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Travel Retail: a global channel for growth and innovation

By [Alex Avery](#)



Welcome to the second in a series of thought pieces from Pragma. The Pragma Monthly is a deep dive into the key issues affecting retail, travel and consumer businesses, to accompany our weekly Pragmatists and our quarterly white papers.

In this paper, we explore the opportunity that travel hubs present for retail and consumer brands, with consideration of the commercial potential for both asset managers and occupiers, and how the model may need to evolve in order to optimise commercial success.

In an environment where conventional high street sales are under pressure from digital and changing consumer behaviours, travel retail locations are increasingly being recognised as key destinations for consumer brands to develop a physical presence. However, do they continue to offer the safe haven of guaranteed footfall, appealing customer demographics, and high spend potential that brands are seeking? And does the business model make them appealing locations to operate in?

The Rise of Travel Retail

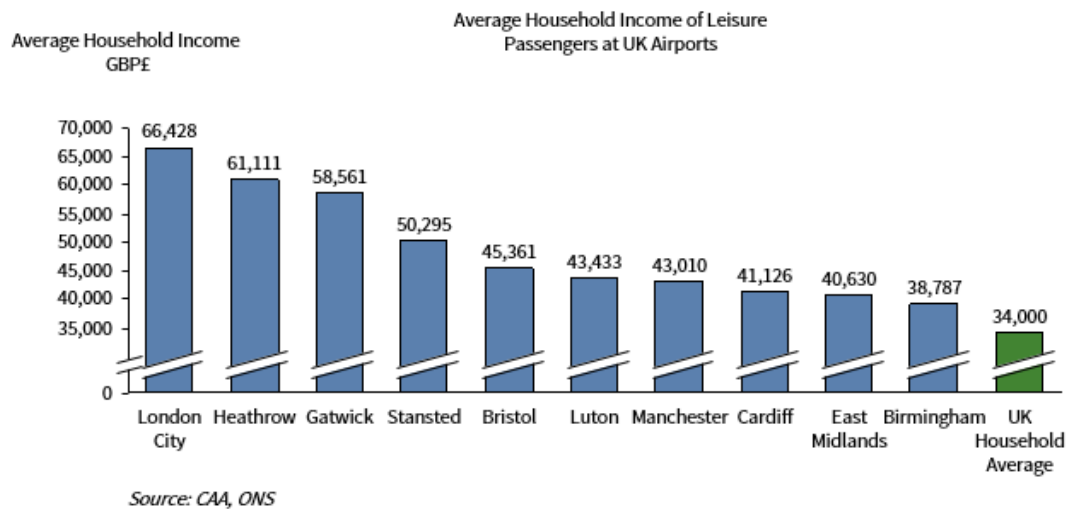
Globally, travel retail has experienced strong growth over the past decade or so, with sales of duty free and travel retail estimated to have more than doubled from US\$30bn in 2005 to US\$60bn in 2015, a CAGR of 7.8%, with the majority of these sales supported by airports, accounting for nearly 60% in 2015 (source: Generation Research). Whilst much of this has been driven by increased passenger traffic, with global air passenger numbers growing by a CAGR of 5% over the same period (source: World Bank), it has also been driven by significant enhancements in the quality and quantity of commercial space provided in travel retail hubs, as infrastructure owners and operators have developed new and enlarged terminals to meet the growing demands of the passenger mix.

Looking beyond the airport duty free environment, train stations have also seen significant improvements in their retail offer, albeit at a slower and less innovative pace. In the UK, Network Rail recorded like for like sales growth of 3.6% in 2016, almost 10 times the reported growth rate of the UK high street over the same period (source: Network Rail).

Whilst conventional high streets and shopping malls continue to struggle with ways to drive footfall and customers to their physical assets in the face of the ever increasing convenience and improved execution of digital retailing, the travel hubs continue to benefit from rising visitor numbers driven by the increased utilisation of the transport modes they serve – a trend experienced across the world in mature markets and to an even greater extent in emerging economies.

To put this into context, the five largest airports in the UK recorded combined annual passenger numbers of c.175m in 2015, only slightly behind that of the five largest shopping malls with c.200m visitors, whilst the UK's busiest train stations surpassed them all, with a reported footfall of c.340m. In addition, whilst annual growth in shopping mall footfall has typically been relatively flat or declining in recent years, travel passenger growth in most instances, continues to rise year on year.

Yet it is not only the high volumes of throughput that make these assets appealing to brands - the demographics of the passenger mix presents a captive audience with high average incomes and spend potential, appealing age profiles that are in the retail sweet spot, often combined with a holiday attitude and willingness to spend. Surveys conducted by the CAA in the UK show that the mean personal income of business passengers at London City Airport was £82,000 in 2015, and £60,000 at Birmingham and Bristol. Even amongst leisure passengers, average gross household income was £66,000 at London City, and £45,000 at Bristol, which is significantly above the UK average of £34,000.



So with these highly attractive volumes and demographics of the captive audience, travel hubs continue to present an appealing channel for brand exposure and sales.

The Improved Environment

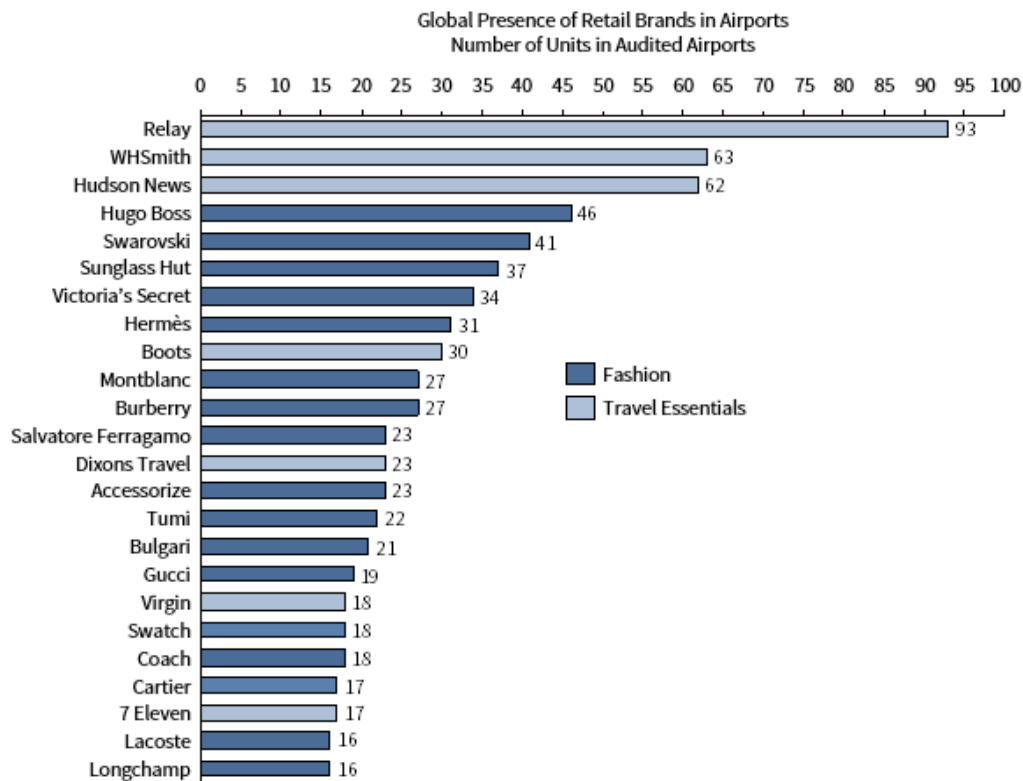
Driven by a combination of movement from public to private ownership, greater commercial focus, and enhanced competition, travel hub operators and investors have been undertaking significant investments to improve and expand the infrastructure of their assets, and are now behaving more like commercially focused consumer brands rather than the soulless functional processing utilities they once were. More commercial space has been added, in improved configurations, with better architectural design and retail planning providing more attractive units for potential occupiers to trade from.



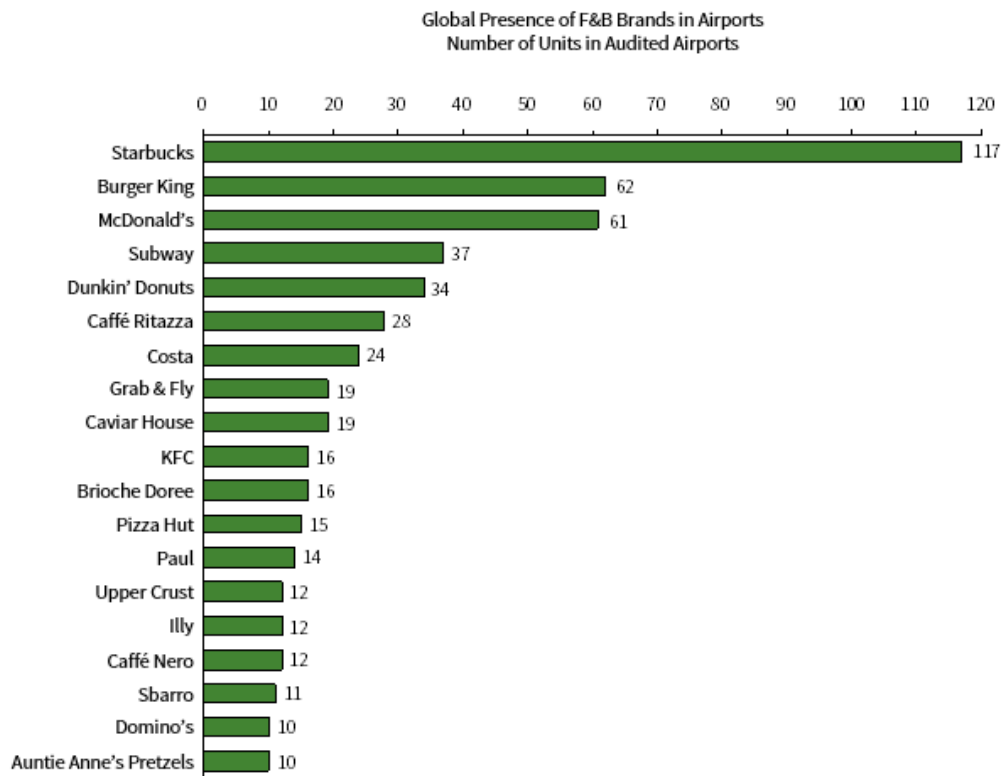
Chanel has recently opened at London St Pancras Train Station

Within this context, a wider mix of retail, catering and service provision brands are now occupying space at airports and train stations around the world. Our internal database of the tenant mix of over 100 airports across Europe, Asia, and the Americas, show that there are over 2,000 unique standalone store brands across retail alone, with just 3% operating 10 units or more, demonstrating the width and depth of operators from luxury through to value.

The chart below (source: Pragma tenant database of 100+ airports) illustrates the most populous retail units (excluding core duty free stores), with travel essentials brands unsurprisingly the most common, but global fashion brands such as Hugo Boss, Burberry, Coach, and Lacoste having a significant portfolio across the airports audited.



In terms of catering, the food & beverage market is more fragmented - our database highlighting 1,800 unique brands, but with only 1% operating 10 or more units, and a higher proportion of local and regional brands. Travel hubs are increasingly recognising the fundamental role that a high quality and appropriately targeted food offer can play in enhancing passenger satisfaction and commercial revenue, and are seeking the best operators to include within their proposition. The chart below (source: Pragma tenant database of 100+ airports) illustrates that the major global coffee and fast food chains predominate, suggesting an opportunity for popular casual dining brands that can adapt their format to suit travel environments, to increase their presence.



Yet despite the high demand for space, the processing and operational requirements for travel hubs place constraints on the amount of commercial area that can be provided, and whilst overall area allocations are increasing, the available space per visitor in airports is substantially lower than the corresponding metric for shopping malls. Airports can allocate between 1,000 and 2,000m² of space per million departing passenger, whereas the corresponding figure for large format shopping malls is between 3,000 to 6,000m² of leasable space per million visitor footfall.

The different tenant mix, including lack of leisure space, supermarkets, department stores and large format units in airports evidently plays a key role in accounting for this differential, but the key point to demonstrate is that airports and train stations benefit from channeling substantial volumes of footfall through small concentrations of commercial space.

Another way of demonstrating the commercial opportunity is looking at the number of tenants in relation to the overall visitor volumes. Westfield London has an annual footfall of 27m, spread over 315 units, leading to a ratio of c.85,000 visitors per unit, whereas London Stansted Airport has 22m total passengers, so 11m departing passengers being exposed to 45 units, creating a more concentrated ratio of c.240,000 visitors per unit.

As such, the commercial performance and trading densities achieved in airports can be three times the average of shopping malls. Whilst some of this differential will be driven by the high densities typically achieved by the core duty free retailers, on a like-for-like basis both fashion retailers and

F&B brands can see trading densities in travel hubs up to two to three times higher than their high street counterparts, driven by efficient units with focussed product offers, high footfall and longer trading hours. For instance, for Hidesign, a leading leather accessories brand in India, has reported that its number one store in terms of sales and profitability is situated at the fast growing Kempegowda International Airport, Bengaluru (out of a portfolio of 74 across India).

For brands such as Pret A Manger, the highly successful UK fresh food outlet, travel represents a key part of their strategy. In 2016, the brand achieved global group sales of £776million, with £124m (16%) delivered by the airport and train station portfolio - Pret's unit at London Heathrow's Terminal 5 generated the highest sales of any unit globally.



Pret A Manger's new outlet at Dubai International Airport (source: Moodie Davitt Report)

From the retail perspective, travel continues to be a fundamental component of the luxury sector. In May this year, Richemont, the global luxury conglomerate, purchased a 5% stake in Dufry AG, the world's largest duty free retailer, with Johann Rupert the owner, commenting that travel retail will grow in importance as the digital age permits more free time for people to travel.

The 2017 Deloitte Global Powers of Luxury Goods report, highlights that travel and tourism are key to generating luxury purchases, with nearly 50% of luxury purchases being made by consumers who are travelling in a foreign market (31%) or whilst at an airport (16%), with affordability and access to a wider range of products being key reasons for purchase. In emerging markets in particular, travel retail presents a key route to market

for luxury brands, especially where the downtown retail operations are not sufficiently developed to offer suitable commercial space.



An impressive luxury proposition - Gucci at Ngurah Rai International Airport, Bali, Indonesia

Operating Model:

Despite the high attractiveness of a strong and growing customer base, and improved commercial space, there are challenges for brands looking to occupy space in travel retail hubs. In contrast to the typical retail property rental agreements, airports typically operate a combination of minimum annual guarantees and a percentage of sales turnover contribution. These can range from 25-30% upwards for core duty free, to 15-25% for general retail (category depending), and 15-30%+ for food & beverage operators. Whilst the previously mentioned high sales densities go some way to mitigating these occupancy costs, the long operating hours, security processes, logistics, and out-of-town locations, create additional operational costs and challenges for travel locations.

We have seen a wider number of brands across both retail and food & beverage demonstrate an interest in adding travel locations to their store estate portfolios. However, for brands unfamiliar with operating in such environments, these barriers can be a key constraint to occupying space, such that many choose to take the route of franchise agreements, and partner with established travel retail operators to gain access to the travel channel.

Beyond the operational and financial considerations, careful attention needs to be given to the unique dynamics of the travel customer profile, purchasing intentions, dwell time, seasonality, and day part, so that the

product offer, merchandising, proposition and price points are effectively tailored to the unique demands of the specific travel environment.

We are often surprised by how little attention brands pay to optimising their proposition in individual locations, and increasingly we are seeing the more experienced travel hub management teams take a proactive approach of collaborative intervention, working with brands to maximise the commercial potential of their stores, to the benefit of all.

What does the future hold?

From a demand perspective, with passenger traffic at airports globally set to double by 2029, with a growth rate of c.5% year on year (source: ACI), the outlook remains strong. Higher growth rates are set to be achieved in emerging markets, and by 2028 the volume of international traffic is forecast to outweigh domestic traffic – increasing the opportunity for higher spending duty and tax free channels.

That being said, the presence of potential customers does not guarantee spend. Data from Generation Research suggests that the annual growth rate of duty free retailing fell from 18% in 2011, to 6% in 2014, registering the first decline since the financial crisis, of -3% in 2015 – despite passenger volumes continuing to grow.

In part, this may be down to challenges experienced in driving sales in the core duty free categories of tobacco and liquor, however, there are also wider market factors that need to be considered, such as changing consumer behaviours, the switch away from retail towards leisure and F&B spend, as well as a diminishing price advantage in airports and the continued global dominance and reach of the ecommerce giants.

With a perception of being sheltered from high street competition, insulated from the market pressures of downtown, combined with a safety net of a value-driven tax free proposition and a captive audience, travel retail has been slow to adapt the proposition, experience, and product offer to meet the demands of the digitally enabled customer, and sales are likely to be suffering as a result.

Despite evidence of a slow-down in recent years, Generation Research forecast duty free and travel retail sales to double by 2025, with a CAGR of 6.8% over the next decade.

What needs to change?

The future of travel retail presents a significant opportunity for asset managers, retailers and brands that can deliver an innovative value-proposition that is tailored to the behaviours and purchasing demands of the travelling consumer.



We are seeing significant innovations take place within high street retail: Amazon Go is looking to revolutionise convenience; Tesla automotive is delivering brand building through high street units; Decathlon sports is condensing large scale warehouses into 200m² multi-channel formats; Bonobos (seen above) is providing a pure showroom experience; and Ray-Ban sunglasses is offering a multi-format concept with product customisation, on-site opticians, and entertainment space in its New York flagship.

We are yet to see the same levels of retail innovation take place in travel environments, despite the attractive fundamentals of high customer volumes, disposable income, dwell time, and spend potential.

We highlight a selection of key areas for asset managers and brands to focus on, to maximise the future potential of travel retail:

Enhance the experience

The commercial space should be perceived as dynamic showrooms, not static hold rooms. Innovative store design and engaging customer service, targeting emotional connections and greater flexibility in adapting the merchandising and offer to seasonal and passenger mix variations will help to catch the attention and give the captive audience a reason to visit. Customers have the potential to touch, taste, see, hear, smell, and be entertained – let them experience the lifestyle of your brand through providing commercial hospitality for a travelling guest.

Promote convenience

With travel retailers benefitting from improved circulation and flow routes

channelling consumers past and through their stores, there has been less incentive to deliver convenience to travelling customers. Digital technology is now changing both the expectations of consumers and the operational potential. Multi-channel experiences that allow a range of options from pre-ordering, to remote fulfilment, mobile payments, and delivery to executive lounge or home will help move purchases from being impulse to planned, and reduce 'inconvenience' as a barrier to purchase. Start taking the retail to the customers, rather than wait for them to walk through the door.

Maximise the opportunities from data

As one of the most data-rich customer environments, with the benefits of flight schedules, flow tracking, dwell monitoring, loyalty programmes, repeat visitors, and global connections, there is a greater opportunity to capture, forecast, and optimise transactional and customer based data to inform marketing communications and retail strategy in travel environments. More targeted data collection and focussed value-enhancing data analytics, combined with sharing of intelligence between asset manager and operating brands will provide benefits for customer and retailer alike.

Implement new metrics to measure performance and value

Asset managers on the high street and in travel environments are increasingly struggling to monetise the value of the physical space when transactions may take place online or off-site. The landlords and brands must work together to develop new models of measuring commercial performance and value, beyond solely the sales registered by the on-site till. Technology such as footfall counters and customer tracking can give both parties visibility on in-store visit volumes, dwell times, and potentially the channel or location that the transaction is ultimately made, and these metrics must soon be incorporated into quantifying the value of commercial space.

Overall, it is time that consumer brands recognised the gold mine of high footfall and wealthy customers that travel hubs will continue to present, and developed innovative travel-specific formats to reap the rewards accordingly.



About the Author

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Alex has wide-ranging experience of leading commercial strategy projects across a variety of geographies including Europe, Asia, the Middle East, Africa, and the Americas, for clients ranging from leading airport operators and commercial developers, to brand owners and private equity investors.

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