Kootenay & Boundary Farm Advisors

Cost of Production — Nelson, Nov 28, 2018

Event Summary

Chris Bodnar of Close to Home Organics (Abbotsford, BC) led participants through an exploration of the steps required for vegetable farmers to determine the full cost of producing food. These concepts can be applied to all agricultural products. Several members of the Basin Business Advisors team attended the workshop and it gave them insights to apply the broader knowledge they have in business advisory services to the agricultural context.

Chris's presentation stressed that understanding how to determine the cost of production of the food a farmer grows is fundamental in order for them to not only recover all the costs incurred in producing that food, but also to make appropriate decisions regarding pricing so that their farm can be profitable and viable in the long-term.

The methods for determining the cost of production must be applied to each single crop on a farm, as each one has unique production costs. It is important for farmers to realize that "popular does not equal profitable" in the case of all agricultural goods. As an example, carrots may be a popular item and easy for a farmer to sell. That does not necessarily mean that a farmer makes any profit doing so. First s/he must determine all the fixed and variable costs involved in producing the crop. Doing so allows the farmer to arrive at the true cost of producing the food, which then allows her/him to set a "basement price". The basement price is the lowest price the farmer can charge without losing money. A farmer can then choose to mark up the price of their crops to different levels (ie 25%, 50%, 100%) appropriately when considering wholesaling their product vs. direct marketing to the end consumer. Depending on a number of variables, farms will be able to produce some crops at lower cost than other crops, giving them an advantage in the marketplace. These crops are known as "profit centres" and are the crops that make the farmer a better return.

As part of the workshop Chris had participants differentiate between production costs and marketing costs. The benefit of understanding production costs is: ability to value your time/labour and greater confidence in setting wholesale prices that are still profitable. Production costs include all the steps involved in producing a product on the farm. Marketing costs can include: time at farmer's market, time and costs of delivering product, packaging supplies, branding, logos, advertising, vehicle costs, stall fees, and even office supplies. An easy standard for farmers to work with is to try and have their marketing cost be 50% of their production cost.

Chris also had farmers differentiate between fixed costs and variable costs. Fixed costs generally remain the same, such as: assets like machinery, infrastructure, mortgage, and other overhead costs like maintenance, insurance, electricity, licences/certification, etc. Variable costs will change depending on volume produced and production practices. Examples: fertility amendments, land preparation time, labour, inputs, pest management costs, etc. By breaking down all the costs of a farm operation into smaller components a farmer can analyze where savings can be made, which is one way to increase profit.

Workshop attendants learned of two methods for analysing their cost of production.

1. <u>Rough Unit Cost</u>: This is a generalized cost analysis for producing any crops. The advantage to this method is it is quick and easy to do and requires less record-keeping. The disadvantage is it is less accurate and also not all crops have the same costs, thus have different profitability.
2. <u>Enterprise Budget</u>: Enterprise budgets are crop-specific. Their advantage is they are much more accurate at determining profitability. The disadvantage is they are time consuming and require detailed record-keeping.

Kwantlen Polytechnic University in Richmond has developed enterprise budget templates in pdf and excel format for 30 common crops that can be downloaded on their website.
http://www.kpu.ca/isfs/enterprise-budgets

Cost of Production Analysis benefits:

- Can help you match your plantings to your sales so you don't grow more than you sell. This saves you money as you don't spend time and money growing thing you can't sell
- Can improve crop yield as it analyzes how a small investment can have benefits, ie: mulch increased yield because cost of mulch was lower than labour required to weed crop and had benefit of increasing crops size due to increased heat and reduced weed pressure

Chris urged farmers to trim waste in three ways: eliminate unprofitable crops, control variable costs, and maximize fixed costs. He recommended reading Ben Hartmans book on "lean farming" or visiting his website for more information about it.

Farmers in the Columbia Basin can access farm business support services through KBFA and our partnership with Business Basin Advisors. Chris also mentioned the BC Ministry of Ag's Agri-Business Planning Program where farm businesses can access up to $5000 in business consulting services.