Walpole

Trading *with Europe*

TRENDS, ISSUES & SOLUTIONS

Executive Summary

The UK luxury sector has a longstanding and profitable relationship with Europe. It is a key export market, a source of investment for UK firms and an integral part of the luxury supply chain. Luxury is an Anglo-European success story, based on delivering an excellent consumer experience for visiting tourists and residents alike.

The current conditions around Britain's trading relationship with the EU present a number of challenges. Delays, increases to costs & paperwork and tariffs and rules of origin all have made trade more difficult. In response, some brands have been forced to establish fulfilment centres in Europe, diverting investment and jobs away from the UK.

Beyond the policy landscape there are several broader challenges that have hit the sector, with the delays, costs and paperwork causing consumers to lose confidence, while inconsistent enforcement at the border has led to brands struggling with exporting even after agreements to smooth trade have been made.

Particular challenges around VAT, returns and shipping of samples have been raised as areas where progress could be made.

We recommend a series of measures that the Government could take, in partnership with industry to improve trading relations. These include:

- Pursue further bilaterals similar to the UK-Italy deal agreed earlier in 2023
- Arrange an agreement with 3rd party logistics firms to standardise processes
- Negotiate an increase to the EUR150 VAT threshold
- Support UK businesses seeking to export through the tax system
- Strike an SPS agreement with the EU
- Back a consumer confidence campaign to win back European customers
- Stop the proposed increases to paperwork and introduction of physical checks on foodstuffs entering the UK from the EU

Introduction

Businesses across the UK have faced challenges trading with Europe in recent years, and the UK luxury sector is no different – prior to the pandemic, the EU represented 42% of the sector's exports, supported by well-established supply and distribution networks. What sets the sector apart is how it has sought to adjust to these new headwinds with pragmatism, finding workable solutions, absorbing the impact of increased costs as well as administrative time, and finding ways to mitigate challenges. However, seven years on from the Brexit vote, as our new trading relationship begins to solidify, there remain a number of practical difficulties which Governments on both sides of the Channel could help to solve.

This short briefing paper focuses on a number of the specific challenges companies are having day to day in doing business with the continent, and proposes a number of adjustments which would make things simpler, smoother and more straightforward for businesses and consumers alike.

The paper is the product of intensive discussions and feedback from our members, including an in-depth CEO roundtable, as well as the accumulated research and insight gained over recent years. It is designed to offer policymakers a series of insights that paint a picture of businesses that have overcome the vast majority of the challenges, and offers small, practical solutions that could be a meaningful improvement to those that are left.

Why does Europe matter to British luxury?

The luxury sector is a global powerhouse and an Anglo-European success story. The British luxury sector has grown in size and influence alongside its European stablemates, while remaining a distinctive and unique contributor to the UK's economic, employment and cultural landscape. The flows of investment, trade and culture that the sector generates move in both directions across the channel contributing to industry which is worth 1.3tr euros globally and growing at a rate of 5-6% annually.

SUPPLY CHAINS

Luxury's commitment to high quality, high craftsmanship goods with traceable, ethical sourcing means that in some cases products or components that cannot be produced domestically can only be sourced from or through the EU. For example, while we have a strong tradition of shoe and leather accessory-making here in the UK, the leather itself is often shipped from Europe to factories in Northampton and the Midlands.

In some cases, workforce challenges mean that the UK may lack the skills necessary to produce the whole product, while in others international consumers put a premium on goods (or part thereof) being sourced from certain regions or countries. As such even when goods are manufactured in the UK, and largely sourced from domestic suppliers, there remains an interdependence between the British and European sectors.

It must also be recognised that the reverse is true and there are some products and skills the UK has which are in short supply in the EU, and therefore barriers to trade have a negative impact for EU businesses as well. For instance, while Italy boasts the best women's footwear manufacturers and silk scarf producers, and Grasse in France is acknowledged as the home of perfume, Scotland is highly regarded for its cashmere production with numerous European luxury brands using British manufacturers to produce their cashmere accessories and clothing. These supply chains operate in both directions, and are central to the business model of the sector.

THE LUXURY CONSUMER

This longstanding interconnection and mutual benefit also exists across the customer base. Luxury is a sector which prioritises the long term, and focuses on retaining clientele. As such, many British luxury brands count European consumers among their regular shoppers. Their habits, and expectations, have been formed over many years of patronage and are rooted in expectations around service and quality. Given that acquisition of new customers can be several times more expensive than retaining existing customers, this longstanding consumer base is vital to ensuring profitability.

Likewise, Europe is seen across the world as the epicentre of luxury, with high-end tourists travelling for the luxury experience. As such, while it is possible to pivot slightly away from Europe, there remains a necessity for brands to be present there to capture international traveller retail spend. This is the case even where brands already have a strong presence in the rest of the world.

> *"Luxury is a global phenomenon, but it calls the UK and Europe its home. It is a generator of jobs and growth in the UK, and that prosperity relies on strong links to the continent."*

Helen Brockelank, CEO, Walpole

For instance, a Chinese customer might buy British goods in China but will also travel to Europe to shop; British brands need to cater to this or will lose that customer to European competitors. As the impact of the loss of Tax-Free Shopping in the UK becomes more entrenched, the need for frictionless exports to the EU is ever greater, as they will absorb more and more of high-end tourist spend.

INVESTMENT

Countless British brands receive investment from Europe's biggest corporate entities, including Kering, Richemont and LVMH. This investment allows businesses to grow through additional funding, expertise and expanded global networks to further drive revenues. There are numerous examples of European investment across the sector including Prada Group purchasing Church's shoes, Chanel's investment in Orlebar Brown, Kering's ownership of Alexander McQueen, and LVMH's investment in Glenmorangie and Belmond. Under the investment and direction of their owners these brands, and many others, have experienced sustained periods of growth, significant investment into their UK operations, digital expertise and workforce.

EXPORTS

Previously the EU represented British luxury's largest export market, accounting for 42% of exports. While this is a significant market, owing to the globalised nature of our member businesses, it is lower than the UK's overall proportion of exports to the EU, which for the same period stood at 49%. However, when considered in the context of 80% of what the sector produces being destined for overseas markets, this 42% translates into a substantial part of businesses' profitability, which pivoting to the rest of the world will not entirely replace.

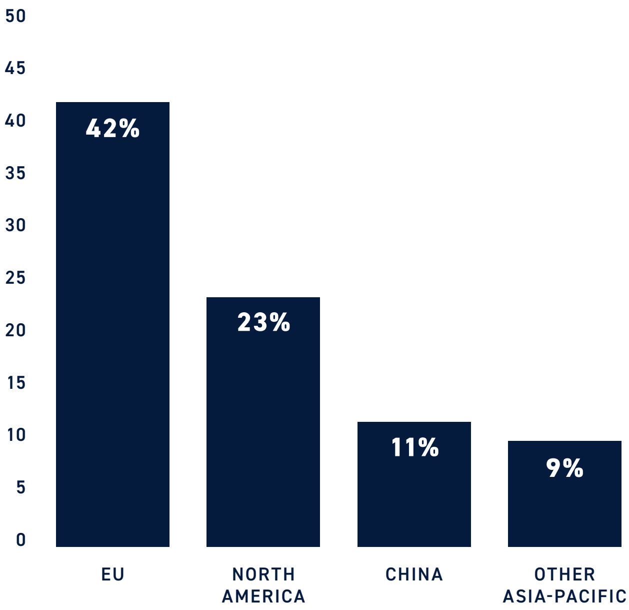


Figure 1: Direction of Trade – 2017 Breakdown by main export markets
Source: Frontier Economics calculations based on Euromonitor and Bain data

Owing to COVID, a more recent analysis of trade effects has proven to be challenging to undertake, however anecdotally we know that some brands have pivoted away from Europe owing to recent trade barriers.

Trends since Brexit

As already outlined, owing to the cumulative impact of the pandemic and the staggered implementation of the withdrawal agreement, concrete data on the impact of the changing trading relationship is difficult to compile. However, it is possible to draw out some general themes and trends from members' experiences.

BARRIERS TO TRADE

The first of these is the impact of both changes to the trading relationship and the impact of the pandemic on global trade operating in combination to drag down competitiveness. However, it is clear that the new trading relationship has created barriers to trade which have a meaningful impact on business – these have taken the form of increased costs, lower demand and more complexity for businesses and consumers.

While in some cases the preparation done to ensure businesses were ready for Brexit meant that they had good crisis management and supply chain plans for when the pandemic hit. In most cases, the combined impact of the increased trade barriers that are slowly being erected with Europe, and the wider global supply chain issues have impacted the ability to do business with a customer that has high expectations for service, speed and quality – which new trade barriers make hard to live up to.

"We had a huge amount of stock, buffer stock for Brexit and then we went into the pandemic, so we managed to keep the factory open and still sell." *British health and beauty business*

SALES TO TOP PERFORMING EUROPEAN CUSTOMERS

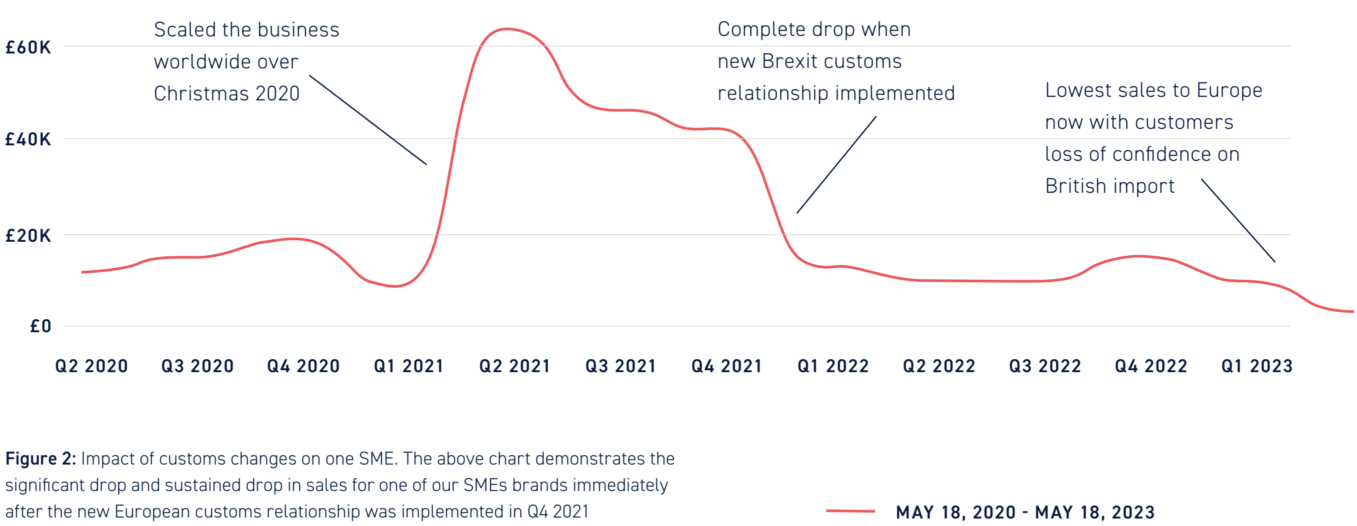


Figure 2: Impact of customs changes on one SME. The above chart demonstrates the significant drop and sustained drop in sales for one of our SMEs brands immediately after the new European customs relationship was implemented in Q4 2021

> *"Shipping food direct to the customer is now impossible... the rules required you to have a phytosanitary certificate to prove that, as the receiver of these goods, the cows that produced the milk that went into the butter that went into the biscuits had been raised and husbanded in a way that was in accordance with EU standards."*

Retail CEO

DELAYS

One of the main concerns raised by our members is not that it is impossible to export, only that it is more difficult and significantly more costly, and that there are delays that exist which previously did not. While this is true for all businesses, the impact of these delays is greater for luxury brands as the customer has both very high expectations and is easily able to alter their spending habits to a more streamlined service, which is available from many EU-based brands.

These delays have a range of contributory factors, however one is the rising volume and complexity of paperwork. This requires certification and compliance checks, and especially for small businesses this added administrative burden is especially costly.

In the initial period after the UK's departure from the EU, there were some cases where large stockholdings had been built up in anticipation of challenges after leaving the EU, which then in turn helped businesses mitigate the impact of supply chain degradation over the pandemic. However this unexpected benefit was limited and as trade barriers have remained businesses have seen delays becoming an unfortunate part of their operating model.

Likewise, delays on components entering the UK have driven companies to alter their business model, with longer lead times and more stock purchased in bulk rather than just-in-time – this in turn drives up cash flow challenges and costs as businesses that now must warehouse large volumes of some components that make up their products.

"Where once we ordered maybe 6-8 weeks before a bottling, we are ordering bottles 6-9 months before a bottling. Our provider is no longer sending bottles directly to us in the UK. If we purchased them through their UK Agent, we would pay almost double the price that we pay in France." *Winemaker*

PAPERWORK

Businesses from across sectors have been affected by a dramatic increase in paperwork since the outset of the new trading relationship. While some have adjusted over time, the burden has been even more onerous for those exporting food and drink, or plant products where export health certificates and additional checks are in place.

In some cases, this is where trade has become impossible – at least for an interim period. This has driven some businesses to temporarily withdraw from the EU market entirely, and caused considerable additional costs for others.

FULFILMENT CENTRES

In order to try to mitigate these risks, many brands are establishing fulfilment centres within the EU. These centres hold stock in order to dispatch to customers without having to ship it across the UK/EU border, with all the challenges that still presents. While these centres typically stock fewer goods than the main UK stores, they still allow high-demand/volume goods to be dispatched more quickly.

This has been mirrored by companies needing to establish a commercial entity within the EU (or find a fiscal intermediary) for VAT purposes. The €150 One Stop Shop threshold is low for any business, but for luxury brands this is exceptionally low, driving more businesses to invest in creating an EU commercial entity.

"The biggest challenge has been more around trying to deal with the VAT side of things." *Founder of a fashion SME*

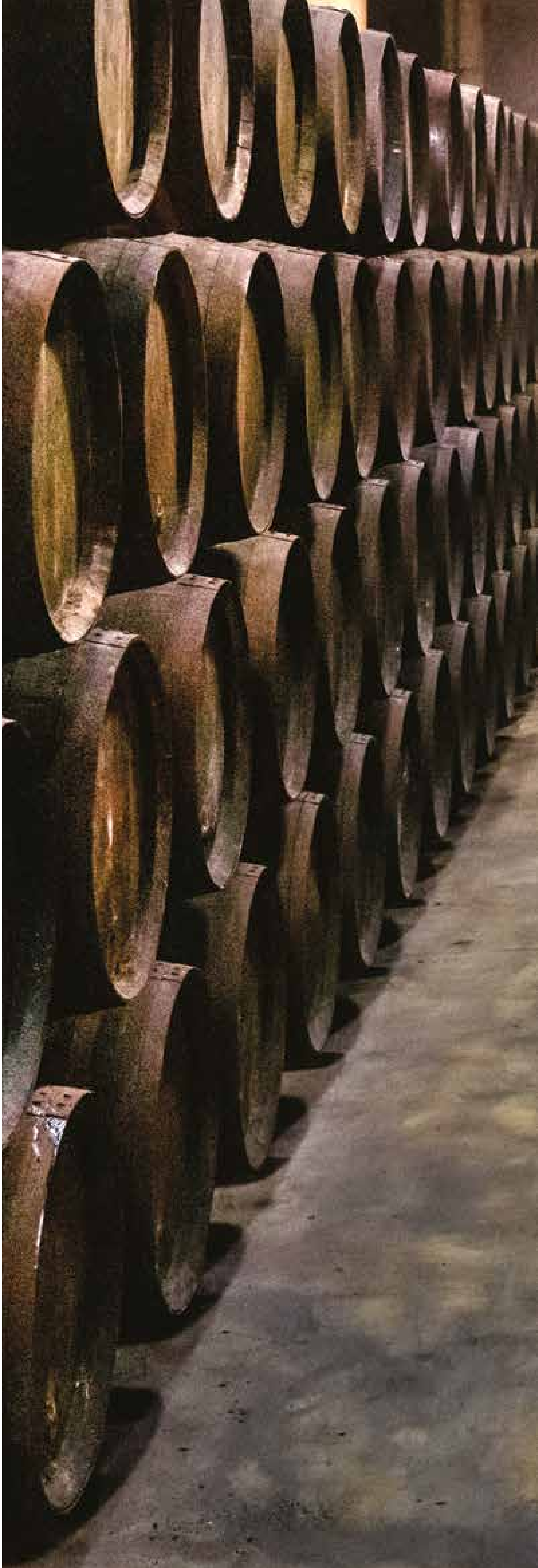
Members have expressed frustration that they have had to take these steps, as their preference would have been for investment in the UK or in expansion, not in plugging gaps in existing services. Overall, it is this opportunity cost, running to stand still, which is most impactful on UK businesses.

TARIFFS AND RULES OF ORIGIN

One of the consequences of this is a greater premium being placed on good quality service from third-party logistics companies to conduct deliveries to the continent, and navigate the more complex landscape, at increased cost.

Finally, one additional challenge has been seen in tariffs and rules of origin. While the Trade and Cooperation Agreement allows for tariff-free trade, the impact of cumulation on businesses is significant.

Some members report that exporting their product for finishing in the EU, and then re-importing it may incur tariffs if the tariff number does not change. This is especially challenging for smaller businesses, for whom access to expert advice and support on these matters can require expensive external advisors or considerable resources to research, implement and manage new processes.



The Macallan's Single Malt Scotch Whisky is matured in the finest quality Sherry-seasoned oak casks, including those sourced from Spain

Spotlight

These trends have created several specific challenges to trading which have been consistently raised by Walpole members.

These challenges are not the fault of Brexit, or UK Government policy. Some are the product of poor implementation on the side of EU member states, and in other cases, the challenge emerges at a consumer or business, not political level. However, these remain challenges that need addressing, and while the sector continues to solve its problems, it looks to do so in partnership with Government.

CONSUMER CONFIDENCE

The impact of the UK's departure from the EU has been one that has generated significant attention and uncertainty from consumers and businesses across the European Union. British companies were the most prepared and have found many solutions to the challenges it has presented. However, the same cannot be said for European consumers and businesses, who our members sell to.

While some EU businesses were well prepared for the changes to the trading relationship, others have struggled to adjust, or simply ended relationships rather than manage the change. Likewise, EU consumers have noticed the uncertainty around trading arrangements and altered their behaviour accordingly, even in cases where there may be little or no impact on them. As such, UK brands have had to invest heavily in rebuilding those relationships.

This has been exacerbated by the difficulties many brands had in the transition period around delays, charges and costs, where uncertainty and confusion drove customers away from buying British products. These habits, once formed, can be difficult to break and represent a significant challenge to profitability in these markets.

"In the first year...35% of our products were being returned because the clients weren't prepared to pay the taxation which they weren't expecting."
Manufacturing and Retail CEO

The impact of this has been felt in a dramatic reduction of business from the EU, and from increases in negative reviews from those who continue to shop with British brands. Delays and unexpected costs to the consumer (through both taxes and courier fees) are doubly harmful to brands as they serve to alienate new clients and provide a negative base of comparison for long-standing customers who remember the more straightforward process of a decade ago.

To address this isn't simply a matter of policy, but of changing perceptions, and these can only be rebuilt over time. That said, there is considerable opportunity here if consumers' minds are changed.

INCONSISTENT ENFORCEMENT

One of the biggest drivers of falling consumer confidence for both B2C and B2B trading is the inconsistent application of the rules and changeable costs to clients. This spans from differences in enforcement between member states to unpredictable pricing through online platforms, and even different approaches to paperwork by individual customs inspectors.

While delays in themselves make it challenging to manage customer expectations and experience – which is central to the luxury offering – the lack of a predictable timescale for delivery can make it even more challenging. This is the case both at the national customs border and within the destination country as couriers enforce their own charges and checks. The potential for varying delays is considerable. In some cases, members report only a delay of a few days, in others, it is much longer.

The impact of this is that businesses must weigh up the risk of alienating customers by publicising the longest potential delay window (thereby driving customers to competitor brands within the EU), or alienating customers through perceived poor service when longer than expected delays do take place. It is a source of particular frustration that this takes place in the EU where standardisation is so prevalent in other areas.

RETURNS

One of the biggest areas of challenge relates to products that are returned. Many businesses use online platforms for their sales and factor taxes etc. into the initial price presented to the consumer. This is especially the case with smaller businesses for whom the cost of running their own platform would be prohibitive.

They do this in order to ensure that the purchase is as frictionless as possible and that customers have the best experience possible – something vital to the luxury experience. However, it leads to challenges with the administration of refunds, especially when administered through online platforms such as Shopify. Businesses can be forced to credit the full order, which would include the proportion of VAT and duties paid by customers which some members then struggle to recover.

While some brands have opted to split out the taxes and charges from the main product price, this is a less positive customer experience. In a hyper competitive marketplace such a luxury, this can be the difference between customer retention and loss. Furthermore, this would still place the onus on the brand to recover the taxes and charges from the 3rd party logistics provider, adding to the administrative burden, which is especially taxing on smaller businesses.

SAMPLES

One further challenge that luxury brands have faced is the challenge of getting samples, free gifts for influencers or tester products for journalists into the EU.

This kind of exporting is essential to luxury businesses' marketing plans as it is critical to building brand awareness, encouraging repeat trade and delivering a high quality customer experience.

The challenge that many brands are facing is that courier companies are unwilling to ship products valued at £0. Members also highlighted the risk of sending high value products to journalists who would not pay customs charges, meaning the product is tied up at customs for long periods of time – representing a considerable value of stock that cannot be realised.

SUSTAINABILITY

One of the other areas raised by members as a concern is the varying approaches to sustainability across the UK and EU. While there are significant concerns about the EU's developing approach to packaging, waste and ecodesign regulations, the current member state-led approach has led to considerable challenges in adapting products and packaging to meet new requirements.

The luxury sector has embraced the need for sustainable business practices and leads the way in delivering meaningful change to its business model to protect the environment. However, the implementation of specific regulations has presented challenges, and in some cases, risks harming the environmental gains the sector has made. For more information regarding these issues, please reach out to our public policy team.

"This clearly creates challenges for us to monitor and manage the requirements of each country and ensure our initiatives that are designed to reduce our environmental impact meet the regulations in each country" *Retail COO*

For the purposes of UK/EU trade however, a plethora of differing requirements, regulations and laws governing packaging, use of plastics and ecodesign has led to compliance challenges for UK businesses seeking to export. Given the central role packaging and presentation of shipped goods has in creating the aura of luxury and delivering a positive customer experience, these regulations are of particular interest for the sector.

Recommendations

While businesses have sought to address these problems through partnering with 3rd party logistics firms, establishing EU-based entities to smooth the export process or other such costly and complex approaches, both member businesses and Walpole believe that the challenges faced by brands could be better addressed by some small policy changes targeted at improving trading without reopening the Brexit debates.

The recent improvements heralded by the Windsor Agreement demonstrate that there is now a willingness to address some of the challenges that emerged from the 2016-2021 period, and that willingness must now be harnessed to deliver improvements for businesses across the UK.

We recognise that a significant number of these recommendations can only be delivered through the agreement of the EU or other third parties, however, the goodwill and re-engagement generated by the Windsor Agreement as well as the opportunity presented by the TCA Review in 2025, opens the door to deliver these recommendations.

However, the Government also holds considerable influence in the market more generally, and could use its position to convene and deliver meaningful change outside the realms of UK EU diplomacy.

BILATERAL AGREEMENTS

The export and investment partnership agreed between the UK and Italy has been cited by members as an example of how the Government has acted to begin the process of streamlining exporting into the EU.

The Government should seek to strike further such deals, especially with France – a key market for the UK luxury sector – and Spain – where members raise particular concern about the challenges of getting beauty products into the country.

VAT

The UK Government should seek an agreement with the EU on VAT cooperation. This would reduce the need for an intermediary and therefore simplify trade for some businesses. Likewise, the UK should work with the EU to encourage them to increase the €150 Import One Stop Shop threshold. The existing US threshold of $800 would act as an excellent baseline to aim for.

SANITARY, PHYTOSANITARY AND VETERINARY CHECKS

The checks on food and produce entering the EU from the UK is a considerable barrier to trade. The UK Government should seek a veterinary agreement with the EU in order to reduce this barrier. If modelled on the New Zealand-EU agreement, it would not present a barrier to Free Trade Agreements with third countries, nor would it require dynamic alignment, as it is based on an equivalence arrangement.

RULES OF ORIGIN

While larger-scale measures, such as rejoining the Pan-Euro-Mediterranean Convention on Rules of Origin, are beyond the scope of this paper, which seeks to provide smaller-scale recommendations, the challenges around cumulation and RoO must nevertheless be addressed.

"We have just had a nightmare getting vines into the country and out of the now obligatory government warehouse, where they were not kept in optimum storage conditions. It was touch and go whether they were still in a condition to plant."

Winemaker

In the interim, should these larger scale measures be impossible, and we note the current review of the PEM Convention, alternative measures should be put in place to support businesses with the significant costs they are facing.

INVESTMENT IN TRADE RESEARCH

The Government rightly offers tax incentives to innovative businesses which invest in research and development, likewise, those who register new patents are incentivised through the Patent Box scheme. It also rewards those firms which invest in new and more efficient plant and machinery through the 'full expensing scheme'.

However, there are no similar incentives for companies which invest in trading internationally, despite the considerable costs of doing so and the Government's stated ambition of boosting exports to £1 trillion by 2030. The introduction of a tax credit or incentive for those firms which invest in researching and building international trading opportunities should be recognised in the same way that the other investments above are supported.

THIRD-PARTY LOGISTICS AGREEMENTS

The Government has considerable power to bring together businesses and other stakeholders. If it was able to bring together third-party logistics organisations and industry to agree a common approach between 3PL firms regarding how they will handle shipments into the EU, this would represent a small but significant easing of trading challenges without requiring the EU's agreement.

CONSUMER CONFIDENCE CAMPAIGN

To address the belief among European consumers that buying products from the UK is more costly, complex and subject to delays, the UK Government should work with the industry to build a consumer-facing advertising and media campaign to allay these fears and encourage customers to buy from the UK. Likewise, to address the concern among European businesses, the UK Government should produce written media for distribution by embassies and at trade shows that lays out the simplicity of trading with businesses in the UK and what resources the Government offers to those businesses trading into the UK.

SCRAP PROPOSED ADDITIONAL IMPORT CONTROLS

We welcome the Government's recent delay to the implementation of the Border Target Operating Model, which would have placed additional pressure on numerous businesses within the luxury sector. Business would welcome certainty around the implementation of these measures however, therefore a longer-term delay – rather than a series of 3 month long extensions – would be welcome.

COMPETITIVENESS

The UK Government should recognise that the new trading arrangements with the EU represent a reduction in the competitiveness of the UK compared to our previous position and undertake a wide-ranging review of how to make up this competitiveness gap.

This should include consideration of macro-economic issues, such as the impact of increases to corporation tax, but also sector-specific concerns, such as the loss of Tax-Free Shopping, which the EU offers – and benefits from increased tourist spending.

Conclusion

The challenges of importing and exporting to the EU under the Trade and Cooperation are not exclusive to the luxury sector.

However, there are specific challenges that affect the sector's business models more deeply owing to the fundamental nature of the way the sector operates, and the centrality of Europe to the sector. This is why the sector cannot simply replace EU trade with non-EU trade.

The result of these changes to the trading relationship has been considerably increased costs and reduced competitiveness in a sector which is an export superstar and growth industry for the future. In hampering the success of the sector this also impedes the Government's own objectives, in particular delivering sustainable long-term growth and its ambitious export targets.

While none of these recommendations will individually revolutionise trade and return the UK's competitive edge, together they would be a step-change in ease of doing business while not re-opening old debates.

About Walpole

Walpole is the UK's only business association for luxury brands, speaking on behalf of more than 250 of Britain's finest and most famous brands across a wide range of sectors. A not-for-profit organisation, Walpole members include Alexander McQueen, Burberry, Claridge's, Glenfiddich, Harrods, Rolls-Royce Motor Cars and Wedgwood. Alongside these household names, 70% of Walpole members are SMEs, from exciting new brands like Makers Cabinet to craftspeople like Kathryn Sargent.

Walpole is recognised in both Westminster and Brussels as a reliable and expert voice on the concerns of the sector and its businesses.

With a mission to promote, protect and develop the business of luxury in the UK, Walpole brings its members together to collaborate and connect both online and in-person. Key events include the annual British Luxury Summit and the Walpole British Luxury Awards. It also provides a collective voice for luxury on key topics, commissions industry-leading research and works with government on issues affecting the sector.

The luxury sector is worth £48bn to the UK economy. It is a British success story which combines domestic manufacturing with world-leading export prowess. 70% of UK luxury businesses manufacture domestically while exports account for 80% of sales. It is a significant growth industry – with the sector growing by nearly 10% pre-pandemic, which contributes over £7bn to the Exchequer.

Walpole

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