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## **Frequent-Flier Miles Are Piling Up. Fliers Won't Benefit Like Airlines Will.**

By Jon Sindreu

***IdeaWorksCompany contributed information to this article - - see italics.***

*Frequent fliers have accumulated more miles without using them because of the pandemic, and carriers will likely deploy a range of tricks to devalue them.*

Are frequent-flier miles worth it? Airline customers may benefit from a lesson in macroeconomics: It is hard to beat those who issue their own currencies.

Carriers' loyalty programs are increasingly attracting Wall Street's attention, as recently disclosed bond documents have shown them to be even more profitable than previously thought. For fliers who accumulate points to redeem them for extra seats or rewards, the programs' appeal to investors suggests they may be getting the short end of the stick.

Airline miles are reminiscent of the coins minted by feudal lords, who pocketed part of the precious metal they used as "seigniorage."

Loyalty points are exposed to the modern form of seigniorage, as well as regular inflation. During the Covid-19 crisis, redemption of points has stopped, but not their issuance, leading to a surge in unspent miles. The four major U.S. carriers reported a combined \$2.6 billion increase in deferred revenues from loyalty programs in 2020, compared with \$808 million in 2019.

***"You have travel returning, pent-up demand and an oversupply of miles," said Jay Sorensen, president of airline consulting firm IdeaWorksCompany. "We are set for a devaluation."***

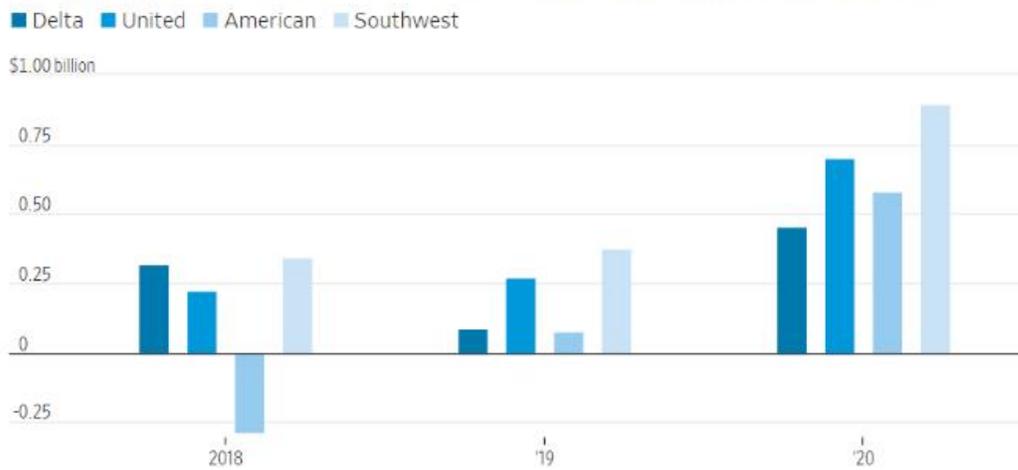
Frequent-flier programs' job is to make fliers spend more than they otherwise would. A 2011 paper found they account for a 5% to 6% price premium.

***Airlines typically list dollar and points prices for flights. Based on the exchange rate, IdeaWorksCompany calculates that each of Delta's SkyMiles is worth roughly 1 cent, meaning rational customers should never pay more than that for a mile.*** Yet Delta's website sells them for 3.5 cents, excluding taxes, implying a full 2.5 cents in seigniorage—though most are sold through promotions.

## A Higher Loyalty

Frequent fliers have accumulated more miles without using them.

Frequent-flier miles, difference between the value of points earned and redeemed by customers



Those who earn miles in exchange for loyalty when they buy flights are also implicitly paying for them. Carriers are able to “price discriminate” and push expensive products onto loyalty members, because they know they tend to be wealthier and fly on a corporation’s dime.

Most airline points, however, are given for swiping credit cards bearing airline insignia. Banks pay carriers to be able to distribute them, but the bill is footed by merchants through hefty interchange fees.

This may seem a good deal for card users being subsidized by the stores. But they are still paying the “opportunity cost” of not opting for cards offering other rewards. Those that give back cash—often 2% of the purchase value—are a good benchmark: Choosing to accrue miles instead implicitly costs around 2 cents a dollar.

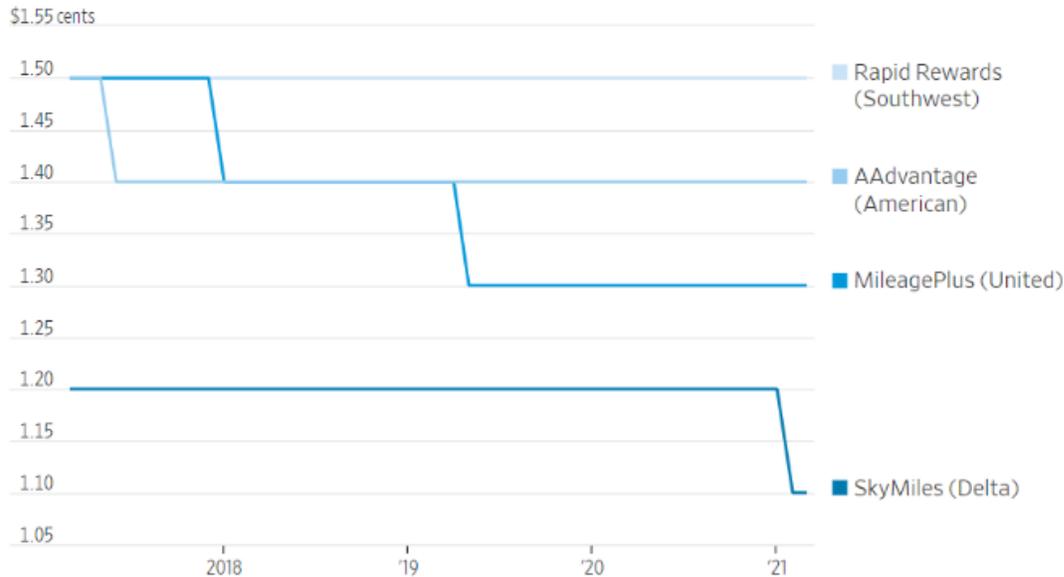
All of these schemes provide the illusion of a clear reward system, which keeps customers engaged: Higher-tier elite members, for example, earn more miles per dollar. In reality, it is very hard to gauge the true value of a mile, given wide variations in reward availability, prices and the cost of earning them.

This is a strategy sometimes called “frame complexity.” Research finds that offering many different prices for the same product gives firms the power to charge more.

It also allows them to exploit behavioral biases. In experiments published in 2004 in the *Journal of Marketing Research*, people’s perceptions of costs were lower when there was “combined currency pricing” mixing loyalty points and cash. Furthermore, customers suffer from “goal gradient” and “endowed progress” biases: They ramp up spending when they are close to a point milestone.

## Flight Drag

The amount a frequent-flyer mile buys in flights and rewards is drifting downwards.



Note: Based on a combination of estimated acquisition costs, value of redemption, availability and change/cancellation policies.

Sources: The Points Guy; Internet Archive Wayback Machine

And, of course, airline loyalty membership can provide non-pecuniary benefits in the form of status and some extra perks.

Accumulating points can still be fully rational sometimes. When the starting point to accrue miles was distance flown and rewards were more easily available—banks weren't flooding the world with points—savvy customers could often spot profitable discrepancies between mile and dollar prices.

Yet over the past decade, carriers have increasingly linked mile accruals and redemptions to the amount of dollars spent by fliers, making it easier for revenue departments to set exchange rates that always favor them.

In recent years, the purchasing power of miles has remained relatively stable but still drifted downward, according to an analysis of valuations collected by The Points Guy, a website financed in part by banks. Before October, a business-class flight between the U.S. and Europe in one of Delta's partner carriers cost about 75,000 SkyMiles, versus 120,000 now.

It evokes the old economics idea that money is a "veil" obscuring true value. While long discredited, it may apply to an economy in which airlines get to fix the price of all goods available.

Carriers will still need to be careful not to alienate customers, given that their networks will be smaller and less attractive after the pandemic.

But recent disclosures have shown that American Airlines, despite consistently ranking lowest on measures of customer satisfaction, runs the most lucrative frequent-flier program among U.S. legacy airlines, so the relationship between the two clearly isn't straightforward. With the true value of miles becoming increasingly opaque, carriers may be able to devalue and keep most customers addicted to miles.

When it comes to having a currency, it is good to be king.