KEY SUCCESS FACTOR - DISTRIBUTION IS JUST THE BEGINNING. Now that you've gotten into distribution, you can celebrate for a minute, and then you must realize that your work has only just begun. Your distributor will carry your product from their warehouse to the grocery store. It's up to you to convince the grocery store to order the product from the distributor or warehouse. If stores do not order your product, the distributor and warehouse will not re-order from you.

Because the distributor will be representing you in the market, be aware of and be prepared to offer the promotion tools expected by distributors, such as sell sheets, etc. Methods for promoting your product to grocers, including using brokers, are provided in *Marketing*, pg. 26.

PRICING

One of the biggest complaints from retailers about dealing with new small growers and food manufacturers is in regard to pricing. Many new small growers and food manufacturers do not understand pricing and how it affects their profit and the retail price[4].

A correct price ensures that you'll have enough profit to promote your product and fund your growth. The correct price means that you may meet your expenses and may be paid a decent return for your efforts. In contrast, if the price of your product is not correct, soon little else in your business will work. Simply put, if your price is too low, you won't have the profit you need to fund your business and promote your product. Eventually, you'll be driven out of business[9].

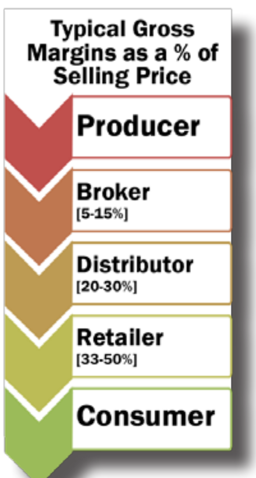
But how do you figure out what the right price is? One way to determine your wholesale price is to work backward from the retail price. One industry expert indicated that it's common for retail price to be an average of four times your cost of goods sold.

Two worksheets are provided for comparing pricing alternatives. Note that neither worksheet includes packaging materials, overhead, and other business expenses, so be sure to include them when considering if your price will net you an income sufficient to run your business.

1. **MICROSOFT EXCEL INTERACTIVE WORKBOOK.** This workbook (*pricingworkbook.xls*) requires only that you enter a few numbers, and it will calculate the rest for you. You must download this form from the attachments site and open it with Microsoft Excel[3].
2. **PRICING WORKSHEET.** This is a worksheet that provides a guide to the pricing formulas. Download from the attachments, print, and fill out.

The following details provide the information you'll need to compute prices.

- Suggested retail price. To start, consider: is your suggested retail price (SRP) comparable to other products in the category? If it's more expensive, do you offer unique ingredients or other attributes to make the product a fair value in the consumer's eyes? Does your suggested retail price allow for the industry standard 33-50% for the grocer and 20-30% for the distributor, maybe even 5-15% for the broker, while still providing you with a wholesale price enough to make a profit (including marketing expenses and paying yourself)? If not, you will need to re-evaluate your price and your product's fit for grocery stores.
- Margins. The net profit (after all expenses) margins for major food retailers are usually in the 2%-3.5% range. The gross margins, however, are often in the 25%-35% range, depending on the category of food product. For example, the margin on a "high turn" product, such as canned beans, is approximately 30%, while the margin on "slow turn" spiced mustard may be 40%. As the workbook suggests, talk to a few grocery stores and find out their expected margins. Generally, it is safe to assume that the retailer will require a 30%-40% margin on food products, and the more competitive the product category, the lower the margin. Specialty, perishable, and lower volume items have higher margins. Many large retailers have private label products. In this case, no matter how low your price is to the retailer, it almost never will be as low as the private label price[5].



- Allowances. View the *Glossary* for explanations of the allowances that can be offered.
- Cost of goods sold. Review the attachment *Costing Programs and Pricing Strategies* for worksheets to help determine COGS.

CONGRATULATE YOURSELF! Once you've established a reasonably correct cost of goods sold, you have completed one of the most tedious jobs involved in determining profits. When you have good data on how profitable your business is, you will be able to adjust your product pricing so that your business will run better[9].

- Selling, marketing and administrative costs. Now your focus can shift to the other costs involved in running of your business. These separate costs are lumped together because they use many of the same resources (telephone, personnel, office space, etc.). Determining this cost also involves lots of number crunching, but the process is less overwhelming than determining the cost of goods sold. All of the entries in this checklist are self-explanatory to anyone who's been in business for even a short while. Again, if you manufacture several items, you must establish costs of selling/marketing/administration for each product separately. Once you have figured this cost, you have only to calculate costs involved with raising money for your business to summarize your costs of doing business.

- Figuring how profitable your product is. Once you've determined the cost of producing, marketing, selling, administering and financially supporting a product, you are closer to knowing how profitable it is and whether it is correctly priced.
- Determining realistic profit goals. Now that you've figured your gross profit margin,what does it tell you about how well your product is doing? General guidelines for specialty foods indicate that their ideal gross margin should be between 40% and 60%. These figures are based on standards in the specialty food industry. Your gross margin should be no less than 40%; if it is, you won't have enough money to support your product.

  You may be surprised that the ideal gross margin has an upper limit of 60%. You may be thinking, "Huh? There should be a ceiling on the profitability of my product? I thought I was in this for the profits." Well, if your product has a gross margin that is above 60%, competitors will be tempted to imitate your product. For the longevity of your business it may be better to take less profit or to be sure you're investing the additional profit in activities that will protect your business long-term.

PRICING TRAPS TO AVOID.[9]
The following should be avoided:

- You cannot set prices based on anticipated "cost of goods" savings. For instance, if you make cookies you may think, "I can sell my cookies for less than they actually cost because once they catch on and become a hot item, I'll be able to buy ingredients in greater volume. When I can buy 40,000 pounds of flour at once, I'll save so much money that it will make up for everything I've lost while the business was growing. Once my business gets really big I'll make more money and be able to bring my price into line with costs. Until then, I'll skimp on other things." If you follow this practice, you are dooming your product to failure. Don't accept the illogical idea that, "Someday when I'm bigger, I'll be able to make money at my current price levels." Remember that to realize the price savings on 40,000 pounds of flour requires a railroad siding, a flour silo, flour infestation controls and a high-speed production line. The money for all of those things must come out of your current profits or further investment. You may be able to be more competitive because of production savings, but you have to get the price right in the first place or your business won't survive and grow.

- You must include in your budget and price all expenses required/demanded by the consumer and the trade. By this we mean that all the costs required to get your product to the ultimate consumer must be built into your budget and pricing plan. Such costs might include sales commissions, in-store demos, advertising, trade shows, promotions, distributor discounts, freight, customer service, etc.). If you don't get your profit margins up to the right level early in the game, you may not have the luxury of surviving a few lean years until your business takes off. Your success hinges on choosing the correct price for your product.

- <u>You cannot spend monies you haven't built into your price</u>. This includes a decent wage for your workers and yourself. Often people who start specialty food businesses neglect to pay themselves. This is equivalent to contracting for indentured servitude. And for what? So your price will be lower than that of your competitor? Are you willing to risk your family's future on the fear of a higher price? Newcomers to the specialty food trade tend to give away their product, their time and their creativity and end up with nothing at all because they are afraid to raise their prices. When the price of your product is correct, you are telling all market segments, "I need to make money on my product, even if I choose to fully invest that money into the growth of my company." This is a perfectly laudable statement and shows that you understand something of the nature of business.

- <u>You can afford any expenditure that is included in your price</u>. Do you believe in your product? Do you believe in your company? If so, then you can build nearly any reasonable cost of business into the price of your product. Must you pay slotting fees? They should go into the price of your product. What about the dozens of complimentary golf balls for buyers? They should go into the price of your product. If the buyer at a huge conglomerate market will take your product only if yousweeten the deal with a special allowance, then build the allowance into the cost of your product and get the business if you can handle the volume. Do you want to invest heavily in TV advertising? And do lots of print ads with coupons? Well, that's why cereal prices are so high. Who do you think pays for the coupons? The consumer does. It's in the price.

- <u>You must reset prices whenever a material change in costs or expenses is experienced or anticipated</u>. It is important for you to keep your prices current with your expenses. If you neglect routine monitoring of your costs and fail to raise your prices when necessary, inflation will bleed away your profits. You must forecast changes in costs of materials and adjust your prices as necessary. Are market analysts predicting a rise in the price of glass? Well, raise your price in anticipation of this change. You can always reduce it if the change does not materialize, or use the extra margin to promote your product.

Pricing your product is one of the most important decisions you will have to make. Your price should give consumers what they want but it also must meet your business needs. Remember, consumers will always want it cheaper but that doesn't mean you should undercharge. While the process can be nerve-wracking, it may make things easier if you realize that you're not the one who has forced the food industry to rely on costly marketing strategies to spark sales. You're not the one who has ruled that food must be sold in supermarkets or specialty food emporiums. Rather, by voting with their dollars, consumers have selected the kinds of stores that they prefer. In so doing, they have indirectly voted for the profit margins that are related to each kind of store. Similarly, consumers have selected the kinds of packaging they prefer, along with their related costs. Consumers have expressed preferences for the quality and size of product that they want, as well as all of the various promotional techniques that are involved. Each consumer preference has a price tag and, in the end, consumers must pay for their choices.

BUSINESS PRACTICES

This section begins with an assessment: are you in business, or are you trying to make money off of your hobby? This is not to be confused with making money doing something you love; rather, it's assessing whether or not you plan to run your business in a business-like manner.

As you were asked in the beginning of this manual: is this your full-time business, or are you making product "on the side" while still keeping a "day" job? For the sake of the reputation of local products among store owners, we suggest that you should pursue selling your product to more than a handful of grocery stores ONLY if this is your primary source of income. If you are part-time (i.e. NOT at least 8-5, Monday-Friday), then selling to a handful of grocery stores is possible, but pursuing warehouse, distribution, and non-local stores isn't likely to be successful.

Here are some common food industry business practices that you must consider.

BUSINESS HOURS. Most brokers, distributors, warehouses, and grocery stores expect that you are available to conduct business on a regular schedule, usually Monday-Friday, 8 a.m.-5 p.m. This can be done in your pajamas at home, or it can be done on the road with your cell phone and laptop, but to sell to grocery stores, you must be available during regular business hours.

TECHNICAL SKILLS. Do you have the computer programs required for doing business and the skills for running them, such as:

- Word processing programs (e.g. Microsoft Word) for contracts, invoices, sales fliers, etc.
- Accounting software (e.g. QuickBooks) for accounts receivable, accounts payable, etc.
- Email software (e.g. Microsoft Outlook) for quick, inexpensive communication with stores
- Website development software (e.g. Adobe Dreamweaver) for developing and updating your website (resources for those with limited skills, such as smallbusiness.yahoo.com/webhosting, are available)

If you don't have these skills, you can either take the time to learn them from local Adult Ed classes, online tutorials, etc., or you can hire out. Common skills that are "hired out" are for accounting and website development/management. The time you free up by hiring out for these tasks can be spent on marketing your product.

The most important message here is that whether you pay for experts or train yourself, your business must have access to these skills.