



PARCEL DELIVERY OPERATORS VIEWS ON RURAL PARCEL DELIVERY IN SCOTLAND

Report for

Citizens Advice Scotland

21 April 2017

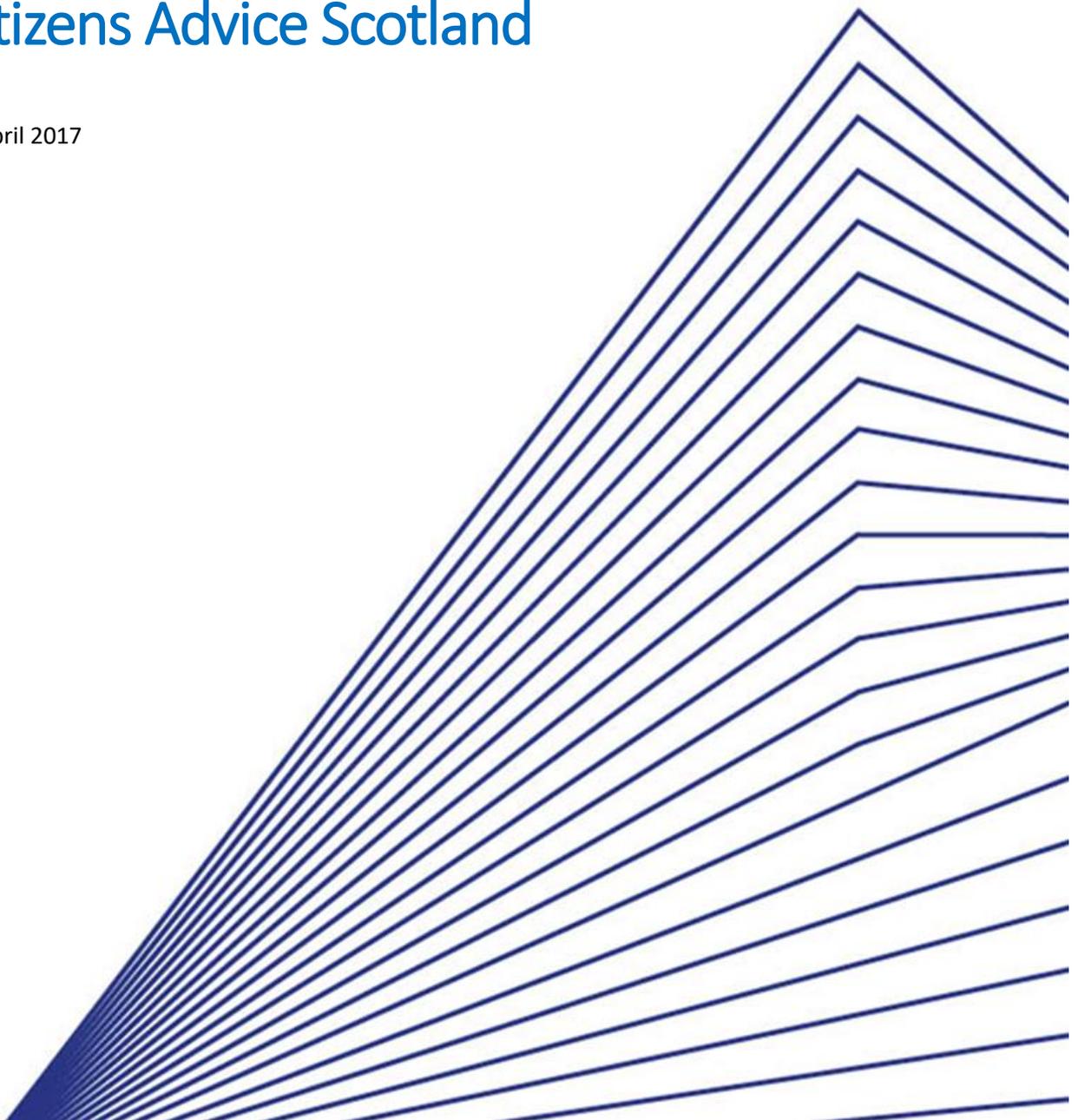


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1 Background

The Consumer Futures Unit (CFU) puts consumers at the heart of policy and regulation in the energy, post and water sectors in Scotland. Part of Citizens Advice Scotland, the CFU researches and gathers evidence, which is used to improve outcomes for consumers.

In 2010, Citizens Advice Bureaux in the north of Scotland raised the concern that consumers who live in rural Scotland and shop online can find that they have to pay extra for delivery. More recent research conducted by the CFU found that while fewer retailers applied restrictions or surcharges to deliveries to the Highlands and Islands, the cost of delivery surcharges has risen significantly against a baseline of flat prices for standard delivery elsewhere.¹

The CFU aims to encourage innovation in the rural parcel delivery industry, recognising that the higher delivery costs faced by rural consumers are normally caused by the higher costs faced by delivery operators in rural areas. The CFU therefore commissioned Triangle Management Services research to explore the opinions of key people in the parcel delivery industry in rural Scotland as to what changes could be made or initiatives developed to reduce the cost of parcel delivery to rural consumers. The CFU's objective is to design policy solutions to alleviate the delivery challenges and identify any areas of consensus that can be converted to early actions.

2 Research Methodology

Triangle's research team conducted a series of expert telephone interviews with qualifying parcels carriers and other transport service providers operating in the Highlands and Islands, in order to gather their views regarding the issues relating to higher delivery costs in rural Scotland. A total of 17 interviews were completed during January and February 2017.

The list of participating companies is included in the Appendix (7.4), together with a copy of the discussion guideline (7.5).

Further information about Triangle Management Services is shown under the Appendix (7.6).

¹ *"The Postcode Penalty: The Distance Travelled"* (Citizens Advice Scotland)

3 Executive Summary

The size of the consumer parcels market in the Highlands and Islands is a fraction of the size of the total UK marketplace. It also probably presents the most extreme logistical challenges to parcels carriers in the UK, because of the vast distances, difficult terrain, scattered delivery points and numerous stretches of sea to cross.

This combination of factors inevitably means that the cost of delivering a small volume of parcels is higher than in a built-up urban area, i.e. the 'drop density' is low. However, there is an established network of national and regional carrier partnerships working together to meet retailer and consumer delivery needs. In addition, a considerable amount of consolidation capability has been developed over the last two years, in a bid to reduce costs and improve quality of service for all stakeholders – parcels carriers, retailers and consumers.

However, delivery lead times are slower than in mainland UK and consumers are possibly paying inconsistent surcharges for home delivery. The handover between national and regional delivery partners is not seamless yet, because end-to-end tracking is not fully implemented across the Highlands and Islands. The parcels operators acknowledge this, but also see that there is an opportunity to work more closely with the retail industry, so as to improve customer service through better communications, awareness-building and delivery solutions tailored around local needs.

There will always be a disparity in delivery costs between single drops in sparsely populated areas and multiple deliveries to a collection point. The fact is that, outside an urban area, consumers will pay lower delivery fees if they collect their parcels, but pay a premium for home delivery. The carriers believe that across the varied geography of the Highlands and Islands, consumers living a long distance from the nearest public services are more likely to prefer home delivery, whilst those living in a small island community may favour the option of collecting their purchases from the village store or other local collection point.

However, the delivery industry believes that the consumer should be given a choice of delivery options wherever possible, but that this should be supported by more consumer education and the promotion of best practice in the online retail industry as to the clarity of delivery terms and fairness of surcharges. Retailers, after all, control the delivery prices they want to charge their customers, not the parcels carriers.

The parcels industry as a whole already works to very tight margins and continually looks to make cost savings through improved efficiencies. There are no radical ways in which delivery costs for consumers in the Highlands and Islands can be reduced overnight. However, operators believe that better value for money can be provided, through the gradual improvement of delivery speeds, customer communications and further development of alternative delivery solutions.

Drone delivery may take a few years before it is commercially available, and indeed, consumers in the Highlands and Islands may reject the impersonality of such a service. In the meantime, the parcels industry supports the idea of collaborative working to explore more community-friendly solutions, such as local PUDOs and possibly hybrid public/private PUDO schemes. The industry does not appear to have fully explored the potential of air freight, which would help retailers match delivery lead times available across most parts of the UK. There is also scope for further alliances within the regional parcels industry, or for the national carriers to provide these companies with business development support and possibly some shared resources, such as IT, training and driver recruitment. After all, it is the local courier that is representing the retailer's image at the doorstep.

Some of these initiatives are emerging, but a more co-ordinated approach, supported by public sector awareness campaigns for consumers and local authorities, could lead to a more consistent delivery service, greater confidence in online shopping and higher levels of customer satisfaction.

To conclude, therefore, the research found that:

- There could be greater transparency in parcel delivery prices, specifically the add-on cost to the Highlands and Islands; both by the parcels operators and retailers.
- The delivery price paid by shoppers is not generally what the carriers charge the retailers.
- The final surcharge charged is the retailer’s decision.
- There is no marketplace consensus on what constitutes a fair surcharge.

3.1 Industry terminology

The following table provides some explanations for industry terminology used in this report.

ADR	<i>Accord ... Dangereuses par Route</i> – regulations controlling the transport of dangerous goods by road (includes lithium batteries, chemicals and perfumes)
B2C vs. B2B	Business to Consumer (delivery to a residential address) vs. Business to Business (delivery to business premises)
Click & Collect	Online purchase and collection from a retailer’s physical store
Consignee	Parcel recipient/addressee
CPC	Certificate of Professional Competence for driver training
Dead mileage	Empty running of freight vehicles on return journeys
Drop density	Volume of parcels to be delivered within a given area per delivery round
‘Last mile’	Delivery from the local depot to the consignee, either a home address or pick-up point
POD	Proof of Delivery, such as signature capture
PUDO network	Network of parcel Pick-up and Drop-off locations, such as parcel shops and self-service parcel lockers
Reverse collections	Collection of goods to be returned to the retailer or manufacturer, for replacement, repair or refund
Road Equivalent Tariff	Scottish Government initiative to link ferry fares to the cost of travelling the equivalent distance on land
Trunking	Long distance transport from national sorting hubs to regional depots
USO	Universal Service Obligation. See section 5.5.1

Table 1 Selected industry terminology

4 Market Background

4.1 Surcharge areas in rural Scotland

Scotland comprises some 476 postcode areas, of which 173 (36%) normally attract a delivery surcharge for consumers buying from many online retailers in the UK. These surcharge areas, which can be loosely referred to as the Highlands and Islands, are in the remoter regions, such as the Western and Northern Isles, Western coastline and central mountainous Highlands. The map below illustrates these postcode areas.

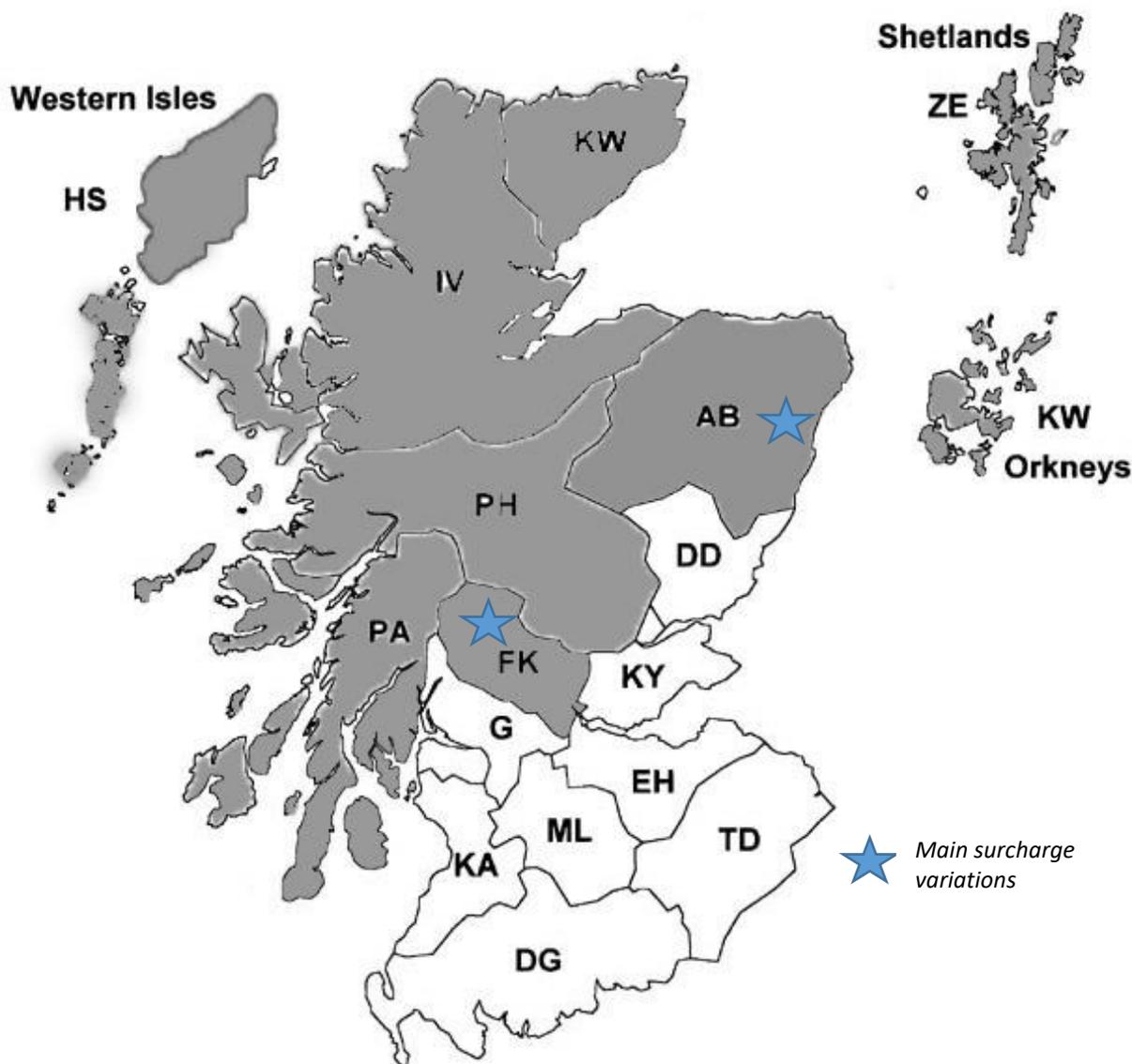


Figure 1 Map of frequently surcharged postcode areas in Scotland

There are surcharge variations across the national parcels carriers, particularly in the AB (Aberdeenshire) and FK (Falkirk) postcode areas. Some carriers do not surcharge any AB and FK postcodes, whilst other carriers do. This is reflected in the delivery prices charged by the retailers that use such carriers. Appendix 7.1 lists those postcode areas which are commonly surcharged, plus a few areas (33) where surcharges are also incurred according to the carrier used.

4.2 The Highlands & Islands position within the total UK parcels market

The Highlands and Islands area poses something of an anomaly; it represents 22% of the national land mass, but has a population size of around 1 million (1.6% of the UK total). Per capita income, however, is just 84% of the national average.

(See Appendix 7.3 Background market metrics for more detail.)

4.3 National and local parcels carriers serving the Highlands & Islands

The table below shows 29 separate parcels carriers serving the Highlands and Islands areas. Half of these are large national operators, with their own fleets, sorting hubs and depot networks of various sizes. The other group of carriers are largely regional specialists, operating within one or more areas of Scotland, including the Highlands and Islands. The list of regional specialists is not exhaustive and shows the largest companies; however, there are a number of other smaller local operators that support both the national and regional carriers.

For the most part, the ‘national’ carriers do not provide an end-to-end service under their own brand for the Highlands and Islands, but use the regional specialists to deliver on their behalf in the more remote areas. Some of the local carriers partner with more than one national operator.

It is worth noting that the UK parcels industry has been consolidating during the last two years and the number of brands is likely to decrease as a result. FedEx acquired TNT Express in 2016 and is in the process of amalgamating the two organisations; whilst, during the same year, Deutsche Post DHL acquired UK Mail Plc. Deutsche Post DHL is the German national postal operator and a leading global postal and logistics services provider. During the course of this research DPDgroup UK announced that Interlink Express (part of DPDgroup) was to be re-branded as DPD Local

National Carriers	Regional Specialists
APC Overnight	Arran Haulage
DHL Express	B Mundell
DPD UK	Caledonian Courier Company Ltd
DPD Local (previously Interlink Express)	Eagle Couriers
DX (Group) Plc	Hebrides Haulage Ltd
FedEx	JA & GD Nicolsons
Hermes UK	M&H Logistics Ltd
Parcelforce Worldwide	Maclennan Motors
Royal Mail	Menzies Parcels
TNT Express (part of FedEx)	Northwards Ltd
Tuffnells Parcels Express	ParcelinQ
UK Mail Plc (part of Deutsche Post DHL)	Shetland Transport
UPS	Skye Express
YODEL	Streamline Freight
	Woody's Express Parcels

In the Scottish parcels industry there has also been a trend towards consolidation, driven by Menzies Parcels, a division of Menzies Distribution. Menzies Parcels has been building a carrier neutral consolidation service across mainland UK, Scotland, and in particular, in the Highlands and Islands. As a result, a number of smaller regional carriers have become part of Menzies Parcels.

The map below shows the locations of the depots and distribution centres of the main national and regional delivery companies in Scotland. There are 100 of these, of which 25 are located in the Highlands and Islands. (In addition to its main depots shown below, Royal Mail also has more than 335 delivery offices across Scotland.)

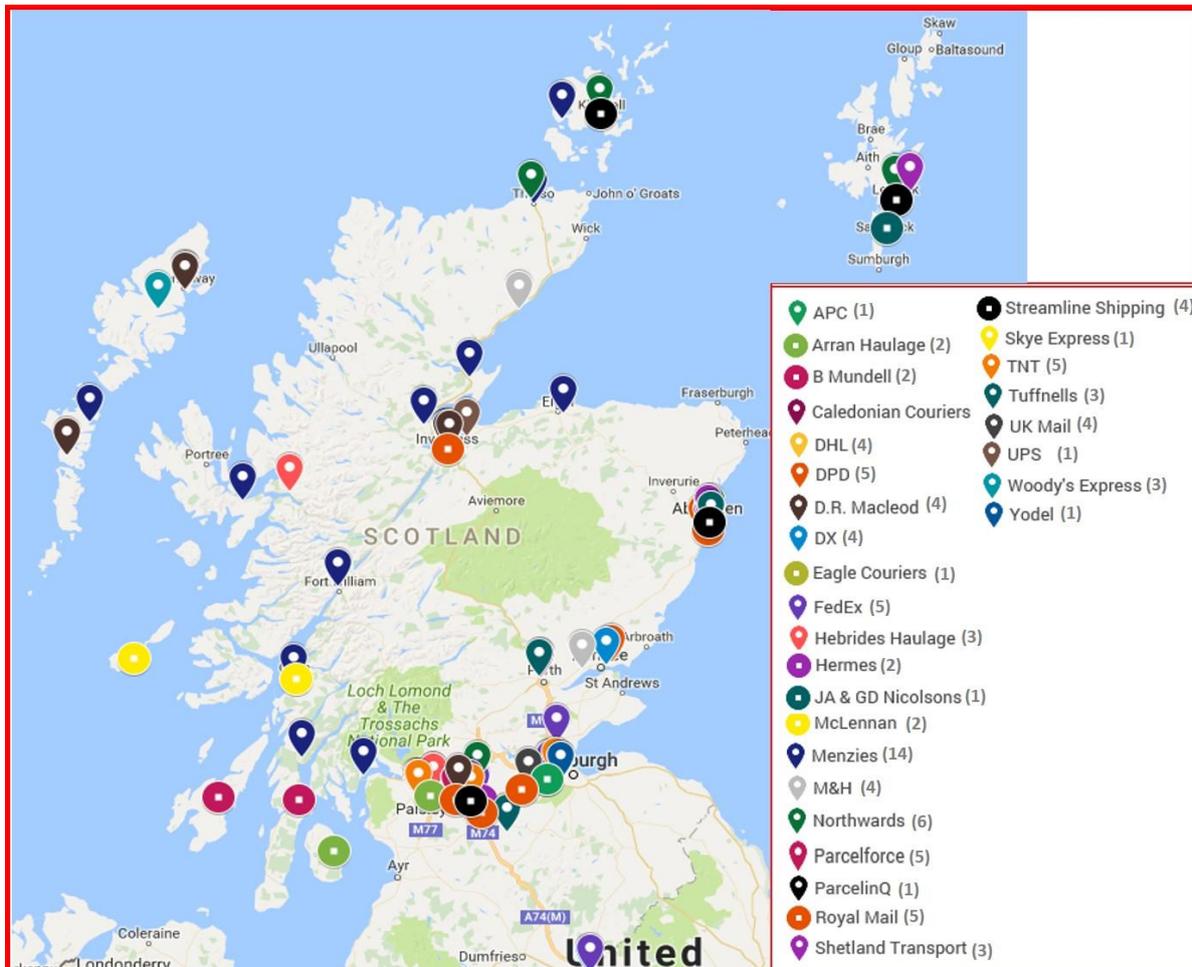


Figure 2 Map showing main carrier depots serving Scotland

4.4 Current published price differences for consumer parcels services

Based on published rates for consumer parcel services (i.e. for sending a parcel), it can be seen that a higher rate is usually charged from a mainland address in England to an address in the Highlands and Islands, compared with an English mainland to English mainland address. The chart below shows the percentage difference for a selection of carriers and reseller channels; ranging from 8% to 203%.

There are no price differences for sending a parcel to the Highlands and Islands with DHL, Collect Plus, Royal Mail and Parcelforce, via their direct consumer sales channels. Consumer parcel services represent a small proportion of total traffic for the carriers shown below, but they generate a higher margin for the operators. Services are accessed either directly from the carrier (e.g. UK Mail's *ipostparcel's* online channel) or from one of the many online resellers, such as Parcel2Go or ParcelHero.

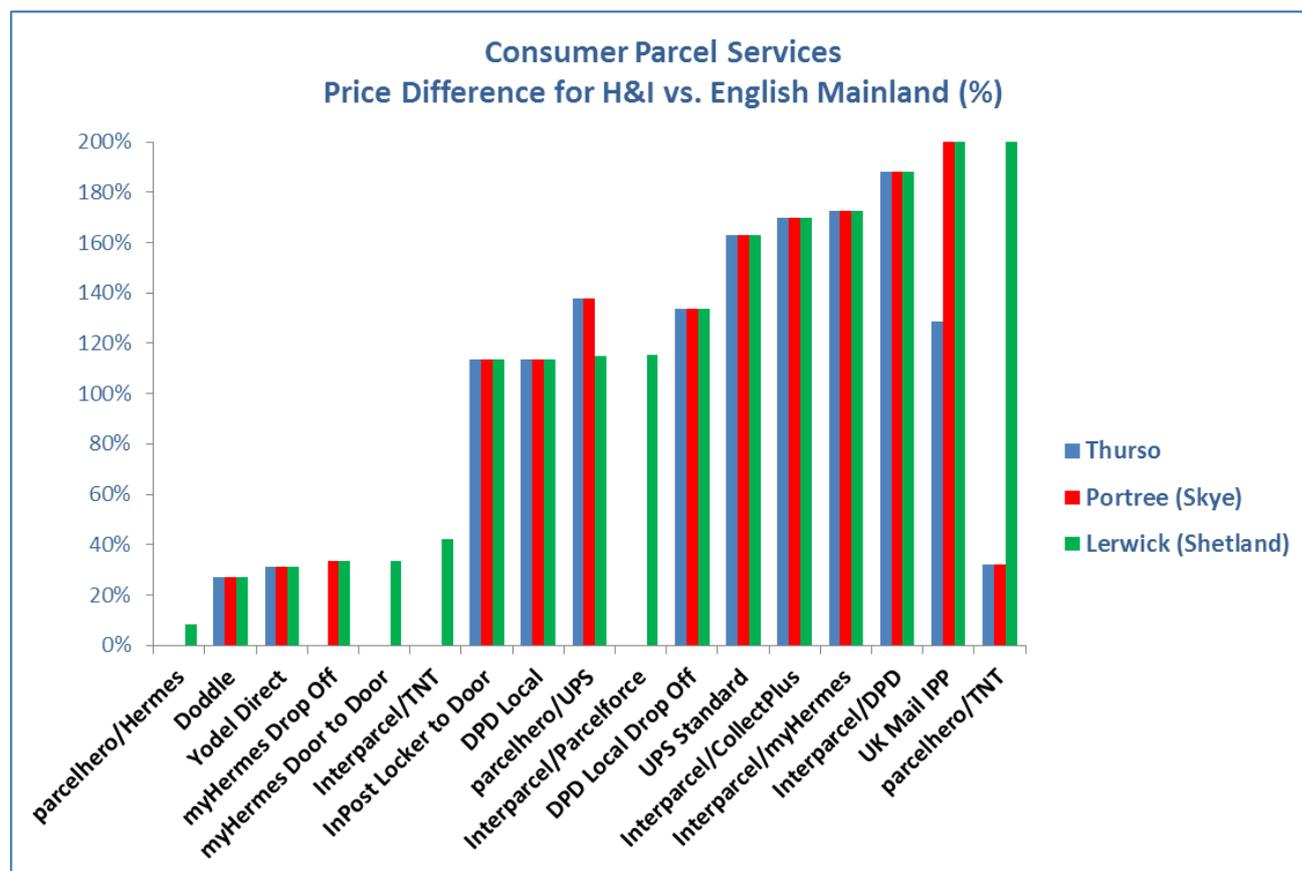


Figure 3 Price differentials for sending a 2kg Medium-sized parcel from the Midlands to selected H&I destinations using selected retail parcel services. (No bar indicates no surcharge.)

The above chart is purely illustrative of pricing differences and is not an exact picture of surcharge levels incurred by retailers, who benefit from volume-related discounts. The resellers also have a discounted rate from the national carrier, but can set their own price levels by service. Apart from consumer-focussed services, such as the Post Office and CollectPlus, the majority of national carriers use the retail channels as a tactical tool for building additional volume for their networks.

5 The Delivery Industry Practice and Views

5.1 Importance of the Highlands & Islands within the business

The Highlands and Islands are important to the delivery industry in different ways. All respondents said the region was ‘strategic’ for them, but the reasons vary between the national and regional operators.

For **the national operators**, the Highlands and Islands represent an average 1% of their total domestic parcels traffic. The percentage share ranged from 0.60% to 5% across those interviewed, and this variation is due to the amount of B2B parcels within their traffic mix (i.e. deliveries to business addresses). The Highlands and Islands tend to account for a more important share amongst those carriers with a higher B2B volume.

However, despite the low monetary value, there is a strategic value for the national parcels carriers being able to provide a delivery service to the Highlands and Islands. In particular, their large customers (retailers, manufacturers and distributors) expect nationwide coverage, with no regional exceptions.

One national carrier said that: *“the ability to deliver to Highlands and Islands is a key part of our service offering and a key strength for us when trying to attract new customers. We take the*

Highlands and Islands seriously and do not want to marginalise these areas, but want to provide the best service possible. We see it as an opportunity to drive revenue.”

For **the regional specialists**, the Highlands and Islands are critically important to their businesses and represent a very high proportion (from 60% to 100%) of their traffic, both in terms of delivering to and collecting parcels from this region. It is important to remember that these local carriers also make reverse collections (collecting returned goods), which could be as much as 2% of all traffic (both consumer and business parcels).

The regional specialists have built their livelihoods around serving their localities. Some also provide deliveries across Scotland, southwards to England and even internationally. Apart from Menzies Parcels, the regional specialists are small family-run companies, often only with one depot. (See Figure 2.)

Their customers are mainly the national carriers, with a small share of their business coming from Scottish shippers. Those carriers specialising in the Islands tend to focus either on the Western Isles or the Northern Isles, for geographic reasons, and they also deliver on behalf of other regional carriers.

5.2 Importance of the Highlands & Islands to retailers and carrier customers

On-line sales volumes generated in the Highlands and Islands reflects the share of national parcels traffic reported by the national carriers. The *IMRG/Metapack Delivery Index Report*, published monthly, regularly shows that the Scottish Islands account for 0.05% of total domestic orders sent by the UK's top 220 online retailers; somewhat smaller than the Scottish Islands' share of the UK population at 0.2%. (This obviously excludes the Highland areas and smaller retailers.)

Carriers reported that the major retailers have to offer national coverage to consumers and are very demanding in terms of service levels, expecting the quality of service and delivery lead times to be as good in the Highlands and Islands as they are in Glasgow. Parcel returns are equally important to many retailer clients, so the ability to collect and consolidate returned goods efficiently supports the retailer's stock management.

There are reportedly higher levels of customer loyalty amongst consumers in the Highlands and Islands, which offsets the relatively low volumes involved. Loyal customers make repeat purchases and cost the retailer less to retain, in terms of price offers and intensive marketing.

5.3 Current services and practice

There is coverage of all areas of the Highlands and Islands, but the service levels and the actual delivery company covering the last mile varies by postcode area.

The national operators

The Highlands and Islands present geographical and cost challenges for the national carriers. Therefore, almost all use one or more local service partners to extend their delivery reach.

Most national carriers have one or more regional depots, usually in Inverness, Aberdeen, Glasgow or Edinburgh; here they use their own delivery fleets and employed drivers to deliver in the local area or within easy reach of the depot. They use a variety of subcontractors and delivery partners to obtain better rates than they can achieve themselves in the remoter areas due to the investment required and the resulting economies of scale.

The national operators deliver to postcode areas where the population size generates sufficient parcels volume for them to reach cost effectively from a Scottish hub. These are typically DD1 to DD7, ML, EH, G, IV1-3, AB urban areas, KY, TD and DG. (Unshaded areas in Figure 1.)

Delivery to remote areas, such as the Highlands and Islands, often conflicts with the national carriers' standard service levels and poses a problem for their supporting tracking information. If ferries to certain islands only run three days a week or are cancelled due to adverse weather conditions, then a next day service cannot be offered.

Similarly, due to the low parcel volumes, some of the regional partners only go to certain postcodes on certain days of the week. This limits the ability of the national carriers to provide a consistent service level to all areas of the Highlands and Islands, as well as across the UK.

As a result, the national carriers generally publish delivery lead-times to the Highlands and Islands that are between one and five extra working days longer than for most of the UK.² Many carriers with time-definite services (i.e. guaranteed delivery or collection by an agreed time) do not offer these services in remote areas.

The regional specialists

The regional carriers largely specialise by geography, according to where they first established their businesses and to the parcel volumes they receive:

- The North and Northern Isles (Shetlands, Orkneys)
- Central Highlands
- Argyll and the Western Isles (Hebrides)

All operate their own delivery fleets and use employed drivers, in preference to sub-contract drivers.

The following map shows the depot locations for the regional carriers located in the Highlands and Islands. There are 25 of these.

² This is also the case for Northern Ireland, Isles of Scilly and Isle of Wight.

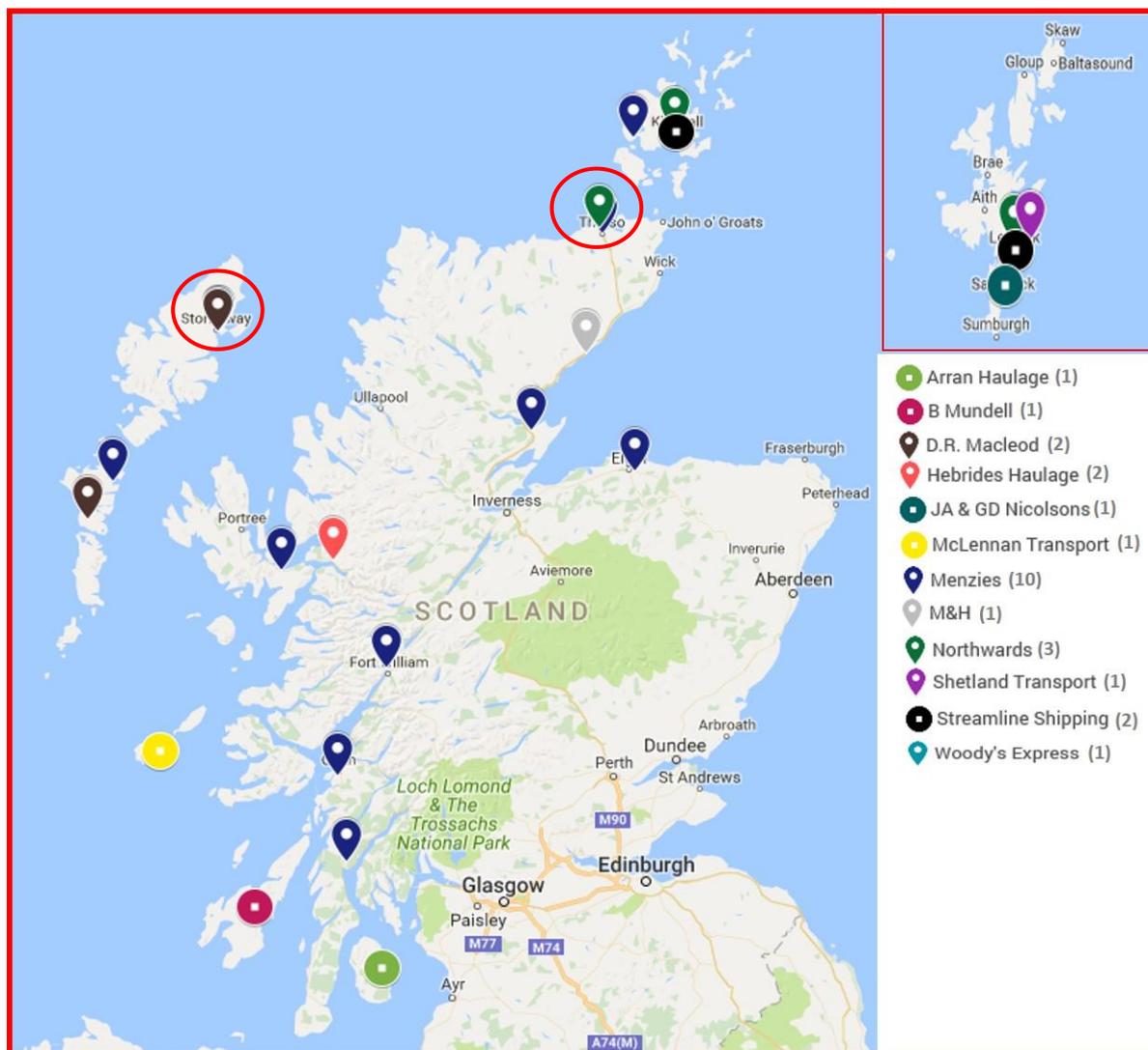


Figure 4 Map showing depot locations in the surcharged areas

Depot Clusters:

Stornoway – Woody’s Express, DR Macleod, Hebrides Haulage and Menzies Parcels all have depots. Thurso – Menzies and Northwards are based here.

Some of the larger regional specialists sub-contract to smaller operators to extend their area coverage, but this is for traffic to areas where the volumes do not justify them using their own vehicles and drivers, and where they do not have the necessary infrastructure; i.e. the smaller islands.

Most regional carriers also carry pallets and other freight types, so that vehicle journeys can be maximised. A number of the larger regional carriers have started to embed their tracking technology into the national carriers’ systems, so that customer services become seamless for the consumer or retailer, when checking a parcel’s whereabouts.

5.4 Pricing model

Across the board, both the national carriers and the regional specialists need to offer their respective customers competitive prices.

The parcel delivery price quoted to the retailer is based on two components – the national carrier’s trunking cost to the regional service provider’s depot and the ‘last mile’ local delivery, which is the section which incurs the surcharge.

Both shipper and carrier customers would prefer a uniform price for the Highlands and Islands region as a whole. A few national carriers, however, require separate prices from their regional partners for onshore versus offshore delivery.

Pricing is on a per parcel basis, but this price is usually based on the customer's traffic profile. The key factors that will affect this price are:

- Annual volume
- Percentage split by onshore vs. offshore
- Service level required
- Parcel weight and volumetric size.

The retailer may be charged a higher surcharge for offshore than for onshore deliveries, regardless of whether the delivery is carried out by the national carrier's own drivers or partners. Whilst the carrier's own fleet gets a better drop density in the area that it covers, any extra margin they make on their own routes is offset against any higher partner rates. This enables them to provide customer pricing consistency.

Those carriers that provide a delivery service within Scotland are able to offer an 'intra-Scotland rate' which includes no surcharges, because the overall mileage is lower to the Highlands and Islands from Edinburgh, for example, than from Corby. However, even for the 'intra-Scotland' services the delivery lead times are still longer to the Highlands and Islands than to the urban areas in Scotland.

The regional specialists charge the national carriers an agreed rate for delivery to the areas they cover. As is the case between the retailers and the national carriers, the prices are negotiated according to the volumes involved and the service levels required. Some national carriers, particularly those with strong B2B credentials, are more demanding in terms of the fastest available delivery service, but are prepared to pay for this. As a result, different national carriers are charged different local delivery rates.

In some localities there appears to be a further layer of consolidation, with the local courier delivering on behalf of one or more regional carriers. This may result in an increased rate paid by the national carrier, because some regional carriers also make an additional charge where they themselves have to use subcontractors.

5.4.1 Costs incurred serving the Highlands & Islands

The survey looked at the various operating costs incurred for delivering to the Highlands and Islands, in order to identify which are the most onerous; ferry rates, fuel, driver hours, subcontractors or other direct business costs. One regional carrier said that it costs 200%-300% more to deliver a parcel to the Highlands and Islands than to Glasgow, for example. For the national carriers, the cost for delivering the 'last mile' in the Highlands and Islands is probably close to 60% of the total transport cost.

The key message emerged that the end-to-end parcel journey needs to be better understood by retailers and consumers, in order to analyse the costs involved and build better consumer awareness. The cost of delivery to the Highlands and Islands is higher than in urban areas in Scotland and the rest of the UK due to three key contributing factors:

- i) The majority of traffic flows are from South of the border into Scotland, therefore the national carriers incur empty running costs on the return leg of the journey back to central sorting hubs.
- ii) The geographic characteristics of the Highlands and Islands results in long distances between delivery points, and
- iii) The drop density is low due to the scattered population.

One regional carrier was keen to make a point about population density and remoteness, although the Isle of Barra is an extreme example of a remote destination.

“The population is less than 1% up here and costs to deliver items are 4 or 5 times more expensive. To get to the Isle of Barra it takes 5 hours and 10 minutes on the ferry. You can fly to New York City from Glasgow quicker!”

The national carriers incur additional costs even before the delivery process is started in the Highlands and Islands. Once a parcel arrives at a UK mainland sorting centre from the retailer’s warehouse (most likely in the Midlands), it is then trunked to the carrier’s depot or sorting centre in Northern Scotland, before going out for regional delivery via a partner. The total delivery cost charged to the retailer starts with the trunking from the central sorting hub to Northern Scotland, which inevitably means returning empty, so, the cost of fuel and driver hours are doubled for this leg of the journey.

This is no different from deliveries made to other points of the UK that incur surcharges, such as Northern Ireland, Isle of Wight and the Scilly Isles. However, unlike to these areas, the Highlands and Islands leg of the journey involves substantially long distances and also usually entails returning empty. In addition, there may sometimes be more than one delivery partner involved, each requiring a margin.

Within mainland UK and to some extent from Northern Ireland, the national operators are more likely to be able to reduce the amount of ‘empty mileage’ by collecting other loads on the return journey.

Figures 7 and 9 illustrate some of the distances and driving times involved from the Midlands to selected delivery destinations in the Highlands and Islands. In many cases the regional leg of the journey can represent from a quarter to nearly half of the total mileage involved. The Midlands was used for this exercise because many of the largest retailers and fulfilment companies have their national distribution centres in this area, with easy access to the M1 and M6 motorways.

As a result, the majority of carriers interviewed pointed to the fuel costs and driver hours required to cover the various distances as being the main contributors to the higher costs.

Fuel

Fuel tended to rate as the first or second highest cost, with the share of the total ranging from 10% to 20%.

On the Islands the regional specialists said that fuel costs are 15% higher than in Aberdeen; they reported paying 5-10p per litre more than in central Scotland. However, the distances covered on the Islands are lower than for those carriers covering the Highlands.

The national carriers have to bear the trunking costs, which, as mentioned earlier, generally includes returning empty, thereby doubling total trunking costs. One national carrier estimated this to account for 15% of total costs.

Driver Hours

The cost impact of driver hours ranged from joint first to fourth in importance, with the variation due to type of carrier and level of driver experience required.

Respondents mentioned increases in the national minimum wage as a contributing factor. Most operators prefer the employed driver model, which is more expensive than using self-employed drivers, due to the overheads. However, employed drivers were thought to bring greater loyalty and a higher quality of service. In the case of the regional specialists, local employment security for the community is also important.

The regional carriers require drivers of a higher calibre, who are familiar with the roads. The roads are notoriously poor in the Highlands and Islands.³ Also, depending on the traffic load mix, some carriers require HGV drivers, who are governed by EU legislation on working hours and need additional training.

In order to retain and attract drivers, costs are reportedly slightly higher on the Islands than the mainland.

Ferries

Ferry fares directly affect those carriers serving the Northern and Western Isles, and some reported these costs as accounting for almost a third of their total costs, but this includes driver hours on the ferry. They pass these costs on to the national and larger regional carriers.

Journey time, traffic volumes and ability to maximise vehicle loads all affect the add-on cost per parcel. One carrier reported that the ferry cost added a fraction of a pound per parcel for a full trailer load compared with up to £3 per parcel for one pallet load.

Ferry journeys are obviously more costly to some islands, such as the Shetland Isles, than to others due to the longer crossings. One respondent quoted that *“The ferry journey is twice the cost of the road stretch, e.g. from Aberdeen to Lerwick costs £575 one way; from Glasgow to Aberdeen it is half this cost or a third of the total journey.”*

CalMac Ferries operates services to and from the Western Isles and Northlink Ferries is the main service provider to the Shetland Isles and the Orkneys. Due to the Road Equivalent Tariff there has been an increase in private vehicle traffic in the Western Isles, and it is suspected that more consumers are collecting parcels from the mainland.

Some respondents pointed to the fact that tighter regulations for vehicle payloads on the ferries has led to a tendency to err on the side of caution, whereas previously payloads may have been treated more ‘generously’.

Local partners

The cost of using local delivery partners contributes a varying amount to total delivery costs. It depends on the regional carrier’s fleet size and whether one or more secondary couriers are involved. Some respondents were quoting up to 50% of their costs, and another operator estimated that partner costs accounted for 75%-85% of the surcharge made.

National and regional carriers largely accept local partner rates, as it would be more expensive for them to use their own delivery fleet.

A blended price (for Highlands and Islands together) is often negotiated with a partner. The regional operator absorbs some of the losses incurred, but reviews and renegotiates regularly if required.

Other costs

General overheads associated with running a haulage business, such as vehicle maintenance and insurance, are accepted as standard across the UK. Some regional carriers raised the point about wear and tear on vehicles being higher in the Highlands and Islands than in urban areas, due to the poor condition of the roads, whilst some are affected by the salty air in coastal areas. Business rates are also still based on old rateable values and felt to be unfair.

A number of regional specialists mentioned that regulatory costs for the haulage industry are getting more onerous, e.g. driver ADR training (dangerous goods), CPC qualifications, licences etc. to stay within the law. Since all the training courses are held on the mainland, it costs more to send a driver from the islands to the mainland, including travel and overnight accommodation.

³ See Appendix 7.3 Background market metrics

5.4.2 Changes in costs - Highlands & Islands versus mainland UK

None of the respondents reported any cost changes specifically affecting operations in the Highlands and Islands. Ferry rates have largely remained stable. Any cost increases are common to the UK as a whole and regarded as a fixed overhead, such as fluctuating fuel prices, inflation and the national minimum wage.

Most respondents had not increased their tariffs; however, a small number of regional specialists reported that they have had to pass on an increase to their carrier customers in 2017 due to rising fuel and wage costs and the requirement to make pensions contributions.

5.4.3 Current initiatives to reduce costs

There was a high level of awareness of consumer price sensitivities, and respondents agreed that if delivery costs can be reduced, then online shopping levels should increase. However, the parcels industry, at both national and regional levels, works on very tight margins.

The national carriers tend to monitor the extra costs very closely, even if the percentage of traffic to the Highlands and Islands is tiny. They are constantly looking at improving network efficiencies to reduce trunking costs, either through further investments in IT or, in the case of the larger operators, by consolidating other freight types from across other divisions within the company to maximise each journey.

One national carrier switches some of the volumes within their Scottish network to their regional partners, so as to keep subcontractor prices as flat as possible. Any savings are passed to their retailer customers.

Because of their size and scale, most of the regional specialists are not able to reduce prices to their carrier customers due to fixed overheads. However, they do have the flexibility to re-arrange non-urgent deliveries to meet the shipper's budget, thereby minimising low volume high mileage deliveries where they can.

The regional carriers are heavily dependent on keeping parcel (or other traffic) volumes as high as possible to maintain profitability. They constantly work at containing costs by streamlining in-house processes and have been investing in a variety of efficient and innovative working practices:

a) Reducing manual data capture

One regional operator has invested in an integrated IT platform that supports all the national carrier labels and provides end-to-end track & trace through to signature POD capture on a single handheld device. This has reduced time and cost, by replacing multiple manual data capture stages and administration. Other operators have invested in scanning technology to improve efficiencies.

b) Reducing the level of failed deliveries

There have been a number of investments in IT, such as driver-to-consignee communications, allowing the driver to inform the consignee when they are going to be in the area. Some regional carriers are now able to send pre-notification texts to the consignee, offering redelivery options or other delivery options, such as a safe place. Failed deliveries are less likely in remote, rural areas because consignees have usually established, albeit informally, safe places for leaving a parcel with their usual delivery drivers. However, where a secure delivery has to be made and a signature is required by the shipper, any methods for achieving a successful first delivery attempt will reduce cost.

c) Development of alternative delivery solutions

Most carriers support the concept of Click & Collect/PUDO services, whereby parcels are dropped off at a central point for later collection by the consignee. In theory, delivery to a central collection point reduces some costs and surcharges could be reduced or removed for the consumer. These solutions

are explored further in section 5.7 (Potential innovations). Such services are either at an early stage of development in the Highlands and Islands or are at a very local level and informal, i.e. not supported by tracking technology.

d) Maximising load utilisation

It is common practise across the regional carriers to ensure that every trailer and vehicle is as fully utilised as possible. For some this is the main way to keep costs under control, and they will mix pallets and parcels if it makes economic sense.

Some carriers have invested in multiuse vehicles in order to reduce dead mileage, i.e. empty running. Parcels can be transported from the mainland to an island, and freight loads are carried on the return leg.

5.5 Market pressures

There is constant pressure from all quarters to reduce delivery costs and surcharges – from the national carriers on the regional specialists, and from the retailers on the national carriers.

However, the following key points are clear:

- There could be greater transparency in parcel delivery prices, specifically the add-on cost to the Highlands and Islands; both by the parcels operators and retailers.
- The delivery price paid by shoppers is not generally what the carriers charge the retailers, and is usually higher.
- The final surcharge charged is the retailer's decision.
- There is no consensus on what constitutes a fair surcharge.

5.5.1 Why are some surcharges so high?

Both carriers and retailers have to make a profit, so the additional costs delivering to the Highlands and Islands have to be passed on. However, there is an overall lack of transparency as to how the surcharges are calculated, and the carrier respondents were not privy to the pricing policies taken by their retailer customers.

The general thinking is that few retailers absorb the extra costs and simply pass them on, and that more effort could be put into avoiding some of the onerous surcharges. For instance, more retailers could offer a choice of carriers at checkout, thereby allowing the consumer to select a more advantageous regional rate. However, this would require further investment by the retailer to negotiate prices with multiple carriers and to develop their e-commerce platforms. Another obstacle is that the large volume discount offered by the national carriers might be reduced if more than one carrier is used. As was stressed earlier, the large retailers favour the large national carriers that can deliver everywhere.

Pressure from retailers

Most carriers acknowledged that the large retailers generally accept there should be a surcharge for the Highlands and Islands. However, it was felt that retailers would prefer a uniform price nationwide and fail to understand the additional costs involved in serving remote, rural areas (and not just the Highlands and Islands).

It was also suggested that, due to competition in the retail market, many retailers set unrealistic expectations with offers of 'free delivery' and 'next day delivery'. Furthermore, there was a certain degree of indifference to the delivery charges paid by consumers in remote areas. Consumer knowledge was felt to be lacking, particularly regarding the true costs of home delivery in remoter areas, as well as regarding those retailers that offer clear delivery information and lower surcharges.

Pressure from national carriers

The UK B2C delivery market is very price sensitive, with high levels of competition across the national carriers, as well as from Amazon Logistics. Amazon competes with both the leading retailers as well as with the national delivery industry, and in Scotland it operates its own fulfilment centres in Gourock and Dunfermline. Amazon's business model is based on a distribution network that is close to the customer. This means that Amazon does not incur the trunking costs and saves at least one day off delivery lead times to Scottish destinations, thereby putting pressure on most national carriers.

Several regional specialists reported that some of the national B2C carriers do put them under price pressure, whilst, in turn, these national carriers apply large surcharges. As a result, such regional carriers feel they are not receiving a realistic price. Other national carriers and B2B shippers appear to accept local delivery costs and do not want to compromise quality of service.

A few regional specialists will absorb higher costs to the islands during the life of an annual contract for the larger national carriers, but this will be renegotiated the following year.

5.5.2 Impact of Royal Mail's USO price levels

Some carriers feel that the USO price level is artificial and is part of the problem, as it sends the wrong message to the market and has influenced consumer expectations. Consumers are not aware that Royal Mail's USO services ('One price goes anywhere') are different from its services for business customers.

Other carriers see Royal Mail as targeting a different marketplace (consumers and SMES), whereas they focus on contract customers with demanding service levels, which Royal Mail's USO service is not designed for. The majority of national carriers said they had not seen any evidence of a skewing effect on the market.

The Universal Service Obligation and 'One price goes anywhere'

In the UK, Royal Mail is the designated provider of the Universal Service Obligation (USO), and regulated by Ofcom under the Postal Services Act 2011 and EU Directive 97/67/EC. Royal Mail has an obligation to deliver mail to every UK address every working day, including remote and isolated communities across the UK (although some exceptions are permitted due to physical accessibility or safety reasons.)

Postal services must be provided at an affordable, uniform tariff across the UK, including a registered items service, an insured items service, as well as letters and parcels up to 20kg. Such USO services are VAT exempt and designed for consumers and SMEs. Most of Royal Mail's online retailer customers are account holders with volume discounts, for which VAT is applied.

Ofcom has to ensure that consumers have choice, a fair price, quality of service and value for money. Therefore, 2nd Class parcel prices are capped up to 2kg and Royal Mail's Quality of Service performance is measured quarterly.

5.6 The rural Scottish parcels market today

Market demand

Parcel volumes to the Highlands and Islands have been rising in line with growth in the overall UK online shopping market. The UK e-commerce market grew in value terms by 16% in 2016 (IMRG Delivery Index), which is borne out by a number of regional carriers who reported annual volume growth of 18%-20% for the Highlands and Islands.

Those carriers specialising in Orkney and Shetland said they were seeing constant growth in traffic. The population of these islands is described as fairly prosperous, with a good quality of life, and there is a positive outlook for further online shopping. (See 7.3 Background market metrics.)

Although still unreliable in some areas, internet speeds have improved in the last five years, and with the introduction of broadband, online shopping has grown rapidly. The Scottish Government's *Digital Scotland Superfast Broadband Programme* will continue to underpin this, promising to deliver access to fibre broadband to around 95% of premises by the end of March 2018. Currently around 86% of Scotland has access to superfast broadband.

The general characteristics of the local market have not changed substantially, but consumers are generally better informed and able to access a greater choice of services, as well as the increased convenience of home delivery.

"I would even say a lot of older people now use the internet for online shopping. We're going to get fibre optic on the island in the next couple of years, which will help. The internet is even more important here."

Customers in remote areas, such as the Highlands and Islands, were described as likely to be more loyal than most, as long as they received good service. They are therefore commercially important to retailers, even if it costs more to serve them. According to research carried out by Royal Mail, although those living in rural areas are more likely to abandon their online cart because they are unhappy with delivery costs, on average rural shoppers spend more per shop than those living in suburban locations (£47.42 vs. £43.55). (*Delivery Matters, September 2016*⁴)

Level of competition

Due to the activities of Menzies Distribution, competition amongst carriers in the Highlands and Islands has reduced. However, the smaller operators that became part of Menzies are likely to be more stable businesses.

Amongst the national carriers, as mentioned earlier, there has been recent consolidation, so that today there are twelve main operators serving the retail market.

Local delivery partners

The number of local delivery partners was described as at a sustainable level for the available volume at the moment. If there were any new entrants, business would not be sustainable in the longer term and there might be business failures due to lack of economies of scale. This occurred a few years ago.

The smaller service providers, such as taxi firms, couriers and one man bands, are an equally important part of the marketplace. *"They are the lifeblood of the community; these local guys put money back into the economy. The role they play must not be forgotten."*

The national carriers felt that, although it is fairly limited, there was enough choice amongst the local delivery companies for their purposes.

⁴ <http://www.royalmail.com/business/system/files/Delivery-Matters-UK-2016-5-Sept.pdf>

Quality of service

Quality of service has generally been improving, due to the investment in IT by the delivery industry as a whole. Some national carriers are keen to drive improvements in deliveries in Scotland in particular, so as to reduce some of the differences between services to the remote areas of Scotland and any other regions of the UK.

Operators emphasised the highly personalised service provided by local couriers in remote communities. *“There are elderly disabled people sometimes. They put deliveries away, make tea, feed the cat etc. You can’t put a price on it. Sometimes it’s the only person they’ve seen all day. Our drivers know all the people; they are part of the local community and are highly reliable.”*

In some regions, particularly to the Inner Hebrides, the local operators report that their ability to deliver within 2 days has been improving; after receipt of parcels in their depots – up to 95% of deliveries are on-time.

However, there still remain challenges relating to service levels and parcel tracking.

Retailers tend to quote 2 days delivery for £2-£3 p&p on their websites, without clarifying the reality, which is closer to 7-10 days if using some operators. The carriers say that next day delivery is technically possible in the Highlands and Islands, but not for the price charged in mainland UK.

One regional specialist to Shetland and Orkney runs a service 6 days a week, and can provide delivery within 3-5 days from Aberdeen. However, some providers to Shetland and Orkney only offer two ferry crossings a week, which reduces the delivery frequency capability. Thus, customers may be paying for a 7-10 day delivery service without realising it, and if one of the ferries is cancelled, it may be longer.

Similarly, according to the volumes and type of destinations, the regional specialists will deliver to the towns and outskirts daily, but the more remote areas on alternate days.

Parcel tracking is currently not fully end-to-end for many of the carrier services. This means that parcels are recorded as ‘delivered’ when they are scanned into the local Scottish depot upon arrival. There is often no IT to support tracking through to actual delivery.

The same lack of connectivity limits the ability of some national carriers to provide consumers with the ability to change delivery dates, times and addresses at any stage after a parcel has arrived with the regional partner. So too does the reliability of mobile communications in certain areas of the Highlands and Islands. However, national carriers and their regional partners have been working closely together to improve consumer communications and parcel tracking.

6 Potential innovations

The research explored industry views on how innovative delivery solutions might help reduce surcharges.

There is a general view amongst carriers that the majority of rural and remote consumers prefer home delivery services, as it saves them time and money, but that, where possible, a choice should be made available. According to research carried out by Royal Mail, 71% of online shoppers living in rural areas have a strong preference for home delivery over collection from a store. (*Delivery Matters, September 2016*)

Caution should be exercised in the introduction of any alternative delivery solutions, such as PUDOs (Pick-up and Drop-off points), as it could push up delivery costs to the doorstep. PUDOs may work effectively at community shops on small islands, but for consumers living in sparsely populated areas they are less attractive.

6.1.1 PUDO networks

On paper, delivery to PUDOs makes economic sense and is efficient. It enables the carriers to make multi-parcel shipments to business premises⁵ that are always attended and saves on mileage, and reduces cost for both the carrier and retailer. The delivery price could be reduced, regardless of whether there is a surcharge element included. PUDOs have also proved very successful as a returns channel for unwanted purchases.

However, alternative options that set out to offer ‘greater convenience’ and cost savings to some consumers may impact negatively on doorstep delivery for others. Since there is a finite amount of traffic for the Highlands and Islands, any parcel deliveries to PUDOs will reduce the remaining volume for home delivery in remaining areas, with potential cost increases or reduced delivery frequency and service levels as a consequence. Also, the national carrier and retailer will expect a lower delivery cost from any regional carrier involved.

Both national and regional carriers agreed that the perception of consumer choice and convenience offered by PUDOs varies. *“The challenge is that not all consumers want to travel to a town to collect their parcels – at their expense.”* The perception of convenience also varies by locality; on the smaller islands most people do visit community stores regularly, whereas those in remote mountainous areas travel less frequently. *“Because we are quite remote, I don’t think people would be happy to drive an hour’s round trip to go and pick up a parcel.”*

Unattended parcel lockers were largely discounted because of the high investment involved and due to practical issues of security, weather, power supply and obtaining approvals.

Some carriers pointed out that Internet services in the Highlands and Islands will also need to improve for PUDOs to be successful.

Current solutions

At a national level, almost all the national carriers have been establishing their own branded PUDO networks, but the most extensive networks in the Highlands and Islands are the Post Office (in partnership with RM’s *Local Collect™* service) and CollectPlus.

The map below shows the current locations⁶ of outlets offering parcel shop services for the main independent PUDO networks serving Scotland. CollectPlus is the only network with a significant presence in the Highlands and Islands, and this includes outlets in Orkney and Shetland.

⁵ Or unattended parcel lockers.

⁶ Based on website information on 31 January 2017.



Figure 5 Location of PUDO network outlets

CollectPlus is still building its network in the Highlands and Islands and does not currently service the Western Highlands or the Hebrides. PUDO outlets rely on the cooperation of local retailers, such as convenience stores and newsagents, and need a certain parcel throughput to justify the investment. Recent challenges faced by PUDO network operators in the Highlands and Islands include a noticeable number of convenience store closures and a lack of interest from shop managers.

Previously working exclusively with Yodel, CollectPlus changed its stance late 2016 and became carrier-neutral. CollectPlus is currently the only PUDO network operator to support deliveries from all carriers and their regional partners. This means that retailers will be able to offer consumers more PUDO delivery and returns options in the Highlands and Islands, should they wish to invest in the website integration.

With 316 outlets in the surcharged areas of the Highlands and Islands the government-owned Post Office network is obviously the most extensive due to its obligation to provide access to postal collection services through post offices and letter boxes. However, the network is currently only open to parcel deliveries and collections by Royal Mail and Parcelforce Worldwide.



Figure 6 Map of Post Office locations across the surcharged areas of the Highlands and Islands

The map above has been compiled from Post Office Ltd website information.

Local initiatives

Some small scale PUDO solutions are already emerging in the Highlands and Islands at a local level. There is a high level of interest in exploring cost-saving options, especially on the smaller islands, where people *do go* to a community shop on a regular basis. However, the smaller regional operators need support with the legal liability, security and technical aspects. Sometimes island politics can also impede the siting of a collection point, if local vested interests are at stake.

Emerging or pilot schemes are still very localised, but offer the potential for integration on a wider scale, once consumer interest and usage has been established. Such examples offered by the regional specialists include:

- An informal collection service from the Inverness depot and partner depots on the islands, but a discount is not currently offered to the consumer.
- Island depots (in Shetland and Orkney) set up as collection points, so that consumers can avoid paying the fee for home delivery.

6.1.2 Public/private PUDO networks

The survey looked at the feasibility and attractiveness of combined public sector and private PUDO networks for the Highlands and Islands, possibly including public buildings, post offices, supermarkets and independent network outlets.

The main cautionary note, as with any PUDO, was that the concept would most likely add extra cost overall if there are too many pick-up points. *“15 parcels to 15 different PUDO points defeats the object.”* *“Possibly every village needs a point, Stornoway could support two to three.”*

The importance of consumer acceptance and usage was stressed, and the need for broadband services to be more reliable.

That being said, however, most carriers were positive and made the following suggestions as to the type of premises that could be incorporated:

- Ferry ticket offices – *where* an unaccompanied pallet or parcel could be put on a ferry from the mainland (no vehicle). *“It makes more sense for the longer 2-3 hour ferry crossings, rather than the short hops.”*
- High Street retailers – where B2B carriers are already delivering, e.g. pharmacies and opticians.
- Remote farms
- Newsagents via the newspaper distribution networks
- Petrol stations
- Supermarkets - Tesco and Cooperative stores are the most prevalent in the Highlands and Islands (22 and 52 outlets respectively), and Tesco’s Click & Collect service is already available in Stornoway, for example.
- Schools and hospitals – one regional carrier already delivers parcels for their employees in one area, but currently makes no charge for this service.
- Mobile service providers - such as mobile shops, banks and libraries. For instance, there are mobile library services that operate a three weekly schedule (5 days a week on different routes) in the Moray Firth area, Far North (Caithness). RBS operates mobile banks in a number of areas as well.

Some of the regional specialists would be prepared to join a public/private network, rather than one run by the larger carriers. They also felt that a public/private partnership incorporating or supported by local community bodies would be better perceived locally.

It was suggested that local government could support a PUDO network by providing access to public buildings. Once set up commercially, the network would pay a transaction fee per parcel to the particular institution, thereby supporting local budgets. One of the sticking points for recruiting the supermarket chains is the fee expected by the store groups, which is felt to be uneconomic by those respondents that have explored the idea.

Looking ahead, although the post office network is currently closed to competitive parcel deliveries, the Postal Services Act 2011 set out the possibility of Post Office Ltd becoming a mutual organisation in the future. This might open up wider opportunities for public/private PUDO services.

Operators generally felt that greater encouragement to use PUDOs would help drive volumes.

6.1.3 Further shared consolidation centres in Northern Scotland

Most carriers thought there was not enough volume in Highlands and Islands to justify any additional consolidation centres, beyond the current activities of Menzies Parcels. Any further expansion of storage and sorting facilities implies extra cost and the extra volumes are not there to justify it. However, there may still be a few more small local couriers that might benefit from working with Menzies.

Several other regional specialists already share depots and some routes with their local partners.

Some of the national carriers thought that more consolidation should be done south of the border on the trunking routes, to save fuel and salary costs. However, the majority of national carriers are very protective of their networks and have varied levels of dead mileage.

6.1.4 Exploiting ferry crossings

Operator views were mixed regarding whether ferry crossings could be harnessed further, by using every available vehicle connected by 'Uber-like' technology. Some thought it was unworkable because the volumes were too small and because a large proportion of ferry traffic consists of tourists and foot passengers.

Others thought it was worth further investigation, but that some investment would be required in Android technology, so as to capture signatures on a mobile and handle payments. However, broadband communications are reportedly still unreliable in some areas and mobile communications are particularly poor. There are also issues with insurance and parcel security which would also need to be resolved.

One national carrier already operates a small scale arrangement for the Isle of Rothesay, whereby they drop off the parcels at the ferry terminal, parcels go as unaccompanied freight and a taxi firm picks up the parcels for delivery on the Island. It is fully tracked, but currently signatures are collected on a paper based system and scanned later.

More arrangements like this with the ferry companies could be organised; the cost saving lies in cutting out a vehicle and driver making the ferry crossing.

6.1.5 Drones and autonomous vans

Respondents were asked about the practical application of new delivery technologies, such as drones and autonomous vehicles. The unanimous opinion was that, although these types of technologies are improving rapidly, commercial usage is currently several years away.

The disadvantages of drones were felt to be potential air safety issues, inability to deal with high winds and adverse weather conditions, plus the current poor quality of Satnav reception in the Highlands & Islands. Longer term, drones could play a part in highly rural deliveries.

There was greater scepticism around autonomous vans, where road conditions and physical obstacles were felt to pose a problem, e.g. garden gates, potholes, dirt tracks and roadworks. It is also unclear as to how parcels are off loaded.

In both cases, methods for collecting signatures for POD have not been established.

Ultimately such technologies do not support the notion of a high quality service that is provided by the human interaction part of current home delivery services.

6.1.6 Other delivery methods

Parcel forwarding services

One regional specialist has launched a consumer parcel forwarding service to Aberdeen, so that Island shoppers (in Shetland and Orkney) can have goods delivered to a non-surcharged mainland address (taking advantage of 'free' delivery where available). The carrier then charges a flat rate based on weight and volume (this weight band could cover multiple items) for home delivery to the Islands. In this way, Islanders can avoid paying high surcharges.

Supermarket home deliveries

Some of the supermarkets offer a limited home delivery service to the Highlands and Islands, but delivery slots are reportedly limited.⁷ It has been suggested that the regional carriers could work more closely with these types of retailers, to consolidate groceries with parcels.

Air freight services

Apart from Royal Mail (which has to meet 1st and 2nd class on-time delivery targets), the delivery industry rarely uses the existing air freight infrastructure in the Highlands and Islands. This is mainly due to the high costs. In order to offer a more cost-competitive service, the aircraft must be full both on the inbound and outbound flights. Current loads are limited to high value or highly perishable goods, such as seafood.

The key advantage of air transport is speed of delivery to the islands from airports in Aberdeen, Inverness, Edinburgh and Glasgow, which would help retailers meet next day delivery promises. By summer 2017, there will be larger aircraft flying between Inverness and Heathrow, as well as Schiphol (Netherlands), which may be attractive for some of the integrators.

The main opportunity for filling outbound flights from the islands lies with the seafood industry, which currently uses road and rail to ship product southbound. Although there have been earlier attempts to coordinate seafood producers so as to consolidate air freight, these have failed, as the seafood industry is quite fragmented.

The Highlands and Islands Airport management company (HIAL) is positive about supporting any pilot projects to test the economic feasibility of running a commercial air freight service.

6.2 Parcels industry ability to collaborate

The UK parcels industry is already working together to provide high quality delivery services in the Highlands and Islands, as well as to improve service levels and greater choice. There is collaboration between the national carriers and the regional operators, as well as amongst the regional carriers.

Competition in the B2C delivery market as a whole, plus pressure from retailers, provides a strong motive for the industry to drive greater efficiencies through innovation. The main obstacle to some types of collaboration for the national carriers may be the fear of losing control over their

⁷ "How much does it cost to live on a Scottish island?" (The Scotsman, 24 May 2016)

operational processes. However, there may be opportunities to be more creative in the Highlands and Islands and collaboration is seen as the most cost effective way forward.

It is possible that some of the national carriers that run their own PUDO networks may look to outsourcing management to a single operator in the future, thereby driving additional consolidation and collaboration. Given that UK retailers are keen on Click & Collect, including PUDO solutions, particularly for returns, the ease of working with one PUDO service provider that could support any parcels carrier would be very attractive.

The consumer is also a powerful force in this marketplace, and there are calls to give the consumer even greater choice over delivery methods – when, where and by whom. With greater consumer awareness about delivery services, shoppers may become the final arbiter of how much more industry collaboration there is.

“The parcels industry is turning all the wheels to deliver at a competitive price; the consumer has a responsibility to make sure they shop wisely.”

6.3 The role of the public sector in helping reduce costs

Apart from the call for tax breaks for transport operators in Scotland and fuel subsidies, the carriers see a useful role for the Government as an educator and influencer.

It was suggested that the public sector, at local and national levels, could promote consumer education and awareness building regarding:

- Alternative lower cost delivery services and comparison websites for parcel delivery prices
- More realistic expectations regarding next day delivery to remote areas
- Local delivery services, e.g. consumer forwarding to the islands
- Usage of PUDOs.

The public sector could continue to apply pressure on online retailers regarding:

- Clearer information on websites regarding delivery to remote areas, prior to checkout
- A choice of delivery options, including PUDOs, multiple carriers and an ‘opt-out’ option, so the consumer can link to their preferred carrier.

The public sector could also support the parcels industry to set up community PUDO initiatives, by helping bring together local businesses, shops, hospitals, schools etc. The nature of local communities is described as quite independent, so government involvement in running such schemes would not be required.

In more general terms, lack of a strategic plan for the Highlands and Islands, including a way forward for freight transport, was felt to be holding back business development in the region. Currently there is no support for business growth or job creation.

6.4 Other challenges

The local economy is a concern for some of the regional carriers, as there is some doubts over whether Scottish businesses will remain or leave in the next year or so. The delivery industry and the Highlands and Islands area need a period of stability, so as to maintain a reliable service and stable prices.

Driver recruitment is a major challenge in the Highlands and Islands, as the industry struggles to compete with other sectors to attract school leavers.

Other frustrations for the smaller regional carriers include rising costs due to government legislation and overcrowded ferries during the tourist season.

7 Appendix

7.1 Postcodes attracting a delivery surcharge

The following table summarises those postcode areas in the Highlands and Islands that commonly carry a delivery surcharge, highlighting the exceptions. A few parcels carriers make a surcharge outside the main areas (Additional Surcharge Areas). As the designated universal service provider, Royal Mail does not apply surcharges for home delivery in any area, although Parcelforce does.

This is based entirely on published information from carrier websites. Surcharges are applied to both deliveries and collections in these areas.

Main Surcharge Areas		
Region	Postcode Areas	Carrier Exceptions
Aberdeen	AB37-AB38	
	AB44-AB45	Yodel
	AB53-AB56	
Falkirk	FK18-FK21	
Outer Hebrides	HS1-HS9	
Inverness	IV1-IV63	
Kilmarnock and Ayr	KA27-KA28	
Kirkwall	KW1-KW17	
Paisley	PA20-PA80	
	PA80	DPD & Hermes
Perth	PH15-50	
	PH17-PH18	Yodel
	PH41	Yodel
	PH49-PH50	FedEx
Shetland Islands	ZE1-ZE3	
Additional Surcharge Areas		
Region	Postcode Areas	Carriers making a Surcharge
Aberdeen	AB31-AB36	DPD & FedEx
	AB41-AB43	Hermes, FedEx, DPD
	AB51-AB52	FedEx
Dumfries and Galloway	DG3-DG9	DHL Express
Inverness	IV1-IV6	UPS
	IV7-IV12	DHL Express
Falkirk	FK14	Yodel
	FK17	DPD & FedEx
Glasgow	G63	DHL Express
	G83	DPD
Perth	PH5-PH10	FedEx

Table 2 Postcode areas subject to surcharges

7.2 Supporting data

Based on shortest routes calculated by Google Maps, the chart below illustrates sample distances to destinations from Coventry. As described earlier, Coventry in the West Midlands was used for this exercise because many of the largest retailers and fulfilment companies have located their national distribution centres in this area, due to its easy access to the M1 and M6 motorways. Routes have been selected as either via Glasgow (308 miles from Coventry) or Inverness (464 miles), but regional delivery routes will vary by carrier.

Distances from Coventry - One Way (miles)

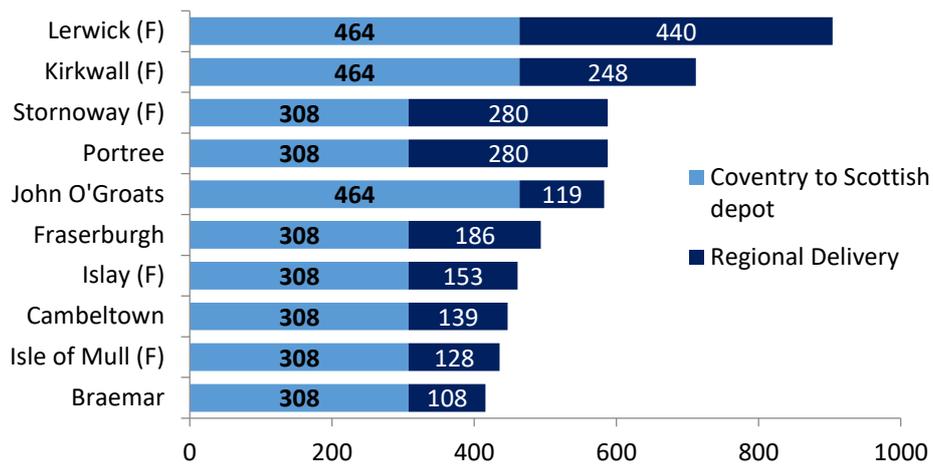


Figure 7 Distances from Coventry. (F) Indicates ferry required

For comparison purposes, Figure 8 below shows distances from Coventry to other remote areas of the UK. Most carriers levy a surcharge on deliveries to the Isles of Scilly and Wight, whilst a few also categorise Northern Ireland as an 'out of area' delivery zone.

Other Regions - Distances from Coventry - One Way (miles)

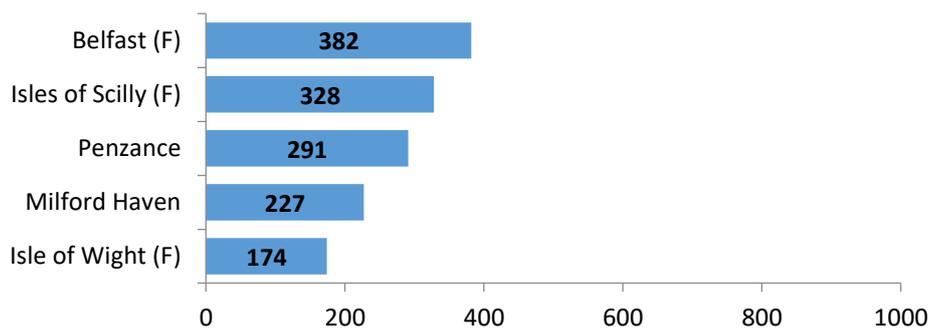


Figure 8 Distances to other remote areas. (F) Indicates ferry required

Figure 9 illustrates the driving hours required, including time spent on ferry journeys, to reach selected destinations in the Highlands and Islands from Coventry.

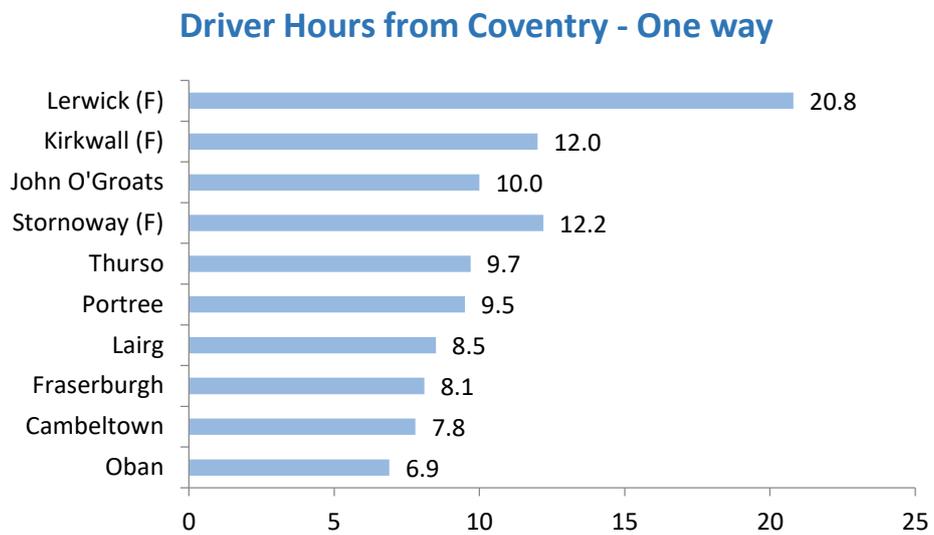


Figure 9 Driver hours from Coventry. (Minutes as a fraction of an hour)

7.3 Background market metrics

Area	Estimated Population mid-2015 ¹	Area (Km ²)	Population Per Km2	GVA £ per head ²	GVA % change 2010-2015 ²	% of All Roads in Red Condition ³
Total Scotland	5,373,000	80,077	67.1	23,685	14.6%	-
Glasgow City	606,340	176	3,454.9	32,305	13.2%	5%
Edinburgh City	498,810	264	1,889.4	36,963	9.7%	7%
Aberdeenshire	261,960	6,313	41.5	*36,726	*16.3%	4%
Angus	116,900	2,181	53.6	**19,612	**8.9%	5%
Argyll & Bute	86,890	6,909	12.6	21,718	20.5%	15%
Eilean Siar	27,070	3,071	8.8	16,989	15.8%	7%
Highland	234,110	25,657	9.1	18,459	18.7%	9%
Moray	95,510	2,238	42.7	23,497	14.2%	4%
Orkney Islands	21,670	990	21.9	20,560	14.6%	3%
Perth & Kinross	149,930	5,286	28.4	***22,540	***15.2%	6%
Shetland Islands	23,200	1,466	15.8	27,143	17.0%	9%

Table 3 Highlands & Islands market metrics

1. Source: ONS

2. Source: ONS Gross Value Added

3. Source: Scottish Road Maintenance Condition Survey (Red indicates critical repairs needed)

* Includes Aberdeen City

** Includes Dundee City

*** Includes Stirling

7.4 Companies participating in the research

Triangle would like to thank all the senior executives from following companies for contributing their time, insights and experience:

- *B Mundell*
- *CalMac Ferries*
- *Collect Plus*
- *DX (Group) Plc*
- *FedEx*
- *HIAL (Highlands & Islands Airports Ltd)*
- *M&H Logistics*
- *Menzies Parcels Inverness (previously AJG Parcels)*
- *Menzies Parcels Oban (previously Oban Express)*
- *Menzies Parcels Aberdeen (Thistle Couriers)*
- *Northwards*
- *Parcelinq*
- *Royal Mail Group (incorporating Royal Mail and Parcelforce Worldwide)*
- *Tuffnells Parcels Express*
- *UK Mail*
- *Woody's Express Parcels*
- *Yodel*

7.5 Discussion guideline

PARCEL DELIVERY TO REMOTE AND RURAL AREAS OF SCOTLAND –2017

DISCUSSION GUIDELINE

CURRENT DELIVERY SERVICES TO THE HIGHLANDS AND ISLANDS

For this study we are only looking at packets and parcels up to 30 kg. We are excluding two-man deliveries unless relevant to the discussion.

To begin with, looking at your current services:

- Q1. *How would you describe your company's position regarding provision of delivery services to the Scottish Highlands and Islands? Would you say it was strategic or tactical?*
- Q2. *How important are deliveries to the Scottish Highlands and Islands to your customers?*
- Q3. *What proportion of your total UK domestic parcel deliveries (including Northern Ireland) are to the Scottish Highlands and Islands?*
- Q4. *How do you currently provide parcel deliveries to these areas? Is it through your own drivers or through a partner company/companies?*
- Q5. *Which postcode areas in the Highlands and Islands do you deliver to? How did you decide which areas to deliver to or not?*

COST IMPACT ON DELIVERY SURCHARGES FOR THE HIGHLANDS AND ISLANDS

- Q6. *How would you describe your pricing policy for delivery to the Highlands and Islands?*
- Q7. *Looking at published consumer parcel prices, it appears that your company's surcharges to the Highlands and Islands range from -% to -% compared with baseline tariffs. It would be useful for the CFU to understand what the main additional costs are behind these surcharges. For example, what percentage of the extra cost is due to the following factors:*

If not percentage, then degree of importance.

Additional Cost Percentage Share/Comments

- a) Ferry fares*
- b) Extra fuel costs*
- c) Extra driver hours*
- d) Local partner dictates costs*
- e) Other (please specify)*

- Q8. *How have the prices you charge for delivery to the Highlands and Islands changed in the last year? What has caused the change and by how much have prices increased or decreased?*
- Q9. *[Following from Q8] Has this this change also applied to your baseline costs? If not, why is there a difference?*

Q10. *Are you taking any steps to reduce your costs (and therefore your surcharges) for delivering to the Highlands and Islands? And if so, what steps are you taking to reduce your costs for delivering to the Highlands and Islands? And to what extent do you plan on passing on any cost reductions to your customers?*

MARKET PRESSURES

Q11. *What stance do your Retailer Customers /Carrier Customers take towards delivery to the Highlands and Islands? Are you under any pressure to reduce surcharges/costs?*

Q12. *As far as you know, do your Retailer Customers/Carrier Customers absorb the surcharge, pass it on at 'cost to them', or do they 'mark up' the surcharges?*

Q13. *How would you describe the rural Scottish parcels market today and what changes are you seeing? For instance,*

- *Level of demand (i.e. volumes) – is it rising?*
- *Competition – has it increased or reduced?*
- *Local delivery partners – are there too many or too few?*
- *Quality of service*

Q14. *How does Royal Mail's USO price level affect the market and consumer expectation, if at all?*

FUTURE DELIVERY INNOVATIONS FOR THE HIGHLANDS AND ISLANDS

Q15. *How effective do you think the following initiatives would be for your company in terms of cost savings? And has your company already explored these and other ideas?*

- i. *Delivery to PUDOs (pick-up and drop-off locations)*
- ii. *Delivery to an expanded PUDO network including post offices, other public and private sector buildings*
- iii. *Participation in a joint public sector/local enterprise network, using mobile technology to book 'next vehicle' either for delivery to home or PUDO*
- iv. *Usage of shared consolidation centres in Northern Scotland*
- v. *Delivery by drone or driverless van*

Q16. *To what extent, do you think, the parcels industry could develop collaborative solutions to reduce delivery costs for consumers in the Highlands and Islands? How could collaboration best be achieved?*

Q17. *In your opinion, how far could local, Scottish and/or UK public policies reduce delivery costs for consumers in the Highlands and Islands? In what ways? (e.g. regulation, support, new partnerships)*

Q18. *Do you have any other comments about challenges you face when trying to keep delivery costs down?*

THANKS AND CLOSE

7.6 Overview of Triangle Management Services

Formed in the UK in 1984, Triangle has established itself as a specialist consultancy delivering a range of business services to leading companies and senior executives managing and shaping the mail and express industry both in the UK and overseas. Triangle aims to provide customers with professional advice and business-oriented solutions through a range of complementary services, including high-level conferences, online and print media, industry specific research and strategic consultancy.

The company's research and consultancy capabilities and expertise are focused on supporting client business investment decisions, strategic planning, performance benchmarking as well as tracking market trends, competitor news, customer developments and new opportunities in the postal, express and logistics industry.

Triangle has a particularly strong offering in UK express industry research, including annual B2B and B2C parcels carrier benchmarking surveys, an annual *Express Carrier Digest*, the *Express Salary Survey* and many bespoke studies.

More comprehensive information about Triangle's activities can be viewed at <http://www.triangle.eu.com>



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