Airline Alliances & Frequent Flyer Programs

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INTRODUCTION:

*It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change*-Charles Darwin.

It would not be an exaggeration to state that today’s markets has undergone radical changes facilitated by advances in global information technology, economic development of third world countries, increasing interplay between various markets, political changes in various nations facilitating openness in trading practices etc. As the Oft-quoted comment these days goes, the markets have turned flatter than ever before facilitating increased movements & transactions between nations, corporates, entrepreneurs and individuals.

Increased opportunities including enlarged existing markets and emergence of new markets has been a mixed bag. Along with its obvious benefits, crippling disadvantages have also followed like its shadow. One of the industries that have had battle its effects is the airline industry. Paradoxically the increased popularity of flying as a medium of faster transportation has also been one of the factors that have brought in impediments to profitability. Since business deals are not restricted by geographical boundaries anymore and people have taken to international travel like never before-be it for business or pleasure, a spurt in demand has resulted in over-crowding within the industry-all vying for the same pie.

With most of the competitors operating from more or less similar technology platforms and offering similar services, major players within the airlines industry has had to battle commoditization of its services and offerings to its passengers. Airline and the tourism industry operate in an interconnected manner and are particularly vulnerable to global incidents like epidemics, natural disasters like earthquakes, cyclones, terrorism, volatile fuel prices etc. These have hurt the industry where it matters the most-profitability!

Every time there is a hit or threat to its financial bottom line, the marketers under pressure to perform and improve cash-flow, would struggle to create innovative marketing campaigns to rise above the communications clutter and attract the customers attention. Ironically in their urgency they end-up using the same self-destructive weapon that they would like to avoid for long term profitability-lower prices. Price-wars cannot be a part of a strategy and every time it is used, it leaves a bitter after-taste among the players within the industry.

The industry has gained maturity over the years, and airlines all over the world have been constantly revising their strategies for growth and encountering competition. This has been driven by one particular need, survival. These strategies cover cost cutting measures, better management and most importantly, strategic alliances with other airlines. Importance of these alliances may be gauged by the fact that they are guided by the bilateral air services agreement system between nations. In many cases code-sharing agreements have been made to maintain or expand coverage & these international codes-sharing has become a part of bilateral negotiations.
THE BUILDING BLOCKS:

An alliance may be understood as an agreement between two or more parties, made in order to advance common goals and to secure common interests. In matured markets, alliances make business sense and are primarily motivated by cost reduction and improved service for the customer among other factors. Typically alliance partners are bound by a single agreement with equitable risk and opportunity share for all parties involved and are typically managed by an integrated project team.

Strategic alliances are common to any industry. Their presence is being felt quite significantly within the airline industry. Formation of alliances has been a collateral outcome of the deregulation of the airline industry in the United States in 1978. Deregulation was the single most important event that brought about radical changes within the industry. Though it took around a decade for the European countries to follow, the effects of deregulation was quick to filter-in and the airlines were finally free from governmental shackles. The airlines now could choose the routes they wanted to fly and fix the prices as they saw fit without any regulatory interventions. Thus, deregulation enabled airlines to operate based on demand-supply realities and other market realities. The freedom had its cons too-now the airlines had to fend for themselves and had to take careful steps in order to walk the path of positive financial bottomlines.

The most commonly used word these days seem to be “globalisation”. The all pervasive globalisation did not happen at one go. Deregulation of the airline industry seems to have been a precursor to it. Globalisation has set new rules and with competition coming from and for new markets, the ground realities have altered Airlines have been slowly adapting to these challenges. Maybe due to the unpredictability of the new market and its inherent vulnerability to global incidents, the industry has had to adapt itself many times over. With adaptation becoming its second nature, alliances with other operations were nothing but a survival mechanism that began many years ago. From basic code-sharing agreements, these alliances have come a long way and today involves much closer co-operation between partners. The flexibility of the format has ensured that even non-flying partners like Hotels; Credit card companies etc have been successfully integrated. No Doubt, these alliances are playing a significant role in the development of the global airline industry.

What the alliances offer a consumer is seamless worldwide travel. To that end, participating airlines have more or less integrated their flight routes, coordinating their schedules and flying from common terminals at shared hub airports so passengers connecting from one alliance partner to another can do so with minimal effort and inconvenience. With an integrated route network in place, airlines in an alliance offer fares that favor a combination of alliance partners, including round-the-world fares that showcase the alliance’s global network, permitting travelers to circumnavigate the earth exclusively using members of a single alliance. The looming presence of alliances notwithstanding, the consumer still seeks his pound of flesh for his patronage from the alliance in the form of loyalty miles. In order to satisfy the consumer craving for miles, member airlines have linked their mileage programs to reward travelers for flying within the alliance network. Loyalty programs thus continue to hold sway with the Airlines Industry.
AIRLINE ALLIANCES:

In layman’s terms, an airline alliance may be defined simply “an agreement between two or more airlines to cooperate on a substantial level”. However Oum, Taylor, and Zhang (1993) offers a more comprehensive definition "a global airline network formed by a group of affiliated airlines which offer seamless services to consumers through a joint use of computer reservation systems, through fares and ticketing, automatic baggage transfer, coordinated flight schedules, code-sharing of flights, joint marketing, sharing of a frequent flyer program, etc." (1).

International strategic alliances represent one of the strategies developed by firms to gain a competitive advantage in the global marketplace. These alliances possess the following characteristics (de la Sierra 1995)(2):
1. The two or more firms that unite to pursue a set of agreed upon goals remain independent subsequent to the formation of the alliance.
2. The partner firms share the benefits of the alliance and control over the performance of assigned tasks.
3. The partner firms contribute on a continuing basis in one or more key strategic areas (e.g., technology, products, and so forth).

Broad objectives of an airline alliance:

Many researchers have examined the various reasons that have led to the formation and sustenance of strategic alliances within the airline industry. Burton and Hanlon (1994) opine that alliances are central to formulation of business strategy. Though there are many objectives, the list below highlights a few important ones

(1) The primary objective for international strategic alliances in the airline industry is access to foreign markets.
(2) Being a part of an alliance enables the carrier to offer a larger number of flights to a much wider choice of destinations, leading to enhanced marketing opportunities.
(3) Airlines benefit from the economies of scale resulting from an increased scope of operations.
(4) Increase traffic on the airline’s routes. Higher traffic levels allow the airline to operate larger, more efficient aircraft at higher load factors, which in turn leads to lower unit operating costs.
(5) Reduce costs through the sharing of facilities and services aircraft maintenance and ground handling.
(6) Increase market feed. Many airlines that are dominant in their home markets have entered into an alliance with an international airline to provide feed to their airlines.
(7) The linking of flights within computer reservation systems allows ticketing and seat assignments for connecting flights to be completed at the point of origin, which benefits the connecting passenger.
(8) Other objectives behind the formation of global alliances between airlines include: the projected growth of international travel versus domestic travel, intensified fare competition, gate-slot constraints, hub congestion, market withdrawal costs, aircraft systems development, human resource development and a desire to match strengths and weaknesses.
International strategic alliances represent one of the strategies developed by firms to gain a competitive advantage in the global marketplace. Strategic alliances between airline partners have become a popular business strategy.

Alliance benefits in a nutshell may be summarised as:

1. Ability to offer a wide range of airline partners.
2. Better lounge/airport facilities.
4. Ability to offer round fares/circle fares.
5. Greater ability to reward passengers.
6. Faster Mileage accrual.
7. Larger number of reward destinations.
8. Better up sell opportunities.
10. Access to extended passenger database.
11. Large and international partner portfolio.
12. Invest in sophisticated campaign management tools.
13. Joint development of easy to use services for passengers.
14. Dedicated professional management for meeting alliance objectives.
15. Increased cost-efficiencies.
16. Increased aircraft utilization.
17. Globalised airline operations.

FFP is the most visible joint product of the alliance on the customers’ side. Consumer loyalty programs such as frequent flyer programs (FFPs) have proven their ability to alter the intensity of price competition between firms. The increasing marginal benefits that are built into the reward schedules of FFPs give consumers an incentive to concentrate their flying with a single carrier, rather than choose carriers on a flight-by-flight basis. Indeed, both economists and policy analysts have suggested that FFPs might enhance the market power of airlines, in particular, of dominant carriers at hub airports. The FFP points available on a flight are clearly a characteristic that consumers consider in deciding which airline product to purchase. Consumers value frequent flyer points because accrued points give them dual benefit- attractive rewards and the benefits of tier status. Thus, the value of frequent flyer points is derived from the value of the rewards for which they can be redeemed and the probability that a consumer will accumulate enough points to redeem a reward and achieve tier status.

Even within airline alliances, FFPs remain a key component of global strategy. It is interesting to note that the very first airline alliance was built around a FFP. The defunct Swissair owned the “Qualiflyer” FFP and took majority stakes in various airlines which were linked with Qualiflyer. The three existing Global Alliances (Star Alliance, SkyTeam and One World) aim to provide many benefits to their clients, including reciprocal mileage accrual and award tickets. Thanks to huge ICT investments, they introduced standard procedures for data exchange, miles and award settlement, recognition of higher tiers, web booking tools, etc.
WORLDWIDE AIRLINE ALLIANCES:

The three largest alliances that are centered on passenger airlines are the Star Alliance, SkyTeam and Oneworld. Alliances also have also been formed between cargo airlines, such as that of WOW Alliance, SkyTeam Cargo and ANA/UPS Alliance. Alliances provide a network of connectivity and convenience for international passengers and international packages. Various aspects of airline alliances have been discussed in detail above.

Loyalty programs are prime pivots that determine the success of airline alliances. Since there are multiple airlines that are part of an alliance thus bringing with them multiple programs with varied and complex rules, alliances typically offers a single alternative loyalty program that is also umbically integrated with the primary loyalty programme belonging to the “home” airline. In order to protect and maintain the primacy of individual airline FFPs most alliances have the rule that the passenger has to take a minimum no. of flights a passenger before being eligible for an alliance loyalty programme. The alliance loyalty programme also has its own set of tiers. The one world alliance tiers are branded as Emerald, Sapphire and Ruby. By creating an alliance FFP programme, a single data pipeline is created from varied sources that are many and also varied, giving the alliance management the opportunity to process large amounts of heterogeneous data.

FACTS AND NUMBERS-A SNAPSHOT

<table>
<thead>
<tr>
<th>STAR ALLIANCE</th>
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<tbody>
<tr>
<td>Year of Formation</td>
<td>1997</td>
</tr>
<tr>
<td>Daily Departures</td>
<td>16,500</td>
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<tr>
<td>Countries Served</td>
<td>159</td>
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<tr>
<td>Lounges</td>
<td>805</td>
</tr>
<tr>
<td>Annual Passengers</td>
<td>499.90 (m)</td>
</tr>
<tr>
<td>Number of Employees</td>
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<tr>
<td>Fleet</td>
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</tr>
<tr>
<td>Available Seat Kilometers</td>
<td>1280.5 (bil)**</td>
</tr>
<tr>
<td>Global Passenger Shares</td>
<td>454.4 (mil)**</td>
</tr>
<tr>
<td>Revenue Passenger Kilometers</td>
<td>980.8 (bil)**</td>
</tr>
<tr>
<td>Operating Revenue Shares</td>
<td>127.2 (bil)**</td>
</tr>
<tr>
<td>Frequent Flyer Members</td>
<td></td>
</tr>
</tbody>
</table>
Airline Alliances & Frequent Flyer Programs

** Source: IATA WATS published 2007. (3) numbers indicate that alliances are a significant factor within the airline industry, and that the success of these alliances will determine the success of global airline markets. Not entirely, but a world class loyalty program is a big contributor to business success.

### SKYTEAM

<p>| | |</p>
<table>
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<tr>
<td><strong>Year of Formation</strong></td>
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<td><strong>Daily Departures</strong></td>
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<td><strong>Countries Served</strong></td>
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<td><strong>Lounges</strong></td>
<td>447</td>
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<td><strong>Annual Passengers</strong></td>
<td>462 (m)</td>
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<td><strong>Number of Employees</strong></td>
<td>356,998</td>
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<td><strong>Fleet</strong></td>
<td>2469 (+1,255 from related carriers)</td>
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<td><strong>Available Seat Kilometers</strong></td>
<td>1042.9 (bil)**</td>
</tr>
<tr>
<td><strong>Global Passenger Shares</strong></td>
<td>375.6 (mil)**</td>
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<tr>
<td><strong>Revenue Passenger Kilometers</strong></td>
<td>818.9 (bil)**</td>
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<tr>
<td><strong>Operating Revenue Shares</strong></td>
<td>97.9 (bil)**</td>
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<td><strong>Frequent Flyer Members</strong></td>
<td>152 (mil)</td>
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### ONEWORLD

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<td><strong>Year of Formation</strong></td>
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<td><strong>Daily Departures</strong></td>
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<td><strong>Lounges</strong></td>
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<td><strong>Annual Passengers</strong></td>
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<td><strong>Fleet</strong></td>
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<td><strong>Available Seat Kilometers</strong></td>
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<tr>
<td><strong>Global Passenger Shares</strong></td>
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<td><strong>Revenue Passenger Kilometers</strong></td>
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<tr>
<td><strong>Operating Revenue Shares</strong></td>
<td>86.8 (bil)**</td>
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<tr>
<td><strong>Frequent Flyer Members</strong></td>
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</tbody>
</table>
### Available seat kilometers*

<table>
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<tr>
<th></th>
<th>Star</th>
<th>One world</th>
<th>Skyteam</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASK (bil)</td>
<td>1280.5</td>
<td>891.1</td>
<td>1042.9</td>
</tr>
</tbody>
</table>


### Number of members since 1997

![Number of members since 1997](image)

### Global Passenger Share

![Global Passenger Share](image)

Source: Star alliance, IATA WATS published 2007. UPS & FedEx not included. *Year 2008
Airline Alliances & Frequent Flyer Programs

Alliance Passenger Share (mil)

Source: Star alliance, IATA WATS published 2007. UPS & FedEx not included. Revenues are stated in USD. Year 2008.

Available Seat Kilometer

Source: Star alliance, IATA WATS published 2007. UPS & FedEx not included. Year 2008
STAR ALLIANCE – SAMPLE UNIFIED LOYALTY PROGRAM:

Star Alliance has two premium levels, Silver and Gold, based on a customer’s tier status in a member carrier’s frequent flyer program. Each of the member and regional airlines recognizes Star Silver/Gold status, with a few exceptions (mainly pertaining to airport lounge access). The statuses have no specific requirements of their own; membership is based solely on the frequent flyer programs of individual member airlines. Many member airlines also have an additional premium status beyond Gold which is not recognised across Star Alliance.

**Star Alliance Silver**

Star Alliance Silver status is awarded to customers who have reached a premium level of a member carrier’s frequent flyer program.

**Benefits of Star Alliance Silver membership:**

- Priority reservations wait listing
- Priority airport stand-by
Benefits of Star Alliance Silver membership:

- Priority reservations wait listing
- Priority airport stand-by

Some airlines also offer the following to Silver members:

- Priority boarding
- Priority airport check-in
- Priority baggage handling
- Preferred seating
- Additional checked luggage allowance
- Airport lounge access

**Star Alliance Gold**

Star Alliance Gold status is awarded to customers who have reached a high level of a member airline’s frequent flyer program.

Benefits of Star Alliance Gold membership:

- Priority reservations wait listing
- Priority airport stand-by
- Priority boarding
- Priority airport check-in
- Priority baggage handling
- Additional checked luggage allowance of 20kg (or one extra piece where the piece concept applies)
- Airport lounge access to designated Star Alliance Gold lounges on the day and at the place of departure, presentation of a valid Star Alliance boarding pass.

Some airlines also offer the following to Gold members:

- Preferred seating (exit seat, or even on a special section on the plane on some carriers, which provides more leg room)
- Guaranteed seating on fully booked flights (subject to the booking class code and notice period)
- Free upgrade (in the form of voucher/certificate or automatic upgrade upon check-in)
CONCLUSION

Close relationships between airlines are nothing new. Despite the cut-throat competition that exists among individual airlines, the industry operates within a highly cooperative framework. Airlines routinely sell and accept each other’s tickets, transfer luggage between each other’s flights and offer other conveniences. It always seems logical for non-competitive airlines to take that kind of cooperation to the next level, sharing codes, creating joint fares and participating in each other’s frequent flyer programs. Airline alliances were just another step in that direction. International strategic alliances are an important strategy in the development of global airline markets. A study estimated that 66 percent or two out of every three passengers fly with an alliance carrier which makes it apparent that in the aviation industry today, alliances play a critical role. While there were many doubters regarding the longevity of global airline alliances, it has more or less been established as a fact of today’s travel life. Today's Airline world is consolidating around three major alliances- Star Alliance, Skyteam and Oneworld.

Loyalty Programs have been a vital marketing tool for the airline industry that has enabled them to constantly add value and de-commoditise their services and offerings. It is interesting to note that joint FFP plans seem to be the most common marketing activity entered into by alliance partners in attempting to build a seamless network for the traveler. Frequent flier programs predominantly developed as a tool to regain customer loyalty and reward frequent & high yield passengers continue to have substantial capability to impact the travel Industry. The successes that the alliances have posted have been due to various reasons including seamless travel, better usage of amenities at airports etc, but one of the vital reasons remain that code-sharing effectively merges the members Frequent flyer miles and programs letting them use built-up mileage from one carrier on several others.

According to Harvard Business Review, A 2% increase in customer retention can have the same financial impact as a 10 percent reduction in operating costs. Joining an alliance is proving to be a cost effective way of increasing both frequencies and network pushing more and more airlines to be a part of alliances. This has resulted in alliances increasing their joint market-share & thus being a catalyst for change in the aviation industry.

In an uncertain conjuncture, airline alliances are becoming more influential due to the numerous synergies that exist in the aviation sector. Each of the big alliances today offers an integrated worldwide network, harmonized customer benefits and coordinated loyalty programmes. Here we are forced to concede that Airline alliances are here to stay and loyalty programs will continue to play their vital role in their success.
REFERENCES:


GLOSSARY:

(1) Available Seat Kilometers: One seat transported one kilometer; the most common measure of airline seating capacity or supply. For example, an aircraft with 100 passenger seats, flown a distance of 100 kilometers, produces 10,000 ASKs. Sometimes ALSO measured in available seat miles (ASMs).

(2) Operating Revenue: Revenues from the performance of air transportation and related incidental services, including (1) transportation revenues from the carriage of all classes of traffic in scheduled and nonscheduled services, and (2) non-transportation revenues consisting of federal subsidies (where applicable) and services related to air transportation.
APPENDICES:

Appendix-1

The phases of Strategic Alliance

1. PHASE ONE
- Code shares
- Joint FFP
- Network co-ordination
- Joint sales
- Shared lounges, etc.
- Alliances logo
- But
- Separate airline brands

2. PHASE TWO
- Common ground handling
- Joint maintenance
- Joint sales in third countries
- Joint call centres
- Common IT platform
- Joint purchasing
- But
- Still separate airline brands

3. PHASE THREE
- Franchising
- Joint product development
- Sharing of aircraft and crews
- Single operating company
- Passengers
- Cargo
- Single alliance brand

ENTRY AND EXIT RELATIVELY EASY
EXIT FROM ALLIANCE MORE DIFFICULT BUT POSSIBLE
EXIT BECOMES VERY DIFFICULT OR IMPOSSIBLE

Source: Doganis, 2001, p. 86
Appendix-2

Schematic Representation of Changes in the Airlines Industry

1940 - 1970s
Point to Point
City Pair Services

1980s
Hub and Spoke
Networks

1990s
NETWORKS
International Alliances
In Global Market