

Frequent Flyer Programs – Overview of Existing Models

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Abstract This paper describes three basic models of frequent flyer programs offered by airlines. Based on the definitions of these models an analysis of airline loyalty programs offered by European carriers was performed. The paper contains conclusions regarding the evolution of frequent flyer programs in Europe. The development process was assessed and prospective advances were identified.

Keywords frequent flyer programs, loyalty management, travel choice,

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1. Introduction

Airlines that operate in developed markets face fierce competition, which sometimes may be classified as hyper-competition. This makes it necessary for airlines to seek revenue in many ways, one of which is through building passenger loyalty. This is especially important in the high-yield segment, i.e. among business travellers^[1]. Frequent flyer programmes (FFPs) have been created to allow frequent flyers accumulate points for their flights and – after they have earned enough of such points – redeem them for air tickets. How points are earned for flights and how they can be “spent” depends on the model adopted by a particular loyalty programme. Frequent flyer programmes also help in improving brand recognition and may potentially increase the market share of a particular airline [2].

Further in this paper terms “loyalty programme” and “frequent flyer programme” will be used interchangeably to describe loyalty schemes offered by airlines. The goal of the study is to examine how these loyalty programmes have evolved and investigate into differences between currently operated models.

The first loyalty programmes were introduced by airlines in the first half of the 1980’s [3]. Studies suggest that the availability of a loyalty programme and perks linked with it are among the main reasons of choosing a particular airline [4]. However, this impact is most probably smaller for low-cost airlines, who offer classic frequent flyer programmes much more rarely and passenger choices in their case are driven mainly by low price of their air tickets.

This paper reviews operating models of frequent flyer programmes by identifying key components that define these programmes. The study was conducted based on desk studies and the analysis of frequent flyer programmes offered by European airlines.

2. Key Components of Frequent Flyer Programmes

Initially, that is at the early stages, frequent flyer programmes were principally loyalty schemes set up to encourage passengers to use services of a particular airline. An opportunity to accumulate points earned for individual travels (with the perspective to redeem them for a free air ticket after having earned enough points) increases switching costs [5] because by choosing another airline one postpones the perspective of reaching the threshold of points that would reward them with a free air travel. Jones & Sasser stress that in passenger air transport industry customer loyalty is higher than average [6]. It proves the efficiency of airline loyalty programmes as tools that enhance the competitiveness of air carriers, who - by using such programmes - foster the supply side of the market. That is confirmed by studies examining the potential of airlines that offer loyalty programmes [7] to win an extra premium in hubs. On the other hand, some authors (e.g. R. Caminal and A. Claiici) indicate that in highly competitive sectors loyalty programmes increase the consumer surplus, i.e., they improve the position of the demand side of the market [8].

There are many aspects of frequent flyer programmes’ models, in which they differ. From the passengers’ point of view, as well as airlines that offer frequent flyer programmes¹, the crucial feature is how points (often referred to as miles) are earned and how “prices”² of award tickets are calculated. Based on that, two baselines models can be dis-

¹ Airline loyalty programmes can be run as independent companies, to which attention is drawn further in this paper.

² The price of an award ticket is the number of points that must be accrued to get such a ticket.

tinguished: distance-based (or mileage-based) that focus on the distance covered during a trip and revenue-based (spend-based) [9] models where spending is the key factor.

Besides the principles of points accrual and award ticket “pricing”, other key components that define the loyalty programme model include: customer target group(s) and programme exposure to industries from outside of the airline sector, where members can earn and redeem points.

2.1. Points Accrual and Redemption Mechanisms

Basic mechanisms of earning and redeeming the points (distance-based and revenue-based) may come in different options which often combine both solutions. Some loyalty programmes (until recently it was true of most of the programmes available in the market) calculate points for the flight distance (usually expressed in miles) and the booking class (which strictly depends on the airfare, i.e., the basis of the price of an air ticket): the distance is multiplied by a factor allocated to a particular booking class, which usually ranges from 10 (for low booking economy classes) up to 300% (for the first class), with some loyalty programmes awarding no points for the cheapest economy class tickets.

Besides earning and redeeming the points based on flight distance and the price of the ticket, we need to mention one more algorithm used by some loyalty programmes, in particular with regard to establishing the value of reward tickets expressed in points, that is, based on the zones. In this instance, the “price” of an award ticket depends on the regions between which the journey takes place. Regions are equivalent of continents (e.g., Europe, North America) or parts thereof (e.g., South-East Asia, South Africa).

On top of that, the “price” of an award ticket expressed in points – the same way you do with cash - depends on the booking class (economic, premium economic, business or first class). Ultimately, the cost of an award ticket offered under a loyalty programme is the resultant of the booking class and the flight distance or the regions of departure and arrival.

In the revenue-based model, the number of awarded points is directly proportional to the price of the ticket, for which points are earned; however, there can be some adjustment factors (which are, e.g., higher for premium class - business and first class – tickets and for high status passengers in loyalty programmes). Proportionally higher amount of points allocated to these passenger segments is designed to foster the loyalty of clients who generate the highest revenue for an airline. On the other hand, points accrued under this model can be redeemed for tickets available for general public, which have a concrete price. We need to stress that many loyalty schemes offer mixed solutions, e.g., points accumulated for flights are calculated under the revenue-based model while “prices” of award tickets are set depending on the distance or zones (regions).

In models, in which “prices” of award tickets are established based on the zones we can come across static and dynamic pricing strategies, i.e., the amount of points required to get a ticket can be set as constant or it can vary

depending on the demand exhibited by customers who pay cash as well as loyalty programme points.

2.2. Exposure to Non-airline Industries

Traditional loyalty programmes offered by airlines were dedicated exclusively to their clients while points could be earned and redeemed on flights only. Since that time, most of the FFPs have evolved and nowadays, to a lesser or bigger extent, they also enable earning and redeeming points on services offered by partners from outside of the airline industry. Naturally, the first non-airline partners were enterprises selling travel-related products and services, such as hotel chains and car rental companies. Nowadays, most loyalty programmes collaborate with such partners. Another step - very important from the point of view of the users as it opens up substantial opportunities to earn additional points – was the exposure of FFPs to the banking sector, most often through credit card *co-branding*. Purchases made with cards co-issued by banks and airlines give their holders additional accrual opportunities in airline loyalty programmes. From the viewpoint of the business entity managing an FFP this is an additional (and a very important) source of revenue: banks purchase points from FFPs to award them to credit card holders [10]. A large portion of revenue of airline loyalty programmes comes from points sold to FFP users as well as partners, in particular financial institutions [11].

2.3. Three Basic FFP Models

In 2012 E. R. de Boer and S. V. Gudmundsson proposed a synthetic approach to how airline loyalty programmes are defined, and formulated three basic FFP models: legacy, advanced and autonomous [12]. Each programme can be assigned to one of these models based on different criteria, such as, e.g., user target groups, FFP place within the organisational structure of an airline, ownership structure, percentage of points that were earned outside the airline, etc. Detailed characteristics of the models can be found in Table 1.

Over more than thirty years since the first airline loyalty programme was launched substantial changes have taken place in FFP operating models. We also need to bear in mind that today, loyalty programmes are at different levels of development, i.e., all the three models coexist side by side.

As loyalty programmes have been evolving, we can clearly see their autonomisation visible not just in their organisational structures (a separate SBU or a separate company, reporting models, etc.) but also in how they generate customer value and thus the potential to build customer loyalty. Going away from a strictly airline programme towards a multi-industry loyalty one may make airline passengers perceive these programmes as less attractive, especially when the majority of points that they can later redeem for air travel are earned from other sources.

Table 1. Types of airline loyalty programmes: evolutionary approach

	Legacy	Advanced	Autonomous
Users	Frequent flyers	Frequent flyers and credit card spenders	Frequent flyers and everyday spenders
Structure	Part of marketing division	Separate SBU	Separate company
Ownership	100% owned by the airline	100% owned by the airline	Owned by airline and/or external investors
Suitable for external investors	No	No	Yes
Financial reporting	On aggregate level	May report revenues separately	Income and balance sheet
Non-air partner accrual as percentage of overall miles accrual	Low (<20%)	Medium (>20%)	Large (>50%)
Partner industries to the programme	Travel related (hotels, car rentals, cruises)	Travel related and financial services (credit cards)	Travel/financial everyday spend (e.g. groceries, fuel, telco services)
Rewards	Award tickets and upgrades for air travel	Air travel and limited merchandise	Air, merchandise and experiential rewards
Staff profile	Airline background	Airline and marketing background	Other backgrounds (airline, retail, finance, marketing and CRM)
Award allocation policy	Fixed – supplemented with distressed inventory	Mixed – combination of fixed and dynamic	Combination of fixed and dynamic – any seat is available for redemption at a price)

Source: [12].

3. Analysis of the European Market

As part of studies on airline loyalty schemes we have identified 37 frequent flyer programmes offered by air carriers registered in European countries. Each of such programmes operates based on a model in accordance with the earlier discussed typology proposed by E. R. de Boer and S. V. Gudmundsson, who specified the features of a dominant model in each case (only a handful of programmes can be classified under a clear heading of one model or another). The models are explained in Table 2. In some cases it was not possible to identify a model in an unambiguous way based on its characteristic features. In these instances we indicated between which models a given programme ranges. In addition to a model we also specified which air carriers use a particular frequent flyer programme.

Table 2. Models of European airline loyalty programmes

Airline	FFP	Model
Aegean Airlines, Olympic Air	Miles+Bonus	advanced
Aeroflot	Aeroflot Bonus	advanced
Aigle Azur	Azur Plus	legacy
Air Europa	Suma	advanced
Air France KLM, Tarom	Flying Blue	advanced /autonomous
Air Malta	Flypass	legacy
Air Moldova	Air Moldova Club	legacy
Air Serbia	Etihad Guest	advanced /autonomous
airBaltic	airBaltic Club	legacy
Alitalia	MilleMiglia	advanced
Aurigny	Frequent Flyer	legacy
Azores Airlines, SATA	SATA Imagine	advanced
Belavia	Belavia Leader	legacy
Binter Canarias	Binter Mas	legacy
British Airways, Iberia, Aer Lingus, Vueling, Air Italy	Avios	autonomous
Bulgaria Air	Fly More	legacy
Corsair	Corsair Le Club	legacy
Czech Airlines	OK Plus	legacy/ advanced
Dniproavia Airlines	Bonus Club	legacy
easyJet	easyJet Flight Club	other
Finnair, Nordic Regional Airlines	Finnair Plus	advanced
Icelandair	Saga Club	advanced
Lufthansa Group, PLL LOT, Adria Airways, Croatia Airlines i in.	Miles&More	advanced /autonomous
Montenegro Airlines	Vision Team	legacy
NordStar	Easy To Fly	legacy
Norwegian Air Shuttle	Norwegian Reward	legacy/ advanced
Pegasus Airlines	BolBol	legacy
S7 Airlines, Globus airlines	S7 Priority	advanced
SAS, Atlantic Airways, Wideroe	EuroBonus	advanced
TAP Portugal	Miles&Go	advanced
Turkish Airlines	Miles&Smiles	advanced/autonomous
Ukraine International Airlines	Panorama Club	advanced
Ural Airlines	Wings	legacy
Utair	Status	legacy
Virgin Atlantic	Flying Club	advanced/autonomous
Volotea	Megavolotea	other
Wizzair	Wizz Discount Club	other

Source: author's compilation.

Interestingly, only one loyalty programme exhibited dominant features of an autonomous model. Legacy model remains the most frequently applied one while the advanced model ranks second. Some programmes are currently in transition from an advanced to autonomous model, so we should expect a bigger group of programmes that fit within the framework of a model sitting at the top of the hierarchy.

On the other hand, we need to note that most (in quantitative terms) loyalty programmes in the above typology are offered by relatively small airlines of limited range of impact, which fly relatively small numbers of passenger. Looking through the lens of the number of passengers who may potentially use individual programmes, we can see that the FFPs offered by three the biggest groups of airlines bringing together traditional air carriers in Europe belong to the transitional model from the advanced to the autonomous one or they openly exhibit dominant features of an autonomous model (Avios that belongs to IAG group). Nowadays, the transformation of operating models of the major airline loyalty programmes in Europe is very clear; recently Miles&More as well as FlyingBlue have changed the way in which miles are earned. In an attempt to establish a more direct link between the benefits and the value created by individual clients, they have shifted from a system that is based on the distance flown and the airfare to the one fully based on revenue flows generated by a passenger [13].

The analysis of differences in the operating models of frequent flyer programmes offered by European airlines would be incomplete without taking a look at low-cost carriers market. In the past the so called budget airlines did not offer any loyalty programmes, however, recently their approach has been changing although the biggest low cost airline in Europe, i.e., Ryanair, still does not offer any scheme that could be referred to as a loyalty programme. Wizzair and Volotea, in turn, offer programmes that involve purchasing a membership by the customer. This membership entitles passengers to buy air tickets and auxiliary services at discount prices.

4. Conclusions

Since their beginning, frequent flyer programmes have evolved on multiple occasions and the most advanced amongst them have become autonomous profit centres and cannot be any longer perceived exclusively as tools helping in solidifying passenger loyalty [11]. There are relatively few autonomous programmes and more traditional schemes that do not go beyond the airline sector continue to prevail. On the other hand, major loyalty programmes are relatively well advanced and reflect many features of autonomisation (according to the typology proposed by de Boer and Gudmundsson), meaning most passengers benefit from programmes that have reached a higher level of development.

This paper contains only an introductory review of frequent flyer program programmes. The continuation of the research in this field is recommended to carry out a more in-depth and detailed analysis of operating models of loyalty

programmes offered by airlines (to examine individual components of such models). A broader geographic scope of the study covering programmes from outside of Europe would also be an interesting option.

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