Setting Prices

Chris Blanchard

It's easy to get caught up in the work and excitement of production, buying new tools, and trying new growing techniques. But if you want to make money farming – and even though it's not about the money, it is the money that makes the wheels go 'round – you've got to get your pricing right. Price your product too high, and nobody will buy it. Price it too low, and you won't make enough to cover your expenses and keep farming. Set your prices right, and you'll maximize your income and minimize your work.

After ten years of farming for other people, I finally started selling my own produce at farmers market in 2000. That year, I had a stand next to a couple who were also just getting started in the adventure of farming. The week our first carrots were ready, I showed up with my Toyota Previa minivan packed to the gills with green-top carrots. My neighbors had carrots, too, and were selling them fifty-cents-a-bunch cheaper than we were. At about 9 o'clock, Jerry turned to me and said, "We're sold out of carrots!" He was clearly proud of having sold out.

We sold carrots all day long, pulling crate after crate of carrots out of the Previa right up until the last few minutes of the market. Why? Because we had our price set right so that we could keep selling carrots all day long. And because we had carrots at our stand until the last minutes of the market, customers kept coming to my stand, where they also bought my salad mix, tomatoes, and beets. Jerry's additional produce languished on his stand.

When you set your prices right, you maximize your effectiveness at making money. They call it "market" farming for a reason.

Price Right, Make More Money

If you sell out of product, your prices are too low. Ideally, you would have a little bit of everything left over to take home to your compost pile or donate to your local food bank.

Let's say you take 10 pints of Sungold cherry tomatoes to farmers market, sell them for $2.00 a pint, and sell out by 9am. Score! You've made $20.00. On the other hand, the biggest draw at your stand is now sold out, and your Swiss chard and bok choy might end up sitting by the wayside, wilting in the sun.

But maybe you're going to sell them for $4.00 a pint. Lots of people walk by and turn up their noses at your outrageous pricing (have those people ever actually grown anything?), but you sell five pints and you've got $20.00 at the end of the day. Plus, you've got five pints to take home, where you can slow roast them in the over for a truly heavenly treat.

Maximize your gross income by setting your prices right:
If you take 10 pints of cherry tomatoes to market...
Sell 10 pts @ $2 = $20
Sell 5 pts @ $4 = $20
Sell 8 pts @ $3 = $24

On the other hand, you could price them at $3.00 a pint, and maybe you'll sell eight (especially if you've got underpriced neighbors who sell out before the demand is exhausted), and then you'll go home with $24.00 and you'll still get to have some slow-baked Sungolds. That sounds like sweet success to me.

And the best part? When you've got a high-demand item throughout the time the market's open, the rest of your produce sells better, too. When somebody's got their wallet out to buy your Sungolds, they're more likely to buy your broccoli raab as well, since they're already making an exchange. Plus, you can gain some loyalty on the part of those late risers who are so often disappointed.

Grow Less, Make More

Scaling up is all the rage right now. If you're in the agricultural education sector and you want funding, just say "scaling up" and agencies start throwing money at you. But it's worth asking if growing more is actually the best way to increase your farm's economic viability. Maybe you just need to raise your prices.

Until you increase your scale such that you can mechanize or take advantage of deep price cuts for bulk purchases, and unless you have high overhead costs, your cost of production per unit of produce doesn't change radically. It just doesn't cost that much less per bunch to grow, harvest and wash two hundred bunches of cilantro than it does to grow, harvest, and wash one hundred bunches of cilantro.

If it costs you $0.75 to produce a bunch of cilantro, and you sell that cilantro for a dollar, you've made $0.25 for each bunch. If you sell a hundred bunches, you've got $25.00 left at the end of the day. Now, you've decided you want to make more money from your farm, so you decide that you should scale up, and double your cilantro production; now you sell 200 bunches, and you've got $50.00 after you've covered your expenses.

Make more by selling less!
100 x ($1.00 - $0.75) = $25.00
200 x ($1.00 - $0.75) = $50.00
67 x ($1.50 - $0.75) = $50.00

But what if you just raised your price instead? If you raise your price to $1.50 per bunch, your costs to produce the cilantro won't change at all – but now you're making $0.75 on each bunch you sell. Classic supply-and-demand economics tells us that our sales will go down, but now you only need to sell 67 bunches to make that same $50.00 after expenses.

Components of Cost

For the market farmer, cost has three main components: overhead, direct costs of production, and direct costs of marketing.

Overhead costs are those costs you assume whether you grow and sell anything or not: interest on loans, interest on tractors, the cost of owning land and buildings, and the amount of money you spend on office supplies. Whether you sell one bunch of carrots at farmers market, or a thousand bunches of carrots wholesale, these costs stay the same.

> While not a cash expense, depreciation is a true cost to your farming business. Machinery and buildings slowly wear out as you use them, and will need to be replaced at some point in the future to keep the farm operating at its current capacity.

Direct costs of production include all of those things you buy and do to actually grow a crop: seeds, transplants, diesel fuel, labor. While these can vary somewhat with the amount of product you grow – a million seeds costs less per seed than a hundred – in operations with low overhead it doesn't cost much less per unit to grow more produce.

The direct costs of marketing are made up of the expenses you assume to sell your produce: stall fees at farmers market, fuel for the delivery truck, and brochures for the CSA all go into marketing expenses.

Don't forget to account for your own labor when you are calculating expenses. Your labor doesn't come for free: you've always got an opportunity cost, whether it's playing ball with your kids or working for wages. If nothing else, value your hourly wage at the same rate you pay (or would have to pay) somebody else to do the equivalent work.

The difference between your cost to grow and sell your produce and the price you receive for it is your profit – the money you make in return for your management expertise, risk, and investment.

Marketing Expenses and Margins

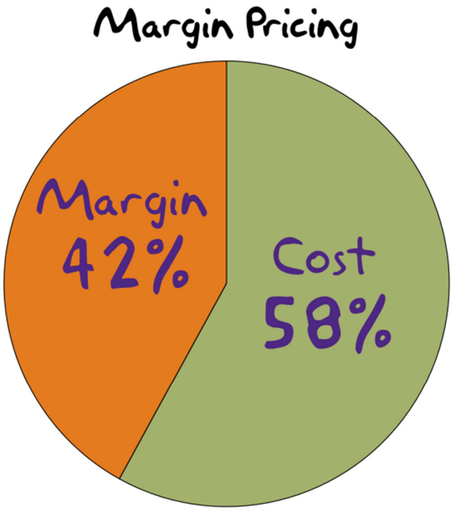
When a company buys your product to sell it to somebody else, they charge more to their customers than they pay you. That's how they cover their own expenses, and it's how they make money in return for their management expertise, risk, and investment.

The additional amount they charge can be expressed in one of two ways: as a markup, or as a margin. Markup describes the additional percentage a reseller makes on the product; margin describes the percentage of the selling price that a reseller makes above the price they paid for it.

Margins are useful because they not only provide a basis for a reseller to price their product, they can also describe the "gross profit margin" that a reseller actually gets. For example, one of my local natural food stores uses a 42% margin as their basis for calculating produce prices, but expects to realize a 35% margin on their produce sales overall. Why? Because they experience a certain amount of "shrink" in their inventory – losses due to spoilages, trimming, blemishes, customer handling, samples, and theft.

The remaining margin has to cover all of that store's direct expenses related to selling produce – all of the labor, bags, and display items – as well as the overhead cost of running the store – electricity, bookkeeping, rent, cash registers, and everything else.

Different outlets have different cost structures, so they use different standard margins. A wholesale distributor I work with locally uses a standard margin of 18% (although they charge more for special orders and highly-perishable items). They have lower expenses per unit sold than the retail store does, so they don't need to charge, or to realize, a higher margin.



If a marketer can spread their costs over a larger volume, or operate more efficiently, or reduce their costs, they can afford to achieve a lower margin; this explains part of why the local Wal-Mart Superstore can sell frozen organic burritos for half the price that the local natural food store can.

At the same time, the fact that Wal-Mart buys frozen organic burritos by the semi-load means that the frozen organic burrito company can afford to sell them to Wal-Mart for a lower per-unit price, because they receive one order, write one invoice, manage one receivable, and manage one delivery. The frozen organic burrito company's sales cost per unit is lower when they can sell by the semi instead of by the pallet or by the case.

$$\frac{\text{cost}}{(1 - \text{margin }\%)} = \text{Sales price}$$

$$\frac{\$1.16}{(1 - 42\%)} = \$2.00$$

And that's where margins matter to market farmers. You need a higher margin over the cost of production when your own selling costs – labor, fuel, stall fees, shrink – are higher. When you sell produce at farmers market, you are doing the work (or paying somebody else to do the work) and taking the risks that a retailer takes, and you need to price your product appropriately. If you sell to a retail store and at a farmers market, your price structure in each of those markets should reflect the cost structure in each of those markets. It costs the same amount of money to grow a bunch of parsley for your farmers market stand as it does to grow a bunch of parsley to sell to a retail store, but it costs a lot more to *sell* that bunch of parsley at a farmers market.

> Conventional wisdom says that selling products directly to the customer is the best way to make a living farming. In the winter of 2008-2009, when my farming partnership broke up, I took a hard look at the margins in each segment of my sales strategy – CSA, farmers market, and sales to retailers. Even though we could get the highest prices at the farmer market – we

> charged the largest margin over the cost of production – once I figured the costs in the costs of transportation, stall fees, and labor, my actual farmers markets profits were much lower than selling through the CSA or direct to retail stores. When I calculated in the opportunity costs as a single father of having to commit every Saturday to being at a farmers market, it became clear that Rock Spring Farm – and Chris Blanchard! – would be better off moving that same product through other outlets.

Setting Prices

Well, that's all fine and good, but what now? In the end, I've still got to set my prices, and I have to compete in the marketplace. So, how do you actually set your prices?

A long time ago, a farmer I worked for passed down some really basic pricing advice that he had received from an old Italian farmer at the Minneapolis farmers market: the cost to harvest and pack your produce shouldn't be more than one-quarter of the price you charge at market. So, if you pay your harvest labor $10.00 per hour, and it takes four labor hours to harvest and pack a hundred bunches of beets, you would charge a minimum of $1.60 per bunch.

$$4 \times \left(\frac{\$10}{1 \text{ hour}} \times \frac{4 \text{ hours}}{100 \text{ bunches}} \right) = \frac{\$1.60/}{\text{bunch}}$$

Paul and Sandy Arnold, of Pleasant Valley Farm in upstate New York, have a rule that says they must make at least $20,000 per acre based on their sales at farmers market. You could set your prices using this example, taking a sampling of your yields: "Today I harvested 60 bunches of Swiss chard from this 1/30th of an acre patch. I think I can harvest 60 bunches each week for the next six weeks. So, I need to get $1.84 per bunch to make $20,000 per acre."

$$\frac{1 \cancel{\text{week}}}{60 \text{ bunch}} \times \frac{1}{6 \cancel{\text{weeks}}} \times \frac{\$20{,}000}{1 \cancel{\text{acre}}} \times \frac{1 \cancel{\text{acre}}}{30} = \frac{\$1.84}{\text{bunch}}$$

Of course, you might want to go to market with that number in your head, and then adjust your pricing based on your competition and sales. If you can sell those 60 bunches at $2.50 a bunch instead of $1.84, then you've just made an extra $0.66 per bunch – and that's money in your pocket! And, at the end of the year, if you have accurate sales and planting records, you can check if you were right to set your prices where you set them.

If you want to go beyond that, you'll need to start to get at your cost of production. You can make this as easy or as complicated as you want; the more detail you track, the more precise your understanding of the cost structure for growing and selling your vegetables will be, but you have to balance the amount of effort you put into this with the results you need or want to get out of it. Since I'm writing an article on pricing, I'm obligated to say that everybody should know their exact cost of production and marketing on every crop and every sales outlet, but I know that few people are going to jump into that degree of detail.

To get an idea of your actual costs, you'll need to do a more extensive analysis. Although most of the crops that you grow on the farm will have the same basic crop structure for growing the crop – everything requires tillage and seeding and weed control – some crops have additional expenses that shouldn't be allocated across all of your crops: tomatoes might get trellised, carrots might take extra-careful hand weeding, garlic gets mulched, and so on. You might want to separate out the more universal expenses from those that apply to specific crops. Seed costs can also vary widely by crop, and some crops are grown from transplants while others are grown from seed.

Once you figure out your production costs, you would also want to calculate the costs associated with your different marketing channels. The price of a CSA share should bear the burden of the expenses that go into packing CSA boxes, producing sales brochures, and delivering boxes; the cost of your farmers market stall and the fuel to get there should be borne by the price of your produce there.

The University of Wisconsin-Madison and Jim Munsch have put together a tool called the Veggie Compass (www.veggiecompass.com) that can go a long way towards figuring out your actual costs per crop and margins per marketing channel, providing a very comprehensive overview of all of this.

In any case, when you work on figuring out your cost of production, know that getting close numbers is more important than getting precise numbers: profits on the market farm aren't usually made on pennies. Find a place between tracking every seed and not keeping track of anything, and use that information; once you start to see the value in the numbers and find a system for tracking them, I'm willing to bet that you'll be willing to put more effort into the process.

It's Not Just Your Costs…

If you want to sell your produce, you have to take into account more than just your cost of production. You have to know what the market – whether it's a store, a restaurant, or a farmers market customer – is willing to pay.

At farmers market, it's worth taking a walk around to see what other people are charging. I had a rule for my stand at farmers market that if anybody had an equivalent price at the market, I would see their price and raise them a quarter. If you know your costs, how long it took you to harvest your crop, or your target per-acre yields, then you've got the ability to know how low you can go and still meet your goals.

If you are selling to a reseller, you have a couple of tools available to you. First and foremost, just ask. If you've got a good relationship with a buyer, they'll tell you what they're paying elsewhere. Often, I don't know where a national price is sitting, or what I might be able to expect for a local-produce bonus on a particular crop – and a straightforward ask gives everybody an opportunity to be open and honest. I just did this with my wholesale asparagus crop, and now I'm making 15% over my price for the last three years because of a labor shortage in Michigan.

In more roundabout ways, or to double-check that you are getting a fair price, you could apply the margin tools above to get an idea of the wholesale price range by checking current prices with the retailer and their competitor. Rodale Institute also maintains the very useful Organic Price Report (www.rodaleinstitute.org/Organic-Price-Report), where you can search by market and crop to get an idea about pricing on the national market.

The Water Under the Bridge Problem

Even though it's ideal to make a plan about where and for how much you are going to sell your produce, most growers live in a world where that plan can easily fall apart once the season gets underway: another farmer shows up with dirt cheap carrots at farmers market, or a buyer goes back on their pricing agreements for wholesale lettuce, and now you've got a problem: you've spent the money and resources to grow the product, but now that it's time to sell it, you can't sell it for enough money to make a profit.

But what if you can still sell the lettuce for more than it costs to harvest it? Or what if you've already picked and washed the carrots and driven them to market and paid your stall fees, and now you realize that you can't sell your carrots for what it even cost you to harvest them?

It's easy to say that you should till in that lettuce to support fair pricing, or just take your carrots home. It's a lot harder to do that when you've got rent to pay and shoes to buy for your children. But if you don't do that – if you allow your prices to be set by the low-ball producer, or the one who doesn't know or doesn't account for the cost of production, or the one who doesn't value their labor – you'll always undersell yourself. There's always somebody ready and willing to sell their produce more cheaply just to get in the market, or to feel good about selling out.

Know your costs, know the margins you need to achieve to make money, and know that you deserve it.