



Breaking down walls

THE AIRPORT sector today faces a challenge as big as any they have faced in recent years. Since airports started making the transition from civic infrastructure to commercial enterprises they have enjoyed a run of strong profit growth – unbroken even by the nightmare treble of SARS, Bird Flu and 9/11 in 2000/2001. But now the economic climate is putting unprecedented pressure on the commercial model. In our view, airports seeking to grow profit in future will have to evolve to a new operational model.

The 1990s and early 2000s were of course characterised by major challenges, but compared to the first half of 2009, they appear benign with retrospect. There were shocks, and management had to respond, but through the period, business proved resilient.

For many years, it appeared that airports could rely on passenger growth and increasing unit profitability as they imparted solid commercial disciplines into the recently privatised airports. Shareholders reaped the benefits of the transition from a “civic gateway” to an enterprise with strong functional silos and strong commercial disciplines. In later privatisations, this was reflected in multiples of up to 20 to 30 times EBITDA.

This steady stream of growth appears to have stalled in recent years. While commercial income per pax grew from 1996 to 2004, since then it has been flat. The easy gains have been made.

The next phase of growth will be harder to achieve, and requires a new model. It will require owners and operators to better understand the value of the system as a whole and the interdependencies between its parts. Airports need to understand airlines; retailers need to understand the overall value chain including brand owner and landlord; airports need to understand the impact that Government agencies have on their retailers; and airports and airlines need to find ways to work together to lower unit cost and add value to passengers. Operators need to peek over, and even break down the walls around their organisation.

In broad terms, future growth above trend will come from three sources:

1. Innovating to create customer value
2. Leveraging the end-to-end value embedded in assets and traffic
3. Thinking “joined up” and getting everyone to work together

First, like their airline brethren, airports must take advantage of opportunities to innovate. Airlines around the world have invested in new products and responded to competition, and their products are increasingly differentiated and tailored to the various customer needs. Airports have had some successes addressing segment needs,

“Airports must break down walls within their own organisations, creating broader accountabilities for outcomes.”

for example with new parking products such as remote parking and premium/valet offers. These services deliver value to passengers and airports alike. The product introductions to date have typically been relatively easy to achieve, as airports have able to implement them in isolation.

The next phase of growth will come from areas where tailoring a product or service is more difficult, for instance where the customer experience is delivered by third parties (for example border agencies). Siloed thinking will be a barrier to this.

To tap into the second source of growth, airports will need to better understand the value of all assets and traffic through the airport. Over the last 20 years, airports have increasingly leveraged core airport assets and in-terminal passenger footflow through, for instance, retail and parking offers. In more recent times, airports have developed strategies to capture the value of the land bank which arises from good transport connections (eg the construction of DFOs). The next step must be to take this thinking further and explore the aerodrome more comprehensively for other opportunities. These may be passengers, employees, IT backbone or advertising sites.

The third source of value rests on the differential economics that an airport owner can deliver. For example, retailers on slender margins are unlikely to see the value in experimenting with new staffing patterns or services. However, there is clearly a strong benefit to the landlord and the brand owner in greater sales. If queues in arrivals get long, they may well harm retailer and airport economics, but there is little incentive for those in control, the border agencies, to act on them.

This source of value is perhaps the most underexploited to date and the most significant. It requires airports to break down

the walls within their own organisation and others. The historical “feudal” or siloed approaches within airports will be a barrier to this kind of “joined up” thinking.

We note that this broader approach appears to be gaining currency in the airline world with airline operators realising the benefits of genuine accountability for customer outcomes.

These three sources of upside, creating customer value, better leveraging the assets and flows on the airport site and increasing their own and others’ “whole of airport” thinking are all achievable. However, the strong functional view of the world that has stood airports in such good stead for the last ten years is a barrier to this.

Airports must break down walls within their own organisations, creating broader accountabilities for outcomes, and break down walls with their airline customers and tenants to better find opportunities for mutual value creation.

It is time to cooperate.

George Woods & Florian Dehne
L.E.K. Consulting