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Airlines still in a spin over loyalty

Air Canada's decision to bring its loyalty programme back in-house raises the question of whether this marks an end to the spin-off-and-sell model for FFPs before it really took hold, or whether there is still mileage in the concept

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Debate on whether more airlines will look to monetise loyalty programmes by spinning them out for divestment has been running ever since Air Canada set the pace in 2005.

While some airlines have followed suit in selling stakes in their programmes, it has been a trickle rather than a flood.

So it was significant when Air Canada last May announced a plan to create a new in-house customer programme in 2020 to replace third-party-operated Aeroplan, when its contract with the plan's operator, Aimia, expires.

Air Canada said the move would align it with other North American airlines, and make it "better able to strengthen its customer relationships and deliver a more consistent end-to-end customer experience".

The rethink by Air Canada was followed in August by the insolvency filing at Air Berlin's TopBonus scheme. That programme had also been sold by the airline, in this case a 70% take to its key strategic airline shareholder Etihad. Administrators are working on securing fresh investment for the scheme, while mileage collection and redemption has since resumed on flights operated by Etihad, and more recently BMI Regional and Germania.

> There is too much value trapped within airline loyalty programmes

While the circumstances differed, the challenges at both renewed questions about the success or otherwise of airlines spinning off their FFPs.

Joseph DeNardi, managing director at Stifel, who has for the past year been pressing the case for there being an under-valuation of airline loyalty programmes, still believes more carriers are likely to look at the option.

"We expect to see an increase in the number of airlines considering a spin-off of their loyalty programmes over the next year or two, though at this point, it seems the interest is focused outside of the USA," he wrote in a December research note.

"The bottom line is there is far too much value trapped within airline loyalty programmes, far too much demand for private equity to invest in airline loyalty programmes, and far too much cash within private equity for nothing to happen within the next few years," he argues.

CLEARER PICTURE

DeNardi though, while believing airlines are not showing the value and detail in the reporting of their FFPs, stresses this does not mean Stifel advocates spinning out loyalty programmes.

"Rather, we would like airlines to begin reporting the loyalty programme as its own operating segment," he says. "We believe this will provide a clearer picture as to how valuable the loyalty programme is and result in management focusing on improving the profitability of the core airline rather than relying so much on the credit card partnership."

Much of the focus of the spin-off and divestment debate has been on the short-term financial gains against the loss of control for an airline over the longer term. That Air Canada should have chosen to take control back, almost a decade after its sold its last shares in Aeroplan, suggests the carrier sees more value in controlling its own programme.

But Evert de Boer, vice-president global business development at On Point Loyalty – and a former Aimia executive – suggests the Air Canada move does not signal the end for spinning off loyalty programmes.

He says lessons learnt are evident in subsequent spin-offs by airlines not selling a majority stake and seeking a beneficial partner through the process. "Virgin Australia and Avianca have found strategic partners rather than going for an IPO. Of course they want the capital, but they also want a strategic partner that can support change," he says.

When Avianca sold a 30% stake in its LifeMiles programme to investment firm Advent International in 2015, it cited the latter's knowledge of the loyalty and the vertical markets in which LifeMiles operates as a key factor.

De Boer also argues against suggestions the sales are driven by airlines needing to generate cash quickly. "If you look at the subsequent spin-offs, they [airlines] all mostly had other ways to access finance and chose it for a strategic reason," he says.

LOSING CONTROL

One long-standing sceptic of the spin-off model is Global Flight managing director Ravindra Bhagwanani, especially if the motivation is purely to raise cash. "The day you start to spin off your FFP because you are in need of cash, the destiny of the whole venture is already set in stone. The only remaining question is when things will go wrong, not if," he says.

"The investor needs to have a long-term vision and align to the overall objectives of the parent airline. Pursuing quick returns on investment – what a typical investor would ultimately be after – is a business model working in some industries; the loyalty industry is not one of them," Bhagwanani adds.

While only a few airlines have taken the plunge in divesting their loyalty programmes, others have separated management of the units. In many cases, such as Lufthansa establishing its Miles & More programme as a separate entity, it has been driven with an eye on developing the schemes rather selling them.

"The business of running an airline and the business of running a marketing company are fundamentally distinct and require very different skillsets," DeNardi observes. "To maximise the longer-term value of these businesses, they must be managed separately in our view." ■

FlightGlobal and Global Flight hosts the 10th annual Loyalty conference in Bangkok, Thailand, on 5-7 February 2018. Find out more about the event and book your place at: flightglobalevents.com/Loyalty2018