

# **19<sup>th</sup> MEETING OF THE VOORBURG GROUP**

**Ottawa, Canada  
2004**

## **PRODUCER PRICE INDEX FOR SERVICES**

### **THE FRENCH PPI FOR MOTOR VEHICLE RENTAL**

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## **Introduction**

The price index for motor vehicle rental is one of the first production price indices in the services sector published in France. Data have been available since 1998. In 2003, we organised the reviewing for this index, in order to update the weightings and companies in the sample. Truck rental does not fall within the scope of this index, long-term rental is also excluded. We have only taken business customers into account. Domestic customers have therefore been excluded from the scope of this article.

## **Industry output**

Motor vehicle rental concerns private cars and small commercial vehicles weighing less than 3.5 tonnes. It is self-drive car rental, rental with driver is classed under transport activities. Lease-option agreements are not covered in this study and are classed with leasing agreements in financial services. Short-term rental may not exceed 12 months; this is a replacement service whereas long-term rental is a substitute for purchase with specific financing methods. It is very rare for a business to operate in both short-term and long-term markets. In the French system of business classification, short-term rental has been a separate item from long-term rental since the last revision in 2003. However, in terms of product classification, there is only one category, regardless of the length of rental. When designing the price index, we considered two different sub-products: private car rental on one hand, and commercial vehicle rental on the other. Private car rental is predominant : almost nine of the ten services chosen come under this category.

There are about 1,400 motor vehicle rental companies in France: 1,000 operate in the short-term market, 400 deal exclusively with long-term rental. Nearly 16,000 people work in this sector, including 12,000 in short-term rental. Short-term rental has been declining slightly over the years in favour of long-term rental. Although more than 70% of car rental firms are short-term rental firms, it generates less than 50% of the turnover. There is a very high concentration : the ten largest companies in the sector account for more than half the turnover. The concentration is even higher when we consider the franchiser-franchisee relationship. In this business sector, a company often allows a company in the sector (the franchisee) to use its brand, in return for an initial fee and an annual charge.

## **Index Methodology**

The price is set with a view to paying back for the vehicle which was bought initially. An annual price is calculated based on depreciation and applying a margin. A daily price is then calculated based on the estimated coefficient of use per vehicle. There are many parameters involved in setting the price : features of the rented vehicle, insurance, the vehicle's mileage, type of fuel, length of rental, rental in Paris or not, time of rental (week or weekend) for example. The price may be calculated by day and/or by kilometre (for example, price for 7 days and for maximum 1,000 km). There are volume discounts

for loyal customers. For many business customers, prices are specified by category of vehicles which are different from the prices for the general public.

In terms of the franchiser/franchisee relationship, the franchiser works with a network of large customers which it can transfer to the franchisee. The prices are set by the franchiser and applied locally by the franchisee. This way of working means that few companies make the price in the short-term car rental market. During the previous period, "low-cost" companies have appeared on the French market, which has changed the terms of competition.

In terms of method of price monitoring, we have favoured the customer approach. When we survey companies, we select their most important customers and/or those which are deemed to be the most representative. After selecting the customers, we choose the services whose prices we are going to track over time. Example of service : price of renting a category A vehicle per day, with 250 km and insurance included in the rental package. This is a price which has been negotiated with the customer. This price may only be revised once a year, on the first of January or on the anniversary of the date the contract was entered into. Nevertheless, the price can sometimes be revised more often (for example, every three months). It is very important to specify the type of contract with all the features of the rented vehicle. This is so that any changes in the terms of the contract (for example the amount of kilometres included in the contract) and/or changes to the model rented (greater number of options and thus better quality of service) can be identified.

Monitoring of catalogue-type prices has been excluded because negotiation is very important in the business customer sector. Monitoring of catalogue-type prices would be a good idea for domestic customers but not for business customers. Some customers obviously generate a great deal of turnover for the rental company so they have considerable negotiating power on prices. Rental companies were also able to supply us with average rental prices per customer and, sometimes, per category of vehicle. However, this average price is very dependent on the average length of rental. In fact the average price per day of rental is reduced as the average length of rental increases (prices per day decrease gradually according to the length of rental). We have therefore not chosen this method which mixed price effects with structure effects, associated with the variation in the average length of rental.

## **Sampling and Weights**

Like other surveys of this type, the survey base is made up of the results, by product, of the annual survey of service companies. We automatically select the largest companies and choose the others at random. The sample consists of 20 firms.

The calculation of weighting is very specific to this branch because of the relationship between franchiser and franchisee. As in other studies of this type, the basic principle is to weight the chosen

services according to the turnover from business customers – excluding subcontractors and exports – of the company surveyed. Nevertheless, franchised businesses obviously depend on the price fixing operated by the franchiser for a substantial portion of their turnover,. They are not "price-makers", despite their business activity. Ten companies in the sample are franchised businesses, which depend on three franchisers (Avis, Europcar, Hertz).

We asked the franchisees to break down their turnover into two segments : turnover generated by national contracts from the franchiser (with the price set by the franchiser) on one hand; turnover generated by purely local customers on the other. We will only take the latter turnover into account when calculating the weighting. Regarding franchisees, we will therefore only follow up customers (with associated services) for local custom.

For the franchisers, we have included all the turnover, consisting of the following two components : the turnover of agencies (Europcar agencies owned by Europcar for example) for local customers who do not come under national contracts; the turnover of agencies and franchisees for customers who come under national contracts. We are therefore implicitly including some of the turnover of franchisees in the franchiser's weighting. This partly explains the very high concentration of the sample : the five largest companies in the sample represent almost 85% of the turnover covered by the sample.

The above choice was made for various reasons. Franchised companies in the sample did not understand and did not see the value in monitoring price of services where they had no influence in determining price at a local level. By monitoring national contracts, for agencies and franchisees, at franchiser level, we are also increasing the extent to which this index is covered within the branch, via the method of calculating weighting. In practical terms, we are avoiding collecting the same information twice, for two franchisees which depend on the same franchiser (for national contracts). This was made possible by the very complete information systems maintained by the franchisers who are the largest companies in this market.

### **Issues on maintaining constant quality**

The problem of dealing with the quality effect arises when the characteristics of the rented car change from one period to another. The change may be minor (addition of an option to the same model, for example) or more important (change of model although the vehicle category is the same). The change may also involve not the vehicle but details of the contract : for example change associated with the number of kilometres included in the contract. In most cases, the price remains the same whilst the features of the rented vehicle have changed. Our company contacts cannot answer the following question: how would the price have changed if the features had stayed the same? Consequently, it is difficult to deal with the quality effect. Hedonic models, such as those used for the consumer price index for motor vehicles, may be a theoretical solution. Nevertheless, this poses great

difficulties in practical terms, due to the burden of response. We need to give serious thought beforehand to the parameters of the service which impact on service quality. For example, what will be the effect on quality if 100 extra km are included in the contract (increase of 200 to 300, for example) ? The impact is completely different according to the user : none for users who want to drive less than 200 kilometres in a day, greater for the others but variable according to the distance covered.

## Some results

In relation to the weighting of series, the curve for all motor vehicle rental is obviously very similar to that for private vehicle rental. There have been several distinct phases in this market between 1999 and 2004. Between the first quarter of 1999 and the third quarter of 2000, prices fell by 4.4%. We can put forward the following explanation : in a fast-growing market, the main players competed strongly over prices during this period. Prices then picked up again for two years, until the third quarter of 2002 (an increase of over 4% for the period). We asked rental companies about this change in trend. There are two possible explanations. Firstly, rental companies passed on the considerable increases in airport taxes which they had to pay in order to operate there. Secondly, the price war signalled a break between the main players. It was thought to be too destructive. Since the end of 2002, prices have dropped again. At first sight, this decrease has occurred at a time when the market is thought to be expanding in terms of its structure. It can be explained by the arrival of "low-cost" companies on the market who have broken prices and also by the desire of some major players to win some market share. According to our company contacts, this decrease is set to continue. However, this could have important repercussions on some companies. In 2003, one of the ten largest companies stopped operating completely for two quarters before it was partially bought out.

