

# **“The Future as We See It”**

**Linda Hopkins, Conference & Research Director  
Tax Free World Association  
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## **Quotes on Screen:**

“In the future, instead of striving to be right at a high cost, it will be more appropriate to be flexible and plural at a lower cost. If you cannot accurately predict the future then you must flexibly be prepared to deal with various possible futures.”

Edward de Bono, creative thinker

“Neither a wise man nor a brave man lies down on the tracks of history to wait for the train of the future to run over him.”

Dwight D. Eisenhower, (1890-1969) U.S. President

“Long range planning does not deal with future decisions but with the future of present decisions.”

Peter F. Drucker, consultant and management author

“Nobody can really guarantee the future. The best we can do is size up the chances, calculate the risks involved, estimate our ability to deal with them and then make our plans with confidence.”

Henry Ford, II, former chairman, Ford Motor Company

## **Transcript to video:**

Death, war and pestilence... travel retail has survived it all. But as you will hear the industry has sized up future opportunities, identified the challenges, calculated the risks, and is boldly moving forward.

The industry rang in 2003 amid many worries. 2002 had failed to produce the kind of post-9-11 recovery travel analysts had projected. Stockmarkets had plunged and consumer confidence was low. The first quarter was a tense period as the world waited for the imminent war in Iraq. There was a sense that 2003 would be dominated by more of the consumer caution and sluggish performance of the previous two years. The future was in a fog.

But one piece of news briefly cast attention on an important development for the future of travel retail. The industry had won its battle against the World Health Organisation which was planning to ban tobacco sales in duty free.

...welcome news as war and a potentially disastrous development hovered over the industry. SARS came onto the radar in late March. But with the war unfolding in Iraq few contemplated the devastating impact the disease would have in Asian travel markets in just a few weeks time.

Despite the war, SARS dominated headlines at the start of the 2<sup>nd</sup> Quarter, casting doubt over a post-war recovery of travel. By the end of April, passenger traffic was down 60% at Beijing Capital and Hong Kong Airports and by 40% at

Singapore Changi. European and North American airports were not immune to the effects of SARS. Global carriers suffering from a drastic fall in passenger demand reacted quickly by reducing frequency.

Fear of SARS was spreading as fast as the virus itself. It soon dominated the travel retail industry's attention and nearly eclipsed the quiet recovery that had begun in some middle east markets even before America declared the war was over. In early April, most carriers had resumed service to the Gulf countries and by the end of the month retailers were seeing a return to normal patterns of traffic and sales.

In the wake of two quarters of turmoil, the industry displayed a remarkable determination to continue investing in what had proven to be a volatile business operating in uncertain times.

The worst for aviation seemed to be over by the end of June, but travel retailers desperately needed a strong increase in July-August traffic to recover from losses earlier in the year. Thankfully it came. Summer traffic surpassed 2002 figures in most airports. But while passenger numbers are firmly on the road to recovery, the world's major carriers and economies are not.

The first two quarters of 2003 have been a painful reminder that threats on a global scale can spring up without warning. What were the lessons learned?

"The most poignant lesson learned, I think," says Dubai Duty Free's George Horan, "was that overpaying for concession contracts leaves an operation vulnerable in times of crisis. A short-term crisis such as SARS created a big problem for many operators and airlines. The emphasis on growing your business is natural but a line has to be drawn when the financial requirements are unreasonable."

Hong Kong airport bore the full brunt of SARS. Nuance-Watson managing director Alessandra Piovesana said the company is taking steps now to help mitigate any future unexpected threats.

"We are reviewing the recent crises with our partners, the Airport Authority, our vendors and brands to find ways to manoeuvre through similar incidents using preventative and/or responsive measures. Unless we draw a common line on how to cope under such circumstances, we cannot safeguard our interests."

She also said the operator was assessing its operational practices, overhead and cash flow management.

Dufry chief executive Frederic Gauchet said recent events were a reminder that airport retailers should operate in the same way as domestic retailers, without banking on duty-free privileges and captive traffic to pull them through a crisis. He believes the current model of airport contracts have been proven unhealthy.

Gulf Air chief executive James Hogan said the crises has forced the airline industry to be introspective and address the systemic problems that hinder its

operations. He believes it will help the industry become healthier for the long term.

The war created better long-term conditions for Kuwait Duty Free. Anthony Chalhoub remarked that the airport now requires earlier check-in, allowing his store to convert browsers into shoppers.

The summer rebound at Kuwait Duty Free was dramatic to quote Chalhoub. Recovery has also been surprisingly fast at Cathay Pacific, said Inflight Sales Manager Anna Cheung. She said Hong Kong's flag carrier along with the tourism authority implemented aggressive campaigns that resulted in a return to 90% capacity by August, and full capacity by September when inflight sales came back on track.

But what of the sluggish economic recovery around the world? For some there is a long road ahead.

Operators in the Americas are still dogged by Argentina's economic ills, by uncertainties in Brazil, currency controls in Venezuela and by the political unrest in Colombia, says Motta Internacional's Pancho Motta. Recovery has started in Brazil, he said, but Argentina, Venezuela and Colombia are moving very slowly.

So what does the industry believe the future will hold?

For airports, the challenge will be to "adapt to a significantly changed airline industry and business environment by increasing efficiency, reducing costs, and expanding services," says ACI's Bob Aaronson. Improved security and marketing and the expansion of facilities to accommodate passenger growth will be key to a thriving airport.

The ferry business will face two challenges, says Silja's Jaana Heino, firstly to continue to attract repeat travel and secondly to deliver a shopping experience onboard that ensures customers will want to return.

DFNI's Dermot Davitt sees plenty of challenges ahead for the duty free business. His prognosis?

"The short term looks bright, but the business faces huge long-term challenges, not least from governments and international organisations. In 10 years' time, there will still be a thriving market in airport retail. But increasingly onerous regulations and in some markets, abolition, will mean that duty-free as we once knew it will be consigned to history."

Challenges aside, China Duty Free Group's Gai Zhixin is optimistic about what the future holds for the duty free and travel retail business.

"In the next five years, I believe the most remarkable development for the China Duty Free Group and the industry in general will be the opportunity created by the increasing outbound market of Chinese travellers whose purchasing ability is growing steadily along with the increasing economic power of China."

Like Piovesana, many industry executives believe travel retail will nevertheless rely on partnerships to maximise the opportunities that come:

"I believe airports will experience an evolution towards a shopping mall atmosphere. The challenge will be for brands, operators and airports to redefine the co-existence of passenger services with top end retail, says Davidoff's Christian Vonthron

"...only through partnership between store operators and landlords do I believe it is possible to maximise the potential of a passenger expecting the same level of service as offered by brands in their domestic stores."

"Today, the challenges are to actively defend the legitimacy of all major categories in travel retail and to partner with retailers and landlords to improve the "retail-tainment" in the shop atmosphere," says Cosmopolitan's Donatienne de Fontaines Guillaume.

"The success of travel retail is linked to its "global offer" of brands and categories. If this offer is threatened or partly lost, then I believe travel retail will be less attractive to travellers."

Finally, London Business School professor Nirmalya Kumar further challenges luxury brands to alter their approach to marketing or risk losing critical market share in the future.

"Brands, especially luxury brands, will need to complement traditional advertising with buzz marketing in order to reach prospects who fall outside traditional media consumption patterns, any small niche target segment and any close-knit community with high interlinks."

You have heard various individuals address a range of themes and developments that concern the future of the duty free and travel retail industry. Barring any unforeseen setbacks, growth will be fueled by what analysts project as a healthy year-on-year increase in international travellers until the year 2020 and the subsequent expansion of the transport infrastructure. An estimated 150 billion US dollars is being invested in airport development worldwide over the first 15 years of the new millennium. A growing trend towards privatizing airport operations is responsible for a large number of these projects. European airport operators are taking their expertise to gateways in the Americas, Asia and the Middle East, and transforming these retail environments in the process.

One of the most exciting prospects for the industry, however, is the emergence of the Chinese traveller—almost 17 million at present and growing annually at an average rate of 7%.

Growth and opportunity abound but several caveats loom large on the horizon. The sharp and sudden decline in travel during the SARS crisis highlighted how vulnerable retail operators are under the current system where they pay a minimum guarantee to the airport landlord.

The duty free business has proven a soft target for regulators and politicians in the past. Most agree that the industry's days of doing battle with the likes of the

World Health Organisation, finance ministers and non governmental agencies are not over.

Lastly, the post-9-11 world order creates additional uncertainty about the future. The industry has yet to calculate the impact of the war on terror, but it has undoubtedly changed the parameters of our business and the consumers we serve.

#### Slide 1-3

Well, ladies and gentlemen, here we are in the last quarter of 2003--a year that by any estimation will be remembered as one of the most challenging in the history of the duty free and travel retail business. But I think that history will show that in the face of death, war and pestilence our industry has remained remarkably resilient and determined. Let's take a look...

A TFWA poll conducted industry wide in mid-October revealed that the damage of the war and SARS crisis in the first two quarters was relatively contained. Half of retailers reported that sales for this period were on par with or above the same period for 2002. Just over half of suppliers reported the same, while distributors and agents to the trade seem to have been slightly harder hit....53% reported that sales were below the same period in the previous year.

#### Slide 4

Despite the sharp and drastic downturn in travel in the first two quarters and sluggish economies globally, the end of the current fiscal year is expected to end with a surprisingly healthy performance for the majority of the industry. On average, less than one-third expect to end the year with sales below last year, while just under half expects to end the year with sales above last year and more than a quarter expect sales to be in line with last year.

#### Slide 5

We've heard this morning from some players in Latin America and East Asia whose sheer determination speak volumes about the future for the business. The poll queried the trade on how they would react if they had to sustain another blow to the business such as what happened during the SARS crisis. To their credit, more than one-third of retailers and over half of airports say they have now developed an action plan to mitigate any sharp downturn in business. What I find encouraging, however, is that suppliers and distributors are so confident in the future of the business that well over half would be prepared to absorb the losses rather than get out of the business. Just under half of retailers and airports say the same. Five percent or less of any group would divest or get out of the business. Why are they so bullish?

#### Slide 6

Ongoing airport expansion and development, is one reason. Almost three quarters of the industry sees this as a decisive or significant issue for the future.

The increasing number of Chinese travellers is another reason. The burgeoning number of outbound travellers from the People's Republic will take a significant toll on the fortunes of the business, according to 63% of the industry.

#### Slide 7

Aside from Chinese travellers and airport expansion, the industry does believe that some developments will have a negative effect on the business. Terrorist threats rank as the top concern for the industry's future, according to 75% of respondents. Two thirds or more identify anti-tobacco lobbies and the imminent enlargement of the EU as developments which will have a decisive or significant impact. To a large extent the trade is also mindful of the impact that consolidation of retail operators and brand owners will have on the business.

#### Slide 8

Just under 60% of suppliers believe that among all major travel groups, the Chinese will be responsible for the most significant growth in their duty-free and travel retail business over the next five years. Almost half of retailers and airports put S. Koreans among the most important travel groups in the near future.

#### Slides 9-10

We obviously have no control over developments such as terrorism and EU enlargement. But the trade has expressed a great deal of pessimism over issues that it can control. Less than one third of the industry believes we can ever see the problem of parallel goods addressed—whether those goods are being supplied by suppliers or by retailers.

#### Slide 11

And how about the much debated issue of overbidding for airport contracts? Entire conferences have been dedicated to the topic, yet only 41% are optimistic that this scenario can be reversed.

#### Slide 12

Retail design is the one area where the trade seems to believe that improvements are in reach. Well over half are optimistic that we can eventually create environments with “theatre” and excitement.

#### Slide 13

And almost two-thirds are optimistic that the trade will eventually be successful in communicating to the intra-EU travelling public the difference between “duty free” and “travel retail”.