THE TRINITY FORUM

THE WHITE PAPER
(PRELIMINARY)

A CONSULTATION REPORT ON THE FUTURE MODEL OF THE AIRPORT TRAVEL RETAIL & DUTY FREE INDUSTRY

Mission statement: “To create a partnership model for the airport Travel Retail industry that encourages world-class retail standards and is driven by the needs, desires and expectations of the end user – the travelling consumer. This to be achieved through airport leadership which encourages investment in retail environments and customer service and ensures maximised returns for all parties in the business – airports, retailers and suppliers (“the Trinity”). This recognises that all parties are stakeholders in the business, sharing risk and reward, in a vibrant selective retail channel for the 21st century.”

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“Let me share a vision: I see a vibrant industry where travellers are excited about getting to the airport in advance. Where they want to have the time to shop.

I issue a challenge to airports, to retailers, to suppliers to learn from beyond the industry, grasp the challenge of change and shape a successful future! The industry has been too much influenced by its environment which by its very nature is somewhat remote from the everyday realities of most people, tucked away in the artificial, extraterritorial world of airports.

This ‘splendid isolation’ has made it blind to the challenges of our time. The industry has to come out of its “closed shop” and learn to turn problems into opportunities. But you can no longer expect your shoppers to make the first step. You have to do it. There is no better time to act than in a time of crisis.”

– Peter Brabeck-Letmathe, Nestlé ceo, Trinity Forum, June 2003
# TABLE OF CONTENTS

Executive Summary 4

1. Introduction 5

2. The Traditional Industry Model and Other Options 8
   A) The Traditional Industry Model Based on Minimum Annual Guarantee
   B) Other Models
      i) Airport-Owned Retailer 10
      ii) Management Contracts 10
      iii) Joint Ventures 11
      iv) Competence Partnerships 11

3. The Perspectives 12
   A) The Airport 12
   B) The Retailer 12
   C) The Supplier 13

4. Scope for Common Ground? 14

5. Key Issues to Address – “How to turn the Trinity into a Quartet” 14

6. Conclusions 16

7. Recommendations and Consultation Points 17

Glossary of Terms 19

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©This Preliminary White Paper is published by Moodie International and The Moodie Report, organisers of the Trinity Forum in June 2003, an event which gave rise to this document.

The Paper draws extensively on the papers presented at the Trinity Forum. We thank the speakers for the opportunity to use excerpts, many of which have formed parts of the body of this Paper’s background and recommendations.

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1. At the conclusion of the successful Trinity Forum in London in June 2003, it was agreed that a White Paper be produced that would research and analyse the current Travel Retail industry model and make appropriate recommendations to help the industry go forward.

2. The White Paper was to be researched and produced by Moodie International, liaising closely with a nominated Committee representing all parties to the industry “Trinity” – airports, retailers and suppliers.

3. This Committee comprises Brian Collie, group retail director BAA (airports); John Sutcliffe, managing director Aer Rianta International-Middle East (retailers) and Patrick Moran, vice-president and director duty free Brown-Forman (suppliers).

4. It was subsequently agreed by the Committee that the White Paper should be presented in two stages, preliminary and final, to allow industry input from all sectors.

5. This White Paper (preliminary) therefore is being widely distributed to the industry from late October, requesting feedback by 1 December. It will be distributed in hard copy and electronic form by Moodie International. The final version will be produced in early 2004.

6. The White Paper (preliminary) highlights the key shortcomings of the current model and attempts to point the way forward. Some key points include:
   i) the consistent failure to focus on the consumer’s needs and aspirations;
   ii) the need to boost retail standards to a consistently world class level in line with the quality of customers attracted by airports;
   iii) the need to incentivise all parties – airports, retailers and suppliers – to participate as stakeholders in the business on a true risk/reward/information sharing basis;
   iv) the need to focus on growing the industry’s low store footfall and penetration rates and driving up the spend per passenger;
   v) that change to the model, driven initially by the airports, which control the assets, will benefit all parties, including the consumer
   vi) to recognise that investment in retail by the airports and other members of the Trinity will not mean erosion of profit but if implemented efficiently will, in fact, increase returns, as well as enhancing the reputation of the channel.

7. This Paper examines the current industry models and pays particular attention to the Minimum Annual Guarantee-based concession formula which it contends is responsible for many of the industry’s shortcomings.

8. While not recommending any single alternative model, it suggests a profit-sharing element be integral to any chosen formula to ensure that all parties go forward on a true partnership basis.

9. This Paper examines the perspectives, priorities and concerns of all three parties and finds that there is much common ground, with the single most important thread being the need to better serve the travelling consumer.

10. It argues that the old tender model is obsolete, divisive and unsustainable, especially in light of recent industry pressures, both internal and external.

11. It concludes with a number of draft recommendations, for which it asks for industry feedback.

12. These cover a range of subjects ranging from greater consumer focus to greater transparency of information; from contract duration to contract flexibility; and from improved footfall and conversion rates to an unrelenting focus on retailing quality.
1. **INTRODUCTION**

1. This Paper came about as a result of a landmark Travel Retail industry conference called the Trinity Forum, held on June 18–20, 2003.

2. The focus of the event was the industry’s financial model, with particular emphasis given to the tender system that has been a dominant element in the 56-year history of the airport (and airline) duty free business.

3. For some time, many of the industry’s leaders – from all sectors of the Trinity – have felt that this system, or at least its historic emphasis on minimum annual guarantees (MAGs), was an archaic and inappropriate method by which to select an airport’s retail partner.

4. There is also a real and growing desire on the part of committed members of the Trinity to create higher standards of retail worldwide. This Paper is as much about those standards as it is about a new model. Creating a new model will not only allow standards to improve substantially but will improve profitability for all parties, based on higher store footfall, store penetration and spend per passenger.

5. The “auction” nature of most open tenders has led to a series of well-publicised “over bids” in recent years that have served no-one well in the medium to long term. This has caused a domino-like effect with one party squeezing the next to the ultimate detriment of the end user – the travelling consumer.

6. The Trinity Forum was born out of a growing groundswell of opinion that the model has to change if the Travel Retail industry is to prosper or, perhaps, even just survive. This Preliminary White Paper examines the various models, explores the issues arising from them, and suggests some of the key approaches, attitudes and solutions that are required if this industry is to flourish and take advantage of the very real opportunities that exist in the travel market of the future.

7. **Two key premises pervade the whole document: the need for higher retail standards via a much more consumer-driven approach; and a fair apportioning of risks and rewards, upsides and downsides between the players in the industry.** It is absolutely essential that the airport (landlord) takes the lead in this regard as it owns the core assets of the business. This is a CONSULTATION document which asks for feedback from all sectors of the industry, which will be integrated into a final White Paper in February 2004.

8. It is generally accepted that industry store footfall rates (defined as % of total traffic entering any store) are as low as 30% globally and store penetration rates (the % of total traffic buying anything at all from a store) an even lower 15–20%. Few would argue that this rate is unacceptably low, given the broadly “captive” nature of the audience. Many believe that the industry model is a major contributor to that failure to convert a higher ratio of passengers to travelling consumers.

9. The traditional tender model’s emphasis has been heavily weighted towards the financial “winner takes all” offer. It gives scant recognition to key elements of any contemporary retailing proposition, ranging from customer service and staff training to the quality and ambience when delivering to consumers.

10. Having paid a premium price to win the auction/gain the contract, retailers have historically then been forced into relentless pressurising of suppliers for the best possible (suppliers would argue, at times impossible) margins in order to make their own bids sustainable. This pressure has been accentuated by the short-term tenure of most concession-based contracts.

11. The results have been an inevitable downward spiral. Recovery from each downturn never quite returns
to, or improves upon, the previous position. The overall business has not developed in line with the continuous growth in global travel numbers (see Figure 1).

12. The consumer has been the ultimate loser. The “collective squeeze” of the traditional model has meant that all parties collectively have not best served the consumer, the very people the industry exists for, because of a financially-driven disincentive to invest, often characterised by a limited offer and a glaring lack of support by increasingly disenchanted brand companies. In turn, this has led to a growing image crisis for duty free retailing, one that is undermining the outstanding growth potential of the business.

13. In this scenario, every party loses out. That includes the landlord, who, while having the ‘safety net’ of a minimum annual guarantee, is missing out on the considerable upside to be derived from an alternative model that encourages higher store penetration rates and increases the average spend per passenger and overall sales.

14. This Paper is not intent on criticising airport authorities. Indeed, it recognises the unique constraints and demands upon them to sustain and expand the very infrastructure that the industry depends on. Airports are under intense pressure to secure sustainable growth and to avoid major peaks and troughs. Airports are not responsible for a retailer’s bidding strategy and can be forgiven a reasonable expectation that any bid from a professional and experienced retailer should be commercially sustainable. Often it is only with the advantage of hindsight that any bid is revealed as “excessive”.

15. For government-owned airports, a tender is often a key part of the accountability process and the acceptance of the highest bid is not only understandable in financial terms, it is also a ready defence against any criticism of the choice of contractor.

16. Historically, many airports saw retail and other non-aeronautical revenues as an add-on, a peripheral non-core business, often outside the existing management’s expertise. Today, though, that is changing fast, with non-aeronautical revenues often generating the majority of airport turnover and profit. This Paper argues that both could be much higher with a new, more relevant model for the 21st century.

17. The prevalent industry model was built for better, less demanding times. This industry grew up on a simple premise – high taxes and duties (and sharp differentials from country to country) could be avoided by shopping “Duty Free” while travelling. Whether it involved Japanese group tours buying high-end, high margin Cognac (that was prohibitively priced on the Japanese domestic market) or Scandinavian day trippers pouring onboard the ferries to buy their liquor, cigarettes or confectionery, retailing was based on one simple proposition – price.

18. But economic and geo-political events and pressures of the past 10 years have changed all that. Intra-European Duty Free (a staple of the liquor and tobacco sector) has gone. Pivotal domestic markets such as Japan’s have been liberalised and local prices have come down significantly. The Nordic countries are slashing their liquor and tobacco taxes. Domestic market discounting of the goods associated with Duty Free stores is a global phenomenon. Put simply, travelling consumers are no longer the “easy sell” they used to be.
19. But there have been other, more recent strains on the industry model. Since the Asian economic and currency crises of 1997, the Travel Retail industry has reeled from one external event after another that has impacted on the business – and which, in the face of, the business has seemed powerless.

20. In the last two years alone, the trade has been punished severely by health crises (foot and mouth disease; SARS); wars (Afghanistan and Iraq); travel-related terrorism (Bali bombing, 9/11); related sharp falls in traffic; and a generally troubled global economic climate. The industry also faces constant legislative threat (WHO threat to Duty Free tobacco sales; intra-EU abolition; pressure to ban glass bottles from airlines, etc). Under such circumstances, even the most resilient model would come under pressure. For the Duty Free/Travel Retail sector, it has been almost intolerable.

21. It is time to change the model. This Preliminary White Paper aims to accentuate and accelerate the spirit of change that has already gathered considerable momentum among all points of the “Trinity”.

22. This paper will be circulated at all appropriate levels among the various elements of the Trinity to ensure a continued dialogue on the issues that face this business and to help drive the process of change. But dialogue is not enough. Action is required.

23. It does not propose any one “solution” to the industry’s structural shortcomings but a variety of profit-sharing models that each emphasise partnership rather than confrontation and hopefully lead to a “stakeholder” mentality in the business rather than the current situation which often sees the members of the trinity as isolated and often antagonistic combatants.

We look forward to your feedback.

Martin Moodie, Managing Director, Moodie International Publisher of The Moodie Report.

On behalf of The Trinity Forum committee: Brian Collie, BAA (airports); John Sutcliffe, Aer Rianta International–Middle East (retailers); Patrick Moran, Brown-Forman (suppliers).
1. The starting question must be: Why does this industry not deliver its mission, and why does it not exploit its full potential? In order to answer this, one should examine some of the main contractual models that exist today amongst the Trinity.

A) The traditional model based on Minimum Annual Guarantees (MAG)

2. These can be percentage-based contracts as well. There are several variations on and hybrids of these core models but undoubtedly the most common model is that of the open tender, concession contract, involving a fixed minimum annual guarantee (sometimes linked to passenger numbers) and variable percentage of revenue. Overbids pertaining to minimum annual guarantee have been at the heart of the industry’s problems over the past two decades - along with the historically short-term nature of such contracts.

3. This traditional tender model was historically a government-owned airport response to the need to enlist the private sector to provide a service and generate revenue from airport retailing. As a seemingly safe option that guarantees a revenue stream for airports, it still carries favour in many sectors of the airport and financial communities.

4. Due to having its origins in the period before wide-scale airport privatisations the model has originated largely from traditional government procurement practices normally associated with purchasing a wide variety of materials and services.

5. It has a number of inherent weaknesses
   a) The item at auction – the right to run an airport’s retail contracts – often has only one defining dimension, i.e. price or rent.
   b) In many cases it does not give sufficient weight to qualitative issues.
   c) It is based, theoretically, on bidders having equal and perfect information. In reality, the incumbent often enjoys a huge advantage in information terms.
   d) Short-term contracts are still the industry norm, which discourages investment in the quality of retail offer. In many cases, they do not allow sufficient time and flexibility to amortize the required investments and costs to maximize the business during the contract’s duration.
   e) Faced with onerous minimum annual guarantees, the retailer is focused on retaining margin and saving costs rather than growing the top line and developing a customer-orientated approach in critical areas such as staff training, promotion, fixtures and fittings and so on. Quality of offer and service is

<table>
<thead>
<tr>
<th>Concessionaire as competing Government entity</th>
<th>Traditional Concessionaire Model (featuring MAG and/or a variable %age)</th>
<th>Management Contract</th>
<th>J V Airport Retailer</th>
<th>Airport Owned or controlled Retail Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ITDC – India; Venezuela; Costa Rica</td>
<td>Hong Kong; Changi; Sydney; Copenhagen; Hawaii etc</td>
<td>BAA &amp; Allders/Alpha 1990s; Bahrain Duty Free</td>
<td>ADP/Aelia</td>
<td>BAA/World Duty Free; Dubai Duty Free; Abu Dhabi Duty Free; Eraman</td>
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Source: Randy Emch, Trinity Forum, J June 2003
invariably the loser.

f) The “auction” encourages “overbids”, for strategic or other reasons.
g) By overbidding, and therefore increasing the pressure to “sweat the assets”, the retailer ends up creating a weakened offer to the customer and usually with a correspondingly weak return. Alternatively they often seek to renegotiate, seek rent relief, or worse, threaten to withdraw from the contract in order to minimize the damage (e.g. Hawaii 2003 – DFS Hawaii; Seoul Incheon 2000 – Hotel Shilla)

6. There have been many well-documented examples of overbidding in this industry, generally to the detriment of the retailer, the concerned authority, the supplier (who is often squeezed for more margin and therefore doesn’t support the store in more consumer-oriented ways) and, most of all, the consumer.

7. Contract renegotiation has become a constant phenomenon in recent years, suggesting the industry model does not have the flexibility to cope with changes in trading conditions, especially those caused by external events (terrorism; health crises etc). These “abnormal” conditions will, in fact, become the norm in the troubled world of the 21st century.

8. A professional retailer believes in serious but rational bidding and understands the financial imperatives of the landlord. The airport has an obligation to seek the best terms, which deliver sustainable long term benefit. But prioritising the financial benefits is damaging and often results in an inappropriate choice of retail partner who is not motivated to grow the overall cake or to deliver world class retailing to passengers.

9. **This Paper contends that it is far better to concentrate efforts on increasing store penetration and spend per passenger (and therefore the overall spend) than have poor sales being generated by an inappropriately incentivised concession contract.**

10. Additionally, there are many damaging repercussions to the landlord of accepting an unsustainably high bid. These include:
    a) The possibility of no Duty Free retailer during part of the awarded concession period
    b) A resultant loss of revenue to the airport
    c) Complaints from the travelling public leading to consumer disenchantment
    d) Poor service levels and high pricing
    e) Restricted and limited range of merchandise offer
    f) Over-priced/high-priced, low value/poor quality merchandise offer
    g) Claims of incompetence/mismanagement against the airport or retailer
    h) Loss of reputation and integrity by the airport and retailer
    i) Future damage to the real value of the concession. Resulting loss of interest in re-bids and/or new bids by other parties who were previously rejected because the highest bidder was accepted by the airport to the detriment of product, service and merchandising
    j) Exposure to litigation

11. Rent guarantees have historically placed the downside risk on the concessionaire, not the airport. While understandably attractive from an airport (or airport financing) perspective, this has translated into a largely one way relationship.

12. If the business is looking for a stronger, more secure path, it needs to start from a much sounder base. The tender construction has to address the key factors that drive (or should drive) the Travel Retail and Duty Free business:
    a) Store penetration (an estimated 85% of all international airport travellers do not purchase any duty free items on a trip)
    b) Increase in average spend per head
    c) Category growth across all sectors
d) Establishing the airport as an integral part of the travel experience and a quality destination retail environment

e) Passengers should be considered ‘Travelling Consumers’, which puts the potential customer base more clearly into definition

13. These core aspects drive the business (as they do any bona fide domestic retail business). They also determine the growth or decline in revenues.

14. The traditional model fails to motivate the retailer to actively address the key issue of how to turn the 85% of passengers who do not buy into shoppers.

15. Instead of focusing on such key issues, some members of the Duty Free industry have become obsessed historically with squeezing the maximum possible margin out of the revenue generated by the minority who do buy. It is an approach that cannot sustain the industry’s development in a new era of lowering, increasingly harmonised duties and taxes and where the downtown retail offer grows more competitive by the day.

16. Unrealistic guarantees are leading to conflicts between landlords, retailers and suppliers. And they are often leading to an inappropriate retail price structure which fails to meet the expectations of customers.

17. Globally, with only a handful of notable exceptions, the image of airport retailing is suffering. This is a critical point. In future, consumers all around the world will become disenchanted with airport shopping unless the value offer is clear and the quality of the shopping environment is first class.

B) OTHER MODELS

i) The Airport-Owned (or Linked) Retailer

18. Examples: World Duty Free (UK), Dubai Duty Free (UAE), Abu Dhabi Duty Free (UAE), Eraman (Malaysia)

19. The airport-owned/linked retailer model can overcome many of the limitations of the traditional model and avoids several of its flaws. In the internationally renowned cases mentioned above, it delivers a consumer-focused, dynamic and ever-changing retail offer that is entirely focused on driving more customers into the shops and driving up spend. It sees airport and supplier working in greater harmony with a common objective to develop the consumer service (shopping) and grow the business.

20. Not surprisingly, two of the above-named are among the world’s top five duty free locations (BAA’s London Heathrow airport is number 1; Dubai number 5).

21. This is possibly the ideal solution though many airports lack the necessary in-house expertise or (in the case of government ownership) the political will to tackle the complexities of the model.

ii) Management Contracts

22. Management contracts are a hybrid of other models with both advantages and disadvantages over the traditional tender model:
   a) They can avoid the problems associated with minimum annual guarantees
   b) The airport gains institutional competence and is more closely involved in the retail management of its real estate and customer base. However, for the retailer, the danger is that their expertise is tapped and the landlord subsequently creates its own operation
   c) They are a potential stepping-stone to airport-owned operation [BAA ran management contracts with
Allders International and Alpha Retail before opting for an in-house operation in the late 1990s]
d) They can also promote a common cause with airport, retailer and supplier all focused on growth.
e) At their best, they can encourage long-term investment.

iii) Joint Venture (Airport and Retailer)

23. This means the sharing of risk and reward between landlord and retailer. Aéroports de Paris’ alliance with its leading concessionaire Aelia at Paris Charles de Gaulle is the most prominent recent example. Again, this approach avoids the shortcomings of minimum annual guarantees and creates a stakeholder mentality between retailer and landlord.

iv) Competence Partnerships

24. Competence Partnership is a concept forged by Dutch retailer Kappé International, long-time fragrances and cosmetics retailer at Amsterdam Schiphol airport and several other international locations. Its principles are worth noting here.

25. Its key tenets are:
   a) Landlord and operator create a new company in a 50/50 joint venture
   b) One board with one to three executive directors, led by a managing director, plus a non-executive director
   c) Standard rent agreed to cover costs
   d) No minimum guarantee
   e) Fee calculated as a percentage of net results
   f) Net profits preserved and paid at end of contract
   g) Equal risk
   h) Clear responsibilities for each party defined
   i) Realistic exit clause
   j) No bank guarantee necessary
   k) Long-term partnership
   l) Both parties can influence policy
   m) Efficiency
3. THE PERSPECTIVES

A) THE AIRPORT

Priorities: Maximising security of income to underpin long-term investment; improving reputation; achieving a balance between the offered concession fee, the quality of technical retail offer/service and the ability to create turnover.

Contribution to the Trinity: Retail space; Passenger flows and information; High-quality consumer base

The classic Travel Retail formula:

Real estate + Customer base + Brands = Golden retail opportunity

1. Airports have some of the best real estate in the retail world. They also have one of the most appealing customer bases in the world. Combined with the world’s best brands, the opportunity is there to create a world-class retail experience.
2. Airports effectively own the retail opportunity.
3. It is understandable therefore, especially in the non-privatisation model, that so many airports operate their retail on a MAG-based “highest bid wins all” philosophy. In the eyes of a financial community that often fails to understand the dynamics of the non-aviation revenue stream, minimum annual guarantees are viewed as “risk free” from the airport perspective.
4. The airport owns the key assets, the prime real estate, and (for a period at least) the customers. They have long term investment demands and every airport is pressurised to squeeze out capacity growth and maximise its capacity. Additionally, the modern consumer expects high quality environments and world class service.
5. Where else can be found the concentration, scale and quality of high-class consumers that is found at an international airport? The retail – and revenue – opportunity is huge.
6. The prevalent current model is low risk, offers (largely) guaranteed income, requires little or no support from the airport and in format resembles the tendering criteria which airports apply to commodity purchasing.
7. It fails to encourage, explore and exploit the tremendous opportunities that the airport environment offers to retail.
8. Remaining with the current system may guarantee short-term income but risks jeopardising the long term return so vital to future capital investment.

B) THE RETAILER

Priorities: Fair return on investment; Low risks

Contribution to the Trinity: Efficiency; Expertise; Innovation

1. The current duty free market worldwide is worth an estimated US$20 billion, of which airports represent US$9.6 billion in 2002, according to Generation DataBank.
2. For retailers, the key drivers and concerns are:
   a) Sales volume
   b) Profit and cash flow generated by being in a high footfall location
   c) Effective cost control
   d) Viable contract terms
e) Length of tenure
f) Customer satisfaction

3. Most suppliers and almost all airports need to import retail capability and that means that the retailer should be an ideal conduit between the airport and the supplier.

4. But that retailer has to share their long-term perspective. The retailer should not act as a barrier between airport and supplier but as a supporting link. The retailer should be providing expertise for the other members of the Trinity, rather than being confined to the role of a margin-manager and contract negotiator.

5. The retailer should be working to create a retail offer that is tailored to the airport and its travellers rather than to a league table of product margins.

C) THE SUPPLIER

Priorities: Maximising sales volumes; Brand exposure

Contribution to the Trinity: Brands; Market and consumer knowledge; Investment in marketing and advertising on domestic markets from which duty free benefits

1. The array of brands presented in today’s modern travel retail environment is unmatched by any other retail channel in the world. Besides the obvious sales opportunity this offers suppliers, the travel retail channel represents a high-class marketing showcase, an international “shop window” unrivalled in any domestic market. They recognise the long-term potential and resilience of the travel related market. And they recognize it is relatively free of secondary or own-label brands.

2. But some suppliers, including the owners of the world’s most illustrious brands, are reviewing whether “Travel Retail” is a distribution channel that they want to invest in. That is not alarmist or scaremongering – the process is being actively debated by many of the top supply companies at the highest level.

3. In this unique channel, a supplier’s key objectives are to:
   a) Deliver to the consumer an exciting and competitive shopping experience
   b) Maximise sales and secure sustainable profitability levels, for the short and mid-long term.
   c) Maximise brand-building opportunities.
   d) Be assured that all brand equity requirements are fully protected.
   e) Develop ways to improve penetration and conversion rates.
   f) Develop a reporting system (quantitative and qualitative) in line with the standards taken for granted on most domestic markets.
   g) Improve operating cost-efficiencies.

4. Three urgent supplier priorities:
   i) That airports fully understand that opting for the “highest bid” is not a guarantee of a vital and vibrant retail offer.
   ii) To emphasise to the retailers that the market is at full stretch - and that as each new crisis hits the industry, the owners and boards of supply companies ask themselves time and again whether they should really be investing in such a volatile market that is underpinned by such an archaic and inappropriate model.
   iii) Increasingly, suppliers are only prepared to support retailers who take an enlightened and long-term approach to partnership, retailers with whom they can invest on an equal footing, and for the long term.

5. Brands in Travel Retail range from some of the world’s most well-known names, to small innovative companies, trying to find their niche in this market. But to varying degrees they have one thing in common – they are trapped at the bottom of a pyramid – constantly squeezed by the layers above them. Those layers can only retain their shape, form, strength and stability, if the base is firm and solid.

6. Suppliers are fully aware of the value of Travel Retail; they have supported it for 50 years and will support it and underpin it for another 50 – but only if the rules of engagement are fair and the returns viable.
4. SCOPE FOR COMMON GROUND?

1. In short, the answer is “Yes” because of:
   a) The real desire on behalf of the Trinity to create higher retailing standards and to satisfy the aspirations of the neglected fourth member of the “Trinity” (or Quartet) – the consumer.
   b) The need to create a long-term business based on viable returns and harmonious partnerships.
   c) The ability to grow the business in line with the projected growth in the potential customer base.
   d) The maximising of sales volume.
   e) The enhancement of reputation.
   f) Effective cost control.
2. The combination of all these factors brings us back to the original Mission Statement outlined on page one of this document. This highlights the interdependent nature of the business, if the industry is going to maximise its true potential as a vibrant retail channel.
3. But brand recognition of Duty Free/Travel Retail as a quality product is not the responsibility of just one or other of the players involved.
4. This means providing an efficient overall environment from the moment a consumer arrives landside at an airport, through the necessary controls and into a quality retail environment airside, where the retailer can supply brands that a consumer recognises as an opportunity which cannot be replicated downtown.
5. The consumer is the common thread across the Trinity and beyond.

5. THE KEY ISSUES TO ADDRESS – “HOW TO TURN THE TRINITY INTO A QUARTET”

i) Value: Travel retail is often perceived as offering poor value, which could deteriorate further.
   a) The flawed financial model already discussed.
   b) The lowering and dismantling of cross-border duties and tariffs around the world.
   c) The trend of EU and NAFTA style free-trade zones, GATT and WTO agreements reducing trade barriers, will continue. These changes are for the benefit of consumers all around the world. But they are not to the benefit of Travel Retail, which has been built on, and sustained by, these anti-competitive tariffs.
   d) Where there is potential for shortage of supply (Champagne, Tequila), duty free will be the first channel to be declined supply because the margins are so poor under the current model.

ii) Image: Travel Retail has a poor image.
   a) Travellers historically entered the shops for a purely functional reason, because it was cheap. Take the incentive of an artificial price advantage away and what is left? In too many Travel Retail locations the world over, Travel Retail no longer offers good value relative to domestic market retail.
   b) It is often viewed as a rip-off, and consumer confidence in it as anything other than a last-minute shopping opportunity is low.
iii) **Sameness:** Travel Retail is characterised by sameness all over the world despite claiming to be an intrinsic part of the travel experience.

There is too much emphasis on short-term returns and therefore a commensurate failure to invest in quality, distinction and local flavour. Travel Retail should be an integral part of the destination travel experience. Consumers should count the airport retail offer as a fundamental and enjoyable part of their journey abroad.

iv) **Short-term thinking:** Contracts are too short

Short-term contracts remain commonplace, which discourages investment in the offer and the environment and minimizes the viability of decent financial returns.

v) **Lack of consumer focus:** The consumer is neglected

Too many airports and retailers fail to realize that if they fail to invest in high levels of customer service throughout all aspects of the retail environment, i.e. location, space, shop design, product range, presentation, promotions, and make the shopping environment an interesting and fun place to be, one that offers real value for money, they will not reap the benefits of higher penetration and higher average spends.

Interestingly, in the Middle East, so recently a war zone and where retailers have been operating amid such conditions for over thirty years, the leading players have bounced back from such adversity faster than any other region. Several – Dubai, Abu Dhabi, Kuwait – are on course to set all-time sales records in 2003. Such resilience is firmly based on the sound concept of putting customers first. This involves offering them first-class shopping environments, a diverse range of product to choose from, real value for money, and a level of customer service that makes their shopping experience worthwhile and enjoyable.

vi) **Airport privatisations and commercialisation:** New thinking required

The trend towards airport privatisation is accelerating in markets all over the world, from China to Ireland. As the newly-privatised airports take shape, they will need a resilient, customer-focused retail model in order to maximize their non-aeronautical revenues.

vii) **Risk and reward:** Encouraging a fair balance between all parties

Where is the risk taken? Is it the airport managing the flow of hundreds of millions of passengers while spending a billion pounds a year to get a low return on capital? Is it the retailer buying and selling day by day, working on margins and struggling with cash flow? Or is it the supplier investing in product R&D, marketing and distribution?

In fact, all parties are taking risks; but the sharing of risk is a key to success. The traditional model, especially, offers an imbalance of risk and reward.

As mentioned in the Foreword, this Paper does not propose any one “solution” to the industry’s structural shortcomings. But the following section – and the recommendations and discussion points that follow – attempt to support the merits of co-operation over confrontation and imbue the industry with a “stakeholder” philosophy to be embraced by all members of the Trinity.
6. CONCLUSIONS

1. The persistent thread – and essential key – to the future of Travel Retail is the adoption of a sharing approach between the Trinity, i.e. a sharing of information and, more critically, of risks and rewards.

2. There must be real desire and goodwill among all points of the Trinity to create world-class standards of retail. Simply changing the model is not enough.

3. It is absolutely essential that the airports take the lead as they own the assets.

4. We recognize that as much as the tender process is anathema to many in the industry, it is likely to remain a reality for many airports, especially in the state sector. In the final section of this Paper we therefore make a number of comments and recommendations to ensure that the tender process, where it is the chosen model, is played out on an equal playing field and incentivises retailers to bid – and operate – creatively.

5. The fact that Travel Retail has weathered so many storms in the opening years of the 21st century proves it has resilience. Nevertheless, because of the extreme external and internal pressures it faces, Travel Retail must fundamentally re-examine the relationship between its constituent parts and with its consumers.

6. The opportunity should be taken to examine the industry afresh and not be constrained by historical practices and attitudes.

7. In relation to the contractual issues, whatever the model, if airports, retailers and suppliers alike work together as one – as a Trinity – there are overwhelmingly positive consequences for all parties, including the travelling consumer.

8. The model must have innate flexibility – integrating a range of scenarios in which all parties can benefit from the good times and cope better with the bad.

9. The old tender model is obsolete, divisive and unsustainable.
7. RECOMMENDATIONS AND CONSULTATION POINTS

Please indicate agree/disagree and make comments overleaf

<table>
<thead>
<tr>
<th>Agree/</th>
<th>disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Consumer: That the quality of consumer shopping experience is integral to any choice of retail partner and/or retail model adopted.</td>
<td></td>
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<tr>
<td>2. That the concept of profit sharing (risk/reward/decision making) be paramount in all contract models.</td>
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<tr>
<td>3. That landlord and retailer (where separate) share objectives and concentrate efforts to grow footfall and conversion rates and drive up average sales per passenger and total sales.</td>
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<tr>
<td>4. Communication: That all parties to the Trinity commit to an improved data flow and exchange with a much greater emphasis on transparency of information.</td>
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<tr>
<td>5. Significant research should be undertaken by the industry on the mindset of travelling consumers – not just into brand buying but much wider on their whole perception of buying when travelling.</td>
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<tr>
<td>6. Contract duration: That an appropriate long term contract term be recommended for all major retail concessions, (subject to usual performance requirements) to incentivise investment in the offer, staff and retail environment.</td>
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<tr>
<td>7. Minimum annual guarantee-based rents: That contracts should avoid the “auction” process of minimum annual guarantees and should be performance-based instead with inbuilt flexibility that recognises the volatile and cyclical nature of the travel industry.</td>
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</tbody>
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### Characteristics of current and proposed tender systems

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Current characteristics</th>
<th>New model attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of contract</td>
<td>Outsourcing</td>
<td>Partnership</td>
</tr>
<tr>
<td>Relationship</td>
<td>Vertical</td>
<td>Horizontal</td>
</tr>
<tr>
<td>Financial engineering</td>
<td>Fixed and/or variable</td>
<td>Profit sharing</td>
</tr>
<tr>
<td></td>
<td>Risk avoiding</td>
<td>Risk sharing</td>
</tr>
<tr>
<td></td>
<td>Cash flow fixing</td>
<td>Maximising cash flow</td>
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<tr>
<td></td>
<td>Net sales</td>
<td>Gross sales</td>
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<tr>
<td>Focus</td>
<td>Quantity</td>
<td>Quality</td>
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<tr>
<td></td>
<td>Supplier</td>
<td>Consumer</td>
</tr>
<tr>
<td></td>
<td>Weaknesses</td>
<td>Strengths</td>
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<tr>
<td>Know-how</td>
<td>Chinese walls</td>
<td>Synergies</td>
</tr>
<tr>
<td></td>
<td>Confrontation</td>
<td>Co-operation</td>
</tr>
<tr>
<td>Scenario</td>
<td>Uncertainty</td>
<td>Growth</td>
</tr>
<tr>
<td>Selection</td>
<td>Tender/auction</td>
<td>Track record</td>
</tr>
<tr>
<td>Duration</td>
<td>Up to 5 years</td>
<td>More than 5 years</td>
</tr>
<tr>
<td>Information sharing</td>
<td>Limited</td>
<td>Transparent</td>
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</tbody>
</table>
Please copy this page and return to Martin Moodie, Moodie International by post at 1000 Great West Road, Brentford, Middlesex TW8 9HH, UK or by fax +44 20 8261 4445 or e-mail any of the following:

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by 1 December 2003
# GLOSSARY OF TERMS

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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</thead>
<tbody>
<tr>
<td>Total Traffic</td>
<td>Number of all passengers in the terminal/airport</td>
</tr>
<tr>
<td>Store Footfall</td>
<td>% of Total Traffic stepping into any store (multi-category or individual category)</td>
</tr>
<tr>
<td>Category Footfall</td>
<td>% of Total Traffic spending some time looking at a particular category of product within a multi-category store</td>
</tr>
<tr>
<td>Store Penetration</td>
<td>% of Total Traffic buying anything at all from a store</td>
</tr>
<tr>
<td>Category Penetration</td>
<td>% of Total Traffic buying a particular category of product from a multi-category store</td>
</tr>
<tr>
<td>Store Conversion</td>
<td>Store Penetration divided by Store Footfall i.e. the proportion of visitors to the store converted into purchasers</td>
</tr>
<tr>
<td>Category Conversion</td>
<td>Category Penetration divided by Category Footfall i.e. the proportion of visitors to the category converted into purchasers</td>
</tr>
<tr>
<td>Store ATV or Store Spend per Purchaser</td>
<td>Average spend per purchaser in the store</td>
</tr>
<tr>
<td>Category ATV or Category Spend per Purchaser</td>
<td>Average spend per purchaser in a particular category within the store</td>
</tr>
<tr>
<td>Spend per Passenger</td>
<td>Total retail spend divided by total traffic (=effectively Store Penetration x Store ATV)</td>
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</tbody>
</table>

# ACKNOWLEDGEMENTS

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THE TRINITY FORUM

THE WHITE PAPER
(PRELIMINARY)

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