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## **AIRPORT CONCESSIONS**

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### ***Summary***

*In recent years airports have become more commercially oriented and have endeavoured to result in an increasing share of their revenues from non-aeronautical or commercial activities. This paper examines the airport concession sector and the important factors influencing concession revenues. Furthermore, the paper seeks to focus attention on various contract strategies of airport concessions, analyzing the example of Dubrovnik Airport. Contract terms between lessee (concessionaire) and lessor (airport authority) are found to be a significant element for better performance of airport concessions.*

***Keywords: airport, commercial revenues, concessions, Dubrovnik Airport***

## **1. INTRODUCTION**

Many airports rely on their concessionaires in order to generate a significant part of their non-aeronautical revenues. The aim of this paper is to identify the principal features of airport concessions. In order to achieve the above aim, the paper is divided as follows. First an overview of the airport operating revenue sources is detailed. This provides the context for following section which outlines the factors influencing concessions revenues. This is followed by a detailed examination of the process for successful letting of concessions and various contract terms. The fourth section analyzes the example of Dubrovnik Airport with regard to various components of a contract between the tenant or lessee and the airport authority. The survey consists of data that was gathered via an interview with airport legal services adviser in December 2007 at Dubrovnik Airport. Finally certain conclusions emerging from the previous mentioned sections are drawn.

## 2. AIRPORT REVENUE STRUCTURES

Traditionally commercial issues have been a peripheral concern to the needs of aeronautical operations. The aim of the airport authority has been to process passengers as quickly and efficiently as possible.<sup>1</sup> However, two different approaches must be emphasized, the traditional view of an airport, i.e. that it exists to ensure the efficient movement of passengers between one destination and another, and an alternative approach, which views airports within a broader framework of economic change and commercial opportunity. This change of emphasis represents one of the most significant contemporary developments to affect the industry.<sup>2</sup>

The so-called “commercial-oriented airport approach“ suggests that the airport evolves to become a more sophisticated market entity that may be described as “multipoint service-provider firm“.<sup>3</sup>

The capital required to develop and maintain an airport is generated from two sources: aeronautical charges and non-aeronautical or commercial revenues (Table 1). Aeronautical charges are levied on airlines by the airport operators for using their facilities and include landing and apron charges and passenger fees.<sup>4</sup>

Table 1.

Airport operating revenue sources

<b>Aeronautical</b>	<b>Non-aeronautical</b>
Landing fees	Concessions
Passenger fees	Rents
Aircraft parking fees	Direct sales (shops, catering and other services provided by the airport operator)
Handling fees (if handling is provided by the airport operator)	Car park (if provided by the airport operator)
Other aeronautical fees (air traffic control, lighting, airbridges etc.)	Recharges (for gas, water, electricity etc.)
	Other non-aeronautical revenue (consultancy, visitor and business services, property development etc.)

*Source: Graham, A. (2007), Managing Airports – An international perspective: Elsevier Ltd., Butterworth-Heinemann, 56.*

<sup>1</sup> Freathy, P., O’Connell, F. (1998), The role of the buying function in airport retailing, *International Journal of Retail & Distribution Management*, 26 (6), 249.

<sup>2</sup> Freathy, P. (2004), The commercialisation of European airports: successful strategies in a decade of turbulence?, *Journal of Air Transport Management*, 10 (3), 191.

<sup>3</sup> Jarach, D. (2001), The evolution of airport management practices: towards a multi-point, multi-service, marketing driven firm, *Journal of Air Transport Management*, 7 (2), 123.

<sup>4</sup> Freathy, P., O’Connell, F. (2000), Market segmentation in the European airport sector, *Marketing Intelligence & Planning*, 18 (3), 104.

Over the last two decades, the trend has been for commercial revenues to grow at a faster pace than aeronautical revenues, as European airports have greatly expanded their retailing outlets, as well as other service offerings.<sup>5</sup>

### 3. FACTORS INFLUENCING CONCESSION REVENUES

Concession in its original context means the payment that the airport authority charges the owner or manager of an operation to conduct commercial activities in the airport, whereas rent or lease refers to the right to occupy certain defined premises or a specific area of realty. In general, however, concessions confer all commercial activities to sell goods and services in the airport, and sometimes the meaning of concession, rent and lease is used indiscriminately.<sup>6</sup>

Currently, most airports all over the world are striving to generate more concession revenues. Therefore, it is very significant for every airport to bear in mind the principal determinants of concession performance.

These include the following:<sup>7</sup>

- total traffic handled by an airport,
- total amount of space allocated for retailing and other commercial activities,
- characteristics of passenger traffic and buying behaviour<sup>8</sup> of those passengers,
- operations and management of concession,
- characteristics of contract and rental fees,
- marketing strategy<sup>9</sup>,
- pricing strategy.

In practise, many airports use concession revenues to cross-subsidize aeronautical operations. The common explanation for the phenomenon is that airports appear to face a constraint on aeronautical charges either because of

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<sup>5</sup> Marvel, M. (2006), Europe's Airports, Travel & Tourism Analyst, Mintel International Group Ltd., No. 2, 33.

<sup>6</sup> Kim, H., Shin, J. (2001), A contextual investigation of the operation and management of airport concessions, *Tourism Management*, 22 (2), 150.

<sup>7</sup> Ibid.

<sup>8</sup> These potential customers could be categorised into four core segments based on their similar motivational structures: (1) strollers and half-day trippers, (2) leisure-interested employees, amusement-seekers and airline crew members staying overnight, (3) employees during their working time and (4) local residents (cf. Geuens, M. et al. (2004), Developing a typology of airport shoppers, *Tourism Management*, 25 (5), 618.)

<sup>9</sup> Choosing an airport is a complex decision for a passenger. Range and quality of shops, catering and other commercial facilities are among the principal factors affecting the choice of airport from passenger perspective (cf. Albers, S. et al. (2005), Strategic alliances between airlines and airports – theoretical assessment and practical evidence, *Journal of Air Transport Management*, 11 (2), 52.)

airline opposition to increase in aeronautical charges or because their own governments hold back or limit such increases.<sup>10</sup>

#### 4. SELECTION OF CONCESSIONAIRES AND CONTRACT TERMS

As previously mentioned, concession revenues are those generated from non-aircraft related commercial activities occurring within terminals and on airport land. Concession business includes running or leasing out shopping concessions of various kinds, car parking and rental and banking and catering, with terminal concessions and car parking and rental being the most important of these. Many airports generate a much higher proportion of their income from concession activities than from aeronautical operations.<sup>11</sup>

Typically the concessionaire pays a fixed rental, plus additional income to the airport once a predetermined profit or turnover level has been reached by the concessionaire. Some agreements, usually those devised by the airport to encourage increased retail presence, are entirely based on the profit/turnover of the concession. These agreements can vary from outlet to outlet at the same airport depending upon location, nature of business, forecast turnover and whether or not the outlet is new.<sup>12</sup>

The process for successful letting of concessions is summarized as follows:<sup>13</sup>

- develop portfolio strategy,
- define market strategy for each concession,
- determine space and location requirements,
- proactively market the airport to potential concessionaires,
- prepare design concepts and specifications for contracts,
- tender/negotiation/selection process,
- monitor and review concessionaire performance,
- work with concessionaires on improvements and redevelopment.

Like average aeronautical charges, average concession revenues per passenger decline with volumes. Concession revenues per departing passenger are lower at hubs, probably because of a high share of connecting passengers, who do not consume rental car and parking services. More concentrated airports make

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<sup>10</sup>Zhang, A., Zhang, Y. (1997), Concession revenue and optimal airport pricing, *Transportation Research Part E: Logistics and Transportation Review*, 33 (4), 287.

<sup>11</sup>Zhang, A., Zhang, Y. (2003), Airport charges and capacity expansion: effects of concessions and privatization, *Journal of Urban Economics*, 53 (1), 55.

<sup>12</sup> Francis, G. et al. (2004), Airports' perspectives on the growth of low-cost airlines and the remodeling of the airport-airline relationship, *Tourism Management*, 25 (4), 509.

<sup>13</sup> Doganis, R. (1992), *The airport business*, Routledge, London, 154.

less concession revenue per passenger, possibly because vertical relations imply that a bigger share of such revenues accrues to airlines.<sup>14</sup>

The duration of each concessionaire agreement and the financial conditions attached to each will vary by airport and retailer. It is unusual to have specified rentals for different parts of the terminal and unlike the majority of concessionaire contracts in the domestic market, rent reviews are uncommon over the duration of the contract. The length of the contract is dependent upon a number of criteria. One of the most important is the level of investment required from the retailer. If little investment is required then a contract is often short term. If any significant level of investment is required from the retailer then a contract of five years would be considered the minimum.<sup>15</sup>

The following section examines various components of a contract between the tenant or lessee and the airport authority using the example of Dubrovnik Airport.

## 5. THE CASE OF DUBROVNIK AIRPORT

Dubrovnik Airport is located approximately 20 kilometres from Dubrovnik city centre. It is a secondary airport and in 2007 handled 1,143.168<sup>16</sup> passengers from a mixture of scheduled, charter and low-cost services. In terms of total passenger volume, with 1,1 million passengers it ranked third amongst the ten<sup>17</sup> international airports in Croatia in 2007. The main scheduled airline is Croatia Airlines, the country's major flag carrier. As well as other Croatian airports, Dubrovnik Airport is 55 per cent owned by the state, with the remaining 45 per cent divided between different levels of local authority.

Dubrovnik Airport is the example of an organization focused on maximizing commercial revenues.<sup>18</sup> The commercial department has different sections with the staff of various disciplines. It is responsible for renting out of office spaces, cargo areas, warehouses, retail services (advertising, car rental, banks). Still, there are some important features to be pointed out. The trade and catering manager is in charge of retail operations, while the general services department is concerned with promoting and marketing the airport. Although not all commercial activities are under the aegis of commercial department, as one would expect, there is a strong relationship among departments, in particular between the commercial and general services department.

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<sup>14</sup> Van Dender, K. (2007), Determinants of fares and operating revenues at US airports, *Journal of Urban Economics*, 62 (2), 319.

<sup>15</sup> Freathy, P., O'Connell, F. (1999), A typology of European Airport Retailing, *The Service Industries Journal*, 19 (3), 125.

<sup>16</sup> <http://www.airport-dubrovnik.hr/statistike.htm> (Accessed 12.I.2008)

<sup>17</sup> <http://www.mmpi.hr> (Accessed 14.I.2008)

<sup>18</sup> Vojvodić, K. (2007), Developing a commercial strategy: The case of Dubrovnik Airport, 7th International Scientific Conference "Business Logistics in Modern Management", Faculty of Economics in Osijek, Osijek, October 11th, Book of Summaries, 30.

Over the period from November to December 2006, the author undertook several interviews<sup>19</sup> with top and middle managers of Dubrovnik Airport. Although the research has been directed to the analysis of the airport managers' evaluations with regard to low-cost model activities, the analysis of the results has also highlighted the fact that all airport managers surveyed perceive both passengers and airlines as their customers and view passengers as equal partners of the airport. The increased focus of airport managers on passengers spending in the terminal is evident.

The primary source of information for the following illustration was the interview undertaken with the legal services adviser of Dubrovnik Airport in December 2007. According to the airport legal adviser, with regard to the components of the contract concluded for airport concessions, different strategies have been implemented by the commercial department depending mostly on the concession purpose and the location of the facilities (Table 2.).

Table 2.

Contract strategies of airport concessions at Dubrovnik Airport

<b>Components of the contract</b>	<b>Features</b>
Contract type – concession fee	<ul style="list-style-type: none"> <li>• Fixed</li> <li>• Percentage of the total annual sales</li> <li>• Mixed method of the minimum guaranteed rate and percentage of the total annual sales</li> <li>• Number of passengers in arrival/departure/domestic/international/total</li> </ul>
Contract period	1-5 years
Recontract type	<ul style="list-style-type: none"> <li>• Priority to the existing operator</li> <li>• Open and competitive bid</li> </ul>
Recontract period	<ul style="list-style-type: none"> <li>• Same as previous contract period</li> <li>• Less than previous contract period</li> <li>• More than previous contract period</li> </ul>

*Source: According to the data gathered via the interview*

This issue is very much affected by the Airport's ownership structure that made it obliged to act according to the Croatian Law on Lease which sets special rules for the certain types of the business lease, for example, offices, office buildings, garages and garage parking place. Open and competitive bids procedure is a legal procedure in the above cases and public tender has to be issued. An initial fee is usually set as a minimum fee that has to be offered by

<sup>19</sup> Vojvodic, K., Vrdoljak Raguz, I. (2007), Managing airports – the impact of low-cost carriers, 7th International Conference On "Enterprise in Transition", Proceedings, Book of Extended Abstracts, Split – Bol, University of Split, Faculty of Economics, May 24th-26th, 221 – 223.

tenderers. In other cases of lease, for example, advertising for posters, light boxes, the lease contract is regulated according to the Croatian Law on Obligations.

With regard to contract type, four above mentioned approaches are used. In applying both the minimum guaranteed rate and the percentage of sales methods, the airport compares two figures, and then requests for the higher of the two.

The contract period is generally known to be 3-10 years for duty-free shops and food and beverage stores, and 5 years for retail and convenience stores. The airport legal services adviser indicated some details of the contract period, i.e., 1 year for the parking contracts, for the rent-a-car and travel agencies and 3-5 years for the office lease, food and beverages and retail.

Whatever the length of the contract period it is important, if an airport aims to maximize concession revenues, that no contracts are renewed automatically on expiry.<sup>20</sup> With reference to recontract type, it is worth pointing out that special priority is given to existing operator. As a matter of fact, according to the Croatian Law on Lease, the lessor is obliged to offer the existing lessee renewal of the contract 60 days the latest before the contract expires, under the same of different terms provided that lessor had settled all debts to the airport. The airport adviser also emphasized that that stipulation referred only to the facilities described as business lease in the mentioned Act so it didn't apply to the outside parking lease, for instance.

Finally, in the case of recontracting, the new contract period can be the same as the existing contract period, as well as shorter or longer than the current one. In conclusion, it is accurate to underline that the performance of the contract strategies within airport concessions has become of crucial importance in the generation of commercial revenues.

## 6. CONCLUSIONS

In this paper, a few points have been made. A perception of airport concessions cannot be separated from the wider developments occurring within air transport industry.

First, it is important to focus attention on commercial activities of an airport in such a way that these activities are given the importance they are worthy of, since they may be bringing about very high percentage of an airport's total revenues. This is reasonable, and significant, due to the fact that many airports generate a much higher proportion of their income from commercial activities than from aeronautical operations.

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<sup>20</sup> Doganis, R., op.cit., 154.

Second, given the role that commercial activities play in the revenue generally, and concessions in particular, the contract strategies of airport concessions remain of vital importance.

Third, the majority of airports have some form of concession arrangement and the generation of revenue by this method is regarded as one of the most widely accepted forms of commercial contract. Airport management must be aware of the fact that the fee revenue from the concessionaires is a field over which it has ascendancy through the contractual agreements that it enters into for its concessions. Consequently, the procedure used in choosing concessionaires has considerable influence on airport's commercial revenues.

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Asistent

Odjel za ekonomiju i poslovnu ekonomiju

Sveučilište u Dubrovniku

**KONCESIJE U ZRAČNIM LUKAMA****Sažetak**

*Posljednjih godina zračne se luke komercijalno orijentiraju i nastoje povećati udio prihoda iz sporednih djelatnosti. U radu se istražuje sektor koncesija u zračnim lukama te važni činitelji koji utječu na prihode od koncesija.*

*Analizirajući primjer Zračne luke Dubrovnik, pozornost se usmjerava na različite modele zaključivanja ugovora za dodjelu koncesijama u zračnim lukama.*

*Uočava se da su uvjeti ugovora između zakupnika (koncesionara) i zakupodavca (operatora zračne luke) značajan element za uspješniju realizaciju koncesija u zračnim lukama.*

***Ključne riječi: zračna luka, komercijalni prihodi, koncesije, Zračna luka Dubrovnik***

***JEL classification: L93***