On-Farm Marketing Controls

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Part Four: Getting Control of Your Pricing

This is the most critical part to be successful marketing directly to consumers. How do you set a price that ensures a profit for your farm business at the end of the year?

When choosing a title for this section, I considered "Controlling Expenses", or "Controlling Margins". But that doesn't really tell the whole story. Normally, when talking to farmers involved in production agriculture, on how to increase profits, the subject focuses on efficiency and reducing expenses. Controlling costs is an important part of ensuring a profit in any facet of agriculture, but it is particularly true with production agriculture, because commodity prices are, in most cases, beyond the control of the wholesale grower. So they have 2 options, (1) reduce costs or (2) increase yields, if they want to improve profitability. So the title "Controlling Expenses" would be a good title for farms in production agriculture, but not for farms that retail.

For farms that are marketing directly to consumers, they have a 3rd option. They can increase their price. Admittedly, there are limits. In most cases, you are not the only game in town. There are usually other farms marketing bison, or beef, or strawberries, or Saskatoons. But if they can separate themselves from their competition by offering the consumer a more tender product, a more flavourful product, a unique product, they can usually command a higher price. With higher prices, a farm marketer can support higher production costs or better yet, enjoy higher profits. The trick is, the consumer has to be able to distinguish a quality difference between your product, compared to your competition. I have a talk that outlines the 20 factors that influence price. Competition is only one.

All that being said, what I want to focus on is, how you can set prices that will ensure you a profit. "Getting Control of Your Pricing" is really the crux of the "Profit Club" that we started in Alberta this past November. Although it takes us most of a day to demonstrate this concept, the major point is, marketers need to understand their production and marketing expenses, and then relate those expenses to their gross sales, before they can price a product to ensure a profit.

Relating Everything to Gross Sales

If there is one figure that most marketers in any business can tell you, it is their gross sales. For that reason, most retailers (grocery store, shoe store, hardware store) find it quite helpful to compare many of their expenses to their overall gross sales. This is also a valuable tool for farm marketers to better understand their retail business as well.

Take for example a farm marketer who has annual gross sales of $100,000 at their on-farm market, or their Pick-Your-Own (PYO), or at their farmers' market stall. Checking their expenses, they see that they spent $3,000 on advertising their business, and $18,000 hiring staff to run the PYO or farmers' market stall. What that tells them is that they spent 3% of their gross sales on advertising, ($3,000/$100,000 = .03 or 3%), and they spent 18% of their gross sales on labour, ($18,000/$100,000 = .18 or 18%).

Relating key expenses to the gross sales, allows a farm marketer to compare one year to the next, to see if their use of labour is getting more or less efficient. What's even more important, one farm marketer can visit another farm marketer who operates a similar business and ask them what percent of their gross sales they spend on labour or advertising, without the other marketer revealing any dollar amounts. In this way operations can compare their two businesses. If it turns out that they are only spending 12% of their gross sales on labour, compared to our example of 18%, the 2 marketers can discuss how the one manages their labour, that allows them to be so much more efficient.

Likewise, a marketer can talk to another farm marketer, operating a business similar in size to theirs, and ask what percentage of their gross sales they spend on advertising. Again no dollar amounts need be shared, but each can discuss how they use their advertising budget to see if one marketer is doing something more efficiently than the other.

Expenses
In the "Profit Club" we spend a fair amount of time on each farm's individual income and expenses. We begin by dividing up the total farm's expenses among whatever enterprises each farm wants to track. Those enterprises might be, their PYO, the farmers' market, their on-farm roadside market, their grain crop and/or beef enterprises.

Once they know what their production and marketing expenses are for an enterprise, it is relatively straightforward to calculate a price that should return a profit to the farm. This process may also show the farmer, of the 5 enterprises they have, one is draining off the profits of the more viable enterprises. That too can be helpful information.

Sample Income and Expense Statement

Farmers' Market Enterprise Income:		
Gross Sales of beef at farmers' market	$100,000.00	
Cost of Production or Auction price (25 head)	$30,000.00	
Gross Profit (before marketing expenses)	**$70,000.00**	$70,000.00
Margin (%)	70%	
Marketing Expenses:		
Slaughter, cut, wrap & label	14,000.00	
Processing – (sausage, jerky)	5,000.00	

Farmers' Market Enterprise Income:		
Labour at farmers' market	$18,000.00	18%
Advertising	$3,000.00	3%
Supplies for farmers' market	$3,000.00	
Stall rental	$3,000.00	
Trucking (to abattoir & market)	$2,000.00	
Accountant & Insurance (market share)	$2,000.00	
Repairs -freezer	$1,000.00	
Debt service (farmers' market share)	$3,000.00	
Other	$2,000.00	
Set aside (future equipment needs)	$3,000.00	
Profit target (farmers' market enterprise)	$10,000.00	
Total	**$69,000.00**	$69,000.00
Expenses as a % of Gross Sales	**69%**	
Net Profit Before Taxes		$1,000.00

Margin
This leads us to a discussion on "Margins". What is it?
The simplest explanation is, any retail price is made up of 2 parts:

What the item cost you to produce and market, e.g.	$2.00
Your margin of profit	$1.00
Total retail price	$3.00

As a cattleman you have 2 options when you raise a herd of cattle. You can take them to auction or you can choose to market a portion of them yourself by taking them to an abattoir, getting them slaughtered, cut and wrapped and go to a farmers' market. The cost of producing those steers was exactly the same regardless of the market you choose. That is the "Cost of Production or Auction Price" listed in the chart above. But the difference comes when you choose to market it yourself, because you then incur all these marketing costs, which we have listed above as "Marketing Expenses". There is no feed cost or vet bills in this list, because those are production costs. What a marketer needs to know is, does marketing through a farmers' market give him a fair profit for all the extra work he has gone to.

So we start by separating out the marketing costs, (listed above) and then calculating what percentage they are to the total gross sales of the beef he sold at the farmers' market. In our example the marketing expenses are 69% of the gross sales. So for this farmer to make a profit, he needs to cover all these marketing costs. In other words he needs a margin of 69%

Also notice that there are 2 lines at the bottom of the chart that you won't normally see in a normal income and expense statement from you accountant. They are, "Set Aside" and "Profit Target". For a business to be viable it needs to be constantly upgrading its marketing equipment. That may be new freezers, new display counters, or a new cash register. These projected expenses need to be factored into your selling price, because they are legitimate marketing costs. They may not be coming till next year, but you should be planning ahead for these costs. You can't continue to operate your business if you don't have a freezer on the farm to store your meat, or if your display counters at the farmers' market are falling apart. This is not to suggest that you should be expected to buy all these items in one year and set a price to pay for all those capital improvements, but you should expect that your business will generate enough "margin" to not only cover the basic expenses, but also allow you to make improvements.

Likewise, you shouldn't be going to all this work and not make a profit. So it is also important that you factor in, as a legitimate expense, a "Profit Target" and expect your retail price to generate that profit for you and your family. The only way to make sure you realize that profit is to incorporate it into your expenses which all total up to the "Marketing Expenses" as a percent of gross sales. You deserve to make a profit.

Also note, in our example, there was also a "Profit Before Taxes" of $1,000.00. This example does not cover a number of aspects like shrink (damaged product, reduced/discounted sales, etc.), and we do not have time to get into inventory and inventory control, but it does show you the basics of how to calculate the margin you require to ensure a profit.

Conclusion

Profit is not a dirty word. Any business should be based on the principal of making a profit. I know that BSE and other factors beyond our control can prevent that. But don't give up; there is always more than one way to make a profit. The goal of "Getting Control of Your Pricing" is to show farm marketers that there is a way to help you establish a retail price, that hopefully will try and ensure that you make a profit.

Summary

Profits can be improved in many ways. You can increase your prices, lower your costs, or increase your overall gross sales. But in the long run, **the system that has the greatest potential of keeping you profitable, is through initiating CONTROLS**. The more control you have over your business, the better you can track its progress and identify its problems.

You can increase your prices, but without controls, a staff member may steal some of it from you. You can advertise to attract more customers, but without tracking your expenses so you know what margin to need to cover your increased advertising costs, your profits could actually decline. You may have an on-farm roadside market, but if you don't control customer traffic flow, your "Average Sale per Customer" may be well below its potential. You may have Pick-Your-Own strawberries, but if (1) you don't have controls on how staff handle cash at the checkout, so you can track it, and (2) how customers move between the field and their parked cars, you are quite likely experiencing theft from both customers and staff. You have worked hard to raise the products you offer for sale, you need the systems in place to ensure you reach your marketing potential and receive what is rightfully yours.

This resource was financially supported in part by The Agricultural Policy Framework (APF), a federal-provincial-territorial initiative