"Pioneering a new era for travel retail business models" in Lima

In striking a long-term concession agreement for duty free at Jorge Chávez International Airport, Lima Airport Partners and Lagardère Travel Retail say they have developed a new type of contract model for the business, based on profit-sharing and transparency. **Dermot Davitt** speaks to both parties about the deal and its potential wider implications.

Editor's Introduction: *In July, Lima Airport Partners (LAP) and Lagardère Travel Retail struck a 13-year concession contract based on profit-sharing for the exclusive operation of duty free stores at Lima Jorge Chávez International Airport. The partners said they were "pioneering a new era for travel retail business models" with the move.*

"This is the first large-scale implementation of a business model that has been widely discussed in the industry to better balance risks and benefits between the airport and retail operator," they noted at the time. "The goal is to unleash growth potential, even more relevant in the context of the Covid-19 pandemic and the resulting drop in global air traffic."

From January 2022, Lagardère Travel Retail will introduce the Aelia Duty Free brand at the airport's duty free stores, across 3,000sq m of space.

Lagardère Travel Retail replaces long-time incumbent Dufry at the location. Crucially too, Lagardère Travel Retail will work with LAP to define a new retail experience for LAP's future terminal, due to open in early 2025.

The profit-sharing agreement, said the partners, will open up "significant revenue potential" for both Lagardère Travel Retail and Fraport-led LAP, as well as greater investment opportunities – ultimately to the benefit of travellers and enhancing the airport experience at the Peruvian hub.

Dermot Davitt *spoke to LAP Chief Commercial Officer* **Norbert Onkelbach** *and Lagardère Travel Retail Executive Vice President – International Development* **Axel Gauthey** *about the process, the business model and what a new style of concession agreement might mean for the wider industry.*

A fresh look for Lima: Artist renderings of the new terminal interiors (this and later pages) create an impression of space and light across the commercial marketplace

Q The Moodie Davitt Report: Can you please outline the background to this new agreement from each of your viewpoints?

Norbert Onkelbach: According to our concession agreement LAP has an obligation to open the new terminal by 2025, stretching the capacity of the airport to 30 million passengers a year.

We entered the planning process for the 19,400sq m of commercial space in the new terminal and it was clear to us that we should have the major duty free operator with us. We wanted to avoid 'double planning' with our construction company, only realising later that market requirements have changed or cannot be implemented in the building. For such a major activity as duty free we wanted to avoid this.

That meant having a partner to take over the duty free opportunity by January 2022, with the current agreement with Dufry coming to an end. So we went to market, with the clear goals to maximise our income of course, and to take the learnings we had from COVID. We wanted to take advantage of that learning curve and understanding of new passenger behaviour accompanying the recovery period, which will be key to developing the right stores in the new terminal. We also wanted to be more customer-centric while having a fair and transparent relationship with the partner.

Commercial planning for a new terminal requires strong cooperation between partners. During the planning process Lagardère Travel Retail asked us the right questions which led to a new quality of exchange in the retail planning process. They were open about sharing not only their sales forecasts but their P&L. You have teams talking to one another, you build up trust along the way, and you have honest conversations about the way forward.

Based on that experience it was a simple next step to also review the commercial partnership model, and to move away from a concession model to a profit-sharing model. We didn't want a JV, and profit-sharing represents a hybrid. You see more of the business but from a landlord view you don't have to put in equity. Control stays with the operator, but you change the model away from simply revenue.

In a classic concession agreement, the operator maximises the sales and then you get your percentage. And we saw through this process that it was not where we wanted to go. You need to understand what the operator can sell to the customer, and look at it from a margin perspective and not from a sales perspective.

COVID accelerated the process of rethinking the concession model but our partnership approach mindset is fully aligned to a model where the airport and retailer capitalise together on new opportunities and enhance the passenger experience.

I should add that during this process, after Lagardère Travel Retail proposed the profit-sharing model, it really opened the door for new thinking in our organisation as well.

Axel Gauthey: The Partnership Selection Process which was initiated by LAP was a first for Lagardère Travel Retail, especially when it comes to such a large duty free opportunity and even more when the landlord is majority-owned by such a recognised international organisation like Fraport.

We provided LAP with a fresh start; our candid approach combined with our innovative ideas were used during the various workshops organised by LAP at the beginning of the process. Those workshops were intensive and pretty challenging for us, but it was definitely worth it as it pushed us to deliver our very best offer.

We very much appreciated the collaborative mindset of LAP which allowed us to test various leads and come forward with creative solutions adapted to LAP needs; this would not have been possible in a traditional tender process. In the end it was a win-win which allowed LAP to get the very best out of Lagardère Travel Retail, and represented the best possible start of a collaborative partnership.

We believe we were able to show flexibility, agility and express a great deal of enthusiasm partly due to the simple fact that this was our very first opportunity to secure a large duty free business in a new region. I also believe that our innovative

Lima Airport Partners awards new terminal construction contract

Lima Airport Partners (LAP) has awarded the contract for design and construction of its new terminal at Jorge Chávez International Airport to the Inti Punku Consortium, an alliance between Sacyr Ingeniería e Infraestructuras, a global infrastructure development company with extensive experience in the airport sector; and Cumbra, a leading Peruvian construction company. The passenger terminal will begin operations in 2025.

The signing of the contract took place at a ceremony presided over by President of the Republic, Pedro Castillo (pictured above), accompanied by the Ministers of Transport and Communications, Foreign Trade and Tourism, and Economy and Finance, among other invited authorities.

The President said: "We must understand the great importance that Jorge Chávez Airport has for the country, as the main entrance door to Peru and in recent times a key piece in the economic reactivation and fight against the pandemic. This expansion will position the country as one of the main logistic and tourist hubs in the region, allowing the arrival of more tourists and more airlines."

LAP CEO Juan José Salmón said: "For LAP, this is the most important milestone in its 20 years operating the airport and reaffirms our commitment to Peru. The expansion is a key element for the economic reactivation, since it puts in value private investment and the Government's commitment to advance with a first-rate infrastructure for the development of the country."

"Despite the challenge of carrying out an international awards process in the midst of the pandemic and adapting the design to the new global context, we are very proud to move forward towards the construction phase and deliver the new terminal to Peru in 2025, positioning Jorge Chávez amongst the best airports in South America," said Anton Aramayo, Director of the Expansion Project.

Miguel Angel Lozano, Inti Punku's Project Manager, said: "We are tremendously motivated to participate in one of the most emblematic infrastructure projects of the country in recent years. We are convinced that the new airport will be a source of pride for all Peruvians who will use it, and, above all, that visitors and tourists will come to see the wonders of this country."

LAP, which is controlled by Fraport (80.01%) holds a 30-year concession to manage and develop the airport.

ideas in terms of concept design adapted to the space in the new terminal was a factor in convincing LAP that we would deliver the ultimate duty free experience for Lima in 2025.

Q Can you describe the mechanics of the agreement in more detail, and how revenues, costs and ultimately profits are shared? What are your respective roles?

Axel Gauthey: The concession contract is a rather traditional agreement by itself. However, the revenues allocated to the airport are based on profit rather than on sales. This is the major evolution that was made to traditional revenue-sharing concession contracts. It provides more flexibility in assortment, pricing, marketing strategies, services and staffing as well as much stronger resilience and adaptation to trends over time.

It is not a joint-venture model and as such all the costs including all the investments are fully supported by Lagardère Travel Retail in the same way as in a traditional concession contract. Both parties have aligned interests to limit the costs while pushing for the right investments to deliver a unique passenger experience and boosting sales.

To give LAP the necessary comfort that they deserve when opting for that model, we have designed a dedicated governance structure, where LAP have not only the possibility to perfectly and transparently understand the business on a day to day basis but also be involved in some key business decisions. Otherwise, the roles and responsibilities of each party are quite traditional. LAP does not sit on the board of the operating company and hypothetical disputes would be handled in a similar way as in a traditional concession contract.

Norbert Onkelbach: I would like to add that we are particularly proud of the governance model we have elaborated. It gives both partners the platform to review the business strategy, to arrive at common business decisions over a long concession period with the focus on presenting the passengers with an outstanding offer which leads to a maximisation of profit.

For LAP the new model means it is not involved in a

Lighting the way: LAP aims to position Lima Airport as one of the region's great airports through its new terminal design and offer

joint venture but can enjoy some elements of a JV, such as the open books of the duty free operation. In the classic landlord-tenant relationship the revenue maximisation model for contracts of the magnitude of duty free has limitations which we wanted to overcome. Profit-sharing is a fair mechanism that gives more freedom to the duty free operator to respond quickly and implement a trial and error approach to seize the opportunities.

Q Norbert, did you have to sell this internally? After all, you are moving from a structure with some guarantees in place to one that might be perceived as holding higher levels of risk. And are you confident of making the same money, or more, under this arrangement?

Norbert Onkelbach: It wasn't difficult in the end, because we had the history of 2020 behind us, which closed the airport for four months, and we could not enforce MAG. Just to explain, we had 5 million passengers before we closed in March 2020, then after we reopened just 2 million from July for the rest of the year. We developed a ladder model of lower MAG in absolute terms but it kicks in at 10%, 20%, 30% and so on according to the passenger numbers. We did this for domestic, international, landside.

We had that learning in parallel to us negotiating the duty free agreement. So if there is more to share, great. But where there is nothing, there is nothing to share.

With this agreement, if things go well, we will be better off as the airport operator than under a flat concession fee structure. In the end, we made an agreement during COVID, and we ended up pretty much on the line of a forecast that we made before COVID, which is credit to our team.

The full recovery from COVID will be around 2024 with an acceleration in domestic flights. For 2025, with the opening of the new terminal, LAP will be able to receive over 30 million passengers. We believe in the increase of spend per passenger given the new opportunities and experience that we will offer to our visitors under the profit-sharing scheme.

LAP says the new profit-sharing model can help it earn more over the life of the contract

Axel Gauthey: I would add that LAP decided to proceed during the COVID crisis, but I'm pretty sure they would not have got a firm, fixed offer with a very good number using a traditional model during these times. That's the beauty of the profit-sharing model. It cuts through a lot of complication.

A traditional process is more constrained, it's not as easy to show the best of what you can offer. So open dialogue with workshops helped, it allowed teams to get to know each other and build trust. And we were so eager also to enter this new market, with a brilliant airport operator, that we put a lot of effort into it. And the good relationships we developed made it happen.

We are excited to start trading as we believe a substantial spend per passenger growth potential is achievable, especially thanks to the profit-sharing mechanism. Having said that, we know that some nationalities spend more than others and obviously the global passenger spend will very much vary according to the evolution of route recovery.

Q Norbert, you have also appointed a new player in this market, though one of course with long experience and expertise around the world. You must have high expectations of what Lagardère Travel Retail can deliver.

Norbert Onkelbach: Yes, the expectation is high but so is our confidence that they can deliver. We really took a 360-degree turn to create this new duty free operation. We have a contract that allows us both to grow. We will cooperate, we have a governance structure that will see work streams meeting regularly, involving senior management often, and that matters because the uncertainty of COVID remains. So we need to have a partner with which we can discuss the ups and downs.

I really believe there is a qualitative side of contracts, which is sometimes not written in the contract itself. We believe strongly in this new way of working together and that is very important. Also positive is that Cyril [Letocart, CEO of Lagardère Travel Retail Peru] went from working on the bid to now leading the project for our partner. I think that is always a strong sign when that happens. You don't lose that knowledge or relationship.

Q Does this agreement suit this uncertain period better than other contract models? And crucially, how does this serve the travelling consumer better?

Axel Gauthey: This profit-sharing agreement allows a full alignment between landlords and retail operators. The whole industry has been talking about the Trinity between landlords, retailers and brands for years, especially the landlord-retailer dimension. The profit-sharing mechanism finally enables a proper and total alignment between the landlord and its retailer(s).

For sure the current crisis makes such a profit-sharing contract particularly relevant but it already made sense before the pandemic. Actually at Lagardère Travel Retail we entered into similar (but not same scale) profit-sharing agreements in the past.

This can therefore be considered as a B2B4C dynamic since the main benefit of that full alignment between landlord and retailer is ultimately for the passengers. They will be able to enjoy extended

brand and product assortments, innovative experiences and good value for money through a competitive pricing strategy, which is absolutely needed to restore the duty free value proposition in travellers' minds.

Norbert Onkelbach: The decision to go for the profit-sharing model was not COVID-driven. One learning out of COVID for our organisation was that the traditional element of MAG could not be enforced in 2020. We had to revisit all contracts and MAGs in our contracts towards a balance of airport sustainability and tenant business feasibility. That is why we have a MAG per passenger in our [existing] agreements.

Q Tell us please about your planned joint investment at the airport, in terms of projects and concepts, and also the key timelines?

Axel Gauthey: Lagardère Travel Retail will take over operations in January 2022 in the existing terminal. Upon opening of the new terminal in 2025, we will start trading there and continue operating at the existing one.

Between 2022 and 2025, LAP, Lagardère Travel Retail and SmartDesign will jointly hold regular workshops to discuss and agree the floorplans, concept design and investments to be implemented in the new terminal. The outcome of this work will be a marketplace that we expect to be a game-changer for the region.

From a capex perspective the investment is solely borne by Lagardère Travel Retail; however both parties will invest time and resources to deliver the ultimate shopping experience for passengers at Lima's new terminal.

It's important to note that together with LAP we have set very ambitious CSR goals which perfectly fit with Lagardère Travel Retail's PEPS (People Ethics Planet and Social) strategy. We systematically keep this strategy in mind when recruiting, when selecting contractors or suppliers, when negotiating with logistics partners and so on.

Norbert Onkelbach: Today we have 85 outlets across 9,000sq m of trading space, in a terminal of 90,000sq m and over 23 million passengers in 2019. So we are

Senior figures from Lima Airport Partners and Lagardère Travel Retail striking what they hail as a "pioneering new era" with this contract

The new duty free agreement in Lima – What they said:

Lagardère Travel Retail Chairman & CEO Dag Rasmussen: "We are thrilled to have found in LAP a like-minded partner who has demonstrated the most innovative and pioneering way of thinking, from selecting an operator via an innovative Partnership Selection Process up to the contract terms. As we continue to face a great deal of uncertainty and are relatively new to the South American region, this profit-sharing agreement is a great vote of confidence from LAP."

Lima Airport Partners CEO Juan José Salmón: "We believe that collaboration is the key to managing business relationships, as well as actively engaging in new partnership models. We are impressed by Lagardère Travel Retail's high degree of engagement and innovation, which they will soon be bringing to the Peruvian airport retail market. In the context of LAP's airport expansion programme, this agreement also sends a strong signal to Peru and the global aviation and travel industries. Our agreement will take us well into the next decade – as we move boldly into the new era of aviation."

This is an agreement that leaves behind "the transactional way of doing business for a more collaborative one" according to LAP

under-performing in retail square metre terms for our market.

From 2025 we will have a dual terminal strategy, which of course means planning for domestic, international and landside areas, times two. To 2024 we will maintain the operations in the current terminal but we will also go to market on F&B, speciality retail and services in 2022 as we develop these category strategies. That will take a few more months so it may be around Q3 next year.

There is opportunity here too. Having lived in Peru for four and a half years, this is a country where F&B is an amazing product, which will fly if it's done right. And we also have to formulate the lounges strategy, and how that also fits with F&B. So really we want to build a terminal where the customer has choices.

From the very outset and in the early days of planning, we engaged SmartDesign Group with a focus to create a new terminal with an immersive environment that maximises the experience for passengers and staff. Together we have created a commercial strategy that drives passenger engagement, allows for flexibility and exudes a Sense of Place for Peruvians and the world.

Each marketplace will be carefully curated to not only provide an essential mix of brands and concepts, but also to entertain, showcase and educate passengers about Peru's deep historic culture and progressive economy.

Working closely and collaboratively with all of our commercial operators, our aim is to provide a new benchmark for the industry – built on the needs of the new and future traveller, and not on the safe, 'cookie cutter' approach of the past.

Q What innovation will the consumer see in terms of design, offer, experience? Are you planning to introduce new or exclusive brands?

Axel Gauthey: When we start operating at the existing terminal, and before we operate at the new terminal, the shop layout will be mostly maintained. But in terms of shopping experience, passengers will from the first day be able to enjoy the Aelia Duty Free experience from customer service to the attractive price positioning and exclusive offers, including a fully revamped Sense of Place area, which will be the key attraction in our shops. We will also change the queuing area, introducing a 'snake' including an impulse offer for which we know there is a demand.

As you know, our Aelia Duty Free concept is based on four pillars: art of the gift, facilitation, customer care and 'here and nowhere else' or Sense of Place. Each Aelia Duty Free shop worldwide features a central area showing the best of local. Lima will be no exception. Our aim is to promote local brands and give the opportunity to small and medium enterprises and entrepreneurs to get more visibility. We are planning to introduce 20 to 30 new local brands, such as Quma chocolate, Kuyay chocolate, La Ladrillera (gourmet food) and Amazonian gin.

We are also currently analysing the possibility of developing a local healthy snacking offer (local chips, gluten free biscuits, vegan products). These would probably not be possible if not in the framework of a profit-sharing model since those brands do not carry enough gross margin to cope with traditional revenue sharing contracts.

In terms of new international brands, in 2022 we will see how to further develop the toys and electronics categories, which we believe today are underestimated and underdeveloped in airports. In addition we are working closely with some P&C brands and will probably add new brands such as Benefit, Vichy, Carolina Herrera make-up and La Roche-Posay. We are also willing to develop new categories such as dermo-cosmetics and haircare.

Norbert Onkelbach: We look forward to the opening with the Aelia Duty Free brand. The LAP vision is to locate the passenger in the middle of our activities. Lagardère Travel Retail has shown us the same commitment to excel in the passenger experience through new and exclusive assortments and through improved customer service. In addition, Peruvian products and brands will be positioned as key elements creating a Sense of Place and contributing to the growth of Peruvian companies too.

Q For the airport, Norbert, is this a model you would consider for other commercial activities?

Norbert Onkelbach: It depends on the strategic relevance within your retail portfolio. Certainly, the income contribution of a commercial activity plays a role. To take the right decision requires solid data analysis about the commercial programme of each airport and alignment with their strategic priorities. A profit-sharing model demands a better understanding of the partner business which should add value to the retail programme.

Q Can this agreement be a template for other airports? If so, what principles need to be in place for it to work?

Axel Gauthey: Yes, definitely. This is not the only profit-sharing contract in the industry even though it is clearly the most striking one. The sole requirement to engage in such a business model is for both parties to be flexible, ready for innovation and collaborative partnership, and accept mutual trust.

Norbert Onkelbach: I agree fully with Axel. Mutual trust is a key element to allow for collaboration and solid business relations. The uncertainty of COVID has taught us that a new way of working for transparent mutual business exchange is a critical success factor in future airport retail management. The uncertainty in the post-COVID period will continue and between our commercial partners at Lima Airport we had to exchange a lot of 'bad news' in the last one and a half years.

On the upside, we had a steep learning curve. This also allowed us to critically reflect on our commercial strategy for the new terminal and set new industry standards. I recommend other airport organisations to consider the model. The challenge is that you need to leave the transactional way of doing business for a more collaborative one.

We are convinced it's a way forward for us, for the industry and for the customer. And we are very pleased to have Lagardère Travel Retail on our side to implement what we started thinking about two years ago, something that makes sense but also that secures our budget. I believe this agreement does all of that, and has much more potential.

The traffic base at Lima Airport

With 23.6 million passengers in 2019, Lima Airport is a key connection point linking North and South America. Its traffic (pre-COVID) was split 55% domestic and 45% international. Before COVID-19, the route network featured 24 passenger airlines serving 50 international destinations.

The major carrier, LATAM, fell into financial difficulties due to the coronavirus pandemic, but was able to maintain operations while undergoing reorganisation and restructuring proceedings under US law (Chapter 11). Current forecasts for the aviation market in Peru indicate that passenger volumes for 2019 will be reached by 2024.

The business benefited pre-crisis from the rise of low-cost carriers (such as Sky Airlines, Viva Air, and JetSmart) in the region, driving both domestic and regional traffic. These are expected to contribute considerably to the recovery and further growth in passenger numbers.

Of the international traffic, around three-quarters was to and from Latin America-Caribbean, with the remainder split between major European hubs and the US and Canada. In 2020 Lima (which closed for four months) served 7 million passengers, and could pass 10 million this year. The target for 2025, once the new terminal opens, is to hit 30 million passengers a year. LAP's Lima Airport expansion programme is one of Peru's mega-infrastructure projects.