

THE OFFICIAL JOHN F. BROWN COMPANY
 **RENTAL CAR PRACTICE NEWSLETTER**

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DEAR RAC CONSULTANT, WHAT I'VE BEEN WONDERING IS...

The rental car companies at my airport keep talking about how important it is that they be allowed to exclude discounts and coupons from gross receipts, and what is worse, at least once a year some of them want large credits for something they call "volume discounts." Should we allow these exclusions from gross receipts? The volume discount credits in particular are a problem for our accounting and auditing staff.

Although rental car companies, in their zeal to increase their market share and lure both corporate and leisure customers to their counters, continue to come up with increasingly aggressive pricing strategies, there are essentially two basic categories of pricing incentives of significance to airports in their definition of gross receipts: (1) coupons and discounts taken at the time of rental, and (2) discounts commonly known as volume discounts applied retroactively to apply corporate discounts "earned" by high rental volumes (that have the effect of reducing concession revenues after the rental has already occurred). Both categories present special challenges for airport concession definition development and particularly for audits of rental car concession revenues.

VOLUME DISCOUNTS

Some rental car companies, primarily the larger companies with a high percentage of corporate business, sometimes enter agreements with corporate customers that trigger a rate discount when the customer reaches a predetermined volume of business. These agreements are known in the industry as "Corporate Rate Agreements," and normally run for one to two years. Rental car companies use these agreements to lure corporate customers, and to encourage these customers to funnel as much of their business as possible to that particular car rental company.

Here is an example of how a "Corporate Rate Agreement" works.

Acme Car Rental has a contract with XYZ Corporation that guarantees a daily time and mileage rate of \$60.00 per day. The Corporate Rate Agreement with XYZ Corporation provides that, if XYZ Corporation does more than 5,000 rental days of business with Acme in any given contract year, Acme will rebate \$75,000 (\$15 per rental day times 5,000 rental days) to XYZ and charge \$45 per rental day for the remainder of the contract period.

The purpose of this rate arrangement is obviously to encourage XYZ Corporation to give as much of their business as possible to Acme Car Rental in order to achieve substantial cost savings in their travel spending.

When Acme rebates the "volume discount" for the first 5,000 rental days, Acme will then turn to all the airports at which XYZ Corporation rented cars and seek to recover from those airports the concession fee on that portion of the \$75,000 attributable to each of the airports.

So, if 25 of the 5,000 rental days occurred at WMR airport, Acme would seek a refund from WMR of \$37.50 (\$15 per rental day times 25 rental days times a concession fee rate of 10 percent).

Because these discounts apply retroactively, resulting in the rental car company owing a rebate to the corporate customer for rentals before the “trigger” volume was reached, the rebate effectively reduces the concessionable revenue at the airports where the corporate rentals occurred.

Retroactive application of volume discounts and resulting concession fee refund requests by car rental companies are, at best, a challenge to most airports’ financial planning, and often an auditing nightmare. The rental car companies who engage in this practice argue that they can track each rental of a corporate customer (such as XYZ Corporation) to the airport where it took place, and therefore can apportion the volume discount accurately. However airports and the rental car companies have had tremendous difficulty reaching consensus on what comprises adequate auditable backup for this position. If an airport chooses to allow the retroactive adjustment of concession fees and the deduction of revenues paid on volume discounts, the concession agreement should make clear the proof required before any concession fee refund can be received. By laying out these requirements in the concession agreement itself and requiring compliance before a credit can be taken, rather than just relying upon “generally accepted accounting standards,” an airport should be able to avoid the tug of war after the credits have been taken.

The larger question is whether these discounts should be allowed at all. The rental car companies argue that it is the spirit of a concession fee that it be paid on revenues actually received, and once a volume discount is triggered and the revenue differential is refunded to the subject corporation, the smaller revenue figure is now the revenue actually received. This is a salient argument, and the car rental consultant editors of this newsletter made that same argument many times in their former roles as rental car company advocates. However, the problem not addressed by this argument is that the concession fees have already been paid, the airports have counted the revenue, and in many instances have committed the revenue in their financial planning. Often in these situations, large rebates in the form of credits to the car rental companies can pose a hardship on an airport.

Dealing with volume discounts has become a bit more complicated as the recent practice of passing the concession fee through to the customer has gained broader application. In our example above, when XYZ Corporation pays \$60.00 per rental day, Acme adds a \$6.00 concession fee pass through charge and collects \$66.00 from XYZ Corporation. When XYZ Corporation’s volume discount is triggered, the effective per day rate is retroactively reduced to \$45.00 and arguably the rental car company is in the position of refunding both the \$15.00 per day rate change and the \$1.50 excess concession fee pass through collected from the customer. Whether or not the rental car company refunds the \$1.50 to the customer has been difficult to assess, but even if the excess concession fee pass through is refunded, the car rental company is still better off than in the days before the concession fee pass through when that excess concession fee of \$1.50 would have come out of the car rental company’s pocket in the first place.

Proving that Acme rebates the \$1.50 concession fee per rental day associated with the retroactive rate change is an added challenge. The actual industry practices are not well documented, but the concession agreement should be clear on this matter.

The primary issue is whether or not airports should allow volume discount adjustments to “already earned” concessionable revenue. And if an airport decides to allow the volume discounts, how should the airport prepare for audits of adjustments?

COUPONS / DISCOUNTS

The second category of discounts involves reductions to a rental rate provided by a rental car company to customers who might be a customer of a travel partner, or a member of an organization with a marketing relationship with the rental car company, etc. For example, when a customer reserves a car with Acme Car Rental, the reservation agent might ask the customer if they are a member of any organization (such as AARP) that has an arrangement with Acme Car Rental for a discount. If the answer is yes, the rate quoted the customer will be reduced at the time of the reservation. Alternatively, the customer might receive a discount coupon in the mail from such an organization, or from an airline or hotel travel partner, or from Acme itself. In that case, the customer will bring the coupon to the counter at the time of the rental. Either way, the amount the customer pays will be the discounted rate. The amount of the reduction rarely shows up on the rental agreement.

The critical distinction between these types of coupons or discounts and volume discounts is that the rate adjustment occurs at or before the time of the rental transaction, and does not pose a situation where the concession fee paid to the airport must be adjusted in any way.

Because car rental rates are a constantly moving target, and because these types of discounts and coupons are the result of marketing efforts by the rental car companies to increase their volume of rentals at an airport, it may be hard to gauge the actual value of such discounts or coupons. Identification of “phantom” revenue lost through discounts would be very difficult to establish. The idea behind an airport requiring the payment of a percentage of gross revenues against a minimum guarantee is that the airport is to be paid a portion of the revenues a concessionaire makes from each transaction. To attempt to collect on revenue the car rental company never receives because it chooses to essentially set its prices with coupons and discounts as a marketing effort is to effectively interfere with rental car industry pricing, and that is outside the scope and objective of a gross revenues approach.

ALTERNATIVE APPROACHES

Airports can, and have, taken a variety of approaches to dealing with these issues.

- 1) **Gross receipts equal “face value.”** Airports may choose to define gross receipts as that amount shown on the face of the rental agreement as the revenue for the transaction. In this approach, the airport allows coupons and discounts taken before or at the time of rental, but does not allow concession “credits” for the retroactive application of volume discounts. The audit burden on the airport is minimized by this approach, and the airport is not put in the position of having to either chase phantom revenue or suffer the impact of the marketing practices of rental car companies related to their corporate customers.
- 2) **Accept all discounts.** An airport can define gross receipts as “net of coupons, discounts and volume discounts,” thereby agreeing to permit volume discounts and agreeing not to pursue the revenue “lost” to coupons and discounts. This is the approach lobbied by the rental car industry, for obvious reasons. If an airport elects this approach, the audit issues associated with retroactive volume discounts can be

abated by including language in the concession agreement detailing the audit requirements, procedures, and record keeping the car rental companies agree, by entering the concession agreement, to follow to substantiate the retroactive adjustment.

- 3) **Add “coupon” revenue and allow volume discount adjustments.** Airports may elect to require the value of coupons and discounts taken at the time of rental to be included in gross receipts, but allow retroactive adjustment for volume discounts. If the airport chooses to make coupons and discounts “concessionable,” the concession agreement should be very specific in detailing the audit requirements, procedures, and record keeping the rental car companies must maintain in order to provide the airport the backup necessary to pursue this revenue. Again, the audit issues associated with retroactive volume discounts can also be abated by including language in the concession agreement detailing the audit requirements, procedures, and record keeping the car rental companies agree, by entering the concession agreement, to follow to substantiate the retroactive adjustment.
- 4) **Reject all discounts.** Airports may choose to disallow coupons and discounts taken at the time of rental, as well as retroactive adjustments for volume discounts. The prohibition of all adjustments to gross receipts eliminates the need for detailed audit procedures for the application of volume discounts, but calls for detailing the audit requirements, procedures, and record keeping the rental car companies must maintain in order to provide the airport the backup necessary to pursue this revenue attributable to coupons and discounts taken at the time of the rental.

We urge our clients to follow the “**Gross receipts equal ‘face value’**” approach. Far greater successes can be achieved by defining revenues to capture various categories of dollars received by rental car companies at the time of rental than by either chasing money never received due to coupons or discounts, or refunding money actually received but refunded due to marketing efforts outside of the purview of the airport.



JOHN F. BROWN COMPANY RENTAL CAR PRACTICE AREA

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