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Analysis of the concept of Frequent-Flyer Programs

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1. Introduction

1.1 Definition

A Frequent-Flyer Program (hereinafter also referred to by the acronym FFP) is a customer loyalty scheme aimed at customers of a specific airline or airline alliance. Like loyalty schemes in other market sectors its purpose is to attract and ultimately retain customers to use the services provided by a certain company, in this case airlines.

1.2 Background

Airlines have tracked customer activity since at least the 1950's but the origins of the modern frequent-flyer program (e.g. one where the basis of revenue for the end customer is based on miles flown by said entity) is popularly said to stem from a scheme introduced in 1979 by Texas International Airlines (Rosen, 2019).

The oldest FFP still active today is AAdvantage, initiated and run by the US carrier American Airlines. It was launched in the United States of America on May 1st, 1981 (AA.com, 2020) and was within a week followed by the competing scheme Mileage Plus, offered by United Airlines (Rosen, 2019). Since then, frequent-flyer programs are found in abundance among airlines of the world and the mechanisms of retaining so called loyalty among passengers have evolved significantly to include tie-ins with credit card companies as well as collaborations with retailers of just about any product imaginable.

A survey made by Official Airline Guides found that 90% of business travellers participated in a FFP (Hanlon, 2007, p. 86).

1.3 Research Questions

What is a frequent-flyer program?
What are the key aspects of a FFP?
Do FFPs hamper fair competition?

1.4 Purpose

The purpose of this paper is to examine the nature of frequent-flyer programs, give the reader a basic understanding of their inner mechanics and purpose as well as discuss how they potentially harm competition.

2. Method

2.1

This paper draws upon analysis of course literature, reports and online based information. To provide context and expose certain mechanisms, the author have chosen to use various frequent-flyer programs as examples. These should not be interpreted as sole or unique examples of described features.

3. Key elements of a Frequent Flyer Program

3.1 Accrual of currency

Flying

The traditional method of accruing currency in a frequent-flyer program is connected to actual travel on a specific airline. Many airlines still refer to their FFP currency simply as “miles” (AA.com, 2020.) while others market them under a different title. As an example patronage on eligible flights on Scandinavian Airlines earns members of their EuroBonus program “points”, British Airways instead calls their currency “avios”, et cetera.

Currency name aside, actual earnings may be wholly based on actual distance of a planned flight route, a pre-defined value or ticket price. Different programs also adds multipliers to earnings depending on price of tickets, booking class or as part of marketing campaigns.

Credit cards

Many financial establishments offer co-branded credit-cards in cooperation with airlines. An example is the range of SAS EuroBonus MasterCard options, offered by SEB Kort Bank AB, a credit card issuer wholly owned by the bank Skandinaviska Enskilda Banken. These credit cards are part of the global MasterCard network and earns the owner EuroBonus points on expenditure made using the card. (SASEuroBonusMasterCard.se, 2020).

Partner offers

FFPs have evolved into offering members currency by a wide variety of means other than actually being a patron of the airline itself. By using a bespoke website, members of the previously mentioned program EuroBonus can earn points on everything from household electricity bills to magazine subscriptions (SAS.se, 2020).

Real currency aquisition

Some FFPs offer the member the option of purchasing points using real currency.

3.2 Redemption of currency

Reward flight tickets

The traditional market for points earned through FFPs naturally is that of redemption in the form of flight tickets. The exchange rate will depend on length of travel and cabin class of choice. The exact number of seats available for booking using points will be limited on each flight. Some FFPs also offer the choice of a mixed payment model where part of the fare price can be paid using points and the rest by actual currency.

Other forms of redemption

As is the case with accrual, points can often be used to pay for other airline specific services (e.g. on board offerings and cabin class upgrade) as well as de facto payment for other products offered in cooperation with various merchants.

3.3 Status levels

Frequent-flyer programs often involve so-called status levels where the member according to a set criteria can be elevated (or downgraded) to reach different tiers. These will involve various sets of perks and in the case of alliance connected airlines often are recognized by partner airlines. As an example, a member of Lufthansas Miles & More program who've achieved "Senator status" will in turn be recognized as a Star Alliance (the alliance of the Lufthansa Group) Gold Member and be able to use any Star Alliance Gold Member lounge worldwide (Miles-and-more.com, 2020).

3.4 Universal recognition and transferability of assets

The legacy loyalty schemes were walled off from competition. Earnings as well as awards were locked to each program and were neither recognized or transferable. With the advent of airline alliances in the late 1990's (further discussed in section 4.1) this has changed somewhat and to a certain extent FFPs are today recognized and useable among carriers within a given airline alliance.

Additionally some FFPs offer a limited possibility to exchange points back and forth between other loyalty schemes. This either using a third party exchange, such as the one offered by www.points.com, or through their own service (where other currencies likely belong to companies who already are accrual partners of the program).

4. Discussion

4.1 Do FFPs hamper competition?

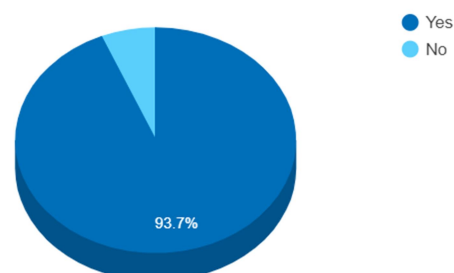
What undoubtedly started as a tool for airlines to reward frequent travellers for their patronage has arguably grown into something that could be viewed as a legitimate business proposition in itself. Today the power wielded by the bigger FFPs are a force to be reckoned with and one of the best ways to exemplify this importance is how strong, well-recognized brands (e.g. American Express, The Economist and others) will pay many FFPs for points and branding rights in order to attract customers to use their respective services. This is a profitable arrangement, especially for the airline behind the loyalty scheme who are being paid for points that on one hand can be viewed as outstanding debt on their balance sheet – a debt that however has a high chance of being written off as the points eventually expire if remained unused for a set amount of years. One estimate put the percentage of unused points as high as 25% (Brown, 2013).

The very first airline alliance, Star Alliance, was formed in 1997 by five major airlines and was soon followed by two competing clusters of airlines – OneWorld (1999) and SkyTeam (2000). Within each alliance FFPs of member airlines are recognized to a certain level and points can as a rule be earned (or spent) on the “home carrier” as well as an alliance member. In theory this arrangement could foster healthy competition as a customer could choose between different carriers and receive their loyalty benefits even if travelling with a competitor. In reality however this hypothetical case is built on the premise that two (preferably more) alliance members would compete on the same route, with identical route structure. This is rarely the case and often the consumer instead will be left with the choice of flying point-to-point (or at least with less stops along the route) with their home airline or through an alliance member hub. Even though points in both cases will be earned there is also the added complexity of different earning structures between airlines. Additionally, this example also leave out competition from competing alliance airlines or independent carriers – who instead have to compete using price or convenience factors (scheduling, point-to-point flights, more conveniently located airports, et cetera).

A poll hosted on two platforms (LinkedIn.com and BusinessClass.se) by the author in July 2020 revealed that out of 221 respondents, 93,7% (207 respondents) agreed that they were willing to pay more for a ticket with a carrier that would reward them FFP points rather than save on airfare with a different carrier but not gain points (see Figure 1).

Figure 1.

”Are you willing to pay more for a plane ticket with a carrier that earns you frequent flyer points rather than book with a carrier that is cheaper but not affiliated with your FFP?”



The fact that the responding people are networking professionals and/or travellers willing to participate in a forum built around airline loyalty schemes left aside, this is a strong indication that FFPs affects price elasticity among its users. It additionally hints at the problems of enticing customers that a new market entrant would have to face.

One option to any contestant would of course be to launch their own frequent-flyer program. After all, as many as 97% of European business travellers are members of more than one FFP (Hanlon, 2006. p. 90). Still, for anyone but travellers who reach the upper tiers of any program and hence have lost their incentive to pick one over the other when making a informed choice between airfares, this presents a situation where the incumbent has a strong upper hand over the challenger.

Finally, even though FFPs on their own are a profitable leg of many a airline business it should be underscored that starting and maintaining one involves substantial financial expenditure. One could very well argue that these costs could be offset against traditional marketing methods, but to a newcomer it would nonetheless pose yet another barrier to market entry.

4.2 Should the legislator intervene?

At first glance frequent-flyer programs may seem like a surefire win-win solution for everyone involved. They are popular with consumers as they provide kick-backs and perks. Likewise they are a valuable asset to airlines - providing additional cashflow when partner companies (e.g. credit card issuers) purchase points in advance for re-distribution, doubling as a marketing tool while at the same time lowering price sensitivity among customers.

However, as previously suggested there are a few objections that can be raised when measuring the attributes of a generic frequent-flyer program using free-market criteria. Tretheway (1989) calls them undesirable and even harmful to society, notably years before mergers and alliances further strengthened their market presence and power.

So what can be done from a legislative standpoint?

Recognizing the inherent problem of regulating an industry that is borderless by nature we still can consider a few potential solutions to problems concerning how strong frequent-flyer programs skew competition.

Norway have previously forbidden (and subsequently allowed) point accrual on certain routes where competition have been deemed threatened by a dominant actor (SASgroup.net, 2012). This is a less intrusive option than shutting down a program entirely, it evens the playing field and the regulator can always return privileges when competition is judged healthy and viable.

A more groundbreaking concept would be mandating frequent-flyer programs to accept transferability of points, both allowing exchange of points to competing schemes as well as inbound transfers. A passenger could then be a FFP member of

airline A, travel on airline B and accrual points that then were allowed to transfer in a non-punitive procedure to said FFP.

Taking the concept even further would be to create a global loyalty scheme which all airlines tap into. Hence travel on any airline would bring in points gathered in a universal wallet that then would be mandatorily recognized by any airline running a FFP. The immediate benefit to the consumer would be obvious – the choice of airfare wouldn't be overtly influenced by the scheme affiliation. It is very likely that the operators of current FFP behemoths would fight anything even remotely reminding of this suggestion. Additionally there would exist considerable hurdles in creating a balanced scheme were no partaking partner would be negatively hit (by bearing the brunt of redemption) while others gained significantly (seeing a surge in passengers who were awarded points that never however were redeemed by said airline).

A third (and final) reflection would be to simply let things be the way they are. It could very well be argued that loyalty schemes have grown into essential features of airlines - just like offering varying legroom, food service and different cabin class products. A well-managed, attractive FFP then would be seen as a nothing more than a feature and its existence yet another puzzle piece to carefully evaluate for any passenger making an informed choice.

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Figure 1. Poll run on LinkedIn.com social feed (<https://www.linkedin.com/in/pilotdaniel/>) and BusinessClass.se (<https://www.businessclass.se/forum/threads/betalar-ni-mer-f%C3%B6r-att-f%C3%A5-po%C3%A4ng.99748/>) between July 16th and July 18th 2020. Total number of respondents: 221. [online] Available at: <https://www.poll-maker.com/poll3023696x37e64028-93>