GROWERTALKS

Growers Talk Business

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Cost Accounting: Shrinkage

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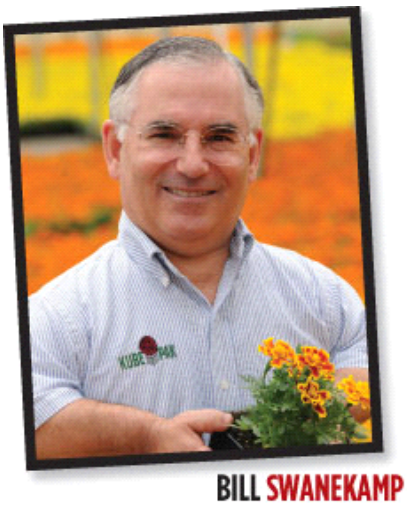

As we round up the discussion on cost accounting, it's imperative we discuss the effect that shrinkage has on costing. Without a doubt, we have the honorable goal of selling all the crops we produce. In reality, that almost never happens! There are two ways we encounter shrinkage: one is from plant loss during the growing process. This can be from root disease, improper media pH, poor germination, phytotoxicity from a chemical application, allowing the plants to get too dry, physical damage from dropping or running over plants and 100 other unexpected things. Another major villain of shrinkage is unsold plants. This occurs for many reasons, but the most popular are bad weather, overproduction or just plain poor plants. None of us wants to admit to the last cause, so normally, we say it's our neighbor that throws plants in the dumpster.

The big question is: if we do have shrinkage, how does it affect the costing of the plants we sell? Obviously, the cost of growing plants that are ultimately thrown away must be added to the overhead of crops that are sold. When this happens, there are two components to these costs—the overhead allocated to the dumped crop and the direct costs of producing these crops. The direct costs include the plant, pot, media or any packaging materials.

First, let's talk about re-allocating overhead costs. If, for example, you've calculated your overhead at around $0.50/sq. ft./week—taking into account space utilization and seasonality, and if you don't sell 10% of your crops—then your revised overhead is: ($0.50 X 10% = $0.05 + $0.50 = $0.55). In another example, if your overhead is $0.50/sq. ft./week and you don't sell 5% of your crop, then your overhead is: ($0.50 X 5% = $0.025 + $0.50 = $0.525). It's clear that as you reduce your losses, your overhead goes down. When speaking about finished crops, our goal should be to have shrinkage of less than 2% and even less for easy-to-grow crops. This means two things: 1) we must be good growers and have minimal loss in the greenhouse; and 2) we must be good planners so that we grow the right amount of each item each season. This, of course, is easier said than done.

If you're a young plant producer, then you know plant losses can be much higher than 5% as referenced

above for finished crops. On the average, a plug producer loses about 10% to 15% of his production due to germination issues and fixing. Since this loss is much greater than that incurred with finished plants, it has a much greater impact on costing and must be taken into account when pricing crops.

So far, we've only talked about re-allocating overhead costs from plants that either died or didn't sell. What about the direct costs associated with these plants? Since the plants didn't sell, the direct costs of the components—the plants, pots, media and packaging—must be taken into account, in addition to the overhead costs. When looking at finished plants, it's typical for the sum of all the costs of producing a finished product to average between 50% and 75% of its selling price. This means that for each bedding flat that's thrown away, it can take up to four flats to cover those costs. With this in mind, if you throw away 25% of a crop that costs 75% of its selling price, then you'll make no profit on that crop. Quite sobering!

Our goal then is fairly clear—we need to sell over 98% of our finished crops to stay profitable. This requires precise planning when it comes to forecasting next year's production numbers and good growing in the greenhouse. If we can minimize our shrinkage, then we can add significant numbers to our bottom line. **GT**

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