Reinventing Reward Programs
How miles and tiers could disappear

Presentation for Mega Event 2018 Long Beach, CA

NOVEMBER 1, 2018
US airline industry continues to grow

**Total system RPMs US Carriers**

**% RPMs for Award Travel**

Source: company reports, MIT Airline Data Project
Legacy programs continue to show growth

Total number of redemptions (air and non-air for 2014 to 2017)

Source: company reports. \(\text{\#} = \text{Estimate. AA did not report non-air redemptions prior to 2016}\)
FFPs are positioned as financial powerhouses

**Exhibit 1: Earnings from Selling Miles to Approach $3B by 2020 for American Airlines**

Source: Stifel (“Here’s Where Doug Parker Gets His $3B, $5B, $7B From; FF #133”), 6 March 2018.
FFPs are positioned as financial powerhouses

Ascending brand, leading partnership with Amex driving growth in high-margin revenue

- Delta's brand and product initiatives have stimulated additional demand for SkyMiles as a currency
- American Express co-brand spend has grown 12% annually since 2013
  - 2017 another record year with ~1 million card acquisitions
- Delta is the largest co-brand partner for American Express and their only U.S. airline card partner
  - $3 billion 2017 contribution, up 50% since 2014 and set to grow another $1 billion through 2021
  - Co-brand revenue stream largely tied to consumer spending trends vs. solely airline ticket sales

Source: Delta Air Lines Investor Day 2017
Revenue Management and FFPSs

- dilution
- displacement
- marginal cost
- spill and re-capture
- variable cost
- take-along

Image: Air France-KLM

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Revenue Management and FFPS

Source: Smiles 3Q 2018 Investor Presentation
Phases in the RM FFP relationship

Evolution of Revenue Management capabilities

- **Phase 1**
- **Phase 2**
- **Future Phase**

Source: MIT Airline Data Project; On Point Loyalty analysis

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# Main stages of RM development

<table>
<thead>
<tr>
<th>1980s</th>
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<th>2000s</th>
<th>Today</th>
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<tbody>
<tr>
<td><img src="1980s.png" alt="Image" /></td>
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</table>

- **1980s**
  - Introduction of RM systems in response to deregulation and increased competition
  - Assumes distinct market segment for a particular flight

- **1990s**
  - Development of “Origin-Destination” RM systems following the restructuring of airline networks around large, connecting hubs
  - Evaluates contribution across the network instead of single flight

- **2000s**
  - Collapse of existing RM systems following the removal of the Saturday-night minimum stay requirement
  - Lowered fare fences create a more amorphous market
  - Dispersion in willingness to pay

- **Today**
  - New distribution capabilities, more data, allow RM to restructure its approach
  - Move to personalized pricing
  - Using more data in RM decisions

FFPs have evolved as well in many aspects

<table>
<thead>
<tr>
<th>1980s</th>
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<tr>
<td><strong>Accounting</strong></td>
<td></td>
</tr>
<tr>
<td><em>Marginal Cost</em></td>
<td><em>Fair value</em></td>
</tr>
<tr>
<td><strong>Accrual</strong></td>
<td></td>
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<tr>
<td><em>Airline-centric</em></td>
<td><em>Partner-focused</em></td>
</tr>
<tr>
<td><strong>Breakage</strong></td>
<td></td>
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<tr>
<td><em>High</em></td>
<td><em>Low</em></td>
</tr>
<tr>
<td><strong>Recognition</strong></td>
<td></td>
</tr>
<tr>
<td><em>Distance flown</em></td>
<td><em>Sectors</em></td>
</tr>
<tr>
<td></td>
<td><em>Revenue contribution</em></td>
</tr>
<tr>
<td></td>
<td><em>Partner contribution</em></td>
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Moving towards the Integrated Phase

1. Shifting underlying economic fundamentals

2. Increasing adoption of RM tactics by FFPs

3. Long-term program design changes

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<th>1990s</th>
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<tr>
<td>Introduction of flat fare pricing with revenue implications</td>
<td>Disruption of &quot;frequent flyer&quot; system</td>
<td>Collapse of existing RM systems in response to deregulation and increased competition</td>
<td>Shifting underlying fundamentals of RM through various initiatives over time</td>
</tr>
<tr>
<td>Demand-driven market segment for a particular flight</td>
<td>Dynamic pricing based on available inventory and customer behavior</td>
<td>Dynamic pricing based on market conditions, customer value, and competitor actions</td>
<td>Shifting underlying fundamentals of RM through various initiatives over time</td>
</tr>
<tr>
<td>Revenue recognition across the network instead of single flight</td>
<td>Revenue recognition across the revenue stream instead of one-time event</td>
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<td>Shifting underlying fundamentals of RM through various initiatives over time</td>
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<td>Distance flown Sectors Revenue contribution Partner contribution Marginal Cost Fair value Accounting Accrual Breakage Recognition</td>
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• Introduction of RM systems in response to deregulation and increased competition
• Increase of willingness to pay
• Move to personalized pricing
• Using more data in RM decisions

1980s 1990s 2000s Today

+ data + technology

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Shifting underlying economic fundamentals

#1: Redemptions generate comparable yields

<table>
<thead>
<tr>
<th>Route 1</th>
<th>Route 2</th>
<th>Route 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>LAX → ATL</td>
<td>LAX → ORD</td>
<td>LAX → ORD</td>
</tr>
<tr>
<td>$321</td>
<td>$277</td>
<td>$274</td>
</tr>
<tr>
<td>27,500 miles</td>
<td>25,000 miles</td>
<td>25,000 miles</td>
</tr>
</tbody>
</table>

Source: company website for RT December 1, return December 6 in Main Economy cabin

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Shifting underlying economic fundamentals
#2: Miles are becoming a form of payment

Source: Lufthansa - Riedle, S. Amadeus Conference Prague. 2018
1. Shifting underlying economic fundamentals

2. Increasing adoption of RM tactics by FFPs

3. Long-term program design changes
Increasing adoption of RM tactics by FFPs

#1: Restricting access to award inventory

Airlines limiting access to first class redemptions:
Increasing adoption of RM tactics by FFPs

#2: Increasing access to award inventory

Source: company websites
1. Shifting underlying economic fundamentals
2. Increasing adoption of RM tactics by FFPs
3. Long-term program design changes
FFPs were designed to track and reward customers.

Source: IATA, On Point Loyalty
Future RM capabilities will transform the FFP

Past

Present

Future

- Personalized Dynamic Pricing
- Full visibility on customer value
- Ability to recognize and reward members individually

Source: IATA, On Point Loyalty
## Re-inventing the FFP in the future

<table>
<thead>
<tr>
<th>From...</th>
<th>To...</th>
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<tr>
<td>Award access is equal to all members</td>
<td>Award access will be individualized based on member value, preference</td>
</tr>
<tr>
<td>Elite qualification is done using published and set thresholds</td>
<td>Recognition will be done using myriad indicators</td>
</tr>
<tr>
<td>Elite benefits are packaged and communicated in the form of tiers</td>
<td>Customized packages will be designed to deliver the greatest possible utility for members</td>
</tr>
<tr>
<td>A single currency is used to reward and recognize members</td>
<td>A currency is no longer required to track and reward members</td>
</tr>
</tbody>
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Conclusion

The FFP-RM relationship has changed as a result of the underlying economics

Displacement will reduce over time as miles become an integral part (form of payment)

Access to high—value award seats will be individualized

Airlines will become increasingly savvy in reserving high-value rewards for high value customers

Technological advances will alter the FFP design

Future capabilities to determine and recognize individual customer value and preferences will change the design of FFPs
www.onpointloyalty.com
About the presenter:
Evert R. de Boer has researched and worked in airline loyalty strategy since 2000. He has collaborated with more than 20 airlines globally on frequent flyer programs in management and advisory roles, and has published numerous articles and white papers on the subject. His latest publication, *Strategy in Airline Loyalty*, offers a comprehensive overview of the airline loyalty landscape.

Following his Master of Science degree in Business Administration at the University of Maastricht, Evert de Boer has completed executive education programs at a number of institutions including the London Business School, the Walter A. Haas School of Business at University of California, Berkeley, and the Desautels Faculty of Management at McGill University.