The current profit situation for most car rental companies in the UK is by no means satisfactory. Why is this? On the one hand, such factors as increasing car fleet costs (a weaker used car market, deteriorating purchasing conditions from manufacturers) and on the other hand the drawn out price war between the car rental companies are to blame.

Realising Profit Potentials in the Car Rental Industry

Increase success via price strategy measures

By Bernhard Boeffgen and Kathrine Kartach

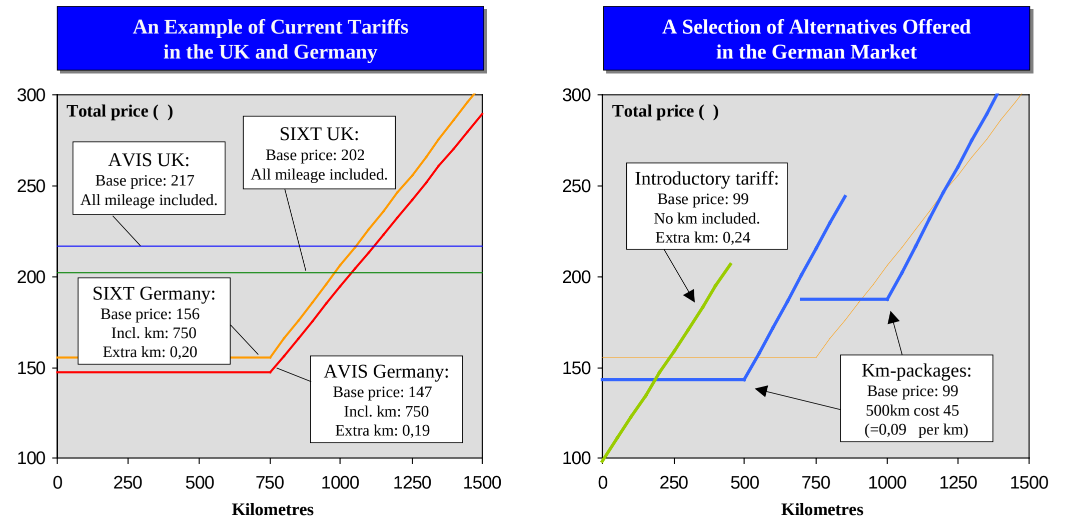
In the last year, however, it seems to have been much calmer on the price front. So does this mean car rental companies are now starting to take full advantage of the most critical profit levers, namely price strategy and yield management? We don't believe this is the case! According to our own experience, car rental companies are still giving away a significant amount of profits through sub-optimal pricing strategies.

Three topics are of particular interest and importance:

- Price differentiation / Price structure
- Willingness-to-pay / Price levels
- Pricing process

1. Price Structure / Price Differentiation

One of the largest profit potentials lies in pinpointing the optimal price differentiation between the different customer segments in the car rental market. Currently, however, this potential is not being fully exploited. In the UK car rental market for example, the major car rental companies use almost identical "basic rental price models", which comprise of a basic daily rental price with all mileage included (see the following figure).



Basis (German market): Internet tariffs 10.01.02, VW Golf etc., 3 days
Basis (UK market): Internet tariffs 19.02.02, Ford Focus etc., 3 days

Each car rental company should now be asking itself if its current price structure is yielding optimal returns or if perhaps a differentiated approach could possibly lead to an increase in profits. For example, in the German car rental market a new price structure has been introduced by each of the major car rental companies (as shown in the above right-hand figure). This structure offers the customer attractive packages which yield greater returns for the rental companies.

Trying to realise profit potentials poses the following questions:

– Does the customer react more strongly to the basic price or the mileage-price? Or in other words, what are the precise price elasticities? In this case, the decisive factor is the subjective perception of the customer.
– Do the elasticities of the different customer segments vary? If so, what effects should this have on the price structure?
– Are supplementary or even alternative price structures sensible, for example offering either a “mileage-package” or “lower base price deal” with no free mileage, as is the case in the German car rental market (see above figure).

Besides these usage-orientated price differentiation models there are other approaches available to boost profits:

- **Private customers vs. Business customers:** Are the right price and service differentiation elements being implemented across the various customer segments? For example, are the requirements of each customer segment being met and is it possible for the customer to make absolute comparisons between the different price levels? If requirements are not being met and price comparisons are possible this suggests car rental companies are missing out on fully exploiting profit potentials. This is certainly food for thought. How could we offer products specifically designed for the business customer segment to exploit these potentials?

- Are **distribution channels** being fully exploited as a means of optimising price differentiation? In the following example we can see that substantial structural differences exist between the different players in the market. The use of different distribution channels provides not only an excellent opportunity for price differentiation but also an opportunity to exploit the full willingness-to-pay of each customer segment. However to optimise this, knowledge of price sensitivities of each distribution channel and the consequent cannibalisation effects is essential.

	Basic Rental Price by Distribution Channel (£)		
	Rental Company A	Rental Company B	Rental Company C
Internet Booking Price	123	132	106
Telephone Booking Price	138	177	106
Travel Agency Booking Price*	-	124	120

Basis: Internet tariffs 19.02.02, Ford Focus etc., 3 days
*Thomas Cook for Rental Company B and Lunn Polly for Rental Company C

The use of different distribution channels provides an excellent opportunity not only for price differentiation but also to exploit the full willingness-to-pay of each customer segment.

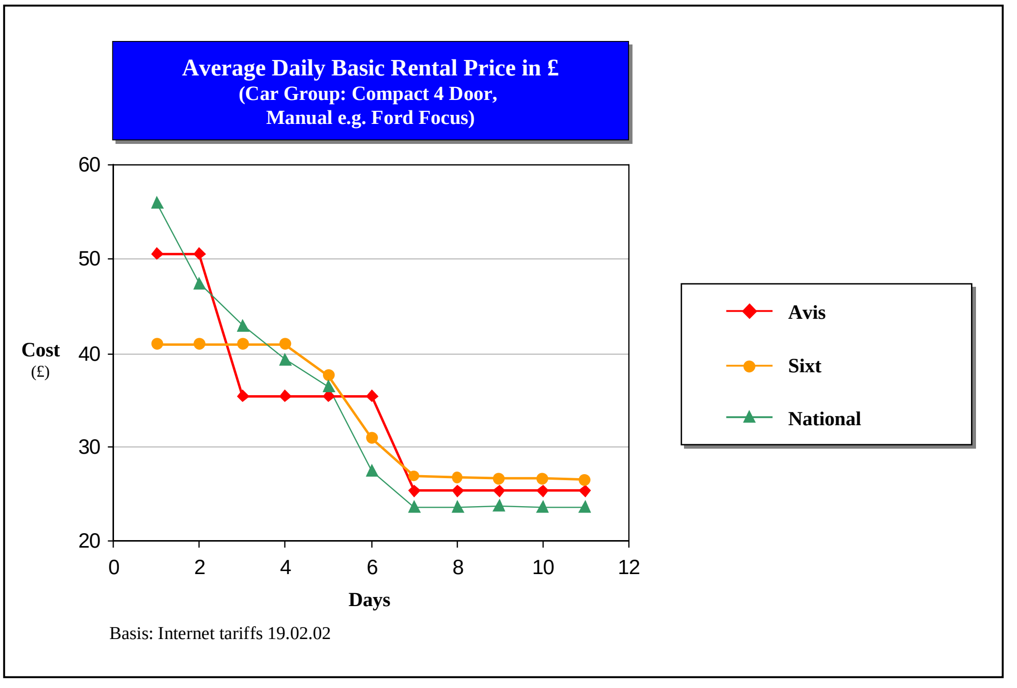
- The individual car groups are another opportunity to differentiate price. Rental prices across the car groups can vary greatly from one car rental company to another. The actual price differences between a "compact group" e.g. Ford Focus and an "intermediate group" e.g. Ford Mondeo are as follows: At National the difference is as little as 6%, at SIXT 10%, at AVIS 11%, at Europcar 19% and at Hertz the difference is as much as 22%! Cost reasons (e.g. different models within the car groups) are a possible cause of these differences. However, the customer does not see nor care about these. So which company actually fully exploits customers' willingness-to-pay?

Naturally, there are also risks associated with price differentiation. Price models, which are too complex can confuse the customer and can become a competitive disadvantage. For this reason price differentiation must be supported by an adequate communication strategy. In order to achieve this communication policies should be developed for the individual customer segments so that the customer is only exposed to that part of the price structure, which is relevant to him and confusion over tariffs is avoided.

2. Price Levels / Price Elasticity

The second most important aspect of pricing strategy is optimising the price level.

The following figure depicts how the 'average' daily basic rental price changes subject to the duration of the rental period for three rental companies.

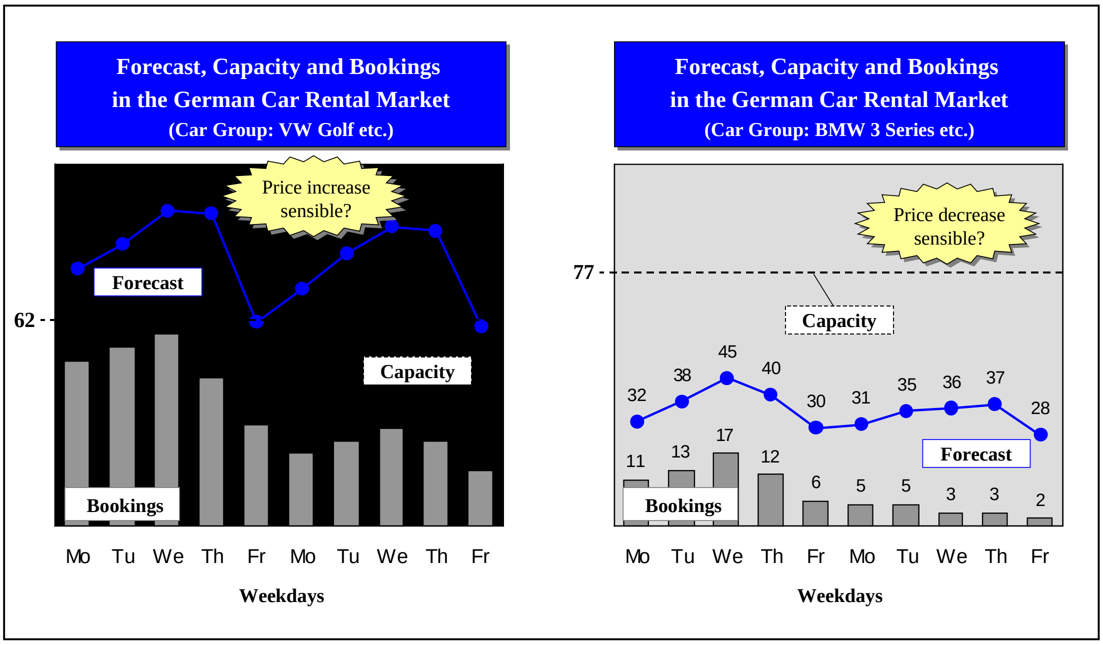


Although a correlation does exist between the pricing approaches of the three companies shown, prices do differ to some extent depending on the duration of the rental period. Each of the car rental companies at some point over the rental period is quoting the most expensive price. However, on average AVIS and SIXT offer slightly better value for money. The question is which company has 'got it right' and which is giving money away?

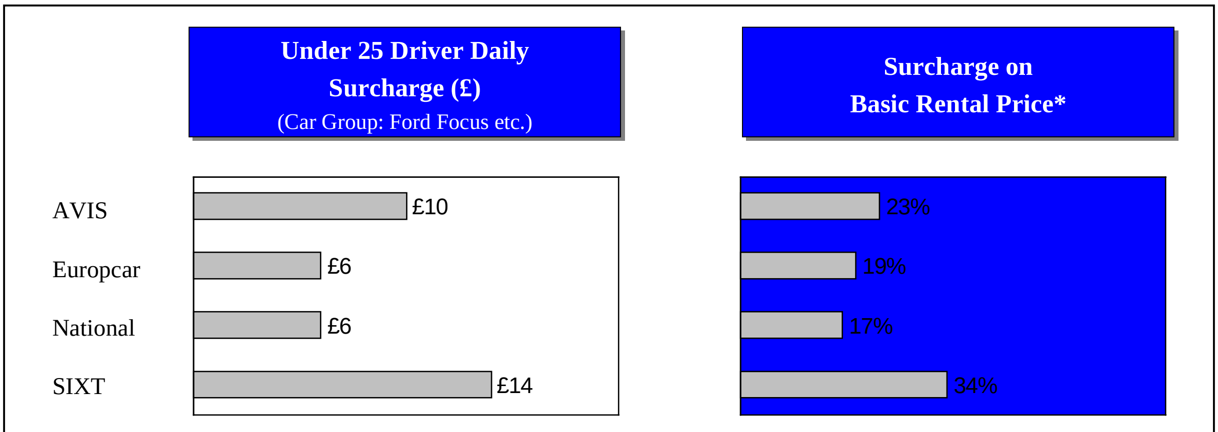
To answer this question we need to calculate the price elasticity, i.e. how demand changes subject to a change in the price level. Using this information the revenue and profit contribution effects can be identified at each price level. There are specific tools available in the market research profession, which can be used to measure price elasticity.

Price elasticity information is a fundamental part of the pricing decision process.

Even for short-term pricing decisions made on the basis of forecasts and available capacity information, knowledge of price elasticities is a fundamental requirement. Only with this information can companies answer questions such as, whether it is actually sensible to apply price changes and to what degree these changes should be implemented (see figure below).



There are a number of other services offered by car rental companies, which can also be addressed using the same methods to increase profitability. For example, consider the surcharge for drivers under the age of 25. This surcharge can have a marked effect on the profit situation, as is the case in the figure below. The driver surcharge prices differ between the car rental companies depending, both on the duration of the rental and on the car group. The absolute price difference between each company also varies significantly.



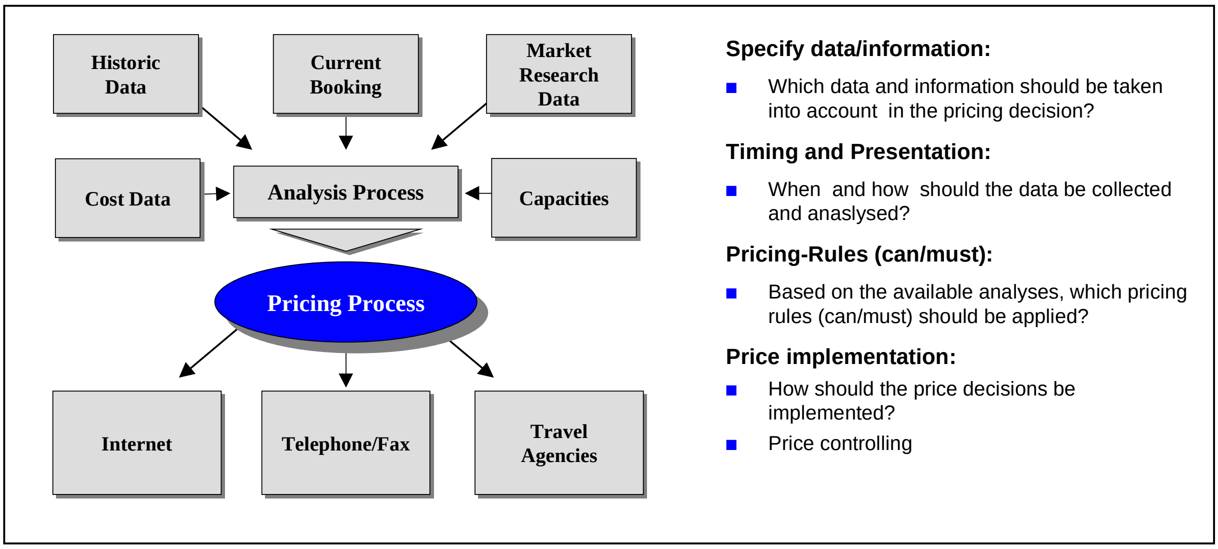
* Rental 19.02. - 21.02., Internet tariffs

How high is the willingness-to-pay for special conditions, such as driver surcharges and insurance? Do we actually know?

Again, car rental companies should be asking themselves what is the optimal pricing structure for surcharges, insurance and other special conditions? How do perceptions vary by customer segment? Of course, to answer these questions price elasticities of the respective customer segments need to be known. Companies should also investigate such avenues as the perceived difference between a more expensive "all-inclusive" offer versus a basic rental price with options.

3. Pricing Process

In addition to price structure and price level optimisation, there is often room for improvement in the pricing process. Short-term pricing decisions are usually taken at a regional level. Based on our experience, this is where a systematic, standardised process for making pricing decisions is lacking. The consequences of such a (lacking) approach can be greatly detrimental. For example, prices are set using gut feeling rather than being based on well-founded information. Furthermore, the basis for a systematic learning process is not in place. The following figure depicts one approach to redesigning the pricing process. The process begins by determining the precise data requirements and concludes with recommendations for implementing the pricing decisions.



Ideally, such a process should be incorporated into a system, which serves as a solid structure for the pricing process. Of utmost importance is the use of clear and precise rules when implementing such a system. As a result regional offices will have a structured price setting procedure to follow and will therefore know how to react in specific situations. This will release companies from their current “blurry” approaches, which are leaving profit on the table. Experience from the tourism and transport sectors show us that there are enormous profit potentials to be gained from applying such systematic approaches.

Summary

1. **The biggest area of untapped profit potential for car rental companies lies in pricing. Profit increases of 30%– 50% are feasible.**

2. **The car rental business offers many price differentiation opportunities. Areas for consideration are: Price differentiation by usage, distribution channels, car groups etc.**

3. **All pricing decisions should be based on a clear knowledge of price elasticities for the respective customer segments.**

4. **Additional services offer a rich source for maximising profit potential. At present, however, willingness-to-pay is not being fully exploited.**

5. **Systematic and standardised price processes are lacking from business operations. This is particularly the case for short-term pricing decisions where decentralised price decision-making is leaving profit on the table.**

6. **Quick wins" can be made with the implementation of an integrative single pricing policy.**

Bernhard Boeffgen is a Partner, Kathrine Kartach is a Consultant with Simon-Kucher & Partners, Strategy and Marketing Consultants in Bonn, Boston, London, Munich, Paris, Tokyo, Vienna and Zurich. According to Eric Mitchell, President of the Professional Pricing Society in Atlanta, Simon-Kucher & Partners is the leading price consultancy in the world.

For further information:
SIMON ⬩ KUCHER & PARTNERS
Haydnstraße 36
D-53115 Bonn
Tel: +49 228 9843 211
Fax: +49 228 9843 320
bboeffgen@simon-kucher.com

Bonn ⬩ Boston ⬩ London ⬩ Munich ⬩ Paris ⬩ Tokyo ⬩ Vienna ⬩ Zurich