

Supply Services
A Self Study Guide for Members and Staff of Agricultural Cooperatives

LESSON FIVE: Pricing and selling procedures



Objective: To introduce the concept of mark-up and price setting and a simple system of record-keeping for sales. The process of estimating price and demand relationships is explained through examples.

Pricing

In your farm supply service, how do you decide what prices to charge your members?

You may not be free to decide all prices yourself; some may be under government regulation. Normally, however, you are expected to decide the mark-up. How do you decide on a suitable mark-up? Do you use some standard mark-up percentage or do you try to calculate exactly how much mark-up you need?

What you need is to earn enough money to cover the costs of the supply services. Here is a very simple example of how to calculate a mark-up:

- Suppose you sell only one product to your members: fertiliser. You expect to sell 1,000 bags in a year.
- You can buy the fertiliser from a supplier at T\$10 per bag. That is the cost price, including freight cost to your warehouse.
- Your total annual costs for the service are estimated at T\$600. That includes costs for administration, labour, storage space and everything else needed to sell the fertiliser. Thus, for each bag, the cost will be T\$0.60. This cost must be paid by the members. If you add it to the cost price, you will get a selling price of T\$10.60 per bag.
- Your mark-up is 6% on the cost price.
- The sales should bring in $1,000 \times T\$10.60 = T\$10,600$, enough to pay the supplier and cover your costs.
- However you have no "safety margin" at all. Suppose some bags get spoiled or your running costs are higher than expected. You would then lose on your supply business! It is better to increase the selling price to allow for this kind of problem. You probably need at least one per cent to cover any loss due to damaged goods, and a little more to cover other problems and to make a surplus for reinvestment.

If you decided to use a mark-up of 10%, instead of 6%, your selling price would be T\$11.

Your estimates will now look like this:

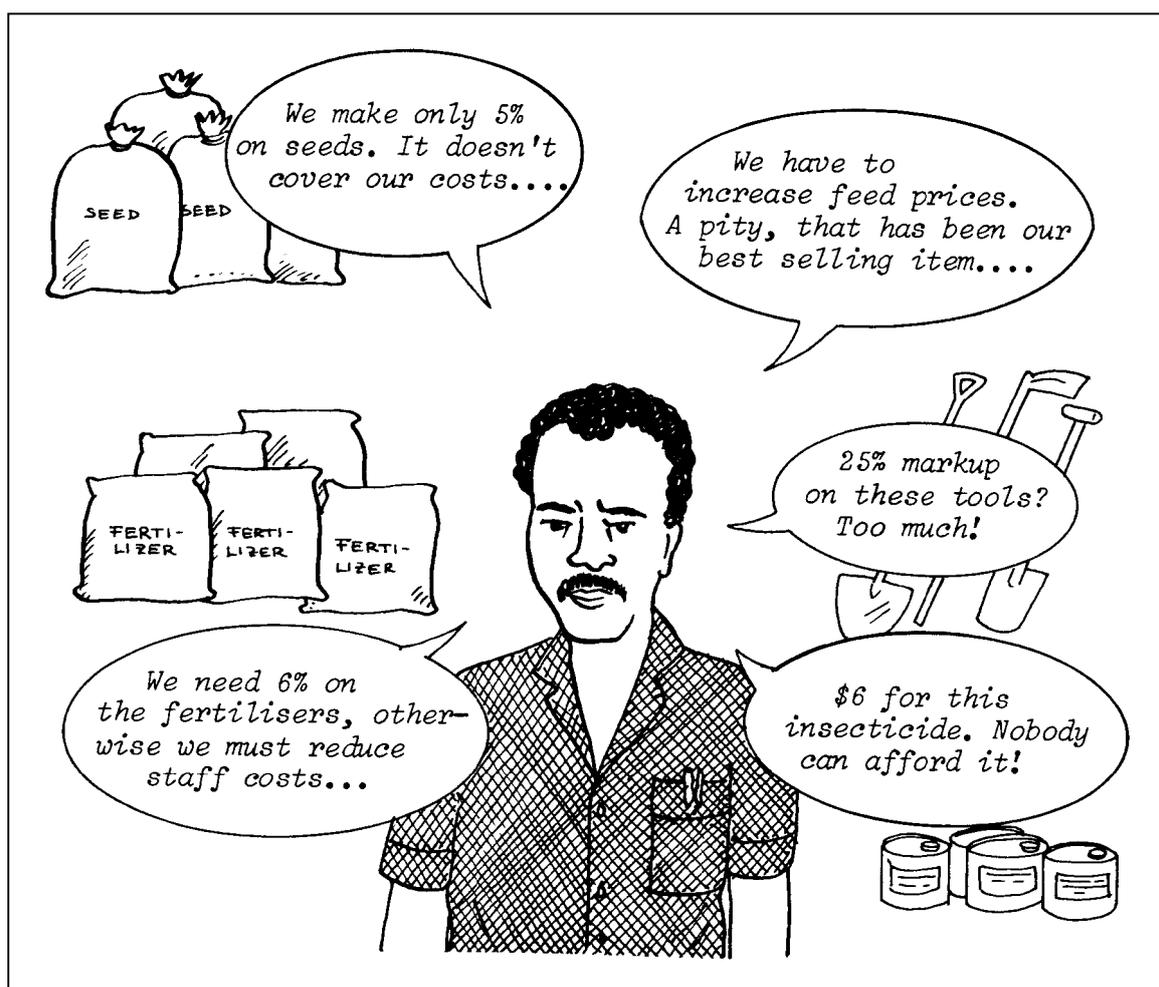
		<u>T\$</u>
Sales	1,000 x T\$11	11,000
Cost of goods	1,000 x T\$10	- 10,000
Gross surplus		1,000
Running costs		- 600
Net surplus		400

This example shows very briefly one way to fix prices in a co-operative: add a mark-up which is enough to cover your costs and a small net surplus.

However, it is obvious that pricing is more complicated than this. You cannot simply work out a fixed mark-up percentage and use it for all goods. Before setting prices you will need to find the answers to a number of questions:

- You are selling a variety of supplies. Which should have a high mark-up? Which should have the lowest possible prices?
- You are usually limited to a very low mark-up on price controlled items. To earn a sufficient surplus you have to use a higher mark-up on other items. How high?
- Your society needs to earn a surplus to be used to develop the business. Which goods can help you to earn a surplus?
- What would happen if you generally increased prices? Your sales might go down, but how many members would suffer? What would happen to your total surplus?
- What would happen if you reduced some prices? Would members take advantage of the decrease and buy more from you? Would your surplus remain high enough?

Too many co-operative managers act as if pricing were outside their authority. They fail to use prices. That is wrong. Prices must be continually reviewed and used as a tool to benefit the society and thus its members.



You should regularly review the prices of everything you sell and ask yourself whether you need to change any. Perhaps a price reduction could help you get rid of some old stock tying up space and money; perhaps a price increase could help you cover some unexpected costs.

Work in a planned and systematic way. You will need to do some estimates. The following examples show you what kind of calculations might be necessary:

Example 1

Product:	Herbicide
Cost price:	T\$1 per tin
Present selling price:	T\$1.20 per tin
Current sales:	10,000 tins per year
Problem:	You need to increase the surplus by T\$500.

Suggestions:

a. Increase the selling price to T\$1.25

Comments on suggestion (a):

- The problem would be solved if you sold 10,000 tins at the new price; you would earn 5 cents extra on each tin. ($10,000 \times T\$0.05 = T\500)
- But the higher price might reduce sales! You now make a surplus of T\$2,000 on the herbicide ($10,000 \times T\$0.20 = T\$2,000$). With the new price, you could make the same surplus if you sold only 8,000 tins ($8,000 \times T\$0.25 = T\$2,000$). If your sales were to drop below 8,000 tins, your society would be worse off than before.
- In addition, some members might have to stop buying herbicide because of the high price and might therefore suffer some loss.

b. Reduce the price to T\$1.15 per tin; sales might increase and perhaps increase the total surplus as well.

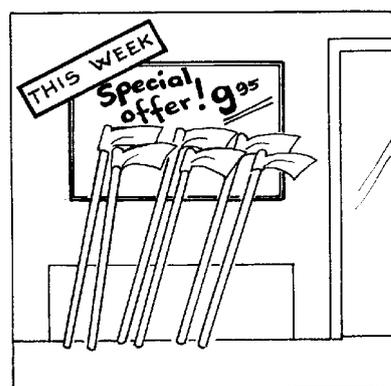
Comments on suggestion (b):

- Present surplus on herbicide is T\$2,000.
- To make the same surplus as before, you would need to sell 13,333 tins at the lower price. To earn a surplus of T\$2,500, you would need to sell 16,666 tins ($16,666 \times T\$0.15 = T\$2,500$). You must decide whether sales would go up by that amount if the price were reduced by 5 cents.
- You must also be sure that the increased sales will not increase administration, storage or transport costs.

Example 2

Product:	Hoes
Cost price:	T\$9.40
Mark-up:	T\$2.60
Selling price:	T\$12.00

Problem: This is a rather new item in your stock and sales are very slow, usually not more than one hoe per week. Would a "discount price" help to promote sales?



Suggestion:

Advertise a "special offer" in your warehouse for a short period. Sell the hoes at T\$9.95.

Comments:

- At the current price you sell only one hoe per week, earning a surplus of T\$2.60. Suppose you could sell 5 hoes at T\$9.95 in one week. The surplus would be $5 \times T\$0.55 = T\2.75 . That is better than usual, even though you have greatly reduced the price.
- Like suggestion (b) in example 1, this shows that you must achieve a very large increase in sales if you want to earn an acceptable surplus on a special offer. If you sold only four hoes at T\$9.95, you would earn less than if you sold one at the initial price.
- You must also consider the possible negative effects of special offers. Members might think there is something wrong with the hoes or that they were being cheated before when charged T\$12.

Selling procedures

Consider the following possibilities:

- Has a member ever taken goods on credit, but the bill was never charged to him?
- Has a member ever claimed that he paid cash for something when you are sure he didn't, but neither of you was able to prove your case?
- Has a member ever claimed that his patronage refund failed to include certain purchases?
- Has a member ever been sold goods on credit when he already owed the society too much for too long?

To prevent this kind of problem, you need a simple, well designed paperwork system for sales and a staff which knows how to operate it.

The example below shows the papers you need and the procedures to follow when selling farm supplies to a member:



- Member Taimni buys three tins of insecticide, at T\$5 each, and one spade at T\$10.
- When Salesman Clark takes the goods out of the store, he notes the fact on the bin cards.
- Salesman Clark receives T\$25 from Taimni and fills out a Sales Note (see next page).
- He gives the original of the note to Member Taimni and leaves a carbon copy of the note in his sales book.

DANUBE COOPERATIVE Wagrama, Longfield		No: <u>246</u>
<u>Sales Note</u>		Date: <u>6.5.85</u>
Member's Name (blockletters): <u>S. TAIMNI</u>	Member's Number: <u>348</u>	
Goods Delivered:	Unit Price:	Price:
<u>3 tins insecticide "Vot"</u>	<u>5:-</u>	<u>15:-</u>
<u>1 only spade 12" Alu</u>	<u>10:-</u>	<u>10:-</u>
TOTAL		<u><u>25:-</u></u>
Goods Received: <u>S. Taimni</u>		
Member's Signature:		
PAYMENT \$ <u>25:-</u> received <u>Clark</u> <u>6.5.85</u> Signature Date	CHARGE \$ _____ to be charged to account no: _____ Posted by: _____	

Why does the member need this sales note?

- It is a receipt, proof that he has paid for the goods. He may also need it for his own records, to keep track of his expenses.

Why does the society need a copy of the sales note?

- The manager and the accountant of the co-operative will use the copy as a "source" for essential bookkeeping. For instance, at the end of a day they will add up all the sales notes and compare the total with the cash received. Since the sales notes are numbered, they can establish that none has disappeared.
- The sales note also provides a source for the co-operative's register of member purchases. This is kept because the co-operative may pay a bonus to members at the end of the year, based on their purchases.

Selling on credit

When members are allowed to buy on credit, the same sales note can be used.

Some co-operatives use a "Cash Sales Receipt" when selling goods for cash and a "Delivery Note", when selling on credit, but in our example above, these two forms have been combined into one: the "Sales Note".

The top part is filled out in the same way, but the receipt in the bottom left corner is not filled in. Instead, the column to the right is used as you can see on the following page.

TOTAL <u>25:—</u>	
Goods Received:	➔ <i>Saint James</i>
Member's Signature:	
PAYMENT \$ _____ received _____ Signature Date	CHARGE \$ <u>25:—</u> to be charged to account no: <u>S-348</u> Posted by: _____

In this case, when the goods are sold on credit, the sales note copy serves as proof that the goods have been delivered to the member. The amount must then be posted in the member's account. To show that he has done so, the bookkeeper writes his signature on the last line.



It may not be necessary for your society to change its sales paperwork system, but you should review it. For each document and each entry required, ask the following questions:

1. Is every entry used by someone for some purpose?
2. Is every copy used by someone for some purpose?
3. Is it possible to combine documents or entries to save time and paper?
4. Is every document as simple as possible?
5. If a particular document (or entry or copy) were no longer produced, would it make any difference to anyone?