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EQUULEUS CAR SHARING INC.: REVENUE MANAGEMENT

At the August 2017 board meeting of Equuleus Car Sharing Inc. (ECS), the primary focus was to establish ground rules for the firm's annual fleet purchasing schedule and to approve the planned expansion into new markets. ECS currently operated in three American cities (Seattle, Denver, and San Francisco). However, ECS's business model called for expanding into three much larger markets (New York, Boston, and Toronto) in the coming months. Typically, ECS replaced approximately half of its rental car fleet on an annual basis. This replacement cycle was consistent with ECS's mission of offering its customers up-to-date vehicles at competitive prices. ECS's management team, headed by the chief executive officer, Doris Johnson, had established a budget of US$10 million[1] for funding the vehicle purchases that year.

Traditionally, the firm paid cash when purchasing new cars; however, the current very low interest rates had caught the eye of the chief financial officer, Johnny Debonair. According to Debonair, preliminary discussions with a local finance company had revealed that ECS could make a down payment for the cars and then pay the remaining balance over a two-year period. In response to this, the vice-chair, Ben Johnston asked, "Why would we wish to pay interest when we can pay cash?" Debonair respond adroitly by saying, "By buying on time we can purchase many more vehicles, which should more than offset the paid interest based on maximizing net present income." He added, "The number of vehicles available at our planned three new locations would be severely limited under the cash model." As the meeting concluded, Johnson directed Debonair to conduct an analysis of both options, cash versus finance, using ECS's new analytics-based resource management system, and to report back within two weeks.

RENTAL CAR INDUSTRY

The global rental car industry was estimated to reach approximately $125 billion in revenues by 2022, which represented a compounded annual growth rate of 13.5 per cent from 2017 to 2022.[2] Typically, the rental car industry was segmented into four broad sectors: rental, lease, purchase, and sharing. The car-sharing business represented a small but growing component of this market. Basically, the car-sharing model focused on customers who wished to (1) utilize a vehicle for short periods of time, often by the hour;

[1] All currency amounts are in U.S. dollars.
[2] Zion Market Research, "Car Rental Industry Share & Trends Will Reach $124.56 Billion Market by 2022," Globe Newswire, December 20, 2017, accessed April 11, 2018, https://globenewswire.com/news-release/2017/12/20/1266919/0/en/car-rental-industry-share-trends-will-reach-124-56-billion-market-by-2022.html.

(2) replace corporate fleets; and (3) employ different types of vehicles for specific functions (e.g., minivan for a sporting event).

Some of the major players in the global rental car industry included Enterprise Holdings, Inc.; Hertz Global Holdings, Inc.; Avis Rent a Car System, LLC; Europcar Groupe SA (France); and Sixt AG (Germany). Enterprise Holdings, Inc., the world's largest rental car firm, alone employed approximately 1.5 million cars. Additionally, most industrial nations had local car rental firms (e.g., Park24 Co., Ltd., in Japan) that primarily concentrated on the domestic market. The continued expansion of the car rental industry was driven primarily by growth in tourism on a global basis. However, there was growing concern in the environmental community regarding the impact of carbon dioxide emissions associated with the car rental industry. As a result, many of the major car rental firms were looking to go green, which involved increased use of all electric and hybrid vehicles. Another major challenge facing the rental car industry was the growing role of ridesharing firms like Uber Technologies Inc. (Uber) and Lyft, Inc. (Lyft). Their market share was continuing to grow as customers shifted from traditional car rental in the metropolitan areas to ridesharing, which eliminated the need for parking and driving in unfamiliar environs. The car rental firms had responded to this new threat by downsizing their car fleets. The dawn of the age of autonomous vehicles (i.e., self-driving cars) represented an even more serious threat to the established rental car business model. To that end, some of the larger rental car firms were in the process of inking agreements with Apple Inc. and Google, two of the current autonomous vehicle powerhouses, as well as with Uber and Lyft.[3]

COMPANY BACKGROUND

ECS, which was founded in 2014, offered several car-sharing options in three metropolitan areas—Seattle, Denver, and San Francisco. Specifically, it offered a city-wide service that rented vehicles by the hour, and a program that provided residents of large apartment complexes and universities access to vehicles on demand. Currently, customers could choose from four different vehicle types: minivan, sport utility vehicle, sedan, and economy. ECS had experienced significant growth over the past few years, with sales approaching $40 million annually. As a result, ECS planned to expand in the New York, Boston, and Toronto markets in the coming months. ECS's management believed that ridesharing represented a new zeitgeist for the rental car industry, and that ECS would be well positioned to take advantage of these new trends.

Debonair understood, based on his preliminary investigation, that the finance company required at least a 20 per cent down payment, and that at least 50 per cent of the purchase price plus interest had to be paid by the end of the first year. The financing company was currently charging 4 per cent interest. ECS used a 10 per cent discount rate for financial planning, and based on inputs from operations, Debonair believed that all of the cars that were purchased could be rented. However, to meet overall market demand, Debonair wanted each vehicle category represent at least 15 per cent and no more than 50 per cent of the total number of vehicles purchased. Cars purchased were depreciated and paid off for over a two-year period, after which they were sold in a secondary market (see Exhibit 1).

[3] Alex Moazed, "Autonomous Cars Will End the $75 Billion Rental Car Industry as We Know It: When Autonomous Vehicles Hit the Road, Renting a Car Will Be an Entirely New Experience," Inc., October 16, 2016, accessed April 11, 2018, https://www.inc.com/alex-moazed/autonomous-cars-will-end-the-75-billion-rental-car-industry-as-we-know-it.html.

EXHIBIT 1: WHOLESALE PURCHASE PRICE AND REVENUE SUMMARY (US$)

Car Type	Price ($)	1st Year ($)	2nd Year ($)
Minivan	27,000	15,000	28,000
SUV	22,000	10,000	19,000
Sedan	18,000	9,000	21,000
Economy	14,000	7,000	15,000

Note: Second-year revenue estimates include the resale value; SUV = sport utility vehicle.
Source: Based on the authors' calculations from information in the case.