Price Strategies for Direct Marketers

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Why we are Discussing Price? Because you have a business and you need to make a profit !

Roadside Marketing Reality:
The market has really changed over the past 10 years:

- Chains are doing a better job
- Consumers buy more prepared food
- Produce sales at many roadside markets are not growing
- Roadside markets are becoming more diversified

Most frequently mentioned factors in setting price:
1- Competition
We spend too much time worrying about low priced competition.
We spend too little time differentiating ourselves from such competition.
2-Cost of Production
Only you care about your cost of production.

The most critical factor in our control of our pricing is our ATTITUDE.
Be positive. Keep an open mind on how you can improve your bottom line.
1- Can you reduce your cost of production for items you grow on your farm? Either by:

- Increased yield
- Increased yield quality
- Reduced costs (labour is usually the largest single expense in horticulture)

2- Can we increase the retail price?

Check out the Competition (do a SWOT Analysis)

- What are they doing that you could do better?
- What are they not doing that you could do?
- If you can't do better than the competition, what would make a consumer come to your farm?

Top 20 Factors in Setting Price (listed in order of priority)

1. Quality & freshness
2. Landscaping (easiest customer)
3. Cleanliness
4. Location
5. Segregation (size, colour)
6. Sampling
7. Advertising & Promotion
8. Wants vs. Needs
9. Unique (new, historical)
10. Personality - family & staff
11. Displays (ambience)
12. Display size / Volume sold
13. Recognized Authority (your reputation)

14. Staff knowledge
15. Customer loyalty
16. Feature/Special/Reduced
17. Organic
18. Additional Services
19. Shelf-life
20. Supply & demand

Look at your operation and see how many of these 20 factors could be incorporated into your operation. They will allow you to increase your prices.

Pricing is to Make a Profit

If roadside marketing doesn't leave you with a net profit (over the wholesale price + your cost of marketing), you should reassess if direct marketing is for you.

Record Keeping

The best way to ensure you are pricing to make a profit, is by keeping good financial records.

The Basic Record Keeping Template Needs the Following Figures:

Gross Sales	$75,000 (100%)
Cost of Goods Sold	$50,000 *(if you have inventory from 1 yr. to the next, you must adjust for it)*
***Gross Profit**	**$25,000 (33%)** *(in this example, we put a 33% **margin** [mark-up as a % of Selling Price] on all the items for sale to give us a **Gross Profit** of 33%, which in this example just covers your **Expenses**, which are also 33% of **Gross Sales**. This means you just covered your **Expenses**, in other words, this market broke even. Hopefully this statement will make sense by the end of this presentation.)*

Expenses:

-Labour	$13,500 (18%)
-Utilities	
-Advertising	$ 1,500 (2%)
-Insurance	
-Maintenance etc.	
***Total Expenses**	**$25,000 (33%)**

Whether you're a new or an established market, you need to know your **Gross Profit** & **Expenses** so you can compare the 2.

If you are planning to start a market, you need to talk to other marketers to get an idea of what expenses you will have to cover, then prepare a budget. You will likely be doing renovations on an existing building, or building something new. Those building expenses are also a part of you **Expenses**. As a general rule, they say you should budget to pay off significant renovations in 5 yrs. If you build a new building, it should be amortized over 10 years at the most.

Only when you are able to project your expenses, can you know how much **mark-up or margin** you will have to put on your products to ensure that you make a profit.

If you are an existing market, you need to sort out the farm expenses from the market's expenses, so that you can figure out whether the market is making you a profit. You don't need to establish your farm produce's "Cost of Production", (that is a farm expense, not a market expense), you simply sell all farm produce to the market at the going wholesale prices.

Also, by tracking your **Gross Profit** and **Expenses**, you can also begin to understand what your **Shrink** is, which we will discuss later.

A good 1st step for a new marketer is to establish your "breakeven". It's critical for pricing to make a profit.

The one figure every marketer knows is their **Gross Sales**.

So marketers typically compare everything to their **Gross Sales**.

Eg. - labour is often 18 % of **Gross Sales** in a typical seasonal family run on-farm roadside market
- advertising is typically 2% of **Gross Sales**, for an established market. It is often more for a beginning market.

Calculating key expenses as a % of your **Gross Sales** is an easy way to compare your market with others. You can ask another marketer who has a business similar to yours, what % of **Gross Sales** he spends on labour and you can see how efficient your labour is compared to his, without revealing actual dollar amounts.

Calculating Your Breakeven - with this example we have arbitrarily picked numbers for **Expenses**, **Gross Profit** and **Cost of Goods**)

Market Expenses:

Fixed expenses (Utilities, insurance, taxes, maintenance, mortgage + interest)	= $10,000
Variable expenses (labour, ads, trucking, supplies)	= $15,000
Total Expenses	= $25,000

The advantage of dividing your expenses into Fixed and Variable is, it helps you realize that you have more control over variable expenses and if profits at your market are disappointing, it is the variable expenses that you need to focus on first. And usually the biggest variable expense is the one to focus on first is. That is usually **labour**.

Example Breakeven Calculation:
Gross Sales = $75,000 (100%)
Expenses = $25,000

(1) Therefore **Expenses** are 1/3 or 33% of your **Gross Sales**

Next you need to know the "Cost of Goods Sold" at your new market.
This includes everything you buy and everything you grow.
Everything you buy – these are items that you buy to resell, eg, other produce items or cider, candy apples, gift items etc. You simply add up all the invoices that you have for products you have purchased. Then you adjust for any inventory you have left over (see page 4)
Everything you grow – we need to establish a realistic wholesale value for all home grown produce.

Establishing a value for products you grow on the farm:
Keep a clipboard at the back door and record the volume of everything that comes into the market off the farm. If you wholesale some, record wholesale price beside the volume, if not, talk to a fellow grower to get a fair wholesale price. You don't need to establish a wholesale price daily, you just need to establish a wholesale price over the season. You maybe able to establish wholesale prices once a month.

In this example, we will assume that you grow apples, sweet corn and pumpkins. If you are an existing market, you should try this record keeping exercise with your own numbers after you finish following his example.
If you are a new marketer trying to prepare a budget, you are projecting that you will sell the following:

- 5,000 bu. apples which have a wholesale value of $7.50/bu = $37,500
- 5,000 doz. corn @ $1.25/doz = $ 6,250
- 5,000 pumpkins @ $1.25ea = $ 6,250

Total **Cost of Goods** $50,000

Expenses = $25,000 (33%)
Cost of Goods = $50,000 (100-33=67%)
- 5,000 bu apples@$7.50/bu
- 5,000 doz corn@$1.25/doz
- 5,000 pumpkins@$1.25ea
Therefore **Gross Sales** must = $75,000 (100%) (to cover the **Cost of the Goods** sold and the **Expenses** and Break Even)

We have talked about **Gross Sales, Cost of Goods** and **Expenses**. The next area to cover is **Gross Profit**. What we need to realize is the very important relationship between Gross Profit and Expenses. To cement that relationship, we have to convince you of the importance of calculating your **Gross Profit** using "**Selling Price**" rather than using "**Cost Price**".
The reason is, we relate everything to our **Gross Sales**, so we give **Gross Sales** a value of 100%. Every other record is related to it and given a value in relation to Gross Sales.

THEORETICAL ROADSIDE MARKET RECORDS:

Gross Sales = $75,000 (100%)
Cost of Goods Sold = $50,000
Gross Profit = $25,000 (33%)
Total Expenses = $25,000 (33%)
Net Profit *= $0.00*

When you work out your mark-up using your **Cost Price**, you end up with a % mark-up that you can not compare to your **Gross Sales**, your **Gross Profit**, or your **Expenses**. I hope to show you the importance of being able to do that. It is only when your **Margin** is calculated **as a % of Selling Price** that you can compare **Margin**, **Gross Profit** and **Expenses**.

Calculating Mark-ups /vs. Margins

Gross Sales = $75,000 =100%
Cost of Goods Sold = $50,000 = 67% (You will need to adjust for any inventory you have – see below)
Gross Profit = ?
Expenses = $25,000 = 33%

Inventory adjustment: All you want in your **Cost of Goods Sold** are the things you actually sold during the period that you are working with, (whatever time period the $75,000 in Gross Sales we are working with, whether that is month or the whole year (we will call it a period). If you bought gifts for the gift department, or pies for the bakery department, but they didn't sell this period, but you plan to offer them for sale during the next period, then you count up your inventory and subtract their wholesale value from the total of all the items purchased during that period. This is called your Closing Inventory. Likewise there could have been items that you purchased during your last period that were not sold, so you offered them for sale during this period. You must add in their wholesale value into the **Cost of Good Sold**. These items are called your Opening Inventory.

If you bought something and you didn't sell it during this period, but it won't ever sell (the apples went soft, the pies thawed and have to be thrown out), then you leave the value of those items in your **Cost of Goods Sold.** We will explain that issue later under the title **Shrink**.

This may sound like a lot of work, but keep in mind that your Closing Inventory for the last period becomes your Opening Inventory for this next period.

Example:

Opening Inventory	= $ 5,000 (the closing Inventory from the last period)
Items purchased or brought in from the farm	= $27,000
Total of all items offered for sale	$32,000
Closing Inventory	= $ 7,000 (items not sold last period but will be offered for sale next period)
Cost of Goods Sold	$25,000

For this example we will assume that we are working with just fresh produce and all the produce is produced on the farm and sold by the end of the year, so there is no opening and closing inventory. But if we had a gift shop or a bakery, there would be inventory.

Since our **Expenses** are 33%, if you put a 33% **Margin** on all items you plan to sell, in theory you will get a **Gross Profit** of 33%, which will equal your **Expenses** and your roadside market would break even.

Mark-ups vs. Margins

Mark-up is the amount of profit you add to an item, related to its **Cost**.
Margin is the amount of profit you add to an item, related to its **Selling Price**.

Mark-up as a % of Cost Price:

Cost of the Item	Retail Price	Projected Profit	Mark-up as a % of Cost
$1.00	$1.50	$0.50	$0.50 / $1.00 = 1/2 = 50%
$1.00	$1.80	$0.80	80%
$1.00	$2.00	$1.00	100%

If we buy an item for $1 and sell it for $1.50, we have a projected profit or Mark-up of $0.50, which is 50% over its cost.

Margin as a % of Selling Price:

Cost of the Item	Retail Price	Projected Profit	Margin as a % of Selling Price
$1.00	$1.50	$0.50	$0.50 / $1.50 = 1/3 = 33%
$1.00	$1.80	$0.80	44%
$1.00	$2.00	$1.00	50%

In this case we buy the item for $1 and sell it for the same price, $1.50. Our projected profit is still $0.50, but in relation to its **Selling Price** the projected profit or **Margin** is $0.50/$1.50 which is 1/3 or 33% of its retail or **Selling Price**.
In both cases the retail price is $1.50, but developing a retail price using 50% over Cost, leaves you with a figure (50%) that you can't relate to either your **Expenses,** your **Gross Profit** or your **Gross Sales**. To have

Expenses of 33% and a Mark-up of 50% over cost, doesn't tell you what you need to know, because you need to know how **Margin, Gross Profit** and **Expenses** compare. We will show this relationship later.

There are only 2 things that make up an item's Selling Price. They are it's wholesale cost and the Margin or projected profit you put on the item. If you know 2 of the numbers, you can figure out the 3rd. We know that our expenses are 33% of Gross Sales, so we need a Gross Profit of 33% just to Break Even. So we will put a 33% Margin on everything we buy to be sold in the market.

How to Calculate Margins:
Selling price = 100%
Margin = 33%
Cost must = 67%

If the item cost =$1.00

$$\frac{\$1.00}{67\%} = \frac{X}{100\%} \text{ (selling price)}$$

$67\% \times X = \$1.00 \times 100\%$

$$X = \frac{\$1.00 \times 100\%}{67\%} = \$1.50$$

This is more math than you need to know. Simply put, we know that the cost of the item is 67% of the **Selling Price**. Therefore we divide the Cost ($1.00) by 67% (.67) and we get $1.50, (the retail or **Selling Price**). Therefore if we put a **Margin** of 33% on an item that Costs $1, we will retail it for $1.50.

So over the year, if we sell 50,000 of these items at $1.50 we would have the following records:

Sell 50,000 @ $1.50 = $75,000 =100% = our **Gross Sales**
Cost of 50,000 x $1 = $50,000 = 67% = our **Cost of Goods Sold**
Gross Profit = $25,000 = 33%

Since your **Gross Profit** of 33% equals your **Expenses** of 33% you, will break even.

Summary: (Putting a margin on 1 item)
Example 2: If you want a 33% margin:
100% - 33% = 67%

Item cost $2.17

$$\frac{\$2.17}{.67} = \$3.24$$

The **Selling Price** will be $3.24 if we put a **Margin** of 33% on it.
We therefore expect to have a 33% **Gross Profit**.

Example 3: If you want a 44% margin:
100% - 44% = 56%

Item cost $2.17

$$\frac{\$2.17}{.56} = \$3.88$$

The Selling Price will be $3.88 if you put a **Margin** of 44% on it.
We therefore expect to have a 44% **Gross Profit**.

Let us assume that you don't want to just cover your expenses, but you want to make a profit of $10,000.

Now Expenses = $35,000 (the same $25,000 of **Expenses** + $10,000 in **Profit**)

So Gross Profit must = $35,000 (to cover all the Expenses – *profit is also an Expense of the business*)
Cost of Goods Sold = $50,000
So Gross Sales must = $85,000

We know that Gross Sales = 100%
So the Cost of Goods are:

$$\frac{\$50,000}{\$85,000} = \frac{X}{100\%}$$

$\$85,000 \times X = \$50,000 \times 100\%$

$$X = \frac{\$50,000 \times 100\%}{\$85,000} = 59\%$$

So if the Selling Price = 100%
And the Cost of Goods Sold = 59%
Therefore the Margin = 41%

So if the item cost $1.00
The Selling Price = $\frac{\$1.00}{.59} = \$1.69$

Summary:
To breakeven, we used a 33% Margin. (100% – 33% = 67%)
The $1.00 cost was divided by .67 (The Cost is 67% of the Selling Price), making a retail price of $1.50
$1.00 / .67 = $1.50

To make a profit of $10,000, we had to increase our margin from 33% to 41% (100% - 41% = 59%)
The $1.00 cost was divided by .59 (the Cost is 59% of the Selling Price), making a retail price of $1.69
$1.00 / .59 = $1.69

In our theoretical roadside market that broke even, we had **Expenses** of $25,000 (33% of **Gross Sales**) and we put a **Margin** of 33% on the Wholesale Cost of each item, giving us **Gross Sales** of $75,000 (100%) and we ended up with a **Gross Profit** of 33%.

The Theoretical Roadside Market Records, where the Market Broke Even:

Gross Sales	= $75,000 (100%)
Cost of Goods Sold	= $50,000
Gross Profit	= $25,000 (33%)
Total Expenses	= $25,000 (33%)
Net Profit	*= $0.00*

The Theoretical Roadside Market Records where the Market Made a Profit of $10,000:

Gross Sales	= $85,000 (100%)
Cost of Goods	= $50,000 (59%)
Gross Profit	= $35,000 (41%)
Total Expenses (excluding $10,000 profit)	= $25,000 (29%)
Net Profit	*=$10,000 (12%)* (29% + 12% = 41%)

In this example our **Margin** was calculated by including both the $25,000 of regular **Expenses** + $10,000 of projected profit, since the $10,000 in reality is an **Expense** of the business that has to be covered by the **Margin**, if we are to make a profit.
In other words, we have to make sure that our retail price contains a **Net Profit**

REALISTIC ROADSIDE MARKET RECORDS:

But in reality, a more common occurrence is that you put a **Margin** of 41% on all your products with the hope of making a **Net Profit** of $10,000

Actual:

Gross Sales	= $81,000 =100% (not $85,000 as expected)
Cost of Goods	= $50,000 = 62% (62% of Gross Sales)
Gross Profit	= $31,000 = 38%
Expenses	= $25,000 = 31%
Net Profit	*= $ 6,000 = 7% (not $10,000 as we had hoped)*

If you put a 41% **Margin**, on all items why is your **Gross Profit** only 38% of **Gross Sales**?

The difference between a **Margin** of 41% and a **Gross Profit** of 38% is **SHRINK**.
In most cases the $4,000 of **Shrink** can be traced to the following:

- Spoilage or Breakage
- Reduced
- Unsold
- Samples
- Theft (customers, suppliers & staff)

If you have **Shrink,** but you still want $10,000 in **Net Profit**, then you need to increase your margin, to cover that loss. **Shrink** is another **Expense**.

Calculating a Margin that Also Covers Shrink:

Cost of Goods	= $50,000	
Expenses:		
- general exp.	- $25,000	
- profit	- $10,000	
- shrink	- $ 4,000	($85,000 - $81,000 = $4,000)
Total Expenses	= $39,000	
Gross Sales needed	= $89,000 (100%)	

What is the **Margin** required now?

$39,000 = X (Margin)
$89,000 100%

X = $39,000 x 100% = 44%
$89,000

Now the item that cost $1.00 needs a **Margin** of 44% rather than 41%.
(100% - 44% = 56%) So the cost = 56% of the selling price.
That makes a **Selling Price** of $1.00/.56 = $1.79, to give a **Gross Profit** of 41%
This will leave you with all **Expenses** paid, including covering **Shrink**, and leaving $10,000 in **Net Profit**.

Gross Sales	= $89,000	=100%
Cost of Goods	= $50,000	= 56% (56% of Gross Sales)
Gross Profit	= $35,000	= 39% (44% Margin was put on items to give a Gross Profit of 39%)
- Shrink = $ 4,000		= 5% (44% Margin – 39% Gross Profit = 5% Shrink)
Expenses	= $25,000	
Net Profit	= $10,000	

Conclusion
You have to know your EXPENSES to calculate the right RETAIL PRICE!
You have to MARKET your products properly to justify the right RETAIL PRICE.

1- Incorporate as many of the "20 Factors That Influence Price", as fits your market, to help you raise your prices.
2- Always look for ways to reduce your costs.

The End