

## FFP Revenue Analysis Consulting Package

### Overview

IdeaWorks offers a one-price solution for an airline seeking to measure the financial performance of its frequent flier program. The two-phase project would provide a “tune-up” for the program to ensure peak operating performance in terms of mileage value and passenger revenues. Outcomes of the project would help management answer questions such as, “Is the program selecting the best candidates for the elite tiers?” and “What reward changes should be made to better align reward value with competing airlines?”

Two consultants from IdeaWorks would survey the program’s financial operations during phase one. Bob Bahlman, the managing director of IdeaWorks’ financial consulting practice, would focus on financial issues. Jay Sorensen, president of IdeaWorks, would concentrate on loyalty marketing, member experience, and program operations. The second phase of the project would include the following activities: research conclusions, analysis of program data, final recommendations, and writing an **FFP Revenue Analysis Report**. An optional component of the second phase provides an on-site presentation of the findings from the report.

### Description of Activities

Phase One Financial Analysis and Project Research	
Key Activities	
<b>I. Interviews &amp; Data</b>	<p>The IdeaWorks team would begin phase one by interviewing the airline’s pricing, revenue management, accounting and loyalty marketing staff. The interviews would determine the airline’s financial objectives and existing reporting capabilities. The following are examples of the type of data needed to begin the analysis:</p> <ul style="list-style-type: none"> <li>a) Total revenue by member.</li> <li>b) Average yield by member (this is not always available).</li> <li>c) Top revenue-producing members by market.</li> <li>d) Average fare and average yield by fare class.</li> <li>e) Top yield-producing members for the system and by key markets.</li> <li>f) Current elite level member distribution by percentile.</li> <li>g) Methods used to account for loyalty programs, to include mileage liability and partner relationships.</li> <li>h) Frequent flier mileage liability on the books.</li> </ul>

<b>Additional Activities That Begin During Phase One</b>	
<b>2. Member Value Index</b>	<p>The discussion during the interviews would define the work to be performed during the project. IdeaWorks recommends development of a Member Value Index (MVI) to determine the revenue contribution and profitability of members at different elite tier levels and within defined customer groups.</p> <ul style="list-style-type: none"> <li>a) <b>Member Value Index by Decile.</b> This MVI statistic would be created by analyzing revenue produced by individual members during a 12-month period. Members would be assigned to deciles (top 10% through bottom 10%) and these would be compared to their current tier status in the program. The results of this evaluation may suggest changes to the current method of determining tier status.</li> <li>b) <b>Member Value Index by Customer Groups.</b> This MVI statistic determines the revenue contribution of individual program members and customer groups. IdeaWorks would create a matrix to map and compare the characteristics of naturally occurring customer groups. For example, one quadrant of the matrix could be composed of “Infrequent but High Yielding” customers.</li> </ul>
<b>3. Currency Valuation</b>	<p>Miles and points are the currency of frequent flier programs all over the world. It’s important to determine the value of loyalty currencies for the airline and its competitors. Customer loyalty is influenced by the value received during the accrual and reward stages of a member’s frequent flier program relationship. IdeaWorks recommends the following activities:</p> <ul style="list-style-type: none"> <li>a) <b>Calculate Hard and Soft Reward Costs.</b> Air travel rewards incur tangible costs such as added fuel burn, catering, and passenger processing. Intangible costs, such as revenue displacement, may also occur and are determined by the airline’s revenue management process. IdeaWorks can estimate the cost of air travel, upgrade, and partner rewards.</li> <li>b) <b>Determine Intra-Company Mileage/Point Cost.</b> Airlines often place an accounting value on the transfer of miles within the company. For example, outstanding rewards are often listed on the balance sheet as a liability. More rare is the assignment of sales costs to bonus mile promotions. IdeaWorks will recommend a value per mile for these types of transactions.</li> <li>c) <b>Establish Pricing for Partner Miles/Points.</b> The price of a partner mile has already been established through the airline’s existing partner relationships. Based upon the analysis performed, the airline might consider changing the price charged to program partners. Competitive pressures should also influence the pricing structure. IdeaWorks would review all benchmarks and recommend a pricing strategy that maximizes revenue (and minimizes cost) for the airline.</li> </ul>

<b>Additional Activities That Begin During Phase One</b>	
<b>4. Elite Tier Financial Evaluation</b>	<p>Very often, airlines develop tier benefits and features as a competitive response without a careful evaluation of direct cash cost or revenue impact. These costs should be compared to the revenue produced by members in the tier, and also compared to programs offered by airline competitors.</p> <ul style="list-style-type: none"> <li>a) <b>Calculate Tier Expense.</b> All of the benefits provided under the airline's tier structure generate costs. These include a prorated portion of the operating expenses associated with premium check-in, dedicated call center access, and airport lounges. IdeaWorks would estimate the cost of the benefits provided at each tier level.</li> <li>b) <b>Comparing Expense and Member Value.</b> It is important to compare the cost of tier features against the benefits provided to members. The total package of costs should be estimated to determine if tier benefits should be changed. For example, the cost of the top tier (along with its features) might be too modest when compared to the tier's Member Value Index. IdeaWorks would calculate the cost of the services associated with the airline's tiers and compare these to the Member Value Index statistics.</li> <li>c) <b>Estimate Cost of Competitor Programs.</b> As an option, the cost of the tier programs provided by competing airlines could be estimated. The expense of each tier could represent benchmarks for comparing the value competitors place on their best customers.</li> </ul>
<b>5. Accrual Rates &amp; Fare Levels</b>	<p>Frequent flier programs are adopting methods to link revenue (fare paid) to accrual. Unfortunately, distance flown provides an imprecise method of linking accrual to revenue production. IdeaWorks would evaluate the current methods used by the airline and its primary competitors. Financial evaluation would assign yield ranges to existing accrual rates in a sampling of markets. This would determine how effectively the current system reflects yield levels. Recommendations would be offered to make adjustments to the current system or to introduce a new system.</p>
<b>6. Mileage Liability Evaluation</b>	<p>The current method of mileage expiration would be evaluated. The future liability under the current method would be forecast, and a recommendation would be made regarding an alternative method to reduce liability within competitive constraints.</p>
<b>7. Additional Evaluation &amp; Analysis</b>	<p>IdeaWorks would perform additional evaluations and analysis as requested by the client. Items for consideration may include financial accounting, partner marketing, co-branded credit cards, bonus offers and promotions, frequent flier program operations, and online services.</p>

**Phase One - Continued**

**Outcome**

The scope of the project, and the complete description of the work product, would be agreed upon during the initial site visit. Phase one includes the following resources:

- a) **Planning and Preparation.** 8 hours for preparing the agenda for the on-site visit to include providing advance materials to persons to be interviewed.
- b) **Airline HQ Site Visit.** Bob Bahlman and Jay Sorensen would travel to the carrier's HQ for 3 days of on-site consulting.

During the visit, IdeaWorks would complete the executive interviews and assess the airline's data capabilities. Work would begin on Member Value Index, Currency Valuation, and Elite Tier Financial Evaluation. However, this work would be completed during Phase Two of the project.

**Phase Two**  
**Conclusion of Research and Development of Report**

**Key Activities**

**I. Final Report**

The second phase of the project would include the following activities: research initial conclusions, analyze program data, make final recommendations, and write the **FFP Revenue Analysis Report**.

The result would be a minimum 20-page report with following material:

**a) Overview of the interview results and data analysis.**

- Analyze key statistics such as: total revenue by member, average yield by member, top revenue-producing members by market, average fare and average yield by fare class, top yield-producing members for the system and by key markets, and current elite level member distribution by percentile.
- Describe current accounting methods for mileage liability and partner relationships.
- Recommend alternative internal accounting methods.

**b) Introduce the Member Value Index.**

- Analyze the Member Value Index by member percentile.
- Analyze the Member Value Index by customer groups.

**c) Calculate the value of program miles.**

- Calculate hard and soft reward costs.
- Determine intra-company costs.
- Recommend pricing of partner miles.

**d) Evaluate financial impact of elite tiers.**

- Calculate expense of elite tiers.
- Compare tier expense and Member Value Index.
- Estimate cost of elite tier programs provided by competitors.

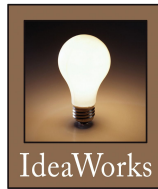
**e) Accrual rates and fare levels.**

- Determine yield ranges for existing accrual policy.
- Discuss impact of policy on different trip lengths.
- Compare accrual rates of competing airlines.
- Model of alternative methods upon yield ranges.

**e) Frequent flier mileage liability.**

- Calculate annual accrual and redemption activity.
- Determine method used to calculate liability (for example, all unused miles, or only accounts having minimum reward level balance).
- Assign financial values to mileage and/or reward liabilities.

<b>Phase Two Conclusion of Research and Development of Report</b>	
<b>Additional Activities That Begin During Phase One</b>	
<b>2. Optional Evaluation &amp; Analysis</b>	IdeaWorks would perform additional evaluations and analysis as requested by the client. Items for consideration may include financial accounting, partner marketing, co-branded credit cards, bonus offers and promotions, frequent flier program operations, and online services. This work would be provided at additional cost to the client.
<b>3. Optional On-Site Presentation</b>	This optional component of the project provides an on-site presentation of the findings from the report. IdeaWorks anticipates this will require Jay Sorensen to travel to the carrier's HQ for the presentation. If desired, Bob Bahlman can accompany Jay Sorensen to provide deeper analysis on financial issues. Ample time would be allowed for presentation of the report and for dialogue.
<b>Outcome</b>	The scope of research activities and the contents of the <b>FFP Revenue Analysis Report</b> would be agreed upon after Phase One. This activity excludes special evaluation and analysis requested by the client. The second phase of this project would require four weeks to complete.



## **Additional Project Details**

### **Project Consultants**

#### **Jay Sorensen**

##### **President - Product, Partnership and Marketing Practice**

Jay Sorensen is a veteran management professional with 25 years experience in product, partnership and marketing development. Of this experience, 13 years were at Midwest Airlines (formerly Midwest Express) where he had responsibilities for marketing, sales, customer service, product development, operations, planning, financial analysis and budgeting. Jay has started guest loyalty programs and co-branded credit cards, developed products in the service sector, improved the delivery of customer service and has helped start companies in the travel and tourism industry.

During his career Jay has worked on product or partnership development programs with corporations such as: Amtrak, A.T. Kearney Consulting, Aurora Health Care, Baymont Inns and Suites, Diners Club, E & J Gallo Winery, MCI Telecommunications, Marcus Hotels & Resorts, Marcus Theatres, National Car Rental, Northwest Airlines, Pepsi-Cola, TransBrasil Airlines and Virgin Atlantic Airways. He speaks at leading conferences in Europe and North America such as the Low Cost Airlines Congress, Frequent Flier Program Conference (FFP), and the Ancillary Revenue Conference (ARAC). Jay is author of the IdeaWorks Guide to Ancillary Revenue; the publication has been purchased by aviation professionals from all over the world.

#### **Bob Bahlman**

##### **Managing Director - Financial Consulting Practice**

Bob Bahlman is a senior executive with a diverse financial background and 23 years experience in strategy development and implementation, contract negotiation, financial and business restructuring. Most recently, he was the Senior Vice President, Chief Financial Officer and Controller for Midwest Air Group, which is a \$400 million airline group serving cities throughout the United States under the Midwest Airlines brand.

His extensive finance experience includes treasury, business analysis, tax function, general and revenue accounting, SEC reporting, internal audit, investor relations, fuel procurement, risk management, information technology and properties and facilities management. Bob has implemented broad-based restructuring strategies to include long-term lease and debt renegotiation, raising new capital through equity placements and managing the process of cost reduction. His achievements included the delicate balancing act of preparing a bankruptcy filing while working, successfully, to avoid a bankruptcy filing.

### **Expenses**

Travel expenses, and other direct expenses such as express delivery and long distance telephone, are reimbursable. Airline travel over 7 hours in duration shall be in business class. Travel expenses are to be reimbursed within 14 days of invoice.

### **General**

All terms, conditions and fees are subject to the provisions of a consulting agreement between the client and IdeaWorks.

### **Consulting Package Price**

Package pricing is available upon request.

Consulting services for each of the key activities described above, such as “valuation of miles/points sold to partners,” can be purchased on an a la carte basis.

Contact: Jay Sorensen, Telephone 01-414-961-1939, [Jay@IdeaWorksCompany.com](mailto:Jay@IdeaWorksCompany.com)