GROWERTALKS

Features

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Growing Your Business—For the Right Reasons

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A basic principle of business is this: You're either moving forward or backwards; it's impossible to do neither. That's the stark reality of business. Even though there are days when you wish you could just tread water, you can't. You'll end up drowning. In light of this, the best option for most of us is to grow our business. Growing in business comes with challenge and risk. [Here], we'll discuss foundational practices and processes on how to strategically grow your business, for the right reasons, with a goal of ensuring your long-term success.

Growing and expanding your business is a two-headed coin. The heads side is financial. Finance is driven by revenue streams; revenue streams fund growth. To warrant an expansion, your business needs to show present and future demand for products and services that will provide the additional cash flow needed to service new debt, expenses and staffing.

The tail side of the coin relates to the infrastructure and investment needs of the enterprise. Through the production plan, we can determine the infrastructure needs based on the types of crops in order to expand cost effectively and fulfill your short- and long-term strategies.

Unlike many other businesses, the horticulture industry utilizes highly specialized, single-use facilities that require large capital investments with low residual resale value. Used greenhouses have very few buyers even when sold for pennies on the dollar. Because of this fact, we need to build structures that are cost-effective, fit our needs over their expected life and which turn a profit, allowing us to make money and retain ownership for a generation or two or even longer.

For owners and managers, the complexity quadruples when the existing business must continue daily operations during construction. It's way too easy getting caught up wearing too many hats. Along with your normal duties, add responsibilities like strategic planner, economic forecaster, financier, architect, engineer, developer, general contractor and on down the list to even skilled (or in my case unskilled) laborer. Organize your time, use lists to stay on task and keep priorities in mind. The existing core business must remain healthy while solidifying new markets for the additional production and growing the company. Revenue streams fund growth; don't take your eye off the ball. Expansion can press us to spread ourselves too thin to effectively achieve positive results.

Taking your operation to the next level is further compounded as your success grows. Continual growth demands increasingly larger investments and contribution of management skills. With so much capital, time and energy being channeled into growth, it's essential to have a clear view of the goals and objectives of the expansion to ensure it's based on a foundation of strategic reasons. Beware of expanding simply to satisfy an ego trip and don't become infected with "square-foot-itis." Be sincere and honest in your analysis, reasoning and conclusions. Long-haul growth is typically based on being "aggressively conservative," building for a controlled growth curve, and building a business that survives the test of time and changing economies.

Pictured: You can tell when a greenhouse operation has been designed with a master plan because it's laid out neatly and efficiently. Photo from the Ball RedBook.

As you look at growing for the right reasons, it's important to remember that size doesn't determine profitability. There exists no direct or indirect correlation. Many "big" growers will tell you they had more fun and took home more money when their businesses were smaller. However, this is by no means a rule. Success and profitability are often the result of dedication, determination and focus. The quickest and easiest way to increase profits is by producing and selling more from your existing facilities.

At Plantpeddler, we strive to work from the business side by drilling down on costing, optimizing our crop mix, analyzing turns per year, focusing on increasing revenue per labor dollar, utilizing specialty and contract growers to maximize income during peaks, diversifying revenue streams, and ultimately growing our profits to fund our growth. Our facilities are in continuous production, with a goal of generating cash flow 12 months of the year. Scale is just one component of the formula. No matter the size, poorly managed operations lose money while intensively managed operations generate profits. In the end, it's the demand for what your company creates that proves the need for expansion. This is the true driving factor for building for the right reasons. Size has no relevancy to success.

Knowing your costs

The marketing side of your business drives sales growth, growth in sales drives production and that fuels the expansion of infrastructure. In our approach at Plantpeddler, we look at it this way: We are first a marketing company that sells our brand and reinforces our image. This drives demand for our products generating sales for the organization. These sales provide direction to the greenhouse production component, which has a mission to produce products that fulfill demand. Based on the success of these three facets of our company, we build additional capacity to ensure we satisfy the current and projected demand.

If we're basing growth on sales-driven demand, we need to understand our niche, analyze opportunities to expand this niche and identify new markets, products and prospects to diversify. What's the basis for our need to expand and how does the opportunity align with our long-term profitability? This leads us to the next series of questions:

Are we producing and selling the most profitable crop mix? Can we optimize our crop mix to generate more income without physical expansion of footprint? Is it possible to increase rotations or use a different input to create more profitable output? In most cases, by knowing your costs, you can produce the highest-returning crops and subcontract necessary, but marginally returning, crops or those that contribute to shrink.

All of this starts with knowing your costs and building profit into your calculations. I'm amazed at how few greenhouse operations have a good handle on their cost of production. No matter your size, you must capture, record and analyze your costs. Accurately separate direct versus indirect (overhead) costs. Build simple worksheets to play with costing scenarios. You may be thinking, "I'm a plant geek and just not into numbers." That's too bad because those numbers matter. If you're going to build for the right reasons, you must be confident that the crops you plan to grow can fund the expansion. Don't be too proud to get professional help or build a friendship with a "numbers geek."

There are two basic models typically used when calculating costs. First is "traditional crop costing," where you add up all inputs and components, capture direct labor charges and do a complex calculation to arrive at an overhead cost based on cost per square foot per week (CSFW or $/sq. ft./wk.). This factor is the catch-all for all things not directly related to the inputs of the crop (includes all fixed expenses as an example). Add it all up and you arrive at a cost of production, to which you need to add a minimum profit margin.

The challenge here is determining an accurate square foot per week cost factor. It requires taking all indirect expenses and dividing it by the total number of utilized (actual growing space) square feet per year. (You can't allocate overhead to space that isn't in production, as this space cannot recover costs.) Along with the variable of utilization, typical operations have a variety of structures with different costs of construction, energy use, annual maintenance, etc. All these factors tweak your cost per square foot accuracy. Ideally, we have values based on these factors, combined with the seasonal demand on space (more overhead allocated to peak versus off-season). It can make for some crazy math.

This should give you the idea that it can be very difficult to get accurate numbers. What typically happens is you develop $/sq. ft./wk. factors that "feel right" and you run with them. To increase accuracy, you can tweak to reflect influences of structure, zone and seasonal adjustments, so long as when you add up all the distribution factors it covers the annual overhead. Though the traditional method can get complicated, treating all production uniformly provides a platform to evaluate cost of producing versus the potential value of a plant. Identifying crops that return the most income is the objective, but even more important is that you're covering your cost of production and adding in your profit margin when setting your pricing. This also serves as a tool to help you understand which crops you should focus on growing yourself (to a very high standard) versus those you should drop or possibly buying in from others. It can get quite tricky, but as you develop your worksheets and grasp the process, your accuracy will improve.

The second costing method is "contribution to overhead," which basically takes the opposite approach to cost and covering overhead. The principle is that we start with the expected price and deduct direct costs with the remaining difference allocated to covering overhead. The bigger the number, the more overhead you cover. To give us a standardized basis, the differential amount is divided by the square feet required each week during production. The final factor we arrive at is "contribution/square foot/week."

Direct expenses typically include container, media, plants or seeds, and any major accessory or input. If the crop is extremely labor intensive, you might include a crop-specific labor factor. Then take your expected or actual price minus direct expensed input costs and that equals the contribution to overhead and profit. Once you've covered all the annual overhead, future residual contributions are profit. At that point, the more you produce the further you distribute the fixed overhead costs and the more money you make. If you have a market and aren't at full capacity, as long as the direct costs are covered, you should grow any crops that positively contribute to "spreading out the overhead" (fixed costs). Remember: Price – Direct Costs = Contribution to Overhead/Profit.

At Plantpeddler, we find value in using both costing models, as they tell us different stories. The traditional helps ensure our prices are set correctly, and the contribution method helps ensure we cover all costs, grow our profits

and take advantage of off-season production when any return helps us satisfy annual overhead. **GT**

Buy the *Ball Redbook* HERE.

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