. The outputs from these tools have been proven to support organizations in their constructive dialogue with governments, regulators and industry bodies. Please see below for a more detailed description of the Deloitte regulatory risk toolkits.

Figure 7. The Deloitte toolkit for regulatory risk

	Understanding the value at risk	Managing the value at risk
Imperative to take action	• Rapidly changing nature of risks. • Early and effective deployment of resources important to achieving successful outcome.	• Engagement with stakeholders and government most likely to succeed when evidence based.
Desired features	• Ability to quantify risk so that it can be compared against other risks and business priorities. • Global in nature. • Transparent and accepted methodology. • Outputs can be produced to meet the needs of a wide range of stakeholders.	• Provides new and compelling insights to grab the attention of stakeholders. • Results seen as credible. • Analysis can be adapted to examine a wide range of possible regulatory interventions.
Example tools	• Global risk analysis for clients. • Supported by intelligence reports on regulatory developments in each market. 	• Comprehensive engagement framework for clients. • Supported by economic impact models to demonstrate overall regulatory policy effects. 

The Deloitte network of member firms

With a strong network throughout the Americas, Europe, Africa and Asia Pacific, Deloitte Consumer Products and Regulatory specialists combine deep industry experience and understanding of regional markets to help companies around the world succeed wherever they operate.

Deloitte member firms serve:

- All eight of the consumer products companies in the FTSE 100.
- Hundreds of other global, regional and national consumer products companies around the world.
- Four of the world's five largest brewing companies.
- Three of the world's largest wine and spirits companies.

Deloitte member firm clients in the Consumer Products industry include:

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Carlsberg
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Clorox Company
The Coca-Cola Company
Columbia Sportswear Co
Danone
FEMSA
Grupo Bimbo
Grupo Modelo
Kraft
L'Oreal
Nestlé
Procter & Gamble Company
Reckitt Benckiser
SABMiller
Wacoal International Corp

Contacts

Consumer Products contacts for Deloitte Touche Tohmatsu and its member firms.

DTTL Global Consumer Business Industry Leader
Antoine de Riedmatten
Deloitte Touche Tohmatsu Limited
aderiedmatten@deloitte.fr

Latin America Consumer Business Leader
Reynaldo Saad
Deloitte Brazil
rsaad@deloitte.com

Asia Pacific Consumer Business Leader
Haruhiko Yahagi
Deloitte Japan
hyahagi@tohmatsu.co.jp

Consumer Products Leader
Jack Ringquist
Deloitte Consulting LLP
jringquist@deloitte.com

Regulatory Leader, Consumer Products
Sam Blackie
Deloitte UK
sblackie@deloitte.co.uk

Consumer Business Propositions Leader
Leon Pieters
Deloitte Netherlands
LeonPieters@deloitte.nl

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