Rex Features

REPORT
GRAHAM DUNN
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IN A SPIN OVER LOYALTY

Recent moves suggest fresh interest among some carriers to separate out their frequent flyer programmes, be it as a source of revenue for the airline or as a possible chance to raise to capital

When Air Canada blazed a trail a decade ago by spinning off and selling its Aeroplan frequent flyer programme, it would be fair to say this did not exactly set off a flood of others following suit.

Even now you can count the number of airline loyalty programmes spun out into separate programmes and strategic investors found on one hand.

Yet whether driven by near-term financial needs or interest in the growth opportunity in the standalone model, there appears to have been a recent uptake of interest in airlines looking to separate out their frequent flyer programme into a standalone unit.

In the past few months, Air Berlin has sold its TopBonus frequent flyer programme to strategic investor Etihad Airways; Brazilian carrier Gol followed up its selection of banks to act as advisors, by securing authorised to launch an IPO of its Smiles frequent flyer programme; and Alitalia in January approved a plan to set up its MilleMiglia frequent flyer programme as a standalone company. The Italian carrier says it has no plans to sell the loyalty operation at present, but did not rule out its future disposal.

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> **IAIN WEBSTER**
> Senior loyalty consultant, ICLP

They join the likes of India's Jet Airways and Virgin Australia to haves announced plans in the past 12 months to spin out their frequent flyer programmes.

Iain Webster, senior loyalty consultant at ICLP, sees airline loyalty schemes broadly following four strategies; those designed to sell more core product, those maximising mileage sales to third parties; those driving ancillary sales; and those seeking to build an asset with value.

"If you've built a business that has a value, I think a lot of CEOs have looked at Air Canada's Aeroplan and decided they should look at a similar opportunity," says Webster.

"More and more airlines are knocking on our door asking us to look at the issue and to help scope a commercial review."

Scot Hornick, partner at management consultants Oliver Wyman, says: "I do think airlines and management teams are beginning to think about it. In the beginning, it was just Air Canada and Aeroplan. It took a while for other carriers to see the wisdom of it and you still find a number of carriers that are reluctant to give away that value.

LEARNING LESSONS FROM RETAIL

Whether the airline retains control of its loyalty programme, spins off the scheme or keeps it in-house, there is increased emphasis from many to expand and take on board lessons learnt from the retail world, particularly in customer engagement.

"Where they [other sectors] do much better than the airline sector is in exploiting the CRM opportunity," says Ravindra Bhagwanani, managing director at FFP consultancy Global Flight. "Look at the level of data airlines have, what they don't do it is exploit this. You compare that to the world of retail, and airlines are just at the beginning," he says, noting that for some airlines there is little incentive to do so because the FFP is so attractive by itself.

"Airlines do a really good job of looking after the elite tier," adds ICLP senior loyalty consultant Iain Webster, but still a majority of their members are inactive. "If you ask airlines how many active members they have, the consistent answer is between 20 and 30%," he says.

"That means there is 70-80% that hasn't done anything. And how many of these have enough miles to take the rewards? Maybe half. It is an asset that is not active."

A lack of engagement with the infrequent traveller is not a new development, nor for some airlines where the prime remit is to manage their top-tier passengers, is it a priority. But Sandra Diem, vice-president of Aimia's global business development – travel, sees a development in this direction

"I think there has been a move in the last three to four years to programmes starting to the recognise the value of the infrequent flyer. When a leisure flyer becomes more engaged, they are more likely to fly that airline again. I think airlines have made some progress here in the last three years," she says.

Key to this engagement is broadening the level of opportunities to redeem, including lower-value items, and that has led to airline loyalty programmes – especially those which follow the coalition model – embracing retail partners. "A retail partner has different business objectives and metrics by which it measures success," notes Deme. "It requires a very different approach in marketing and programme designs to successfully meet the objectives of the retail partners."

However, adopting more of a retail outlook requires a different skill set. "I don't think there are enough people working in airline loyalty departments that come from a marketing background," suggests Webster.

"You need marketeers. You still need airline people as you need a balance, but you do need that fresh blood from the marketing side."

MORE LIKE AMAZON

One of the most common phrases in evidence when it comes to airlines adopting more of a retail mindset is that airlines need to think "more like Amazon". While the retailer is seen as a flag-bearer for ancillary revenues, it is one thing for airlines to aspire to take on some of these lessons, but altogether different to adopt them.

"If you look at the airline along the points of contact it has with the passenger, it is not clear it could do the same sort of sophisticated marketing [as retail]," notes Scot Hornick, partner at consultants Oliver Wyman. "[But] a loyalty programme, especially a coalition model, has the kind of talent you can attract that could do it.

"A loyalty programme spin off gives you a different platform to attract talent and partners. You are not talking to an airline, but to a marketing company with a broad mandate. That's a different value proposition," he adds.

"I think, from our perspective, it does make a lot of sense for airlines to spin off their loyalty programmes." But, he adds, only if there is time to get the value exchange right. "When you rush through this," he says, "you don't get the value exchange right. Then the strategic investor gets more value than they should. The airline [then] runs the risk of trying to renegotiate the programme at a time when you no longer control that discussion. So that is the risk of jumping too soon."

EXISTING LIABILITIES

Webster says one of the biggest issues for a carrier is deciding what it is going to do with its "existing liabilities or deferred revenues". Most airlines have millions, if not billions of unredeemed miles. So it's not just the cost of the operation, but what will you do with these miles," he notes.

Webster also points to the difficulties of valuing breakage correctly – forecasting the amount of miles which are not redeemed is not an exact science.

"So it's do you give up equity in it? And if so, how much? And to who? And how do you shift the value of historic liabilities?" he says. "But there are investors who are beginning to wake up to what the potential might be."

The motives for spinning off loyalty programmes may differ across airlines. Air Canada envisaged a possible IPO for Aeroplan from the outset.

When Qantas spun out its frequent flyer programme it had planned to sell a minority stake in 2008 through an IPO. It has still to do this, however, and has since seen the coalition-based model grow strongly. The scheme had reached 8.6 million members generating EBIT of A$231 million ($239 million) in its last financial year.

In April, Qantas rival Virgin Australia announced plans to create a separate division for its Velocity frequent flyer programme, recruiting former Qantas loyalty specialist Neil Thompson to run the unit.

However, it has made no mention of selling equity, and says its focus is to grow the scheme "to capitalise on the significant earnings growth potential through third-party partnerships and improved participation of our frequent flyers".

SELLING EQUITY

Indian carrier Jet Airways does appear to have selling some equity in its programme on its agenda. It outlined plans to "leverage" the evolution of the loyalty industry by spinning out a marketing service company to manage its JetPrivilege programme last year.

"Initially, the marketing services company will be a 100% subsidiary company. As and when negotiations with the potential knowledge partners crystallise into a concrete decision, it is proposed that some percentage of the company's stake be offered to the knowledge partners," the carrier explained in 2011-2012 annual report.

"A full spin-off really depends on the market conditions and the shareholder strategies"

EVERT DE BOER
General manager – travel, Aimia

It says the process will lead to it transforming its JetPrivilege programme into "a larger retail-based coalition loyalty programme and, through its operations, unlock greater commercial value".

Meanwhile, restructuring German carrier Air Berlin moved quickly to carve out its frequent flyer programme and sell a 70% stake to strategic partner Etihad Airways. In November, it confirmed plans to sell the stake and closed a deal netting it €184 million ($245 million) by the end of the year, contributing to its recovery efforts in 2012.

"It's a long and difficult process to separate out the programme from the airline that requires the airline shareholders and executives to be committed," says Evert de Boer, general manager, global business development – travel of loyalty management specialists Aimia – which was itself established out of Aeroplan. "Of course there is a pay-off in the end, including the transparency that a separation enables.

"To a great extent, what we see today is that programmes are being separated out from the airline, but the ownership still resides with the holding company or parent company.

"I think we'll see more and more of this. Whether there's going to be a full spin-off? It really depends on the market conditions and the shareholder strategies," he says.

Sandra Diem, vice-president of Aimia's

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EMIRATES LOOKS SKYWARDS ON LOYALTY

Emirates' landmark co-operation deal with Oneworld member Qantas is already changing the landscape of global airline partnerships and this is now filtering through to its frequent flyer programme.

This year's *Airline Business*/Global Flight Loyalty 2013 comes to Dubai at a busy time for its home airline's loyalty programme. In the space of a day in February, Emirates was able to announce the creation of a new top-level tier to its Skywards frequent flyer programme, followed by new wide-ranging benefits for the scheme's members through its tie-up with Qantas.

The new Platinum levels, which sit above Skywards' existing Blue, Silver and Gold tiers, target its top-level flyers who have earned more than 150,000 miles.

Emirates has added a top-level tier to its frequent flyer programme

PLATINUM BENEFITS

"The new tier is designed to show our most valued customers how important they are to Emirates and to offer greater recognition and benefits to those who choose to fly with us on such a frequent basis," says Emirates executive vice-president, passenger sales worldwide, Thierry Antinori.

Platinum members will be able to receive exclusive benefits usually reserved for First Class passengers, including First Class check-in, baggage delivery and access to the First Class lounges in Dubai with a guest. Existing Gold Emirates Skywards members eligible for Platinum status will be automatically upgraded to the new tier from April.

The creation of a Platinum tier is similar to that of its new partner Qantas. The latter is switching its transit point for European flights from Singapore to Dubai. As a result of its global business development – travel, says: "It is a benefit if the airline still remains a shareholder, it does not need to remain a major shareholder. But it needs to have enough skin in the game."

Diem highlights the wider benefits of separating out loyalty programmes as standalone businesses. "One of the big advantages of spinning off a programme is that it's run as a separate business.

"Therefore, it has the ability to make the decisions that are required to build a business. The capabilities that are required to run a programme are quite a lot different from the capabilities needed to run an airline. It enables the CEO to invest in the right infrastructure, capabilities and skills, like marketing, loyalty and data analysis," she adds.

Webster adds: "It's about the cultural change. You don't just relocate the same 50 people into a separate office. It needs to have direct marketing, data insight and partnership relationship skills, but still have the umbilical cord to the airline.

"British Airways retains its own team in charge of its Executive Club and the recognition elements of the programme and a different operation in Crawley in charge of monetising the currency through Avios," he says. "The fact Avios is owned by BA tells you something about the value they see in it." ■

GETTING MILEAGE FROM FFP SALES

AIR CANADA: parent ACE Aviation Holdings generated more than $1 billion by selling down its stake in the airline's FFP Aeroplan in four tranches, between 2005-2008. The initial IPO valued Aeroplan at about $2 billion.

AEROMEXICO: Aimia, then Aeroplan, paid $35 million for a 29% stake in Aeromexico's Club Premier, later increasing that to a 49% stake. Club Premier has increased members more than a fifth during the past two years.

TAM: the Brazilian carrier raised almost R724 million ($392 million) from an IPO in its loyalty programme Multiplus in February 2010. The scheme generated net profits of R274 million in 2011.

AIR BERLIN: the Oneworld carrier sold a stake of 70% in its Topbonus frequent flyer scheme to strategic partner Etihad Airways in December 2012, netting the carrier €184 million ($245 million).


Trevor Smeaton

The *Airline Business*/Global Flight-organised Loyalty 2013 forum takes place in Dubai on 25-27 February. To find out more about the event, visit: **loyalty-conference.com**

tie-up with Qantas, which remains subject to final regulatory approval, members of the carriers' respective loyalty programmes will be able earn miles on each other's flights – with some exception for Skywards members on the Qantas domestic network.

There is reciprocal lounge access for Gold members or above and tier status in either airline programme will be reciprocally recognised when flying on the joint Qantas-Emirates network.

REWARD OPPORTUNITIES

"There will be certain changes required of the programme but for the most part the partnership will provide members with more earning and reward opportunities as the Australian domestic network now becomes available to them," explains Brian LaBelle, senior vice-president at Emirates frequent flyer programme Skyward.

"In addition they receive tier membership benefits for flights on Qantas which is pretty much a first, as we aren't part of an alliance where this typically tends to happen."

It is part of continued evolution of the Skywards programme across membership tiers including partnerships with Alaska Airlines and JetBlue in the USA and European carriers TAP Portugal and EasyJet.

"Rewards with EasyJet have already proved to be very popular with members based primarily in the UK and in other European countries along with redemptions from members in the East," explains LaBelle.

"It is certain to drive engagement in the UK and other European markets as the EasyJet network allows members to expand their travel options across Europe and North Africa giving members the opportunity to use their Skywards Miles to fly to over 130 destinations within Europe and North Africa.


Platinum gets you first-class lounge access

"This strategic partnership will provide our robust Skywards members base, 31% of whom reside in Europe, with a novel way of redeeming their miles and expanding their travel possibilities."

LaBelle believes these moves continue a tradition of innovation within the Skywards programme. "Skywards was one of the first programmes to allow confirmed upgrades with Miles way back in 2000," he says.

"It still remains one of our unique features with members having the ability to upgrade to a higher cabin from any fare and with the ability to do it in advance or at check-in or on-board. A large majority of our rewards are upgrades highlighting the popularity of this choice amongst members."

He cites the popularity of members being able to redeem miles for hospitality and general admission to major sporting events, linked to Emirates' high profile sponsorships.

The airline also introduced its Miles Accelerator feature in 2010 – for which it was recognised in the 2011 Loyalty Awards – through which members can book flights with bonuses to enable them to boost their miles and reach their rewards even quicker.