buying business travel

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Analysis: Is the golden era of frequent-flyer benefits over?

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IdeaWorksCompany contributed information to this article - - see italics.

THIRTY-FIVE YEARS AFTER AMERICAN AIR-LINES launched the world's first major frequent-flyer rewards scheme – AAdvantage – it is poised to become the last of the 'big three' US legacy carriers to complete a fundamental revamp of its particular loyalty programme.

Unlike the initial scheme offered back in 1981, allocating reward points to flyers based on the distances involved, American is now introducing a system from this July onwards that tilts the rewards earned to those who pay more for their tickets. Both its main rivals, Delta Airways and United Air-lines, have already pivoted in this direction.

This radical reshaping of the frequent-flyer rewards landscape is, not surprisingly, causing concerns among many travellers who are seeing the ability to achieve reward miles or points significantly reduced and the cost of redeeming those they already have rising.

Social media comment from travellers who opt for the lowest fares and get the least rewards has, predictably, been highly critical; those with elite status who pay higher fares and get the best rewards, less so.

But as the global airlines have shown with their egregious pursuit of ancillary fees, they're very much focused on increasing revenues. Total ancillary fees levied by the world's airlines last year reached a record US$59.2 billion according to the consultancy IdeaWorks, with US airlines alone accounting for a third of this revenue stream.

Ancillary fees, moreover, are one of the key reasons why global carriers are now making bumper profits: the International Air Transport Association (IATA) says the world airline industry collectively achieved record net profits of US$33 billion last year, with US$36 billion pencilled in for 2016.

PROFITABLE CHANNELS

While ancillary fees now cover much of what airlines used to include in the fare – from baggage to priority boarding, extra legroom to in-flight food – some 38 per cent of ancillary fee revenue last year came from the airlines' frequent-flyer programmes as well as commissions from hotels, car rental companies and other services sold by the carriers.

But for US carriers, selling frequent-flyer points to credit card companies and others is the most lucrative way of bringing in extra revenue. The top six airlines (Alaska, American, Delta, Hawaiian, Southwest and United) earned 55 per cent of their total ancillary revenues – US$18.1 billion last year – from their reward programmes. Delta alone made more than 62 per cent of its ancillary revenues from Sky Miles.

In contrast, the 109 global airlines outside the US included in the IdeaWorks database earned only 15 per cent of their total ancil-lary revenues from selling reward miles; the most lucrative source of extra revenue for them was baggage fees (30 per cent).

Given the importance of Sky Miles to Delta's ancillary earnings, it's perhaps surprising that it was the first of the three remaining US 'legacy' carriers (Delta, United and American) to instigate at the start of 2015 such a fundamental change to its rewards programme, by linking reward miles to fares rather than mileage.

But it was not the first airline to recognise that the original basis for rewarding flyers on distances flown was flawed. Air New Zealand in 2004, with its Airpoints rewards programme, was first, and it was followed over the years by several others, includ-ing Virgin Australia, Vueling, Jet Blue and Air Asia.

Southwest Airlines, the biggest US do-mestic carrier, also relaunched its Rapid Rewards scheme in 2011 on a revenue-based model. And Delta was even partially scooped by Qantas, which in July 2014 implemented a new system with a complex formula based on regions travelled within various fare categories.

FOCUSING ON SPEND

Perhaps the real question is why it took Delta and other major airlines so long to change. Reward programmes in other sectors of the economy are centered on spending rather than an arbitrary metric, such as distance. Hotels, for example, base their loyalty scheme rewards on room rate and other spending by guests. Tesco's Clubcard awards shoppers with one point per pound spent – not on the number of times you visit its stores.

But there was another factor behind the airlines' switch to a revenue-based model. When the first loyalty schemes were launched in the early 1980s, airlines were struggling to fill the new generation of larger aircraft, especially given the weak global economy at the time. So a loyalty scheme made sense to help fill empty seats by encouraging more travellers to fly by using their 'free' miles.

The aviation landscape has changed since then, and load factors have risen steadily this decade following the recovery from the economic crisis of 2007-08. Last year saw a 6.5 per cent increase in global passenger demand (as measured by passenger revenue kilometres), above the ten-year average growth rate of 5.5 per cent, according to IATA.

Now it makes sense to focus on passengers who spend the most and fly most frequently: travellers with elite status in the airline reward programmes.

REVENUE vs DISTANCE MODEL

But it was no snap decision by Delta to switch: it reportedly started planning the change to a revenue model five years before the January 2015 relaunch of Sky Miles. United, which merged with Continental in 2010, swiftly followed suit in March last year, while a month later British Airways made changes to its Executive Club loyalty scheme. While not explicitly switching to a revenue-based model, BA effectively did make the transformation.

The major change was that discounted economy fares would earn only 25 per cent of the miles flown per flight, while more expensive last-minute and premium cabin fares would earn up to 300 per cent of miles flown. Hence, a BA flight travelling the 3,400 miles from New York's JFK to London Heathrow before the switch would have seen those at the budget end earn 3,400 points and those in first class 6,800. After the change, that range went from 850 to 10,200. And BA's On Business scheme for small- and medium-sized enterprises (SMEs) has also changed to a spend-based model.

The seemingly slow response of Ameri-can Airlines to these changes is explained by its need to complete the integration of US Airways, acquired in late 2013 but only finalised last October. American, however, has also adopted a cautious approach to changing its AAdvantage programme: in January, for example, it changed the qualifications for elite status in its programme, basically making it easier to qualify. This was good news for those who might struggle to join these elevated ranks, but not so good for those who would easily qualify, since there will now be more members chasing upgrades.

In March this year, American's next move was to effectively devalue the worth of its reward miles, matching the changes by both Delta and United. And the final change is expected "in the second half of 2016" according to the airline, when reward miles "will be calculated based on what you pay for your ticket (base fare plus carrier-imposed fees, excluding any government-imposed fees) and your elite status".

It adds: “The higher your status, the more you’ll earn.” Thus, AAdvantage’s lowest elite status – a ‘member’ – will get five free miles for each dollar spent, while those in the top level (Executive Platinum) will receive 11 miles per dollar.

Even though Delta made its own programme changes nearly a year ago, it is still tinkering with the system. From May 16, Delta is sharply reducing an existing benefit for its elite status travellers: previ-ously Diamond and Platinum members – the two highest elite levels – could get up to eight people travelling with them up-graded to Delta’s Comfort+ class (premium economy). Now it will be only one.

From the beginning of June it is also changing the way it prices awards for redemption. “The number of miles needed will change based on destination, demand and other dynamics,” says Delta.

Effectively, it is moving to a dynamic-pricing model, the same as the way it and other airlines calculate their fares. This will also reduce transparency, according to analysts. In-demand flights will cost more points, although the reverse will also apply for less popular destinations and dates. This emphasises just how complex reward schemes have become. Even Randy Petersen, the veteran commentator on frequent-flyer schemes and founder of the Frequent Flyer Services website, admits: “It’s really confusing, especially as the average person gets carried away by all the special bonuses, which means they’re not looking at the details.”

REAPING THE REWARDS

But while certainly confusing, the real elephant in the room remains exactly who should get the benefits – the company that pays for the flights or the traveller who puts up with the inconvenience of travel and being away from home and family? The airlines, of course, insist the individual traveller named on the ticket gets the rewards, rather than the corporate entity that paid for it. But schemes such as BA’s On Business do recognise that the company should also get some reward.

However, a straw poll of travel buyers in-dicates that some companies do take a hard line with rewards. “All frequent-flyer miles are used to keep travel costs down and all employees have to give them back to the company,” says a buyer at a pan-European retail products franchisor. “We only use the reward points to buy free tickets – not for upgrades or anything else.”

Yet a buyer at a London-based adver-tising agency is more relaxed about the issue, revealing that “employees may retain frequent-flyer benefits for personal use, although airline selection must not be compromised by this”.

One issue that does come up in negotia-tions with the airlines over corporate deals is matching the status of the employee in any switch of airlines, says CTM director Stuart Birkin. “Any corporate will face chal-lenges if they move from one preferred carrier to another and then start the points/status of the traveller from scratch. As part of the negotiations, travel managers should be factoring in status match programmes for key travellers and fast-track status promotions for other employees.”

In the final analysis, perhaps the more surprising development in the airline loyalty world has been the recent conversion by Europe’s two biggest airlines (in terms of international passenger numbers) to the appeal of frequent-flyer programmes after years of eschewing them. Not only is Easyjet now rewarding top customers with its new Flight Club loyalty scheme (see panel, below) but rival Ryanair last month followed suit with My Ryanair Club, whose benefits for regular travellers includes discounts and a free return flight when a dozen flights are booked in a year.

Yet this is not Ryanair’s first ever loyalty scheme: back in 1988 it launched its Frequent Flyer Club (and even a business class) before both were ditched a year later for being unprofitable – by a then fledgling director called Michael O’Leary.