GROWERTALKS

Cover Story

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ROT (Rules of Thumb) for ROI (Return on Investment)

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Plantpeddler's FormFlex hanging basket system was justified through increased efficiency—especially labor reduction.

Tax write-offs and opportunity cost

Alvin Vos and his son, David, co-owners of Vander Giessen Nursery in Lynden, Washington, usually don't do ROI calculations when considering a new investment. Instead, they focus more on the tax write-off and opportunity cost of not making the investment.

Said David, "I guess I don't really have a good answer for how we calculate ROI—mostly, my dad and I put our heads together and if we both think an investment is a good idea, we go for it. Very non-scientific, I know, but that's my answer!"

For instance, when they began considering a complete rebuild of their 70-plus-year-old greenhouses and garden center 15 years ago, David had a gut feeling that they were missing out on sales and customers by having spaces that were too limited and outdated.

"And that proved true," he said. "As soon as we had the new garden center, customer counts and sales saw a huge jump the following year."
Similarly, as their business was growing, they knew the existing warehouse would limit their purchasing ability during the fall buyer expos. So they built a new warehouse "and now that we have a larger warehouse, we've filled it up and wonder why we didn't build it bigger!"

Another purchase that required no formal calculations: a stockchaser to move plants and products from the warehouse and greenhouses to the garden center across the street.

"We didn't do any math to determine how it would pay for itself," said David. "But our backs and legs thank us for not having to do manual labor anymore!"

Hard-to-estimate benefits

“We try to make a reasonable estimation of payback when purchasing equipment, but it can be very difficult to be accurate,” said Doug Cole, owner of D.S. Cole Growers in Loudon, New Hampshire. “You can put a lot of numbers on paper, but quite often it comes down to our best estimate.”

Doug offers up his Growcoon machine as an example. Growcoons are biodegradable net pots that hold your desired substrate. Doug said the overall cost of making and using Growcoons isn’t much different than making paper-style pots. So why did he purchase the machine?

- They can make the trays as they need them and not stock pallets of premade paper pots.
- They like the way cuttings root in Growcoons.
- Employees can stick into Growcoons faster due to the soft substrate in them.
- Plugs are easy to pull from trays when transplanting.

Said Doug, “To put the above criteria on a spreadsheet is difficult.”

Another example is a major investment he made in raising the height of the original Venlo glass greenhouse to install a fog system and improve the climate. For Doug, the high cost was almost impossible to justify in dollars and “sense.” But in hindsight, “it was probably the best investment we have made in years, due to increased quality,” he said.

“The nice thing about being the ‘decision maker’ (and the owner) is that you are allowed to make these decisions. Then you can only kick yourself if it was a bad decision.”

My CPA made me do it

Mike Gooder of Plantpeddler in Cresco, Iowa, is one of the fortunate few in horticulture who has a CPA on staff—Joan Leuenberger. “Joan brings a level of understanding that has helped transformed us financially,” Mike said.

Mike and Joan look at ROI from three foundational points of analysis:

1. Increased capacity, leading to increased revenue. “This, of course, has to be based on profitable additions to production or there’s no ROI potential,” said Mike.
2. Increase efficiency in operations, especially focused on labor reduction. Examples would be their ISO cutting sticker or FormFlex hanging basket line. This can be more complicated to calculate, Mike said. Plantpeddler tracks cost of labor and labor hours as a ratio to gross income and net profit. “We have reduced that factor considerably over the past five years.”
3. Improved product quality, leading to increased market opportunity, higher sell through, decreased shrink and increased profitability. An example would be investing in water quality infrastructure. This is the hardest of all to calculate, as the investment impacts so many facets of the business.

“In most situations, we target investments with payback in three years or less,” said Mike. “Oftentimes, on these quick-return investments, we might see that return in a couple of years.”

But there’s always a balance between quick returns and long-term investments, he added. “You have to take a step back and put some longer plays in the mix, to create the base of capacity required to make the next basis for a round of projects to improve overall ROI and profitability.”

One example of a long-term play is their new retail garden center facility.

“We know the payback is long, but gives us the ability to increase margin on a portion of our production and an outlet for potential crop overages. Both can increase profit overall.”

Some might say a CPA might be too cautious with things like cash flow and get in the way of big investments. Mike said it’s the opposite, and Joan agrees.

“In fact, I was most adamant about building a new retail shop because of all the defects with the current space. And also for buying three more ISOs, once I heard a new, big-volume multi-liner customer this year was super happy with the quality of our product.”

Will it make life easier?

The four Van Wingerden brothers who run Metrolina Greenhouses in Huntersville, North Carolina, take a practical approach to ROI, said Art Van Wingerden—things like making life easier for employees, saving time and controlling overhead costs.

“For instance, you can look at a flat filler and ask, ‘How long will it take to pay it back?’ It’s a $50,000 investment … but what does it cost if you don’t have it?” asked Art, who then answered, “More employees doing tasks that they aren’t going to love.”

Then there’s cutting time from processes, like sticking cuttings, which has to happen very quickly, but for only a short period of the year.

“It’s like a combine for a farmer—he can’t do business without it, but how can he justify paying over $1 million for something he only uses four weeks out of the year?”

By the simple fact that he couldn’t farm without it.

Metrolina has long been known for their use of biomass heating, which has a long ROI—in the 10- to 15-year range, Art said. He prefers wood over gas and oil in part because there’s always an abundance of fuel available, whether downed trees or ground-up pallets (now 40% of their fuel supply, he said). That helps them control their heating costs long-term.

Art summed up their ROI philosophy this way: “We look at each investment and ask ourselves, ‘Is it something the greenhouse needs? Will it make our life and the employees’ lives or work easier? Can we get more done with fewer people?’”

Four rules of thumb

Dave Van Belle of Van Belle Nursery in Abbotsford, British Columbia, Canada, candidly states, “Regarding CapEx investment, we have a process, but I would say it could use improvement.”

But he’s got four tried-and-true rules of thumb he employs to help with the decision:
Rule of thumb #1: “Generally, if someone here can demonstrate an investment has a payback period of under two years, we typically green-light it, no matter what.”

Rule of thumb #2: “Does it save labor? These investments get priority.”

Rule of thumb #3: “Maybe it doesn’t save labor, but it makes the job so much easier that we simply know it pays and then we do it.”

Rule of thumb #4: “Under $100,000 means we don’t require as much calculations—for good or for ill.”

Dave added that they keep a running list of investment “ideas,” and during their fall budgeting process they identify and prioritize them. They set a budget limit to encourage fierce debate for the top priorities. However, if an obvious smart investment comes up (like passenger vans for seasonal workers, which had a one-year payback), they do it regardless of the budget.

One area of improvement for Van Belle? “Doing a postmortem a year later,” said Dave. “Were our calculations accurate? Were our assumptions good?”

“Not just a numbers game”

“There are times when you have no choice about a capital investment,” said Bill Swanekamp of Kube-Pak in Allentown, New Jersey. “For example, when your boilers are 40 or 50 years old and they are worn out, the decision to spend the money is essential. You really have no choice, except for what type of new boiler you will install. But since this is a capital item that can last 40 to 50 years, the big question is: What type of boiler will last just as long as the old one and what kind of fuel savings will we enjoy?”

The last time they replaced their boilers, they opted for high-efficiency burners that cost about $20,000 more. But they saved 10% to 20% per year in fuel costs. The payback was about 11 years on an investment that will last 50.

“This is a good investment,” said Bill.

Another example: a new transplanter.

“It was very expensive, but the major basis for the decision was the inability to hire sufficient staff to do the transplanting by hand. The old transplanter was 20 years old and we were told by the manufacturer that if any parts of the machine broke, no replacement parts were available. Yes, the new transplanter cost $250,000, but without it the spring transplanting could not be done. ROI is not essential under this condition. Quality of equipment is, though. How good and reliable is the new transplanter? That is more important than the cost.”

Then there are those non-essential investment—things that aren’t essential to the success of the business, but are needed.

“For example, maybe the office has not been refreshed for the past 25 years and it is looking old and drab. You don’t make any more money from decorating the office with new carpet or paint or pictures, but it looks great. There is no return on investment, but you and the rest of the office staff feel really good about coming to work.”

Summarized Bill: “The point I am trying to make with these examples is that ROI is not just a numbers game. You need to analyze the entire situation and decide what is best for the business for the long-term. If you are looking to recoup your investment in three to five years, there will be very few situations where this will work out.”

Ask yourself these questions

John David “JD” Boone of Dothan Nurseries in Dothan, Alabama, admits to having no foolproof formula for calculating ROI, in part because every situation is different, he said. Instead, he asks himself these questions:

- Do I really need this?
- Will it help us get the job done faster, better or more efficiently?
- Am I being honest with myself—is this just a shiny thing I want or is it something we actually need?
- What’s the worst that could happen if I go for it? (“I ask myself this question all the time—it’s my favorite.”)

“Nine times out of 10, once I think it through, the worst-case scenario isn’t nearly as bad as I made it out to be. Asking these questions usually helps me make the call.”

Retail-grower ROI

Is the ROI calculation different for a seasonal retail-grower? Jerome Vite of Vite Greenhouses in Niles, Michigan, believes so in their case. Said Jerome (who 30-some years ago had a career in finance and banking), “We have just a few rules of thumb that my brothers and I discuss before making a purchase: 1) Do we need it? If yes, 2) Can we make a 25% down-payment? If yes, 3) Do we have the cash-flow to pay it off in three years (equipment) or five years (greenhouse)? If yes, 4) Will the bank provide financing? If yes, we pull the trigger.”

Jerome added that they always try to make sure that short-term assets are funded with short-term liabilities (line or credit) and long-term fixed assets are financed with long-term debt.

“We are pretty conservative when it comes to debt,” he said. “There are too many in the business who over-leveraged and experienced dire consequences.” **GT**