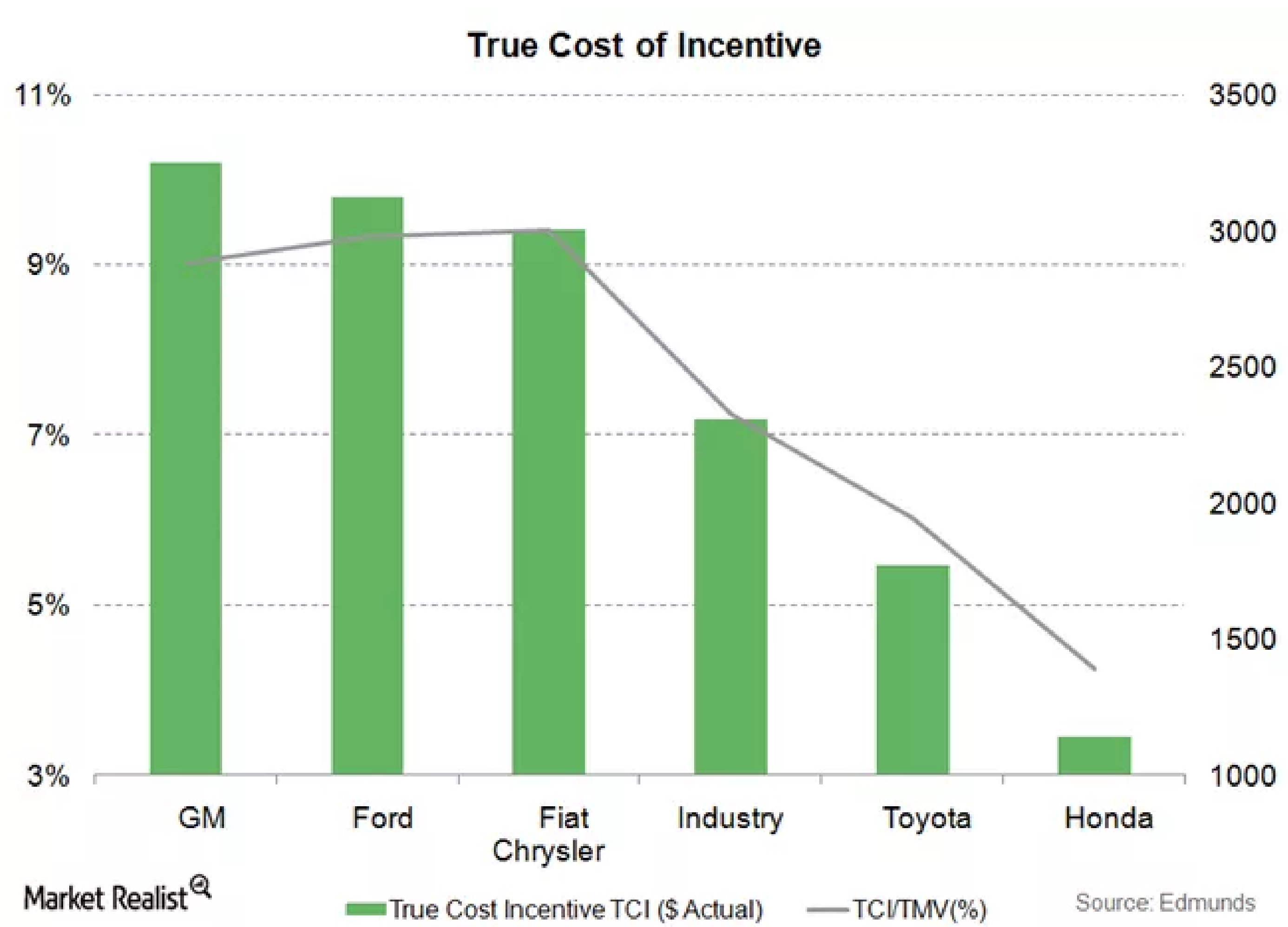
Automakers use incentives to entice customers

By Henry Kallstrom | Feb 5, 2015 2:41 pm EDT

Industry practices
Automakers provide a host of incentives:

- cash rebates
- lower interest rates
- loyalty programs
- subvented leases



Typically, companies provide incentives in a slow market. They offer incentives for low-selling models. The true cost of an incentive is the average incentive cost provided by the automaker per vehicle sold.

This cost came down from $2,594 per vehicle in 2010 to $2,305 in 2014. This is a reduction of $289 per car sold. That indicates an increase in consumer demand.

The total number of vehicles sold in the US in 2014 was 16.5 million. With $289 in savings per vehicle, the industry managed a profitability increase of $4.7 billion simply by reducing incentive costs.

True market value

A good indicator of incentive costs for auto manufacturers is the TCI (true cost of incentives) to TMV (true market value) ratio. Edmunds compiles TMV. TMV relates to the price of cars actually sold.

TMV only increased at a compound annual growth rate, or CAGR, of 1.7%—from $29,670 in 2010 to $31,787 in 2014. At the same time, the TCI to TMV ratio for the industry decreased by a CAGR of 4.29% from 8.7 to 7.3. As a result, automakers benefited more from a decrease in incentive costs because prices increased at a very marginal rate.

US automakers' incentive expenditure

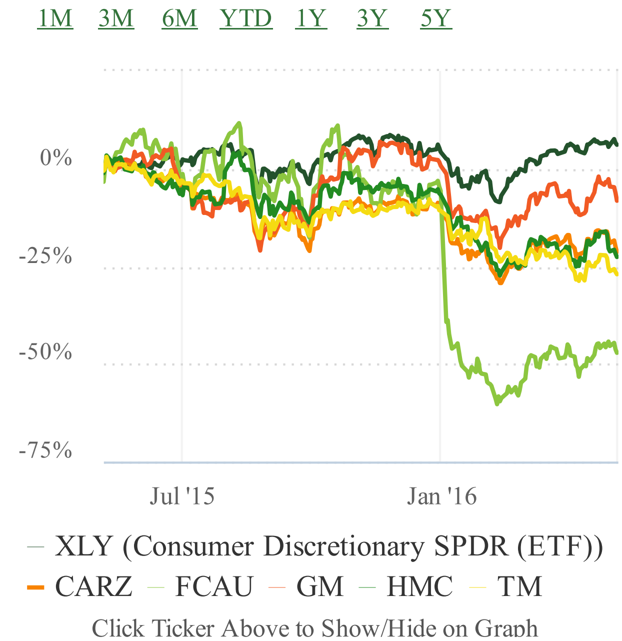
As shown in the above graph, General Motors (GM) spent the most on incentives in 2014. It spent $3,248 per vehicle. Ford (F) was next. It spent $3,123. Chrysler (FCAU) was third with a $3,006 expenditure.

Interestingly, Japanese manufacturers spent very little on incentives. Toyota (TM) only spent $1,772 per vehicle in 2014. Honda (HMC) spent even less at $1,143. The "Big Three" manufacturers in Detroit had to spend a lot more to lure customers who otherwise seemed willing to flock to Japanese automakers.

Luxury car brands spend a lot less on incentives. Most of their spending goes towards targeted advertising. BMW spent $1,462 per vehicle in 2014. Daimler spent $2,160 per unit sale. Investors can gain exposure to these companies through the First Trust NASDAQ Global Auto ETF (CARZ).

In the next part of this series, we'll explore why consumers prefer leasing a vehicle over purchasing one.

Consumer Discretionary
Performance


1M 3M 6M YTD 1Y 3Y 5Y
0%
-25%
-50%
-75%
Jul '15
Jan '16
XLY (Consumer Discretionary SPDR (ETF))
CARZ
FCAU
GM
HMC
TM
Click Ticker Above to Show/Hide on Graph