FINANCIAL MANAGEMENT: BUDGETING AND PRICING FOR AGRITOURISM

– Module 3 –
Extension Training to Support Agritourism Development in the Northeast

Funded by the Northeast Sustainable Agriculture Research and Education program
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Image: www.greatbendpost.com

KNOW YOUR INCOME GOALS

Most often, agritourism enterprises are developed to expand farm income. It is important to carefully define income goals. For example:

- Break even/turn a profit in the first year.
- Provide supplemental income while holding a full-time job off-farm.
- Earn all of my (my household's) income from farming [within a specified time frame].
- Meet current and long-term family income needs (e.g., college tuition, health insurance, retirement planning).
- Expand farm income enough to allow my children to become partners in the farm business.

Income needs from the farm business will change over one's life time. Revisit goals periodically and evaluate progress toward them.

Source: Sullivan, P. & Greer, L. (2011). Evaluating a farming enterprise. National Sustainable Agriculture Information Service. 20pp.

PARTIAL BUDGETING

- **Partial budgeting** is an important decision-making tool for comparing the costs and benefits of alternatives facing a farming business.
  - Importantly, only changes in farm finances specifically attributed to an enterprise alternative are examined.

- For example, consider a producer of 300 acres of corn that is contemplating the construction of a 5-acre corn maze.
  - A partial budget reflects only the income and expense differences due directly to the corn maze (e.g., design and maintenance costs, added insurance and labor, ticket revenues, etc.).

Partial Budgeting Framework

1. *Define the potential enterprise change*
2. *List the added returns*
3. *List the reduced costs*
4. *List the reduced returns*
5. *List the added costs*
6. *Summarize the net effects*

Source: Roth and Hyde (2002. Partial Budgeting for Agricultural Businesses. Penn State Agricultural Research and Cooperative Extension.

THINK THROUGH POTENTIAL NEW OR EXPANDED BUDGET ITEMS

Examples…to name a few

- Buildings (new construction or improvements)
- Increased utilities costs
- Fencing
- Legal/accounting professional
- New equipment
- Permits
- Land
- Taxes
- Landscaping
- Maintenance/depreciation of existing equipment or infrastructure
- Hayride wagon
- Signage
- Handicap accessible areas
- Corn maze design
- Restroom facilities
- Hand washing stations
- Ticket booth & tickets
- Cash register
- Improved lighting
- Tables & seating
- Pavilion/tents
- Added insurance
- Parking lot expansion/ improvements
- Retail store inventory
- Food & drinks
- Increased staffing
- Marketing
- Animals/pens
- Staff apparel

POTENTIAL AGRITOURISM INCOME SOURCES

- Admission fee
- Tour fee
- Sales of fresh farm products
- Sales of processed or value added products
- Craft/souvenir sales
- Activity fee
- Tasting fee
- Facility rental
- Show fee
  - (e.g., equine competition)
- Farm lodging
- Food service

Don't forget about grants or loans (e.g., Small Business Administration, Rural Economic Development Agencies) & crowdsourced funding for projects (e.g., Kickstarter, Crowdrise, IndieGoGo, Profounder, Spot.Us.).

PRICING

Setting an appropriate price point for each product or service is critical.

- A farmer's time is a limited resource and must be valued at an appropriate price.
  - Analyze competitors' pricing
  - Examine trade publications
  - Conduct research on target customers' willingness to pay for products/services
  - Know your costs

Price = balance between

1. Internal costs – production, marketing, etc.
2. Market demand – what buyer will pay & competing products/services
3. Strategic goals of the company

Evaluate price often and adjust as needed

BREAK-EVEN ANALYSIS

A useful tool to determine the minimum price per unit (e.g., visitor/ticket) required to cover all costs.

Requires a careful enumeration of all fixed and variable costs associated with a new agritourism activity.

Fixed Costs (FC) do not vary with the number of guests. Examples:

- Construction/Repairs
- Taxes & Insurance
- Marketing
- Depreciation

Variable Costs (VC) will vary with the number of guests. Examples:

- Employee wages
- Fuel
- Seed

Break-Even Point = Total Fixed Costs / (Price – Variable Costs)

SIMPLIFIED* EXAMPLE - HOW MANY 1-HOUR FARM TOURS DO I NEED TO OFFER IN ORDER TO BREAK-EVEN ON MY INVESTMENTS IN FARM INFRASTRUCTURE?

Total Fixed Costs (TFC): $4,000

- Insurance = $1,000
- Improved parking area = $1,000
- Farm Market Improvements = $1,500
- Child play area = $500

Variable Costs (VC): $40

- Wages (5 workers @ $8/hr) = $40
- Fuel = $10

Cost charged per tour (P): $100

* Simplified example – no depreciation, new equipment, taxes, interest payments on purchased assets, etc. are being considered.

BE = TFC / (P – VC)

BE = $4000 / ($100 - $50)

BE = $4000 / $50

BE = 80 farm tours

Anything over 80 tours = profit/return to operator

Are 80 farm tours feasible?

Is it consistent with time commitment expectations?

Would a higher price (and thus lower BE) be accepted by my customers?

What are my (operator) income goals and how many more tours would be required?

How sensitive is the estimated break-even point to my pricing/budget assumptions?

From Schilling, et al. (2011). Marketing 101 for your agritourism business. Rutgers Cooperative Extension.

A MODIFIED BREAK-EVEN ANALYSIS

- The preceding example can be modified to incorporate a desired profit/return to operator using the **Cost and Profit Method**

- **EXAMPLE:** Assume the farmer plans to host 100 1-hour farm tours this season. She wants to earn a return (profit) of $3,000 from farm tours (roughly $30/hour). What price point should be charged?

  - First calculate: [Total Fixed Costs + Total Variable Costs + Total Profit]
    - [$4,000 (TFC) + $5,000 (TVC) + $3,000 profit] = $12,000 total revenue needed

  - Next calculate the price point required per tour to earn the needed level of revenue needed to cover costs and yield the desired level of profit
    - $12,000/100 tours = **a price point of $120/tour**

ADDITIONAL CONSIDERATION FOR DETERMINING PRICE

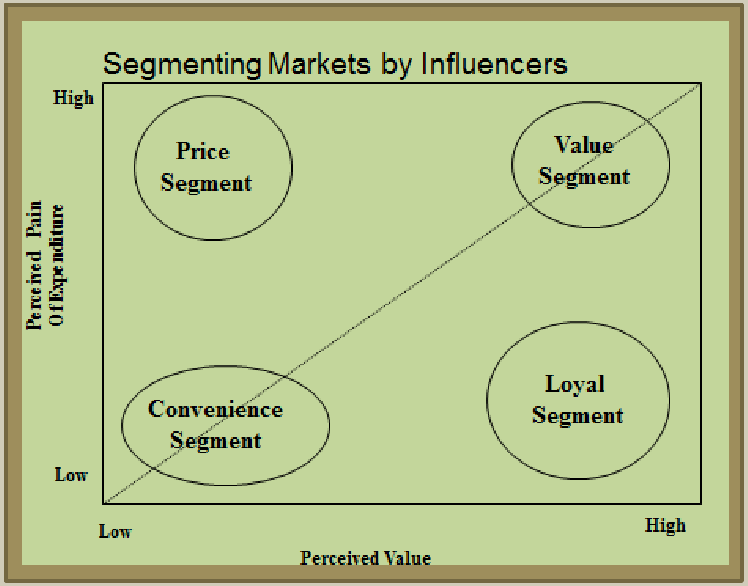
- Perceived buyer value
  - Price based on the perceived value in the eyes of the buyer
  - Identify the segment of market who will value product/service most
    - Requires research
    - For example: survey potential/current users; follow-up with current customers, etc.
- Type of buyer
  - May have various prices, options, bundles depending upon the type or group of buyer to whom you are marketing (e.g., frequent customers, bulk orders, etc.)
- Price as indicator of quality
  - In certain circumstances, price = quality and higher price = higher quality
- Based on competitors
  - Keep in mind the uniqueness of a product can be a selling point for a higher price

Be sure to price high enough to cover costs and make a profit!

Evaluate your prices often and make adjustments as needed!

SEGMENTING MARKETS BY INFLUENCERS

- Price Segment
  - Seek to buy at lowest price, some level of quality
  - Not very attractive customer unless competing entirely on price
- Loyal Buyer
  - Strong preference for one brand based on reputation, tend not to evaluate alternatives
  - Less worried about cost – want a relationship & connection
- Value Segment
  - Limited incomes, sensitive to differences among products, carefully check all features, pay high price only if it's "worth it"
  - Hardest to keep happy
- Convenience Buyers
  - Not concerned about differences among brands or costs
  - Need to solve a problem for buyer
  - May make impulse buys



Know your intended customer & what influences them.
Be realistic with who you want to attract & who you can attract!

Source: Dawn Thilmany McFadden, Colorado State University

“IF YOU DON’T HAVE SOME CUSTOMERS THINKING YOU CHARGE TOO MUCH, THEN YOU AREN’T CHARGING ENOUGH!”

- DAWN THILMANY MCFADDEN, COLORADO STATE UNIVERSITY

NEW PRODUCT/SERVICE PRICING STRATEGIES

- **Skimming (Skim Pricing)**
  - Charge high price for new service – early adopters/customers are not very price sensitive
  - Price can be lowered to reach more buyers
  - Price high during introduction but lower as competitors enter
  - Works best when buyers are insensitive to price
- **Penetration Pricing**
  - Opposite of skimming
  - Low price initially to penetrate mass market quicker
  - As market share is gained, price increases
  - Works well when buyer is sensitive to price

ADDITIONAL PRICING STRATEGIES

- **Odd-Even**
  - Take advantage of human psychology & emotional buying. For example: $499.95 vs. $500
- **Bundle**
  - Offer 2+ products together for one price. For example: Corn Maze + Pumpkin or Corn Maze + Ice Cream
- **Discount/Promotional**
  - Buy 1 Get 1
- **Line Pricing**
  - Levels of pricing - price & products received increase with each option level
  - Option 1 – pay for each activity individually
  - Option 2 – provides access to X activities
  - Option 2 – full access to all activities
- **Optional Pricing**
  - Add-on, optional extras

Image: blacklocus.com

KEEP GOOD RECORDS

- Records do not have to be detailed or complex to be useful!

- Records allow producers to:
  - Analyze progress
  - Identify areas of good (poor) performance
  - Plan for the future
  - Demonstrate ability to lenders

- Suggested records to keep
  - Balance sheet
  - Income statement
  - Cash flow statement
  - Enterprise budget

For more information, refer to:
Financial Management & Analysis' Rod Sharp, Colorado State University - *http://tinyurl.com/p7o3ndh*
Agritourism and nature tourism in California, University of California Agriculture and Natural Resources - *http://sfp.ucdavis.edu/agritourism/*

Image: credithelp.dnb.com

EXIT STRATEGY

- Part of a good financial plan is having an **exit strategy**
  - Specify situations in which the business or parts of the business would close
- Doing something in today or in the future simply because it was done in the past may not be the most sensible business decision
- The economic viability or desirability of certain farm activities may change over time
  - An activity may become less (more) profitable over time
- A successful agritourism will adapt and be responsive to evolving market opportunities – changes will occur
  - Sometimes a good idea simply runs its course

“Sound financial analysis is no longer an option but a necessity for survival”

- Rod Sharp, Colorado State University

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QUESTIONS? COMMENTS?

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