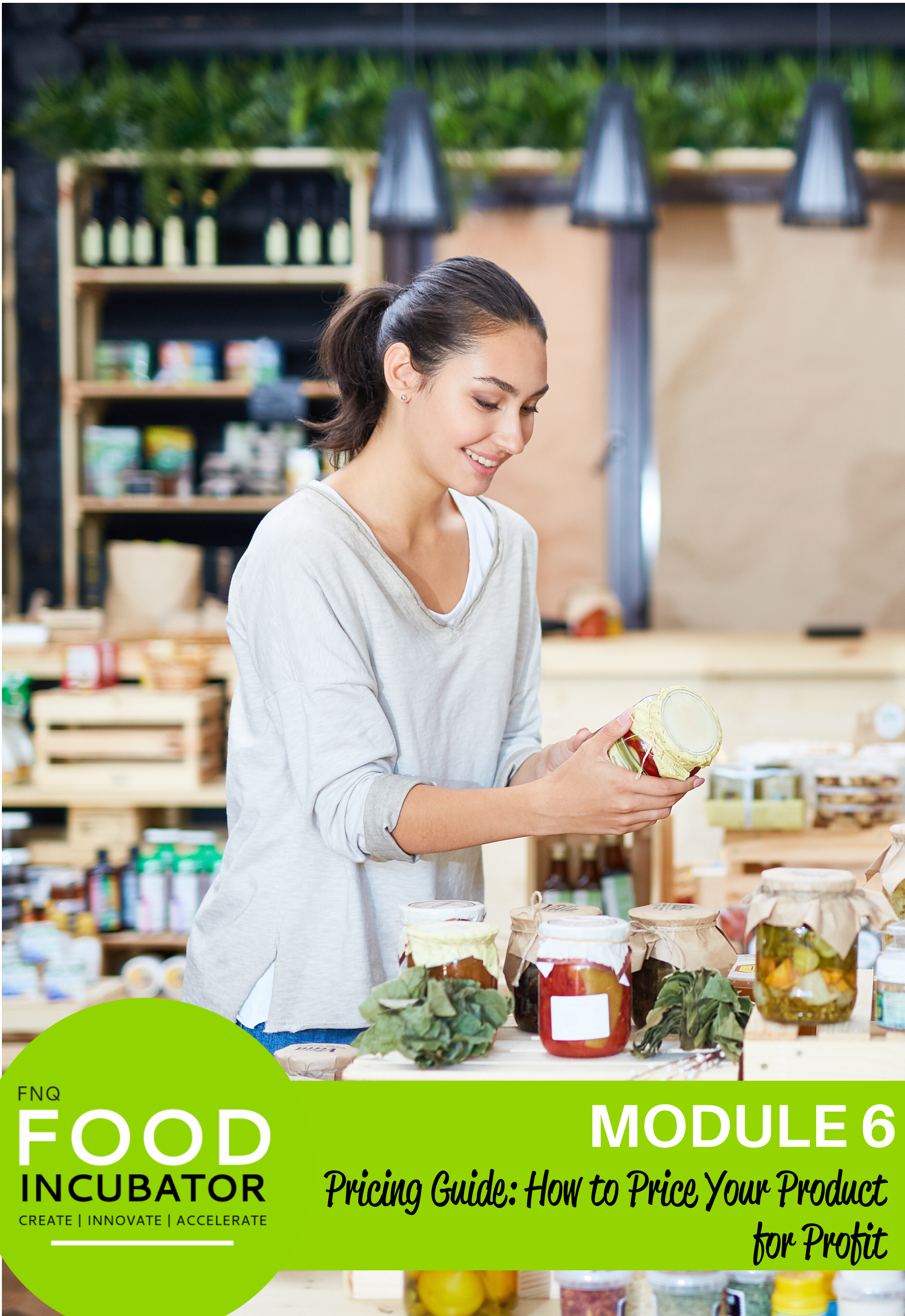

FNQ
FOOD
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MODULE 6

Pricing Guide: How to Price Your Product for Profit

PART 1 Learning Outcomes

On successful completion of this module you will be able to:

PART 2 Priced to Perfection

To speak your mind or to hold your tongue... to stick to the plan or improvise like your life depends on it... baked or fried... doughnuts or cupcakes...You thought those were the difficult decisions in life, didn't you...? Well, think again.

When we receive questions or queries from clients who appear to be particularly stressed out, we can often hazard a guess as to what's got them burdened with an overwhelming sense of apprehension and worry.

At the FNQ Food Incubator we're regularly approached by anxious food and beverage entrepreneurs who are distraught by the prospect of finalising pricing structures and deciding upon overall price strategies.

When we receive questions or queries from clients who appear to be particularly stressed out, we can often hazard a guess as to what's got them burdened with an overwhelming sense of apprehension and worry.

Pitch your product pricing too high and you run the risk that prospective customers will tut-tut and let out an exasperated sigh as they return what they perceive to be your too-costly food item to the shelf.

Pitch too low and you end up cringing at your year-end figures (and possibly wondering if it's time to part ways with your entrepreneurial aspirations and return, head bowed, to the reliable 9-5 job you possessed in a previous lifetime).

So, how to solve the problem of pricing your products to perfection? What is the 'Goldilocks' formula? Not too high, not too low – just right.Read on to discover more about the pricing criteria you should be considering.

THE OFFER

Think about what's included in your cost of goods sold. It sounds overly simplistic, but anything you do or use to produce your finished food or drink product should be included in your final product cost. With this policy in mind, ensure that you have a full 360° view of the costs you accumulate before your branded and packaged product is ready to ship. For example:

- Your ingredients: Take a full inventory of all of the ingredients you use to produce your product. Don't leave anything out – not even a pinch of salt! Plus, you should remember that shipping needs to be factored into your pricing. How much does it cost you in fuel to collect ingredients from your local wholesaler? Are you charged a delivery charge when you get ingredients delivered to your production premises?

- Your packaging: As marketing specialists we promote the idea that presentation is key to product positioning. Certainly not an after-thought, jars, bags, boxes, labels, string, etc. are important components in your marketing mix – they influence how your brand is received and interpreted by potential buyers. However, nothing in this life is free. The elements that are part and parcel of your packaging and presentation strategy need to be included in your costing estimates. Naturally, once again, shipping should be included in your calculations.

- Your labour: How long does it take you to produce your product? What hourly pay rate would you like to command? Whether you produce in your own home or a purpose-built facility, you need to put a value on your time and labour. Don't be shy about putting a price on these fundamentals and evaluating yourself and your skills as a key business 'resource'.

KNOW YOUR COMPETITION

Before you even considered launching your current product range, we're sure you diligently and carefully researched the competitive environment that you were about to enter into. Most certainly, part of that research would have involved an analysis of competitor pricing strategy.

If you've now reached a point where your business is up and running and you're struggling with the finer points of pricing decisions, now would be a great time to delve back through your initial market research notes. Look at your early research findings in relation to:

- How similar your products are to those offered by your direct and indirect competitors?
- Do you offer added benefits or features that your competitors don't? Or, is the reverse true?
- Do your competitors provide a product range that is, in some ways, more advanced or superior to yours?

Of course, no entrepreneur wants to be obsessively focused on his or her competitors. However, it's simple, but true… By recognising the prices that are supported by your competitors' customers, you'll gain a more accurate perspective in relation to the price points that will also work for you.

THE DISTRIBUTOR 30

In between the realms of the retailer and the producer, there's a third party entity that often plays an important role in the route-to-market.

Distributors act as liaisons between producers and retailers and they're frequently tasked with securing shelf space for food and beverage products. And, while the distributor takes his or her own profit 'cut', there's no reason to view the role in an unfavourable light.

It's commonplace for distributors to take a 25-30% margin. In short, this is the price you pay for their services as your 'sales representatives' in the market. Especially convenient when you don't yet have a large sales team to get out and about selling your products to retailers, the 25-30% margin can be viewed as a 'sales representation and sales management' fee.

In addition, if your business is entering a new and unfamiliar market (overseas or within a region where you've yet to make a sales impact), the distributor can be expected to use a pre-established network of contacts to your benefit.

In exchange for the distributor's share of the profits, you should hope to see an overall increase in your turnover and market reach.

So, what to know if you're considering the distributor route to market…?

Well, although some regional price fluidity is acceptable, the consumer expects to pay roughly the same price for your product no matter what store he/she buys the item in.

That means that you can't just add an extra 30% onto the retail price!

Instead, you need to discount the price the distributor buys from you by the distributor margin i.e. a 25-30% discount. The end result should mean that the consumer buys at a standard recommended retail price that fluctuates very little from one supermarket/deli/food hall to the next.

PRIORITISE PROFIT (AND DON'T APOLOGISE FOR IT!)

Running your own business is tough; it's risky. There's no safety net when you're your own boss – things go wrong and you can't complain to HR when you need to work overtime or when stress becomes slightly unmanageable.

So, a silver lining would be nice, right?

Well, we can never guarantee that it will be the case, but it should ring true that the harder you work, the higher your financial reward. Once sales targets are met and your business expenses are accounted for, you, the hard-working entrepreneur, should glean the benefits.

Pricing your products correctly will help you reap the most generous reward possible. In addition, a comfortable profit can make your effort feel all the more worthwhile – it's scientifically and medically proven (maybe!) that respectable end-of-year figures and a healthy bank account will ease the headaches encountered on the bumpy road to entrepreneurial success.

And, remember, don't apologise for establishing price points that provide fair monetary compensation for your endeavours. Because, well, as they say, you're worth it…

PRIORITISE PROFIT (AND DON'T APOLOGISE FOR IT!)

You need to start seeing maths as your friend.

Do you break out in a cold sweat when faced with pricing spreadsheets? Do you completely freak out at the thought of crunching numbers for your upcoming financial projections?

If you're being plagued by nightmare flashbacks of horrific school maths lessons, it's high time to change this pattern of negative thinking.

Get a new perspective! Let's take those maths skeletons out of the closet once and for all! Because, when you realise that they can help drive your business forward, numbers will start to feel like your brand new best buddies.

Begin by contemplating how much money you want to make. What's the magic figure? Do you want to make $65k a year from your food business? How about $105k? Whatever the number, try using your target turnover to size up how many units you'll need to sell to reach your target. How many sales per week/month/year will allow you to achieve your fiscal objectives?

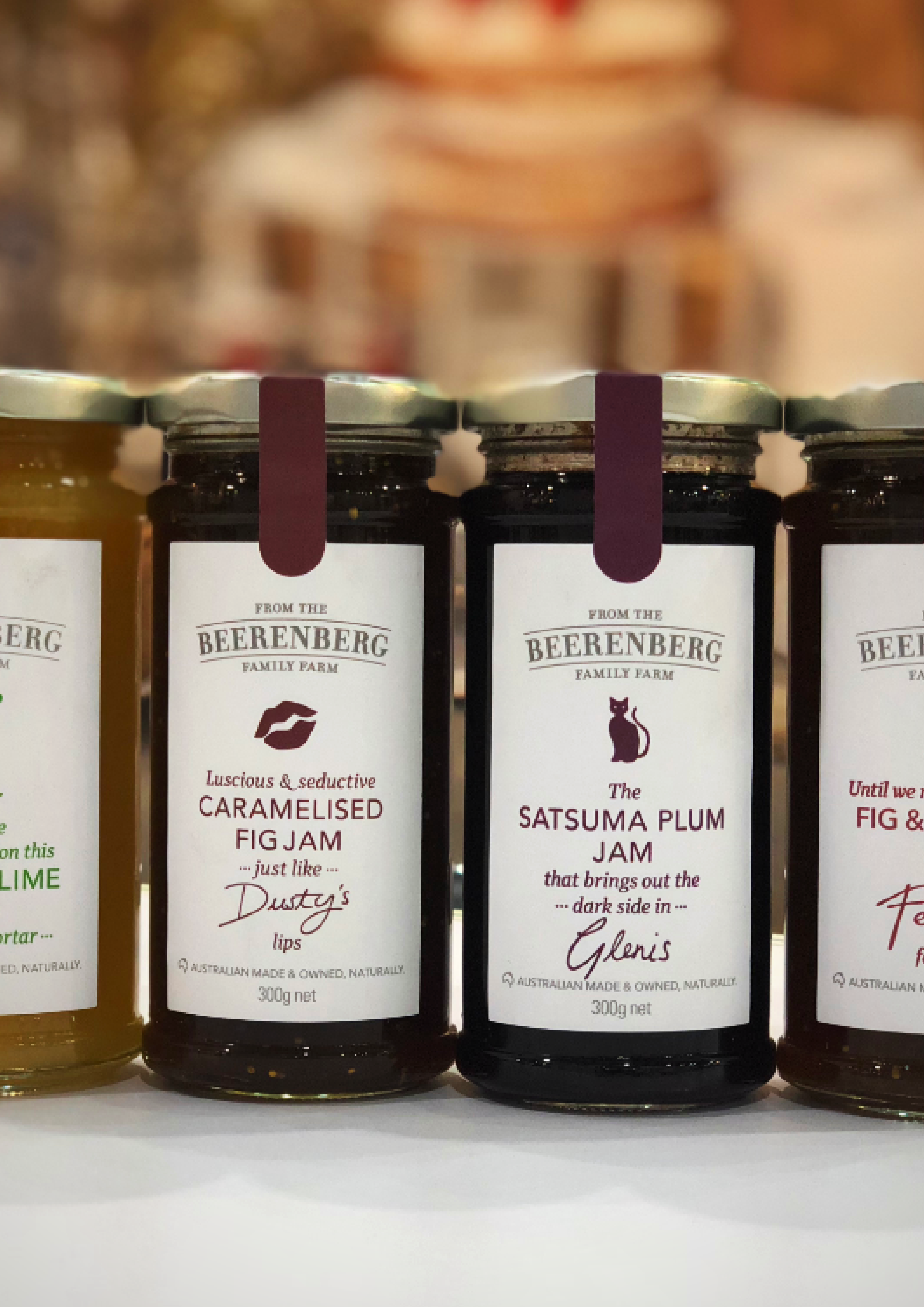
And a final 'top tip' in relation to pricing:After you've established an initial pricing strategy, you should subsequently focus on decreasing costs.

To start with, try improving your economies of scale!

Buy more ingredients in bulk and aim to increase the number of units you can produce in the same amount of time.

REMEMBER:

The above advice is general. Every business faces diverse opportunities and challenges. So, if you have any specific questions about developing your pricing strategy, we're always happy to help. Why not contact us to book an initial no-obligation consultation.



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FAMILY FARM
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PART 4 Product Costing Models

The ability to accurately measure the total cost of making your product is crucial. To do this you can use a "Product Costing Model" which can help you calculate all the variable costs associated with making your product.

Your product costing model can become more complex as your business grows.You can use a simple product costing model (see example below).This tool allows you to analyse the impact of changes in recipe, ingredient costs or packaging size on product margin.

A simple product costing model helps you calculate the Direct Unit Cost per jar, package or case of your product and includes the sum of all other costs (labour, ingredients, procurement, utilities, equipment, space, packaging, waste management, financing production). Strawberry jam is used in the example below:

PROCUREMENT

- As a small business it is common to use your personal vehicle and time to purchase and pick up ingredients and packaging. Assume it took 1 hour to drive and purchase ingredients and packaging. The cost then includes 1 hour labour ($22.90) plus a travel charge for kilometers on the vehicle (50 kilometers valued at $0.50 per kilometer).

(($22.9 + (50 x $0.50)) ÷ 500 units
= ($22.90 + $25) ÷ 500 units = $47.90 ÷ 500

Procurement cost = $0.9 per unit

LABOUR PER UNIT

- Assign a cost to your labour per unit even if you are using "free" labour. The minimum wage in Australia is $19.49/hour. Statutory costs (annual leave, superannuation etc) can add another 17.5% to that cost, so the minimum labour cost is $22.90 per hour.
- If it takes 4 hours to prepare, assemble, package and clean up, using 3 workers to make 500 units, the minimum labour cost would be:
- (($22.90 x 4 hours) x 3 workers) ÷ 500 units = ($91.60 x 3) = $274.80 ÷ 500

Labour cost = $0.54 per unit

INGREDIENTS PER UNIT

- Add up all the ingredients used to make your jam
- 250 litres of strawberries at $0.75 per litre, 50 kilos of sugar at $2/kilo and 2kg pectin at $10/kg. The unit cost would then be:

((250L x $0.75/L) + (50kilos x $2.00) +(2kg x $10/kg)) ÷ 500 units = ($187.50 + $100 + $20) ÷ 500 units = $307.50 ÷ 500 units

Ingredient cost = $0.62 per unit

EQUIPMENT COST PER UNIT

- You purchased $245.00 worth of bottling equipment. In order to calculate the contribution of this investment per unit of production you need to estimate the number of units you expect to make in a year. Assume you expect to make 3,000 units of jam. Because this is small equipment that can be depreciated in the year of purchase, the equation is as follows: $245.00 ÷ 3000 units

Equipment cost = $0.08 per unit

FACILITY RENTAL

- You rented a municipally-inspected facility for $500 for a full day. The cost for this batch is as follows: ($500) ÷ 500 units

Facility Rental = $0.08 per unit

PACKAGING & LABELS COST

- You bought 600 jars/lids at $1.12 per unit and 600 labels at $0.24 each.
- During the process, 32 jars were broken prior to labelling and an additional 4 were lost after labelling.
- There were 16 defective labels.

To calculate the unit cost of packaging it is important to include lost packaging. However, left over packaging that will be used in the future must not be calculated in the cost. In this case the batch used 536 jars and lids at $1.22 and 520 labels at $0.24. (($1.22 x 536) + ($0.24 x 520)) ÷ 500 units = (653.92 + $124.80) ÷ 500 = $778.72 ÷ 500

Packaging and labels cost = $1.56 per unit

Don't let fear of choosing the "wrong" price hold you back from launching your store. Pricing is always going to evolve with your business, and as long as your price covers your expenses and provides some profit, you can test and adjust as you go. Run a price comparison to see how your strategies stack up.

Taking this approach will give you a price you can feel confident about, because the most important thing when it comes to pricing is that your pricing helps you build a sustainable business. Once you have that, you can launch your store or your new product, and use the feedback and data you get from customers to adjust your pricing strategy in the future.

PART 5 How To Choose a Pricing Strategy

Choosing a pricing strategy is an incredibly important part of any business's journey. Just as any important decision in business, a pricing strategy needs to be backed up by solid customer information, metrics, and more.

QUANTIFY YOUR BUYER PERSONA

Every process should start with this step, because quantifying your buyer personas has a cascading impact on your product, marketing, financial planning, etc. To be clear though, we're not talking about a pretty powerpoint deck with cute names like "Startup Steve" and "Enterprise Eddy" (although these aspects definitely do round out the personification of your personas). Rather, we're referring to deeply defined and well researched personas that answer questions like the following:

- What is the price each buyer is willing to pay?
- What is the estimated Lifetime Value (LTV) of that customer?
- What is the estimated Customer acquisition cost (CAC) of that customer?
- What are the top three marketing channels you're finding this buyer in currently?
- Who does this buyer report to? Who reports to them?
- Which three features do they care about most? The least?
- Which value proposition do they care about most? The least?
- Who else needs to approve a purchase (if anyone)?

PART 5 Co-packing Your Product

A co-packer, or contract manufacturer, is an established food manufacturer that processes and packages your product according to your specifications within their facility. A co-packer may not be right for you in the early stages of production as their requirements and expectations may be too much for a small business to handle.

If you decide to use a co-packer, choose carefully and implement a program that makes certain your co-packer is processing and packaging the product according to your specifications. You may not manufacture the product, but you are responsible for it, so monitor your co-packer to ensure your product and process meet your standards.

ADVANTAGES TO CO-PACKING

There are definite advantages to co-packing. For example:

- You get a consistent product cost
- You do not need to invest in facilities and full production equipment
- You get the benefit of their manufacturing expertise
- You can use their production personnel who are already trained
- Start-up time is reduced
- It will be the co-packer's responsibility to maintain the plant and keep the equipment up-to-date
- You will have ongoing technical support from their personnel
- You can manufacture at a pace that matches your market's needs
- There is no time commitment on your part; you can focus on other aspects of your business

DISADVANTAGES TO CO-PACKING

There are also some drawbacks to using a co-packer. Make sure your contract covers issues such as these:

- Product quality, safety, and delivery
- Protection of your product formula
- Cost agreement
- Minimum orders
- What, if any, tolerances you have for deviations from your product specification document

ESTABLISHING YOUR CRITERIA FOR A CO-PACKER

Before you contact potential co-packers, you need to define your specific needs. Some things you should consider include:

- Their level of certification or the standards they operate under
- The price you are willing to pay for their services
- The quality that must be maintained
- The volume you need produced
- Distribution and delivery methods required
- Your level of involvement in manufacturing
- The timing of your needs
- The availability of warehousing
- Any specialisation required e.g.,canning equipment

You may not find the perfect facility to co-pack your product. Make a list of your most important objectives then determine which co-packer best suits your needs.

CO-PACKING COSTS AND GROSS MARGIN

After the test run, the co-packer will give you a breakdown of the fixed and variable costs of producing your product in their plant. Make this part of your agreement. This is your product costing model from which you will derive your gross margin. As a general rule of thumb, if you were targeting for a 40 per cent gross margin before you used a co-packer, you can expect to target for a 25 per cent gross margin when someone else packs your product.

Generally, if you can offer the co-packer high volumes or long-term business, you will be able to negotiate a better agreement.

Now go back to your business plan. What is the maximum retail price consumers are willing to pay for your product? Do this calculation below to determine if you can afford this co-packer:

- $(Retail price of your product)–40% (retail mark-up) = $A
- $A(answer from above)–20% (distributors' mark-up) = $B
- $B(answer from above)–co-packer's price= your gross margin. Does this number match your business plan goal? If not, you may need to find another co-packer.