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Contact: Jay Sorensen
For inquiries: 414-961-1939
www.IdeaWorksCompany.com

European Travelers Get the Point: Low Cost Carriers Add Frequent Flier Benefits Industry Analysis from IdeaWorks

Among Europe's top 25 low cost carriers, Aer Lingus, Air Berlin, Air Europa, Condor, flybe, Hapag-Lloyd, LTU and Monarch offer frequent flier programs.

The low-cost carrier revolution continues to grow in Europe, the Americas and Asia. Low-cost carriers (called "LCCs") serving the United States have long offered frequent flier benefits, and now more of Europe's airlines are doing the same. IdeaWorks analyzed over 55 low cost carriers to determine how frequent flier programs are developing in the highly competitive European market. Here is a sampling of the observations from the Industry Analysis:

- Europe's top two LCC giants - - Ryanair and easyJet - - don't have frequent flier programs; while all of the top nine low cost carriers in the United States offer frequent flier benefits.
- The number of paid roundtrips required for a free ticket ranges from as few as four to as many as 32, with most requiring 10 to 20 roundtrips for a reward.
- Participation in major airline programs such as Lufthansa and Scandinavian is possible through their low cost affiliates: Condor, Blue 1 and air Baltic.
- Frequent flier program relationships with hotels, car rental companies and retailers among Europe's LCCs are limited when compared to the scope of partners offered by programs in the U.S. market.
- Among the more than 55 LCCs reviewed, only 12 currently offer frequent flier benefits - - but this number is expected to grow in 2005 and 2006.

This Industry Analysis reviews the frequent flier programs offered by the top LCCs in Europe, describes their unique qualities and compares them to their U.S. counterparts.

Defining Low Cost Carriers

Classifying airlines has become an increasingly difficult task. Not long ago, airlines typically fell into three categories: major, national and regional. Even these categories provided difficulties - - for example, a small flag carrier with transatlantic flights didn't seem to fit the "major" or "national" categories very well. In today's environment, the field has become more crowded with categories such as "full service," "legacy airline," "low fare airline" and the topic of this report, "low cost carriers."

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The recent report created by the Australian-based investment house Grant Samuel for Virgin Blue Airways provides clarity on the issue of definitions. The table below contains excerpts from the report's description of full service and LCC business models:

Table 1	
Typical Features of Airline Business Models ¹	
Full Service Carrier	Low Cost Carrier
Range of in-flight service classes	Single in-flight service class
Wide range of complimentary and other services (including meals, entertainment, frequent flier programs)	Do not provide additional services, or provide on a user pays basis
Higher fares reflecting service level and higher proportion of full fare business travelers	Comparatively lower fares
Fleet comprised of a range of aircraft types to support a variety of markets and sector lengths	Utilizes a single aircraft type which reduces maintenance costs and turnaround times
Operates a system incorporating one or more hub and spoke networks	Usually operates a point-to-point network structure. High level of aircraft utilization with higher load factors
Focus on network profitability	Focus on route profitability
Operates from leading airports in major cities	Operates from airports in cities with a lower cost of living or from secondary airports resulting in reduced terminal costs and congestion
Highly unionized work force often characterized by restrictive work practices	Less unionized work force with less restrictive work practices

IdeaWorks relied upon the above definitions and other resources such as online directories of LCCs (AttitudeTravel.com) and individual airline web sites to create a list of the largest LCCs in Europe. The top 25 were determined by the number of passengers carried based upon the most recent data available for each airline:

Table 2
Europe: Alphabetical Listing of Top 25 Low Cost Carriers ²
Aer Lingus • Air Berlin • Air Europa • bmibaby • Condor • dba • easyJet • Excel Airways First Choice Airways • flybe • Germanwings • Hapag-Lloyd (TUI) • HLX (TUI) • LTU Maersk Air • Meridiana • Monarch Airlines • My Travel Airways • MyTravelLite.com Norwegian Air Shuttle • Ryanair • Thomas Cook Airlines UK Thomson/Britannia Airways UK • Transavia • Virgin Express

IdeaWorks notes that market instability and the rapid growth of LCCs creates a dynamic environment that makes any attempt to offer exact definitions and rankings very challenging and often subject to individual interpretation.

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Ryanair and easyJet dominate the group with each carrying approximately 26 million annual passengers. By comparison, the smallest airlines on the list carry approximately two million passengers annually. As a group, the 25 airlines are estimated to represent annual activity in excess of 169 million passengers.

The competitive environment in the United States consists of fewer, but larger airlines. The top nine LCCs in the United States are estimated to carry over 191 million passengers annually. Approximately half of the activity is generated by Southwest which carried over 81 million passengers during 2004. America West is in a distant second place with over 21 million passengers.

Table 3 United States: Alphabetical Listing of Top Nine Low Cost Carriers ³

AirTran • America West • ATA Airlines • Frontier • Independence • JetBlue Song (by Delta) • Southwest • Ted (by United)
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Precise definitions of LCCs in Europe and the United States are plagued by the peculiarities of a highly competitive market place. For example, many airlines in Europe blur the distinction between “scheduled” and “charter” service. This report typically relied upon the direct sale of air-only seats via the airline’s web site as a condition for inclusion as a LCC.

Market forces have also prompted legacy carriers to develop home grown versions of LCCs. Delta launched Song in the United States and Lufthansa has Condor in Europe. Legacy airlines are also morphing into LCCs, such as America West in the United States and Aer Lingus in Europe. The exclusion of Icelandair from the list was a difficult choice but one that relied upon Icelandair’s network qualities and reliance on connecting traffic. Perhaps Icelandair has its own niche as a profitable airline that defies categorization.

IdeaWorks analyzed over 55 Europe-based LCCs - - a statistic made all the more amazing by the fact it doesn’t include all of Europe’s LCCs, such as the recent launches of Blue Air and Centralwings. Consolidation among the LCCs is very likely as market forces select the most capable competitors; a factor which will influence the survival of Europe’s more traditional carriers.

Frequent Flier Programs Grow Beyond Their Roots

It wasn’t supposed to be this way. The legacy airlines hoped their frequent flier programs would remain a key distinguishing characteristic of a full-service product. Advertising sometimes featured two columns - - one column listed the many benefits of choosing a full service airline while the other column (usually blank) reminded customers of the lack of service offered by discount airlines. Even Table 1 in this report supports this practice by listing frequent flier programs as a distinguishing characteristic of a full service carrier.

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While legacy airlines have been busy cutting product benefits to save money, the LCCs are carefully adding those most valued by customers. Many LCCs have learned a well-managed frequent flier program more than compensates for its cost and can become an attractive profit center through the addition of partner-related revenues.

The change began in 1987 when Southwest Airlines - - the family patriarch of LCCs - - launched its "Company Club" frequent flier program. Herb Kelleher, Chairman of Southwest Airlines, reminisced about the decision:⁴

"We didn't want a FFP. But it came to my attention that FFPs were siphoning business travel away from us. We did it defensively, and I think if we had not done that, we would have been terribly disadvantaged."

Mr. Kelleher's comment, along with the prevalence of frequent flier programs among LCCs, clearly demonstrates the benefit has become a "must have" in the U.S. market.

This and other developments have contributed to the confused distinction between full service and LCC models. Delta, as a full service carrier, slashed fares for business travelers and launched Song as a low-cost affiliate. LCCs such as AirTran provide a two-cabin service while jetBlue offers free video entertainment at every seat as an amenity. Perhaps the only reliable distinction between full service airlines and LCCs may be the significant labor savings currently enjoyed by the LCCs.

The LCC Experience in the United States

The United States could be viewed as a marketing incubator for the global airline industry. American Airlines created the first frequent flier program and Southwest Airlines is credited for creating and perfecting the LCC model. The U.S. market has also hosted the ongoing drama of major airlines battling new entrants. Major airlines have largely persevered by using overwhelming market dominance - - a major weapon of these battles being the frequent flier programs that have kept many customers loyal to the full service brands.

The current environment in Europe is somewhat similar to that which existed in the United States during the early 1980s - - dozens of new airlines using lower fares to compete with major airlines for passengers. Yet, today's market is far more sophisticated because of internet distribution, newer aircraft, onboard entertainment options and an overwhelming consumer acceptance for low cost carriers.

Frequent flier programs have become an important ingredient in the product mix of LCCs in the United States. In this regard, the development of frequent flier programs in the U.S. market might help predict the competitive behavior of full service airlines and LCCs in Europe.

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The following attributes of the U.S. experience are likely to have resonance in Europe's LCC marketplace:

- **Pervasive:** Frequent flier benefits are pervasive among LCCs; the top nine LCCs all offer programs. Airline industry media coverage indicates some of the smaller LCCs are considering frequent flier benefits in the future.
- **Low Cost Affiliates:** The low cost affiliates of full service airlines, such as Song and Ted, offer seamless access to the frequent flier programs of the parent airline. For example, Song passengers can earn and redeem in Delta's SkyMiles program . . . including its worldwide alliance network.
- **Rewards:** The programs offered by LCCs provide a generous payout requiring 7.5 to 12.5 paid roundtrips to earn one roundtrip reward ticket.
- **Partners:** Partner networks are well developed among the LCCs with the majority having partners in the hotel, car rental and co-branded credit card categories. Partner activity, with a particular emphasis on co-branded credit cards, has become a significant source of revenues for frequent flier programs.

The following table provides an overview of the frequent flier programs offered by the largest LCCs in the United States:

Airline	Program Name	Accrual Basis	Reward - domestic US r/t	Reward Ratio - r/t to earn free ticket*
AirTran	A+ Rewards	1 credit per o/w flight	16 credits	8
America West	FlightFund	Miles flown	25,000 miles (also offers 15,000 mile short-haul)	12.5
ATA Airlines	ATA Travel Rewards	250 points per o/w flight	6,000 points	12
Frontier	EarlyReturns	Miles flown	15,000 miles	7.5
Independence	iClub	1 point per \$1 spent	1,500 points (max. 1,500 mile trip)	12
JetBlue	trueBlue	Fixed points by zones based upon distance	100 points for system wide trip	12.5
Song	Delta SkyMiles	Miles flown	25,000 miles	12.5
Southwest	Rapid Rewards	1 credit per o/w flight	16 credits	8
Ted	Mileage Plus /TedClub	Miles flown	25,000 miles	12.5

*For mileage based programs: assumes an industry average one-way accrual of 1,000 miles. iClub accrual is based upon \$62.48 average o/w fare from the carrier's 4th quarter 2004 results. jetBlue accrual is based upon medium o/w trip length earning 4 points.

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The smallest LCC in Table 4 is Frontier, which carried more than 6.4 million passengers in 2004. Smaller LCCs in the U.S. market include Spirit, Transmeridian, Sun Country and Allegiant. None of these currently offer frequent flier benefits.

Frequent Flier Programs and Europe's LCCs

One major distinction exists between the U.S. and European LCC market place - - the prevalence of frequent flier programs. Among Europe's top five LCCs, only Air Berlin offers frequent flier benefits. Ryanair and easyJet, as the LCC giants in Europe, are notable because they have not entered the frequent flier fray. But the presence of frequent flier programs among a growing number of competitors offers telling evidence that this scenario may change.

Ryanair is unique among LCCs for offering a co-branded credit card in advance of starting a frequent flier program. The Ryanair.com Visa card was launched in 2003 and its U.K. version offers an amazing payout of one free roundtrip for every five tickets purchased with the card (The card was described in the December 2004 report issued by IdeaWorks – Troubled Airline Industry Returns to Innovative Marketing Programs during 2004.) The presence of the credit card program offers early evidence that Ryanair realizes the profit potential of partner activities.

The launch of a frequent flier program by Ryanair or easyJet would have a dramatic impact on LCCs in Europe. This event would force many LCCs to reconsider their strategy regarding frequent flier benefits. Germany is currently the epicenter of frequent flier activity in Europe. Four of its major LCCs offer frequent flier benefits: Air Berlin, Hapag-Lloyd, LTU and Condor. Even with its substantial LCC activity, the United Kingdom is a distant second in terms of frequent flier programs. Only two LCCs in the United Kingdom offer programs: flybe and Monarch.

Most LCCs in Europe are less generous with reward travel than their U.S. counterparts. The majority require 10 to 20 roundtrips to earn a free roundtrip ticket. Accrual is often determined by distance-based zones, not by the actual distance flown.

The Fidelitas program offered by Air Europa and the Passport to Freedom program from flybe are two notable exceptions. Fidelitas uses a complex matrix relying upon fare classes and travel zones to determine accrual amounts. Using a lower fare example from the Paris – Malaga route, the program requires 32 roundtrips to earn a free ticket on the same route. The reward ratio becomes more generous with higher priced fares. The Passport to Freedom program requires the purchase of flybe's Economy Plus fares - - a condition that effectively limits participation to business travelers. To compensate, the program is exceedingly generous; only four roundtrips are required to earn an economy roundtrip reward.

The following table provides an overview of the frequent flier programs offered by the largest eight LCCs in Europe:

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Airline	Program (Supported Languages)	Accrual Basis	Accrual Partners	Reward Choices	Reward Ratio – r/t for free ticket (Route)*
Aer Lingus	Gold Circle Club (English)	Zone based such as 150 points o/w Ireland to Europe, 200 points for Premier Class	oneworld Alliance, regional hotel chains, car rental	Aer Lingus, oneworld Alliance, hotel stays, merchandise, spas and travel	15 (Ireland-Spain)
Air Berlin	Top Bonus (English, German, Spanish)	Zone based such as 1,000 points o/w within Europe	Hotel chains, car rental, Niki Airlines, MasterCard	Air Berlin, Niki Airlines (taxes paid)	15 (Germany-Spain)
Air Europa	Fidelitas (Spanish)	Complex points-based chart determined by distance and fare paid	6 airline partners, hotels, car rental, MasterCard	Air Europa, 6 airline partners, hotels, car rental and merchandise	32 (France-Spain)
Condor	Lufthansa Miles & More (Multiple)	Zone based such as 750 points r/t within Europe	Star Alliance, hotels, car rental, banking, telecom, retail, Miles & More Visa	Condor, Lufthansa and Star Alliance, hotel chains, car rental and merchandise	20 (Germany-Spain)
flybe	Passport to Freedom (English, French)	Valid only for Economy Plus fares: 10 points o/w segment	None	flybe, Air France (1 route only) hotel stays, car rental, wine, flowers and parking	4 (UK-Spain)
Hapag-Lloyd	bluemiles (German)	Zone based such as 2,000 points o/w within Europe	Hapag-Lloyd Express (Mallorca flights)	Hapag-Lloyd (taxes paid)	10 (Germany-Spain)
LTU	Redpoints (German, English, Spanish)	Zone based such as 2,000 points r/t within Europe	None (credit card does not earn points)	LTU	10 (Germany-Spain)
Monarch	Vantage Club (English)	Points based and route specific	None	Monarch	9 (UK-Spain)

* "Route" describes the market example used to determine typical accrual. Air Europa example assumes lower priced fare between Paris and Malaga.

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The frequent flier programs offered by Europe's LCCs provide many innovative features. One distinction from the United States is the presence of "truly-free" rewards. Table 5 notes Air Berlin and Hapag-Lloyd provide frequent flier rewards with all taxes and fees paid by the airline.

Several family-friendly benefits were also noted among the frequent flier programs. LTU offers a family account option that allows up to six family members to accrue miles into a single master account. Air Europa and LTU reduce the quantity of points required for child rewards. On Air Europa, children under 12 enjoy reward travel at half the usual number of points, and infants are ticketed at 10% of the adult point requirement. LTU tickets children age 2-11 at 70% of the adult reward requirement.

Four of the frequent flier programs analyzed provide elite tiers for the most frequent of fliers. Aer Lingus, as a member of the **oneworld** Alliance, provides exceptional access to airport clubs, upgrades and other benefits. Air Berlin, Air Europa and Monarch offer elite benefits. Examples of typical elite benefits include additional checked baggage allowance, priority wait list, priority check-in, expedited baggage claim, bonus accrual and limited lounge access.

Language is an important issue within the European market. Table 5 notes the language support offered for the frequent flier program portion of each web site. For more than one airline, the presence of frequent flier benefits was only noted in the native language of the airline and completely omitted from the foreign language versions of the web site.

Observations and Conclusions

IdeaWorks predicts frequent flier benefits will be offered by virtually all of Europe's top LCCs. For the very same reason expressed by the Chairman of Southwest Airlines, Europe's LCCs will be compelled to add frequent flier programs to capture and retain customers in highly-competitive markets.

Existing frequent flier programs offered by Europe's LCCs will continue to evolve and grow. Travel partner participation (hotels, car rental companies and credit cards) will become more robust and aggressive. These relationships have proven to be excellent profit generators and loyalty enhancers for airlines. Elite levels, which are currently available from half of the programs analyzed, will become more prevalent and grow in complexity. Relationships between LCCs are likely to grow, such as reciprocal reward benefits and codeshare routes.

Full service airlines will increasingly rely upon powerful frequent flier programs to create marketing advantages for their low cost affiliates. United and Delta provide full access to their frequent flier programs in the United States; travel on Ted and Song even qualifies for elite status.

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In Europe, Scandinavian has included full access to EuroBonus for its Blue 1 low cost affiliate. Lufthansa limits access to Miles & More for passengers of its Condor low cost affiliate; flights on Condor don't qualify for elite status. Elsewhere in the world, Qantas recently opened frequent flier participation to the higher fare passengers of its JetStar low cost affiliate.

Distinctions, such as limitations on accrual and elite qualification, are likely to disappear as full service airlines recognize an elite member's contribution to the entire airline group rather than specific brands.

The eight European programs analyzed by IdeaWorks reveal unique characteristics such as family accounts, reduced reward requirements for children, merchandise rewards and truly free reward travel (taxes and fees paid by the airline). These benefits may cross the Atlantic and find their place within the programs offered by LCCs in the United States.

About IdeaWorks: IdeaWorks was founded in 1996 as a consulting organization building brands through innovation in product, partnership and marketing and, building profits through financial improvement and restructuring. Its international client list includes the hotel, airline, marine, railroad, consumer products and health care sectors. IdeaWorks specializes in brand development, customer service improvement, customer research, competitive analysis, creating partner-marketing strategies, cost reduction programs and business restructuring. IdeaWorks brings value as a consultant by researching the expectations of the customer, learning from the wisdom of the client organization and applying innovative ideas to create solutions for clients and consumers. Learn more by visiting: www.IdeaWorksCompany.com

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Endnotes:

¹ Report of the Independent Expert to Virgin Blue Airways, Grant Samuel & Associates, Pty. Limited, Dated February 25, 2005, available at http://www.virginblue.com.au/about_us/investors/

² Rankings for Europe LCCs are based upon passenger boarding data from a variety of sources such as airline financial reports, industry trade magazines, airline trade groups and government entities. Scheduled/charter airlines include total enplanements.

³ Rankings for U.S. low cost carriers based upon passengers boarded for January – October 2004.

⁴ Herb Kelleher's quote referenced in "History of Frequent Flier Programs" at FrequentFlier.com.