

ANCILLARY REVENUE REPORT SERIES FOR 2012

It's a Constant Challenge to Keep Corporate Travelers from the Candy Store of a la Carte Goodies

Travel managers admit to Congress that a survey of member companies reveals 58% are unable to track the total amount travelers spend on a la carte fees.

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Issued 07 June 2012

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Issued by IdeaWorksCompany.com LLC
Shorewood, Wisconsin, USA
www.IdeaWorksCompany.com

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About Jay Sorensen, Writer of the Report

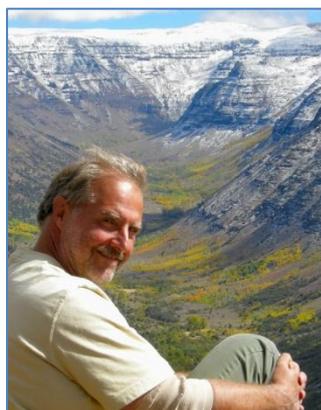
Jay Sorensen's research and reports have made him a leading authority on frequent flier programs and the ancillary revenue movement. For 2012 he was a keynote speaker at the FFP Spring Event associated with the Freddie Awards in New York, the IATA Passenger Services Symposium in the Middle East, and the MEGA Ancillary Revenue and FFP Event in San Diego. His published works are relied upon by airline executives throughout the world and include first-ever guides on the topics of ancillary revenue and loyalty marketing. He was acknowledged by his peers when he received the Airline Industry Achievement Award at the MEGA Event in 2011.



Jay, with sons Aleksei and Anton, on the top of Brokeoff Mountain in Lassen Volcanic National Park in northern California.

Mr. Sorensen is a veteran management professional with 27 years experience in product, partnership, and marketing development. As president of the IdeaWorksCompany consulting firm, he has enhanced the generation of airline revenue, started loyalty programs and co-branded credit cards, developed products in the service sector, and helped start airlines and other travel companies. His career includes 13 years at Midwest Airlines where he was responsible for marketing, sales, customer service, product development, operations, planning, financial analysis and budgeting. His favorite activities are hiking, exploring and camping in US national parks with his family.

About Eric Lucas, Editor of the Report



Eric, at his favorite summer retreat, Steens Mountain, Oregon.

Eric Lucas is an international travel, natural history and business writer and editor whose work appears in MSN/Bing Travel, Michelin travel guides, *Alaska Airlines Magazine*, *Westways Magazine* and numerous other publications. Founding editor of *Midwest Airlines Magazine*, he is the author of six books, including the 2009 Michelin *British Columbia Green Guide*. Eric has followed and written about the travel industry for more than 20 years. He lives in Seattle, Washington, where he grows and sells organic garlic; visit him online at www.TrailNot4Sissies.com.



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16
airlines

have signed up to sell ancillary services using the Amadeus solution in the travel agency channel

6
airlines

Air France, KLM, Iberia, Finnair, Qantas and Corsairfly are currently selling ancillary services through travel agencies

9
countries

are currently using our solution to sell ancillary services including: France, Denmark, Norway, Sweden, Finland, The Netherlands, Belgium, Luxembourg and Spain

57
airlines

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23
airlines

have implemented Amadeus' EMD Server

4 million
EMD

were processed in 2011, using the Amadeus EMD server.

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It's a Constant Challenge to Keep Corporate Travelers from the Candy Store of a la Carte Goodies

Travel managers admit to Congress that a survey of member companies reveals 58% are unable to track the total amount travelers spend on a la carte fees.

The popular idiom “like kids in a candy store” refers to the inability of children to restrain themselves from practicing prudent purchase behavior when surrounded by gummy bears, milk chocolate, or sugary confections of any kind. The phrase provides different interpretations for the three parties involved. Children have no issue with an overindulgence of candy. Parents are frustrated by the expense of the oh-so-predictable dental bills. Shopkeepers are generally delighted by the commerce produced by eager children and permissive parents.



Jacquie Chesser, official candy purveyor to IdeaWorks, admits she is delighted when customers spend wildly while in her Goody Gourmet's store in Shorewood, Wisconsin.

The idiom also describes the travails of today's travel marketplace with unconstrained travelers, frustrated corporate travel managers, and revenue-eager airlines. Corporate employees feel entitled to add comfort and convenience when away from home. Corporate travel managers and CFOs want to know the complete cost of trips when comparing vendors. We all know about the airlines; many are happy to tempt any unmanaged traveler with sugary-sweet perks such as priority boarding, exit row seating, and airport lounge access.

The travel managers referenced in the headline are members of the National Business Travel Association. In their testimony to a Congressional committee, the group pleaded for “transparency and consistency” in the regulation of airline fees and taxes.¹ The organization's complaints reflect a pervasive feeling of helplessness among corporate travel departments all over the world. The addition of airline fees adds another category of non-negotiated expenses to a long list, which includes a la carte fees for hotels, car rental companies, and many other traveler services.

Systemic change is occurring in the industry. The creativity of airline management and subsequent innovations can outpace the capabilities of distribution systems. These conditions have provided airlines the opportunity to act on an ever-present desire to form direct relationships with consumers. The airline industry feels well equipped to tackle the needs of everyday travelers by becoming a better shopkeeper. However, the airline industry's unstoppable need for revenue — in an era of ever-increasing oil prices — has snagged corporate travelers into the a la carte web. What works well for everyday customers is proving a nettlesome problem for corporate travel managers.

¹ Prepared Remarks of the NBTA to the Subcommittee on Aviation, 14 July 2010.

Airlines tempt travelers with tasty a la carte delights

The most admired retailers master the art of getting consumers to spend more than originally planned. A visit to any retail emporium, such as a Tesco in England, Woolworths in Australia, or Target in America, engages shoppers in a deliberate plan to encourage spending. Entry areas are stocked with items priced at \$1 or €1, end caps on aisles suggest better values, and checkout lanes are packed with impulse items. These merchants are labeled as being savvy for their efforts, whereas the same methods in the airline industry are called Machiavellian. Here lies the nub of the airline industry's frustration.

Airlines are moving from a "booking process" to retailing methods. For example, one simple all-inclusive fare once defined the complete cost of flying from Portland to Paris. This was a legacy of the industry's regulated past and the limitations of early automation systems. Only a single price was permitted in a regulated environment and it always included the traditional components of airline travel. The airline industry was one of the first to go "online" in a sense in the mid-1970s when American and United introduced computer reservation systems.² Early attempts at automation required pricing simplicity. These factors delayed airlines from reaching today's desired destination of retail mastery.

One-price-fits-all is dead; airlines now desire sophisticated retail methods. Consumers entering an airline storefront are now encouraged to spend more. Airlines, such as Ryanair, have been using a la carte methods since the early 1990s.³ A la carte fees have slowly spread globally through the efforts of low cost carriers and ultimately by network airlines copying their pricing methods. The effort has sometimes been clumsy and poorly conceived. Airlines disguised fees as "taxes and surcharges" and included them in the consumer's shopping basket without proper identification. These methods are unfair and thankfully will disappear as airlines become better retailers by trial and error, and through new consumer regulations.

Korean Airlines has literally taken retailing to extreme heights with the inclusion of a fully stocked duty free shop on its Airbus A380 aircraft (pictured at right). Starting with first class, and ending with economy class, passengers are invited to browse the showcase and shop cosmetics, alcoholic drinks, perfumes, and accessories.⁴ The shop, which displaces 13 passenger seats, displays up to 64 items. Retail in-the-air provides special challenges not found on the ground; display items have magnets attached that automatically engage when turbulence occurs. Today's efforts are largely directed at the online sale of air travel and services.



Image: Korean Airlines

² "The Evolution of the Airline Industry" by Steven Morrison and Clifford Winston, 1995, Brookings Institution (page 61).

³ "Michael O'Leary: Plane crazy" article dated 07 October 2006 in the Independent.

⁴ "Korean Air unveils A380 flying duty-free shop" article dated 05 April 2011 in Flight Daily News.

Let's examine how one travel retailer — American Airlines — might tempt a customer traveling from Portland, Oregon to Paris with an array of travel treats. Our traveler chooses a four segment roundtrip journey from Portland via Dallas/Ft. Worth to Paris:

A la Carte Temptations – American Airlines Roundtrip Economy Class, Portland – DFW – Paris	
Temptation	A la Carte Price
Double AAdvantage mile accrual – 13,128 total bonus miles	\$393
2 nd checked bag, roundtrip (1 st transatlantic bag is free of charge)	\$120
Group one boarding zone — purchased at airport kiosk	\$9 (outbound)
	\$9 (return)
Preferred seating with 4 to 6 inches more legroom and located near the front of the main cabin	\$44.66 (domestic)
	\$88 (transatlantic)
Gogo inflight internet flight pass (US domestic flights only)	\$12.95 (outbound)
	\$12.95 (return)
Onboard food and beverage such as a Caesar salad and a split of wine (food and alcohol is no charge on transatlantic flights)	\$17 (outbound)
	\$17 (return)
Admirals Club, single visit lounge passes (two at Dallas/Ft. Worth during layovers and one at Paris)	\$50 (DFW outbound)
	\$50 (DFW return)
	\$50 (Paris)
Trip insurance by Allianz Global Assistance	\$91.95
Total – if all services listed are purchased (net of airfare)	\$965.51
<i>Review of American Airlines fees conducted at AA.com during March 2012.</i>	

The base fare with taxes and fees for the Portland – Paris (May 2012) itinerary queried would be \$1,522. If our traveler truly behaved with the reckless abandon of a “kid in a candy store” an additional \$965 could be added to the price . . . this represents 63 percent added to the original price. Of course, this does not represent pure profit for the airline but the margins on many of these items, such as double AAdvantage miles, checked bags, and group one boarding are extremely high and likely in excess of 70 to 80 percent.

It's important to note all the extras are truly optional and only serve to increase passenger comfort and convenience. Encouraging customers to spend more is considered an art practiced by better companies. Investors buying shares in Darden Restaurants (NYSE: DRI) expect wait staff to eagerly encourage guests to spend more at the company's Olive Garden, Red Lobster, and Capital Grille locations. Those extra appetizers, drinks, and desserts really pack a punch for the bottom line. And yes, the same is true for companies throughout the travel industry to include hotel chains, car rental firms, cruise lines, and attractions. The most reliably profitable airlines are champs at this, and routinely generate around 20 percent of revenue from ancillary revenue activities.⁵

⁵ “Airline ancillary revenue soars to \$32.5 billion worldwide in 2011” press release dated 19 October 2011 from IdeaWorksCompany.

The conflict with corporate travel occurs when the question is asked, “Who pays for these extras?” It’s easy for a corporate travel office to assign travelers to a specific cabin class, such as economy, economy plus, business or first. This is booked before the employee departs within the highly controlled environment of a travel management company. The decision to book an employee in a premium cabin can be based upon job title, length of flight, and even the profitability of the company. The criteria are usually well defined and approval is granted or declined before a boarding pass is given to the employee.

Mayhem apparently occurs when the traveler hits the road and begins to rack up expenses for services the company might like to exclude . . . if it had the chance. Almost all of the a la carte services described in the American Airlines Portland — Paris example are purchased by a traveler after the original booking is made by the company travel department. The following results from a survey sponsored by the Global Business Travel Association (GBTA) and Egencia (an Expedia Company) address the issue of airline fee reimbursement:

Are Airline Fees Reimbursed by the Company? 651 responses from a survey of GBTA members and Egencia customers	
A la Carte Service	% of “Yes” Answers
Checked bags	91%
Buy on board food	47%
Onboard internet access	35%
Extra legroom seating	12%
Priority boarding	8%
Alcoholic drinks	6%
Inflight entertainment	3%

Source: Corporate Travel Policy Benchmarking and Insight 2011 report sponsored by GBTA and Egencia.

Self-employed business travelers and holidaymakers don’t need to check with the home office before buying a drink or paying for onboard internet access. These passengers are free to choose and only limited by the cash in their wallet or the limit on their credit card. Company employees can choose these perks too, but they almost always expect the company to pick up the tab when the trip is completed and expense reports are submitted. Estimates reviewed by IdeaWorksCompany suggest airline fees represent 2 to 4 percent of a company’s total travel budget.⁶ However, a small percentage can become a big expense. Microsoft spent \$700 million on travel and entertainment during 2010.⁷ A modest 2 to 4 percent of that would equal a very meaningful \$14 to \$28 million.

Corporate travel managers are upset by control they’ve lost as a la carte fees have become prevalent in the airline industry. Yes, they do miss the days when a single fare covered all the service a traveler could reasonably expect during an airline journey. The one-size-fits-all approach to pricing, also called a fully-bundled product, has been strained by ever-increasing oil prices, low cost airline competition, and the general trend to encourage online consumers to point and click their way to create customized services and products.

⁶ “Companies have trouble tracking fees in expense reporting” article dated 19 August 2011 at ExecutiveTravel.com.

⁷ “Corporate Travel 100” article in the 27 September 2010 issue of Business Travel News.

Luxury hotels excel at a la carte fees

The airline industry is by no means unique in tempting consumers with a la carte comforts and convenience. From the perspective of travel managers, this path to pricing perdition has already been well trod by hotels and car rental companies. Who hasn't considered the self-pampering of a beverage from the mini-bar or an in-room movie after a particularly brutal day of travel? And those upgrade mavens dressed in gold, red, green, or yellow uniforms behind the car rental counter relentlessly seek the revenue produced when you move up a car class or two. It's up to the corporate travel manager to decide whether a perk is permitted or punished. Continuing the theme of Portland to Paris, IdeaWorksCompany did a little sleuthing on the a la carte fees encountered by a traveler checking into a business hotel in Paris:

A la Carte Temptations – Westin Paris 3-night stay during the first week of May 2012 at the Westin Vendome	
Temptation	A la Carte Price
Breakfast buffet in the Le First Restaurant	€39 (\$52)
High speed internet access in a guest room	€19 (\$25)
High speed internet access in the business center	€20 (\$27) per hour
Valet parking	€36 (\$48)
Glass of wine in the “Tuillerie” bar	€9 to €13 (\$12-17)
Bottle of beer from the in-room mini bar	€11 (\$15)
Local call from a guest room – 5 minutes	€10.70 (\$14)
Watching a movie in the guest room	€19 to €27 (\$25-36)
Hotel laundry – man’s shirt	€9 (\$12)
50-minute body massage in the spa	€120 (\$159)
Total for a 3-day stay	
Daily for these: breakfast, guest room internet, valet parking, glass of wine, local call, movie, and laundered shirt, plus one body massage during stay	€545 (\$723)
Review of hotel fees conducted at Westin.com during March 2012 and response from the hotel to a fee query. Exchange calculations performed at XE.com during March 2012. US Dollar fees rounded up to whole amounts.	

The best room rate (not prepaid) found at Sheraton.com for a king bed was €430 (\$570). With little prompting, our traveler could easily add €545 (\$723) to the €1,290 (\$1,710) expense of a 3-night hotel room. That represents ancillary revenue in excess of 42% of the base price of the hotel room. A la carte has long been a crucial revenue component for successful hotels. A professor with New York University’s Tisch Center for Hospitality, Tourism, and Sports Management estimated fees charged by US hotels generated a record \$1.8 billion during 2011.⁸ That’s a lot of internet access, liquor miniatures, and in-room movies. These activities are rarely bookable when a hotel reservation is made. Instead, it has become well-accepted practice for employers to reimburse travelers for these expenses upon presentation of the prescribed documentation.

⁸ “U.S. Lodging Industry Fees and Surcharges Continue Upward Trend in 2011 to New Record - \$1.8 Billion” press release dated 20 September 2011 from New York University.

Reviewing fee reimbursement policies for airline travel and hotel accommodations suggests employers are more inclined to approve lodging-related fees than those charged by airlines. The lower rate for inflight internet in the table below suggests most companies believe it's a luxury, rather than a tool to improve productivity. The same philosophy no doubt was applied to hotel internet access when first introduced; items once viewed as luxuries slowly become "must have" services. Supplier relationships can also evolve over time to take the bite out of a la carte fees. Travel managers do negotiate the addition of routine services, such as exercise room access, internet, and breakfast, into rate contracts. Their efforts to date in this area with airlines have been far less successful. The table below intentionally excludes lunch and dinner, which often are not taken at the hotel.

Airline and Hotel Fee Reimbursement Policies		
651 responses from a survey of GBTA members and Egencia customers		
A la Carte Service	% of "Yes" for Hotel Fees	% of "Yes" for Airline Fees
Parking	89%	n/a
In room internet / onboard internet access	84%	35%
Airport - hotel shuttle	70%	n/a
Late check-out	24%	n/a
Fitness center	21%	n/a
In-room mini bar / alcoholic drinks	9%	6%
In-room movie / inflight entertainment	4%	3%

Source: Corporate Travel Policy Benchmarking and Insight 2011 report sponsored by GBTA and Egencia.

Contrary to travel media rhetoric, the world continued to turn on its axis after the introduction of a la carte fees by airlines. Companies do rely upon time-tested processes to administer the myriad of expenses incurred by travelers staying at hotels, driving rental cars, taking the subway, dining in cafes, and flying on airplanes. Unfortunately, the systems used by travel suppliers, credit card companies, and corporate travel departments, don't reliably speak the same language. Travel managers are also understandably sensitive to this latest challenge because air travel is a big part of the corporate travel budget. According to a global survey of more than 1,700 travel managers, air transport accounts for 47 percent of the average travel budget with lodging next on the list at 20 percent.⁹ The arrival of airline fees simply represents the latest in a string of challenges faced by travel managers.

Strange and wonderful treats are around every corner

The most frustrating (and for some the most exciting) feature of the ancillary revenue revolution is its unpredictability. Willy Wonka, the star of *Willy Wonka and the Chocolate Factory* and who could readily be our movie-theme mascot for this report, promised visitors to his chocolate factory "strange and wonderful treats around every corner." The kids in the story were delighted by the array of treats provided when they visited the factory, such as a chocolate river, lickable wallpaper, everlasting gobstoppers, and fizzy lifting drinks. But the adults in the story were nervous about the disruptive nature of Mr. Wonka and his very unusual factory.

⁹ AirPlus International Travel Management Study 2010, at AirPlus.com.

The metaphor describes the troika of personalities engaged in the corporate travel process. Travelers seek to pick and choose services that add comfort and convenience during a business trip. Airlines, like shopkeepers, are eager to provide an ever-expanding array of services to delight their customers and pluck more cash from their wallets. Travel managers are the unfortunate “parents” caught between the kids and the supplier of treats. Real life parents can use their eyes and ears to monitor the behavior of children. By comparison, travel managers seem poorly equipped to control the ever-changing buffet provided by a la carte pricing.

The challenge faced by travel managers is obviously frustrating. As shown in the survey results provided by a leading travel payment and management vendor, less than 40 percent of travel managers use headquarter-based tools to actively track airline fee spending. Most activity goes unreported or is captured by travelers through traditional expense reporting.

How is your company currently tracking airline ancillary fees? Multiple responses were accepted – Survey of 101 corporate travel buyers	
We are not tracking airline ancillary fee data	44.3%
Relying on travelers to include manually in expense reports	37.5%
Automated capability in expense reporting tools	14.8%
Manually reviewing corporate card reports for likely airline fee data	11.4%
Including fee menus in expense reporting tools	6.8%
In travel management company reports	4.5%
I don't know	4.5%
<i>Source: Ancillary Aggravation Eases report dated August 2011 from AirPlus.</i>	

Credit cards could be a reliable method to capture spending data. Here too, travel managers face limitations due to reporting inconsistencies. Airline fee reporting through credit card records remains elusive because fee coding varies by carrier and is not always used. Software has been developed that provides spending estimates based upon assumptions linked to a fee profile established for specific airlines. Simply stated, a la carte fees remain a moving target. Airlines keep developing “strange and wonderful treats” and continue to change how these services are sold.

Travel managers can do more to help themselves. A magic wand will not suddenly appear to fix reporting and control issues during 2012 or in the foreseeable future. Travel policies have often not been updated to address airline fees or are so vaguely worded as to invite disputes between employee and employer. For example, here’s how one company instructs travelers on the topic of airline fees:

Reasonable and actual airline fees, within the cabin class for which the traveler is authorized (such as coach or business class), are reimbursable. Such add-on fees include, but are not limited to, checked baggage fees and advance seat selection fees. Add-on airline fees should be paid by the traveler and submitted for reimbursement with an original detailed receipt.

This policy relies on the employee to discern the “reasonableness” of a fee and to disclose the purchase in an expense report. For a small company this might work well, but it’s not an effective method for a company spending millions on airline fees.

Help is on the way as the ancillary revenue revolution becomes more predictable. Anarchy is never a continuous condition; and contrary to current discontent, markets do become orderly and settled. IdeaWorksCompany offers these predictions on how the actors in this story will someday benefit from the flexibility and frugality promised by a la carte pricing:

- **Industry-wide standards are making a difference.** Initiatives such as EMD (Electronic Miscellaneous Document) make it easier for airlines to use global distribution systems to sell a la carte services. This is already used by some airlines to allow travel agents to book and prepay checked bags, extra legroom seats, and upgraded meals. Likewise, the list of Optional Services administered by the Airline Tariff Publishing Company (ATPCO) provides standardized codes that describe a compilation of 300+ individual services and fees.
- **Airlines will support a la carte sales through GDS.** The revenue potential is simply too tempting to ignore. With annual worldwide ancillary revenue at \$32.5 billion, this amount could jump to \$100 billion¹⁰ in the future, as travel agencies and online travel agents become integral components of ancillary revenue distribution. This boost will be provided by travel agents who deliver more than 60 percent of airline tickets sold worldwide through global distribution systems.¹¹
- **Reporting and spending controls will improve.** Travel managers will tighten spending controls by better defining the limits of a la carte fee reimbursement for employees. Credit card companies will implement more thorough reporting as a point of distinction for their payment products. Airlines will provide fee descriptions for their co-branded credit cardholders.

This report will close with a final analogy based upon the movie *Willy Wonka and the Chocolate Factory*. The story concludes when Charlie is the child chosen by Willy Wonka to inherit the Chocolate Factory. Throughout the movie, Charlie was the only child demonstrating self-control as one of the kids invited to visit the candy factory; this trait won him the big prize in the end.

This might be the element that’s missing from an analysis of how companies can better manage the cost of travel. A la carte pricing naturally allows the consumer to assume more control. Tied to this privilege is the necessity of restraint and better support from headquarters. After all, it’s not the shopkeeper’s fault — it’s the relationship between employer and employee that will best determine whether the company’s treasures are spent wisely. Here’s a fact worth repeating from the beginning of this report, “Shopkeepers are generally delighted by the commerce produced by eager children and permissive parents.” If you have any doubt, just chat with an airline CFO about ancillary revenue in an era of spiraling fuel prices.

¹⁰ The ABCs of EMDs report by IdeaWorksCompany (page 6) issued November 2011.

¹¹ Speech of Rob Fyfe, CEO of Air New Zealand, IATA World Passenger Symposium, 12 October 2011.

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- Is Greed Still Good? (75 minutes)
- Ancillary Revenue Boosts the Bottom Line (75 minutes)
- Moving to Merchandising Methods in the Cabin (90 minutes)
- Airline and Hotel Fees: Wicked, Good, Misunderstood? (75 minutes)
- Allegiant Air: How to Be Better Than Ryanair (60 minutes)

Frequent Flier and Loyalty Marketing:

- Loyalty by the Billions (60 minutes)
- Solving the Reward Availability Problem (60 minutes)
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Contact Jay Sorensen, President, IdeaWorks Company ■ Jay "at" IdeaWorksCompany.com ■ IdeaWorksCompany.com