Finance and Economics Frequent-flyer schemes

Lifting off Loyalty programmes have been a lifeline for airlines

WHEN EXECUTIVES at American Airlines unveiled the world's first frequent-flyer programme 40 years ago, they probably didn't imagine it would one day be worth more than the airline itself. Last year analysts valued the scheme at around $18bn-30bn, eclipsing the company's current market capitalisation of $12.9bn.

Such programmes have proved a boon to American carriers in the pandemic. Firms including American Airlines have raised $30bn in debt backed by the schemes.

Airlines once hoped simply to foster loyalty by offering customers freebies. Passengers collected miles as they travelled and were awarded a free flight once they racked up enough of them.

But schemes today are far more sophisticated. Airlines profit by selling miles to credit-card firms at a price that exceeds the cost of providing reward flights and dishing out other perks, such as hotel stays.

They also gain when miles expire unused or are cashed in for something of poor value. According to McKinsey, a consultancy, 15-30% of miles expired unused before the pandemic.

Credit-card issuers in turn use miles to lure customers with bonuses. Airline-affiliated cards tend to rake in much more in transactions a year than other cards.

Many miles are therefore earned not in the air, but through card spending on the ground. That explains why customers earned $6.8bn-worth of miles across big loyalty schemes in 2020, even as many kept to their homes.

If they were to rush to convert those miles into free flights as travel takes off again, the profitability of such schemes would be jeopardised. But airlines have another way to ensure that their programmes stay profitable: they can deflate the value of their miles.

In the early 2010s American airlines began to calculate the value of a mile based on a complex formula of fares and routes. In 2015 Delta Air Lines stopped disclosing how the value of its miles was calculated and embarked on a series of devaluations, prompting competitors to follow.

In the past year or so Delta, Southwest and United have devalued miles on major routes by 6-20%. Airlines have tapped loyalty schemes for cash before, by selling miles to credit-card firms at discounted rates.

United traded its miles with JPMorgan Chase, a bank, for $600m in the financial crisis. But the pandemic saw the first use of loyalty programmes as collateral in America, says Benjamin Metzger of Barclays, another bank.

United was the first to do so with a secured loan in June 2020. Delta followed with a bond offering soon after. The deals have attracted more investors than bonds secured by old aircraft (which, unlike loyalty schemes, depreciate).

Scheme-backed debt tends to boast a better credit rating than the airline issuing it. And investors are comforted by the structure of the deals, which use the schemes' cash flows to repay debt, and limit risk if an airline goes bust.

Affinity Capital Exchange, a fintech firm, is working with JPMorgan to securitise air miles, so that they can be more easily traded. The trick for airlines in all this is to balance the costs and benefits of perks so that customers stay engaged, while carriers' margins are preserved.

Endless devaluations could rattle that equilibrium and upset securitisation arrangements. Sky-high valuations are not assured.

我的笔记