LOYALTY MARKETING REPORT SERIES FOR 2014

# Revenue-Based Accrual as the New World Order

With United following Delta to revenue-based loyalty, what are the implications of these fundamental shifts in loyalty marketing programs?

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Issued 15 September 2014

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## Contents



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Issued by IdeaWorksCompany.com LLC
Shorewood, Wisconsin, USA
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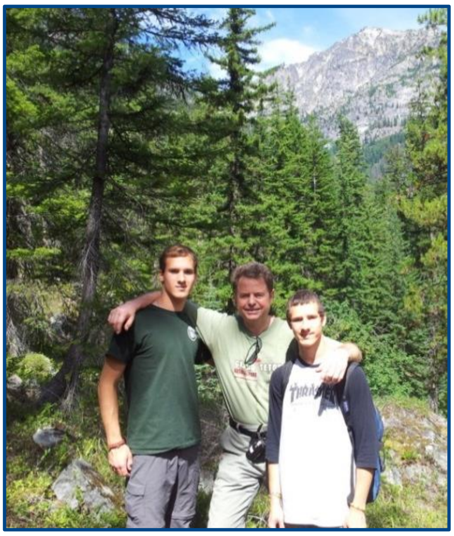
## About Jay Sorensen, Writer of the Report

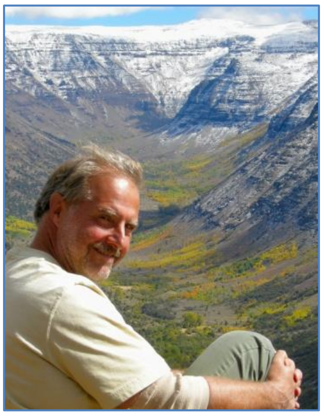


*Jay, with sons Anton and Aleksei, on the North Fork Trail in North Cascades National Park in Washington.*

Jay Sorensen's research and reports have made him a leading authority on frequent flier programs and the ancillary revenue movement. He is a regular keynote speaker at the annual MEGA Event, spoke at IATA Passenger Services Symposiums in Abu Dhabi and Singapore, and has advised the US Congress on ancillary revenue issues. 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.

Mr. Sorensen is a veteran management professional with 30 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 Michelin travel guides, Delta *Sky* Magazine, *Alaska Airlines Magazine, Westways Magazine* and numerous other publications. Founding editor of *Midwest Airlines Magazine,* he is the author of eight books, including the 2013 Michelin Alaska 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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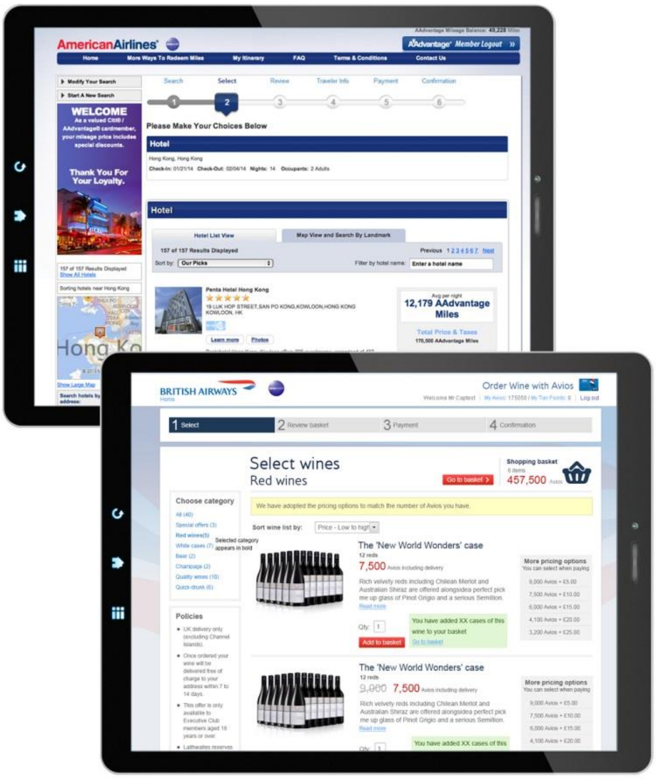


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## Revenue-Based Accrual as the New World Order

Delta Air Lines has certainly created a strong tailwind for itself. Profits are at record levels, corporate debt is declining, lie-flat seating has been introduced globally to business class, and the cash dividend has been increased for investors.[1] The changes testify to the better conditions enjoyed by travelers, employees, and investors, as the US airline industry frees itself of the ills of recurring bankruptcy, unbridled growth, and fares that don't cover operating costs. Financial paralysis is leaving the corporate body and minds are clearing to conduct the business of competing through new products . . . rather than low prices. Delta has expressed a profound eagerness to change almost everything about its business, so it's not surprising this philosophy finally touched the SkyMiles program. This report reviews how the frequent flier business is positioned for change due to moves made by key players and their desire to compete on the basis of innovation in accrual methods. (Elite status is a different topic not covered in this report.) There is much to learn from the efforts of Delta, Southwest, and Qantas as they introduce big changes to their loyalty programs.

### The times they are a-changin'

That's the title of a popular ballad by American singer-songwriter Bob Dylan. It's an appropriate line to introduce the change announced by SkyMiles on 26 February 2014. Similar to the protest nature of Dylan's music, Delta's changes had the result of angering, delighting, and confusing various constituencies. That's the outcome to expect when any boat is rocked, and the changes announced by Delta certainly disrupted the smooth sailing of anyone who took the time to play with the Mileage Comparison Calculator displayed at the carrier's website. Gone forever as of 01 January 2015 is the notion an economy class fare accrues miles on the basis of distance flown. Instead, the almighty US dollar will determine the miles posted to member accounts. For example, a regular member receiving 3,892 miles today for a $274 roundtrip between Los Angeles and Atlanta will earn 1,370 miles for the same trip in 2015.

*Delta makes it easy to compare old and new. Here a $274 base fare for roundtrip Los Angeles – Atlanta travel in October 2014 is compared under current and 2015 accrual methods for a general (non-elite) member.*
*Image: Delta.com website*

[1] "Delta: Setting A New Standard" investor presentation dated 04 June 2014 at Delta.com.

The new math is far more dramatic when higher fares and top-elite status are considered. There will be roundtrips that can accumulate the maximum allowed limit of 75,000 miles. Just imagine, a single long haul roundtrip taken in business class by an elite member can deliver the reward of three US domestic roundtrips at 25,000 miles each. Make no mistake, the business of airline loyalty dramatically changed with Delta's announcement. This currency revaluation is already reverberating through a global airline market of miles, points, rewards, and status.

### Mileage-based accrual prevails today

The airline industry is unique in its avoidance of revenue-based accrual. Virtually every other industry links loyalty programs to consumer spending. Retail, telecom, petrol, grocery, utilities, and service providers value customer relationships based upon the amount spent and not arbitrary metrics such as distance and time. Tesco, the UK-based discount retailer, provides Clubcard members one point per pound spent. Grocery purchases at Woolworths in Australia earn one Qantas point per dollar spent with the Everyday Rewards program. Residents of Singapore shopping for consumer electronics at a Challenger store accrue one ValueClub point per dollar spent.

Frequent guest programs universally rely upon spending to determine member accrual. Members of Hilton HHonors, Marriott Rewards, IHG Rewards, and Starwood Preferred Guest don't accrue points based upon the number of room nights, guests per room, or quantity of pillows. These global companies only care about the bottom line and that's measured by the guest's room rate and other spending such as food and beverage.

*Imagine the fun and frolic . . . had hoteliers based accrual upon the number of pillows on your bed rather than the mundane metric of guest spending.*

Airlines can be somewhat forgiven due to the early history of frequent flier programs. When these programs were launched in the early 80s, the majority of reservations were booked by travel agents. Their computer systems did not transmit the fare purchased by the traveler. Only after a paper ticket was lifted at the airport, and processed through the complexity of a "revenue accounting" system, did the airline know the true value. Even today, this data is lacking in some alliance and codeshare relationships. Loyalty marketing demanded a far easier and quicker posting of accrual than this system could deliver. But the airlines did know how far a passenger flew based upon origin and destination.

Fares back then were predictably tied to distance and so an early accrual method was born. Frequent flier program members would accumulate miles based upon the distance flown. But airline deregulation severed the convenient link between distance and pricing. Very low fares for long trips and very high fares for short trips began to appear. So-called "mileage runs" in which an absurdly low fare would accrue an amazing quantity of miles became popular topics for program evangelists. Likewise, high value customers paying big ticket prices earned the same amount of miles received by members paying the lowest fare for the same flight.

Airlines began to tinker with their loyalty machines to create more equitable distributions of mileage wealth. Business class travel delivered double miles. Sometimes discounted fares accrued reduced mileage, or maybe no miles at all. Airlines couldn't ensure better customer service for their best customers, but they could shower them with more miles.

Bonus miles for silver, gold, and platinum elite members were created as a perk for high value customers. Airline marketers and finance people conspired to better align program perks with the value of a customer being reflected by the revenue per mile flown ("yield"). Fare codes began to influence the accrual of miles and consumers found themselves in a world in which a "W fare" might accrue 25% of the normal miles and a "U fare" would get 135%. If the best loyalty methods are based upon clarity and a lack of complexity . . . these were methods that only the most committed could comprehend.

**Table 1: Key Accrual Methods Used by Frequent Flier Programs**

| **Accrual Method**<br>*Airline Example* | **How it Works** | **Benefits for Airlines** | **Disadvantages for Airlines** |
|---|---|---|---|
| **Simple Points**<br>*Flybe - Rewards 4 All* | Points are accrued on a trip or segment basis with possible adjustments for fare types. For example, a flight on Flybe accrues one point for most fare types. | • Program administration and accounting is simple.<br>• Consumers easily understand how many points are earned.<br>• Favors lower fares and short distance commuter travel. | • Linking accrual to yield requires complex bonus structure tied to fare codes.<br>• Loyalty incentive is weakest for longer distance and higher yield travel. |
| **Mileage Based**<br>*American - AAdvantage* | Accrual is based upon distance traveled and posted as miles or kilometers. Lowest priced fares accrue full miles. Higher priced fares earn a bonus such as double miles. | • Most traditional of the methods and has gained acceptance through widespread use.<br>• Favors lower fares and long distance commuter travel. | • Linking accrual to yield requires complex bonus structure tied to fare codes.<br>• Loyalty incentive is weakest for higher yield travel. |
| **Discounted Mileage**<br>*Japan – Mileage Bank* | Accrual is based upon distance traveled and posted as miles or kilometers. However, accrual for lowest priced economy fares is reduced. For example, discounted economy fares on JAL accrue at 30%, 50%, and 70% of distance flown. | • Based upon the tradition of the mileage-based method so consumers are familiar.<br>• Reduces reward expense associated with low yield travelers. | • Linking accrual to yield requires complex bonus structure tied to fare codes.<br>• Some airlines exempt lowest fares from accrual which reduces FFP participation and co-branded credit card use. |
| **Zone Based**<br>*SAS – Eurobonus (intra Europe routes)* | Geographic zones determine how many points are accrued. Domestic flights within Nordic countries earn 500 points (Go fares) and 1,000 points within most of Europe on SAS. | • Program administration and accounting are simple.<br>• Easy to describe accrual rates to consumers.<br>• Tends to favor lower fare travel. | • Accrual levels not intuitive and must be displayed.<br>• Linking accrual to yield requires complex bonus structure tied to fare codes.<br>• Does not integrate well with other carriers that are mileage-based. |
| **Revenue Based**<br>*Pegasus - Plus* | The amount spent by the consumer determines accrual. Pegasus Plus members earn points for the purchase of tickets, excess luggage, meals, and seat selection. | • Easy for consumers to understand.<br>• Aligns reward expenses with individual fare yields.<br>• Good method for integrating a la carte sales into the FFP. | • Newest method and requires system changes and consumer education.<br>• Does not integrate well with other carriers that are mileage-based.<br>• Strategy might discourage favor lower yield travelers. |

*Data collected from airline websites August 2014. Analysis by IdeaWorksComany.*

As demonstrated by Table 1, there is variation in the methods used by airlines. The overwhelming choice is the accrual of miles or kilometers based upon the distance flown by the member, described as mileage based or discounted mileage in the table. Participation in a global airline alliance encourages standardization. This is especially true among the smaller carriers in the alliance; the global network airlines define a common standard by default due to their huge presence. That's why Delta's changes will have a profound effect all over the world . . . and also explains why the moves made by Southwest (a non-alliance airline) didn't have the same impact.

## Southwest and the all new Rapid Rewards of 2011

Southwest Airlines re-launched its Rapid Rewards frequent flier program on 01 March 2011 with the promise of "**No blackout dates. No point expiration. Every seat is a reward seat**."[2] It was a bold move designed to vastly expand customer participation. The former program offered the strongest appeal to short-haul commuters – short hop, low fare fliers − who flocked to Southwest in its early years. The airline and its customer base had evolved, but its program had not. Longer flights and casual fliers had become prevalent. Passengers flying less than 8 trips during a two year period never qualified for a reward trip due to a severe credit expiration policy. Long haul and higher fare customers accrued at the same rate as someone who purchased a $29 ticket for a 50-minute flight. Reward options and perks for elite members were very limited and compared poorly to other loyalty programs.

The result was an almost complete makeover of Rapid Rewards. The program switched from simple points style accrual to a revenue-based method. Members could now buy rewards, and have access to every available seat, by spending their accumulated points. International air travel, hotel stays, and gift cards were added as rewards made available to co-branded credit cardholders. The draconian expiration policy was replaced with a far friendlier method that only required activity during a 24-month period to keep points current. According to program management, the process took four years from conception to implementation.[3]


*Southwest has dealt itself a very good hand of cards. IdeaWorksCompany estimates ancillary revenue from the Chase portfolio is now nearly $1 billion . . . up from an estimated $233 million in 2010.*
Source: Yearbook of Ancillary Revenue by IdeaWorksCompany

The results have been extremely positive for the airline. Program membership increased, participation rates jumped, and the co-branded credit card portfolio produced millions more in ancillary revenue. Robert Jordan, COO for the airline, commented on the success of Rapid Rewards in an article in *Forbes* magazine, "*We're seeing just a tremendous response to the program. The share of wallet that we get. The annual spend per member. Every single metric is up double digits. Every year since we introduced the program. Our Chase Rapid Rewards Visa card is one of the largest Visa card portfolios in the world. And it's seen just tremendous growth since we've changed the program*." [4]

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[2] "Southwest Airlines Introduces the All-New Rapid Rewards Program!" press release dated 05 January 2011 at Southwest.com.
[3] Jonathan Clarkson, Director of Rapid Rewards, July 2014 conversation.
[4] "Southwest COO Robert Jordan on Business Traveling, Rising Fares" article dated 20 May 2014 in *Forbes*.

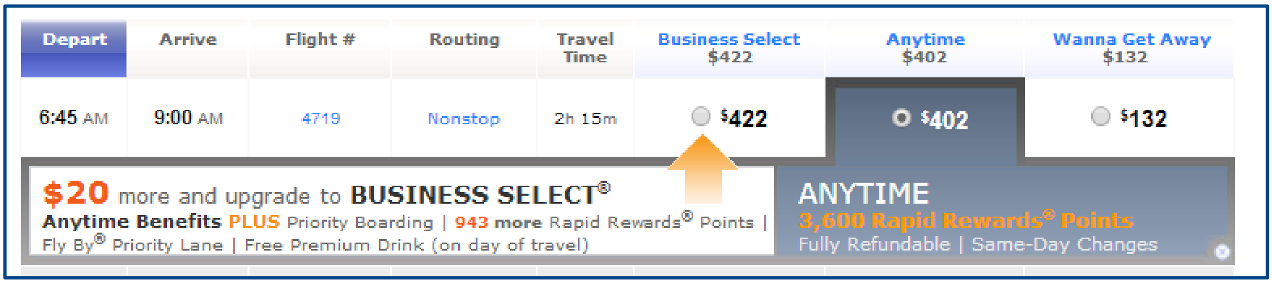
Some were not happy with the change. There was a noticeable volume of negative mail from members and critical posts made by those who comment on the business of loyalty marketing. Southwest management anticipated these issues. Confusion and anger were addressed by a very thorough communication strategy that focused efforts on opinion makers. The potential loss of business from select customer groups was mitigated by targeted offers that delivered bonus points as a perk to ease transition pains.

Linking point accrual to spending and reward redemption to market fares motivates members to be financially aware. They behave like any consumer participating in a "cash-based" economy. Rapid Rewards members are more frugal when buying rewards and look for the best deals. Fortunately for Southwest, these are also the least-popular flights. When the airline places its fares on sale, its reward prices also drop. This is a significant distinction from Delta SkyMiles, which did not announce a switch to a pay-with-miles redemption method. Southwest also differs from Delta by using a different style multiplier method for accrual.

Southwest offers three fare types: Business Select, Anytime, and Wanna Get Away. Business Select offers the most perks and is priced highest; Wanna Get Away delivers the lowest price. The accrual multiplier favors higher yields:

- Business Select accrues 12 points per $1 base fare.
- Anytime accrues 10 points per $1 base fare.
- Wanna Get Away accrues 6 points $1 base fare.

The airline works to remove any mystery regarding the quantity of points provided by each fare. Clicking on a price during the booking process creates a pop-up that not only defines fare benefits, but also lists the exact accrual for the ticket purchased.




*Southwest puts the perfect points pitch in the booking path; $20 buys 943 more points and of course, a few more perks.*

The price difference between Business Select and Anytime fares is quite modest. The bonus points accrued are undoubtedly a motivating factor for many customers choosing to upgrade themselves to the Business Select product (seat size remains the same). Elite members also receive more points for every trip taken. Southwest's lowest tier is A-List and provides a 25% bonus, while A-List Preferred provides an oh-so-generous 100% bonus.

Concurrent with introducing revenue-based accrual, Southwest completely remade its reward structure. Points can be used to purchase reward travel in much the same manner as cash. The carrier's website allows consumers to easily toggle between cash and point prices with the click of a mouse. Travelers who plan ahead can enjoy terrific bargains in the same manner they do when using their credit card to buy a non-reward ticket.

The consumer truly benefits when the revenue-based accrual and pay-with-points methods are paired. Members who accrue fewer points – because they buy cheaper fares – can compensate by looking for reward ticket bargains. But it's the high value customers who really benefit from this pairing. Table 2 lists the point accruals and reward paybacks associated with various combinations of fare levels and elite status.

**Table 2: Comparing Reward Payback for Southwest Rapid Rewards**
Based upon economy class travel between Atlanta – New York (LGA) as an example

| Fare Type | R/T Base Fare Amount | Elite Status | R/T Points Accrued | Reward Price Observed | Paid Roundtrips Required for a Reward * |
|---|---|---|---|---|---|
| Wanna Get Away | $218 | None | 1,306 | 15,238 points Wanna Get Away roundtrip reward | 11.7 |
| | | A-List | 1,633 | | 9.3 |
| | | A-List Preferred | 2,612 | | 5.8 |
| Business Select | $757 | None | 9,086 | | 1.7 |
| | | A-List | 11,358 | | 1.3 |
| | | A-List Preferred | 18,172 | | 0.8 |

*Data collected from Southwest.com August 2014. Calculations by IdeaWorksComany. Travel dates were 01-08 October 2014.*
** Calculated by dividing Reward Price Observed by the R/T Points Accrued.*

The table uses the Atlanta – New York LaGuardia (distance of 1,522 miles) market as an example with air fares varying from $218 to $757 for a 01 October 2014 departure and an 08 October return. Based upon the member's elite status, accrual ranges from 1,306 to 18,172 points. The lowest reward seat price for the same dates (and seemingly for the market overall) is 15,238 points. The right side column in Table 2 displays the result of dividing this reward price by the accrual amount.

At the lowest fare, and no elite status, less than 12 roundtrips are required to receive an Atlanta – New York reward ticket. This result would fall when reward prices are higher. For example, nearly 37,000 points was the posted reward price for a query made a few days before departure in August. Members with A-List Preferred status, who also happen to purchase high yield fares, realize a windfall of points which can reliably provide a free reward ticket on a large number of Southwest routes.

## High value customers are highly accrued

Delta Air Lines didn't impulsively make its big "2015 SkyMiles Program" announcement on 26 February 2014. The evaluation, according to a SkyMiles executive, began 5 years earlier and was initiated by the frequent flier group at the airline.[5] There was once a correlation for FFPs between the fare paid and mileage flown, but pricing had changed and the connection between revenue and mileage became less direct. There was a growing desire to have accrual tied to revenue. Under today's system, a passenger paying a $218 fare for roundtrip Atlanta – New York travel accrues the same as someone who pays $751. The disparity becomes far larger when transcontinental economy and business fares are compared. Those paying $218 are delighted by the status quo . . . while the higher fare customer feels . . . in a word . . . cheated.

[5] Karen Zachary, Managing Director, SkyMiles, July 2014 conversation.

It might be easy to accuse Delta of making a major gamble with this change. But outsiders should be cautioned about jumping to conclusions without the benefit of the scope of data that Delta executives undoubtedly tapped during its 5-year journey. The airline knows which passengers provide the most profit. There are obvious indicators of this when reviewing recent press releases . . . full flat beds have been added, premium economy is now offered, SkyClub locations are undergoing renovation, and VIP check-in is available at more key airports.

*To sleep perchance to earn. Starting in 2015 Delta BusinessElite travelers will rest soundly under their duvets while accruing thousands more miles.*
Image: Delta Air Lines website.

Airlines spend big money in areas that offer the most potential. Said another way, Delta can realize revenue of 74 cents (US$0.74) for every mile they fly a business class passenger between Atlanta and London . . . and 12 cents ($0.12) for a passenger sitting in economy.[6] That's greater than 6 times more. Of course, higher costs are associated with business class. But who do you think is going to capture the most management attention?

When redesigning a program, the easiest choice would be to give every member more miles. But economics don't work that way, unless you are a member of Congress. In the real world, someone's good fortune equals a bit less for someone else.

The accrual change proposed by Delta means the majority of travelers will accrue less while a smaller group will earn appreciably more. Table 3 compares the results of the mileage-based and revenue-based methods. Delta's accrual multiplier is based upon the status of the member and ranges from 5 to 11 times the base fare. For basic members traveling in coach, the revenue-based method provides more miles when yield is above 20 cents ($0.020) per mile. The results of the reduction are very visible in the right side column. Likewise, higher yield travelers realize the very pleasant effect of doubling (or more) of points accrued.

**Table 3: Comparing Delta Accrual and Reward Using Current and 2015 Methods**
Based upon economy class travel between Atlanta – New York (LGA) as an example

| Fare Type | Yield | Elite Status | Current Mileage Accrual | 2015 Mileage Accrual | 2015 Compared to Current |
|---|---|---|---|---|---|
| Supersaver $218 roundtrip | 14 cents per mile ($0.14) | None | 1,522 | 1,090 | -28% |
| | | Silver | 1,902 | 1,526 | -20% |
| | | Gold | 3,044 | 1,744 | -43% |
| | | Platinum | 3,044 | 1,962 | -36% |
| | | Diamond | 3,424 | 2,398 | -30% |
| High fare $751 Roundtrip | 49 cents per mile ($0.49) | None | 1,522 | 3,755 | 147% |
| | | Silver | 1,902 | 5,257 | 176% |
| | | Gold | 3,044 | 6,008 | 97% |
| | | Platinum | 3,044 | 6,759 | 122% |
| | | Diamond | 3,424 | 8,261 | 141% |

*Data collected from Delta website August 2014. Calculations by IdeaWorksComany.*

[6] Review of fares August 2014 at Delta.com for 01-08 October 2014 Atlanta – London roundtrip.

Delta's US domestic average passenger yield was approximately 15.7 cents ($0.157) per mile for 2013.[7] This suggests a considerable number of Delta's passengers will accrue fewer miles starting in 2015 as average yield is below the 20 cent tilting point described above. There's another statistic to note and it may explain why Delta is changing to revenue-based accrual. According to a survey of business passengers who fly Delta, 64 percent are unmanaged travelers.[8] Essentially, these consumers are free agents who are not controlled by corporate travel policies. The high yield travelers within this group are perfect candidates for the combined mileage boost provided by the 2015 changes and ongoing roll out of premium product enhancements. Here's the statistic that reveals even more; the top 4 percent of Delta's customers represent more than 25 percent of its revenue.[9] Attracting a few more customers at that level can swing profits by the millions.

There is risk here. Financial modeling has its limits and experience will ultimately be the best teacher. Beyond Southwest, the path of revenue-based accrual has been traveled by frequent guest programs all over the world: Airpoints by Air New Zealand (2004),[10] Velocity from Virgin Australia (2005),[11] Punto by Vueling (2006),[12] Elevate from Virgin America (2007),[13] Norwegian Reward (2007), TrueBlue by JetBlue (2009),[14] WestJet Rewards (2010), and PINS associated with airBaltic (2011),[15] BIG associated with AirAsia (2011),[16] and Pegasus Plus (2012).[17] Of course, virtually every hotel loyalty program from Best Western to Wyndham already bases accrual on guest spending. Focus groups conducted by Delta indicated it was easier for consumers to accept change from Southwest than Delta.[18] Fortunately, over time the majority of consumers are "getting it" because revenue-based accrual makes intuitive sense. But they arrive at this conclusion more slowly because Delta is a major airline with a long history of operating a mileage based program.

Rewards are a key component of a frequent flier program and Delta's changes here are less dramatic. Changes for 2015 include the introduction of one-way rewards, miles + cash redemption, and a promise to provide more reward seats at the lowest redemption levels. The carrier has already made progress on the latter, as Delta's result in the Switchfly Reward Seat Availability Survey for 2014 jumped by 18.6 percentage points from 2013. But the airline hasn't revealed further plans, such as adopting the pay-with-points reward method used by Southwest.

## Qantas chooses revenue-based complexity

Within months, United followed Delta when it announced changes to its MileagePlus program effective 01 March 2015. Even the same accrual multiplier levels were adopted, ranging from 5 to 11 miles per dollar spent. However, Qantas jumped Delta and United by implementing its revenue based accrual system on 01 July 2014.[19]

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7 US DOT Form 41 US Bureau of Transportation Statistics (schedules P12 & T2) viewed at MIT.edu.
8 Atmosphere Research Group's US Travel Online Survey, Q1 2014.
9 "Delta Plots Major Rewrite of Frequent-Flier Rules" article dated 26 February 2014 in the *Wall Street Journal*.
10 Air New Zealand press release dated 12 November 2004.
11 "Virgin Blue's Velocity Program" article in Edition 7 (Dec 06 - Feb 07) in *FFP Online* (AirlineInformation.org).
12 Disclosure to IdeaWorksCompany by Vueling executive, September 2014.
13 "Virgin America Launch: Frequent Flier Program Pays You Back for Money, Not Miles" article dated 02 August 2007 at Jaunted.com.
14 "JetBlue's Revamped TrueBlue Program Touches Down" press release dated 11 November 2009 at JetBlue.com.
15 Disclosure to IdeaWorksComany by PINS (originally BalticMiles) executive, September 2014.
16 "AirAsia launches loyalty scheme to boost sales" article dated 14 November 2011 by the Associated Press.
17 CarTrawler Yearbook of Ancillary Revenue for 2013, page 29.
18 Karen Zachary, Managing Director, SkyMiles, July 2014 conversation.
19 "How to win in Qantas Frequent Flyer Shuffle" article dated 02 July 2014 in the *Sydney Morning Herald*.

The speed in which Qantas went from its March 2014 announcement to a July 2014 launch may explain why the airline chose to modify rather than replace its existing accrual method. While points remain the currency of the program, these are no longer accrued on the basis of distance flown. But under the new system, points are not linked directly to fares. Instead, Qantas offers a complex system of 15 travel regions, which must be combined with 8 fare categories, to eventually define how many points are accrued for a trip. The result is a bewildering array of 120 defined accrual levels. IdeaWorksCompany presents comparisons for two key markets in Table 4:

**Table 4: Comparing Qantas Accrual Using Old and New Methods**

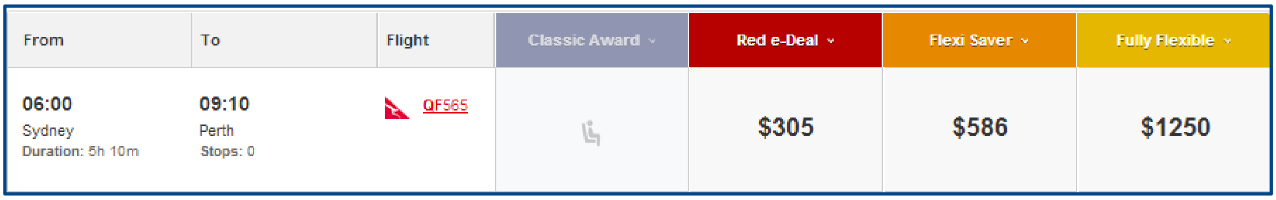
Change row represents new method compared to old (all figures for one way travel)

| City Pair Examples *(distance)* | Method | Discount Economy | Economy | Flexible Economy | Premium Economy | Flexible Premium Economy | Business | Flexible Business | First |
|---|---|---|---|---|---|---|---|---|---|
| Sydney – Perth *(4,080 miles)* | Old + | 2,040 | 2,040 | 2,040 | 2,040 | 2,040 | 3060 | 3060 | n/a |
| | New | 1,450 | 1,450 | 2,200 | 2,700 | 2,900 | 3,300 | 3,600 | n/a |
| | Change | -29% | -29% | 8% | 32% | 42% | 8% | 18% | |
| Sydney – LAX *(14,980 miles)* | Old + | 7,490 | 7,490 | 7,490 | 9,363 | 9,363 | 11,235 | 11,235 | 14,980 |
| | New | 4,500 | 6,750 | 9,000 | 11,250 | 12,400 | 13,500 | 15,750 | 18,000 |
| | Change | -40% | -10% | 20% | 20% | 32% | 20% | 40% | 20% |

*+ Includes class of service bonus. Data collected from Qantas website August 2014. Calculations by IdeaWorksComany.*

Similar to Delta and United, the airline is placing more accrual emphasis on higher yielding fares. Discount and regular economy accrual dropped for the city pair examples shown in Table 4. Full economy fares and premium cabin fares all increased under the net accrual method introduced on 01 July 2014. Intense price competition within the Australia airline market provides ample motivation for an airline to switch from mileage based accrual. Since 2003, the index of discounted fares dropped more than 40 points (adjusted for inflation) by 2014. During the same period, full economy fares increased more than 15 points. Simply stated, the single measuring stick of miles flown is no longer viable due to the wild variation of prices in a single cabin class.

The challenge faced by customers is the daunting complexity of the new method introduced by Qantas. Shown below is a booking display for a Sydney – Perth flight. Frequent flier miles are not displayed until the process continues with flight selection in the next step of the booking path. If revenue-based accrual is intended to encourage members to upgrade to a higher fare . . . that benefit has been lost with the lack of disclosure associated with this price display.




But the challenge for program members is deeper. The fare descriptions (Red e-Deal, Flexi Saver, and Fully Flexible) don't match the eight fare categories listed in program materials. Clicking the "Red e-Deal" fare description does provide a 490+ word pop-up box that eventually classifies the fare as "Discount Economy" for the purposes of calculating how many points are accrued. Imagine the difficulty of knowing accrual levels for travel booked through 3rd parties.

There is no easy method to implement big changes, but Qantas seems to have designed an especially complicated path for their customers to comprehend. One journalist said this of the Qantas effort, "*The communication of the changes – which struck me as hurried, ill-executed and confusing – didn't help matters.*"[20] A review of media coverage of the change indicates an initial pushback similar to that faced by Delta and Southwest. Qantas will face the real challenge of getting consumers who benefit from the change to appreciate the higher level of accrual and to react by booking the higher yield fares Qantas wants to sell.

### The slow one now, will later be fast

This report opened with a reference to Bob Dylan and will close with an ending lyric from the same song, "The slow one now, will later be fast." The best-written lyrics enjoy application far from their original intent, and this report will stretch Dylan's words to the airline industry. With major alliance players Delta, United, and Qantas firmly in the game of revenue-based accrual, there is no turning back. Make no mistake, there's no ignoring the fact that Delta's business class travelers will earn up to 75,000 miles for a long haul roundtrip. Any airline persisting in the practice of delivering 20,000+ miles to their members for the same trip will be at a huge competitive disadvantage. Fortunately, there is much to learn from airlines that have already trod this trail.

**Top-10 Tips for Making the Change to Revenue-Based Accrual**

- **Consider a response that's unique.** You need not match the prevailing offer. Doing so will risk being called a follower. This will be difficult for those in an alliance or joint venture.
- **Provide plenty of advance notice.** This allows your program members to digest the changes, and for your airline to make corrections before implementation.
- **Remember your key partners.** They are called alliances for a good reason, it's because the partners work toward a common economic benefit. Major accrual changes should occur after consultations and never arrive as a surprise received via press release.
- **Don't budget all your miles.** Create a 10 to 15 percent reserve to provide the opportunity to launch bonus offers for reasons that were unanticipated.
- **Simplicity is a virtue.** Create accrual methods that a member could easily explain to a friend. To do otherwise is to risk confusing your members and penalizing the priceless benefit of word-of-mouth referrals.
- **Promote accrual in the booking path.** Consumers will trade up to a higher fare when made aware of the benefit of additional miles or points. Southwest Airlines provides an exceptional example of this.
- **Anticipate behavior of at-risk members.** Analysis should identify member groups which will lose benefits. Create bonus offers to ease their transition to the new accrual method.
- **Create online comparison tools.** Don't hide the facts of before and after. Allow members to compare how their fortunes will change. Provide members with an online tool to calculate accrual.
- **Don't punish lower yield consumers.** After all, they represent the majority of program membership and can someday grow into higher yield customers.
- **Remember pay-with-points is the perfect complement.** Switching to revenue-based accrual, while leaving the reward method untouched, represents unfinished business. Announce or implement reward improvements at the same time.

[20] "How to win in Qantas Frequent Flyer reshuffle" article dated 02 July 2014 in *The Age*.

Airlines all over the world are considering the sale of their frequent flier programs. Lufthansa is actively moving in this direction with shareholders voting at its 29 April 2014 annual meeting to spin off the Miles & More loyalty program. Speculation has swirled around the Qantas Frequent Flyer Program and a possible sell-off by the airline.[21] As the management team at Aeroplan is aware, this type of move requires a program to broaden its focus to a general retail-oriented membership.

Frequent flier program executives can certainly create strategies to woo their treasured elite members with more miles, kilometers, and points. But ignoring the greater mass of members incurs great risk. These are the "everyday members" who buy a few tickets each year, accrue points with program partners . . . and very importantly . . . buy goods with the carrier's co-branded credit card. That's the danger associated with designing a program that focuses benefits on high value customers. Perhaps it's not surprising that Lufthansa recently disclosed it will "Enhance the program's appeal for less frequent flyers" as the airline begins the process of spinning off the Miles & More unit.[22]

It will be a fascinating two years as frequent flier program executives decide what they want their programs to become. Will an airline lavish attention on high value customers at the expense of infrequent fliers? Or, might a carrier move to create a general loyalty program with an emphasis on everyday consumers? American Airlines indicated as of August 2014 it's not planning changes to its accrual method and will focus on the major task of merging its AAdvantage program with US Airway's Dividend Miles program.[23] Undoubtedly some will identify a hybrid path that attempts to deliver value to all types of travelers. Delta, Qantas, Southwest, and United have already made their move . . . now it's time for the rest to consider theirs.

[21] "Qantas could share spoils if Frequent Flyer arm is spun off" article dated 12 July 2014 in the *Herald Sun*.
[22] "The Lufthansa Group – The Way Forward" July 2014 investor presentation at Lufthansagroup.com.
[23] Interview of American Airlines Group CEO Doug Parker in *Business Travel News* dated 05 August 2014.

# Boost Your Carrier's Revenue IQ with Master Class Workshops

**Illuminate and innovate with on-site Master Class Workshops by IdeaWorksCompany.** Enjoy the convenience and savings of private seminars held at your headquarters with an agenda chosen by you. Create your own agenda from a library of presentations provided by global airline consultant and analyst Jay Sorensen.

You may choose a 1- or 2-day format and consider including time for one-on-one consulting. Simply add coffee breaks and lunch to the schedule. It's a convenient, cost-effective, and customized method to educate airline managers on crucial marketing issues. You can fill the room with general staff or limit attendance to senior leaders. The presentation style is designed to encourage debate and discussion in a confidential environment.

## ANCILLARY REVENUE AND A LA CARTE PRICING

**Ancillary Revenue in a Time of Crisis**
This 75-minute presentation, with ample Q&A time, defines ancillary revenue, provides a worldwide overview of a la carte activity, and gives practical advice on implementing fees and revenue enhancements. It provides the perfect introduction to ancillary revenue with an emphasis on brand development, consumer relations, sales methods, and employee support.

**Show Me the Money**
This 75-minute presentation, with ample Q&A time, provides greater depth of discussion on core ancillary revenue opportunities: checked baggage fees, seat assignments, early boarding, co-branded credit card, and upgraded meal options. Specific carrier examples and "per passenger" revenue statistics are included.

NEW **Choice and Creativity: Carriers Build Ancillary Revenue by Empowering a Consumer's Right to Choose**
Air New Zealand, Air Canada, and Wizz Air use three contrasting retail methods that can boost revenue more than 20%. This 60-minute presentation describes three retailing methods that encourage customers to spend more: a la carte, fare families, and branded fares. Learn the website merchandising tactics that produce premium revenues for airline travel.

NEW **Profit From Innovation: Benefits of Ancillary Revenue Reach All Over the World**
Airlines will learn they are not alone in the pursuit of ancillary revenue during this 45-minute presentation. Within the industry, innovators include AirAsia, KLM, and Virgin America. Global practitioners in other industries include Disney, Norwegian Cruise Line, and Starbucks. The presentation describes new products and the revenue achieved by other airlines.

**Moving to Merchandising Methods in the Cabin**
This 90-minute presentation, with ample Q&A time, applies best practices to boost onboard food and beverage sales. All too often carriers expect stellar results but use obsolete processes. Flight attendants push the same trolleys and management relies on catering methods developed decades ago. IdeaWorksCompant conducted extensive research to determine how industry leaders maximize sales in other enterprises, such as casual dining, sports and entertainment, grocery stores, hospitality and train travel.

### Airline and Hotel Fees: Wicked, Good, Misunderstood?

During this 75-minute presentation, with ample Q&A time, IdeaWorksCompany weaves a wonderful tale involving a cast of characters: Southwest, Delta, Hilton and Holiday Inn Express. Specific topics covered include: 1) How wickedly-good baggage revenues compare to the goodness of bundling, 2) A la carte adventures and the hotel industry's yellow brick road to profits, and 3) Confused and complacent munchkin consumers.

### Allegiant Air: How to Be Better than Ryanair

This 60-minute presentation, with ample Q&A time, describes why Allegiant Air is the worldwide ancillary revenue leader when measured on a per-passenger or percentage-of-revenue basis. Allegiant is often called a holiday company that happens to own an airline. This session explores the unique marketing strategy of this airline and suggests how other airlines might benefit from elements of its business model.

## FREQUENT FLIER AND LOYALTY MARKETING

### NEW Going Beyond Air Travel with Alternative Rewards

Airlines are working to prevent a mileage meltdown by opening their wallets and embracing new reward choices. This 45-minute presentation describes how frequent flier programs are boosting member options with airline-branded rewards and by moving from everyday merchandise to unique experiences.

### Loyalty by the Billions

IdeaWorks analyzes how frequent flier programs pour cash into airline coffers. This 60-minute presentation, with ample Q&A time, describes how these programs provide piles of cash from the sale of miles and points to partners, the a la carte fees associated with reward travel, and the revenue rewards members give the airlines when they buy more travel.

### NEW Card-Carrying Generosity

During this 45-minute presentation, IdeaWorksCompany reviews the credit cards offered by the five largest US airlines, such as American and United, and the travel reward cards offered by their bank partners, such as Chase and Citi. Consumers win when banks and airlines compete for cardholders. This presentation includes tips on how airlines can win the revenue game too.

### NEW Fly High or Sink Low: Reward Programs Create Their Reputation

The opportunity and challenge began with the arrival of co-branded credit cards. This 30-minute presentation reviews results from the Switchfly Reward Seat Availability Survey. Benefitting from research involving more than 7,000 online booking queries, this presentation demonstrates how reward availability is no accident. It's a program attribute that defines a carrier's relationship with its most frequent customers.

### NEW Airlines Woo Members with Wild, Weird and Wonderful Rewards

IdeaWorksCompany reviews the frequent flier programs associated with 150+ airlines to find the most distinctive rewards that go far beyond flying. This 45-minute presentation describes why airlines offer alternative rewards. Seven alternative reward styles are presented. Learn how these rewards can enhance member engagement in the program or help craft a brand's personality.

### NEW Revealing Research on which FFP Rewards are More Rewarding

Which rewards provide members best value per mile spent and how can airlines build better value? This 45-minute presentation evaluates the competition by banks and airlines for travel reward cardholders. Banks not only issue co-branded cards for their airline partners, they've also developed their own travel reward cards. Learn how each type of card offers special customer appeal and how airlines can best compete.

### Solving the Reward Availability Problem

This 60-minute presentation, with ample Q&A time, explores the revenue-aware solutions developed by Alaska Airlines, Delta Air Lines, and Aeroplan. Innovation and accountability are key factors in addressing an issue that many consumers complain about and many airline executives prefer to ignore. Learn how one-way rewards, pay-with-miles, and mileage bank approaches are providing new ways to relieve the frustrations of frequent fliers.

### Worldwide Guide to Reward Availability

This 75-minute presentation, with ample Q&A time, reveals which of the world's largest 22 frequent flier programs offer the most reward seats online. IdeaWorksCompany conducted 6,000+ booking queries to create a fascinating look at the much discussed controversy over reward seat availability. Learn how some carriers provide more reward seats and why others are downright stingy.

## GENERAL AIRLINE INDUSTRY

**Guide to the Airline Industry — Extended Seminar**
This 2-hour presentation, with ample Q&A time, provides an exceptional overview of the airline industry from the perspectives of brand, pricing, product, and strategy. This longer presentation covers the following categories: 1) Worldwide review of airline strategies, 2) How low cost carriers are remaking the marketplace, 3) The new economics created by ancillary revenue and a la carte pricing, 4) Targeting small business and self-managed travelers, and 5) Frequent flier 101.

## HOW YOUR COMPANY WILL BENEFIT

Master Class Workshops by IdeaWorksCompany:

- Jump start your strategic and practical knowledge of ancillary revenue.
- Determine what's best – a la carte, bundled alternatives, or a hybrid approach.
- Create a blueprint for success based upon lessons from all over the globe.
- Generate consumer preference and trust by avoiding the "fee trap."
- Build employee support and thwart media and regulatory backlash.

## IMPORTANT DETAILS

**About the Presentations** Audience size is determined by the client and may range from a small group of top executives to a cross-functional contingent of marketing, sales, pricing, customer service, and onboard product employees. The client is requested to provide a power point projector and erasable white board. Time is allowed for discussion during and at the conclusion of each presentation.

**Add more educational value to the seminar with Guides from IdeaWorks** Group licensing fees are available for the ezRez 2010 Guide for Ancillary Revenue and a la Carte Pricing and the 2010 Loyalty Marketing Guide.

**Reimbursed Travel Expenses** Client to reimburse Consultant for travel expenses by separate invoice. Such expenses shall include air travel, overnight hotel accommodations, car rental, meals, and airport parking. Travel expenses can be reduced when the seminar is included in an existing travel itinerary.

## CONTACT INFORMATION

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