THINK FARM READY|START|GROW

27 Pricing Farm Products
Resource Kit for Nova Scotia Farmers

Know Your Costs and Price for Profit

What should I charge for my product (vegetable, fruit, meat, preserves, etc.)?

All business owners grapple with pricing. It is an important question since the success of a business relies on the ability to make a profit. The amount of money left when all the costs related to generating the revenue are covered is the profit.

Profit = Price – Total cost of Goods

When "pricing products for profit", it is important to establish a price that will cover all costs (direct variable costs, indirect variable costs and fixed costs) and return a profit while ensuring satisfied, repeat customers. The set price must be high enough for the business to earn a reasonable profit but not so high that customers will look elsewhere for the product. When making pricing decisions, producers need to focus on costs and also pay attention to the customer demand, and competition.

Costs

The first, fundamental step in pricing is determining the cost of production.

Cost of Production = Direct Variable Costs + Indirect Variable Costs + Fixed Costs

The direct variable costs are the costs related to the production of a specific commodity or crop, things like seed, fertilizer, pesticides, feed, vet supplies etc.

The indirect variable costs are the expenses used in the production of all commodities or crops on the farm, such as expenses as fuel, labour and utilities.

The fixed costs are the costs that remain the same regardless of what is produced or how much, such things as property taxes, fire insurance and depreciation.

If you are not established in production and do not have the benefit of history to calculate the cost of production you still need to get some good estimated numbers for the development of your projections. If you can't find a local source of enterprise budgets, you can start with sample budgets and use reasonable estimates to help you get a sense of the financial feasibility of your business idea. If you go through this exercise and determine that you'll need to sell carrots at $11/lb in order to make a profit, you'll either need to adjust the plan or come up with an innovative gourmet niche market that can handle that price!

The process of calculating the cost of production starts with good record keeping. Costs for each product need to be kept separate. This is called enterprise accounting. In addition to keeping good records, it is important to set some profit goals. Profit goals will help you set an accurate price and decide the amount of product you will grow. A goal is a clear statement about your future business plans. You need to consider personal goals, cash flow needs and product position to develop an accurate profit goal. Profit goals are an important type of business goal. They state how much profit the business should earn. You can set your profit goals as a percentage above the product cost subtotal or set a total profit figure for the entire business. Use industry price ranges to help set the profit level most suitable for your crops or horticulture products. A profit goal will guide decisions on the amount of product you will grow or produce and the price you will charge.

Price

Price is only one of the four P's of marketing: Price, Product, Placement and Promotion. Price is important to the profit on the farm, but the other P's of marketing contribute substantially to the price that you can get. Profit is the 5th P, the one that keeps you in business.

There is one danger in setting price based on costs only - you may still under price the product or service relative to the competition. Uniqueness in your products is one feature that allows you to be more of a price setter than just a price taker. Eric Gibson, author of *Sell What You Sow*, feels that price influences how your product is perceived. Many customers equate higher prices with higher quality and lower prices with lower quality. Don't take the profits out of your products by pricing them too low. He states that cost-cutters usually go broke in the long run. Being known as the cheapest or always having a sale attracts the bargain hunters. Once you have lowered prices, it's hard to raise them. It may be better to move an oversupply of product by giving them out as free gifts or as samples. Establish a fair price for you and the customer and stick with it.

Take an industry focus on your pricing by researching what price competitors are charging and competing products are selling for. Use competitors' prices to help design a price range. When competition is less intense for certain crops, you can charge at the top of the price range. If competition is intense, you should price at the lower end of the range unless you can distinguish your product through quality or a unique selling feature.

Two methods of setting price are the cost-profit method and the gross margin method.

Cost and Profit Method:
With this method you need to add your variable costs (direct and indirect) to your fixed costs and profit which will give you the total needed for that product (income). If you divide the income by the number of units produced you will get a price/unit.

For example:
If it costs you $3000 total variable costs, $2000 fixed costs and you need $2000 profit from the product, then your total income from that product needs to be $7000. If you have 950 units, your price per unit is $7.38 per unit.
$3000 + $2000 + $2000= $7000
$7000/950= $7.38

Gross Margin Method:
This method derives a price from the whole business sales, costs and planned profit. This method is usually used by retail businesses that resell a lot of products.

157 College Rd.
Truro, NS
B2N 5E3

tel: (902)893-5649
fax: (902)893-2757
website: www.gov.ns.ca/thinkfarm

Know your expected vegetable sales= $7,000
Know your total fixed costs + desired profit = $4000 (this is the gross margin needed)
Know your unit variable cost = $3.16

Divide your gross margin by total sales: $4000/$7000= .57 (this is 57%)
Divide the unit variable cost ($3.16) by 1- 57% (calculated as 1- 0.57) to determine the per unit price:
$3.16/(1-.57) ----> $3.16/.43 = $7.34 per unit

Summary

You need to understand your costs but you also need to understand the competitive markets in order to successfully price your products or services. You have to competitively price your products or services while ensuring you are able to make a profit. The following five questions help to summarize the information you need to know and consider:

1. What are the direct costs of your product or service?

2. What are your business's indirect expenses?

3. What is your breakeven point?

4. How is your competition pricing their offerings?

5. What is the current state of your industry and the overall economy?

All of the pricing decisions you make in your business should offer a win-win outcome where your customers get a good value for their money and your business makes a reasonable profit that provides ongoing capital for you to reinvest in your business and offers a return to you the owner.

[Note: The content for this fact sheet was taken from the *Guide to Farming in NY: What Every Ag Entrepreneur Needs to Know*, a publication of the NY Beginning Farmer Project, Cornell Small Farms Program. It was revised by Lori Kittilsen, Business Development and Economics Division, Nova Scotia Department of Agriculture. March 2010.]