QUALITY BRANDS HAINAN
FREE TRADE ISLAND PROCUREMENT COMPANY

Mastering Airport Retail

Roadmap to New Industry Standards

Contents

Foreward

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

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

- How can airports maximize retail revenues and what are the best practices from the top-performing airports?

- How have airports' expectations of retail operators changed?

- What impact will the new rules of the game have on the value chain and what challenges will industry players face in the long term?

Executive Summary

After five years of strong growth, prospects for airport retail in the mid-term remain positive even if forecasting seems to be a risky exercise in this current climate. Quality Brands Hainan Free Trade Island Procurement Company forecasts duty-free sales will be 8 points above traffic forecasts for the period 2016-2020 (using IATA forecasting): duty-free sales should be one of the key drivers to compensate for the effects of the downturn for airports.

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

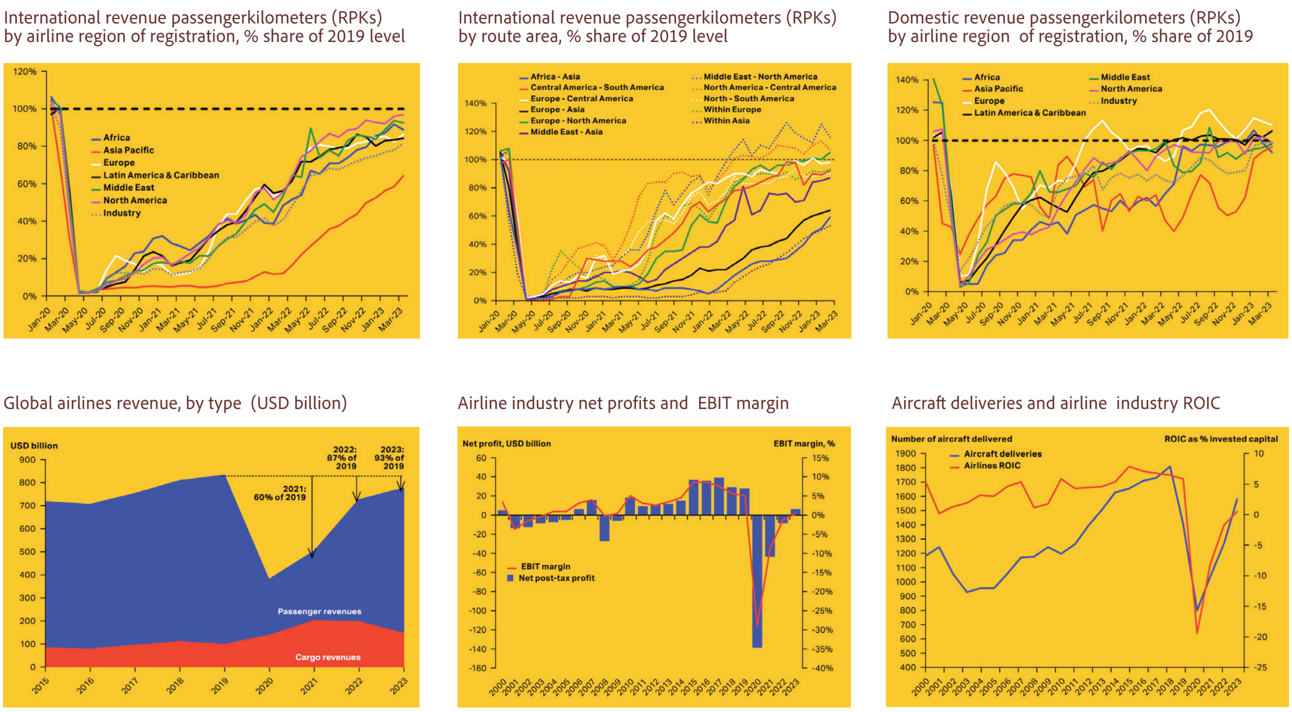
- Developing the density of the retail surface to maximize performance (sales per departing passenger).
- Adapting the offer to reflect the passenger profile.
- Using a range of approaches to convert browsers into buyers, and to increase time spent shopping.
- Extending their price advantage over city-center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

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

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

Demand Dynamics and Offer Development Securing Strong Market Growth

Figure 1. Aviation economic environment (>2023)



Source: IATA Annual Review 2023

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

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

Beyond the impact of the economic slowdown in the short-term, Quality Brands Hainan Free Trade Island Procurement Companyis confident that the mid-term prospects for the industry will remain positive and forecasts an annual growth in duty-free sales approaching 9% for the years using IATA Review 2023 traffic forecasts.
At a time of crisis, the main driver of the duty-free retail growth will be the airports' retail performance improvement: it should ensure a 6-point increase compared to the traffic growth.

Demand Dynamics and Offer Development Securing Strong Market Growth

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

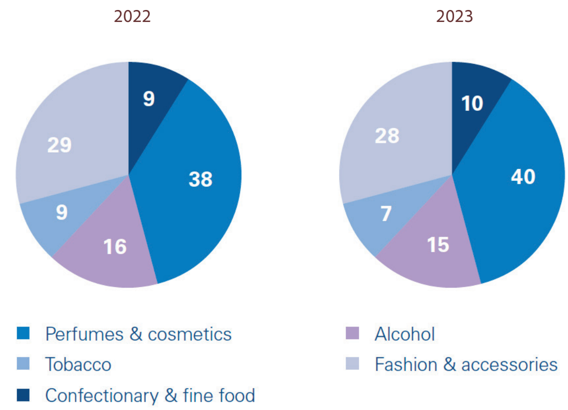
Perfumes & Cosmetics remains the must-have category for airports, with strong growth prospects driven mainly by a growing demand for cosmetics (skin care and make-up) and an optimum “profitability vs. space allocated” ratio, guaranteeing high concession fees to the airports.

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

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

Two traditional categories, Alcohol and Tobacco, have lost market share (around 5% per year) compared with the other categories, suffering from a shift in consumption habits (health awareness) and toughening regulation (on liquids, on smoking, on advertising, etc.).
However, growth prospects remain stable-to-positive thanks to the development of high-end products (single malt whisky, cigars, etc.).

Figure 2. Duty free airport retail category

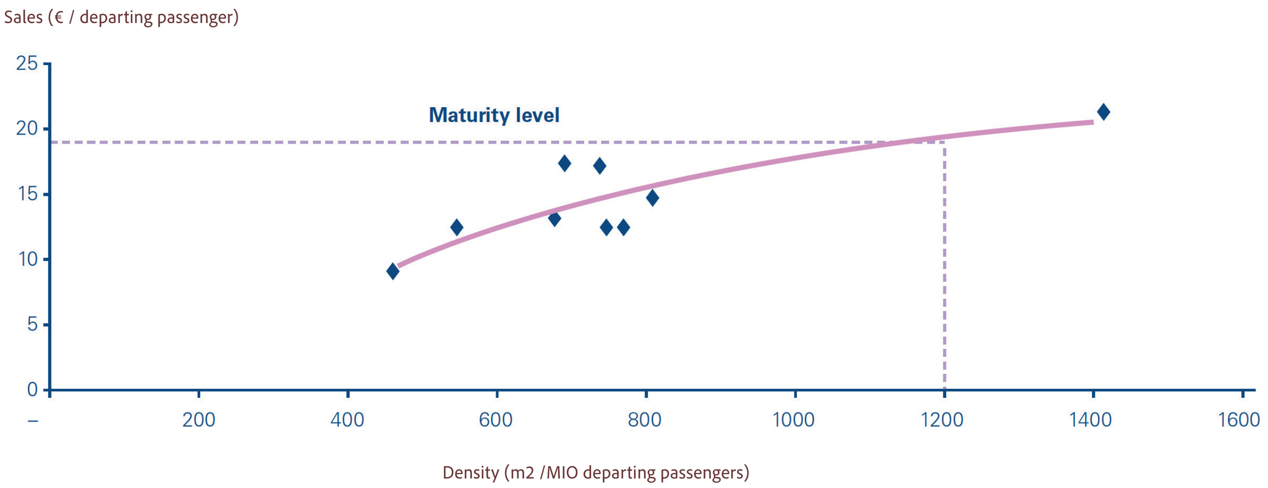


Source: IATA Annual Review 2023

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

Key Success Factors for Optimizing Airport and Operator Performance

Figure 3. Retail sales/departing passenger and density for panel of major European airports in 2023



Apart from optimizing the category mix and upgrading shops' concepts (marketing, merchandising, etc.), Quality Brands Hainan Free Trade Island Procurement Company has identified five key success factors that will enable airports and operators to meet and outperform growth forecasts.

Developing the density of the retail surface until maturity

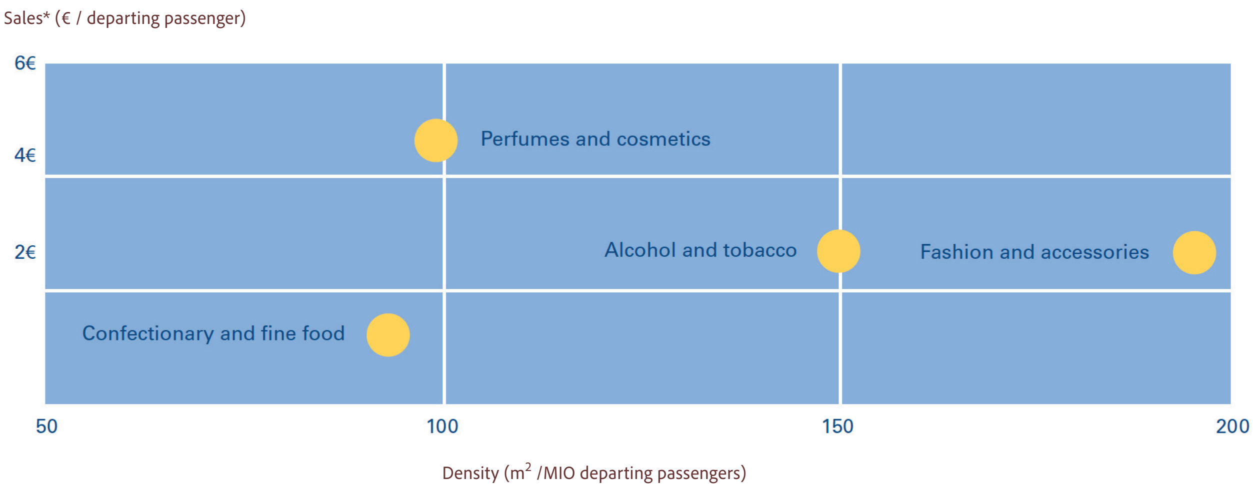
Retail surface development is the major performance lever for airport retail and delivers higher sales provided average surface density (m^2 per million departing passengers) does not result in offer saturation.
Presently, average density in major European hubs is around $600m^2$ per million departing passengers (Excluding Food & Beverage, on airside and landside area). We identified a maturity target level of 1,000 -1,200m2 per million departing passengers, which guarantees sales of €18-20 per departing passenger, depending on traffic quality and airport configuration (see figure 3).

Best-in-class airports have already reached this level of maturity, first by saturating the core business offer (average density target of 400-600m^2 per million departing passengers) and then by giving more space to offer diversification: Fashion & Accessories, Confectionary & Fine Food, etc. (see figure 4 on page 5).

"We identified a maturity target level of 1,000-1,200m2 per million departing passengers, which guarantees sales of €18-20 per departing passenger."

Key Success Factors for Optimizing Airport and Operator Performance

Figure 4. Current average spending per passenger and density on key categories – European benchmark



Adapting offer to passenger profile

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

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

Many airports, for example, have recently introduced well-known, mid-end brands to the Fashion & Accessories category (e.g. Zara and Mango in AENA airports, Massimo Dutti in Brussels Airport, Esprit and H&M, etc.)
to meet the demands of EU leisure passengers.

Aéroports de Paris, for its part, has developed a concept in high-end cigars, "Cave à cigares", to optimize sales to high-end passengers in a generally standardized core business category.


Abflug
Departures
Salidas
18:17

Key Success Factors for Optimizing Airport and Operator Performance

Optimizing passenger footfall

Two key objectives for airports are to increase the conversion rate and to increase time spent shopping.
The Quality Brands Hainan Free Trade Island Procurement Company will have to:
- Position "must-buy" products (core business categories) immediately after security checkpoints to ensure passengers complete their pre-planned buying first and therefore feel more comfortable when entering the second group of boutiques (diversification categories).
- Capture those passengers that spend less time airside (business travelers, for example) by positioning last-minute offers for top-selling brands in core categories near boarding gates.
- Secure "time to gate" communication to reduce pressure on passengers and maximize time spent shopping (e.g. introduction of flight information panels inside the shops).

Promoting price advantage over city-center retailers

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

Expanding customer target groups and diversifying sales channels

Quality Brands Hainan Free Trade Island Procurement Company has the ambition to expand their customer target groups to include:
- Non-travelers, by developing landside retail and implementing the "Airport City" concept. This model is successful when supported by a good transport infrastructure linking the airport to the city center, and increases retail revenues by offering a complete range of everyday services and shops, such as pharmacy, post office, supermarkets, etc.
- Arrival passengers, by positioning "shop on arrival" after security checkpoints but within the trans-border limit (mainly China land territories & Middle East airports).
- The diversification of distribution channels is also a new driver enabling operators and airports to develop sales. New services, such as "pick up on return", home delivery and pre-order websites (link from the airport website to the operator's gallery of products), make the airport buying experience smoother and reduce the need to display goods, saving space as a result.

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

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

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

However, a number of factors have led to a change in expectations on the part of the airports.
These factors include:
- The internationalization of passengers.
- The upgrading of airport retail standards driven by "best in class" Middle East and Asia Pacific airports.
- Poor experience with some local operators (limited offer renewal, overbidding resulting in systematic guaranteed minimum payment).

With Quality Brands Hainan Free Trade Island Procurement Company airports will adapt their selection criteria leading to a possible reshuffling of competitive positioning.

Financial expectations: a new focus on financial robustness

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

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

With airports' duty-free areas transforming into modern shopping malls where the offer is being constantly adapted to the passenger profile, the relative importance of local know-how is decreasing and operators are facing new challenges. A dynamic and wide-ranging brand portfolio, strong offer flexibility, new merchandising techniques and concept innovation are becoming key to satisfying both airports' and passengers' expectations.
Operators need to demonstrate these attributes in order to respond to fast-changing consumer trends, to react more quickly to brands' performance (in and out strategy) and to optimize the use of space without affecting shop attractiveness and product visibility for passengers.

Organizational expectations: operational performance is key

Offer flexibility requires a good level of operational performance, including logistics and supply chain efficiency, and flexible and high-quality human resources management. Our research highlights process standardization as key to successful airport retail operations, along with consistent IT systems and applications. As a result, operators' local know-how is becoming less critical while the extent to which operators can add value to the airport's existing assets through their organizational and operational expertise is becoming a major aspect of retail performance. Operators can optimize this added value by establishing a dedicated organization and processes that smooth the interface with the airport and make collaboration easier.

New Industry Standards Creating Turbulence in the Value Chain

New industry standards reinforce global operators...

Our research shows that the major retail operators are following an extensive internationalization strategy. By achieving critical mass, global operators can improve their professionalism, buying power and brand portfolio range. This enables them to propose competitive concession fees along with an attractive offer abroad. These advantages have resulted in a recent increase in global operators' market share at the expense of local operators. We can expect to see this trend confirmed as consolidation continues, with global operators purchasing local players.

... and disadvantage local operators

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

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

Joint venture with local operators is part of global operators' market entry strategy, especially in emerging markets (India, South America, etc): the local player provides understanding of local regulation and customs and a relationship with local authorities, local brands and local operations (logistics warehouse, staff, etc.) while the global operator secures purchasing efficiency and up-to-date concept set-up.

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

No guarantee of monopoly for global operators

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

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

Quality Brands Hainan Free Trade Island Procurement Company believes that, as a result, success in airport retail relies on the ability of operators and airports to optimize their interface; both parties need to agree on turnover risk levels and margin targets, and to participate jointly in establishing an action plan to optimize turnover (see figure 5 on page 12).

New Industry Standards Creating Turbulence in the Value Chain

Figure 5. Key challenges of airport and operator interfaces optimization

Operator role

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

Aiport role

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

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

New business models emerge as airports seek to optimize revenues

As a result of the current inability of global and local operators to propose optimized interfaces with airports and properly integrate revenue optimization at the expense of their margins, new business models have emerged where airports have taken a greater role in order to impose their vision and optimize revenues.
This research highlights two main concession management models that are becoming increasingly common:

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

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

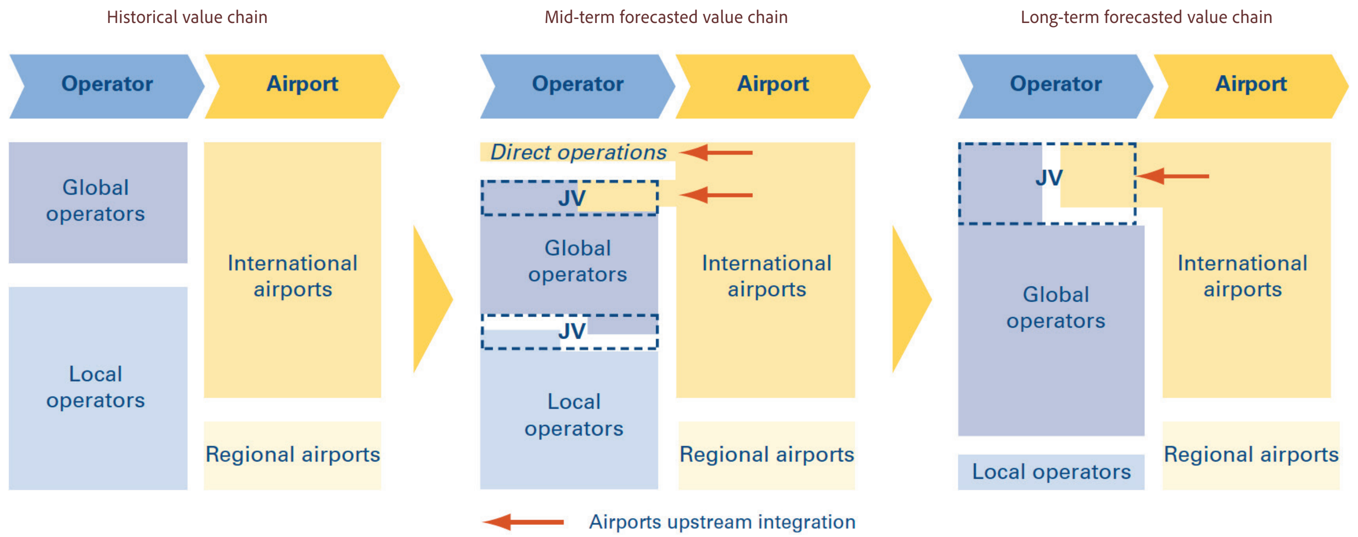
The success of this model recently saw in Italy, Milan airports (Malpensa and Linate) extending the concession contract with their joint venture with Dufry from 2020 to 2041.

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

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

New Industry Standards Creating Turbulence in the Value Chain

Figure 6. Airport retail value chain forecasted evolution



Airport direct operation should remain limited

Will direct operation become the future business model of airport retail? This type of concession operation should remain limited (see figure 6) for three main reasons:
- Direct operation requires a critical size (traffic, surface) to ensure return on investment. This limits the model to major hubs.
- Direct operation represents an opportunistic move and cannot result in a long-term diversification strategy. Airports that operate their own retail platform will not be able to gain a competitive advantage that will enable them to operate abroad or extend their retail activities beyond the airport.
- The ability of direct operation to generate higher revenues and margins through more competitive prices has still to be proven. Attractive prices alone are not sufficient to increase revenues and margins; they must be supported by innovative concepts. In addition, opportunities for achieving economies of scale in buying and logistics, etc. are limited in this model.

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

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

Conclusion

Quality Brands Hainan Free Trade Island Procurement Company will address these questions:

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

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

Setting these different levers, however, remains a complex challenge for both airports and operators. Key success factors identified through best practices may enable players to establish a better understanding of the areas they need to address, but customizing the levers and applying them to improve retail performance effectively on a given platform is very difficult.

Moreover, these key levers encompass a wide range of functional competencies (infrastructure, purchase, logistics, legal, marketing, etc.), which makes setting them even more challenging for airports and operators who find themselves having to involve and co-ordinate a wide range of different resources.

In order to support airports in dealing with these challenges, Quality Brands Hainan Free Trade Island Procurement Company has developed a specific methodology that enables to design long-term, win-win partnerships and to reach a lasting performance in airport retail.

The Winner Solution

Quality Brands Hainan Free Trade Island Procurement Company is currently working to bring in Hainan:

- Modern, Comfortable, and Elegant Environment
- Beauty & Wellness areas
- Exclusive shopping concepts
- Unique Italian Corner
- Fine Restaurants
- Show Cooking Corners
- Dedicate Business Center
- Kids world Area
- Vip Clubs
- Events Zones
- A global Communication area

A Sustanaibility place

Quality Brands Hainan Free Trade Island Procurement Company is working to shape its places sustainably. Concerning the environment, our operations are linked to large energy and fuel consumption and to greenhouse gas emissions, contributing to climate change. The aspect of water usage is also involved.

Quality Brands Hainan Free Trade Island Procurement Company is developing sustainably considering the materials they are using, designing ways to save energy, and constantly aspiring to improve operational efficiency. The strive towards energy-efficient or renewable energy-based services is visible. Measures are taken to reduce carbon emissions, waste, and effluents.

When considering energy management, Quality Brands Hainan Free Trade Island Procurement Company starts with a map depicting the energy use across all the facilities and the suggestions to optimize them. It is possible to generate energy from renewable sources, like solar, wind, biomass, and hydrogen.

Contacts

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