PROBLEMS OF MINORITY FUEL-OIL DEALERS

By

Joseph P. Kalt

and

Henry Lee

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I. Introduction

During the past several years numerous claims have been made from both inside and outside the industry that minority fuel oil dealers face unique obstacles that restrict their profitability and threaten their survival. It has been claimed, for example, that minority fuel oil dealers are hampered by especially severe impediments in the competition for contracts for oil, loan funds from banks, and assistance from the federal government. This study seeks to explore these and related claims and to suggest possible remedial actions. Interviews were conducted with minority and majority fuel oil retailers, oil wholesalers, banks, and federal, state, and local officials. The study has focused on the metropolitan areas of Boston, Massachusetts, Providence, Rhode Island, and New York City. Time and geography have limited the scope and comprehensiveness of this effort, and further empirical analysis is warranted. Existing data on minority fuel dealers is poor and the data which can be found is often incomplete. However, despite these limitations, we feel confident that our findings are an accurate depiction of the situation confronting minority fuel oil dealers in the Northeast.

Our primary findings are twofold:

1) The heating oil market is declining in volume, and therefore, retailers are finding it increasingly difficult to keep their rapidly rising costs from exceeding their revenues. If a dealer is both new and small, these difficulties are compounded.

2) Fuel oil retailers who service low-income, inner-city neighborhoods are confronted with: a) higher costs; b) greater difficulties in obtaining supply contracts; c) significant obstacles in obtaining credit either from banks or government; and d) less stable and less predictable cash flows. Again, these problems are more severe for new retailers trying to enter the market than larger existing dealerships.

These two major findings shed considerable light on the sources of the difficulties encountered by minority fuel oil dealers. The presence of racial discrimination would be very difficult to prove or disprove. Although we cannot claim there is no discrimination, we do feel confident that discrimination is of lesser importance than the underlying characteristics of the market in which minority fuel oil retailers must typically operate. Minority dealers tend to be small (under five million gallons of annual sales) and tend to serve low-income inner-city neighborhoods. A majority of these dealers have entered the business since 1973. Therefore, the claim that minority dealers confront unique and difficult obstacles is valid--not because these businesses are run by minorities, but because they are new, small, and serve a high-risk clientele.

This report is divided into five sections. Following the introduction, the evolving role of minority oil retailers in the Northeast market is reviewed in the second section. The third section examines the specific problems confronting minority dealers, including obtaining start-up capital and finding sources of supply. The fourth section addresses the problems associated with serving the inner-city market. Finally, in the fifth section, specific recommendations are introduced to meet the problems outlined in the earlier sections.

II. MINORITY FUEL OIL DEALERS - THEIR ROLE IN THE INDUSTRY

II.A. Market Setting

The Northeast, and especially New England, is heavily dependent on oil for energy. In 1978, oil accounted for seventy-nine percent of New England's energy consumption compared to only forty-nine percent for the United States as a whole.[1/] Further, in New England, seventy-one percent of the homes used oil as the primary heating fuel, which far exceeds the national average.[2/]

The price shocks of 1973 and 1979 have had a major impact not only on the New England consumer, but also on the heating oil distribution industry. Between 1973 and 1979, the price of heating oil rose 183 percent. The average price per gallon in 1973 was 24.1¢ and the average price today is in the vicinity of $1.25 per gallon.[3/] In the period of the 1950s and 1960s, there were over one thousand retailers in Massachusetts;[4/] today that number has shrunk dramatically. Further, dealer margins on a percentage basis have declined at a time in which equipment, labor, and other costs have outpaced inflation.[5/] Competition, together with the threat of reimposition of government price controls and the constant presence of more subtle political pressure, have made it almost impossible for oil retailers to increase these margins to a level that would be comparable to the margins that they were making five to ten years ago.

In addition to pricing problems and shocks, some experts believe that, because of recent trends in urban renewal, inner-city fuel oil dealers may find themselves in a dwindling market.[6/] Many of the new buildings in cities in the Northeast that are being erected are primarily using electricity, or gas for heating purposes. However, the best estimates are that urban renewal will only cause a maximum reduction of fifteen percent in the inner-city market and the actual percentage will probably be substantially lower.

The cost of doing business has risen dramatically in the heating oil distribution industry. Seven years ago, a delivery vehicle cost approximately $18,000. Today, that same vehicle sells for somewhere between $35,000 and $50,000.[7/] Moreover, credit terms offered by wholesalers have tightened dramatically. Several years ago, most wholesalers allowed retailers thirty to forty-five days to pay for a delivery of oil. At present, however, terms rarely exceed ten days and often are on a cash-on-delivery basis.

Are there any solutions to the problems facing minority retailers in the fuel oil market? According to a recent Department of Energy report:

> The home heating oil industry appears to have matured into the final stages of its life cycle. Demand for the product is decreasing, as consumers turn to other fuel sources or reduce their consumption in response to higher fuel prices.[8/]

This is a grim picture of the market, yet in the same report, a possible solution is proposed:

> ... with home heating oil in the declining stage of its life cycle a natural indsutry shake-out becomes inevitable. A survival of the fittest setting emerges, and as has been seen from the attrition figures, some firms will have to go out of business. Those that can best cope with the new environment, with its greater demand for having a good business acumen, will have the best chance to remain profitable. Nevertheless, more and more firms will get out of the home heating oil business as profits will become less and less accessible.

II.B. Entry of the Minority Dealer

The entry of minority dealers into the heating oil marketplace is a relatively recent event. The New England Minority Fuel Oil Dealers Association reports that there are currently fifty minority dealers in New England, and that eighty percent of these dealerships were started after 1974.[9/] Collected survey data confirms these figures. Interestingly, minorities have entered this market at a time when many other dealers are leaving. In fact, a disproportionate number of the new entrants into this industry are minorities.

The reason for the recent entry of the minority dealers into the marketplace is directly related to the exodus from the inner-cities of the previously established dealers. Minorities primarily serve vacuum areas--areas other dealers leave, creating opportunities for new dealers to come in. The exodus of majority dealers began in the 1960s, but accelerated in the years after the price hikes of 1973. Its major cause was related to the costs of doing business in the inner-city. These costs have at least three special elements: 1) poorer cash flows; 2) higher distribution costs; and 3) higher overhead costs.

Inner-city residents are typically low-income and are relatively poor credit risks. Consequently, they are served on a cash-on-delivery basis, or on severely limited credit terms. Yet, even with these arrangements, oil retailers serving this area often experience severe cash flow problems, as a result of late receipt of payments, unpaid bills, cancelled orders, and so forth. For the retailer, these problems can in turn lead to a crunch when wholesalers must be paid. If this problem becomes chronic, the retailer will be forced to seek additional bank financing at very high interest rates which can only be recovered by increasing the price to his reliable customers. In some instances, the retailer cannot obtain the financing or afford the interest rates and is simply forced out of business.

Retail distribution costs depend on delivery sizes. As oil prices increase, the number of gallons a low-income person will purchase at any one time decreases. The costs of distributing twenty-five gallons per household are substantially higher on a per gallon basis than the cost of distributing 200 gallons. Most large oil retailers do not like to deliver any less than 150 gallons per drop, and tend to avoid or leave market areas whose average demand per delivery is below the 150 figure. But, for the same total expenditure that purchased 150 gallons in 1973, only about 35 gallons can be bought today.

The overhead costs of inner-city fuel oil retailers are adversely affected by the riskiness of the retailers' operations. This riskiness takes several forms. Many of the inner-city areas are perceived as being unsafe. Companies serving these areas often feel compelled to assign two people per truck and thereby increase their overhead costs. Further, their insurance rates are substantially higher as a result of inner-city crime and accident rates. Finally, poorer cash flow, higher costs, and risky operating conditions undermine retailers' ability to obtain bank financing for their equipment and product. Those factors also constrain the ability of retailers to negotiate contractual relationships with wholesalers. As a result, many inner-city retailers pay substantially higher interest rates for loans and must rely almost entirely on the volatile spot market for the product. When all these incremental costs are added up, the cost of delivering oil to the inner-city is three to five cents per gallon greater than average.

There is one notable exception to this scenario. In New York City, there has not been a large exodus of existing dealers from the inner-city and their minority customers. One of the reasons is that a great many minorities entered this market in the early 1970s prior to the embargo due to a concerted effort in that city to promote minority businesses. These firms relied heavily on the ten percent federal government (contract work) set aside for minority businesses. They also appear to have received substantial help from some of New York City's larger banks and many of its influential political figures. In this instance, there was a concerted effort on the part of local government and businesses to leverage the development of minority firms--from an economic development/minority business perspective. The New York City experience, however, is an anomoly.

In the mid-seventies, price controls made it extremely difficult for fuel oil retailers to recover their marginal operating costs. Although these controls came off of heating oil in 1976, the threat of reimposition has continued to have an impact on retailer margins. As long as any system of price controls is calculated on the basis of average costs rather than marginal costs, there will be a strong temptation for retailers to move away from those market areas and customers where marginal costs are highest. Indeed, this phenomenon has been taking place in many inner-city areas since 1973. As majority dealers have moved out, minority dealers have moved in. Without this exodus, this opportunity would not have been present and the growth in the number of minority dealers would not have been so pronounced. Further, these new minority dealers primarily serve minority consumers.

III. THE PROBLEMS OF MINORITY DEALERS

III.A. Starting Capital

The first thing that is needed to start a new business is capital. In the fuel oil business, the starting capital or "fixed cost" of doing business is quite substantial. In order to start a retail fuel oil dealership, the potential entrant must have enough money to obtain equipment and oil, pay employee salaries, and cover the relatively minor expenses associated with securing insurance and operating permits. A reasonable estimate of start-up costs is $50,000.[10/]

From a survey of banks who finance heating oil retail companies, it is clear that $50,000 in start-up funds is difficult to obtain. Dealers must generally provide $25,000 from other sources, such as personal savings, or willing investors. Moreover, banks typically require sources of repayment other than oil inventories. Specifically, they demand collateral in the form of durable assets such as trucks or storage equipment. For a dealer starting out, this can establish somewhat of a Catch-22 predicament: to buy this equipment, bank financing is often needed, yet such financing cannot be obtained without such equipment. Finally, new retailers seeking bank financing must provide evidence that they can operate their prospective businesses in a financially sound manner. For the new dealer, this requirement is a problem when no historical records of relevant work experience are available.

The potential entrant into the inner-city oil retailing business who is able to qualify for bank financing typically faces relatively high interest rates and tight repayment schedules. This reflects the noted business risk associated with the market to be served. Presently, most banks charge two to three points over prime for existing oil retailers. At a time when the prime rate was approximately fourteen percent, one banker summarized the situation by noting:

> If you own a couple of trucks with garage space for storing them, a reliable source of supply customers who are good credit risks, and no outstanding debt on your equipment, then you probably will be able to obtain a $25,000 loan at sixteen percent.

A second conceivable source of capital available for new heating oil retailers is the Small Business Administration. As a rule, however, the SBA will not extend a loan to any firm that has not been established for at least one year.[11/] Thus, for anyone wanting to enter the market, going to the SBA often proves fruitless.

A potential minority retailer who is unable to secure a bank or SBA loan to start a dealership can turn to another source of help--the Federal Government's Minority Set Aside Program. Specifically, federal law requires that ten percent of all government oil contract work be set aside solely for minority businesses. This ten percent might appear to be sufficient to help some minorities enter the market, however, it is evident from interviews with established dealers that new minority dealerships are not benefitting from this program. New dealerships seldom have enough on-hand capital or equipment to compete with pre-1970 firms for these contracts. As a result, the present structure of the Minority Business Set Aside Program successfully grandfathers in older established minority firms and effectively excludes post-1973 firms.

Not only is it particularly difficult to obtain financing for a new inner-city heating oil dealership, but, for reasons noted above, the level of necessary starting capital is generally higher in the inner-city market than in other markets. As a result of crime problems, dealers in the inner-city pay more to be insured.[12/] Moreover, because inner-city dealers usually charge C.O.D., they typically have great sums of money with them and are therefore more prone to robbery. Thus, it usually takes two people to deliver oil (one to watch the truck, and one to deliver the oil), which means that two salaries must be paid.

The general tendency for initial capital requirements (and financing costs) to be higher for inner-city retailers is not a new phenomenon; nor is it a phenomenon that appears to be based on non-economic factors such as discrimination. Relatively high start-up costs and scarce capital is a problem faced by any entrant into the inner-city heating oil retail business, and it is a problem that will continue as heating oil prices increase and volumes delivered decline.

III.B. Obtaining a Reliable Source of Product

Our survey of the retail fuel oil market, indicates that the greatest problem for most small dealers is finding a wholesale source of supply. As stated above, new minority dealerships most often serve areas that have been left by majority dealerships. For this reason, it might seem reasonable to assume that a new minority dealership would use the same oil source as the exiting majority dealership. This assumption is not supported by the empirical evidence. Federally-established allocation rights to fuel oil supplies are not automatically transferred with a change in ownership of a fuel oil dealership; and once an existing dealership leaves, the wholesaler's supply becomes an object of open bidding.[13/]

In normal non-shortage periods, inner-city dealers encounter problems in obtaining supply as the riskiness of retail operations, the instability of retail cash flow, and high failure rates for new and small businesses adversely impact wholesalers' willingness to enter into long-term contractual relationships. The supply problems of new heating oil retailers are particularly severe during periods of shortage, such as the 1973-74 embargo period and during the 1979 Iranian crisis. During times of shortage, wholesalers tend to serve traditional dealers first and allocate their remaining supplies on a first come-first serve basis. Many minority dealers interviewed maintain that because wholesalers give priority to traditional customers in times of tight supply, oil supplies are not available to dealers who were unable, through no fault of their own, to enter into the same contractual arrangements as the traditional customers.

The result of these forces is that many minority dealers are forced to buy oil on the spot market. During the winter months, spot market oil usually sells for a higher price than contract oil.[14/] For example, in the winter of 1978-79, the average price for spot market oil was always higher than that for contract oil (often by as much as $20 a barrel).[15/] It should also be noted that most data sources agree that during periods of oil shortages, even the spot market becomes very tight.

It is important to point out that in and of itself, the need to purchase oil at higher-than-contract spot prices is not necessarily a significant problem in terms of the viability of the heating oil market. If the affected retailer has a local monopoly in the relevant market area, higher product costs may be passed on without threatening the firm's survival. If the affected retailer is faced with competition that is able to compete more effectively on price, higher spot prices will not be completely passed on, but it would make little sense (in terms of both society-wide economic efficiency and the welfare of heating oil consumers) to insulate high-cost, less-efficient retailers from the tests of competition.

Those minority dealers who are fortunate enough to obtain long-range contracts usually deal with secondary suppliers. Secondary suppliers are those wholesalers who are supplied oil by a refiner, but do not refine oil themselves. The supply relationships obtained by secondary suppliers are relatively insecure as a result of the interest fully-integrated refiners have in guaranteeing supply to their own operations. Similarly, because most large secondary wholesalers are also retailers, their own retail operations have greater supply security than arms-length buyers. In some cases, minority dealers would rather buy their oil C.O.D. from a primary supplier than on a contract basis with a secondary supplier, since they believe that secondary dealers have a strong incentive to discriminate against firms which potentially compete in the same market.

From our interviews with minority dealers, the impression was given that contracts with primary suppliers are difficult to obtain.[16/] One authority (a representative of a leading New England trade association) states that he does not know of any primary supplier in the state of Connecticut that has given a black dealer a long-term contract.[17/] Dealers in Connecticut say that primary suppliers will not even sell them oil C.O.D., but will only direct them to secondary suppliers.

Although there is no formal criteria by which primary suppliers evaluate potential contract purchasers, a number of factors are considered. First and foremost, most of the oil to be sold through long-term contracts is reserved for long-standing customers. There is not a large supply of surplus contract oil and obtaining the small fraction available is difficult for any new dealer whether he be large or small, black or white. Primary oil dealers prefer to sign contracts with larger dealers who are financially secure, who can easily meet tight credit requirements, and who have a proven track record. Further, they tend to favor those dealers who have large amounts of storage capacity or some other means of moving surplus fuel (usually oil delivered during the summer). The companies that fit these criteria are usually larger secondary dealers who both buy wholesale and sell retail heating oil.

The survey of the problems of supply acquisition faced by minority dealers reveals no overt evidence of discrimination. Rather, there is a continuing pattern of minimizing financial risks. A primary supplier, for example, who has a choice of signing a contract with one large, financially secure secondary dealer or several small, new inner-city retailers, will, unless otherwise pressured, sign a contract with the secondary dealer. Some observers and market participants believe that wholesalers are afraid to discriminate; and what might appear to be arbitrary discrimination among retailers is the result of the economic incentives influencing wholesalers to honor explicit and implicit contracts and to maintain goodwill with their larger and longest-standing customers.[18/]

The one area in which the criteria by which retailers obtain contracts which are less clear and, perhaps, more prone to discrimination is that of a new retailer without an established line of credit or track record attempting to obtain a line of credit. One representative of a large New England secondary wholesaler has noted that:

> Getting a long-range contract depends on your credit rating and the type of person you are. If you are new and you come with cash in hand, then you can get oil if it is available. Otherwise, forget it unless they like you--getting a year long contract is a totally subjective decision.[19/]

It is not surprising in this setting that many minority dealers interviewed did not believe there is discrimination in acquiring oil, but did think there is discrimination in acquiring the credit necessary for a long-term contractual arrangment.

This discrimination in the acquisition of heating oil supplies and credit stems, at least in part, from federal price and allocation controls, of both the formal and informal (jawboning) varieties. First, such controls are the cause of shortages--of being unable to get the product no matter how much one is willing to pay. Second, contrary to popular perception, price and allocation regulations make it less costly for heating oil suppliers to engage in discriminatory or arbitrary behavior. When price is eliminated as a means by which suppliers allocate their products, non-economic criteria can be pursued without loss of business or revenue. Social groups subject to discrimination, poor access to regulatory decision-makers, and/or inadequate legal representation typically are placed at a serious disadvantage in such situations. Even the threat of the imposition of mandatory price and allocation controls in the heating oil market, for example, can foster discrimination. Control programs freeze buyer-supplier relationships; and the would-be supplier fearing that he will be locked into a relationship will tend to discriminate against marginal retailers. In a non-controlled environment, the supplier has the ability to withdraw from the arrangement if problems ensue, or if better opportunities arise. This incremental flexibility would enable most suppliers to be less risk adverse on entering into contractual arrangements with marginal buyers.

III.C. Other Problems Confronting Minority Dealers

In addition to the problems of a generally declining market and expensive start-up requirements, inner-city heating oil dealers must confront difficulties associated with short-term credit crunches and lack of membership in trade associations.

So-called credit crunches arise when a retail firm cannot raise money (through the sale of its oil) quickly enough to pay its own debts (either to its wholesale supplier or to its bank). These crunches most often affect dealers that allow time payment, but they can also affect dealers that charge their customers C.O.D. When customers are unable to pay for their oil, the dealer is confronted with a dilemma of either delivering the oil and facing the high probability of never being fully repaid, or not making the delivery and letting the customer go cold.

Fuel oil assistance programs aid poor people in paying for their oil, but assistance programs, themselves, can create credit crunches. Many such programs involve substantial and often unpredictable delays between the time the oil is delivered and the time the dealer receives payment from the government (or the agency designated by the government). Thus, dealers who have a disproportionate number of customers on assistance programs can face severe credit crunches particularly during periods of unusually high demand. The smaller the retailer, the more serious this problem becomes. A larger clientele translates into a cash flow that is more stable and less susceptible to transitory disruption by the actions of any individual customer or subset of customers. Moreover, one option that many large heating oil dealers have for avoiding short-term credit crunches is access to funds from the sale of other products such as replacement burners, furnaces, and thermostats. This option is less often available to minority dealers than to other dealers since small inner-city minority retailers are less often integrated into other product lines and low-income inner-city consumers typically purchase such commodities less frequently.

There are times when even the best efforts of the dealer are not enough to prevent a credit crunch. The result is an immediate need to borrow funds. The first place the affected dealer is likely to find financing is a commercial bank. As already discussed, however, bank financing can be difficult to obtain. The next option is the SBA, which will grant loans to small businesses that cannot secure bank loans. However, for a minority dealer in a credit crunch the SBA can be a dead-end. Many dealers state that the SBA takes a very long time to give dealers the money they need. The bureaucratic forms are very complex and time consuming. Finally, the SBA has fairly tight (but probably not inapropriately so) criteria in issuing loans and is certainly far from a sure source of funding for a small minority dealer, confronting an immediate credit crunch.

A final problem facing minority dealers is a lack of information concerning changes in their market and their industry. They generally do not receive this type of information because they generally do not belong to trade associations. Throughout New England, minority participation in trade associations is less than five percent and in some cases one percent.[20/] When asked why minorities are not members of associations, association officials claimed that minorities are suspicious that the association reflects the interests of larger majority firms. It is not clear why small dealers generally do not form associations of their own. The lack of association membership results in minority dealers missing a substantial amount of relevant information which could improve the management of their dealerships.

IV. SPECIAL PROBLEMS OF THE INNER-CITY

The success or failure of the minority heating oil dealer is directly connected to the characteristics of the customers that are served. The inner-city oil consumer must present the dealer with unique problems. This section looks at three specific topics:

1) A profile of the inner-city inhabitant
2) Who serves the inner-city dweller
3) Assistance programs for inner-city heating oil consumers

IV.A. Profile of the Inner-City Resident

The Census data collected in 1970 reveal that the inner-city areas of large metropolitan communities are predominantly populated by minorities and the poor.[21/] Since blacks comprise the greatest number of minorities in most major U.S. cities and reside in the inner-cities because that area offers the cheapest housing, many blacks live below or near the poverty level:[22/]

> The proportion of the black population and households in poverty is significantly higher than that for the Nation and whites.... For example, in 1974, twenty-seven percent of black households and twenty-eight percent of the black population were estimated to be in poverty. The corresponding percentages for the Nation and whites were ten and eleven percent and eight and nine percent, respectively.[23/]

Using six different methods of measurement, the Department of Energy projects that black households will, in 1985, continue to pay a larger annual percentage of their income toward home heating oil than white households.[24/] These facts indicate that inner-city blacks typically face the problems of poverty as well as having to use a greater portion of their incomes to obtain heating oil.

Many people using oil for home heating are investing in devices that increase the efficient utilization of the oil they buy (oil burner retrofits, thermostats, etc.). For the average inner-city inhabitant, however, these measures are often beyond their limited budgets. Replacing an older inefficient burner with a high-speed, flame-retention head burner can save sixteen percent in the average home.[25/] Yet, such a burner costs approximately $600. At this cost, the average inner-city heating oil consumer must rely on programs such as the Department of Energy's low-income weatherization program if oil-saving investments are to be made. The expansion of programs to weatherize low-income homes would clearly benefit inner-city heating oil consumers, but, by further shrinking the market, would adversely affect inner-city oil dealers.

IV.B. Service to the Inner-City Dweller

A special problem faced by many inner-city dwellers is finding and maintaining a constant supply of heating oil. As noted above, majority dealers have left many inner-city areas and have been replaced by minority dealers. However, collected evidence suggests that many minority dealers are having trouble staying in business. This situation creates the very important question of who will serve the inner-city. This question was posed to numerous officials from business and government. The answers were mixed, ranging from extreme pessimism about finding anyone to serve these areas to overt optimism that the large majority dealers would never allow an entire section of the city to go without a source of oil.

Both extremes are unrealistic. The economic reality is that inner-city heating oil consumers will have to pay more on a per gallon basis to attract dealers into this high-risk market. In an earlier section of this report, it was argued that serving a high-risk market, such as the inner-city, created higher costs that are in the range of three to five cents per gallon. If minority firms fail and majority firms are reluctant to re-enter this market, this risk premium will increase until it is high enough to attract suppliers back into the market. The continuing net entry by minorities suggests, however, that current premiums are sufficient to guarantee service, although the identity of particular retailers is likely to remain unstable.

Insofar as the risk premium reflected in the price of heating oil in the inner-city market reflects all of the costs of serving this market, it promotes the efficient use of the nation's energy resources. From an equity perspective, however, a high risk premium is very troubling, since those who can least afford the high price of heating oil must pay more for this product than wealthier people. In many instances, this premium will be paid by the federal government either through transfer payments or the existing low-income energy assistance program; but in some cases, it will not.

IV.C. Assistance Programs

Local, state, and federal fuel oil assistance programs presently provide millions of dollars to help poor people pay their home heating bills. For the most part, these programs are of great assistance. The present administration of these programs, however, could stand improvement in many cases.

Every large metropolitan area researched in this report has some type of home heating assistance program. The programs usually pay up to $600 (annual total) of oil, gas, or electric bills per eligible household. For most programs, participating families chose their own dealer; and if they could not find one, the assistance program attempted to locate one for them. In some of the larger multi-unit housing areas such as New York City, the assistance monies went directly to the landlord, who in turn paid the oil dealer.

These various assistance programs are of significant benefit to many people (in 1979, over 23,000 families participated in the Boston program). Yet, many of these programs are creating problems for both the inner-city consumer and dealer.

Numerous inner-city dealers expressed reluctance to serve customers who were eligible for assistance programs. Dealers feared credit crunches stemming from the assistance programs' failure to give out checks in a timely fashion. This credit crunch threat is especially real for the dealers who serve the inner-city resident because, as noted, they are usually small and without ready access to capital. Again, using Boston as a target city, of the 330 dealers participating in the assistance program, seventy to eighty percent of them are one or two truck operations.[26/] Dealers of this type cannot afford a long hiatus between the time they deliver the oil and the time they get paid.

IV.D. Summary

In summary, the typical inner-city inhabitant finds it difficult to: 1) pay for heating oil, 2) invest in oil saving devices, 3) get a continuing source of supply, and 4) rely on an assistance program which has experienced significant implementation problems.

V. CONCLUSIONS AND RECOMMENDATIONS

V.A. Introduction

In the opinion of many, the government is not doing all it can to help minority businesses and, specifically, minority fuel oil dealers. Many minority dealers feel that the government should apply additional pressure on major (primary) wholesalers to enter into contracts with minority dealers. One dealer stated that he was not looking for a handout of a long-term contract, but that he wanted the security of buying oil from a wholesaler who was not also a competing retailer. Another suggested that state and local officials should set aside oil specifically for minority dealers. One market observer suggested that the government should provide training for small oil dealers to insure that they become better business managers.

The picture of the minority fuel oil retailer that emerges from this study is one in which the difficulties faced emanate from underlying economic conditions that make business survival and profit extremely problematic. Although the deplorable consequences of discrimination in the reatil heating oil market should not be minimized, it is apparent that the problems being encountered by minority heating oil dealers arise primarily because such dealers are typically new, small, and serving high-risk customers, rather than because they are minorities per se. Of course, this conclusion is of small consolation to dealers themselves. It also does not alter the facts that it is minorities that are bearing the brunt of the problems of serving inner-city heating oil consumers. The problems for public policy are ultimately problems of poverty--and the fact that poverty remains a condition faced disproportionately by minorities.

V.B. Recommedations

Our policy recommendations are shaped by this conception of the problems faced by minority heating oil dealers. We take the broad policy objective of progressive income redistribution as given and our policy recommendations are aimed at achieving this objective with maximum efficiency. Our recommendations are predicated on the following guidelines: a) the efficient use of the nation's energy resources requires that energy prices reflect the costs of supplying the product in question; b) in the absence of non-economic distortions, extraordinary measures designed to insulate selected firms from the rigors of the marketplace result in inefficient and often inequitable allocations of supply; and c) any programs that are adopted should be operated in the most effective manner possible.

With these guidelines in mind, we make the following recommendations:

1) In the design and implementation of low-income energy assistance programs, mechanisms should be developed to allow for prepayment of oil deliveries. Prepayment will ease the cash flow problem which plagues inner-city dealers and will lower delivery costs by allowing larger drops of oil per household.

2) The Small Business Administration should adopt provisions for immediate availability of short-term funds to inner-city small businesses. Such a program would involve pre-processing and pre-approval of SBA credit so as to reduce current delays. This will help to alleviate the credit crunches that currently threaten inner-city heating oil retailers and will make retailers better credit risks in the eyes of private financial institutions.

3) In the design and implementation of low-income heating oil assistance programs, mechanisms should be developed to tie the level of payments to the price-per-gallon premium paid by inner-city residents. Current assistance programs may offset the present price premiums. Future increases in these premiums, however, will warrant increases in those assistance levels. Failure to provide sufficient assistance will over time create strong political pressure for the reimposition of price and allocation controls which could only compound the problem of the inner-city retailers.

4) Reimposition of price and allocation controls in the heating oil market should be discouraged. When binding, price controls produce shortages, leave inner-city consumers unable to get the oil they require, and create precisely those conditions under which discrimination is most likely.

5) Information on conditions in the heating oil market available in the Energy Information Administration and other parts of the Department of Energy should be systematically and rapidly provided to inner-city oil dealers. This will allow dealers to keep abreast of developments in contract prices, spot prices, inventories, public policy changes, etc.; and will promote more accurate business planning.

6) An examination of local, state, and federal government heating oil contracting processes should be immediately undertaken. Contracting practices that inhibit the ability of new and small retailers to

compete should be reformed. Special attention should be given to the federal government's Minority Set Aside Program, which effectively precludes participation by new and small minority dealers.

The first two of our recommendations are directed at the cash flow problems of minority heating oil dealers. The goal is to improve the effectiveness of programs that currently have a tendency to exacerbate, rather than alleviate the financing difficulties of dealers. As detailed above, the cash flow problems of minority heating oil dealers create credit crunches that must be weathered if the firm is to survive. Moreover, if the threat of credit crunches can be reduced, minority firms will become more credit-worthy in the private sector and the problems associated with acquisition of start-up capital will be significantly reduced.

Energy assistance programs provide either for reimbursing the dealer or for direct cash payment to the low-income recipient. In the former instance, delays of several weeks between delivery and payment are common. In the latter instance, the retailers' cash-flow problem is lessened, but the recipient only is given sufficient monies to purchase oil in small amounts, thereby increasing the costs per gallon of delivering the oil. Options to prepay vendors would eliminate the delays inherent in reimbursement schemes and would allow for larger amounts of oil per delivery. Since eligibility for these programs is a function of income and since the variation in an individual's demand per winter is rarely greater than thirty percent, prepaying fifty to seventy percent of the estimated cost of the oil directly to the vendor in December should be possible. If demand increases because of weather, the outstanding percentage could be paid through the normal reimbursement mechanisms. If this recommendation is perceived as too radical a change, the program could be further regulated by only prepaying each month's demand.

Prepayment by energy assistance programs could improve the cash flow positions of minority heating oil retailers, but would be unlikely to completely eliminate credit crunches. The need for short-term financing would still arise, albeit less frequently and in lesser amounts. Improvement in the Small Business Administration's operating procedures could be made to make the SBA more responsive to short-run conditions. Such improvements might entail establishment of a working file for interested firms, including preprocessing of applications, pre-examination of credit records, and pre-assessment of the soundness of the firm's business practices. With such a file complete prior to a credit crunch, the bureaucratic red-tape at the time of a crunch could be reduced to an assessment of the short-term situation itself.

It would be inappropriate to undertake government subsidy programs to assist oil retailers doing business in the inner-city unless such subsidies were part of a broader social goal such as special programs to assist small business in general. The business problems of inner-city dealers are fundamentally the result of the high-risk nature of inner-city consumers. The solutions to these problems should be shaped to address this basic cause, rather than its symptoms. The sources of the high-risk nature of the inner-city are rooted in a long history of discrimination, impoverishment, poor education, and unemployment; and, ultimately, solutions must be founded on far broader policies affecting our basic social structure than on policies affecting the heating of homes.

Of course, other things equal, energy assistance programs and other redistribution measures should be designed so as to minimize the risk factor associated with doing business in the inner-city. So long as such a factor exists, however, it is a social cost of doing business. The efficient allocation of society's scarce resources requires that firms serving high-risk markets take appropriate actions in their buying, selling, pricing, and management so as to avoid the negative consequences of risk. The potential gains to customers (in the form of lower risk premiums in the prices they pay) that might occur as a result of subsidizing the risk-bearing of retailers could easily be eaten up by inefficiency in firms' operations.

Allowing inner-city oil dealers to bear the risks of their operations means that the fate of any individual retailer is less certain than it otherwise would be. It does not mean that the existence of the industry as a whole is less certain. On average, retailers are remunerated for the risks they bear, with remuneration taking the form of the price premium noted above. Recent and continuing entry by minority dealers attest to this process. Of course, consumers ultimately pay for supporting inner-city retailers in risky operations. Our third recommendation addresses the equity problems that result.

It is beyond the scope of this study to assess the appropriateness of the transfer payments currently made to minorities and the inner-city poor. It is also beyond the scope of this study to assess whether current transfer schemes have already equitably accounted for inner-city price premiums in heating oil and other commodities. Our third recommendation is narrowly conceived and is designed to point out that: 1) as oil prices continue to increase, the consequences of failing to provide sufficient and effective low-income assistance will grow more serious; 2) increases in inner-city price premiums exacerbate the problem; and 3) the political process will demand increasing assistance levels as a response to increasing prices of a product weighted so heavily in low-income people's expenditures.

Our fourth recommendation embodies two objectives: promoting the survival of minority heating oil dealers and guaranteeing the availability of oil to inner-city consumers. Price and allocation schemes transfer the locus of economic power toward the political/bureaucratic arena. Groups such as minorities that are plagued by discrimination, poverty, and lack of access to legal and lobbying resources seldom fare well under schemes that make decisions on supply and price arbitrary and remove such decisions from the pressure of profit-and-loss tests. The solution to inner-city problems of supply acquisition under price and allocation controls is not in an improved controls system. In the absence of controls, minority dealers are guaranteed that supplies are available and that the higher costs they may have to pay to acquire those supplies will be reimbursed.

Prior to decontrol in January of 1981, price controls were in effect for nine years. It would be overly optimistic to expect the market to adjust perfectly to this new environment. Problems of transition are inevitable. Government should be sensitive to these problems, but their solutions should not significantly impede or slow down the transition. Otherwise, the pain of readjustment will be greater and will have to be endured over a longer period of time.

Our fifth recommendation is geared toward improving the management of minority heating oil dealerships. In a market as volatile as the oil market, accurate information on and forecasts of prices, inventories, demand trends, etc. becomes crucial to effective retailing. Anticipation of demand trends, for example, could aid minority dealers in shoring up their cash flows when a credit crunch threatens or in allowing customers a little more payment flexibility when a threat subsides. As another example, information on conservation techniques could promote the integration of minority dealers into energy counseling services. Since various offices within the Department of Energy currently collect or generate virtually all available information of relevance and since once such information is collected its dissemination is virtually costless, its distribution should be promoted. This may require the designation of a locus of responsibility within the Department of Energy that could be charged with the task of specifically reaching inner-city heating oil retailers.

Our sixth recommendation addresses the problems that new minority heating oil retailers have in winning bulk contracts. As noted, the Minority Set Aside Program appears to disproportionately benefit well-established firms. In addition, our surveys indicate that government contracts outside the Set Aside Program are characterized to an undetermined extent by preferential treatment of well-established dealers. An examination of, particularly, local and state contracting practices is warranged, with an eye toward recommendations for reducing barriers faced by new market entrants.

FOOTNOTES

1. U.S. Department of Energy, "The New England Energy Situation", Regional Office - Region I, Boston, Massachusetts, 1979, p. 6.

2. Data from Massachusetts Energy Office from New England Energy Congress Final Report.

3. U.S. Department of Energy, op.cit., p. 3.

4. Interviews with oil retailers (Leslie and Burkhart).

5. U.S. Small Business Administration, "A Public Hearing: Retail Fuel Oil Dealers", Boston, Massachusetts, 1979, p. 21.

6. Interviews with oil retailers.

7. U.S. Small Business Administration, op.cit., p. 82.

8. U.S. Department of Energy, "Analysis of the Competitive Viability of Independent Middle Distillate Marketers", Economic Regulatory Administration, Office of Petroleum Operations, Washington, D.C., 1979, p. 207.

9. Ibid., p. 208.

10. Interview with Jim Monroe, President, New England Minority Fuel Oil Dealers Association, Hartford, Connecticut.

11. Expert and Dealer interviews (Leslie, Monroe, King, Wells, Burkhart).

12. U.S. Small Business Administration, "SBA Business Loans", Regional Office, Boston, Massachusetts, 1979, p. 11.

13. Interviews with oil retailers and DOE officials (Woodward, and dealers).

14. Interviews with oil retailers (Burke, Griffin and dealers).

15. Platt's Oil Price Handbook and Almanac, 1979 Prices, McGraw-Hill, Inc., New York, 1980, pp. 81-101.

16. Ibid.

17. Minority dealers interviews.

18. Expert interviews (Burkhart).

19. Expert interview (Hennessy, Burkhart, Monroe, Woodward, Burke, Amato).

20. Expert interview with the representative of Metropolitan Fuel Company, (John Griffins).

21. Interviews with officials from oil trade associations (Leslie, Wells, Burkhart).

22. U.S. Department of Commerce, "Negro Population", Bureau of the Census, Subject Report, Washington, D.C., 1973.

23. U.S. Department of Energy, "A Distributional Analysis of Trends in Energy Expenditures by Black Household", Energy Information Administration, Washington, D.C., 1979, pp. 35-36.

24. Ibid.

25. U.S. Department of Energy, "Energy-Saving Options for Home Oil Equipment", Solar and Conservation Office, Washington, D.C., 1980.

26. Interviews with oil retailers (McBrearty).