DATABUILD

Exploring Small Producers & Importers of Soft Drinks with Added Sugar

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Glossary

Term	Meaning
Aspartame	An artificial sweetener commonly used as a sugar substitute in some foods and beverages.
BSDA	British Soft Drinks Association; an industry body representing organisations within the soft drinks industry supply chain.
Brix testing	Testing a solution using a Brix meter (a refractometer) to determine the sugar content.
Dilutables	Concentrated syrup or cordial, intended to be diluted prior to consumption.
Flavour house	A business that develops natural and / or artificial food and drink flavourings and ingredients.
GVA	Gross value added is a productivity metric that measures the economic contribution (in this context) of a particular sector.
Importer	In this context, an organisation that is bringing one or more soft drinks with added sugar into the United Kingdom from producers / distributors outside of the United Kingdom.
Intellectual property (IP)	A work or invention that is the result of creativity, such as a design or process, to which one has rights and for which one may apply for a patent, copyright, or trademark.
Producer	In this context, an organisation that produces soft drinks with added sugar within the geographical bounds of the United Kingdom.
SME	Small-Medium Enterprise. For this project, businesses were selected who represented the smaller end of the market. No organisations with more than 250 employees were interviewed within this research.
Soft drinks with added sugar	Any water or juice based non-alcoholic beverage product within which sugar has been added to sweeten the drink (and / or for other purposes). This includes carbonated drinks, cordials, syrups, and fruit juices (with added sugar).
Stevia	A sweetener used as a sugar substitute, derived from the leaves of the *Stevia rebaudiana* plant.

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Executive summary

In Budget 2016, the Government announced its intention to introduce an industry levy on the production and import of soft drinks with added sugar. HMRC commissioned Databuild to conduct research with small producers and importers of soft drinks with added sugar, to feed into development of the levy

In Autumn 2016, Databuild conducted 50 qualitative interviews with small producers and importers of soft drinks with added sugar.

Overview of small operators in the industry

- The industry for soft drinks with added sugar covers a range of products, including carbonated drinks, cordials, syrups, fruit juices and smoothies. The research found that businesses dealt both in mass market products, as well as niche or specialist soft drinks.
- Producers reported that they tended to either produce their own products or contracted out elements of production to third party organisations. These third-party organisations tended to be medium sized production plants who offered a wide range of services to small producers.
- For most organisations interviewed, soft drinks with added sugar were the primary source of income. For some (particularly importers and producers of other beverage products like alcoholic mixers / low calorie drinks) these were just a part of their business. Few producers were found to be exporting products.
- Soft drink production amongst the businesses interviewed varied markedly; whilst the smallest business produced 100 litres annually, the largest produced tens of millions of litres. Importers were less able to estimate import volumes, but those that could explained that volumes ranged from 50,000 litres through to 1.5 million litres annually.
- Before the levy announcement, some organisations reported they already offered lower sugar alternatives or had explored demand for these; they see these as an opportunity for growth, particularly with the advent of the levy.
- Sugar was considered by producers and importers to be an important consideration in terms of taste and texture. Some organisations reported challenges in marketing and

selling alternatives with lower sugar / using artificial sweeteners. Not all organisations tested products for sugar content[1].

Perceptions and implications of the levy

- All respondents were aware of the soft drinks industry levy to some degree. Typically, producers possessed a greater understanding than importers.
- Many respondents interviewed were unclear on certain aspects of the levy; for example, which products would be in scope, when the levy would come into effect, how it would be enforced, and how "added sugar" would be defined.
- Organisations that were least concerned by the levy felt that:
  - Their product(s) wouldn't be in scope of the levy (while in fact some of their products would be)
  - Consumers would pay more for drinks with added sugar once the levy is implemented
  - Their exposure to the levy was low because soft drinks with added sugar only represented a portion of their overall business
- Some organisations were sympathetic to the policy aims of the levy and tackling child obesity. However, most believed that the levy would not be beneficial. Some businesses had concerns or questions including why this sector had been selected for introduction of a levy and to what extent costs could be able to be passed on to customers.
- Most respondents felt they would be able to reformulate products in response to the levy. Some organisations felt they wouldn't be able to pass on the added cost and would aim to continue selling the same products at a higher cost. Some would not consider changes to their products until they had a better understanding of the levy.
- If subject to paying the levy, most organisations identified that they would not struggle with the paperwork. A few noted that the levy might encourage them to use a bookkeeper.

Exemption for small producers and importers

- Some organisations favoured an exemption for smaller operators as this would help businesses remain viable. These organisations were concerned that without an

[1] While this is a requirement under EU labelling guidelines, this finding may suggest that for some organisations, the brand owner was not aware of the testing stage and that this wasn't something they were involved with.

exemption the levy could act as a barrier to innovation and to new operators entering the market.

- Some organisations were against the idea of an exemption. They were concerned that this might make things more complex, was anti-competitive and would introduce a barrier to growth.
- Most respondents felt that an exemption should be based on production or import volumes.

Communications regarding the levy

- Most organisations received information about the levy from general sources, e.g. national news. A few organisations received information from trade bodies they were members of.
- Most organisations preferred to be contacted electronically. They felt that a 'What you need to know' type document from HMRC, with regular updates / reminders, would help them understand the policy and what it will mean for them.

1. Introduction

1.1. Background

In the 2016 Budget, the Chancellor outlined the Soft Drinks Industry Levy, a UK-wide levy on producers and importers of drinks containing added sugar content. This is intended to come into force in April 2018[2].

The levy will be charged on drinks with added sugar (which is either produced or imported) with a total sugar content of more than 5g of sugar per 100ml, with a higher rate to be implemented for drinks containing a total sugar content of more than 8g per 100ml. Drinks with less than 5g of sugar per 100ml will be exempt.

The Government intends to implement an exemption or tax relief for the smallest producers and importers within the sector.

It is within this context that Databuild were commissioned to deliver research to:

- Understand how smaller organisations in the industry operate; who they are, their characteristics and operational practices, which products and product types they are associated with, production methods, supply chains, behaviour and plans, and who their markets and customers are.
- Understand how the levy is likely to impact small producer / importer business operations and how they are likely to respond to its introduction.
- Inform the nature of, and eligibility criteria for, any exemption or relief.

1.2. Methodology overview

The research comprised two stages:

- Stage 1 - Scoping: This stage comprised conversations with key trade bodies and a rapid evidence assessment. This then established key characteristics of producers and importers of soft drinks with added sugar as well as an industry overview. The findings from the scoping stage were also used to develop the sampling approach and survey instruments for the main stage of work.
- Stage 2 – Main research: The main stage of research comprised 36 qualitative interviews with producers and 14 qualitative interviews with importers based across the United Kingdom. Respondents were typically company owners or directors / managers. The majority of these interviews were conducted face-to-face, with a smaller proportion

[2] https://www.gov.uk/government/publications/childhood-obesity-a-plan-for-action/childhood-obesity-a-plan-for-action

conducted via telephone. Interviews typically lasted approximately 45 minutes and fieldwork took place in September and October 2016.

Topic guides for the interviews in stage 2 covered business models, operations, supply chains, markets / customers and plans for the future (which included discussion of the levy and its perceived impacts). Copies of the topic guides and more detail on the overall methodology can be found in the appendix.

1.3. Considerations for the reader

- This research was qualitative; whilst in places numeric characteristics of businesses are discussed (for example, turnover and employee numbers for comparative purposes), these should be treated as indicative only and do not represent market level analysis.
- The scoping stage identified that many organisations contracted out one or more activities, such as production, packaging and distribution. Whilst the original approach included plans to interview some of the (typically medium sized) businesses offering these services to small and medium businesses, it was not possible to interview any businesses that were *solely* providing services for other businesses[3]. However, it was possible to conduct three interviews with businesses that were generating *some* of their income from selling services to other businesses as well as producing their own products.
- Whilst the objective of the research was to understand smaller businesses within the industry, this necessarily included some businesses who will likely sit above any threshold or exemption for small businesses. This allowed detailed insight into the smaller end of the market and to feed into the development of where a threshold or exemption threshold should sit.
- The interviews revealed large variability in the range of characteristics of small producers and importers of soft drinks with added sugar. Whilst there are broad groupings that can be applied to the industry (for example, categorising those that do and don't use external contractors to produce drinks on behalf of the brand owner), the extent of variability meant that developing a segmentation model was not considered appropriate.
- Where applicable, illustrative verbatim comments from respondents are included throughout the narrative of the report.

[3] These businesses did exist but could not be recruited

- Interviews were only conducted with SME businesses; that is businesses with fewer than 250 employees. Where the report contrasts findings or behaviours between different sizes of business this still refers to SMEs. In this report where quotes are attributed:
    - Micro applies to businesses with fewer than 10 employees;
    - Small applies to businesses with 10-25 employees; and
    - Medium applies to businesses with 25-250 employees.
- *Unless otherwise specified, findings reported within this report are based on the synthesis of evidence collected through interviews with small producers and importers.*

2. The industry for soft drinks with added sugar: Overview of industry

This section sets out a high-level overview of the UK industry for soft drinks with added sugar, and mainly draws on the findings collected during the scoping stage of the work.

The UK market for soft drinks can be divided into the following five distinct product groups[4]:

- Carbonated drinks;
- Dilutables, including cordials and syrups;
- Bottled still and carbonated water;
- Fruit juices (made of 100% fruit juices); and
- Smoothies and juice drinks (made of less than 100% fruit juice content).

Several large businesses dominated the market. Coca-Cola Great Britain, AG Barr PLC and Britvic Soft Drinks Ltd dominated the carbonated and dilutable segments of the soft drinks market.[5] At least half of the market was made up of household names such as Coca Cola, Britvic, PepsiCo and Tropicana (amongst others). During an interview, one trade body estimated that all of the 'small' producers put together were likely to be responsible for less than 5% of soft drinks with added sugar consumption in the United Kingdom.

Trade bodies estimated that approximately a quarter of UK manufactured volume was own label products for supermarkets. These tended to be produced by companies such as Princes, Refresco-Gerber and Cott Beverages. Incidentally, these were the same companies that small producers reported they were typically contracting various production activities to.

There was a general dearth of robust, publicly available industry information on soft drink supply chains and markets in the UK. Secondary evidence sources were able to provide a general market overview of the drinks industry, though much information was hosted directly by key trade bodies such as the British Soft Drinks Association (BSDA) on their websites. These sites often set out facts and figures (which include information such as Gross Value Added[6] arising from the sector, growth / financial performance, and expected job creation levels) and describe

[4] Though note there may be significant overlap in product offerings

[5] Note that these businesses were not interviewed and this finding was the result of secondary research. Source: *Soft Drinks (2015)* https://www-keynote-co-uk.ezproxyd.bham.ac.uk//market-report/drink/soft-drinks

[6] http://www.investopedia.com/terms/g/gross-value-added.asp

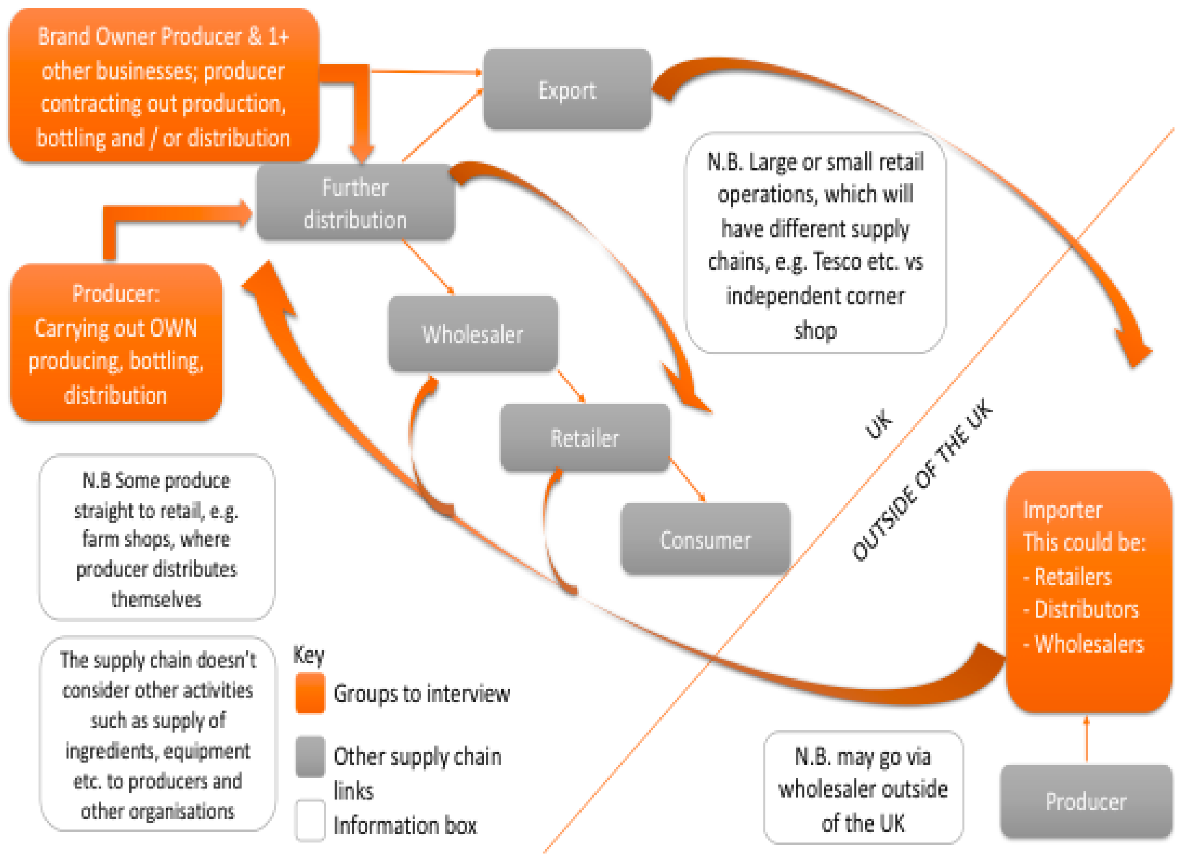
the strategic importance of the industry in UK manufacturing. More granular details around how markets and supply chains fit together, and how the sector works, could not be identified online.

2.1. Supply chains

Understanding the industry and supply chains for small producers and importers of soft drinks with added sugar was a primary objective of this research. A high degree of variability around how individual businesses slotted into the supply chain was identified among organisations that were interviewed.

A map of the industry was developed to illustrate supply chains (Figure 1).

Figure 1: Supply chain map for soft drink producers in the UK



Following the scoping stage, some additional observations could be made:

- Few producers were found to be exporting; and
- Importers tended to be distributors and wholesalers, and the research did not identify many retailers who imported to sell products on directly to the end consumer.

The remainder of this section sets out the main findings, examining four key areas – business models, purchasing, product types, and contracting.

2.1.1 Business Models

Businesses explained that the manufacture of a soft drink product involved the production itself ('making' the drink), then the packaging (both canning / bottling and bulking up into, for example, cases) and distribution of the product. Separate to production, respondents explained there were various other 'back office' activities associated with the supply of a product, including branding, and development / implementation of a sales and marketing strategy[7].

Organisations displayed differing arrangements for overall operation of the business as highlighted in the table below:

Table 1: Business models identified within UK soft drink producers

Business models – what was the producer[8] responsible for?		
Everything: the producer undertook all functions, including production, packaging and distribution. This group typically included businesses that had reached a 'certain size', but did also include some smaller SMEs	Certain aspects of production: the producer contracted out certain elements of production, such as production itself, packaging and / or distribution. This group included SMEs of all sizes	Brand owner only: the producer was only responsible for owning the brand / recipe, and outsourced all physical production steps. This group included SMEs of all sizes.

Many small producers reported that they sub-contracted out the production, bottling and / or distribution of products to third-party production factories; these were plants typically owned by medium sized businesses. Where decision making took place (either with the brand owner or a production plant) influenced how organisations were able to respond to the levy and change their behaviour / operational processes.

Over time, respondents reported that businesses that offered services to other producers (for example bottling plants) had developed and grown their own service offerings and in the process had become better at marketing and selling their services to potential customers:

[7] Though, smaller businesses were less likely to have defined plans in place for activities such as marketing.
[8] For importers, the key distinction was whether they were responsible for UK distribution or whether this was contracted out to one or more other organisations. Both approaches were found among the organisations interviewed.

- A few companies reported they recognised when setting up their business that their strength was in the marketing and not necessarily production / distribution of a product. These companies therefore used third parties for specific tasks from the beginning.
- One organisation noted that their annual turnover needed to exceed £25m before they felt it would be effective for them to set up their own factory.

The research identified that smaller businesses frequently chose to focus their efforts on being the brand owner (for one or more beverage products). These businesses owned the label, managed branding, marketing, sales strategy, and other office functions. Medium sized businesses were more likely to be producing their own products. This is an important consideration for HMRC in terms of where the levy will be applied.

Sometimes businesses reported that the brand owner wanted to maintain full control of what was happening in terms of ingredients, packaging and other aspects of production. In other instances, brand owners were less concerned with this and deferred details and some decisions to the contracted organisation. In all cases, however, brand owners provided a specification and recipe for a product and expected the third party to adhere to this rigorously.

The research found a few companies operated niche business models based on supply and use of specific equipment; they supplied equipment to dispense soft drinks with added sugar to pubs and restaurants. They supplied the equipment for free, and entered customers into contracts to purchase their syrup. The end user was obliged to purchase a minimum quantity of syrup over a 12-month period and if they did not achieve this minimum purchase threshold, then the syrup producer charged them the difference. Similar circumstances were identified for companies selling frozen drinks; a minimum threshold of syrup needed to be purchased or they faced a financial penalty.

2.1.2 Purchasing

Few organisations were found to have contracts with the organisations they were supplying to. Often, they therefore had no certainty around levels of demand, meaning operators could be immediately susceptible / vulnerable to industry changes; pricing and expectations were frequently negotiated and agreed with each transaction.

- Businesses that were interviewed described that large retailers (such as supermarkets) typically bought from a producer directly, whereas other (smaller) retailers typically bought from a wholesaler. Small retail chains were sometimes involved in deals directly with producers or imported, but this was less likely the case than for larger retailers.
- Respondents explained that wholesalers ranged in size from a single site through to chains operating at national level. Wholesalers often dealt with producers and importers of products (for example, distribution companies who sold on to them) or were

importing themselves. The wholesaler might be part of a buying group, where they negotiated purchases from producers for their members.

- Most organisations interviewed did not have contracts with their customers (such as wholesalers and / or retailers). Where these *were* in place, they ranged from a contract for one 'run' of a product to a specified volume, through to commitments to supply product(s) for a specified period of time, for example, two years. Some producers were more comfortable not having the certainty of a contract with a customer, the reason being that if their operational costs changed, they could reactively update what they charged for a product (which might not be possible if a contract was in place, particularly as noted by one respondent if the contract was with a supermarket).

  "It will price the product out [of] the market … That's what I believe will end up happening because the supermarkets will not budge [on price to consumer]. We don't make market prices, the market dictates that" (Small importer)

2.1.3 Working arrangements with other businesses

- Many small producer businesses contracted out key production steps, whilst some produced their own products for themselves. Various factors contributed to whether the organisation produced themselves or contracted various activities out. These included:
- Cost effectiveness. Respondents reported that often it was not cost effective for small players to make all of the necessary investments to manufacture, bottle and distribute their own products.
- Ability to invest. Profitability could be variable from product to product depending on sale price and profit margins, meaning some organisations generated more profits than others. Producers of niche and premium products were found to be more likely to be generating profits that allowed them to fund and establish their own production facilities, rather than contracting these steps out.
- Technical proficiency. Whether any individuals at the business possessed a higher level of technical knowhow.
- Scale of production. How much product the company produced; the company being at the low end in terms of production quantities (for example they only produced a few hundred thousand litres per year) was associated for some with producing and other tasks taking place in house.
- Customer location. Whether the business was mainly selling to local markets[9], meaning distribution costs were low.

[9] At the very small level this may be selling through farm shops and fayres

- Keeping it 'local'. The business' desire to make a handmade, locally produced product, using their own staff to deliver a product that they felt surpassed the quality of those produced within third party production plants.
- Attitudes to control of production. A few organisations commented that they felt contracting out meant loss of control of various aspects of production, and this was viewed as an unacceptable risk.

From a synthesis of the responses and in the view of some businesses, it appears that because respondents reported cost as a key driver for whether they outsourced, the levy (and increasing cost) may result in changes to which businesses (and how frequently) are contracting various activities out to others.

Importers that were interviewed also sometimes had relationships with distribution companies who moved products into and around the UK on their behalf. This behaviour did not seem to be linked to specific size or type of business; where the customer was located far from the importer, sometimes the business still used their own fleet to distribute and in others they used a third party (or a mixture of both approaches).

2.2. Operators in the industry

Understanding the characteristics of small producers and operators in the industry along with behaviour and decision making, is important for:

- Confirming HMRC's understanding of what businesses in the industry 'look' like;
- Considering how an exemption might be designed based on level of production;
- Understanding how businesses with differing setups and business models might respond to the levy (for example, how important soft drinks are as a proportion of product sales, which may influence levels of concern around the levy's introduction).

2.2.1 Producers: characteristics

Size characteristics: ranges

- Ranges identified through interviews with producers were as follows:
- Number of employees ranged from 1-2 through to approximately 170. Most organisations had between 2 and 50 employees.
- Production volumes of soft drinks with added sugar ranged from 100 litres through to 30 million litres annually. For volumes excluding cordials there appeared to be:
    - Around an equal number of businesses producing less than 100,000 litres, as the number producing between 100,000 and 200,000 litres;
    - More sparse distribution of production volumes above 200,000 litres.

- For cordial / syrup producers, there were an equal number of organisations producing less than 20,000 litres annually, as those producing between 20,000 and 1m litres (undiluted volumes).
- Turnover from soft drinks with added sugar ranged from a few thousand pounds up to £5m. The highest reported turnover from soft drinks with added sugar was in excess of £50m, though this organisation identified themselves as an SME. Although they acknowledged they were at the higher end of the spectrum, they based this on the fact they had fewer than 250 employees.

Product range

- A variety of products were produced and imported by businesses in the industry, which has relevance for the scope of the levy and rates for different products. Broad product types included:
    - Mass market products such as colas that were produced to compete with named brands, or produced as supermarkets' own labelled products.
    - Niche products, including less common product flavours such as bubblegum / strawberry and styles that were targeted at very specific consumer groups (for example, malted drinks targeted at consumers of specific ethnic minority backgrounds).
    - Premium products that were targeted at more affluent consumers, for example high end mixers for alcoholic drinks.
- Some businesses were associated with a number of product types, whilst others focused on one product area or type (such as only premium drinks, or only fruit juices with added sugar). A few producers only produced one specific product or flavour of product. In contrast, some producers were more generalist and had developed their product ranges opportunistically; for example, one business began producing mixers with added sugar to complement their alcohol business. They had since branched out into cordials and premium carbonated drinks that were less targeted at alcohol consumers.
- As well as typical drinks, a few of the organisations interviewed were producing soft drink with added sugar products to be consumed in other ways, for example frozen slush.

Some producers reported they already produced lower sugar products, either in relation to their traditional products, and / or when compared to the wider market as a whole, but reported variability in demand for these; low sugar varieties typically made up small proportions of overall turnover. However, low calorie products tended to be a larger proportion of turnover for producers of mixers for alcoholic drinks, for example tonic water and slimline tonics.

Motivations for producing drinks with added sugar and selected business model

For some of the producers interviewed, their primary income was from soft drinks with added sugar. For others, this represented only a small proportion of overall turnover; for example, where their primary income was generated from beverages that were out of scope of the levy, such as flavoured water with artificial sweeteners, or food products. Some food producers identified a demand for beverages from their customers and seized the opportunity to begin producing drinks for their established customer base.

- A few producers specialised in the sale of alcohol and began producing soft drinks with added sugar to supply these as mixers to the customers of their alcohol products. Some identified that the market was dominated by one supplier and as a result, they decided to begin producing a premium product to appeal to consumers of higher end spirits.

  > *"We knew that it was just [large supplier] that mainly supplied to the entire country. People told us this product was alright, but not of the highest quality, so we started thinking" (Medium producer)*

- A few organisations displayed particularly niche circumstances. For example, one company operated restaurants, pubs / bars, hotels and nightclubs, and began producing their own drinks for supply to the establishments they operated. A couple of businesses produced soft drinks similar in taste to alcoholic drinks, but marketed at consumers who didn't consume alcohol.
- A few companies were motivated to set up their business by potential opportunities to produce drinks with health benefits / to appeal to health-conscious consumers. These businesses typically felt that they were more successful than most in developing and selling low sugar drinks.

  > *"The way that things were changing, we knew that more people were interested in something using only natural ingredients that wasn't full of all of the preservatives and other things added into drinks, we knew that there was an audience there for this" (Small producer)*

- A small number of businesses saw a gap in the market for adult soft drinks that were not sweet, but were made from locally sourced ingredients.

  > *"There is a gap in the market. There are no local producers of soft drinks in the region." (Small producer)*

Business models and operations

When prompted, few respondents identified issues with how efficiently they felt their business was operating. The research found that 'traditional' organisations (for example those that reported little change in processes over time) seemed to be less aware of the levy / felt less well positioned to change in response to it.

As noted in the section on supply chains (section 2.2), distribution was outsourced by some producers. Some of these businesses used one body to distribute nationwide, whilst others used multiple businesses depending on geography, or used specific companies for specific products. Business decisions to outsource were typically motivated by costs. Some producers had always done this, while some had begun to outsource more recently, to deliver cost savings for their business.

Most producers were not importing products. However, a few possessed production operations outside of the UK and were importing their own or other branded products for UK consumers. A couple were importing different products than those they manufactured in the UK, to offer a wider range of drinks to customers of their UK manufactured products. A couple of producers imported concentrates and then processed and packaged the concentrate into a finished drink for sale to UK consumers.

Only a few producers exported products. Instances where this occurred were often linked to religious holidays outside of the UK, where a UK producer supplied non-UK wholesalers with large volumes at key times.

Some producers were members of trade bodies, typically specialist trade bodies for producers of beverages. For these organisations trade bodies tended to be a key source of information and news (including in relation to the levy).

2.2.2 Importers: characteristics

Size characteristics: ranges

- Ranges identified through interviews with importers were as follows:
    - Number of employees ranged from two to approximately 60. Most organisations had between two and 15 employees;
    - Imported volumes of soft drinks with added sugar ranged from 50,000 litres through to 1.5 million litres annually:
        - Half were importing volumes at or below approximately 250,000 litres annually; and
        - Half were importing volumes of between 450,000 litres annually and 1.5 million litres annually (with a couple of businesses importing volumes of 1.5 million litres annually.
    - Turnover from soft drinks with added sugar typically ranged from the low thousands of pounds through to approximately £2m annually. One organisation reported that their annual turnover from soft drinks with added sugar was £8m.

Product range

Businesses defined as importers for the purposes of this research used a variety of terms to describe themselves. Some organisations that imported goods described themselves as 'importers', some called themselves 'distributors' (but may or may not distribute for themselves), whilst one owner of a company which primarily imported goods called itself a 'marketing company'.

In light of this, HMRC may need to use broad terms or provide clear definitions to ensure businesses don't mistakenly self-exclude on the basis that they don't think that the levy applies to them.

Importers dealt in a range of product types, but the most common products that were imported were carbonated drinks, cordials and fruit juices.

Motivations for importing drinks with added sugar and selected business model

Organisations reported a variety of importing behaviours. Organisations either:

- Solely imported; either for cost reasons or because this was the only way they can access the product / this was their business model;
- Imported some products *and* distributed products manufactured in the UK (for example, they imported to increase stocks of a product also manufactured in the UK);
- Mainly distributed products manufactured in the UK, but would infrequently import if they identified a lucrative opportunity.

Companies described some specific and varied motivations for their import of soft drinks with added sugar. One business owner with a background in financial services, identified an opportunity through financial dealings with international communities to begin importing products for specific ethnic communities in the UK. A couple of importers imported products to a central port location, bulked and packaged these together and then exported the products straight back out to ports in Europe for consumption on cruise ships. These companies were unclear whether the levy would apply to them, given consumption took place outside of the UK.

Business models and operations

Most importers were found to be either distributors who sold on to wholesalers, or wholesalers themselves who sold on to retailers. Only a couple of importers sold products directly to consumers, although this was never their sole route to market.

For most businesses, importing soft drinks with added sugar was the primary source of income. However, for a couple of businesses the import of drinks / soft drinks with added sugar made up a very small proportion of what they imported. For example, one business imported 400 different product lines, with just 25 of these being drinks and 15 being soft drinks with added sugar:

> *"We originally set up to import food from [region], but over time our customers started asking if we could supply drinks, that's how we originally started the drinks side of the business" (Medium importer)*

Few importers were members of trade bodies, and those that were reported membership of a wide range of bodies; some food / drink focused, but most were related to general business, logistics and distribution, such as the Federation of Small Businesses and the Freight Transport Association. Few importers reported trade bodies as a source of information in relation to specific product-focused legislation, such the levy.

Some reported that they would cease importing soft drinks entirely if better opportunities to import food or other goods were identified. Import was demand driven for businesses who weren't solely importing.

It is worth noting that importers for whom soft drinks were only a small proportion of their business were not especially bound to importing these products and might cease imports altogether in response to the levy:

> *"It might stop us importing soft drinks if consumers won't accept higher prices." (Medium importer)*

2.3. Chapter summary

- The industry for soft drinks with added sugar covers a range of products, including carbonated drinks, cordials, syrups, fruit juices and smoothies. The research also identified some operators dealing in niche products, such as frozen slushes.
- Producers who did not make their own products tended to contract out one or more elements of production (e.g. bottling, distribution) to third party organisations. This choice tended to be driven by cost, i.e. businesses reported that it was not cost effective to produce entirely "in house" until they reached a certain size.
- Importers reported using other organisations to distribute on their behalf, if they didn't do this themselves. This choice tended to be linked to convenience.
- Businesses defined as importers for the purposes of this research used a variety of terms to describe themselves. In light of this, HMRC may need to provide clear definitions to ensure businesses don't mistakenly self-exclude on the basis that they don't think that the levy applies to them.
- Self-reported production volumes varied markedly; the smallest business produced 100 litres of soft drinks with added sugar annually, right through to the largest who produced 30m litres. Importers were less able to estimate volumes of imported soft drinks with added sugar (as these could vary significantly year on year, sometimes linked to an opportunist approach to import of drinks), but those that could explained that volumes ranged from 50,000 litres through to 1.5 million litres.
- For most organisations interviewed, soft drinks with added sugar were the primary source of income. For some, particularly importers and producers of other beverage products like alcoholic mixers / low calorie drinks, these were just a part of their business. Few producers were found to be exporting products.

- A couple of importers were importing product for consumption on cruise ships. These companies were unclear whether the levy would apply to them, given consumption took place outside of the UK.
- The majority of producers and importers commented that demand is highest for drinks that contain sugar and drinks with lower sugar (if available) were typically a smaller component of their turnover.

3. How organisations operate

A key component of this research was to understand how organisations operated and how they produced / imported products; examining characteristics such as production methods, customers and plans for the future. This will help further inform HMRC's understanding of the industry, and what the levy might mean in practical terms for businesses in scope.

3.1. Production and production methods

This section explores production ingredients and methods, use of sugar, quality control and the timing of production.

Given the nature of HMRC's research questions in this area, most information relates to what was reported by producers (though, importers were asked to comment on their knowledge of the products they were importing, and factors such as whether they tested for sugar to confirm what was reported on labels).

3.1.1 Ingredients used

Where organisations produced products themselves, they typically sourced ingredients from one or more specialist suppliers / wholesalers. Only a couple of respondents bought ingredients from retailers and did so in small quantities. These producers only produced small volumes of soft drinks with added sugar.

Producers of premium products typically used higher value ingredients, and this was reflected in the sale price. These businesses firmly believed that they produced a much higher quality product than mass produced offerings on the market, and coupled with effective branding and marketing, this meant consumers were willing to pay more for their drinks.

Many producers reported that what set their product apart was producing organic or 'all natural' products. These producers were particularly concerned about the prospect of needing to change recipes, as the use of, for example, artificial sweeteners would mean they had to retract these claims from their products. Many felt this would not be well received by customers.

> *"Some drinks just don't taste right with less sugar. We would not add artificial sweeteners to our current product range as we are known for only using natural ingredients, which is one reason why our customers specifically choose us." (Medium producer)*

3.1.2 How sugar was used

Businesses reported that sugar was an important component of drinks for a number of reasons, including flavour. Interviewees said that soft drinks with added sugar provided consumers with a burst of energy and had a more 'satisfying', enduring aftertaste than similar drinks without added sugar. Several producers also described soft drinks with added sugar as 'fuller bodied' and discernibly more viscous than artificially sweetened drinks.

> *"We have always been conscious of sugar in our drinks, but they are well balanced and full bodied and low sugar. We run a stall and our customers are always asking us about what is in our drinks, how it is made and how sweet it is." (Small producer)*

> *"Sugar was crucial to making a good quality cordial and using sugar alternatives would negatively affect the taste of the drink." (Micro producer)*

Sugar was cited as an important preservative in some of the 'all natural' products produced by some of the premium producers, who would be unable to use artificial preservatives and retain their 'all natural' claim. Sugar was also important in frozen drink products, as a couple of respondents commented that without sufficient sugar the drink would not freeze properly.

> *"We did look into reformulating, but we need that amount of sugar to preserve the drinks. The only other way we would possibly get around it is to put [chemicals to prevent product freezing] in, which I strongly object to… I would rather use natural ingredients than chemicals." (Small producer)*

Organisations were either using liquid forms of sugar (for example, sucrose) or granulated sugar. From the interviews conducted, the choice to use one or the other was mostly due to personal preference and the specific drink being produced. However, in one instance this was linked to the product being sold as 'organic'; the producer could source organic granulated sugar but didn't have access to an organic liquid sugar.

In exploring alternatives to sugar, organisations were looking for a product that had the same effect in terms of taste and texture, but most didn't believe that satisfactory alternatives currently existed.

> *"We've tried using Stevia, which is just absolutely disgusting. Really, sort of, really horrible aftertaste" (Small producer)*

> *"We will look into reformulating drinks with less sugar but it depends whether sugar alternatives provide the same taste. Our customers look for a certain taste. It is more likely that we introduce a sugar free version alongside our existing drinks so customers can choose for themselves." (Micro producer)*

If research and development / innovation around alternatives to sugar was taking place within the industry, most organisations were not aware of this.

3.1.3 Production methods

Most producers reported some level of automation to production, and those that contracted out production were typically doing so to businesses that had invested heavily in equipment and where the majority of processes were automated.

In comparison, some producers were doing more “by hand”. This ranged from part automated systems and stirring vats of syrup by hand, to producers who were doing everything without specialist equipment and in makeshift premises.

Respondents reported broadly similar processes for different products; ingredients may differ, but most were using similar equipment. Carbonated drinks typically started as a syrup. Some producers would go on to sell syrup for post-mix use to the on-trade (e.g. pubs and restaurants), whereas some mixed this and bottled it to be sold as a prepared, diluted drink.

A couple of producers reported that production took place at different factories in different locations depending on the packaging type of the end product. One company, for example, reported that bottled drinks were produced and bottled in the UK, whereas cans of the same products were produced and canned outside of the UK at a plant in Europe.

Where producers were using a third-party body to produce their drinks, in some instances the third party sourced the ingredients to the recipe of the brand owner. In other cases, the brand owner needed to purchase and arrange delivery of ingredients to the producer (along with packaging; for example, empty bottles) to enable them to produce the drinks.

3.1.4 Quality control

Producers reported a mix of approaches to quality control:

- Where organisations were smaller, or produced just one or two niche products there was variability from batch to batch.
- Where organisations were contracting out production, some would simply take receipt of quality reports and trusted the third party to work to the specification and recipe. In other cases, the brand owner spent time with the third party overseeing quality and ensuring for themselves that products were up to standard.
- Some producers identified that they sent products off for lab testing / confirmation against a specification and would be provided with results. There were tolerances for various characteristics that they worked within, for example levels of acidity / sugar content. However, this level of stringency was not identified by all producers.

Some producers performed brix testing[10] to ensure the consistency of a product and that it conformed to the specification / recipe. This tended to be medium sized organisations. Micro and small organisations were sometimes performing these tests, but were more frequently found not to be formal in their approach to testing for sugar. Only a couple of importers brix tested the products they imported, and largely they were only aware of the sugar content by

[10] Used to determine the sugar ratio of a solution.

examining labels on packaging. Testing for sugar content was largely not something that importers reported they routinely performed.

The varying levels to which organisations tested for / understood sugar content of drinks, meant there was a reasonable margin of error around the stated sugar content of some drinks[11].

3.1.5 Timing of production / imports

Businesses generally reported that production and import took place across the year. However almost all businesses reported there were peaks and troughs in volumes. Variability in demand typically corresponded to either summer (where there was more demand for drinks to keep people cool[12]) and / or the period leading up to Christmas. A couple of producers noted that approximately half of their turnover would be generated in the run up to Christmas. Several producers identified a period of lower production after Christmas, which they felt coincided with consumers "tightening their belts" following higher spending in November and December.

> *"There is a slight fluctuation, particularly when it comes to certain brands. If we mention the [specific name] brand, that's quite seasonal. I think people see it as a non-alcoholic alternative, maybe, to a glass of wine at Christmas or something like that. Whereas, your fruit juices and things are probably more constant throughout the year." (Medium producer)*

Some producers also noted booms in trade associated with the start of the autumn term for university students, particularly for energy drinks with added sugar.

3.2. Changes to methods over time

Overall, very few organisations reported changes to their methods over time. Where changes were reported, these were due to:

- Growth. For example, one importer started out distributing products in a van, but as their business grew they needed to invest in a small fleet of vehicles and contracted out some distribution to a third party, who had capacity to move increasing volumes of products.

  > *"Originally it was all just me, but I reached a point where I couldn't physically make all of the delivery runs and some deliveries were becoming late." (Micro importer)*

[11] It wasn't clear in all cases whether the margin of error was within legal limits.
[12] Though producers noted that soft drink sales were highly weather sensitive, and a poor UK summer sometimes noticeably affected sales, and meant that producers and importers slowed down production and export to get rid of excess stock if demand was lower than anticipated.

- Changes of ownership. For example, one producer reported that their company was sold and the buyer organisation mandated a number of changes to production methods to improve the efficiency of operations.

A few respondents reported they intended to make changes to the business as they grew, typically towards a higher degree of automation than they employed at present.

3.3. Contracts

Contracts can broadly be split into:

- Contracts that brand owners had with various other organisations involved in the production, packaging and distribution of products; and
- Contracts that brand owners had with customers.

Where contracts are in place between brand owners and their sub-contractors, the wording tended to be prescriptive. However, most reported that there would be a good degree of flexibility and this was not a concern to respondents.

> *"On paper it looks strict, but we know if things need to change and we don't have much control that we can call them up and they'll usually be pretty reasonable." (Small producer)*

> *"Yes we have contracts in place, but [I] don't think that us or them [contractor] probably pay any attention to what is written in the contract. They do a job for us, we pay them. If it's not up to scratch then they won't get paid." (Micro producer)*

Contract lengths were typically from one to three years. Most producers reported very good relationships with their contractors and no organisations reported disputes (though a couple noted that they would change contractor if this was commercially astute, for example if they could get a cheaper deal elsewhere). Several organisations noted that they were constrained in the contractors they could work with due to location, or if the contractor needed specific equipment / expertise with a particular type of drink.

> *"It's good that we have a solid relationship as we don't have much choice here around who can offer what – if we needed to get the product made elsewhere but then moved back to customers here our costs would go up a lot" (Small producer)*

3.4. Markets for products and routes to market

The research highlighted the variety of ways that organisations were moving products to end consumers, and how products were targeted. As noted in section 2.2, most organisations were supplying products to wholesalers, though a few were selling direct to the public. For example, a couple took orders online and would supply a specified minimum amount of product even to residential addresses. Some were supplying to large supermarkets, direct to chains of independent stores, and to breweries. Some organisations of all sizes were supplying to more niche outlets, such as farm shops and health food shops.

As noted earlier, only a few producers exported products. Most producers supplied nationwide, though a few were constrained to specific regions.

Many businesses produced / imported products targeted at specific consumer groups. These businesses sold to outlets who supplied these consumers, particularly in cities such as London, Birmingham, Manchester and Bradford; their small size did not limit their geographic reach.

3.5. Plans for the future

3.5.1 Plans for the future

Most organisations had plans to grow over time, but most of these did not have defined growth plans or targets. Those that had targets tended to be medium sized organisations. Plans tended to be either to add new products to their offering, or produce / distribute greater quantities of specific products, or a combination of both.

For organisations who sought to develop new products, most reported that it would typically take six to eighteen months to bring a product to market. The longest it could take to develop a new product was reported as two years, with one organisation reporting they were able to develop a new product in as little as six weeks. The process of developing new products often involved working with flavour houses[13] to develop recipes and then one or more phases of testing with consumers. Larger SMEs sometimes conducted their own market research to establish likely demand for products.

Separate to the levy, some organisations were already taking steps to reformulate their products, although some noted that hearing of the levy had expedited their actions in this respect.

One organisation identified that changes to recipes would mean that all brix testing equipment needed to be recalibrated by specialist engineers, which brought a cost to adjusting sugar levels in recipes.

3.5.2 Challenges for businesses in the industry

This research explored attitudes and other external influences (besides the levy) that organisations identified could affect the success of their organisations going forward. The factors identified included:

- Uncertainty about the economy. Many respondents identified this was a significant concern at present. Many of these companies highlighted that plans to invest in new

[13] Companies / laboratories that specialise in developing flavours and ingredients.

equipment or grow the business were on hold until there was more certainty on what the commercial environment would look like in a few years' time.

- Consumer tolerance of price increase. Some producers / importers supplied products with very tight profit margins; some producers / importers found it challenging to break even when there were fluctuations in currency or in the cost of ingredients. Some producers said where products were sold at fixed price points, it was a challenge to negotiate an increase in sale prices with supermarkets and other retailers.
- Competition. Some producers noted that competition in their industries was fierce, particularly those who competed with large brand name producers. Many companies noted that the key to their success had been innovating and offering premium alternatives to mass produced products, or specialising in key flavours of drinks that weren't already on the market.
- Changes in consumer drinking habits. Several respondents who supplied to the pub and restaurant industry noted the general downturn in trade for beverages.
- Supply chain issues. A few producers reported that they sometimes experienced breaks in the supply chain. This was linked to cash flow and issues such as their ability to pay their suppliers whilst awaiting their customers paying them. These issues still occurred despite their efforts to ask for timely payments. They described situations where their customers had not paid them for the supply of products, which meant they had been left unable to pay their suppliers for ingredients / services. Production halted whilst waiting for the movement of funds.

3.5.3 Opportunities

Due to general Government / consumer pressures around improving health and reducing sugar intake (including the influence of the levy), some organisations felt there were opportunities to develop lower sugar varieties or produce drinks that used artificial sweeteners.

A key area of expansion for several businesses was examining further opportunities to develop premium mixers for alcoholic drinks.

Alongside reducing sugar, some organisations were already looking at reducing pack size to supply drinks to children in education. These organisations were, for example, trying to lead moves away from 500ml bottles of soft drink to smaller portions that would mean consumers were ingesting less sugar per unit portion (and that they potentially saved money, as they were purchasing a smaller volume of the product).

3.6. Chapter summary

- Organisations typically sourced ingredients from one or more specialist suppliers / wholesalers, but a few that produced smaller quantities bought direct from retailers such as supermarkets. Several businesses felt what set their drink(s) apart was that they were 'all natural' / organic and avoided use of artificial ingredients.
- Sugar was considered by producers, importers and consumers to be an important consideration in terms of taste and texture. Some organisations reported challenges in marketing and selling alternatives with lower sugar / using artificial sweeteners. Not all organisations tested products for their sugar content.
- Although businesses reported that production / importing took place all year around, all reported there were peaks and troughs in their activities, such as during summer and in the lead up to holidays such as Christmas.
- Although a few producers made their drinks by hand, most businesses reported that there was at least some degree of automation to the production process. Changes to methods were rare and where changes occurred, this was due to growth or changes of ownership.
- Many organisations had plans to grow, either by adding new products to their range or through producing / importing larger volumes of the same products.
- Prior to the levy announcement, some organisations already offered lower sugar alternatives or had explored demand for these.
- Producers and importers sold to a range of customers in a variety of ways, most frequently through wholesalers but some supplied direct to retailers. Some businesses produced soft drinks for the mass market, whilst others targeted at specific types of consumer, e.g. specific ethnic minority communities or the health conscious consumer.

4. The Soft Drinks Levy – findings from the industry

4.1. Level of understanding of the levy

All respondents were aware of the Soft Drinks Industry Levy and had heard at least something concerning the levy prior to the research. Understanding of the levy (for example what was in scope) was found to be variable.

It is important to note that the interviews were conducted during September-October 2016, and since this time, more information has been publicly released about the levy, its scope and the exemption for smaller businesses.

4.1.1 Respondent understanding of the levy

Most organisations sourced information on the levy from general sources, for example, national news. Some sourced information from industry bodies and trade publications. Few organisations were aware of the separate joint HMRC / HMT consultation[14] prior to this being discussed at the end of the interview. A very small number of organisations said there was not enough information available on the levy in the public domain.

Importers in particular were unclear what constituted "added sugar." Some producers were aware that milk based drinks were outside of the scope of the levy, but were unclear whether other specific drinks were in scope. Those that produced and imported cordial were often unclear to what degree they would be in scope of the policy[15].

- *"How do you know when the sugar gets delivered to you and how will HMRC know what's going into these drinks? Is it going to be on 1%, 2%, how is it going to work? For cordials, is it going to be sky high because it is thick? Or when it is diluted? It's not very clear on how it is going to be implemented." (Medium producer)*

Producers and importers were sometimes unclear on who would need to pay, in terms of where the liability to comply with the levy would sit. Outside of expressing opinion on where they felt

[14] Separate to this research, in August 2016 HM Government (HMRC / HMT) also published a consultation on the levy. Databuild were asked to encourage participants within this research to also consider responding to the consultation. Details are available at: https://www.gov.uk/government/consultations/soft-drinks-industry-levy

[15] This was detailed by HMRC & HMT in the consultation document and the consultation responses document.

the levy should be applied, some queried whether, for example, *they* would need to pay, or whether it would be the producer of a product contracted out for production, or a retailer.

> *"If we produced on behalf of a supermarket, should it not be them that attract the levy, rather than us? ... where people are bringing their brands to us to pack, it seems wrong to me, completely wrong, that it should affect us and it will affect the number of people who are able to start up, because we will not make products for people if they're coming to us wanting sugar products done for them, sugary products done, and it is adding to our levy." (Small producer)*

Most interviewees brought their own questions to Databuild's researchers or asked where they could find more information at the end of the interview, demonstrating an appetite to better understand the levy. Answers to some of these questions were already available in the public domain, which highlights that there was some confusion around where to look for reliable information and details in relation to the levy.

4.1.2 Respondent understanding and concerns

While some organisations did possess a good understanding of the levy, slightly more of those businesses interviewed appeared to demonstrate a weak understanding[16]. Levels of concern regarding the levy were also mixed according to what degree respondents were worried about the levy and the risk of adverse effects to their business. Where organisations demonstrated weak understanding and low concern, this appeared to typically be due to assumptions that either:

- They would not be in scope. This included one cordial producer who had assumed that it would be very difficult to regulate the levy for cordials. Another assumed the policy was only targeted at the very large producers and they wouldn't be in scope for this reason.

  > *"From what we know we've just thought that this is aimed at the big players, we see ourselves as pretty small fry, the drinks are only a tiny portion of what we bring in" (Micro importer)*

- It would not be possible to produce, or there would never be demand for, a lower sugar variety of a drink. These producers / importers were confident that consumers would be willing to pay more for the same product. This was particularly true of premium and niche product producers, who felt that any level of levy would not put their product out of price reach of consumers.

[16] Assessed by Databuild based on responses to what organisations were aware of in relation to the levy, and general comments throughout the interview

- They were primarily exporters. For the very small number involved in exporting, the levy would not apply to them because they were chiefly exporting products.

  "As we only import to export back out, the levy might not apply to us. It may have an impact on UK economy overall though as if products are more expensive in the UK, it increases the likelihood that we will just source the same brands from abroad." (Small importer)

- Soft drinks / soft drinks with added sugar were not a large part of their business. Some importers were not concerned that the levy would impact greatly on their business because they primarily focused on other things. A couple noted that they could cease importing soft drinks altogether if the levy were to affect them, and did not perceive this to be a major issue were this to occur.

Importers in particular were not clear how they would know which form of sugar was used in the product(s) they imported (which links to an absence of testing in this space for many importers).

It is worth noting that some respondents had interpreted the policy objective of the policy very literally and believed it was only concerned with childhood obesity. On this basis, many of these respondents were unclear why they were in scope of the levy at all, as their products were not intended for consumption by children. For example, producers of soft drinks and alcoholic mixers that were clearly targeted at adults.

> *"We produce adult soft drinks rather than for children. The reason why this (the levy) was brought in was because of childhood obesity. So why have we been dragged into it when we do not market at children?" (Medium producer)*

4.2. Perceived benefits of the levy

There were some organisations that were in favour of the levy. They felt its introduction would be beneficial to tackling some of the health issues in society. These organisations tended to be lower volume producers and / or those whose motivations were to some degree driven by a desire to produce 'healthy' products. One organisation felt that the levy didn't go far enough and the Government needed to more rapidly look at other product types.

However, the majority of organisations did not perceive the levy to bring benefits to the UK as a whole. Whilst most acknowledge the importance of tackling childhood obesity, a range of attitudes were encountered.

> *"I see the advantages of it from a health perspective. From a business perspective it is going to be quite a challenge. Businesses we sell into won't be able to see a price increase, our markets are solely driven by pricing and not healthiness" (Micro producer)*

- Many felt 'picked on' and did not understand why soft drinks had been targeted. This was the case for producers who targeted adult consumers. This extended to those who didn't understand why some milk and yoghurt based drinks with added sugar were not in scope, as well as non-beverage products like breakfast cereals, which were often marketed at children.
- A few (often medium sized) organisations highlighted that whilst the levy could cause job losses for producers of soft drinks, the industry could see growth in specialist consultants. For example, supporting medium sized organisations in securing an exemption. Some organisations noted they would be more likely to use a bookkeeper to manage their paperwork once the levy was implemented.

  "I think we'd be ok, but I might get someone in formally to manage the books so we don't do anything that means we have to pay a penalty" (Micro importer)

Most respondents suggested that the levy would drive some companies to examine the level of sugar in the drinks they produced and sold. Any costs passed on to consumers could influence product choices and demand for lower sugar products.

4.3. Perceived concerns

As discussed earlier in this section, many respondents raised concerns in relation to the levy and the potential effects on their business. As noted in section 4.1 there were many questions around how the levy would be implemented and who was in scope.

Respondent concerns are discussed under the subsequent sub headings.

4.3.1 Scope

As noted in section 4.1, many producers and importers felt they were outside of the policy "aim" for the levy. They felt that their drinks did not contribute to childhood obesity as they were aimed at adults, and that the design of the levy forced businesses to change their drinks which would restrict adults' choices.

The fact the levy primarily targeted water / juice based drinks with added sugar was highlighted as a frustration, with a few organisations highlighting that dairy based drinks could be high in fat as well as sugar.

A couple of respondents also queried why soft drinks without added sugar were not in scope, noting that certain fruit juices could be high in natural sugars.

Specifically in relation to cordials, there was interest from cordial / syrup producers in terms of how the levy would apply. For example, a couple of businesses felt that a restaurant might over dilute a cordial to get more portions from the same volume, but a consumer would add more cordial themselves when drinking at home to give themselves a sweeter tasting product. There was therefore interest among producers of cordials and syrups over how the levy would be enforced[17].

4.3.2 Design

Some felt that the tax should simply be added to the cost of sugar rather than only targeting one particular product sector.

A few organisations felt that the levy was designed in the wrong way; they believed the levy should be paid by retailers, which they felt would stimulate demand for lower sugar products.

A few organisations felt that a levy wasn't the correct approach, and believed a cut in VAT rates for lower sugar drinks would be more effective[18]. These organisations believed it would stimulate demand for these and lead consumers to themselves choose lower sugar varieties of drinks because they were cheaper.

4.3.3 Jobs and employment

In contrast to the beliefs expressed in research by trade bodies about the general market, only a few respondents within this research discussed the potential for job losses within their *own* organisations. Some respondents did comment that job losses may occur in the wider supply chains. One producer said that they did not have a sustainable business model for one product line. If they had to increase prices for this product, they felt there would be a large detrimental impact on demand, meaning they would need to make redundancies and close their plant.

4.3.4 Substitution of sugar with artificial sweeteners, and other ingredients

Several organisations felt if they replaced natural sugar with artificial sweeteners, it would nullify some or all of their key product appeal as being 'all natural' or organic. These organisations felt that their target customers would not accept these changes to recipes and they would lose business to competitors.

A few commented on the difficulty of achieving the correct flavour profile for soft drinks using alternatives to sugar, and that this could be expensive and time consuming.

> *"It is very difficult to get the flavour profile right for drinks with sweeteners in comparison to their full sugar ancestors. I am of the opinion that only one company has ever got an artificially sweetened drink right" (Small producer)*

One respondent noted that in reducing the sugar in their product, the proportional amount of salt content in relation to other ingredients would increase which could carry health concerns. Labels typically indicated the percentage of each ingredient in the product. This respondent

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[17] This was detailed by HMRC & HMT in the consultation document and the consultation responses document.

[18] The UK Government is, however, not legally able to do this.

believed this could send the wrong message to consumers, i.e. that salt content had increased / was high. This particular producer targeted health conscious consumers, who were more likely to read product labels.

4.3.5 Pricing

A chief concern for many of those interviewed was pricing, and where the cost of the levy would sit / to what degree it was permissible to pass this on to customers.

> *"A lot of contractors have said to us if you put your price up you can't charge us or pass the cost on otherwise we will drop you. They are wiping their hands of it whilst at the same time they might increase their prices." (Small producer)*

Whilst some premium and niche producers were less concerned about price increases to customers, those producing 'mid-range' products were concerned that if their prices were pushed up, their products would become out of reach of their target consumers. These products were not necessarily branded / marketed at high end premium consumers; they wouldn't expect demand to be maintained through high-end consumers beginning to purchase what was traditionally viewed as a more mid-market product.

At the very low-price end of the market (e.g. sale of non-branded carbonated drinks in independent fast food outlets), several respondents felt that any increase to their sale price would be unacceptable to customers. Those who supplied soft drinks for sale within budget fast food deals and to budget shops (both instances where there tend to be fixed price points), felt they would need to take the hit to their profits or supply in smaller portion sizes (the latter was felt to be an unacceptable solution to customers). These types of organisations highlighted that their consumers were not health driven and deliberately wanted a sugary drink.

> *"There's not a chance that we could soak up the cost. It's being introduced at this moment, which is the most difficult period that I've ever witnessed in 25 years in soft drinks. We are seeing currency movements that are having extraordinary effects on our profit margins. Those are biting more and more every day." (Medium producer)*

A few businesses highlighted that because contracts with retailers were uncommon, competition would become fiercer when prices go up. Large retailers were felt to be particularly stringent with suppliers in terms of rejecting any increases to sale price; this would squeeze profits for businesses producing soft drinks.

Where supermarkets indicated that they would be happy to pass on some of the cost of the levy to customers, respondents reported that they were already indicating they would raise prices to fixed price points.

4.3.6 Potential exploitation

Some organisations held concerns around the degree to which large organisations would be able to reduce their exposure to paying the levy.

A few organisations commented that producers might set up multiple distinct businesses to handle separate products, ensuring that all fell below any threshold for an exemption if this was introduced. In a similar vein importers queried whether, if imported volumes came from multiple smaller importers rather than one medium sized or large importer, these smaller separate consignments would then avoid being subject to levy payment. It is however worth noting that this will not be possible due to the design of the levy.

Respondents felt that it was necessary to share more information on how the levy would be enforced with the industry[19]. Not only would this help organisations understand what they would face if they weren't compliant, but also to provide confidence that a business' competitors would not be able to take advantage or find and exploit loopholes to reduce their exposure.

4.3.7 Growth of illegal trading in soft drinks

Some respondents believed that demand for products was not going to change. Any kind of levy risked making it lucrative for a "grey" market to expand, with illegal importers, mentioned in this context in particular, undercutting law-abiding organisations.

> *"People already dodge as many payments as they are able, declaring the bare minimum." (Micro importer)*

A couple of respondents questioned the capacity of the authorities to regulate the industry for soft drinks; products which they felt were in more common demand than narcotics. They felt that driving movement of products underground (because some organisations would find ways to subvert legal pathways for product distribution) would mean that the Exchequer would lose out on levy money and undermine the goals of the policy.

4.3.8 Ability to reformulate

A few producers were concerned about the cost of needing to modify production equipment and calibration / testing gear to account for changes to recipes; this would be costly and detract from their capacity to grow the business.

> *"Until I know what is going to happen with the sugar tax… I'm a small one-man band, and I haven't got that money to invest and to reformulate, and everything. It's like, it's not*

[19] This was detailed by HMRC & HMT in the consultation document and the consultation responses document. This finding may reflect that businesses were not aware or had not read this document at the time of interview.

broken, so don't fix it. And how much that would cost, and making it that we actually ended up with the same products that people wanted could be a long, time-consuming thing, and an expensive thing. And I haven't got that sort of money, just to do it." (Micro producer)

Some respondents noted that it was more challenging to reformulate some products over others. An example commonly cited was that it was more challenging to reformulate a lemonade than it was to reformulate a cola. In addition, producers of niche products like slushes felt that they were uniquely unable to reduce sugar content because they needed the sugar to thicken / ensure slush was the right consistency and froze / mixed properly. They had not successfully produced a mixture without sugar that gave a satisfactory, high quality end product.

4.3.9 Other concerns

A few organisations queried whether the levy would apply on the volume produced / imported or the volume sold. They noted that, due to spillages and wastage, if the levy was applied on raw volume produced, there would need to be some form of rebate available. This meant that if the levy was applied on raw production volumes, some businesses could face higher price rises to accommodate for the levy than others (based on the efficiency of their processes and ability to minimise waste).

"With beer duty you can claim [duty paid on damaged stock] back [...] *stock spoilage is more likely for a small producer than a big producer. There should be a relief for damaged stock. It is a big issue." (Small producer)*

Several organisations stated that artificial sweeteners currently on the market were "lacklustre" and not ideal for their products, and their use resulted in an inferior (or even unpleasant) taste and texture. These organisations questioned the impact that the levy would have on innovation and development of new sweeteners and whether enough research was being done / could be completed in sufficient time ahead of the implementation date for the levy[20].

4.4. Perceived impact on respondent organisations

Responses to the levy fell into a few distinct groupings:

Figure 2: Perceived impact of levy

[20] Since the announcement of the levy businesses, including some large organisations, have announced significant reformulation of key products to reduce sugar content even further. This indicates that reformulation and innovation are occurring.

Unable to change: Don't think they have any scope to change products and will try to pass on costs to consumers (or face difficulties)	**Able to change:** Think they would be able to make changes to products in response, to limit exposure to levy
Unwilling to change: Unwilling to consider changes without further understanding	**Unintended change:** Unintended behaviour (e.g. raising prices of low sugar drinks to offset price rises for drinks fully exposed to levy)

Unable to change. A few businesses deemed that they had no scope to alter the recipe of their products / import different products. These producers and importers would try and pass on the added cost to consumers, who in some cases they felt would simply pay more for products. Businesses who felt they would be unable to pass on the cost of the levy to customers, would need to accept a drop in their profit margins. These organisations said they would assess whether to continue producing or importing soft drinks with added sugar. Some felt they would cease their business activity altogether, whilst others might look to begin producing other types of drinks that were outside of the scope of the proposed levy.

A couple of respondents reported they would be driven to explore producing overseas, where cheaper ingredient and labour costs might offset the added cost of paying to import their soft drinks with added sugar.

Able to change. Most businesses felt that they would be able to make changes to their recipes and would explore reformulating their products in response to the levy:

- Some already did this, but didn't experience enough of a commercial driver to follow through to bring products to market, or customers didn't like the products / demand was low. The levy made these products more commercially viable.
- Some would seek to implement any changes to recipes gradually, reformulating their product at various intervals; to allow the palates of their customers to adjust.

Unwilling to change. A couple of producers would not be willing to implement any changes until they had a better understanding of what the levy was, how it would be applied and who would be in scope[21]. These companies sometimes noted that they would need to invest or adapt equipment to ensure it was suitable to produce lower sugar products, and so did not want to commit to investment until they fully understood all of the details.

[21] These businesses were typically not aware of the HMRC & HMT consultation document which set out further details

Unintended change. Some companies reported that they would likely raise the prices of all products by a fixed amount, not only those products that were in scope of the levy. They would do this to ensure that the products with added sugar did not rise in price significantly, as they thought this would affect demand for these products.

No patterns in organisational characteristics (for example size, product types) were identified in relation to perceived response to the levy.

4.5. Ability to pay

On the whole, many respondents said they would not significantly struggle with paperwork and understanding the specifics of what they needed to declare to HMRC. Most commented that they already had to administer paperwork, for example paying VAT, and therefore further obligations wouldn't pose a challenge to the organisation. There were however a small number of organisations who said they would struggle:

> *"You know, we're not a Britvic, and we're not a Coca-Cola. This is just an extra job we've got to do somehow, monitor it somehow. We don't know how, until we get some clarity about how it's meant to be collected. And it's going to be very difficult for us." (Medium producer)*

> *"Certainly when it comes in, that probably would be an added, in terms of legal and professional fees, that probably would be another add-on cost to us. I haven't discussed that yet with the accountants, but if they were having to spend over and above our allocated time on our business, yes, we would be charged for that as well." (Micro producer)*

Some did however note that to avoid mistakes and ensure compliance, they might be more inclined to use the services of a professional bookkeeper. The research found that some already used a bookkeeper. There appeared to be some correlation with size of business, with smaller businesses more likely to manage paperwork themselves.

Cash flow was identified as a significant issue, particularly for small businesses. Businesses would need to have the funds in place to pay the levy. If their customers were late in completing payments to them, then this could result in late payment of the levy. This would depend on how often the levy needed to be paid to HMRC. Some respondents commented that allowing monthly payment of the levy would be helpful. This would help to smooth out the process of paying, rather than needing a larger sum in their accounts to pay in a single annual instalment.

4.6. Views around possible exemption for smaller operators

Respondents expressed a range of views around a potential exemption, with particular viewpoints (either for or against an exemption) not clearly linking to other organisational characteristics.

Respondents typically fell into one of the following four groups:

- Welcoming of the idea of an exemption for small producers and importers. These businesses commented that, either due to size or other factors (such as not producing drinks for children), they should be exempt from the levy. They felt that being exempt would help their businesses remain viable and ensure that they were still able to compete and maintain their market position against larger sized organisations. These organisations also frequently commented that the levy could act as a barrier for new organisations, and product / process innovation. This could be due to either:
    - Respondents having less cash to invest in trying new things if they had taken a hit to their profit margins in response to the levy, especially where they were unable to fully pass on the cost of the levy to customers;
    - Respondents who were new entrants to the market being less likely to take risks, knowing that the products for which there might be most demand for also carried a higher tax exposure (than would have been the case prior to the levy).
- Accepting of the levy. A few businesses commented that they felt the Government would be irresponsible *not* to be levying the drinks that they produced. They were quite accepting that this was the action of a progressive society that sought to help guide consumers to making more health-conscious choices.
- Indifferent / not concerned. For example, importers where only a small proportion of their products were soft drinks with added sugar, or businesses that were 'okay' with the levy if it was something the whole industry needs to comply with.
- Against the idea of an exemption. These businesses felt that there should be no "special favours" for particular businesses and a level playing field was important in order not to undermine the policy objectives. There was also a strong feeling amongst some organisations in this group that if the levy affected everyone then it was more acceptable to the industry. These organisations often felt that an exemption:
    - Made things more complicated; and,
    - Could stunt companies' attitudes towards growth and create a ceiling which they would be unwilling to push through.

Some respondents were under the impression that a threshold for exemption had already been set, though, as thresholds had not yet been developed/released by HMRC at the time of the research, it may be assumed that these respondents based this belief on thresholds relating to taxes for other types of beverage.

Respondents mostly felt that an exemption should be developed / based on production or import volumes. Most respondents felt that they should be in scope of an exemption, so it was challenging for them to describe the threshold “objectively” (most for example said that it should be set at a level which included them – most didn’t comment on whether they saw themselves at the high or low end of any exemption). Some larger SMEs felt they should be in scope for an exemption, and some noted they felt they were too big and didn’t expect to be in scope.

A couple felt that turnover could be the criteria on which an exemption was developed. However, some commented that using turnover as an eligibility criteria was disingenuous as, depending on the price of a product, a turnover of £1m could equate to vastly different volumes of soft drinks with added sugar. Organisations for whom soft drinks were only a small component of turnover also stressed that volumes would be a fair and equitable way to establish an exemption.

> "*You can gauge how big a company is from production volumes…it is the only measurable thing, but they [HMRC] should look at the process involved, for example the quantity and quality of what is going into the drink*" *(Micro producer)*

> "*They [HMRC] should also look at company size as well. [They] should not tax me and bigger companies the same amount* […] *I'm one person supplying 40 places.*" *(Micro producer)*

A couple of respondents commented that HMRC should ensure that 95% of soft drinks with added sugar consumed in the UK are levied. This should begin with the larger organisations and work its way down. Everything at the very low end should be automatically exempt, in order not to burden smaller businesses.

Organisations typically felt that for non-exempt businesses, only the volume of drinks above any exemption threshold should be subject to the levy.

> *“Only [production volumes] above the threshold should be subject to levy, rather than everything [total volume produced] after you reach a certain point. Otherwise, growth is too much of a disincentive.” (Medium producer)*

4.7. Information needs

As noted in section 4.1, at the time of interview many organisations believed that they were not well informed and did not articulate a strong level of understanding of the levy when it was discussed. In some of the interviews, communication channels and information and policy news / updates were discussed.

- Most respondents, at least to some degree, received their information from the national news; often framed within negative news stories about the impacts of the levy.
- Those organisations that were members of trade bodies obtained some news and updates on the levy from these bodies. This information tended to include commentary from the trade body about what it meant for their business.
- Few organisations had gone out and proactively sought information in relation to the levy. Those that had were typically using internet search engines to locate information. They indicated that the top 'hits' in search results included the types of sources set out in the preceding bullets, such as articles published by trade bodies amongst links to Government issued information.
- Most organisations preferred to be contacted electronically in comparison to other means (such as by post). Organisations wanted everything set out for them, without the use of jargon; they felt that a 'What you need to know' type document from HMRC, with regular updates / reminders, would help them understand the policy and what it would mean for them.

4.8. Chapter summary

- All respondents were aware of the levy. However, understanding varied considerably. Many respondents interviewed showed some degree of confusion around what was in the scope of the levy. For example, producers of milk based drinks were not always clear whether these were in scope of the policy. Cordial / syrup producers also often displayed confusion around how the levy might be enforced for drinks which were intended to be diluted prior to consumption.
- Some organisations were more concerned by the levy than others. Organisations that were least concerned typically felt that either they wouldn't be in scope, customers would tolerate price rises or that their exposure was low because soft drinks made a small part of their business.
- A few organisations sympathised with the policy aims of the levy at tackling child obesity. However, most believed the levy would not be beneficial. Some businesses were unclear and unhappy their sector had been selected for the introduction of a levy.
- In response to the levy, some organisations felt they would be able to pass on the added cost to customers, whilst some didn't think this would be possible, especially those that supplied to budget shops selling at fixed price points.
- If subject to the levy, most organisations felt they would not struggle with the paperwork. A few noted that this might encourage them to use a bookkeeper.
- The research identified a range of opinions around a potential exemption. Some organisations welcomed an exemption for smaller operators. They believed that this would help businesses remain viable and encourage new entrants to the sector. Others

were against the idea of an exemption. They were concerned that the levy might make things more complex and introduce a barrier to growth. Most respondents felt that any exemption developed by the Government should be based on production or import volumes.

Appendix: Detailed methodology

Introduction

A scoping exercise was undertaken in August 2016 for the purposes of:

- Helping to gain an initial understanding of the industry and supply chains for soft drinks with added sugar;
- Understanding characteristics of producers and importers working in the industry, with a particular focus on organisations at the smaller end of the spectrum;
- Subsequently, informing the sampling approach and topic guides used to engage with businesses in the main stage of fieldwork.

There were two elements to the scoping exercise:

- Secondary research – reviewing review of secondary evidence to help understand the industry and supply chains, using a Rapid Evidence Assessment approach[22]. This entailed using online search engines to search the following combinations:
- Soft drinks, beverages...
- ...*AND* industry, UK, European
- ... *AND (in appropriate combinations)* supply chain(s), supply chain map, size, business manufacturing, producer(s), product(s), distribution, logistics, imports, exports, trade, retail, wholesale, routes to market, operations, operators, operating, sugar, sweetened, sugar sweetened, sugar content, levy, costs, tax, SME(s), multinational(s), news, opportunities, barriers, behaviour
- ... *AND (in appropriate combinations)* supermarkets, own brands, convenience stores, networks.

Primary research – interviews with key trade bodies, which covered the following key areas:

- An overview of the trade body function and their activities;
- Details of membership;
- Discussion of markets and supply chains for soft drinks producers, with a particular focus on smaller operators;
- How producers and importers of different sizes tend to operate;

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[22] Rapid evidence assessments provide a more structured and rigorous search and quality assessment of the evidence than a literature review but are not as exhaustive as a systematic review. This type of review is designed to give good penetration of the data in a shorter space of time than more intensive reviews.

- Whether and how the trade body could support the main stage of the research (i.e. engaging with producers and importers directly).

In-depth telephone interviews were conducted with four key trade bodies.

All trade bodies appeared engaged and outlined how they were able to support the research going forward, including:

- Directly contacting their members and wider networks to encourage participation (including instructions to 'opt in' to the research);
- Mentioned the research within newsletters to widen awareness that the exercise was taking place across a given time period;
- Provided information to help further inform understanding of the industry and supply chains.

In addition, and to help inform the sampling approach, discussions were conducted with three database providers (two database providers used regularly by Databuild and one specialist drinks industry consultancy). As part of these discussions, practical issues such as numbers of organisations in their database were discussed.

Sampling approach

The sampling approach was informed by information provided by HMRC and desk-based research. This produced a list of businesses which were considered eligible, and from which to base the sampling frame.

In light of these sources, the following stance to sampling was adopted:

- A flexible approach to identify organisations. The reasons were twofold: a definitive population of "small" producers and importers was not arrived at through the scoping work; and database providers were unable to provide a database that *only* contained added sugar soft drink producers (and excluded large producers);
- Securing support from the producing / bottling / distribution companies to help identify / encourage their customers (the brand owners) to participate. Stakeholder organisations engaged within the first stage of the work were contacted again, who put out a call to industry to 'opt in' to the research;
- Incorporated screening questions for importers and producers within the recruitment script to help understand the exact nature of businesses being engaged and establishing whether an interview with that organisation should be arranged.

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Sample frame

For importers, results from a commodity import search was used as the basis for the recruitment database. Following initial cleaning, the database had approximately 225 organisations.

For producers, the sample frame included organisations identified from a range of sources:

- Information from HMRC;
- 'Free find' organisations identified by Databuild during the scoping stage;
- Organisations listed within a commercial database;
- Organisations opting in to the research via calls distributed by stakeholders and businesses operating production/bottling/distribution plants;
- Snowball sampling – any organisations identified by others as within scope of the research[23].

Number of interviews

The following number of interviews were carried out:

- 14 interviews with importers: Those that fall under this group may be retailers themselves, wholesalers or distribution companies.
- 36 interviews with producers: The sample was structured based on sample source, to ensure that we covered relevant organisations right across the industry. Strict strata for size of business were not set given that the research aimed to explore a range of businesses around any potential threshold for "small" businesses, as defined through the levy. The interviews were planned to include a variety of business locations, ages, and types of products being produced (for example cola or lemonade); conversations with industry stakeholders showed that these are not are particularly important drivers of behaviour meaning strict interview quotas were not set[24]. Proportional strata were however set based on geographic distribution of companies in the database. Based on this mapping, the following regional counts of interviews were achieved:
    - 16 in London & the South-East;
    - 7 in the South of England / South-West;
    - 3 in Wales and Northern Ireland (combined);

[23] Prior to contacting any of these, we made sure that they were not already known to us through other means

[24] Though these details were explored with respondents during screening to ensure a reasonable spread of diversity across the industry was achieved.

- 10 in the Midlands and East Anglia;
- 11 in the North of England;
- 3 in Scotland

Recruitment script / screening interview for producers

TO GATEKEEPER

Good morning / afternoon. I'm calling from Databuild on behalf of the Her Majesty's Revenue and Customs, or HMRC.

If necessary, for assurance: You may have received a letter/email in relation this work. *If this is not the case and they request further information in writing, capture an email address and re-send the notification letter by email.*

Databuild are currently undertaking research for HMRC engaging with soft drinks producers and importers, in light of the Soft Drinks Industry Levy announced in the 2016 Budget.

I'm looking to speak to the individual within the organisation who you think is best placed to answer questions in relation to your production of / import of soft drinks with added sugar. *Depending on size of business this may be a different role at different businesses for example managing director, operations director, other roles. Researcher to query and ensure that the individual we interview is best placed to provide details relating to what the business does, how the business operates and how decisions are made.*

Can you please put me through to <IDENTIFIED RESPONDENT> now?

- *If unavailable, ask for a convenient time to call back*
- *If possible, capture a direct line or mobile for the identified respondent*

If needed:

- *Databuild is conducting this research on behalf of HMRC. Databuild is carrying out this work in compliance with the Market Research Society Code of Conduct; offer MRS verification number if they wish to check we are a certified market research company*
- *Explain how details were obtained*
- *Offer HMRC contact details if they wish to check the authenticity of the research with HMRC*
- *All responses will be treated in strict confidence, and no responses will be used in an attributable format.*

TO RESPONDENT

Databuild are currently undertaking research for HMRC engaging with soft drinks producers and importers, in light of the Soft Drinks Industry Levy announced in the 2016 Budget. Are you aware of the levy announcement?

Yes – researcher allow respondent to recall what they are aware of. If the respondent is incorrect or unable to recall details, Databuild to provide an overview of the levy, using information from the infosheet to help explain the rationale and objectives for the policy.

No - researcher to offer basic definition for example what the levy is, what it proposes to do, the 'early' thinking on how it will be implemented for example varying levels based on sugar content

HMRC are interested in how your business operates and your perspectives on the market in general. This will help HMRC to develop the levy, ensuring businesses' views are taken into account. *[If applicable]* HMRC are keen to ensure that any form of levy that is developed does not disadvantage the smallest producers, and the findings of this research will help HMRC consider the basis on which an exemption for small businesses might be developed.

Can you please confirm that you are in a position to talk about how soft drinks production/import works for your organisation – for example how decisions are made, how your supply chain operates, the production processes and ingredients you use – and provide information in relation to how the introduction of the levy might influence the organisation

- Yes – CONTINUE
- No – *capture the respondent that they recommend, and ask to be connected*

Do you have a few minutes for me now to run through some questions to capture some basic information about the business? This will take about three minutes.

- Yes – CONTINUE
- No – *researcher to ask when might be convenient to call back to complete screening/*

Understanding eligibility – screening (when correct respondent confirmed)

Responses to screening questions will be captured and input into the recruitment database to determine whether to proceed with interview. If at any stage it is determined, we do not need any further completed interviews from a particular type of respondent then the researcher will ensure to capture all information to help inform HMRC knowledge of size / coverage / locations and then thank the respondent and end the conversation.

Screening criteria and thresholds for size to be discussed with HMRC following receipt of findings from the scoping stage. Screening questions here are expected to be likely of interest for deciding the balance of organisations that are interviewed

- Can I just confirm / ask your location and postcode?

- Can I confirm that you produce, or import any soft drinks with added sugar, or both?
    - *Recruiter to note that cordials, squash and syrups are in scope*
    - *If not doing this, thank and close interview*
- How many litres of soft drinks with added sugar are you producing / importing on an annual basis? (Capture Litres / other unit measure)
- How many employees does the organisation have? (capture number)
- What is your organisation's turnover? (capture number / prompt with bands)
- Which different types of soft drinks with added sugar do you produce / import? (capture details)
    - Carbonated drinks – what type?
    - Still drinks - what type?
    - Sugar sweetened Fruit Juice (NB pure fruit juice is not in scope)
    - Cordial/Squash
    - Syrup
    - Other - what?
- (IF PRODUCER) Do you sub-contract out any business functions – production, bottling, distribution? *Capture for each*
    - Yes
    - No
- When did you first begin producing / importing soft drinks?
    - Within the last 3 years
    - Not within the last 3 years
- Is soft drink production / import your primary source of income or is it one component of your business / something else? (capture details)
- Are you a member of any trade associations?
    - Yes
    - No

If screened out:

Thank you for your time. We are interested in speaking to a range of businesses, which is why I just ran through those questions. From your responses, at this stage I don't need to arrange a further conversation to discuss your organisation and its activities in further detail. Thank you again for speaking with me for the last few minutes to cover these questions. If anything changes, and there is a need for me to speak to your organisation in further detail, would you be happy for me to call you back to arrange a conversation to do this?

- Yes – *note in database*
- No – *note in database*

If not screened out:

Thank you for your time so far. We are interested in speaking to a range of businesses, which is why I just ran through those questions. From your responses I can determine that you would be eligible to participate within this research and help inform HMRC's wider understanding of markets for soft drinks production and how differently sized producers operate. This conversation would take approximately 45 minutes to complete.

We would like to talk to you in person if possible. *Can offer telephone option if they aren't keen for f2f – capture the reasons they are unsure*

Researcher to confirm address and arrange convenient time for visit. Check email address and include details in confirmation email.

Recruiter to send confirmation email (if respondent uses email) to outline the factual questions that we are interested in (to allow respondent chance to prepare).

If needed:

- *Interviews are expected to last in the region of 45 minutes, depending on your availability and the depth of your responses*
- *Databuild is conducting this research on behalf of HMRC. Databuild is carrying out this work in compliance with the Market Research Society Code of Conduct; offer MRS verification number if they wish to check we are a certified market research company*
- *Explain how details were obtained*
- *Offer HMRC contact details if they wish to confirm the authenticity of this research*
- *Your responses will be treated in confidence and responses will not be used attributably*
- *Researcher will ask whether they are happy for conversation to be recorded (don't need to raise during recruitment, but explain if they ask).*

Topic guides

For qualitative research, topic guides are intended to work flexibly, allowing the researcher and respondent the freedom to move around (for example not following a set order, or indeed necessarily *covering all probes if the desired information is provided by the respondent elsewhere in the interview) and discuss interesting insights as they are encountered. Question phrasing will be flexible and may not always follow the exact wording as set out in the guide. Explanatory guidance notes for the researcher are cited in italics.*

Topic guide 1 - Producers of soft drinks with added sugar

Introduction / rapport building (5-8 minutes)

Researcher to confirm if they are happy for conversation to be recorded for quality purposes & passing anonymized transcript to HMRC. Ensure they understand that the report is going to be published, but that no responses they provide will be used in an attributable format.

Researcher to:

- *reiterate the proposed levy and flesh out rationale for the research / answer any questions from the respondent*
- *explain how responses will be used (NB, if queried, care about overpromising - all views will be taken into account but it won't necessarily definitely produce the result the participants want),*
- *confirm whether respondent is happy for the conversation to be audio recorded.*

During this opening section we will allow respondents the opportunity to share their views on the levy freely and frankly early in the conversation, sharing thoughts and opinions openly at the start will mitigate against this 'overshadowing' other parts of the conversation, enable the respondent to 'relax' (knowing they have shared points of importance to them), feel engaged, and go on to provide useful insights during subsequent parts of the conversation.

To begin with, I would like to run through a few questions to understand some basic details about the business / confirm some of the information provided during screening. These questions will take around 5 minutes to cover.

- What is their role and what are their responsibilities?
- What does their business do? Key products (and services)?
- Are soft drinks with added sugar their primary source of income? Probe for details around which product or products have the highest commercial importance
- How long have they been in business, and what were their original motivations for producing soft drinks with added sugar?
- (in brief) how is the business structured – how is production set up, how many sites do they have, where are these located (and why)?
- Are they members of any trade associations? *Capture details*

- What is their awareness of the proposed levy – in brief, how do they think it could affect them? *Useful to understand what they do and don't know in relation to the levy*

How production operates (12-15 minutes). Now I would just like to move on to some questions about your role in the supply chain and how the business / production (*as applicable)* operates. These questions will take up to approximately 15 minutes to cover.

- *Questions asked as applicable, depending on exactly what they are responsible for within the production process. Researcher to probe for any points of differentiation between different soft drink with added sugar products*
- What exactly is the direct role of their business within production? *Are they for example only the brand holder / responsible for marketing and 'back office' type functions, or do they also produce their beverages, bottle them, distribute them?*
    - What is their business model; how many staff does the business employ, and how is the business structured?
    - Do they produce / bottle / distribute their beverages themselves – or do they contract one or more of these elements out? Capture details
        - Why have they chosen to operate in this way?
        - What volumes of production are they contracting out?
        - (if contract out) Discuss nature of contracts – how long these are for, what services exactly are included. Did they ever do these things themselves and at what point did they begin to contract these out? *Was this linked to for example a volume or sales threshold at which they could no longer do things 'in house'. What were the drivers*
        - How much flexibility is built into contracts – how easy is it for them to change things if necessary? *for example, due to changes within the supply chain out of their control, such as a need to change a source of ingredients*
        - Are contracts based on delivery of single / multiple products?
        - Do they have any contracts with supermarkets?
            - What is the nature of these contracts, and how would they pass on the additional cost if they were to need to pay the levy?
            - Have they begun discussions with them yet? What has been discussed?
    - What are their opinions on how effectively production operates at present?
- How many different categories of soft drinks with added sugar do they produce? Capture details

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  - What volumes do they produce – in total, and by soft drinks with added sugar (by individual drink, if more than 1)
  - How have production volumes changes over time? What drove any changes *Researcher to probe and understand the shape of any changes for example rises/falls in production, by product.*
    - *Was the change gradual or did it occur over a short space of time – why?*
  - Do production methods differ for different products?
- (If producing) What production methods do they use?
  - To what degree is production automated vs. for example processes done by hand
  - Have production methods changed and evolved over time, and why?
  - Is production constant across the year, or does it fluctuate – why is this the case? *Also, discuss how this links to demand for products across the year*
    - *Capture details to help understand annual production – and whether this happens in a specific time window or is spaced across the year. How do they describe the volumes they are producing (for example what measure of time do they specify)?*
- At what point do they add sugar within the production process?
  - Do they test for sugar content? Who does this test? How do they test for sugar content – how do they ensure a uniform product?
  - Are artificial sweeteners cheaper than using sugar? What is the difference in terms of price?
- In which ways are they selling their products – *consider packaging / storage for example bottles, cans, bag in box pre-mix*
- How do they manage their business?
  - Do they have access to IT systems?

Markets for products (8-10 minutes). Now I would like to move on to some questions about the markets in which you operate and how you are selling. These questions will take up to approximately 10 minutes to cover.

- *Where are the markets for their products – who are their customers and what are their routes to market?*
  - What exactly is the direct position of their business within the supply chain?

   - With the respondent, try to visualise a product being produced; in terms of supply chain what happens before and after the point of their involvement in the process? *Discuss in detail the exact steps that take place and the geography of these steps for example what happens where*
- Who do they produce soft drinks with added sugar for – do they sell their product 'generally' or are they producing for a specific market or specific retailer (such as large supermarkets)
- Where are their customers – are products sold for example locally / nationally
   - How far do their products travel before being sold?
- How long do products tend to be stored before being sold? *Researcher to link this to production methods / ingredients / life of the products (how perishable)*
- What contracts / arrangements do they have in place to distribute their products? Who are these relationships with?
   - How much of this do they distribute themselves, and to which business – and how much is distributed by other companies?
- Are they currently exporting any of their products – which ones and why? When did they begin exporting, and what were their initial motivations?
- What proportion of their turnover results from soft drinks with added sugar production? *If respondents mention unit cost then researcher to note this down; equally if they volunteer information in relation to profits*
   - What is their total turnover?

Plans for the future (12-15 minutes). Finally, I would like to move on to some questions about your future plans for the business. These questions will take up to approximately 15 minutes to cover.

- What are their plans for the business and their product range over time?
   - Do they have specific plans to grow? *Or are they happy where they are – probe for details*
   - Do they have plans to introduce new products, or reformulate existing products – why? *Researcher to be clear to differentiate and probe whether plans have changed due to levy announcement*
      - Do they currently, or have they explored or have plans to explore, reducing the sugar content of drinks or offering 'diet' varieties of their brands? Why / why not – what were the drivers and what did they decide to do?

        - What is the demand from customers for lower sugar content drinks, and how does demand for these products compare to demand for drinks with higher sugar content?
    - How do they anticipate their production volumes changing in the future?
        - Do they have plans to increase / decrease production, and why? *Consider specific products*
        - Are they specifically looking at securing national distributional/supermarket contracts? What expansion in volumes would they expect?
- What do they consider to be the key opportunities for themselves and producers like them? *Thinking specifically in terms of soft drinks with added sugar*
- What do they feel to be the key barriers to growth for themselves and producers like them? *Thinking specifically in terms of soft drinks with added sugar*
- To what degree do barriers limit their capacity to change how they produce or develop new products? Why?
- How do they perceive the proposed soft drinks levy? *Recall views from start of the interview*
    - What are their key concerns?
    - What do they perceive to be the key benefits?
    - Do they feel that they are able to change their product offering in response to the levy, and how would they go about doing this? *Ask for reference to specific products and sugar content and how they plan to vary this*
        - What would they be able to do and how/why; what are they unable to change?
        - Are there particular drinks that can't be reformulated / reformulated as easily?
        - Are they considering changing their offer?
    - What impact do they feel that the levy will have on:
        - Their business – *general thoughts / first impressions – what is the first thing that respondents say?* How might they – at this point in time, based on their current understanding - respond?
        - Demand for different product types
        - Turnover - Sales prices of products. If they did need to pay the levy, how would they respond to this cost – would it be passed on to customers, or what would they seek to change in their production method / business model?

        - If they did need to pay the levy – how well equipped do they feel to manage this internally for example admin? *How well do they feel they understand their obligations and specifically tax obligations at present?*
    - The wider supply chain – considering right from where they get their ingredients through to how they are getting products to market
  - Do they feel that any other types of organisations – such as larger producers – will be better able to absorb the cost of the levy? Why is this the case? Do they expect that other types of companies may be able to exploit loop holes – how might they do this?
  - Are there any 'unexpected' drinks which may make classification difficult – *cordials are one that has come up, is there anything else? One mentioned so far from interview was a business importing a product in liquid form but then selling it on frozen, therefore out of scope for the levy)*
- What are their opinions in relation to what any exemption should be based on, i.e. what the eligibility criteria and whether it should be a universal exemption or a relief? *Researcher to explain key terminology if needed*
  - *Researcher to record relationship between what they say and changes they were considering / feel they may be able to make*
- How well informed do they feel in terms of the levy and understanding what is happening? *Researcher to comment in write up on how well informed they actually are, based on our understanding of the particulars. What are their apprehensions, are these grounded in the facts of the matter as they stand at the moment?*
  - How do they access information?
  - Where do they get levy information from currently?
  - What information should HMRC share with them, and how frequently?
  - What channels could HMRC use to share information with businesses like theirs?
- Is there anything further you wish to say on the levy, or anything else related to this research, before we end the interview?

Interview close

Thank you for your time today.

Researcher to recall and confirm earlier response to whether happy for interview to be recorded and, if they agreed, transcribed

HMRC would also like us to inform you that they, jointly with Her Majesty's Treasury, have recently launched a public consultation seeking insights and feedback in relation to the proposed levy. This consultation covers different topics to those we have covered here today, and we are encouraging businesses within the industry & supply chains for soft drinks with added sugar and other stakeholders to participate within the consultation exercise. The consultation document can be found online at <GIVE URL>. Those responding can choose to answer as few or as many questions as they wish (for example focusing on only those which respondents feel are relevant). Please advise any of your customers or suppliers that this consultation is currently taking place, should this be of interest to other businesses you are engaged with.

If needed: any technical questions which the interviewer doesn't know the answer to should be directed to HMRC (the contact on the consultation document)

If myself or a research manager wish to check any of your responses or collect any additional details (via telephone), would you be happy for us to contact you again??

- Yes / no

Finally, would you like to take Databuild's number, or the number of the market research society if you'd like to check any details relating to my company or the work we do?

- Databuild
- MRS
- Neither

- Thanks again for your help with this research – goodbye.

Topic guide 2 - importers of soft drinks with added sugar

Introduction / rapport building (5-8 minutes)

Researcher to confirm if they are happy for conversation to be recorded for quality purposes & passing anonymized transcript to HMRC. Ensure they understand that the report is going to be published, but that no responses they provide will be used in an attributable format.

Researcher to:

- *reiterate the proposed levy and flesh out rationale for the research / answer any questions from the respondent*
- *explain how responses will be used (NB, if queried, care about overpromising - all views will be taken into account but it won't necessarily definitely produce the result the participants want),*
- *confirm whether respondent is happy for the conversation to be audio recorded.*

During this opening section we will allow respondents the opportunity to share their views on the levy freely and frankly early in the conversation, sharing thoughts and opinions openly at the start will mitigate against this 'overshadowing' other parts of the conversation, enable the respondent to 'relax' (knowing they have shared points of importance to them), feel engaged, and go on to provide useful insights during subsequent parts of the conversation.

To begin with, I would like to run through a few questions to understand some basic details about the business / confirm some of the information provided during screening. These questions will take around 5 minutes to cover.

- What does their business do? How long have they been in business, and what were their original motivations for importing?
- What categories of products do they import, and for what purpose?
  - Why do they import, as opposed to, or as well as, sourcing products from UK suppliers and producers?
  - Are they importing the product directly, and to whom do they supply products? *Capture details. They could be:*
    - *importing directly for sale for example they are a small chain of convenience stores*
    - *a wholesaler / cash 'n carry - importing to sell on,*
    - *an extra step in the supply chain for example they move the product and sell stock to cash 'n carries while their role is only transit / haulage*
  - Have they always been importing soft drinks with added sugar – when did they start to do this, and what were the drivers?
- Is import of soft drinks with added sugar their primary source of income? *Capture details of what the business does, and probe for details around which product or products they import have the highest commercial importance, and why*
- (in brief) how is the business structured – how is their operation set up, how many sites do they have, where are these located (and why)? *For example, do they operate close to ports because they import*

- Are they members of any trade associations? *Capture details*
- What is their awareness of, and views on the proposed levy – how do they think it could impact on their business and the industry for soft drinks with added sugar more widely? *Useful to understand what they do and don't know in relation to the levy*

Supply chains and markets (20-25 minutes). Now I would like to move on to some questions about your role in the supply chain, how the business operates and markets for your products. These questions will take up to approximately 25 minutes to cover.

- *Questions asked as applicable, depending on exact nature / role of their business – building on initial information captured within the introduction. Researcher to be conscious of the fact that importers operating in grey market – trading of commodities through channels that are legal but unintended by the original producer*
- What were their original motivations for starting to import?
- What exactly is the direct role of their business within the supply chain?
    - With the respondent, try to visualise a product arriving in the UK, what happens between when it is produced (if they can comment), when it arrives into the UK and when it is sold to a customer? What are the responsibilities of their business – what role do they play? *Discuss in detail the exact steps that take place prior to a product being produced outside of the UK, and the product making its way to a consumer in the UK, and the geography of these steps for example what happens where – are they focused in supplying to one region of the country, or are they a nationwide operation? Why?*
    - What is their business model; how many staff does the business employ, and how is the business structured?
        - What happens and where?
            - Are all staff UK based, or do they have any operations elsewhere?
    - Are they involved in manufacturing the products which are imported to the UK – *for example UK company but with production wholly based elsewhere and UK operations focused only on distribution*. Why did they choose to operate in this way?
    - What steps take place before the product is imported – how many producers or suppliers are they sourcing soft drinks with added sugar from?
    - Do operations outside of the UK also import and distribute products for sale within other countries, or do they purely support their operations in the UK (for example storage of products to bulk up quantities prior to these being imported into the UK)

- Which soft drinks with added sugar do they import, and why? *Capture whether product is named brands (for example coke, Pepsi or Irn bru) specialty brands that appeal to specific consumer groups (for example bubble tea, vita malt, aloe vera etc.) or others. Researcher to probe how this links to end markets*
    - How many different products do they import, and how has this changed over time?
        - What volumes are they importing? *Capture details, by products*
        - Are they aware of the sugar content of the products you import? If so, is there a mix between sugary, low content or no sugar products?
        - How – if at all – do they test or confirm that a product is as described on the label
        - How frequently are they importing? For each product, is this throughout the year or do they import seasonally? Why is this the case (for example linked to fruit production, currency fluctuation, other factors)
        - What different types of products do they import in terms of packaging for example bottles / cans / other – why is this the case, and what is the split?
    - Do they always seek to import the same products, or are they more opportunistic *(for example looking to import a product on which they feel they can command a greater financial return?)*
    - Are they involved in movement of stock of the same products that are produced in the UK; *for example so they are importing some 'brand X' and also involvement in movement of the same 'brand x' produced in the UK; considering that certain brands are licenced in different ways and to different producers in different countries.* Why do they operate in this way? *For example UK production too low to satisfy demand for a specific product, so they seek to import*
        - Or, are they importing different products to other products they are involved with within the UK?
- Do they currently, or have they explored or have plans to explore, importing brands with differing sugar content to the UK market? Why / why not – what were the drivers and what did they decide to do? *International versions of brand name soft drinks can be sugarier than UK versions. Researcher to discuss whether importers are handling any of these products, and the drivers for doing so*
    - What is the demand from clients/customers for lower sugar content drinks, and how does demand for these products compare to demand for drinks with higher sugar content?
        - How does demand vary between clients/customers?
        - How has demand varied over recent years? Is demand seasonal?

- *(researcher linking strongly to what has already been said in terms of the nature of the business and its imports)* What happens to product once in the UK?
    - Is it moved directly to point of sale, or is it moved somewhere for storage – why?
    - How are products being moved around – and by whom? *For example, if they are a wholesaler importing, do they move products to their location or does another company perform this function?*
        - What contracts / arrangements (if any) do they have in place to support their operations?
        - How much product do they distribute and / or go on to sell themselves, and how much is moved on to other companies?
    - Does anything happen to the product in the UK before going on to be sold – for example adding labels in English – or are steps such as this taken overseas? Who performs these functions and where do they take place?
- What contracts / arrangements (if any) do they have in place to distribute their products? Who are these relationships with?
    - What is the nature of these contracts; how long do they typically last and how flexible are they? Are they based on delivery of single / multiple products?
    - (If any relationships with supermarkets)
        - What is the nature of these contracts, and how would they pass on the additional cost if they were to need to pay the levy?
        - Have they begun discussions with them yet? What has been discussed?
- Are they involved in export operations and why? Does this involve movement of soft drinks with added sugar out of the UK?
- Who do they see as their main competitors, and what competitive pressure might they envisage under the levy? *NB This is important because we'll probably be speaking to largely reputable businesses, but their competitors could well be 'grey market' small scale type importers who will not necessarily be particularly visible to HMRC.*
- What proportion of their total turnover results from import of soft drinks with added sugar drinks?
    - What is their total turnover?

Plans for the future (12-15 minutes). Finally, I would like to move on to some questions about your future plans for the business. These questions will take up to approximately 15 minutes to cover.

- What are their plans for the business over time?
    - Do they have specific plans to grow as a business? *Or are they happy where they are – probe for details. Think in terms of different types of importer – so if they are a small chain of convenience stores do they plan to open new stores, or if they are a more general importer do they plan to import more goods and target other regions of the country? Capture details*
    - Do they have plans to import and / or sell new products?
    - If they are manufacturing outside of the UK, do they have plans to reformulate existing products – why?
- With specific reference to the transit and sale of soft drinks with added sugar, what do they consider to be the key opportunities for themselves and businesses like them?
- What do they feel to be the key barriers to growth for themselves and businesses like them?
- To what degree do barriers limit their capacity to change how they operate or the products they import – why?
- How do they perceive the proposed soft drinks levy? *Recall views from start of the interview*
    - What are their key concerns?
    - What do they perceive to be the key benefits?
    - Do they feel that they are able to change the product(s) they import to the UK in response to the levy, and how would they go about doing this? *Ask for reference to specific products and sugar content for example opting to import diet / low sugar drink varieties*
        - What would they be able to do and what permits their ability to do this; what are they unable to change
        - Are there particular drinks that can't be reformulated / reformulated as easily by the producer companies?
    - What impact do they feel that the levy will have on:
        - Their business – *general thoughts / first impressions – what is the first thing that respondents say?* How might they – at this point in time, based on their current understanding - respond?
        - Demand for different product types
        - Turnover - Sales prices of products. If they did need to pay the levy, how would they respond to this cost – would it be passed on to customers, or what would they seek to change in their business model?

        - If they did need to pay the levy – how well equipped do they feel to manage this internally for example paperwork? How well do they feel they understand their obligations and specifically tax obligations at present?
    - The wider supply chain – considering both effects WITHIN and OUTSIDE of the UK *for example what might the impacts be on producers outside of the UK, and do they foresee challenges in securing stock if they wished to import different products with different levels of sugar than they do now?*
  - Do they feel that any other types of organisations – such as larger importers – will be better able to absorb the cost of the levy? Why is this the case? Do they expect that other types of companies may be able to exploit loop holes – how might they do this?
  - Are there any 'unexpected' drinks which may make classification difficult – *cordials are one that has come up, is there anything else? One mentioned so far from interview was a business importing a product in liquid form but then selling it on frozen, therefore out of scope for the levy)*
- What are their opinions in relation to what any exemption should be based on, i.e. what the eligibility criteria and threshold should be, whether it should be a universal exemption or a relief? *Researcher to explain key terminology if needed*
  - *Researcher to record relationship between what they say and changes they were considering / feel they may be able to make*
- How well informed do they feel in terms of the levy and understanding what is happening? *Researcher to comment in write up on how well informed they actually are, based on our understanding of the particulars. What are their apprehensions, are these grounded in the facts of the matter as they stand at the moment?*
  - How do they access information?
  - Where do they get levy information from currently?
  - What information should HMRC share with them, and how frequently?
  - What channels could HMRC use to share information with businesses like theirs?
- Is there anything further you wish to say on the levy, or anything else related to this research, before we end the interview?

Interview close

Thank you for your time today.

Researcher to recall and confirm earlier response to whether happy for interview to be recorded and, if they agreed, transcribed

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If needed: any technical questions which the interviewer doesn't know the answer to should be directed to HMRC (the contact on the consultation document)

If myself or a research manager wish to check any of your responses or collect any additional details (via telephone), would you be happy for us to contact you again??

- Yes / no

Finally, would you like to take Databuild's number, or the number of the market research society if you'd like to check any details relating to my company or the work we do?

- Databuild
- MRS
- Neither

- Thanks again for your help with this research – goodbye.

DATABUILD

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