




# Initial Assessment of the Impact of Removal of the Extra Statutory Concession on Goods Supplied at Duty-Free and Tax-Free Shops



UK Travel Retail Forum

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 **York Aviation**

# Key Points

UK airports are world leaders in the development of commercial revenue streams and many are now heavily reliant on these revenues. Retail concession revenues make up a significant proportion of these commercial revenues. The UK Government’s proposed action to remove the Extra Statutory Concession (ESC) on VAT on goods supplied at duty-free and tax-free shops strikes at the centre of this business model, targeting the highest yielding element of the travel retail market, at a time when retailers and airports need support to recover and build back.

The exposure of UK airports to markets outside the EU varies considerably. Heathrow has by some margin the largest exposure in pure volume terms, over 50 million passengers, and in percentage terms, 62%. However, others, notably Gatwick and Manchester, also have over 30% non-EU passengers. A number of the UK’s major regional airports have 20% or more of their passengers travelling to / from destinations outside the EU, including Birmingham, Glasgow, Newcastle and Aberdeen<sup>1</sup>. It should also be remembered that, post-BREXIT, competitor airports in the EU will be able to generate enhanced revenues off UK bound passengers and that the expectation within the UK industry was that the reverse would also apply. The proposed position will not only not deliver equality but will worsen the competitive imbalance between UK and EU airports.

Heathrow is estimated to be the worst affected airport, with an impact on operating profits of over £200 million (a percentage reduction in operating margin of around 20%). Others are, however, also significantly affected, with, for instance, Gatwick losing around £38 million and Manchester around £19 million. Losses at other airports are smaller in volume terms but are still significant in terms of their effects on operating margins.

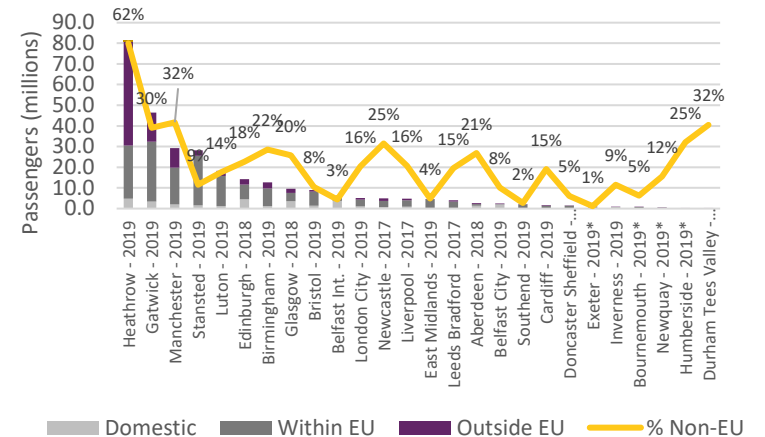
The combined impact of COVID-19 and the removal of the ESC on operating margins, particularly at smaller airports, represents an existential threat. Major airports will also suffer huge erosion of margins and the potential losses in terms of revenues are significant. Heathrow is estimated to lose around £744 million in operating profits in 2021, with Gatwick and Manchester seeing reductions in operating profits of £197 million and £112 million. The UK’s major regional airports often lose in excess of £10 million in operating profits and up to as much as £48 million.

The potential impacts of the removal of the ESC will have a significant impact on UK airports ability to support GDP and employment. We estimate that the removal of the statutory concession would result in a £2.1 billion loss in GDP and potentially cost nearly 19,400 jobs. Against the backdrop of the massive impact of COVID-19 on the economy, the redundancies that have already occurred and the projections for unemployment growth over the next few months, this is further blow to the UK’s economic prosperity.

The potential economic impact also needs to be considered against the potential gains that might have been made following the return of duty and tax free shopping after BREXIT. The net loss from this reversal in positions would be in excess of £3.2 billion in GDP and nearly 30,000 jobs.

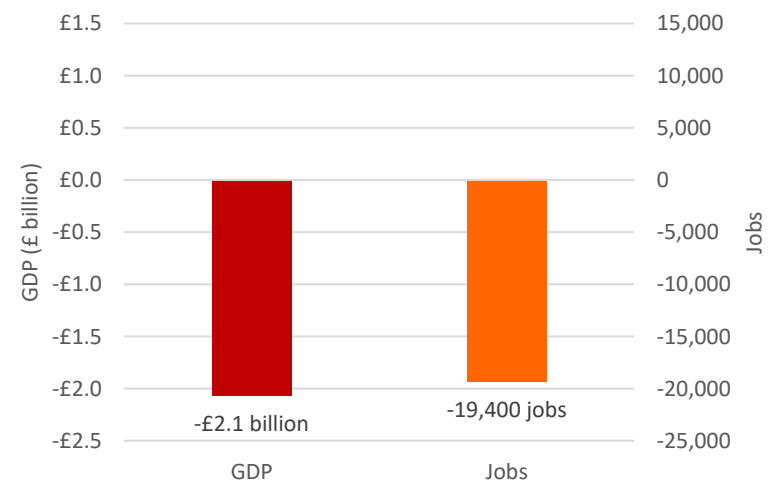
<sup>1</sup> Onward connecting traffic has been estimated using CAA Passenger Survey data. Data from some airports suggests these estimates may be conservative.

Passengers by Final Destination at UK Airports



Note: Year refers to the time period for the estimate.  
 \* Estimated from other data.  
 Source: CAA Passenger Survey.

Potential Economic Costs of the Removal of the ESC



# Introduction

On 11<sup>th</sup> September 2020, the UK Government announced its intention to remove the Extra Statutory Concession (ESC) on VAT on goods supplied at duty-free and tax-free shops from 1<sup>st</sup> January 2021. This will mean that VAT will have to be charged on all goods sold airside in UK airports, excluding excisable goods, regardless of where the passenger is travelling to. Essentially, this will result in a significant rise in the prices offered to consumers with consequent impacts on overall demand, sales revenues to retailers and concession revenues to airports. This comes at a time when the aviation industry and its partners are already under huge financial strain from the devastating effects on the industry from the COVID-19 pandemic.

UK airports are world leaders in the development of commercial revenue streams and this expertise has enabled them to reduce their reliance on airport charges, offer incentives to airlines and, in consequence, build connectivity and passenger demand. The converse of this is that many UK airports are now heavily reliant on commercial revenues, particularly retail revenues, for financial sustainability and investing in infrastructure. The UK Government's proposed action strikes at the centre of this business model, targeting the highest yielding element of the travel retail market, at a time when retailers and airports need support to recover and build back.

This short paper provides an initial assessment of the potential impact of the proposed change on the headline financial position of the UK's airports. This represents a high level assessment based on publicly available information and data drawn from York Aviation's previous work for the UK TRF on the potential implications of BREXIT for the travel retail market in the UK. The impacts described should be seen as order of magnitude estimates rather than precise financial modelling.

The paper covers a broad range of UK airports for which data is available but it should be recognised that the level of data available for each varies and estimates based on benchmarks have been used in some places. The key public sources of data used include:

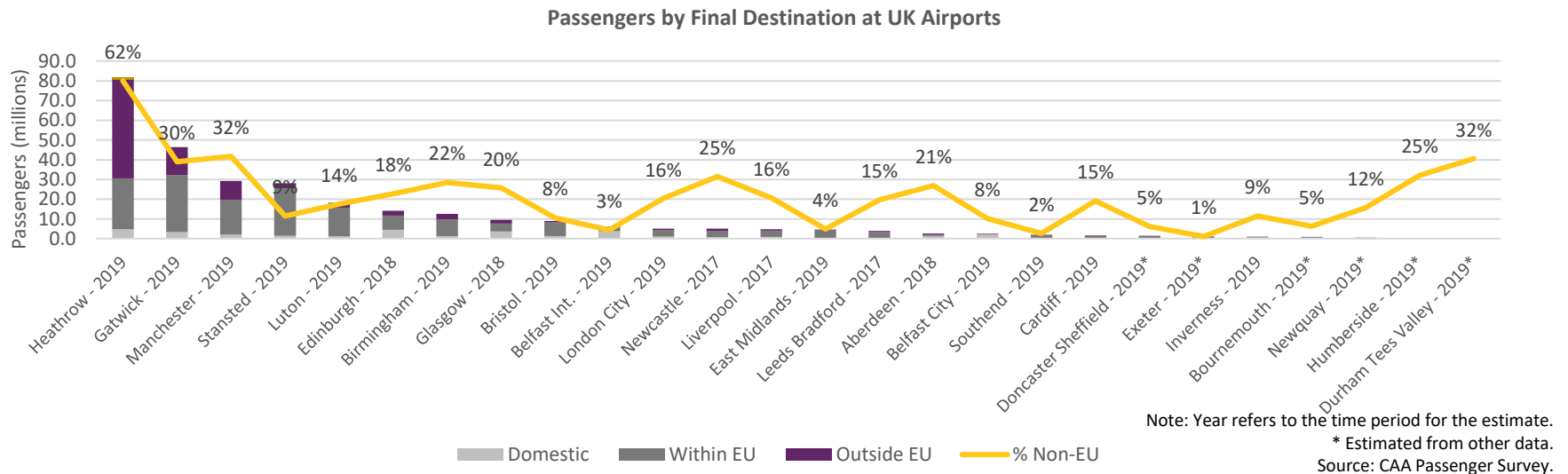
- CAA Passenger Surveys;
- CAA Airport Statistics;
- Jacobs / Leigh Fisher UK Airports Performance Indicators series;
- Financial Statements from retailers and airport companies.

The analysis explores a number of issues:

- the exposure of UK airports to the main affected market, passengers travelling to / from destinations outside the EU;
- the reliance of UK airports on commercial revenues and specifically retail revenues;
- the potential effect of the removal of the statutory airside concession on airport operating viability at 2019 demand levels;
- the cumulative effect of the COVID-19 pandemic and the removal of the ESC.

# Exposure of UK Airports to Passengers Markets Outside the EU

All UK airports will be affected by the loss of the ESC.



The exposure of UK airports to markets outside the EU varies considerably. Heathrow has by some margin the largest exposure in pure volume terms, over 50 million passengers, and in percentage terms, 62%. However, others, notably Gatwick and Manchester, also have over 30% non-EU passengers. A number of the UK’s major regional airports have 20% of more of their passengers travelling to / from destinations outside the EU, including Birmingham, Glasgow, Newcastle and Aberdeen<sup>2</sup>.

It should also be noted that the extent of exposure in percentage terms does not necessarily follow a pattern in terms of airport size. Some relatively small airports with hub services have a significant exposure to non-EU markets as a proportion of their passengers, for instance Humberside and Durham Tees Valley. This generally reflects the availability of hub services at airports.

Ultimately, while UK airports vary in terms of their exposure to non-EU markets, all handle some non-EU passengers and hence have the potential to be impacted by the loss of the ESC.

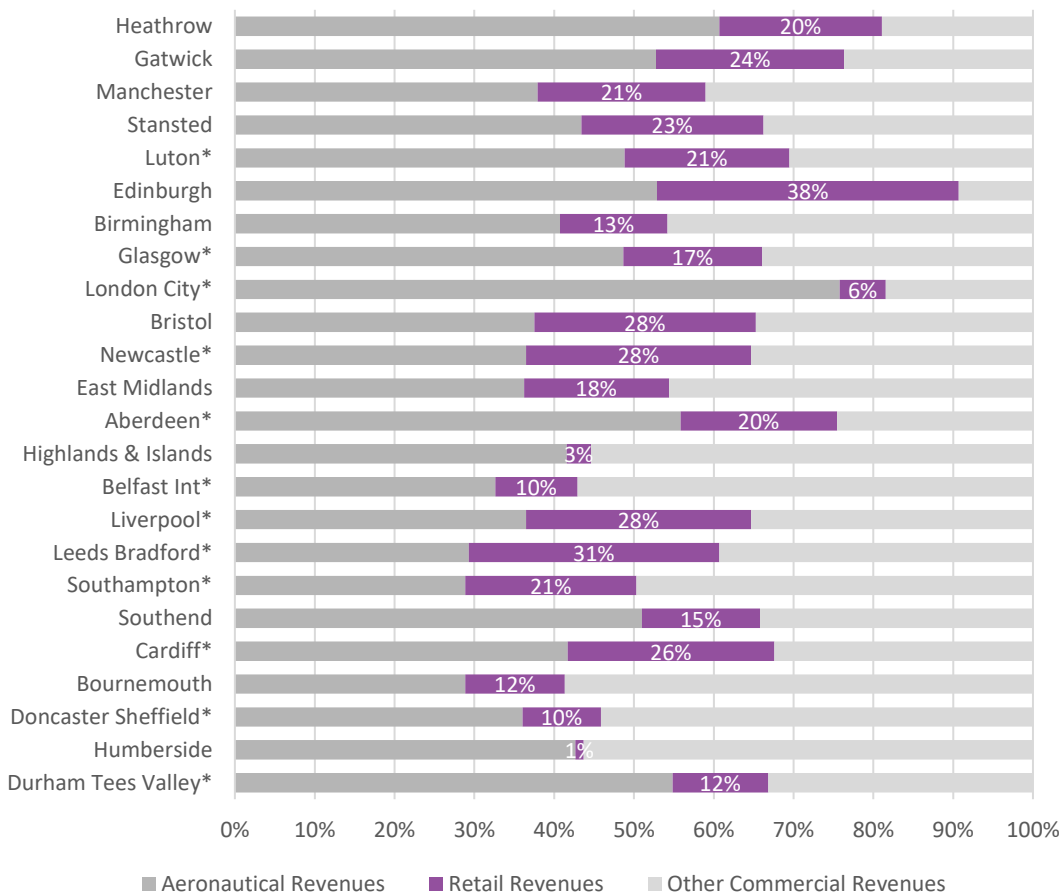
It should also be remembered that, post-BREXIT, competitor airports in the EU will be able to generate enhanced revenues from UK bound passengers as these sales will become duty and tax free and that the expectation within the UK industry was that the reverse would also apply. The proposed position will not only not deliver equality but will worsen the competitive imbalance between UK and EU airports.

<sup>2</sup> Onward connecting traffic has been estimated using CAA Passenger Survey data. Data from some airports suggests these estimates may be conservative.

# UK Airport Reliance on Retail and Commercial Revenues

UK airports typically derive around 21% of their revenues from retail sales. However, for some the figure is considerably higher.

Estimated Breakdown of UK Airport Revenues in 2019



UK airports are generally heavily reliant on commercial revenues to support overall revenues and retail concession revenues<sup>3</sup> make up a significant proportion of these commercial revenues.

Heathrow generates by far the largest retail revenues at around £585 million. This equates to around 20% of its revenues. The next largest airports by retail revenues are Gatwick and Heathrow, generating around £191 million (24% of revenues) and £97 million (21% of revenues) respectively.

Other airports are, however, considerably more reliant on retail revenues. Edinburgh generates around 38% of its revenues from retail, with Leeds Bradford the next highest at 31%. Others with a notably higher than average reliance on retail revenues include Bristol, Newcastle, Liverpool and Cardiff.

The UK's airports are, therefore, likely to be highly sensitive to changes in the regulatory environment around airport retailing.

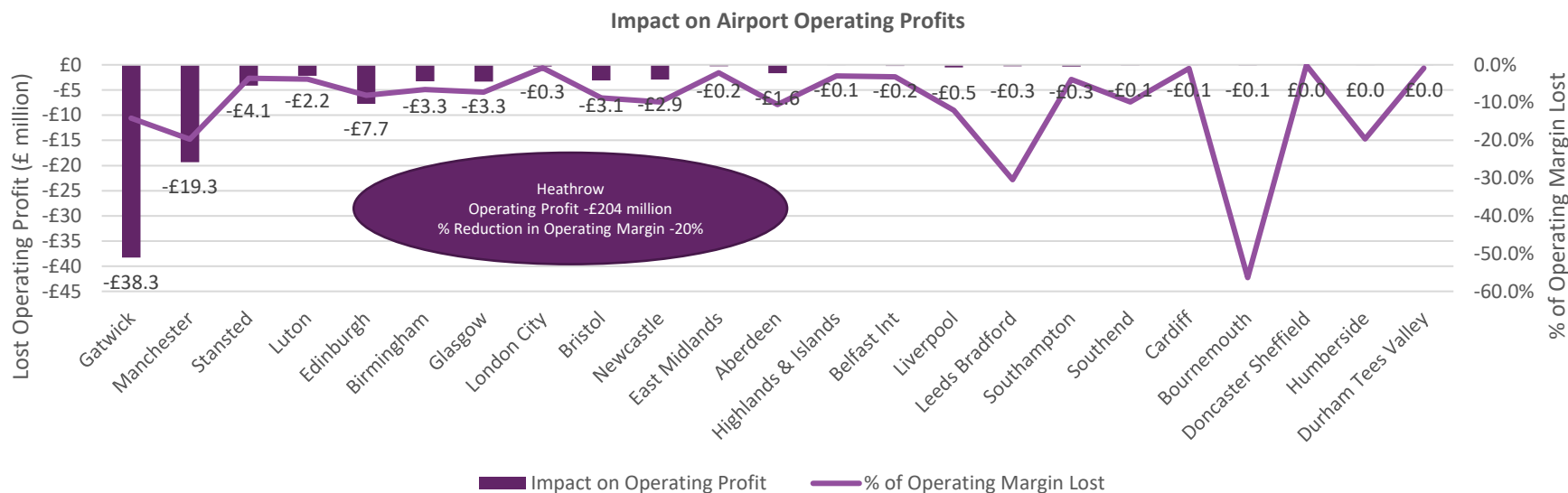
\* Estimated breakdown.

Source: Jacobs / Leigh Fisher UK Airports Performance Indicators.

<sup>3</sup> These do not include parking revenues.

## Impact on Airport Revenues and Margins in Normal Times

Heathrow is by far the most affected airport but others also suffer significant losses

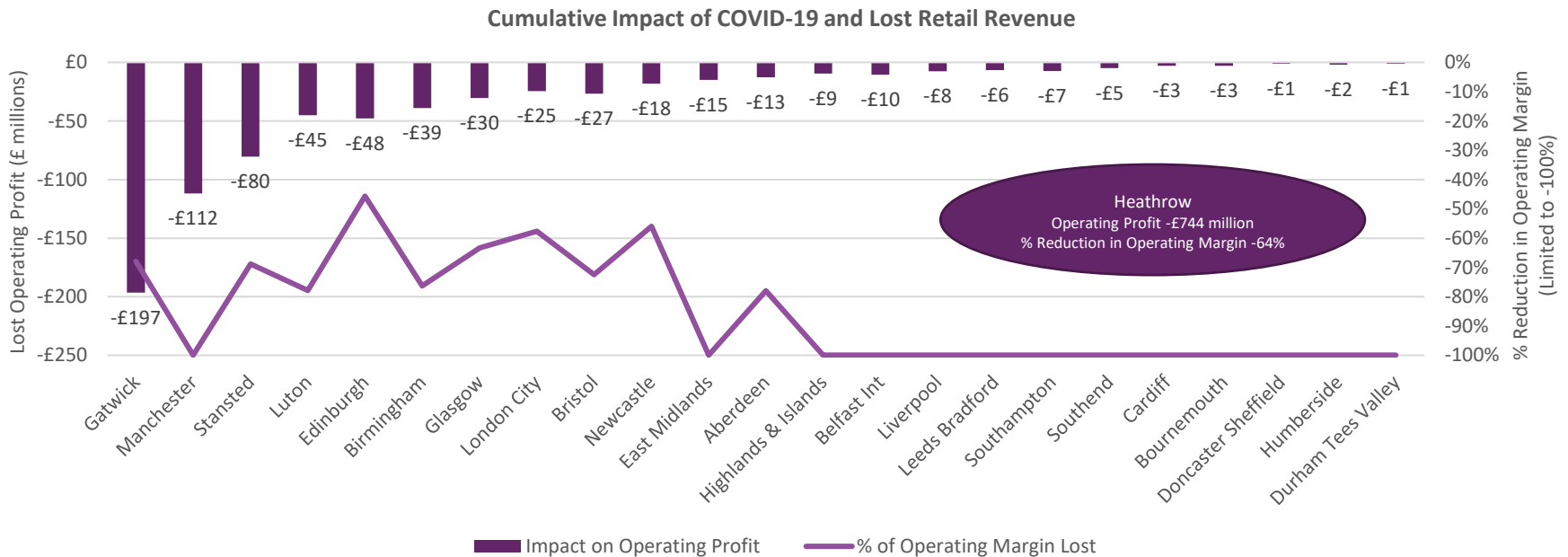


The chart above shows estimated impacts on operating profits at UK airports. This is based on data developed during previous research by York Aviation on the potential impact of BREXIT on travel retail sales and the associated economic impacts. The estimates assume that non-EU passengers reduce their expenditure to be in line with current EU passengers. It should be recognised that this is likely to be a conservative estimate as it does not reflect any losses relating to changed relationships with suppliers of goods as retail at airports loses its status as a separate market or from reduced investment in retail infrastructure in the future.

Unsurprisingly, given that it is by far the UK's largest gateway to non-EU markets, Heathrow is estimated to be the worst affected airport, with an impact on operating profits of over £200 million (a percentage reduction in operating margin of around 20%). Others are, however, also significantly affected, with, for instance, Gatwick losing around £38 million and Manchester around £19 million. Losses at other airports are smaller in volume terms but are still significant in terms of their effects on operating margins. It should also be remembered that there is potential to damage the structure of competition in the UK market, particularly in relation to long haul services. If the UK's regional airports lose the additional retail revenues that come from the non-EU market currently, it will make it harder for them to compete and make the business case for investment in new long haul services in the future, pushing the UK towards a situation in which Heathrow becomes even more dominant in long haul markets than it is now.

# Cumulative Effect of COVID-19 and Lost Retail Revenue

The cumulative effect of COVID and the loss of retail revenue is potentially devastating for UK airports.

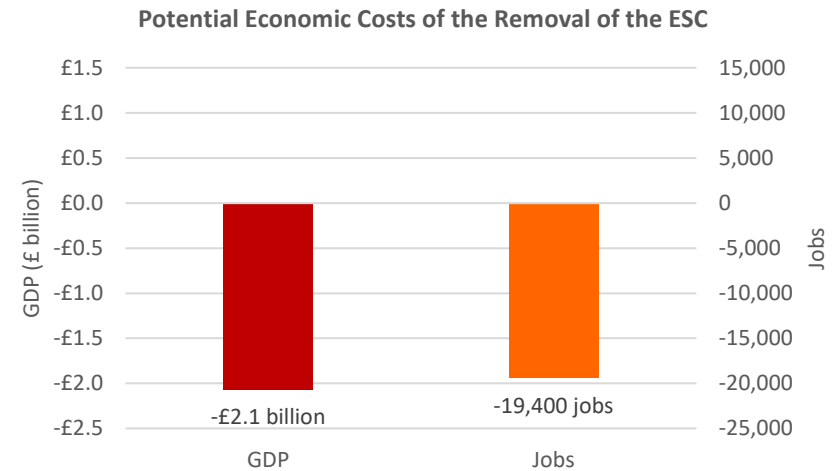
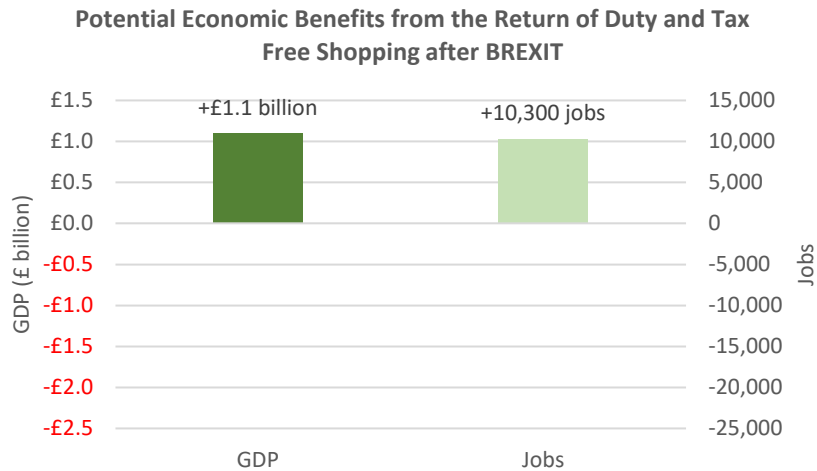


The impact of COVID-19 has been devastating for the UK air transport industry and has caused massive financial damage. In comparison, the loss of retail revenues from the Government’s proposals is relatively small. However, in combination the effect is likely to mean long term scarring and damage to the sector. This analysis assumes that in 2021 UK airports are all still operating at 25% below 2019 levels. This is, of course, a simplification but provides a basis for demonstrating the potential cumulative effects.

The impact on operating margins, particularly at smaller airports, represents an existential threat. Major airports will also suffer huge erosion of margins and the potential losses in terms of revenues are significant. Heathrow is estimated to lose around £744 million in operating profits in 2021, with Gatwick and Manchester seeing reductions in operating profits of £197 million and £112 million. The UK’s major regional airports often lose in excess of £10 million in operating profits and up to as much as £48 million. In many cases operating margins are reduced to zero or worse (the chart is limited to -100%) or current operating losses are significantly increased. UK airports have already stopped their capital expenditure and investment programmes in the face of the pandemic, with knock-on consequences for the construction sector. Loss of retail revenues relating to the loss of the ESC will undermine the business case for a return to investment and hamper the ability of airports to support economic recovery.

## Impact on the Economy

BREXIT should have enabled airports to support economic growth through the return of duty and tax free shopping for EU travellers. This change will have the opposite effect and damage a stricken industry



The potential impacts of the removal of the ESC will have a significant impact on UK airports ability to support GDP and employment. Extrapolating from the previous work undertaken by York Aviation previously for the UK TRF on the potential economic impacts of the return of duty and tax free shopping, we estimate that the removal of the statutory concession would result in a £2.1 billion loss in GDP and potentially cost nearly 19,400 jobs<sup>4</sup>. Against the backdrop of the massive impact of COVID-19 on the economy, the redundancies that have already occurred and the projections for unemployment growth over the next few months, this is further blow to the UK's economic prosperity.

It is also needs to be considered against the potential gains that might have been made following the return of duty and tax free shopping. The net loss from this reversal in positions would be in excess of £3.2 billion in GDP and nearly 30,000 jobs. It should be noted that some of this effect may be offset following BREXIT through increased sales of excisable goods but, ultimately, this is the smaller part of the travel retail market at UK airports and it is highly unlikely that this could ever make up the short fall.

<sup>4</sup> These are extrapolations of the potential impact not fully modelled estimates.



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