



**The Korean Customs Service has confirmed that Incheon Airport's large duty free contracts are being broken up into smaller retail businesses across 12 zones.**

In a public notice, KCS has announced that there will be eight licenses in the following locations covering the main product categories.

They are: Passenger Terminals East and West perfume and cosmetics (2); Passenger Terminals East and West liquor and tobacco (2); Passenger Terminal Central luxurygoods and fashion (1); Passenger Terminals East and West fashion and accessories (2); Concourse – one outlet covering all categories.

In addition, there will be four 'SME (*small and medium-sized enterprises*) zones with the winning bidders able to sell all categories of merchandise in Passenger Terminals East and West, while a further two concessions will operate in Passenger Terminal Central, offering Perfume and Cosmetics and other goods.

The KCS adds that there will be a minimum of three operators for the general zones and four for those allocated to SME zones – meaning one operator per zone.

As a result, Korean Customs has indicated that the number of duty free operators is set to increase from three today to a minimum of at least seven, although this could obviously be subject to change considering some 'local' companies that Incheon International Airport Corp might like to see bid, may not do so in the final analysis.



***Shilla Duty Free at Incheon International Airport.***

There have already been past issues with small retailers failing to secure merchandise supplies in the fashion business and failing to bid for this contract in the past and IIAC is well aware of this.

As reported by *TRBusiness*, Lotte Duty Free and Shilla Duty Free's seven-year contracts run out in February 2015 and the Korea Tourism Organization's much extended contract expires at the same time.

This latest development to split the business amongst more contracts and operators is in line with current Korean Government policy to cut large company dominance of the duty free industry, even though this has proven to be fraught with difficulties.

For example, just two years ago, two rounds of bids failed dismally to find small and medium operators to take over the Korea Tourist Organisation's (KTO) concessions. KTO still retains these by default, after no less than three 'temporary' license extensions.

Then, in 2013, 12 new small and medium-sized wannabe duty free concession holders were appointed to run downtown shops in second-tier cities – only for four of them to return their licenses after big problems

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with sourcing products i.e. many brands would not deal with them since they had limited track records.

There is also a big question related to the retail offer in Incheon Airport's second terminal, which is expected to be completed by 2017 – one year ahead of the PyeongChang Winter Games in 2018. This is expected to increase overall capacity by 18m to 62m when it opens.



**Lotte Duty Free at Incheon International Airport.**

## **MAJOR DEVELOPMENTS AND CONCERNS AT INCHEON:**

*(The following data is based on multiple personal visit one-to-one interviews by TRBusiness over the last 12 months with Incheon International Airport Corp; Lotte Duty Free; Shilla Duty Free; Korea Tourism Organization; and many other operators).*

- Duty free revenue growth at Incheon Airport has slowed behind the downtown shop growth rates in Seoul, as high spending Chinese visitors increasingly buy luxury watches and other expensive items in downtown duty free stores.
- Internet duty free shopping is growing fast and particularly amongst South Korean travellers prior to

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travelling abroad who collect purchases on departure at Incheon Airport. Lotte's downtown flagship store in Seoul recorded internet sales +27% to \$263m in 2013, while Shilla Duty Free's Seoul downtown flagship store recorded near double-digit growth to around \$150m last year. Significantly, neither of these totals appears in Incheon Airport's duty free sales total of \$1.8bn last year.

- Lotte Duty Free's total sales in South Korea reached \$3.3bn in 2013 with \$1.1bn from airports. Lotte's average spend across all customer nationalities at Incheon was \$90 and \$400 for Chinese customers.
- Shilla Duty Free accounted for more than 40% of Incheon Airport's total sales in 2013, with Chinese accounting for 35% of all purchases at all of Shilla's South Korean airport shops - including Incheon. Chinese average spending at Shilla's shops was equivalent to \$400 per head.



### ***The Korea Tourism Organisation at Incheon Airport.***

- In total, 40.8m international departing and arriving passengers used Incheon Airport in 2013, representing a 4.6% increase compared with almost 39m in 2012.

- In 2012, South Korean passengers accounted for 53% of duty free purchases at Incheon Airport, worth a total of \$1.73bn, followed by Chinese passengers accounting for 17% of sales after their purchases increased by half, and then by Japanese customers whose purchases represented 16% of total sales.

- The changing passenger mix at Incheon Airport impacted on duty free sales at the airport in 2013. For the first time, Chinese passengers at Incheon outnumbered Japanese. As a result, duty free purchases by Chinese passengers increased, while Japanese passenger purchases fell. Over the last year, Chinese passengers have been responsible for virtually all of the spending growth in Incheon's shops. [Korea Customs reported more than one year ago that Mainland Chinese had become the highest spenders at Korean duty free shops. In the first seven months of 2013 it recorded Chinese duty free spending at \$863m, – ahead of the \$845m spent by South Koreans. This total has since increased further.

- One big question every potential bidder should be asking is how future Terminal 2 shops will impact on the business in future. According to IIAC, full planning for T2 is not expected to finish until the end of this year.

- The well being of Incheon's duty free business today is inextricably linked to its high-spending Mainland Chinese passenger base in terms of any growth at the same time that internet pre order is growing fast for South Korean passengers. Will IIAC be including contractual guarantee relief clauses if Chinese visitor numbers should drop dramatically for any reason?



***Shilla also has a thriving internet pre-order business (primarily with Korean passengers) that is not included in the sales turnover it generates from its shops at Incheon International Airport.***

#### **WHO HAS WHAT RETAIL BUSINESS TODAY:**

- Lotte Duty Free, which records almost half of Incheon's duty free sales, holds four concessions at Incheon Airport. These include two licenses the company won to sell liquor and tobacco, fashion goods and general merchandise, plus (former) AK Duty Free's single shop, which it took over with its P&C licenses.
- Shilla Duty Free, which records over 40% of Incheon's duty free sales, holds two concessions at Incheon Airport to sell perfume and cosmetics (West and East wings main terminal and Concourse), plus fashion goods and general merchandise (main terminal central area and Concourse).
- The Korea Tourist Organisation (KTO) holds a single concession to sell fashion goods and general merchandise (main terminal West Wing), using its profits to fund South Korean tourism promotion. Unlike the six other concessions that were allocated by competitive bidding, state-run KTO's duty free license was gifted directly by previous government decree.



***The Shilla Duty Free-managed Louis Vuitton boutique at Incheon International Airport was enlarged earlier this year to display travel line items and the Louis Vuitton men's collection. A second entrance has also been installed providing access to the rear of the boutique. How this will run after the new bidding processes are complete and the awards have been made next year remains to be seen, although it operates on an individual standalone contract.***

#### **WHO MIGHT BID FOR THESE NEW LICENSES?**

- Existing concession holders Lotte Duty Free, Shilla Duty Free and KTO will doubtless bid for whatever they are permitted to – excluding the four SME zones that have already been ring fenced for small and medium business enterprise retailers.
- Other potential contenders – either by themselves or in joint ventures – could feasibly include the very successful Seoul-based duty free downtown store operators of Walkerhill Duty Free and Donghwa Duty Free, although both are currently focused on expanding their downtown stores *[without the burden of any annual minimum guarantees-Ed]*.

***Several newcomers are also obviously expected to look at the SME bids, although some may still be open to joint ventures. These include:***

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- Shinsegae Duty Free: part of the department store group that holds the P&C concession at Busan Gimhae International Airport. It also operates a downtown duty free store in Busan – plus Incheon Airport-based landside shops.
- DufryThomasJulie: South Korean joint venture company formed by ThomasJulie & Co and Dufry International AG, which recently won the liquor & tobacco license at Gimhae Airport.



***Lotte Duty Free has also been expanding its duty free business overseas in Jakarta Airport Indonesia, Guam Airport, Singapore Changi Airport and Kansai Airport in Japan.***

- Hanwha Timeworld: A subsidiary of department store operator, Hanwha Galleria, this company has already announced it will bid for concessions, after winning the Jeju International Airport duty free license.
- Entas: Another potential local bidder which is owned by a restaurant group, which is already developing a large downtown duty free store in Incheon.

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- Other major 'foreign operators' who may obviously bid include DFS, which already has experience in operating at Incheon Airport when it first opened with its Discovery brand. *(It left more than \$1bn on the table at a previous round of open bids, yet was still not successful-Ed).*

Having said this, DFS is known to be determined to put its best foot forward again the Incheon Airport tender process.

- Along with others, the aforementioned Dufry will also be a serious contender through its joint venture, just as other major operators will doubtless be tempted to participate – and especially now that IIAC appears to be splitting up some of its concessions into less riskier packages. The ability of 'foreign companies' to tie up with good local Korean partners may be crucial to success for any of these entities however.

***[Written by Doug Newhouse, with contributing material from David Hayes, including all images which are TRBusiness copyright].***