Frequent-flyer miles

Fly me to the moon

The earning and spending of frequent-flyer miles has become a big business—perhaps too big

FREQUENT-FLYER miles have come of age. Twenty-one years ago this week, American Airlines launched AAdvantage, the world's first mileage-based frequent-flyer programme. Today, some 100m people around the world belong to at least one such scheme. One in three American adults collects frequent-flyer miles. But how safe are they?

Airlines first introduced mileage schemes to build up customer loyalty. They also provided a vast marketing database, allowing airlines to track a passenger's travel history and to focus advertising. Today, however, almost 50% of miles are earned without even leaving the ground. The biggest earners are credit-card spending and telephone calls, but car rental, hotels, share-trading or refinancing a mortgage all offer extra opportunities to top up your miles. In America you can even get miles on your income-tax payments, if you pay by credit card. The world's top frequent flyer, reputedly a publishing executive who charges his firm's postage bill to his own credit card, has racked up 25m miles—enough to fly London to Sydney return 250 times.

Free tickets purchased with frequent-flyer miles account for an average of 8% of airlines' revenue passenger miles. But the proportion varies by airline. Last year, free tickets accounted for an estimated 10% of the miles flown by American Airlines' passengers, up from 8.4% in 1996. British Airways will not reveal how many free seats it gives away, but it is thought to be stingier.

On most airlines, one mile is earned for every mile flown. But what is a mile worth? Airlines sell miles to partner companies, such as credit-card firms, at an average of just under two cents a mile. Since last year some American airlines have been selling miles directly to passengers, at three cents per mile, to allow them to top up their accounts. But if you make the best use of your miles, such as flying first class across the Atlantic, the market value can be up to nine cents a mile.

The miles that employees earn flying on business are a big fringe benefit that the state would love to tax. But valuing such perks and enforcing the tax is currently too difficult. In February America's Internal Revenue Service announced that, for now, frequent-flyer miles would not be taxed.

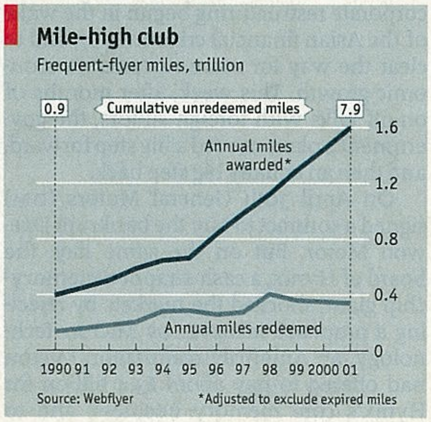
Frequent-flyer junkies treat miles almost like a second currency, but they are not freely tradable. The fine print of all programmes says that you cannot sell, buy or barter miles. However, as with any controlled currency, there is a thriving black market. Brokers, such as Award Traveller, will buy your miles at a discount (by paying you to redeem them for a ticket in the name of one of their customers). Airlines try to crack down on such sales. If you are found out they can confiscate the ticket and close your account.

Once it was all a gimmick

Frequent-flyer miles started as a marketing gimmick, but the sale of miles has become a nice earner for airlines. In 2001, they sold roughly $10 billion-worth of miles to partners, such as credit-card firms. This boosts airline's revenues; and the marginal cost of giving away free seats that would otherwise be empty is minimal.

But what about the future financial liability arising from unredeemed miles? Airlines include a contingent liability in their accounts, to cover the future cost of unredeemed miles. They value them at marginal cost—a lot less than the price they sell them for. From a strict financial point of view, there is little risk to the airlines. The liability of unredeemed miles cannot cause an airline to go bust, because it can limit the number of free seats available. However, there is a looming problem for frequent flyers themselves.

It is becoming easier to earn miles, yet the number of seats is limited. Randy Petersen, editor of InsideFlyer, a magazine for frequent flyers, has some alarming figures on his website (www.webflyer.com). The total number of miles awarded each year by airlines worldwide has doubled over the past five years; but miles redeemed have increased by only one-third



30m miles well spent

(see chart). In 2001, over four times as many miles were earned as were redeemed, and miles do not expire so long as members have earned or used them in the past three years. As a result, airlines' liability surged to almost 8 trillion miles by the end of 2001. At the current rate of redemption, it would take 23 years to clear this liability even if no new ones were issued.

Already, too many miles are chasing too few available seats. After September 11th there were lots of empty seats, making it easy to get a free flight. But as travel returns to normal, many travellers complain that it is once again difficult to get free seats or upgrades on the flights they want. Miles can also be used to buy holidays, car rental and goods such as books and CDs, but these purchases currently account for only 3% of redemptions.

Airlines could respond by increasing the number of miles required for a free flight, as they did in the mid-1990s. Some of them have already become more flexible. American allows members to pay extra miles to claim a free seat without the usual restrictions on seat availability and date of travel, if there are empty seats on a plane. But increasing the miles needed for a ticket or making free tickets harder to get both have the effect of devaluing frequent-flyer miles.

The fine print of frequent-flyer programmes makes chilling reading. The rules for AAdvantage warn that "the accumulation of mileage credits does not entitle members to any vested rights...In accumulating mileage, members may not rely on the continued availability of any award." The clear lesson is: use your miles while you can. US Airways has launched a deal where, for a mere 10m miles, you can buy a seat on the first private spacecraft to take passengers into space, scheduled for 2004. Why wait? ■