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Contact: Jay Sorensen
For inquiries: 414-961-1939

The Fall of Frequent Flier Mileage Values in the U.S. Market - Industry Analysis from IdeaWorks

Mileage buying power is weakest for the programs offered by American, Continental, Delta and United.

The buying power of frequent flier miles, as measured by the number of miles required to buy a reward ticket for U.S. domestic travel, has dramatically decreased since 1994. Falling air travel prices and reward level increases are major contributing factors to the drop in the value of a frequent flier mile:

- In 1994, when the prevailing U.S. reward level was 20,000 miles, the typical frequent flier mile would purchase **2.1 cents** of reward travel.
- During 1995 most airlines raised their domestic U.S. reward level to 25,000 miles and the value of a frequent flier mile dropped by nearly 18% to **1.7 cents**.
- Since 2001, falling domestic air fares have brought the value of a frequent flier mile down to **1.4 cents** in 2004 - - its lowest level since 1994.

The 20,000 mile reward ticket offered in 1994 for domestic travel in the United States, when adjusted for decreases in domestic air fares, should only require 17,000 miles today. Quite the opposite has occurred, as the standard reward level for five major U.S. airlines has actually increased to 25,000 miles.

Members of the programs operated by American, Continental, Delta, Northwest and United have experienced the largest drop in mileage buying power due to the continuation of the 25,000 mile standard reward level - - even in today's environment of deeply discounted fares.

The Frontier Airlines EarlyReturns frequent flier program provides a notable exception to this trend by offering a standard reward level at 15,000 miles for domestic U.S. travel and providing its members the highest value at 2.4 cents per mile.

Frequent Flier Rewards and Average Fares

IdeaWorks has analyzed frequent flier reward levels and average air fares in key U.S. markets to calculate the buying power of frequent flier miles during an eleven-year period from 1994 through 2004.

Consumers maximize the value of frequent flier program participation by redeeming miles for higher value tickets and using cash to purchase lower value tickets. Typically, miles are redeemed for longer-haul trips to leisure-oriented destinations.

IdeaWorks began this analysis by creating a market sample to represent the value of a typical frequent flier reward ticket. The nine U.S. markets listed in Table 1 are noted for their high passenger volume and long-distance characteristics; they have also been referenced in the travel media as top frequent flier reward choices:

Table 1
Key Frequent Flier Reward Markets
Atlanta - New York
Boston - Los Angeles
Chicago - Los Angeles
Chicago - New York
Los Angeles - New York
Los Angeles - Washington DC
Miami - New York
New York - Orlando
New York - San Francisco

Average air fares were assigned to each market based upon data available from the U.S. Department of Transportation and the Air Transport Association (see note 1 at the end of this analysis). Passenger volumes for each market were used to assign a weighted value to each air fare. The result created an average weighted air fare for each year from 1994 to 2004. For example, the average reward ticket in the market sample had a price of \$420 in 1994 and \$354 in 2004.

Average reward ticket values were compared to the number of miles required by major airlines for domestic reward travel in the United States. Exceptions to the standard level exist and are described in the narrative of this analysis. Some programs, such as those operated by AirTran and Southwest, do not utilize miles and were not included in the analysis. Aloha and Hawaiian were not included in the analysis due to their limited continental U.S. route structure.

Historical and Current Reward Mileage Levels

For many frequent flier program members, 1995 was made significant by the dramatic increase in the number of miles required for reward travel in the continental United States. During 1995 the standard reward level for most airlines increased from 20,000 miles to 25,000 miles - - a level which still dominates frequent flier reward travel today.

Among the major airlines, Alaska is unique for its 20,000 mile reward level, while America West and US Airways offer discounted levels based upon season or distance. America West offers a 15,000 mile reward for shorter trips up to 750 miles. US Airways offers a 20,000 mile reward during the fall/winter travel period of September 15 through the end of February.

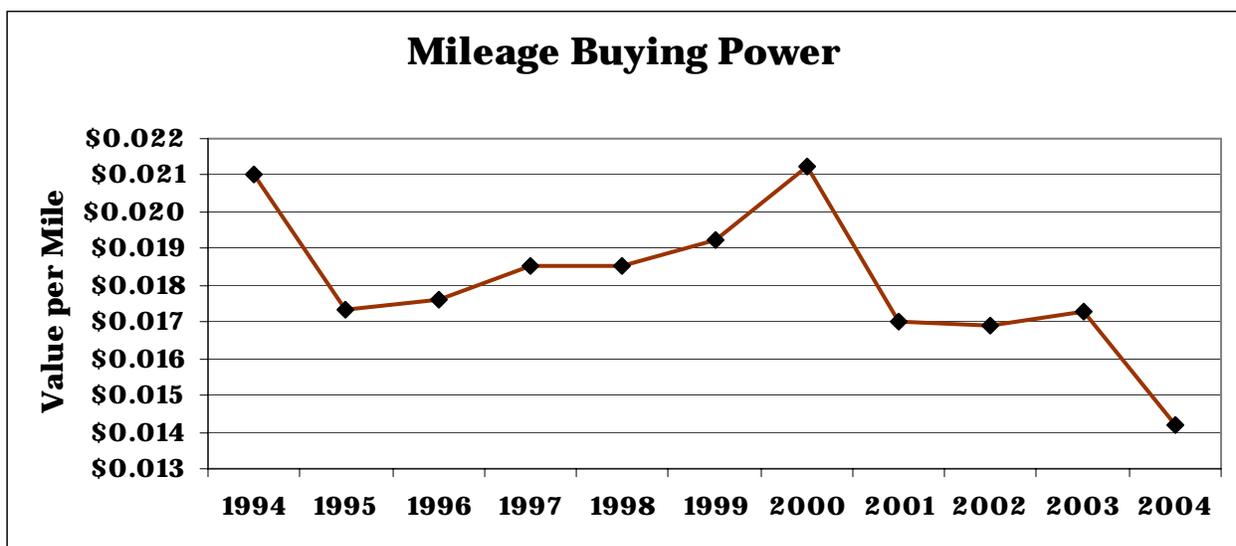
Frontier clearly breaks ranks with all other airlines with its 15,000 mile domestic travel reward. The 15,000 mile level has remained a constant since the EarlyReturns program was unveiled in 2001.

The standard 25,000 mile reward level currently applies for the following major U.S. airlines: American, Continental, Delta, Northwest and United. As a group, these “Major Five Airlines” (a name applied for this analysis) represent over 70% of airline activity when measured by 2003 revenue passenger miles. United and American recently offered a limited-time 15,000 mile promotion for reward trips up to 750 miles. However these nearly duplicate American and United offers have not become part of their standard reward charts.

Mileage Buying Power and the “Major Five”

The influence of the “Major Five Airlines” (American, Continental, Delta, Northwest and United) on frequent flier programs looms large in the travel industry due to the significant size and presence of these airlines. Their dominance has effectively established the 25,000 mile reward as the de-facto standard domestic reward level. The domestic travel reward is a valid measure of comparison, as it easily dwarfs all other reward choices in terms of member popularity.

The “Mileage Buying Power” graph below displays the buying power of a frequent flier mile, which is calculated by dividing the weighted air fare by the standard reward level for each year of the 1994 through 2004 analysis period:



The dramatic drop from 1994 to 1995 can be attributed to the increase of the standard domestic reward level from 20,000 miles to 25,000 miles. The gradual increase from 1996 to 2000 reflects the relative health of the airline industry and its ability to increase average air fares. The fortunes of the industry reversed dramatically in 2001 with steep pricing declines brought by falling passenger demand and rampant discounting. The value of reward travel, as reflected by average air fares for the market sample, continued its deep descent into 2004.

The graph reflects the reality of the travel market. When compared to the 1994 mileage value of 2.1 cents, the 2004 mileage value of 1.4 cents represents a 33% drop. When compared to the "post 20,000 mile reward" environment of 1995 with its 1.7 cent mileage value, the 2004 mileage value represents a drop of 20%.

The Major Five Airlines have maintained the price of reward travel at 25,000 miles - - even while the value of air travel has dropped substantially. This has resulted in a decline in the value and buying power of the frequent flier miles earned by program members. The Major Five Airlines would be required to drop their standard reward level to 17,000 miles to recover the mileage value offered to members back in 1994.

Comparison of Mileage Buying Power

Because reward levels vary between airlines - - so does the value of their frequent flier currency. The highest buying power is offered by airlines with the lowest reward levels such as Frontier and Alaska. Table 2 lists the current buying power of the top mileage-based programs in the United States:

Table 2 Mileage Values of Frequent Flier Programs	
Frequent Flier Program	Mileage Value
Frontier EarlyReturns	\$0.024
Alaska Airlines Mileage Plan	\$0.018
America West FlightFund	\$0.017
US Airways Dividend Miles	\$0.015
American AAdvantage	\$0.014
Continental OnePass	\$0.014
Delta SkyMiles	\$0.014
Midwest Miles	\$0.014
Northwest WorldPerks	\$0.014
United Mileage Plus	\$0.014

Mileage values were determined by dividing the weighted air fare for 2004 by the mileage level required by each program for domestic reward travel. America West and US Airways feature a two level standard reward structure for domestic travel.

America West FlightFund offers a 15,000 mile reward for trips up to 750 miles and a 25,000 mile reward for longer-distance trips. FlightFund's mileage value was computed using a composite reward level of 21,645 miles (1/3 of the 15,000 mile level and 2/3 of the 25,000 mile level). US Airways Dividend program offers a seasonal 20,000 mile reward for travel between September 15 and the end of February and a 25,000 mile reward for the rest of the year. Dividend's mileage value was computed using a computed reward level of 23,310 miles (1/3 of the 20,000 mile level and 2/3 of the 25,000 mile level).

Observations and Conclusions

The result of this analysis confirms what frequent flier program members have long suspected - - the value of their frequent flier miles have decreased. This document analyzes quantifiable measures such as average air fares and frequent flier reward levels. It has omitted qualitative issues such as the widely-held perceptions of decreased reward availability and the growth of redemption restrictions. If these were included in the analysis, the results would likely indicate even greater decreases to the value of frequent flier miles.

The Major Five Airlines clearly have a problem. Air fares are on a continued downward trend and have yet to bottom out. Millions more miles are entering the system through new sources - - notably co-branded credit cards. Low-fare passengers are increasingly competing for the same excess inventory that was once reserved for reward travel. Added to this scenario is a growing liability of millions of unused reward tickets.

Consumers should expect to see more reward sales and creative solutions as downward pressures continue on current reward levels. The 15,000 mile short-haul reward offered by America West, and tested by American and United, is likely to become prevalent. Newer airlines unburdened by past practices and reward liabilities will likely continue to lead the pack in terms of providing their members with the best reward value.

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. Learn more at www.IdeaWorksCompany.com

Sources for Program Analysis and Note (1): Information describing frequent flier reward levels is from the web site operated by each airline program. Note (1): Air fares from 1996 through 2004 are from the 3rd quarter Consumer Air Fare Report published by the USDOT Office of Aviation Analysis. Air fares for 1994 and 1995 were calculated by applying the Annual Passenger Prices data (published by the Air Transport Association) to 1996 USDOT Consumer Air Fare Report results.

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