

Offshore fulfilment – competitive advantage and facts

By Robert Colquhoun

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In 2005 Dream Direct launched Razamataz, Classic TV & Film, and after two years was already in profit due, in part, to offshore fulfilment.

The Benefits

Offshore fulfilment describes the direct shipment of goods to European Union (EU) consumers from a fulfilment location in a non-EU territory.

As CEO of Dream I researched and implemented offshore fulfilment for Razamataz and our offshore subsidiary company and in my new consultancy role have done the same for others. Is offshore fulfilment relevant to your business? Very likely. These are the chief benefits:

- offshore fulfilment services are decidedly competitive with those in the UK, particularly for high volume and low bulk product, and even after accounting for a modest increase in carriage;
- offshore fulfilment provides a platform for European expansion. Due to their wider reach the bigger fulfilment providers often offer added value such as multi language and currency customer service and payment systems, European data services and compliance, subscription fulfilment, custom packaging, and pan European transport and postal services;
- the bigger global or European providers are financially sound and well managed. They are dependable and provide all the sophisticated and comprehensive accounting, IT, reporting, customer service and fulfilment you are likely to need - and measure up favourably on risk evaluation. All of which can ease the strain of growth to an overstretched management team;
- VAT free shipments on parcels of less £18 goods value, defined as Low Value Consignment Relief, or LVCR;
- high levels of stock security in respect of shrinkage and transit.

The best of this is that offshore fulfilment works for large, medium and small direct retailers. I started at only a few hundred parcels a week. Offshore fulfilment can work for start ups, and as a rough guide I estimate that as you approach 50,000 parcels annually you should look into it.

Before setting up operations at Dream I had bad experiences with two outsourced fulfilment companies. I determined control was paramount and that meant in-house operations. I had a dream team so at Dream it worked well, however it was always a distraction and probably, overall, more expensive. With the experience and knowledge I now have my instinct would be for outsourced fulfilment, which is indeed the case on a current project. With fulfilment it is definitely horses for courses and a comprehensive outsource selection process is fundamental, but quite straightforward.

If you are considering outsourcing part or all of your fulfilment, particularly if you have a growing overseas component, then you should include offshore providers in your candidate list. Set up and management is as straightforward as in the UK, and you will be impressed by the rates, systems and

management. Depending on the location the cost of goods-in logistics and goods-out carriage is often offset by savings or the advantages of working with a quality organisation.

The gain is significantly maximised when combining the advantages of offshore fulfilment with the benefits of VAT free LVCR shipments.

LVCR

The essence of LVCR is that it permits products in a single parcel to be shipped VAT-free into the UK if under £18 parcel value, and into Europe if under 22 Euros. Consequently high volume, low value products can be shipped into the EU from outside the EU at greater margins and/or at more competitive prices. In an LVCR context, offshore fulfilment is the direct importation of goods via postal means by consumers to the European Union (EU) from a fulfilment location in a non-EU territory, and supplied by a non-EU company.

LVCR is part of EC legislation and is described, rather turgidly, as a mechanism to avoid the administrative burden and disproportionate cost of VAT collection on low-value consignments imported from outside the EU. The relief can be set between 10 Euros and 22 Euros (£8-£18 in the UK) by individual EU members. The cost of collecting the VAT on such goods is inevitably increasing and two of the biggest EU members are pressing to increase the upper threshold. There is a review in December this year but any amendment is unlikely to be mandatory.

LVCR is sensible legislation designed to save tax payers money. It is not about VAT avoidance, but is about balancing the bureaucratic cost of collecting the duty on incoming consumer parcels from non-EU countries with the value of the VAT collected. If you have ever ordered from a USA based website and encountered the subsequent duty collection process you will have an inkling of the good sense of LVCR.

There are structural requirements governing LVCR, and as far as fulfilment into the UK is concerned, HM Revenue and Customs impose strict conditions on companies operating LVCR relief. Correct structure is essential - in my experience the main points are:

- business must be conducted by an autonomous non-EU company, i.e. an offshore company;
- fulfilment must be from outside the EU;
- if the offshore company has an associated UK company all legal and trading arrangements must be clearly delineated from those of its associate, e.g. its own supplier and outsourcing agreements;
- the contract between the customer and the offshore company must be clearly stated in all T&Cs;
- it is always necessary to seek local VAT and specialist professional advice. Most professionals are, understandably, not well informed on this corner of EU law, so specialists are required.

This is all very do-able, the whole process and fulfilment operation can be achieved in 2 to 3 months. To my knowledge all those companies who have set up properly have experienced no subsequent difficulties, with problem free VAT inspections for example.

An offshore company is not especially burdensome within the likely scope of its business plan. Day to day management is within the capabilities of even a small team - being similar to the monitoring and control requirements of any outsourcing arrangements. The Sigma Group in Guernsey provided pick, pack and despatch services for our offshore subsidiary and Razamataz, consistently meeting the 24 hour turnaround SLA, and was trouble free with minimal management distraction.

LVCR is available to the importer, i.e. to the importing EU consumer purchasing from an exporting non-EU company. The offshore company may:

- be a subsidiary but must be autonomous;
- subcontract activities, such as marketing and finance, to UK suppliers including a UK parent or associated company;
- market its offshore products separately in the UK or alongside other UK products provided by an associated or joint venture UK company. The terms and conditions must clarify the contracting parties. I believe that with Razamataz I trail blazed the multi-channel marketing – catalogue, press ads and internet – of offshore company products alongside UK products. My experience is that joint marketing presented difficulties neither to us nor to our customers – and which I believe proves the value of thorough research and preparation.

Competitive advantage

Undoubtedly LVCR provides a competitive advantage for direct retailers in non-EU territories targeting EU consumers. These direct retailers enjoy any competitive local operating costs that are available, and then simply inject parcels straight into the EU distribution infrastructure. Such parcels, being exported from a non-EU territory, do not attract local VAT if any, and if under the LVCR threshold do not attract EU import VAT. Thus the non-EU direct retailer increases margin by up to the VAT equivalent, or the retailer may increase competitiveness by reducing prices without losing margin.

The benefit from implementing LVCR is rapid and generally considerable, so facilitating a quick and rewarding ROI for the offshore, non-EU company.

Practicalities

Offshore fulfilment has been a growth industry in Switzerland and the Channel Isles (CI), their close proximity to the EU ensuring fast and efficient distribution links with little or no delay compared to local delivery times, and both being outside the VAT territory of the EU. The CI are UK crown dependencies but self governing and not EU members. Other countries providing offshore fulfilment into the EU include Israel, the USA, Mauritius, and Hong Kong.

Fulfilment from non-EU territories is not significantly different to that in the UK. Goods-in are received at the offshore location from international suppliers as usual. There are the usual storage, pick, pack and despatch arrangements. All sizes and weights are suitable, although parcels from 100 grams up to 1.5kg make up the bulk – commensurate with the LVCR under £18 profile. LVCR focuses on the intrinsic value of the goods in the parcel, so single multi-item orders may be fragmented into multiple parcels, and P&P is excluded from the intrinsic value calculation.

Swiss and CI fulfilment providers commonly have local and UK customs clearing arrangements, and feed consignments directly into Royal Mail regional hubs – delivering improved security and saving time in the process. There are daily transits from Switzerland at low rates, and Jersey and Guernsey Post rates are very close to those of Royal Mail.

It is critical to obtain specialist professional advice when negotiating the minor but important intricacies of offshore company setup, and the cost will almost certainly be recouped over time. Particularly important is VAT advice, I found it more than a little helpful to be able to phone a friend (who more than likely will be able to phone an official friend) when dealing with such authorities.

There will be many scenarios where offshore fulfilment provides an optimal solution; here are three from my experience:

- growth or new plans mean your UK warehouse is reaching capacity. High volume/low bulk inventory can be competitively outsourced offshore, extending the life of existing facilities and saving further investment, also achieving savings, and possibly with the advantage of LVCR VAT free shipping;
- your overseas orders are increasing, or you see opportunity in Europe. The cost and hassle of different languages, currencies and logistics are daunting. Offshore fulfilment is one solution;
- the comprehensive service offered by one offshore provider - including customer service, fulfilment, IT and reporting - allowed an internet vendor to confidently outsource, and combined with increasing overseas orders, this facilitated faster than planned profitable growth.

Channel Islands fulfilment (CI)

The advantage of LVCR has been one key to the success of some locally owned CI businesses, for example, optical companies, Flying Flowers, Healthspan and Healthy Direct. Play.com, a Jersey owned music and video direct retailer, utilised the competitive advantage most effectively. I hope Play will be happy for me to suggest that they almost single-handedly tilted the entertainment price playing field off level - so much so that national brands such as Amazon, Tesco, HMV, Virgin, Asda, and others, established offshore subsidiaries in order to compete and to level the playing field back again.

Entertainment is not the only sector to benefit from LVCR. Others include: flowers, seeds and plants, health, gifts, clothing, computer supplies, ink cartridges, hifi, games, leisure, education and optical. As you can see pretty well any product is suitable.

The CI are home to a number of fulfilment providers, the largest being Jersey based Indigo Lighthouse which offers a comprehensive multi-language/currency/payments, database and fulfilment service. The smaller providers offer competitive pick and pack services.

In 2004 certain UK retailers struggled to compete with the lower prices of DVDs and CDs. These retailers lobbied the Treasury claiming unfair competition. My own view is that market forces are taking care of the issue with a clear consumer preference and trend away from high street entertainment sales to the internet.

Individual EU member countries may not discontinue LVCR, although it can reduce the threshold down toward £8, with a resultant increase in the volume and cost of VAT duty collection. In March 2006 the Treasury estimated VAT revenue lost to LVCR at £85 million. The duty collection price tag is estimated at £200 million and rising, so it is reasonable to assume a lost VAT ceiling of at least this figure before the Treasury would become seriously concerned.

The Treasury appeared to respond to the lobbying by applying some pressure on Jersey and Guernsey governments. In July 2005 Jersey States issued a new policy focusing on the limitation of "growth in the activities of UK based companies that channel sales of CDs and DVDs through Jersey". Guernsey followed with a similar statement later. And in 2006 certain companies ceased fulfilment in Jersey and some commenced in Switzerland.

Open for business

Swiss fulfilment operators are actively seeking new direct retail clients, as are Jersey and Guernsey fulfilment operators. Corporate information is scarce in these countries so any estimate of current offshore UK volumes is somewhat of a guess. My own estimate is toward 40 million parcels annually.

Of course it is possible that the legislation could be changed or amended, with a resultant change to LVCR. Any change in LVCR will be the same for all, and the wider benefits of offshore fulfilment will remain.

This information is not definitive but I consider it to be the salient information relevant to offshore fulfilment based on my own commercial experience. I hope this article assists you and dispels some of the myths. In our EU-centric environment I believe it makes good commercial sense to explore fulfilment outside the UK, and it is clear to me that improved growth and margins can be a rapid and direct result. Food for thought I hope.

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