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"A call to (not??) hedge"......

As oil prices continued to do, well, what they do, you can feel the tension mounting. Heating oil companies who offered fixed-prices in June, but didn't get around to locking in their wetbarrels, practically jumped off roofs as Hurricane Katrina was bearing down on New Orleans. Those who offered cap programs during the spring or summer, but, too, did not manage to buy their price protection (whether in form of wetbarrels with put options, or with call options—or a combination), suffered through similar pangs as Hurricane Rita approached the oil patch in Houston. Companies that locked in panicky customers during the dog-days of September, and locked in their own fixed-prices (with wetbarrels or futures contracts), felt their skin start to crawl as they were greeted with a warm October and early November leading to a decline in prices of as much as 45 cents per gallon, in the aftermath of Hurricane Wilma.

After last summer ('04), you would have thought that oil dealers would have learned that not matching up protection with the risks they are assuming does not make much sense. As one of our clients pointed out to us, there is a quote that says that the definition of insanity is doing the same thing as last year, and expecting a different result.

The good news is that we are (hopefully) out of hurricanes for this season. The bad news is that the finger-pointing just seems to get worse and worse. There seems to be a growing rift between the have's (have hedged) and the have-not's (haven't hedged). Rumblings from the latter group—and several industry "leaders"—have been calling for the end of pricing programs. The logic asks why oil companies should offer programs to customers that don't (or might not) benefit the oil companies themselves. Why not just buy at the rack, mark it up, and deliver to the customer. Why all the programs, and marketing, and hedging, and, and......?

There are many answers to those who would rather that all pricing programs go away, but let's just focus on a few. Firstly, the reason that you offer *anything* that will benefit a customer is because (a) you are in a *customer service* business, (b) it may engender customer loyalty (note that the number #1 complaint by heating oil dealers is the rate of customer attrition), (c) it may separate you from your competition, and (d) you can achieve (and often increase) predictable profits. While I am a very big fan of the last reason, all four speak to the reason that you are in the heating oil business. You want to provide a good product (generally, the service and delivery, since oil is oil), at a fair price, that will allow you to achieve a fair profit margin. There is no real glory in the business, but there are profits to be had.

One thing that should be remembered is that you always have a choice about whether or not to offer a pricing program—be it a fixed-price program or a capped-price program. A number of years ago, some heating oil dealers started giving away free (limited) service contracts as a means to solicit for new business. Others either jumped on the bandwagon, or just stuck to their guns, and continued to charge for service (via a service contract, or a time and materials plan). Many did not like the idea that service should be "free", while others (those who offered the service) just included the service costs in their delivery price of oil. Arguments—good arguments—can be made against the logic of the free service contracts, while other arguments can be made in favor of the plan. But, most importantly, no oil dealer who offered a free contract did so because there was a gun put to his or her head.

If your competitor offers a pricing program, do you have to? Absolutely not. If you think that the economics of offering a program are damaging to your business, should you offer a pricing program? Absolutely not. Are all of your competitors who do offer programs providing their customers with some level of certainly in an increasingly uncertain world? I would say, yes. If the pricing programs were not perceived to be beneficial to customers, their popularity would quickly wane. Is it a coincidence that those who are the most vociferous complainers about pricing programs are usually the ones who either offered a program and didn't hedge, or are those who didn't offer a program since they "knew" where prices were headed—but the prices didn't cooperate? I don't think so.

It is very easy to point fingers. Actually, it is much easier to do that than to look in the mirror. Look around, and you will see many, many companies that offer pricing programs to their customers. The customers know what to expect, and the oil companies—*If they have made a plan, and followed the plan*— are hedged, and are reaping the benefits of predictable profits.

As many readers of this column are aware, I am a very big advocate of capping prices, as opposed to fixing prices. As mentioned above, those who fixed prices during the insanity of prices in September are certainly having some credibility and/or attrition issues. However, they knew that going in. The decision NOT to spend money on options protection is a decision to accept the consequences of falling prices. Those who offered cap programs, however, are like the gasoline dealers in November who are increasing their margins—often to their highest margins ever. When prices fall sharply, wholesale drops faster than retail, but end-users just see falling prices. Customers (perceive that they) are paying less and retailers make extra margin. That is the beauty of the capped offering (when hedged properly).

As we get further into the '05-'06 winter season, the questions about prices and weather are more important than ever before. The industry HAS changed. It is not the same business as it was 20 years ago. If you treat it as if nothing has changed, you are assuming a certain level of risk—to your margins, your customer base, and to your sanity—that can be avoided. However, you cannot expect those who have changed with the times to regress, just because you have decided not to catch up. ❑