

Frequent Flyer programs — 25 years old and still growing

SO you've booked your flight using frequent flyer points: It's a bit cramped down the back of the plane but you're delighted to receive something for nothing from the airline you've faithfully supported for years, writes Ian Jarrett.

But how much is the airline really giving away? How much does your favourite airline benefit from your decision to book that seat with frequent flyer points accumulated through credit card spending? And how much has that 'free' flight cost you?

A flight from Perth to Sydney may be worth several hundred dollars to a passenger, but the marginal cost of giving away an otherwise empty seat is estimated to be about A\$20 to cover the cost of ticketing, food (if it's served) and a few litres of extra fuel.

Airlines don't give away seats until they're confident that all paying passengers have been accommodated. So there's little or no displacement cost - the revenue lost when an award traveller preempts a paid ticket holder — to fly a non-paying passenger.

American Airlines launched its mileage-based AAdvantage frequent flyer scheme 25 years ago to encourage customer loyalty. Since then it has been estimated that 163 million people around the world collect miles.

No wonder airlines love their



frequent flyer programs. Not only do they encourage loyalty, often chaining a flyer to one particular airline or airline alliance — they also make money for a carrier, even when the core business — flying passengers from one point to another — is generating losses.

Mac Patel, who runs Sydney-based Travel Consulting Group (TCG), says that despite the overt focus by full service airlines on culling non-essential costs, "there is no sign that FFPs are being wound down or even simplified".

"The question for operators in today's straitened environment is not so much whether FFP programs should be retained, but how these loyalty schemes can be structured to be more effective and satisfy the dual and often conflicting priorities of enhancing competitive advantage and reducing expenditure."

As you sit back and relax onboard, consider this: According to The Economist magazine, frequent flyer points are the world's second largest currency. The total number of frequent flyer miles worldwide — about eight trillion — is worth an estimated

US\$500 billion. The number has risen 20 percent since the end of 2000, while in 2005 the total stock of unredeemed miles was worth more than all the US and other dollar bills in circulation.

There are now almost 100 ways to accrue frequent flyer miles, and many of them don't require boarding a plane. About 40 per cent of all frequent flyer miles today are earned on the ground.

Not everyone burns his or her miles, however. In the United States, unredeemed miles today, on average, account for 30 percent of the total.

The huge stockpile of unused FFP points has become a significant balance sheet burden for airlines at a time when the industry is subject to massive losses and spiralling debt, said Patel.

"As the larger carriers continue to review and restructure their FFPs, they are concentrating on the components most likely to deliver real value in competitive terms. As a consequence, the more mature and sophisticated programs in the Asian region have

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targeted high levels of membership growth in the next 12 months to drive revenue generation within a tightly controlled cost regime.

“By contrast, airlines in fledgling markets such as China are focused more on alliance-building to strengthen their FFPs as consolidation gathers momentum.”

Many airlines have followed American’s lead by allowing members to earn miles for purchasing goods and services at hundreds of establishments, including other airlines, hotels, restaurants, credit card companies, most categories of retailer, even mortgage and real estate brokers. For each mile earned by a program member, airlines bill the partner company between US\$0.01 and US\$0.02.

Those cents add up — to US\$1 billion annually for American Airlines, and close to US\$12 billion for the industry, estimates Randy Petersen, publisher of InsideFlyer magazine. A round trip of 12,000 miles is worth around US\$400 to an airline.

While the number of points earned per mile flown is a major consideration when choosing a program, so is the size of the airline’s network and the number of partners it has. Says Patel: “It’s no use choosing an airline that gives you twice as many points per mile as all the others if it only flies to three places and has links with two hotel chains and one small car hire company.

Travel Consulting Group’s research of major airlines flying to Australia indicated that Qantas has the most partners with 111 hotels, 25 airlines, six car hire companies and 16 financial services companies. Cathay Pacific has 18 airline partners and more than 150 non-airline partners.

Some people will do anything to get points - by legal means or otherwise.

When Wendy’s restaurants across America offered soft drink purchases redeemable for frequent flyer rewards, their garbage bins were looted by with people searching for the coupons attached to discarded cups.

Both Qantas — which has 4.3 million



FF members worldwide — and Singapore Airlines — have been victims of fraudsters. A former Qantas staff member hacked into his employer’s website and awarded himself 11 million FFPs — enough for 230 flights over two years. He browsed the Qantas database to find customers who had not claimed their points and moved them to his own account.

Last year a Singapore Airlines employee in Australia was jailed for fraudulently awarding himself 17.6 million miles.

If you are a Virgin Atlantic frequent flyer, you could even up in space. The UK carrier is offering to reward FF members with a trip on Virgin Galactic’s space tourism flight, due to launch in late 2008.

The catch? You’ll have to have two million Virgin FF points in your account, which for those members travelling on discount economy fares would equate to 218 return flights between Sydney and Hong Kong, or 95 Sydney to London trips.

If you believe your frequent flyer program advantages have been whittled down over the years, you’re probably right. Many frequent flyers complain that it’s more difficult to book free seats with their miles than it was a few years ago.

Catherine Wolthuizen from the Australian Consumers’ Association says one of the main problems is the scheme

has simply got too big for itself.

“Consumers find them so popular that they go out, use their cards as they’re meant to, paying it off within the interest-free period and getting the free reward. The banks are now trying to make them pay for that with higher fees, as much as 30 percent per year,” she says.

“What’s the point of paying a A\$60 a year fee for administering your frequent flyer credit card points if it takes you four years to accrue enough points to fly to Melbourne?”

The goal posts are frequently moved, forcing flyers to change their plans as their points are devalued by changes to conditions. Even worse is the prospect of losing points altogether, as happened with Ansett Australia Global Rewards.

Fears that US airlines operating under Chapter 11 bankruptcy protection may fold with the loss of members’ frequent flyer points has encouraged some flyers to protect their points with insurance.

In response to widespread fears of losing their frequent flyer miles, American Express recently began offering its credit card customers Air Miles Protection, an insurance policy for airline miles. Policies are currently available only to residents of 38 US states.

For US\$5.40 per month, members can protect up to 60,000 miles in the programs of American, America West,

Continental, Delta, Northwest, United and US Airways.

The legacy carriers are under pressure from low cost airlines, most of whom initially spurned frequent flyer and other loyalty schemes.

Virgin Blue recently unveiled its Velocity program, in conjunction with foundation launch partners National Australia Bank, Emirates, Virgin Atlantic, and Europcar.

Virgin Blue chief executive Brett Godfrey said the program was developed after studying "the experiences and frustrations of Australian frequent flyers, including members of our competitor's program and those who were members of the former Ansett Global Rewards".

Godfrey said one of the primary frustrations of existing frequent flyer programs was "not being able to get a seat when you want to travel". Velocity claims it will overcome frustrations by offering any seat redemption on "every flight, every route, every day, all year round availability". It also promises no blackout periods.

Patel concludes: "Today, FFPs are clearly more than a must-have or even an efficient marketing tool. They are an integral part of full service airline strategy with an aim to building stronger relationships with their high yielding customers.

"The emergence of the low cost airlines as competitors to full service operators does not so much raise the question of how long FFPs can be sustained, but how far value airlines might progress without them."

FLIGHTS REQUIRED FOR AWARD — LONDON-SYDNEY

Number of paid flights in Business Class required by loyalty schemes to earn an award flight in Business Class

FFP scheme	Flights required	Airline used
All Nippon Airways	3.37	Singapore Airlines
Singapore Airlines	5.44	Singapore Airlines
Cathay Pacific	5.49	Cathay Pacific
Qantas Airways	9.66	Qantas Airways
Emirates	6.98	Emirates

FLIGHTS REQUIRED FOR AWARD — LONDON-HONG KONG

Number of paid flights in Business Class required by loyalty schemes to earn an award flight in Economy Class

All Nippon Airways	4.63	All Nippon Airways
Cathay Pacific	4.00	Cathay Pacific
Singapore Airlines	5.50	Singapore Airlines
Emirates	4.23	Emirates
Qantas Airways	6.67	Cathay Pacific

Note: Figures are for basic membership level at January 2006. Round trips required for a free flight.

Source: Travel Consulting Group

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