



AT THE 2005 APRO CONVENTION AND BUYING SHOW, A SEMINAR ENTITLED “WHY 94 PERCENT OF YOUR MARKET IS NOT RENTING” SPARKED A TREMENDOUS AMOUNT OF DISCUSSION AND AN EXCHANGE OF IDEAS. IN UPCOMING ISSUES OF PROGRESSIVE RENTALS, WE’LL DELVE DEEPER INTO WHAT WAS PRESENTED, WHAT WAS DISCUSSED AND WHAT STRATEGIES MIGHT HELP TO BRING IN THOSE ELUSIVE “NON-CUSTOMERS.”

WHY PEOPLE DON’T RENT, PART I:

Pricing *and* rates

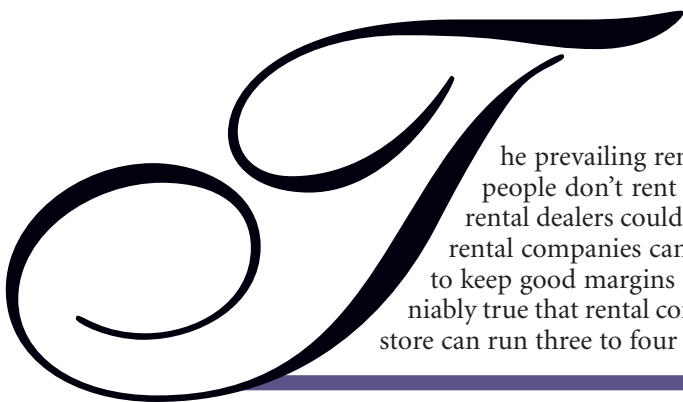
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2004 Trenholm RTO Image Survey revealed that rental dealers have only scratched the surface of their potential base, serving less than 10 percent of the consumers who fit the RTO demographic. This is not news. The industry has wrestled with this reality for the past 15 years. All of those millions of consumers who could—or should or would—rent, but don’t, remain a tantalizing target for the industry.

This was a popular topic at a seminar held during APRO’s recent convention in Las Vegas. At the seminar, APRO board member and Michigan rental dealer Sidney Burton offered some novel insights into why people don’t rent in spite of sophisticated efforts by bright professionals in a robust business to broaden the customer base.

Burton’s analysis will be presented in a multi-part series of articles detailing the findings he culled from his careful study of what people—RTO customers and non-customers alike—said in the focus groups that were a part of the Trenholm study. This first article will focus on pricing and rental rates. Future articles will look at social stigma, product quality, consumer (mis)understanding of the RTO concept and where people get the ideas they have about RTO.

BY ED WINN III



The prevailing rental wisdom has always supposed that the answer to the question of why people don't rent was—and still is—that RTO costs too much. If that is really the reason, rental dealers could lower prices and attract more business. That same wisdom supposes that rental companies can never get prices as low as the big box retailers and so maybe it is better to keep good margins and make do with the customer base that does exist for RTO. It is undeniably true that rental companies have higher costs of doing business than retail. Payroll in a rental store can run three to four times payroll in a comparable retail store.

It is also true that some rental business models have attempted to address this issue by focusing on monthly customers instead of weekly. A monthly business costs less to run than a weekly business. That model has arguably attracted new and different customers, and in addition to Aaron Rents, there are notable independents out there with stores that gross hundreds of thousands of dollars per month with a primarily monthly business base. These stores have higher than average keep rates, generally lower rental rates and lower earnings percentages than more traditional RTO stores.

But is price the only reason that people don't rent? Not according to the people who talked about RTO in the focus groups. And the pricing issue is more complicated than first meets the eye.

When people who don't rent—and consumer advocates, for that matter—complain that RTO costs too much, they are talking about the Total Cost (the total amount a customer will pay if he or she rents long enough to obtain ownership). The comparison is being made between the Total RTO Cost and the cost of the same product at retail. This is the comparison that gets trotted out in every criticism of RTO. There is often a chart with a TV or some other electronic item and the retail selling price from Best Buy or Sam's or some other discount retailer is held up against the Total Cost in a nearby rental store—and the difference is often dramatic.

The industry has responded in a couple of ways. One is to deny the validity of the comparison and to point to the features that exist in an RTO transaction that do not exist in an outright sale. The industry hasn't done this enough and probably cannot do this enough. And, finally, no matter what the industry does, the comparison is not likely to go away in consumers' minds.

Another approach the industry has taken is to side step this comparison and insist that customers are not concerned with the Total Cost. Instead dealers maintain that customers want to know how much it costs to get possession of the item per week or per month. Indeed, the weekly rental rate and less often the monthly rate is the primary focus of a lot of RTO advertising. If the Total Cost is disclosed, it is because the law requires it, not because it is a selling point.

It may be that the universe of potential RTO customers is bifurcated here. Some people ignore the Total Cost, see a manageable weekly rental rate and come into the store and rent. Other people, by a factor, seemingly, of 10 to 1, see the Total Cost, decide that it is too high and go somewhere else. That may be the end of the story, what with the costs of run-

ning an RTO business being what they are, as dealers can only lower the Total Cost so much before they start losing money and go out of business. But the issue is important enough to merit a little deeper digging.

Let's focus in on rental rates. Rental dealers have long been willing to reduce the rental term on used merchandise, but generally have been loathe to reduce the rental rate because of cash flow issues. What does this look like, exactly? What do customers think of this practice? Is it good for the image of the industry?

Assume a dealer has a product with a \$25 per week rental rate and a 24-month (104 week) term when brand new. The company will reduce the term over time, but never the rate, and so a chart for this product will look like this

| CONDITION | RENTAL RATE | TERM | TOTAL COST |
|-----------|-------------|-----------|------------|
| NEW | \$25/WEEK | 24 MONTHS | \$2,400 |
| USED | \$25/WEEK | 18 MONTHS | \$1,800 |
| USED | \$25/WEEK | 12 MONTHS | \$1,200 |
| USED | \$25/WEEK | 6 MONTHS | \$600 |

Think first about the people who are focused on how much it costs per week and who ignore the Total Cost, which may be all or nearly all people who come into the store and actually rent something. The fact that the Total Cost is being lowered with each rental, and may actually be a bargain as the unit depreciates, is lost on them. If they are looking only at the rental rate, then three out of four customers, all of the customers who are renting a used item are going to feel like they are getting a bad deal, since someone else is renting a brand new product for exactly the same price and they are stuck with a used product. Such a pricing policy—how much per week—makes the rental company look sneaky at worst and uncaring at best and the practice makes the customers mistrustful. That is what they said in the focus groups.

If dealers accept the premise that some to many of their customers are only looking at the rental rate, then this pricing policy, a mainstay of the industry for more than 30 years, is foolishly and fatally flawed. No customer is going to feel good about paying the same amount each week for a used thing when he knows that somebody else got a new one.

It would make far more sense, from the customer's point of view, to drop the rental rate, certainly between new and used product, even if the term does not get shortened. And the lower the rate for used goods, the more attractive the

deal, the more willing a customer will be to rent the used goods, the fresher a store's inventory will be, and maybe, just maybe, the less mistrustful customers will be of the RTO store, and the more positive will be their word of mouth about the business.

Here is what such a pricing policy might look like

| CONDITION | RENTAL RATE | TERM | TOTAL COST |
|-----------|-------------|-----------|------------|
| NEW | \$25/WEEK | 24 MONTHS | \$2,400 |
| USED | \$20/WEEK | 22 MONTHS | \$1,800 |
| USED | \$15/WEEK | 20 MONTHS | \$1,200 |
| USED | \$10/WEEK | 15 MONTHS | \$600 |

Note that the Total Cost does not change. The dealer can get whatever turn he wants or needs for the unit. It may take a few months longer to collect all of the money and there may be increased service costs as a result. However, there should also be fewer pick-ups—customers will be able to make a \$15/week payment when they could not come up with a \$25/week payment, and some of the negative feelings that customers harbor against RTO companies will be assuaged. That might mean more customers. This assumes that there are people out there, once again, who are focused solely on the rental rate and who will be attracted to a \$10 or \$15 per week payment who were not attracted to a \$25 per week payment. The store will have to advertise the lower rates and also that the merchandise is used, but the bet is that there are people who are not renting today who would rent at the lower rate.

The rates do not necessarily have to be lowered progressively. What is most important is to differentiate between rental rates for new items and rental rates for used items. Ideally, a dealer will differentiate the rates in a meaningful way that will have an impact on shoppers and customers.

So, a dealer might rent the unit for \$25 brand new. When it comes back in, he might rent it out used for \$20 for the remainder of its life in inventory. The dealer will be waiting longer for his money, but he will still get it all. He will be deferring \$20 per month and, if the average rental term for a customer is four months, the dealer will get his full \$2,400 in 29 months instead of 24 months (assuming no early buy out). Instinctively, the lower the rental rate for used product, the higher will be the demand, but the lower rate will have an impact on cash flow, and like the Total Cost, the rental rate can only go so low before it quits making economic sense.

Rental dealers are generally under the impression that the rental rate is the most important economic factor influencing a customer's decision to rent. Rental customers in focus groups, report that, among many other things, they do not like paying the same rental rate for a used product as for a new product. That seems like such an easy complaint to remedy, thereby making the business look just a little bit better in the eyes of the customers we do have. ■

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