

Prepared for TRX by PhoCusWright Inc.
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Navigating the Turbulence of Airline Ancillary Fees

Introduction

Historically, airlines have, for the most part, sold a single product – a seat. The price of the seat was based on the cost associated with getting a passenger from point A to point B, and included all the related surcharges, taxes, services and fees associated with that specific seat. This simple pricing structure gave travel managers transparency into the cost of air travel on any given carrier at any time.

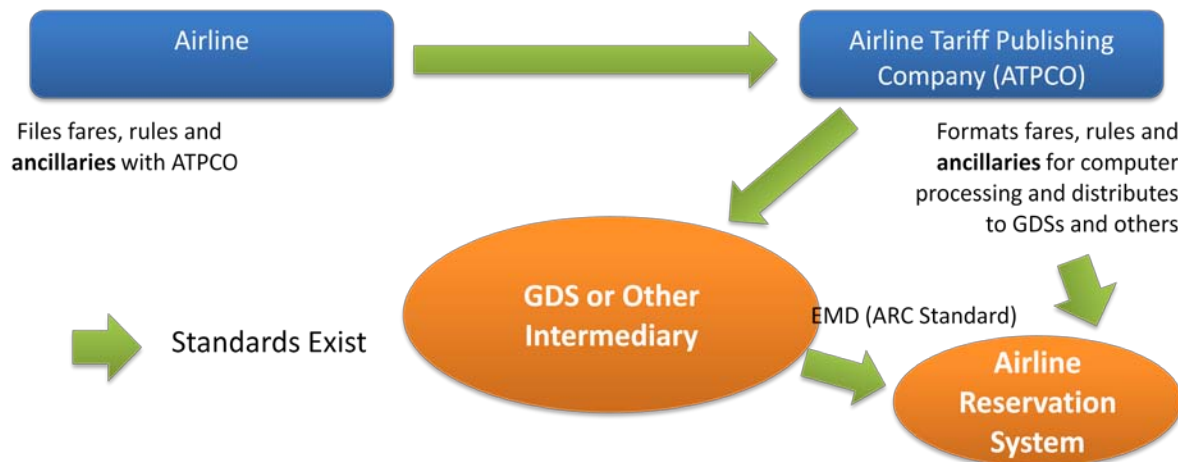
Visibility became polluted when U.S. airlines, buoyed by a recessionary economy and the success of carriers in Australia, Canada, and Europe, unbundled products and services that were previously included in the base price of the seat. These products and services – all geared toward creating additional airline revenue – are referred to as ancillaries or optional services.

Unbundling, or the separate pricing of an airline seat and related travel services, has fragmented the managed business travel purchase process, and challenged travel managers to find new ways to track the total cost of air travel. Tracking will become more difficult as the industry waits for expense reporting standards to emerge, and as airlines add new ancillaries, introduce new pricing strategies, and try to reinvent the travel distribution process. Ancillary services will represent a larger portion of air travel spend, and travel managers must be ready to measure the scope of this change and its impact on travel budgets. These changes have given rise to the need for a complete reengineering of the processes relating to the sale of air travel.

Airlines first introduced ancillaries as direct sale items through their websites, kiosks and ticket counters. The majority of travelers affected were leisure and unmanaged business travelers. With their eyes on this target customer, airlines took steps to expand their distribution through global distribution systems (GDSs). GDS distribution required structure for both the description of the ancillaries offered, and the record of purchase returned to the airlines. Airlines and their supporting organizations – the Airline Tariff Publishing Company (ATPCO) and the Airlines Reporting Corporation (ARC) – addressed these issues. Their efforts resulted in a set of standard nomenclature for current and anticipated ancillaries. This nomenclature provided the foundation for ATPCO to deliver ancillary descriptions and pricing data

to intermediaries, and for ARC to develop a new kind of record – the electronic miscellaneous document (EMD). The EMD communicates the details of the ancillary purchase from the intermediary to the airline (see Figure 1).

Figure 1: Ancillary Distribution and Purchase Processing

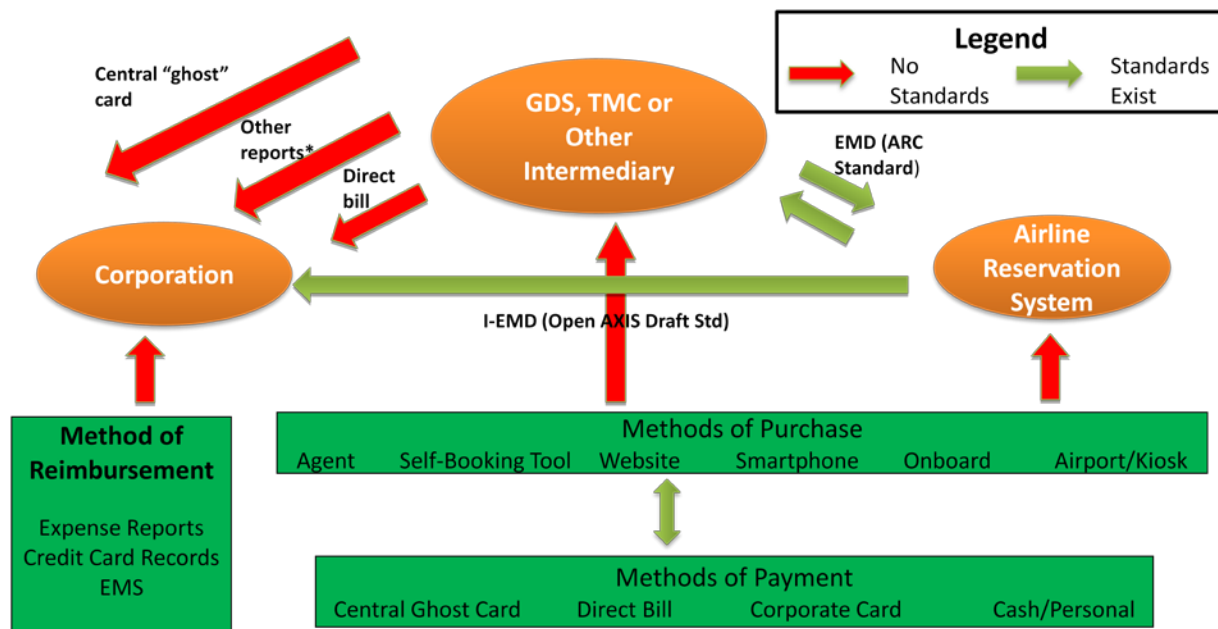


Source: PhoCusWright Inc.

New standards and EMDs enable travel agents using the GDS point of sale (POS) tools to sell ancillaries at the same time a customer purchases an airline seat. While these efforts are pivotal, they do not address the substantially more rigorous purchasing, tracking and reconciliation requirements of managed business travel, or the purchasing of ancillaries via the supplier-direct channel.

The travel distribution industry has developed a complex suite of processes and tools over the past two decades to establish and enforce travel policy, track spend, and negotiate the best deals with airlines. Unfortunately, as the airlines collaborated to add ancillaries to their product mix, they did not take into account the change in the associated business processes, such as travel spend management, which is significantly affected by ancillaries. Despite the fact that expense reporting and tracking are necessary parts of a spend management program, only a draft standard exists for identifying and reporting on ancillary purchases. This draft standard, introduced in November 2010, is for the informational electronic miscellaneous document (I-EMD) from the recently formed and airline-owned Open AXIS Group (comprised of Air Canada, American Airlines, Continental Airlines, Delta, Frontier Airlines, United and US Airways) (See Figure 2).

Figure 2: Ancillary Reconciliation



Source: PhoCusWright Inc.

This visibility will become more challenging as airlines increase fees for ancillaries, expand the ancillary services they offer, test new pricing and merchandising strategies, and target business travelers with day-of-departure upgrades. Travel managers are discovering that ancillaries are an issue that can no longer be ignored, despite the challenges associated with tracking and quantifying their impact.

Methodology and Purpose of Report

TRX, Inc. commissioned PhoCusWright to prepare a white paper to examine the value and viability of the approaches for tracking ancillary services. This paper will discuss current options and advise on how to choose the one that best aligns with corporate travel expense management processes.

To gain a travel manager perspective, PhoCusWright executed a two-pronged approach by:

- 1) Completing a 10-question email survey among 76 corporate travel managers who attended the August 2010 National Business Travel Association's (NBTA) annual convention. The survey probed the importance of tracking ancillary spend, and asked about current tracking processes and reimbursement practices.
- 2) Conducting in-depth telephone interviews with 10 travel managers of U.S. companies in late August and early September 2010. These interviews examined: each company's

perception of the longevity of ancillaries in the market; its approach to tracking ancillaries; the role of the corporate card in managing ancillaries; awareness of and time frame for using available ancillary tracking solutions; and the implications of fare bundles and ancillaries on each firm's airline negotiations and 2011 travel budget.

The purpose of this white paper is to understand the:

- Current impact of ancillaries on corporate travel spend
- Approaches companies take to track/manage ancillary travel spend
- Views of travel managers on the value of managing ancillary spend
- Potential for industry standards for ancillary spend reporting
- Ideal solution for managing ancillary spend
- Sense of urgency in managing ancillary spend

Executive Summary of Key Findings

Ancillaries are becoming a lucrative and growing revenue stream for U.S. airlines. More than 100 products and services (including checked bags, additional legroom, premium upgrades and onboard meals) are for sale. Ancillaries garnered US\$7.8 billion for U.S. airlines in 2009, one third of which was generated from baggage fees alone, according to the U.S. Department of Transportation. The total jumped 40% from 2008 and comprised 6.5%¹ of all airline revenue. This rate of growth and amount of revenue – coupled with an ever-expanding list of fees – signifies that ancillaries are here to stay.

PhoCusWright research and travel manager interviews revealed the following:

- Ancillaries increase business costs, creating a sense of urgency on the part of travel managers to understand their scope and impact. PhoCusWright's analysis of 2009 ancillary spend found that ancillaries represent roughly 2-14% of the cost of a ticket. This percentage is expected to increase dramatically in the coming years.
- Identifying and tracking fees by carrier is a daunting task for travel managers. This is especially true without an integrated system of reporting across carriers and card companies, and without the ability to attribute this spend to a traveler and the corporation. Undeterred by the challenge, three fourths of companies surveyed still feel it is extremely or somewhat important to track ancillary spend within their organizations.

¹ Grossman, David (June 8, 2010). "Airline Fees a Nightmare for Corporate Travel Planners," *USA Today*.

- To understand the true impact of ancillary sales as part of corporate travel spend, travel managers are extrapolating information from a plethora of sources such as credit card data, expense management systems, self-reported expense data, and data from the few airlines that offer basic reporting capabilities. Data collection and reporting processes have not progressed as far or fast as the shopping and purchase processes, and the true costs of ancillaries are hidden within a complex set of industry dynamics. These include:
 - **Multiple types of ancillary fees**
 - **Multiple points of sale**
 - **Lack of detailed data**
 - **Point of sale comparability**
 - **Access to ancillary fee data**
 - **Complimentary ancillaries for premium travelers**
 - **Issues linking shopping and purchasing data**
- Instituting policy is often the first step corporate travel managers use. Four in 10 firms have adapted or are in the process of adapting corporate travel policy to define both allowable and reimbursable ancillary expenses, just as they have done with other transient travel spend categories. While policy compliance is a good start, it doesn't capture all ancillary spend.
- Understanding the full amount of ancillary spend is essential for detecting fraud, waste and abuse; for planning and budgeting; and for assisting with supplier negotiations. Unfortunately, beyond expense tracking and travel management company (TMC) reporting, only a limited number of solutions provide tools that can capture ancillary spend.
- An industry-wide solution requires all points of sale to offer clear and consistent coding of ancillary spend. In addition, credit card companies will have to report ancillary spend with the same level of detail (level-III data) that they report other travel spend.
- An industry-wide solution is likely to be three to five years away. In the interim, PhoCusWright advocates that corporate travel managers use third-party systems that currently exist to obtain the detail required for insight into and oversight of ancillary spend. This ideal interim solution should:
 - Provide tools to detect and translate the meager and inconsistently coded data feeds that the airlines provide to credit card companies.

- Detect and itemize when multiple ancillaries are purchased in a single transaction.
- Interpret and keep current with the constantly changing airline ancillary pricing strategies.
- Read the data feeds from all major credit card companies and convert them into level-III detail.
- Accept GDS data (e.g., passenger name record, or PNR, and back-office data) when GDSs are able to process the sale of ancillaries at the time of ticket purchase or before the trip.
- Incorporate data from I-EMDs and EMDs as just two of many sources used, since many airlines cannot accept EMDs or generate I-EMDs, and others need third-party conversion services to process them.

While the exact amount of spend is difficult to quantify, travel managers believe strongly in the importance of managing ancillary spend. Only with effective management of ancillaries can corporations enforce policy compliance, budget for future air travel, and create leverage for negotiations with airlines. A standards-based approach for tracking ancillary spend is many years away. Travel managers who want to track this spend are faced with a lack of detail and the difficulty of developing the return on investment (ROI) to justify the expense of ancillary-tracking software and systems. Until an industry-wide standard is available, PhoCusWright believes that travel managers should look for a solution that analyzes and reports on multiple credit card, expense report, EMD, I-EMD and GDS data feeds for ancillary purchases.

History of Ancillaries

Ancillary services in hotels, car rental, and other forms of travel have been around for a long time. However, the air product has always been the “seat.” While it varied by cabin, price and sometimes legroom, the basic product was still the “seat” from point A to point B. With this model as an anchor, airline fare processing, distribution, purchase, settlement, expense approval and reconciliation business processes (with supporting software and computer systems) have traditionally supported this single “seat” product. There were exceptions, such as unaccompanied minor fees or requests for vegetarian meals, which were handled as special service requests (SSRs) and embedded in the airline PNR. However, SSRs occurred so infrequently that most airlines did not automate processes to deal with them, and instead used text scanning technology to detect them in PNR remarks fields. Without industry standards or automated booking processes, SSRs offered no real precedents or model for handling ancillaries.

In the mid-2000s, carriers in Australia successfully unbundled optional services from the sale of seats, and sold these services separately. In North America, Air Canada pioneered a similar approach with fare bundles, which paired the sale of a seat with popular ancillaries. This success was not lost on U.S. airlines, which selectively experimented with unbundling ancillaries from seat sales. The airlines discovered that while travelers complained, they would generally accept the airline's unbundling of products and services because they only paid for the services they used.

In the U.S. in 2006 – and without a lot of fanfare – ATPCO (owned by the airlines) convened a panel of air industry experts to develop standard definitions for ancillaries. Over a three-year period, this group developed standard nomenclature for the distribution of over 100 possible ancillary items. This nomenclature is being added to the airline fare data (fares, rules and conditions of service) ATPCO already distributes. This data allows GDSs and other airfare processing companies such as ITA Software to perform searches for airfares.

This standardization catalyzed another airline-owned company, ARC, to provide the standards for GDSs and other intermediaries to communicate the sale of the airline ticket back to the airline (Note: Outside the U.S., the International Air Transport Association, or IATA, manages this through its billing and settlement plan processes). To provide standards to support this communication, ARC created a purchase record of the ancillary: the EMD. To enable airlines to communicate ancillaries to corporations, the Open AXIS Group is establishing a process to make the information contained in EMDs available through an I-EMD. The I-EMD is an XML-based image of the EMD that can be implemented more quickly and less expensively than legacy Edifact messaging.

While the ATPCO, Open AXIS and ARC efforts sorted out what the airlines required to implement ancillaries, they failed to address many of the related business processes designed around the airline “seat” product. The major distribution platforms (the GDSs) foresaw the impact of ancillaries as part of the air POS and implemented the necessary capabilities. They have all announced (or put in production) new, user-friendly capabilities to allow GDS users shopping for air travel to shop for and purchase ancillaries.

The rest of the industry has been slow to change business processes and computer systems to accommodate ancillaries. This is the result of several factors:

1. Lack of a cross-functional team to establish processes and standards that support business processes outside the airline's frame of reference. The processes and standards for ancillaries already established for distribution platforms are all within the purview of airline-owned entities (ATPCO, ARC, Open AXIS, IATA). There is nothing like ATPCO or Open AXIS for the TMCs.

2. Airlines are not providing TMCs with an economic incentive to sell ancillaries. Ancillary sales will cost TMCs development dollars: TMCs will have to invest in revising their systems and improve agent productivity to assist with ancillary sales.
3. Airlines are inconsistently reporting the sale of ancillaries to credit card companies. Consequently, card companies report ancillary expenditures in different ways.

The lack of standards beyond the GDS/ATPCO/ARC/Open AXIS/IATA airline domain substantially impairs the ability of travel managers to effectively manage spend. Without the required detail about which ancillary was purchased, why, and how much was spent, travel managers cannot know what ancillaries, if any, should be allowable by policy and reimbursable.

Data is available on ancillaries, but travelers and companies report it in varying levels of detail and in myriad ways. The process of expense reporting, diversity of points of sale, and lack of implemented standards are illustrated in Figure 2. The extent of the problem is fodder for discussion. U.S. airlines have begun gradually, with the greatest focus on baggage, flight change and Wi-Fi fees, but this is the thin end of the wedge. Fees for upgrades, meals, blankets and added legroom are looming, with many more still under the hood. The problems that corporate travel managers face with ancillaries will only increase.

Importance of Tracking Ancillary Spend in Managing the Total Cost of Air Travel

Ancillary revenue is becoming increasingly important to U.S. carriers' bottom lines. In fact, the U.S. Department of Transportation reports that ancillary products and services generated more than \$7.8 billion in fees for U.S. airlines in 2009. This represents a 40% increase over 2008, and comprises 6.5%² of all airline revenue. This rate of growth and amount of revenue – coupled with an ever-expanding list of fees – means ancillaries are here to stay.

While a number of travel managers wish ancillaries would go away, the clear consensus among those interviewed is that ancillary fees are here to stay because they mean too much to airlines' bottom lines. Ancillary fees, while representing a hidden cost for corporations, are an

“Extra charges are a long time coming because the airline business model is broken.”

² Grossman, David (June 8, 2010). “Airline Fees a Nightmare for Corporate Travel Planners,” *USA Today*.

important revenue stream for airlines and mark a new and sustainable income source. Several interviewees do not begrudge the airlines attempting to make a profit. Their biggest concerns are the challenges of implementing new processes and technologies to provide insight into ancillary spend. Unless the government finds a way to tax ancillaries, airlines have no incentive to facilitate the tracking of these fees. By necessity, tracking would then need to come from a third-party provider, with access to multiple sources of data.

How big is the problem for corporations? The short answer is, nobody really knows. cursory analysis by several interviewed firms reveals that ancillary spend ranges from 2-14% of air ticket spend; however, the degree of impact can vary considerably depending on several factors, such as:

- (1) The proportion of corporate travelers who are frequent fliers. Airlines either waive or “comp” many service fees for elite and full-fare travelers. Conversely, as airlines tighten qualifications for membership, fewer travelers become eligible for elite airline status. In both these instances, companies have no way of understanding the true cost savings or exposure of ancillaries.

“Not sure what we’re going to use. We need to be able to understand how much we pay in fees and how much we saved by not paying fees because of premium status.”

- (2) Staggered rollout of ancillaries. Since airlines are introducing new ancillaries every day, numbers from the prior year are not accurate predictors of ancillaries’ impact on the total cost of an airline ticket and overall air spend.
- (3) Expense classification and reimbursement guidelines. Differences in how ancillaries are classified, accounted for, and reimbursed directly affect a company’s ancillary spend. A per diem expense system tends to underreport ancillary spend, as only those fees outside per diem limits are visible (e.g., Wi-Fi charges), while fees within guidelines are not itemized (e.g., in-flight meal).
- (4) The source of ancillary reports. The value of ancillary reports is directly proportional to the number and types of data sources used to generate them. Most reports provide only a select view of the ancillary details.

Travel managers meet with airlines annually to negotiate discounts and preferential terms and conditions. Complete data about their air travel spend is necessary for travel managers to have a strong negotiating position. Without accurate data on ancillaries, leverage with airlines is undermined. Figure 3, based on data captured from airlines’ 2009 annual reports, reports to the Department of Transportation and reported in *The Guide to Ancillary Revenue and a la Carte Pricing by IdeaWorks, 2009*, shows the revenue impact of ancillaries on major U.S. airlines.

Figure 3: Ancillary Services Revenue as a Percent of Airline Total Revenue Sales (USD)

Airline	Ancillary Revenue* (USD)	% of Total Revenue	Revenue per Passenger (USD)
United	\$2,031,322,000	11.5%	\$23.07
American	\$2,005,308,000	9.3%	\$17.75
Delta	\$1,485,770,000	4.9%	\$8.53
US Airways	\$718,984,000	6.3%	\$8.52
Alaska Airlines	\$490,596,000	13.3%	\$20.25
JetBlue	\$382,634,000	10.7%	\$15.76
Southwest	\$329,412,000	2.9%	\$3.53
AirTran	\$278,575,000	11%	\$10.74
Average			\$12.31

Source: *The 2010 Amadeus Guide to Ancillary Revenue*, Jay Sorensen, IdeaWorks

*Original data in euros. Converted to dollars using a 1.333 conversion rate.

At first glance, average ancillary revenue per passenger of \$12.31 substantiates the view that ancillaries do not yet present a significant cost risk. However, this figure will only increase as airlines expand their ancillary offerings. A study by *IdeaWorks* indicated that 2009 ancillary fees were 43% more than 2008.³ This study reports that if all airlines adopted the practices of the airlines that are farthest ahead in “ancillary” revenue, this increase would have been over 300%, or \$94.6 billion. This study further estimated that, worldwide, 2010 revenue from ancillary fees will exceed \$22.5 billion. The U.S. Department of Transportation reports that U.S. airline revenue from ancillaries⁴ in 4Q09 was up 18.3% over the previous year.

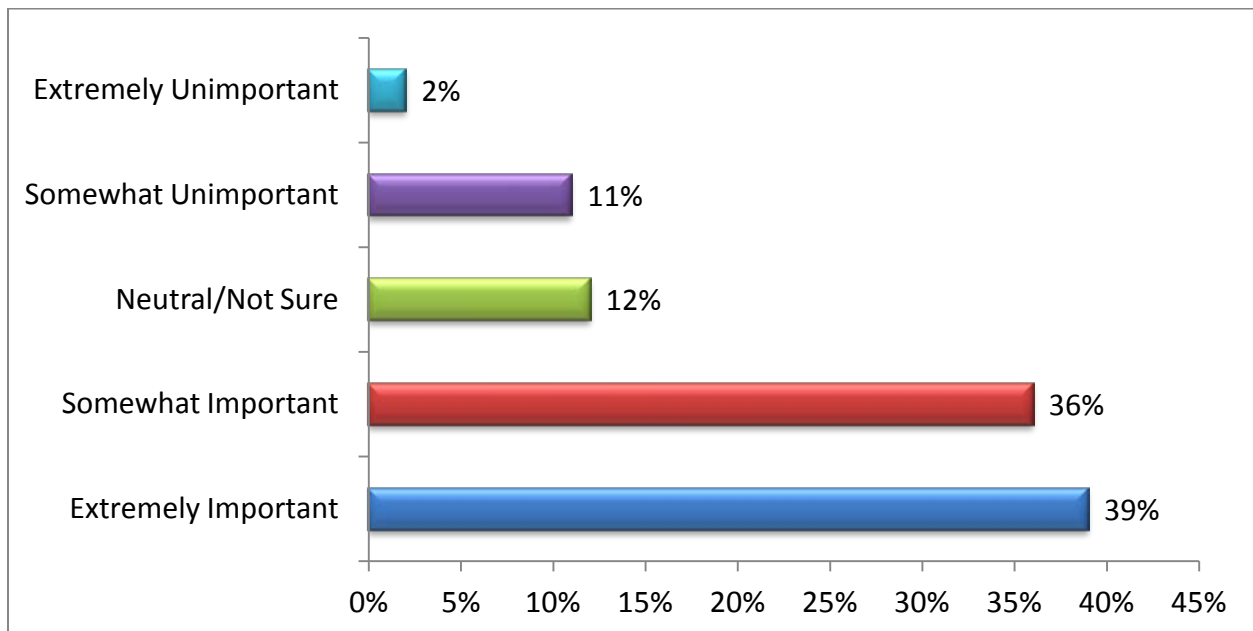
³ *Amadeus Guide to Ancillary Revenue* by IdeaWorks, October 2010

⁴ Ancillary fees include baggage fees, reservation change fees, and miscellaneous operating revenue, including pet transportation, sale of frequent flier award miles to airline business partners, and standby passenger fees. Revenue from seating assignments and onboard sales of food, drink, pillows, blankets, entertainment, or any other ancillary items are reported as transport-related revenue and cannot be identified separately.

PhoCusWright’s survey revealed that even with the uncertainty about the exact percentage of travel spend that ancillaries represent, travel managers are increasingly aware of the importance of tracking this spend. In fact, three fourths of respondents now believe this is extremely or very important (see Figure 4).

Figure 4: Importance of Tracking Ancillary Spend

Question: How important is it for your company to track spend on ancillary services?



Note: Figures may not total 100% due to rounding.

Base: Travel Managers (n=76)

Source: PhoCusWright’s Travel Manager Survey, August 2010

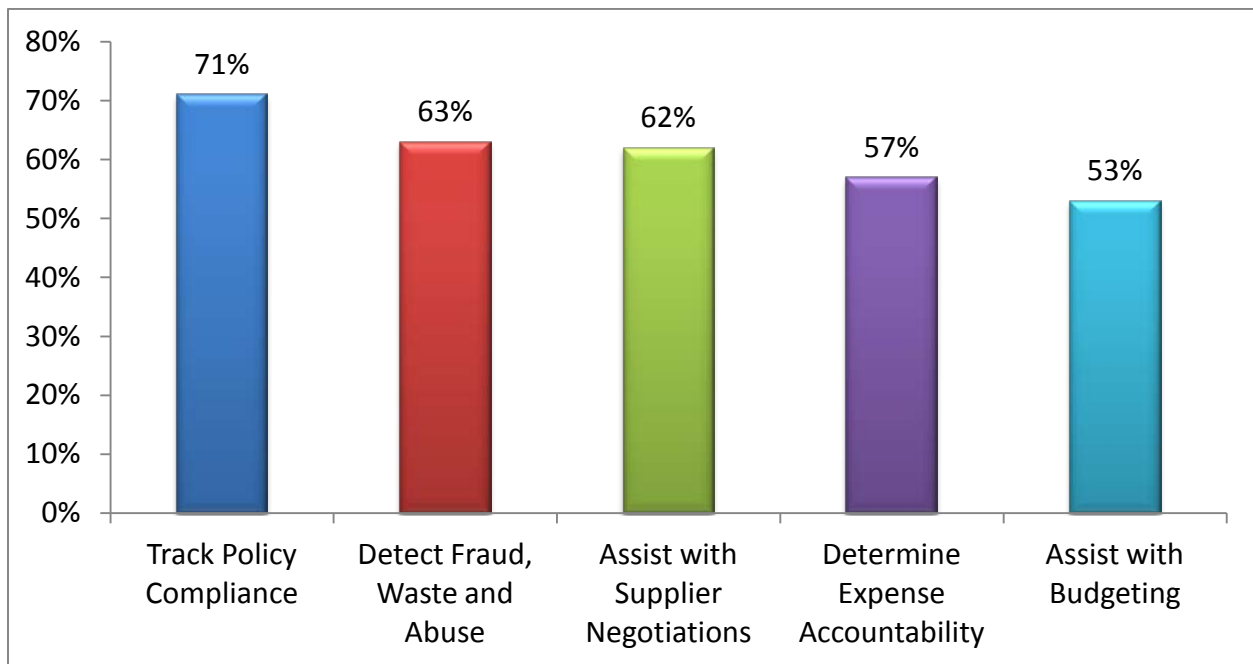
As transient travel increasingly reports to procurement, travel managers indicate they are or will soon be held accountable for mitigating the risk and any unnecessary costs associated with ancillary fees. In fact, more than half of all travel managers surveyed acknowledged multiple benefits of tracking (see Figure 5). More specifically, tracking provides: insight into policy compliance; assistance with supplier

“Ancillaries represent hidden fees or all of the costs on top of the air ticket. You don’t know the true cost of air travel until you have data about these fees.”

negotiations; detection of fraud, waste and abuse; expense accountability; and assistance with budgeting. Tracking also provides important detail to substantiate client-reimbursed expenses and to recalibrate travel policy.

Figure 5: Value of Tracking Ancillary Spend

Question: What value will your organization derive from tracking ancillary spend? (Select all that apply.)



Base: Travel Managers (n=76)

Source: PhoCusWright's Travel Manager Survey, August 2010

Complexities That Prevent Effective Tracking of Ancillary Spend

The proportion of total air spend accounted for by ancillary fees is, of late, one of the most sought-after and elusive metrics for corporations to obtain. The true cost is hidden within a complex set of industry dynamics that makes it extremely difficult to estimate. These dynamics include:

- **Multiple types of ancillary fees:** While ATPCO has established definitions for ancillaries, there is no consistency in reporting the different types of ancillary purchases. Ancillaries may be associated with special services related to a flight, with products and services unrelated to a flight (e.g., a lounge pass), or with the method of purchase (e.g., credit card, extra miles). *This inconsistency in reporting*

prevents travel managers from getting a holistic picture of the impact ancillary services have on total air spend.

- **Multiple points of sale:** Ancillaries can be purchased at the POS when the airline ticket is purchased, anytime after the airline ticket purchase, at online check-in, at airport check-in (ticket counter), or even en route (on the plane). The majority of customers buy these services after purchasing tickets. As a result, the fee does not get linked to a specific airline ticket, the sale is not applied to the appropriate firm, and airline-specific incentives (typically paid by airlines to travel agents) are not accounted for. This disconnect is a function of the fact that low-fare search, POS systems, expense, accounting, airline ticketing, and credit card systems and processes are all designed for the sale of a seat – not for ancillaries. *This lost insight diminishes a company's leverage when negotiating with airlines.*
- **Detailed data:** While the exact percentage of ancillary spend paid via corporate cards is not yet known, travel managers report that the majority of purchases are made with the same card used for the airline ticket. Unfortunately, card statements lack the level-III detail that would reveal the specific ancillary purchased, the fee

associated with it, and to which ticket (if any) it corresponds. Visibility is further clouded by the fact that each airline reports ancillaries differently to each credit card company. *This lack of specificity makes it challenging for travel managers to know whether the charge is legitimate and the fee accurate.*

- **POS comparability:** The travel options the customer sees will not reflect the fees associated with unbundled services until travel agencies and travel management companies update proprietary POS tools to accommodate ancillary comparison shopping. This gap impedes effective comparison shopping and the ability to choose in-policy flights based on the complete cost of the air trip. It also eliminates visual guilt. *The result is increased overall air spend because the lack of POS comparability puts air compliance programs at risk, and negates the value of policy-prescribed minimum thresholds required for travelers to select non-preferred carriers.*

“The biggest obstacle is getting the level of detail (level-III data) you need to use as leverage with airlines. Today airlines only provide one line.”

CREDIT CARD REPORTING DATA LEVELS

Credit card merchant data reporting uses three levels of detail, each building on the previous level:

Level 1: Merchant name, transaction amount and date

Level 2: Adds tax and merchant information

Level 3: Adds itemization, description of the items purchased and more detailed tax data

- **Access to ancillary fees:** Without access to ancillary fee information through customary booking methods, business travelers will circumvent prescribed processes and seek out this information on airline websites. However, as the Consumer Travel Alliance (CTA) indicates, major U.S. airlines do not disclose the vast majority of existing ancillary fees on their websites.⁵ *As a result, companies incur higher ancillary fees at the airport than they would through advanced purchases.*
- **Complimentary ancillaries for premium travelers:** While it may be advantageous to have these fees waived because of status level, travel managers are at the mercy of airlines, which can arbitrarily decide (and periodically change) which services are provided free of charge to which frequent travelers. This requires travel managers to manage not only ancillary spend, but also ancillary spend exposure, or the risk associated with having fewer travelers who qualify for premium status. *Unmonitored ancillary spend can quickly increase your company's total air spend.*
- **Linked shopping and purchasing data:** ATPCO distributes the data that supports air shopping to intermediaries globally. Currently, it adds ancillaries to its shopping information. EMDs enable intermediaries to transmit details of ancillary purchases to the airline. *While EMDs satisfy the need for airlines to create a record of an ancillary purchase, they do not provide travel managers with the detail necessary to strategically manage ancillary travel spend. It is the intent of the Open AXIS Group to establish I-EMDs so airlines can report ancillary sales to corporations to facilitate their oversight and management of travel spend. The I-EMD will become another source of data about ancillary spend.*

Ancillary Expense Management Solutions Used Today

To manage business travel spend, corporations have implemented a variety of practices. These include preferred suppliers, corporate cards (individually or centrally billed), and reimbursement controls. In a managed program, employees are governed by corporate travel policy and use detailed, level-III data to control travel spend. This has worked very well for air ticket purchases; however, because this data is not available for ancillaries, travel managers have a hard time gauging and governing ancillary purchases. In fact, PhoCusWright interviews found that in the absence of mandatory receipts and standardized airline coding for ancillaries, corporations have been left to their own devices to piece

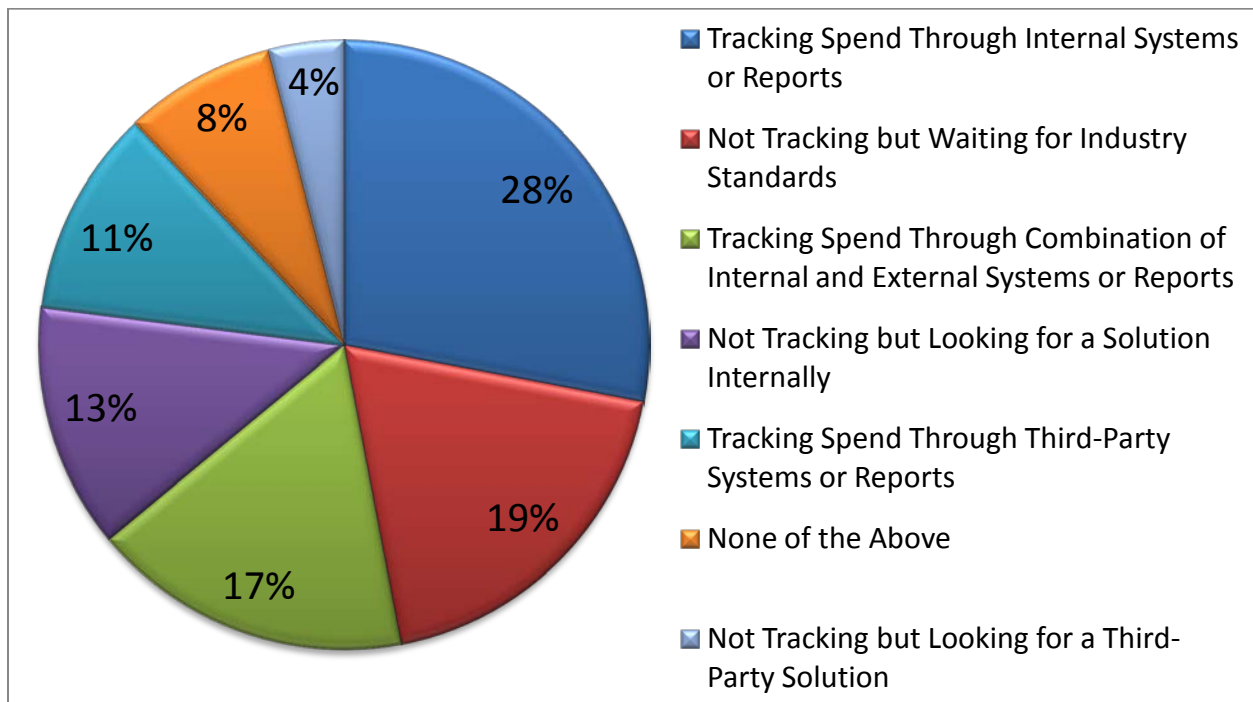
⁵ September 20, 2010. "Analysis finds major U.S. airlines not disclosing most fees on web sites," *Consumer Travel Alliance*: consumertravelalliance.org/?p=372

together spend information to track ancillaries. This section highlights the approaches companies use to track ancillary expenses and the role of travel policy. It also discusses the key value points and challenges associated with each approach.

Nearly six in 10 companies (56%) have taken steps to gauge the impact of ancillary spend on their travel budgets (see Figure 6). Not surprisingly, companies are using a plethora of approaches. The largest group (28%) tracks spend through internal systems or reports. These include self-reporting aids in an automated expense reporting process. An additional 17% use a combination of these methods and external tracking methods, while 11% rely on third-party sources for ancillary data. Companies that do not currently track are either looking for an internal solution (13%), looking for an external one (4%), or waiting for industry standards to develop further (19%).

Figure 6: Approach to Tracking Ancillary Spend

Question: What approach is your company taking to track ancillary spend?



Base: Travel Managers (n=75)

Source: PhoCusWright's Travel Manager Survey, August 2010

Travel Policy

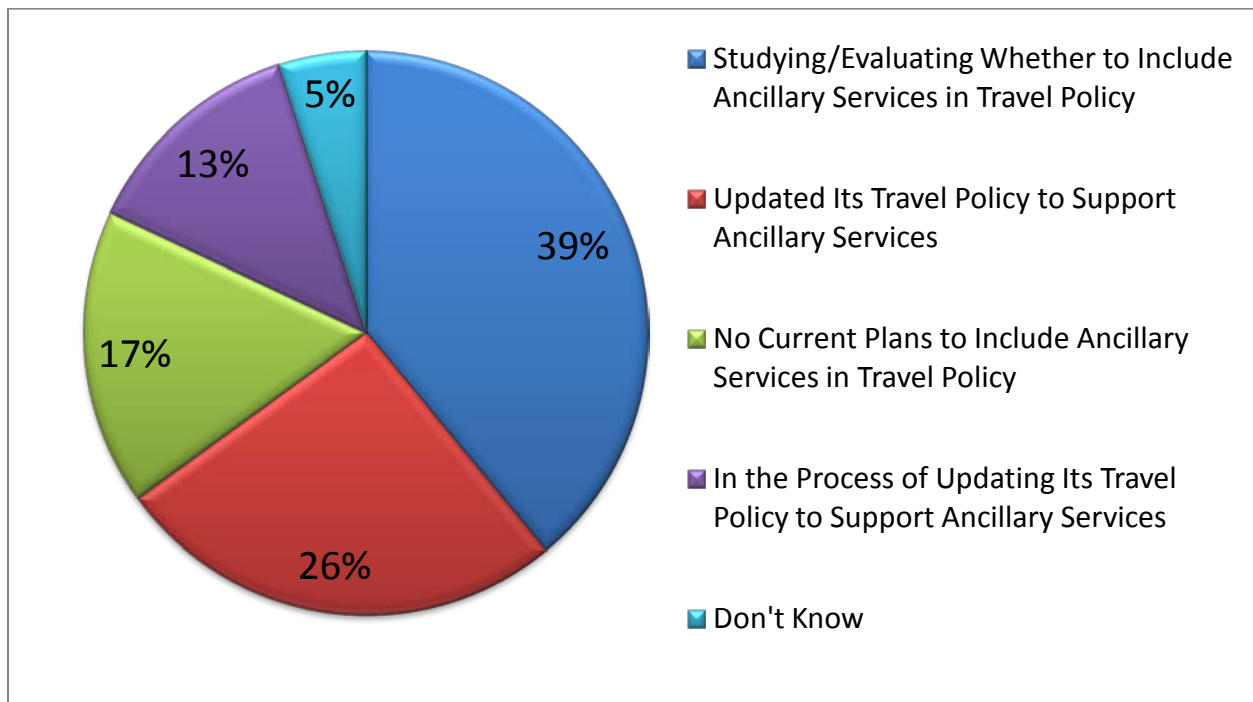
Travel policy gives corporations the ability to regulate employee purchases and define permissible expenses. It also serves as a great first step in limiting unnecessary spend associated with ancillaries. In

fact, travel managers indicate that travel policy serves as their first level of defense. It provides the framework for what are allowable and reimbursable ancillary expenses. When leveraged properly, it effectively guides and governs ancillary spend. However, it offers little business intelligence about spend behavior, specific ancillaries purchased, and fees paid.

PhoCusWright found that companies are in various stages of adapting travel policy to support ancillary purchases (see Figure 7). The largest group of companies (39%) is currently evaluating whether and how to include ancillary purchases into policy. Four in 10 (39%) have been a bit more proactive; they have already updated policy or are in the process of doing so. And one in six currently has no plans to adapt travel policy.

Figure 7: Status of Travel Policy for Ancillaries

Question: Which statement best describes the stage your company is currently at in adapting corporate travel policy to allow for the purchase of ancillary services?



Base: Travel Managers (n=75)

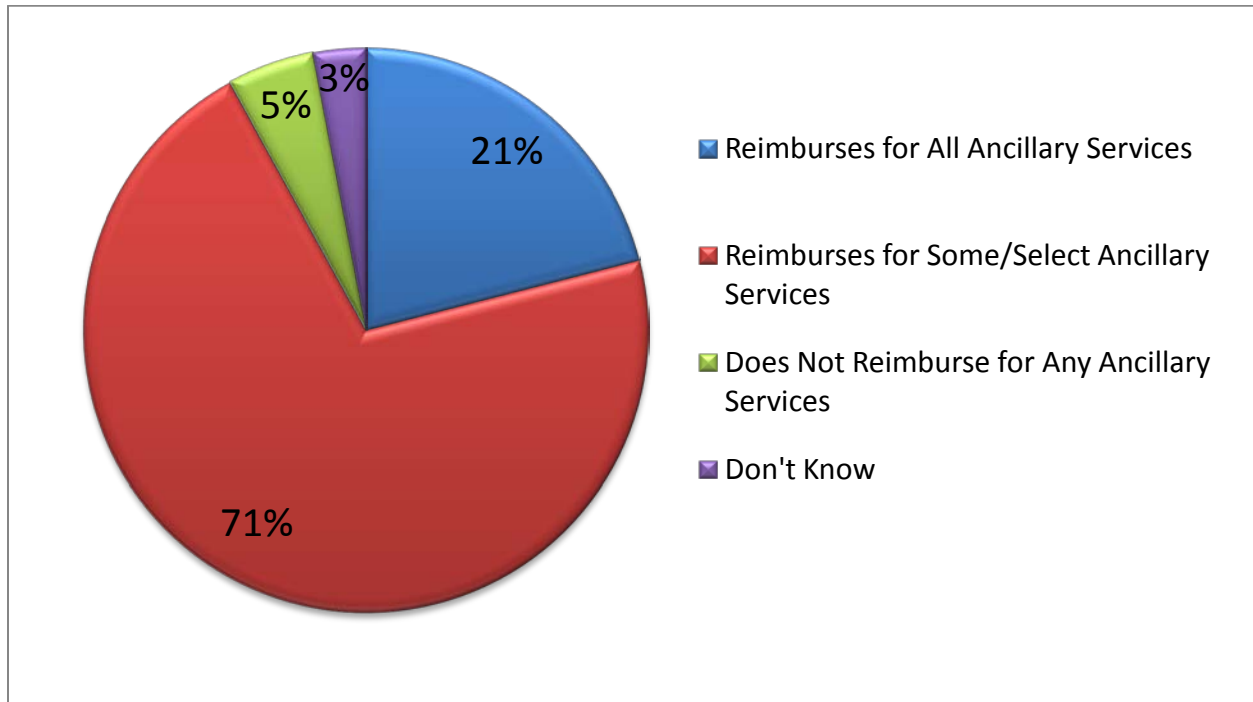
Source: PhoCusWright's Travel Manager Survey, August 2010

Regardless of how well-articulated travel policies are about which ancillary expenses are allowable, companies are quite discretionary about which ancillary expenses are reimbursable. According to the PhoCusWright survey, nearly three fourths (71%) reimburse for select ancillary expenses. Travel managers indicate that this determination is typically based on the purpose of travel, the use of per

diems, whether the company pays or the client reimburses for travel expenses, and what is reasonable given the length of the trip and duration of air travel. One fifth of travel buyers reimburse for all ancillary expenses (see Figure 8).

Figure 8: Reimbursement Controls for Ancillaries

Question: To what extent does your company currently reimburse travelers for ancillary services?



Base: Travel Managers (n=76)

Source: PhoCusWright's Travel Manager Survey, August 2010

Data Sources

Corporate policies governing ancillary purchases are still in the formative stages, as travel managers continue to examine and evolve the role of travel policy in providing oversight for the purchase and reimbursement of ancillaries. It is, therefore, important to look at the ancillary data available to travel managers for gauging compliance and enforcing policy. Spend data serves as a rich source of detailed information, and can be derived from payment cards and available reporting. Each is discussed in the following pages and summarized in the Appendix of this paper.

Payment Card Data

Integration of a payment card into a managed travel program enables travel managers to run detailed reports to confirm the incidence of corporate card use, adherence to preferred suppliers,

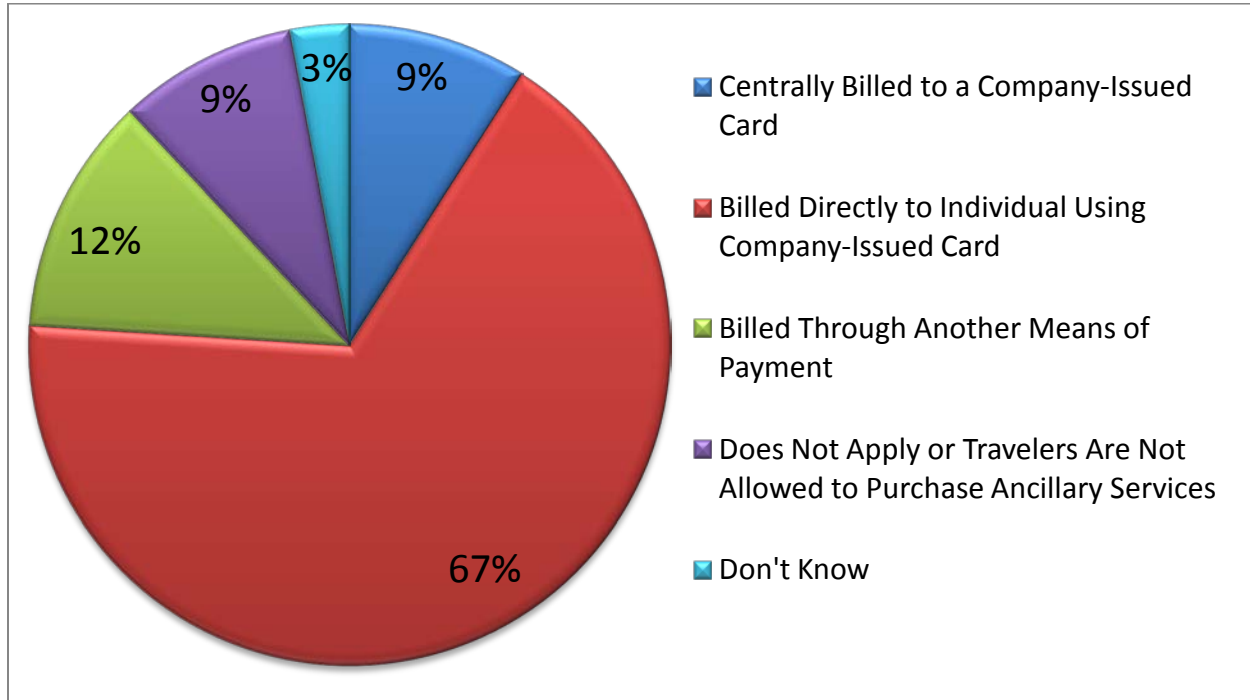
and compliance with spend policies. It also enables the capture of post-air and en route purchases of ancillaries. The method of billing associated with the payment card is a critical determinant of the amount of data and detail travel managers have for ancillary spend analysis.

Individually Billed Corporate Card Data: Use of an individual corporate card positions the traveler as personally liable to the card company for payment. When travelers purchase ancillary services, these expenses are predominantly billed to the individual using a company-issued card. In fact, two thirds (67%) of travel managers use this approach (see Figure 9), and place the onus of reporting ancillary detail on the traveler. While the card provides valuable purchase data, airlines are inconsistent in reporting information pertaining to ancillary services. Consequently, this solution requires custom logic to identify the nature of ancillary purchases and the associated airline ticket, if there is one (to tie to cost centers). With this approach, data is derived from a single source and does not reflect any ancillary purchases paid by cash.

Centrally Billed Corporate Card Data: A centrally billed, or ghost, card allows all air tickets and trip-related ancillary services to be identified and allocated to the appropriate cost center and traveler within the organization. While data from a centrally billed ghost card links ticket with ancillary spend data, it is only useful for ancillaries purchased through the TMC at the same time as the ticket, in advance of the day of travel. Because travelers buy the majority of ancillary services at check-in or en route, this method of payment alone has limited value in tracking ancillary spend. In addition, using the ghost card for ancillary tracking only works if the airlines follow the ATPCO standards for ancillaries. Capturing non-ATPCO standardized ancillary sales requires custom logic to analyze the ghost card and identify the nature of the ancillary purchases. The centrally billed ghost card suffers from the same challenge as the individual corporate card in that it does not provide level-III detail for ancillaries.

Figure 9: Method of Billing

Question: When travelers in your company purchase ancillary services, are these expenses:



Base: Travel Managers (n=76)

Source: PhoCusWright's Travel Manager Survey, August 2010

A corporate card is an excellent source of spend data. Its value diminishes, however, when it is the sole source of ancillary spend information, as well as when multiple card payment options and multiple issuers are used. In these instances, travel managers must integrate these data sources to obtain a holistic picture of a company's ancillary spend.

Report Data

Travel managers can also obtain business intelligence about ancillary spend through various types of reports.

Traveler Expense Reports: When the company does not prescribe a specific method of payment or issue a corporate card – or when a traveler uses a personal credit card – travel managers must rely exclusively on expense reports submitted by employees or extracted by a computer for insight into ancillary spend. Data on employee-submitted expense reports may be derived from the traveler's own accounting of trip expenses, prepopulated card data, or a combination

of both. Details about ancillary expenses can be captured via an automated pop-up table in the expense reporting tool, where the employee can select the specific type of ancillary spend and reason for the expense. The data can also be parsed from expense reports using computerized business logic without the employee having to prelabel the nature of the expense. This latter approach is more complex but not extremely difficult.

Using self-reported expense reports to provide ancillary granularity is dependent on employee accuracy and integrity. Because many ancillary fees fall below the receipt threshold, employees have substantial discretion in identifying the purpose and amount of the ancillary fee. The computerized approach is better in that it uses computer algorithms to attempt to identify ancillaries. Both approaches miss data that is misidentified or misreported in expense reports. In addition, ancillaries purchased on a ghost credit card may not be required in expense reports.

Travel Management Company Reporting: All purchases through the TMC go through mid- and back-office processing. It is possible to intercept this data and use it as a source of ancillary purchase information. Using TMC data suffers from the same limitations as the centrally billed corporate card. It is a good source of data for ticketing and advanced purchase of ancillaries, but does not cover ancillary purchases outside the TMC's system.

Airline Reporting: Currently, each airline reports ancillaries differently (that is, if the airline even provides reports). Putting airline data into a consistent format and integrating data across different carriers for a holistic picture would require substantial processing. However, through the efforts of the airline-formed group, Open AXIS, airlines could potentially report the sale of ancillaries back to corporations. This would require travelers to tag their PNRs with the corporate name at the time of ancillary purchase (or tie the purchase to the traveler's airline profile). This is the intended purpose of I-EMDs. While an I-EMD provides more granular data about ancillaries purchased prior to boarding (e.g., amount, description of ancillary, name of traveler), it does not provide complete transactional data or insight into onboard purchases.

Electronic Miscellaneous Documents (EMDs): There are two types of transactional EMDs: EMD-S and EMD-A. EMD-S (stand-alone) is used for ancillary purchases not associated with a ticket coupon, such as reserving a lounge conference room for a business meeting. EMD-A (associated) is used for services associated with a specific ticket, and expires when the flight is complete (e.g., seat upgrade, baggage check). It is widely believed that access to EMDs will solve the ancillary challenge during the pre-sale phase. Unfortunately, EMDs are not a panacea for tracking ancillary charges. Purchases made directly with airlines may not generate EMDs. In addition, many airlines are unable to receive and process EMDs, while others are using third-party services to reformat the data into an acceptable format. As discussed above, the airline industry is attempting to improve the reporting of ancillary sales back to corporations with the I-EMD; however, the I-EMD is limited by many of the same shortfalls as the EMD.

Third Party Reports: Already accustomed to aggregating business intelligence (BI) data from multiple and disparate sources of information, third-party travel information providers are able to extend these processes to include ancillary data sources and provide a holistic view of ancillary spend.

Standard Industry Solution

The nature of airline ancillaries means no single solution can holistically and accurately track a firm's ancillary spend. This is because ancillaries can be purchased in multiple ways (e.g., cash, card, check), at multiple times in the travel process (e.g., presale, before departure, day of trip, en route), and using multiple channels from multiple sources.

Ideally, planning to add ancillaries to the airline product offering would include standard identifiers (such as UPCs in the retail sector) that airlines, credit travel agencies, TMCs and card companies could use. As shown in Figure 1, airlines supported standards within the organizations they owned – ARC and ATPCO – but didn't adequately address the impact on the industry as a whole. The National Business Travel Association is attempting to form a coalition of interested parties in a cross-industry working group to address reporting standards for ancillaries. Any solution will require strong leadership, agreement between groups with divergent business interests, and systems development, testing and implementation. An industry-wide solution will likely take three to five years or longer.

The Ideal Ancillary Management Solution

In a perfect world, ancillary purchases would be provided to businesses with level-III detail so they could be managed through existing business processes like any other expense. This would be the case regardless of the point of sale or when the ancillary was purchased. Unfortunately, until the infrastructure gains the maturity to provide this detail, third-party products will be necessary to create the data detail that travel managers require. PhoCusWright believes that the "ideal" interim solution should be able to:

- a) Combine and parse data from multiple purchase sources, intermediaries, payment vehicles, card issuers, airlines, and industry or standards sources.
- b) Convert the data that credit card companies have obtained from airlines into meaningful information. This involves a knowledge base that understands each carrier's data format and contains the algorithms to convert this data into a format useful for travel management.

"Use disparate databases because each one has missing information or gaps, and we need to be able to link the trip to the details (we pay off of expense data, obtain the detail from the credit card and use itinerary data from the TMC)."

- c) Recognize when multiple ancillaries are contained in a single transaction, regardless of when the ancillary was purchased. This involves combinatorial logic.
- d) Stay current in the face of ever-changing airline ancillary offerings, pricing strategies, federal reporting guidelines, and industry standards. Tremendous vigilance is necessary to keep pace with potentially hundreds of airlines that are working with over 100 ATPCO standard ancillaries, an undetermined amount of non-standard a la carte ancillaries, and fare bundles (combinations of ancillaries or ancillaries plus airline tickets).
- e) Read credit card records, determine ancillary purchases, and convert data for these purchases into the equivalent of level-III data. This is particularly important when the traveler is required to use a corporate card (whether or not it is centrally billed) for all ancillary services.
- f) Collect data from expense reports (for ancillary purchases bought with cash or personal credit cards) and compare reported data against airline fee tables to ensure accuracy.
- g) Extract ancillary purchases from the GDS-generated or TMC-provided data that supports PNR creation and back-office processes. This is useful when the corporation does not use a ghost card report for travel spend detail.
- h) Use EMDs as data sources as they become more widely accepted and standardized.
- i) Embrace I-EMDs as an additional data source.

Summary & Next Steps

Future of Ancillary Services

As airlines aggressively work toward increasing ancillary revenue, managing ancillary spend becomes like trying to hit a moving target. In addition to current a la carte ancillaries, U.S. carriers are experimenting with new pricing and merchandising options, such as:

- Distance-sensitive pricing, or varying the price of ancillary services based on the duration of the trip or miles flown.
- Variable pricing, or testing the price elasticity of ancillaries by frequency of travel, spend volume of corporation, etc.
- Prepay discounts, or a dollar or percent savings associated with purchasing ancillaries prior to the day of departure.
- Annual prepaid plans, or a dollar or percent savings associated with purchasing ancillaries in bulk (typically at time of airline negotiations).
- Demand-based pricing (using revenue management technology), or varying the price based on the perceived value of the ancillary and when it is purchased in the process.

Airlines in Australia and Canada have had success with bundling popular ancillaries as packages, and selling these packages at appropriate prices. While these bundles can be static (pre-planned), they can also be created and priced dynamically. In addition, American Airlines is pioneering an approach whereby distribution platforms such as GDSs send these queries directly to American for a customized reply, which may include dynamically priced ancillaries (instead of processing airfare queries on their own platforms, as they currently do). This affords American ultimate control over the pricing structure and frees it from the ARC and ATPCO standards when selling ancillaries. American's approach is central to the work of the Open AXIS Group, and is being supported by the seven major airlines that comprise the group.

Another wild card in the future of ancillaries is the prospect of taxation. Unbundling ancillaries from the base airfare means they are not subject to U.S. government excise tax. This is a major loss of revenue to the U.S. If Congress extends the airline excise taxes to ancillaries, the accounting and documentation will improve, providing better data that could benefit travel managers.

There is no doubt that airline ancillary offerings are here to stay. Uncontrolled by government regulation, ancillaries will become a larger part of air spend and challenge travel managers to effectively measure, track and manage them. As airlines refine their merchandising and distribution strategies and expand their offerings, travel managers will be tasked by procurement and financial officers to report on

the total cost of air travel and its bottom-line impact. This reporting will be compounded by the very nature of ancillaries and by the ways airlines enable customers to purchase them: annually; individually; as part of a bundle; at the time of the air ticket purchase; prior to arrival at the airport; at the airport; onboard the plane; and using any payment method or available device, from PCs to smartphones. All these factors complicate the measurement and tracking process, and underscore the importance of a solution that captures market variability and the detail required for accurate spend visibility.

Recommended Next Steps

Travel managers must be proactive and vigilant about tracking the volume and impact of ancillary services, as this process will only become more complex and dynamic in the future. Tracking ancillaries requires leveraging the company's existing travel management and spend management procedures, as these represent the best and most integrated sources of data. With rare exceptions, multiple expense data sources are necessary to capture (and get accurate visibility into) a company's ancillary spend. To be prepared, travel managers' strategies must focus on policy compliance, budgeting for future air

This is a high priority for our company. We need to scope out what we spend and the savings opportunity to determine the budget for a third-party solution."

travel, and negotiations with airlines. Strategies should include:

- Accurate assessment of current ancillary spend. Use current and past TMC, card and other reports to create a rough estimate of the impact ancillary fees have on the cost of air travel at the company. This estimate will help travel managers establish preliminary policy guidelines, get a sense for the anticipated trajectory of spend in the short term, gauge the ROI of implementing an ancillary tracking solution, and understand the risk exposure of not proactively managing ancillary spend.
- Strategic use of airline membership programs. While some airlines are firmly committed to charging for ancillary services, others waive fees for frequent travelers. Travel managers should investigate options that mitigate the cost of ancillaries. Two great initial steps are 1) registering frequent travelers into the most cost-effective frequent flier programs, and 2) educating road warriors about the fee savings associated with doing so.
- Updated travel resources. At a minimum, travel managers should detail within corporate policy which ancillary expenses are allowable and reimbursable by the company, and the proper procedures, tools and payment methods required for data capture. This policy information needs to stay current to include regulations around and introduction of new fees. Ultimately, a company should deploy automated expense reports that ensure the most current and comprehensive list of ancillaries is presented for traveler self-reporting.
- Use of social media to limit ancillary spend exposure. Leverage the experiences of road warriors by encouraging traveler-to-traveler communications about ways to (ethically) reduce or avoid ancillary fees.

- Use multiple data sources for spend visibility. By the very nature of who, how and when ancillaries are sold, no single source of data can provide accurate and holistic ancillary information. However, each source contributes to the complete picture. Travel managers must gather data from card reports, TMC reports, GDSs, airline reports, expense systems, EMDs, I-EMDs and general ledgers. It is optimal to use the most efficient and comprehensive tracking solutions available.
- Negotiations with carriers. Be proactive and aggressive about negotiating ancillary fees with your preferred partners, especially in markets and on routes where your firm drives market share. The only way to gauge airline receptivity is to put ancillaries on the bargaining table.
- Use a tracking solution. Use the ideal solution guidelines in this white paper to select a vendor that can assist in regularly and comprehensively tracking ancillary spend. The more data you have, the better your negotiating position will be with airlines for better fares, ancillary discounts and overrides. Do not wait for the industry to develop standards; it could be five years or more before that occurs.

Appendix

Ancillary Purchase and Reporting Alternatives			
Corporate Travel Expense Management Policy	Method of Payment for Air Ticket	Method of Payment for Ancillary Expenses	Sources of Ancillary Spend Data
(A) Employees bear the full burden of costs and submit expense reports for reimbursement.	Method of payment not defined by company, company does not issue corporate card, or personal credit card is used	Cash or personal credit card.	Expense reports for both ticket and ancillary expenses.
(B) Employees make all travel purchases (including air) on a company-provided card. The costs are billed to the traveler who is reimbursed by the corporation.	Corporate card with individual liability.	Company-provided credit card or cash.	Combination of card and expense reports. EMDs and I-EMDs
(C) Employees bear the full burden of costs (except air) and submit expense reports for reimbursement. Air is purchased through a central ghost card.	Centrally billed card.	If pre-purchased through a TMC or travel agency, payment is on the centrally billed card. Other purchases are cash or on a personal credit card.	Combination of ghost card or GDS data and expense reports. EMDs and I-EMDs
(D) Employees make all travel purchases (except air) on a company-provided card. The costs are billed to the traveler, who is reimbursed by the corporation. Air is purchased through a central ghost card. Some ancillaries will be cash transactions that show up in expense reports.	Centrally billed card.	If pre-purchased through a TMC or travel agency, payment is on the centrally billed card. Other purchases are cash or on a company-provided credit card.	Combination of ghost card or GDS data, expense reports, and individual card reports. EMDs and I-EMDs
(E) C or D, except there is no ghost card and the central billing comes from the GDS transaction data.	Central billing.	If pre-purchased through a TMC or travel agency, on the central bill. Other purchases are cash or on a personal or company-provided credit card.	Combination of central bill or GDS data, expense reports, and individual card reports. EMDs and I-EMDs