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Strategy: Airlines Seek New Ways To Reward Frequent Flyers

United, American, Delta dangle auctions, incentives at passengers.

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IdeaWorks contributed information and quotes to this article

October 2, 2006 - - With 1.2 trillion airline miles chasing too few seats on U.S. carriers, the shortcomings of frequent flyer programs are becoming increasingly obvious on the redemption side.

So obvious, in fact, that the innovations—introduced when financial services-branded cards entered the incentive travel space—are now being mimicked by the airlines themselves. The airlines also have initiated such programs as auctions in which consumers can use their frequent flyer miles to bid on trips and cars.

When American Express earlier this year rolled Blue Sky—a pseudo frequent flyer program flagging redemptions through any travel brand (hotels, car rentals, cruise lines and travel tours included)—it had no point caps, expiration or blackout dates. Other plastic, like Bank of America Reward, Discover's The Mile Card and Chase Platinum, dangle travel points for purchase incentives, also with no annual fee and, in some cases, 0% interest for up to six months. This prompted United, American and Delta to offer more bonus miles and to waive or reduce first-year annual fees for their credit card products.

"The trade off [with financial services cards] is consumers use their points to buy a ticket with cash and the reward ratio is not that good," said Jay Sorensen, president at marketing consultancy IdeaWorks, Shorewood, Wis. "But your airline mileage program, excuse my English, ain't any good if you can't get a seat."

Consumers spending on the ground with cards that earn miles now generate more revenue for airlines than frequent flyer passengers who actually buy tickets. Court papers from United's Chapter 11 filing showed that Mileage Plus contributed more than $800 million to the carrier's coffer last year and was United's only profitable program. Air Canada reaped $225 million in 2005 when it sold a 12.5% stake in its Aeroplan loyalty program. A Bear, Stearns report late last year estimated that American's AAdvantage program, the oldest and largest in the category (with 50 million members), was worth at least $2 billion.

Still, the lack of gratification for members could endanger the cash cow. Redemption among the top nine airlines rose 6.5% last year over 2004, but the carriers' liability of unused miles jumped 13.9%, per IdeaWorks. At the Loyalty World conference last September, Ulrich Hauschild, vp-customer loyalty at Lufthansa, noted that only 8% of frequent flyer members redeemed miles for flights.

"That's a pretty low redemption rate for your primary reward product," said Rick Ferguson, editorial director at Colloquy, a loyalty marketing publication.

Airlines are now looking at coalition marketing—recruiting vendors from noncompeting categories—to increase redemption opportunities for frequent flyer members. "The airlines [need] to reward people in a way that doesn't hurt their program," said David Terry, gm at AmEx Consumer Promotions Group. "If I'm not using my miles for travel, they have to do something to keep me interested."

Continental and United hold auctions where members can bid on travel packages and unique experiences. Mileage Plus members have bid more than a million miles for a Chrysler Crossfire. Besides hosting 150 vendors at its Mileage Plus Mall, United also has a Choices credit card, which enables members to accumulate Choices currency to use with cash to buy any available seat on a United flight.

Sorensen said carriers must stop looking at frequent flyer rewards as giving a seat for free, considering that a member probably spent thousands of dollars to accumulate 25,000 miles for a ticket that otherwise would cost $300 if it was purchased. "There's money behind that seat," he said. "The airlines are trying to get the best of both worlds and that philosophy is failing them."