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The economics of airline award travel

Why there is too much mileage currency chasing too few seats

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IdeaWorks contributed information to this article - - see italics.

It is only natural consumers fear for their mileage accounts when airlines file for bankruptcy. After all, given the airline industry's troubles, can they really afford to be giving away free seats? Hardly. But then mileage award seats are not exactly free.

"The airlines make hundreds of millions from their loyalty programs," says Jay Sorensen, president of IdeaWorks Company, a Wisconsin-based consultant. This is why the last thing an airline wants, especially one in bankruptcy, is for the mileage accumulation to stop. It's also why they issue assurances regarding program viability simultaneously with their bankruptcy announcements.

There are two types of program participants. There are the frequent fliers, who "earn" seat awards by loyally accumulating miles through ticket purchases — the same way doughnut buyers "earn" a thirteenth when they buy a dozen. Then there are the frequent spenders. They rack up miles with hotel stays, car rentals and mainly through mileage-linked credit cards, super-charging their "loyalty" without necessarily taking a flight.

Sorensen estimates that at least half of all miles are now being accumulated on the ground through such purchases. And that is where the big money is made on free seats. It's also where the economics of award travel has gone astray.

"Airlines are victims of their own success," says Rick Ferguson, editorial director of The COLLOQUY Group, Frequency Marketing, Inc., an Ohio-based loyalty marketing consultancy. "They've become addicted to the revenue from mileage programs."

The economics are simple. For every dollar charged to the co-branded card, the airline receives a little over a penny from its card-issuing partner. Effectively, the bank buys the mile that is credited to the frequent "flier" account for that penny. With millions of loyalty

program members charging thousands of dollars each year, those pennies add hundreds of millions of dollars to the airlines' bottom lines. Little wonder the airlines encourage continued accumulation and are so determined to keep their programs going, even when parts of their fleets are not going anywhere. It's also why the seats themselves are not exactly "free." They have been paid for, but not by the flier.

When a consumer claims an award, redeeming typically 25,000 to 30,000 miles for a ticket, the airline has already received \$250 to \$300 from that consumer's credit card issuer, basically as prepayment for the ticket. Given the preponderance of discounted fares, this can be more than they would have received selling the ticket outright.

From a flier's standpoint, it becomes even harder to understand why award seats are so hard to get, given this prepayment. Many assert the seats are being sold publicly instead of awarded. Were that the case, it would mean the seats are being sold twice, once to the bank, then resold to paying customers instead of awarded to a loyalty program member.

"Seats aren't really sold twice," explains Ferguson. "Those miles are still in the consumer's account for later use." Yet, the flier is not on a plane in the earned seat, but a "paying" customer is.