

Making It Happen

Profitability and Success

Case Study 2: Parsonsfield Farm

Is This the Right Price?

Overview

Mary Parsons owns and operates Parsonsfield Farm. She raises pastured chickens and sells the meat direct to customers at farmers' markets. She also sells the birds wholesale to local stores and butcher shops. Mary has a simple mission for the farm: *To produce sustainable meat for local and regional markets, and to farm with environmentally sound methods.*

To that end, Mary buys organic certified grain for her birds. Her margins are slim with feed being her biggest expenses. She realizes she could lower her costs by using conventional feed, but it doesn't align with her mission.

After completing her third year in operations, she revisited the initial goals she laid out when launching the business:

1. Grow to \$60,000 in sales by year 3, and \$130,000 by year 5
2. Provide net income for farmer of \$35,000 by year 5
3. Establish local and regional sales channels
4. Operate responsibly within the neighborhood and community
5. Develop sustainable practices on farm

In looking at her sales for year 3, she's pleased to see that she's ahead of her target with her revenue goals. But when she looks at the bottom line (net income), she's not sure she can achieve her net income (profit) goals by year 5.

She has a few concerns about her business model:

- Her products are selling alongside conventional birds in the stores to whom she sells wholesale. Her marketing strategy and pricing structure are not working to give her the profitability she is looking for.
- With the organic feed, her costs are much higher than if she used conventional feed.
- Is she even in the right market for sustainably raised poultry?

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Mary is not sure if she should price differently, prioritize certain markets, or adjust her feed type and costs to make her business more financially sustainable. She asks her business mentor for advice.

Step 1. Understand Cost of Production Analysis

Mary goes through her records and is able to extract the following information for her 3rd year in business:

- She purchased 4,200 chicks for a total of \$11,000 including shipping
- Her total feed bill was \$38,000.
- She purchased a total of \$5,000 in supplies. This included bedding for the chicken coop, materials to keep the housing in good shape, as well as supplies and packaging to process the birds
- She processed birds 20 times throughout the year, and she paid her crew a total of \$300 each day of processing.

In addition, she had the following expenses

- Rent was \$6,000 for the year.
- Phone and internet was \$1,000
- Liability Insurance was \$1,000
- Fuel, repairs, and maintenance for the delivery truck was \$2,000.

When she looked at her QuickBooks, she noted that she sold a total of 4,000 birds for a total of \$80,000 in sales. She feels comfortable with that number since her target sale price was \$5 per pound. Doing quick math, she figures that each bird sold for an average of \$20 and weighed 4 pounds.

Decide

What is Mary's cost of production?

What is her gross margin per bird?

Do you think she can meet her profit targets by year 5? Why or why not?

Step 2. Competitive Analysis

Mary knows that if she's going to increase profits, then she has three options: increase sales, raise prices or decrease expenses. Certainly, she will explore her expenses again, to see what she can better control. She also wants to look at the competition to see what others are charging for chickens; maybe she can charge more. Mary conducts a competitive analysis. She goes to local supermarkets, butcher shops, and other farmers' markets.

She reviews prices in her area and finds the following average prices:

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- Whole Cut-Up Chickens at the Stop & Shop \$1.99/lb
- Whole Cut-Up Free Range: at Whole Foods: \$4.00/lb.
- Another farmer sells his organic birds for \$4.00/pound (though Mary knows his aren't pastured)
- The Meat Market is also selling organic/pastured birds for \$6.50.

Mary sees that she currently charges much more than the supermarkets, and about the same price as her organic competitors. Given her cost of production, she doesn't feel confident reducing her prices to be less expensive than her competitors. And if she raises her prices (as her financial modeling suggests she should), she might lose some of her customers.

Decide

How do Mary's birds compare to the competition?
 What do you think Mary should charge for her birds?
 What factors determine your pricing strategy?

Step 3. Breakeven Analysis

Mary is now in her second year with her new pricing model (\$22/bird or \$5.62/pound), and she's projecting she'll sell 5,000 birds this year (though she knows she needs to sell even more than that to reach her profit goals). She's managed to keep her costs in check; her cost of production is holding steady at \$14.25 per bird, and her overhead costs are \$15,000. She still wants to make \$35,000 in profit.

She's approached by a new grocery store in her community. They commit to buying 1,000 birds over the course of a year; about 20 birds a week for 50 weeks. She's thrilled at the prospect of having such a large customer, which could help her get closer to her goals, but she's concerned about the terms. The store feels that Mary should lower her price to \$20 each since they are making such a large commitment. Further, they're asking Mary to deliver. She estimates that the cost of each delivery is about \$60 – considering the value of her time to load the truck, make the delivery and the wear and tear on her vehicle.

Decide

Given the reduced sales price, how many birds does Mary need to sell each week to cover her costs?
 What risks are involved and how could she mitigate them?
 What do you advise Mary to do?

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