How Smart ARE You, Really?

Marketing Webinar for Direct Marketing Farmers

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Webinar Questions and Answers

1. I don't really "do" math so a lot of this went too fast for me. Is there a book you can recommend so I can take it slowly?
Profit Planning through Volume/Cost Analysis by John Y D Tse. It is available through Amazon.com. But you can always revisit this presentation. Substitute your own information into the formulas. For extra assistance contact your county Extension office. They can help you to quantify your costs, do a whole farm budget and arrive at your own pricing formula to meet your farm and personal goals.

2. Why is (1-margin) used in your pricing formula?
Because margin gives you the percent of the selling price that contributes to profit, the standard formula is done this way. (1-margin) equals your variable costs, so mathematically we are expanding the variable cost from a portion of the whole up to the whole amount. Bottom line is, this math works.

3. How do you figure the percent profit you need to make (yours was 4%)
This is based on my farm goals. I know what I need to maintain in profits to do the expansions I want as well as to plan for future needs of both the farm and my family. Using the goals worksheet, you should understand your own goals and determine the profits you will need to achieve those goals. 4 is actually a pretty weak amount, but planning for some profit is a great way to start.

4. Do you have a formula for the choice between putting things on sale and processing for later sale? We can sell tomatoes cheaper fresh, or process as frozen to sell later. Customers do not want to pay more, but actually want a discount for frozen product. How would you handle this? Compare margins. Run the price formula on each leaving margin the variable, since price is known. You may discover the customer does not want to pay you enough for the frozen work. Unless you use frozen as a way of reducing shrink you should be wary of doing more work for less money?!? If the customer will not pay for the value added work they are telling you not to do it. So don't. In a capitalist society we vote with money. So consumer votes tell you who you are and what to sell at what price. If you freeze to reduce shirk, then technically the tomato cost is zero as you would otherwise throw them out. So you can't charge the frozen product for the tomato when the fresh product should have been charged for it. When you are taking good tomatoes to make a cheaper product you have a problem too. They are no longer shrink and have to be charged at full value to the frozen product. So the answer depends on what you can sell the tomato for the first time you try.

5. How do you choose what margin you want?
The margin is determined by calculating my overhead and desired profit. Having a good handle on your farm overhead and having gone through the exercise of goal setting will give you the information you need to run the formula and determine the margin you need to cover overhead and achieve your profit goals.

6. How do you separate family living from owner's salary? Shouldn't the family living be paid for by the owner (ie the farmer, in this case)? The family living expenses comes from the owners salary. If the owner is drawing a regular salary, then he is covering his family living expenses. This salary is part of the business' overhead and should be planned for. Many farmers do not take a regular salary, but instead pay their family living expenses out of farm income. So those expenses are "salary" and part of the farm overhead. Look at the case of your farm labor. Their salary covers their living expense, but is a cost of business for the farm. It is planned for and becomes a part of the pricing formula to ensure expenses are covered and profit is built in. The farm owner's salary must also be considered a cost of doing business. It occurs with startling regularity so PLAN FOR IT.

7. I find it difficult to see how you can quantify agriculture similar to how you can quantify manufacture. There are so many variables that affect the outcome of your crop you can't possibly quantify profit by numbers of input vs. numbers of output. With discounting, if you have items that are perfectly good and would be thrown away otherwise, isn't it better to discount them so you don't have to bring them back from the farmers' market in the truck and spend the time to restock them? First, on the issue of discounting, there may be times that it would be appropriate. However, you need to think about customer expectations and perceptions. Are you teaching consumers to wait to buy your products at the end of the day when they are assured of paying a lower price? You are then hurting your price structure because you will sell less and less at full value as customers learn to shop late. Also, will this hurt your reputation with your customers? How do early customers react when their neighbor buys the same product for a significantly lower price? Hint, it ain't good! Does the lower price make you appear to the customer as having a lower quality product and thus lowers your reputation? I would suggest that instead of discounting that you find other ways to use the extra product. For example, our extra strawberries in the Spring were frozen and then used in the Fall to add strawberry flavor to apple cider. The value added product used the strawberry "shrink", and gave us a unique product that we could sell at a higher margin and we were able to maintain our price structure and actually improved our reputation in the Fall.

I would argue that farming is not different than manufacturing in terms of risk, it's just that the risks are different. All businesses have risk. The key is to understand what those risks may be and find ways to manage or mitigate them. For example, weather is our biggest risk. Adding irrigation or using high tunnels helps to manage those risks. Car companies, for example, have risks, such as labor strikes, oil embargoes, wrecking the price of plastic etc. They plan for them, as should farmers. When doing your pricing formulas, add a "fudge" factor in to accommodate those often unknown but expected risks that could impact your production and sales. Add 4 to 40% depending on your previous track record at forecasting and how risky the venture is. Does it still work with fudge factored in? Then my confidence is higher that the whole thing will work. Plan for the unexpected. It happens every year… so why is it such a big surprise?

8. Why do you add family living costs into your costs at all? Family living costs are not directly related to production? - at least not in our household.

  a. **I'm confused, if you add family expenses as a part of your cost you would have to be a sole proprietor, that wouldn't work in a partnership or a coop would it?**

Family living expenses are fixed costs regardless of whether family living is paid out as a salary or by each individual expense. Fixed costs are those that cannot be directly correlated with a crop, but are expenses that are always incurred. Family living costs are, and thus is overhead and should be planned for within the pricing formula to cover overhead, rather than requiring them to be taken from the profits. You want to keep your farm profits for farm expansion, such as buying new equipment or land, adding new products and employees, reducing debt faster etc. If family living expenses are not considered as a business expense, the farm profits would be devoured to cover this. You also run the risk of profits being too small to adequately cover living expenses.

9. What program do you use for your accounting system?

a. **Ag squared has received a lot of attention in record keeping...do you use it?**
b. **Have you tried Square, the mobile POS product?**

We use an accounting program that allows us to track income and expense by crop. We use S & S Programming, Computerized Personal Accounting for books and payroll. This comes out of W. Lafayette, Indiana. While this is the only one I use, there are others. But what you need is any accounting package that allows you to track by crop. Quickbooks, is another one, that tracks by class.
In the store I use a point of sale program called QuikRegister to track inventory. We have not done much mobile yet.

10. How do you evaluate your worker's time on a crop (weeding, harvesting, etc)? Do you have a standard 'time sheet'?

All of our workers use a standard time card and punch a clock when they change jobs. Then the farm manager labels the time periods by crop. The bookkeeper can enter their time into the accounting software by the crop. This allows me to know what my labor expenses are per crop.

11. Is there an issue of changing prices over a season so irregularly?

You have to look at customer expectations. When a price is stable, customers know what to expect. So I usually set my prices at the beginning of the season and hold them there. However, there are times when it is necessary to adjust a price. This is usually from outside forces, like the issue with apples this year. Prices had to rise to cover the loss from the early Spring frost. So if there are changes in market conditions, price changes should reflect that. Otherwise, I prefer to leave prices alone. Customers know what to expect when they shop with me, and I am better able to fulfill my crop allocation goals.

12. I have a farm with 100+ species...do you draw the line on getting down to the specifics on EACH crop....i.e. when do you generalize and when do you keep diving into the specifics. Do you ever find that calculating detail on variable costs is not worth it at a certain level of detail?

There are times when I do not spend a lot of time on calculations for a crop. Those are the crops that are an insignificant portion of our expense and income. For example, we raise rhubarb. There isn’t a lot of expense in the crop and it’s not a large crop for us, so it doesn’t contribute a lot of revenue. As such, I only do minimal calculations. However, the test should be whether the crop has an impact on your revenue. If it does, then you should be doing the calculations on each of those crops. It’s important to know, understand and plan the contribution of each crop to your farm’s profitability so that you can adequately price the product and realize the profit levels you need to meet your farm goals. I would do all 100 at least once. I have to know which crops work and which don’t. The rule in retail is 20% of your products make all the margin and 20% consume the margin from the middle 60%. So grow more of the top 20 and quit the bottom 20. So how do you know what are the 20 worst contributors to overhead and profit? How will you know unless you do the math? Year to year this changes so that means you have to do the math… again!

13. Many customers understand the quality of the produce under the organic label. In trying to stress quality to the customer how do you set yourself apart from other organic producers when the produce looks or tastes similar?

It’s important to set yourself apart from your competitors in the market. This can be done with your displays, for example. If you can create a more appealing display, it will attract customers. Customer service is another way to set yourself apart. Do you provide recipes or other information about your product that would be helpful to your consumers? This can help build customer loyalty. But the best way is to talk to your customers. Build a relationship with them. Tell them about your farm, your growing practices, etc. Make them feel as though they are a welcome and vital part of your farm. The loyalty that will develop will help to keep them coming back to you every time they come to market.

14. You've referred to various information collection strategies (i.e. counting cars to determine selling doughnuts). Can you suggest other ways to collect information that will better know our customers?

I like to be in the parking lot and see people coming and going. Watch their faces, learn about what they expect and see them come back to the car. Did we blow away their expectations?   We put food in our festival because a mom asked me which way to McDonalds…. It was not self-evident to, me, the cheapskate that never eats out.

The previous webinar, Learning to Look Around, provided a lot of information on this. I would suggest that you listen to that webinar, archived on the Farmers Market Federation website, http://www.nyfarmersmarket.com/work-shop-programs/webinars/program/132.html

15. Do you differentiate between administrative costs and operating cost?
Yes, administrative costs are fixed costs and are incurred regardless of the crop grown. We can’t easily assign them to particular crops, but they have to be accounted for, therefore, they are part of the farm overhead. Operating costs, such as field workers, are tied to specific crops and are part of our variable costs.

16. Isn't this good for a product that is new and you are trying to generate a market for? (Referring to discounting, particularly introductory pricing.)
I don’t like to do introductory pricing that gives an artificially low price on a product. It gives the wrong value message to a consumer. I would prefer to sample the product and sell it at the appropriate price. Sampling increases my shrink, but, it incentivizes consumers to buy the product at full value. That way they understand the value/quality of the product and don’t come back at a later date, expecting an artificially low price, and being surprised by the full price. In other words, I want customers to perceive the quality of the product through my pricing. I also know that it is very difficult for a customer to accept rising prices. So I don’t set up a scenario where I have to raise the price.

17. Could you give some examples of shrink?
   a. Would food you take for your personal use be considered shrink?
Shrink is anything that is unsalable or even just a change in grade, down. If produce deteriorates and has to be composted, that is shrink. If a bottle of maple syrup is broken, that is shrink. When I look at food that my family consumes, I look at the value of the product when it is taken off my store shelf. If it is good quality, then I place a full value on it and it is part of my family living expenses. If it is in deteriorated condition, such as bruised apples, then I consider it shrink.

18. So you are basically working backward from your total sales and total overhead, and figuring out how much of the overhead and profit to allocate to each enterprise. Now, if you can't market that enterprise to fulfill its "quota" of overhead and profit, should you eliminate it?

That's correct, you are basically working backward. But when a product does not fulfill its allocation to overhead and profit, I don't immediately eliminate it. First I like to look at a 3 year history of the product, if it's available. Maybe there were extenuating circumstances this year that caused the product not to contribute its quota. If that's the case, I keep the product for another year. If I see a downward trend over the 3 year history, then I most likely drop the crop. But first I will look at whether my allocation expectations were realistic. Can I make marketing adjustments, package size, presentation etc? Can I make adjustments to the crop planning that will help this crop to be profitable and contribute to overhead and profit? If not, then the crop is gone.

19. What do you mean by a 100% allocation?

a. Are you referring to an allocation toward your OH costs or desired profit?

Full allocation for a crop is when it contributes the amount expected to overhead and then to your profits.

20. So, your margin is 40% of your sales, what does that tell you?

Calculating our margin helps us to apportion the overhead amount of each crop/product and ultimately the total contribution each crop will make to your profits. Do not, however, mistake mark-up for margin. Margin is the percent of the selling price that is fixed cost and profit. Mark up is the percentage of the cost price that you add on to get to your price. They are very different and if you only look at mark up, you will be underselling your product and not achieving your profit goals. One is top down and the other bottom up so they cannot interchange.

21. How does one determine the best place for one's specific farm on the volume/price continuum?

The greater the number of outlets you have, you greater the volume of sales you will have. For example, Walmart has 8970 outlets and does approximately $46 million per year per location. Because they have such high volume, they can sit towards the high volume, low price end of the continuum. Most farms have only 1 location, or maybe 3 or 4 if they are using multiple marketing venues. But the fewer the locations, the smaller the operation, the less volume you have. You will need to be placed on the higher priced end of the continuum to remain profitable. Most farms, mine included, should be very close to the custom shop end.

22. Do you have any suggestions on how to cost out an item with various components like a mixed bouquet? Use the bundling example in the presentation. Price out each component of the bouquet. That way you know what each flower will be contributing to the bouquet and to your profits. It may help you to understand that what flowers can be used profitably or the quantity of each flower that can profitably make up your bouquets. It will also ensure that you are selling your bouquets for the price that will fully contribute to overhead and profits.

23. I don't understand why, if $5 is a price point, $ 4.75 would be a better price at the market. Why not $5? It's all about customer perception. (not yours, theirs) There is a big psychological difference between $5 and $4.75 or even $4.99. Once you break the price point barrier, customers may be stopped in their purchasing. If I am looking for a $20 gift and find an item for $20.17, I will not buy it because it's over 20! The last 18 cents was too significant for me and breaks the deal. With that said, though, you should have a good understanding of your customer base to know what they will accept and what they won't. You might want to try the price at $5 and see if it is acceptable. If not, you can always reduce to

$4.75. (But if you start at $4.75, it will be difficult to test a higher price!) Prices are funny that way, they do not like to go up!   Dollar stores live on: “if it’s only a buck it’s nothing.”   They add all those dollars together to get millions. Customer perception absolutely rules.   Its irrational, for sure, its profitable when you can work with it.