

FREQUENT FLYER BENEFITS – THE SKYSHOP EXTENSION

People who travel by air probably have at some point of time thought about getting a frequent flyer card so that they can earn miles for free travel. Some would already have an assortment of frequent flyer cards riding around in their wallets.

Frequent Flyer Programs (FFP) are incentive programs run by airlines in order to reward customers for their continued loyalty. The concept behind the same being that airlines want their passengers to become lifetime customers as it is costlier for any airline to acquire new customers rather than to retain the ones they already have.

“So how do they reward you? The more frequently you fly with them, the greater your rewards.”

However, today's FFPs offer benefits above and beyond just free air travel...

Most line haul airlines and now even a few of the low cost carriers (LCC) offer its customers a Frequent Flyer Program. Although all programs are designed individually and show differences on a detailed level, the basic scheme as well as the rules and regulations of the programs are similar. As a traveller, one earns free points for the miles that one flies, on a particular airline and this is where creative accrual as well as retention programs matter.

On the accrual side most FFPs have created a broad partner network which enables its members to earn miles on many different occasions (e.g. credit card, mobile phone, retail). On the redemption side, majority of the FFPs focus on classical rewards (free flights, upgrades, hotel and car rental vouchers).

As competition grows stronger and margins become slimmer in the airline industry, the demand for top tier customers grows... As a result SkyShop solutions are increasingly being looked at as that new simple yet innovative tool. There is need for airlines to differentiate & retain (and even attract) the top tier customers. In this endeavour some FFPs have gone up the value chain by implementing a SkyShop solution and are therefore able to offer their members a larger variety of physical gifts or events against which redemption can be made. Lufthansa's WorldShop and Emirates' High Street are good examples of the SkyShop solution.

What is SkyShop?

A SkyShop run by an airlines is the extension of the FFP and offers its customers the possibility to order physical products from different categories (e.g. Home, Electronic, Travel) or book certain events (e.g. Holiday trip, meet your star) against their miles/points. A SkyShop primarily enlarges the customers' options of redemption. The customers can order either via a physical catalogue and/or via a WEB shop.

Usually the customer can choose between various payment methods, such as:

- Miles/ Points earned
- Cash (credit card)
- Miles/ Points earned + Cash

The products or vouchers are then delivered directly to the delivery address of the customer. Some programs have also implemented pick-up points or shops on major airports.

Sky Shop Advantages

In general there are three major advantages which are created through the introduction of a SkyShop:

- Program enhancement / increase of customer satisfaction
- Increase of redemption quote without additional liabilities
- Generation of additional revenues

A. Program enhancement

The members of the FFP are usually the main target group for the SkyShop. Especially the possibility to use their miles for purchase is highly attractive. Two tiers of the FFP are especially in the focus:

- Top Tier – Platinum or Elite members
- Lowest Tier – Base members

By definition, Top Tier members spend a large amount of their time in airplanes and hotels or use rental cars. Therefore classical rewards are not interesting for them anymore. A SkyShop offers them new and exciting opportunities to spend their miles. This increases the attractiveness of the program and automatically their loyalty towards the airline.

Base members often do not have enough miles in order to receive a reward. This can lead to a loss in interest and will certainly not create loyalty. The miles+cash payment method in this case gives them the opportunity to use their existing miles in order to receive an interesting reward for a lower cash price. This positive experience eventually creates loyalty for the program and the airline.

B. Reduction of liabilities

A SkyShop solution will eventually lead to an increase of the redemption quote which consequently reduces liabilities of the airline.

Effective from July 1st 2008 the accounting rules under IFRS have changed. From this date on airlines are not allowed anymore to build the provision on incremental costs but have to build the provision on turnover.

Example: A redemption ticket for 35,000 miles from London to Barcelona has an average sales price of 500.00 €. Therefore the airline has to build a provision for each mile earned at 0.014 €.

Under the accounting rule US GAAP companies still have the choice if they want to build the provision for miles on incremental costs or on turnover. As both world leading accounting rules tend to harmonise this might also change for US GAAP in the not too far future.

C. Additional revenues

SkyShop Solutions also create an additional revenue stream for the airlines. There will be some direct and also some indirect new sources for revenue while introducing a SkyShop solution.

Direct additional revenue streams are:

- Cash orders
- Miles+Cash orders
- Marketing of advertising space in physical catalogue
- Marketing of advertising space in online shop (Banner, etc.)
- Special promotions with selected redemption partners

Indirect additional revenue streams are:

- Due to the fact that more miles are redeemed against rewards from the catalogue, there are more revenue seats for sale available
- An attractive FFP increases loyalty which increases sales
- To earn miles via airline partners (e.g. credit card, mobile phone, hotels, car rentals, retail) becomes more attractive. This leads to higher mile sales to partners
- An attractive program leads to a positive market appearance and a good word of mouth. Both creates a pull effect which consequently attracts new customers and increases sales.

In any FFP, miles/ points only have value when a member has accumulated enough miles/ points to reach an award threshold. Moreover, miles expire regularly and may impede the process of miles accumulation. This is where the Skyshop Solution can add value for the member.

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