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The IdeaWorks Report on Frequent Flier Partnerships for the World's Top 20 Low Fare Carriers

Condor, Jetstar, Song and Ted enjoy significant partner advantages from the frequent flier programs operated by their major airline affiliates.

Frequent flier programs are becoming an important component of the low fare airline environment. Travelers enjoy the added savings and perks, while low fare airlines appreciate the millions of dollars in revenues produced by their partner relationships. This has caused more low fare airlines to reconsider long-held views on frequent flier programs. What was once seen as an extravagance is now considered an effective tool to capture market share and generate incremental revenues.

IdeaWorks recently completed analysis of the frequent flier partner activities associated with the world's top 20 low fare carriers as measured by 2004 passenger traffic results. This report describes activities in the following partner categories: airline alliances, hotels, rent-a-car, personal finance, communications, retailers and credit cards. The final portion of the report provides additional details and real world examples on the economics and financial benefits of partner relationships.

The Largest Low Fare Airlines

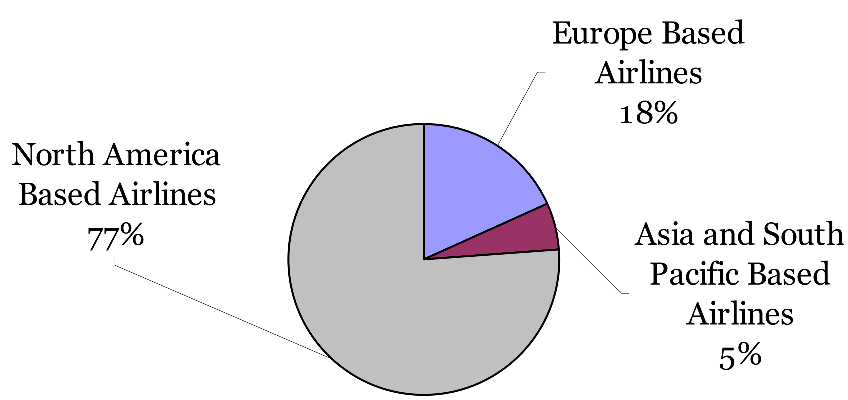
The top 20 list excludes those low fare leaders that don't offer frequent flier programs such as Europe's Ryanair and easyJet, Australia's Virgin Blue and Brazil's Gol. The following low fare airlines comprise the top 20 list:

Table 1: Largest Low Fare Airlines with Frequent Flier Programs
Aer Lingus - Gold Circle Club • Air Berlin - Top Bonus • Air Europa – Fidelitas AirTran - A+ Rewards • America West – FlightFund • ATA - Travel Rewards Cebu Pacific - Summit Club • Condor - Lufthansa Miles & More flybe - Passport to Freedom • Frontier – EarlyReturns • Hapag-Lloyd – bluemiles Independence Air – iClub • JetBlue – trueBlue • Jetstar - Qantas Frequent Flyer Lion Air – Passport • LTU – Redpoints • Song - Delta SkyMiles Southwest - Rapid Rewards • Ted - United Mileage Plus • WestJet - Air Miles

Candidates for the top 20 list were generated from a variety of airline industry publications that have described the emergence of the global low fare airline sector. The final list was limited to by those providing frequent flier programs and their 2004 passenger traffic. Song (affiliated with Delta Airlines) and Ted (affiliated with United Airlines) do not provide separate results; their 2004 traffic was estimated to be 7 million passengers and is based upon company statements and other industry sources. At 7 million passengers, Song and Ted are approximately the same size as Independence Air in the United States and Europe's Condor.

The top 20 list includes low fare airlines from all over the world: 11 airlines in North America, six in Europe and three in the Asia/South Pacific region. The list is currently dominated by ten airlines from the more established US low fare sector. As expected, the presence of Southwest Airlines, and its 81 million annual passengers, greatly influences the distribution of passenger traffic by region shown in Graph 1 below. However, the Europe and Asia/South Pacific regions are gaining importance as areas with expanding low fare airline activity.

Graph 1: 2004 Passengers by World Region on the Top 20 Low Fare Carriers



Significant marketing distinctions do exist by region. For example, the largest nine low fare airlines in the United States offer frequent flier programs. In Europe, only four of the top ten airlines offer frequent flier benefits to their customers - - with Ryanair and easyJet the major exceptions. It's too soon to characterize the Asia/South Pacific region, as many of its low fare airlines are still in the early stages of development.

The United States market is dominated by Southwest as the "mother of all low fare airlines" and America West as a major airline and early low-fare convert. The birth of the "airline within an airline" phenomenon also occurred in the United States with the launch of Song by Delta and Ted by United. This history has led to an environment in which frequent flier programs have become an integral amenity.

The European experience has been very different; its major airlines are playing virtually no part in the development of the low fare sector. Ryanair and easyJet established the European low fare model by beginning their lives as humble start-ups. Likewise, the development of frequent flier programs has been distinct from the experience of the US airline industry.

Europe's established airlines originally viewed frequent flier programs as avoidable expenses. While programs in the US were well established during the early 1980s, Europe's airlines largely waited until the 1990s to launch their programs. This delayed development, combined with recent economic challenges, has contributed to a slower introduction of frequent flier programs among Europe's low fare airlines. The competitive landscape would dramatically change if Ryanair or easyJet were someday compelled to introduce frequent flier programs.

Accurate measurements of low fare airline activity in Asia are difficult to capture because of the limited statistics provided by major participants. New entrant activity in India will likely increase the region's future share of low fare airline traffic. The importance placed on amenities in the Indian market suggests frequent flier programs may be an early competitive issue. The addition of frequent flier perks for Jetstar customers has likely prompted Virgin Blue to consider a competitive response.

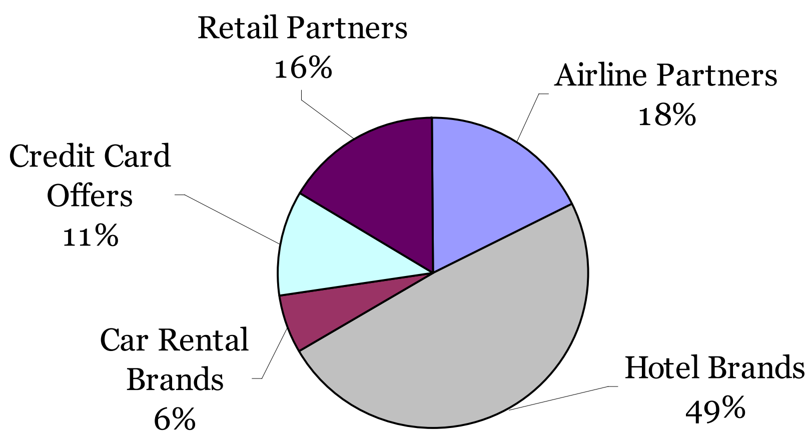
The dynamics of frequent flier programs all over the world have been dramatically changed by the introduction of partner opportunities such as co-branded credit cards. Now, airline managers can view their frequent flier programs as attractive generators of cash through the sale of miles to their credit card partners and as a necessary link to establish relationships with other airlines.

Frequent Flier Programs and Partner Activities

Early frequent flier program history did not include partners such as hotel chains, car rental companies, retailers, telecommunication providers or credit cards. Hotels and car rental companies were originally added as inducements to boost participation and make the programs more important to business travelers. Airlines have only recently begun to dramatically increase partner activity in a wide array of categories as a method to create revenues. Some airlines, such as United, have developed their programs into stand-alone franchises that represent an extremely attractive source of profits.

The low fare airline sector is embracing the addition of partner relationships. Only three frequent flier programs, among the 20 low fare airlines analyzed, excluded partner relationships: 1) flybe – Passport to Freedom, 2) Independence Air – iClub, and 3) Lion Air – Passport. Graph 2 lists the distribution of partners in major program categories:

Graph 2: Total Partners by Category for the Top 20 Low Fare Carriers

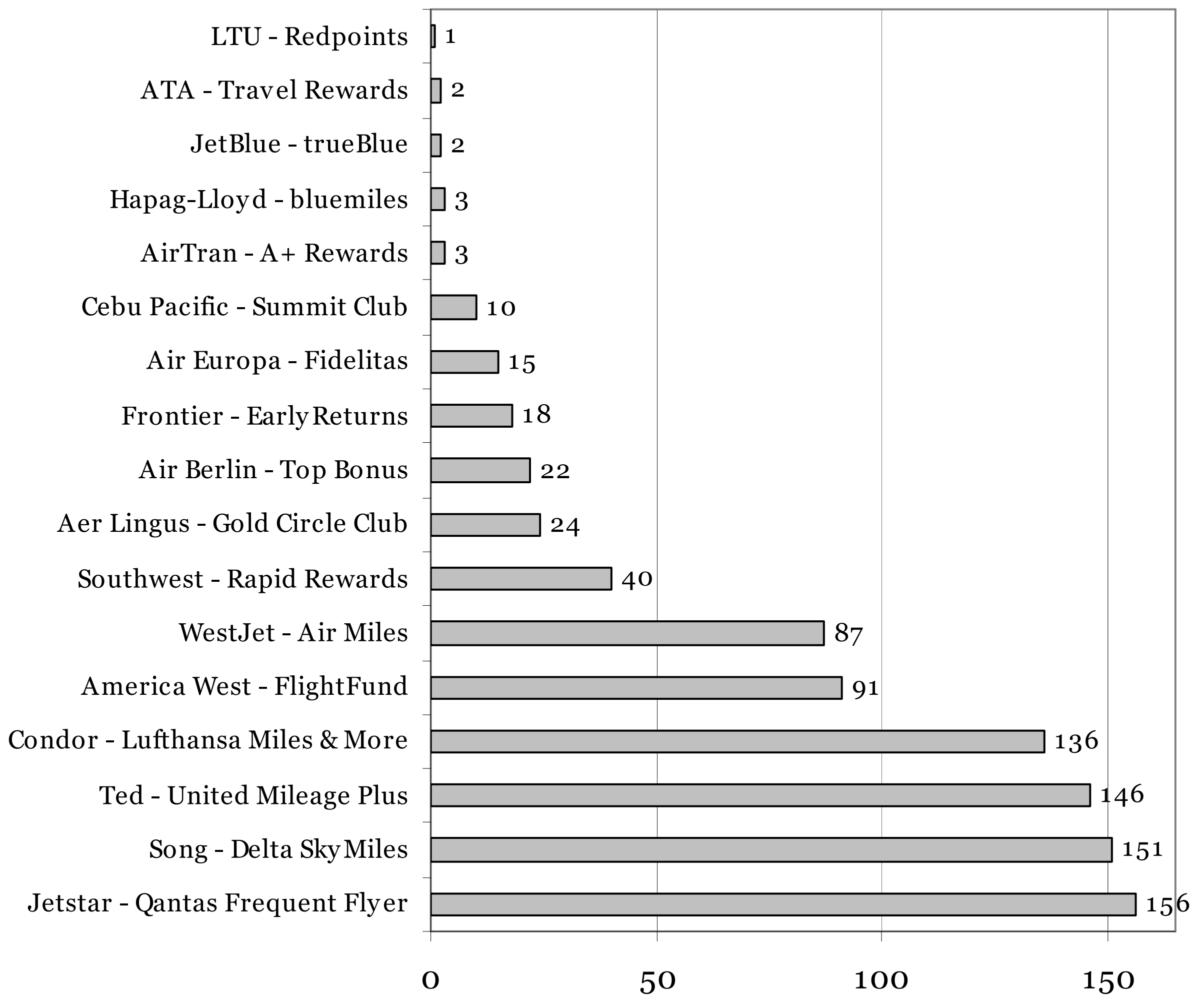


Establishing partnerships with other airlines was an early method to boost reward destination coverage. Almost instantly, domestic airlines such as America West could leap past competitors like Southwest Airlines by adding the global reward coverage of an international partner - - such as British Airways. Links between airlines have slowly grown into the global networks of the Star, oneworld and SkyTeam alliances. Customers quickly grasped the advantage of using one frequent flier program to unlock a world of coordinated perks, services and rewards from a global franchise of airlines.

Hotels are an extremely important category for frequent flier programs. The development of global hotel collections, such as InterContinental, Starwood and Choice, has dramatically boosted brand coverage. Car rental companies, facing the inherent commodity nature of their product, largely rely upon their frequent flier program links as effective methods to communicate with travelers and gain market share. Partner activity continues to expand as other categories, such as retailers, telecommunication companies and financial services, seek the benefits delivered by frequent flier programs.

Partner activity is not evenly distributed among the 20 programs analyzed. Clearly the frequent flier programs associated with major airlines, such as Lufthansa Miles & More and United Mileage Plus, provide a vast array of partner opportunities. The ownership link between a major airline and its low fare affiliate provides tremendous benefits. At this top level, the total quantity of partnerships ranges from 136 to 156 brands. The statistics in Graph 3 count individual partnerships that allow members to accrue miles or points. The brands featured in programs range from large to small - - such as the worldwide operations of Hertz (in 11 programs) to a single partner location such as the Great Northern Hotel in Tasmania, Australia (in one program).

Graph 3: Low Fare Programs and Total Partner Count

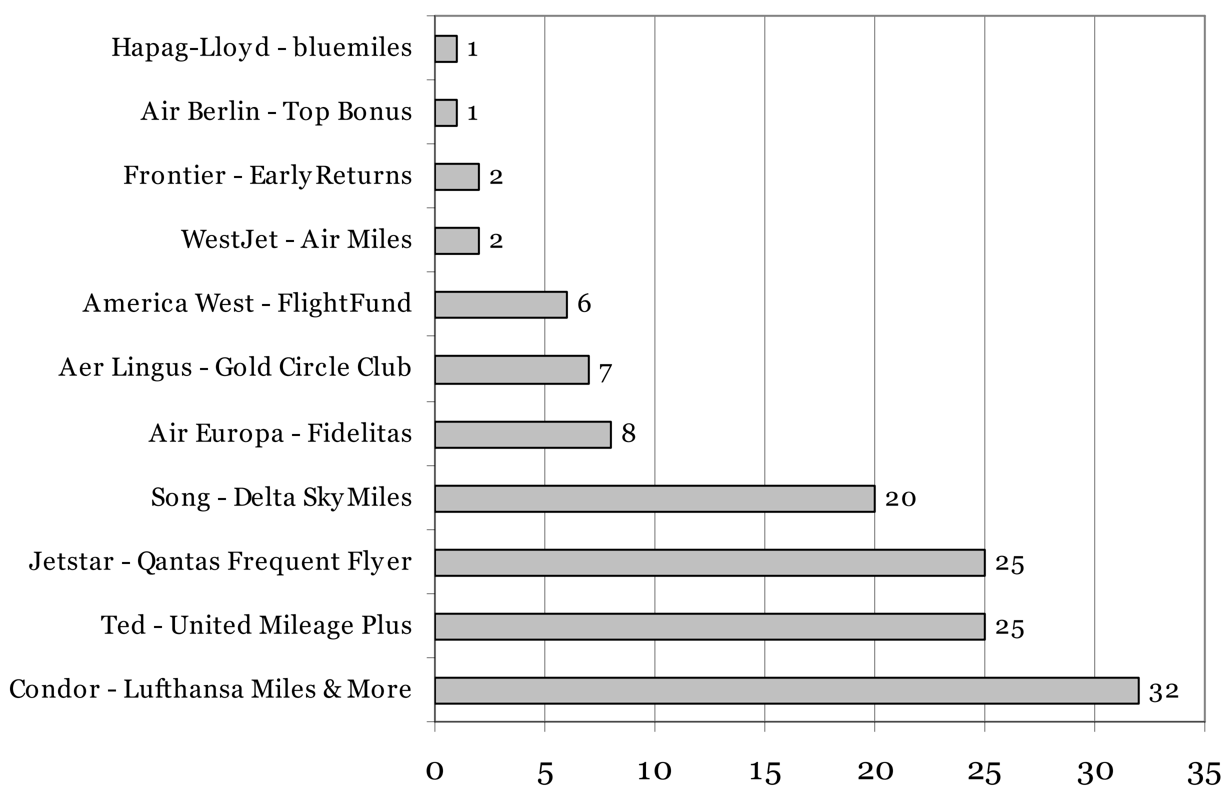


Three low fare programs without partners are not listed.

Airlines Partnering With Airlines

Airlines establish two types of relationships with other airlines. Codeshare agreements allow an airline to place its brand on another flight. These expand the reach of an airline far beyond its normal markets and help capture additional passengers. Frequent flier agreements between airlines offer a similar link by expanding accrual and reward opportunities to new destinations. Both types of agreements have expanded rapidly in the era of global airline alliances. Condor, Jetstar, Song and Ted have benefited from the alliance memberships and partner networks of their major airline owners. Graph 4 lists partnerships that allow accrual on other airlines; it readily depicts the distinction between these well-connected carriers and those that are largely independent:

Graph 4: Low Fare Programs and Their Airline Partners



Nine low fare programs without airline partners are not listed.

More and more frequent flier programs rely on airline link-ups to deliver worldwide benefits. For example, customers flying German carrier Condor can choose rewards on a vast network of 32 airlines offered by the Lufthansa Miles & More program.

The lack of airline partnerships can limit the attractiveness of a program. The members of the following eight programs are limited to the destinations flown by the airline: 1) ATA - Travel Rewards, 2) Cebu Pacific - Summit Club, 3) flybe - Passport to Freedom, 4) Independence Air – iClub, 5) JetBlue – trueBlue, 6) Lion Air – Passport, 7) LTU – Redpoints, and 8) Southwest - Rapid Rewards. AirTran – A+ Rewards, which does not have airline partnerships, provides a unique reward option in which it purchases tickets on other airlines to any destination in the world.

The presence of airline partnerships creates the unique circumstance in which customers can enjoy savings on low fare airlines and redeem travel on traditional higher-fare airlines. Table 2 lists the airlines most frequently appearing as partners in the programs offered by low fare carriers:

Table 2: Airlines With the Highest Occurrence in the 20 Programs
Participates in 4 programs: Northwest Airlines
Participates in 3 programs: Alitalia • British Airways • SAS Scandinavian • Singapore Airlines South African Airways • United Airlines • US Airways • Virgin Atlantic Airways
Participates in 2 programs: Air Canada • Air China • Air France • Air New Zealand • American Airlines Asiana Airlines • Austrian Airlines Group • Blue1 • bmi • Cathay Pacific Continental Airlines • Croatia Airlines • EL AL • Emirates • Iberia Airlines KLM Royal Dutch Airlines • LAN • LOT Polish Airlines • Lufthansa • Qantas Airways Spanair • Swiss International Air Lines • TAP Portugal • Thai Airways

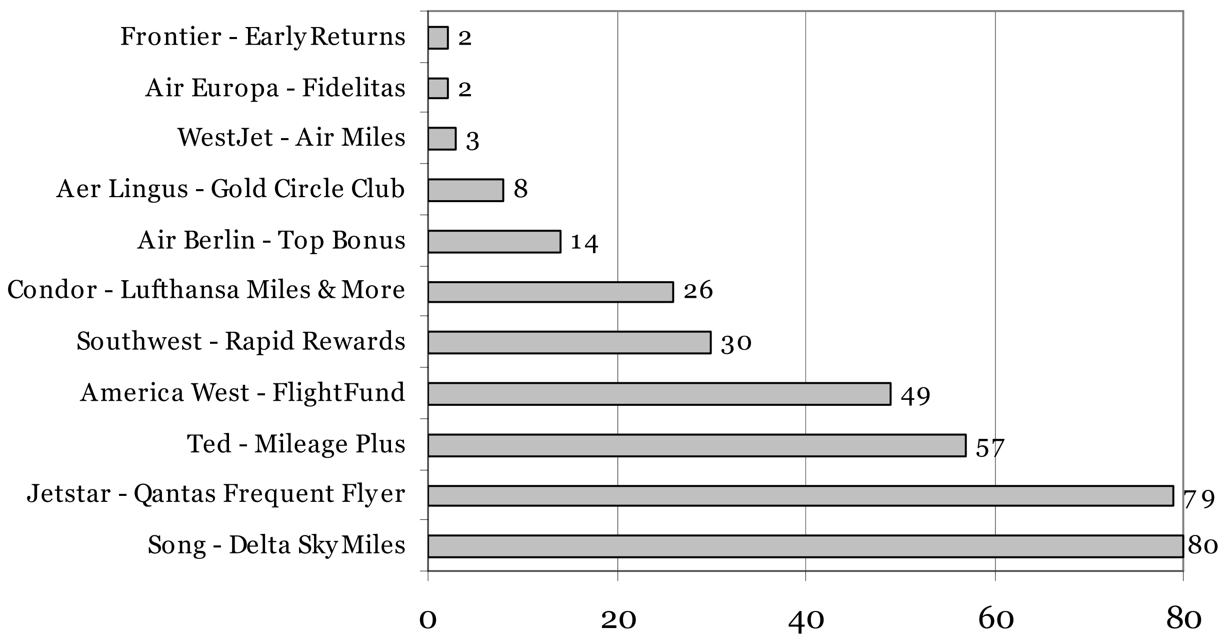
Northwest Airlines leads the group for its participation in the programs offered by: 1) America West – FlightFund, 2) WestJet – Air Miles, 3) Air Europa – Fidelitas, and 4) Song – Delta SkyMiles. The presence of the Star and oneworld alliances is also apparent among the low fare affiliates of Delta, Lufthansa, Qantas and United.

Airlines and Hotel Brands

Hotel participation is a major component of frequent flier programs on a brand-wise and individual hotel location basis. Programs such as Song – Delta SkyMiles and Jetstar – Qantas Frequent Flyer offer the greatest number of hotel chains. Smaller programs may take a different approach by concentrating on single hotel locations in key home markets.

Hotel chains have long relied on airlines for capturing and maintaining market share. Business travelers typically place airline reservations at the beginning of the travel planning process, with hotel reservations next and the final component being local transportation such as a rental car or limousine transfer. Again, the benefits of an association with a well-connected carrier are apparent in Graph 5. Jetstar – Qantas Frequent Flyer and Song – Delta SkyMiles provide the greatest number of hotel brands (single hotel locations are not reflected in the graph).

Graph 5: Low Fare Programs and Their Hotel Partners



Nine low fare programs without hotel brand partners are not listed.

America West – FlightFund is unique for being an airline operating outside of the global airline alliance arena, and yet it has more hotel brand partnerships than Condor – Lufthansa Miles & More and Aer Lingus – Gold Circle Club. However, nine of the programs offered by low fare carriers don't offer hotel partner opportunities: 1) AirTran - A+ Rewards, 2) ATA - Travel Rewards, 3) Cebu Pacific - Summit Club, 4) flybe - Passport to Freedom, 5) Hapag-Lloyd – bluemiles, 6) Independence Air – iClub, 7) JetBlue – trueBlue, 8) Lion Air – Passport, and 9) LTU – Redpoints.

Partner relationships have been greatly aided by the rise of global hotel collections, such as InterContinental, Starwood and Choice. For example, a frequent flier program can add up to eight brands through a single agreement with Choice Hotels International.

Table 3 lists the hotel brands which occur with the greatest frequency in the programs offered by the low fare airlines:

Table 3: Hotel Brands With the Highest Occurrence in the 20 Programs
Participates in 6 programs: Courtyard • Crowne Plaza • Hilton Hotels • Holiday Inn • Holiday Inn Express Hyatt Hotels & Resorts • Marriott Hotels & Resorts • Renaissance Hotels & Resorts
Participates in 5 programs: Clarion • Comfort Inn • Conrad Hotels • Doubletree • Embassy Suites Hotels Four Points by Sheraton • Hampton Inn • Hilton Garden Inn Homewood Suites by Hilton • InterContinental Hotels & Resorts Park Inn • Radisson Hotels & Resorts • Sheraton • The Luxury Collection Westin Hotels & Resorts
Participates in 4 programs: Best Western • Candlewood Suites • Comfort Suites • Coral by Hilton • Econo Lodge Hawthorn Suites • Hotel Indigo • Park Plaza Hotels & Resorts • Quality Residence Inn • Rodeway Inn • Scandic • Sleep Inn • SpringHill Suites • St Regis Staybridge Suites • TownePlace Suites • W Hotels

Even with the activity shown in Graph 5 and Table 3, plenty of opportunities remain in this category with overall participation at a relatively low level in all world regions.

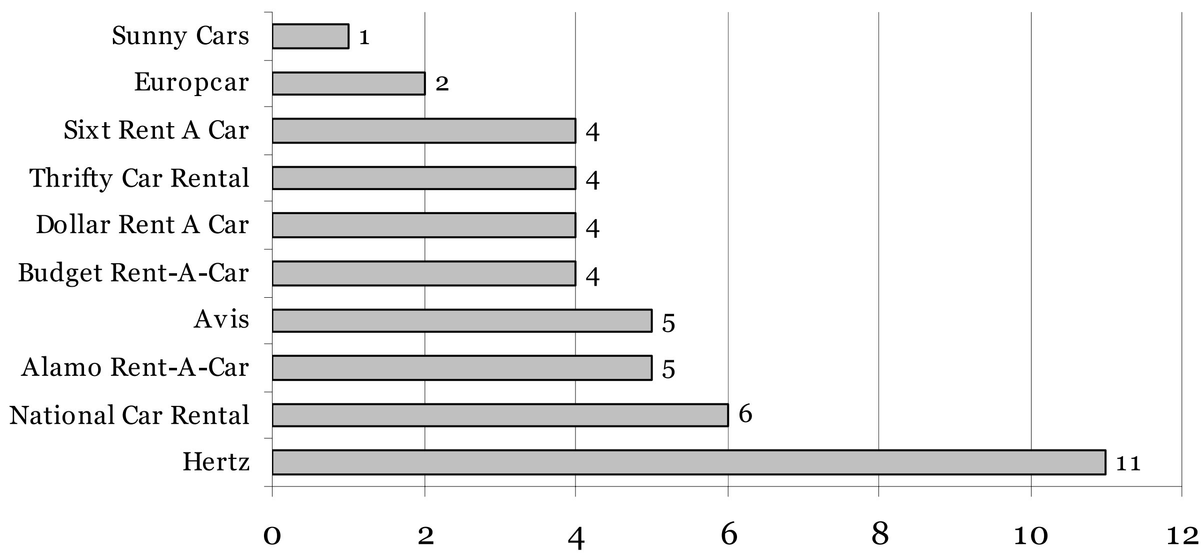
Other Key Partner Areas

The most mature programs are typified by the inclusion of five additional partner areas: car rental, communication, personal finance and retail companies. The fifth area is credit cards, which is fully described in the final section of this report.

Car rental companies are a popular choice because of the direct association with travel. These relationships often include commission agreements in which the airline can earn income by booking car rentals or merely passing the referral to the car rental company. Ryanair, which does not offer a frequent flier program, noted in its 2004 annual report that commissions from its Hertz agreement generated over 35 million Euros (US$42.4 million) in revenue - - more than 3.2% of total airline revenues. If coupled with a frequent flier relationship, this amount would likely grow even larger.

Hertz clearly leads all other car rental companies in establishing relationships with the frequent flier programs offered by the top low fare airlines. Graph 6 describes the relationships that exist with the 12 airlines featuring car rental partnerships.

Graph 6: Car Rental Participation in the Top 20 Programs



Twelve of the frequent flier programs have car rental partners .

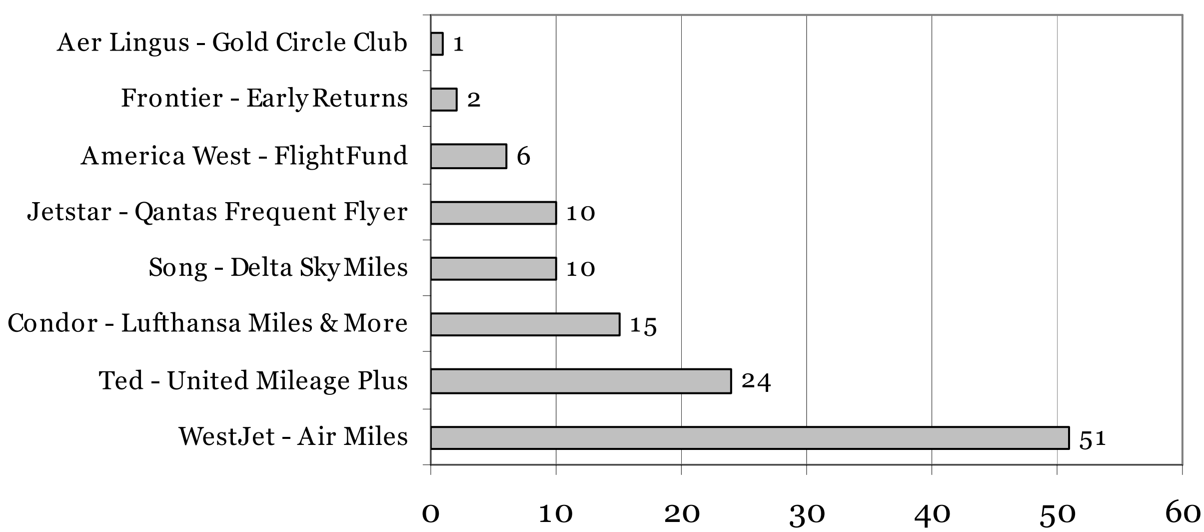
Communication and personal finance partner opportunities are well established in the United States, but appear to have limited application elsewhere in the world. The prevalence of mobile, wireless internet, long distance and local telephone providers may reflect the deregulated nature of the communication industry in the United States. Financial services relationships include banks, mutual funds and stock brokerages with an emphasis on internet-based companies. Many of these partners use significant bonus offers, such as 5,000 miles, to encourage purchase behavior by program members. Major airline programs, such as United Mileage Plus and Delta SkyMiles, earn significant revenues from the sale of millions of miles to partners such as Nextel (mobile phones), Sprint (long distance) and NetBank (online banking).

Retail represents a major frontier for frequent flier programs with physical and online store participation. For example, Ted – United Mileage Plus offers an impressive array of grocery stores. Yet, it is the online marketplace that appears to offer an ideal application for bonus offers. Major frequent flier programs offer online florists, corporate gift giving and even airline-branded shopping malls.

SkyMilesShopping.com and the MileagePlusMall.com provide frequent flier miles to consumers making purchases under their umbrella of online stores and brands. These shopping sites are operated by vendors that establish relationships with retailers and fund the purchase of miles through referral commissions. They rely upon program collateral to create exposure for more than 100 participating stores.

Special note should be made of WestJet's Air Miles program. Air Miles is an independent program owned and operated by the Loyalty Group of Canada. WestJet has a wide-ranging relationship with Air Miles and has adopted the program as its in-house frequent flier program. Air Miles has over 15 million members in Canada, which represents more than 70% of Canadian households. As shown in Graph 7, WestJet – Air Miles has a very strong retail presence with far more partners than any of the traditional frequent flier programs included in this analysis.

Graph 7: Low Fare Programs and Their Retail Partners



12 low fare airlines without retail partners are not listed.

Frequent flier programs have become effective loyalty machines for retailers because frequent travelers represent an attractive higher income customer base that is also very interne-savvy. Retailers appreciate the proven power of using bonus offers to build sales and encourage repeat purchases. By selling miles or points to retailers, frequent flier programs are generating benefits from consumer spending in areas not directly related to air travel.

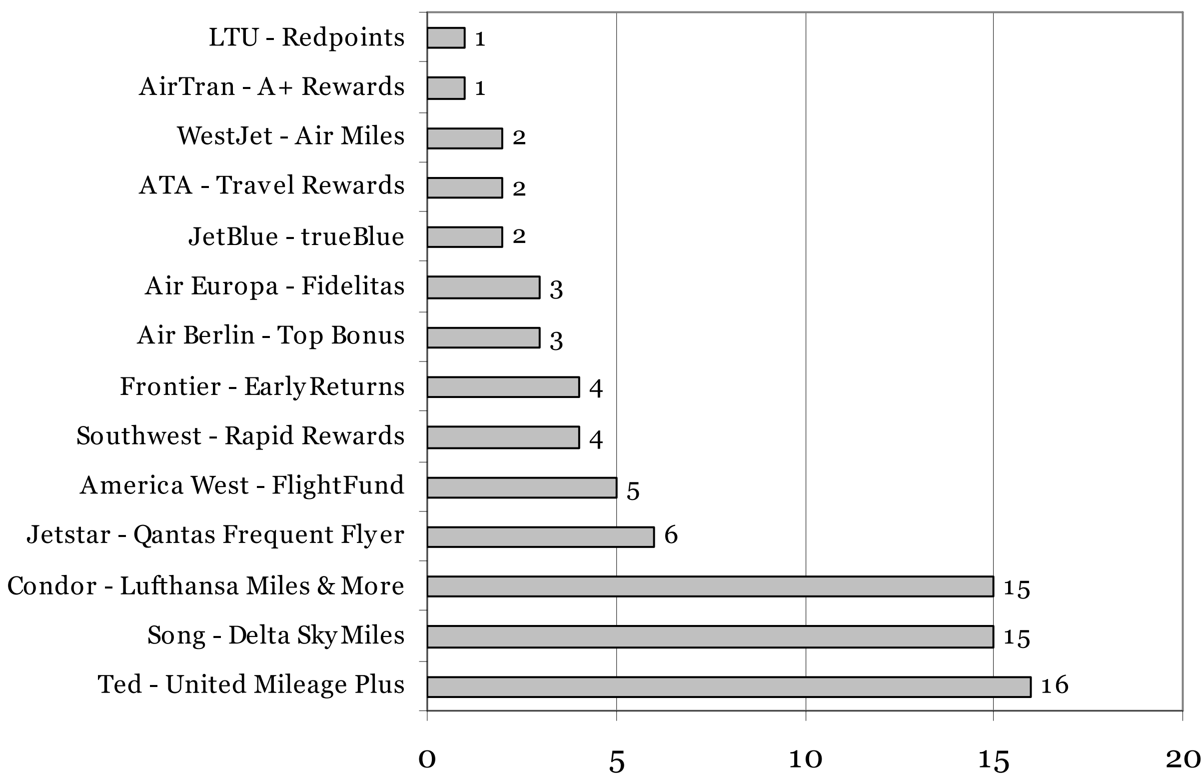
Airlines and Co-Branded Credit Cards

More low fare airlines are learning to "follow the money" by seeking co-branded credit card relationships. Properly executed co-branded credit cards can generate great pools of profits for an airline. It is believed some credit card programs are now generating nearly US$1 billion in revenues for individual airlines.

Low fare airlines have been keen to develop this lucrative revenue source. Even carriers without well-developed partner networks have struck deals with credit card banks. Other opportunities await too, such as the popular American Express Membership Rewards program and the Club Rewards program from Diners Club. The latest to introduce a new relationship is the jetBlue – trueBlue program with its just-launched JetBlue Card from American Express.

Card-issuing banks also scour the landscape to seek new co-branding opportunities. This combination of activity often leads to multiple card credit card options within a single program. Multiple credit card offers may also exist due to the geographic limitations of bank partners which may restrict issuance to a particular region. However, some airlines simply wish to maximize a consumer's choices by making Visa, MasterCard, American Express and Diners Club offers available to their members. Graph 8 lists the total number of points- or miles-earning credit card options offered by the programs analyzed:

Graph 8: Low Fare Programs and Total Credit Card Options



Six low fare airlines without credit card options are not listed.

The credit card options listed for each airline include co-branded cards associated with Visa, MasterCard and American Express, and the points-earning programs offered by American Express Membership Miles and Club Rewards by Diners Club. Major frequent flier programs dominate the list due to the existence of credit card relationships in countries outside of the home market of the airline.

Annual reports filed by the airlines sometimes reveal details on the revenues produced by their partner and co-branded credit card relationships. United Loyalty Services (ULS) is the subsidiary of United Airlines that operates the Mileage Plus frequent flier program.

During 2004 it generated revenues of US$822 million largely through the sale of miles to partners of Mileage Plus. IdeaWorks believes the majority of these revenues were produced by United's many credit card relationships. Very tellingly, ULS was the only United reporting segment with positive earnings for the last four years since 2001. The same annual report lists Mileage Plus membership at 45 million members - - equaling average revenue of US$18.26 per member from partner-related mileage activities.

The most recent financial report from low fare Frontier Airlines provides very specific details on the relationship between EarlyReturns and Juniper Bank. Frontier received an advance payment of US$10 million from Juniper Bank for its new credit card program during fiscal year 2003. During the 2004 fiscal year, the credit card program generated US$2.4 million; revenues increased to US$12.2 million for the most recent fiscal year. Membership in EarlyReturns was estimated at 900,000 for 2004, yielding average co-branded revenues of $US13.50 per member (not per cardholder).

Midwest Airlines and its Midwest Miles frequent flier program was not included among the top 20 low fare airlines. However, its financial reports provide interesting details for a smaller scale airline carrying just over 2.3 million passengers. Its partner activities generated US$7 million during 2004. IdeaWorks believes the Midwest Airlines MasterCard issued by Juniper Bank produced the majority of these revenues. Membership in Midwest Miles was 1.8 million members during the same year, which equates to average partner revenues of nearly US$4 per member.

This sampling of annual reports provides an interesting array of results from a wide range of programs. Those offered by major airlines have strong numerical advantages such as a global membership base and the largest partner networks. But smaller carriers can also generate millions of dollars in ancillary revenues from modestly sized programs having far fewer members and partners. While the results from US-based airlines may not have direct application to low fare airlines in the Europe and Asia/South Pacific regions, the numbers should amply illustrate the revenue potential provided by partner relationships.

Conclusions

Globally, the future looks very positive for partnership growth at low fare airlines. Program coverage in the US market is well developed with Spirit as the largest low fare airline without a frequent flier program. However, plenty of partner growth remains with all of the independent airlines - - especially in the hotel and retail categories.

The tilting point in the European market will likely occur when Ryanair or easyJet launch a program . . . an event which will dramatically impact all of Europe's airlines. EasyJet is the more likely candidate with a growing number of companies under the orange "easy.com" umbrella. Beyond the airline, the brand now includes car rental, hotel accommodations, mobile phones, personal finance, entertainment, retail and a new cruise line - - an ideal setting for a frequent flier program to generate cross-platform awareness, encourage trial purchases, and create brand loyalty.

The Asia/South Pacific region represents a developing market for the low fare sector in which the role of frequent flier programs is largely unwritten. Some early actions suggest this region will see an increase in frequent flier and co-branded credit card activity. For example, the addition of Qantas frequent flier benefits to the Jetstar product has likely placed Virgin Blue at a disadvantage. Air Asia has developed a MasterCard program similar to Ryanair, which rewards free travel outside of the structure of a frequent flier program. These activities will likely encourage competitive responses and the launch of new frequent flier programs.

What has been a market place of extremes - is now becoming a market of convergence. Traditional airlines are learning about the savings delivered by the unbundled travel experience, such as charging fees for services traditionally included in the price of an airline ticket: checked baggage, seat assignments, meals and beverages. Likewise, low fare airlines are learning lessons from the major airlines and their frequent flier programs. In this realm, robust partner activities can generate millions of dollars of ancillary revenues through the sale of miles to partners in the hotel, rent-a-car, personal finance, communications, retail and credit card categories.

The question of frequent flier program development no longer needs to rest solely on the issue of program benefits versus operating costs. The added advantages and revenues provided by partnerships can help tilt the scale towards developing and launching a program. This is an outcome where everyone can benefit - - the airline, its customers, its partners, but most importantly, its investors.

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, profit improvement, 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: IdeaWorksCompany.com

Sources used in this Industry Analysis: Unless otherwise noted, frequent flier program information presented in this report are based upon an online review conducted during July 2005 of the airline web sites; passenger traffic numbers are from various airline industry publications and airline web sites.