Airlines rethink reward systems

As Air France-KLM becomes the latest carrier to move from distance to revenue as the basis for earning miles in its frequent flyer programme, Global Flight managing director Ravinda Bhagwanani looks into the inherent complexities the co-existing schemes present for airlines considering whether to make the switch in models

Air France-KLM's move to switch the basis of frequent flyer mile accrual from distance to revenue marks the latest sign of this trend expanding into new regions.

The SkyTeam carrier trailed the news of a revamp to its Flying Blue frequent flyer programme when releasing its third-quarter results on 3 November. The formal details followed, which alongside the switch to a revenue-based scheme also includes the creation of "Experience Points" as a mechanism for members to gain higher tier status.

News of the change had already emerged, however, after it had apparently tested the new scheme on its live reservations system. Customers attempting to book flights after April 2018 were told they would no longer earn distance-based mileage credits for their flights, but revenue-based. As a consequence, the changes were widely discussed in online forums before the formal announcement.

By switching the accrual logic of its scheme, Air France-KLM will join the roughly 20% of airlines already operating schemes on a revenue basis. More than 40 airlines have now opted for that currency option. This camp comprises most low-cost carriers, but is gaining momentum in other sectors as well.

DRIVING REVENUE

Early adopters, including the US majors and South African Airways, have since been followed by announcements this year from LATAM, Hainan Airlines and now Air France-KLM. All mark the first switches by major network carriers to a revenue basis in their respective regions.

With some 60% of all FFPs still working on the traditional distance basis, it is certainly premature, however, to call the end of currencies other than revenues. Indeed, some recent programme redesigns, including those of Alaska Airlines and Copa Airlines, deliberately stuck to the mileage basis, seeking to strengthen the differences in value contribution through a more fine-tuned accrual split according to fare class.

Air France

Air France-KLM unveiled wide-ranging changes to its frequent flyer programme in November

For instance, Alaska Airlines now credits its Mileage Plan members up to 350% of miles flown in business class on British Airways flights in order to counter the revenue-based model of major US carriers, which favours high-yield long-haul customers. Historically, the business-class bonus in US programmes stood at 25% or, in rare cases, 50% of miles flown, which delivered an argument for seeking a stronger differentiation by switching to a revenue basis.

While Alaska Airlines might enjoy an outsider role in the US market by sticking to a mileage basis – alongside the likes of Hawaiian Airlines and Frontier Airlines – the picture is different for network carriers in other markets. The revenue model has some inherent shortcomings, however, which cause hesitancy when it comes to switching.

Firstly, revenue is not automatically a measure for profitability. Is a person paying €600 on a transatlantic round-trip flight really worth more than a client paying €500 on a same-day, short-haul return flight?

> It is premature to call an end to currencies other than revenue

Secondly, there is a difficulty in partner integration. Given the impossibility of obtaining revenue information from partner airlines, they will continue to accrue on a mileage basis. This adds complexity to the programme since revenue- and mileage-based accrual rules need to co-exist. This also creates discrepancies within the programme. Depending on the accrual rules for partners, there will likely be cases where a Flying Blue member could earn more miles when, for example, flying on a China Southern Airlines flight while earning miles on a distance-based scheme than they would on the same route on an Air France flight under a revenue-based accrual system.

Finally, commercial realities are not taken into account, and differing pricing strategies in the various markets can lead to undesired results. If Air France takes as a basis its fare structure in France, where it might be able to generate €5,000 or €6,000 for a business-class long-haul flight, the competitive situation in neighbouring countries will often see corporate agreements at 50% of such price levels. Hence, even

Alaska Airlines

Alaska Airlines has stuck to a mileage-based scheme as it continues to evolve its loyalty programme

if the FFP proposition is fair in the home market, it risks becoming unattractive in other markets and adds a competitive disadvantage towards local incumbents – the opposite of its aim.

These shortcomings are of less or, in some cases, no relevance to low-cost carriers with a short-haul network and a comparably flat fare structure, explaining its popularity in this market sector.

Other currencies are not ideal, either. Many carriers are wary of putting a lot of effort into switching from one less-than-optimal system to a system that might be only slightly superior. It is obviously subject to individual reasoning whether such a move might make sense or not.

These unresolved difficulties also lead to different results in terms of net accrual rates across the revenue-based FFPs of major airlines, still operating on a virtual mileage basis for partner integration. The table (*below*) highlights differences for some selected revenue-based FFPs according to values for base members.

REDEMPTION TIME

Extending the revenue-basis logic to the redemption side does not help to resolve the issue either. By aligning the revenue value to the redemption value in a dynamic manner, you automatically end up with tremendous award levels in premium cabins. Again, this might work for independent carriers living in their own world, but the example of South African – the only traditional carrier having opted for that approach – shows the issue: a round-trip award flight to Europe in business class on South African is regularly charged 500,000 miles or more, while the redemption value per mile might actually be not so bad.

20%

Rough share of airlines that run a revenue-based FFP

Since South African is a member of the Star Alliance, however, it also applies a standard, capacity-controlled redemption table for these partners, where your redemption values should move within certain corridors for competitive considerations. Under this table, you may redeem a round-trip business-class award flight on a Star partner from South Africa to Europe for 130,000 miles only. So, if you really want to fly on South African as a Voyager member, you may redeem a combined South African/Lufthansa itinerary by adding a domestic segment in Germany beyond Munich or Frankfurt and the much lower Star table would still apply.

The combination of large fare spreads and competitive considerations make any attempt to use a revenue-based redemption approach hardly viable for network carriers without damaging the economics of the FFP. By pushing the revenue logic to the redemption side, airlines either ignore competition and/or the economics of their programme.

It comes as no surprise the revenue model is predominantly popular at low-cost carriers, although these airlines were also the first ones to introduce layers of complexity to the system, undermining their early claim that revenue-based systems are simpler. In the programmes of Southwest, Norwegian, Gol, Vueling and others, you would not earn the same amount of points per currency unit spent at all fare types.

Taking the revenue logic to network carriers adds further complexity. For example, a Delta Air Lines member can earn a revenue-related amount of redeemable miles on Delta flights and Delta-ticketed partner flights; a distance-based amount of redeemable miles on partner airlines; a distance-based amount of qualification miles on Delta and eligible partners; and a distance-related amount of qualification dollars on partner airlines. The debate should perhaps not be about who benefits from such a system, but who is still able to understand it.

So, could there actually be other motivations for airlines to change the system, hidden in this currency debate?

Several airlines have indeed mentioned cost considerations for their changes. In reality, it is more confusing to understand for customers at first sight whether they are better or worse off if you take away an apple from them and give them a pear instead, rather than if they simply cut the apple in half.

Airlines should, however, be careful with such a strategy. The fight for loyal customers is harder than ever. And with well-informed clients, customer-unfriendly actions will ultimately backfire on them in the form of lower market shares. ■

Accrual rates for selected revenue-based FFPs

Airline	Accrual rate	Miles/USD
American, Delta, United	5 miles/USD	5
Aer Lingus	3 miles/USD or EUR	3.0/2.6
Air Europa	3 miles/EUR	2.6
Air France-KLM	4 miles/EUR	3.5
Gol	2-4 miles/BRL	6.5-13.1
Hainan Airlines	10 kms/10 CNY	4.1
LATAM Airlines	5 miles/USD	5
South African Airways	1 mile/1.6 ZAR	8.9
Virgin Australia	5 miles/AUD	6.5
Vistara	8 miles/100 INR	5.2

Note: USD exchange rates as per 7 November 2017. Source: Global Flight analysis

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