

Pricing Horticulture Products

The purpose of this factsheet series is to help producers and processors understand the key elements needed to manage a business. The factsheets also discuss some of the essential components used to develop a business plan and assess the profitability of a business venture.

What should I charge at my U-pick for strawberries or for my fresh vegetables at the farmers' market? All business owners grapple with pricing. It's an important question since business success relies on your ability to make a profit. To find the right price for your horticulture product you need to strike a balance between product costs, the attitude of your target customer and the competition. Horticulture products include bedding plants, fresh fruits and vegetables, fresh-cut flowers and culinary herbs.

Pricing need not be an onerous task. How you price your horticulture products is worth some thought and effort since it directly affects your ability to make a profit. Take some time to research the following six management questions.

- How much does it cost to grow my product?
- What is my break even point?
- What are my profit goals?
- How will I market my product?
- What price range do my competitors charge?
- What is the customer demand for my product or service?

Note: Use the worksheet on page 9 to help you find the best price for your horticulture products.

How much does it cost to grow my product?

It's important to keep good records for your business. By reworking the records you use to keep track of costs you can calculate complete product costs. A product cost is a subtotal of the money you spend to grow, package, distribute and promote your horticulture products. It's important that you include all costs in the product cost subtotal. Even the cost for unsold plants should be listed.

Example:

Average gross revenues for a greenhouse bedding plant crop were estimated at \$6.80 per square foot. Average operating costs amounted to \$4.35 per square foot with average investment and depreciation costs of \$0.86 per square foot. The average operator's labour cost was estimated at \$1.14 per square foot. When all of the above costs were added together, total production costs were \$6.86 per square foot.

Be sure you include all costs in your product cost subtotal. If you plan to use a retailer or distributor remember a typical margin over your price is 40 per cent. For example: you have found a gift store who is interested in stocking your cut flowers. The store requires a 30 per cent margin and will price the flowers at \$3.00 per bunch. Can you cover your costs and make a profit at \$2.10 per bunch?

The formula to calculate selling price is:

$$\begin{aligned} \text{Selling price} &= \text{cost} \times \text{factor} \\ \$3.00 &= \$2.10 \times 1.429 \end{aligned}$$

The factor used in the formula can be found in the Mark-up Equivalency Table below. Use the margin column to find 30 per cent then look across to the factor column to 1.429.

When you know the selling price and the margin you can calculate your price by using the following formula:

$$\text{selling price} \div \text{factor} = \text{cost (or price)}$$

$$\$3.00 \div 1.429 = \$2.10$$

Mark-up Equivalency Table		
Margin %	Mark-up %	Factor
30.0	42.9	1.429
31.0	45.0	1.450
32.0	47.1	1.471
33.0	49.3	1.493
34.0	51.5	1.515
35.0	53.9	1.539
36.0	56.3	1.563
37.0	58.8	1.588
38.0	61.3	1.613
39.0	64.0	1.640
40.0	66.7	1.667
41.0	70.0	1.700
42.0	72.4	1.724
43.0	75.4	1.754
44.0	78.5	1.785
45.0	81.8	1.818
46.0	85.2	1.852
47.0	88.7	1.887
48.0	92.3	1.923
49.0	95.9	1.959
50.0	100.0	2.000
60.0	150.0	2.500

Entrepreneurship Facilitator's Manual, Second Edition 1995, Module 4.4, Price the Product, page 15.

Product costs include both variable and fixed costs. Most of your expenses will fall into these three categories.

Materials costs

All material or supply costs used to make a product should be listed in the materials cost group. Materials expenses are variable costs. Each time you spend money to make a product you increase your variable costs. To identify variable costs, look to see which costs keep pace with the amount you produce. When the number of tomatoes grown in your greenhouse drops by half, your variable costs will also drop by half.

Example:

A grower of specialty geranium bedding plants would include the costs for containers, planting medium, fertilizer, water, plant cuttings, boxes and the material shipping costs in the materials cost group.

Labour costs

Each time you pay people (including yourself) to seed, fertilize and harvest the crop, you should add the amount to labour costs. Include labour costs for machine operators and for the people who package or prepare bedding plants for shipping. Most labour costs are variable costs since they change with the number of units grown. The Agriculture Statistics Yearbook can provide you with average labour costs for some industries.

Overhead

This is a catch-all for the money you spend to operate the business. Common overhead expenses are land and equipment expenses, insurance, utility costs, depreciation and salaries for management staff. If you can't directly trace cost to labour or materials, it likely belongs in overhead. All overhead costs are fixed costs. Fixed costs are a part of operating a business. They can't be tied to the number of units produced since they are the same whether 10 or 10,000 are produced. You have to pay the fixed costs whether or not you sell anything.

Product cost is an important first step in setting product price. It tells you the minimum your product can be priced at. You need to know your product price before you can calculate how many units you must sell to break-even. The break-even point is where there is neither a loss nor a profit from the sale of your products.

More detail on the elements of product price is explained in the factsheet, The Essentials of Pricing. Once you know product cost you can use customer and competition analysis to further refine your product price. Both methods are detailed in the Methods to Price Your Product factsheet.

What is my break-even point?

A good product price strikes a balance between costs, volume and profits. You can use a break-even calculation to see whether costs are covered by a certain price and volume. Break-even analysis can also help you analyze how a price change will affect your business. Before you start planting a new crop or trying a new bedding plant variety, perform a break-even analysis to be sure it will earn a profit for the business.

To achieve the profit goal you set for your business you must add it to the break-even point. The break-even calculation tells you where total revenue equals total cost. If you set price or volume below the break-even point, you will lose money each time you sell your herbs or bedding plants. When you set your price above the break-even point, you can be sure profit will be earned. You can also increase the volume you produce to reach your target

profit provided your price is set above the break-even point.

To calculate break-even point you must know your fixed costs, variable costs and unit contribution margin. We have defined fixed and variable costs in the cost section. To calculate contribution margin you subtract variable costs from the product price. You can use contribution margin to experiment with various price levels before you settle on a final price.

Contribution margin is a quick way to figure how much of your fixed costs each unit can carry.

Unit contribution margin =
current selling price per unit - unit variable cost

Example:

The Plump Berry Farm produces two pint baskets of saskatoon berries for \$2.40 per unit variable cost and sells them at a local farmers' market for \$4.00 per basket.

Unit contribution margin
 $\$4.00 - \$2.40 = \$1.60$ per basket

This means each basket of saskatoon berries produced can pay \$1.60 fixed costs for the company to break-even.

Break-even point in units = $\frac{\text{fixed costs}}{\text{unit contribution margin}}$

Example:

The Plump Berry Farm has \$3,000 in fixed costs for the saskatoon berry basket operation.

Break-even in units = $\frac{\$3,000}{\$1.60} = 1,875$ baskets

To have no profit but cover all the costs at \$4.00 per basket, the Plump Berry Farm must sell 1,875 baskets of berries.

To achieve a target profit or target operating income for the business use the following formula:

$$N = \frac{\text{fixed costs} + \text{target profit}}{\text{unit contribution margin}}$$

Example:

The Plump Berry Farm has many product groups from their farm, but they want the saskatoon berry baskets to generate \$2,000 profit each year.

$$N = \frac{\$3,000 + \$2,000}{\$1.60} = \frac{\$5,000}{\$1.60} = 3,125$$
 baskets

To earn \$2,000 profit for the business, The Plump Berry Farm will need to sell 3,125 baskets of Saskatoon berries at the farmers' market.

What are my profit goals?

Profit goals will help you make two other business decisions. Based on your goals you can set an accurate price and decide the amount of product you will grow. A goal is a clear statement about your future business plans. You need to consider personal goals, cash flow needs and product position to develop an accurate profit goal.

Profit goals are an important type of business goal. They state how much profit the business should earn. You can set your profit goals as a percentage above the product cost subtotal or set a total profit figure for the entire business. Use industry price ranges to help set the profit level most suitable for your crops or horticulture products. A profit goal will guide decisions on the amount of produce you will grow and the price you will charge.

Align your product position with the profit goals for the business. Product position is the way you promote your horticulture products to target customers. Niche marketing is a type of product position that could work well for the horticulture industry. To create a niche market you need to find a group of customers with unmet needs, then set out to meet those needs.

How will I market my product(s)?

There are many ways to get a target customer to buy your bedding plants, fresh cut flowers or culinary herbs. Each method has advantages and disadvantages. We will look at direct marketing, indirect marketing and international marketing methods.

Direct marketing

To ensure success in direct marketing you need to do some research. You need to research how your product compares to others in the marketplace, the demand for the product and the unique benefits of your product.

There are many types of direct marketing:

Farmers' market

A farmers' market is a focal point where producers and processors gather on a regular basis to offer home-grown produce, agricultural and home-crafted products to sell directly to consumers. All Alberta approved farmers' markets operate under rules and regulations implemented by Alberta Agriculture and Rural Development. Individual farmers' markets may also have additional rules and regulations. The theme is, "Make It, Bake It or Grow It."

The advantages of farmers' markets are direct contact with a larger, regular and loyal customer base, lower marketing and overhead costs, increased income, a great way to sell excess produce and a market to test new

products. The disadvantages of farmers' markets are extra time away from your horticulture business, possible low sales volume and the costs of transporting product to the farmers' market.

For more information on farmers' markets, please refer to the study entitled, *Farmers' Markets in Alberta: A Direct Channel of Distribution*.

On-farm sales (farm store or U-pick)

If your farm has plenty of parking space and is easy to get to, it may be ideal to encourage customers to come to the farm. To offer on-farm sales you need a cash register, weigh scale and likely a cooler, depending on your produce. On-farm sales offer lots of flexibility on length of season, size, hours of operation and product mix. The advantages of on-farm sales are on-site location, a broad range of products, year-round employment and additional income. The disadvantages of on-farm sales are extra capital is required for buildings, finding and keeping reliable suppliers, and the need for a good location. Check the municipal, provincial and federal regulations to be sure you comply with zoning, health, insurance and benefits requirements.

Community shared agriculture (CSA)

The CSA is a direct marketing arrangement where a farmer enters into an agreement with a group of consumer shareholders to deliver fresh produce and other farm-grown food products (eggs, meat, flowers, honey, milk, etc.) for an agreed upon price. In most cases, the shareholders pay the farmer prior to the growing season. Farmers benefit by receiving capital up front, securing their market for the season and sharing the risks of farming with the shareholder. Many shareholders contribute volunteer labour to help plant, weed and harvest the crop. This also reduces the farmer's costs. CSA works best close to urban areas where there's a large consumer population of committed shareholders.

Mail order sales

Growers of perennials and small shrubs can use a mail order system to expand your customer base without spending extra capital on storefront buildings. This type of direct marketing is effective if you can arrange for courier service.

Food service or door to door sales

When you sell and deliver your horticulture product to homes, retail businesses, institutions and restaurants, you are in the door to door sales business. Business owners like this type of direct marketing since it has low overhead cost, easy entry and exit, and no location requirements. The disadvantages include legal restrictions, licensing requirements and a possible lower quality image.

Other types of direct marketing you could use to sell horticulture products include a web page and telephone selling. Can you think of others?

Indirect marketing

When you select an indirect market, you place one or several indirect market channels between your horticulture products and the customer. A horticulture industry survey report found most indirect marketing channels use a 22 per cent mark-up. Reasons for selecting indirect marketing include: a lower time commitment, a broader customer base and lower capital requirements. Examples of indirect market channels are wholesalers, retailers, institutional buyers and brokers.

Domestic wholesaler

A wholesaler pays for your horticulture product and takes title of the goods. Most wholesalers have invested in buildings and capital so they can operate large, efficient operations. They are able to store large volumes of produce and sort, handle and package the produce to meet the needs of various customers.

Retailer

Some retailers buy horticulture products directly from you and sell them to the consumer. The types of retailers who buy from producers are small one-store retailers, or very large retailers who have invested in storage facilities and transportation. Garden centres are an example of a specialty retailer. Their only business is selling plants to customers. An Alberta horticulture industry survey report found 13 per cent of bedding plant sales were made to garden centres.

Institutional buyers

As people live more of their lives away from their homes, the institutional market grows. Examples of institutions that might buy your horticulture products are schools, hospitals, hotels, nursing homes and military bases. The larger institutions often find it more cost effective to buy directly from horticulture producers. They would rather absorb the transportation costs rather than purchase from wholesalers.

Broker

A broker can provide an expert sales force, local representation and stable sales costs. Some of the tasks a broker can do for your business include: representing your product, visiting stores regularly, monitoring product sales, handling complaints, pulling product or rushing an unplanned order. Many brokers also handle any special promotions or displays you request, and monitor competitor activity. Fees for brokers range from 3 to 10 per cent (commission). The commission fee is negotiated along with fees for special services such as the planning of promotions or data collection.

To find a broker, talk to five or six businesses you would like to sell produce to and find out which brokers they use. When you interview a broker, take along some facts such as: a product description, suggested retail price, shelf life, the type of packaging used and the amount you can supply. Plan to discuss fees, major clients, experience with the product category and the five largest retailer accounts they currently handle. You need to know if the broker has a conflict between your product and other products they currently market.

International marketing options

As the world continues to go global, it's natural to think of the possibility of marketing your horticulture products internationally. Most business advisors recommend you have a good domestic customer base before you consider marketing internationally. However, you may decide to grow a horticulture product exclusively for an international market. You may also know someone who has detailed knowledge of a foreign market and is prepared to help with the groundwork.

There are some good reasons to consider an international market. Provided your horticulture products are priced properly, an expanded market should increase profits. International markets offer a larger and more diverse market base and can give you more security through diversifying into different global economies.

Marketing internationally also has major risks. Most foreign countries have growing and packaging standards. Your produce must meet these conditions before you are allowed to sell into the market. You also need to consider the costs of foreign currency exchanges, cultural differences and the need for additional market research. International marketing is a long-term commitment requiring up-front capital and patience. The Canadian Food Inspection Agency regulates the importing and exporting of horticulture product, including quarantine requirements.

It's a good idea to prepare a short list of countries you are interested in exporting your horticulture products to. Before you select an international market remember to research regulations, trade barriers, tariffs and taxes, market size, the degree of competition both domestically and from foreign operations, the distribution network and political issues.

Advantages and Disadvantages of Marketing Methods

Advantages

Direct Marketing	<ul style="list-style-type: none"> • lower marketing costs, larger customer base and potential for increased income • able to earn more profit on products you sell • a market to test new products • direct contact with customers
Indirect Marketing	<ul style="list-style-type: none"> • some indirect sellers are most cost effective and efficient due to economies of scale • buyers and sellers are linked together very efficiently • some types of indirect sellers take responsibility for marketing your produce
International Marketing	<ul style="list-style-type: none"> • expanded markets can increase profits will have a larger and more diverse customer base • less chance of sharp sales decline if selling to many different economies

Disadvantages

Direct Marketing	<ul style="list-style-type: none"> • additional time required to sell products • may need additional capital for buildings • extra costs if transporting products to customers • need to comply with legal restrictions and licensing requirements
Indirect Marketing	<ul style="list-style-type: none"> • adds an extra cost to your product • lose contact with the customer if you sell through indirect channels only • you may find there are few indirect sellers interested in distributing your product
International Marketing	<ul style="list-style-type: none"> • your product must meet the growing standards of the country you wish to sell to • need to manage foreign currency exchange, cultural differences and additional market research • need to invest capital and patience to wait for return on investment

What price range do my competitors charge?

Take an industry focus on your pricing by researching what price competitors are charging. Use competitors' prices to help design a price range. When competition is less intense for certain crops, you can charge at the top of the price range. If competition is intense, you should price at the lower end of the range unless you can distinguish your product through quality or a unique selling feature.

There are six steps you can take to learn more about the competition and their pricing.

- **Step 1 – Prepare a main competitor list**
Prepare a list of all the competition and then select who your key competitors are. You want to focus on main competitors, otherwise the price range may be too large and not appropriate to your horticulture business. To learn more about the competition you can do a secondary research study of your industry and ask customers and suppliers for their opinions.
- **Step 2 – Analyze the main competitors**
Ask customers about your competition. Tour competitors’ businesses to learn how products are priced and distributed. Prepare a list of your horticulture products, along with their strengths and weaknesses. Do the same for each of the main competitors. Be sure to link product price to each competitor.
- **Step 3 – Welcome customer complaints**
Make it easy for customers to tell you what needs improving and act on it. Customers can tell you how your price compares and what you can improve. Include your customers in market research as they are often well informed.
- **Step 4 – Assess whether new competition will enter your market**
Most industries are open to new entrants and you should expect more competition. Constantly check with customers, suppliers and your competition to see if they have heard of any new businesses.
- **Step 5 – Discover where the competition is selling**
You need to find out which stores purchase goods from the competition, and why. Try to find out if the competition offers other types of reductions or price cuts to buyers.
- **Step 6 – Observe trade show activity**
Trade shows can help you find new customers and learn more about your competition. If you sell bedding plants, take the time to attend industry trade shows to see how your competition prices and markets its products.

By researching these six steps you will know the prices competitors charge and why they charge what they do? Use this analysis to develop the upper limit of your price range. Be sure you compare your products to competitors.

For example:

Plump Berry Farm Competitor Assessment			
Competitors	Strengths	Weaknesses	Price Range
Southern U-pick	lower price, broad selection of field berries	customers must travel to farm and pick produce	\$3.00 per 2 pint basket
Berry Merry Market	attractive baskets, clean, bright specialty shop	higher priced goods, limited range of sizes	\$4.00 per 2 pint basket

What is the customer demand for my product or service?

Demand is a term used to show how badly the customer wants your bedding plants or organic vegetables. You can use the customer demand for your produce to set price. To price according to demand you must know more about the size and nature of your customer base and their feelings about price.

Asking some basic questions can reveal a lot about customer wants, needs and feelings about price. These questions might include:

- How many buyers are there and where do they live?
- How old are my customers, how much do they earn and what is their education level?
- What size and type of family does my customer have?
- How does my customer like to spend money?
- What does my customer do in their spare time?
- Does my customer believe price indicates the quality of a product?
- Where could I improve on competitor’s products?
- What type of service does my customer value?

To answer these questions you will need to do research. You will need to keep your eye on general market trends, particularly if your horticulture products have many substitutions. For example, the demand for horticulture products is expected to increase due to larger disposable incomes, an aging population and increased public awareness.

You can use two types of market research to answer demand questions: primary data and secondary data. Primary data gives specific information about the wants and values of your customers. This type of research asks target customers to answer carefully worded and

sequenced sets of questions. Formal primary research often requires a market research professional to design the research method and to interpret the data.

Primary research asks people for their opinions and ideas in more detail. You can conduct informal primary research in your business by listening to customers. Question your customers about pricing, service, quality and new products. Invite your customers to fill out customer comment cards or brief questionnaire forms.

Formal primary research uses specifically worded questions to identify and measure customer wants and needs. To accurately assess people's attitudes the market researcher draws on marketing, psychology and statistics knowledge. If you plan to make major changes to your products or pricing, you may want to seek the services of a market research professional. They know how to word statements, design questionnaires and analyze the results to provide unbiased information.

More elaborate primary research could include written surveys, telephone interviews, focus groups or on-site customer interviewing. To learn more on primary research you can use how-to-books, contact business people who have used primary research or contact an Rural Development Specialist – Business or Agrifood Development Specialist at Alberta Agriculture and Rural Development.

Secondary data uses existing materials and research. While the information is often general, you can learn more about customer characteristics and typical prices for horticulture products. Secondary data is inexpensive since most can be found in public libraries, over the Internet or through publicly funded business development centres.

All research projects should begin with a secondary data search. To learn more about target customers and their attitudes toward pricing, you can check Statistics Canada, Business Development Bank of Canada (BDC), Dun and Bradstreet reports, trade magazines, government newsletters and the Internet. There are many types of trade magazines. They can provide information, intelligence and contacts in the horticulture products industry. Some trade magazines of interest to the horticulture products sector are: *Greenhouse Canada*, *Alberta Greenhouse*, *Alberta Market Gardeners Assoc. Newsletter*, *Grower Talk*, *Fruit Facts*, *Herbal Times* or *Growers Grapevine*.

Turn to the worksheet on page 9 to review a brief example of a market assessment for Plump Berry Farm.

Understanding how to price your horticulture product is an essential step in developing your business. You must continually monitor your price including your costs of production, your competition and your customer and be prepared to make adjustments. In competitive businesses, the successful product is the one that can change quickly and continue to operate profitably.

Glossary

Break-even point – where total revenue equals total costs.

Broker – someone who provides producers with an expert sales force, local representation at the retail level and a stable sales cost.

Contribution margin – calculated by subtracting variable costs from price – is a quick way to figure what fixed costs each unit can carry.

Direct marketing – a method where producers sell their products directly to the consumer.

Fixed costs – are usually overhead costs or the costs you incur to operate the business.

Indirect marketing – placing one or more market channels between your product and the customer.

Labour costs – the amount you pay the people who make your products.

Market channels – using one or several businesses to distribute products from the producer to the consumer.

Materials cost – the value of all the material or supply costs used to make your product.

Overhead costs – includes office expenses, insurance, utility costs, depreciation and salaries for management.

Product cost – is a subtotal of the costs incurred to make, package, promote and distribute the products, and operate the business.

Product life cycle – a pattern that varies with the industry, product, technology and market where a product is introduced, grows, matures and declines in sales.

Product position – describes what target customers think about your product.

Secondary data search – uses existing reference materials and research to learn more about customer characteristics, the types of competition and potential demand for your product.

Variable costs – includes the ingredients and materials used to produce a product for sale. Variable costs increase proportionally to an increase in number produced. May include pots, seeds, or cuttings.

Wholesalers – firm that buys products from producers and processors to sell to food retailers and foodservice. The main functions are to purchase, transport, assemble, store and distribute.

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<p>Competitor Pricing (industry focus)</p> <p><i>Main Competitor A</i></p> <p>Strengths</p> <p>Weaknesses</p> <p>Price range</p> <p><i>Main Competitor B</i></p> <p>Strengths</p> <p>Weaknesses</p> <p>Price range</p>	<p><i>Southern U-pick</i></p> <ul style="list-style-type: none"> – lower price, broad selection of basket sizes and berry varieties – need to travel to farm and pick product – \$3.00 per basket <p><i>Berry Merry Market</i></p> <ul style="list-style-type: none"> – fancy baskets, clean, bright speciality shop. Demonstrates products and recipes – higher prices, limited range of basket sizes – \$4.00 per basket 	
<p>Customer Demand (market focus)</p> <p>Nature of customer base</p> <p>Wants, needs and feelings of customer base</p> <p>Secondary data-search findings</p>	<ul style="list-style-type: none"> – loyal customer who prefers fresh product – 25 to 45 years of age, either lives alone or is a member of a two-person household – likely to have post-secondary education – associates quality with price – expects freshness and quality when buying from farmers' markets – like to support local producers – research has found that people are eating 40 per cent more fresh produce today than in 1970. By the year 2000 it's estimated that the consumption of fresh and chilled foods will increase by 100 per cent. This will provide new market opportunities particularly for fruits, vegetables and related industries – direct marketing bypasses traditional "middlemen". By doing this vendor can realize additional income from 40 to 80 per cent on their products. (<i>Farmer's Markets in Alberta – Direct Channel of Distribution</i>) 	

Note: This is a small example of demand level (market focused) assessment. Refer to the questions on page 6 for more details on preparing a demand assessment