

Mastering Airport Retail

Roadmap to New Industry Standards



Contents

Executive Summary	1
Demand Dynamics and Offer Development Securing Strong Market Growth	2
Key Success Factors for Optimizing Airport and Operator Performance	4
Focus on Operator's Financial Robustness, Offer Flexibility and Operational Performance.....	8
New Industry Standards Creating Turbulence in the Value Chain	9
Conclusion	12
Contacts	13

Foreword

Over the past five years, the efforts of the airports to develop revenue from non-aeronautical sources have driven strong growth in the airport retail sector. The sector will become all the more strategic as the decline in air traffic forces airports to reduce their dependency on airline fees. Airports are battling to improve performance and optimize the management of concessions, while retail operators face the challenge of responding to the airports' new expectations and growing competition.

This study by Arthur D. Little, based on a comprehensive industry outlook and substantial experience in travel retail strategy consultancy for key clients in the Travel & Transportation sector, provides an insight into some of the key questions for the sector:

- How can airports maximize retail revenues and what are the best practices from the top-performing airports?
- How have airports' expectations of retail operators changed?
- What impact will the new rules of the game have on the value chain and what challenges will industry players face in the long term?

Authors:

Vincent Bamberger, Aurélia Bettati, Stefan Hoeffinger, Thomas Kuruvilla, Vincent Wille.

Executive Summary

After five years of strong growth, prospects for airport retail in the mid-term remain positive even if forecasting seems to be a risky exercise in this current climate. Arthur D. Little forecasts duty-free sales will be 6 points above traffic forecasts for the period 2008-2012 (using IATA December 2008 forecasts of +2%, we estimate duty-free sales could grow by up to 9% over the period): duty-free sales should be one of the key drivers to compensate for the effects of the downturn for airports.

To sustain growth and outperform the market in the coming years, airports and operators will need to focus on five key success factors:

- Developing the density of the retail surface to maximize performance (sales per departing passenger).
- Adapting the offer to reflect the passenger profile.
- Using a range of approaches to convert browsers into buyers, and to increase time spent shopping.
- Extending their price advantage over city-center retailers.
- Expanding customer target groups to include non-travelers and arrival passengers, and diversifying distribution channels.

As part of their drive to optimize performance, airports are applying new criteria in their assessment of operators tendering for concession contracts. Operators' local know-how and the way they leverage it to propose the highest concession fees is no longer as important as it has been; airports are increasingly looking for operators who can demonstrate financial robustness, strong offer flexibility, international know-how and high-quality operational performance. These changes in airports' expectations reinforce global operators' competitive advantage. Indeed, the trend among operators towards internationalization and consolidation helps them reach a critical size, allowing them to improve their professionalism, increase their buying power, extend their brand portfolio and offer very competitive and robust concession fees. In order to survive, local operators are repositioning themselves in niche categories or at regional airports or entering joint ventures with global operators. In the long term, however, these smaller operators are strongly exposed.

These developments however do not guarantee a monopoly for global operators in future. Airports are increasingly seeking out new business models in order to optimize their revenues and Arthur D. Little expects to see international airports claiming a greater stake in the value chain through the development of joint ventures between airports and global operators. Ultimately, it is the ability of airports and operators to collaborate effectively that will determine their success in realizing the potential of the airport retail market.

Demand Dynamics and Offer Development Securing Strong Market Growth

Figure 1. Duty-free airport retail dynamics (2002-2012^e)

Sales per category	CAGR 2002-2008 ^a	Trend 2008 ^a -2012 ^e	Drivers
Perfumes & cosmetics	+17%		■ Cosmetics booming market (skincare, make-up)
Alcohol	+12%		■ Restriction on liquids compensated by high-end offer development
Tobacco	+7%		■ Health awareness policies compensated by traffic growth
Fashion & accessories	+12%		■ Dedicated surface increase ■ Offer enlargement
Confectionery & fine food	+16%		■ Concept improvement ■ Local destination products development
Duty free airport retail	+13%		

Annual growth 0-5% 5-10% >10%

Source: Generation Research (2002-2007), IATA traffic forecasts (12/08), ^aArthur D.Little estimates. Note: forecasts in USD excluding landside sales

The last five years have been an outstanding period for airport retail with average annual sales¹ growth of 14% (including duty-free and duty-paid sales), driven mainly by airports' strategy to develop non-aeronautical revenues. In order to secure targeted return on investment, airports now aim to achieve 50% of revenues from non-aeronautical sources, with retail representing the main source.

As a result, airports have increased the space dedicated to duty-free shops significantly, focusing largely on core business categories (Perfume & Cosmetics, Alcohol and Tobacco). This has led to the development of shopping malls, such as the 25,000m² retail project at Beijing Airport Terminal 3.

Beyond the impact of the economic slowdown in the short-term, Arthur D. Little is confident that the mid-term prospects for the industry will remain positive and forecasts an annual growth in duty-free sales approaching 9% for the years 2008-2012 (see figure 1) using IATA December 2008 traffic forecasts (+2% for the 2008-2012 period).

At a time of crisis, the main driver of the duty-free retail growth will be the airports' retail performance improvement: it should ensure a 6-point increase compared to the traffic growth.

“Though the impact of the economic slowdown remains uncertain, we forecast annual growth in duty-free sales approaching 9% for 2008-2012.”

¹ Shops' sales and not airport revenues (royalties) for the period 2002-2007

² IATA forecast of December 2008

Demand Dynamics and Offer Development Securing Strong Market Growth

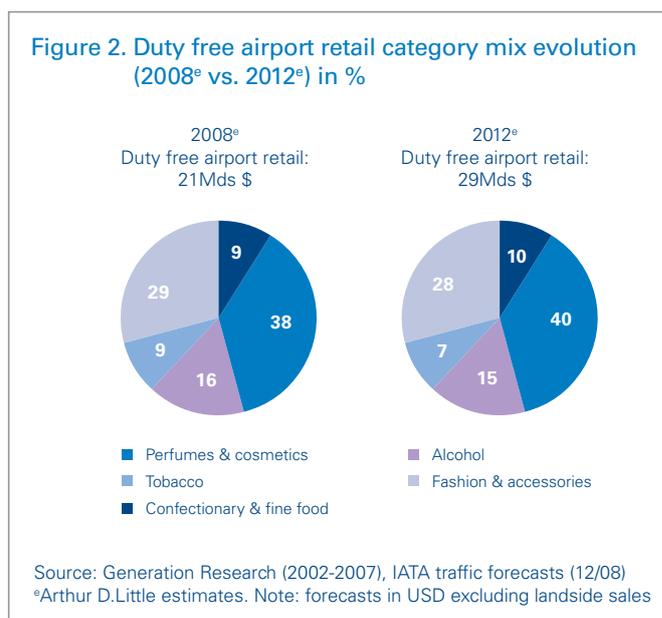
However, the growth prospects are hiding different category dynamics (see figure 2):

Perfumes & Cosmetics remains the must-have category for airports, with strong growth prospects driven mainly by a growing demand for cosmetics (skin care and make-up) and an optimum “profitability vs. space allocated” ratio, guaranteeing high concession fees to the airports.

Fashion & Accessories has been a strong growth driver for the past five years thanks to an enlargement of airports’ offer (space dedicated to this category, brand portfolio, etc.), a development of brands’ direct operations and an upgrading of shops’ merchandising and concepts. Although the economic slowdown will have the greatest impact on this category (especially luxury products) in the short term, Arthur D. Little forecasts very positive growth in the mid-term due to current segment immaturity.

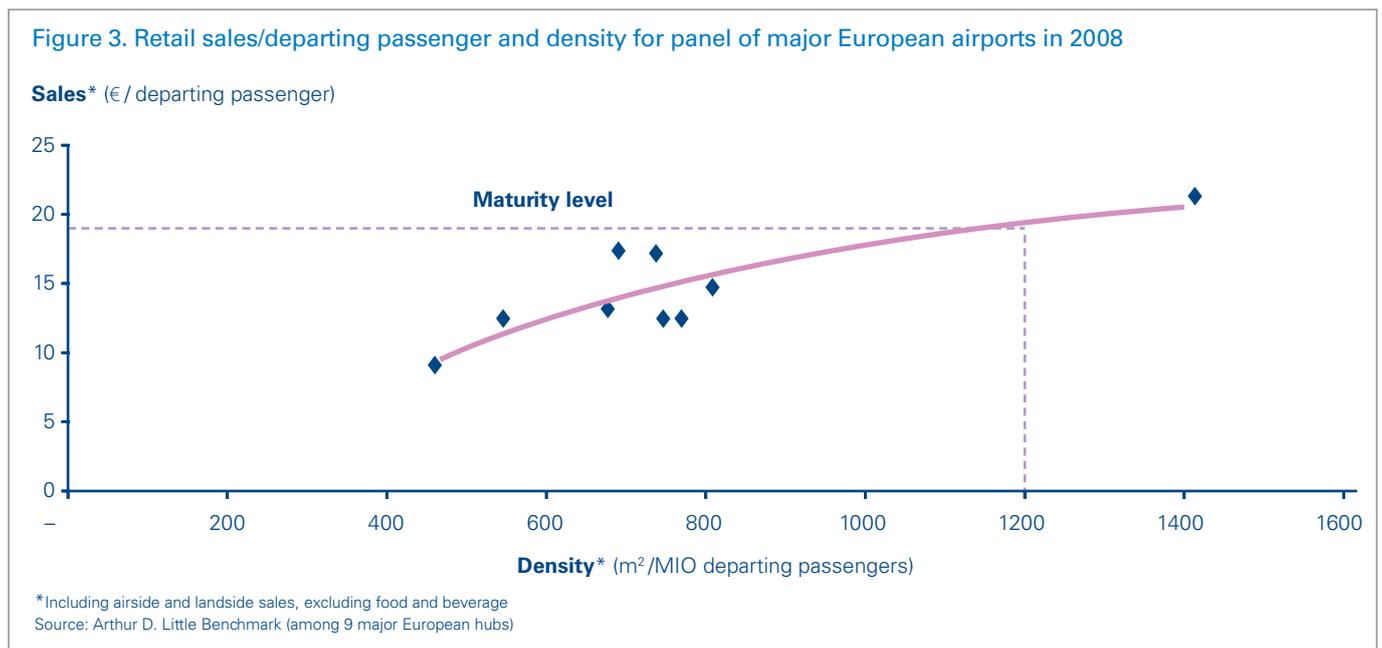
Confectionary & Fine Food is the new growth driver benefiting from an increasing demand for local destination products (gift items) and the improvement in delicatessen concepts. Our forecasts predict strong, double-digit growth for the next five years.

Two traditional categories, Alcohol and Tobacco, have lost market share (from 29% of duty-free sales in 2002 to 24% in 2008) compared with the other categories, suffering from a shift in consumption habits (health awareness) and toughening regulation (on liquids, on smoking, on advertising, etc.). However, growth prospects remain stable-to-positive thanks to the development of high-end products (single malt whisky, cigars, etc.).



“Perfumes & Cosmetics remains the must-have category for airports. Confectionary & Fine Food is the new growth driver.”

Key Success Factors for Optimizing Airport and Operator Performance



Apart from optimizing the category mix and upgrading shops' concepts (marketing, merchandising, etc.), Arthur D. Little has identified five key success factors that will enable airports and operators to meet and outperform growth forecasts.

Developing the density of the retail surface until maturity

Retail surface development is the major performance lever for airport retail and delivers higher sales provided average surface density (m² per million departing passengers) does not result in offer saturation.

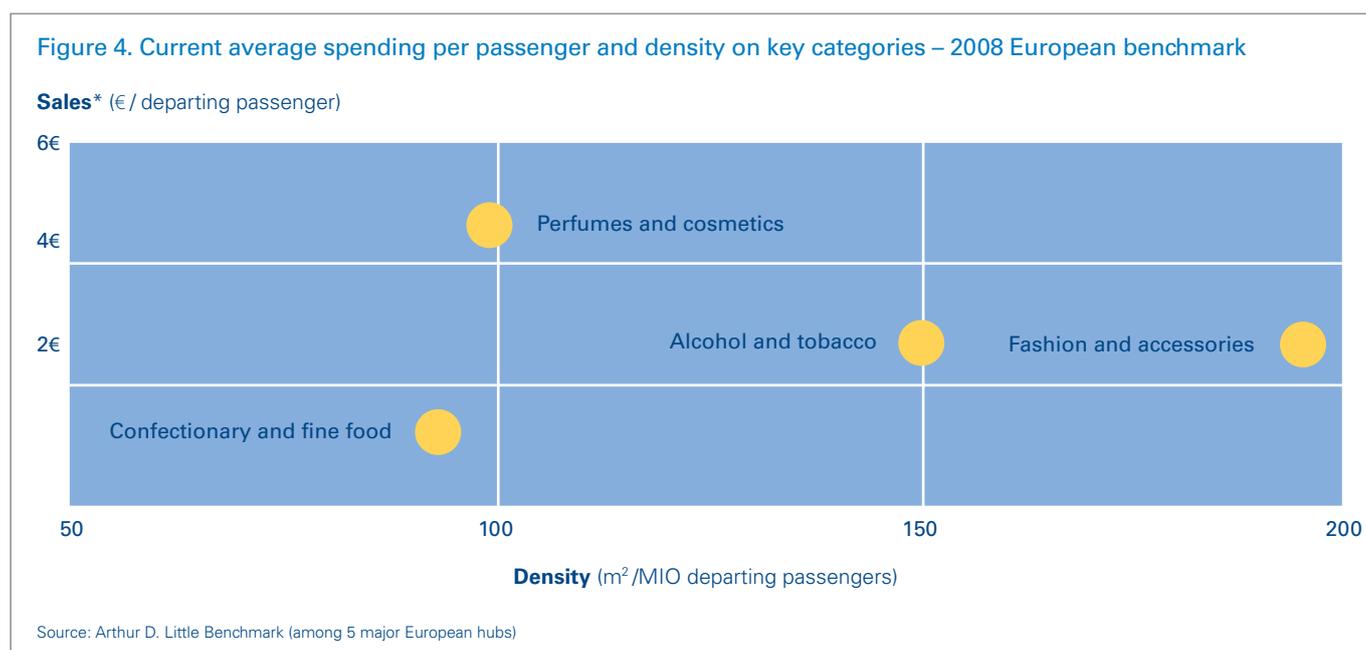
Presently, average density in major European hubs is around 600m² per million departing passengers³. Arthur D. Little research identifies a maturity target level of 1,000-1,200m² per million departing passengers, which guarantees sales of € 18-20 per departing passenger, depending on traffic quality and airport configuration (see figure 3).

Best-in-class airports have already reached this level of maturity, first by saturating the core business offer (average density target of 400-600m² per million departing passengers) and then by giving more space to offer diversification: Fashion & Accessories, Confectionary & Fine Food, etc. (see figure 4 on page 5).

“Arthur D. Little research identifies a maturity target level of 1,000-1,200m² per million departing passengers, which guarantees sales of € 18-20 per departing passenger.”

³ Excluding Food & Beverage, on airside and landside area

Key Success Factors for Optimizing Airport and Operator Performance



Adapting offer to passenger profile

Reproducing a standard duty-free offer at every airport is no longer relevant. Adapting the offer, e.g. price (high-end vs. mid-end), brands, products (color, size, etc.), to the passenger profile is now a key lever for optimizing revenues. As a result of market studies and surveys, airports and operators are now better placed than ever to select the most appropriate mix according to passenger destinations.

“Many airports, for example, have recently introduced well-known, mid-end brands to the Fashion & Accessories category to meet the demands of EU leisure passengers.”

Many airports, for example, have recently introduced well-known, mid-end brands to the Fashion & Accessories category (e.g. Zara and Mango in AENA airports, Massimo Dutti in Brussels Airport, Esprit and H&M in Schiphol Airport, etc.) to meet the demands of EU leisure passengers. Aéroports de Paris, for its part, has developed a concept in high-end cigars, “Cave à cigares”, to optimize sales to high-end passengers in a generally standardized core business category.

World of whisky

Mastering Airport Retail



Key Success Factors for Optimizing Airport and Operator Performance

Optimizing passenger footfall

Two key objectives for airports are to increase the conversion rate and to increase time spent shopping.

The Arthur D. Little study demonstrates the need for airports to:

- Position “must-buy” products (core business categories) immediately after security checkpoints to ensure passengers complete their pre-planned buying first and therefore feel more comfortable when entering the second group of boutiques (diversification categories).
- Capture those passengers that spend less time airside (business travelers, for example) by positioning last-minute offers for top-selling brands in core categories near boarding gates, as seen in the “Vizzit” concept at Schiphol Airport.
- Develop walk-through shops, as planned in Sydney where 3,500m² of walk-through will be developed.
- Secure “time to gate” communication to reduce pressure on passengers and maximize time spent shopping (e.g. introduction of flight information panels inside the shops).

Promoting price advantage over city-center retailers

In order to compete with city-center retailers, airports and operators have recently introduced innovative pricing policies, securing communication around their price advantage airside (lowest price guarantee) and proposing, when permitted, a unique pricing policy airside for both Schengen and non-Schengen passengers (Copenhagen Airport, Belgian Sky Shops, etc.).

Stockholm Arlanda Airport walk-through

The 1,700 square metre walk-through shop within the Stockholm Arlanda Airport is larger than six tennis courts and has eight metre high ceilings. This configuration and its location directly after the security area at T5 will enable to capture some 60% of all passengers on their way to the gates.

Photo by: © Jonas Borg/Stockholm Arlanda Airport

Expanding customer target groups and diversifying sales channels

The Arthur D. Little study highlights the ambition of some airports to expand their customer target groups to include:

- Non-travelers, by developing landside retail and implementing the “Airport City” concept. This model is successful when supported by a good transport infrastructure linking the airport to the city center, and increases retail revenues by offering a complete range of everyday services and shops, such as pharmacy, post office, supermarkets, etc.
- Arrival passengers, by positioning “shop on arrival” after security checkpoints but within the trans-border limit (mainly South America & Middle East airports).
- The diversification of distribution channels is also a new driver enabling operators and airports to develop sales. New services, such as “pick up on return”, home delivery and pre-order websites (link from the airport website to the operator’s gallery of products), make the airport buying experience smoother and reduce the need to display goods, saving space as a result.

Focus on Operator's Financial Robustness, Offer Flexibility and Operational Performance

Setting airport retail key success factors requires from airports' management the definition of an appropriate sourcing policy and an efficient selection process that enable them to work with the best operators.

Historically, airport retail has been dominated by local operators (incumbents), with the renewal of concession contracts with these operators being based on their local know-how, their knowledge of the airport's constraints and management, and their capacity to leverage other on-site concessions.

However, a number of factors have led to a change in expectations on the part of the airports. These factors include:

- The internationalization of passengers.
- The upgrading of airport retail standards driven by "best in class" Middle East and Asia Pacific airports.
- Poor experience with some local operators (limited offer renewal, overbidding resulting in systematic guaranteed minimum payment).

Arthur D. Little's research shows that, as a result, airports are now adapting their selection criteria leading to a possible reshuffling of competitive positioning.

Financial expectations: a new focus on financial robustness

The concession fees level remains a major selection criterion for airports. However, the growing pressure on retail operators to achieve higher targets and invest in offer renewal and shop concepts means airports are being more careful in assessing the robustness of the operator's business plan (through deep analysis of both the top and bottom line) and the capacity of the operator to fulfill the plan's objectives. The operator's overall buying power and proposed brand performance benchmarks are key factors for the airports in this regard.

Offer expectations: flexibility and international know-how come to the fore

With airports' duty-free areas transforming into modern shopping malls where the offer is being constantly adapted to the passenger profile, the relative importance of local know-how is decreasing and operators are facing new challenges.

A dynamic and wide-ranging brand portfolio, strong offer flexibility, new merchandising techniques and concept innovation are becoming key to satisfying both airports' and passengers' expectations. Operators need to demonstrate these attributes in order to respond to fast-changing consumer trends, to react more quickly to brands' performance (in and out strategy) and to optimize the use of space without affecting shop attractiveness and product visibility for passengers.

Organizational expectations: operational performance is key

Offer flexibility requires a good level of operational performance, including logistics and supply chain efficiency, and flexible and high-quality human resources management.

Arthur D. Little research highlights process standardization as key to successful airport retail operations, along with consistent IT systems and applications. As a result, operators' local know-how is becoming less critical while the extent to which operators can add value to the airport's existing assets through their organizational and operational expertise is becoming a major aspect of retail performance. Operators can optimize this added value by establishing a dedicated organization and processes that smooth the interface with the airport and make collaboration easier.

New Industry Standards Creating Turbulence in the Value Chain

New industry standards reinforce global operators...

Arthur D. Little's research shows that the major retail operators are following an extensive internationalization strategy. Along with industry consolidation (e.g. the acquisition by Autogrill of BAA's World Duty Free (WDF), the remaining 50% share of Aldeasa and Alpha Retail Group), this internationalization creates a global playground for airport retail.

By achieving critical mass, global operators can improve their professionalism, buying power and brand portfolio range. This enables them to propose competitive concession fees along with an attractive offer abroad. These advantages have resulted in a recent increase in global operators' market share at the expense of local operators.

We can expect to see this trend confirmed as consolidation continues, with global operators purchasing local players, such as Dufry and Aldeasa in the South American market.

... and disadvantage local operators

With their smaller brand portfolio, limited negotiating power and, in many cases, lack of international perspective on demand/supply trends, local operators will find it increasingly difficult to compete with global ones. Will these local players disappear altogether?

Arthur D. Little analysis reveals that, in the short to mid term, local players tend to survive by repositioning themselves in one of three ways:

- In niche categories, such as local gastronomy and souvenirs, where local know-how is a key competitive advantage.
- At regional airports, where the concessions surface is not yet sufficiently attractive to global players and where local operators can use their knowledge of domestic passengers and local operations to secure their competitive position temporarily.
- In core categories at major hubs, through joint ventures with global operators, in order to safeguard their historical position.

Joint venture with local operators is part of global operators' market entry strategy, especially in emerging markets (India, South America, etc): the local player provides understanding of local regulation and customs and a relationship with local authorities, local brands and local operations (logistics warehouse, staff, etc.) while the global operator secures purchasing efficiency and up-to-date concept set-up. Thanks to its joint venture with Aldeasa, for example, former state monopoly India Tourism Development Corp. (ITDC) succeeded in maintaining its incumbent position at Mumbai International Airport by winning a contract renewal in 2007.

In the long term, however, local operators are strongly exposed: once global players have acquired local know-how, they will compete independently for hubs' tender offers (without their local JV partner) and will also compete for regional airport concessions in order to optimize and amortize their national logistics and purchasing structure.

No guarantee of monopoly for global operators

Developments in the competitive environment mean that global players cannot necessarily expect to establish a monopoly at the major hubs; in fact, to a certain extent, global operators' objectives are at odds with the airports' current priorities.

Global operators are concerned mainly with optimizing margins and less with developing turnover. As a result, they are reluctant to take risks to increase turnover, such as introducing new brands or new concepts for which they will negotiate lower margins. By contrast, airports are paid according to turnover fees and have increasing expectations in terms of revenue optimization.

Arthur D. Little believes that, as a result, success in airport retail relies on the ability of operators and airports to optimize their interface; both parties need to agree on turnover risk levels and margin targets, and to participate jointly in establishing an action plan to optimize turnover (see figure 5 on page 10).

New Industry Standards Creating Turbulence in the Value Chain

Figure 5. Key challenges of airport and operator interfaces optimization

Operator role

- Define brand and product mix
- Manage purchase and logistics
- Define marketing policy
- Determine price/promotion policy
- Ensure HR quality
- Manage shops' IT system



Airport role

- Design retail mix strategy
 - Retail surface density
 - Category mix
- Define retail space configuration (pathway, shops locations, etc.)
- Anticipate traffic evolution and impact on retail sales

- Adaptation of the offer (brand and product mix) to the traffic
- Optimization of retail space configuration and density integrating both operator and airport expertise
- Consistence of the marketing, price and promotion policy with the airport specificities
- Joint performance analysis through IT reporting transparency to define action plans

Source: Arthur D. Little analysis

New business models emerge as airports seek to optimize revenues

As a result of the current inability of global and local operators to propose optimized interfaces with airports and properly integrate revenue optimization at the expense of their margins, new business models have emerged where airports have taken a greater role in order to impose their vision and optimize revenues.

Arthur D. Little's research highlights two main concession management models that are becoming increasingly common:

1. A joint venture between the airport and a global operator.

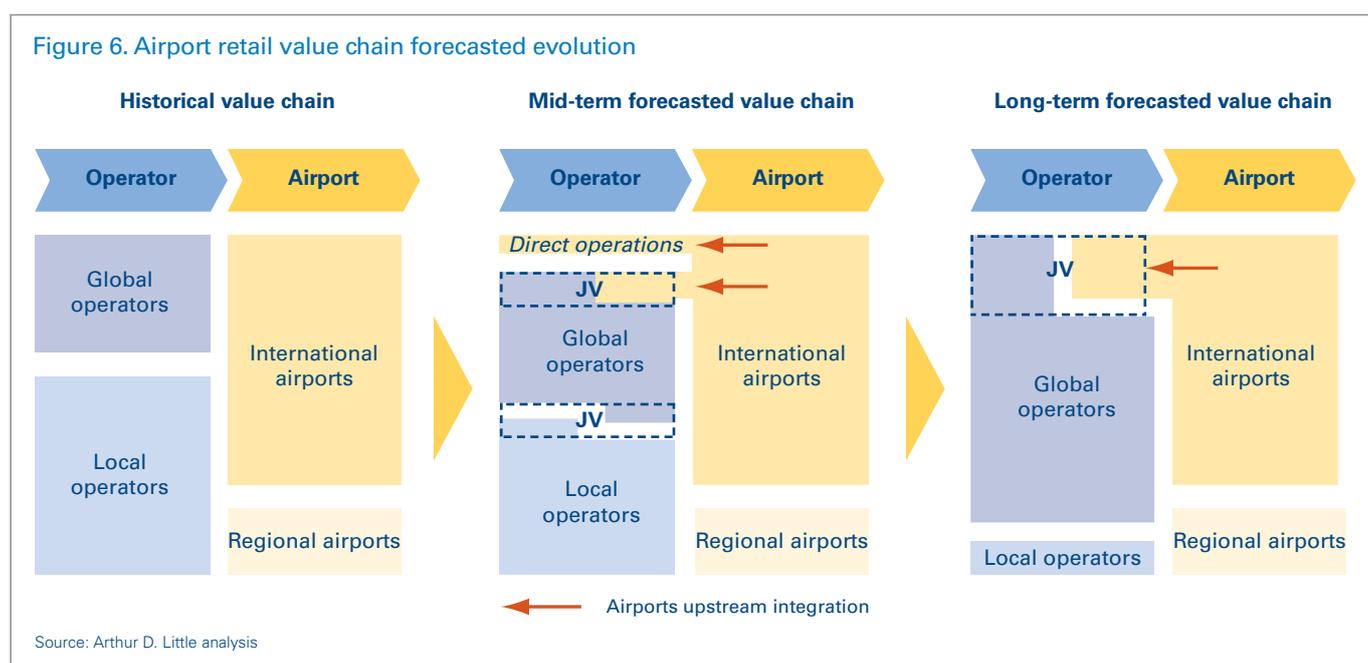
A joint venture between an airport and a global operator imposes de facto collaboration through a risk-sharing model. A local dedicated organization and governance bodies covering both sets of shareholders makes sharing information easier. By defining strategy (brand selection, investments, etc.) jointly through these governance bodies, the airport and the operator can balance margin and revenue optimization.

The success of this model recently saw Milan airports (Malpensa and Linate) extending the concession contract with their joint venture with Dufry from 2020 to 2041.

2. Direct operation of the retail space by the airport.

Direct operation, where the airport bypasses operators to deal with brands and operate shops itself, remains embryonic and tends to be implemented in airports with critical mass and established retail operations (staff, logistics, etc.), such as Dubai, Amsterdam Schiphol and Rome Fiumicino. Direct operation gives airports complete control over the offer and the concepts and, because there are no turnover fees squeezing margins, allows the airports to maintain competitive prices.

New Industry Standards Creating Turbulence in the Value Chain



Airport direct operation should remain limited

Will direct operation become the future business model of airport retail? Analysis by Arthur D. Little shows that this type of concession operation should remain limited (see figure 6) for three main reasons:

- Direct operation requires a critical size (traffic, surface) to ensure return on investment. This limits the model to major hubs.
- Direct operation represents an opportunistic move and cannot result in a long-term diversification strategy. Airports that operate their own retail platform will not be able to gain a competitive advantage that will enable them to operate abroad or extend their retail activities beyond the airport.
- The ability of direct operation to generate higher revenues and margins through more competitive prices has still to be proven. Attractive prices alone are not sufficient to increase revenues and margins; they must be supported by innovative concepts. In addition, opportunities for achieving economies of scale in buying and logistics, etc. are limited in this model.

Whether the airport/operator joint venture model becomes increasingly successful or whether global operators reassert their position by improving their interface with airports, it is clear that in the long-term collaborative models will be the winners.

“Attractive prices alone are not sufficient to increase revenues and margins; they must be supported by innovative concepts.”

Conclusion

In their move to Mastering Airport Retail, airports should address the successive questions:

- How is the airport's retail performance with regards to best practices (gap analysis) and what revenue optimization is at stake?
- Which concession management model should be targeted taking into account the local context and the optimization at stake?
- How can airports mobilize the different competencies in order to design and set the new operating model?

Whatever the concession management model, the ability of players in the value chain to work closely together will determine their success in meeting the challenges ahead. Effective collaboration will be vital in order to develop the offer, optimize concept quality and improve performance, all of which will help players to realize market potential and resist value chain turbulence.

Setting these different levers, however, remains a complex challenge for both airports and operators. Key success factors identified through best practices may enable players to establish a better understanding of the areas they need to address, but customizing the levers and applying them to improve retail performance effectively on a given platform is very difficult. Moreover, these key levers encompass a wide range of functional competencies (infrastructure, purchase, logistics, legal, marketing, etc.), which makes setting them even more challenging for airports and operators who find themselves having to involve and co-ordinate a wide range of different resources.

In order to support airports in dealing with these challenges, Arthur D. Little has developed a specific methodology that enables to design long-term, win-win partnerships and to reach a lasting performance in airport retail.

Contacts

If you would like more information or to arrange an informal discussion on the issues raised here and how they affect your business, please contact:

Belgium

Vincent Wille
+32 2 7617-362
wille.vincent@adlittle.com

China

Thomas Schiller
+86 10 65677055
schiller.thomas@adlittle.com

France

Vincent Bamberger
+33 1 55 74 29 47
bamberger.vincent@adlittle.com

Germany & Central Europe

Stefan Hoeffinger
+43 1 515 41-32
hoeffinger.stefan@adlittle.com

Italy

Andrea Bassanino
+39 02 673 76209
bassanino.andrea@adlittle.com

Japan

Yusuke Harada
+81 3 3436 8931
harada.yusuke@adlittle.com

Middle East

Thomas Kuruville
+971 4 433 5401 (Dubai)
+966 557 150 441 (Saudi Arabia)
+65 9846 1468 (Singapore)
kuruville.thomas@adlittle.com

Netherlands

Martijn Eikelenboom
+31 10 2018 815
eikelenboom.martijn@adlittle.com

Nordic

Petter Kilefors
+46 8 50 30 6542
kilefors.petter@adlittle.com

Portugal

Grant Greatex
+35 1 210 091 500
greatex.grant@adlittle.com

South-East Asia

Jeffrey Lai
+60 3 2164 6063
lai.jeff@adlittle.com

South Korea

Sukgeun Lee
+82 2 720 2040
lee.sukgeun@adlittle.com

Spain

Jesus Portal
+34 91 702 74 34
portal.jesus@adlittle.com

United Kingdom

James Catmur
+44 870 336 6780
catmur.james@adlittle.com

USA & South America

Markus Lahrkamp
+1 646-248-6082
lahrkamp.markus@adlittle.com



Duty to Trade

Over the past five years, the efforts of the airports to develop revenue from non-aeronautical sources have driven strong growth in the airport retail sector. The sector will become all the more strategic as the decline in air traffic forces airports to reduce their dependency on airline fees.

Arthur D. Little

Arthur D. Little, founded in 1886, is a global leader in management consultancy, linking strategy, innovation and technology with deep industry knowledge. We offer our clients sustainable solutions to their most complex business problems.

Arthur D. Little has a collaborative client engagement style, exceptional people and a firm-wide commitment to quality and integrity. The firm has over 30 offices worldwide. With its partner Altran Technologies, Arthur D. Little has access to a network of over 16,000 professionals. Arthur D. Little is proud to serve many of the Fortune 100 companies globally, in addition to many other leading firms and public sector organizations. For further information please visit www.adl.com

Copyright © Arthur D. Little 2009. All rights reserved.

This report is printed on FSC certified paper.
FSC (Forest Stewardship Council) is an international non-profit organization which supports the world's forests.

www.adl.com/airportretail