

Airport Beacon Report



www.airportbusiness.net

November 2005

CONSIDERATIONS FOR AIRPORT SPONSORED FBOs

By Mark R. Davidson, A.A.E., Vice President

In January/February 2005, Michael and I wrote an article for Airport Business magazine called "When the Airport Eyes the Fuel". The following article expands upon some of the issues addressed in that article. If you would like a copy of the Airport Business magazine article, please send a request to mdavidson@airportbusiness.net.

Airports operating fixed base operations (FBOs) are not rare occurrences any more. Across the nation, more and more airports have decided to "pick up the hose" and fuel aircraft themselves, instead of allowing the private sector to provide the service. Reasons why airports decide to get into the business vary from location to location, but some of the reasons may include the perceived increased generation of revenue, lack of interest from qualified private FBOs, or even an out-cry from based tenants to take over in anticipation of lower fuel prices if the airport is in charge. Whatever the reason, there are many things to consider before and after an airport chooses to enter the aircraft fueling service industry.

Some airports have set their sights on the potential fuel revenues that they perceive are available if they get into the business, and consequently fail to consider some of the reasons they should not participate in the business. This article is going to focus on some of these issues including risk/liability, marketing, the need for quick reaction, as well as alternatives to consider.

Risk/Liability

First of all, there are numerous risks involved in fueling aircraft and operating a FBO that many airports tend to overlook. For instance, the risk of



Say Cheese!

financial liability is probably much greater for an airport-operated FBO than for a privately-operated one, if for no other reason than deeper pockets. Other risks can come in the form of employee injury, property damage, fuel quality, environmental exposure, and negative cash flow. In fact, one can argue that the risk can also include an increased exposure to criminal acts by employees or even poor customer service levels that negatively impact the entire community. For instance, an executive flying into an airport to evaluate sites for a new distribution center is not going to arrive on AirTran Airways. They will likely arrive on a corporate aircraft and utilize the FBO, which will be the executive's first and last impression of the community. A negative experience with the FBO may tarnish the entire visit to the region. Operating an FBO is a major risk beyond just losing money.

Marketing

Another consideration that is often overlooked is marketing. One of the primary functions of airport

management is to market the airport. While some airports are fortunate enough to have dedicated staff to this function, many do not. Regardless, having a third-party FBO provides the airport with at least a secondary marketing department. While the airport is out trying to get more people to utilize the airport, so is the FBO. Despite the fact that the FBO may be doing it solely for self-benefit, the fact remains that if the FBO succeeds in generating more traffic, the airport succeeds.

In many cases, a private FBO migrates into a larger network by becoming a franchisee or is part of a national chain. In these cases, marketing dollars can be maximized with limited budgets. By becoming a part of a larger network, these FBOs have instant access to resources and experience as well as an instance reputation. Take for example, McDonald's vs. Joe's Hamburger Shop. Joe may have the best hamburger and/or customer service in the city. However, the word is slow to get out beyond the locals. On the other hand, McDonald's is instantly recognized and customers know what to expect (be it good or bad).

The Ability to React Quickly

An airport's politically imposed bureaucracy is another element that needs to be addressed before jumping into the FBO business. FBOs have to be able to react quickly to the market and customer needs. Often an airport-run FBO cannot compete adequately since they have strict bureaucratic operational and procurement regulations. Issues such as fuel pricing, equipment maintenance, and bulk fuel discounts become a nightmare due to the imposed restrictions, spending authorization, and/or procurement steps. In most cases, a private FBO manager has the autonomy to negotiate with a corporate tenant, while airport-run FBO managers are searching for signatures or waiting for the Board's next monthly meeting to obtain authorization. Government FBOs often miss out due to their inability to react efficiently and effectively to the market and customers.

Service Standards

Let's face it, government employees are not generally as motivated toward customer service as the private sector. While there are exceptions to every rule, the fact that it is much harder to fire a government employee than one working for a private company plays a role in many people's attitude toward the importance of enduring "the customer is always right" attitude. Customer service is the driving force behind any successful FBO. No, it is not price! Customer service is what puts an FBO on the map and puts money in the owner's pocket. Too often, an airport gets into the FBO business because of pressures from based tenants and some vocal transient customers, usually related to a perceived high price of fuel. However, if you delve deeper, you will usually find out that customer service is the primary culprit. Price is an issue because the customer does not feel that they are getting anything in return for the cost of the fuel. Others will spend \$100 to save \$0.05 per gallon on fuel, despite only buying 10 gallons (you do the math).

While fuel is the primary economic driver for most FBOs, there is a drastic variation between an FBO's gross revenue and net revenue. There are many expenses that are often overlooked. There are many "customers" of an FBO that are really just "loiterers". In other words, they hang out in the FBO and drink coffee, eat popcorn and cookies, and talk to staff (and each other), without buying anything. Even if they buy fuel, it is often in small amounts that may actually cost an FBO money to serve them. (Note: A typical FBO must sell a minimum of about 20 gallons per uplift to begin making a profit.) If your airport is pondering getting into the FBO business, look carefully at the reasons why you are considering this direction, and make sure you can actually do it cheaper and better.

Management Agreements

Although the statements herein would tend to lead you to believe that we do not support airport-run FBOs, that is not always the case. There are certainly a number of situations that dictate an airport-run FBO may be in the best short and long-term interest of an

airport. This usually relates to a situation where the annual fuel volumes at an airport are less than 500,000 gallons. Volumes below this threshold usually indicate that insufficient profits will be available to support a private operation, unless the FBO is primarily focusing on other revenue-producing services.

However, there is another alternative that is beginning to gain notice in the industry: FBO management agreements. Management agreements are currently found in a variety of different forms at several airports across the country. From parking operations to security, many airports have contracted with private firms to alleviate themselves from operational headaches and to draw upon the private's firm efficiency and expertise. The financial arrangements can range from a flat annual fee to an agreement with incentives such as profit sharing. Benefits of these type of agreements can be applied to FBOs, as well. A management agreement with an FBO can sometimes provide an airport with the flexibility and control that it does not have with a n operator under a lease/operating agreement, or even an airport-run FBO. An FBO management agreement can be tailored to the individual airport to enhance customer service, increase revenue, or even limit liability and risk.

Several airports have ventured into this territory recently, most often to gain control over pricing and service levels offered by the FBO. Most often, commitments are short-term (about 5 years), providing the airport with the flexibility to modify terms and conditions after an initial "trial run" with an operator. This scenario may be beneficial at your airport; however, it is important to understand some of the shortcomings typically realized in these arrangements.

1) Airports are usually responsible for all capital investments both before and during the agreement, since the operator will not have adequate time to amortize any significant investments;

2) The quality of operators to choose from in an RFP process may be more limited because many FBOs

will avoid agreements that limit their upside financial potential;

3) The airport may be forced to "start over again" after the initial term (which could be a positive or negative);

4) Under a management agreement, the risk is shared between the airport and operator, which may inhibit actual returns;

5) Finally, there will possibly be on-going tensions about the operator's pricing structure and management style, because the airport has a direct stake in the success or failure of the operation.

All in all, before the airport decides to try the FBO industry, enter a management agreement, or sign-up for a long-term lease/operating agreement, make sure that you weigh all of the options and choose the best alternative for your airport which limits liability and risk, allows you the ability to react quickly to market changes, maximizes the available marketing dollars, and improves customer service. Without examining all the options, the airport may not be as efficient or effective as it could be.

Joke of the Month

A man, his wife, and his mother-in-law went on vacation to the Holy Land. While they were there, the mother-in-law passed away.

The undertaker told them, "You can have her shipped home for \$5,000, or you can bury her here in the Holy Land for \$150.00."

The man thought about it and told him he would just have her shipped home. The undertaker asked, "Why would you spend \$5,000 to ship your mother-in-law home, when it would be wonderful to have her buried here and spend only \$150.00?"

The man replied, "A man died here 2,000 years ago, was buried here, and three days later he rose from the dead. I just can't take that chance."

FUEL FLOWAGE FEES

By Michael A. Hodges, MAI, President and CEO

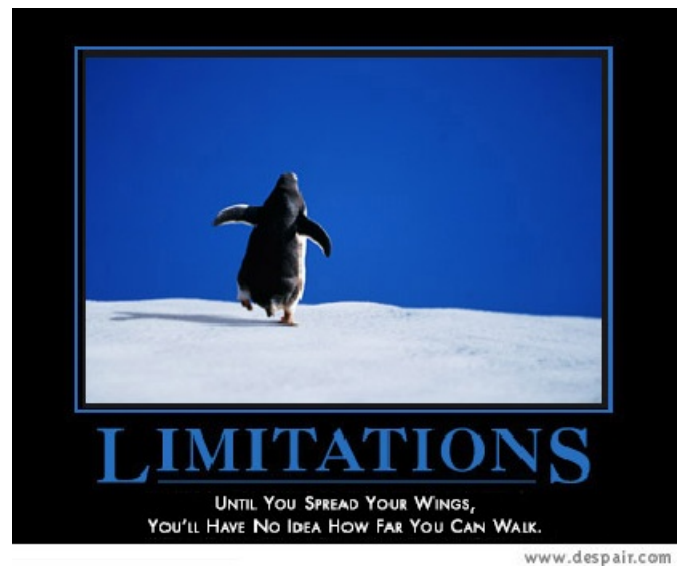
Fuel sales are generally the “bread and butter” of an FBO, and the fuel flowage fee (associated fees paid to the airport which are tied to fuel sales) can potentially have a significant impact on an FBO’s success. As important, it can also impact an airport’s ability to maximize revenues from this source.

The general concept is that a flowage fee is a business-related expense, similar to other charges that are not directly tied to the real estate. Like percentage rents, fuel flowage fees are associated with an FBO’s right to operate a for-profit business on the airport. Ground rents, facility rents, etc. are associated with the right to occupy real estate on the airport. As such, just like land and facility rents must be evaluated to ensure their consistency in the market, fuel flowage fees also need to be analyzed to determine their reasonableness and impact on the ability of the FBO to make a reasonable profit from the sale of fuel. As noted in the previous article, there is a vast difference between the “gross revenue” derived from the sale of fuel and the “net revenue” eventually generated. In addition to the cost to buy the fuel, the costs associated with personnel, trucks, insurance, maintenance, credit card fees, etc., must be considered as part of the expense of selling fuel.

Because the fuel flowage fee is typically “passed-through” directly to the customer, the amount of the fee added to the price of fuel, taxes and profit can negatively impact potential customers. Although market considerations always influence the ultimate retail price of fuel, excessive fees as compared to competing airports can eventually influence pricing structures. FBOs not only compete locally but regionally, as well. Moreover, based upon the capabilities of an aircraft, they may also compete nationally. Because most airports establish a fuel flowage fee at a “non-negotiable” rate, an atypically high fuel flowage fee not only impacts the FBO, but also may affect the revenue stream of the airport. If a fee is too high, and the FBO feels that they are unable to absorb the excessive portion of a fuel flowage fee, then the ultimate price of the fuel may

be pushed to a level where maximum quantities of fuel are not sold. This is especially true with FBOs that impose ramp/handling/service fees, where the fees are usually weighted against minimum fuel purchases. As a result, sometimes it is more profitable for an FBO to charge a ramp/handling/service fee, as opposed to maximize the sale of fuel.

In summary, it is imperative for airport management to take the time to learn and understand the issues faced by FBOs relative to the sale of fuel in order to provide a maximize the FBO’s growth and prosperity, which ultimately spills over to the growth and prosperity of the airport.



ASK ABS

In each issue, we have included a section called "Ask ABS", where we request aviation-related questions from our readership. Each month we publish one question that we receive from our readers with a joint reply from our professional consulting team. Even if your question is not selected, all questions submitted will be responded to via e-mail. Please submit a question by e-mailing Mark Davidson at the following: mdavidson@airportbusiness.net

Ironically, this month’s question was related to fuel flowage fees, and came from Bill Towle, Director of the St. Cloud Regional Airport in St. Cloud, Minnesota. Bill asks: *In your Basics of Small Airport Management Workshop I attended, you talked about*

the fuel flowage fee being used as a type of landing fee for GA aircraft. I thought I heard you say that if we are charging the air carrier a landing fee, then we cannot charge them a fuel flowage fee because this would be double-dipping.

I can't find it in my notes, but is this true? If so, is it written in any FAA publication?

Bill, there is no FAA regulation or rule anywhere (to my knowledge) that says you cannot charge a fuel flowage fee *and* a landing fee to an airline serving your airport. The fuel flowage fee was originally created as a fee in-lieu of landing fees for general aviation aircraft. It was determined that charging landing fees to general aviation aircraft ultimately cost more to implement than was collected. The volume of GA activity is generally much more significant than air carrier traffic, and it often comes and goes before anyone has the chance to collect a fee. Moreover, often the level of the fee is such that it does not make economic sense to go after it. However, the fuel flowage fee is a good way to collect fees for use of the airport from GA traffic, primarily because it is easy to administer and collect through the FBO that provides the fuel.

Most airports do not charge fuel flowage fees to air carriers, primarily because they get landing fees from them. Basically, the reason for landing fees or fuel flowage fees is to make sure that everyone that utilizes an airport contributes in some way to the maintenance and operation of the airfield. However, there are some airports that have elected to collect both, and there is nothing wrong with that conceptually. However, if you do charge both, you need to make sure your cumulative fees are not excessive to the level that it serves to minimize an airline's incentive to serve your market. Basically, it comes down to what the market will bear, and only you know what the "threshold of pain" is at your airport.

"A MUST TRY **HOLIDAY** RECIPE"

Here is a chicken recipe that also includes the use of popcorn as a stuffing. When I found this recipe, I thought it was perfect for people like me, who just are not sure how to tell when poultry is thoroughly cooked, but not dried out. Give this a try.

BAKED STUFFED CHICKEN

6-7 lb. Chicken
1 cup melted butter
1 cup stuffing (Pepperidge Farm is good.)
1 cup uncooked popcorn (ORVILLE REDENBACHER'S LOW FAT)
Salt/pepper to taste

Preheat oven to **350** degrees. Brush chicken well with melted butter, salt, and pepper. Fill cavity with stuffing and popcorn. Place in baking pan with the neck end toward the back of the oven. Listen for the popping sounds.

When the chicken's ass blows the oven door open and the chicken flies across the room, it's done.

Airport Business Solutions is recognized as the leader in providing valuation, analysis, and consulting services to airports and aviation businesses, and offers a diversity of backgrounds and experience which provides a new, creative, and "outside the box" perspective on a myriad of aviation issues and problems.

In addition, our international affiliate, Airport Business Solutions International (ABSI), has helped numerous airports worldwide with a variety of airport management and operational issues and problems. Problems at international airports are no different from those experienced at airports in the U.S., and the diversity of experience and breadth of knowledge of ABSI has been valuable in achieving comprehensive solutions.

For More Information

Michael A. Hodges, MAI
President/CEO
Airport Business Solutions
10014 N. Dale Mabry Highway, Suite 101
Tampa, Florida 33618
Phone (813) 269-2525
Fax (813) 269-8022
mhodes@airportbusiness.net
www.airportbusiness.net