

## CASE STUDY

# How to Turn a Profit from Airport Operations



Incheon International Airport is considered a model of best practice in airport operations. Photo credit: Edwardson Brian M. Manuel/ADB.

*Though a state-owned enterprise, Incheon International Airport is run like a private business, earning enough money to fund its expansion.*

## Overview

One of the world's largest and busiest airports, Incheon International Airport is highly rated for the quality of its facilities and services. The Republic of Korea has been modernizing and expanding the airport since it opened in 2011, positioning it as a major transport hub in Northeast Asia.

Though owned by the government, Incheon airport can operate and manage itself autonomously like a profit-oriented enterprise, one of the success factors behind its high service quality and profitability. This setup has enabled continued expansion with minimum government subsidy.

Other factors include policies that promote competition, harmony, outsourcing, and efficiency in operations.

This case study is adapted from [Incheon International Airport: Its Success and Implications for Developing Countries](#) of K-Developedia, an initiative of KDI School of Public Policy and Management.

# Challenges

The government decided to build a new international airport for the Seoul metropolitan area because the existing Gimpo International Airport had reached capacity by the late 1980s with no room for expansion due to geographical constraints. However, policy makers had to resolve conflicts and resulting trade-offs, which is usually the case for big investment projects.

In the Republic of Korea, as in other countries, equitable development across provinces has been a sensitive political issue. While local governments have not participated financially with investments in local airports, the central government has built three new airports and remodeled others to increase their capacities while simultaneously building Incheon International Airport. It invested nearly the same amount in local airports as it has in the Incheon airport. Yet many of these local airports struggle with excess capacity after losing traffic to the high-speed rail (KTX) and highways. This has resulted in a huge trade-off between equal development among regions and efficiency of resource allocation.

In addition, there is conflict between Gimpo International Airport and Incheon International Airport, which both serve the capital, Seoul. Although the Gimpo airport is much closer to central Seoul than Incheon and has enough excess capacity to accommodate a few more international flights, the government has been reluctant to grant licenses in order to maintain Incheon International Airport as a hub airport. The conflict resolution and trade-off between efficient use of infrastructure and promoting a hub airport is an important issue for the government.

# Context

Gimpo International is conveniently located near Seoul's center, but it had disadvantages. In addition to proximity to the Democratic People's Republic of Korea and mountains constraining physical expansion, nearby residential areas prohibited 24-hour operation because of noise restrictions.

It took more than a year to find a suitable location for the new airport. An ideal site was selected close enough to Seoul and with low construction costs, no problems with noise, and capacity to expand. The location was initially criticized for being 58 kilometers from the center of Seoul. The problem of distance was overcome by building an exclusive highway; an airport railway was constructed later.

Construction of Incheon International Airport began in 1992, and it opened in 2001.

# Solutions

The government has been able to solve conflicts among various transport modes and airports by minimizing government subsidies to the airport. This was made possible by the airport's high profitability.

## Tapping private financing

The government provided up to 40% of the \$8 billion needed to construct Phases 1 and 2 of the airport;

the remaining 60% was funded by Incheon International Airport and private companies, including airlines and construction companies. The airport funded Phase 3 by itself without any government subsidies.

Incheon International Airport has a higher credit rating than the government, owing to its high operating profit ratio of more than 60%.

There have been limited private investments in the airport's development. These include a few build-transfer-operate projects, such as cargo terminals built by Korean Air, Asiana Airlines, and DHL. There are two cases of foreign investments in the airport's development. One is German-based DHL's cargo terminal and the other is Australian financial company Macquarie acquiring a partial stake in the Incheon Airport Highway Corporation.

The main reason the government allowed private companies to build terminals and invest in auxiliary businesses is that the central government faced budget constraints and wanted to give investment opportunities to facility users. Consequently, the government periodically allows concession holders to invest in the building of their own facilities.

### Single-till management system

Airside charges, including landing fees, can be cross-subsidized by the high profits from landside and be kept relatively low.

The single-till managing system has made it possible to charge low landing fees and other airport user fees. For instance, the landing fee at Incheon is only 30% of that charged by Kansai Airport in Japan. The low aeronautical charges have helped Incheon airport attract airlines, flights, and passengers. Its passenger terminal's earnings are high enough to compensate for the airside losses.

### Outsourcing and a tendering system for space rental

Outsourcing routine daily airport maintenance work and leasing commercial space to private businesses through a tendering process are important sources of efficiency and profitability for the airport.

Outsourcing enables a large entity like the Incheon International Airport to be managed conveniently and achieve cost efficiency by employing a relatively small number of people.

However, the outsourcing of maintenance work is being criticized as a violation of the rights of workers. The government is trying to transition these jobs into regular positions for in-house employees.

Private companies provide many services at the airport, such as ground services, concessions, and operation of the cargo terminal. A tendering system is used to rent space to duty free shops and other concessions. This has resulted in high profits and efficiency in the airport's operation and management. The airport provides relatively new and advanced facilities and equipment required by airlines for flight operations and ground services in and around the airport at reasonable prices.

## Supportive policies

Among the policies adopted by the government are to promote competition, privatization, and harmony. To encourage competition, two different airport entities were established: Incheon International Airport Corporation and Korea Airport Corporation. Both were designated as market-based public corporations in order to enhance efficiency and profitability through autonomous management. This has led to allowing these airport corporations to pursue profits like private companies.

Under its “Policy of Harmony,” the government originally designated Incheon airport for international operations and Gimpo airport for domestic routes. But as GIA has better access to central Seoul, the government allowed airlines to operate a few international flights from Gimpo to Tokyo, Osaka, Beijing, Shanghai, and Taipei, which are major cities in neighboring countries located within a 2,000-km radius from Seoul. Making connections between Gimpo and Incheon airports is relatively easy thanks to good road and rail transportation links.

There is also harmony between air transport/airport policies and the country’s 5-year development plans, which ensure consistency in policies.

## Results

Incheon International Airport has received world recognition for the quality of its services. It is among the top 5 largest airports in international cargo and passenger transportation.

The airport also ranks high in terms of profitability. It has an operating profit rate of 60% from total revenue of \$1.9 billion, and its net profit ratio of 44% yielded \$841 million in 2016. Non-aviation revenue accounts for 64% of total revenue. Rental income from duty-free shops in the passenger terminal is the biggest revenue source, making up almost 60% of non-aviation revenue.

In 2019, the airport announced plans to further expand its facilities to accommodate a hundred million passengers annually by 2030.

Given its track record, the Korean airport is seen as a model of best practice by other countries. The airport has provided technical consulting services to other airports, which include airport master plans, evaluation of economic/technical feasibility of airport projects, and operations and construction know-how since 2009.

## Lessons

Success factors include the government’s airport hub strategy, single-till management strategy, competition and outsourcing, and close cooperation between customs, immigration, and quarantine agencies. Besides these, the most important thing in an airport project is deciding where to build the new airport, and secondly, who will own it and how it will be operated.

Another key factor in the case of the Incheon airport was the selection of an ideal site, which provides space for expansion. Policies that promoted competition and outsourcing while maintaining government ownership also ensured the sustainability of airport operations.

## Resources

K-Developedia. [Incheon International Airport: Its Success and Implications for Developing Countries](#) .



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### K-Developedia



K-Developedia is an open access repository established to allow easy access to resources on the Republic of Korea's 70 years of development experience. It targets decision makers in developing countries and researchers in the development field.

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