FÊNIX SMILES - THE SMILES LOYALTY COMPANY CASE

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ABSTRACT
This aim of this case is to report the evolutions of Smiles' business model since its origins as the loyalty program of the largest Brazilian airline of its day, VARIG, to the present time as an independent publicly traded company, switching to become a coalition program. Throughout the case, the reader will encounter several business management situations, especially from the viewpoint of strategic decisions and definitions related to the tripod of value creation, configuration and appropriation, inherent to studies of Business Models. It is hoped that this case will contribute to the enrichment of studies related to Strategy and, above all, Business Models, using a real situation that will allow readers to experience the reality of one of the main companies in its industry. Teaching notes are presented at the end, proposing applications to explore the case, theoretical background and questions for discussion. The present study was conducted in 2015 with the consent of the company's head of marketing for academic purposes and updated using secondary data in 2017.
Keywords: Marketing; Business model; Coalition program; Loyalty/Fidelity program; Competitive strategy.

THE CASE

Contextualization

The aim of this case is to present the evolution of the Smiles business model since its creation as a loyalty program of the largest Brazilian airline of its day, VARIG, as an independent publicly traded company, which switched to become a coalition program. Throughout the case, the reader will encounter several business management situations, especially from the viewpoint of strategic decisions and definitions related to the tripod of configuration, construction and value appropriation inherent to studies of Business Models, and concepts stemming from diverse fields of knowledge in Business Management. This will enable students to conduct a critical analysis of this content to identify the application of theory in business practice. Thus, the case is presented, and some forms of its use are proposed, followed by questions for suggested discussions. It is hoped that its use will help to enrich studies associated with the fields of Strategy and, especially, Business Models through a real situation that will provide readers with an experience of the reality of one of the main Brazilian companies in its sector, configured as a very important factor for the qualification of professionals in the field of Business Management. The present study was conducted with the consent of the Board of Directors, who authorized its publication in academic circles.

Icarus Creates Phoenix

The history of Smiles dates back to 1994, when the now defunct VARIG (Viação Aérea Rio Grandense) created its loyalty program. The company was a pioneer in passenger air transportation in Brazil, having been operational for eighty years, from 1927 to 2007.

When the Smiles program was launched, VARIG was considered the largest airline in Brazil, a benchmark in terms of service quality all over the globe, either on its own flights or in its partnerships with other companies.

In this context, the company, whose planes bore the image of the mythological Greek figure Icarus on their fuselage since its foundation, created its loyalty program to keep up with the main airlines around the world and form closer ties with its main customers and encourage them to build a lasting relationship with the company. This would discourage them from flying with competitors who, at the time, mainly included VASP, TRANSBRASIL and TAM.

The embryo of Smiles was a relationship program created by VARIG, the VClub. It was reshaped in 1994 and given the new name of Smiles, becoming the loyalty program (which became known in Brazil as a fidelity program) of the airlines that made up the VARIG Group. In addition to VARIG itself, the group included the regional airlines Nordeste and Rio-Sul, as well as the Uruguayan airline Pluna.

Throughout the time that Smiles was under the management of VARIG, it was restricted to being a loyalty program through which members could accumulate and redeem miles (points) from the airlines in the VARIG Group and its partners in the first major strategic alliance of airlines on the planet, Star Alliance, of which VARIG was a founder. They could also accumulate miles by acquiring products and services from some of the program's partner companies, which operated in various Brazilian retail sectors. Therefore, it was exclusively known as a mileage program, and given the English name Smiles, which would lead passengers to think of miles and smiles. Thus, from a marketing viewpoint, this was an excellent idea for a name.

In the same year that the Smiles program was launched, Brazil implemented a new economic plan, the Real Plan, which sought to control inflation and stabilize the currency. In its first phase, from June 1994 to January 1999, an unreal parity was established between the Brazilian and American currencies. This partially helped the airlines because most of their expenses have to be paid in foreign currency. However, when this situation came to an end in January 1999, the controls on exchange rates were relaxed, leading the market to practice real prices. This resulted in the illusion of parity being left behind, and costs for Brazilian companies rose substantially without them being able to increase prices, as Brazilian people's wages and salaries were not linked to foreign currency. This new reality meant that the three largest Brazilian airlines, who had been weakened since the Cruzado Plan in 1986, when prices were frozen, once again faced serious financial difficulties. These difficulties worsened throughout 1999 and early in the following year, in the runup to the first low-cost airline in Brazil, GOL Linhas Aéreas Inteligentes, becoming operational. This would lead to a substantial transformation of the Brazilian airline sector.

In the early years of the twenty-first century, Brazilian airlines suffered greatly. They faced major financial crises, which culminated, on 17 June 2005, in a request for judicial recovery from VARIG. This judicial recovery process was the first major process of its kind under the auspices of the "New Bankruptcy Laws". These laws had been enacted only eight days before the request for judicial recovery was made. The result of the process was the sale of a number of the Group's assets, including the subsidiaries VEM (Varig Engineering and Maintenance), which was acquired by the Portuguese airline TAP, and VARIGLOG, the logistical wing for air freight operations. It was purchased by Volo Brasil, a company formed by the American investment fund, Matlin Petterson, and three Brazilian businessmen. Later, VARIG was divided into two parts. One was called FLEX, the old VARIG, which continued the judicial recovery process. The other part, the new VARIG, was given the name VRG Linhas Aéreas. It was constituted by its structural and financial area and was acquired in an auction by its former subsidiary VARIGLOG, which, in 2007, sold it to GOL. The Smiles frequent flier program was part of its structural area.

At first, Smiles was considered a huge liability for VRG, as its accounts showed that a considerable volume of miles remained to be redeemed by passengers on VARIG flights, which would now be operated by VRG under the brand names of VARIG and GOL. On 21 December of that year, the largest airline consortium, Star Alliance, announced that FLEX, the old VARIG, would cease to be a member within ten days as it did not meet the requirements necessary to remain a member.

In this desolating scenario, Smiles strengthened its perception in the eyes of the managers of GOL as a serious problem to be solved owing to the huge volume of miles to be converted into plane tickets and the dissatisfaction of their thousands of customers who would not be able to have tickets issued to over a thousand destinations around the globe, as they would be restricted to just over fifty destinations through the new controlling company, GOL.

At this time, the company began to develop a department within GOL that would be responsible for alliances with partner companies in several countries. This would be the salvation of Smiles and turn the liability into one of the group's biggest assets.

While GOL was forming partnerships with renowned airlines worldwide, Smiles was looking to win back consumers. Some points in this trajectory should be considered.

Phase 1: Value Creation

Smiles timidly became part of GOL as a small department that took its first steps along with the alliance department. It was very different from what GOL had planned, as low-cost airlines do not have mileage programs, and now it was obliged to honor the miles that it had inherited and continue the program. How could this huge liability be transformed into something profitable for the company? That was the major challenge.

To meet this challenge, GOL went through three distinct phases. The first lasted approximately five years, from 2007 to 2012. The second was quicker, from 2013 to 2015. The third began in 2015 and has lasted until today.

In its first phase, when it was implemented at GOL, Smiles was a basic loyalty program, in which the credit and use of miles was simple, framed in tables related to distances between the takeoff and landing of flights. There were no variations in the amounts charged to issue tickets or the prices of tickets issued. Passengers were segmented according to their rate of interaction with the program, flying with partner airlines at four levels, ranging from Blue Smiles to the highest, Diamond Smiles. In between were the Silver Smiles and Gold Smiles levels. With the legal separation of the company, all partnerships, airlines and others, were discontinued, and a new phase began.

The first alternative found was to use the program to increase its share of business travelers. These passengers are usually the ones who use the airline most with the highest average number of tickets. This was one of the reasons for acquiring VRG, the change in the level of the company in search of more corporate and international passengers, in addition to greater and more frequent access to the country's main airports, especially shuttle flights between Rio de Janeiro and São Paulo. However, for this to occur, the airline had to make itself attractive to this public, and one of the key points was the possibility of issuing tickets with frequent flyer miles to destinations overseas. As GOL's flights were restricted to neighboring countries, in the first year the company formed a strategic partnership with the largest airline in the world, the American Delta Air Lines. From December of that same year, Smiles customers could accumulate and redeem miles on flights through this important partnership. Thus, GOL and Smiles enjoyed greater flexibility due to the agreements over shared flight numbers.

From then on, the managers of Smiles had a firm opinion regarding ecosystems, in accordance with Frow et al (2014), who explain that the co-creation of value suggests that the market is a place with room for dialogue between consumers, companies, communities of consumers and networks of companies. To these authors, in the context of the market, the term ecosystem is commonly used to describe interdependence between actors, their adaptations and evolutions. If the changes are very serious and actors cannot adapt according to the new conditions, then the ecosystem will collapse. They also claim that, within an ecosystem, as in the case of Smiles, there are undoubtedly three levels, micro, meso and macro, and value propositions operate within each level, between levels and to shape levels.

The core aspects of the first phase focused on taking advantage of Smiles' huge closely guarded customer base, reactivating these customers and creating special offers to arouse their interest in forming a relationship with GOL by using the Smiles program. It was also an opportunity to upgrade the brand by associating the brand with Smiles, which had been operating in the sector for thirteen years. Smiles had the VARIG brand in its

DNA, with 80 years of expertise in the industry behind it worldwide and its excellence in services.

To regain the place it had occupied in the past, in 2009, in partnership with Banco do Brasil and Bradesco, Smiles launched its co-branded credit card, a card sponsored by the issuer and Smiles. This had existed in the past in a partnership with Santander, but during the crisis that VARIG had undergone, the partnership was terminated. With this credit card, a new product emerged that would allow customers to accumulate miles with a conversion rate higher than is generally made available by cards from other financial institutions through purchases made with the card. It also provided Gold and Diamond customers with several exclusive benefits, such as access to the airline's lounge (exclusive waiting room) at the Galeão Airport in Rio de Janeiro and Guarulhos in São Paulo, as well as a certain limit of free excess baggage. These benefits are of interest to frequent fliers, who usually have high incomes. Although it seems commonplace in the industry, the head of marketing at Smiles, Bruna Milet, explained the importance of this card: "[...] through it, the miles you accumulate are transferred directly to Smiles, which is also an important loyalty tool because the customer ceases to have the option of moving to another program, so he gains more miles. It is a really important and really interesting card for customers who love to accumulate miles because they get a 'Platinum' card, which is equivalent to a 'Black' card from another bank, with much lower tariffs. The number of miles you get for every real you spend is much higher and ends up being a really interesting option. So, the co-branded credit card is an important tool in terms of customer loyalty".

In March of that year, another strategic partnership was formed, this time with a European airline that is a paragon of excellence in the sector, the Air France/KLM Group, which provided access to a number of destinations around the world, especially in Europe through shared flight number agreements.

In this phase, in June 2012, a new partner joined Smiles, Qatar Airways, considered by the specialist agencies as one of the best airlines in the world, with headquarters in Doha, the capital of Qatar, where its main hub is located. This opened up a new region for Smiles, especially in Asia, giving Smiles members greater access to three continents, America, Europe and Asia.

It is important to highlight that the activities developed by Smiles are, in practice, what the authors Amit and Zott (2001) had already shown a decade before. They explain that the emergence of virtual markets clearly provided access to new resources for value creation, ranging from relationship capabilities and new complementarities between company resources and capabilities that could be exploited. However, to Amit and Zott (2001), virtual markets also present a challenge to the Resource Based View. This is because resources based on information and capabilities have a high level of mobility compared with other kinds of resources and capabilities, and this increases their importance to electronic companies. Furthermore, the migration of value normally increases and the sustainability of new values that are created may be reduced. The authors also recall that strategic networks are stable interorganizational ties that are strategically important to the companies in these networks. These ties should take the form of strategic alliances, joint-ventures, long-term purchase and supply partnerships and others. They conclude by showing that the network perspective is clearly important when it comes to understanding the richness of the creation of electronic businesses because of the importance of networks of companies, suppliers, consumers and other partners in the virtual market, although this does not totally capture the potential for value creation in electronic businesses that allow new and unique forms of transactions.

From the viewpoint of creating and developing new products, Smiles innovated by launching in the market two alternatives that allowed the diverse categories of customers to make better use of their miles. These alternatives were allowing members to purchase miles to obtain the balance necessary to buy tickets and to issue tickets by combining miles and money, an initiative known as "Smiles & Money". These two innovative products were fundamental for a better understanding of their customers and to decide on the future of the company and its potential growth. The approach of the Smiles program at this stage of value creation came very close to the entrepreneurial ecosystem described by Autio et al (2017), where there is a focus on discovering opportunities and innovation in business models.

In that same year, the company began feasibility studies to transform Smiles into an independent company. This occurred in the month of July and required its managers' creativity to leverage the business. In the second half of the year, the promotions intensified in order to form a closer relationship with customers.

Thus, despite being the longest phase, this new stage, which lasted five years, was one of few, albeit important, changes compared with the other phases that consolidated this business unit for the future, as it would begin the next year as a company legally independent of GOL.

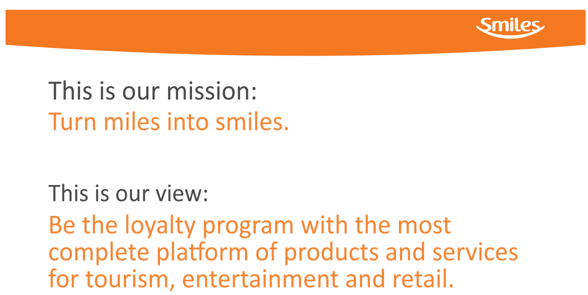
The path followed by Smiles was in keeping with what Lepak, Smithand Taylor (2007) defined as value creation. To these authors, individuals create value through the development of innovation and appropriation of activities, services, works, products, processes or other contributions perceived as being of value to target consumers relative to their needs and when the monetary sum gained through this service is greater than what it would be using an alternative resource, producing the same activities, goods, services and products that generate greater utilities or low unit costs for users compared with the available alternatives. They also argue that individuals generate value by creatively doing more innovative work or providing more innovative services that are more appropriate in the eyes of employees or other end users in a particular context. The authors conclude by saying that, at the organizational level, value creation includes any activities that generate a level of innovation and appropriate benefits that target users or consumers normally seek and are willing to pay for.

Fase 2: Value Configuration

In early 2013, the Smiles company, now legally independent, requested from the CVM (Securities Commission) permission for an initial public offering of shares. This took place in April of that year, having captured R$1.132 million, and was considered the last successful IPO before the crisis that swept Brazil in 2015.

In that same year, Smiles consolidated its business model on a platform of complete solutions in tourism, entertainment and retail for its stakeholders, constituting its mission and business view with the spin-off, which is when a company is born from a research group of another company. This is illustrated in Figure 1.

Figure 1 Smiles mission and view



Source: Provided by Smiles S/A.

At the time, the company was experiencing what Demil and Lecocq (2010) reported regarding changes in business models when they explained that, in theory, changes to the business model of a company can lead to better or worse performance in terms of profit margins, which could serve as signs of the sustainability of the business. In general, a company will become involved in a change when its performance is not what it expected or is in decline. Nevertheless, business models with weak performances may be only transitory and independent of the sustainability of the forecast business model. In other words, start-ups or new business units often have to lose resources before they begin to make a profit.

The experience gained from the new products of "direct sale of miles" and "reactivation of miles" confirmed to the managers that it was important to encourage customers to adhere to the program. This led to the addition of one more product to this family, the "transfer of miles" between Smiles accounts, an old wish of customers who desired to unify points from two or more accounts into one ticket purchase. This family of products jointly allowed members to make a number of combinations that significantly enabled the possibility of purchasing plane tickets. They also increased the active customer base and strengthened the relationship between company and customer.

In this respect, a trend in several retail sectors was adopted at Smiles, the Smiles Club. This was the first mileage relationship program in Brazil, an innovation that the two main competitors took over a year to replicate. It is interesting to note that the embryo of Smiles had also been called a club, the VClub, and now the company launched a new club. Through the Smiles Club, members have three options and access to several benefits and anticipated promotions when they pay a monthly fee, which reverts to their count as a bonus in the form of miles. The Smiles Club is of paramount importance to the company, as Bruna Milet explained. "[...] the Club was the greatest innovation of Smiles because it is a continuous form of revenues. So, it has power that goes beyond the money that it brings in. It attracts revenues from credit card operations because if you are paying to have miles, say, 1000 miles or 3000 miles in a loyalty program, you are not going to move to the competition. You are already paying here and will also have a bonus to transfer. So, more important than the revenue and turnover directly associated with the product is the loyalty it generates. This has already been studied, that the Club customer is the most engaged customer. The Diamond customer, for instance, is one who sticks close to the Club. He is the customer that is committed to the club and is especially faithful to the loyalty program".

Therefore, the proximity between company and customers of the Smiles Club was essential for the company's future actions when they celebrated the twentieth anniversary using the slogan "365 Reasons to Smile".

It should be highlighted that what the company was experiencing was perfectly in keeping with the arguments of Demil and Lecocq (2010) regarding strategy in business models when they claimed that, as strategy, a business model is committed to responding to internal and external factors. External factors are restrictions imposed by changes in the environment or jolts that can lead to abrupt changes in the organization's operations. To these authors, a company can predict some changes in the environment, such as the arrival of an aggressive competitor, higher costs of some resources or the emergence of substitutes that prompt changes in the business model. Internal factors include results that stem from the decision making of senior or middle management, but also from dynamics through or between the core components. The authors also recall that the permanent increase in the firm's knowledge (learning) regarding the efficient use of its resources or the discovery of new uses (or a combination) will enable the development of a new value proposition that may not be related to environmental changes.

All these innovations needed to be well publicized in the market, and beginning in 2013, Smiles returned to the national media, declaring its new stance in an easily understandable way. It was no longer limited to being GOL's loyalty program. It was now a coalition program with a diversity of partners and a new logic for accumulating miles. For this reason, its form of communication was unprecedented. While its main competitor used educational language in its announcements, explaining exchanges and encouraging the use of points, Smiles resorted to emotional language, informing the public of the benefits of exchanges and encouraging smiles. Therefore, the company acted in perfect keeping with its new mission, whose campaign slogan was "When you use Smiles, you come back smiling" ("Quem vai de Smiles volta sorrindo)".

Regarding the coalition program, Bruna Milet explains why it is different: "[...] this model is considered a coalition model. For instance, in models that are not coalition models, if you build up a few points at the pharmacy, you can only exchange them for a toothbrush. With an airline, you are only going to get a few points and not be able to exchange them for anything. In a coalition model, the advantage is that you can gather everything in just one place and exchange them for what everyone wants in a loyalty program, which is exchanging points for plane tickets".

Finally, also with regard to 2013, it is necessary to highlight the strategic investment agreement made by Smiles at NetPoints. This guaranteed the possibility of controlling the company's shares, with the acquisition of up to 50% of the shares plus one, making NetPoints the retail wing for exchanging miles for Smiles' utility goods.

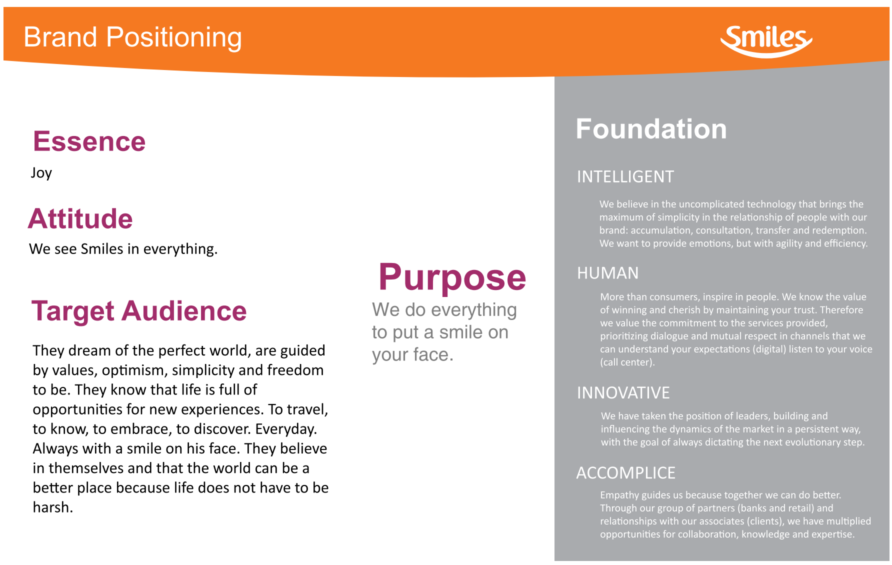
At the end of the year, the operations of Smiles were configured as a virtual company. The company arrived at this point ready to take its future steps, especially in terms of the organizational structure of the company in keeping with the ideas of Venkatraman and Henderson (1998) regarding virtual organizations. According to these authors, a virtual organization does not have a distinct structure (such as functional, divisional or matrix), as they address virtual organizing as a strategic characteristic applicable to all organizations, reflecting three distinct and interdependent vectors: (1) customer interaction (virtual encounter), which addresses the new challenges and opportunities for company-to-customer interactions; (2) the asset configuration vector (virtual sourcing), which focuses on firms' requirements to be virtually integrated in a business network, in sharp contrast with the vertically integrated model of the industrial economy; and (3) the knowledge leverage vector (virtual expertise), which is concerned with the opportunities for leveraging diverse sources of expertise within and across organizational boundaries. They also explain that each vector of their model has three distinct stages: (1) the first stage focuses on the task units (such as customer service, purchasing or new product development); (2) the second stage focuses at the organizational level on how to coordinate activities to create superior economic value; and (3) the third stage focuses on the interorganizational network to design and leverage multiple interdependent communities for innovation and growth. The authors also highlight that, with regard to the asset configuration vector, the third stage focuses on the establishment of a resource network, in which the firm is part of a vibrant and dynamic network of complementary capabilities. The authors also emphasize that a corporation does not become a conventional portfolio of products or businesses, but a portfolio of capabilities and relationships, and the entire organization is placed implicitly or explicitly in a resource network where it has competencies. This is because corporations increasingly rely on external sources, not only for support activities but also for critical resources. Therefore, positioning a firm within a broader resource network in the marketplace is a driver of competitive advantage. Finally, they conclude by saying that the strategic leadership challenge is to orchestrate an organization's position in a dynamic, fast-changing resource network. In the virtual integration model, one firm does not dominate all the others in a network. Every firm balances its leadership position relative to one set of resources, with secondary roles related to other complementary resources. According to Venkatraman and Henderson (1998), every organization is dependent on relationships to gather complementary resources. Such coalitions highlight another important characteristic of virtual organizing, the blurred distinction between competition and cooperation, as every company is positioned within a resource network and simultaneously plays competitive and cooperative roles.

The year of 2014 arrived, bringing new challenges, including the need for a new brand strategy. In that year, Smiles embarked on several offensives to consolidate its business model on a number of fronts. This attitude is in keeping with the debate of Brito and Brito (2014) with regard to sustaining a competitive advantage over longer periods. To these authors, in a competitive environment, most firms do not succeed in maintaining a competitive advantage for a long time, meaning that it is necessary to conduct a continuous search for new competitive advantages.

On one front, the company expanded its strategic partnerships with major airlines, beginning in February with Aerolineas Argentinas, followed in November by the Portuguese airline TAP, and ending the year with the Italian airline Alitália. This meant a considerable increase in the number of destinations in South America and Europe.

On another front, the company increased its family of products, encouraged by the success of the Smiles Club, launching "Ticket Reservations" with the payment of a fee or for free (up to five reservations with up to nine passengers at the same locator) for members of the Smiles Club. This product contributed greatly to customers' decisions to transfer their miles from their credit card or other partner to Smiles, as it clarified doubts regarding the possibility of transferring miles and conditions for issuing tickets, as a transfer between Smiles partners lasts, on average, for three days. It was also approved by the CADE (Economic Defense Administrative Council) in the agreement over investments in NetPoints, which addressed an essential factor for strengthening this partnership on the platform, thus enabling the reshaping of Smiles Shopping.

Figure 2 Characteristics of the new positioning of the Smiles brand

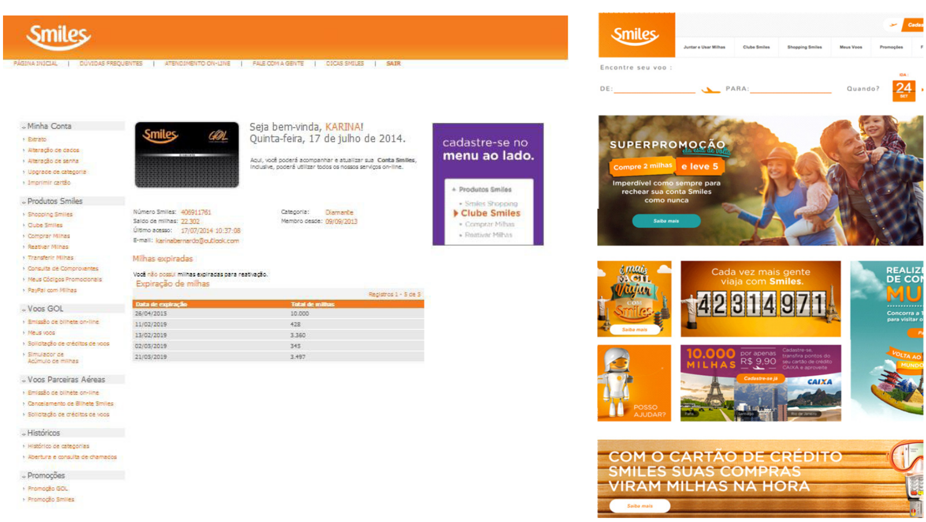


Source: Provided by Smiles S/A.

In the planning for the repositioning of the brand and growing closer to its customers, Smiles radically changed the diagramming and architecture of its website, and made an exclusive version available for mobile applications, which facilitated customer access and helped to attract new users as a result of the very friendly environment. The changes to the website are illustrated in Figure 3. Some elements proposed by Kuester, Konya-Baumbach and Schuhmacher (2018) can be seen from the CARE structure: customers orientation, authenticity, representation, and(customers) education.

However, the apex of this year would be celebrating twenty years of Smiles, in other words a twenty-year-old company with a customer base of ten million that began to take its first steps once again with this new and promising business model. To commemorate this occasion, the communication platform "365 Reasons to Smile" was created. Its emergence was described by the head of marketing, Bruna Milet: "[...] the idea emerged in the discourse of the president, Leonel, at a meeting we held at the agency, when he said he wanted Smiles to be part of people's everyday lives. So, we began to do some research and noted that Smiles was offering promotions constantly, almost every day. So, we already had this culture, only it was not officially recognized as such. So that is how it went. We counted and we saw that we had a promotion practically every day and so we started saying that we would have one per day, and we sought a retail vision with the idea that every day we would have something to offer our customers. We created a culture that there are many things going on at Smiles. The campaign helped to stress that idea in customers' minds, helping them to remember, making them consider us as an option. We did not expect customers to learn all our daily promotions by heart, but we hoped that they would always consider us as an option".

Figure 3 Images from the old and current Smiles website



Source: Provided by Smiles S/A.

Figure 4 Examples of publicity from "365 Reasons to Smile"

Source: Provided by Smiles S/A

With this briefing, the video campaign was launched, with a commitment from the president of Smiles, on both cable and network channels and daily videos on YouTube, confirming the commitment that every day of the year Smiles would give customers a reason to smile. The slogan was "Smiles, every day a reason to smile", with 365 reasons over the 365 days of the year. Every day, announcements were made on the radio, advertisements with a typical impact on digital media, e-mails sent to mailing lists and daily posts and tweets on social media.

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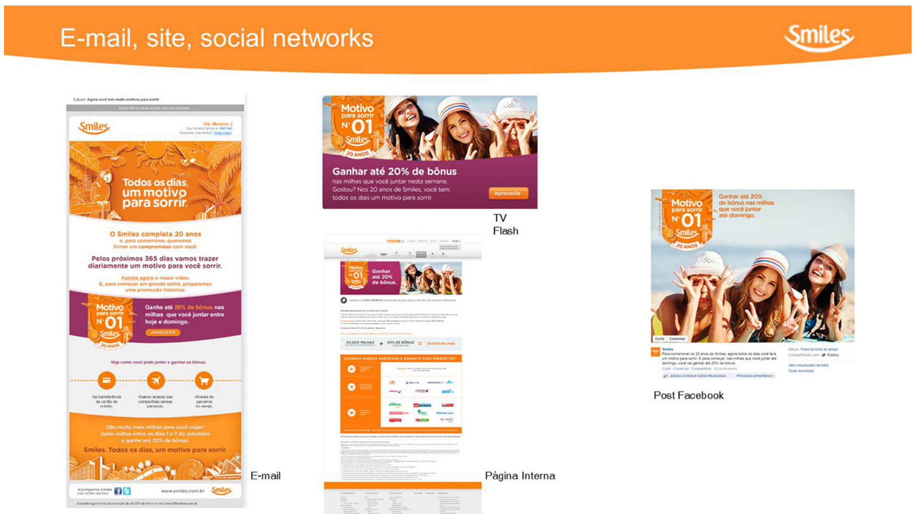
Figure 5 Examples of media on the "365 Reasons to Smile" communication platform



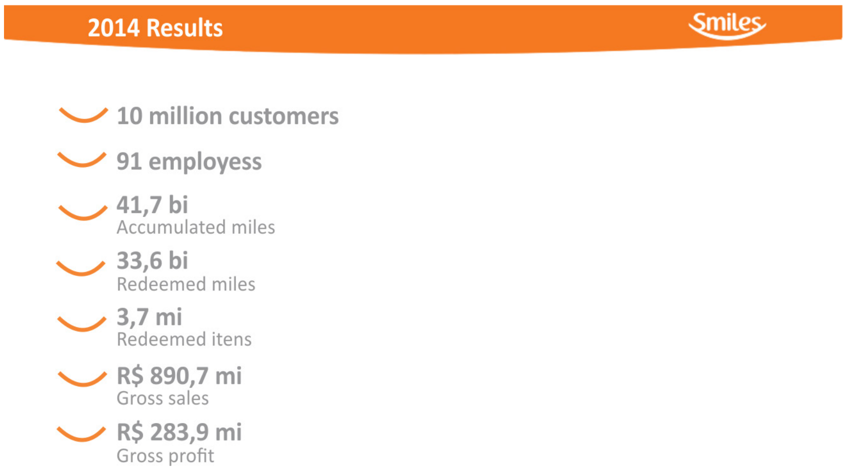
Source: Provided by Smiles S/A.

This project involved every area of the company in a daily effort of planning and actions, which had hitherto not been done, as highlighted by Bruna Milet. However, its results would surpass all expectations: "[...] when the campaign began, we already started with two months of previously defined promotions and that was something we had not had before. Because of the campaign, we made greater plans. It helped the company to organize, integrate its areas and learn from the results of the promotion".

Despite being a lean company, where all employees knew each other and were close, interaction between the members of the team changed with the onset of "365 Reasons to Smile", thereby allowing the company structure, due to the inherent features of the business, to assimilate organically.

The year of 2014 ended on a positive note, with significant figures for Smiles, as shown in Figure 6.

Figure 6 Smiles performance indicators for 2014



Source: Provided by Relationships with Investors of Smiles S/A.

In 2015, the search for international partners continued, adding two more important airlines during the year. In April, Copa Airlines, with a strong presence on the American continent through its Central American hub, became a Smiles partner. In August, Korean Air, an important Asian airline, was added to the list. Smiles now had over 700 destinations to put a smile on the faces of its thousands of customers.

Another focus during this period was the strengthening of the platform with partners outside of the airline business. A partnership was formed with another giant in its sector, Accor Hotels, one of the largest hotel chains in the world, which allowed miles to be accumulated and used at its hotels. Furthermore, another partnership was formed in the tourism industry when an agreement was made with the largest cruise line in the world, Royal Caribbean. Miles could be accumulated or redeemed through the purchase of cruises.

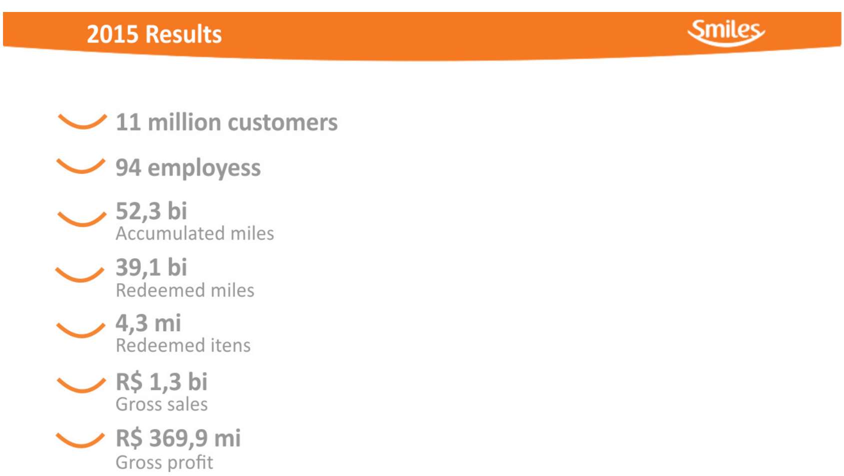
The Smiles product family was also expanded, now allowing the payment of airport taxes and hotels with miles.

The greatest proximity to customers, leveraged in the last months, was strengthened with the implementation of the so-called Humanized

IVR, an electronic telephone service that is a little more informal and precise, as explained by Bruna Milet. Smiles was the first Brazilian company to implement the system: "[...] the informal and humanized service system is very interesting, because in addition to being friendly, it can solve problems without the cost of an attendant talking to customers, which is much more expensive than a recording. We conducted some research and discovered that most customers called us to find out whether the flight they had booked was confirmed, and we invested in this, and a really informal recording was made to answer these customers' questions. Now, customers are satisfied, and for Smiles the cost was really low, so the service is excellent for both parties. In my opinion, this technology really works".

Another year came to an end. Despite the economic crisis that affected the airline sector and the entire economy, the results were positive for Smiles, as shown in Figure 7.These results are in keeping with Bamiatzi et al (2015), who claim that the firm effects are strengthened in the face of adversity, while the industry and country effects are weakened.

Figure 7 Smiles performance indicators in 2015



Source: Provided by Relationships with Investors of Smiles S/A.

Phase 3: Value Appropriation

If, on the one hand, the positive figures achieved since the spin-off were encouraging for the stakeholders, on the other hand, they were challenging because they carried in their wake an expectation of continuity in a company with a perspective of serving a customer base of twenty million. Following three intensive years, "365 Reasons to Smile" had come to an end, but it has been so eagerly accepted by the public that the company decided to extend it into the next year. Now, in 2016, it was time to continue growing, but also to gather the fruits, as the business was beginning to settle as planned. In other words, it was time to begin the third phase, which remains ongoing: the value appropriation phase.

The importance of this value appropriation phase is emphasized by Chesbrough and Rosenbloom (2002), who argue that value creation is necessary, but not sufficient, for a company to take advantage of its business model. This is because when the firm identifies the value chain necessary to deliver its offers, it should address how to take part of this value for itself and that a mechanism to capture part of this value is the use of complementary assets. This is because creating and appropriating value also involves interminable actions, both within the vertical value chain and from the value network.

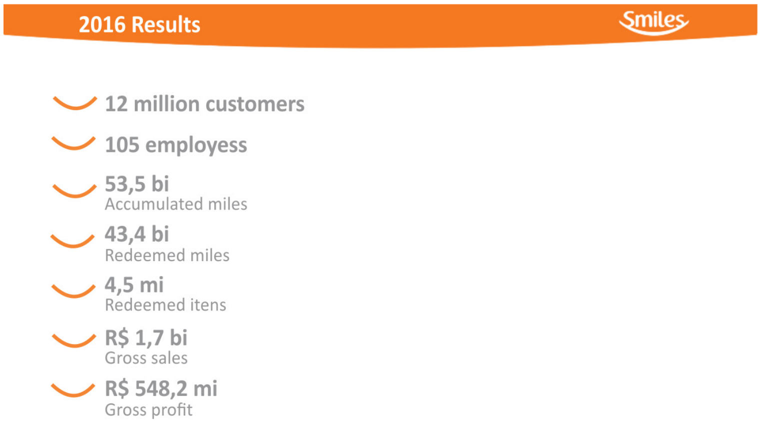
Regarding the partnerships, four large airlines made agreements with Smiles. In January, members began to enjoy the services of Air Canada, another North American giant, and in March Etihad Airways, considered one of the best airlines in the world. Two months later, in May, Aeroméxico, a traditional Mexican airline, joined the list, which was further bolstered in October by Emirates, another international airline of excellence. Now, thirteen of the world's main airlines, along with the anchor of the program, GOL, were part of Smiles, giving its members access to over 850 destinations around the globe. Partnerships with airlines are vital for Smiles, so much so that Bruna Milet, the head of marketing, stated that: "[...] to maintain this level of growth, it is necessary to adopt constant innovations in the accumulation of miles, because when a customer has a mile in his account, he is going to use it. Nobody will lose miles on purpose, and the company will work continuously to make sure customers actually use their miles. The main task is to seek new partner airlines. Back then, there were few international partnerships and today customers can fly to over 160 countries with the Smiles partner airlines. And every quarter we announce new partnerships".

Regarding products, 2016 saw one more alternative for suing miles, which was the expansion of "Smiles & Money", which could be used in all the partnerships on the platform.

Concerning the non-airline partners, two strategic steps were taken to strengthen the company vision, with the addition of Pão de Açúcar Group, one of the largest companies in the Brazilian retail sector, and Rocketmiles, which gave the company a more robust presence in the hotel sector.

The year of 2016 drew to a close with two further advances. The first was in keeping with Ojala, Evers and Rialp (2018), who addressed the digitalization and modularization of services, highlighting that people increasingly interact with firms through digital platforms. At the same time, these platforms allow organizations to expand their operations globally and in a scalable manner. This occurred at Smiles through the inclusion, in the layout of the website, of specific icons for hotel reservations, with Rocketmiles, and vehicle rental, with Localiza, beside the issuing of plane tickets. This action shows the importance of broadening these two fronts and seeking complete solutions in tourism, as well as launching the application for smartphones and tablets. The firm was the first in the sector of company loyalty to allow the issuing of plane tickets with the anchor company and all the other partners, as well as payment with Smiles & Money and joining the Smiles Club. The second advance was the announcement of a new policy for accumulating miles with GOL, which was to be implemented in January of 2017, promising to be a unique increase to the business of the now New Smiles (Nova Smiles), as it was announced to the customers. As in the previous years, the results for 2016 continued the growth the company had enjoyed, as shown in Figure 8.

Figure 8 Smiles performance indicators in 2016



Source: Provided by Relationships with Investors of Smiles S/A.

As the company approached the five-year mark as an independent, the managers' decision making, especially from 2014 to 2016, was essential for the process of value appropriation, with repercussions on diverse indicators, such as:

a) Financial indicators:

- Growth of 20% in the customer base, rising from 10 to 12 million;
- Growth of 90% in gross revenues, rising from R$890 million to R$1.7 billion;
- Growth of 93% in net profits, rising from R$283.9 million to R$548.2 million;
- Higher value of shares on the Brazilian stock exchange in 2014, with 9% appreciation only in the first week when the new website went online.

b) Brand strategy:

- Growth in "It would be my first choice";
- Growth in "It offers its customers an exclusive benefit";
- Gaining advantages in all the points that consist of Brand Equity on Brand Power;

- 14-place rise in the Brand 2015 ranking, occupying 21st place in brand value, ahead of all competitors in the sector;
- It was considered the best mileage program of 2015, according to the Brand Dynamics 2015 survey.

In early2017, the "Best and Greatest of 2016" ranking of Exame magazine conferred the following awards on Smiles:

- 1st company in terms of wealth per employee in Brazil;
- 1st in terms of highest growth in the service sector in Brazil;
- 2nd best company in the service sector in Brazil.

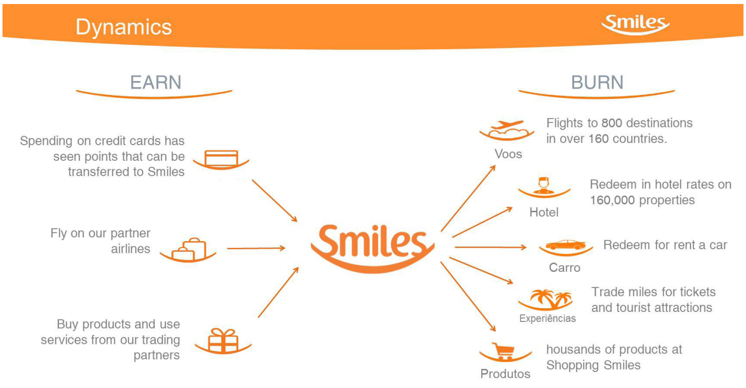
The Business Model

Through an analysis of the creation, configuration and value appropriation processes at Smiles, it is possible to understand the company's business model.

First, the dynamic consists of the entry and exit of miles, as shown in Figure9, and as highlighted by Bruna Milet: "[...] the loyalty program has its 'Earn' side, which is the accumulation of miles, and its 'Burn' side, which is using the miles. So, all you study in this segment, mainly in English, or even in Portuguese, involves this story of earning and burning. There is even a rate for Earn and Burn. When you see analysts from banks being interviewed, they are always talking about this, the ratio between miles coming in and miles going out. The important thing is always to keep it at a healthy level".

It is interesting to observe that, in accordance with Demil and Lecocq (2010), the term Business Model emerged in the management literature in the late nineteen nineties, especially with the internet and its massive adoption by electronic commerce, in other words, at the same time that Smiles emerged. The authors also claim that, based on Penrose's view of the firm, they believe that the business model can be described based on three core components: resources and competences, organizational structure and propositions for value delivery. This is perfectly in keeping with the trajectory of Smiles.

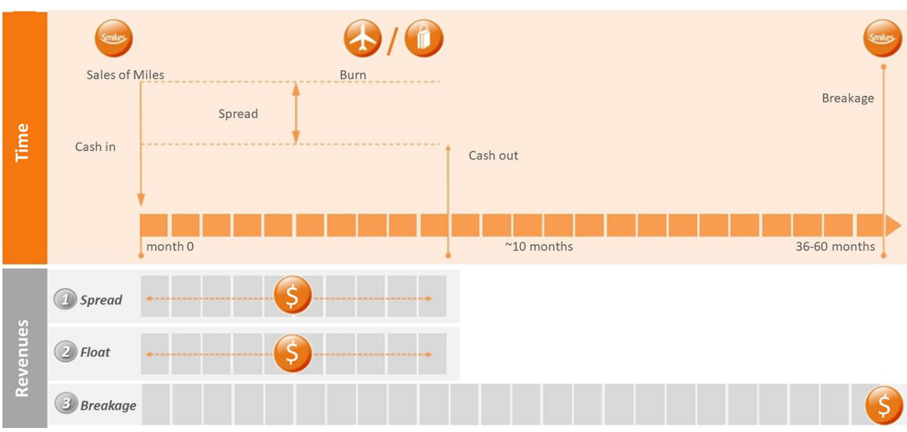
Figure 9 Dynamic used in the Smiles business model



Source: Provided by Smiles S/A.

The Smiles business model has three important sources of revenue: (1) Spread, (2) Float and (3) Breakage, with each having a different average period between input and output to remain in the company coffers, as shown in Figure10.

Figure 10 How Smiles earns money



Source: Provided by Relationships with Investors of Smiles S/A.

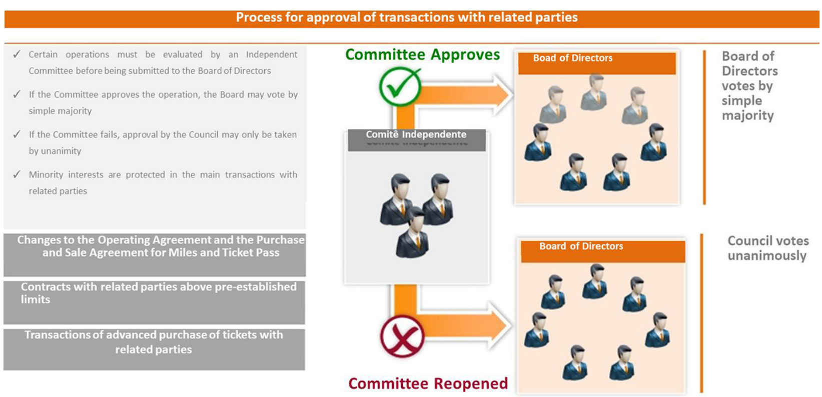
The first source of revenue, the spread, consists of profit from the difference between the cost of acquiring miles, resulting from the cost price of the goods or services acquired by the company from its partners and the selling prices of miles to companies on the platform and members of the program. In this source of revenue, the average period between the input and outflow of miles at the company is ten months.

The second source of revenue, the float, consists of profit from financial operations based on miles deposited at the company. In this source of revenue, the average time between the input and outflow of miles is also ten months, as it stems from the same origin as the first source. In this sense, Bruna Milet provides an important item of information by explaining that: "[...] in any loyalty program, be it Smiles or its competitors, 80% to 90% of the revenues from miles are through credit card transactions. It is interesting that people think that miles come from the airline, when the opposite is actually true. The airline brings many customers into the program, but the bank is the one that transfers most miles through the credit card. Therefore, the banks are fundamental partners in a loyalty company".

The third source of income, breakage, consists of the expiration of members' miles. As there are various segments in the program, the time between the input and outflow of miles can vary from 36 to 60 months. In this specific case, Smiles has an important position in keeping with its mission, as explained by Bruna Milet: "[...] it is an interesting source of revenue, but one that Smiles does not like, because it involves a kind of disengaged customer. Because if the customer is letting his miles expire, he is unlikely to stay with you. He tends to be dissatisfied because if the customer wants to travel and his miles expire, it is a sign that he was not able to use them or forgot, and this is not good for the program".

An interesting aspect that deserves to be highlighted is the relationship of governance between Smiles and Gol, a positive point that has been emphasized by investors. Although the companies have the same controller, they operate independently and are simultaneously suppliers and customers of both. On the one hand, Smiles is a manager of Gol's loyalty program. It acquires miles from Smiles for credits originating from flights made by Gol's customers. On the other hand, Gol is a supplier of Smiles, which purchases seats from the airline to issue tickets through its platform. Miguel et al (2014) studied value creation between firms and observed that value creation is only significant when there is relational governance and complementarity of resources. To establish this governance, there is a rigid contract between Smiles and Gol that requires an independent committee to approve certain operations before they are submitted to the company's Board of Directors. If this independent committee approves of the operation, the Board of Directors can put it to a simple majority vote. However, if the independent committee does not approve of the operation, the Board of Directors can only approve it unanimously. Thus, the minority investors are protected in the main operations with the related parties, as shown in Figure11.

Figure 11 Actions of the independent committees and Board of Directors



Source: Provided by Relationships with Investors of Smiles S/A.

The relationship between the sister companies, GOL and Smiles, was highlighted by the head of marketing, Bruna Milet: "[...] there is a clear contract that regulates this and it states clearly how the price that Smiles will charge for miles from GOL is calculated, and this is readjusted under previously established contractual conditions, also determining how many seats GOL has to make available to Smiles and the average cost of these seats. Based on what occurred the previous year, the calculation that will be used in the coming year is made. So, the rules are very clear and defined for ten years so that there are no doubts about it. This contract is also part of the IPO process, the documentation to present to the investors and the part that refers to governance has been highly praised. For instance, no transactions between the two parties can be made that has not been approved in the approval of the representative of the minority shareholders. This is a way for the minority shareholders and their representatives to be aware and also guarantee that no loans are made from one party to the other without due collateral and without considering market conditions with regard to interest, etc".

The decisions made by the company regarding its business model are in keeping with the explanations of Casadesus-Masanell and Ricart (2010) concerning what makes a business model. To these authors, business models are composed of two different types of elements: (a) the concrete choices made by the managers regarding how the organization should operate; and (b) the consequences of these choices. They go on to say that they distinguish three types of choice: policies, assets and governance structure. These authors also argue that a business model is a reflection of how strategy is implemented. They claim that strategy coincides with the business model, but an external observer can imagine company strategy by analyzing its business model. The substantial difference between strategy and business model can be seen when the company's plan of action requires changes to its business model (change in policies and/or assets and/or governance, when particular contingencies take place. When this is the case, strategy and business model no longer coincide, regardless of whether the business model modifications involved are substantial or only minor.

Another interesting issue to be highlighted is the similarity between this new business model implemented through the spin-off of the company, especially the IPO, with the banking sector. Despite being another product, for the reader to understand better, the mile operates in a way that is very similar to a monetary unit, whose exchange rate varies owing to supply and demand, as well as the actor involved in the transaction, which characterizes the Smiles business model.

To round off, it is worth highlighting how the head of marketing, Bruna Milet, summarized this business model: "[...] it is important to complement some things about the loyalty business, which is that it is a generator of cash flow, costs practically nothing as it requires very little labor, since the costs involved have more to do with technology, etc., so the cost is very low and generates cash flow. It receives all payments in advance because the bank buys miles from us and the customer only uses them months later, and this money stays with us. Therefore, it is part of the business model and shows how good it is. A business that has no debts, runs no risk of a default, this is wonderful. Operational costs are very low, especially because they are framed by technology and marketing".

Future Flights

Smiles maintains its efforts to create and communicate value to its customers as a way of generating satisfaction and profitability. According to Kumar and Reinartz (2016), value creation depends on two actions. First, companies need to create value that is perceived by customers. Customers then reciprocate by creating value for the company through engagement and loyalty. Efforts to create value will be shown in the following paragraphs.

Currently, the reduced offer of international flights because of the recession in the Brazilian economy since 2015 means that it is more difficult for Smiles customers to find the flights that they need through the international partnerships. This can lead to discontent for customers who concentrate their operations on the company in search of advantages from the new Smiles Club.

More recently, in June 2017, Smiles made a bold decision that stemmed from its larger product portfolio through the New Smiles Club, which expanded the number of plans to seven different bundles and, above all, extended the validity of miles for club members to ten years. On the one hand, this could be viewed as a competitive advantage for the company, as it attracts and retains customers, as none of its competitors has made a similar offer. On the other hand, it could pose a financial challenge to the company, as it will have a greater liability because it has to guarantee more miles that would previously have been computed as Breakage, associated with a longer financial cycle that could generate more profit in the financial market.

Furthermore, the company has a broader focus on other products in addition to the traditional accumulation and use of miles with airlines. These include more promotional campaigns in partnership with Smiles Shopping, through partnerships in the retail goods sector and Rocketmiles, its partner in the hotel segment.

Figure 12 New Smiles Club

Source: Provided by Smiles S/A.

The final reflection is on the debate over how Smiles will react to diverse challenges, such as the goal of twenty million customers, the search for new commercial partners, expansion and innovation of options of rewards and greater operational efficiency in a segment where direct competitors replicate innovations with great ease and agility.

TEACHING NOTES

Data Sources

The case was based on a semi-structured interview with the company's head of marketing, publications in the press and the company website, including the section on relationships with investors.

Educational Goals

The educational goal of the case is to discuss concepts such as Marketing Strategies and the Business Model, focusing on the evolution of the business model of Smiles S/A, based on the fundamental aspects of loyalty programs, or fidelity programs as they are called in Brazil, as well as coalition programs, brand repositioning and new product development. However, despite its significant growth in the last five years, many challenges remain on the company's horizon.

Use of the Case

The case could be used for discussions in fields of knowledge that involve marketing strategies, business models and innovation, as well as other fields of Company Managements. These discussions could be held by undergraduate and graduate students.

Suggestions For a Teaching Plan

To analyze this case, it is fundamental for students to have had access to works on marketing strategy, new product development and, especially, business models.

To answer the questions, it is essential for the student to read and interpret the text beforehand, individually and using the literature, which will support the answers. Later, to enrich their knowledge, it is interesting for students to discuss the case in groups and make statements that encourage a wider scope of responses.

Finally, two situations are suggested: (1) students should present a single response, per group, to each question; and (2) the teacher should lead a general plenary discussion, attempting to make everyone participate in the session.

Questions for Discussion

1. Describe the Smiles business model, using the components of the RCOV framework proposed by Demil and Lecocq (2010) as a reference.
2. How can the value creation process proposed by Lepak, Smithand Taylor (2007) be characterized in the Smiles case?
3. How could the value creation in e-business model proposed by Amit and Zott (2001) be applied in the Smiles case?
4. Using the proposal of Casadesus-Masanell and Ricart (2010) as a reference, explain the choices made by Smiles in its business model and represent the image of the Smiles business model through its interactions.
5. Can you identify in the case situations that show that the firm operates within an ecosystem perspective for value creation? If so, explain it, considering the three levels of ecosystem and their interactions as proposed by Frow et al (2014).
6. Certo, Whithers and Samadeni (2017) conducted a study to assess the impacts of within-firm and between-firm changes on their performance over time. Explain how these two dimensions of changes affected the trajectory of Smiles.
7. The concept of Dynamic Capabilities is reviewed and subjected to a more in-depth study in the article of Helfat and Martin, (2015). The authors highlight their strategic importance and capacity to generate value over time. Identify the dynamic capabilities at Smiles and prepare a framework of how they were explained in the building of strategy.
8. Lemon and Verhoef (2016) debate the relevance of the consumer's experience and journey to companies. This debate becomes more topical due to the higher number and greater variety of contact points between company and customer. Identify how

these contact points were changed over time and how Smiles managed its customers' journey to create potential for their experience.

9. Despite the growing debate on social media, reports through these channels remain tentative in the text on the case. Based on the article by Key and Czaplewski (2017), which presents a process for actions on social media based on integrated marketing announcements, present a proposal for Smiles considering the most recent times.

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