Why fewer COEs mean luxury car boom

Ivan Png and Qiang Fu

3 February 2011

Straits Times

Last year, the Government cut the number of certificates of entitlement (COEs) for new cars to just over 42,000, which was about 40 per cent fewer than in 2009. Against the backdrop of limited COEs, sales of luxury cars have boomed, while the demand for mass-market makes has slumped. Why?

SALES of Rolls-Royces more than trebled from 10 to 37 units, closely followed by Ferrari, which more than doubled its sales volume from 32 to 69 units. At the other end of the market, Proton sales fell by almost 40 per cent from 413 to 256 units, while Chery sales fell even more precipitously, down by more than half from 309 to 139 units.

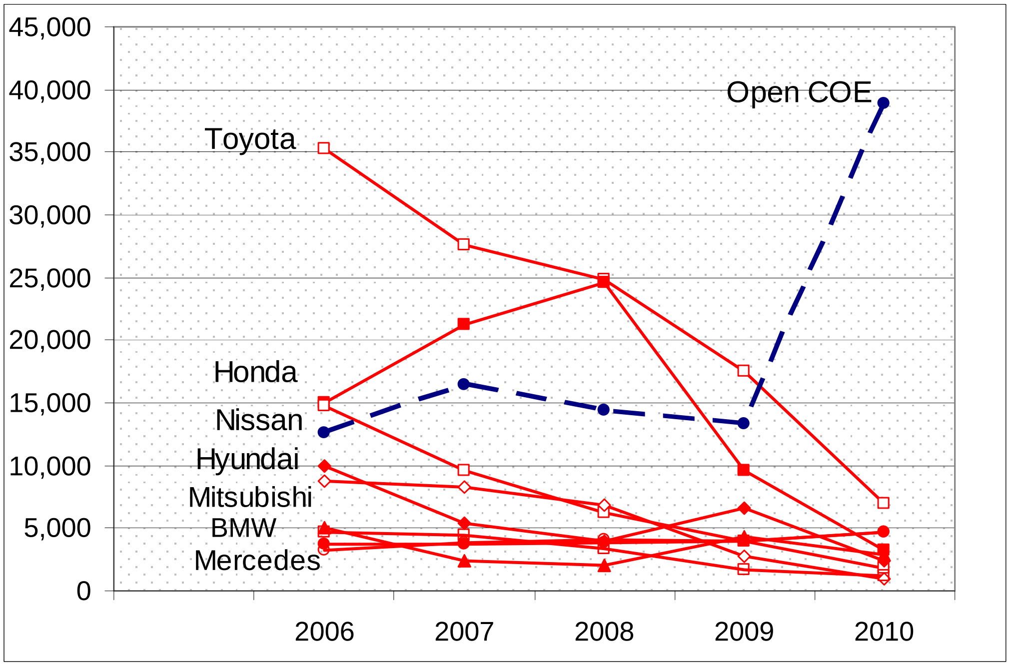
The story was similar among the luxury makes. BMW increased sales by almost 20 per cent from 3,926 to 4,708 units, neck-and-neck with Mercedes-Benz, which increased sales by 18per cent from 3,997 to 4,705 units.

By contrast, the sales of traditional market leader Toyota slumped by over 60per cent from 17,555 to 6,927 units. Traditional number two Honda suffered an even sharper drop - by almost two-thirds, from 9,584 to 3,272 units.

Why has the pattern of the demand for cars changed so drastically?

One reason is a general trend - contrary to media reports, the shift towards premium European makes is not a new phenomenon. We compiled the accompanying chart from Land Transport Authority statistics. (See chart)

Sales of Toyota, Nissan and Mitsubishi have systematically fallen over the last five years - even between 2006 and 2009, when COE prices were relatively stable. Only Honda managed to grow, reaching a peak in



Source: Land Transport Authority

2008 and then joining the general downward trend.

Without detailed research, we can only speculate on why the demand for the major Japanese makes has been declining.

Another reason for the shift in the pattern of demand must be the price of COEs. The COE is just like a tax - except that it is set by public demand and the Government, rather than directly by the Government. Like any other tax, the COE is actually borne by buyers and sellers.

Generally, car buyers pay more (in total) and bear part of the COE price, while car dealers earn less profit margin and also bear part of the COE price. Who pays for the COE in the first instance - buyer or dealer - doesn't matter. What matters is the price sensitivity of car buyers and dealers.

If car buyers are relatively price sensitive, then dealers must bear more of the COE. If car buyers are relatively price insensitive, then dealers can pass on more of the COE to buyers. Similarly, the price sensitivity of the dealers affects how much of the COE the dealers will bear.

Buyers of BMW and Mercedes cars are probably less sensitive to price than buyers of Toyotas and Hondas. Further, BMW and Mercedes distributors make larger profit margins, and so can more easily bear part of the COE price than distributors of Toyota and Honda cars can.

Thus, both on the demand and supply sides, there is more willingness to pay for the COE among the premium European brands than in the mass-market Japanese makes.

So sales of BMWs and Mercedes are holding up - and indeed growing - while sales of Toyotas and Hondas are withering.

Ivan Png is the Lim Kim San professor at the NUS Business School and professor of information systems and economics at the National University of Singapore. Qiang Fu is assistant professor of strategy and policy at the school.