

## **“Non-Aviation” activities and the introduction of new thinking and ideas in the airport business: Empirical evidence from an Italian case study**

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### ***Abstract***

***Purpose:*** This paper aims to describe the main changes occurring in the airport industry with particular attention to the increasing relevance of the non-aviation activities. In fact, during the most recent decades, the airport business has evolved into a dynamic and competitive industry. In order to reduce their deficits airport management policies have progressively favoured the commercial aspects in order to produce greater profit margins. In many countries, greater management elasticity in business administration has occurred, and important modifications have been introduced in the national and international regulations according to a market oriented perspective.

***Design/methodology/approach:*** The method used is the case study approach and the analysis utilizes empirical data originating from the airport in Olbia.

***Findings:*** Findings show how the choice to invest in the non-aviation sector can be ascribed to the strategic orientation adopted by airport managers.

***Originality/value:*** Empirical evidence can highlight certain trends in the industry, whose values can lead to a core definition of the new paths of development for the airport

business to follow in the non-aviation dimension, and identifying at the same time innovative business ideas for opening up new market scenarios.

**Keywords:** airports, non aviation activities, business ideas, case study

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## 1. Introduction

Airport-related business during the last decades has been substantially transformed into the reality of a dynamic and competitive industry. In effect, the industry has faced a number of changes that have produced a substantial redefinition of how and what the business sector – seen as a whole – is attempting to achieve in its goals.

In this sense, many attempts have been made to reach an appropriate model for the airport business to support growth and development of infrastructures which have suffered significant deficits in the past (Gillen, 2011; Graham, 2008; Asheesh & Sandford, 2001; Jarach, 2001).

In many countries, greater elasticity in managing business operations has been legislated and important modifications have been introduced in national and international regulations according to a market oriented perspective (Gillen, 2011; Graham, 2008; Doganis, 1992).

Undoubtedly, one of the main innovations refers to the growing attention given towards the development of the “non-aviation” dimension in the context of general airport business activities.

Since 1978, with entry into law of the Airline Deregulation Act, with jurisdiction over the aviation industry in the USA, great changes were generated with regard to business operations and significant innovations were introduced regarding management of airport systems.

In the European region, another question addressed by airport companies has been the policy of integration finalized in the creation of a common market. The removal of political and commercial boundaries, indeed, caused many problems for operators regarding their operational scenarios.

In addition, catastrophic terroristic events, such as the attack on the "Twin Towers", together with other global phenomena, such as SARS, have imposed special attention on one hand to security systems and on the other to encouraging and promoting a sense of trust among travellers.

Airport-related activities also, face the challenge of coordinating the number of commercial ventures that exist around the core business and that can enable it to develop a systemic relationship with various stakeholders.

Graham (2008) summarizes in three key points the changes that have occurred recently in airport management:

- Expansion of commercial activities
- Privatization processes
- Diversification of ownership

In Italy, these effects have had a significant impact on the deregulation and privatization of the industry (Sebastiani, 2004).

The paper proceeds as follows: Section 2 provides a short overview on non-aviation activities in the airport industry; Section 3 briefly describes the Italian airport system; Section 4 discusses aims, methods and a hypothesis originating from research; Section 5 shows the resulting empirical evidence from a case study analysis; Section 6 includes some preliminary conclusions.

## **2. "Non-Aviation" activities in the airport business: A brief overview**

In literature Doganis (1992) defines the airport as a complex of assets (runway, buildings, plant and equipment) enabling the development of air transport for passengers, cargo and mail.

According to Jarach (2001), "In recent times, industry's best-in-class practices have tended to move away from the classical mono-modal approach, where airports struggle between each other and other modes of transportation to increase the weight of their secondary demand, in favour of a new strategic model of management".

The relevance of the non-aviation component regarding airport revenues and their regulation (Kratzsch & Sieg, 2011) is a well-established issue in literature. Zhang

and Zhang (1997) point out how the percentage of total airport revenues represented by non-aeronautical or commercial components is continuing to grow. Presently, among the wide range of airport activities, the most important services are operational, traffic-handling and commercial (Kramer, 2010; Morrison, 2009; Reiss, 2007; Bork, 2006).

More specifically, in fact, airport management has faced a radical transformation in the sense of a redefinition of the business operational limits in order to focus their efforts on the activities outside the core business, i.e. on the "non-aviation" activities.

Starting from these considerations, the element of interest, therefore, is the dynamic aspect of management, relating to the exercise of infrastructure development and the various activities that have become connatural to the demand growing in differing market segments.

Some descriptive data offer a quick snapshot of the relevance of this aspect. According to the 2010 ACI report, the worldwide total airport income in 2009 reached USD 95 billion, whereas aeronautical revenues accounted for 53.5%, and non-aeronautical revenues made up 46.5%. Non-aviation revenues (NAR) rose by 3% in 2009, driven by the retail sector (+2%), real estate (+10%), car rental concessions (+9%) and food and beverage (+7%). In Europe, ACI-Europe (2010) shows that the revenues of European airports, in the last decades, have shown a gradual increase in the non-aviation category, reaching 12.1 billion euros (47% of total revenues) in 2009. Such figures show how NAR represents a vital component in airport management and can determine their financial viability especially in a downturn period, since they generate higher profit margins than aeronautical activities.

This transformation cannot be approached exclusively to achieve higher profits, but also to rationalize the whole system that needs to find a balance between economic and public interests.

Graham (2009) states that "within each global region and each country, commercial revenues will vary according to a multitude of factors [...] These factors will directly depend on whether the airport adopts a 'single till' approach, encompassing all revenues when aeronautical charges are set or whether it uses a 'dual till' when aeronautical and commercial activities are treated as separate financial entities".

"Airports are keen on using their commercial revenues – says Abeyratne (2001) – to help cover the costs of huge investments being made on infrastructures improvement. However, the 'single till' approach, which is widely used and takes into account both charges imposed on airlines and passengers for using aeronautical services and income derived from non-aeronautical activities as a single income source when setting charges, has been criticized as creating a cross subsidy whereby profits from commercial activities are used to offset aeronautical costs".

The transport sector is indeed affected by profound changes and is gradually losing its traditional image of a protected and monopolist business, because of modifications caused by European legislation that impose the principle of the "open market" in which different legal entities are forced to compete in terms of effectiveness, efficiency and profitability, addressing in a more flexible and timely manner the new required demands originating from the aviation sector.

The importance of change in these forms does not concern the legal framework, but rather the evolution of productive capacity and dynamic management in a context that is free from cumbersome procedures of public administration and in which, using the know-how of private entrepreneurship, one can create a virtuous circuit also for creating employment opportunities.

It is increasingly clear that a redefinition of the air transport business must necessarily deal with a new "business idea", designed to facilitate the structural integration of the airport company in their product and market system in order to reach more effective levels of competitiveness and efficiency.

Paraphrasing Richard Normann, the emerging "climate of operative tension" in a business context which removes or exploits eventual "disfunctions" occurring in a company's daily functioning may result to be, in effect, an important "driver" from which a climate for new business ideas is formed.

Truitt and Esler (1996) observe that increasingly, non-aviation activities at airports are being autonomously managed by separate companies under management contracts, often as an alternative to privatization through divestiture.

In this paper, after a short presentation describing the Italian airport industry, we will discuss - in the light of empirical evidence - possible solutions to be implemented in the relevant business context in which the existence of

“spontaneous driving forces” can lead to a redefinition of corporate strategies, focusing particularly on the growth of the “non-aviation” dimension.

### **3. The airport business in Italy: Different modes of business administration**

A brief overview of the normative characteristics of the Italian airport managing systems is important to better understand its particular features that led to the reform of airport business procedures traced back to the Legislative Law Decree 537/93. This act defines the principles of an airport management system in which the private sector represents specific interests and asserts its relevance to ensure the further development and modernization of determinate infrastructures. The economic and legal models created to boost the privatization process also aim at standardizing different modes of governance within the various existing forms of management.

Until the introduction of this reform act came into effect, the previously differing forms of management were:

- Partial concession (the airport company is responsible for the non-flight airport infrastructures. The company provides services for aircrafts, passengers and freight while the Government administrates the flight infrastructure)
- “Precarious” partial concession (in which the company of interest, during the time dedicated to the completion of the convention and the subsequent pending ministerial decree, receives in advance the possession of various properties from the airport entity in order to continue functioning under a partial concessionary set-up)
- Total concession ‘by special-law’ (the airport company is responsible for the development of the complete infrastructure)
- Direct management (the ENAC, the Civil Aviation Authority directly ensures the organizational and maintenance needs of airport assets).

In contrast, the reform act itself states that the mode of total concession is the version that must replace the various types of existing management (i.e. partial or precarious).

Therefore, the need to delegate management to a single operator in accordance with private rules oriented to flexibility is imperative.

According to this view, the concession of total management to limited companies is consistent with a new concept of the airport entity, seen now as a modern enterprise that interfaces with a variety of activities and develops its considerable economic potential at the same time giving more attention to passenger needs, a characteristic which has come to play a "central role" in the air transportation system.

In essence, under this model the concessionaire plays the role of the investor to whom is delegated the reinforcement of the entrepreneurial capacity of the infrastructure.

Actually, in some circumstances, the extreme delay in the implementation of this reform has frustrated expectations from the public sector.

During the implementation of the privatization process, it is still the government's responsibility to intervene and ensure, through a normative provision, the resources needed for successive phases developing airport facility improvements.

Therefore, we can say that the design of the reform plan resulting from the previous system is still functioning.

In the light of the framework discussed so far, management of Italian airports as outlined in their various organizational characteristics is as follows:

- Partial concession (Albenga, Ancona, Asiago, Bolzano, Brescia, Crotone, Cuneo, Forlì, Grosseto, Lucca, Oristano, Padova, Parma, Perugia, Reggio Calabria, Reggio Emilia, Rimini, Salerno, Siena, Trapani, Treviso, Venezia "Lido", Vicenza)
- Total concession "by special law" (Roma "Fiumicino e Ciampino", Milano "Linate e Malpensa", Venezia "Tessera", Torino "Caselle", Genova and Bergamo)
- Total concession ex D.M. 521/97 (Bari, Brindisi, Foggia, Bari, Napoli, Firenze, Olbia, Bologna, Pisa, Cagliari, Catania, Palermo, Trieste "Ronchi dei Legionari", Alghero, Pescara, Verona "Villafranca" and Lamezia Terme)
- Direct management (Lampedusa, Pantelleria, Roma Urbe and other small airports).

Regarding the debate on varying airport management infrastructures Asheesh and Sandford (2001) and Carney and Mew (2003) have offered an important contribution.

The ownership of the airport companies has assumed various configurations in differing countries and in relation to appropriate normatives and regulations.

It can be argued that the different ownership structures have been developed within a continuum transformed from public to private ownership.

In the following way it is possible to identify structures:

- Owned totally by public sector (with direct control by the State or by the Authority)
- Mixed owned by public and private sector
- Owned totally by private operators.

In the case of Italian airports, the various companies' ownership characteristics outline how the share capital is mostly the property of local authorities for instance, municipalities, Chambers of Commerce and in only a relatively few cases by private shareholders (ENAC, 2010).

#### **4. Aims, hypothesis and method**

Through this study we are attempting to understand if and under which conditions the non-aviation dimension can be considered as a strategic business unit in order to support the long-lasting competitiveness of the airport system as a unified entity.

Accordingly, this paper aims to address this issue through an explorative approach analyzing one particular Italian case study. This analysis is of particular interest when the country under study – in this case Italy – is characterized by a heterogeneous situation in reference to inherent airport characteristics (for instance, for passengers traffic volume, mix of low cost and traditional carriers operations, etc.) and lower non-aviation revenues than existing worldwide.

However, in this context, relatively few studies exist. Abrate and Erbetta (2010) show how economic concerns can have a strong connection with changes in airport organization, involving in particular outsourcing of handling operations and

development of commercial activities. Curi, Gitto and Mancuso (2008, 2011) in their first study investigate airport efficiency and in the second, they separate the factors of efficiency related to the ability in managing airside activities (operational) in contrast to factors relating to the management of a complete range of financially-related business activities.

The analysis utilizes empirical data originating from the airport in Olbia. These analyses represent interesting "laboratories" for data information implemented through the adaption of a market-oriented approach to business development.

The study's hypothesis is that a well-organized non-aviation sector can contribute significantly to boosting growth of overall airport business. In this sense, the related hypothesis is that the development of an efficient non-aviation dimension can be useful in dealing with economic and financial issues related to general air traffic business.

The methodological approach utilized here is the case study analysis (Yin, 1994).

In the selection of case studies for this research project, we have used a non-probabilistic (judgmental), sampling technique. We also utilized so-called "purposive sampling", often used to obtain illustrative outlines of specific realities through the use of particularly representative cases (Saunders, Lewis & Thornhill, 2003).

The study was carried out and the relevant analysis performed with data directly gathered from the Olbia airport website, and through analysis both of financial reports and semi-structured interviews. The utilization of interviews enabled us to confirm the analysis of the collected data.

Thus, in order to test the assumptions of this study, we carried out research based on secondary data analysis. Which in particular refers to "documentary secondary data" that include consolidated and single balance sheets of the selected company, airports' traffic data and annual statistics. The main sources are the websites of the airport company, Assaeroporti (the Association of Italian airports companies) and ENAC (the National Aviation Authority). This choice reflects the positive assessment of data validity (Cowton, 1998).

The main advantage of using secondary data is the enormous saving in resources and the possibility to analyse a larger data set.

In order to contrast potential biases and to support measurement validity particular attention has been paid to the selection of sources. In fact, obtaining data collected for other specific purposes can represent a disadvantage in research or inappropriate responses to the questions that are raised.

## **5. Olbia - Costa Smeralda's airport case study**

### **Introduction**

GEASAR S.p.A., Olbia Costa Smeralda's company airport, founded in 1985, initiated its operations in March, 1989, after receiving authorization from the Italian Ministry of Transportation.

In October, 2004, after 15 years of operations, the company received a forty-year concession for acquiring total management of the Olbia airport.

At the same time, the ENAC also issued a "Certificate of Airport" under the "Rules for the construction and operation of airports" adopted by the Board of ENAC in October, 2003. This document certifies the airport operations and provides continuous control processes related to its security.

Currently in Italy, the Olbia airport is the first-placed airport among those of its category to receive this certification.

Within the theoretical framework as defined above, the airport company in question is probably exemplary in adopting an innovative strategic policy in managing its business, establishing new thinking and elaborating fresh business ideas by reconfiguring the boundaries of the business in a more decisive manner, and also by further developing non-aviation activities in order to ensure its economic survival and infrastructural development.

From a methodological point of view, the approach followed for this research project has favoured the selection of only a single case example.

It is clear that research based on multiple cases is often considered more effective and hence the entire study is considered more robust. However, at the same time it is clear, too, that the rare case, the critical case and revelatory case are more likely to be considered as individual cases.

The previously stated insight does not preclude a necessarily resulting generalization of findings (although not on statistical grounds) if it is compared to situations with similar characteristics.

### **Company Profile**

GEASAR is a company belonging to the "Meridiana Group" (2010). Its business model is based on the development of an "integrated tourism" offer by encompassing air transport, management of airport services and the organization of travel arrangements and accommodations.

Shareholders consist of: Meridiana SpA (79.8%), Chambers of Commerce of Sassari (10%) and Nuoro (8%), Sardinia Region (2%) and Consortium Costa Smeralda (0.2%). GEASAR has a total control (100%) of Eccelsa srl and Cortesa srl.

The level of revenues for the year 2010 amounted to 30,403,000 Euros and the employment level is 222.6 equivalent units on an annual basis. The incidence of non-aviation revenue is approximately 44% of the total.

Belonging to a corporate group, of course, involves significant impact on the strategies Olbia's airport management must define and further develop as integral part of its activities. GEASAR pursues several objectives:

- Planning the development and the realization of airport infrastructures
- Managing airport infrastructures according to criteria of effectiveness and efficiency
- Promoting regional development.

Referring to main data traffic, the airport is positioned, according to 2010 data, at the 17<sup>o</sup> place for aircraft movements and at the 27<sup>o</sup> place for total cargo transported.

### **The "Non-Aviation" Dimension**

After signing the forty-year period contractual concession, the company confirms its role as operator of the total operational and management activities at the Olbia airport.

Among the main activities emphasized are: the management of handling services (Eccelsa Aviation srl) and the management of commercial activities directly through Cortesa srl and indirectly through sub-concessions.

In accordance with the strategic business development plan, GEASAR will pursue contemporary development of "aviation" and "non aviation" activities.

The level of Italian tariffs determines the profitability of financial loss in the supply of aviation services. This also exerts strong pressure on the financial and profitability structure of airport companies, and prevents the airport from self-financing its own development.

Consistent with this assertion and with the objective to diversify its business, the company has launched a series of investments in equipment and infrastructures to improve services and non-aeronautical activities.

Precisely to meet this need, for example, it has developed the MBC (*Meeting and Business Center*). The MBC is an initiative in collaboration with SPS s.r.l (*Sviluppo Performance Strategie*), to support the business operations of private and public companies, and offers services in training and organization of appropriate meetings and conferences.

An opportunity is also created in further infrastructure investment for the construction of a new terminal, permitting - among other things - the enlargement of spaces assigned to sub-licensees and start up enterprises such as a restaurant targeted to a high-level segment of travelling clientele.

In addition, presently two new commercial initiatives for *food and beverage* have been activated: the self-service restaurant for airport operators and a wine bar in the commercial area of the passenger terminal.

Inside the airport, the company hosts - to encourage the growth and expansion of the tourist culture while also promoting the development of economic and social enterprises - a degree course in "Economic and Business Tourism". This initiative has been widely approved by professionals operating in the sector, and it is a concrete example of promoting integration between the airport, the university and citizenry of the local community.

As far as the aeronautical aspect is concerned, the subsidiary, Eccelsa Aviation s.r.l., obtained in May 2008 the important "Certification service provider of ground

handling" (handler). The company achieved, among other things, a prestigious award in 2009 in the private aviation industry, ranking it among the best companies in the international area in terms of quality and service.

Recently, GEASAR internalized maintenance activities, management of airport infrastructures and systems, previously assigned to other companies, to integrate executive and functional know-how that is considered strategic to its promising potential.

The management of GEASAR, in 2008, developed in collaboration with the Sardinia Region, a series of contacts foreseeing the creation of an airport in northern Sardinia for the realization of synergies in aspects of management and market development.

### **Concluding remarks**

The case study analysis seems to show how the creation of new business ideas is necessarily the result of a process of knowledge development (learning) allied to management's ability to interrupt the conservative mind-set. In fact, the most crucial competence in the service economy concerns the implementation of a good systems of value creation aimed at redistributing capabilities to increase value (Normann & Ramirez, 1993; Normann, 2001; Gadrey, 2005). This new attitude represents the cornerstone of innovative strategic management.

Reconfiguration of the business that occurred in GEASAR shows the dominant character of a *prime mover*. The "prime movers" are companies or organizations that imagine and realize that untapped or underutilized links can be released to co-create innovative value if they are better organized. These enhance value creation through reallocating capabilities, getting them to work together more effectively, and ensuring the client benefits by becoming a more effective value creator. In doing so, they can change the playing field and the rules of the game in a strategically profound way (Ramirez, 1999; Ramirez & Wallin, 2000).

The "prime mover" is also represented by those persons who rather than focusing solely on their core competencies, can develop more fundamental abilities, by mobilizing and managing external actors and the relevant skills that they bring to the workplace.

Ultimately, they represents those persons - at any level of the organization - who are able to develop "an integrated model bringing together others with perhaps dissimilar assets and skills, who can still coalesce as a team aimed at building a new and effective system of value creation" (Normann, 1974, 2001).

## **6. Preliminary conclusions**

In conclusion, it can be argued that the case study analysed envisages a possibly beneficial solution to one of the current problems of airport operators, discussed above, that relates to the systematic governance of the diverse activities taking place inside the airport and in the coordination of the various responsibilities on the part of different stakeholders.

In this perspective, it seems appropriate to say that the managers of the company in question have been able to find a way to overcome the difficulties inherent to these realities, and have been able to define an appropriate conceptual framework within which to allocate airport business.

Furthermore, it is evident that the role of the non-aviation dimension, as shown in the development of the case study, assumes a particular significance in the point of view of a complete reconfiguration of terms regarding airport business efficacy.

In this sense, our considerations seem to be consistent with Morrison's (2009) analysis regarding non-aviation activities.

In particular, Morrison argues that "the attractiveness and impact of non-aeronautical activities at commercial airports varies naturally according to the business opportunities defined by land, location and assets. [...] The degree of competition between airports is likely to encourage the development of complementary non-aeronautical businesses [...]. The development of these businesses can have differing impacts on aeronautical fares and infrastructure investment depending on the governance structure of the airport".

Finally, the case study analysis can highlight certain trends in the industry, whose values can lead to a core definition of the new paths of development for the airport business to follow in the non-aviation dimension, and identifying at the same time innovative business ideas for opening up new market scenarios.

Empirical evidence strongly suggests that the choice to invest in the non-aviation sector can be ascribed to the strategic orientation adopted by airport managers. In

this sense those companies which appear to be "satisfied" by what they gain from traditional activities should begin to think about the opportunities to expand the profits of airports also by extending commercial activity offerings. This hypothesis seems an interesting direction to undertake for future research.

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