



**FINAL REPORT**

# Impact analysis of the Health Star Rating system for small businesses



*Prepared for  
The Department of Environment and Primary Industries (Victoria)  
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## *Abbreviations*

AFGC	Australian Food and Grocery Council
CIE	Centre for International Economics
FoPL	front of pack label
FSANZ	Food Standards Australia New Zealand
HSR	Health Star Rating
NIP	nutrition information panel

## *Summary*

### ***The Health Star Rating system is part of a suite of measures being used to inform healthy eating choices***

Food labels are the principal source of information for consumers at the point of sale, and convey a product's brand image as well as its essential characteristics.

Providing nutritional information to consumers through food labelling is crucial to empower them to make informed choices that affect their health and wellbeing. In Australia, the forthcoming introduction of a Health Star Rating (HSR) system aims to enable a direct comparison between individual foods based on their nutritional profile.

The HSR system is a voluntary, industry-led scheme. The adoption of the HSR system by businesses is dependent on industry awareness and overall attitude, as well as the potential benefits, opportunities, costs and risks that the system may bring. These impacts are of particular concern for small businesses, which in Victoria form the majority of operators in the food manufacturing industry.

### ***Only small businesses with highly rated products look set to embrace the system***

The benefits and opportunities that small businesses associate with the HSR system are largely contingent on products receiving high star ratings. In such cases, the HSR system may serve as an official validation of existing product branding, and may open up new markets amongst consumers who would not usually be guided by nutritional content.

### ***Costs are substantive enough to limit voluntary uptake***

The nature of costs associated with the HSR system is common to most businesses, and centres on the effort required to calculate star ratings and on changes to label design and production.

However, small businesses face particularly high costs due to their limited in-house capacity to perform these functions. Some of the key financial costs include:

- costs associated with calculating the HSR, which may be in the order of between \$500 and \$900 per product
- redesign costs associated with front-of-pack labels, potentially in the order of \$2 000-3 000 per product
- reprinting costs for front-of-pack labels, depending on the complexity of print plates (number of colours), with costs ranging from \$350 to 5 000 per plate
- write-off of existing label stock, which varies enormously depending on how many months of label/packaging stock businesses keep on hand.

Overall costs will also depend on how many product lines a particular business has.

Businesses are concerned about the potential risk to their brand value of low star ratings, but also acknowledge the risk of not adopting the HSR system and failing to meet consumer demands. For now, due to the relatively high costs of implementation, many small businesses prefer to ‘wait and see’ what the market response is before adopting the HSR system.

### ***Future investment in the HSR system needs to provide clear information to businesses and consumers...***

At present, there is no clear channel for advising small businesses on the HSR system, which has resulted in misinformation and misunderstanding — and consequent anxiety amongst small businesses regarding their obligations. The first step in facilitating voluntary uptake of the HSR system will be to improve awareness amongst small businesses.

Governments should act quickly to dispel misinformation and clarify the next steps in the HSR adoption process. Small businesses also require more assistance in understanding and calculating their ratings, as the existing spreadsheet-based calculator is not intuitive to use. Possible channels for communicating with small businesses include sub-sectoral food industry bodies, regional and local food industry associations, and Food Innovation Australia Ltd.

Raising consumer awareness will also be important for creating market demand for the HSR system, and thereby a greater incentive for businesses to voluntarily adopt.

### ***... and to facilitate a slower rate of uptake***

The costs of adopting the HSR system are relatively high for small businesses. However, to the extent that these costs can be mitigated, voluntary adoption may be accelerated.

Costs may be mitigated by allowing for a long implementation period, which would enable businesses to limit the loss of existing label stock, as well as to potentially time the introduction of the HSR to coincide with other planned label changes.

### ***Understanding the limitations of uptake***

It may be unrealistic to assume that the HSR system can obtain full coverage across all businesses in Victoria. For very small businesses, and those producing gourmet or artisanal products, the cost of adopting the HSR system may pose a significant threat to the viability of their operations. As purchases from these businesses are unlikely to constitute a substantial part of an average consumer’s diet, the exclusion of these businesses from the HSR system is not likely to have a material impact on achieving the system’s public health objectives.

## 2 *Impetus for the Health Star Rating system*

### *The role and impact of food labelling*

#### *The rationale for food labelling*

Food labels are the principal source of information for consumers at the point of sale.<sup>1</sup> They are a highly valued communication channel for a product's branding, as well as a means to convey essential product characteristics. These include not only food safety considerations, such as the use-by date or presence of allergens, but also specific dietary features — such as energy values or the levels of fat, sugar, sodium and other nutrients.

The over-consumption of specific nutrients has been linked to the incidence of obesity and a greater risk of diet-related chronic diseases. Providing nutritional information to consumers at the point of purchase is essential to empower them to make informed choices about products that affect their health and wellbeing. A clear positive relationship has been found between consumers' health consciousness and/or dietary concerns, and the frequency with which they refer to food labels.<sup>2</sup>

The rationale for government intervention in the provision of nutritional information relates to the risk of asymmetric information flows: in the absence of intervention, the food industry is likely to provide more information on positive health attributes than negative health attributes — including omitting attributes that may have adverse health impacts.

Government intervention can help to achieve a more balanced flow of nutritional information, so that consumers can make more informed purchasing decisions that are better aligned to their needs. This, in turn, may contribute towards achieving desired public health outcomes.

This rationale is illustrated in chart 2.1, using the example of a Health Star Rating as a means of nutritional information provision.

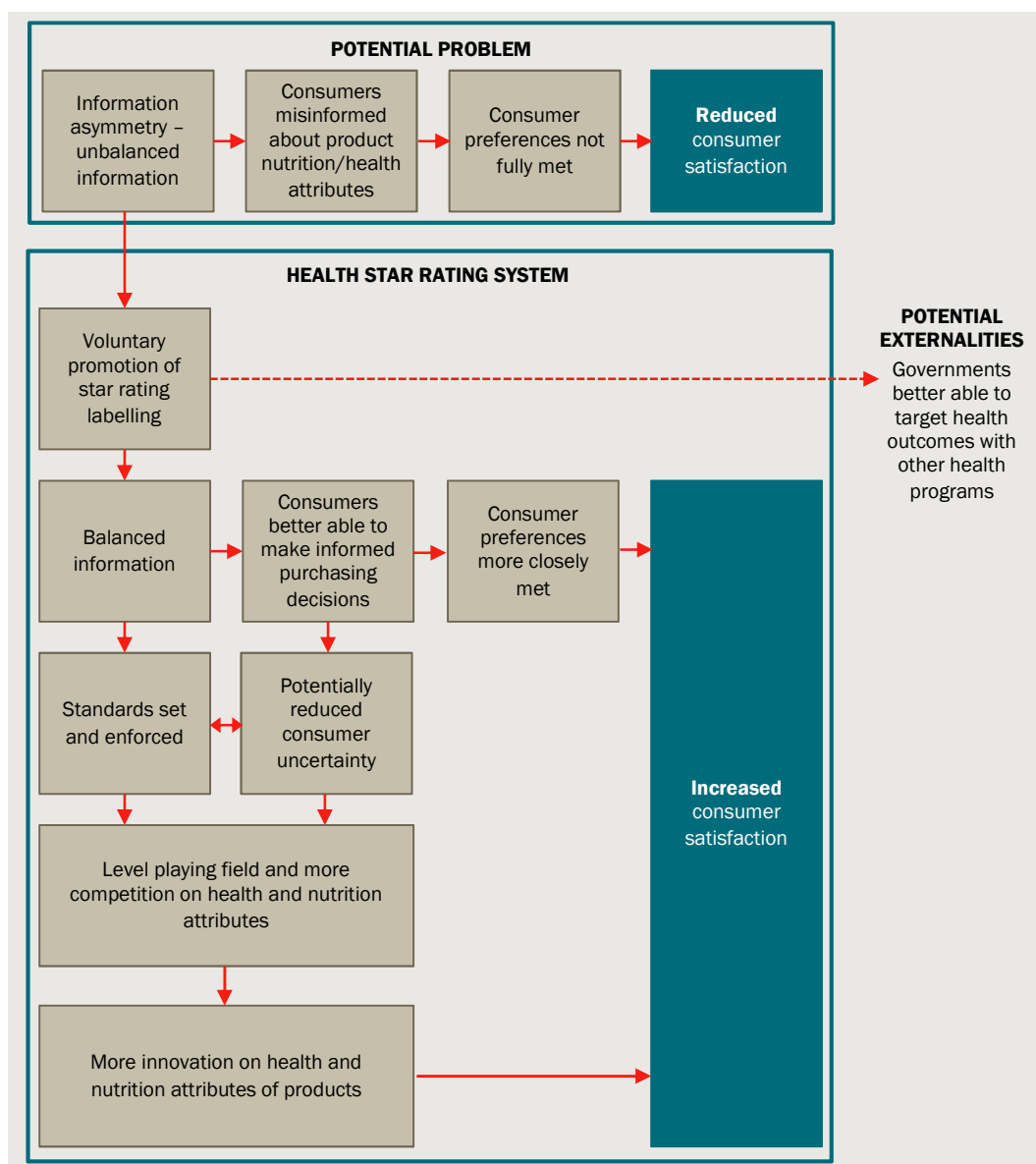
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<sup>1</sup> Blewett, N. et al. 2011, *Labelling Logic: Review of Food Labelling Law and Policy*, Council of Australian Governments/Australia and New Zealand Food Regulation Ministerial Council: Canberra, p.32.

<sup>2</sup> Food Standards Australia New Zealand 2008, *Consumer Attitudes Survey 2007: A benchmark survey of consumers' attitudes to food issues*, report prepared by TNS Social Research Consultants: Canberra, p. 58.



## 2.1 Rationale behind government intervention in health and nutrition claims



Data source: The CIE.

### Overview of the Health Star Rating System

The rationale and desired role for government intervention in nutritional labelling in Australia is set out in the national Review of Food Labelling Law and Policy undertaken in 2011 ('the Blewett Report').

This review made a number of recommendations with respect to the labelling of food products in Australia — including that '*an interpretative front-of-pack labelling system be developed that is reflective of a comprehensive Nutrition Policy and agreed public health priorities*'.

A front-of-pack labelling (FoPL) Steering Committee was established to oversee this process, together with a FoPL Project Committee for the actual development of the

system. The Committee was comprised of representatives from State and Territory Governments, industry bodies, public health organisations, and consumer bodies. A Health Star Rating (HSR) system was adopted as the preferred FoPL system in June 2013.

### ***Objective of the Health Star Rating system***

As noted in the Blewett Report, the use of interpretative symbols on front-of-pack labels can provide consumers with a readily understood signal of the food's 'healthiness' with respect to aspects of established dietary guidelines, particularly key nutrients and energy. The ultimate objective of a FoPL system should be to assist consumers to locate and comprehend nutrition information, making it easier for them to choose healthier options from among competing alternatives.

The HSR system aims to enable a direct comparison between individual foods based on their nutritional profile. In so doing, it is designed to be understandable by the majority of the Australian population — particularly those who may have difficulty using existing nutrition information panel (NIP) information, such as diverse socio-economic or cultural groups, or individuals with low levels of literacy or numeracy.

### ***Key elements of the Health Star Rating system***

The HSR System comprises three principle elements:

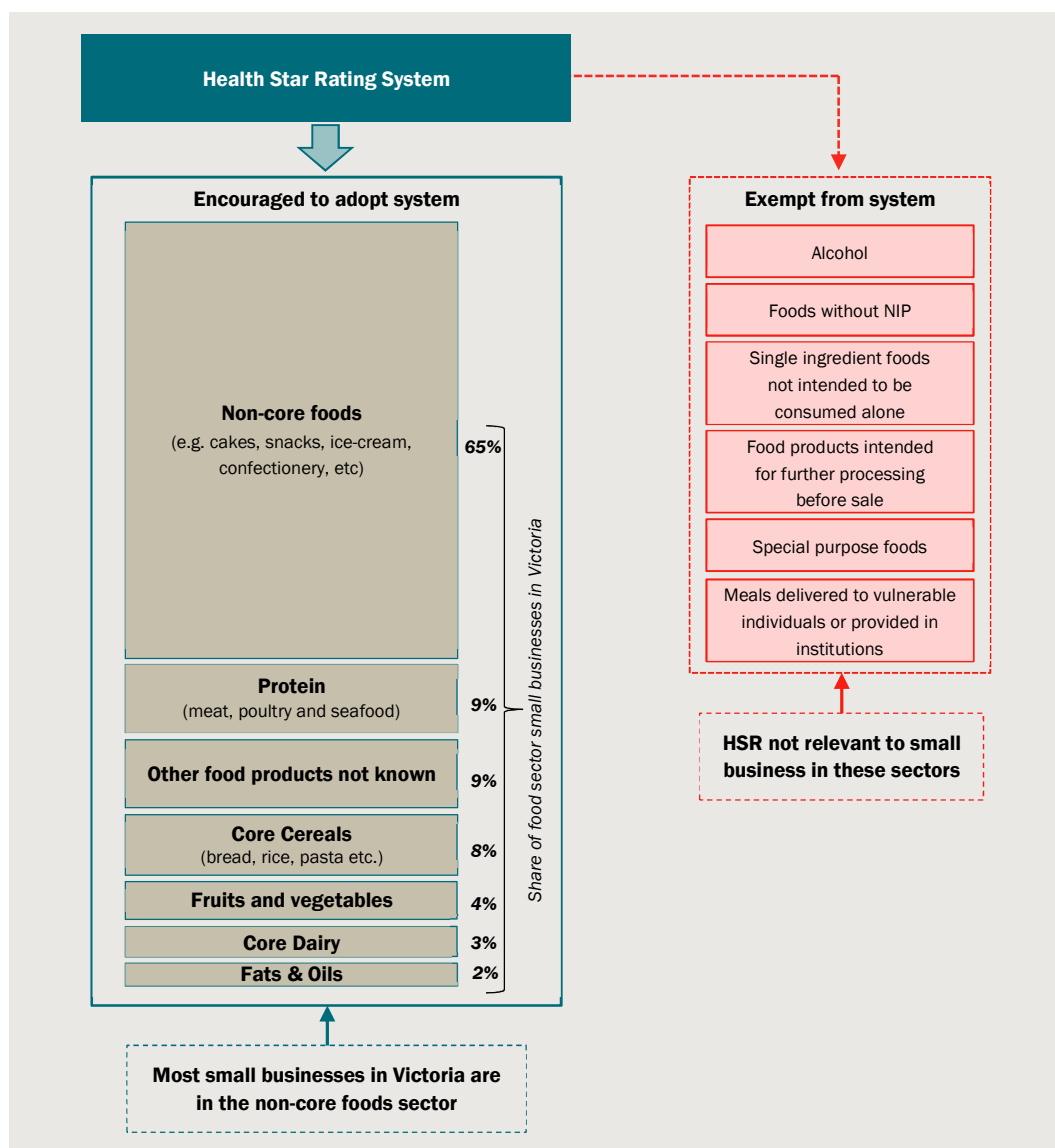
- a health star rating — an overall evaluation of the food product based on its nutrient profile, presented as a star rating graphic
- an energy declaration — the average energy content of the food product, and
- nutrient content declarations — individual label icons indicating the average nutrient content of prescribed nutrients (saturated fat, sugars and sodium), along with the option of a single 'positive' nutrient.<sup>3</sup>

The HSR system is a voluntary industry-run scheme that has been optimised for use on all packaged, manufactured or processed foods presented to consumers in the retail sector — although certain products are exempt (chart 2.2). In Victoria, the majority of small businesses that would be encouraged to adopt the HSR system fall within the 'non-core food' sector — including confectionery, baked goods, snacks, and other similar products.

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<sup>3</sup> FoPL Steering Committee 2014, *Health Star Rating System: Style Guide*, FoPL Steering Committee: Canberra, p. 3.

## 2.2 Intended coverage of the Health Star Rating System



Data source: ABS 81650, *Counts of Australian Businesses, including Entries and Exits*, Jun 2008 to Jun 2012 and the CIE, based on the Health Star Rating System Style Guide (2014). This chart uses the ABS definition of 'small business' (0-19 employees).

### *Food manufacturing in Victoria*

Small businesses dominate the food manufacturing sector in Victoria, accounting for 74 per cent of all businesses (table 2.3). The majority of small businesses operate in the 'non-core foods' sector, particularly in baked goods. While not all of these may produce packaged items that will be subject to the HSR system,<sup>4</sup> it is nonetheless evident that the introduction of the HSR will affect a large number of Victorian small businesses.

<sup>4</sup> Some businesses may be producing 'fresh value-added products', which will largely be exempt from the HSR system — FoPL Steering Committee 2014, *Health Star Rating System: Style Guide*, FoPL Steering Committee: Canberra, p. 1.

### 2.3 Food manufacturing sector in Victoria

	Businesses in Victoria	Small businesses	Proportion of Victorian businesses that are small
	No.	No.	Percent
Non-core foods (cakes, biscuits, confectionery, etc.)	1 584	1 160	73
Protein (meat, poultry, and seafood)	320	231	72
Other food products	228	168	74
Core cereals (bread, rice, and pasta)	198	135	68
Fruit and vegetables	141	117	83
Core dairy (milk, cheese, yoghurt)	90	72	80
Fats, oils	87	84	97
<b>Total</b>	<b>2 648</b>	<b>1 967</b>	<b>74</b>

Note: This table uses the ABS definition of 'small business' (0-19 employees).

Data Source: ABS 81650, *Counts of Australian Businesses, including Entries and Exits*, Jun 2008 to Jun 2012

## *Purpose of this study*

### *Objectives*

The objective of this study is to analyse the impact of the implementation of the HSR system on small businesses in Victoria, and to assess:

- awareness of the HSR system among small businesses in Victoria
- potential benefits, opportunities, costs, risks and uncertainties associated with adopting the HSR system
- what drives variance between small businesses in terms of their experience with the HSR system, and
- what can be done to improve the viability of the HSR system as a voluntary, industry-led initiative.

The nature of the assessment lends itself to a primarily qualitative analysis, and this study focuses on the narrative behind small businesses' response to the HSR system. Where possible, quantitative estimates of impacts have been collected, but these should not be interpreted as averages for the industry due to the relatively small sample of businesses interviewed.

### *Scope*

This study is restricted to assessing the impact of the HSR system on small businesses in the Victorian food manufacturing industry. Although the Australian Bureau of Statistics' definition of a 'small business' is any company employing fewer than 20 people, based on discussions with Government and industry representatives it was decided that a threshold

of up to 150 employees would be more useful for the purposes of identifying interviewees for this study.

It should also be noted that the focus of the study is on impacts for business. It is not an assessment of the merits or net impact of the HSR system, and as such does not consider any potential costs or benefits to consumers of the system.

### *Approach*

The evidence base for this study was established through an intensive consultation process involving:

- representatives of industry bodies, during a workshop at the beginning of the project
- representatives of the Victorian Government, during the same workshop as well as by regular ongoing communication throughout the project, and
- Victorian small businesses, through individual face-to-face and telephone interviews.

Small businesses to interview were identified with the assistance of the industry bodies who participated in the workshop, and of the Victorian Department of State Development, Business and Innovation. A total of 20 interviews were held. Further information on the stakeholders consulted is provided in Appendix A.

### *3 The Health Star Rating system and small business*

**There are a number of potential benefits, opportunities, costs and risks to small businesses in adopting the HSR system.**

**Adoption depends critically on industry awareness and overall attitude towards the system. While most businesses appreciate the intent of the HSR system, few believe that it will be effective in influencing consumer purchasing decisions.**

#### *Evaluation framework for understanding small business impacts*

An evaluation framework was developed based on consultation with the Victorian Government and industry representatives. The framework sought to identify potential benefits, opportunities, costs and risks arising at different phases of adoption for the HSR system — as shown in chart 3.1.

#### *Benefits and opportunities*

In the implementation phase, businesses with products that are already ‘healthy’ would be expected to benefit from the additional validation provided by the HSR system. These same businesses may be able to harness this as an opportunity to expand their consumer base, using a high HSR as a marketing tool. In the medium to long term, businesses may be able to realise greater benefits by reformulating products to obtain higher ratings.

#### *Costs and risks*

The cost impact of the HSR system is expected to be highest during the implementation phase, when initial investments in calculating ratings and changing label design will need to be made. Some risks to adoption are likely, such as the potential impact on brand value. In the medium to long term, the nature of risks will most likely evolve to risks of *non*-adoption. As consumers adapt to the HSR system and come to expect it, businesses that do not adopt may be negatively perceived, resulting in a loss of market share.

#### *Assessing impact strength*

The drivers of impact of the HSR system on small businesses will change over time. In the implementation phases, businesses’ capability to effect the labelling change and the incremental change that is needed to comply — along with the actions of their competitors — are likely to drive adoption. In the medium to long term, increasing consumer awareness of the HSR system may influence businesses further.

### 3.1 Evaluation framework for understanding for small business impacts

		Implementation Phase	Medium to Long Term
<b>Benefits and opportunities</b>		<b>Demand and growth</b> Harnessing consumer demand for health information	<b>Product reformulation</b> Incentive to make product healthier
		<b>Product differentiation</b> Enhancing existing health attributes	
<b>Costs</b>		<b>Time and effort</b> <ul style="list-style-type: none"> <li>Calculating ratings</li> <li>Administering change</li> </ul>	
		<b>Labelling</b> <ul style="list-style-type: none"> <li>Design</li> <li>Print run</li> </ul>	
		<b>Marketing</b> <ul style="list-style-type: none"> <li>Rebranding</li> <li>Offsetting negative perceptions</li> </ul>	
		<b>Write-offs</b> <ul style="list-style-type: none"> <li>Existing label stock</li> </ul>	
<b>Risks</b>	Adoption	<b>Impact on brand value</b> <ul style="list-style-type: none"> <li>Negative perception of low rating</li> <li>Less aesthetically appealing</li> <li>Sameness; loss of uniqueness</li> </ul>	
		<b>Inaccuracy</b> <ul style="list-style-type: none"> <li>Misunderstanding of algorithm</li> <li>Human error</li> </ul>	
	Non-adoption		<b>Perception of risk</b> Perceived as misleading
			<b>Loss of market share</b> Competitors who adopt may gain market share
			<b>Limited supply channels</b> Larger retailers may refuse to stock product unless it adopts
<b>Drivers of impact strength</b>		<ul style="list-style-type: none"> <li>✓ Business awareness of HSR system</li> <li>✓ Incremental change required to comply</li> <li>✓ Existing capabilities to manage change</li> </ul>	<ul style="list-style-type: none"> <li>✓ Consumer awareness of HSR system and impact of ratings on purchasing decisions</li> </ul>
		<ul style="list-style-type: none"> <li>✓ Level of adoption amongst businesses</li> </ul>	

Source: The CIE

### *Current awareness of the HSR system among small businesses*

- Awareness is higher in sectors with active industry body participation in the HSR process. However, there are no clear channels for advising businesses on the HSR system, resulting in misunderstanding and misinformation.

Awareness among small businesses of the HSR system is the first driver of adoption. The majority of businesses interviewed for this study were aware of the HSR system prior to the consultation process, as shown in table 3.2.

However, this should not be interpreted as an indication of awareness across all small businesses in Victoria. A number of interviewees were identified by industry groups in the confectionery and dairy sectors, who had already taken a particular interest in informing their members about the HSR system. Outside of these sectors, awareness was lower, and interviewees noted that they were usually not members of industry groups — and thus did not have a formal channel through which to receive information on the HSR system. Several of these interviewees were only aware of the HSR system through recent media coverage regarding the launch and removal of the official website, while others were only informed about the system when one of their sales channels, Coles, requested that they provide health star ratings.<sup>5</sup>

Among those businesses who had not received ‘formal’ advice on the HSR system from an industry body, there was a substantial amount of misunderstanding and misinformation as to what the system will entail. Several believed that the system was going to be mandatory, while others thought that it was going to be a traffic light system. Such misunderstandings have created unnecessary concern amongst small businesses.

#### **3.2 Awareness of HSR amongst interviewees (prior to consultation for this review)**

	Number of interviewees	Percentage of interviewees
	No.	Per cent
Yes – through industry group	9	45
Yes – through own research / media	5	25
Yes – through request from supermarket to adopt	3	25
No	3	15
<b>Total</b>	<b>20</b>	<b>100</b>

Source: The CIE

<sup>5</sup> Four businesses advised that they had received a request from Coles for their health star ratings in the first week of April 2014 — prior to the official launch of the HSR system. Businesses were asked to calculate their ratings based on the draft industry guide provided during consultations in November 2013. They were advised that products had to score a minimum of 3.5 stars (gluten-free) or 4 stars (not gluten-free) to be placed in the health food aisle.



## *Initial response to the HSR system*

- **There are mixed feelings towards the HSR system among small businesses in Victoria. Most businesses appreciate the intent of the HSR system, but few believe that it will be effective in influencing consumer purchasing decisions.**

Although the consultation process focused on the impact that the HSR system could have on small businesses, assuming that the system itself was a given, the businesses interviewed often had strong opinions on the actual HSR approach. Almost all interviewees appreciated the intent of the HSR system, and understood the rationale of providing more information to consumers to assist them in making healthier purchasing decisions. However, very few interviewees felt that the HSR approach was the best way to achieve any public health objectives relating to diet-related diseases.

Setting aside any cost implications, key objections to the HSR system raised by small businesses include the following:

- **It is not holistic:** the HSR is an over-simplification of complex nutritional information into a single rating. It does not take into account important micronutrients (such as vitamins and minerals) or the product's glycaemic index. It also does not reward products that are organic or natural (i.e. no chemical additives).
- **Consumers will be confused:** there is already a substantial amount of nutritional information in the nutrition information panel (NIP), as well as other health claims that are made on front-of-pack labels. The HSR will simply add to these overlapping messages.
- **Consumers will ignore it:** consumers will choose based on taste or price before they look at health considerations.

Businesses working in the 'health food'<sup>6</sup> sector tended to fall into the first group, while those in confectionery/baked products tended to fall into the latter two. Given that the HSR system has already been approved as the preferred FoPL approach to nutritional labelling, the consultations did not press for further detail on businesses' opinions in this respect. The discussion focused instead on the impact of the approved HSR system on small businesses.

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<sup>6</sup> For the purposes of this report, the 'health food' sector is considered to be those businesses marketing their products based on their health attributes, such as low sugar, low fat, no additives, etc. In many cases, these overlap with businesses producing for the 'free-from' market (gluten-free, lactose-free, etc.). This sector also includes vegetarian/vegan products intended as meat replacements.

## 4 *Assessment of small business impacts*

**The impact of the HSR system on small food sector businesses in Victoria is a function of the likelihood of adoption. This in turn depends on the potential benefits, opportunities, costs and risks that businesses may realise from adoption.**

**The benefits and opportunities associated with the HSR system are largely contingent on products receiving high star ratings. In this case, the HSR system may serve as an official validation of existing product branding, and may open up new markets amongst consumers who would not usually take the time to interpret NIPs.**

**The nature of costs associated with the HSR system is common to most businesses, and centres on changes to label design and production. Small businesses face particularly high costs due to the outsourcing of these functions — and these costs may be substantial relative to their annual turnover. With respect to risk, small businesses are particularly concerned about the impact of the HSR on consumer demand, and on their brand value. They also acknowledge, however, a risk associated with not adopting the HSR system, in terms of lagging behind their competitors and failing to meet consumer demands.**

### ***Incentives for uptake — benefits and opportunities***

- **Businesses operating in the health food sector believe that the HSR system will bring benefits and opportunities — but this is largely contingent on their products receiving high ratings**

Some of the small businesses interviewed identified a number of benefits and opportunities associated with the HSR system from a business perspective. Almost all of these interviewees operate in the health food sector, and the realisation of benefits or opportunities is largely contingent on their products receiving a good rating. Amongst those who had tested the HSR calculator on their health food products, some were pleased with the high star rating obtained (for certain mueslis and fruit juices, for example), while others were disappointed with low ratings (such as for kale chips<sup>7</sup>).

Two businesses were sufficiently positive about the HSR system to commit to begin implementation voluntarily as soon as it is launched, regardless of the associated costs — as shown in Case Studies 1 and 2 below.

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<sup>7</sup> Contrary to what may be expected, kale chips do not perform favourably under the HSR due to their naturally high sodium content, and because they are typically sprayed with olive oil to add flavour.

## ***Identified benefits***

### *An official validation of health-oriented marketing*

Several businesses that are already marketing healthy products believed that the addition of a star rating on their labelling would provide further validation of their healthy status. This assumes that their products do actually achieve high ratings, and that consumers are made aware of the government-mandated nature of the HSR system.

### *Positive consumer perceptions*

For health food businesses, it was felt that their existing customer bases would perceive the early, voluntary adoption of the HSR system positively, thereby adding to the business' brand value.

## ***Identified opportunities***

### *Potential opening up of new markets*

While some interviewees cautioned against the HSR system 'over-simplifying' complex nutritional information, others felt that this would in fact facilitate purchasing decisions for consumers. This was seen as an opportunity particularly amongst those consumers who would not typically consider the NIPs in detail, for example older generations who are not familiar with daily intake guides. This could increase demand for products with higher stars that could be marketed as healthier alternatives.

### *Opportunity to reformulate products*

Two interviewees in the health food sector, as well as one producing baked goods, thought that the HSR could serve as an impetus to reformulate their products to improve the star rating. This was seen in a positive sense (actually making the products healthier by lowering saturated fat content or sugar levels), rather than as an opportunity to 'game' the system by artificially inflating the rating — although this was also an identified risk (see next section).

#### 4.1 Case Study 1: Vegetarian/vegan products

##### *Business profile*

Case Study 1 is located in regional Victoria and employs 25 people, with an annual turnover of \$6 million. It produces a range of vegetarian and vegan products, including vegetable burgers and sausages, soy cheese, and packaged tofu.

##### *Awareness and impact of HSR system*

- Only became aware of the system through an article in a food-related magazine
- Very positive about adopting the system as it aligns with their marketing  
*“It relates well to our products — I’m confident we would get good ratings”*
- Believes that consumers will benefit from the simplified information  
*“Older consumers are less savvy when it comes to NIPs/daily intake guides — the health stars would be easy to understand. The HSR would open up this new market”*
- Not concerned about the potential costs  
*“There would be costs but it would be worth it”*

##### *Estimated costs*

The estimated costs and time needed for this business to adopt the HSR system are shown below:

Cost area	Cost per product	Total cost for company
	\$	\$
Calculating rating	No additional testing needed	0
Label redesign	n/a	30 000–40 000 for redesign and printing together
Print plates	n/a	
Label write-off	Minimal if there is a 12 month implementation period	
<b>Time needed to implement</b>	<b>12 months</b>	<b>30 000–40 000</b>

## 4.2 Case Study 2: Gluten-free/free-from products

### *Business profile*

Case Study 2 is located in metropolitan Melbourne and employs six people, with an annual turnover of between \$3 and \$4 million. It produces muesli and snack bars, with an emphasis on nutritional content (gluten-free, dairy-free, no added sugar, etc).

### *Awareness and impact of HSR system*

- Came across the HSR system by chance when researching how to make health claims — subsequently was approached by Coles to calculate ratings
 

*“We’re already in the health food sector, and keen to market this aspect”*
- Positive impression of the system, which could be a useful marketing tool
 

*“The HSR is easier for consumers to understand. Our products already score highly”*
- Concerned only about awareness of the HSR system amongst consumers
 

*“Producers can contrive many labels — consumers need to be aware that this is official”*

### *Estimated costs*

This business was not able to estimate additional costs, although it noted that there would be an initial outlay on redesigning labels and ordering new print plates. Some time will be needed to phase in the changes.

## ***Barriers to uptake — costs and risks***

All businesses identified a range of costs and risks associated with the implementation of the HSR system. Most businesses felt that the costs and risks outweighed any potential benefits from adopting the system, such that the businesses would not adopt the HSR system voluntarily. Several businesses preferred to ‘wait and see’ how the market reacts to the HSR system, so as to better assess the risks of adoption compared to non-adoption, before voluntarily incurring any costs.

### ***Identified costs for businesses***

- **Businesses identified similar types of costs, although the magnitude varies substantially. For small businesses, the necessity of outsourcing many elements of the HSR calculating and labelling process increases their costs substantially.**

### *Calculating the HSR*

The amount of employee time needed to calculate the HSR was of some concern to the businesses interviewed. However, the cost of any additional testing that would need to be done to calculate the HSR was perceived to be more important for many interviewees. The small businesses interviewed seldom have in-house laboratory facilities, and most

rely on the FSANZ online calculator to determine NIPs. As the FSANZ calculator does not assess fibre, this would need to be done by an external food technologist in order to obtain a complete HSR. This is estimated to cost between \$500 and \$900 per product.

#### *Redesigning front-of-pack labels*

The businesses interviewed felt that it was important to display the HSR in a way that was consistent with their branding, and which complemented the existing style of their front-of-pack labels. Given the limited amount of space available on most front-of-pack labels, this would often entail substantial investment in changing label layout and design. As most businesses outsourced their graphic design, this would necessitate an additional cost — potentially in the order of \$2,000-3,000 per product.

#### *Reprinting front-of-pack labels*

This was the most readily identified cost impact, the main component of which involves replacing the print plate for each product. The cost of this depends on the complexity of the label colouring — as table 4.4 shows, more complex print plates (with more colours) are more expensive to replace.

### **4.3 Estimated print plate costs**

Number of colours	Estimated cost (per plate)
	\$
One	350
Two	750 – 800
Eight	3 600 – 5 000

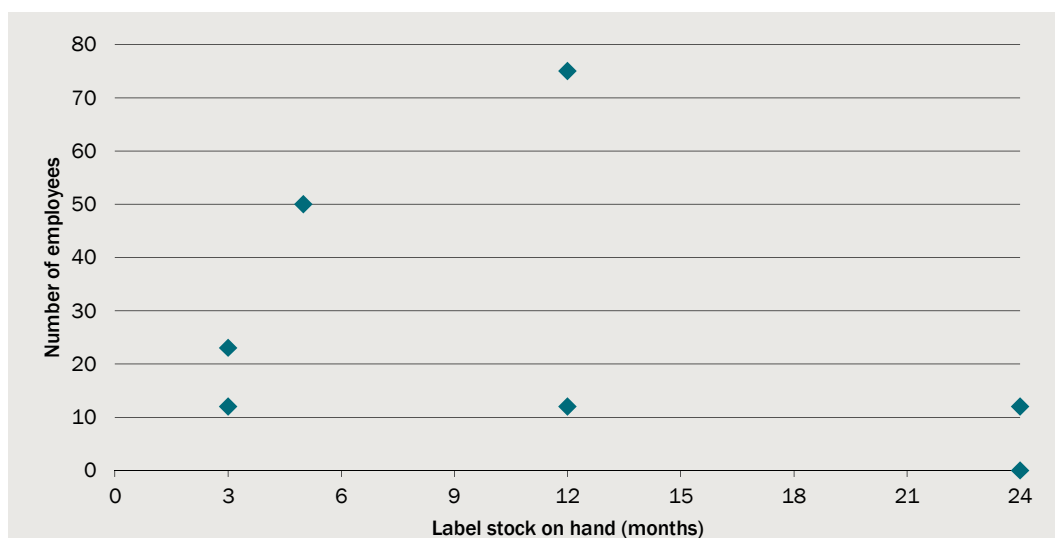
Note: Estimates based on figures given during the interviews.

Source: The CIE

#### *Write-off of existing label stock*

Old label/packaging stock will need to be replaced with new labels showing the HSR, but the extent to which this would impose an actual cost on businesses depends on how much stock they keep on hand at any time. As chart 4.4 shows, there is large variation between businesses in terms of how many months of label/packaging stock they keep on hand. Some interviewees claimed that as small businesses, they had to order large quantities of labels at a time in order to keep per unit costs down, while others stated that their limited cash flows prevented the stockpiling of large quantities of labels.

#### 4.4 Length of time label/packaging stock is kept, by business size



Note: Only seven businesses could give an average amount of time for keeping label stock. Others stated that the length of time depended on sales and varied too much from product to product to give an estimate. There is insufficient data to show business size based on turnover, as most businesses preferred not to disclose this information.

Data source: The CIE

#### *Overall estimate of cost*

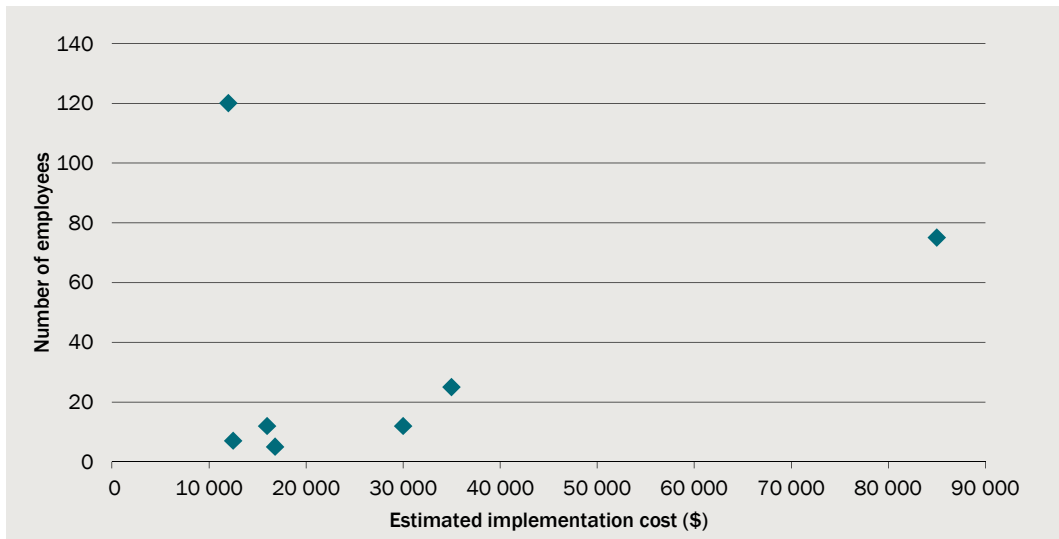
While the nature of costs was broadly the same across businesses, the magnitude varied substantially, depending on various factors:

- the extent to which businesses could calculate ratings in-house (i.e. whether any additional product testing is required);
- whether label design is outsourced;
- the complexity of label design and the required print plates;
- the amount of label stock kept on hand; and
- how many product lines the business has.

As chart 4.5 shows, there is a correlation between the size of the business (which can be taken as a proxy for the number of product lines), and the cost that will be incurred in adopting the HSR system<sup>8</sup>. However, amongst smaller businesses, the cost generally accounts for a greater proportion of annual turnover — as shown for Case Study 3 below.

<sup>8</sup> It should be noted that in many cases, the quantification of costs was not possible due to the person interviewed not having the necessary data (particularly if their role was in marketing or communications rather than management or operations).

### 4.5 Estimated overall cost to business, by business size



Note: One business is excluded from the chart – a company with 23 employees that estimated costs to be \$400 000. This was primarily due to its large number of product lines (50).

Data source: The CIE



## 4.6 Case Study 3: Cheese producer

### *Business profile*

Case Study 3 is located in regional Victoria and employs 12 people, with an annual turnover of \$500,000. It produces artisanal cheese for sale — primarily by independent retailers, but also through farmers' markets.

### *Awareness and impact of HSR system*

- Aware of the HSR system through involvement in industry association
- Generally likes the idea of providing more information to consumers, but feels that cheese is unfairly treated

*“The intention of the HSR is good but it is a blunt instrument — it needs more complexity”*

- Concerned about the impact on brand value and consumer perceptions

*“The stars will misrepresent the integrity of the product... they don't capture the beneficial health aspects of cheese. It would be infuriating to have to defend our product”*

- Costs of implementation are high relative to turnover — close to 10 per cent

*“We will definitely not adopt the HSR system when it is introduced”*

### *Estimated costs*

The estimated costs and time needed for this business to adopt the HSR system are shown below:

Cost area	Cost per product	Total cost for company
	\$	\$
Calculating rating	No additional testing needed	0
Label redesign	n/a	30 000
Print plates	n/a	
Label write-off	Two years' worth of stock	15 000
<b>Time needed to implement</b>	<b>24 months</b>	<b>45 000</b>

### *Identified risks (from adoption)*

- **Small businesses are particularly concerned about the impact of adopting the HSR on consumer demand, and on their brand value**

The businesses interviewed identified several risks and uncertainties that influenced their decision not to adopt the HSR voluntarily at this stage.

### *Reduced consumer demand*

The risk of reduced consumer demand varies depending on the nature of the product sold. For businesses with acknowledged ‘unhealthy’ products that obtain low star ratings, such as confectionery, the risk of reduced consumer demand was perceived to be minimal — these businesses generally do not believe that the HSR system will influence consumer preferences. However, for businesses operating in the health food and dairy sectors, there was greater concern about perceived misrepresentation of the healthiness of their product by the HSR system (due to it valuing macronutrient content over other nutritional characteristics), and the consequent impact on consumer purchasing decisions.

### *Diminished brand value*

Small businesses emphasised that their branding was the most important way they could distinguish their products from competitors. As such, the FoPL is seen as a ‘prized piece of real estate’ for communicating the brand’s value. Any additional information on the FoPL, such as the HSR, is perceived to be both aesthetically displeasing and distracting to consumers — thereby reducing brand value. This was particularly the case for businesses producing gourmet or artisanal products (such as chocolates or cheese).

### *Human error*

The method of calculating the HSR is confusing for many small businesses, several of whom had difficulties in using the current spreadsheet. There is concern that errors may be made in calculating the ratings for products, resulting in a misrepresentation of their nutritional characteristics.

### *Product shelf-life may be reduced*

For those operating in the artisanal cheese market, the delicate nature of their product and unique packaging (perforated cheese wrap) means that larger labels will significantly reduce breathability, and thereby negatively impact product quality and durability.

### *Identified risks (from non-adoption)*

Although few businesses intended to adopt the HSR system voluntarily, they nonetheless acknowledged that there may be some risks in doing so. The risks of non-adoption are more likely to be realised in the medium to long term.

### *Competitors may game the system*

Businesses who did not believe the HSR system could confer any benefits to their operations were not concerned about their competitors gaining any competitive advantage simply through adopting the system first. However, some businesses did have concerns that their competitors — particularly larger ones — may seek to unfairly ‘game’ the HSR system by artificially inflating their star ratings. This could be done, for example, by replacing sugar with artificial sweeteners, adding unnecessary fillers to boost

fibre content, or reducing sodium levels but increasing the use of artificial preservatives. The businesses interviewed did not want to engage in such practices, primarily because they wanted to keep their products as 'natural' as possible to maintain other health claims, but also because they felt it would have a negative impact on taste.

#### *Negative perception from consumers*

A few interviewees noted that even though they did not intend to adopt the HSR system voluntarily in the near future, they may need to reconsider depending on consumer reactions. One business noted that consumers 'will probably come to expect' the star rating on all products, at which point they would feel obliged to comply with the system in order to meet customer expectations.

### ***Overall likelihood of adoption***

It is clear that most businesses prefer not to incur the costs associated with the HSR system voluntarily, and many would rather 'wait and see' what the market response is — whether their competitors adopt the system, and whether consumer demand appears to be responding. This is illustrated in Case Studies 4 and 5 below.

Some businesses noted that they would adopt the HSR system voluntarily if it could be timed with other pre-planned changes to their product labelling. This is already the case for one confectioner who was undergoing a product rebranding in any case. For another business (Case Study 6), the driver for change in their labels is to market new health claims made under the revised Standard 1.2.7 of the Food Standards Code.

#### 4.7 Case Study 4: Gluten-free/free-from products

##### *Business profile*

Case Study 4 is located in metropolitan Melbourne and employs seven people, with an annual turnover of just under \$2 million. It produces gluten-free biscuits, cake mixes, muesli and savoury snacks.

##### *Awareness and impact of HSR system*

- Unaware of the HSR system until Coles requested ratings for their products  
*"In the end, it's all about the supermarkets — they will make or break a brand"*
- Strong brand identity — risk from competitors who may score higher ratings  
*"As a small business, our branding is our only way to differentiate against competitors"*
- Product formulation gradually shifting from 'free from' to 'healthy', as consumers demand healthier products — but wide variation between products  
*"We might just have to accept that we will have a range of stars across our products"*
- Unsure if the HSR will change consumer behaviour — therefore not worthwhile to voluntarily adopt right now  
*"We will wait and see if the system remains voluntary"*

##### *Estimated costs*

The estimated costs and time needed for this business to adopt the HSR system are shown below:

Cost area	Cost per product	Total cost for company
	\$	\$
Calculating rating	Additional testing costs	Cannot be estimated
Label redesign	Cannot be estimated	Cannot be estimated
Print plates	500–1 000	10 000–15 000
Label write-off	Minimal if there is a 2-3 year implementation period	
<b>Time needed to implement</b>	<b>2-3 years</b>	<b>10 000–15 000 at minimum</b>

## 4.8 Case Study 5: Frozen meals/pastries

### *Business profile*

Case Study 5 is located in metropolitan Melbourne, and employs 12 staff with an annual turnover of \$5 million. It produces a range of frozen sweet and savoury gluten-free products.

### *Awareness and impact of HSR system*

- Aware of the HSR system, but doesn't believe it will influence consumers  
*“All the information is already on the NIP, but people are lazy and not interested”*
- Concerned that adopting the HSR will increase costs  
*“There'll be no cost to supermarkets — manufacturers will have to absorb it all”*
- Also concerned that other businesses will try to game the system by artificially increasing their ratings  
*“This will be evident at the end of the voluntary phase, by which time all products will have 3 or 4 stars”*
- Will only adopt the HSR if it looks to be advantageous to its products

### *Estimated costs*

The estimated costs and time needed for this business to adopt the HSR system are shown below:

Cost area	Cost per product	Total cost for company
	\$	\$
Calculating rating	900	Up to 28 800
Label redesign	6 500	Up to 208 000
Print plates		
Label write-off	Minimal	
<b>Time needed to implement</b>	<b>n/a</b>	<b>Up to 236 800</b>

## 4.9 Case Study 6: Snack bars

### *Business profile*

Case Study 6 is located in metropolitan Melbourne and employs 23 people, with an annual turnover of \$20 million. It produces a range of fruit and nut bars, some as 'healthy snacks' and some as 'indulgent treats', with an emphasis on natural ingredients (additive-free).

### *Awareness and impact of HSR system*

- Very aware of HSR system through involvement in AFGC committee
- General negative perception of the HSR system
  - “Government is asking industry to implement what should be their own program”
- Concerned that it will be confusing for consumers
  - “Very similar products get different star ratings. How can consumers judge the difference between 3 and 4 stars, or between 4 and 5 stars?”
- Believes that health claims under Standard 1.2.7 are a more powerful incentive
  - “If I can make a high level health claim that is linked to a specific disease, that is a greater incentive to reformulate my product than the HSR”
- Will not adopt the system due to prohibitive costs (20 per cent of annual turnover), even though most products obtain 3 or 4 stars

### *Estimated costs*

The estimated costs and time needed for this business to adopt the HSR system are shown below:

Cost area	Cost per product	Total cost for company
	\$	\$
Calculating rating	No additional cost	\$0
Label redesign	\$3,000	\$150,000
Print plates	\$5,000	\$250,000
Label write-off	Can be avoided	\$0
<b>Time needed to implement</b>	<b>24 months</b>	<b>\$400,000</b>

### *Businesses unlikely to be affected*

The HSR system is optimised for use in a retail context. As such, food manufacturers whose main market is the **food services** industry will be largely unaffected by the introduction of the HSR. Several of the businesses interviewed supply both the food services and retail sectors, but do not believe there will be demand for the HSR amongst food services clients, for example major airlines or corporate event organisers. In

addition, businesses operating in the **wholesale** sector will be relatively unaffected, as most implementation costs will occur at the packaging stage.

### *How can adoption be facilitated?*

- **Investment is needed in improving awareness of the HSR system amongst small businesses, and in assisting them to calculate ratings. A long implementation period will enable them to mitigate the cost impacts of adopting the HSR.**

The small businesses interviewed identified a number of ways in which the voluntary adoption of the HSR system could be encouraged, and in which mandatory adoption — if introduced — could be facilitated.

#### *Encouraging voluntary adoption*

A clear message was that **awareness of the HSR system needs to be improved** — both amongst small businesses and amongst consumers. The current absence of a formal channel for providing businesses with information on the HSR system has resulted in misinformation and misunderstandings, which in turn has discouraged businesses from investigating the system further. Several businesses also noted that many of their peers were not aware of the HSR system at all. In terms of consumer awareness, it was considered essential that investments be made in informing consumers of the meaning of the HSR system and how it should be interpreted.

Most businesses would appreciate **more assistance in calculating the HSR**. The basis for the calculations, as outlined in the Industry Guide, was found to be quite complex. The HSR calculator spreadsheet was not very intuitive for businesses to use, and there was some concern about the potential for human error in calculating the ratings. Several businesses suggested that an online calculator, such as the one provided by FSANZ for the NIPs, would be more helpful.

#### *Facilitating mandatory adoption*

The most common suggestion for facilitating mandatory adoption for small businesses was to allow for a **long implementation period**. This would enable businesses to limit the loss of existing label stock, and spread their adoption costs over a long time so as to minimise impact on cash flow. For those businesses that provided an estimate of the time needed to implement the HSR system, the average was 20 months. It was however noted that the transition period for the new Standard 1.2.7 under the Food Standards Code is three years, and that this could be an appropriate timeframe for adopting the HSR.

A longer implementation period may allow businesses to time the introduction of the HSR to coincide with other planned label changes — for example due to product rebranding, or to the marketing of new health claims. In this case, the incremental cost of adopting the HSR system would be minimal — as illustrated in Case Study 7.

#### 4.10 Case Study 7: Fruit juice producer

##### *Business profile*

Case Study 7 is located in metropolitan Melbourne, and employs 30 staff with an annual turnover of \$5 million. The company produces a range of fruit juices and fruit drinks, with a fresh fruit content of between 40% and 100%.

##### *Awareness and impact of HSR system*

- Aware of the HSR through the media — and subsequently through a request from Coles to provide ratings
- Concerned about the basis of the HSR calculator

*“We use fruit purees but can’t get fibre points, even though we have more fibre than other types of juice”*

- Would probably adopt the HSR system when other changes are made to labels
- Sufficient time to implement the system is important

*“It will be more cost-effective to adopt it when we’re already reviewing label design”*

*“We have limited manpower and have to do everything in-house”*

##### *Estimated costs*

This business was not able to quantify the costs associated with adopting the HSR system, but estimated that it would need 12 months for full implementation.



## 5 *Key findings and next steps*

### *Benefits, costs and risks for small business*

#### *An overview of findings*

The findings from the consultation process can be summarised as follows:

- Adoption of the HSR system depends critically on industry awareness, but the absence of a clear channel of communication on this has resulted in misinformation and misunderstanding among small businesses.
- The benefits and opportunities associated with the HSR system are largely contingent on products receiving high star ratings, in which case the system may validate existing product branding or open up new consumer markets.
- Small businesses face relatively high costs in adopting the HSR system due to the need for outsourcing of most label design and production processes, and these costs may be a significant proportion of annual turnover.
- There are risks associated both with adopting and not adopting the HSR system.

#### *Did findings align with expectations?*

These findings largely align with what was expected based on the initial consultations with Victorian Government and industry representatives which informed the evaluation framework. However, there are some potentially expected changes that were not substantiated (or had limited agreement) during the interviews:

- **Adoption of the HSR as a drive for product reformulation:** for a handful of businesses, the HSR was identified as a potential opportunity to reformulate products to obtain higher ratings. However, for most businesses, it was felt that product reformulation (for example, reducing saturated fat) would come at the expense of taste or texture. Most businesses traded in products that had been established in the market for several years, and were hesitant to change product formulation for fear of reducing consumer satisfaction.
- **Marketing costs:** none of the interviewed businesses stated that they would invest in additional product marketing if they were to adopt the HSR, even if a low rating was obtained. For the confectionery or baked goods sector, where low ratings would be expected, businesses intended to mitigate any negative consumer perceptions by only adopting the energy icon thumbnail (rather than the full star rating) — which they felt consumers would largely disregard, therefore precluding the need for any compensatory marketing.

- **Labelling requirements for export markets:** it was initially thought that businesses who exported part of their production overseas would incur additional costs, due to having to establish a separate label production line for the export market (that would not include the HSR). However, most businesses who were questioned on this aspect stated that they had separate label production lines for their export markets anyway, due to different language and labelling requirements. In this case, the addition of the HSR to their domestic labels would not make any difference to the exported products.

### *Specificity of small business*

The majority of costs and benefits identified during consultations are not specific to small businesses. Any business is likely to incur costs associated with label redesign or reprinting. However, the magnitude of costs relative to annual turnover and available cash flows is of particular concern for small businesses. These businesses outsource many parts of the product testing and packaging process, entailing higher costs when labelling requirements change. The capacity of small businesses to absorb these costs within their profit margin is often limited.

### *Potential unintended outcomes*

There are two potential outcomes evident from the consultations that were not intended with the introduction of the HSR system. The first is the **unexpected stress placed on small businesses** who have been misinformed about the nature of the HSR system. Businesses who discovered the HSR system through their own research, the media, or through a supermarket's request for HSR calculations were more likely to misunderstand various aspects of the system – its voluntary nature, how ratings are calculated, and that it is not a traffic light design. This has resulted in anxiety amongst some small businesses with respect to their adoption of the system.

The second is the **possibility for businesses to 'game' the HSR system**, by reformulating products to gain a higher star rating without necessarily being 'healthier'. Examples of this would be replacing sugar with artificial sweeteners, or using less salt but adding more preservatives. For many small businesses that pride themselves on making products with no artificial ingredients (and not only in the health food sector), 'tweaking' their product formulation in such a way is not tenable. There is therefore a risk that their products will receive lower ratings than those of larger companies, which in turn may negatively impact on consumer perceptions and demand.

### *Understanding the limitations of uptake*

It may be unrealistic to assume that the HSR system can obtain full coverage across all businesses in Victoria. There are several business types for whom the system is unlikely to ever be viable, regardless of any assistance provided by government<sup>9</sup>:

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<sup>9</sup> This list is based on the consultations held, and may not be exhaustive.

- **Businesses producing gourmet or artisanal products:** these businesses trade heavily on their brand value, and on the nature of their product as a ‘special treat’ or gift (such as hand-made cheese or chocolates). They believe that consumers have made a decision to purchase their products, irrespective of nutritional content, long before they see the product packaging. In these cases, the inclusion of the HSR rating on front of pack labels is perceived to negatively impact on the aesthetics of the product branding, without providing any added value to the consumer.
- **Micro-businesses:** defined by the ABS as having fewer than five employees, these businesses have very limited capacity to absorb the costs associated with introducing the HSR. They may keep up to two years’ worth of label stock on hand at any time, and may only change their label design once every few years — so there are few opportunities to time the introduction of the HSR with other labelling changes.
- **Businesses with specific products unsuitable for labelling:** the artisanal cheese sector raised some specific concerns relating to the effect of larger labels on the shelf life of their products.

The exclusion of these businesses from the HSR system is unlikely to have a material impact on achieving the system’s objectives, as purchases from these businesses are not likely to constitute a substantial part of an average consumer’s diet.

## *Implications for government*

Based on the consultation findings, there are a number of ways in which governments can optimise the uptake of the HSR system among small businesses.

### *Getting the message out quickly*

#### *To small businesses*

The market is moving faster than the government in terms of publicising and supporting the HSR system – as seen in the request from Coles for its suppliers to provide their health star ratings. Small businesses do not have any clear, formal channels for receiving information on the nature and timing of the HSR system, resulting in confusion and uncertainty. Governments should act quickly to dispel misinformation and clarify the next steps in the HSR adoption process. Possible channels for communicating with small businesses include:

- Sub-sectoral food industry bodies, such as Dairy Australia and the Australian Industry Group
- Regional and local food industry associations, such as the Plenty Food Group — a food manufacturing industry network for companies based in Melbourne’s north, and
- Food Innovation Australia Ltd (FIAL) — an industry-led, Federal Government-funded initiative to accelerate collaboration and innovation in the Australian food industry.

*To consumers*

Consumer awareness of the HSR system will drive their demand for and use of this information, and subsequently the likelihood of adoption among businesses. A coordinated effort should be made to raise consumer awareness around the government-mandated nature of the HSR system, how the stars are calculated, and how they should be interpreted.

*Providing support to small businesses*

Small businesses need assistance in calculating the HSR, as the potential for human error is high. The existing spreadsheet-based calculator is not intuitive to use. An online HSR calculator, similar to that used by FSANZ for the NIPs, would be of great assistance to small businesses. More generally, small businesses would also appreciate having a clear contact point, in the government or elsewhere, for any queries they may have about the HSR system.

## A Stakeholder consultation

### *Stakeholders consulted as part of this review*

#### A.1 Stakeholders consulted (workshop)

Industry bodies	Victorian Government
Australian Food and Grocery Council	Department of Environment and Primary Industries
Australian Industry Group	Department of State Development, Business and Innovation
Dairy Australia	
Australian Specialist Cheesemakers' Association	

Source: The CIE

#### A.2 Small businesses consulted (individual interviews)

Product type	Number contacted	Number interviewed
Baked goods	4	4
Snack bars/cereals	5	3
Confectionery	9	5
Dairy	8	2
Frozen meals/pastries	6	2
Fruit and vegetables	5	2
Oils and fats	2	1
Vegetarian products	1	1
<b>Total</b>	<b>40</b>	<b>20</b>

Note: A combination of telephone and face-to-face interviews were held.

Source: The CIE

**A.3 Profile of small businesses consulted (total = 20)**

Characteristic	Number of businesses interviewed
<b>Number of employees</b>	
0	1
1-4	1
5-19	7
20-49	4
50-99	5
100-149	2
<b>Annual turnover</b>	
\$0 - <\$250k	1
\$250k - <\$1 million	1
\$1 million - <\$2 million	2
\$2 million - <\$5 million	3
≥ \$ 5million	6
Not disclosed	7
<b>Primary market <sup>a</sup></b>	
Domestic – local	2
Domestic – regional	2
Domestic – national	19
International	8
<b>Sales channels <sup>a</sup></b>	
Local markets	2
Direct to consumer – website	2
Supermarkets	12
Independent retailers	13
Cafés/restaurants	3
Food service	2
Wholesale	2

<sup>a</sup> More than one response may be relevant, thus figures do not add up to 20.

Source: The CIE

## B Questions guide for consultations

### Interview Guide

#### Small business consultation: health star rating system

##### Key business characteristics

1. Please provide responses regarding the following characteristics of your business:	
Number of employees	
Annual turnover (approximate) <i>(optional)</i>	
Market for product <i>(e.g. local, regional, national, international)</i>	
Sales channels <i>(e.g. markets, supermarkets, independent retailers)</i>	
Packaging type used <i>(e.g. paper, foil, glass, plastic, metal, etc)</i>	
Labelling type used <i>(e.g. pre-printed adhesive sticker, direct print onto packaging, etc)</i>	
Labelling process <i>(e.g. automated, by hand, etc)</i>	

##### Awareness of the health star rating system

1. Were you aware of the health star rating system before being contacted for this consultation? If yes, how did you find out about it? What is your overall view on it?	
Response:	

##### Potential impacts of the health star rating system

2. What <u>opportunities or benefits</u> do you think the health star rating system would bring to your business? <i>(for example: market diversification, new customer bases, etc)</i>	
Response:	

<b>3. What kind of <u>costs</u> would the health star rating system impose on your business, including for calculating the rating, implementing it, and any ongoing costs? <i>(for example: changes to product labelling, write-offs of existing label stock, etc)</i></b>	
<b>Response:</b>	

<b>4. If your business <u>did</u> adopt the health star rating system, would this pose any <u>risks</u> to your business? If yes, please elaborate. <i>(for example: impact on brand value due to a low rating, impact on aesthetic appeal, etc)</i></b>	
<b>Response:</b>	

<b>5. If your business <u>did not</u> adopt the health star rating system, but it was still introduced in the market, would this pose any <u>risks</u> to your business? If yes, please elaborate. <i>(for example: impact on your market share, misperception amongst consumers about why your company is not participating, etc)</i></b>	
<b>Response:</b>	

<b>6. Does your business intend to voluntarily adopt the health star rating system when it is introduced? If so, what time frame would you need for successful implementation? If not, why not?</b>	
<b>Response:</b>	





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