

# FUTURES \$ OPTIONS



## The high cost of (not) offering a cap.....

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It has been well documented that this past year was NOT the year to push (actually, to even offer) fixed-price programs to your customers. Regardless of explanations, intent and logic, the seismic moves in heating oil prices over the past year drove customers to break contractual obligations with reckless abandon. We saw companies lose large percentages of their fixed-price customer base through the fall and into the early winter, as prices fell as much as \$3 dollars per gallon from their early-summer highs.

Of course, the reason that so many companies offered, and so many customers accepted fixed-price programs, was the notion that heating oil retail prices—having moved from \$2.50 per gallon, to \$3.50 per gallon, to \$4.50 per gallon, to over \$5.00 per gallon—were headed even further into the stratosphere. In addition, although the “logic” said that prices couldn’t really go that much higher, and that the notion of offering a cap (especially in hindsight!) would have made perfect sense, the extremely high cost of offering a cap drove marketing departments to the point that it was just easier to fix someone at \$4.79 per gallon than to cap them at \$5.09 per gallon.

As the economy weakened, and energy prices plummeted, customers who belonged to cap programs saw their delivered prices fall. While certainly, the delivered price did not fall nearly as far or as quickly at the drop in the wholesale cost of heating oil (making for a banner year for most cap “offerers”), seeing falling prices from delivery to delivery was generally all that the cap customer was looking for. The fixed-price customer who, we should repeat, AGREED TO THE FIXED PRICE, started looking at whether the fixed price was the right move. When prices fell by 25 cents, there was some grumbling. Once it was approaching a dollar, it was enough to keep CSRs busy full-time. Once prices fell by a \$1.50, the roar from dissatisfied customers was accompanied by mass cancellations.

Some companies held the line, and attempted to enforce the terms of their contracts, sometimes with success, but usually with the full understanding that the customer would be gone—not to return—after this season. Other companies, while realizing that the ire of the customers were not going away, attempted to assuage the customers by “renegotiating” the terms with the customers (a procedure also known as losing money—sometimes lots of money—in an attempt to keep the customer for a longer term and to make the lost money back). Generally, the “new” terms were in the form of a cap, not a fixed price (“Fool me once, shame on you; fool me twice, shame on me.”).

As a populace, Americans want the best price for everything. As an industry—starting with free service plans—oil dealers all too often feed into that mentality. The notion of customer count trumping profitability has led some dealers to mortgage the future for today (sounds similar to parts of our government’s bail-out plan—but that is for another article). As this article is written, prices have risen from their mid-winter lows, but are still well below last summer’s highs.

Customers who are finishing up with their fixed-price programs (the ones who haven’t departed for greener pastures) will be looking long and hard at what to do next season—AND WITH WHOM! Aggressive (smart?) marketers are starting to focus their attention not only on signing up their own customers for next season, but also gearing up to approach the pool of (yes, incorrectly) unsatisfied customers from this past season.

Hopefully, those who are making the offers—both to existing and new customers—will remain keenly aware of a) what it takes to keep customers, and b) what it takes to remain profitable. These two don’t always go hand in hand, but if keeping customers means that you can’t allow prices to rise, AND you must allow prices to fall, AND you can’t charge enough money to the customer to allow for that pricing flexibility, is that a customer worth saving?

Many customer cancellations this past season were borne out of frustration (that their neighbors were paying so much less) and emotion (that “someone else” needed to be blamed for the fact that prices had fallen and they hadn’t benefited). Logic really took a back seat in the roller-coaster ride that oil prices took. The \$3-plus range in price that we saw will do that to people. The question is whether anyone can really predict when the swinging prices will stop.

I am not advocating offering a cap because I have the slightest idea where prices are heading. Nor am I an advocate because I think that a contractual obligation (i.e. a fixed price) should be broken without repercussions. Lastly, I am not pushing forward the notion that working 20, 30 or 40 cents per gallon into your margins will be an easy thing. However, I think that unless you want to become someone who has to guess where prices are going to be “next year,” each and every year, for the rest of your career, there is an easier way to run this portion of your business. Fixed prices are right 50% of the time (when prices rise). Variable (rack-plus) prices are also right 50% of the time (when prices fall). Can you afford to keep a stable customer count only 50% of the years? What is the REAL cost to not offering a price cap?