WHITE PAPER

Short-cycling in a bull market: Advantages, disadvantages and how to know if it's right for your fleet

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Introduction

As we continue to rebound from the global economic recession, the North American resale market has been one of the most remarkable bright spots from a fleet perspective. Particularly since the spring of 2010, the continuing high demand for low-cost transportation coupled with the decreased availability of both new and used vehicles has caused used vehicle sales to steadily gain momentum. And with the recent disaster in Japan further limiting new vehicle supply and production worldwide, the past few months have produced some of the strongest returns on used vehicle sales we've seen in recent years.

With that in mind, the temptation naturally exists for fleets to cycle their vehicles as quickly as possible to ensure that they take advantage of the market while it's still hot. Indeed, some fleet management companies are going so far as to actively encourage their entire client bases to take their vehicles off lease earlier than normal—or "short-cycle"—in order to realize immediate, favorable resale returns.

But while short-cycling can be an attractive strategy given the unusually strong resale environment, there are a number of potential drawbacks. As with many fleet decisions, it is important to consider multiple factors before deciding to take your vehicles off lease early.

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The case for short-cycling

The pros of short-cycling are certainly there. Besides the obvious advantage of using the favorable resale market to garner high returns against book value, various disposal credits are currently available to help offset some of the cost of new vehicles going into service. Early-term maintenance costs will also dip, and fleets can generally take advantage of improved fuel efficiency on newer models. In addition, driver morale and satisfaction could increase as drivers will likely relish the opportunity to replace their vehicles earlier than expected.

The case against short-cycling

Perhaps the most important caution against short-cycling is that there is no guarantee that it will result in any significant additional savings over time. Short-cycling essentially just shifts your expected disposal adjustment forward by six months, rather than necessarily making you extra money. For example, while short-cycling will help you save on maintenance costs by having newer vehicles, you will at the same time be losing out on savings that would have come from low later-term depreciation costs on your existing vehicles. In fact, your depreciation could jump considerably on a new vehicle with a higher capitalized cost, effectively mitigating any early impact that maintenance savings would have.

While many people are justifiably bullish on the strength of the used vehicle market, it is inadvisable to make sweeping strategy decisions that rely on it staying that way over extended periods of time. For example, consider that a major factor in the strength of the current resale market is the high demand for and low supply of used vehicles. If inventories suddenly increase (e.g. by rental companies cycling large numbers of vehicles after vacation season, an influx of fleet vehicles suddenly hitting auction floors as fleets try to take advantage of the market, etc.), the market could suddenly dip and leave you with higher monthly payments on new vehicles that will be subject to a weaker resale market when they come out of service.

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Other factors to consider

Supply chain concerns are also a major factor. In addition to the struggles resulting from the disaster in Japan, railcar shortages have affected vehicle shipping and transportation throughout the U.S. This could result in increased delivery times and costs. Given the timing of collective bargaining discussions between the United Autoworkers union and the manufacturers this fall, any slowdowns or work stoppage could also significantly affect vehicle production and result in limited access to new vehicles to replace those that are short-cycled.

Wheels recommendation

Be selective. There are certain situations that may warrant short-cycling. For example, if you have a vehicle in your fleet that is a gas-guzzler or is expensive to maintain, short-cycling it will allow you to replace it with one that is more fuel-efficient and with lower early-term maintenance costs. In addition, if you are changing your selector's general product mix to include vehicles with much lower capitalized costs than your existing vehicles, short-cycling may increase your savings potential.

But generally speaking, if you have been effectively managing your depreciation, continuing your normal replacement cycle is probably the best option for you. By doing so, you will continue to realize the cost savings advantages of late-term depreciation rates, and you will not incur the risk related to quickly replacing current lease costs with higher capitalized costs.

It also appears likely that the used vehicle market will continue to stay strong in the near term, as new vehicle prices continue to increase due to new technologies and production materials, major redesigns to help meet emerging federal fuel economy standards, and ongoing supply limitations. By maintaining your existing replacement cycle, you will therefore ensure that you can take advantage of the resale market while not necessarily being at its mercy.

If you are thinking of short-cycling, we recommend that you do so only after a detailed analysis of your fleet's needs and close consultation with your Wheels Account Team. It is important to remember that remarketing strategies are best applied on a vehicle-by-vehicle basis rather than as a fleet-wide policy initiative, and that a quick-fix solution does not always yield the best long-term results.

To learn more about short-cycling, please contact a member of your Wheels Account Team or e-mail us at info@wheels.com.

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