

# KNOW YOUR COSTS AND PRICE FOR PROFIT

Price is the dollar amount that you ask for sales of a product or a service. It is one of the four P's of Marketing (price, product, placement, and promotion) that contribute substantially to determining pricing, and is critically important to the profit on the farm. There are various costs that go into deciding what price you will charge for your product.

1) Start with the input costs = **Variable Costs (VC)** i.e. fertilizer, seed, gas, labor

If you don't cover these you will have to shut down in a short amount of time.

2) Add in ownership costs = **Fixed Costs (FC)** i.e. depreciation, interest, repairs, taxes, insurance

If you cover these you will meet your breakeven cost to the business, but have nothing left for yourself. Every item should contribute to ownership costs. If you don't cover ownership costs, you will have to shut down in a longer amount of time.

3) Add in a return to you = **Profitable Price** - this is the price you need to survive in the long run.

## Sample Calculation for Determining Price - Pricing for Profit

Add variable cost + fixed costs + profit needed for the particular product = Income. Divide by number of units produced = price/unit

*For example:*

If it costs you \$3,000 total variable costs and \$2,000 total fixed costs and you want \$2,000 of profit for a specific product then your total income from that product needs to be \$7,000. Divide this by the number of units produced, and you will have the price per unit.

$\$7,000 / 950 \text{ units} = \$7.38/\text{unit}$

## Value vs. Price

Many direct market farmers are afraid to charge what they need to in order to have some profit for themselves. You are providing more value to the buyer as you are closer to the customer. Ask yourself: *Do you want to be a 'setter' or a 'taker'?*

## Value = Quality + Service + Price

- ✓ Your buyers want a quality product that you can provide because you can grow varieties for flavor instead of travel characteristics.
- ✓ Your buyers want to know how their food was grown. They like the fact that they have a relationship with you. This takes time on your part, but they are willing to pay for it.
- ✓ You can introduce them to new products and ways to cook specialty items. This is education that they are willing to pay for.
- ✓ Fresh un-waxed products, less fuel used, and community support are also cited as reasons many consumers are willing to pay more for local products.
- ✓ You can charge more for early season products when customers are eager to taste the first fresh local strawberries or sweet corn, so strive for early sales.

## Allocating Expenses by Enterprise

To track labor and equipment costs by product requires excellent records. You can keep track of tasks and expenses such as plowing time and fertilizer for the whole farm and allocate by square feet used by a particular product. Keep track of daily time spent for special efforts or expenses required by specific products such as transplanting separately. Add all of these together to determine costs per product. Be sure to keep track of harvestable yields or the amount of product that was actually sold, as this impacts the price per unit...

## Plan for Profit – Don't Drop Prices

What if you have corn at \$3.50/dozen according to your calculations and your neighbor has \$3.00/dozen? Can you still make a profit by lowering your price? Sometimes it is better to sell fewer at the higher price than sell more at the lower price. For example, if your margin on the \$3.50 is \$0.50 toward profit and you sell 300 dozen, that = \$150 in profit. You would have to sell 600 dozen if you sold at \$3.25 to get the same profit. For a 7% decrease in price you have to sell twice as much product.

Do **not** price your farm product below the market just because the farm income is inconsequential for you. For example, you may be able to afford to sell a dozen fresh brown eggs for \$1.00, but other local farmers who rely on farm income for their families cannot – they might need the full price of \$3.00 a dozen to cover their expenses and do not have the off-farm income you do. They could lose sales unfairly due to your indiscretion. In the interest of cooperating fully with your local farm community, keep your prices in line with market rates for any farm product, even if you can afford not to.

## Long Term Strategies

Many beginning farmers start out with a pricing strategy that reflects what everyone else is charging, called the "going rate for market". While this is a good place to begin, it is not where you want to be forever. It is important to know your costs and price for profit to ensure long term viability of your farming operation.