



# UK Airport Retail Post-Brexit: Upside or Downside?

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## 1 Introduction

The UK exits the EU on the 1<sup>st</sup> of January 2021. In a surprise move the UK government announced that, from that date, all UK airports will reinstate duty-free sales to EU passengers. They will also remove the VAT exemption from all passengers, and will remove VAT returns for overseas visitors purchasing goods in British high-street stores.

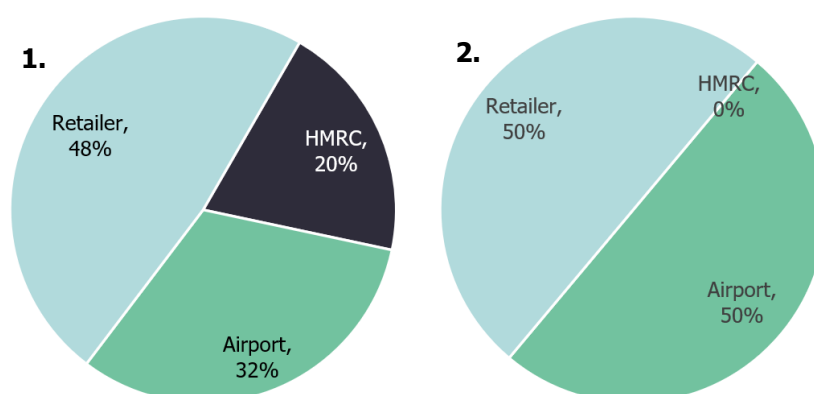
This paper examines the implications of the removal of the airport VAT exemption, and the return of airport duty-free allowances. Skylark analyses the potential impact on pricing for UK passengers and travellers visiting the UK and concludes that while there are positive impacts for UK regional airports, they will be minimal. The position is clearer for larger UK gateway airports, where the changes are a net negative. The downside impacts are as follows:

- Regional airports with a high EU and domestic passenger mix could benefit from the return of duty-free good as margin and profit impact may be small
- Gateway airports with high levels of non-EU traffic will lose the benefit of tax-free trading
- Overall, UK airports competitiveness could be negatively affected when compared with other EU airports retaining tax-free pricing
- While the expansion of duty-free discounts is positive for all airports the price advantage could be greater in EU airports than UK airports, thereby providing a competitive advantage for EU airports

## 2 What is the Government's rationale for removing VAT-free trading?

Currently, there is a lack of differential pricing at UK airports for non-dutiable goods. Passengers pay the same price regardless of their destination, and regardless of the applicability of VAT. The following three pie charts demonstrate a hypothetical structure of revenue when a non-dutiable item is sold at an airport:

**Figure 2-1: Distribution of Revenue from Non-Dutiable Goods at a UK Airport**



1. *Travelling to the EU:* From the sale of, for example, a £60 bottle of perfume, 20% goes to HMRC at VAT, 32% goes to the airport, 48% goes to retailer
2. *Travelling non-EU:* The same bottle of perfume is sold at £60, with zero going to HMRC, and the retailer and airports splitting the full sale price

From 1st January 2021, revenue from non-dutiable goods will be as chart 1 as the VAT deduction can no longer applied.

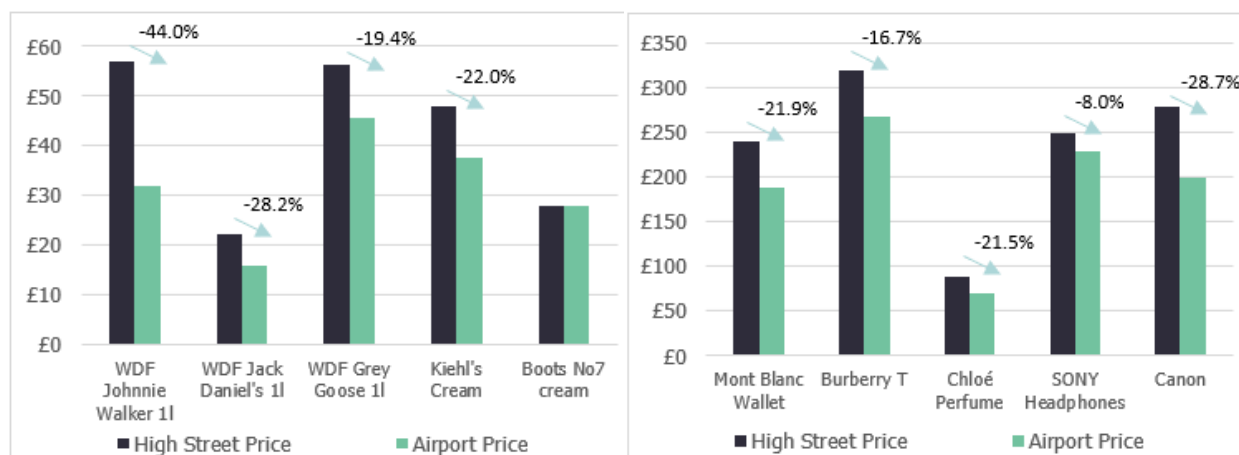
The UK government is legislating to remove VAT exemptions from all retail outlets. The stated aim is to align the UK's rules towards the EU with the UK's approach to the rest of the world as the Brexit transition period terminates at the end of 2020. Northern Ireland will continue with the current arrangements until a new agreement can be reached. The Treasury in its decision expressed concerns with the current arrangements on airport goods, stating that the tax concession is not always passed on to consumers, with retailers increasing prices to gain larger profit margins. However, it is important to acknowledge the key phrases in this statement of **"not always"** and **"may be"** increasing prices.

Skylark conducted research on the pricing of goods at UK airports in an attempt to verify this statement, and concluded that:

1. Almost all retailers are selling goods at reduced prices compared to the UK high street
2. Some are not always passing on the full benefit to the consumer. For example, Boots charges the same prices at the airport as at their high street stores.
3. Most luxury retail brands are offering prices with the full VAT reduction.
4. Electrical product pricing, from the retailer Dixons, range from 8%-30% reductions from their high street store pricing (relative to a VAT rate).
5. The travelling passenger is therefore generally benefitting from common pricing where retailers either sell at a discount equivalent to the tax or pass on the tax-free benefits when travelling outside the EU. This is also the case for the largest trading units in airport duty-free shops.

The figures below illustrate the sample taken at Heathrow, Manchester, Leeds, and Bristol Airports. Lower prices are offered to passengers at all airports compared to the high street.

**Figure 2-2: Sample of core duty free products and luxury goods**



Source: Heathrow Airport Website, Leeds Bradford Airport Website, Dixons, World Duty Free, Supermarket Comparison Airports, Skylark Analysis  
 Note: WDF=World Duty Free

The Treasury claims that current tax-free pricing encourages trade away from the high street, and by removing this pricing advantage at airports tax revenues will increase through greater sales at high street stores. Evidence contrary to this has been apparent over time with the proliferation of retailers opening stores at airports in addition to their high street operations on a purely commercial basis. Examples of retailers that have benefitted from dual high street and airport operations include Dixons/Curry's, WHSmith, Boots, Superdrug, Accessorize, Fat Face, Next, JD Sports, Watches of Switzerland, Hugo Boss, Ted Baker, and Mulberry.

Skylark further believes that the removal of VAT refunds for overseas visitors is likely to significantly affect many UK retailers outside of airports. Popular tourist shopping destinations such as Bicester Village, London’s West End, and York are preparing for huge losses in tax-free sales, as the exemption is now limited to goods posted home.

The Government announcement has led to an outcry from many senior officials within the travel and aviation industry. The Government has been asked to reconsider and note the damaging effects this change will have on UK airports, which are already reeling from the devastating effects from the COVID-19 pandemic.

As a result of the reintroduction of the VAT on all duty-free goods, current duty-free prices will have VAT reapplied increasing prices by 20%. Therefore, passengers travelling outside of the EU will see prices increase by 20%. Retailers and airports could mitigate this by taking lower margins for non-EU passengers.

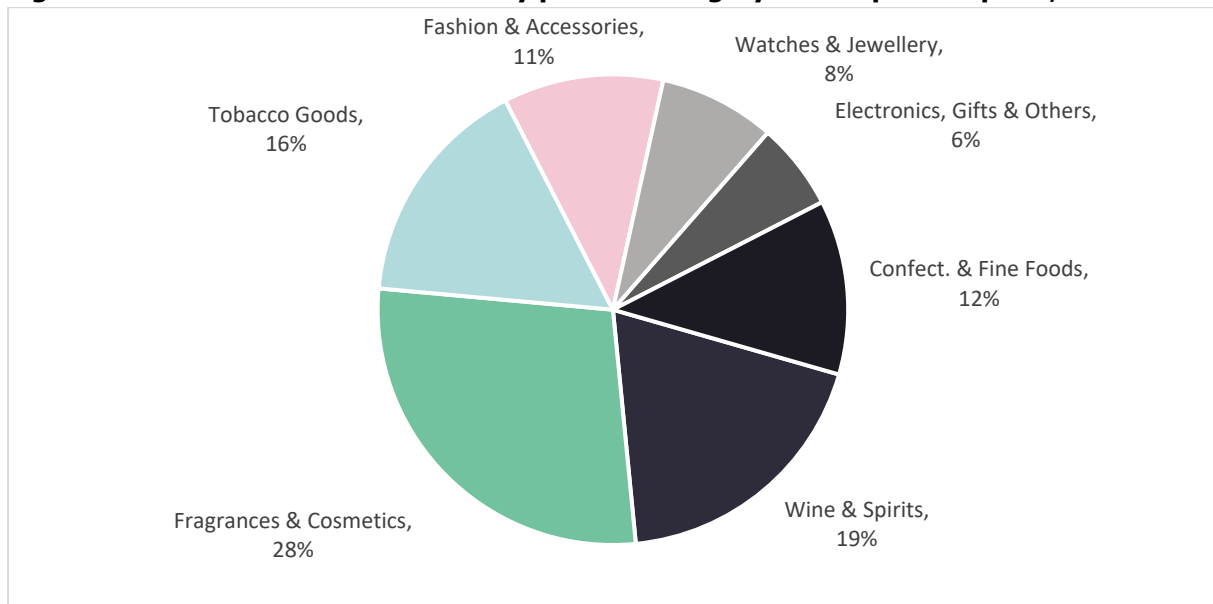
### 3 Is the re-introduction of EU duty-free compensation for the loss of VAT exemption?

Concurrent with the loss of VAT exemptions, the Government has announced that passengers travelling from the UK to the EU will be able to purchase duty-free goods once they have passed airport security. Passengers will also be able to purchase duty-free goods on-board aircraft to all non-domestic destinations.

This change “should” result in increased sales and profits for airports and airlines providing the passenger with a real price advantage over high street pricing of liquor and tobacco products. But is it enough to compensate for the loss of VAT-free goods?

The Government is suggesting that the benefits of duty-free allowances would outweigh the costs of the loss of the VAT exemption. However, the largest category of sales in European airports comes from fragrances & cosmetics, so that the loss of VAT exemption on these products at UK airports may significantly reduce UK airport revenues.

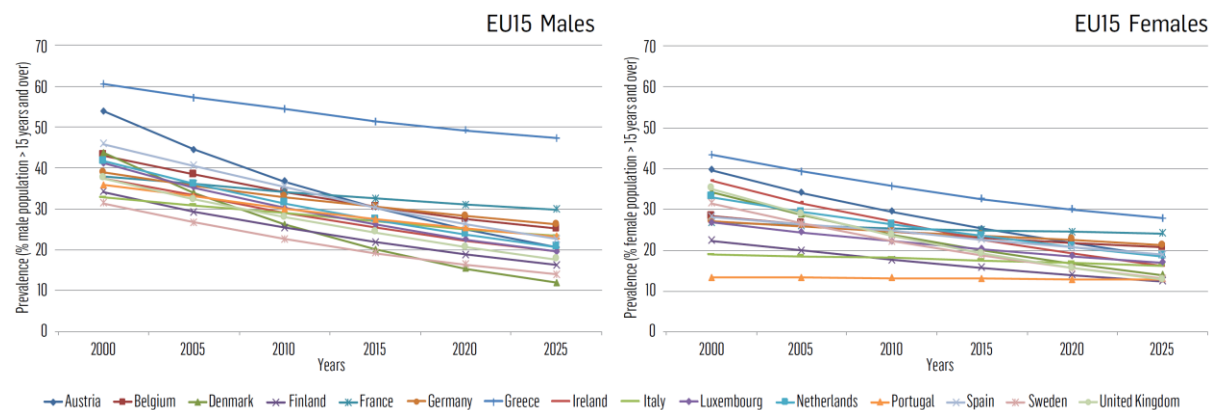
**Figure 3-1: Market share of revenue by product category at European airports, 2014**



Source: The European Travel Retail Confederation, Duty Free World Council

Although tobacco sales remain a significant proportion, a general decline in tobacco usage and associated sales (see Figure 3-2) leads Skylark to believe that the reintroduction of duty-free is unlikely to mitigate reduced profits from removal of VAT.

**Figure 3-2: Trends and Projections of Tobacco Smoking Prevalence in EU15 countries**



Source: WHO Tobacco Use Trends Report, 2019

In considering whether there will be a net benefit from the legislative changes, two key issues are relevant:

1. How will passengers change buying decisions when travelling from the UK to the EU given that they have the option of buying at either end of their journey?
2. What will their perception of pricing be?

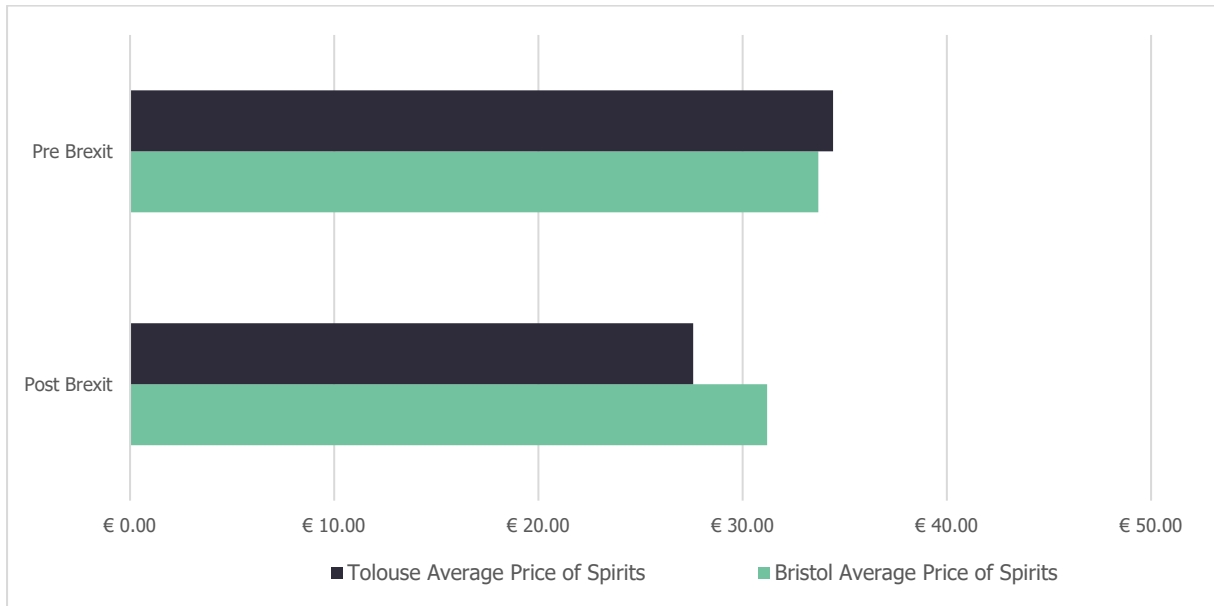
One key point is that tobacco sales at airports have been in decline for several years, exacerbated by the increasing popularity of e-cigarettes. Figure 3-2 illustrates the long-term trend for tobacco sales and profits in Europe, supporting the view that the reintroduction of duty-free trading for this category is unlikely to mitigate the loss of tax-free trading for other categories.

When shopping at an airport after the new legislation is implemented, travellers to Europe may choose to purchase items within a European airport, as the EU will regard the UK as a third country and therefore passengers returning will benefit from VAT savings that are no longer available in the UK. Those passengers returning will also be able to benefit from duty-free pricing on liquor and tobacco.

Skylark has analysed how prices may change at UK airports after the 1<sup>st</sup> January 2021 to understand potential drivers to passenger shopping behaviour, and to understand how this may affect UK airport revenue. A price analysis pre- (current tax-free airport rates, 20% cheaper than high street prices) and post- (VAT re-applied, duty removed) the legislation change has been conducted using the average price of alcoholic spirits, and the price of an electrical item and a typical fragrance. Skylark conducted the analysis under two scenarios: a passenger flying from Bristol to Toulouse, and a passenger flying from Toulouse to Bristol.

The case study concludes that, post-legislation, the average price for passengers buying spirits at Toulouse will be 12.5% cheaper than at Bristol. The rational choice will be to buy at Toulouse which is the reverse of the situation today where it is cheaper to buy at Bristol.

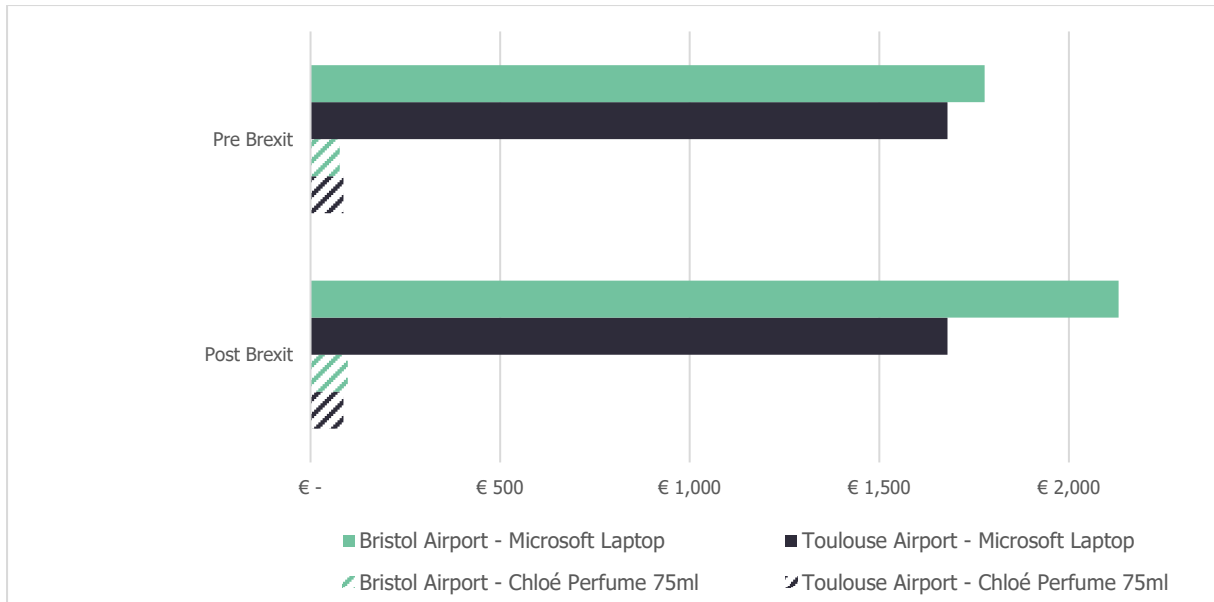
**Figure 3-3: Average Price of Spirits at Bristol & Toulouse Airport, Pre- and Post-Legislation**



Source: Skylark Analysis, Dixons, World Duty Free, gov.uk, ec.europa.eu  
 Note: UK prices have been converted into Euros

For electrical and beauty goods, Dixon’s is currently selling items between 8%-20% lower than the high street, however the VAT discount could be removed following the new legislation. This will be the same for all goods sold at UK airports with a current VAT discount. At EU airports, all goods could continue to be sold at the VAT discount value.

**Figure 3-4: Price of Electrical and Beauty Goods at Bristol & Toulouse Airport, Pre- and Post-Legislation**



Source: Skylark Analysis, Dixons, World Duty Free, gov.uk, ec.europa.eu  
 Note: UK prices have been converted into Euros

Based on this small sample, Skylark concludes that in many cases it will be cheaper to purchase goods from EU airports compared to UK airports after the legislation is put in place. The primary reason for this is that EU airports will retain tax-free pricing.

## 4 Personal Allowances for Passengers Travelling from the EU to the UK

The government is increasing the alcohol allowances for EU arrivals, aligning what is currently in place for all other international arrivals. The introduction of allowances will prevent EU passengers arriving in the UK importing unlimited amounts of tax-duty-paid goods for their own use, however the government has said they will increase the current allowance levels for alcohol for all passengers. The government have promised “one of the most generous allowances anywhere in the world”. The current non-EU allowances will apply to existing categories of tobacco and all other goods. Table 1 outlines the new allowances that will be introduced:

**Table 1: UK Current and New Alcohol Allowances for Arrivals Outside of the EU and Future EU**

Alcohol – Current	Alcohol – New
16 litres of Beer	<b>42 litres of beer</b>
4 litres of still wine	<b>18 litres of still wine</b>
1 litre of spirits and other liquors over 22% OR 2 litres of sparkling wine, fortified wine or any alcoholic beverage less than 22% ABV	<b>4 litres of spirits OR 9 litres of sparkling wine, fortified wine, or any alcoholic beverage less than 22% ABV</b>
Or any proportional combination of the above	<b>Or any proportional combination of the above</b>

Source: gov.uk

In summary, changes in the personal allowance is likely to benefit other EU countries where UK passengers can bring more goods back into the UK and is unlikely to benefit UK airports, unless arrivals duty free shopping is introduced.

## 5 Mitigating losses and maximising upsides during this market turmoil

It is now more important than ever for airports to be inventive and create competitive and attractive offers that, if not beat, then at least match prices on the high street and online. Passengers need more transparency in airport pricing in order to restore passenger confidence that airport prices are competitive. Therefore, airports need to significantly promote revised and clear pricing advantages for products within the airport against the high street. The importance of common industry pricing and promotions will be more critical in 2021 than ever before.

Skylark believes that the following solutions and ideas will mitigate downsides and maximise upsides, allowing the retail offering in UK airports to remain competitive and so continue to operate successfully and profitably.



### *5.1 Airport Arrival Shops - Expand the Wine and Spirits offering selling at Equivalent Duty and Excise Free Prices to All Arriving Passengers*

Currently, the following airports offer arrivals shops after baggage collection, offering prices that are equivalent to the outbound tax-free discount prices for any passenger arriving – irrespective of EU or non-EU origination:

- Heathrow Airport
- Gatwick Airport
- Birmingham

UK airports are currently not permitted to offer arrivals duty-free, however trade bodies are lobbying the government to change this law which could significantly help boost duty-free revenues within the airport and offset the lost revenue from the proposed change in legislation. If this law is changed then Skylark believes airports should expand their liquor and tobacco offering and extend their duty- and tax-free pricing to their arrival's shops. The following steps should be taken:

- Airports to expand their arrivals store offerings, providing greater ranges of liquor and tobacco
- Offer at the equivalent prices of outbound discounted prices
- Offer discount prices to all arriving passengers

If duty-free is sold to arrivals, the store will need to be located before customs, with current arrivals shops needing to be relocated and expanded in the baggage reclaim area.

### *5.2 Review Allocation of Retail Space*

With alcohol and tobacco having duty-free sales re-instated, it will be important to prioritise the promotion and space allocation of duty-free liquor and tobacco. Skylark suggests that:

- Airports create dedicated product stores for wine, whisky, and other spirits with strong marketing and clear promotions, with stores being easily visible and accessible to all passengers
- Skylark recommends reviewing airport retail space layout and merchandise space allocations to reflect new margin structures and maximise margin per square metre for airport shops and their concessionaire retailers

### *5.3 Expand Online Pre-order and Pre-booking, and Expand Home Delivery*

Skylark believes implementing an online sales partnership between airports, airlines, retailers, and duty-free operators could also boost non-aeronautical revenues within airports allowing easy pre-planned shopping for passengers. Ensuring that an efficient "deliver to your home" service is implemented and promoted will also enhance a more seamless shopping experience for passengers within the airport. The shopping practice for younger customers is to use online purchasing delivered direct to home and so airports offering this service will align their offer with this ever-increasing trend.

Passengers post COVID will likely be more comfortable shopping online, with online sales increasing significantly since the start of the pandemic. By April 2020, online shopping had already surged 129% in the UK and Europe. Airports need to capture and maximise this trend.

Irrespective of Brexit and COVID, airports are already developing their digital offers to increase airport retail sales.

#### *5.4 Partnerships Between Origination Airports, Airlines, and Destination Airport*

If outbound airports work together with airlines and destination airports, they could form an agreement that allows passengers to purchase goods in their outbound airport, or onboard the aircraft, and collect the item in their destination airport at discounted duty-free prices. Airlines do not have enough space on-board the aircraft to carry all the different duty-free alcoholic goods, so by forming a partnership, all three parties could benefit as well as the passenger, with this option providing passengers with a seamless purchasing experience.

This strategy would require a well-coordinated approach from the airport operators and other duty-free operators.

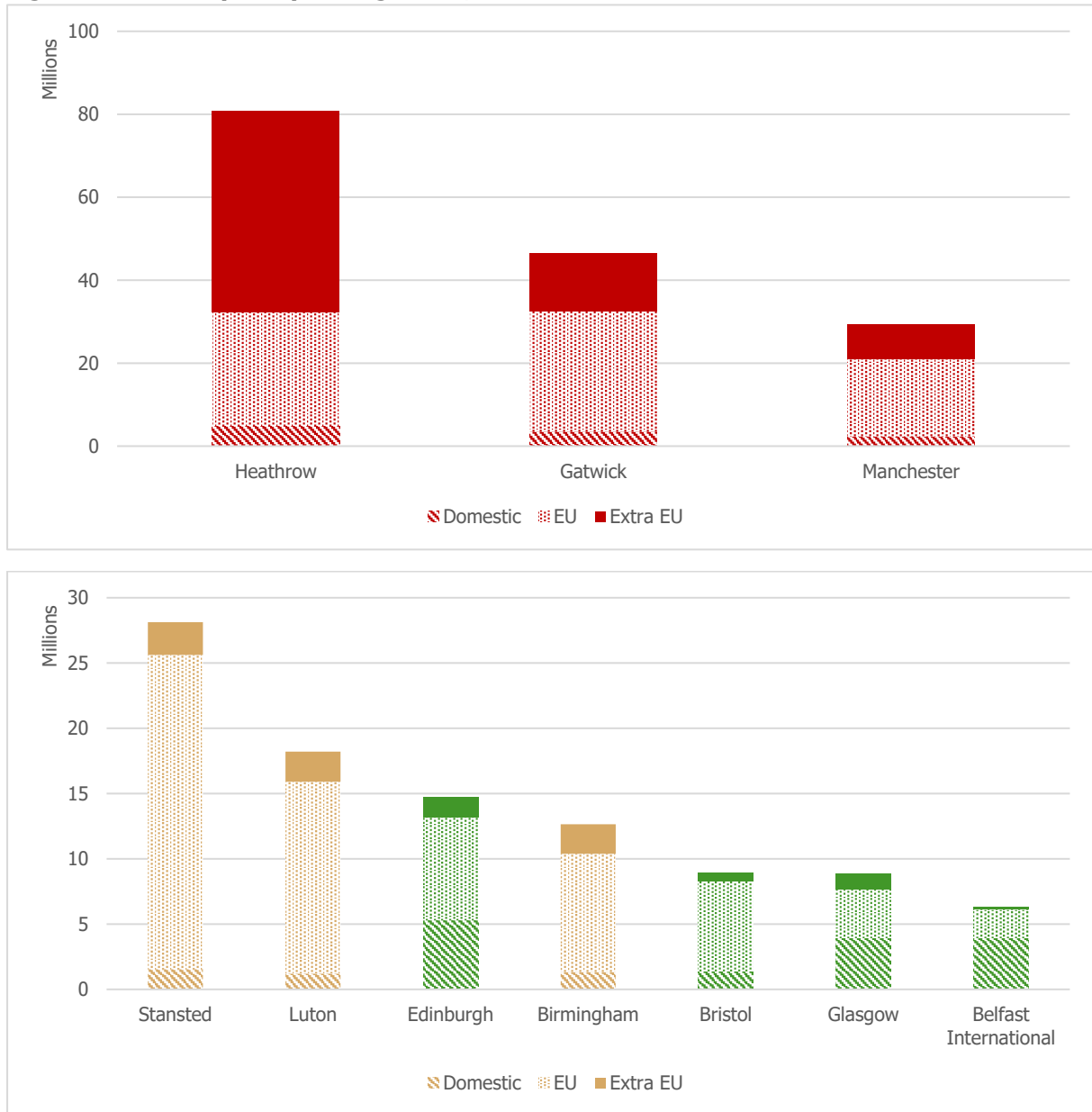
#### *5.5 Continuation of Tax-Free Discounting to Non-EU Destinations*

Skylark suggests that tax-free pricing to all non-EU passengers out of UK airports should be continued by retailers. The current discount trading to EU passengers should also be continued. The passengers would therefore experience a clear one discounted price for all customers across the airport. The implications of this being a loss of margin for both the airports and the retailers on non-EU destinations where current contractual (tax-free for EU) margins are extended to non-EU destinations. Essentially this is the same strategy that was applied following the loss of duty free in 1999.

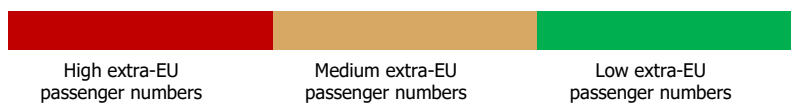
Skylark would propose that all current pricing continues for all passengers, therefore "tax free" pricing to all customers, with the retailer absorbing the VAT as a cost.

Where airports currently have a high EU and domestic passenger mix with low extra EU International passenger levels the margin and profit impact will be small. Where an airport has a high extra EU international passenger mix, the profit and margin impact will be greater. Figure 5-1 below shows which airports are more likely to experience reduced margins.

**Figure 5-1: UK airports passenger mix, 2019**



Source: CAA



Overall, Skylark concludes from the individual impacts identified above will vary between airports, however on balance will affect Heathrow, Gatwick, and Manchester, with relatively higher levels of extra EU traffic, more negatively than the regional airports that have higher intra EU traffic.

### *5.6 Reintroduce and offer across UK airports "never knowingly undersold" policy – price matching the high street and online*

BAA airports previously offered a no-quibble refund if passengers could prove the same item was available at a cheaper price at other high street locations. Many retail brands, including premium outlets such as John Lewis Partnership and Selfridges as well as several supermarket groups have offered this service. Historically, the level of airport passengers claiming refunds under such an offer was lower than on the high street, and was outweighed by additional sales.

The introduction of online price matching is a natural extension of this policy in line with current retail shopping trends.

## 6 Conclusion

It is apparent that further, extensive research and analysis would be required to fully understand the impact that the change of legislation will have on passenger behaviour, airport revenues, and the future outlook for airport retail. However, Skylark concludes that the impact on UK Regional airports will be minimal and potentially positive with the addition of duty-free trading for liquor and tobacco. Gateway airports with high levels of non-EU traffic will lose the benefit of tax-free trading. Skylark believes that overall, UK airports competitiveness will be negatively affected when comparing with other EU airports which will be retaining tax-free pricing, as the price advantage will be greater in EU airports than UK airports. The effect that this new legislation will have on UK airports will depend on how they adapt and change to maximise what potential opportunities exist.

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To discuss this article or any issues arising from the current uncertainties facing airport retail please contact

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