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Planning for the Retail Farm Market

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Introduction

Farm retail marketing commonly referred to as farmer-to-consumer direct marketing dates back to the early 1930s. Interest in this marketing alternative generally runs quite high in geographic locations that are near large population centers. The writing of this guide was undertaken to outline the process involved in establishing new and/or improving existing farm retail market operations. The importance of this publication stems from the need to constantly make changes in the running of a market in a manner which is cost efficient and conducive to obtaining customer satisfaction.

Two techniques are generally used to plan for the development of or improvement to a farm retail market. They are: (1) the development of a marketing plan and (2) the management audit. This paper describes the basic concept and use of each technique. Depending upon the question at hand it may or may not be necessary to complete each step outlined. Additional assistance can be obtained from business associates, professionals, and by attending industry conferences.

Building a roadside market without taking time to study and analyze potential outcomes is a gamble and likely to be extremely costly. It is important to consider the amount of competition, demand, and consumer tastes and preferences for produce items. Determination of potential demand and existing competition is termed market research. While it can be costly, it can help to reduce the possibility of losses. Even a small amount of time and effort devoted to research and analysis can lead to much greater chances of success. The focus of this guide and specifically this chapter lies in the planning process and steps necessary to establish a successful farm retail market outlet, roadside stand, roadside market, or u-pick

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operation. This paper covers the planning process for the establishment or improvement of a farm retail market.

Development of A Marketing Plan

The marketing plan requires the individual to think through the process for how a product to be grown or produced will be sold. Decisions become based upon a matter of profitability thus eliminating emotion or guesswork. Establishing a business or enterprise with a plan greatly improves the individual's chances of success.

The marketing plan allows the individual to consider the options available for selling products, available resources, the target market (both in terms of demographic characteristics and the demand for products), marketing trends in terms of consumer preferences, price objectives necessary to achieve profits, and the decision on whether to proceed with the enterprise in question.

There are numerous elements and variations in developing marketing plans. Marketing plans can be developed to answer simple questions such as whether a specialty crop should be added to the product mix of an operation. Marketing plans can also be developed to consider more complex questions such as the establishment of a farm retail market. It is important to note that any good marketing plan must be flexible. Necessary adjustments will be identified with experience.

Steps in Developing a Marketing Plan

1. Determine the objectives for establishing a retail farm market.
2. Determine the geographic size of the market area (trade area, natural area for commerce, census tracts, county, city). Evaluate the competition (market mapping).
3. Determine customer characteristics and profile (demographics, life style, income). Present and potential.

4. Determine the products and services demanded by various segments of the market.
5. Determine the market volume by product group.
6. Determine the market trends that relate to the market volume by product group.
7. Forecast potential market sales for the next three to five years. Where are the changes?
8. Estimate the potential market share and trend of market share.
9. Identify market opportunities (niche).
10. Establish strategies for implementing the plan.
11. Elect the product mix, market site, and market type.
12. Implement the plan / evaluate / make adjustments. A good marketing plan must be flexible.

Market Resources

A primary factor affecting a farm retail market's potential success is the amount of competition in the locale. All supermarkets, convenience stores, corner markets, farmers' markets, and roadside markets within a certain location selling similar items compete for potential customers. A mapping of the area showing the location of each competitor may be useful in assessing the local competition. Clearly, an additional market in an already saturated area has a much lower potential for success.

Aside from competitors, it is important to know the customer base. A study of population levels for the surrounding towns and cities may show a large number of potential customers. In this case, the area may be able to support a greater number of competitors. The opposite may hold true for low population areas. Population totals for surrounding towns can be obtained from census data found at the library or from the city or town hall.

The distance of towns and cities from the proposed outlet must be analyzed. If they are too far away, the number of people from the city or town shopping at the outlet will be limited. Furthermore, the actual location of a proposed farm retail market is absolutely critical to its success. The volume of traffic passing the site will have a direct effect on the number of customers that will shop at the market. Traffic volume can be affected by the number of local businesses in the area. Locations where several businesses are

located along the same road as a proposed market would indicate traffic intensity and more exposure. Conversely, if the proposed site is secluded, traffic may be low, thus limiting exposure. Traffic patterns along specific roads can be obtained from studies conducted by the Department of Transportation. Ignoring the importance of this information places the success of the proposed market in jeopardy.

Traffic patterns around a site can either facilitate or hinder a market's accessibility to passing motorists. Markets located along a two-lane highway may permit access to motorists passing in either direction. One-way roads and the positioning of traffic lights can also affect the number of people stopping at the market. To be most useful, traffic count information should be compiled in an organized manner.

Target Market Description

While knowledge of the location and number of consumers in a local market is important, the behavioral traits and characteristics of potential customers is equally important. A study of demographic information such as age, income level, household size, location of residence and/or work place, ethnic group, and education level will show the level of diversity in the local market. From these characteristics, lifestyle patterns of the population can be determined. Are there common interests, beliefs, values, and behavior patterns for the demographic groups in the area? When the demographic traits are known, is it easier to predict what customers expect from the products they buy and from the places where the products are purchased?

The traits of the target market and their expectations will, to some extent, govern the variety of items as well as the type of outlet established. The trend toward healthy diets, if reflected in the target market's attitude, would favor the health benefits from eating produce. Similarly, if the target market expects convenience due to time constraints, a market that has more than just produce (such as ornamental and related items, impulse items, and a gift section) may be more inviting to consumers. Demographic information, also found in the census data or obtained from the state, can be used to determine a demographic profile for the target market. Are the type of people expected to frequent the outlet a significant fraction of the area's population? If so, the likelihood of success is greater.

Existing Market Demand

Once the demographic profile of the target consumer is decided and the size of the target market is deter-

mined, the next step involves estimating the total demand for produce in the market. The demand can be derived by multiplying the number of people in the target market by the per capita consumption of e.g., fruits and vegetables. Demand can be derived on an item by item basis. Particularly in the case where growing and marketing a specific specialty crop is being considered. This will give the total local demand for fruits and vegetables. While consumption patterns do vary across the country, national estimates provide a starting point for the analysis.

Product and/or customer service differentiation will play an important role in the development of a marketing scheme. The type of marketing effort chosen must establish a comparative advantage over existing markets. Often times this is accomplished by offering a new product in addition to the staple items. Adding value to the product, commonly referred to as "value added," or providing a customer service considered unique e.g., hay or wagon rides to and from fields for u-pick or a hayride just to get a pumpkin are a few examples.

Determination of a comparative advantage for the market should be based on the existing target market's traits and characteristics. The most recent trends in consumer tastes and preferences will help to determine if the trends are reflected in the target market.

Developing Objectives and Strategies for Implementing the Plan

Once objectives for the enterprise have been established and the overall marketing plan developed, it now becomes necessary to define the specific strategies for accomplishing the objectives. Strategies must be set in realistic terms. At this point it may be wise to review the objectives that were set previously to decide if they are valid or need adjustment. Further adjustments may become necessary once the capital requirements, manager's time, and labor needs are thoroughly determined. Additionally, other considerations include: available acreage to plant and harvest, yields per acre, and the total volume of produce to become available. In setting objectives and strategies it is generally a good idea to think in terms of starting out small with the intent of getting larger if and when the opportunity arises.

Product Mix

It now becomes necessary to select the set of products which will make up the product mix. This selection should reflect the target market's potential demand as well as the grower's ability to obtain supply.

Market Site and Type

The location of the market often determines its success. In some cases the site for the market is predetermined due to capital constraints as well as zoning laws. In other instances, there is considerable freedom to select the site of the market. This situation requires careful study of the market as well as important location factors presented under market resources.

Once the site is determined, the next step is to select the appropriate type of retail environment which will promote the objectives and strategies for the enterprise. Selection of the market type is inherent upon many of the market analysis factors discussed thus far. A type of market should be chosen which best reflects the target market's lifestyle and should ultimately allow any identified comparative advantage to be realized.

The following sources of information will be useful in performing various steps in the marketing plan:

1. U.S. Agricultural Census
2. U.S. Census
3. State crop and livestock reporting service
4. Local extension office
5. State extension specialists and college of agriculture
6. USDA - Extension Service
7. State department of commerce
8. State Chamber of Commerce
9. Local Chamber of Commerce
10. Suppliers
11. Employees
12. Boards of directors of banks and cooperatives
13. Cooperative members and customers
14. Local news media
15. Competitors
16. Soil conservation service
17. Agricultural and stabilization service
18. State department of agriculture
19. Trade publications
20. Banks and financial institutions
21. Library
22. County planning and zoning office
23. State economic development office
24. County economic development office
25. College of urban affairs

At times the information being sought for a specific marketing plan is readily available and simply a matter of contacting the correct source. After completing the marketing plan, a picture of the market potential for the products, services, or ideas that are being tested begins to emerge.

Management Audit (Analysis)

The next step in the planning process is to study the business firm, either existing or to be developed, from the viewpoint of how it will be managed. It is important to consider how demands identified in the previous section will be met. The outline and subsequent lists of questions for the management audit were developed from the extension professional's perspective. The idea is that a team of extension professionals would analyze a firm and produce the report. However, there is nothing to prevent a firm from developing a team to produce a similar result. The end product of this phase of the market analysis will be the objectives, organization, finances, personnel, and technologies necessary to operate the farm market under study.

The management audit is a loosely organized set of procedures for asking "pertinent questions" relative to a given business activity. The basic approach is to examine the enterprise, from the point of view of overall management of resources. Then the several segments of the enterprise (facilities, technologies, organization, finances, personnel, markets, etc.) are examined in detail for strengths and weaknesses. This is done within the separate elements and between the many elements. A combination of management, engineering, technological, and economic principles are used as criteria to judge the performance of the total enterprise and its several parts.

Procedure for Performing a Management Audit

1. Identify the case firm (farm) based upon request for assistance or mutual agreement between the parties involved.
2. Identify the management audit team - agent, specialists, individuals with specific knowledge and expertise pertinent to the perceived problem at hand. Team participants should have their specific roles identified including the writing of the final report.
3. Identify responsibilities of host firm (farm) - such as (1) complete cooperation with the audit team in providing records and information as well as (2) responding to questions to the best of their knowledge and (3) availability of all personnel for questioning, if appropriate.
4. Use of data and findings - all parties must understand the limits of confidentiality of data and findings and respect the agreement.

5. Collect descriptive data on firm (farm) before making visit to perform audit:
 - A. Financial data - Profit & loss statements, balance sheets, cash flows (3 to 5 years)
 - B. Production and marketing data - appropriate records (3 to 5 years)
 - C. Physical description of the business (farm), include pictures.
6. Divide the firm (farm) into major subject matter areas and profit centers for detailed study:
 - I. Subject matter
 - A. Overall management
 - B. Sales and marketing
 - C. Production
 - D. Organization
 - E. Facilities
 - F. Financial
 - G. Technological
 - II. Profit centers - any major division of the business that:
 - A. Requires capital
 - B. Requires separate management
 - C. Is capable of producing separate returns or profits.

Examples of profit centers might be: dairy, livestock, grain, vegetables, fruit; any meaningful departmentalization for agribusiness firms.

7. Assignment of specific responsibilities for each member of the audit team for this particular audit (a team member may have more than one assignment) should be done *before* the physical audit.
8. The *On-Site* Phase of the Management Audit
The team should plan to spend whatever time is necessary "on site" to make observations, ask questions, and collect pertinent information. This could range from one day with basic situations to a week or more in extremely complex situations. Extra time spent "on-site", within reason, can pay big dividends in terms of providing assistance to the client.

Note: Before leaving the "site," the audit team should meet to be sure that each member has all

the information necessary to write their portion of the report.

9. *The Report*

The report should be prepared as soon as possible after the audit so that the situation will be fresh in all parties' minds. One individual should be designated to coordinate the report writing phase of the project. This person's responsibility will be to collect the contributions of all the team members and integrate their findings into a comprehensive, meaningful, usable report. When completed, this report should be presented to the firm's (farm) management by the team in a "face-to-face" situation. This will allow for interchange of views and the answering of questions on both sides.

Following appropriate introductory and descriptive segments of the report, the basic format for each specific subject matter area or profit center should be:

| <u>Problem</u> | <u>Recommendations</u> | <u>Follow-up (person responsible & timing)</u> |
|----------------|------------------------|--|
|----------------|------------------------|--|

An appropriate summary section and an appendix for pertinent data should complete the report.

10. *Follow-up*

General provisions for follow-up activities should be made at the end of the report presentation session. Specifics of follow-up will, of course, depend upon the nature and severity of problems that have been identified. It is essential that a person on the audit team and one from the firm (farm) are specifically identified and given the responsibility and authority to proceed with the follow-up.

Areas of Questioning for Overall Management Section

1. Agribusiness manager's (farmer) philosophy, views, and value statements.
2. Statement of objectives - goals, criteria, evaluations. A written mission statement should be developed.
3. Develop a written plan to include:
 - a description of the overall business

- a financial statement
- a statement on how the business is structured - physical
- how the business is physically organized
- how marketing is accomplished and prevailing competition
- what are the technological considerations

4. Statement of policies and procedures - written
5. Organization chart - written, areas of responsibility and authority including written job descriptions and ladder of advancement. Describe the roles of each job (perception, interaction, backup).
6. Avenues of communication - sources of information, training needs
7. Describe any road blocks - movement of ideas, goods, instructions.
8. Morale
9. Procedure for handling complaints
10. Decision making - process, effectiveness
11. Evaluation - criteria, controls, periodic review and appraisal
12. Identify central threads of problems and look for general solutions.

Sample Questions in the Management Area

1. What is your job? (areas of responsibility and authority).
2. What is your involvement in planning for the firm (farm)?
3. What is your involvement in policy formulation?
4. What are the objectives of this firm (farm)? Your own personal objectives?
5. What decisions do you make?
6. How do you measure success of this firm (farm)?
7. Describe the avenues of communication in this firm (farm) both formal and informal.
8. What are your sources of information for managing the business?
9. What standards of performance are used to evaluate management of this firm (farm)?
10. What business are you in?
11. What training do you need to do a better job of management?
12. How does the community view the business?
13. Who is your competition?

14. Who is your back-up? Can he or she do the job?
15. What does the boss think of you? How and when are you evaluated?
16. What do you think of the boss? How do you evaluate him or her?
17. What suggestions do you have to improve this business?
18. Are there any other considerations?

Financial Planning and Budgeting

Financial planning is an important aspect of the completion of the marketing plan and/or the management audit. It is an ongoing process in the running and establishment of a farm retail market. Different financial instruments such as the enterprise budget, profit and loss statement, balance sheet, and cash flow statement have varied uses. Much has been written regarding this subject for the farm market. This paper will cover a few selected uses of budgeting and financial instruments presented in a very basic and easily understood manner.

The Operating Statement

The operating statement is designed to show the results of business operations over a specific period of time. Operating statements are used by financial institutions to assist in deciding whether a business is likely to be able to repay a loan. An operating statement is generally prepared once per year. Many businesses prepare the operating statement each quarter of the year.

The Balance Sheet

The balance sheet identifies a firm's capital assets that exist at a given point in time, balanced against liabilities plus owner's equity. The term "balance sheet" comes from the fact that total assets must equal total liabilities including owner's equity.

Cash Flow

Financial institutions are interested in cash flow for debt service. Essentially, the cash flow of a market is the amount available for debt service (to pay interest and principal payments on current and long term liabilities).

Pro Forma Statements

The pro forma statement is simply a projection of the balance sheet and the operating statement into the future. Pro forma statements help to give an indica-

tion of a firm's future earnings and potential problem areas.

Enterprise Budget / Break-Even Analysis

A budget is a projection of revenues and costs, usually over a growing season. The enterprise budget is used when a decision is pending regarding the selection of a crop. While the budget is no guarantee as to the success of launching a new enterprise, it serves as a valuable gauge in determining potential profitability.

Costs can be grouped into several categories. *Variable costs* are generally thought of as cash or out-of-pocket costs and are varied throughout the production process. These costs can be controlled by the manager by either increasing or decreasing the volume of business. Variable costs must be covered in a production period. Examples of variable costs include seed, fertilizer, plants, pesticides, fungicides, irrigation(s), mowing, interest, land rent, boxes, bags, advertising, and field labor.

A *fixed cost* is incurred even if an input is not used during the course of business operations. Furthermore, a fixed cost remains constant regardless of the level of production or sales. Depreciation, insurance, property taxes, and interest are generally fixed costs. Since taxes are also considered out-of-pocket costs, they may appear in the cash costs section of the budgeting process. Some costs are both fixed and variable in nature. The important distinction between fixed and variable costs is that variable costs can be controlled by the manager in a production period, while fixed costs can not.

Financial and Productivity Ratios

Net Operating Profit - Profits can be calculated in either dollars or percent of sales over a given period of time. The dollar figure is obtained by subtracting expenses from the gross margin.

Example:

$\$150,000 - \$140,000 = \$10,000$ *net operating profit* before income taxes. The percent of sales is obtained by dividing the net profit by sales: $\$10,000 / \$140,000 = 2.5\%$.

Profits may be increased by better controls, increasing gross margins, by increasing sales, or some combination.

Return on Owner's Equity - This measure combines a balance sheet item, owner's equity, with an operating statement item, profits. It provides a rate of return for the capital the owner has invested in the business.

Example:

$\$5,000 \text{ before tax market income} / \$10,000 \text{ owner's equity} = 50\% \text{ return on owner's equity, before tax.}$

Return on equity may be increased by better cost control, by increasing sales, increasing margins or both, and by wise use of borrowed capital.

Return on Investment - This ratio measures the return on total capital of the business, including owner's equity. This is considered a bottom line financial measure.

Example:

$\$5,000 \text{ profit} / \$141,000 \text{ total liabilities} = 3.55\% \text{ Return on Investment, before tax.}$

Return on investment may be increased by better control of costs, increasing sales, increasing margins, or some combination.

Inventory Turnover - This measures productivity within the market and considers how often inventory is sold or turned.

Example:

$\$400,000 \text{ cost of sales} / \$30,000 \text{ average inventory value} = 13.3 \text{ times per year inventory turns.}$

Increasing inventory turns may improve the operating efficiency of the market. This requires aggressive inventory controls such as reducing or discounting slow moving items.

There are many other measures of operating efficiency and capital ratios that are important. The four that are presented here represent a start in providing measurement of some of the standards which may be desirable for farm market operators. Consult with an accountant, extension management specialist, or a standard financial text for more detailed information.

Regulations and Insurance

State, county, local laws and regulations pertaining to the establishment and operation of a farm retail market business need to be thoroughly investigated. In most states, the state department of agriculture is an excellent source to begin for obtaining assistance in making necessary contacts. Laws and regulations are likely to exist that govern parking, entrance-exit requirements, zoning, advertising (signs and roadways), public health, weights and measures, pesticide use, labor, taxes, licenses, etc. The farm retail market operator should be aware that laws and regulations are subject

to change. Therefore, careful planning and information gathering should always take place before any marketing operation begins.

Direct marketing represents a much different way of selling products than traditional wholesale farm sales methods. Once the decision to begin a farm retail marketing business has been made one of the important considerations is the need for adequate insurance. Potential farm market operators will need to discuss these needs with an appropriate insurance agency. Additional assistance may be obtained from extension management specialists and other farm retail market operators.

Market Planning Summary

After completing a thorough and detailed set of analyses related to the farm retail market, it becomes necessary to answer the basic question, "Is the project feasible?" The first part of the question deals with the area of physical and technological feasibility. Can the job get done physically and technologically? Does an adequate market exist? Can the necessary products be grown or purchased? Are the proper facilities available to get the job done? Will the management and employees be able to handle the product, merchandise the items to be sold, price products, and provide adequate levels of customer service? Does a market "niche" exist? Has the proper level of value-added been considered for the customers? Will the establishment of the farm retail market work?

The second part of analyzing the feasibility of a project deals with the economic considerations. Will the farm retail market pay? Are the budgets, financial statements, and cash flow projections completed? Have the proper analytical tools been used in the planning process?

This is where the decision comes to the bottom line. It is important for the potential farm market operator to be satisfied with the analysis that is completed in deciding to establish a new or improve an existing market.

Selected References

German, Carl L., et al., *Guide to Planning the Farm Retail Market*, Cooperative Bulletin # 52, University of Delaware, Newark, Delaware, December 1994.