Exploring and Testing the Prevailing Business Models in Travel Retail

A report prepared for the
European Travel Retail
Confederation

By

The Institute for Retail Studies
Stirling Management School
University of Stirling
Scotland
UK

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The Institute for Retail Studies

University of Stirling Management School

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FOREWORD

By the President of the European Travel Retail Confederation (ETRC)

As the European travel retail sector continues its post-pandemic recovery, the need for resilient, adaptable, and future-focused business models has never been more urgent. This report, commissioned by the European Travel Retail Confederation (ETRC), represents a timely and comprehensive exploration of the contractual frameworks that underpin our industry—an industry that is not only vital to airport economics, but one that connects millions of travellers with world-leading brands and experiences.

The disruptions brought about by recent global events—most notably the COVID-19 pandemic—have exposed as never before the vulnerabilities of traditional commercial models, particularly those reliant on rigid financial commitments and fixed expectations. At the same time, these challenges have catalysed innovation and opened the door for reimagined partnerships grounded in flexibility, mutual benefit, and a more equitable sharing of risk and reward.

In commissioning this study, ETRC sought to provide all partners in our industry with not just a diagnostic tool, but a roadmap—one that reflects the diversity of Europe's airports, the variety of retail formats, and the evolving expectations of passengers. The research, conducted by the Institute for Retail Studies at the University of Stirling, combines academic rigour with real-world insight, informed by extensive interviews with leading stakeholders across airports, retailers, and brands.

What emerges is a nuanced understanding of the various business models—fixed MAG, variable MAG, profit-share, and joint ventures—and the different scenarios in which each may succeed or fall short. Clear also is the centrality of any tendering process employed and the crucial role comprehensive data provision plays. Critically, the report does not advocate for a one-size-fits-all solution. Instead, it provides a framework for decision-makers to tailor strategies based on airport size, traffic composition, economic conditions, and stakeholder objectives.

As ETRC President, I am proud to present this important contribution to the ongoing dialogue about the future of travel retail. It is our hope that the findings will inspire greater collaboration, more sustainable practices, a willingness to rethink established norms, all underpinning a shared commitment to building a stronger travel retail ecosystem for the years ahead.

NIGEL KEAL

President ETRC

COMMENT

From the Director General of ACI EUROPE (Airports Council International)

Travel Retail is essential to the financial model of most European airports. Overall, airport revenue from business areas beyond aviation, the non-aeronautical business, accounted for 37% of total airport revenues in 2024 – showing Travel Retail still has the potential to grow.

Europe's airports will further require an additional €360 billion in capital expenditure (CAPEX) by 2040 to address the long-term trend in passenger demand along with decarbonisation, resilience and digitalisation. In that context, optimising revenue from non-aeronautical operations will become even more relevant, and so will a true collaborative approach to enhancing the passenger experience.

ACI EUROPE welcomes this report on Exploring and Testing the Prevailing Business Models in Travel Retail commissioned by ETRC as it does not advocate for a one-size-fits-all solution, which would not take into account the variety of the 600+ airports we represent in 55 countries.

Rather, it provides a nuanced understanding of the various business models and different scenarios in which each may succeed or fall short based on airport size, traffic composition and economic conditions among others. Critically, the report clearly highlights the role of the tender process, notably the provision of comprehensive data.

The COVID-19 pandemic has exposed the vulnerabilities but also the incredible resilience of our businesses, driven by flexible and sometimes creative strategies. Now seems like the right time to ensure lessons are learnt and support investment, customer service levels and, ultimately, the commercial revenue on which all Travel Retail stakeholders depend.

At ACI EUROPE, we look forward to continuing this dialogue with ETRC, putting innovation, collaboration and the passenger at the heart of a stronger and sustainable future of airport retail.

Olivier Jankovec
Director General
European Region of Airports Council International (ACI EUROPE)

ACI EUROPE represents over 600 airports in 55 countries, and its members facilitate over 95% of commercial air traffic in Europe. Air transport supports 14 million jobs, generating €851 billion in European economic activity (5% of GDP). In response to the Climate Emergency, in June 2019 ACI EUROPE members committed to achieving net-zero carbon emissions for operations under their control by 2050, without offsetting. Based in Brussels, ACI EUROPE leads and serves the European airport industry and maintains strong links with other ACI regions throughout the world. ACI EUROPE maintains close relationships with many national airport operator associations and with a number of organisations with interests related to aviation, such as ETRC.

STATEMENT

From the Tax Free World Association (TFWA)

Duty Free and Travel Retail continues to offer a unique platform for brands to connect with international travellers in dynamic, qualitative and high-visibility environments. As the market dynamics evolve, understanding the frameworks that shape this channel is increasingly important.

The Tax Free World Association acknowledges the recent publication of the European Travel Retail Confederation's (ETRC's) study on prevailing business models in travel retail.

The study provides an overview of various commercial frameworks currently observed across the sector and outlines how these may relate to the operational context for stakeholders, including brands, retailers, and landlords.

For brands, the research may serve as a reference when considering how different contractual arrangements could intersect with areas such as investment, visibility, and passenger engagement. It also highlights the relevance of adaptability in a sector shaped by changing traveller expectations and broader global trends.

TFWA views this publication as a valuable contribution to the ongoing wider industry dialogue around how commercial practices could evolve in response to shifting market conditions. Stakeholders may find it useful to consider the study alongside other sources when reflecting on the diversity of perspectives and practices within the travel retail environment.

We thank ETRC and the authors for their work and note its contribution to continued exchange across the trave retail and duty free industry.

TFWA is a global, non-profit organisation based in Paris that brings together over 490 companies representing around 3,000 renowned brands active in Duty Free & Travel Retail. Members include world-renowned names as well as newer entrants across many product categories, from beauty and fashion to wines and spirits. Its mission is to identify trends and opportunities, build awareness and provide a business platform for the global Duty Free & Travel Retail industry to prosper. An important part of that is organising annual industry conferences and exhibitions in Cannes, Singapore and elsewhere. In 2024, TFWA celebrated its 40th anniversary.

Disclaimer: This statement is provided for informational purposes only and does not constitute legal advice or a recommendation. Readers are encouraged to assess their own positions independently and ensure compliance with applicable laws and contracts.

EXECUTIVE SUMMARY

This report, commissioned by the European Travel Retail Confederation (ETRC), examines the effectiveness and sustainability of the business and concession models that underpin duty free and travel retail in Europe.

Based upon a series of in-depth, qualitative interviews with key decisions makers from the industry, it explores, through scenario analysis, how different contractual models perform under varying market conditions.

The report notes that:

- There is no single, universally optimal contract model for travel retail. Each airport's strategy should reflect its unique size, passenger demographics, and ownership structure.

- The sector has traditionally relied on concession-based contracts, where retailers pay airports a share of sales revenue, underpinned by a Fixed Minimum Annual Guarantee (MAG).

- While this model has worked well during periods of economic growth, it has proven less resilient when responding to market shocks and downturns, such as those caused by terrorist attacks, geopolitical instability, and most notably, the COVID-19 pandemic.

- The inflexibility of a Fixed MAG model can lead to contract failure, curtailed investment, and a poorer passenger experience. In response, airports and retailers have considered alternative contractual models such as those with a variable MAG, profit-sharing and joint ventures.

- Variable MAG models offer a more balanced risk-sharing mechanism, linking payments to traffic volumes and / or passenger destination.

- Profit-share and joint venture models encourage greater alignment and collaboration between retailers and airports but require high levels of trust, transparency, and governance.

The report concludes that flexible contractual models allow for innovation, experimentation, and better customer engagement. Such activities are essential in an evolving retail landscape. As the industry recovers and reshapes post-pandemic, greater flexibility and collaboration between stakeholders are essential. Models must be resilient, adaptable, and reflective of a changing and uncertain global environment, ensuring sustainability and value creation for all parties involved.

PART I: INTRODUCTION AND CONTEXT

Origins of the study

As the duty free and travel retail industry recovered from the COVID-19 pandemic, ETRC was requested by a number of members to look into establishing a workstream to draw lessons from the pandemic, in particular to evaluate the effectiveness of the prevailing business and concession models in duty free. The sustainability of these models is of critical importance to the health of the travel retail sector, given that it is usually the viability (or otherwise) of the model that influences investment, customer service levels and, ultimately, the commercial revenue on which airports depend.

From its origins at Shannon Airport in the West of Ireland, where the first airport duty free shop was opened in 1947, the duty and tax free industry has grown into a global retail sector that, prior to the pandemic, was worth over US$86 billion in annual sales (TFWA Handbook, 2023)[1]. Among factors driving the sector's consistent growth were the emergence of high-spending Asian travellers, and the willingness of premium brands to invest in a market that provides a valuable "shop window" to an affluent, international customer base.

Despite decades of almost uninterrupted growth to 2020, tensions arising from the prevailing business model have always been present, especially in airport commercial activities. The majority of airport retail contracts have to date been based on a concession model, under which the retailer pays the airport landlord a share of sales, backed by a "Minimum Annual Guarantee" (MAG) payable should sales not exceed an agreed level. It is generally felt that this model works well when the market is growing but is not always adaptable to market contraction or to sudden shocks to which the travel market is vulnerable (for example, following terrorist attacks, shifts in travel patterns and pandemics).

The traditional concession model can also lead to unrealistic bidding for contracts especially in a market which is lucrative and, highly competitive. Duty free and Travel Retail concessions are typically awarded for periods in excess of five years, meaning that the most lucrative contracts are tendered relatively infrequently and are thus all the more sought after. In such instances, retailers are sometimes bound to a MAG that does not reflect current economic conditions which consequently leads to them curtailing investment in the physical infrastructure of the stores and in the services provided to the customer. Such actions negatively impact upon the traveller experience, ultimately resulting in lower revenues for airports, retailers and brand owners.

Given these tensions, other business models have been introduced and tested, including concession models with different forms of variable MAG, joint ventures between airports and retailers, profit-sharing agreements and "supply-only" contracts.

This study was commissioned to analyse and explore the principal business models that are deployed in the European airport duty free and travel retail industry, based on insights from stakeholders and data analysis. As the sector emerges from the most serious crisis in its history, the time is perhaps right to reassess the contractual basis upon which the market has been built.

[1] TFWA Handbook, 2023, Generation Research

The aims and scope of the study

It is important to state that the purpose of this study is not to promote one business model above another, or to present one model as "the best". Airports are unique, with different passenger profiles, commercial priorities, and ownership structures. Commercial departments must take these and other factors into account when deciding the most suitable model for their airport.

ETRC's aim through this study is to present the characteristics of the various models, the factors that influence their performance, and analyse the strengths and weaknesses of each. The objective is to help airport commercial planners and their business partners decide upon the most appropriate retail contract and for the maximisation of returns to all parties.

The scope of the study is focused on the duty free and travel retail sector, although its findings may also be relevant to other areas of travel retail, for example fashion and luxury, press and convenience, and food and beverage. ETRC has chosen to focus on airport retail, although it is hoped that the study will also be of interest to companies active in other channels, for example cruise and ferry retailing.

The study will, we trust, complement and build on previous discussions of contractual models (see below) and provide ETRC members and their business partners with a resource that helps them better understand the factors to take into account when planning the commercial offer at airports in Europe and beyond.

Recent industry history and market conditions

Over its nearly 80-year history, the duty free and travel retail market has proved a uniquely attractive retail channel – to airports, retailers, brands, and most importantly, to travellers.

> ***"Airports offer us the ability to gauge the opinions of 100 nationalities in three months. No other form of retailing does this."*** *(Brand Owner, Wines and Spirits)*

Duty free and travel retail represents a crucial source of income for airports and is often the largest contributor to non-aeronautical revenue. Revenues raised through retail sales help finance infrastructural development, enable upgrades to the traveller experience, and allow aeronautical charges to remain competitive – thus keeping the cost of travel low. For retailers, the duty free and travel retail channel offers an opportunity to engage with an affluent, sophisticated and cosmopolitan customer base. For brand owners, airports offer the opportunity to showcase and test new products, launch exclusive ranges and enhance the visibility of their brands before an international audience.

Periods of rapid growth in global duty free and travel retail sales have coincided with the emergence of high-spending Asian travellers. For example, the opening of the Japanese travel market in the 1960s and 1970s was followed by an upsurge in the number of outbound Chinese travellers, a phenomenon which continued until early 2020 and the COVID-19 pandemic.

As might be expected for any retail sector dependent upon international travellers, duty free and travel retail industry is vulnerable to market externalities. These shocks may be caused by economic downturns, geopolitical tensions and conflicts, and public health crises. For example, the abolition of intra-EU duty free in 1999 forced a complete reassessment of the market in Europe, and necessitated changes whose effects are still being felt today. Since the turn of the millennium, the most serious crises have included the September 11th 2001 terrorist attacks (and subsequent conflicts); the SARS outbreak of 2003, and the economic crash of 2008-10.

All these shocks pale by comparison to the impact of the COVID-19 pandemic. Global duty free sales fell by an estimated 47% in 2020 (see Table 1.1), a figure that would be higher were it not for the unique growth of the offshore duty free market of Hainan, in China. In Europe, duty free sales plummeted by over 70%, and fared only slightly better in 2021.

Amid the near-total collapse in passenger traffic, many airports were able to reach agreements with their retail concessionaires to mitigate the exceptional circumstances while ensuring that the small number of travellers were catered for. However, this adaptation was not universal. Some airports were, for various reasons, unable to change the terms of their retail contracts, resulting in significant losses for their concessionaires. Even where a degree of flexibility was introduced, the pandemic demonstrated the weaknesses inherent in some variants of the classic duty and tax free contract model.

As the COVID-19 crisis began to subside, many retailers and brands inevitably questioned whether the prevailing model was fit for purpose. The continued slow recovery of passenger numbers in some parts of the world – notably in Asia Pacific, where outbound Chinese travel continues to remain below pre-pandemic levels – ensures that the question of the business model remains relevant.

Table 1.1: Duty free and travel retail sales by region 2012-2022 (US$ millions)

Region	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Asia Pacific	19,902.2	22,317.9	24,729.4	25,294.4	27,375.3	30,827.3	38,831.9	46,157.3	33,045.8	34,342.2	33,407.5
Europe	19,272.3	20,139.3	20,581.9	18,856.7	18,732.9	20,060.7	20,802.7	21,115.4	6,280.8	8,863.6	16,655.6
Americas	10,855.7	11,162.5	11,725.3	11,276.4	10,853.4	11,655.2	11,799.8	11,492.6	3,822.0	5,030.2	8,637.0
Middle East	5,005.8	5,560.6	5,867.3	5,810.8	5,573.3	5,982.7	6,362.8	6,327.8	2,160.0	3,645.5	4,969.4
Africa	764.0	819.7	848.4	761.7	778.1	786.9	808.6	864.7	315.5	422.9	606.5
TOTAL	**55,800.0**	**60,000.0**	**63,752.3**	**62,000.0**	**63,313.0**	**69,312.9**	**78,605.7**	**85,957.7**	**45,624.0**	**52,304.4**	**64,276.1**
% change	-	+7.5%	+6.2%	-2.7%	+2.1%	+9.5%	+13.4%	+9.3%	-46.9%	+14.6%	+22.9%

Source: Generation Research, TFWA Handbook 2023

Figure 1.1: SWOT analysis of duty and travel retail market

STRENGTHS	WEAKNESSES
Attractive, growing customer base Market driven by specialists with decades of experience Central to airport and transport investment Data-rich environment	Low penetration and conversion Weak online engagement Inflexible business model/high cost of entry Ineffective exploitation of data and lack of data sharing Vulnerability to falls in traffic among key nationalities
OPPORTUNITIES	**THREATS**
Room for further growth in key markets Scope to innovate, in product range, retail execution and customer engagement Untapped opportunities in tech and AI Potential synergies between retail sectors (eg duty free and F&B)	Regulatory challenges (eg to tobacco sales) Economic pressures/high travel costs Aggressive bidding resulting in contract failures and bankruptcies Traditional retail offer leads to lack of interest among younger travellers Withdrawal of key brands unwilling to meet cost of entry

Duty free and travel retail remains a valuable investment opportunity for brands and retailers and an attractive shopping destination for travellers who can often buy unique products or lower priced items than in their domestic market. But the low footfall and conversion rates at airports around the world suggest that these motivations to purchase are not enough in themselves. The duty free and travel retail market has arguably been slow to innovate and to find new ways to enthuse shoppers. One reason for this lack of activity has been the inflexibility of the business model. As will be illustrated, the findings from this study strongly favour a move towards contractual agreements that encourage experimentation and innovation.

The health of the duty free and travel retail sector is crucial to airports' profitability and its capacity to invest. Given this imperative, it is in the interests of all parties to adopt a retail model that delivers value, whatever the market conditions.

Other industry resources on this subject

The business model in duty free and travel retail has been the subject of debate for some years. Indeed, in 1998 two of the authors of this study co-authored a publication, *European Airport Retailing: Growth Strategies for the New Millennium*[2], in which the prevailing business model is explored. Although much has changed in the market since then, the principles outlined in that publication remain relevant today.

Since then, the suitability of the model has been addressed by various individuals and entities whose insights have helped reflect and shape opinion within the industry.

The *Trinity Forum White Paper*, published in 2002 and coordinated by Martin Moodie with the participation of various senior industry executives, sought to highlight flaws in the existing travel retail business model and encourage greater dialogue between the three parties of the "Trinity" – landlords, retailers and brands. The paper generated debate during the challenging post-9/11 period and gave rise to an annual conference, the Trinity Forum, which continues to this day.

More recently, trade association Tax Free World Association (TFWA) has commissioned and published a number of reports that touch on this subject, including *The Partnership Imperative in Travel Retail* (Boston Consulting Group, 2018) and *Travel retail faces its moment of truth – strategies to reinvigorate the marketplace* (Kearney, 2023). Both reports contain ideas on how industry stakeholders can work together more effectively to create an engaging retail experience for travellers – which should, of course, be one of the key objectives in optimising the business model.

It is also vital to acknowledge the important work done by Airports Council International (ACI) World through the creation of its ANARA (Airports Non-Aeronautical Revenues and Activities) sub-committee. ANARA, which comprises approximately 50 executives representing airports, retailers, brands and consultants, was set up during the latter part of the pandemic to develop best practices and recommendations for the improvement of airports' commercial businesses. ANARA has overseen the publication of a number of papers which help give an understanding of the current airport retail landscape, and which ETRC members will certainly find useful and enlightening.

[2] Freathy.P,and O'Connell. F (1998*) European Airport Retailing: Growth Strategies for the New Millennium* MacMillan Press Ltd. London

PART II: METHODOLOGY

To achieve the aims and objectives set by ETRC in commissioning the study, the project methodology was divided into two stages.

Stage One

To understand the different business models currently being operated by retailers within the duty free and travel retail industry, the first stage of the project comprised a series of qualitative interviews with key players from the sector (Table 2.1).

These included airport retailers who operate a variety of contractual models across a range of different sized airports, both within Europe and the rest of the world. The authors also interviewed brand owners from each of the core duty free product sectors (perfumes and cosmetics, alcohol, tobacco and confectionery and fine food). In addition, the research sought the opinions of airport authorities and interviewed individuals responsible for commercial operations and the generation of non-aeronautical revenues. Specialist tender management agencies and market analysts, were also consulted for their insights.

Stage One focused upon understanding the different types of retail business model that are deployed in the airport retail sector, and the relative strengths and weaknesses of each. Each interview was undertaken by at least two of the research team and typically lasted sixty minutes or more. All data was subsequently transcribed and common themes identified.

In addition to the qualitative interviews, this stage of the research drew upon a range of previously published secondary sources, including data and reports from ACI, TFWA, Pi Insight and ETRC itself. Further details on sources can be found at the end of this study.

Table 2.1: Project interviewees

Interviewee job title	Organisation
Global Public Affairs Director	Global Travel Retailer
Director of Retail	Global Travel Retailer
CEO Travel Retail	Regional Travel Retailer
Global Head of Business Development	Global Travel Retailer
Director of Business Development	Global Travel Retailer
Director of Corporate Communications and External Affairs	Global Travel Retailer
Business Development Director	Global Travel Retailer
Chief Operations and Business Development Officer	Global Travel Retailer
VP Business Development	Global Travel Retailer
Duty Free Vice President	Brand Owner
Commercial and Business Development Executive	Brand Owner
Director External Affairs Duty Free	Brand Owner
Travel Market General Manager	Brand Owner
Managing Director	Brand Owner
Managing Director	Brand Owner
President Travel Retail	Brand Owner
General Manager Duty Free	Brand Owner
Head of Corporate and Legal Affairs	Brand Owner
Retail Director	Airport Authority
Chief Commercial Officer	Airport Authority
Senior Business Developer	Airport Authority
Business Development Director	Airport Authority
Commercial Director	Airport Authority
Head of Commercial	Airport Authority
Commercial Director	Airport Authority
Managing Director	Market Insight Provider
Founder and Owner	Tender Management Agency

** The brand owners interviewed included representatives from four duty and tax free product categories: liquor and wines, perfumes and cosmetics, tobacco products, and confectionery and fine foods*

Stage Two

Using the information gathered from the first phase of the research, Stage Two involved the development of four airport scenarios, as explored in Part V of this study. Each scenario envisages an airport of a defined size, and includes data on the passenger profile and spending patterns typical to an airport welcoming that level of traffic. Assumptions were made with regard to the split of EU and non-EU traffic in each airport scenario, along with levels of duty free/duty paid spend per passenger. In addition, different economic conditions and growth forecasts were included as well as a range of different market externalities. The data used in each scenario is designed to reflect an authentic trading environment, and to mirror the commercial conditions typically experienced over the course of a concession period.

The aim of this part of the study is to illustrate how different contract models respond to various market conditions. While the data used is experimental and the scenarios are not based on specific airports, it is hoped that the results provide a quantitative illustration of the relative strengths and weaknesses of the models analysed.

A note on the assumptions employed

Readers of this study will appreciate that the contract model in travel retail is subject to a large number of variables, and to infinite external factors that can help or hinder its performance.

There are numerous methods of calculating the revenue share and the minimum annual guarantee (MAG) within a classic concession contract. These may be linked to passenger numbers, to traffic sector (for example, domestic, EU or non-EU) or to nationality. Typical retail contracts will also include a concession fee by product category, itself potentially linked to traffic, and minimum requirements on service levels, capital expenditure, etc.

External factors that influence the performance of the business model can be economic (including fluctuations in consumer confidence, the health of the airline and aviation market and, crucially for duty free and travel retail, exchange rates), geopolitical (including conflicts, travel bans and tensions between states) or health-related (the COVID-19 pandemic being the most recent example).

The aim of the scenarios in Part V are to provide meaningful illustrations without adding the level of complexity that might be truer in “real life”. While acknowledging their simplicity, more in-depth, analytical cases would make the examples difficult or impossible to follow. Every airport is unique, and its commercial “fingerprint” is impossible to fully replicate. The scenarios in this report are designed to illustrate key principles and variables affecting the viability of the models rather than provide an exhaustive reproduction of the life of an airport concession.

A more detailed explanation of the construction of the case studies can be found in Part V.

PART III: THE AIRPORT TENDERING PROCESS FOR DUTY FREE AND TRAVEL RETAIL

Before looking in detail at the prevailing business models, it is important to address how tenders are typically conducted, and the factors that can influence the process.

In general terms, the more thorough the preparation, the more satisfactory the outcome for all parties. In this section we will look at the tender structure and content, and the questions airports and retailers should consider before and during the process.

Why tender?

For many airports, the above question is irrelevant. Legal obligations usually require publicly-owned airports – and those appointed by governments – to tender their commercial activities within a defined timeframe.

Airports without such obligations may decide to enter into direct negotiations with their commercial partner(s), if they are satisfied with their performance over the course of the previous contract.

The decision to tender is motivated by various factors dependent on the circumstances of each airport, with the principal reasons as follows:

- Ensuring that the full value of the concession is being attained;
- Refreshing the store design, product offer, range of customer services etc;
- Raising of commercial and retail standards;
- Optimising new commercial space;
- Facilitating the shift to a new business model (e.g. from concession to joint venture).

The tender process can be an efficient means for an airport to benchmark its commercial offer and ensure it is delivering value to both travellers and shareholders. The following example details the various stages an airport may choose to follow in order to attract a suitable partner.

Preparing the tender: how to allocate the commercial space

Once the decision to tender the commercial space has been taken, the airport or concession-issuing entity will decide which business model to adopt, and how the commercial space should be divided. Parts IV and V of this study look in detail at the contractual models that are typically deployed in airport retail, and their appropriateness for airports of various types and sizes.

Ahead of the tender, the airport's commercial team may review the overall amount of commercial space available as well as the size of each retail outlet. The retail mix will also be considered and reflect the airport's passenger profile and market positioning. At this stage, the location of the various retail units within the commercial space will also be decided upon and terminal plans developed. It may be expected that these plans are shared as part of the tender document.

To assist with the tender preparation, airports may decide to use a Specialist Management Agency (SMA). SMAs are independent bodies and may have more experience in managing tenders than the airport itself (the latter may participate in a bid only once every five or more years). Using an SMA can give the airport added insights on current market practice, identify potential bidders and help stimulate interest in the commercial opportunity. However, many airports prefer to manage the tender process in-house.

A key decision in the tender process relates to the way in which the commercial space (including duty free and travel retail, speciality retail, press, convenience, food and beverage, currency exchange, etc) is divided between the various retail activities. An airport may decide to allocate its duty free and travel retail concessions in the following ways (Table 3.1):

Table 3.1: Types of duty free and travel retail concessions

Model	Description	Advantages	Disadvantages
Concessions tendered by individual product category	Product categories (eg perfumes and cosmetics, liquor and tobacco, fashion and luxury) are tendered separately	Can enhance overall value of the concession; allows appointment of specialists	Can lead to piecemeal offer and confusion for shoppers, and to sub-optimal retail layout
Multiple operators operating separate duty free and travel retail concessions	Separate duty free concessions allocated to different companies with the right to sell the same products	Heightened competition can lead to attractive pricing for travellers	Duplication of the duty free offer is inevitable; use of space can be inefficient and the offer confusing for shoppers
Concessions tendered by market sector	Airport appoints a single operator to run all units within a defined market sector (eg duty free, F&B, fashion and luxury)	Attractive economies of scale for bidders; helps ensure specialist input; lower risk of failure	Some complexity for airport to manage multiple concessionaires; can be difficult to make changes when needed
Master concession	Airport appoints a single company to run all commercial space, including duty free, F&B, press etc	Simplifies management of commercial activities; ensures consistency of commercial approach	"All eggs in one basket"; difficult to enact change when necessary and can lead to loss of control and influence by the airport

Preparing the tender: deciding the concession duration

One of the most important considerations for an airport when preparing a tender, will be the duration of contract they award. This decision, will in part, be dependent upon a range of different factors. For example, if the offer is for a large commercial space that requires significant capital expenditure prior to operation, retailers may typically require a contract length of at least seven years in order to make a satisfactory return on their investment. For a master concession that involves the management of multiple units, the optimal contract length may be in excess of ten years.

The optimal contract length is also linked to the contractual model chosen. A shorter-term contract may be appropriate for a traditional concession but given the complexity of establishing and operating a joint venture, a longer-term relationship would be more appropriate.

Short-term duty free and travel retail concessions – for example, of three years – offer the advantage of allowing airports to frequently consult the market and thus regularly refresh their commercial offer. However, it is increasingly recognised that these limited duration contracts do not encourage investment on the part of the retailer, and can lead to short-term, profit maximising behaviour.

Recent experience in travel retail has shown the importance of contract duration. The COVID-19 pandemic has led airports and their commercial partners to pay closer attention to worst-case scenarios in their business planning. Longer contracts can help a retailer absorb sudden changes to market conditions and remain profitable over the course of the concession, while helping airports avoid the risk of contract failure.

The question of optimal contract length will be discussed further in the description of the contract models in Parts IV and V.

Preparing the tender: be aware of regulatory threats

In planning the tender and defining a contract model, the airport should consider the likelihood of any regulatory changes coming into force over the course of the concession. For example, changes to product allowances that might limit sales of items such as liquor and tobacco can significantly affect the retailer's revenue-generating capacity. Depending on the profile of the individual airport, such regulatory changes can have a severe impact on the viability and overall value of a retail business.

Preparing the tender: deciding on the data to provide

An important decision in pre-tender planning concerns the information that should be provided to potential bidders. In order to allow interested parties to submit informed proposals, it is preferable for them to have access to as much relevant detail as can be shared. Without this, bidders are more likely to either make unrealistic decisions that bear little resemblance to market reality; or, to take a more conservative approach in order to mitigate risk. Although withholding information may lead to overbidding and the generation of short-term gains for the airport, the winning concessionaire may find itself under immediate pressure to cut costs and reduce investments. This in turn results in a poor traveller experience and stagnation in the commercial offer.

The data provided in the tender documentation may include:

- 10-year passenger traffic data by terminal as appropriate;
- Passenger traffic by airline, destination, nationality and demographics;
- Traffic movements disaggregated by day, month and season;
- Passenger traffic forecasts over the duration of the concession concerned;
- Historic sales data by store and by product category;
- Sales forecasts (where historic data cannot be provided).

The tender documentation may also include details of any planned changes to the commercial space, and expectations with regard to capital expenditure and customer service levels.

Some airports may be constrained in what they can provide; for example, their agreement with the incumbent retailer may prevent them from providing historic sales data. However, sharing adequate data as part of the tender process ensures a "level playing field" for bidders. While the incumbent retailer will always have the advantage of experience, by making relevant data available the airport can ensure an equitable process for all parties.

Preparing the tender: design and other guidelines

If the airport has clear preferences with regard to store layout and design, retail branding and product assortment, airport architectural and design standards and specifications, building services provisions, logistical facilities and arrangements, these should be clearly communicated as part of the tender document, along with any requirements concerning the format of the technical and marketing presentation.

Preparing the tender: deciding how to evaluate the bids

One of the most important decisions the airport must take before launching the tender relates to the evaluation of the bids received. Does the airport require detailed technical proposals alongside or separate from the financial bid? If separate, what weighting will be given to the former and the latter?

Each airport will, of course, have its own priorities, in this and every other area of tender planning. These priorities will decide whether an airport gives equal weighting to the technical and financial bids, or whether one takes precedence over the other. Whichever approach is selected, the evaluation process should be explicitly stated within the tender document.

In order to avoid the financial proposal being the sole factor deciding the outcome of a tender, many airports will first evaluate a technical proposal – that is, the bidder's ideas on design, product range, store layout, marketing, pricing policy, CSR, digital offer, etc. A scoring system for each element is often deployed, with only those bidders reaching a certain threshold invited to be part of the financial evaluation.

The financial envelopes submitted by qualified bidders are then opened and the proposals assessed. These may also be subject to a scoring system developed by the airport. The two scores are then combined according to the defined weighting, and a preferred bidder – or a number of preferred bidders – may emerge. At that point some airports may request a 'final offer' before any decision is made.

The process outlined above is just one of many variations and possible means of evaluating the proposals received during the tender process. What seems crucial is that the financial proposal should not be assessed in isolation. A "dual envelope" approach can help the airport ensure that its technical criteria are met, while ensuring due importance is given to the financial offer.

"Data is the currency by which we win or lose. There must be an opportunity to include greater and more intelligent use of available data into concession contracts."

(Brand-owner)

To encourage realistic financial proposals, airports could also consider providing their own evaluation of the value of the concession. By including within the tender document an estimate of the target minimum annual guarantee and revenue share that they consider reasonable, the airport could help to ensure that the bids received remain realistic.

Launching the tender

To ensure a high level of interest in the tender opportunity, the airport may appoint a specialist agency as well as advertise through financial and trade media.

In the early stages of the process, potential bidders are usually invited to a briefing held at the airport, accompanied by a site visit to the commercial space being tendered. A Q&A session will be expected in order to clarify any elements of the tender document and answer queries that arise.

A crucial point relates to the time given to potential bidders to respond. Preparing a bid is a time and resource consuming process, and it is in both the airports and the bidder's interest to ensure that adequate time is given to develop proposals that meet the expectations of all parties. It is suggested that a period of three months, from launch to deadline, is the minimum required to give the best results.

During the time given to companies to prepare their bids, the airport will usually define a window for bidders to contact them with any questions. To ensure transparency, some airports have a policy whereby a question raised by one bidder may be communicated to all interested parties. Following the closure of this window, no further contact is permitted until the bid deadline.

The tender deadline

A date and time will usually be fixed by which point bidders must provide the airport with all the elements requested under the terms of the tender. To ensure due process is respected, airports will not usually open any proposals until the deadline has passed.

The evaluation process

As outlined above, the airport should be as transparent as possible with regard to the evaluation process, by publishing the weighting of the technical and financial proposals within the tender document. After assessing the bids, the airport may decide to invite preferred bidders to contest a second round of the tender, which can involve oral presentations and/or a final, “best offer” financial proposal.

The concession award

The final decision to award the concession should be taken as far in advance of the contract commencement as possible, especially if a new retailer has been selected. The handover of retail space can be a complex process and often requires significant work on the part of the incoming concessionaire. Some preparations can be made in advance, but there will be much to do upon signing the new concession contract – for example the acquisition of any trading licences or even the creation of a new local subsidiary. Ideally the tender timetable should allow ample time between the award of the contract and the beginning of the new incumbent’s operations.

In closing this section, it is important to restate that there is no “one size fits all” solution for the tender process at airports. The same is true of the business models we will explore in the following sections. However, the tender process adopted can very much influence the type and nature of the business models proposed. The purpose of this chapter is to outline how tenders in duty free are typically structured and organised, in order to provide context for the exploration of the business model over the following pages.

PART IV: UNDERSTANDING THE MODELS

This section of the study seeks to define the principal contract models that are typically deployed in duty free and travel retailing, along with the main variations of each model. The strengths and weaknesses of each model are explored, on the basis of insights received from industry stakeholders (see Part II).

Definition of the models under analysis

Concessions remain the primary means of generating retail revenues within an airport and as a consequence, vary significantly in their terms, conditions and duration. In broad terms, airport retailers operate one of four types of concession contract:

Table 4.1: Concession types

Concession Type	Description
Fixed Rent Model	Retailer rents commercial space from the airport authority and pays a fixed fee.
Revenue Share Model	Retailer rents commercial space from the airport authority and pays a fee that includes a percentage of retail sales.
Profit Share Model	Both the airport and the retailer agree to share a proportion of profits according to a pre-determined formula. A MAG may still be included in the agreement.
Joint Venture Model	The retailer and the airport authority agree to jointly manage the retail operation and create a new company to do so, collaborating through a process of common governance. Typically, the JV will pay a concession fee to the airport authority.

Other types of commercial contract may also be deployed, two examples of which are below.

Table 4.2: Management and supply contracts

Contract Type	Description
Supply Contract	An airport (or local operator) runs the retail business, appointing an external distributor to supply product.
Management Contract	A retailer is contracted by the airport to operate a concession in return for a fixed fee. Typically, the airport retains ownership of the retail business, and may decide to take back full control upon expiry of the management contract.

This study will focus on the models outlined in Table 4.1.

Fixed Rent Model

Under this form of agreement, the retailer rents commercial space from the airport authority and pays a fixed fee for an agreed period of time. Typically, a fixed rent concession means that the airport authority has no involvement in the retail operation and acts purely in the capacity of landlord.

Advantages

- Stakeholders are able to focus on their areas of expertise.
- Roles are clearly defined.
- As likely revenues are known in advance, the financial planning process is easier to forecast.

Disadvantages

- A lack of participation in the generation of commercial income means that the airport authority may have only a limited understanding of the retail business.
- There is little incentive for an airport to explore ways of improving operational and commercial efficiencies in order to enhance the traveller experience.
- There is often a tendency to adopt shorter term revenue maximising strategies rather than longer term approaches to growth generation.
- As rentals are not linked to turnover, fees may be set at a level whereby retailers struggle to meet their financial obligations, especially in difficult market conditions. This may lead to limited investment in the store infrastructure and customer service.
- Passenger traffic may increase and the airport loses out on the extra revenue due to the rent being fixed.

Fixed rent contracts are increasingly rare within the travel retail sector, in part because of their inflexibility. As this model does not allow for revisions based on traffic fluctuations, it provides significant risk for the retailer. The fixed rent structure can also encourage unrealistic proposals to be tabled during the tender process.

> ***"Unless there is some flexibility in the contract model, a retailer will base their product range on what makes them the most money, rather than on what the customer wants."***
>
> *(Retailer)*

Revenue Sharing Models

Fixed MAG Model

Concession contracts are often based on a Minimum Annual Guarantee (MAG) and a negotiated percentage of retail sales, where the fee paid to the airport is the greater of the two. Traditionally the MAG has been a fixed amount – proposed by the winning bidder during the tender process – and is designed to act as a safety net, providing the airport with a minimum level of revenue whatever the market conditions or the retailer's commercial performance.

The amount paid by the retailer through the MAG will be subject to periodical increases (typically every twelve months) and will follow a formula agreed between both parties. For example, 70% - 80% of the total concession fee paid to the airport authority in the previous year will become the new MAG in Year Two.

Advantages

- A fixed MAG concession model provides the airport with a degree of financial reassurance that assists in strategic planning. Agreement on the MAG renewal formula similarly provides the retailer with an opportunity to plan future investments.
- Similar to a fixed rent model, this form of concession contract provides the retailer with a degree of independence from the airport operator (although subject to certain conditions concerning pricing, merchandise mix etc).

"Predictability is crucial for us. Every day we spend huge amounts on improving our infrastructure. That would not be possible without the assurance that our retail model gives us." *(Airport authority)*

Disadvantages

- As there is no incentive for the airport authority to be involved in the retail operation, it may have only a limited understanding of the wider commercial pressures affecting the sector. The objectives of both parties may therefore not be strategically or operationally aligned. Relations between parties are therefore more likely to be transactional rather than collaborative.
- This form of contract can encourage the airport authority to pursue short term financial goals, rather than longer term strategic objectives.
- While the Fixed MAG model works well during periods of market growth, it is vulnerable to sudden external shocks. Its reliance upon historical data for forecasting – for example, in passenger numbers – means any subsequent decline in traffic has the potential to undermine the efficacy of the model. While overcoming such vulnerabilities can be achieved through contractual safeguards, enacting such provisions can undermine the working relationship between both parties.

- As with the fixed rent model, a fixed MAG structure can lead to unrealistic bids from organisations wishing to 'flag plant' or quickly build market share. In such cases there is a danger that the financial provisions will come to dominate the tender bid at the expense of other factors, such as the coherence of the commercial strategy.

"MAGs that are totally unrealistic have led to the withdrawal of some brands from travel retail. The traditional contract structure does not encourage product differentiation, personalisation and innovation. This is one of the reasons why conversion rates are so low all over the world." *(Brand-owner)*

Setting the MAG in the first year therefore remains a significant challenge for both parties and a number of different metrics may be used to help decide the initial amount. These include passenger numbers, destination (EU / Non-EU and the typical average passenger spend of each), product assortment and sales by category, and the size of the retail space.

Ensuring a realistic Year One MAG is crucial. Set too low, the airport may fail to reach its target commercial revenues. Set too high, the retailer may struggle to meet its obligations under the contract. This in turn can lead to a series of contingency strategies being employed, such as:

- Range restrictions: the retailer focuses upon stocking products considered to generate the highest revenue per m². Too great a focus on high-yield items can reduce differentiation, product innovation and experimentation.
- Renegotiation of supplier terms and conditions: an attempt is made to pass a proportion of the costs on to the brand owner negatively impacting relations and reducing the quality of future collaboration.
- Reducing investment in the physical infrastructure and areas such as staffing, recruitment and marketing.
- Increasing prices, resulting in the erosion of the price differential with downtown retail.

The short-term gains that an airport may make from an unrealistically high MAG are therefore negated by the long-term impact upon service and the customer experience. The financial pressure on the retailer may ultimately manifest itself in an early cessation of trade and the requirement for the airport to retender.

"Covid proved that the fixed MAG model cannot function." *(Retailer)*

Variable MAG Models

Increasingly, concession contracts in duty free and travel retail are based on a Variable MAG model. Driven by market externalities such as COVID-19, political uncertainty and economic downturns, this agreement still includes a base rent typically linked to the Consumer Price Index (CPI). However, the contract makes provision to alter the MAG to reflect changing circumstances. For example, a decline in passenger traffic – of, say, 11% below forecast – may lead to a 1% reduction in the MAG paid to the airport authority. The greater the decline in traffic, the greater the reduction of the MAG.

Airports and concessionaires may also agree to set different MAGs according to traffic destination, that is, EU (duty paid) and non-EU (duty free). As we will see in Part V, spending levels vary considerably depending on a customer's final destination, which dictates whether they can purchase at duty free prices or not. Setting a MAG that varies according to traffic sector can ensure a fair balance of risk and reward and mitigate any traffic fluctuations over the course of a contract.

Similarly, parties may agree to a MAG set by nationality, to reflect the varying spend levels among key traveller groups at a given airport – for example, the spend of French or German passengers compared to Chinese or Korean travellers. Such a model, while more reflective of the commercial reality, adds a considerable degree of complexity that may not be appropriate or manageable for some airports. A simpler solution may be to differentiate between "nationals" and "non-nationals", given that spending levels are usually much higher for the latter.

Whichever method is used, the Variable MAG model can be seen as offering the following advantages and disadvantages:

Advantages

- The airport retains a "safety net", while the concessionaire is given greater protection against external market changes.
- The level of risk is more equitably shared between both parties.
- With the goals of airport authority and retailer better aligned, communication is more efficient and geared towards joint problem solving and exploiting opportunities for expanding the market.
- A retail business can be profitable even when market conditions are difficult.
- Both parties are encouraged to invest in enhancing the traveller experience.

"With some models – for example, a joint venture – the risk is shared too much. With a MAG linked to traffic, the balance is about right. If we deliver the traffic, it's up to the retailer to deliver the sales." *(Airport authority)*

Disadvantages

- For the airport, a variable MAG adds uncertainty with regard to revenue forecasting;
- As long as the MAG remains the core feature of the model, unrealistic tender proposals remain possible.

It is important to note that under most revenue share models, the split between airport and retailer will usually vary by product category and reflect the relative sales and profit levels generated by each.

"Flexibility is the key. The concession structure has to take account of the specific characteristics of each product category, and of the airport's passenger profile."

(Brand-owner)

Profit Share Models

Although not yet a common feature of the duty free and travel retail sector, profit share models are seen as a viable alternative to the traditional concession structure. Under this type of arrangement, airport and retailer agree on a percentage share of any profits generated over the period of the contract. This does not preclude the existence of a MAG and typically the retailer remains responsible for operating and investing in the stores.

At the same time, the airport authority is expected to play a proactive role in overseeing the business and creating the conditions for sustainable sales growth. Collaboration under this form of agreement obliges both parties to identify opportunities for growth and for cost savings – for example, through improvements in supply chain efficiencies, joint advertising and the streamlining of administrative procedures.

This model requires total transparency between airport and retailer. Regular independent audits will be conducted, with reports given to an oversight committee. The success of the model depends on a high level of trust between the parties, and a close working relationship between dedicated, well-established teams on both sides. Agreements on budgets, financial outlays and investments will need to be reached, with regular reforecasts. This model functions best if the local teams responsible for the partnership are given a degree of autonomy to allow the necessary speed of response.

"[The profit share model] gives us "skin in the game" without requiring major investment. It allows an exchange of data that gives us the ability to make forecasts with the best available knowledge." *(Airport authority)*

The key "pros and cons" of this model can be expressed as follows:

Advantages

- Encourages collaboration and joint problem solving; the goals of airport and retailer are fully aligned.
- Encourages strategic planning on issues such as route expansions, gate allocation and passenger profiles.
- Encourages data sharing between airport and retailer.
- Provides the retailer with a degree of protection against external market changes.
- The model can be considered more customer-centric, as it gives the retailer the confidence to innovate, to evolve the merchandise mix and to experiment with new product categories.
- Risk and reward fully shared between the parties.
- It helps avoid unrealistic tendering.

"Travel retail is fast moving. Under a profit share model you can adapt to emerging trends more quickly and with less risk." *(Retailer)*

Disadvantages

- Limited applicability; for example, state-owned airports may not have the autonomy or authority to agree to a profit share model, or have the management resources and expertise required.
- There is the potential for the blurring of roles between airport authority and retailer leading to a loss of accountability.
- A potential tension exists between centralised purchasing terms set by corporate HQ, and the implementation of a local strategy.
- The model requires constant oversight and can be reliant upon key individuals for the success of the relationship. As the model requires a collaborative mindset on the part of all parties, it is vulnerable to personnel change.
- Can be difficult to get agreement over specific funding initiatives. One party may not see proposed additional expenditure as adding value and seek to block or limit investments.
- Requires all signatories to 'create value'. Tensions may arise when one of the parties are perceived as underperforming or not engaging.
- Local agreements between the airport authority and the retail operator may not always align with the broader corporate strategy of either organisation.

"We are not against the profit share model, but it is totally dependent on trust."

(Retailer)

It is important to stress that the profit share model can be underpinned by a MAG, thus giving the airport greater visibility of future revenues.

Even the strongest proponents of the profit share model in travel retail agree that it is not appropriate for every location and not all companies will be comfortable with an "open-book" approach. However, the profit share model encourages the alignment of objectives between both parties and helps ensure a commercial strategy that is focused on the traveller experience.

Joint Venture Model

Joint ventures (JVs) take many different forms. Typically, a JV is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. They most commonly take the form of a separate legal entity. Each of the participants in a joint venture is responsible for profits, losses and costs. Risks and returns are shared and the activity is managed through a system of agreed common governance. As the venture is its own entity, it remains separate from the participants' other business interests.

In recent years, a number of airports of varying sizes and geographies have embarked on JV partnerships with travel retailers to manage their commercial activities.

The form that the JV actually takes may be subject to both national and international regulations. For examples, a JV with a local business may be a legal prerequisite and subsequently lead to the formation of a tri-partite agreement between an airport, a retailer and a local partner.

The JV model requires a number of conditions to be in place for the best results. Among them are the following:

The correct partner: sufficient time and effort needs to be allocated to selecting the correct JV partner. Choosing a partner that does not have the vision, strategy or ability to support the relationship are amongst the most common reasons for failure.

A common alignment between each party is essential for the success of a JV. From the outset, all entities involved need to agree common goals and purposes as well as timescales. These objectives may be commercial (for example, expected ROI) as well as non-financial (for example, a commitment to sustainability). Both parties within a collaborative relationship need to be clear over what is required during the period of the contract.

Active not passive participation: all partners in a JV agreement are required to play a substantial and active role in the relationship. This should extend beyond the management team and consider the role that may be played by shareholders in the success of the venture. If one side of the partnership remains inactive or dormant, then the long-term viability of the project is likely to be limited.

Length of contract: given the complexities of establishing a JV and the investment required, contracts should ideally be longer than for concession agreements (a minimum of 10 years with preference for longer agreements of up to 25 years).

Size of airport: given the management resources, investment and infrastructure required to establish a joint venture operation, some airports may not command the critical mass to justify such a model (although in some cases it may be possible to create a JV that has responsibility for a portfolio of airports).

Among the advantages and disadvantages of the JV model are the following:

Advantages

- A JV partnership may lead to a higher degree of commercial engagement from the airport than other models – goals between the partners are closely aligned.
- At the strategic level, a JV can demonstrate market resilience especially during periods of economic uncertainty. JVs not only share a proportion of the commercial risk but also encourage a solutions-based approach through dialogue and joint problem solving.
- A JV may also encourage the airport to adopt a more holistic approach when selecting a partner, rather than being obliged to accept the highest financial offer.
- Greater airport involvement in the commercial business can result in a more meaningful use of data and more effective communication with travellers at various touchpoints.
- A JV partnership may provide the retailer with additional skills and expertise, for example in understanding local customs and practices, regulatory compliance, due diligence and corporate governance.

"In our view, companies should stick to what they do best. For us, that's running an airport; for our retailers, it is running the stores." *(Airport authority)*

Disadvantages

- A JV is often complicated and costly to set up.
- A JV partnership may limit the ability of the retailer to respond quickly to market conditions as the requirements of all parties will need to be considered, discussed and agreed.
- As part of the JV agreement, formal, corporate processes will need to be established, adding a complexity to the commercial model.
- If commercial performance does not reach the level required, the JV model can be difficult to modify or exit.
- The performance of the JV can be negatively impacted if there is a high level of turnover of commercial management across the partnership.

It is generally agreed that commercial JVs between airports and retailers function best in large airports with significant levels of retail revenue. Success is highly dependent on experienced and dedicated personnel; before making the decision to enter into a joint venture, airports will need to ensure they have the right resources in place. As with the profit share model, trust between the partners is paramount.

"Covid helped us understand very clearly what can happen if the business model is not adaptable enough. It was the retailers that felt the greatest impact, and they have understood that change is needed. But it is the airports that are key to achieving real progress." (Brand-owner)

As this section demonstrates, there is no "one size fits all" contract model in travel retail. An airport's approach will depend on its size, its ownership structure, its passenger profile, its market positioning, and its commercial objectives. But it seems clear that, in a post-COVID-19 world, flexibility is the key to ensuring growth for all parties and a fair balance of risk and reward. All models perform well when market conditions are positive, but if they do not allow sufficient protection during tougher times, the fragility of the model becomes clear.
The next section attempts to demonstrate that introducing a degree of flexibility into the contract model can help ensure profitability whatever the external conditions.

PART V: EXPLORING THE MODELS

In this section we will explore four scenarios, each based on an imaginary airport whose characteristics are described in detail. In each airport, the duty free and travel retail business is operated according to a different contract model, over a period of seven years in which market conditions change.

Each case is designed to examine the impact of certain variables on the business model.

- In **Scenario One**, we will see how a decline in passenger traffic can have a dramatic impact on a fixed concession model.
- **Scenario Two** shows what can happen when the value of an airport retail business is over-estimated by a bidder during a tender process.
- **Scenario Three** features a large airport with a diverse customer base, where the structure of the contract model can change the balance of risk and reward between landlord and retailer.
- **Scenario Four** demonstrates the importance of traffic by sector (EU and non-EU) and the influence that changes in these traffic flows can have on the business model.

These illustrations cannot include every possible factor that influence the retailer-airport relationship. The aim is to demonstrate how different contract models are affected by market externalities and to explore whether certain models are better adapted to absorb unanticipated changes in the trading environment.

SCENARIO ONE: BOREAS AIRPORT

1. Background

Boreas is a Northern European airport located in an EU country south of the Arctic Circle. Its location makes it popular with winter sports enthusiasts, walkers and individuals wishing to experience the Northern lights. It is one of eleven small regional airports managed by the state authority. The data contained within the case examines passenger flows and revenue spend over a period of seven years.

2. Economic Outlook

Historically, the country has had a strong economy based upon oil, gas as well as chemical and metal production. However, the data illustrates that the country fell into a recession approximately four years ago. This had an immediate impact upon prices and interest rates affected consumer demand for the next two year. More recently, real GDP growth has improved and is expected to be 0.1% in this coming year and forecast to increase to 1.2% by the year after (Table 5.1.1).

Table 5.1.1: Economic indicators

Indicators	Current Year	Next Year	Following Year
GDP growth (%, YoY)	-1.2	0.1	1.2
Inflation (%,YoY)	3.2	2.1	1.4
Unemployment (%)	6.6	6.3	6.1

At the start of this year there has been a slight improvement in consumer confidence. This has been stimulated by wage growth exceeding inflation and cuts to personal taxation. Both measures are set to strengthen purchasing power and support household spending. At the same time analysts are concerned that a new package of consolidation measures coming into force may impact upon a recovery in consumption. In particular an increase in the standard rate for VAT from 22.5% to 23.5%.

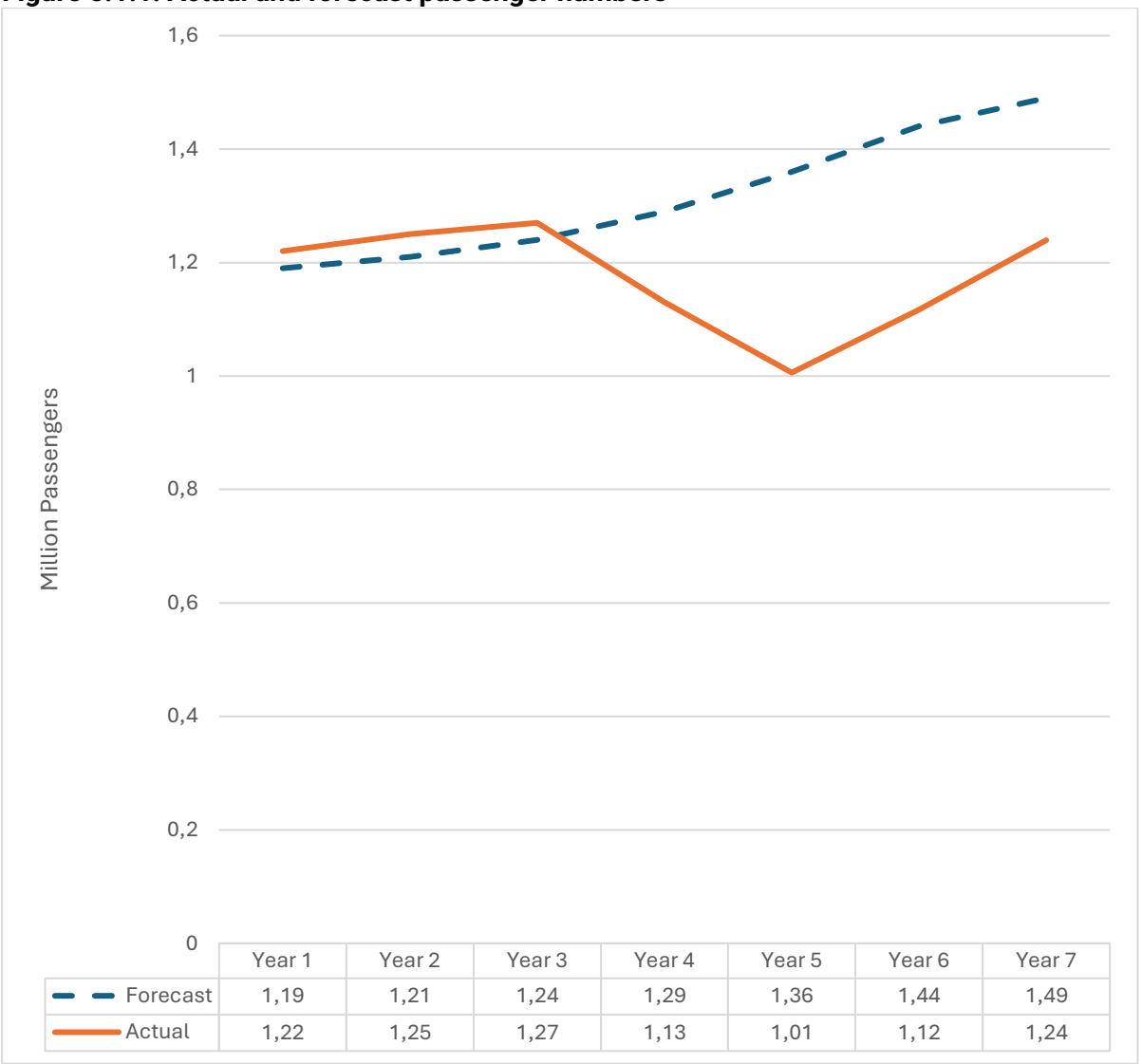
3. Boreas Airport overview

- Currently ten different airlines operate from the airport, but only two offer flights all year round;
- Since the outbreak of the Ukraine conflict, all flights to and from the Russian Republic have ceased;
- The airport does not have any transit passenger traffic;
- International flight arrivals are primarily from the UK and Ireland, Germany, Switzerland and Holland. These are almost exclusively, seasonal charter flights;
- The airport employs 11 people full time, increasing to around 50 during the high season.

4. Boreas Airport Passenger Traffic

Figure 5.1.1 illustrates that between Years 1 and 3, the actual number of individuals travelling exceeded the airport's forecast. However, in Years 4 and 5 there was an 11% year on year decline in passenger numbers. Since then, passenger numbers have been increasing at a similar 11% year on year rate.

Figure 5.1.1: Actual and forecast passenger numbers



	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Forecast	1,19	1,21	1,24	1,29	1,36	1,44	1,49
Actual	1,22	1,25	1,27	1,13	1,01	1,12	1,24

A breakdown of the passenger mix reveals a relatively even split between passenger arrivals and departures (51%/49%) while scheduled and international passengers make up 58% and 30% respectively (Table 5.1.2).

Table 5.1.2: Passenger breakdown

Arrivals	611,020		
Departures	603,770		
Total	1,214,790		
Scheduled		702,020	
Charter		512,770	
Total		1,214,790	
International			364,440
Domestic			850,350
Total			1,214,790

The latest figures show a 3.35% increase in traffic over the previous year. Passenger volumes are unevenly distributed throughout the year. December is the busiest month for the airport accounting for 372,327 passengers (approximately 30.7% of total passenger traffic). This compares with an average of 97,183 passengers per month between the months of May and October.

5. Airside Retail at Boreas Airport

The current airside retail offer includes two F&B units and a general merchandise unit offering books, newspapers, a limited range of pharmaceutical products as well as a selection of sandwiches and soft drinks. There is no fast food offer in the airport.

The airport has a single duty free and travel retail store offering Liquor, Tobacco, Beauty and Confectionery. The offer also includes a small range of local souvenirs. The store has approximately 168m² of net selling space with another 18sq metres of storage.

Total duty free and travel retail sales within the store amounts to €3,644,970 per annum.

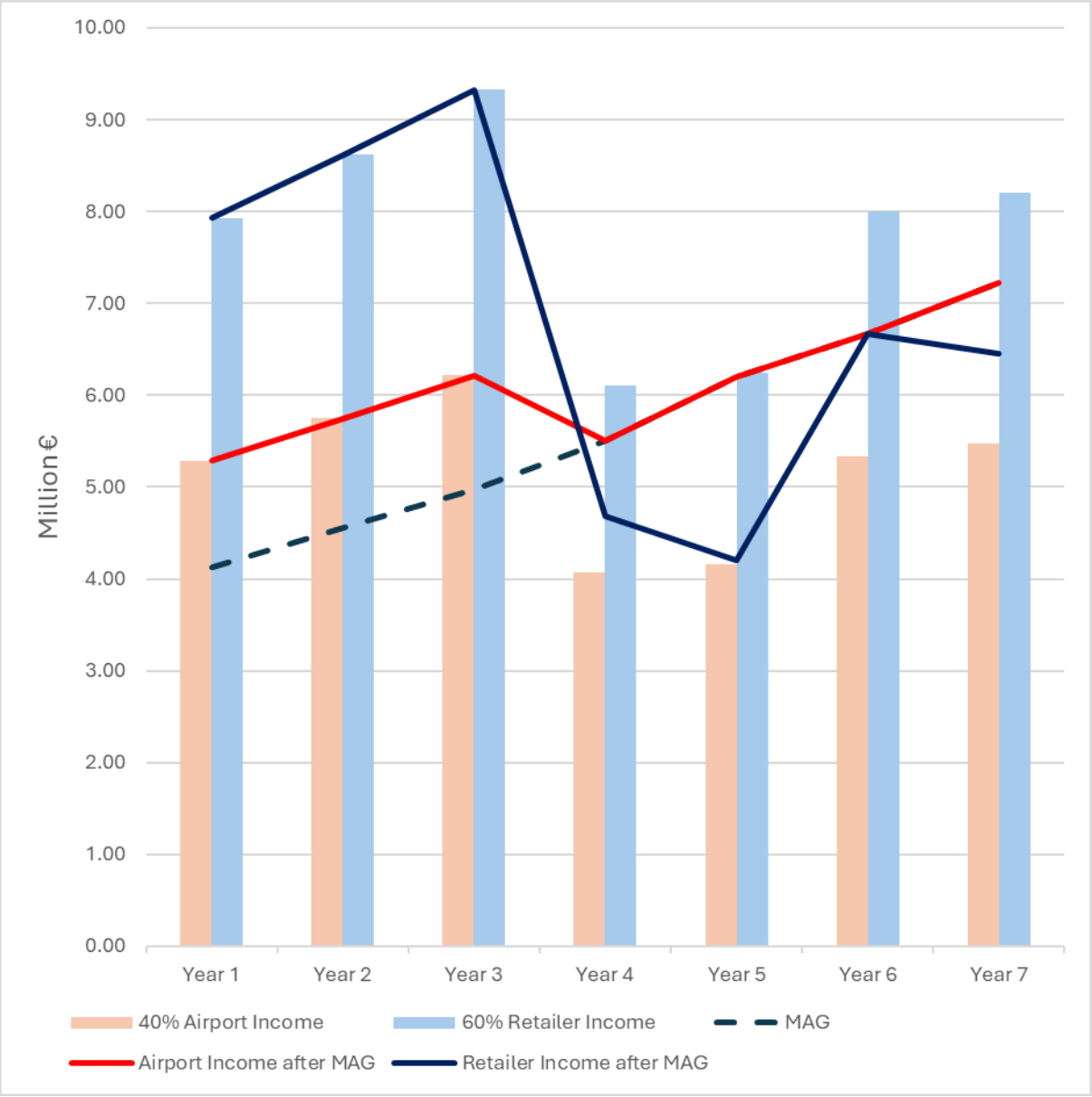
In Year Seven, the average passenger spend across all airside commercial activities in the airport was €18.75 per person, while the average, retail transaction within the store, was €11.03.

Table 5.1.3: Passenger and revenue data: Boreas Airport

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Passengers (Millions)							
Forecast	1.19	1.21	1.24	1.29	1.36	1.44	1.49
Actual	1.22	1.25	1.27	1.13	1.01	1.12	1.24
+/- Forecast	+0.03	+0.04	0.03	-0.16	-0.35	-0.32	-0.25
Sales Per Pax (€)	10.83	11.49	12.24	9.01	10.34	11.94	11.03
Total Revenues (€m)							
Forecast	12.89	13.90	15.18	16.78	18.89	20.33	22.02
Actual	13.21	14.36	15.54	10.18	10.40	13.33	13.67
MAG (€m)							
Fixed	4.12	4.56	4.98	5.50	6.20	6.67	7.22
Revenue Share pre-MAG (€m)							
Airport 40%							
Forecast	5.16	5.56	6.07	6.71	7.56	8.13	8.81
Actual	5.29	5.75	6.22	4.07	4.16	5.33	5.47
+/- Forecast	0.13	0.18	0.15	-2.64	-3.40	-2.80	-3.34
Retailer 60%							
Forecast	7.73	8.34	9.11	10.07	11.33	12.20	13.21
Actual	7.93	8.62	9.33	6.11	6.24	8.00	8.20
+/- Forecast	0.19	0.28	0.22	-3.96	-5.09	-4.20	-5.01
Revenue Share post-MAG (€m)							
Airport	5.29	5.75	6.22	5.50	6.20	6.67	7.22
Retailer	7.93	8.62	9.33	4.68	4.21	6.66	6.45

The MAG at Boreas is fixed and there is an agreed 40% airport / 60% retailer revenue share. For Year One, the MAG is set at 80% of the airports forecast revenues (€5.16million*0.8). Each subsequent year the MAG is again set at 80% of forecast sales, plus a 2% CPI adjustment.

Figure 5.1.2: Duty free and travel retail revenues



Between Years One and Three, total revenues exceed the forecast and the MAG was not employed. However, the decline in passenger traffic during Years Four and Five led to the airport to enforce the MAG between years Four and Seven. The financial consequences of this for both the airport and the retailer are illustrated in Tables 5.1.4 and 5.1.5.

If the airport operated under a simple revenue share model with no MAG, then both parties would see their actual revenues approximate to 75.6% of forecast sales over the period of seven years (Table 5.1.4).

Table 5.1.4: Revenue share without MAG

	Revenue Forecasts (€ million)	Revenue Actual (€ million)	Difference (€ million)	Actual revenue as a % of forecast sales
Airport	48	36.28	-11.72	75.59
Retailer	72	54.43	-17.57	75.59

However, when the MAG is employed, this contractual requirement leads to the following revenue share readjustment (Table 5.1.5).

Table 5.1.5: Revenue share with MAG employed

	Revenue Forecasts (€ million)	Revenue after MAG (€ million)	Difference (€ million)	Actual revenue as a % of forecast sales
Airport	48	42.84	-5.16	89.26
Retailer	72	47.87	-24.13	66.49

In financial terms, the additional cost to the retailer of the Fixed MAG at Boreas is €6.56 million or 12.05% of their total sales turnover.

Observations

The fixed MAG model functions well when traffic and sales per passenger are growing steadily, as at Boreas Airport during Years 1 to 3. However, the fragility of the model becomes clear when market conditions change, as in Year 4 of this illustration.

The fixed MAG performs the function for which it is designed – to give the airport a "safety net". At Boreas, this ensures the airports Year 4 revenues compare favourably with those during the first three years of operation. However, the triggering of the fixed MAG in Year 4 means the retailer's revenue is reduced by almost a quarter that year and does not recover thereafter.

This imbalance of risk is likely to have a number of effects on the duty free and travel retail offer at Boreas. The retailer will be forced to introduce cost-cutting measures that may impact on staffing and customer service, coupled with price increases on many product lines. There will most likely be an increased reliance and focus on the brands and products that generate the most revenue per m². This is likely to the detriment of innovation and experimentation. Moreover, it is unlikely that investments in areas such as digital services will be introduced.

This scenario also illustrates that, under this contract model, it is incumbent on both airport and retailer to ensure that forecasts made during the tender process are realistic and take account of the possibility of sudden market change.

SCENARIO TWO: NOTUS AIRPORT

1. Background

Notus Airport is located in a EU member state in Southern Europe. The airport is approximately 18km from the nearest city which has a population of just under 750,000. The region has a hot, semi-arid climate and experiences mild winters and dry summers. The economy is heavily reliant upon both tourism and agricultural exports (lemons, oranges and olives). These sectors combined account for approximately 75% of the region's GDP.

During the summer it is estimated that up to 23 million tourists will visit the city and travel into the surrounding countryside. The majority of these visitors arrive either by air or via the newly opened cruise terminal.

Notus Airport was significantly redeveloped just over fifteen years ago, with additional space being given over to the generation of commercial income. As it is a state-owned enterprise, all commercial activities (including retail, car parking and F&B) are subject to a competitive tender. The usual length of concession has been seven years.

Sancus Trading was the first duty free and travel retailer to operate at Notus Airport after the redevelopment. After managing the concession for seven years, this concessionaire was replaced by Acrasia Global following a competitive tender. The data below details the trading performance of both companies over a fourteen-year period.

2. Economic Outlook

After a sustained period of economic growth, approximately five years ago the country experienced a sharp decline in its tourist base. This had an immediate impact upon local employment and led to increases in prices and consumer demand.

Table 5.2.1: Economic indicators

Indicators	Current Year	Next Year	Following Year
GDP growth (%, yoy)	-1.2	0.2	1.4
Inflation (%, yoy)	3.9	4.1	4.0
Unemployment (%)	9.6	8.8	7.1

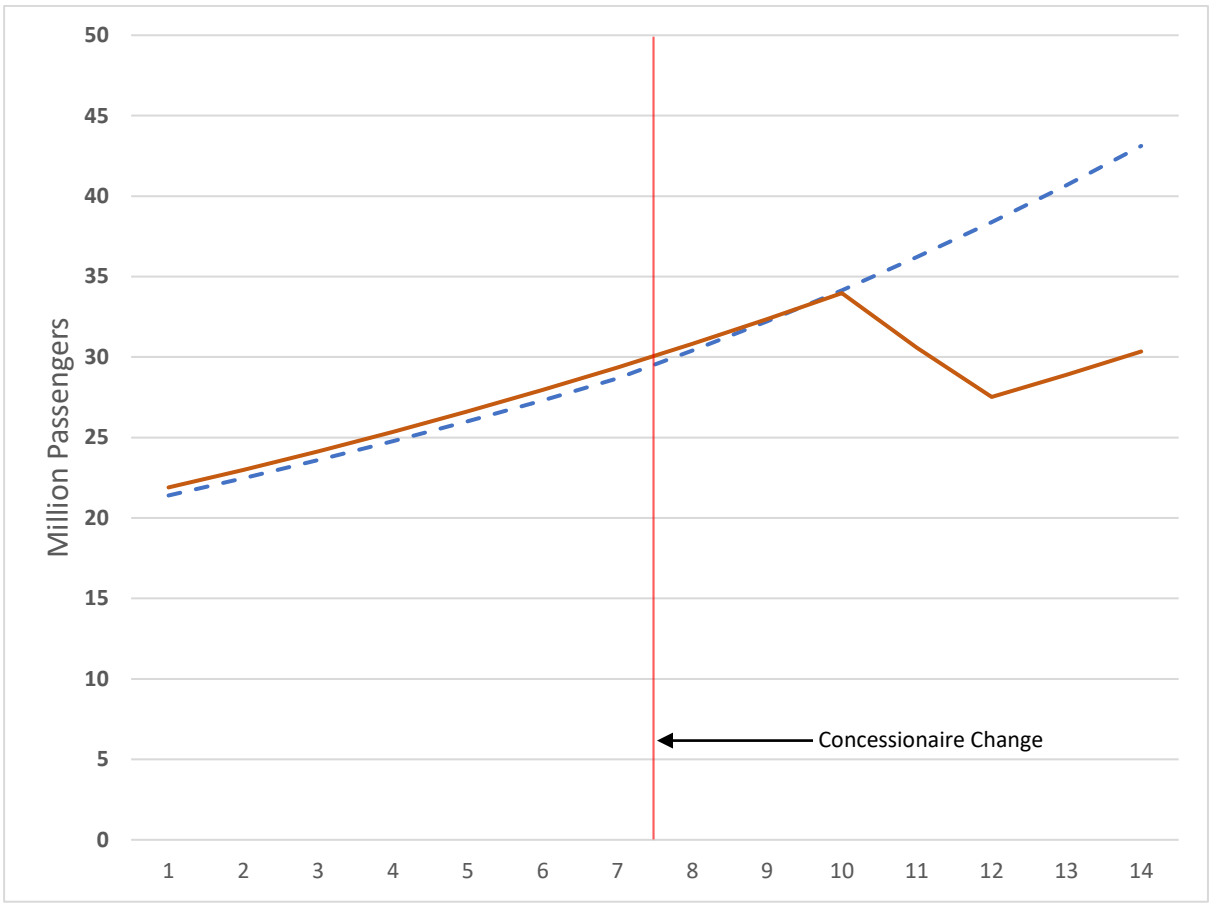
More recently, visitor numbers have begun to increase with total overnight stays (domestic and foreign tourists) being at their highest levels for six years. Thanks to this boost from tourism, the region saw the volume of retail trade sales grow by 4.1%. Although not fully recovered, real GDP growth is expected to be 0.2% higher in this coming year and forecast to increase to 1.4% by the year after (Table 5.2.1).

3. Notus Airport overview

- Notus Airport employs approximately 650 people, although nearly 8,000 people work for the various companies and organisations based in and around the airport;
- It operates from a single terminal with three piers;
- Currently 63 different airlines operate from the airport;
- 32% of travellers are domestic;
- The airport has only limited transit passenger traffic (less than 2%);
- Flight arrivals are primarily from Spain, Germany and the UK;
- There are a limited number of intercontinental routes are to the USA, North Africa and the Middle East;
- Approximately 72% of travellers are leisure passengers;
- There is just over 14,000m² of commercial space (including 29 F&B outlets and 21 shops);
- The airport attracts a number of international clothing, lifestyle and accessory brands;
- The tender for the duty free and travel retail tender was launched by the airport a year before the expiry of Sancus Trading's concession, according to the requirements of the local municipality that owns the airport;
- There was some disquiet from potential bidders as the airport provided minimal data on the number of existing travellers, possible airline route developments and future passenger numbers;
- Acrasia Global replaced Sancus Trading after it offered the airport a significantly improved revenue split and MAG guarantee than the incumbent.

4. Notus Airport Passenger Traffic

Figure 5.2.1: Actual and forecast passenger numbers



Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Forecast	21.4	22.5	23.6	24.8	26.0	27.3	28.7	30.4	32.2	34.2	36.2	38.4	40.7	43.1
Actual	21.9	23.0	24.1	25.4	26.6	28.0	29.3	30.8	32.4	34.0	30.6	27.5	28.9	30.3

Figure 5.2.1 shows that between Years One and Seven the airport experienced a passenger growth rate of approximately 5% per annum. This exceeded the airport's forecast in each year. As a consequence, when the contract was re-tendered, the airport forecast a passenger growth rate of 6% per annum from year eight onwards.

However, due to a decline in tourism and leisure passengers, overall traffic numbers fell below forecast for the first time in Year Ten. In Years Eleven and Twelve, this decline continued and Notus Airport suffered a 10% YoY fall in passenger traffic. Eventually the market began to recover with a 5% increase in the final two years.

A breakdown of the passenger mix reveals a relatively even split between passenger arrivals and departures (50.5%/49.5%), Scheduled and international passengers make up 27% and 72% respectively (Table 5.2.2).

Table 5.2.2: Passenger breakdown (latest figures)

Arrivals	15,018,395		
Departures	15,321,797		
Total	**30,340,192**		
Scheduled		8,191,851	
Charter		22,148,341	
Total		**30,340,192**	
International			21,844,938
Domestic			8,495,254
Total			**30,340,192**

Passenger volumes are unevenly distributed throughout the year. The summer season is defined as being between May and September and accounts for 64% of passenger traffic (approximately 19.4 million travellers).

Table 5.2.3: Busiest routes to and from Notus Airport

Rank	Airport	Passengers	% Change on previous year
1	Hamburg	1,516,339	+ 3.2%
2	Manchester	1,079,405	+ 4.2%
3	Barcelona	1,075,443	+ 2.5%
4	Düsseldorf	1,061,987	+ 1.9%
5	Madrid	957,198	+ 10.4%
6	Hannover	848,993	+ 3.2%
7	Dublin	847,164	+ 0.8%
8	Birmingham	846,773	+ 1.1%
9	Frankfurt	842,730	+ 0.3%
10	Alicante	798,518	+ 1.5%
11	London Stansted	797,711	+ 2.1%
12	Zurich	695,294	+ 0.8%
13	Paris Orly	681,877	- 0.2%
14	London Luton	666,914	+ 2.5%
15	Stuttgart	663,002	+ 3.7%
Total		13,379,348	40.1% of total traffic

5. Airside Retail at Notus Airport

- Duty free and travel retail at the airport comprises a main walk-through store, plus three Express stores;
- The main retail store employs nineteen full time members of staff and up to twenty-six, part time employees depending upon the time of year;
- Total duty free and travel retail space comprises approximately 2,000m² of net selling space across the four units (1400m² + 200m² + 200m² + 200m²) with another 180m² of storage;
- In Year 14, total sales across the four airside stores were approximately €251.52 million;
- The figures on average passenger spend across all airside commercial activities in Year 14 was €12.98 per person. Of this, €8.29 was spent on duty free and travel retail goods.

6. Concession One: Sancus Trading (Years 1-7)

Table 5.2.4 highlights the income generated from duty free and travel retail and the split between the airport and the first retail provider (Sancus Trading). The contract agrees a 40% airport / 60% retailer revenue share with a Fixed MAG.

For Year One, the MAG is set at 80% of the airports forecast revenues (€55.04million*0.8). Each subsequent year the MAG is again set at 80% of forecast sales, plus a 2% CPI adjustment.

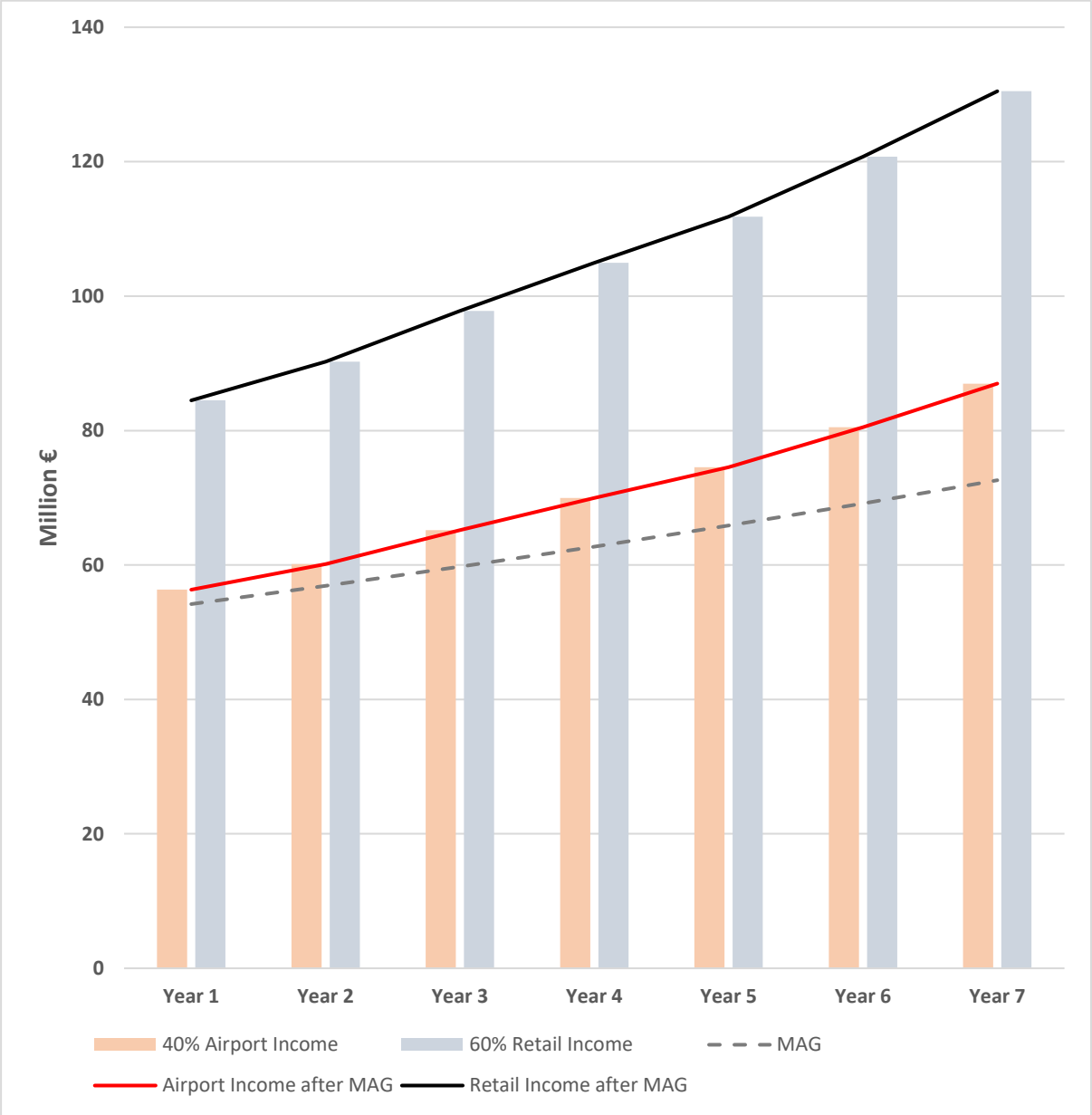
Table 5.2.4: Sancus Trading passenger and revenue data

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Total Passengers (Millions)							
Forecast	21.4	22.47	23.59	24.77	26.01	27.31	28.68
Actual	21.9	23.00	24.14	25.35	26.62	27.95	29.35
Sales Per Pax €	6.43	6.54	6.75	6.9	7	7.2	7.41
Total Revenues (Millions €)							
Forecast	137.60	146.95	159.26	170.93	182.08	196.65	212.50
Actual	140.82	150.39	162.98	174.93	186.34	201.24	217.47
MAG (Millions €)	44.03	48.20	52.24	56.07	59.72	64.50	69.70
Revenue Share Pre MAG (Millions €)							
Airport 40%							
Forecast	55.04	58.78	63.70	68.37	72.83	78.66	85.00
Actual	56.33	60.15	65.19	69.97	74.53	80.50	86.99
+/- Forecast	+1.29	+1.37	+1.49	+1.60	+1.70	+1.84	+1.99
Retailer 60%							
Forecast	82.56	88.17	95.55	102.56	109.25	117.99	127.50
Actual	84.49	90.23	97.79	104.96	111.80	120.75	130.48
+/- Forecast	+1.93	+2.06	+2.24	+2.4	+2.55	+2.76	+2.98
Revenue Share Post MAG (Millions €)							
Airport 40%	56.33	60.15	65.19	69.97	74.53	80.50	86.99
Retailer 60%	84.49	90.23	97.79	104.96	111.80	120.75	130.48

The contract stipulated that the MAG should be fixed. For Year One, the MAG is set at 80% of the airports forecast revenues (€55.04million*.80). Each subsequent year the MAG is again set at 80% of forecast sales, plus a 2% CPI adjustment.

Figure 5.2.2 illustrates the trading performance of Sancus over that initial seven-year period. As the airport experienced 5% year on year growth in passenger traffic, retail revenues exceed the minimum guaranteed amount. As a consequence, the MAG was not triggered.

Figure 5.2.2: Sancus Trading: revenue share model



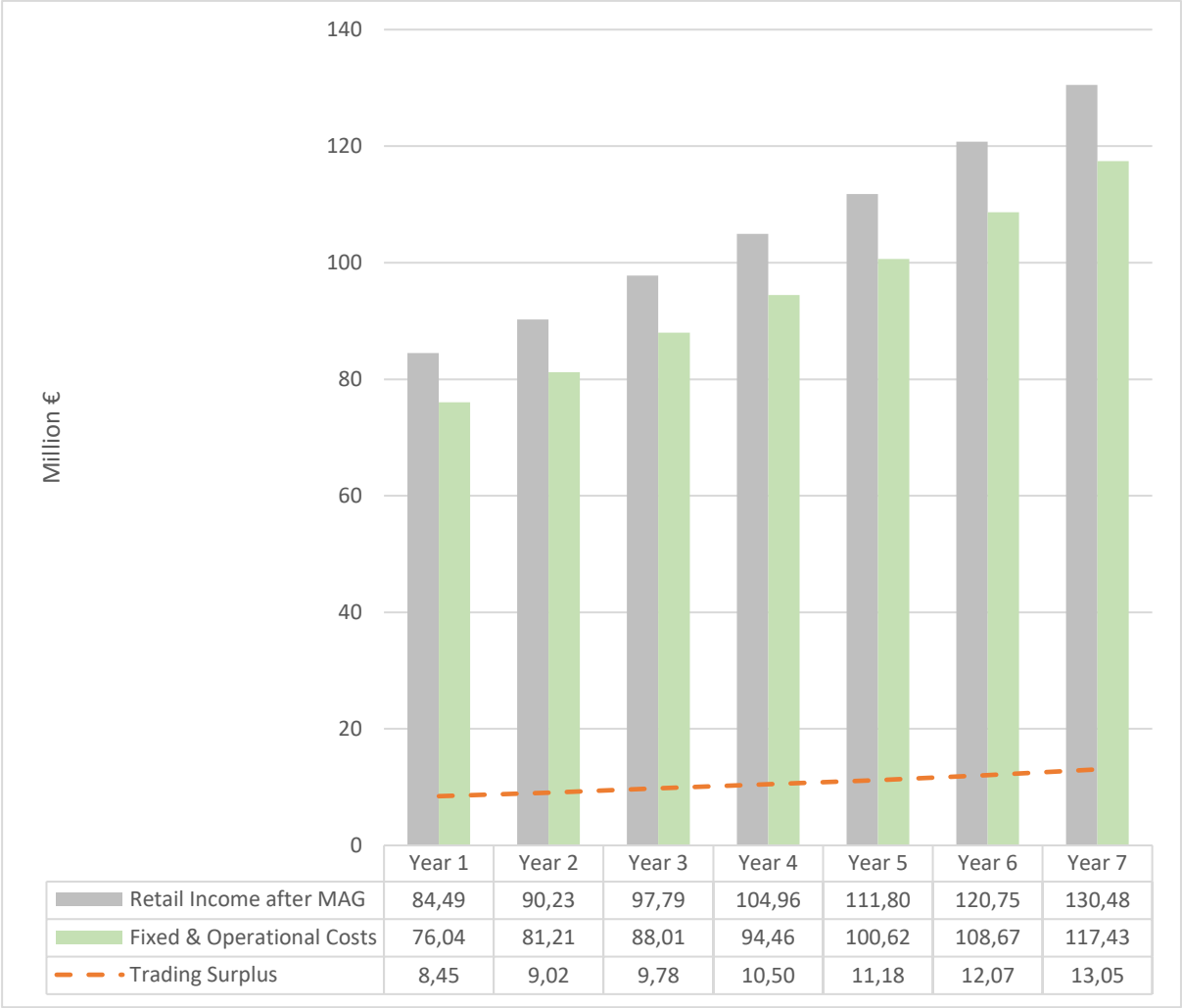
In addition to the concession fee paid to the airport, Table 5.2.5 provides an estimated breakdown of the additional costs incurred by Sancus during their period of operation at Notus airport.

Table 5.2.5: Sancus Trading consolidated seven year Income and Expenditure account

	Income (€ Millions)	Expenditure (€ Millions)	As % of Income
Retail Sales	1234.16		
Concession Fee		493.66	40%
Cost of Goods Sold		431.95	35%
Staff Costs		86.39	7%
Operating Costs		37.02	3%
Logistics & IT		37.02	3%
Capex		24.68	2%
HQ/Support		49.37	4%
Total Expenditure		**1160.09**	
Trading Surplus	**74.07**		**6%**

Sancus Trading operated on a net margin of approximately 6% across the period of the contract. This is illustrated further in Figure 5.2.3.

Figure 5.2.3: Sancus Trading: YoY Income and Expenditure account



	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Retail Income after MAG	84,49	90,23	97,79	104,96	111,80	120,75	130,48
Fixed & Operational Costs	76,04	81,21	88,01	94,46	100,62	108,67	117,43
Trading Surplus	8,45	9,02	9,78	10,50	11,18	12,07	13,05

7. Concession Two: Acrasia Global (Years 8-14)

As noted above, Notus Airport launched a competitive tender for its duty free and travel retail concession upon expiry of Sancus Trading's contract. The contract was awarded to Acrasia Global, who took over the operation of the stores from Year 8.

Table 5.2.6 highlights the total income generated from duty free and travel retail and the split between the airport and the new concessionaire (Acrasia) during years eight to fourteen. The new contract agreed a 45% airport / 55% retailer revenue share (compared with the 40/60 split in effect during the previous concession).

Table 5.2.6: Acrasia Global: passenger and revenue data

	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14
Total Passengers (Millions)							
Forecast	30.40	32.22	34.16	36.21	38.38	40.68	43.12
Actual	30.82	32.36	33.97	30.58	27.52	28.89	30.34
Sales Per Pax €	7.48	7.9	8.08	8.04	8.05	8.2	8.29
Total Revenues (Millions €)							
Forecast	227.38	254.56	275.98	291.09	308.94	333.58	357.47
Actual	230.50	255.61	274.51	245.84	221.53	236.94	251.52
MAG (Millions €)	81.86	96.22	104.32	110.03	116.78	126.09	135.13
Revenue Share Pre-MAG (Millions €)							
Airport 45%							
Forecast	102.32	114.55	124.19	130.99	139.02	150.11	160.86
Actual	103.72	115.03	123.53	110.63	99.69	106.62	113.18
+/- Forecast	+1.4	+0.48	-0.66	-20.36	-39.33	-43.49	-47.68
Retailer 55%							
Forecast	125.06	140.01	151.79	160.10	169.92	183.47	196.61
Actual	126.77	140.59	150.98	135.21	121.84	130.32	138.33
+/- Forecast	1.71	0.58	-0.81	-24.89	-48.08	-53.15	-58.28
Revenue Share Post-MAG (Millions €)							
Airport 45%	103.72	115.03	123.53	110.63	116.78	126.09	135.13
Retailer 55%	126.77	140.59	150.98	135.21	104.75	110.85	116.39

For Year One, the MAG was set at 80% of the airports forecast revenues (€102.32 million*0.8). Each subsequent year the MAG is again set at 80% of forecast sales, plus a 4% CPI adjustment.

The airport's agreed share of retail revenues exceeds the minimum guarantee during the first four years of the new contract. However, a slight drop in passenger numbers in Year Ten, followed by more significant declines in Years Eleven and Twelve, led to revenues being significantly below forecast and the MAG being triggered during the final three years of the contract (in red).

Figure 5.2.4: Acrasia Global: revenue share model

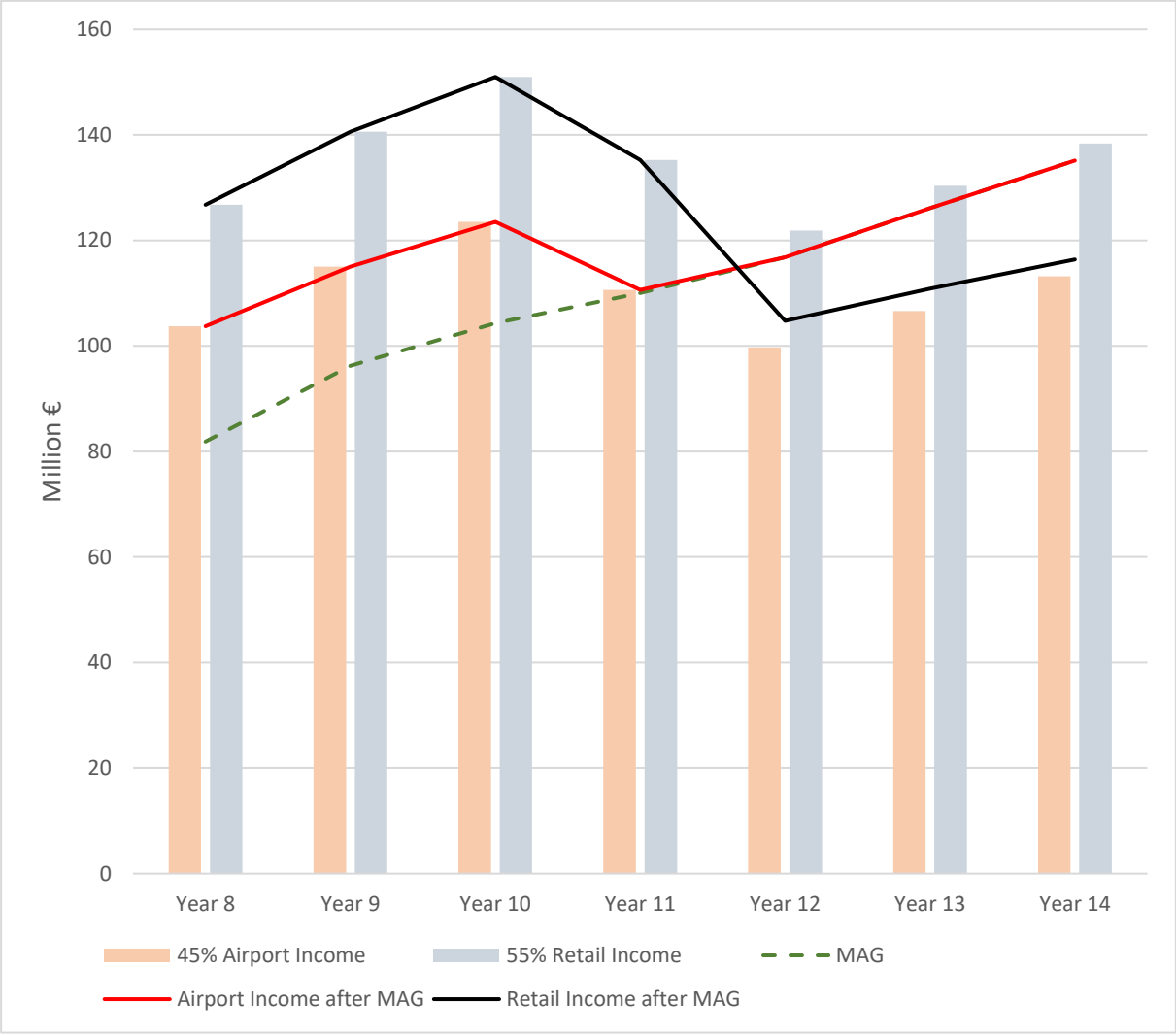


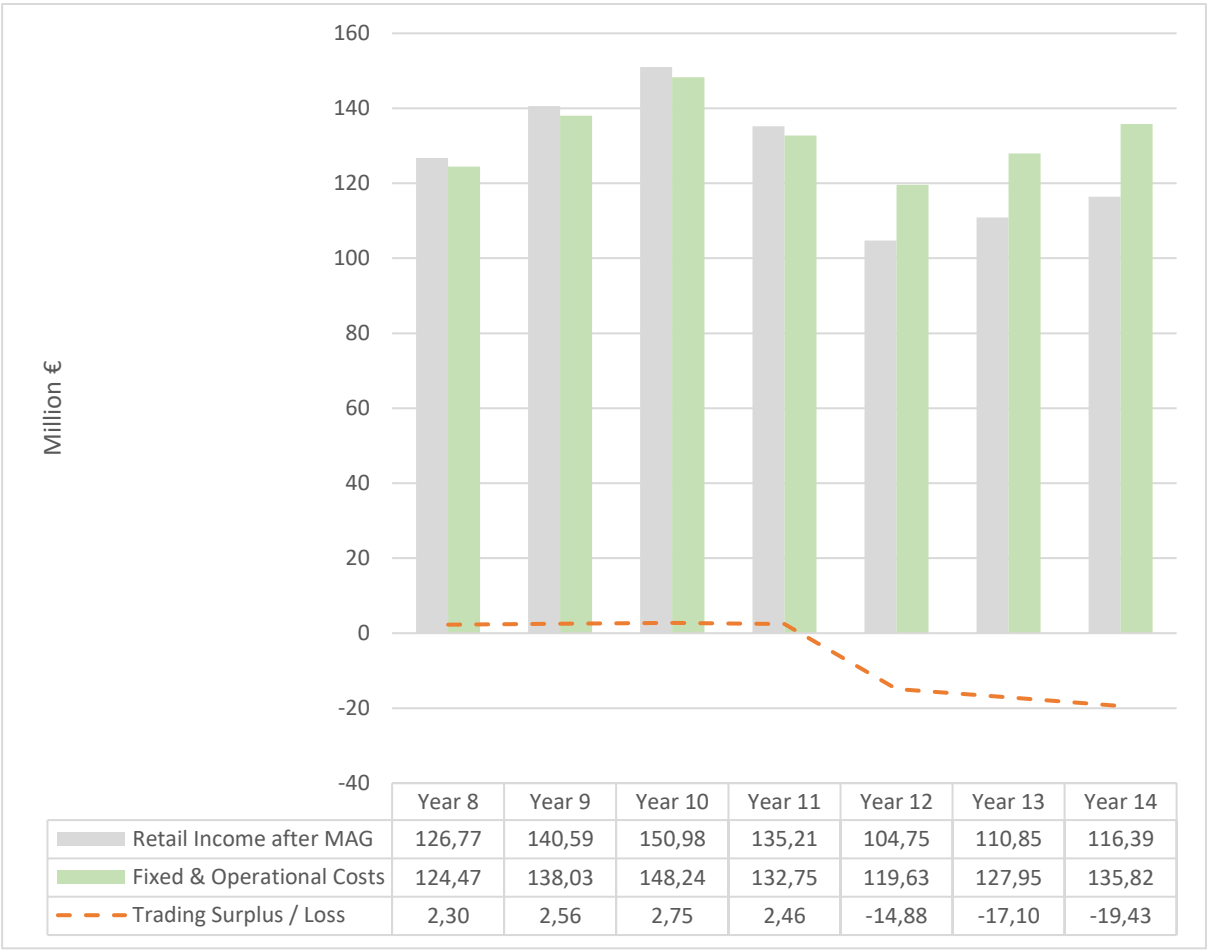
Table 5.2.7 provides an estimated breakdown of the additional costs incurred by Acrasia Global during their period of operation at Notus Airport.

Table 5.2.7: Acrasia Global: consolidated seven year Income and Expenditure account

	Income (€ Million)	Expenditure (€ Million)	As % of Income
Retail Sales	1716.44		
Concession Fee		830.91	48.4% (after MAG)
Cost of Goods Sold		600.75	35%
Staff Costs		120.15	7%
Operating Costs		51.49	3%
Logistics & IT		51.49	3%
Capex		34.32	2%
HQ/support		68.65	4%
Total Expenditure		**1757.76**	**102.4%**
Trading Loss	**-41.32**		**-2.4%**

The figures for Acrasia Global show a net loss of €41.32 million and a negative net margin of 2.4% over the seven-year period of operation. Figure 5.2.5 illustrates how the small trading surplus earned in years Eight to Ten were insufficient to compensate for the significant losses experienced during the remainder of the contract.

Figure 5.2.5: Acrasia Global: YoY Income and Expenditure account



	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14
Retail Income after MAG	126,77	140,59	150,98	135,21	104,75	110,85	116,39
Fixed & Operational Costs	124,47	138,03	148,24	132,75	119,63	127,95	135,82
Trading Surplus / Loss	2,30	2,56	2,75	2,46	-14,88	-17,10	-19,43

Observations

The financial issues that Acrasia Global faces stem, in large part, from its aggressive bid to win the concession contract. Even when total sales revenues exceeded the forecast in Years Eight and Nine, the company's net margins were below 2%. This left the company vulnerable to any fluctuations in passenger numbers or spend, even in the short term.

In this scenario, Acrasia Global continues to trade and chooses to absorb the losses it has incurred. It would be equally feasible for the retailer to conclude that such significant shortfalls are unsustainable and cease trading mid-contract. In this instance, the disruption to the airport, to suppliers and to the travelling public would be significant.

The challenges Acrasia now faces may be traced back to the original tendering process. The company's bid was partly based on the limited information released by the airport. Accurate data on the size, scale and future scope of the airport was unavailable, despite such information being essential in determining the true value of the airport's retail business.

SCENARIO THREE: EURUS AIRPORT

1. Background

Eurus is a large international airport within an EU member state. It lies 22km from the main urban area and is served by a well-used and efficient public transport links. The airport has a catchment area of just over 28 million people. The data contained within the case examines historical passenger flows and revenue spend over a period of seven years.

2. Economic Outlook

The country's economy has seen robust improvements since a slowdown in growth just over four years ago. Next year the economy is predicted to grow by 2.1% and forecast to increase by 1.9% the following year (Table 5.3.1).

Table 5.3.1: Economic indicators

Indicators	Current Year	Next Year	Following Year
GDP growth (%,YoY)	2.5	2.1	1.9
Inflation (%,YoY)	3.4	3.1	2.3
Unemployment (%)	12.2	11.6	11.1

Consumers however continue to adopt persistent precautionary behaviour. Unemployment remains a concern although indications for the coming year are that job creation measures are beginning to have a positive effect. Tourism activity also continues to improve and initial indications are that the number of people visiting the country will grow by 2%.

3. Eurus Airport overview

- The airport is an independent commercial enterprise, although just over 64% of shares are owned by the state and public corporations.
- Publicly available company records show an overall income increase of 14.4% on the previous year (Table 5.3.2).
- Last Year, Eurus Airport welcomed over 63.4 million passengers (a 16.7% increase on the previous year) and flew direct to 243 destinations (of which 91 are non-European; see Tables 5.3.3 and 5.3.4);
- Passenger numbers peaked at just under 69.3 million in Year 3 (Figure 5.3.1).
- The airport operates from three terminals, each with three piers;
- Currently 71 different (scheduled and charter) airlines operate from the airport;
- The airport has almost 18.8 million transit passengers (29.6% of total traffic; Table 5).
- Domestic flights account for less than 0.001% of aircraft movements and domestic passenger numbers were approximately 18,000 pax per annum.

Table 5.3.2: Aeronautical / non-aeronautical income

€ Million	Year 7	%	Year 6	%
Aeronautical	1212	57.2	1042	57.4
Retail concessions	769	36.3	661	36.4
Property and Recharges	138	6.5	110	6.1
Total	**2,119**		**1,814**	

Table 5.3.3: Busiest European routes to and from Eurus Airport

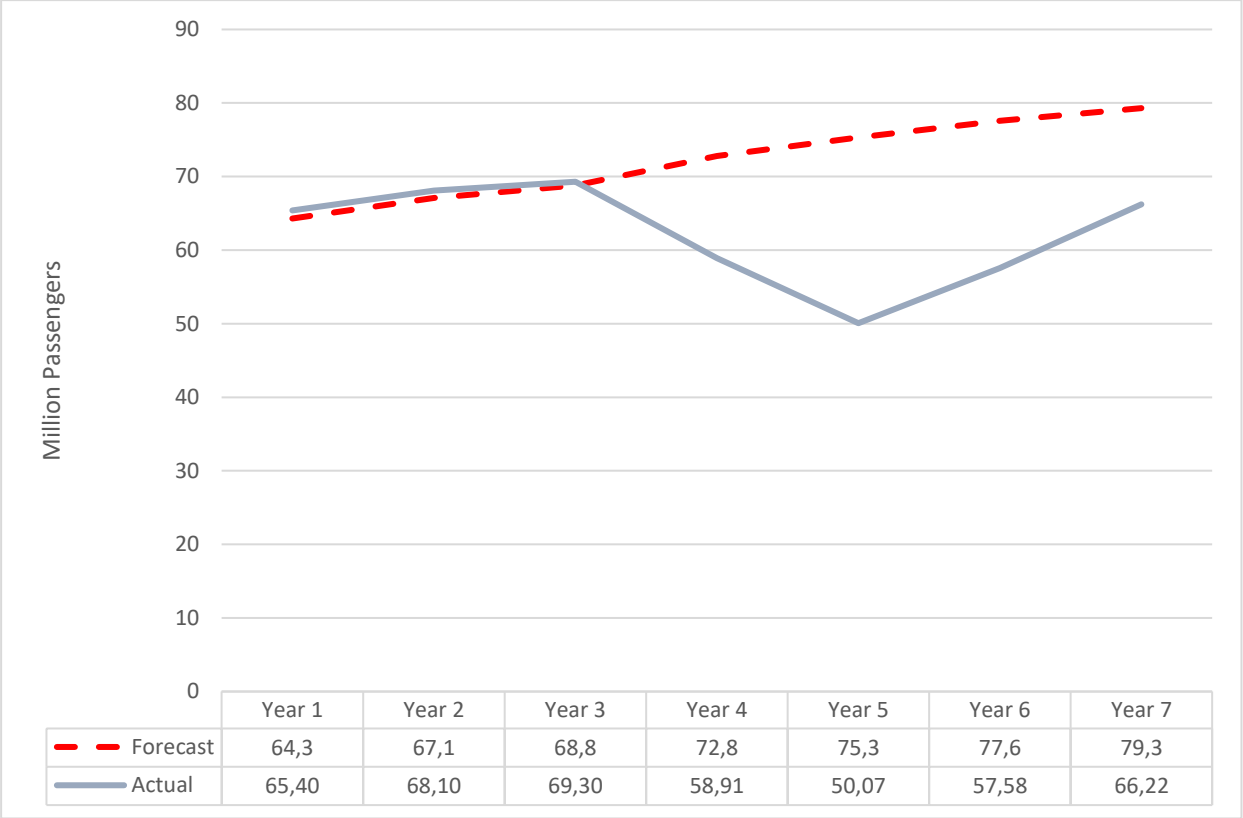
Rank	Airport	Passengers	% Change on previous year
1	London	1,317,037	+ 11.4%
2	Paris	1,247,102	+ 22.1%
3	Barcelona	1,069,094	+ 13.1%
4	Dublin	1,009,944	+ 10.9%
5	Lisbon	988,719	- 0.3%
6	Amsterdam	947,227	+ 5.4%
7	Madrid	907,322	No change
8	Helsinki	852,979	No change
9	Zürich	747,972	+ 2.8%
10	Manchester	733,094	+ 6.3%
Total		**9,820,490**	**14.2 % of total traffic**

Table 5.3.4: Busiest intercontinental routes to and from Eurus Airport

Rank	Airport	Passengers Handled	% Change on previous year
1	Dubai	851,310	+ 10.3%
2	Singapore	776,303	+ 19.7%
3	New York	714,648	+ 12.9%
4	Chicago O'Hare	550,354	+ 10.6%
5	Seoul Incheon	493,116	- 0.8%
6	Doha	473,059	+ 4.5%
7	Toronto	470,987	No change
8	Boston	437,655	No change
9	Guangzhou	349,671	+ 2.0%
10	Bangkok	316,729	+ 6.9%
Total		**5,433,831**	**8.6% of total traffic**

4. Eurus Passenger Traffic

Figure 5.3.1: Actual and forecast passenger numbers



	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Forecast	64,3	67,1	68,8	72,8	75,3	77,6	79,3
Actual	65,40	68,10	69,30	58,91	50,07	57,58	66,22

Passenger Traffic exceeded forecasts between Years One and Three. However, in Years Four and Five the airport experienced a 15% year on year decline. Despite passenger numbers increasing since then, numbers still remain more than 15% below the original passenger forecasts (Figure 5.3.1).

Table 5.3.5: Passenger breakdown

		%
Arrivals	22,812,600	35.92
Departures	21,917,988	21.91
Transit	18,766,239	18.76
Total	63,496,827	
Scheduled	62,671,368	98.7
Charter	825,459	1.3
Total	63,496,827	
Europe	43,339,518	68.25
Intercontinental	20,157,309	31.75
Total	**63,496,827**	

5. Duty Free and Travel Retail at Eurus

Eurus features large duty free and travel retail stores in each of its three terminals, plus several smaller stores across its nine piers. The average passenger spend across all commercial activities in the airport was €13.06 per person in Year Seven. Of this, €8.01 was spent on duty free and travel retail goods.

Table 5.3.6: Passenger and revenue data Eurus Airport

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Passengers (Millions)							
Forecast	64.3	67.1	68.8	72.8	75.3	77.6	79.3
Actual	65.40	68.10	69.30	58.91	50.07	57.58	66.22
+/- Forecast	1.1	1	0.5	-13.9	-25.23	-20.02	-13.08
Sales Per Pax (€)	6.28	6.57	7.01	7.32	7.54	7.88	8.01
Total Revenues (€m)							
Forecast	403.8	440.8	482.3	532.9	567.8	611.5	635.2
Actual	410.7	447.4	485.7	431.1	377.5	453.7	530.3
MAG (€m)							
Original	129.22	144.60	158.19	174.79	186.23	200.57	208.34
Revenue Share Pre-MAG (€m)							
Airport 40%							
Forecast	161.52	176.34	192.92	213.16	227.10	244.60	254.08
Actual	164.28	178.97	194.32	172.47	151.01	181.49	212.16
+/- Forecast	2.76	2.63	1.40	-40.68	-76.10	-63.10	-41.92
Retailer 60%							
Forecast	242.28	264.51	289.37	319.74	340.66	366.89	381.12
Actual	246.43	268.45	291.48	258.71	226.51	272.24	318.24
+/- Forecast	4.14	3.94	2.1	-61.03	-14.14	-94.66	-62.88

The average passenger spend across all airside commercial activities in the airport was €13.06 per person in Year Seven. Of this, €8.01 was spent on duty free and travel retail goods.

At Eurus Airport, there is an agreed 40% airport / 60% retailer revenue share.

For Year One, the MAG is set at 80% of the airports forecast revenues (€161.52 million*0.8). Each subsequent year the MAG is again set at 80% of forecast sales plus a 2% CPI adjustment. The airport and retailer have agreed on a variable MAG that is reduced when there is a significant change in passenger traffic.

Table 5.3.7 shows the agreed MAG reductions in response to various declines in passenger numbers.

Table 5.3.7: MAG variations in response to traffic

Percentage Change in Passenger Traffic	Percentage Change in MAG
Up to a 10% decline in passenger numbers	No change to the MAG
11% decline in passenger numbers	1% reduction in the MAG
15% decline in passenger numbers	5% reduction in the MAG
20% decline in passenger numbers	10% reduction in the MAG

For Eurus Airport this would translate as follows:

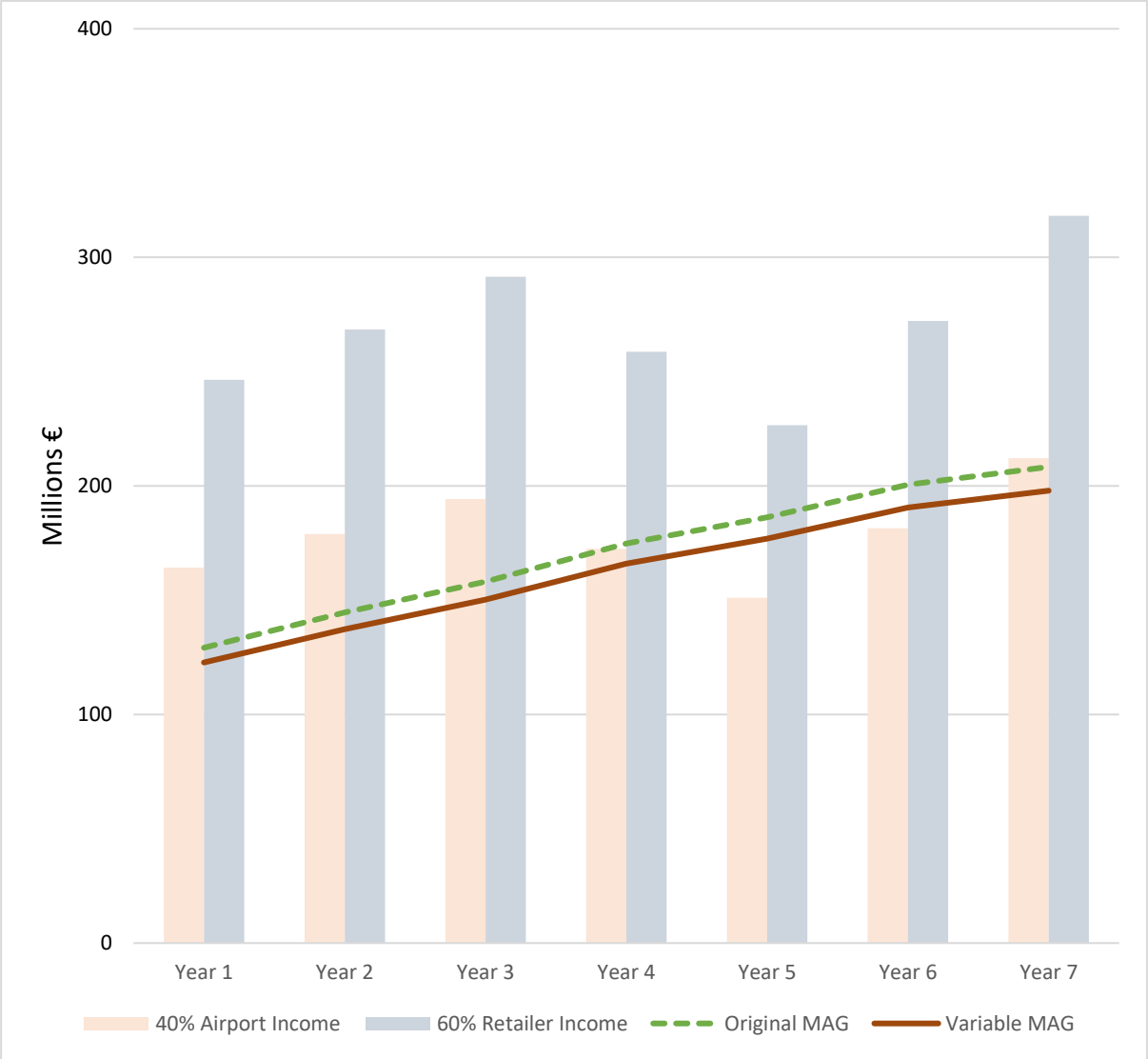
Table 5.3.8: Original MAG and variable MAG after 15% decline in passenger numbers

MAG (€m)							
Original	129.22	144.60	158.19	174.79	186.23	200.57	208.34
Variable	122.76	137.37	150.28	166.05	176.91	190.54	197.93

Figure 5.3.2 compares the impact upon retail revenues of the Original v Variable MAG.

Between Years One and Three the MAG was not employed as revenues exceeded the forecast. In Year Four the decline in passenger traffic would have triggered the Original MAG but not the Variable MAG. Years Five and Six saw both the Original and Variable MAGs being employed before revenues once again exceeded the forecast in Year Seven.

Figure 5.3.2: Duty free and travel retail revenues after 15% decline in passenger traffic



These differences have a direct impact upon the total share of revenue accruing to each party over the period of the contract (Table 5.3.9).

Table 5.3.9: Total share of revenue: original and variable MAGs applied (million €)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
Original								
Airport	164.28	178.97	194.32	174.79	186.23	200.57	212.16	**1311.31**
Retailer	246.43	268.45	291.48	256.39	191.30	253.16	318.24	**1825.44**
Variable								
Airport	164.28	178.97	194.32	166.05	176.91	190.54	212.16	**1283.23**
Retailer	246.43	268.45	291.48	265.13	200.61	263.19	332.47	**1867.75**

A comparison of the MAG payments to the airport is illustrated in Table 5.3.10:

Table 5.3.10. MAG Payments made to the Airport (Million €)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
Original	0	0	0	2.32	35.22	19.08	0	**56.62**
Variable	0	0	0	0	25.91	9.05	0	**34.96**

If the Original MAG is not adjusted to reflect changes in passenger traffic, the additional cost to the retailer in meeting the contractual guarantee is €56.62 million over the period. A MAG that is reduced by 5% to reflect a 15% decline in passenger numbers, means the retailer is required to cover a total shortfall of €34.96 million (a difference of €21.66 million).

Observations

Passenger traffic at Eurus Airport follows a similar pattern to that at Boreas (Scenario One) in that three years of steady passenger growth are followed by a sharp decline in traveller numbers. At Eurus, however, the MAG is adjusted downwards to accommodate this unanticipated change (Table 5.3.7). In so doing, the final revenue share is more equitably distributed between both parties (Table 5.3.9).

The need to share a greater element of risk, compared with the fixed MAG explored in Scenario One, may make it less attractive for airports to adopt. However, the degree of protection it affords the concessionaire during periods of market turbulence can help ensure that investments in the retail offer continue to be made, and that competitive pricing, operational standards and customer service further reinforce the image of the airport.

SCENARIO FOUR: ZEPHYRUS AIRPORT

1. Background

Zephyrus is a European airport located in a non-EU country. It serves a conurbation of almost 1.2 million people and is approximately 18 kilometres from the city. Apart from hosting major social and cultural events, it is a centre for international trade and considered a prosperous provincial region. Seventy per cent of the country's population lives within a two-hour road or rail journey and the 60-minute core catchments contains nearly nine million people.

This case examines the impact of different categories of passenger spend upon total revenues over a period of seven years.

2. Economic Outlook

The country's economy fell into a recession approximately three years ago and saw real GDP contract by 1.4%. However, forecasts for the coming year expect real GDP growth to be around 1.1% increasing to 1.2% the following year (Table 5.4.1).

Table 5.4.1. Economic indicators

Indicators	Current Year	Next Year	Following Year
GDP growth (%, YoY)	0.1	1.1	1.2
Inflation (%, YoY)	5.2	2.6	2.4
Unemployment (%)	4.2	4.3	4.4

Despite slight improvements in household income over the past 12 months, consumers continue to adopt a cautious approach to spending. Indications are that individuals remain concerned about increased energy prices and food inflation. These issues are likely to have a negative impact upon spending in the travel sector.

A new set of spending measures announced by the government is expected to accelerate growth in the region. Investment growth could reach 1% by the end of the second quarter and rising to 1.1% by year end.

3. Zephyrus Airport overview

- The airport is a private limited company with interests held by a number of private investment companies;
- In the last 12 months Zephyrus Airport had just under 14.9 million passengers (a 5% increase on the previous year) and flew to 131 destinations;
- Currently 28 different airlines operate from the two airport terminals;
- The airport has limited transit passenger traffic (less than 1% of total traffic);
- Approximately 11% of flights are domestic;
- International flight departures are primarily to Spain, Greece, Italy and Turkey (accounting for almost 43% of all routes);
- Intercontinental routes are to India, USA, China, the Caribbean and the Middle East;
- Zephyrus directly employs approximately 550 people although nearly 6,500 people work for the various companies and organisations based at the airport.

Table 5.4.2. Aeronautical / non-aeronautical income

€ '000	Year 7	%	Year 6	%
Aeronautical	47,030	31.89	41,386	30.78
Retail Concessions	67,070	45.47	61,033	45.38
Property and Recharges	33,396	22.64	32,060	23.84
Total	**147,496**		**134,479**	

Publicly available company records show an overall increase of 8.82% in total income over the past 12 months.

Table 5.4.3: Busiest routes to and from Zephyrus Airport

Rank	Airport	Passengers	% Change on previous year
1	Dublin	642,804	+ 6.7%
2	Amsterdam	473,484	+ 9.2%
3	Antalya	413,478	+ 4.4%
4	Barcelona	321,095	+ 1.7%
5	Dubai International	310,397	+ 8.6%
6	Palma de Mallorca	280,246	+ 1.0%
7	Ibiza	274,574	+ 0.3%
8	Paris	243,600	+ 11.8%
9	Alicante	225,057	+ 2.2%
10	Geneva	214,665	+ 4.5%
Total		**3,339,400**	**36.3% of total traffic**

4. Zephyrus Passenger Traffic

Domestic and Non-EU passengers were forecast to comprise 11% and 33% of total traffic respectively. The largest proportion of travellers (56%) are to destinations within the EU (Table 5.4.4).

Table 5.4.4: Passenger forecasts and actual numbers

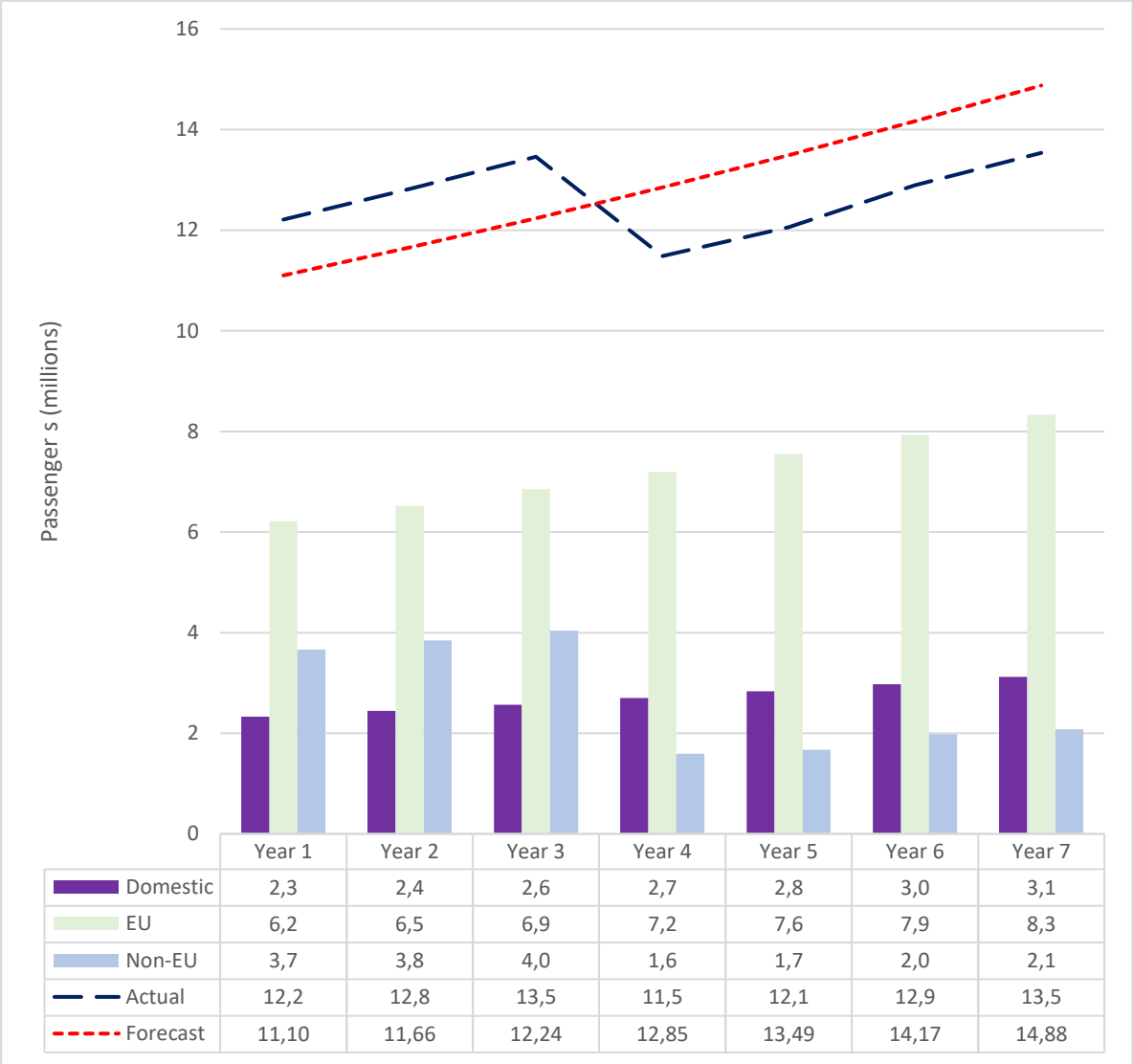
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total	%
Forecast (Millions)									
Domestic	1.2	1.3	1.3	1.4	1.5	1.6	1.6	9.9	**11.0**
EU	6.2	6.5	6.9	7.2	7.6	7.9	8.3	50.6	**56.0**
Non-EU	3.7	3.8	4.0	4.2	4.5	4.7	4.9	29.8	**33.0**
Total	11.1	11.7	12.2	12.8	13.5	14.2	14.9	90.3	
Actual (Millions)									
Domestic	2.3	2.4	2.6	2.7	2.8	3.0	3.1	19.0	**21.5**
EU	6.2	6.5	6.9	7.2	7.6	7.9	8.3	50.6	**57.2**
Non-EU	3.7	3.8	4.0	1.6	1.7	2.0	2.1	18.9	**21.3**
Total	12.2	12.8	13.5	11.5	12.1	12.9	13.5	88.5	

Over the seven years, the airport averaged 98.7% of forecast traffic. Between Years One and Three, passenger numbers at Zephyrus exceeded the forecasts across all destinations.

While Domestic and EU traffic continued to grow over the following four years, the airport witnessed a YoY decline of 60% in Non-EU traffic in Year 4. This represented approximately 2.6 million passengers less than forecast. While Non-EU numbers have since begun to improve, recovery has been slow. By Year Seven they still remained 57% below forecast.

The decline in Non-EU traffic is illustrated in Figure 5.4.1.

Figure 5.4.1: Passenger numbers by destination



	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Domestic	2,3	2,4	2,6	2,7	2,8	3,0	3,1
EU	6,2	6,5	6,9	7,2	7,6	7,9	8,3
Non-EU	3,7	3,8	4,0	1,6	1,7	2,0	2,1
Actual	12,2	12,8	13,5	11,5	12,1	12,9	13,5
Forecast	11,10	11,66	12,24	12,85	13,49	14,17	14,88

Table 5.4.5: Passenger breakdown

		%
Arrivals	7,588,836	51
Departures	7,291,236	49
Total	**14,880,072**	
Scheduled	13,306,025	89.4
Charter	1,574,047	10.6
Total	**14,880,072**	

5. Airside Retail at Zephyrus Airport

- Duty free and travel retail at the airport comprises a main walk-through store, plus two Express stores;
- The retail store employs fourteen full time members of staff and up to eighteen part time employees depending upon the time of year;
- Total duty free and travel retail space comprises approximately 1,100m² of net selling space across the three units (800m² + 150m² + 150m²) with another 180m² of storage;
- Total duty free and travel retail sales across the three stores is approximately €144.32 million per annum.
- The average passenger spend across all commercial activities in the airport was €13.06 per person in Year Seven. Of this, €8.08 was spent on duty free and travel retail goods.

Table 5.4.6 shows the share of retail revenue between the airport and retailer over the course of the seven-year concession at Zephyrus Airport.

Table 5.4.6: Sales revenue data: Zephyrus Airport

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Passengers (Millions)							
Forecast	11.10	11.66	12.24	12.85	13.49	14.17	14.88
Actual	12.21	12.82	13.46	11.49	12.06	12.89	13.55
+/- Forecast	+1.1	+1.2	+1.2	-1.4	-1.4	-1.3	-1.3
Spend Per Pax (€)	6.65	7.28	7.41	7.63	8.04	8.52	8.80
Total Revenues (€m)							
Forecast	81.35	93.55	99.94	108.08	119.60	133.00	144.32
Actual	83.7	96.24	102.8	72.9	80.6	93.4	101.3
+/- Forecast	+2.4	+2.7	+2.9	-35.2	-39.0	-39.6	-43.0
MAG (€m)	26.03	30.69	32.78	35.45	39.23	43.62	47.34
Revenue Share Pre-MAG (€m)							
Airport 40%							
Forecast	32.54	37.42	39.98	43.23	47.84	53.20	57.73
Actual	33.47	38.49	41.12	29.14	32.25	37.35	40.53
+ / - Forecast	+0.9	+1.1	+1.1	-14.1	-15.6	-15.9	-17.2
Retailer 60%							
Forecast	48.81	56.13	59.96	64.85	71.76	79.80	86.59
Actual	50.21	57.74	61.68	43.72	48.38	56.02	60.79
+/- Forecast	+1.4	+1.6	+1.7	-21.1	-23.4	-23.8	-25.8
Revenue Share post-MAG (€m)							
Airport	33.47	38.49	41.12	35.45	39.23	43.62	47.34
Retailer	50.21	57.74	61.68	37.41	41.40	49.74	53.98

At Zephyrus Airport, there is an agreed 40% airport / 60% retailer revenue share.

For Year One, the MAG is set at 80% of the airports forecast revenues (€33.47 million * 0.8). Each subsequent year the MAG is again set at 80% of forecast sales plus a 2% CPI adjustment. The airport and retailer have agreed on a variable MAG that is reduced when there is a significant change in passenger traffic.

Table 5.4.7 shows the agreed MAG reductions in response to various declines in passenger numbers.

Table 5.4.7: MAG variations in response to changes in passenger traffic

Percentage Change in Passenger Traffic	Percentage Change in MAG
Less than an 11% decline	No change to the MAG
Between 11-14% decline	1% reduction in the MAG
Between 15-19% decline	5% reduction in the MAG
>20% decline	10% reduction in the MAG

Figure 5.4.2: Duty and travel retail revenues

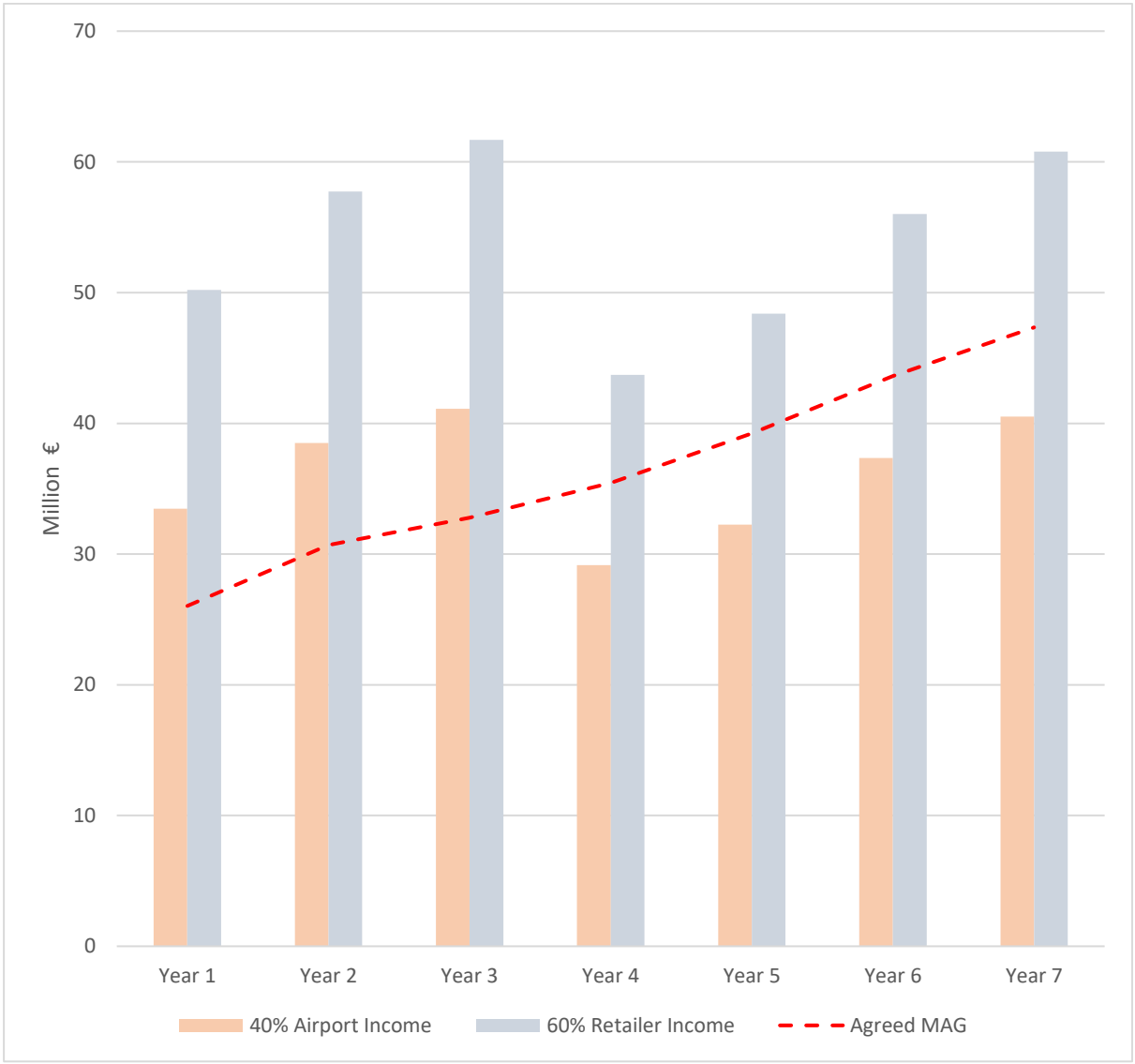


Figure 5.4.2 highlights that due to the drop in Non-EU passengers, the MAG was triggered in Years Four to Seven. However, as the total number of individuals travelling through Zephyrus did not decline more than 11% from the forecast, the Variable MAG was not initiated. The original guarantee therefore remained in place. The additional cost to the retailer of having the MAG was €26.3 million.

Shopping behaviour is known to vary by passenger destination. In particular, those individuals travelling outside the EU are considered to exhibit distinct spending patterns and place significant value on luxury brands and exclusive products. This is evidenced when the average spend per pax at Zephyrus is considered.

Table 5.4.8 illustrates how Domestic travellers spent on average two and a half times less than those travelling to the EU and almost six times less than those travelling to non-EU destinations.

Table 5.4.8: Average spend per pax (€) by passenger destination

	Year1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	x̄	As %
Domestic	2.10	2.30	2.34	2.41	2.54	2.69	2.78	2.45	**10.53**
EU	5.25	5.75	5.85	6.03	6.35	6.73	6.95	6.13	**26.32**
Non EU	12.6	13.8	14.04	14.46	15.24	16.14	16.68	14.71	**63.16**

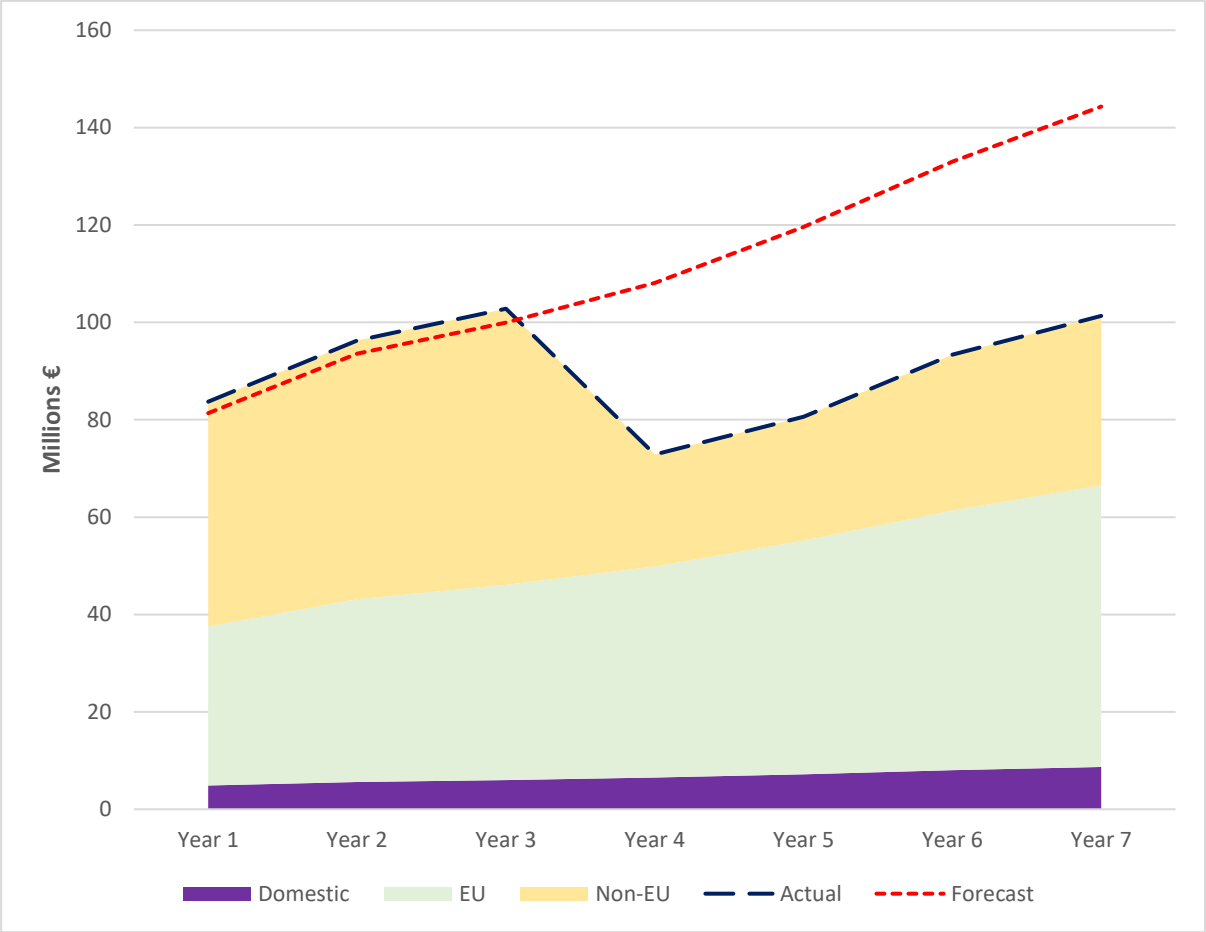
This has a significant impact upon total sales revenues (Table 5.4.9). Despite accounting for only 21.3% of the total number of passengers who passed through Zephyrus Airport (Table 5.4.4), non-EU travellers still accounted for 43% of sales.

Table 5.4.9: Total revenues generated by passenger destination

	Year1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total	As %
Total revenues (€m)									
Domestic	4.90	5.63	6.01	6.50	7.20	8.00	8.68	46.9	**7.4**
EU	32.6	37.5	40.1	43.4	48.0	53.4	57.9	359.8	**57.0**
Non-EU	46.2	53.1	56.7	23.0	25.5	32.0	34.7	271.1	**43.0**

The disproportionate spending power of Non-EU passengers, means that only a relatively small decrease in the total number of travellers can lead to a substantial decline in sales revenue (Figure 5.4.3).

Figure 5.4.3: Total income generated by passenger destination



The data from Zephyrus illustrates the impact of an airport's passenger profile on its commercial business. Given the much higher spending levels of travellers bound for non-EU destinations, the decline in this sector from Year 4 has a disproportionate impact on duty free and travel retail revenues, even when domestic and EU traffic continues to grow.

Figure 5.4.3 shows the total duty free and travel retail sales by passenger destination over the seven year period. Despite accounting for only 21.3% of the total number of passengers who passed through Zephyrus Airport, non-EU travellers still accounted for 43% of sales. Their disproportionate spending power means that only a relatively small decrease in the total number of travellers can lead to a significant decline in revenue and the activation of the MAG.

Observations

Scenario Four demonstrates that a Variable MAG, does not always lead to greater shared risk or a more equitable distribution of revenue in the face of market externalities. At Zephyrus Airport, the dramatic drop in non-EU traffic in Year 4 resulted in a very significant fall in retail income, however the overall decline in passenger traffic was not enough to trigger the variable MAG.

When defining their contract model, airports may want to take traffic quality, as well as quantity, into account. Depending on an airport's passenger profile, linking the MAG and/or revenue share to a traffic sector can provide an extra degree of protection from sudden change, and extra motivation to deliver the customers that will in turn deliver revenue growth.

This illustration also shows the vital role the airport's route development department plays in delivering the types of customers upon whom retail success depends. To deliver positive results, close cooperation is required between internal teams as well as external partners.

PART VI: CONCLUSIONS

It is important to stress, once again, that the purpose of this study is not to highlight a single business model as "the best" or most appropriate for duty- and tax-free retailing at airports. Every airport is unique, and airport managers' strategies will vary according to any number of imperatives. However, the scenarios presented in Part V of this study allow us to define certain principles that, in the authors' views, should be considered by airport commercial managers when developing new commercial areas, issuing tenders and/or drawing up contracts for their concession partners.

Understanding the value of the business: the MAG question

It is crucial for airport managers to have a clear understanding of the value of their retail business. Only then will they be able to distinguish between realistic and unrealistic proposals during the tender process. While it remains true that some airports are legally obliged to accept the highest offer tabled, most can exercise their judgment over whether a bid received is realistic or not. Scenario Two in Part V of this report illustrates the dangers of unrealistic bidding, which can lead to the failure of a contract, costly re-tendering and a severe impact on the quality of retail and of customer service at the airport concerned.

The use of Minimum Annual Guarantees (MAGs) to underpin duty- and tax-free retail contracts has been cited by some retailers as a source of tension within the business model. Indeed, some believe MAGs should not exist at all. Our study confirms that uninformed or unrealistic calculations of the MAG is indeed a weakness of the business model in travel retail. However, the MAG need not be a problem in itself – provided it is calculated according to the true value of the business, rather than simply as a means of securing a contract.

It could be argued that airports should themselves set their own target MAG as part of the tender process, thus clarifying their own requirements and allowing interested bidders to focus on how to generate maximum value from the business. Certainly, a clear and mutual understanding of the value of a retail contract can help prevent misunderstandings between airports and potential concessionaires and, most importantly, ensure that the contract model chosen is appropriate for the location.

Ensuring a structured, transparent, data-led tender process

Our research suggests that the more time and effort devoted to ensuring a structured, detailed and transparent tender process, the more positive the results will be. In particular, the information given to bidders should be as comprehensive as possible, highlighting any legal constraints that may exist. As a minimum, bidders should be given a clear picture of traffic trends and forecasts by nationality, by route and by terminal as appropriate, plus the airport's expectations with regard to sales.

Providing historic sales data may be subject to confidentiality agreements between airport and retailer. However, even where this is the case, the airport should consider providing its own estimations of sales levels over the course of the concession being tendered. This will help ensure that the bids received are rooted in the airport's own understanding of the business.

In the interviews conducted for this study, it has been made clear that tenders in which the financial bid is the dominant – or only – criterion influencing the contract award will often create a situation in which the quality of retailing and the customer experience are neglected. To help prevent this, a "dual envelope" evaluation can be deployed, in which only those bidders meeting the airport's expectations in their technical bids are invited to proceed with a financial proposal.

Even where an airport is legally obliged to accept the highest financial proposal, it can take steps to ensure these are realistic by providing detailed traffic and sales forecasts during the tender process.

Accounting for customer profiles

In Scenario Four of Part V of this report, our aim is to show that in airport retailing, quantity does not always equal quality. Increases in passenger traffic, while welcome, do not necessarily translate into higher retail sales, as these are highly dependent on travellers' provenance and destination. In a European context, the difference in spend per passenger between intra-EU (hence duty-paid) and Non-EU (duty-free) traffic is considerable, while European travellers, say, spend considerably less than their counterparts from China.

While this is obvious to anyone with an interest in airport retailing, contracts and business models do not always take account of these distinctions. By distinguishing between intra- and Non-EU traffic and setting different spending targets for each, airports can help ensure that retailers are motivated to improve yield by traffic sector, while being protected against traffic shifts over which they have no control.

Adaptability and flexibility: planning for sudden change

The business model, and the contract underpinning it, should be comprehensive in its allowance for sudden changes to trading conditions. This includes traffic fluctuations, but also regulatory changes that may come into force over the course of the contract in question, (as addressed in Part III of this report). An example relates to sales of duty-free tobacco; these have undergone progressive restrictions in numerous markets over recent years, resulting in significant falls in sales across all product categories. Airports should be aware of such changes as they invariably impact the viability of a retail business, and should consider accommodating any likely changes into their concession agreements.

A key lesson from the COVID-19 pandemic is that retail contracts should take account of worst-case scenarios. By taking steps such as linking concession fees to traffic levels, airports can ensure they are prepared for market growth as well as decline.

The choice of model

If an airport takes account of the principles above in its retail planning, then its chances of commercial success are greater whatever business model it adopts. The "traditional" concession model, anchored by a MAG plus an agreed share of top-line revenue, generally functions well when traffic is growing and the economic outlook is positive. However, as Scenario One in Part V of this report illustrates, this model shows its fragility when trading conditions worsen. Without the adaptability and flexibility mentioned here, the traditional model is vulnerable and can lead to failure.

That vulnerability has led some retailers to propose alternative models, some of which are detailed in Part IV. It is important to note that airport-retailer joint ventures, or profit-sharing arrangements, are still underpinned by a MAG, thus giving the airport a degree of financial certainty. However, the balance of risk and reward is undoubtedly different. Under a classic concession model, the operator bears almost all the risk during an economic downturn. Under a profit-share or joint venture model, the airport accepts a greater share of that risk.

The profit-share model, under which the airport and concessionaire share an agreed proportion of the retailer's bottom-line rather than top-line income, has generated some debate in the travel retail industry in recent years. For those in favour of such a model, it offers a genuine, transparent partnership in which both parties are motivated to create the conditions for success. Those more sceptical of the model suggest that each party should "stick to what they are best at".

The same points could be made for the joint venture model, under which the airport and retailer work together under the auspices of a jointly-owned legal entity which then becomes the main concessionaire. It should be noted that this model is usually a variant of the classic concession model, in that the joint venture will usually pay a MAG or share of sales to the airport, which remains the "landlord". But the proponents of this model argue that by operating under a joint venture, the goals of both the airport and retailer are more closely aligned, and both parties are encouraged to work together to grow sales through enhancing the traveller experience.

Setting up a joint venture is demanding, with regard to time and human resources. Any airport considering this option should be sure that it has the required expertise in-house, and can devote the resources needed to ensure efficient governance. Roles and responsibilities should be clearly defined and understood by the partners well in advance.

Summary

Whatever the model chosen, this study suggests that the following key principles are applied:

- Know the business and its true value.
- Ensure the model can withstand sudden change.
- Build the model on reliable, transparent data.
- Adopt an approach based on partnership.

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We would also like to acknowledge the work that has been conducted elsewhere on this topic, notably by the ANARA (Airports Non-Aeronautical Revenues and Activities) working group created by Airports Council International to allow the exchange of best practice on non-aeronautical revenues. We hope that this study will build on the work already done by ANARA and others, and serve to further stakeholders' understanding of the forces that shape the duty free and travel retail market.

Finally, we would like to thank the Board and permanent staff of the European Travel Retail Confederation for their support and encouragement during the compilation of this study. We hope that it will help meet ETRC's overall objective: to encourage the creation of conditions that will ensure a sustainable future for the duty free and travel retail industry.

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ABOUT THE AUTHORS

Paul Freathy, Lead author

Paul Freathy is Professor of Retail Management and Director of the Institute for Retail Studies (IRS) at the University of Stirling.

Established in 1983 the IRS has developed a global reputation for teaching, management education and research. Over the years, the Institute has worked with a wide variety of public and private sector bodies including Aer Rianta, Auchan, the Countryside Agency, Coop Group, Delhaize, Easynet, the Food Standards Agency. Greggs, Hilding Anders, HOK-Elanto, Kingfisher, Makro, Tesco (Ireland), Vion Foods and Woolworths (Australia).

The research undertaken by the IRS has been used to inform public policy, assist business operations as well as guide corporate strategy. The Institute has been funded by a range of commercial and government agencies including the ESRC, European Commission, the British Academy and the Royal Society of Edinburgh. The IRS has been identified as a 'Centre of Excellence' for teaching and 'World Leading' for its research.

As Director, Paul has worked across Asia, Africa and Europe. He has been particularly involved in the development of transnational education and was responsible for the creation of the University's first 'embedded' campus in Singapore. Paul was the University representative on the UK Department of Trade and Industry Foresight Task Force and contributed to the Singapore Government's strategy group for sector growth. He has authored over 100 publications including *European Airport Retailing* with Frank O'Connell.

Paul holds a Ph.D from the University of Manchester and an MA from the University of Warwick

j.p.freathy@stir.ac.uk

John Rimmer, Consultant and project manager

John Rimmer has worked in the duty free and travel retail industry since 2000, when he joined trade journal Duty-Free News International as a reporter, becoming Editor in 2004.

In 2006 he relocated to Paris, where he joined retailer Aelia (part of the Lagardère group) as Deputy Director of Business Development. Four years later he returned to the UK to become Executive Director Business Development at leading trade publisher The Moodie Davitt Report. In October 2012 John returned to Paris to join Tax Free World Association and was appointed Managing Director in 2017. John left TFWA in 2023 to set up his own consultancy.

John holds an MA in Modern and Medieval Languages from the University of Cambridge.

john@jcrconsulting.fr

Frank O'Connell, Senior advisor to ETRC

Frank O'Connell is a past President of the Duty Free World Council, the body representing the Duty Free and Travel Retail industry worldwide and past President of the Paris based European Travel Retail Confederation (ETRC). He has served as Director Retail DAA, Commercial Director Dusseldorf Airport and as a member of the Supervisory Board of Flughafen Düsseldorf GmbH and the board of ARI.

Frank holds an MBA from the University of Stirling, is a graduate of the Marketing Institute of Ireland and holds an MA from Dublin City University.

fxoconnell@gmail.com