

LOYALTY MARKETING REPORT SERIES FOR 2013

Premium Class Rewards Provide Best Value for Frequent Flier Members

Value per mile exceeds 5 cents for United's intercontinental first or business class rewards, but the 25,000-mile domestic reward equals 1.4 cents per mile

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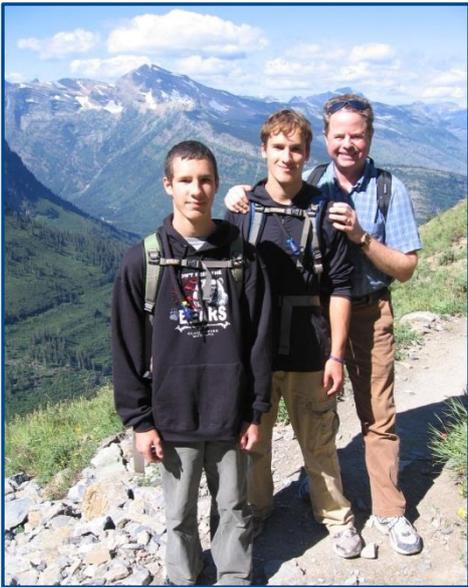
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About Jay Sorensen, Writer of the Report



Jay, with sons Anton and Aleksei, on the Highline Trail in Glacier National Park in Montana.

Jay Sorensen's research and reports have made him a leading authority on frequent flier programs and the ancillary revenue movement. For 2012 he was a speaker at the FFP Spring Event at the Freddie Awards in New York, and at the IATA Passenger Services Symposium in the Middle East; and chaired the ancillary revenue track at the MEGA Event in San Diego. His published works are relied upon by airline executives throughout the world and include first-ever guides on the topics of ancillary revenue and loyalty marketing. He was acknowledged by his peers when he received the Airline Industry Achievement Award at the MEGA Event in 2011.

Mr. Sorensen is a veteran management professional with 28 years experience in product, partnership, and marketing development. As president of the IdeaWorksCompany consulting firm, he has enhanced the generation of airline revenue, started loyalty programs and co-branded credit cards, developed products in the service sector, and helped start airlines and other travel companies. His career includes 13 years at Midwest Airlines where he was responsible for marketing, sales, customer service, product development, operations, planning, financial analysis and budgeting. His favorite activities are hiking, exploring and camping in US national parks with his family.

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Eric Lucas is an international travel, natural history and business writer and editor whose work appears in MSN.com, Michelin travel guides, Delta Sky Magazine, Alaska Airlines Magazine, Westways Magazine and numerous other publications. Founding editor of *Midwest Airlines Magazine*, he is the author of six books, including the 2012 Michelin *British Columbia Green Guide* and 2013 *Michelin Alaska Guide*. Eric has followed and written about the travel industry for more than 20 years. He lives in Seattle, Washington, where he grows and sells organic garlic; visit him online at www.TrailNot4Sissies.com.

Eric, at his favorite summer retreat, Steens Mountain, Oregon.



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Premium Class Rewards Provide Best Value for Frequent Flier Members

One of the recurring debates about the booming loyalty marketing industry is whether rewards provide notable value . . . and which rewards are the most valuable. To answer this, IdeaWorksCompany conducted booking research using United's MileagePlus program (largest in the world) to determine which rewards provide members the greatest dollar value. The answer was clear: Booking first class travel to Hawaii, Europe or Asia provides best value for redeeming frequent flier miles. These choices allow members to realize more than four cents per mile, versus a cent or more redeeming US domestic economy class rewards. IdeaWorksCompany completed more than 170 queries at United's website to assess fare values associated with economy, business, and first class reward travel. The results provide a glimpse into the strategy used by United and other carriers that rely on mileage-based reward charts and capacity-controlled rewards.

Extra effort is required for those seeking maximum value. MileagePlus has made it comparatively easy to score a domestic saver reward seat at 25,000 miles. It was among the top-rated airlines in the annual Switchfly Reward Seat Availability Report and was found to offer its lowest priced rewards 80 percent of the time.¹ Among the queries performed for this analysis, saver rewards were available every time. But to maximize value per mile, members need to reach a bit higher on the reward chart. First class saver rewards to Hawaii, at 40,000 miles roundtrip, were found to deliver reward value of 4 cents per mile. Even higher first class saver rewards to Europe or Japan starting at 135,000 miles yielded more than 5 cents per mile. The hunt for premium class saver seats to exotic destinations is more challenging, as these rewards were difficult to find. It's an interesting outcome for frequent flier programs because at one time, just the opposite was true.

Airlines have become unwilling gift givers

The frequent flier programs introduced by major airlines in the US during 1981 were unbelievably generous by today's standards. American's first program made every first class seat available and didn't bother with reward seats in economy.² It was truly a gift from airline management that was intended to impress the recipient. Not surprisingly, airline customers embraced the concept and first class cabins began to fill with free travelers. Unrestricted economy rewards were later added to address program popularity.



During the early 1980s, every day was like a birthday with the gift of unrestricted first class rewards.

¹ "Value Airlines Fill Top 7 Slots with Best Reward Seat Availability, and Among Global Airlines Singapore is Best" press release dated 09 May 2013, IdeaWorksCompany.com.

² "The Big 2-5 - - Celebrating 25 Years of Frequent Flyer Programs" article dated May 2006, InsideFlyer.com.

Carrier generosity began to wane in 1988 when American and United introduced capacity controlled rewards.³ Those willing to forgo complete flexibility could opt for a lower 20,000-mile domestic reward with complete flexibility priced at 40,000 miles.

The latent effects of airline deregulation in 1979 and the consumer's unwavering focus on low fares was forcing airlines to always consider the bottom line of income statements. The "gifts" began to disappear. Cocktail hours, wine served with economy class dinners, fresh headrest covers for each flight, and pillows for every seat, eventually disappeared. Some amenities clung on such as food, coffee, and soft drinks. But each of these were subjected to endless cost cutting . . . meals became bagged sandwiches, coffee became undrinkable, and a full can of soda became a cup. The same was true of frequent flier reward seats, which became scarce as economic recession and runaway fuel costs required airlines to sell more seats to cash-paying travelers.

Like any commercial enterprise, airlines do respond to the opportunity of profit. Co-branded credit cards began to appear during 1987 and included offers from American, Continental, and United.⁴ These cards would forever change loyalty marketing philosophy by replacing "gift giving" with "revenue generating." Airlines sold miles to banks with seemingly reckless abandon and generated millions of dollars in revenue throughout the 1990s. Their methods were akin to a government printing more money to prop up its finances. Limiting the seats available for reward travel made airline accountants happier, but consumer resentment was making headlines and the once-mighty airline mile had become devalued.

More reward choices creates better reward value

Fortunately, many airlines now embrace a "more is better" philosophy by beefing up their reward charts. Travel on partner airlines has become a feature expected by frequent fliers. It's a smart addition that provides more destination coverage and more access to reward seat inventory. Car rental and hotel rewards are also becoming a regular feature for more developed programs. These are nice companions to air travel and provide easy booking flexibility.



MileagePlus members may bid for a flight simulator experience complete with a flight to Denver, overnight hotel, and up to 2 hours with a pilot instructor. Image: United.com

New reward categories allow airlines to distinguish themselves from the competition. A visit to United's website reveals an array of choices for all types of members, from casual fliers to top elite travelers. If it's sold online, it's likely offered as a MileagePlus reward item. Members may redeem miles to download music and movies, stream television shows, buy Broadway show tickets, bid on luxury vacations, attend sporting events, subscribe to newspapers and magazines, and enjoy restaurant savings. Miles can be donated to charities or redeemed for airport lounge access.

United provides special benefits to credit cardholders and Premier elite members, such as the ability to redeem a standard reward to secure the last seat on a peak flight — even to Hawaii during Christmas season. In addition, elite members enjoy discounted mileage prices on car rental, hotel, and merchandise rewards.

³ "New Rules For Bodies In Motion/Free Flight Modified By Two Major Airlines" article dated 17 July 1988 in the Orlando Sentinel.

⁴ "Airlines Sweeten Deals for Frequent Flyers" article dated 28 June 1987 in the Boca Raton News.

Frequent flier programs add more choices due to a genuine desire to keep members engaged in a relationship with the airline, as well as removing mileage liability. United's senior management knows MileagePlus must be rewarding to be worthwhile. Members who have regular redemption events are more loyal to the airline, buy more travel, and spend more with program partners. This array of mercantile activity generates revenue from the sale of airline tickets along with the sale of miles to partners such as Allstate Insurance, Avis, Chase Bank, InterContinental Hotels, and Mercedes Benz. United disclosed mileage sales in excess of \$2.8 billion for 2012⁵ which represented more than 7.6 percent of the carrier's annual revenue. Savvy airlines know this significant source of cash will only keep flowing if members believe miles have value as an attractive global currency.

Mileage value is determined by applying retail prices

IdeaWorksCompany made 170 booking queries to establish prices for US domestic, Hawaii, and global itineraries available to MileagePlus members. Fare levels were divided by the number of miles required for reward travel to determine mileage value. Table I displays the results from these queries for saver, standard, and upgrade rewards for travel in economy, business, and first class cabins. Mileage values range from a low of \$0.01 for standard rewards on intercontinental routes to a high of \$0.054 for business class upgrades on intercontinental routes.

Table I: MileagePlus Air Rewards – Mileage Value Assessment					
Type	Cabin Class	Region	Mileage Level	Average Fare (less fees and taxes)	Mileage Value
Saver Rewards	Economy	US Domestic	25,000	\$362	\$0.014
		US – Hawaii	40,000	\$703	\$0.018
		Intercontinental	60,000 to 65,000	\$1,118	\$0.018
	Business	Intercontinental	100,000 to 120,000	\$4,904	\$0.045
	First	US Domestic	50,000	\$1,363	\$0.027
		US – Hawaii	80,000	\$3,203	\$0.040
		Intercontinental	135,000	\$6,929	\$0.051
Standard Rewards	Economy	US Domestic	50,000	\$558	\$0.011
		US – Hawaii	80,000	\$947	\$0.012
		Intercontinental	110,000 to 130,000	\$1,226	\$0.010
	Business	Intercontinental	250,000 to 300,000	\$5,268	\$0.019
	First	US Domestic	100,000	\$2,482	\$0.025
		US – Hawaii	160,000	\$4,091	\$0.026
		Intercontinental	295,000 to 320,000	\$10,536	\$0.034
Confirmed Upgrade Rewards*	First	US Domestic	40,000 + \$150 fee	\$854 net savings	\$0.021
		US - Hawaii	55,000 + \$250 fee	\$1,634 net savings	\$0.041
	Business	Intercontinental	40,000 + \$1,100 fee 60,000 + \$1,200 fee	\$2,158 net savings	\$0.054

Source: IdeaWorksCompany reward and fare queries conducted 17 July 2013 for October, 2013 to February 2014 travel dates. * Note, upgrade mileage levels and co-pays were those observed for booking queries.

⁵ United Continental Holdings Form 10K for 2012.

The data base consisted of 50 US domestic reward queries, 50 US – Hawaii reward queries, and 70 intercontinental reward queries. The following provides additional information for each of the query types:

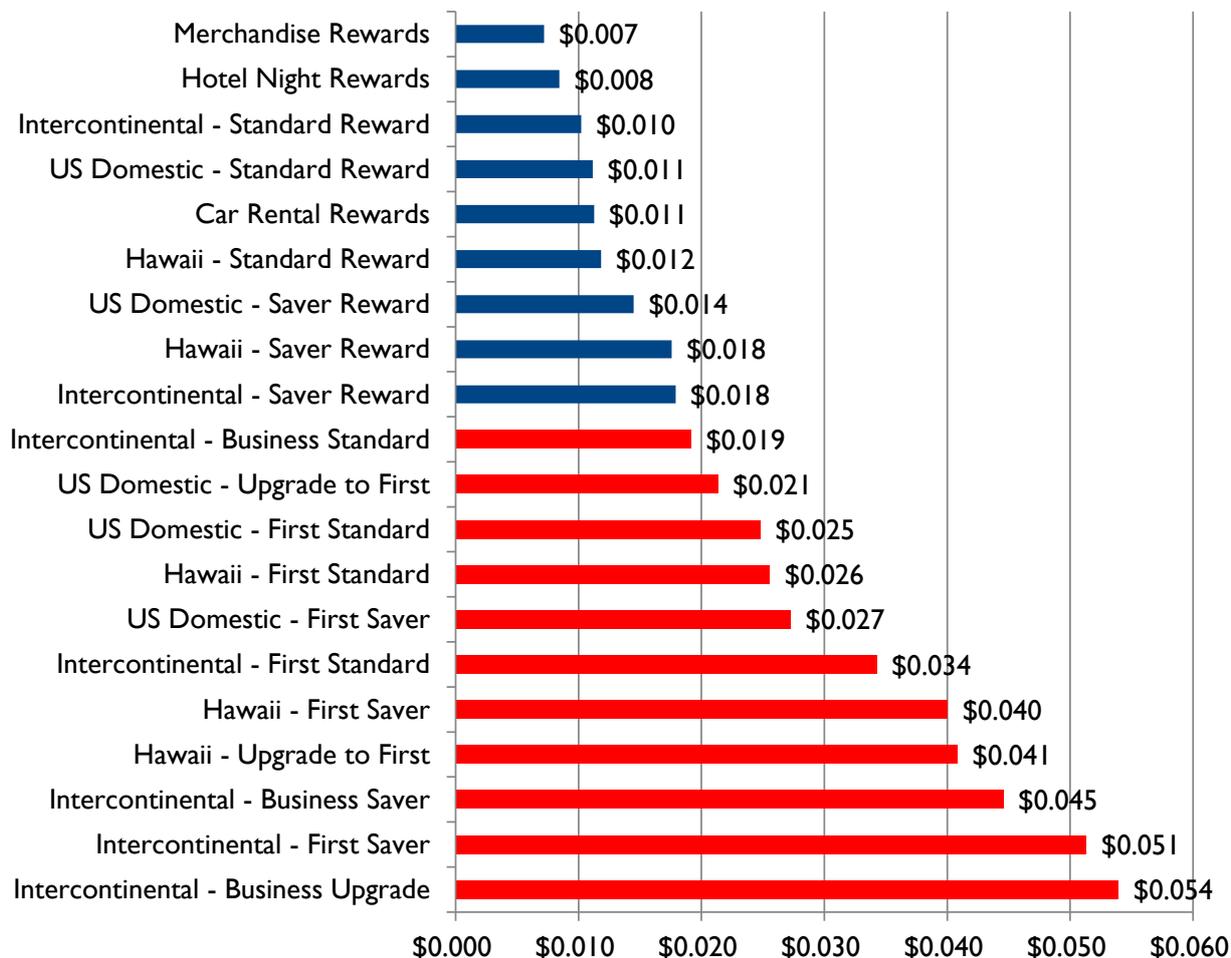
- **Saver rewards:** These are capacity controlled and require the fewest quantity of miles. For each query, the lowest fare associated with a saver itinerary was used. Because members are responsible for paying security fees and international taxes, these were deducted prior to calculation. It should be noted, United does not assess fuel surcharges for reward travel.
- **Standard rewards:** Plenty of seats are made available for these rewards. MileagePlus credit cardholders and Premier elite members have access to all inventory at this level. Similar to saver rewards, the lowest priced fare (less security fees and international taxes) represented the low end of valuation. The top end of valuation is represented by the highest fare found for the class and city pair queried. Standard reward mileage value is the numerical average of these two values. This recognizes the potential value delivered to elite members when the last seat is booked on the flight (and when fares are highest).
- **Upgrade rewards:** United provides a very convenient option that allows low fares to be upgraded and confirmed to the next cabin after making a co-pay and redeeming a fixed quantity of miles. The value provided by this reward is the cash payment avoided by buying a fare for the upgraded cabin desired. The savings are reduced by the base fare and co-pay.
- **US Domestic rewards:** Ten major markets such as Chicago-Las Vegas and New York-San Francisco were queried on 17 July 2013 for 7-night itineraries for dates between October 2013 and February 2014. Queries were made for economy and first class, and upgrades from economy to first class.
- **US – Hawaii rewards:** Ten major markets such as Chicago-Honolulu and San Francisco-Maui were queried on 17 July 2013 for 7-night itineraries for dates between October 2013 and February 2014. Queries were made for economy and first class, and upgrades from economy to first class.
- **Intercontinental rewards:** Ten major markets such as Chicago-London and San Francisco-Tokyo were queried on 17 July 2013 for 7-night itineraries for dates between October 2013 and February 2014. Queries were made for economy, business, and first class, and upgrades from economy to business class.

The mileage value provided by key non-airline rewards such as car rentals, hotel accommodations, and merchandise was also calculated. Similar to the methods used for air travel, retail prices and mileage levels were determined from actual booking queries. Ten queries were made for car rentals and hotel stays for Las Vegas, London, New York City, Orlando, and San Francisco (these rewards include taxes). Leading brands such as Avis, Hertz, Hilton, Hyatt, and Sheraton were queried at Expedia.com to determine retail prices (including taxes) with mileage levels determined at the MileagePlus reward booking site. United disclosed to IdeaWorksCompany five of its most popular merchandise rewards: 1) Apple 13" MacBook Pro, 2) Michael Kors Runway Gold Chronograph Watch, 3) Beats By Dr. Dre Headphones, 4) Keurig Platinum Brewing System, and 5) Dyson Digital Slim Multi Floor Vacuum. Prices (excluding shipping) were shopped at leading retailers with base mileage levels reviewed at the MileagePlus online merchandise catalog.

The reward values from Table I have been integrated with the reward values calculated for car rentals, hotel accommodations, and merchandise. These represent core reward categories and are displayed in Chart I. The reward list is not exhaustive and does not include reward items such as entertainment tickets, magazine subscriptions, and auction items.

Chart I: Mileage Value by MileagePlus Reward Category

Premium class rewards are shown in red



Source: IdeaWorksCompany reward and fare queries conducted 17 July 2013 for October, 2013 to February 2014 travel dates.

Reward value seems related to ease of redemption

Making the extra effort to book a first class saver reward seat to London or Tokyo provides a payoff in excess of 5 cents per mile. Overall, premium class saver rewards provide best mileage value. These are also observed to be the most challenging seats to find. Queries began by seeking seats in the first half of October 2013. Oftentimes, the search continued from November to February until saver seats were found for London or Tokyo (seasoned members book 11 months ahead). On the other end of the reward value spectrum, car rental, hotel, and merchandise rewards are readily obtained by entering the item desired with almost no possibility of the request being declined. But easy redemption comes at a cost with mileage values around \$0.01.

Standard rewards provide good value but at typically twice the mileage required (and sometimes more) for a saver reward. United is generous with saver reward availability on US domestic routes, so the need to redeem 50,000 miles instead of the usual 25,000 miles is often not required. But intercontinental routes were more tightly controlled, and members might easily find the need to redeem 250,000 miles for a standard business class reward for London rather than a modest 100,000 miles for a saver seat. Fares increase accordingly when premium class seats are in tight supply, and of course this provides a big boost to the mileage value calculation.

The top rated business class upgrade for intercontinental routes not only provides best value, it was more available than saver rewards. The upgrade reward requires the consumer to purchase a low fare, redeem a fixed number of miles, and make a copayment. The example below provides roundtrip business class travel from Chicago to Tokyo at a \$1,389 economy fare, with a \$1,200 copay, and 60,000-mile reward redemption.

<p>from \$1,389 30,000 Miles/Person/Each Way</p> <p>\$600.00 Fee/Person/ Each Way</p>	<p>Depart: 1:00 p.m. Thu., Oct. 3, 2013 Chicago, IL (ORD - O'Hare)</p>	<p>Arrive: 4:15 p.m. +1 Day Fri., Oct. 4, 2013 Tokyo, Japan (NRT - Narita)</p>	<p>Flight: UA881 Aircraft: Boeing 777-200 Fare Class: United BusinessFirst (R) Meal: Lunch See On-Time Performance View Seats</p>
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Alternatively, the consumer could book a business class fare for \$4,978 and not redeem miles. Thus the mileage reward is an option members might consider if maximum comfort is desired for a long haul trip at a modest cash outlay.

The analysis focused on the rewards offered by United Airlines and MileagePlus. The saver reward levels used by United are similar to those featured on the Star Alliance reward chart, which provides access to more than 25 additional airlines. Different fare values and mileage levels prevent a direct comparison to other carriers and frequent flier programs. But the overall hierarchy shown in Chart I will likely be largely similar for mileage-based programs.

United's Explorer credit card strives to maintain a competitive edge

The attractiveness of United's selection of credit cards is determined by the value delivered by its MileagePlus frequent flier program. The loyalty benefits provided by MileagePlus to United Airlines outweigh the cash generated from the sale of miles to partners. Based upon past disclosures made by another airline regarding its program statistics,⁶ IdeaWorksCompany believes more than 50 percent of United's \$37 billion 2012 revenue was generated by the members of its MileagePlus program.

The cards offered by Chase Card Services, such as the United MileagePlus Explorer card, are a vital component of the carrier's strategy to engage consumers. They too generate a healthy sum of money on their own merit. Very likely, \$2.5 billion of the \$2.8 billion generated by the sale of miles to program partners during 2012 can be attributed to credit cards. In almost every regard, the success of MileagePlus is now linked to its credit card offer . . . and the success of the Chase card portfolio is tied to the attractiveness of the frequent flier program.

⁶ 2007 American Airlines Investor Update by Dan Garton, EVP of Marketing.

United and Chase Card Services unveiled a new credit card called Explorer in 2011.⁷ Along with the provision of free checked bags, cardholders could enjoy elite style perks:

- **Priority Boarding:** Cardholders may board United flights immediately after elites and prior to general boarding, so they have earlier access to overhead space and can relax as the rest of the plane boards.
- **Airport Club Passes:** Each year, cardholders receive two United airport club passes on their membership anniversary date (a \$100 value).
- **Upgrades on Reward Tickets:** MileagePlus Premier members — who are also cardholders — are eligible to receive upgrades on domestic reward tickets in the same manner as with purchased tickets.
- **Any Reward Seat, Any Time:** If seats are available for sale, they can be redeemed at the Standard Award level. There are no restrictions or blackout dates. This benefit is reserved for cardholders and Premier members.

There are additional benefits, to include the accrual of double miles when the card is used to purchase travel on United Airlines. More recently on 01 June 2013, those pesky and annoying foreign transaction fees were removed by Chase.⁸ All of these changes were likely made to ensure competitive positioning in a crowded card marketplace. The Venture card from Capital One remains a continuous thorn in the side of any US airline marketing executive.

The Venture card is aimed directly at the lucrative airline co-branded market with a promise of double miles, no hassle rewards, and no foreign transaction fees. When measured by outstanding consumer balances, Capital One has become the fourth largest card issuer in the US.⁹ Chase is firmly in the #1 slot with nearly 18 percent of outstanding consumer credit card balances. However, the sheer volume of Capital One's \$1.3 billion advertising expenditure for 2012¹⁰ and the seemingly ubiquitous presence of actor and spokesman Alec Baldwin and the Viking characters in its US television ads is difficult to ignore.



Spokesman Alec Baldwin is everywhere, from airports to airplanes, touting the “Fly Any Airline Anytime” message from Capital One and its Venture card.

⁷ “Chase and United Unveil United MileagePlus Explorer Card; New Card Provides Exclusive Airline Privileges and Unmatched Travel Benefits” press release dated 19 July 2011 at United.com.

⁸ “Chase Enhances the United MileagePlus Explorer Card With No Foreign Transaction Fees” press release dated 22 June 2013 at JPMorganChase.com.

⁹ JPMorgan Chase 2013 Investor Day, Consumer & Community Banking presentation at JPMorganChase.com.

¹⁰ “Top 11 U.S. Financial Services Advertisers and their Online Spend” article dated 01 July 2013 at NetBanker.com

A travel rewards credit card is not a replacement for a frequent flier program. But airlines (and hotel chains) are concerned it might replace the need to hold one of their co-branded credit cards. The Capital One Venture card actively seeks top of wallet status by offering double miles on all purchases, charging no foreign transaction fees, and featuring a reward method that erases travel purchases. When the card is used to purchase travel, the cardholder has 90 days to redeem miles that remove the charge from the card statement. Frequent flier programs allow members to redeem miles without the need to pay for air fare and reward capacity is often limited. Whereas, with the Venture card, any travel charge can be removed. Every dollar charged accrues two miles and each mile provides a \$0.01 statement credit.

Table 2 displays the results when query results were applied to the Venture card's reward methodology. The results do not include any accrual bonus such as double miles for United Airlines purchases with the Explorer card. Each reward saver and standard query was priced using the Venture card reward methodology. For example, a Chicago – Orlando saver reward query was priced at \$307 (excluding FFP fees/taxes). This reward would require the redemption of 30,700 Venture card miles, which would be accrued by spending \$15,350 with the card. This same reward would require 25,000 MileagePlus miles, which would be accrued by spending \$25,000. Under this example, the Venture card provided better mileage value. The process was repeated for each of the ten city pair queries made for each reward category. The strength of each card is clearly defined by the results. For example, the Venture card provided better mileage value for 90 percent (9 out of 10) of domestic saver reward queries.

Table 2: Explorer and Venture Cards
Percent of queries yielding better mileage value

Reward Category	Premium class rewards are in red	
	MileagePlus Explorer	Capital One Venture
Intercontinental Standard Reward	0%	100%
Domestic Saver Reward	10%	90%
Hawaii Standard Reward	20%	80%
Intercontinental Saver Reward	30%	70%
Hawaii Saver Reward	30%	70%
Domestic Standard Reward	30%	70%
Intercontinental Business Standard	40%	60%
Domestic First Saver	70%	30%
Intercontinental First Standard	90%	10%
Domestic First Standard	90%	10%
Hawaii First Standard	90%	10%
Hawaii First Saver	100%	0%
Intercontinental Business Saver	100%	0%
Intercontinental First Saver	100%	0%

Source: IdeaWorksCompany reward and fare queries conducted 17 July 2013 for October, 2013 to February 2014 travel dates.

United's Explorer card does provide double miles when it's used to purchase United tickets. The analysis was repeated with the assumption that 20 percent of Explorer card charge activity would accrue double miles linked to United ticket purchases. For example, \$10,000 charge activity would include United ticket purchases of \$2,000. This activity would accrue 12,000 miles (10,000 base miles plus a 2,000-mile bonus). The results did improve mileage value for MileagePlus members, but the economy rewards dominance of the Venture card listed in Table 2 was largely unchanged. Notable changes for the Explorer card were a significantly improved result for intercontinental business standard rewards to 90 percent (from 40 percent) and an increase to 50 percent for Hawaii saver rewards (tied with the Venture card). Venture card's double miles offer for all purchases remained a powerful feature.

Lower fare values relative to the distance flown (called "yield" in the airline industry) provide an advantage for the Venture card. Redeeming Venture card miles to credit the purchase of an economy class ticket almost always provides better mileage value than frequent flier program redemption. As one moves down the table into the realm of premium class travel, the advantage switches to the frequent flier program. This is because airlines have largely favored these rewards with lower mileage levels on their reward charts. However, as described earlier, the premium class saver reward seats can be challenging to find.

The Explorer card completely dominates three premium reward categories: Hawaii first saver, intercontinental business saver, and intercontinental first saver. MileagePlus also provides unique value with its upgrade rewards, as these are not offered through the Venture card reward mechanism. Yet, the Venture card dominates the crucial saver category. As disclosed by Aeroplan (the loyalty program associated with Air Canada) standard-style rewards only represent 15 percent of its air travel reward activity.¹¹ The importance of the US domestic saver reward category is paramount, and this fact is not lost on Capital One's management team when they stress the "Fly any airline. Anytime." message.

The Venture card's reward methodology offers an obscure benefit. Because the cardholder has purchased travel . . . they also can accrue airline miles in a frequent flier program. Traveling to Hawaii on a MileagePlus reward ticket won't accrue miles. But when a Venture cardholder buys a \$675 New York – Honolulu roundtrip ticket, they can accrue more than 9,900 miles in a frequent flier program. Afterwards, the cardholder redeems 67,500 Venture miles to erase the purchase from their Venture card statement. The accrued miles remain in their frequent flier program. This amazing alchemy is not possible for air travel rewards from a frequent flier program. However, the same benefit is provided when a MileagePlus member redeems miles for a car rental or hotel stay. In effect the program is buying these rewards for the member and accrual for the rental or stay can almost always qualify for accrual in a frequent flier or hotel loyalty program.

United MileagePlus counters with the difficult-to-match benefits listed at the beginning of this section. Waiving bag fees for cardholders, arranging lounge access, and securing priority boarding benefits are practically impossible without a carrier's cooperation. It's a smart strategy for United and one that's also used by other airlines. Premium travel perks are reserved as an airline specialty, while better reward value for economy class has currently been captured by Capital One and its Venture card.

¹¹ "Aeroplan – The Next Decade" presentation dated 27 June 2013 at Aimia.com.

Airlines have an inherent ability to deliver better value

Merchandisers know they have limits in the reward game, while service providers have a natural reward cost advantage. Grocery stores in the US operate at a 2 to 3 percent margin.¹² Providing reward value of \$1.00, such as a can of Tomato soup, would cost the grocer \$0.97. Similar economics apply to Capital One when it reimburses a cardholder for travel purchased from any retailer using the Venture card. The \$675 ticket to Hawaii costs almost the full amount with only a small savings associated with the merchant fee. By comparison, airlines have a tremendous advantage. The ticket to Hawaii might have a marginal cost of \$50. These would be related to the expense directly associated with occupying a seat . . . a couple of soft drinks, added fuel burn, and incremental costs associated with creating an electronic reservation.

That's equivalent to an eye popping margin of 93 percent. The margin can quickly disappear if the reward traveler prevents the airline from selling the same seat to a cash-paying traveler. That's why airlines are so careful (and stingy) when making seats available for reward travelers. An airline can be considered a "reward factory" whereas a bank travel card is effectively a reseller of travel rewards.

Intense competition often exists for seats on a flight. This is especially true for premium class seats, such as those in the business and first class cabin. There are always fewer premium seats than economy seats on an aircraft, and the corresponding business and first class fares are dramatically higher. Accordingly, the airline would prefer to sell these to a corporate traveler rather than provide them to a reward member . . . even if some of the miles redeemed were accrued through credit card activity.

United builds better value into reward choices for its Premier members. These elite members, from Premier Silver to Premier 1K, enjoy more access to reward saver reward seats, lower reward prices on car rentals, hotel accommodations, and merchandise, reduced reward change fees, and other benefits. As an example, IdeaWorksCompany found mileage discounts ranging from 29 to 36 percent for merchandise rewards available to top Premier members.

Lessons Learned – How Programs can Build Better Value

- Airlines can add difficult-to-copy perks such as early boarding, space available upgrades for reward travel, and priority security screening for credit cardholders; these are practically impossible for banks to include as cardholder perks.
- Travel reward cards issued by banks could negotiate upgrade offers with select carriers. International carriers that don't have a meaningful US cobranded credit card presence might be attractive candidates.
- Airlines can increase mileage value through lower reward levels. MileagePlus offers a lower reward level for flight distances up to 700 miles.
- Car rental, hotel, and merchandise rewards provide easy mileage redemption options. Better value can be offered to elite members as an attractive perk of having status.
- Pay-with-points allows members to enjoy the value provided by low fares. Domestic itineraries priced at \$99 or \$499 are fixed at the same 25,000 mile reward level. It's great value at the top end, but poor value at the low end.
- Be careful about adding too much . . . you will likely confuse and lose consumers.

¹² "What's Behind the Rush Into the Low-Margin Grocery Business" article dated 06 June 2013 at CNBC.com.

It's difficult to find the perfect balance between loyalty-building generosity and revenue generating capacity controls. At present, the results of this analysis suggest United MileagePlus favors traditional frequent fliers seeking premium class travel, elite perks, and checked bag savings. Travel reward cards, such as the Venture card, are aiming for a larger demographic of value-seeking consumers. It's a space Capital One seeks to capture, but it's one that might be difficult to hold. Lurking in the future is the threat of pay-with-points methods which IdeaWorksCompany predicts will eventually replace mileage-based accrual and redemption. The method is now embraced by Southwest and JetBlue and provides a lower cost for many reward itineraries.

The arrival of pay-with-points could easily switch the advantage back to the airline co-branded credit cards. Fortunately for consumers, it's a battle that should result in better reward values for all.



Pegasus Airlines soars with 42% more ancillary revenue

The results tell a compelling tale of ancillary revenue bliss and a productive relationship. IdeaWorksCompany started working with Pegasus Airlines in 2010.

IdeaWorksCompany helped Pegasus boost a la carte activity in core ancillary revenue areas such as onboard café, baggage fees, and seat selection.

For its latest full year, the airline disclosed per passenger ancillary revenue jumped by 42% in the three core areas since 2009. The total ancillary revenue increase was in excess of €36 million. That's the type of return that delights CFOs, CEOs, and airline investors.

The advice and expertise offered by IdeaWorks Company, when combined with the carrier's entrepreneurial spirit and outstanding people, has established a firm flight path to better profits.

How IdeaWorksCompany builds ancillary revenue bliss...

- Series of on-site workshops on the topics of ancillary revenue, a la carte pricing, and loyalty marketing.
- Extensive background research through interviews of Pegasus frontline employees, program managers, and company executives.
- 90-page strategy document providing a ranking of opportunities, service design, revenue projections with 75 individual revenue benchmarks.
- Ongoing support to ensure revenue-producing results.

2009 to 2011 Ancillary Revenue Results



Onboard Café
Increase of 17%
per passenger



Baggage
Increase of 60%
per passenger



Seat Selection
Increase of 109%
per passenger

Turkish Delight...

“ We worked with Jay Sorensen and IdeaWorksCompany in the areas of ancillary revenue, frequent flier programs and international marketing opportunities, and I have observed he is one of the best experts in the industry in these areas. He uses his deep knowledge and experience to bring together customized analysis and solutions based upon the customer's needs, marketplace, customer profile, and the best practices in the world. His analysis and recommendations have always been solid and executable and therefore generate incremental revenue opportunities. Pegasus highly recommends IdeaWorksCompany. ”

— Onur Dedekoylu, Vice President of Marketing

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