

# Robert M. Kerr Food & Agricultural Products Center



## FOOD TECHNOLOGY FACT SHEET

### Adding Value to OKLAHOMA

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# Are you making a profit on your products?

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## Introduction

Many entrepreneurs and start-up companies do not consider all the factors needed to establish a pricing structure for their products. However, factors unique to different sectors of the food industry can make a significant difference when determining bottom-line profit based on the target consumer for products. For example, products targeted at retail consumers require more money for packaging and presentation of the product to establish brand recognition. Conversely, less money is required for packaging if the product is focused toward the foodservice segment, as most of those items are bulk packaged for further preparation in the various kitchens of restaurants, country clubs, hospitals or in-plant cafeterias. The gourmet market is yet another consideration, as the product and presentation should be unique and emphasize the quality that distinguishes it from the basic retail items. In most instances, gourmet packaging is usually the most expensive of the groups because more of the jars, lids, labels, boxes and other packaging materials are specialized in design.

## Cost of Goods

Whether a company decides to manufacture its own products or have them co-packed by an existing company, the profit or price structure process should begin with determining cost of goods. Every recipe has to be analyzed for proportionate costs of raw materials used to make the product to determine the actual cost. This would include all ingredients, containers, lids, labels and boxes, as each one of these components is reflected in the finished cost of goods. It is important to determine which method provides the best opportunity to be competitive in a specific product category, such as finding a co-packer versus manufacturing the product in house. There usually is an advantage in finding a

reputable co-packer to make the products because they already purchase many of the raw materials, containers, lids, boxes and other raw materials required for production. Since a co-packer buys items for several companies, it can buy larger volumes that cost less per unit than an individual company could. In addition, if a company uses its own production facility, there often are costs not associated with using a co-packer, such as equipment, insurance, utilities, building maintenance and other expenses. The ultimate goal should be to have a quality product at the best possible price to be competitive in the product category.

## Additional Cost Considerations

Once a final cost of goods is established, there are several other components that also have to be defined. Listed below are several additional costs that must be added to the finished cost to ensure the profit structure is maintained. All of these factors have an expense that will be added to the finished cost of goods.

1. Where will the product be stored prior to shipment, and what is the cost of outside storage if it is required? That cost has to be included for each case based on the total cost for storage.
2. How will the product be delivered to the customer? If a company decides to deliver the product, a cost per case for fuel, mileage and time must be established. If the product is delivered by an outside service, what is that cost, and what is the minimum delivery charge?
3. Most warehouses and distribution centers require slotting fees that can cost between \$3,000 and \$7,500 per item to be inventoried. For example, if a company has

three types of salsa – mild, medium and hot – the slotting fee applies to each type.

4. How or who will represent the product to the buyers and the various warehouses and distribution centers? The vast majority of these buying departments require some type of representation for products, and in most instances they prefer an established food broker that represents other product lines in their warehouses.
5. In the event a company is required to contract with a food broker to represent its product, and the company is not familiar with working with brokers, the buyer may recommend two or three brokers who he or she believes would be a fit for the products.
6. Most reputable food brokers require a contract that defines the geographic area of their responsibility and specifies how the product will be introduced to the market. The average monthly charge for food brokers can range between 5 and 8 percent of sales for each order shipped to the warehouse.
7. It is not uncommon for most new products being introduced in the market to offer some type of promotional incentive to stimulate sales. Some of the methods they use could be in-store instant coupons, one free case for every 10 purchased, buying a newspaper advertisement, product demos or special introductory pricing.
8. Food service distribution warehouses are different than retail in that there must be specific customer or chain of restaurants that “spec” the products for purchase. It is very rare that they will slot product in their warehouse without a customer who will purchase a specified quantity each week or month.
9. Food service distributors also will expect the company or the company’s food broker to represent products to end users as well as educate their sales force. It is always better to use a broker if at all possible, as they have a network of contacts in the geographic area, and in most cases, they have established themselves through the other products they represent.
10. Food service distributors rarely charge slotting fees like the retail warehouses, but they will expect some method of financial support. In most cases they ask for a salesman “spiff” for a certain amount of money per case as an incentive for the first 30 days. They also will

expect a company or its food broker to participate in their food shows during the year, and some might require a quarterly contribution based on sales to their annual promotional fund for corporate promotions.

11. It also is important to interview brokers about how they will represent the product and where they see the best potential and application for sales and building a customer base. Who in the brokerage will be responsible for sampling the products to the end user, and will they allow companies to participate in the process?
12. Always define the expectations for the broker in the very beginning to determine if the broker feels those goals are realistic, and try to establish objectives for each quarter of the year so adjustments can be made if necessary. It is strongly recommended that a brokerage agreement be signed by both parties so any issues can be resolved by the contract.

## Final Profit Analysis

There are many factors to consider and important decisions to be made to ensure companies receive a profit for products. If a company chooses to use a co-packer, representatives should meet with several to see which one best fits the company and can make it the most competitive in its category.

There also are subtle ways to keep the final price in line with the competition. For example, 16-ounce containers usually use the same lids and are the same circumference as 18-ounce containers. However, the visual difference between the two sizes is negligible. If a product costs .972 cents per ounce, an 18-ounce jar would cost \$1.75. Using a 16-ounce jar costs only \$1.56 per jar, which can save your company \$2.28 for each 12-jar case. In addition, using fewer colors for your labels may reduce the cost from 5 cents to 4 cents per label, or 12 cents per 12-jar case.

Foodservice products that normally are bulk packaged often do not require individual labels. Therefore, companies should utilize a container that holds a large number of units because larger boxes that hold 36 or 48 units are usually less expensive than those that hold 12 or 24. On the other hand, gourmet products not only require well-presented jars, labels and containers, but also they command a higher price per unit to meet the competition in the gourmet category. There are many ways to market products to consumers, but every company should ensure it will profit from its products by determining all the costs before starting.