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The IdeaWorks Report on Innovative Reward Alternatives for the World's Largest Airlines

Airlines in Asia, Europe and the United States offer hotel stays, car rentals, vacation packages and merchandise as alternatives to air travel rewards.

Airline frequent flier programs are beginning to open their wallets and spend cash on new alternative reward choices that go beyond air travel. The airlines are borrowing the successful strategy used by hotel chains to enhance their frequent flier programs through a broader array of reward categories and partners.

IdeaWorks recently completed analysis of the reward alternatives offered by the frequent flier programs associated with the world's largest airlines as measured by passengers carried during 2004. The top ten airline list includes carriers in the United States, Europe and Asia:

Table 1: Top 10 World Airlines Based Upon 2004 Passengers Carried

In order of ranking, with largest appearing first
American Airlines • Delta Air Lines • Southwest Airlines • United Airlines
Air France-KLM • Japan Airlines • Northwest Airlines • Lufthansa Airlines
All Nippon Airways • Continental Airlines

Source: Air Transport World Magazine, July 2005, page 33

This report describes rewards offered in the following categories: airport clubs, hotel accommodations, car rental, other travel, online auctions, gift catalogs, in-flight duty free merchandise, and magazine subscriptions.

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Reward choices vary greatly among the airlines included in the analysis. For example, United Airlines allows its Mileage Plus members to redeem miles on more than 30 cruise lines. American Airlines provides vacation packages to more than 300 worldwide destinations in exchange for AAdvantage miles. Lufthansa has an amazing number of hotel locations in its Miles & More program; members may redeem miles for accommodations at nearly 700 hotels worldwide.

Consumers should welcome these new choices - - especially those believing traditional air travel rewards are not readily available. Frequent flier program members should always compare reward values before choosing between traditional air travel and alternative rewards. Many will find airline tickets still provide the best value. Limited availability, and the prevalence of low fares, may tempt program members to request an alternative reward. However, IdeaWorks has determined air travel rewards usually deliver twice the value per mile when compared to alternative rewards such as hotel, car rental or merchandise certificates.

Changing Times for Airlines and Consumers

The introduction of alternative rewards may provide some relief during a very difficult time for travelers and airline management. Severe economic challenges have required legacy airlines to reduce their costs - - which has led to product declines and far fewer in-flight amenities. Each airline listed in Table 1, with the exception of Southwest, qualifies as a legacy airline due to higher cost structure. The increasing presence of low cost competitors, such as jetBlue and Frontier, has created havoc for legacy airlines.

Consumers are enjoying the low fares generated by this highly competitive marketplace. However, storm clouds have been gathering, as evidenced by the unprecedented recent bankruptcies of four major airlines in the United States. U.S. legacy airlines are coping by shifting capacity to calmer international markets in hopes of attracting higher yields and to escape the low fare airlines.

IdeaWorks believes legacy airlines have adopted another coping mechanism to ensure financial survival. Reducing the availability of seats for air travel rewards allows more seats to be sold to fare-paying consumers. Frequent flier program members have likely reacted by deferring reward travel and allowing their account balances to grow. Evidence of this trend was provided earlier this year by IdeaWorks when it estimated U.S. airline frequent flier reward travel dropped by over 300,000 tickets and unused reward liability grew by \$378 million in 2004¹.

The substantial mileage liability carried by legacy airlines represents a disadvantage not shared by their low cost competitors. Legacy airline customers have accumulated miles for a far longer time and many have account balances in excess of the 30,000 miles required for free reward travel. These members represent a continuous source of demand for reward seats - - a condition not yet experienced by the low cost airlines.

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The frequent flier liability issue is not unlike the disadvantage faced by legacy airlines with their pension liabilities. However, legacy airlines do have inherent advantages. Legacy airlines have benefited handsomely from the revenues produced by the sale of frequent flier miles to program partners. United Loyalty Services (“ULS”) is the division responsible for the sale of Mileage Plus miles. ULS generated revenues of \$822 million² during 2004, which represented 5% of United’s total operating revenues for the year.

IdeaWorks believes most frequent flier programs realize over 65% of their revenues from the sale of miles to banks issuing co-branded credit cards; the percentage for some programs is likely to be far higher. Applying this statistic to the 2004 revenues of ULS generates an estimated \$534 million contribution from United’s co-branded credit card products³.

The profits generated from the sale of miles can be used to purchase alternative rewards from program partners such as hotel chains and car rental companies. Adding new reward choices naturally makes a frequent flier program more attractive to consumers and helps relieve some of the demand for air travel reward seats.

Summary of Alternative Rewards

IdeaWorks analyzed frequent flier program information provided on Web sites of the ten major airlines included in the analysis. All of the airlines operate major international networks with the exception being the purely domestic U.S. network operated by Southwest Airlines.

International readers of this report should note the information presented is limited to the reward benefits available to US-based frequent flier program members. International airlines often vary program features in individual countries to address local competitive issues. The content of this report provides a good overview of the marketing developments associated with alternative rewards, which is summarized for each airline in Table 2 on page 5 of this report.

This following describes the significant features offered by the ten airlines in these categories: airport clubs, hotel accommodations, car rental, other travel, online auctions, gift catalogs, in-flight duty free merchandise, magazine subscriptions, and charitable contributions.

- **Airport Clubs.** This feature allows members to redeem miles as a method to pay the annual fees required for airport club access. Three US-based airlines offer this attractive feature: American, Delta and United. Typically, members may redeem 70,000 to 80,000 miles for annual membership. Lower mileage requirements are often available for elite members. Spouse and domestic partner memberships are available at slightly higher mileage levels.

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- **Hotel Rewards.** Hotels and resorts are the most popular category with some type of lodging benefit offered by six of the airlines. Members may redeem miles for 1-night or weekend hotel stays for two persons. Airlines tend to purchase hotel certificates from their existing mileage-accrual partners. Reward certificates usually limit redemption to a specific list of locations or to a particular hotel quality category for an entire chain. Table 2 lists the number of hotel locations offered by each airline.

Lufthansa clearly leads the other airlines with 695 participating hotel locations. Their Miles & More program provides an exceptional choice of twenty hotel brands such as Hilton, Barcelo, Hyatt, Kempinski, LeMeridien, Marriott, NH Hoteles, Radisson SAS, Raffles and Starwood.

The choices offered by Miles & More range from small intimate inns to glamorous destinations. Rusticae is a collection of small, charming hotels in Portugal and Spain and 1-night stays are available for 30,000 miles. Opulent choices include the Waldorf Hilton in London for 30,000 miles or a package featuring the Victoria-Jungfrau Grand Hotel & Spa at Interlaken for 130,000 miles.

Japan Airlines offers a diverse collection of 125 worldwide locations representing many brands. Japan Airlines and All Nippon Airways feature their corporate branded hotels such as Hotel JAL and ANA Hotels. United Airlines has taken an exclusionary approach by limiting its Marriott, Hyatt and Radisson rewards to its 1K, Premier Executive and Premier members.

- **Car Rentals.** Self-drive car rewards reflect existing partner relationships and are offered in some form by four of the airlines. Lufthansa offers the most extensive list with four car rental companies: Avis, Hertz, Sixt and Europcar. As with its hotel rewards, United chooses to limit its Avis, National, Alamo and Hertz rewards to its 1K, Premier Executive and Premier members.
- **Other Travel.** This is by definition a very broad category providing a number of different experiences such as vacations and cruises. American allows AAdvantage members to redeem miles as a method of payment at its AAVacations.com Web site.

American Airlines Vacations redemptions begin at 500 miles and may be combined with credit card co-payment for hotel stays, airport transfers, car rentals, and tours for over 300 destinations around the world. For example, members may book the Bellagio in Las Vegas for a 3-night stay for two persons and pay \$874 or redeem 109,250 miles. Members must redeem miles for airline travel in the normal manner; air travel can't be included as a component of packages purchased with miles through American Airlines Vacations.

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United allows its Mileage Plus members to redeem miles for free cruises on over 30 cruise lines through United Cruises with an online booking process similar to AAVacations.com. For example, members may reserve a 7-night Alaska cruise from Seattle on Holland America Line in a large double occupancy inside stateroom and pay \$2,263 or redeem 353,565 miles for the 2-person cruise.

Table 2: Summary of Alternative Rewards

Programs	Airport Clubs	Number of Hotels	Car Rental Brands	Travel	Online Auction	Gift Catalog	In-flight Duty Free	Magazines for Miles
American AAdvantage	Yes	(a)	(a)	Vacation Packages				Yes
Delta SkyMiles	Yes							Yes
Southwest Rapid Rewards								
United Mileage Plus	Yes	(b)	(c)	Cruises	Yes			USA Today, Wall Street Journal
Air France/KLM Flying Blue		79	Hertz, Avis	Perks & Events in France			Yes	
JAL Mileage Bank		176		Vacation Packages		Yes	Yes	
Northwest WorldPerks								Yes
Lufthansa Miles & More		695	Avis, Hertz, Sixt, Europcar			Yes		
ANA Mileage Club		30				Yes	Yes	
Continental OnePass					Yes			Yes

Notes:
 (a) Hotel and car rental rewards offered via American Airlines Vacations as part of a package.
 (b) United only offers Marriott, Hyatt and Radisson hotel rewards to its 1K, Premier Executive and Premier members.
 (c) United only offers Avis, Alamo, National and Hertz car rental rewards to its 1K, Premier Executive and Premier members.

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Air France and KLM, through their Flying Blue program, take a more regional approach to travel rewards by offering uniquely French experiences. Members may exchange 42,000 miles to drive a Porsche 911 on a Paris area race course, 25,000 miles to enjoy a 25-minute helicopter tour of Paris, or 20,000 miles to take a cooking class at Escoffier Paris. Hotel accommodations and park admission are also offered at Disneyland Paris.

- **Online Auctions.** These events allow members to use miles to bid on auction items in a manner similar to that used on eBay. United and Continental currently offer online auctions featuring a limited number of items. This activity adds an element of fun to frequent flier participation. However, auctions are not likely to generate substantial mileage redemption activity.

United's "Mileage Plus Auctions" offers six categories of items: Action & Adventure, Gourmet, Inside United, Rest & Relaxation, Sports, and Travel. Recent auctions include a unique "Italy by Vespa" 7-night tour of France (including first class airfare from the United States, breakfasts, lunches, dinners, and of course - - a Vespa rental) and a 2-hour United cockpit aircraft simulator experience with a United Airlines flight trainer. Continental's "OnePass Online Auction" currently provides four categories: Arts & Entertainment, Sports, Travel, and Other.

- **Gift Catalogs.** Lufthansa Airlines, Japan Airlines and All Nippon Airways offer select merchandise choices. Lufthansa offers its Miles & More members two shopping alternatives. "WorldShop Gourmet Shopping" features items from seven merchants: Legacy Wine Cellars, Dean & DeLuca, Viking, Harney & Sons, Wine Accessories, Carl Brandt, and Payne-Mason Cigars. For example, members may order Gloria Ferrer Vintage Reserve Brut Royal Cuvee 1993 sparkling wine for 7,019 miles or an entire 200-bottle wine cellar for 862,581 miles. The "WorldShop powered by SkyMall" offers a substantial selection of the items normally found in SkyMall's regular catalog.

The Japanese carriers offer Asian flavor with online malls that are largely designed to serve Japanese customers living in America. Members of the Japan Mileage Bank and ANA Mileage Club programs may redeem miles for yen- or dollar-based gift certificates. ANASuper.com is a Japanese supermarket and department store with over 1,000 items from fresh fish, meat, and vegetables to Japanese rice cakes and bread, appliances and household goods. US-based members may order spicy rice crackers, prepared squid, Shiitake mushrooms, melon soda and even Okamoto condoms. "JALPAK International Gifts" offers Japan Mileage Bank members a smaller selection of Japanese foods, chinaware and art.

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- **In-Flight Duty Free Merchandise.** This is a natural benefit for international airlines to provide to their program members. Air France/KLM, Japan Airlines and All Nippon Airways allow frequent flier members to exchange miles for certificates redeemable for in-flight duty free merchandise purchased on flights.
- **Magazines for Miles.** This uniquely American reward is perhaps the earliest type of alternative reward offered by US-based airlines. All of the U.S. airlines included in the analysis, with the exception of Southwest and United, allow frequent flier program members to redeem nominal quantities of miles for subscriptions to a choice of more than 40 magazines. United offers subscriptions to USA Today and the Wall Street Journal.

Other alternative rewards may be offered by the ten airlines. The rewards presented in this analysis represent the categories most frequently offered by the programs reviewed.

Value of Alternative Rewards

Consumers choosing alternative rewards have a variety of motivations, which may include easier redemption, transferability, and even the desire to fly less frequently. These benefits do have a cost, as the value provided by a mile redeemed for an alternative reward is likely to be lower.

Airlines prefer members to choose air travel rewards because the cost of filling an otherwise-empty seat is very low. Whereas, alternative rewards are typically purchased from partners using an airline's precious cash.

Table 3 lists the values calculated by IdeaWorks for each airline included in the analysis:

Table 3: Estimated Value of Alternative Rewards	
Program	Value Range per Mile
American AAdvantage	\$.007 to \$.008
Delta SkyMiles	\$.0057
Southwest Rapid Rewards	No alternative rewards offered
United Mileage Plus	\$.005 to \$.007
Air France/ KLM Flying Blue	\$.003 to \$.0045
JAL Mileage Bank	\$.01 to \$.013
Northwest WorldPerks	No meaningful value
Lufthansa Miles & More	\$.003 to \$.0045
ANA Mileage Club	\$.01 to \$.013
Continental OnePass	No meaningful value

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The values in Table 3 reflect the application of retail prices to a sampling of three to four reward items offered by each airline. The Delta SkyMiles estimate is limited to the value associated with its Crown Room airport club rewards. The miles associated with the very limited selection of alternative rewards offered by Northwest WorldPerks and Continental OnePass were not found to have a meaningful value; magazine subscriptions and online auction activities don't generate substantial or reoccurring benefits for members.

The European airlines offer a very attractive array of alternative reward choices, but are the stingiest among the carriers analyzed. Estimates for Air France/KLM and Lufthansa range from \$.003 (3/10ths of a cent) to \$.0045. By comparison, many of the American carriers value the miles redeemed for alternative rewards more generously. American, Delta and United range from \$.057 to \$.008 per mile. The Japanese are the most generous with a per mile valuation ranging from 1 to 1.3 cents.

IdeaWorks estimated the value produced by miles redeemed for domestic air travel rewards at 1.4 cents (\$.014) per mile in a prior 2005 report⁴. Applying this estimate to a typical 30,000 mile U.S. domestic air travel reward generates a value of \$420. Spending the same 30,000 miles on an alternative reward could generate a benefit having a value ranging from \$90 to \$390.

Consumers should always calculate the value provided by each reward before redeeming their miles. Frequent flier members frustrated by a lack of seat availability may find the flexibility provided by alternative rewards to offer a more attractive alternative.

Donating Miles – The Charitable Option

Six of the airlines provide another option for frequent flier miles; members may donate miles to benefit the charity of their choice. Table 4 on the following page lists the charity choices currently available from each airline. Procedures vary between the airlines, but in every case, the charity receives the full benefit of the miles. These organizations appreciate the ability to defray their operating by using free tickets for their travel needs. Many child-oriented organizations, such as Make-A-Wish, use the reward tickets to directly benefit children and their families.

As a final note, IdeaWorks wishes to describe a unique benefit revealed during its analysis of alternative rewards. While not representing a direct reward benefit, American Airlines offers a unique benefit to members donating cash to the National Park Foundation. In addition to the 10 AAdvantage miles earned for every \$1 donated to benefit National Parks, members will also receive a complimentary National Park Pass - a \$50 value. Visit NationalParks.org to donate.

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Table 4: Donating Miles to Charities		
Program	Charities **	Total Number
American AAdvantage	Make-A-Wish, Miles for Kids	2
Delta SkyMiles	CARE, Fisher House Foundation, Make-A-Wish Foundation, United Way, AID Atlanta, American Red Cross, Boys & Girls Clubs of America, The Breast Cancer Research Foundation, Children's Miracle Network, Habitat for Humanity International, Juvenile Diabetes Research Foundation, March of Dimes, Salvation Army, Shepherd Center, Special Olympics, UNICEF, United Negro College Fund.	17
United Mileage Plus	Ability Awareness, Airline Ambassadors, Red Cross, AmeriCares, Children's Circle of Care, Conservation International, Disabled Sports USA, Dream Foundation, Guide Dogs of America, Hospital for Sick Children Foundation, Make-A-Wish, Muscular Dystrophy, National Cancer Prevention Fund, Operation USA, Orbis, Elizabeth Glaser Pediatric AIDS Foundation, Ronald McDonald House, Rotary International, Roundtable Children's Wish London, Salvation Army, Sarvodaya, Shriner's Hospital, Special Olympics, TREO Transplant Recipient's International Organization, US Olympic Team, Victor Chang Cardiac Research Institute Sydney, AIDS project of Los Angeles, Silver Lining Foundation	28
Air France KLM Flying Blue	French Red Cross, Enfants de la Terre, La chaîne de l'espoir, L'Envol, Mécénat Chirurgie Cardiaque Enfants du Monde, UNICEF, Right to play, Save a Child's Heart (combined Air France / KLM charities)	7
Northwest WorldPerks	American Cancer Society, American Red Cross, AmeriCares, America's Second Harvest, Big Brothers Big Sisters of America, Boys and Girls Club of America, Challenge Aspen, Children's Cancer Research Fund, Children's Diabetes Foundation, Children's HeartLink, Dream Foundation, Elizabeth Glaser Pediatric Aids Foundation, Epilepsy Foundation, Fisher House™ Foundation, Inc., Guide Dogs of America, Habitat for Humanity, Junior Achievement, Juvenile Diabetes Research Foundation International, KidCares, Leukemia and Lymphoma Society, Literacy Partners, Make-A-Wish Foundation of America, March of Dimes, National Marrow Donor Program, National SAFE KIDS Campaign, Operation Smile, Oxfam International, Salvation Army, Share Our Strength, SightFirst, Special Olympics International, St. Jude Children's Research Hospital, STARBRIGHT Foundation, The Nature Conservancy, Toys for Tots Foundation, UNICEF, United Negro College Fund.	37
Continental OnePass	American Red Cross, AmeriCares, CAREFORCE, Golfers Against Cancer, Healing the Children, Make-A-Wish Foundation of America, Make-A-Wish Foundation International	7
** Some airlines rotate the selection of charities; listing is subject to change.		

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Sources used in this Industry Analysis: Unless otherwise noted, frequent guest program information presented in this report is based upon an online review conducted during the week of January 9-13, 2006 of frequent flier reward pages at airline Web sites. The analysis in this report applies for frequent flier members residing in the United States. IdeaWorks does not define alternative rewards as those gained through exchange relationships with third parties such as American Express Membership Miles or Points.com. Programs providing discounts on the purchase price of merchandise for an exchange of miles are also not included.

Disclosure: IdeaWorks makes every effort to ensure the quality of the information available in this report. Before relying on the information, readers should obtain any appropriate professional advice relevant to their particular circumstances. This Industry Analysis was independently produced and has not been completed as work on behalf of a client company. IdeaWorks cannot guarantee and assumes no legal liability or responsibility for the accuracy, currency or completeness of the information.

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Endnotes:

¹ “U.S. Airline Frequent Flier Reward Liability Grew More Than \$378 Million in 2004 - Industry Analysis from IdeaWorks” Issued April 25, 2005 (available at IdeaWorksCompany.com).

² All ULS statistics from the 2004 United Airlines annual report, Segment Information section.

³ More information is available from the May 18, 2005 IdeaWorks report titled “United Airlines Shutdown Would Impact 45 Million Mileage Plus Members and 145 Partner Brands - Industry Analysis from IdeaWorks” (available at IdeaWorksCompany.com).

⁴ “The Fall of Frequent Flier Mileage Values in the U.S. Market - Industry Analysis from IdeaWorks” Issued February 16, 2005 (available at IdeaWorksCompany.com).