Presentation

Loyalty at the Forefront of the Transformation Curve

Open Innovations 2017
Moscow, Russia
17 October 2017
Loyalty at the forefront of the innovation curve
Introduction to Frequent Flyer Programs
Three core themes today

- The airline loyalty landscape
- The frequent flyer program as a digital intermediary
- Future growth
Introduction to airline loyalty
Quick history of FFPs


Disruption was at the foundation of FFPs

The strongest growth occurred as a result of deregulation in the U.S. and the European Union

**Major changes in the model over time**

<table>
<thead>
<tr>
<th>Description</th>
<th>Statistics</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing importance of non-air rewards</td>
<td><em>almost 1 out of every 3 miles</em></td>
<td><strong>Miles &amp; More</strong> Lufthansa</td>
</tr>
<tr>
<td>Revenues earned for non-air activity dominate</td>
<td><em>&gt; 90% revenues non-air</em></td>
<td><strong>multiplus</strong></td>
</tr>
<tr>
<td>Alignment between customer value and rewards</td>
<td><em>spend SGD 50,000 minimum</em></td>
<td><strong>Singapore Airlines KrisFlyer</strong></td>
</tr>
<tr>
<td>More precise rules for accrual eligibility</td>
<td><em>earn 5 – 11 miles per $ spend</em></td>
<td><strong>American Airlines AAdvantage</strong></td>
</tr>
</tbody>
</table>

*source: company reports*
## Relevancy of FFPs today

<table>
<thead>
<tr>
<th>FFP is the largest consumer of seats</th>
<th>FFP represents the single largest customer set</th>
<th>FFP provides largest consistent cash flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Share of RPMs for award travel</td>
<td>▪ Single largest repository of customers</td>
<td>▪ Long-term agreements with financial services providers</td>
</tr>
<tr>
<td>▪ Maintains pricing integrity</td>
<td>▪ Offering the highest level of data quality from multiple sources</td>
<td>▪ Provides steady cash flow into the airline which tends to be less cyclical</td>
</tr>
<tr>
<td>▪ No distribution fees for this channel</td>
<td>▪ Strong levels of engagement and multiple touch points</td>
<td></td>
</tr>
<tr>
<td>▪ Significant monetization opportunities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Southwest Rapid Rewards

- **12.7%**
  - Share of award travel of 2016 RPM

### IAG International Airlines Group

- **40%**
  - Share of revenues generated by members

### Delta SKYMILES

- **USD 4 bn**
  - Projected 2012 contribution

---

The FFP as the hidden gem
Successful digital disruptors in transportation

- The business does not own the physical assets
- The business is highly scalable – based in the cloud
- The business matches consumers and producers
- The business does not hold any stock
- The business sells mainly through digital channels
- The business makes extensive use of data analytics and predictive modeling
Product convergence: Zodiac Cirrus III seat
A quick characterization of the airline industry

- Bargaining power of suppliers
- New entrants
- Rivalry amongst competitors
- Bargaining power of buyers
- Threat of substitutes

Return on Invested Capital performance

source: IATA Profitability and the air transport value chain / McKinsey analysis
Higher valuation perception of FFPs compared to listed legacy carriers

source: EY - Frequent Flyer Program: Ready for take-off
## Different business models

<table>
<thead>
<tr>
<th>Airline</th>
<th>vs.</th>
<th>Loyalty program</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Unpredictable earnings</td>
<td>• Strong and consistent cash flow generation</td>
<td></td>
</tr>
<tr>
<td>• Substantial operating complexity</td>
<td>• Straightforward, lightly regulated business but increasingly competitive</td>
<td></td>
</tr>
<tr>
<td>• Capital intensive</td>
<td>• Asset light, highly scalable</td>
<td></td>
</tr>
<tr>
<td>• Business sentiment and fuel price key macro economic factors</td>
<td>• Consumer spending key macro economic factor</td>
<td></td>
</tr>
</tbody>
</table>

source: Deutsche Bank
FFPs have built rich data sets

- transactional
- behavioral
- socio-demographic

image: Deutsche Lufthansa
FFPs have become network players

35% percent of all credit card spending in Australia (AUD 100 billion per year) earns Qantas Frequent Flyer Points

The FFP meets the criteria to be successful

- The business does not own the physical assets
- The business is highly scalable – based in the cloud
- The business matches consumers and producers
- The business does not hold any stock
- The business sells mainly through digital channels
- The business makes extensive use of data analytics and predictive modeling
Optimizing the FFP
Scenario 1: the end of distressed inventory

FFPs need to find new ways to ensure a sufficient and equitable supply of award seats

Scenario 2: the super-informed consumer

Members are actively exploiting arbitrage opportunities to get the most advantageous access to awards

image: Emirates
Scenario 3: fungibility of loyalty currencies

MEMBER DIRECT
LifeMiles
25% gross billings (2014) from member direct miles purchases

FINANCIAL SERVICES CONVERSION
citibank
conversion to major FFPs giving member choices

TRAVEL CONVERSION
Hilton Honors
conversion of frequent guest program to FFP

The increasing fungibility of frequent flyer currencies will require program operators to reconsider the attractiveness of the core value proposition

Conclusions

1. Unique position of the FFP
2. A catalyst for growth
3. Right structure & support required
THANK YOU
This presentation is an excerpt of a thought leadership article by Evert de Boer that first appeared in “21st Century Airlines – Connecting the Dots” by Nawal Taneja. Routledge, 2017.

About the presenter

Evert R. de Boer has researched and worked in airline loyalty strategy since 2000. He has collaborated with more than 15 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.