

AGRI-FACTS

Practical Information for Alberta's Agriculture Industry

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Pricing Processed Food Products

Setting a price for your products is one of the hardest parts of running a processed food business. The price has to be low enough that your customers see value, but high enough that you earn a profit.

If you set the price lower than what consumers are willing to pay, you could be leaving valuable revenue on the table. If the price is too high, you may struggle to sell your product.

This factsheet explores four issues to consider when pricing your processed food products.

- How to calculate the cost and profitability of your product
- Finding the market channel(s) that best match your business goals
- How knowing your competitors can help you set a price
- How consumer demand affects the pricing of your product

How to calculate the cost and profitability of your product

The cost incurred to produce the product is just the beginning. When determining your product's price, include all your costs. Most of your costs will fall into two categories: variable (direct and indirect) and fixed.

Variable costs

For variable costs, include those expenses that change with the number of units made or grown. For some of the costs, you will see a direct relationship to the number of units made or grown while for other costs, the relationship may not be quite as clear.

These costs include (but are not limited to) the following:

- raw ingredients
- processing expenses or fees for co-packers
- packaging costs such as boxes, bags, labels
- shipping and/or transportation
- labour costs you pay people to make your food product, for example:
 - yourself or family members
 - contract/seasonal employees
 - machine operators
- marketing costs (advertising, price lists)
- display costs (tables, tent, booths, signage)

Include all
your costs when
setting your
product price

Fixed costs (overhead)

For fixed costs, include expenses that do not change from month to month. The costs occur no matter how many units are made or grown.

These costs include (but are not limited to) the following:

- land and equipment expenses
- kitchen, building or facility costs
- insurance (building or liability)
- utilities
- management salaries

Note: it does not matter which category you put a cost in as long as you account for all your costs.

Cost of Production = Variable Costs + Fixed Costs
(direct and indirect)

Understanding your break-even point

A break-even point is a standard calculation in business used to discover the point where costs are covered by a

certain price and volume. The break-even point is the price at which there is neither a loss nor a profit from the sale of your product.

For this break-even example, you will need to know the cost to produce one unit of product (variable costs), plus what your monthly business costs are (fixed costs).

$$\text{Break-even point} = \frac{\text{fixed costs/month}}{\text{unit contribution margin}}$$

Remember, this example is intended to show the process, and your numbers will vary depending on the type of product you offer and your own costs.

Break-even scenario

Happy Cheese Company produces Camembert and sells it to a broker. Their cost to make 100 grams of cheese (variable costs) is \$1.50 per 100 gram, not including the monthly business (fixed) costs.

The broker wants to buy the cheese at a price of \$2.25 per 100 gram.

How many 100-gram units will Happy Cheese Company need to sell to cover their monthly fixed costs and break even?

Happy Cheese Company will subtract the variable costs per 100 gram from their selling price to see how much the sale of each 100-gram "unit" will contribute towards covering their fixed costs.

$$\text{Unit contribution} = \$2.25 - \$1.50 = \$0.75$$

Unit contribution margin = sale price - variable costs

So, each 100-gram unit contributes \$0.75 towards covering the monthly fixed costs of Happy Cheese Company's business.

Happy Cheese Company has \$1,200 per month in fixed costs for the cheese operation.

$$\text{Break-even} = \$1,200 / \$0.75 = 1,600 \text{ packages} \\ \text{in units} \qquad \qquad \qquad \text{of cheese}$$

To break even (have no profit), but cover all their costs (variable + fixed) by selling at \$2.25 per 100 gram, the Happy Cheese Company must sell 1,600 of the 100-gram packages of cheese each month.

Break-even analysis can also help you analyze how a price change affects your business. Using the same example, Happy Cheese Company sells the cheese to a different broker for \$2.75 each. Here is what happens to the number of packages of cheese they need to sell to cover the same costs and break-even:

$$\text{Unit contribution} = \$2.75 - \$1.50 = \$1.25 \text{ per 100 gram}$$

goes towards covering Happy Cheese Company's monthly fixed costs.

The Happy Cheese Company has \$1,200 per month in fixed costs for the cheese operation.

$$\text{Break-even} = \$1,200 / \$1.25 = 960 \text{ packages} \\ \text{in units} \qquad \qquad \qquad \text{of cheese}$$

A higher wholesale price of \$2.75 per 100 gram will mean they can sell 640 fewer 100-gram packages (1,600 - 960) per month and still break even, compared to selling at a lower price of \$2.25 per 100-gram package.

You can use break-even analysis before you plan for a new food product or decide on a new price to be sure the new product or price will generate enough income to cover the costs of your business.

How do I calculate my profit goals?

Covering your costs is an important starting point. Making sure you earn sufficient profit to ensure your business thrives is the next critical step.

You can set your profit goals as a percentage above the cost of the product, or you can set a total profit figure for the entire business. Make sure you are familiar with the product price range in your industry, so your profit goal is suitable for your food products. You will need to balance your need for a profit with a price that consumers see value in.

This next example shows profit as a percentage above cost, using products made by a jam producer. Typical retail industry margins in Alberta for this type of product are between 30 per cent and 40 per cent.

Profit as percentage

Cheryl makes specialized jams, jellies and chutneys and has done extremely well at farmers' markets. She has been approached by two different specialty retail stores: one wants to stock her apple chutney, and one is interested in stocking her sage jelly. The first retailer wants a 30 per cent margin and will price the chutney at \$5.00 per 250-ml jar of apple chutney; the second retailer will set the price at \$6.25 per 250-ml jar of sage jelly and wants a 40 per cent margin.

How can Cheryl figure out the best wholesale price she will receive?

Since Cheryl knows the selling price and the margin, she can calculate the price she will receive by using the following formula:

$$\text{selling price} / \text{mark-up factor}^* = \text{cost to producer}$$

$$\$5.00 / 1.429 = \$3.50 \quad \text{OR} \quad \$6.25 / 1.667 = \$3.75$$

* Sample margins converted to mark-up factor are listed in the table below. For this example, find the margin percentage (30% or 40%) in the first column, then look across to the second column to the mark-up factor of 1.429 or 1.667.

Mark-up Factor Table	
Margin %	Factor
30.0	1.429
31.0	1.450
32.0	1.471
33.0	1.493
34.0	1.515
35.0	1.539
40.0	1.667
45.0	1.818
50.0	2.000
60.0	2.500

This calculation has helped Cheryl determine that she will earn more profit by going with the second store, even though their profit margin is higher than the first store. The only thing left for Cheryl to decide is whether she can cover her costs and make a profit at the wholesale price of \$3.75 per 250-ml jar of sage jelly.

Finding the market channel(s) that best match your business goals

There are many possible market channels for your food product, each with its advantages and disadvantages. Examine which type of market channel is the best fit for you, your product and your business.

Each channel will have different requirements, such as storage for your product, fees to place your product or discounts for brokers. These costs will affect the price you set.

Price can also vary by channel due to market demand. For example, the price of a specialty jar of dilled carrots offered at a farmers' market will be different than the price for a similar jar at a large grocery retailer.

Here are some common marketing channels for a processed food product.

Direct Marketing

- farmers' markets
- farmgate sales
- trade shows or trade fairs
- mail order/online sales

Advantages

- direct contact with customers
- lower marketing costs
- potential to earn more profit on products you sell
- a market to test new products
- networking with similar sellers and/or finding collaboration opportunities

Disadvantages

- additional time required to sell products
- some of the channels are seasonal
- extra costs if transporting products to customers
- customer base is smaller than other market channels

Indirect Marketing

- brokers
- retailers (small shops or larger grocery stores)
- restaurants
- institutional food service buyers (schools, hospitals)

Advantages

- larger customer base
- good distribution system has been established
- some take responsibility for marketing your product
- opportunity for higher sales volume

Disadvantages

- adds an extra cost to your product due to fees or commissions paid
- selling product at wholesale prices
- lose contact with the customer if you sell only through indirect channels
- may be difficult to source indirect sellers interested in distributing your product

For more detailed information on opportunities and challenges for the direct marketing channel, see the Agriculture and Forestry publication *Farm Direct Marketing for Rural Producers*, Agdex 845-6.

How knowing your competitors can help you set a price

Cost-based pricing is just one way to determine your price and works best in a market with limited competition. In a market with more competition, it is best to look at what your competitors are charging.

Knowing your competitors' prices can help you price your product. When competition is low for your product category, you can choose to price at the top of the price range. If competition is high, you can choose to price at the low end of the price range. If your product has a unique quality or selling feature not being marketed by your competitors, you could demand a higher price.

Here are six ways to learn about your competition's pricing strategies:

Prepare a competitor list

Select who your key competitors are and review how their prices compare to yours. Focus on those with a similar product and similar-sized business to keep price comparisons relevant to your business.

Analyze your main competitors

Ask customers and suppliers about your competition. If possible, visit a competitor's business to learn how products are priced and distributed. See how your competitor's product strengths, weaknesses and price compare to yours.

Watch new competitors as they enter your market

Regularly check with customers, suppliers and your competition to gather information about new businesses in your field. A growth in competition could require an adjustment in your pricing.

Use your networks to stay informed

Stores that carry your products (or do not yet) are a great resource as they can tell you about other companies they purchase from and why. You might ask if the competition offers discounts to retailers or price cuts to consumers.

Attend trade shows

Industry trade shows are a great way to find new customers and learn about how your competition prices and promotes its products.

Welcome customer input

Have a process that makes it easy for customers to communicate with you about your product. If you are conducting market research, be sure to include your current customers in the process because they have experience with your product.

How consumer demand affects the pricing of your product

In Alberta over the last decade, consumer demand has increased for foods that take a short time to prepare, including ready-to-eat foods, snacks and mini-meals, one-dish meals and custom quick meals or meal kits. This trend has resulted in many new opportunities for food processors.

Market-focused pricing takes into consideration consumer trends, purchasing patterns and demand for food products similar to yours.

Once you have determined that there is a market for your product, you will want to find out if consumers think your product offers good value for their money. To learn what consumers think, you will need comprehensive information about your customers, the size and nature of your customer base and their feelings about price.

Ask the following questions:

- How many customers do I have and where do they live?
- What is the age, income and education of my customers?
- Where do my customers spend their money?
- Do my customers believe price indicates the quality of a product?
- Why might a customer favour my competitor's product?
- What type of service does my customer value?

Getting accurate consumer information can be time-consuming and costly, but it is an important factor for setting price. Companies often hire market research firms to determine answers to these questions. A market research professional will design the research questionnaire and provide unbiased analysis of the results.

Market research information is also available through public libraries, on the Internet or through publicly-funded business development centres such as the Business Development Bank of Canada. This type of information tends to be general, but it is less expensive to access than creating new research.

This following list of trade magazines and online resources may also be of interest to those in food processing:

- Food Processing <http://www.foodprocessing.com/>
- Bakers Journal <http://www.bakersjournal.com/>
- Canadian Grocer <http://www.canadiangrocer.com/>
- Foodservice and Hospitality
<http://www.foodserviceandhospitality.com/>
- Gourmet Retailer <http://www.gourmetretailer.com/>
- Specialty Food <http://www.specialtyfood.com/>
- Prepared Foods <http://www.preparedfoods.com/>
- Food and Beverage Packaging
<http://www.foodandbeveragepackaging.com/>

Bringing it all together: the Pricing Processed Food Products Worksheet

Making informed pricing decisions for your processed food products is an essential step in developing your business. Monitoring your cost of production, your competition and what your customers want – and being flexible enough to incorporate price changes over time – are key to a successful product and a profitable business.

Below is a working example for a business and product that brings together all the topics in this factsheet. Use this process as a way of setting your own price, using numbers specific to the type of product you offer and your profitability goals.

This factsheet presents an overview to the subject of pricing of processed food products. For a more detailed analysis on different aspects of pricing, see the factsheets on The Essentials of Pricing, Agdex 845-1, or Methods to Price Your Product, Agdex 845-2.

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Pricing Processed Food Products Worksheet – Know Your Costs and Market Assessment

Example: Nature's Own Spreads – Sage jelly

Product Cost	example
Total variable costs per unit	\$2.80 per 250 ml jar
Total fixed costs per month	\$1,200
Current selling price	\$4.75 per 250 ml jar
Break-even Price	example
Unit contribution margin = selling price – unit variable cost	\$4.75 – \$2.80 = \$1.95 per 250 ml jar
Break-even = $\frac{\text{fixed costs/month}}{\text{unit contribution margin}}$ point	$\frac{\$1,200}{\$1.95}$ = 616 of 250 ml jars
Profit Goals	example
Develop a profit goal for the business	To generate \$1,000 profit monthly from the business
Target Profit:	
N = # of units required to make a profit	
N = $\frac{\text{fixed costs} + \text{target profit}}{\text{unit contribution margin}}$	$N = \frac{\$1,200 + \$1,000}{\$1.95}$ = 1,129 of 250 ml jars
Marketing Channels	example
Direct Marketing Options:	
<ul style="list-style-type: none"> • Farmers' markets • Farm gate sales • Mail-order/on line 	
Indirect Marketing Options:	I plan to sell to a specialty retail store for \$4.75 per 250 ml jar
<ul style="list-style-type: none"> • Broker • Retailer • Restaurant • Institutional buyer 	
Target Price Range	\$4.75 per 250 ml jar

Competitor Pricing	example
Main Competitor A	Many Jams Company
Strengths	broad product list use indirect marketing, strong specialty market image
Weaknesses	higher prices, smaller volume
Price Range	\$6.00 to \$7.00 per unit (retail)
Main Competitor B	Every Day Jams
Strengths	strong specialty market image
Weaknesses	low volumes, narrow product range
Price Range	\$4.50 to \$6.80 per unit (retail)
Demand Level	example
Demographics of customer base	upscale urban consumers who shop at local shops 30 - 50 plus with secondary education
Wants, needs and feelings of customer base	associates price with quality nice packaging since viewed as specialty item convenient small size for smaller families or couple
Secondary data-search findings	consumers looking for new breakfast solutions customers want variety in their food and meals consumers looking for new flavor and texture

Note: your costs may be considerably different than those in the example.

Cost of Production – Processed food ([Fillable Worksheet](#))

Variable Expenses	example
Ingredients – for food product Processing expenses (commercial kitchen rent, co-packer etc.) Labour (including paying yourself) Packaging costs (jars, labels, boxes etc.) Transportation (shipping, travel to Farmers Markets etc.) Marketing costs (advertising, samples etc.) Farmers Markets booth fees etc. Other	
Fixed Expenses	example
Insurance (liability, vehicle) Utility costs (heat, electricity telephone) Equipment Office supplies Operating interest Professional fees (accounting) Management salaries Other	

Cost of Production = Variable costs + Fixed costs