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?
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?

<table>
<thead>
<tr>
<th>Item</th>
<th>Source &amp; package size</th>
<th>Total cost ($)</th>
<th>Units needed for your recipe (one batch)</th>
<th>Units per package</th>
<th>Costs for one batch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pectin</td>
<td>Ball Original Fruit Pectin 4.7 oz pkg</td>
<td>4.99</td>
<td>1.75 oz</td>
<td>2.7</td>
<td>1.67</td>
</tr>
<tr>
<td>Lemon juice</td>
<td>RealLemon 32 oz bottle</td>
<td>2.28</td>
<td>¾ cup (2 oz)</td>
<td>16 2 oz portions</td>
<td>0.14</td>
</tr>
<tr>
<td>Sugar</td>
<td>5 lb bag</td>
<td>3.00</td>
<td>7 cups</td>
<td>11.25 cups or 1.61 7-cup portions</td>
<td>1.87</td>
</tr>
<tr>
<td>Strawberries</td>
<td>1 quart fresh, whole</td>
<td>1.99</td>
<td>5 cups crushed (2.5 quarts)</td>
<td>0.40</td>
<td>4.95</td>
</tr>
<tr>
<td>Packaging (jars, lids, labels)</td>
<td></td>
<td></td>
<td>1 jar, lid + label ($0.42 each)</td>
<td></td>
<td>3.36</td>
</tr>
</tbody>
</table>

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 your cottage food sales?
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?

\[
\frac{1,000}{3.00} = 333 \text{ units per year}
\]

$3.00 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)

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

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

Comparisons across substitutes

Average retail price of beverages in Canada
52-weeks ending October 2017 ($ CAD/Litre)

Milk is a Great Value Beverage

- Soft Drinks: $0.92
- Juices & Drinks: $1.50
- Milk: $1.51
- Almond Beverages: $1.96
- Refrigerated Beverages: $2.18
- All other milk alternatives: $2.23
- Soya Beverages: $2.28
- Rice Beverages: $2.84
- Fruit Beverages: $3.23
- Extreme Energy Drinks: $6.33

https://www.dairyfarmers.ca/about-us/what-we-do/supply-management/myths-realities
The Role of Market Environment and Capital Investments in Food Supply Chain Dynamics
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

- Colorado chefs
- Nutritional awareness
- Economic impact awareness
- Food safety confidence
- Farm/farmer connection
- Awareness of seasonal availability
- Better labeling
- Better flavor
- Better price
- More prepped options

Bar chart showing the percentage of respondents motivated by different factors in 2016.
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?

### August Average Protein Prices by Region

<table>
<thead>
<tr>
<th>Product</th>
<th>Maximum</th>
<th>Location</th>
<th>Minimum</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ground Beef</td>
<td>$12/lb</td>
<td>South Pearl St. Highland Ranch Golden</td>
<td>$7/lb</td>
<td>Alamosa Palisade</td>
</tr>
<tr>
<td>Beef Ribeye</td>
<td>$32/lb</td>
<td>South Pearl St. Highland Ranch Golden</td>
<td>$17.99/lb</td>
<td>Longmont</td>
</tr>
<tr>
<td>Ground Buffalo</td>
<td>$15/lb</td>
<td>Golden</td>
<td>$8.75/lb</td>
<td>O.T. Ft. Collins</td>
</tr>
<tr>
<td>Buffalo Ribeye</td>
<td>$26/lb</td>
<td>Golden</td>
<td>$18/lb</td>
<td>South Pearl, Denver</td>
</tr>
</tbody>
</table>

- Grocery store: 54.6%
- Wholesale store: 23.2%
- Health food store: 9.3%
- Convenience store: 1.4%
- Farmers’ Market: 3.9%
- Specialty market: 1.7%
- Direct Purchase: 1.0%
- Home Gardening: 2.3%
- Home delivered: 0.8%
- Hunting and fishing: 1.1%
- CSA: 0.3%
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

<table>
<thead>
<tr>
<th>HOME</th>
<th>ABOUT US</th>
<th>HOMESTEAD MEATS</th>
<th>RANCHES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Whole, Half or Quarter Beef $3.75/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Arm Roast $4.90/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Brisket $5.39/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Chuck Roast, Boneless $4.90/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Cube Steak $6.07/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Flank Steak $10.76/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New York Strip Steak $16.84/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Oxtail $3.46/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Porter House Steak $17.70/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rack of Ribs $3.59/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ribeye Steak $17.15/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prime Rib, Boneless $13.70/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Prime Rib, Bone-In $12.90/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rump Roast $5.39/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Short Ribs, Bone-In $2.90/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sirloin Steak $9.11/LB</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ground Beef 80/20 $5.50/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ground Beef 90/10 $6.50/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ground Beef Patties $5.90/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Hanging Tender $9.01/LB</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Heart $2.83/LB</td>
</tr>
</tbody>
</table>

http://homesteadmeats.com/
ORGanic PROduce
No PESTICIDES, HERBICIDES
OR BAD VIBES
Theory of Planned Behavior (TPB)

- Fishbein and Ajzen 1975; Conner and Armitage 2002

Diagram:
- Attitudes
  - Perceived Social Norm
  - Perceived Behavioral Control
    - Perceived Availability
    - Perceived Consumer Effectiveness
  - Perceived Consumer Effectiveness
- Purchase Behavior
## Valuing Food Labels

<table>
<thead>
<tr>
<th>ATTRIBUTES</th>
<th>Gala Apples</th>
<th>Red Round Tomatoes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Product Origin</strong></td>
<td>Locally Grown</td>
<td>Locally Grown</td>
</tr>
<tr>
<td></td>
<td>Grown in Washington</td>
<td>Grown in CA/FL</td>
</tr>
<tr>
<td></td>
<td>Product of Chile</td>
<td>Product of Canada</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Product of Mexico</td>
</tr>
<tr>
<td><strong>Certified Organic</strong></td>
<td>Uncertified</td>
<td>Uncertified</td>
</tr>
<tr>
<td></td>
<td>USDA Organic</td>
<td>USDA Organic</td>
</tr>
<tr>
<td><strong>Certified Fair Trade</strong></td>
<td>Uncertified</td>
<td>Uncertified</td>
</tr>
<tr>
<td></td>
<td>Certified Fair Trade</td>
<td>Certified Fair Trade</td>
</tr>
<tr>
<td><strong>Carbon Footprint</strong></td>
<td>60g/lb</td>
<td>100g/lb</td>
</tr>
<tr>
<td></td>
<td>120g/lb</td>
<td>800g/lb</td>
</tr>
<tr>
<td></td>
<td>180g/lb</td>
<td>1500g/lb</td>
</tr>
<tr>
<td><strong>Unit Price</strong></td>
<td>$1.49, $1.89, $2.29, $2.69, $3.09, $3.49</td>
<td>$1.49, $1.89, $2.29, $2.69, $3.09, $3.49</td>
</tr>
</tbody>
</table>
Sample Choice Set

Apple 1

$2.69/lb
Product of Chile

I will buy this apple.

Apple 2

$3.49/lb
Locally Grown

I will buy this apple.

Neither.
Median WTP Comparisons (Tomatoes)
New Red Fire

Selected for Nutritional Benefits!

Vegetables like red leaf lettuce, that contain dietary fiber, vitamin A, and vitamin C may reduce the risk of coronary heart disease and some types of cancer.

Selected for Nutritional Benefits!

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
- Discounts
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?