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Oil costs? All aren't obvious

Firms pinched; customers next



Prices are up for all petroleum-based products, such as the plastic container Environ's Angel Perez is moving.

Staff Photo by Travis Long

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By VICKI LEE PARKER, Staff Writer

Alan Cason noticed something strange at his toy store this year. The cost of plastic toys has climbed steadily, while others remained flat.

The culprit? Rising crude oil prices.

"The wooden toys had no price increase; it's definitely in the plastics," which are made using petroleum-based products, said Cason, co-owner of Abrakidabra Toys in Cary.

After two price hikes this year, Cason said he had to pass the cost on to his customers. Plastic toys that used to cost \$10 will now cost \$12, and more increases may be coming, he said.

"If we pay more for it, we have to charge more," he said, even if that means losing some customers to large retailers, such as Wal-Mart.

Companies in a wide swath of industries are struggling to manage expenses tied to the dramatic rise in crude oil prices, which have climbed 34 percent in the past year. Some have absorbed the costs and watched their profits shrink.

But many businesses are being forced to consider passing the extra expense on to customers. Some local companies are finding that more difficult than others.

This week, the federal government released two reports that showed energy costs are driving up inflation. Consumer prices jumped 0.5 percent in July, pushed by crude oil prices. A separate report showed that prices at the wholesale level rose 1 percent last month, the biggest increase since October.

The figures suggest that as businesses pay more for supplies, the added costs eventually will be passed on to consumers, creating more widespread inflation.

Most companies are getting a lesson in economics: The success of raising prices depends on a variety of factors such as the demand for your product, global competition and your customers.

Nomaco, which makes plastic insulation for water heaters and the popular foam noodle flotation toys, is in a tough spot.

The costs for the Zebulon company's raw materials such as polyethylene have increased more than 50 percent in two years.

The company has raised prices three times during that period but has been met with strong resistance from some of its large corporate customers, which include Wal-Mart and Home Depot.

"The smaller businesses understand and are very cooperative," said Mick Dannin, Nomaco's chief executive. "They understand that you can't do anything about it. The bigger ones are very difficult. They say, 'We don't accept price increases.'"

Companies that sell nonessential items are also in a bind. They fear they may lose customers if they raise prices.

Jackie Ammons, owner of The Flower Shop in Wendell, said she has held off passing on costs to her customers even though her delivery expenses have increased 31 percent this year.

"Flowers are a luxury item, and people treat them that way. ... You feel that you can't add so much on the delivery charge because there is only so much people will tolerate."

Ammons said she has been trying to conserve in other ways. "We wait until we have several orders and make just one swing around town to try to conserve gas."

But that's not enough, and Ammons knows that soon she'll have to raise prices, too. "It's getting to the point that I have to," she said.

She said she is planning to increase the delivery charge for local customers from \$2 to \$3, or maybe \$4.

For companies that can't immediately recoup higher costs, it has meant absorbing hefty expenses.

During the second quarter at Waste Industries, the cost of fuel to keep its 800 trucks and commercial vehicles on the road rose 20 percent, said Stephen Grissom, chief financial officer.

Grissom said that the Raleigh-based trash hauler is already adding fuel surcharges to its commercial customers. During the remainder of the year, it will expand those fees to its residential customers, 160,000 in North Carolina.

Successfully passing on costs also depends on where the company falls in a supply chain.

Environ, a Smithfield company that uses petroleum products to make underground thermoplastic pipes and accessories for gas stations, is fortunate to have big oil companies as both customers and suppliers.

"Many of them [the oil companies] are raising prices themselves," CEO Mike Webb said. "They understand that the [price of the] product they buy from us should be raised."

Many consumers have already seen increases in items directly tied to fuel costs, such as airline tickets, utility bills and perishables such as fruits and flowers. The soaring prices at the gas pump are the most visible example.

But that's just the beginning, said Campbell Harvey, a Duke finance professor.

"At first you see [an increase] in the most obvious things. ... Basically, there is a bit of a lag but eventually this doubling of the oil price will work its way through the system and end up in the price of final goods."

Companies that find it too difficult to pass on the increases may have to take other steps.

"We will start seeing companies cut back production or shut down. It's not happening now. That's a

possibility," said Mike Helmar, who tracks North Carolina for Economy.com, in West Chester, Pa.

Overall, the long-term effect of the high fuel costs will be to dampen the economic rebound the country has enjoyed for nearly two years, economists say, especially if consumers balk at paying higher prices for goods on top of higher energy bills.

"The rising energy prices and [the Federal Reserve's interest-rate] hikes will slow economic activity in 2006," said Mark Vitner, senior economist at Wachovia Securities in Charlotte. "That means less jobs, income growth and less activity in the housing industry."

Looking further ahead, growth in other countries such as China and India, which is helping boost demand for oil, is not going to slow, said Ken Mayland, chief economist at ClearView Economics.

"That means the price of oil will remain high or go higher," he said. "And if you think this is something, wait till winter comes."

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