

# Finding your right price<sup>\*</sup>

Susan Smalley

MSU Sustainable Food and Farming Systems

You may remember the popular 1960s game show, The Price is Right! Contestants were shown a prize — something like a new car or a living room full of furniture or a vacation package. They had to guess the price of the prize package. The winner was the contestant who guessed closest to the real price without going above it.

That game is a familiar one to many direct marketing farmers who feel they are guessing each time they set prices to sell the products they raise. The truth is, setting prices is both art and science. You can approach pricing in many ways and there is no magic formula that will tell you the right price for your products. If you price too low, you won't cover your costs. If you price too high, you will lose customers. You might think of pricing as the bridge between your marketing strategy and your financial health. So it's important for you to spend some time and effort to develop a pricing strategy that works for your operation.

The most basic element of pricing is to know your costs. You must know what it costs for you to produce and sell your products to your customers **before** you can price it to make a profit. What if you don't have a detailed cost analysis? Start keeping good records today and use whatever you have to start. One good time to work on your cost analysis and marketing strategy is after the growing season and just after you prepare your farm tax return. Working through Schedule F requires you to review your farm income and expenses.

Can't you just phone your local Extension office or look on the Internet to find out your costs of production? Your Extension agent has access to a range of budgets. Looking at these "average" costs can often be helpful, but using the average or book value does not substitute for knowing your real costs. Each farm has a unique set of costs that depend on its particular mix of land, labor, machinery, buildings, interest, depreciation, enterprise mix, etc. Determining your costs will improve your ability to:

1. Control and monitor your farm through accounting.
2. Identify and analyze problems your farm faces.
3. Plan for change and growth.
4. Determine your profitability and pricing strategies.

Your farming business has several types of costs:

**Fixed costs** are also known as overhead or ownership costs. They must be paid whether or not you produce anything. The so called "DIRTI 5" provide a starting point to calculate fixed costs: depreciation, insurance, repairs, taxes, interest. You have to decide on a reasonable way to allocate fixed costs across the items you produce.

---

<sup>\*</sup> New Agriculture Network's on-line newsletter with seasonal advice for field crop and vegetable growers interested in organic agriculture. Vol. 1, No. 4 - May 27, 2004

**Variable costs** change depending on what and how much you produce. They include categories such as seed, fertilizer, machine costs, labor, marketing, etc.

**Total costs** are the sum of the fixed and variable costs for your farm business. To determine total costs for a particular crop or enterprise, you would allocate the appropriate portion of fixed costs and all of the variable costs associated with that enterprise.

You can then determine average **total costs per unit** (a pound of apples, a pound of ground chuck, a quart of blueberries, etc.) by dividing the total enterprise cost by the number of units of that enterprise you produced. The difference between your average total costs and the product price represents your **profit or loss** on the item.

Pennsylvania State University provides information on line to help farmers develop and use enterprise budgets at:

<http://agalternatives.aers.psu.edu/farmmanagement/Farm.html>

That is one good starting point.

Another is the accompanying *Starting to Track Your Costs* table. No matter what format you use to begin, you will eventually need to adjust the categories to fit how you farm and to emphasize which costs matter the most to you.

Once you calculate your costs, you are in a position to consider your **floor** and **ceiling** prices. A floor price is the least amount you can charge for a particular product or service — covering your costs and making a profit. A ceiling price is the highest price you can charge for a particular product or service. You might determine the ceiling by the highest price a competitor charges or by what you think the market will bear. The difference between your floor and ceiling prices provides your pricing range. Deciding where to price within that range will depend on a combination of your profit and volume goals.

This article provides a basic introduction to product pricing. Completing one of the tables with your real costs as much as you can is an important first step in calculating costs and then pricing your products. Wouldn't it be a lot easier just to look at what others are charging and at what kind of customers you have and set a price based on those factors? Both of these strategies are fine, but **only** after you know your costs and your profit goal. Your costs will be different than your neighbor's costs – at least a little, and maybe a lot. Your profit goal may also be different. And your product will probably be different.

What about pricing based on your buyers' income and interests? That's another valid point. But again, only after you know your costs. If your customers won't pay above your floor price, you can't stay in business.

One New York grower offers the following observations on pricing:

\* Price is integrally connected to quality and marketing, so:

- \* Offer only top quality
- \* Accommodate your customers
- \* Guarantee your product, and THEN

- \* Get as high a price as the market will bear! People are willing to pay for top quality.
  - \* Don't be upset if a few people refuse to pay your price.
  - \* Try not to lower your prices, even when your competitors drop theirs.
- \* Selling directly to consumers offers farmers opportunities to increase profits by
  - \* Differentiating your product — consider adding your logo and label.
  - \* Giving samples so customers can taste your product.
  - \* Suggesting ways to use your product, recipes, etc., to increase demand.
  - \* Providing service to increase customer loyalty.
  - \* Making dynamic displays and using attractive packages.
- \* Keep detailed records and
  - \* Calculate your profits per acre (or per row foot) per crop.
  - \* Calculate labor as percentage of gross receipts per crop.
  - \* Estimate your break-even point per unit (quart, pound, etc.) per crop.

### **How to avoid dropping prices**

If special sales and lower prices are appropriate due to oversupply or promotional activities, it may be a better strategy to retain your base price and then provide your customer extra value instead of just dropping your price. A Massachusetts farmer provides one example:

When corn is over-supplied and other farmers are down around \$2.75/dozen, we keep our base price of 35 cents/ear, six ears for \$2.00; a dozen ears for \$3.75. To attract customers, we let them know we'll provide one "free" ear when they buy six for \$2.00, and two "free" ears when they buy twelve for \$3.75. We find more people buying dozens at \$3.75 to get 14 ears than we normally do. We receive 27 cents/ear and keep our base price for future marketing. Our competition receives 23 cents/ear and will have difficulty raising prices in the future should the supply change. Of course, quality is critical in this strategy.

### **Acknowledgment**

This article is reprinted from the October 2003 issue of ***Michigan Organic Connections***, the bi-monthly newsletter of the Michigan Organic Food & Farm Alliance. The October 2003 issue contains additional commentary on organic foods and nutrition, along with other featured articles on organic and local food systems, and can be found at [www.moffa.org](http://www.moffa.org) (under Newsletters).

STARTING TO TRACK YOUR COSTS		Cost/Crop	# Units Produced	Cost/Unit
<b>Production</b>	Tillage	\$		\$
	Seed	\$		\$
	Weed control	\$		\$
	Insect, disease control	\$		\$
	Fertility inputs			
	Irrigation	\$		\$
	Tools, machinery	\$		\$
	Labor	\$		\$
	Fuel	\$		\$
	Repairs, maintenance	\$		\$
<b>Harvest/Storage</b>	Tools, machinery	\$		\$
	Fuel	\$		\$
	Repairs, maintenance	\$		\$
	Labor	\$		\$
	Cooling	\$		\$
	Washing	\$		\$
	:Packaging	\$		\$
	Storage	\$		\$
<b>Transportation</b>	Fuel	\$		\$
	Repairs, maintenance	\$		\$
	Depreciation	\$		\$
	Labor	\$		\$
<b>Marketing</b>	Labeling	\$		\$
	Printed material	\$		\$
	Phone calls	\$		\$
	Facilities	\$		\$
	Taxes	\$		\$
	Labor	\$		\$
	Permits	\$		\$
<b>Other</b>	Property taxes	\$		\$
	Rent/mortgage	\$		\$
	Insurance	\$		\$
	Facilities depreciation	\$		\$
<b>Return to owner</b>		\$		\$

: