

# The car rental industry in the us economics essay



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The car rental industry is a multi-billion dollar sector of the US economy. The US segment of the industry averages about \$18.5 billion in revenue a year. Today, there are approximately 1.9 million rental vehicles that service the US segment of the market. In addition, there are many rental agencies besides the industry leaders that subdivide the total revenue, namely Rent-A-Car, Dollar Thrifty, Budget and Vanguard. The rental car industry is highly consolidated which naturally puts potential new comers at a cost-disadvantage since they face high input costs (since companies in this industry have revenues of billions of dollars), with very low possibilities of economies of scale. Moreover, most of the profit is generated by a few firms including Enterprise, Hertz and Avis. For the fiscal year of 2006, Enterprise generated \$7 billion in total revenue. Hertz came in second position with about \$3.9 billion and Avis with \$2.75 in revenues. During this year, revenues were about \$20 billion, with the top six companies having combined market shares of over 90 percent. Competition in this industry goes beyond nationally, companies are expanding globally, and for example Rent-A-Car is operating in the U. S, Canada, U. K, Ireland and Germany. In the U. S market there is a strong competition between the six largest companies, especially between Enterprise Rent-A-Car and Hertz for the rental facilities in airports. The level of vertical integration in the industry has been reduced in the last decades, by letting these companies more flexibility in the market and leading to higher profit margins. In fact, among the industry players only Hertz is vertically integrated through Ford. The market size of this industry is large so there is high demand for renting, but due to the very strong competition, the profit margin is not so high or attractive, moreover, it is best attained by economies of scale. Competitiveness has

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risen to such an extent that, according to Business Travel News, vehicles are being rented until they have accumulated 20, 000 to 30, 000 miles until they are sent for sale to the used car industry.

What is competition like and how strong are the competitive forces?

There are many factors that shape the competitive landscape of the car rental industry. Competition is fierce not only because the market is saturated and well guarded by industry leader Enterprise, but competitors operate at a cost disadvantage along with smaller market shares since Enterprise has established a network of dealers over 90 percent the leisure segment. On the corporate segment, on the other hand, competition is very strong at the airports since that segment is under tight supervision by Hertz. Competitively speaking, the rental car industry is a war-zone as most rental agencies including Enterprise, Hertz and Avis among the major players engage in a battle of the fittest.

The five competitive forces

Competitive Rivalry Among Sellers

There are many factors that drive competition within the car rental industry. Over the past few years, broadening fleet sizes and increasing profitability has been the focus of most companies within the car rental industry. Enterprise, Hertz and Avis among the leaders have been growing both in sales and fleet sizes. In addition, competition intensifies as firms are constantly trying to improve their current conditions and offer more to consumers. Hertz, for example, integrates its Never-Lost GPS system within

its cars. Enterprise, on the other hand, uses sophisticated yield management software to manage its fleets.

### The Potential Entry of new Competitors

Entering the car rental industry puts new comers at a serious disadvantage. Over the past few years following the economic downturn of 2001, most major rental companies have started increasing their market shares in the vacation sector of the industry as a way of insuring stability and lowering the level of dependency between the airline and the car rental industry. On one hand, this action has ensured the success in the long run of the existing firms; on the other hand it has made it much more difficult for new entrants to join this market. Existing firms such as Enterprise, Hertz and Avis carefully monitor their competitive radars in order to be ready to attack any potential new entrant in the market. Another barrier to entry is created because of the saturation level of the industry. In 2006, Enterprise had a rental location within 15 miles of 90 percent of the US population. Because of the network of dealers Enterprise has established around the nation, it has become relatively stable, and most importantly, less reliant on the airline industry compared to its competitors.

### The Threat of Substitute

There are many substitutes available for the car rental industry. From a technological standpoint, renting a car to go the distance for a meeting is a less attractive alternative as opposed to video conferencing, virtual teams and collaboration software with which a company can immediately setup a meeting with its employees from anywhere around the world at a cheaper

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cost. In addition, there are other alternatives including taking a cab which is a satisfactory substitute relative to quality and switching cost, but it may not be as attractively priced as a rental car for the course of a day or more.

While public transportation is the most cost efficient of the alternatives, it is more costly in terms of the process and time it takes to reach one's destination. Finally, because flying offers convenience, speed and performance, it is a very attracting substitute; however, it becomes an unattractive alternative in terms of price relative to renting a car. On the business segment, car rental agencies have more protection against substitutes since many companies have implemented travel policies that establish the parameters of when renting a car or using a substitute is the best course of action. Generally, the threat of substitute is reasonably low in the car rental industry since the effects the substitute products have do not pose a significant threat of profit erosion throughout the industry.

#### The Bargaining Power of Buyers

An interesting trend that is currently underway throughout the industry is forcing car rental companies to adapt to the needs of corporate travelers. This trend significantly reduces supplier power or the rental firms' power and increases corporate buyer power since the business segment is extremely price sensitive, well informed about the industry's price structure, purchase in larger quantities and they use the internet to force lower prices.

#### The Bargaining Power of Suppliers

Supplier power is low in the car rental industry. Because of the availability of substitutes and the level of competition, suppliers do not have a great deal

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of influence in the terms and conditions of supplying the rental cars. Because the rental cars are usually purchased in large quantities, rental car agents have significant influence over the terms of the sale since they possess the ability to play one supplier against another to lower the sales price. Another factor that reduces supplier power is the absence of switching cost. That is, buyers are not affected from purchasing from one supplier over another.

What forces are at work to change industry conditions?

One of the most important forces in the car renting industry is the use of internet in companies. Internet has made possible instant linking between renting stores in different locations and provides a lower distribution and inventory cost. What is more, improvement in technology and the installation of different tools, including the GPS system in rented cars has made this industry more competitive for customers. The installation of specialized software in the facilities where cars are given for rent, for checking preferences of customers in different regions, gives details about what cars are mostly preferred and how many of them should be in that store, reducing storage costs.

Which companies are in Strongest/ Weakest positions?

As a moderately concentrated sector, there is a clear hierarchy in the car rental industry. From an economic standpoint, disparities exist from a number of dimensions including revenue, fleet size and the market size each firm holds in the market place. For instance, Enterprise dominates the industry with a fleet size of approximately 600, 000 vehicles along with its market size and its level of profitability. Hertz comes in second position with <https://assignbuster.com/the-car-rental-industry-in-the-us-economics-essay/>

its number of market shares and fleet volume. In addition, Avis ranks third on the map. Avis is among one of the companies that is having issues recovering its revenue margins from prior to the economic downturn. For instance, in 2000 Avis returned revenues of approximately \$4.23 billion. Over the course of the next several years following 2000, the revenue of Avis has been significantly lower than that of 2000. As a way of reducing uncertainty most companies are gradually lowering the level of dependency on the airline industry and emerging the leisure market. This trend may not be in the best interest of Hertz since its business strategy is highly linked to the airports.

What strategic moves are rivals likely to make next?

Since this industry operates in very narrow profit margins, it is very important to predict what the competitors' next moves will be in order to be as prepared as possible. In 2007 there were some developments in this industry which were concerning Rent-A-Car's executives. These developments included a possible merger between Dollar Thrifty Automotive Group and Vanguard Car Rental as well as direct attacks on Enterprise's off-airport rental markets and insurance company clients by Hertz, the second rental company in the industry. Avis uses its OnStar and Skynet system to better serve the consumer base and offers free weekend rental if a customer rents a car for five consecutive days.

What are the key factors for competitive success?

There are many key success factors that drive profitability throughout the car rental industry. Capacity utilization is one of the factors that determine <https://assignbuster.com/the-car-rental-industry-in-the-us-economics-essay/>

success in the industry. Because rental firms experience loss of revenue when there are either too few or too many cars sitting in their lots, it is very important to efficiently manage the fleets. This success factor represents a big strength for the industry since it lowers if not completely eliminates the possibility of running short on rental cars. Efficient distribution is another factor that keeps the industry profitable. Despite the positive relationship between fleet sizes and the level of profitability, firms are constantly growing their fleet sizes because of the competitive forces that surround the industry. In addition, convenience is one of the crucial attributes by which customers select rental firms. Another key success factor that is common among competing firms is the integration of technology in their business processes. Through technology, for instance, the car rental companies create ways to meet consumer demand by adding the convenience of online rental among other alternatives. Furthermore, firms have integrated navigation systems along with roadside assistance to help their customers find the desired location easier and faster.

Is the industry attractive or unattractive and why?

There are many factors that impact the attractiveness of the car rental industry. Because the industry is moderately concentrated, it puts new market entrants at a disadvantage. What is more, existing companies in the industries can take measures to attack new entrants. Because of the risks associated with entering the industry among other factors, it is not a very attractive sector of the marketplace. From a competitive standpoint, the leisure market is 90 percent saturated because of the active efforts of Enterprise to dominate this sector of the market. On the other hand, the <https://assignbuster.com/the-car-rental-industry-in-the-us-economics-essay/>



airport terminals are heavily guarded by Hertz. Realistically speaking, entry in the industry offers low profitability relative to the costs and risks associated. For most consumers, the main determining factors of choosing one company over another are price and convenience. Because of this reason, rental firms are forced to offer more to the consumers for less just to remain competitive. Based on the impact of the five forces, the car rental sector is not a very attractive industry to potential new market entrants.