

Setting rental rates is a balancing act

By Bill Veneris

The goal of any pricing strategy is to maximize profits. For most businesses, this does not mean selecting the highest possible price, nor the lowest – but rather finding the price that generates the most sales at the highest profit. This price can be found by identifying relative demand for the item, factoring in competition in your market, and especially by analyzing the effects of a variety of pricing scenarios on your bottom line.

Analysis of different pricing strategies may lead you to some surprising conclusions – some of which may contradict the prevailing attitudes toward pricing in the rental industry today.

Playing the rate game: should I go higher or lower?

When attempting to find the rental rate that will provide the most profit, many rental operations wonder: should I raise my rates and hope my utilization doesn't erode to the point that I'm making less than if I kept my rate the same? Or, should I lower my rates (often in a bid to match a competitor's lower rate) and hope my utilization increases enough to increase profits?

Let's analyze this question by assuming you rent a skid steer loader for \$150 a day and are trying to decide whether you should lower your rate 10% to match a competitor's rate or raise your rate 10% to make more on each rental you win. In this instance, let's also assume your goal is to maintain a dollar utilization of 65% on the skid steer, and we assume the skid steer originally cost \$18,000. Table 1 shows the effect of this scenario.

Daily Rate	Var Cost	# of Rentals	Total Revenue	Var Cost Total	Net Revenue
\$150	\$37.50	78	\$11,700	\$2,925	\$8,775
\$135	\$37.50	87	\$11,745	\$3,263	\$8,482
\$165	\$37.50	71	\$11,715	\$2,663	\$9,052

Column one shows the rate options being analyzed. Column two represents an estimated variable cost (on a daily basis) of turning the rental item. Column three shows the number of rentals required to attain the 65% utilization goal. Column four shows the total revenue of the rentals (all approximately 65% utilization). Column five shows the total variable cost (daily variable cost multiplied by the number of rental days), and column six shows net revenue.

Notice that if you lower your rate by 10%, you'll need to rent the skid steer 87 days to reach your 65% utilization goal. Because you're renting the loader nine more times, your variable cost increases. The result: lower profits.

Now take a look at the effect of raising your rate by 10%. In this instance, you can maintain the same 65% utilization rate with seven less rentals. Lower variable costs mean higher profits. In fact, renting at a 10% higher rate has produced more profit than at your original rate.

Rates, time utilization, and profit

Since many rental operators also analyze equipment performance on the basis of time utilization, let's take a look at how the 65% dollar utilization shown above translates to time utilization. In analyzing time utilization, we'll assume 100% time utilization is 312 days per year (this assumes you are open six days a week).

Daily Rate	# of Rentals	Total Revenue	Var Cost Total	Net Revenue	Time Utilization
\$150	78	\$11,700	\$2,925	\$8,775	25%
\$135	87	\$11,745	\$3,263	\$8,482	28%
\$165	71	\$11,715	\$2,663	\$9,052	23%

The last column in Table 2 shows time utilization for the three pricing scenarios. Notice that the rate with the highest net revenue (\$165/day) has the lowest time utilization, while the rate with the lowest net revenue (\$135/day) has the highest time utilization.

This analysis shows the importance of carefully reviewing how rental rates can affect time utilization. The goal should not be to simply maximize time utilization, but rather to find the rate that will produce the most profit.

The effect of rental term on time utilization performance

What is the effect of the rental term on time utilization percentages? For this analysis, let's assume again that we have a 65% dollar utilization goal and our time utilization is based on a 312-day year. And let's also assume that, for our skid steer loader, the weekly rate is four times the daily rate and the 4-weekly rate is three times the weekly rate. The "# Days" column in Table 3 shows how many "daily rate" days there are in each rental term category. For example, if the daily rate is \$150, the 4-weekly rate would be 12 times the daily rate, or \$1,800. The rate columns show the time utilization required to attain our 65% dollar utilization goal.

Term	# Days	\$150/day	\$135/day	\$165/day
Day	1	25%	28%	23%
Week	4	38%	42%	34%
4-Week	12	50%	56%	45%

Notice how rate discounting for longer term rates has a significant effect on time utilization. In this example, at the \$150/day rate, if your typical rental term is four weeks, you would need 50% time utilization to attain 65% dollar utilization. If the rentals are daily, you would only need 25% time utilization. If you're doing weekly rentals, your time utilization must be in the high 30% range.

Also notice that if your competitor drops their rate to \$135/day and typically rents their loader out for a 4-week time period, they would need to rent out their skid steer at 56% time utilization. If you focus on daily rentals and charge \$165/day, you only need 23% time utilization to match their dollar utilization.

This example illustrates the complexity of using time utilization rates to compare business performance. Often rental operators are told they need to get their time utilization up in the 50 to 70% range to be competitive. This may be true if you are competing directly for a long-term rental. But there's plenty of room to be profitable with lower time utilization on shorter-term rentals.

Factoring in competition

Of course, competition must be weighed when setting rental rates. In some situations you may even be required to adjust rates on a contract-by-contract basis. Ask yourself several questions: Is this item widely available in the market? (this is a supply and demand issue). Can I justify that my particular offering in this category is superior in features, service, performance, etc.? (i.e. product differentiation). How large is the revenue opportunity? (i.e. if this is an expensive item, customers will tend to shop around before selecting a vendor). What's the term of the rental? (i.e. if it is a long-term rental, competition will usually be greater). Does my competition proactively go after business for this item using an outside sales force? (if so, you better be on the job site too). Is this a "need it now" rental (i.e. will there be little competition because the customer needs the item immediately and may not have time to shop)?

All of these factors need to be weighed when setting rental rates. Perhaps you have a line of specialty equipment no one else has in your market. In this instance, the rate should be as high as the market will bear. If it is difficult to win on highly competitive rentals, you can position yourself as the high-value, customer-service oriented rental operator who can respond quickly and efficiently to meet shorter term, interim rental needs (at a premium price). If you can respond faster to an unexpected need, you will be called first and there may not be any competition. These are just a few strategies for winning in competitive situations.

When you must play the rate-matching game

Unfortunately there are times when you may need to play the rate-matching game. A rental item in your fleet carries a cost every day it sits in your yard, and you may reach a point where you can't afford not to be in the market, renting that item. When this time comes, you'll need to determine how low your utilization can go before the item is costing you money versus making you money. Find alternative ways to compete and use marketing to identify new markets for your product. If all else fails, sell the item and invest in inventory that can produce profits.

Pricing is not an exact science, but an art. However, it can become more like a science if you carefully consider the variables that affect price and, ultimately, profit. The analyses in this article suggest there is less risk involved in raising prices than in lowering prices. Do your homework. Understand your market. Find out which items are more or less sensitive to price. And then find that balance in which your rental rates can make the most profit for your rental operation.