



The Extra Mile

Frequent Flyer Programs by the Numbers

What the airlines' annual reports reveal about their loyalty programs.

IdeaWorks contributed information to this article (see italics)

May 30, 2005 - The conventional characterization of the airlines' ubiquitous frequent flyer programs is that they are clever marketing schemes whose principal goal is fostering loyalty, which in turn generates more ticket sales. And on the expense side of the ledger, well, all those free award tickets are assumed to cost the airlines a pretty penny.

A close reading of the airlines' annual reports tells a different story.

The programs undoubtedly have a loyalty effect, concentrating consumers' attention and purchase activity on a select few travel suppliers at the expense of others. But the precise impact of mileage programs on an airline's revenue is hard to quantify. For any given ticket, miles may have been a deal-maker or a non-factor or something in between. Neither the best marketing minds nor a battery of mainframe computers can tell which.

What can be quantified is the revenue generated by the sale of miles to program partners. And by that measure, the programs are huge.

American Airlines' AAdvantage, the original and largest mileage program, allows its members to earn miles for purchasing goods and services at more than 1,500 establishments, including other airlines, hotels, credit cards, most categories of retailer, mortgage and real estate brokers, and so on. For each mile earned by a program member, American bills the partner company between 1¢ and 2¢. Those pennies add up -- to \$1 billion annually for American, and close to \$12 billion for the industry, estimates Randy Petersen, publisher of InsideFlyer magazine.

Just as the public tends to underestimate the revenue associated with the programs, they also overestimate the programs' costs.

While the value of a frequent flyer award ticket might be several hundred dollars or more in the eyes of a program member, it only costs the airline \$10 to \$20. According to Jay Sorensen, president of IdeaWorks, a travel-industry consultancy, that's because airlines don't give away seats until they're confident that all paying passengers have been accommodated. So there's little or no

displacement cost (the revenue lost when an award traveler preempts a paid ticket holder) to fly a non-paying passenger -- only the modest expense of a few additional liters of jet fuel and an extra bag of peanuts.

Also helping to keep costs low is the fact that many frequent flyer miles go unused. For seven airlines which cited a figure, Sorensen computed the average "spoilage factor" at 30.6 percent, ranging from 12 percent for Alaska Airlines up to 70 percent for JetBlue.

The airlines do not account for their programs as freestanding enterprises, itemizing their revenues, costs and bottom-line profits. But massive revenues and miniscule costs are clearly a recipe for profitability. Hence the tail-wagging-the-dog irony: the major airlines' loyalty programs are money-makers, even as their core business -- flying passengers between point A and point B -- continues to generate dizzying losses.

Perhaps more relevant to the day-to-day experience of program members are the airlines' award-redemption statistics.

Sorensen estimates that more than 14.7 million passengers flew on frequent flyer awards during 2004. Taken in isolation, that's an impressive figure. But it represents a 2.1 percent decrease from the 15 million frequent flyer awards flown the previous year, in spite of an 8.4 percent increase in available seat miles, a standard industry measure of capacity.

Even more troubling than the decline in absolute numbers is the change in relative terms. As a percentage of airlines' total capacity, award travel declined 11.4 percent from 2003 to 2004.

Of the Big Six carriers, only US Airways reported an increase in award usage -- from 7 percent of its seats in 2003 to 8 percent in 2004 -- almost certainly the result of a run on award travel by program members betting that US Airways was close to collapse.

Among the largest airlines, most allocated between 5 and 8 percent of their seats to award travelers during 2004. Two exceptions: America West and JetBlue gave away 1.5 percent or less of their available seats to members of their loyalty programs.

Citing the combination of record passenger loads and continued losses, Sorensen notes that "the industry has sought to sell every seat it can -- even those that once were saved for frequent flyer award travel."

That assessment will come as no surprise to frequent flyer program members increasingly frustrated in their attempts to redeem miles for award seats.

Travelers won't find much solace in having their suspicions validated that awards are measurably harder to come by. But they may be heartened to learn that the programs are vital to the airlines' survival, and are therefore more likely to be fixed than they are to be abandoned or allowed to atrophy further.