Colorado State University

The Dynamics of Colorado Food Markets: Strategic Pricing for Business Profitability

From Kitchen to Commercial

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Pricing in Practice

Value is not determined by those who set the price. Value is determined by those who choose to pay it.

Simon Sinek

NEVER LOWER YOUR PRICE, ADD VALUE

GRANT CARDONE

Pricing

- Cost-Based Pricing (Supply Side)
  - Better as a Decision tool than Pricing mechanism
- Value Based Pricing (Demand Side)
  - Anchored on Consumer Values and Perceptions
- Competitor-Based Pricing (Comparative)
  - Have your peer companies set the reference price?
  - Differentiation helps refine price

Costs are a Baseline/Starting Point

- The costs of "food production" are too narrow as the only information, but essential to know
- Competitive aspects relate to reference prices of national and mature brands
- Value pricing relates to the more subtle costs of your artisanship, marketing & customer service

Questions that will help you better understand your costs (and ways to control them)

1. How will you process your product?
   - This will influence your costs
2. Where will you source your ingredients?
   - How seasonal are your ingredients?
3. Will you need help?
   - Do you need to hire employees?

DOLLARS
&
SENSE

Break-even analysis grounds your plan

1. Your variable costs of production
2. The sales price of one unit of product
3. Contribution margin
4. Your fixed costs of production
5. Your break-even price (and units sold)

Your costs of production

Costs of production are *any* expenses you will incur to produce your product.

1. **Variable costs**: costs that depend on the amount of product you make. Examples include:
    a. Recipe ingredients
    b. Utilities (electricity & water)
    c. Labor
    d. Packaging
    e. Most marketing costs

✵To begin, keep most costs variable so you can adjust to actual sales levels

Mapping your Costs

Strawberry Jam Ingredients –Your Variable Costs of Production

* Which ingredients could you buy in bulk or at wholesale prices?

Item	Source & package size	Total cost ($)	Units needed for your recipe (one batch)	Units per package	Costs for one batch
Pectin	*Ball Original Fruit Pectin 4.7 oz pkg*	*4.99*	*1.75 oz*	*2.7*	*1.67*
Lemon juice	*RealLemon 32 oz bottle*	*2.28*	*¼ cup (2 oz)*	*16 2 oz portions*	*0.14*
Sugar	*5 lb bag*	*3.00*	*7 cups*	*11.25 cups or 1.61 7-cup portions*	*1.87*
Strawberries	*1 quart fresh, whole*	*1.99*	*5 cups crushed (2.5 quarts)*	*0.40*	*4.95*
Packaging (jars, lids, labels)			*1 jar, lid + label ($0.42 each)*		*3.36*

Source: Martha Sullins, CSU Extension

Your costs of production

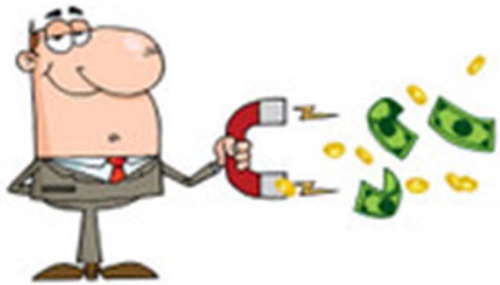
Your other set of costs are the investments you make to produce your food product, regardless of how much you produce:

2. **Fixed costs**: costs you must cover–
    a. Insurance
    b. Food handler training
    c. Specialized pots, pans and other equipment or tools

Some marketing costs vary depending on where and how you sell your product

- If you sell in a farmers' market you will have to:
  - Pay an application fee to be a vendor
  - Pay a stall fee and any applicable sales taxes
  - Buy a tent, table and other equipment to showcase your product to customers
  - Staff your booth for market duration

- What are other possible outlets for for your cottage food sales?



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HitToon.com/225534

3. Calculate your contribution margin

- Sales price – variable costs = CM
- $7.00 – $4.00 = CM
  - This contribution margin tells you how much is contributed from each unit of sales toward paying your fixed costs and profits.
- Now what are your fixed costs?

5. So how much product do you have to sell to cover all of your costs?

- This is your break-even:

$$\text{Break-even units} = \frac{\text{Fixed costs}}{\text{Price-costs of production (CM)}}$$

Ex: Sales price=$7.00-$4.00= $3.00 (CM)
Fixed costs=$1,000/year

How many units per year?

$$\frac{\$1{,}000}{\$3.00} = 333 \text{ units per year will cover your F+V costs}$$

Small Business Tools to Assist

Product Cost & Pricing Tool

RECIPE: Grandma's Chocolate Chip Cookies (prices & quantities are for example only)

INGREDIENTS	TOTAL QUANTITY	TOTAL PRICE	PER UNIT PRICE	UNITS IN RECIPE	INGREDIENT COST
All-Purpose Flour (in ounces)	400	13.99	$ 0.035	10.35	$ 0.362
Baking Soda (in ounces)	16	0.99	$ 0.062	0.1	$ 0.006
Salt (in ounces)	16	0.77	$ 0.048	0.1	$ 0.005
Butter (in ounces)	16	2.99	$ 0.187	8	$ 1.495
Sugar (in ounces)	80	7.59	$ 0.095	5.34	$ 0.507
Brown Sugar (in ounces)	32	2.89	$ 0.090	5.81	$ 0.525
Vanilla Extract (in liquid ounces)	8	13.99	$ 1.749	0.25	$ 0.437
Eggs	12	2.69	$ 0.224	2	$ 0.448
Chocolate Chips (in ounces)	12	3.69	$ 0.308	18	$ 5.535
			$ -		$ -
			$ -		$ -

https://www.smallfoodbiz.com/downloads/food-product-cost-pricing-spreadsheet-us/

The Role of Competitors

Identifying your competition

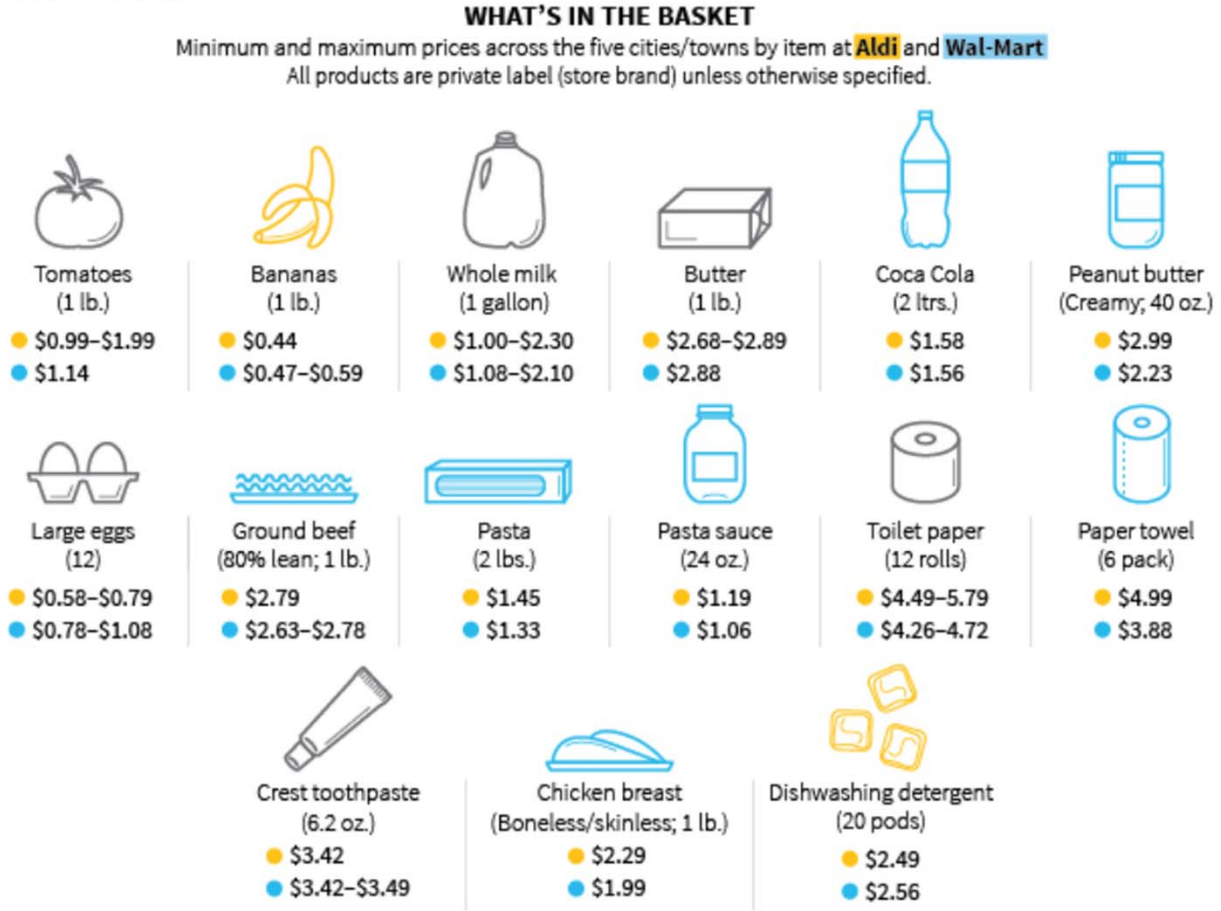
- You should assess your business' strengths and weaknesses, and compare them objectively to your competitors'
- Competition can be other businesses, regions, or similar products
  - Could you compete on price?
  - Could you copy some of your competition's strengths?
  - Could you take advantage of your competition's weaknesses?

Collect market information on consumers & the competition

- Secondary methods:
  - Web sites (meet-ups, Colorado MarketMaker)
  - Retail stores, farmers markets
  - Other surveys, relevant data from other sources (CSU, USDA)

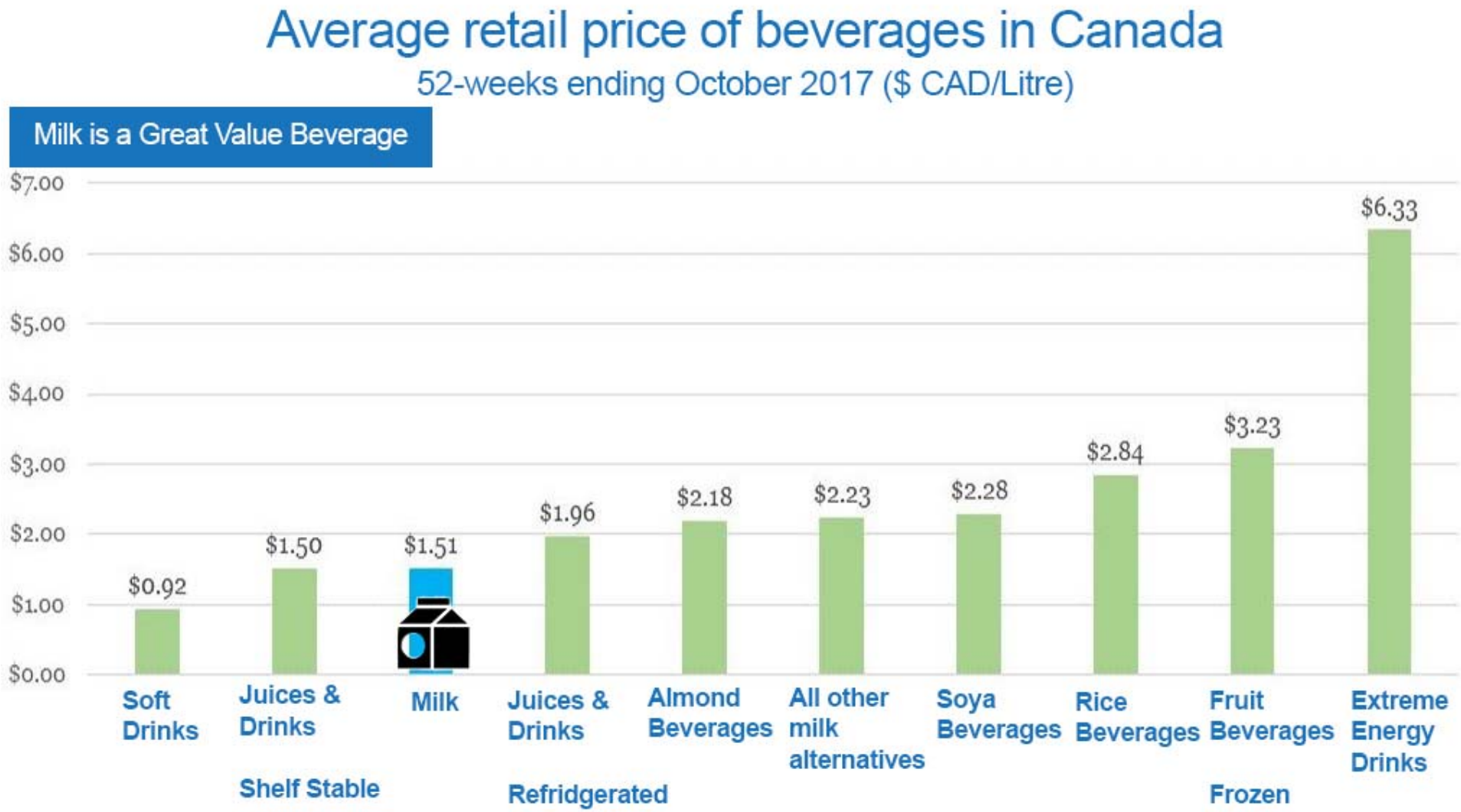
- Primary methods:
  - Observation
  - Your own surveying (online, mail, in person)
  - Test marketing, experiments, tastings
  - Information you already collected-->Your recordkeeping (returned items, comments-good and bad)

Even WalMart does Competitor research



https://www.reuters.com/article/us-aldi-walmart-pricing-exclusive/exclusive-aldi-raises-stakes-in-u-s-price-war-with-wal-mart-idUSKBN1870EN

Comparisons across substitutes



https://www.dairyfarmers.ca/[illegible]t-we-do/supply-management/myths-realities

The Role of Market Environment and Capital Investments in Food Supply Chain Dynamics

Human, social, cultural

Investments in types of capital

Physical, financial

Uncertain

Market conditions

Certain

Customer-focused start up firms

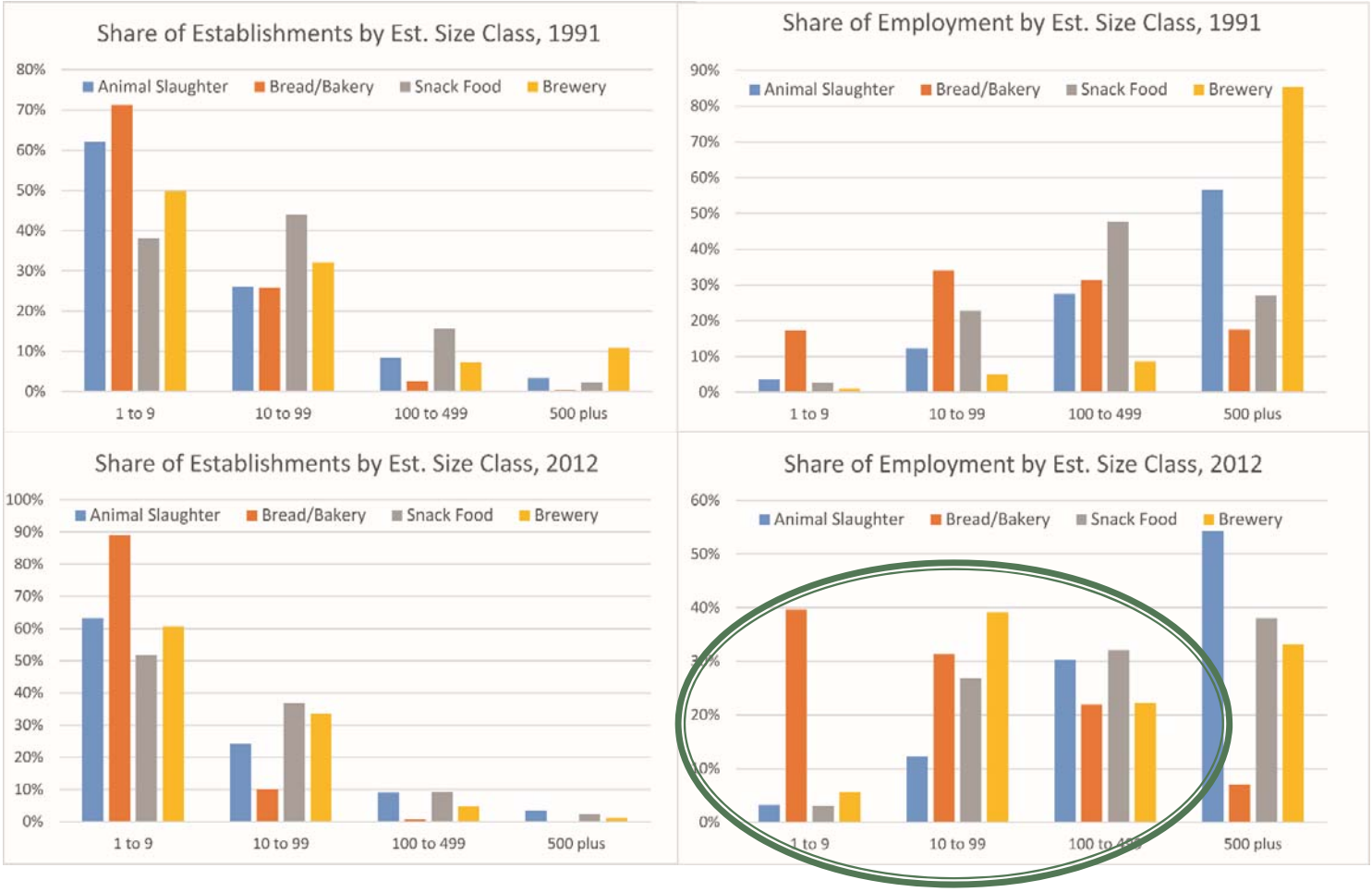
Regional, artisanal brands

Craft food enterprises

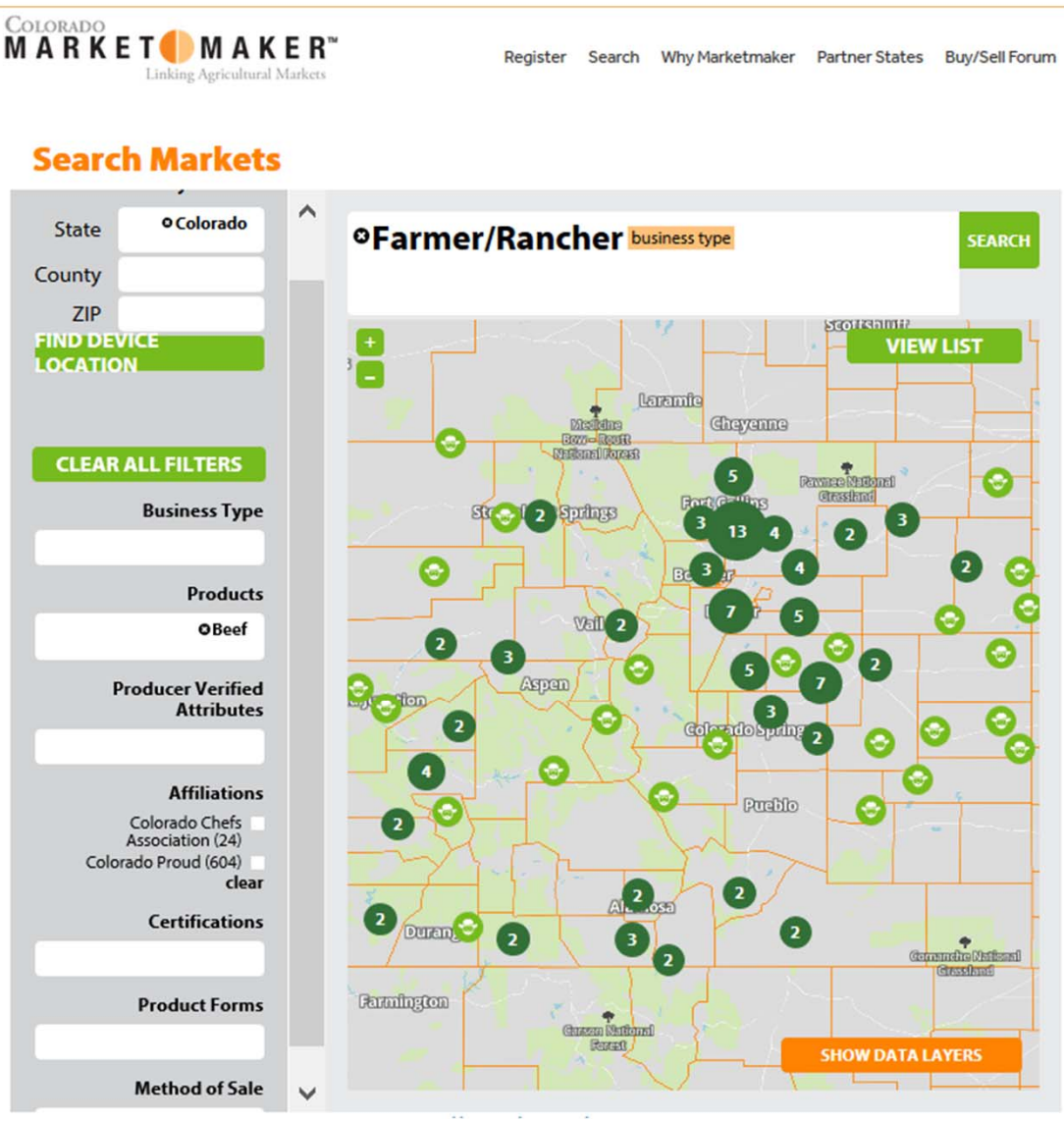
Mature product lines

Implications for size…

- Employment growth, year to year, should eventually alter structure of industry
- A "middle class" has essentially re-emerged in some sectors
- What are implications for competition? Pricing?



Use MarketMaker to Assess Competition



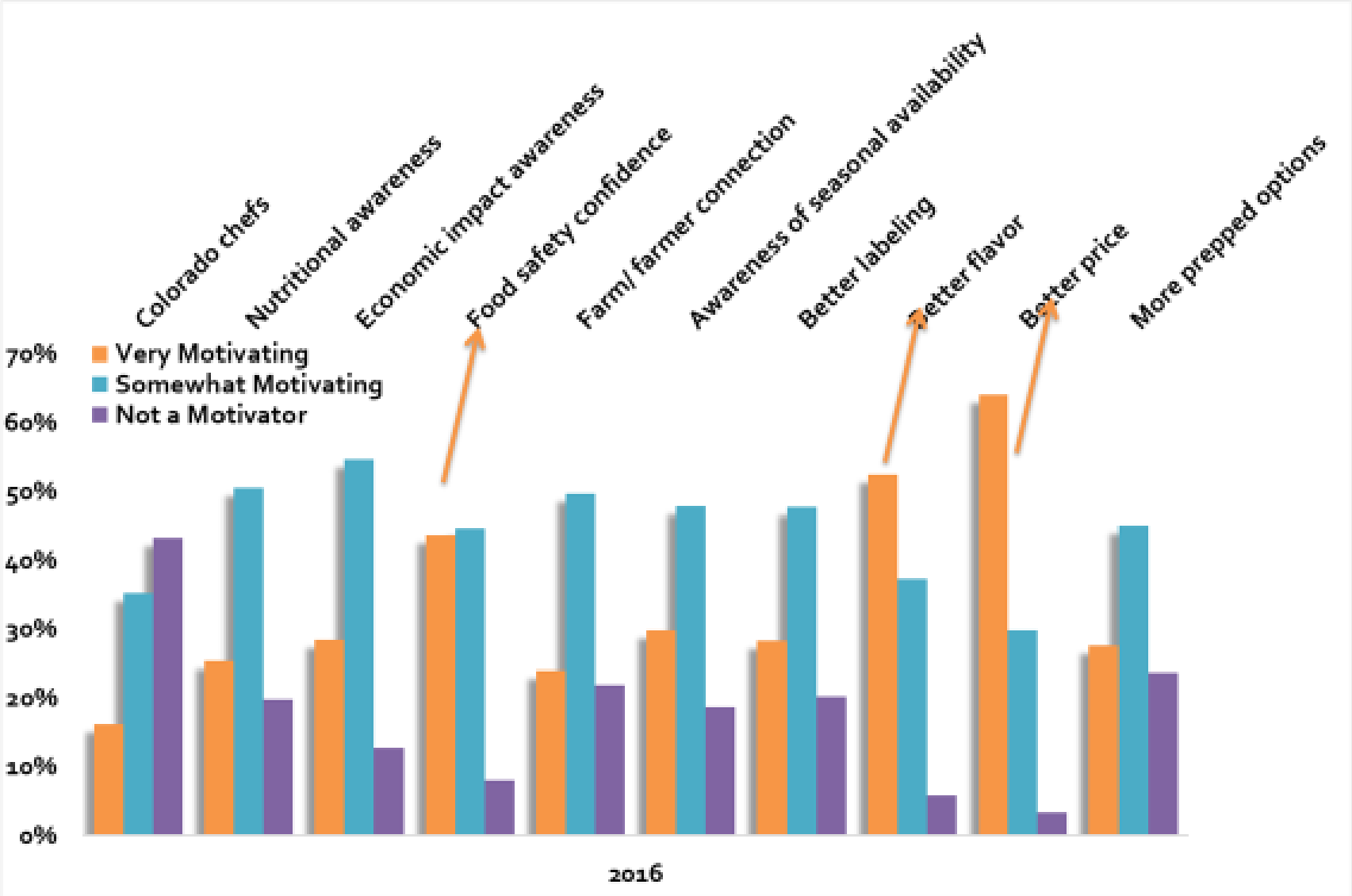
How do we Assess Value?

Is this a $50 cupcake tower or a $150 tower?

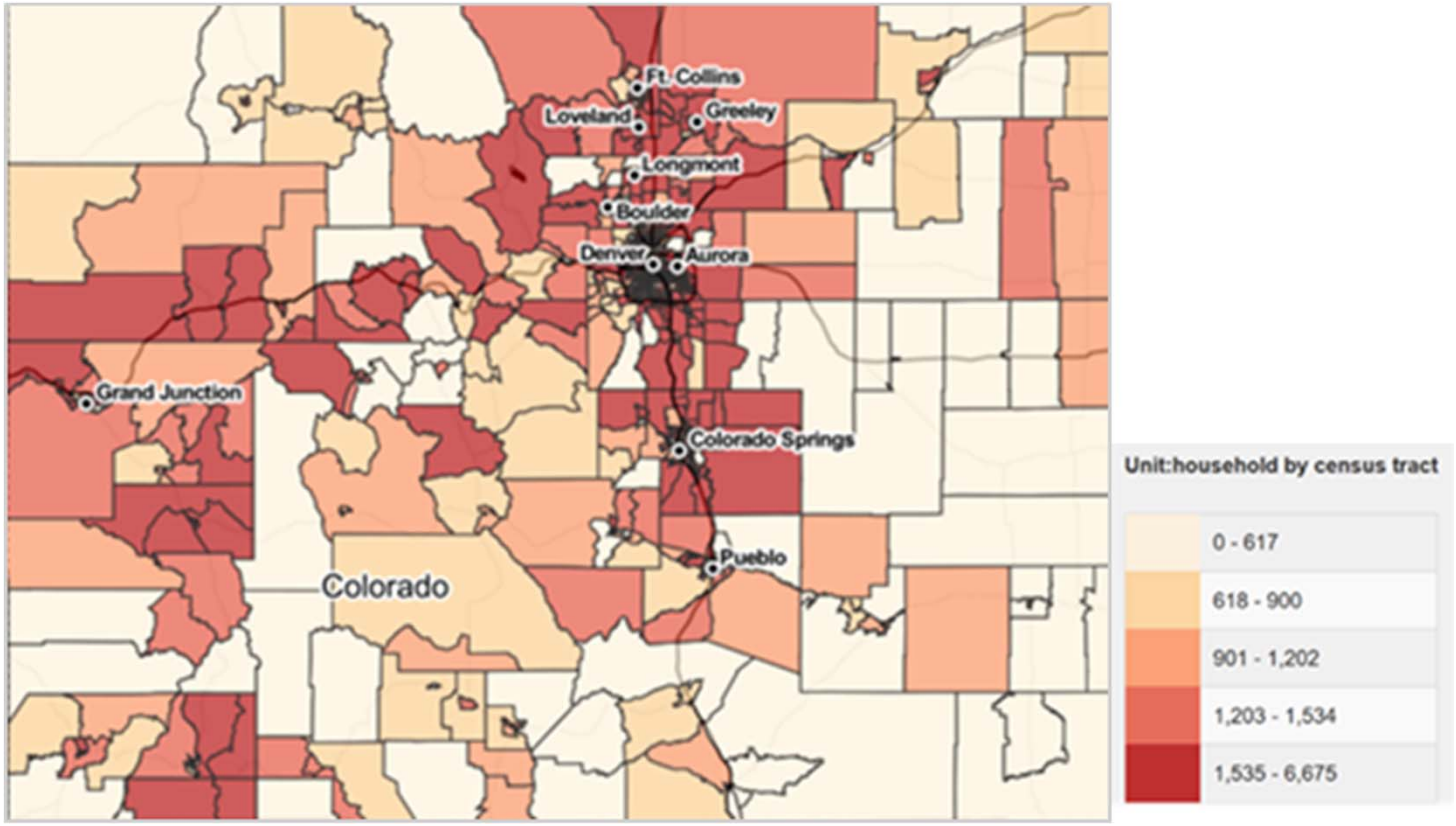
What Pricing Patterns are Useful to Consider?

- Place
  - Geographic markets have varying consumer numbers, demand (price sensitivity) and competition
- Product (Differentiation)
  - What labels matter in direct markets?
  - Are some products better aligned to establishing “loyal customers”?
- Perishability
  - Seasonality may be a key driver of prices
  - First to market is one approach to compete

Motivations to buy more CO produce

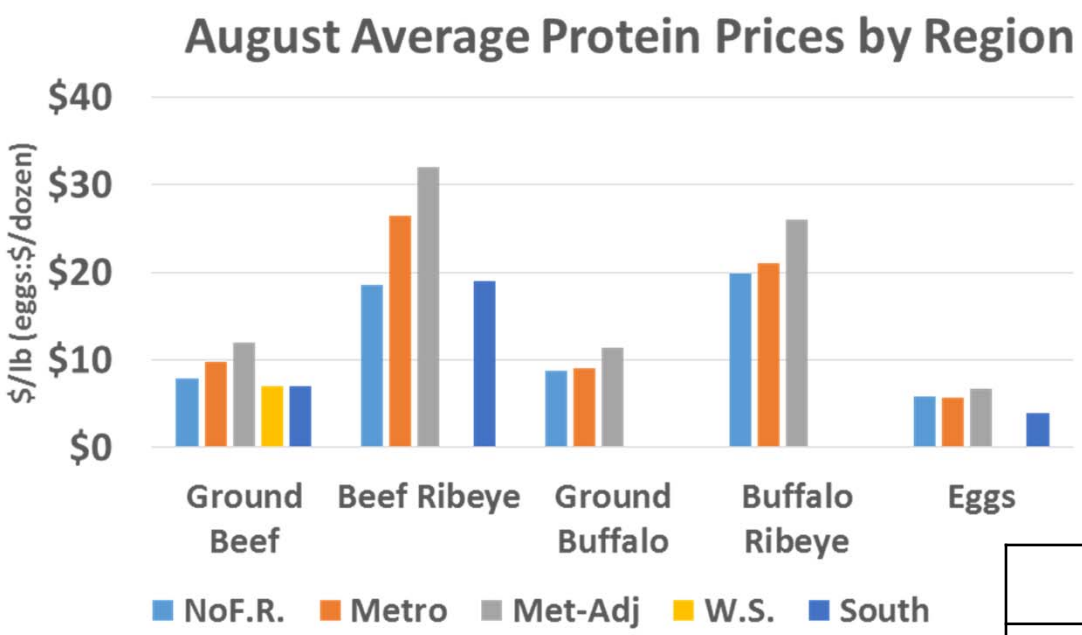


Spending varies across Colorado Food at Home



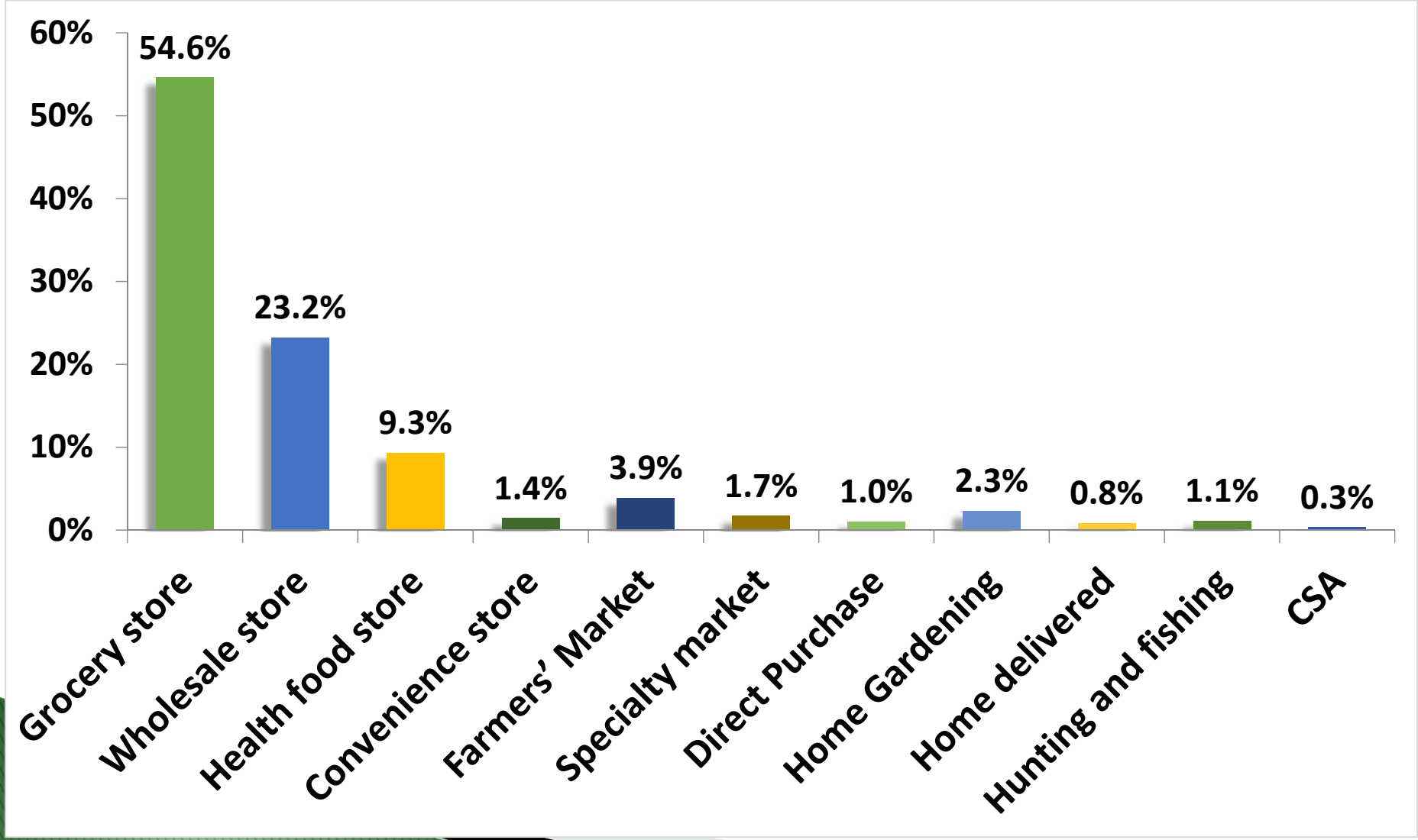
Source: Colorado MarketMaker, https://co.foodmarketmaker.com/main/market_research

What were the average price differences of animal products by region during August?

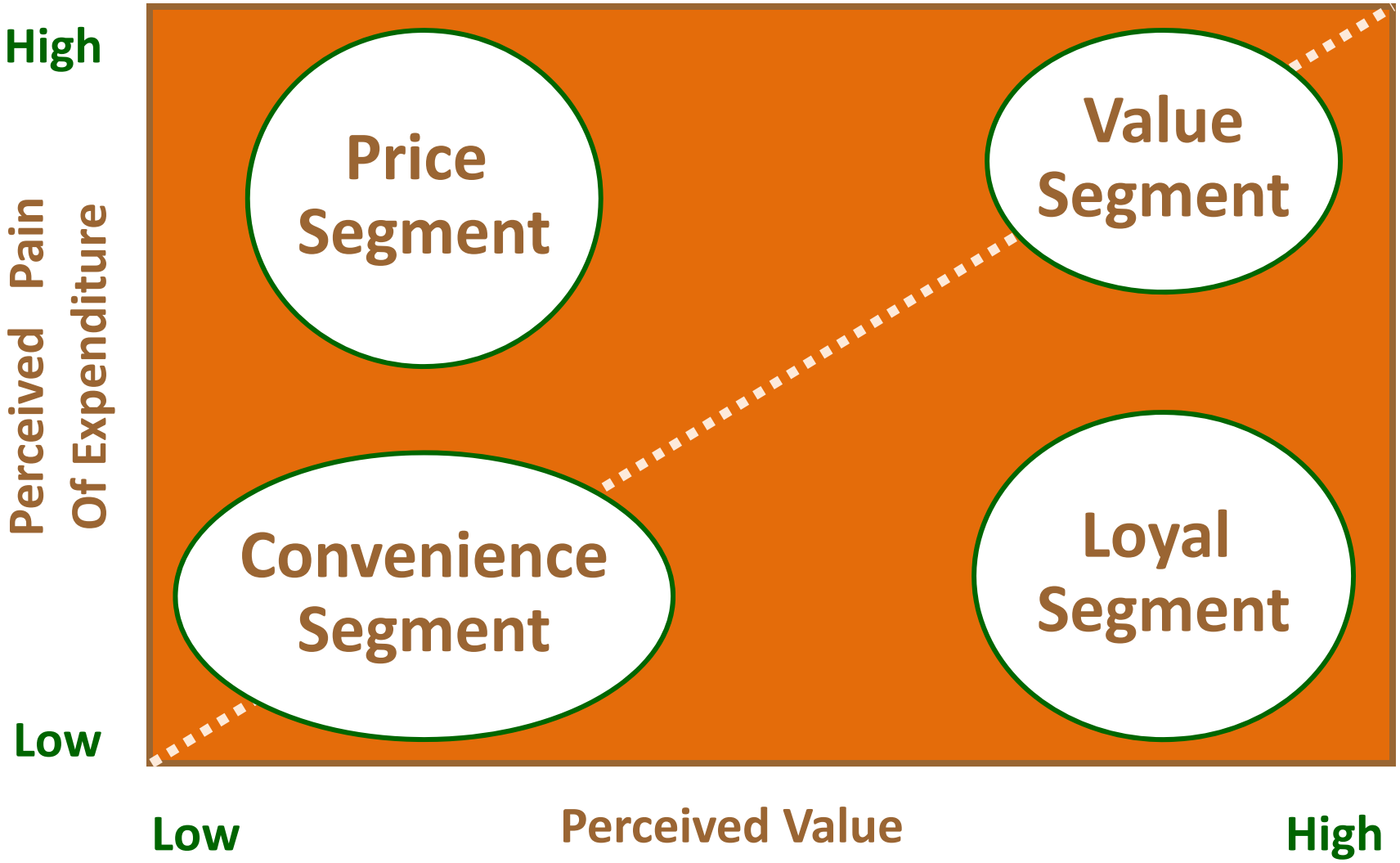


	Maximum	Location	Minimum	Location
Ground Beef	$12/lb	South Pearl St. Highland Ranch Golden	$7/lb	Alamosa Palisade
Beef Ribeye	$32/lb	South Pearl St. Highland Ranch Golden	$17.99/lb	Longmont
Ground Buffalo	$15/lb	Golden	$8.75/lb	O.T. Ft. Collins
Buffalo Ribeye	$26/lb	Golden	$18/lb	South Pearl, Denver

Drawing on the Public Attitudes Survey: Food Dollars Spent in a Variety of Markets in 2016



Segmenting Markets by Influencers



Identifying your customers

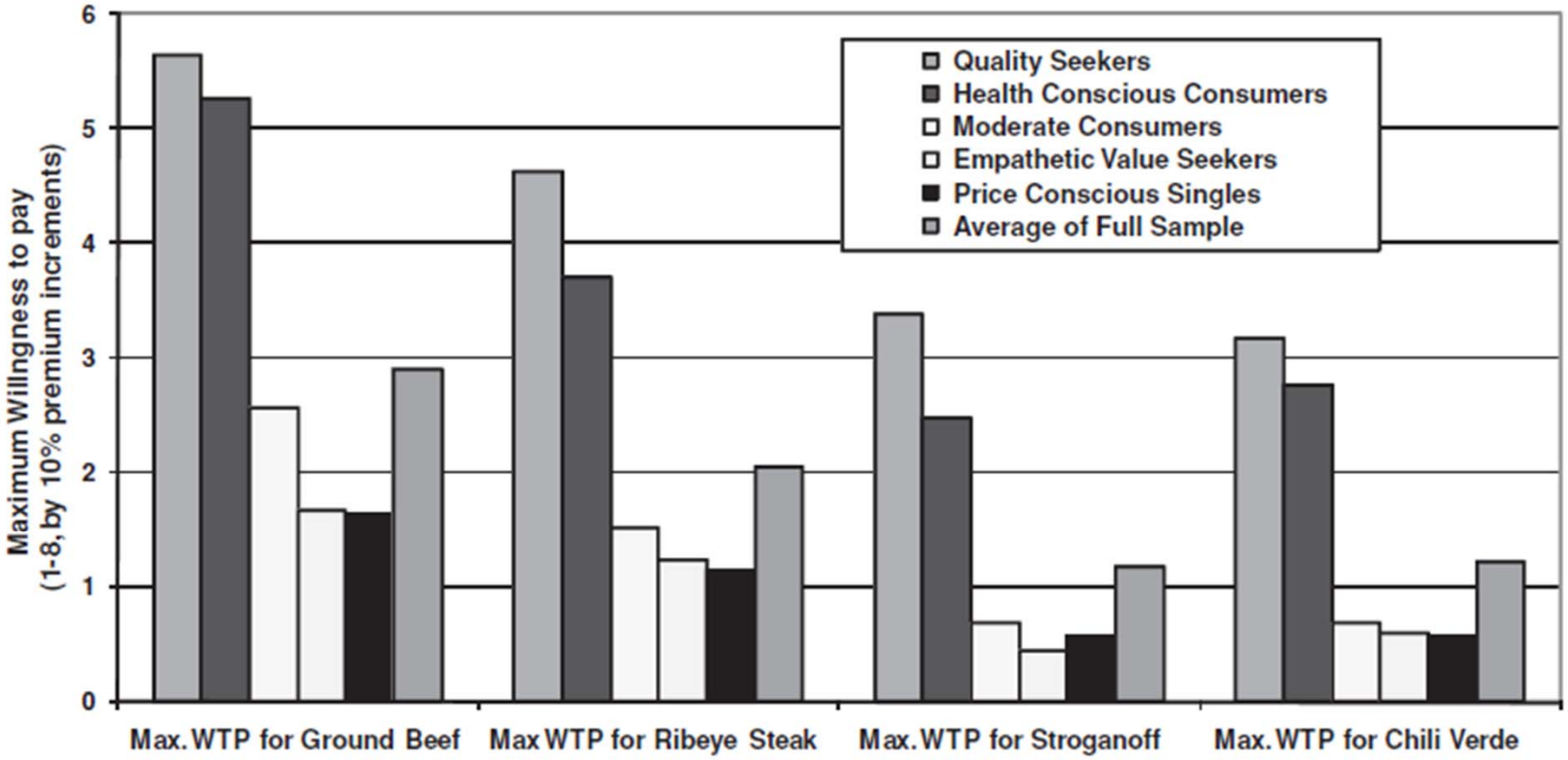
- What are they looking for? What motivates them?
  - Loyal are return customers … less worried about costs, want a relationship
  - Value segment are hardest to keep happy, but do recognize and value quality
  - Convenience segment are those you can get to make impulse buys … less price sensitive
  - Price segment is not too attractive unless you compete entirely on price
- Where do they shop for similar products?
- How often?
- Why will they choose your product(s) over the competition's?

Pricing Policies

- Price Skimming
  - Loyal and Convenience customers
- Penetration Pricing
  - Value and Price-oriented segments
- Combination Strategy
  - Coach AND First class passengers on planes
  - Larger, penetration base covers fixed cost sales goal….small, skimming segment provides "Earnings" for the airlines

A study on Colorado Beef (2004)

Figure 6. Potential price premiums willing to be paid by consumer clusters



Source: 2004 CSU consumer survey (Ziehl, 2004).

Homestead Today

HOME ABOUT US HOMESTEAD MEATS RANCHES

New York Strip Steak	$16.84/lb
Oxtail	$3.46/lb
Porter House Steak	$17.70/lb
Rack of Ribs	$3.59/lb
Ribeye Steak	$17.15/lb
Prime Rib, Boneless	$13.70/lb
Prime Rib, Bone-In	$12.90/lb
Rump Roast	$5.39/lb
Short Ribs, Bone-In	$2.90/lb
Sirloin Steak	$9.11/lb

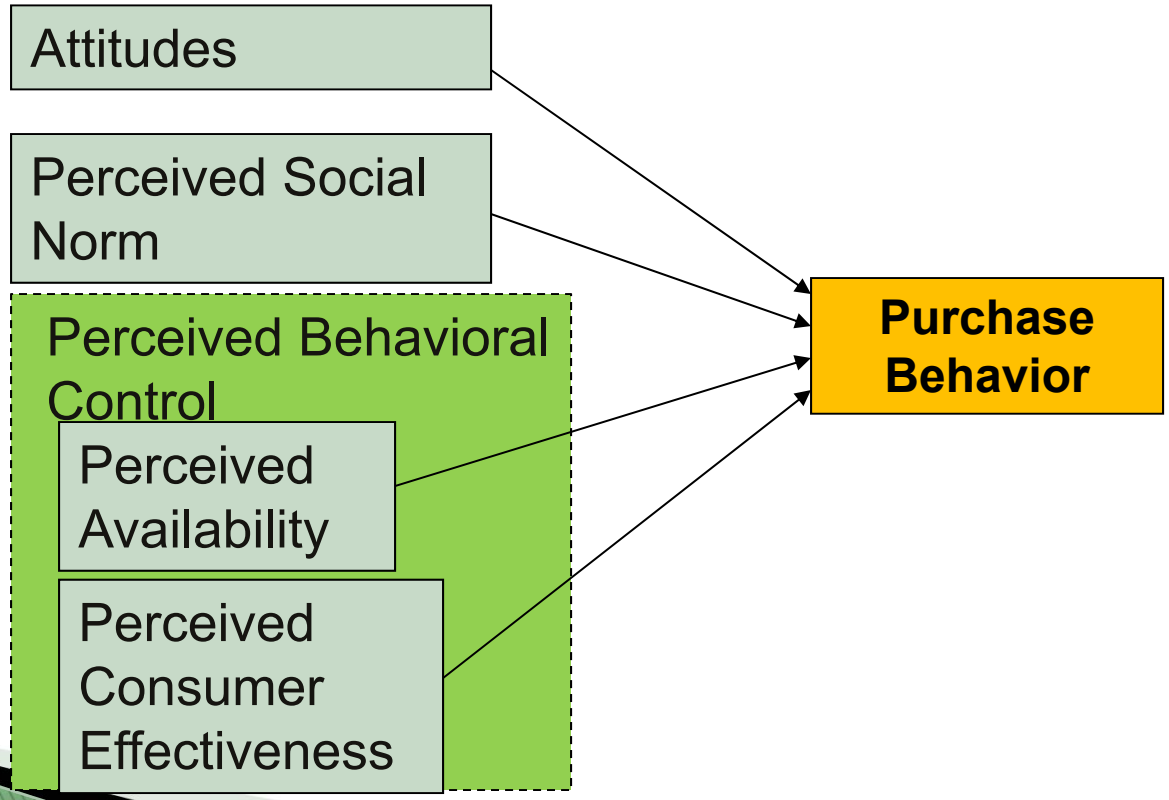
Whole, Half or Quarter Beef	$3.75/lb
Arm Roast	$4.90/lb
Brisket	$5.39/lb
Chuck Roast, Boneless	$4.90/lb
Cube Steak	$6.07/lb
Flank Steak	$10.76/lb
Ground Beef 80/20	$5.50/lb
Ground Beef 90/10	$6.50/lb
Ground Beef Patties	$5.90/lb
Hanging Tender	$9.01/lb
Heart	$2.83/lb

http://homesteadmeats.com/

F
ORGANIC PRODUCE
NO PESTICIDES, HERBICIDES
OR BAD VIBES

Theory of Planned Behavior (TPB)

- Fishbein and Ajzen 1975; Conner and Armitage 2002



Valuing Food Labels

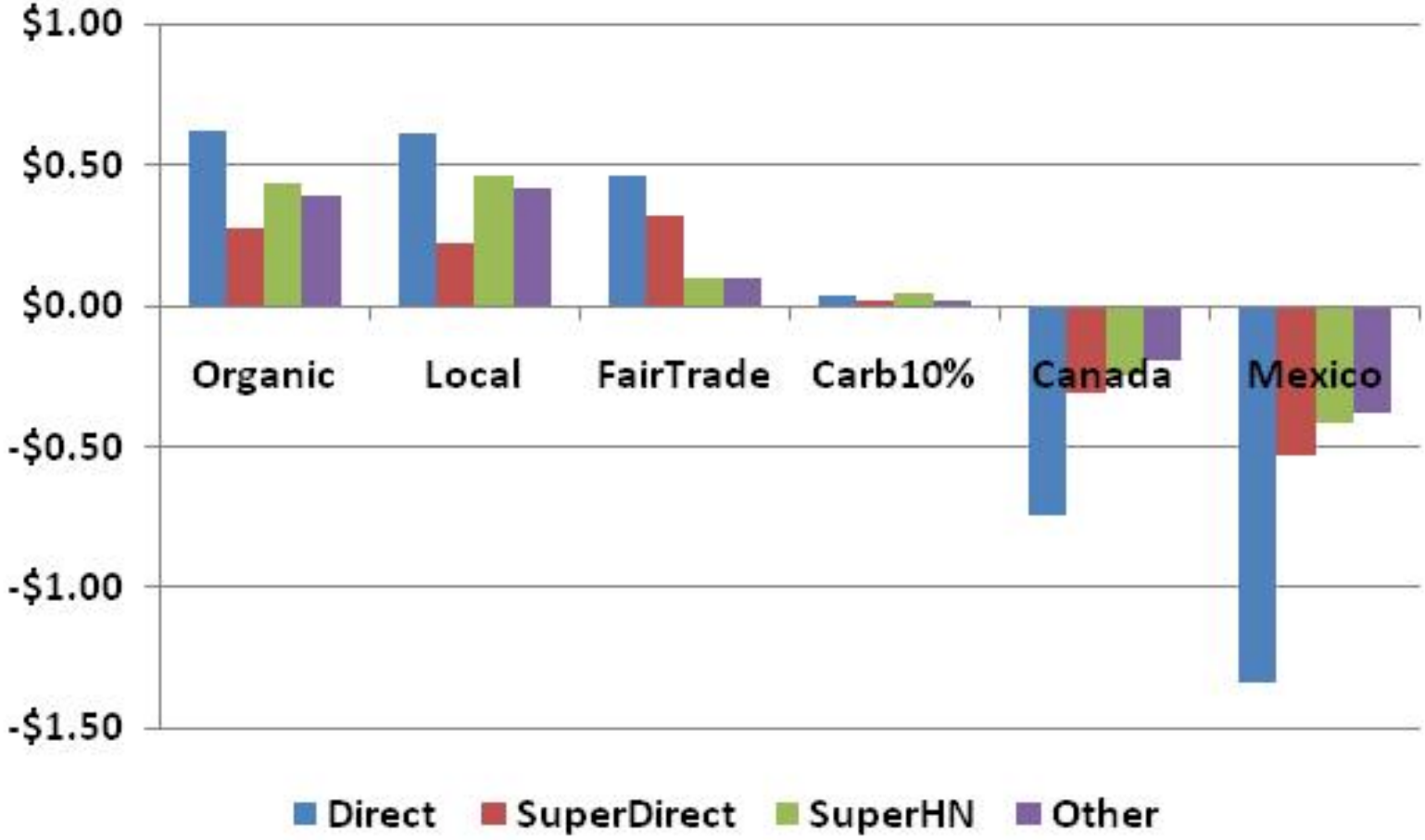
ATTRIBUTES	LEVELS Gala Apples	 Red Round Tomatoes
Product Origin	Locally Grown	Locally Grown
	Grown in Washington	Grown in CA/FL
	Product of Chile	Product of Canada
		Product of Mexico
Certified Organic	Uncertified	Uncertified
	USDA Organic	USDA Organic
Certified Fair Trade	Uncertified	Uncertified
	Certified Fair Trade	Certified Fair Trade
Carbon Footprint	60g/lb	100g/lb
	120g/lb	800g/lb
	180g/lb	1500g/lb
Unit Price	$1.49, $1.89, $2.29, $2.69, $3.09, $3.49	$1.49, $1.89, $2.29, $2.69, $3.09, $3.49

Sample Choice Set

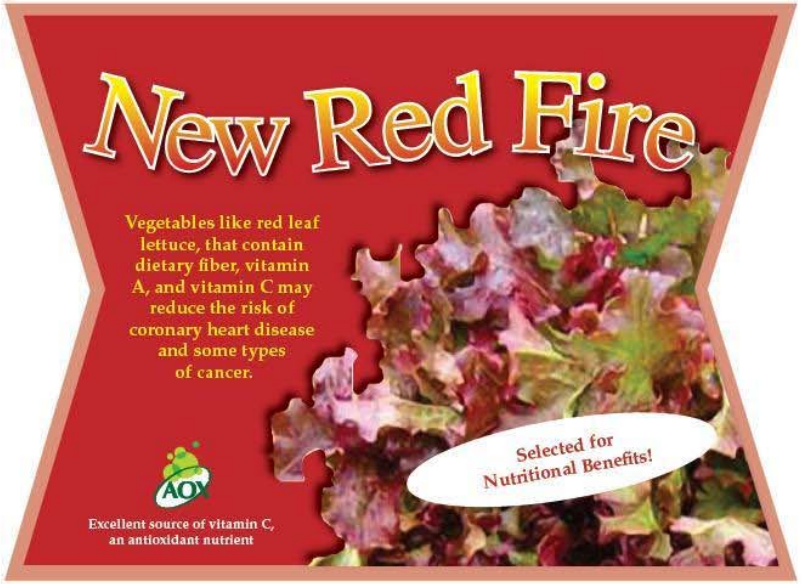
Apple 1	Apple 2
$2.69/lb	**$3.49/lb**
Product of Chile	Locally Grown
USDA ORGANIC, Carbon 60g/lb	Fair Trade, Carbon 120g/lb
I will buy this apple. ☐	I will buy this apple. ☐

Neither. ☐

Median WTP Comparisons (Tomatoes)



PRICE: $2.99



PRICE: $2.99

Organic Label and Claims

- Respondents **differentiate** between products on the basis of label claims
  - The non-specific claim of reducing risk of a human health condition is the **most highly valued** stand-alone attribute
- Bundling of attributes may **add or subtract** value depending on the specifics
  - There is **positive correlation** between valuation of nutritional attributes and organic attributes
- Valuation of claims **varies significantly** across individuals

Other Pricing Methods

- Introductory Price Cuts
- Loss Leader Pricing
- Price Point Pricing
- <u>Discounts</u>

Keys to success

- Mindset Marketing
  - Every decision affects your “brand” and its value
- Keep your “team” informed and involved
  - Customers, buyers, employees
  - Relationship marketing is part of your pricing strategy
- Evaluate and adjust continually
  - Practice adaptive management by staying informed and up-to-date
  - Competitors, customers, costs….and channels

Questions?