

Meeting with A.T. Kearney

12/08/2013, 14.00-15.00, CAA House - K4 Discovery

Attendees:

A.T. Kearney: Robert Ziegler, Richard Sharp

CAA: Duncan Kernohan, Tim Griffiths, Anna Zalewska

Meeting Minutes:

1. A.T. Kearney provided an overview of the study process, the client types and the objectives of the study. A. T. Kearney noted that this was the first time that their work had been used as part of a regulatory submission. Key points made by AT Kearney were that the study is intensive, expensive - £100-200k and based on detailed examination of the airports internal information sources to provide a detailed and comparable understanding of where performance can be improved relative to peers. In AT Kearney's opinion two advantages of the study against other studies were that it specifically covered airports and through its comprehensive segmentation provided far more certainty over the comparability of the data and costs. All participating airports have gone through the same 6-10 week process of allocating their data to the benchmarking structure.
2. CAA explained the purpose of the meeting to understand how their study compared with similar work, in particular the Helios study on central service costs, which indicates that the airport could reduce costs in some areas.
3. The CAA stated that the Helios study was not inconsistent with the AT Kearney work and suggested that at current performance Gatwick were close to average peer group benchmarks. However this study also included more aggressive 'world class' benchmarks based on Gartner and Hackett benchmarking data, which included competitive businesses and suggested that Gatwick could achieve more as a stretch target. A.T. Kearney noted that Gatwick costs appeared to be lower than average. They also raised the concern that non-airport based data might well not be relevant and that the studies did not appear to be based on the comprehensive inside-out approach and might therefore not be comparing like with like. Where, as in this case, costs were below the overall average and the airport did well in the majority of areas, in A.T. Kearney's opinion a reasonable and balanced judgement would appear to be that the airport was operating efficiently
4. A.T. Kearney talked through their approach to the study and their interaction with Gatwick, several key points were made including:
 - a. The sample size did not include very small or non-European airports in order to maintain comparability.
 - b. The methodology was very well established and applied in a rigorous and systematic way. This was necessary to protect A.T. Kearney's reputation and the GCB brand. If clients did not believe that the benchmarks they were being compared with had been applied in an objective manner, the

benchmarking would lose its credibility and A.T. Kearney would no longer be able to sell the product.

- c. The work was based on a substantial and comprehensive examination of internal management information, subject to appropriate scrutiny and challenge
 - d. Opex included uncapitalised opex for consistency with other airports.
 - e. Around 50% of the airports were privatised with the rest state owned. Privatised (and most state owned) airports were likely to be subject to some form of regulation. However, in A. T. Kearney's opinion of far more importance was whether the airports were aggressively profit maximising and therefore cost reducing rather than whether or not they were regulated.
 - f. The average size of the sample was around 25m passengers
 - g. There was no selection of the peer group - this is the group for which data is available and had asked to be included. There is likely therefore to be something of a bias towards airports which were highly motivated to examine and reduce costs
 - h. AT Kearney stated that the study did not include non-European airports: (Global Competitive Benchmarking (or GCB) is the product brand name used across a number of industries)
5. The CAA pointed out that Gatwick was at the maximum of the sample in terms of the % of low cost carrier flights and stated that this might tend to reduce Gatwick's costs relative to the sample. AT Kearney responded that Gatwick was not typical of a low cost airport. A.T Kearney stated that the metrics shown in slide 5 of the report were based on the full panel and A.T. Kearney had used a subset of these airports to benchmark Gatwick.
 6. The CAA asked if the benchmarks in the study represented a fair estimate of the efficient frontier, or if Gatwick could be expected to go further than this in some areas based on performance against the 'frontier'. A.T, Kearney stated that the benchmarks were based on average performance against benchmarks and performance better than average was marked green. They also stated that it is difficult to determine a frontier based on a small sample. They accepted that even if a company was performing better than average performance (or indeed at a notional efficiency frontier) it did not indicate that there was no further scope for efficiency over time.
 7. The CAA questioned the benchmarking of strategy costs in the study stating that, in its view, Gatwick had high costs in this area which did not appear to be reflected in the A.T. Kearney study. A.T. Kearney noted that Regulatory Management was a separate function in the GCB approach and not included in the functions included in the study provided either at Gatwick or at its benchmarks. In practice, such costs would naturally be expected to be high at an airport undergoing price control regulation in the years prior to a regulatory determination.
 8. The CAA stated that there was strong evidence of staff costs inefficiency at Gatwick and that this was likely to influence the performance of GAL against benchmarks. AT Kearney stated that it could not comment on this or how CAA had

reached their judgement. However, given that out-turn staff costs in the study appeared to be lower, it may be that Gatwick have employed staff more effectively and or used more outsourcing to achieve an overall efficient outcome.

Actions

9. The CAA requested more information from AT Kearney in several areas including:
 - a. The process of normalisation, in particular the treatment of staff costs, exchange rates and any indices of labour cost, power cost or price indexes used to convert data into a common currency. This information is needed to understand the comparability of assumptions with other studies.

Answer: We use international accepted sources to harmonize single values of each participating airport for the benchmark. These are as follows:

Cost/Revenue type	Harmonization Index	Source
Personnel cost	EIU Labour Index	Economist Intelligence Unit
External services cost	EIU Labour Index	Economist Intelligence Unit
Power cost	Electricity and natural gas price indices	Eurostat and International Energy Agency (IEA)
Fuel Cost	IEA Statistics, Energy Prices and Taxes	International Energy Agency (IEA)
All other Cost	Purchasing Power Parities (PPP)	Eurostat and OECD
Local Revenues	Purchasing Power Parities (PPP)	Eurostat and OECD
International Revenues	no harmonization	

Local revenues: revenues generated with local customers (e.g. car parking, advertising)

International revenues: revenues not comparable via the local PPP (e.g. airline landing fees, retail revenue)

Currency Exchange Rates: We are using the average exchange rate of the referring benchmark year (Source is OANDA, a market maker and worldwide trusted source for currency data)

- b. A table showing the minimum, maximum, average and Gatwick's position within the benchmark sample used in the study across key metrics including passengers, traffic units, % of low cost carriers, % long haul flights, revenues and other areas. This is needed to understand how the sample compares with other studies.

Answer: Most of this information has already been supplied in the introduction of the study and will not be elaborated upon to protect our client's confidentiality. We want to

reinforce the importance of understanding the cost of each airport in detail versus a perceived “comparability” of the sample.

- c. An assessment of the ‘frontier’ benchmark of each metric- for example the upper quartile or maximum performance of cost per passenger. Or a statement why this could not be provided or relied upon.

Answer: To identify the 1st quartile of results one would add or subtract half a standard deviation to or from the average. Such a number - while mathematically correct - would be highly misleading due to the low statistical significance of this result in relation to the sample size. We do not supply this number to any of our clients for this reason. At the same time we would like to note, that the detailed level of analysis that the GCB provides is already a stretch, as it does not allow for advantages and disadvantages to net out at a higher level but looks at the individual disadvantages of each airport process.

- d. A clarification of what licences were included in the commercial revenues to better understand the comparability of the benchmark with other studies.

Answer: Other concessions and licenses include revenues from fees paid to the airport company for offering services at the airport, e.g. taxi and bus services, mobile phone frequencies or Wireless LAN.

- e. An explanation of the level of capitalised cost included in each metric.

Answer: Different countries use different accounting standards. We find different interpretations of these across our sample airports. This is especially true for the rules governing the capitalization of labour cost as part of projects. Therefore, we re-operationalize internal labour cost that has been capitalized. This is a very strenuous and detailed process for the airport but improves the overall comparability of opex.