



## Knowing Your Cost of Production

*Profit is a matter of pennies saved*

When it comes to running a business, many companies don't truly know how much money goes into producing their final product. In today's economic climate, knowing how the rising cost of inputs can affect your bottom line is vital. The key to increasing your margin or profit is to really know what it costs to produce your end product. Knowing your true cost of production isn't just important in tough economic times; when conditions improve, it allows you more flexibility to consider expanding or placing more funds in reserve.

"It's imperative to know what it costs to produce a bag or cubic yard of mulch," says David Roller with Colorbiotics. "A few cents per bag or cubic yard can make or break many businesses when dealing with large volumes of material. How can you determine your price if you don't know your cost of production?"

Tracking costs is a daily, weekly or monthly task. Unfortunately, most businesses only review their costs at the end of the fiscal year when it is too late to make adjustments. Roller notes that the top six expense items for mulch operators are raw material, plastic bags, fuel, labor, color, and equipment.

"I would say a majority of our customers know their raw material and labor costs," says Roller. "But they need to dig deeper to understand all of their operating costs in order to know where to make improvements. I estimate less than half actually know their true cost to produce a yard of mulch. Labor costs are trivial in most cases; it is a minor cost for most operations compared to colorant, fuel, and equipment costs."

According to Roller, if your workforce is not properly trained on how to operate the colorant equipment, they can very easily — with the touch of a couple buttons — increase the cost of the finished product of colored mulch dramatically. You can go from putting on 3 to 3.5 pounds of colorant per yard, which then increases your end cost significantly.

For example, if you budgeted for 3 pounds of colorant per yard, but purchased 400,000 pounds of colorant and sold 100,000 cubic yards of material, you either have 100,000 pounds of colorant left or you actually used 4 pounds of colorant per yard. Unless you are tracking your production output and costs on a regular basis, you would not know this until the end of the fiscal year.

"If you don't know these operational costs, such as daily, weekly and monthly output, you can't accurately determine your costs," says Roller. "By tracking this information, many operations can reduce their production costs. Saving 2 cents per bag may not sound like much — but if you are selling 5 million bags, that's \$100,000 in savings."

### ***Planning ahead***

Patrick Geraty with St. Louis Composting understands this well. St. Louis Composting is the largest composter in the region, recycling more than one-third of all yard waste generated in the county.

According to Geraty, if you don't know your cost to produce a yard of mulch, you can sell all spring and be upside down within a matter of months due to rapidly changing costs.

"We are paying \$1.50 more per gallon for diesel fuel in 2008 compared to last year," says Geraty. "We operate eight horizontal and tub grinders that can consume up to 42 gallons of fuel per hour at full production. That increase in the price of fuel has had a major impact on our production costs. I'm not in this business for practice — tracking our costs allows us to plan ahead and make adjustments as needed."

That planning came into play this spring. Geraty typically sets the price for his products in the fall for the following season. However, this year he had to raise the price of his colored mulch by \$2 per cubic yard in May and added a fuel surcharge on all delivered material.



“Not only has the cost of fuel increased, but so has the cost of colorant and wood fiber,” says Geraty. “Due to the wet spring, our grinders have not been working as much and we’ve had to source wood from other sources, increasing our production costs. If not for our monthly reviews, we would have been selling our product at a loss.”

Geraty is also investing in more efficient equipment to help reduce costs. The company recently purchased a flat deck screen to replace its two trommel screen units. The screens are used to remove fines from the wood fiber before the colorant is applied. The trommel screens had to be fed with wheel loaders, whereas the grinder can load directly onto the flat deck screen, eliminating the loaders and their related expenses.

“We use the best equipment and employ the best people,” says Geraty. “But tracking our production costs is what allows us to plan ahead.”