



COUNTING VALUES

Food Hub Financial Benchmarking Study

A report by Farm Credit East, Wallace Center at Winrock International, Morse Marketing Connections and Farm Credit Council, coordinated by the NGFN Food Hub Collaboration*

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NGFN Food Hub Collaboration



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FOOD HUB FINANCIAL BENCHMARKING STUDY

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EXECUTIVE SUMMARY

COUNTING VALUES: Food Hub Financial Benchmarking Study

The nationwide emergence of food hubs is an indicator that local food is becoming more readily available in higher-volume sales channels. The more than 300 food hubs operating around the country use a wide range of business models. All share the general function of helping farmers and other local food producers take their differentiated products to market. These intermediaries provide customized aggregation, distribution, and related supply chain services. Food hubs also strive to deliver on local market promises—the good food values driving this sector's growth. Good food is defined as food products and practices that are healthy for the body, green for the planet, fair for producers and workers, and affordable for all. Good food values range from concerns for public health and social justice to demand for local economic and environmental returns.

Foundational Performance Data

Counting Values presents a set of financial and operational performance benchmarks for food hubs. Business benchmarking is a process of comparing results across a sector to set standards for analysis. This study aims to establish the basis for comparing results across a business sector that is both new and multipurpose. Food hubs operate in the thin-margin food distribution industry, and they take on additional expense working with smaller farmers, offering technical assistance, and filling gaps in other grower and community services. Are food hubs able to support themselves with their operations? What management decisions make the most financial difference?

Establishing such benchmarks is an important step in the local and regional food sector's evolution. The study's metrics shed light on food hubs as business enterprises. They also illuminate food hubs' performance as intermediaries, building access to markets for producers and satisfying consumer and community demand for local food sector products and benefits.

The benchmarks also support decision-making. Food hubs and related businesses can use the benchmarks to compare operational and financial results and plan for the future. Investors, lenders, and grant makers can use the benchmarks to assess enterprises and opportunities.

A Quick Look at the Benchmarks

For the Counting Values study, the Wallace Center and Farm Credit Council analyzed 2013 financial and operational data from 48 regional food hubs. This study builds on experience from a pilot 2012 food hub benchmarking study. The 48 participating food hubs are geographically dispersed and range greatly in size, length of operation, and business models.

To compare results across this range of enterprises, the study looks at profitability through gross margin data; that is, net income before depreciation and taxes, and without including grant income and contributions.

PROFITABILITY: The typical food hub operates at a close to break-even level. The highest performing 25 percent posted a 4 percent profit, compared with the average of -2 percent. Within this relatively narrow spectrum, the most profitable food hubs were larger, older, for-profit operations. Those with sales greater than \$1.5 million averaged profits of 2 percent, while food hubs 5 to 10 years in operation averaged a 1 percent profit. On average, for-profit food hubs earned a 1 percent profit compared with not-for-profit food hubs, which posted -7 percent before taking into account grant income or contributions.

EFFICIENCIES: The top 25 percent may have earned their 4 percent profit through 3 percent lower cost of goods sold (the cost of acquiring or producing goods sold) and through greater labor productivity. The top hubs spent 39 percent more on labor (cost per worker equivalent). Those workers outperformed their peers by 56 percent (sales per worker equivalent). These factors can make a big difference in a thin margin business. The gross margin of the typical food hub in the study was 14.5 percent. That means only 14.5 cents of every sales dollar remained after selling the product to cover overhead or provide profit. Balancing profit margins with goals for an equitable food system is an ongoing challenge for some food hubs, which can be addressed in part with more efficient operations.

MANAGEMENT: Benchmarks' true power is using data along with good management records to focus on improvements for the coming year. Each participating hub received an analysis of their financial performance compared to the benchmarks reported in this study. Hubs that use the benchmark data in combination with sound financial, operational, and marketing practices will enhance their capacity to optimize value to all players in the regional food system. Farmers, food producers and communities will benefit. So will lenders, investors, and grant makers. Sustained profitability for regional food hubs is critical to the emergence of this new force for community economic development throughout the United States.

THE VALUE OF A BENCHMARK RESTS IN ITS ABILITY TO SHOW THE BIG PICTURE OF THE SECTOR BEING STUDIED, WITH ENOUGH DETAILED INFORMATION FOR BUSINESSES IN THE SECTOR TO IMPROVE THEIR FINANCIAL AND OPERATIONAL PERFORMANCE.

The Wallace Center and Farm Credit Council offer the Counting Values benchmarking study to support business development and capital investment. It is designed to help businesses grow and capital flow in the good food sector. The study illuminates the dynamics shaping markets and business models. It offers a starting point for assessing different enterprises and opportunities.

Demand for local foods will continue to grow in economic significance for food producers and in cultural and public health significance for communities. Understanding how this market sector works is important not just to farmers and food hub operators, but also to investors, grant makers, and lenders who need to understand where the risks are for each stage in the value chain and for the sector as a whole.

N.B.: Counting Values' benchmarks complement the broader 2014 National Food Hub Survey, a project of the Michigan State University Center for Regional Food Systems with the Wallace Center at Winrock International. Results of the 2014 national survey are expected in fall 2015. Together, the two studies provide the best available data on intermediated market channels for good food products and practices.

INTRODUCTION AND BACKGROUND

Definition and Key Characteristics of Regional Food Hubs

A regional food hub is a business or organization that actively manages the aggregation, distribution, and marketing of source-identified products primarily from local and regional producers for the purpose of strengthening producer capacity and their access to wholesale, retail, and institutional markets. Source-identified means that, to some extent, the stories of the food, the producer, the production methods—or simply the location—stay with the product. One distinguishing characteristic of a food hub compared with a conventional produce wholesaler is intent. By design, many food hubs have a mission to strengthen local producers' capacity and increase their access to markets. For additional information on food hubs and their effects on producers, communities, consumers, and more, please refer to foodhub.info, the Regional Food Hub Resource Guide, and the 2013 National Food Hub Survey (both developed through the National Good Food Network [NGFN] Food Hub Collaboration).

Although the definition describes a “business or organization,” most food hubs are run as businesses, regardless of tax filing status: they are striving (and in many cases succeeding) to support all the core functions of aggregation, distribution, and marketing with revenue generated through sales or services. Understanding what makes food hubs economically sustainable and profitable is what motivates this benchmarking study.

ONE DISTINGUISHING CHARACTERISTIC OF A FOOD HUB, AS CONTRASTED TO A CONVENTIONAL PRODUCE WHOLESALER, IS THE MISSION INTENT EXPRESSED.

Though hubs share many features, they operate using a wide diversity of business models. Some sell exclusively wholesale to businesses, others only directly to consumers (retail), yet others a combination of both (hybrid). Some act more as brokers, others have significant infrastructure, some operate packing lines, while others require producers to pack and grade their own product.

The participants in this study were spread across the entire United States, with solid representation from three regions: East, Midwest, and West. There is no minimum or maximum revenue expectation for food hubs. The hubs in this study ran the gamut. Very large and very small hubs—both in revenue and size of the warehouse—are included. Some hubs have been in operation for decades and only recently discovered they are called a *food hub*, and other hubs are only two to three years old.

Benchmark Studies

A benchmark study collects financial and operational information from businesses in the same industry or sector. This information is analyzed to determine validity and comparability, standardized, and then aggregated to view a range of performance. The value of a benchmark rests in its ability to show the big picture of the sector being studied, with enough detailed information for businesses in the sector to improve their financial and operational performance.

Benchmarking Food Hubs

There is a tremendous lack of data on local food hub performance, both from a financial and an operational standpoint. Part of the reason for this is that the US Department of Agriculture and other data collectors have traditionally focused on what farm product is being sold (such as grains, eggs, beef, or watermelons). Studying local and regional food systems requires a shift to track sales, volume, price, and other activity in the marketing channel of local and regional foods.

RATHER THAN TRACKING INDIVIDUAL PRODUCTS,
STUDYING LOCAL AND REGIONAL FOOD SYSTEMS
REQUIRES A SHIFT TO TRACK SALES, VOLUME, PRICE, AND
OTHER ACTIVITY IN THE MARKETING CHANNEL OF LOCAL
AND REGIONAL FOODS.

Understanding how this market sector works is important, not just to farmers and food hub operators, but also to lenders, investors, and even savvy grant makers, who need to understand where the risks are at each stage in the value chain, and for the sector as a whole. Many predict that consumer-driven demand for local foods will continue to grow in economic significance for farmers and in cultural significance to communities. It is important to understand the dynamics of an industry or sector to attract the capital, the investment, and the support that will allow individual businesses and industry infrastructure to grow and develop.

METHODS

Participants

Invitations were sent to more than 100 hubs in spring 2014. Full data submissions were received from 48 hubs.

Data Collected

- 2012 and 2013 balance sheets
- 2013 income statement
- 2013 statement of cash flows
- Set of data questions (see Appendix A)

Data Summary

The data were collected from the participating hubs from April through September 2014, focusing on the 2013 calendar year. Naturally, there were a number of different product mixes and a variety of revenue streams. However, the study compares hubs across the sector on a level playing field by simply looking at their financial performance. Further analysis addresses gross sales volume, location, and marketing channel (retail vs. wholesale vs. hybrid).

OPERATIONS, INCOME, FINANCIAL POSITION

Scope of Operations

While each food hub is operated by a management team that directs a unique approach to its own markets, many similar characteristics lend this sector to a benchmark study for an overall view of the industry and its trends. From a business perspective, the exclusive features of a food hub's model are important to distinguish the hub from its competition. Whatever the mix of features, the model must be economically sustainable. For instance, some food hubs operate year round, while others follow the local growing season. Management must

make a strategic decision between shutting down during slow months to conserve expenses and trying to maintain and grow sales in the slower months to cover the cost of product and contribute to overhead and profit.

All food hubs source local products. However, each hub has a different definition of local, which involves state lines or product sourced from within a prescribed radius. Admittedly, a definition of local based strictly on distance is restrictive. The average sourcing distance for food hubs is 385 miles.

The Product	2013 (48 Hubs)
Sourcing Distance (Miles)	385
Strictly Organic	3%
Grew Some of Own Product	23%
Bought from Incubator Farmers	31%

Additional factors that affect sourcing distance include the product mix or goals of the food hub. For instance, if the food hub only sells organic products, it may need to increase its sourcing distance to gather certified product. In this study, only 3 percent of hubs work strictly with organic products. Although this study did not request information on mix of production practices, anecdotally, many of the hubs offer a variety for their customers.

Other hubs studied (23 percent) grow some of their own product rather than procuring everything from outside vendors. This entails farm labor and operating costs, not to mention agricultural production risks. Several food hubs have a community-based education mission, and have developed programs to teach beginning farmers how to produce and market their agricultural products. These are considered incubator farms, and 31 percent of the hubs studied incorporate incubator farms as part of their business model.

Organization and Operations

Many food hubs have organized as a 501(c) 3 operation, with not-for-profit status. This does not mean that these organizations are not profitable, but rather represents their social mission or structure. Over one third of the hubs in this benchmark study held not-for-profit status.

Organizational and Operational	2013 (48 hubs)
Not-for-Profit Status	38%
Take Ownership of Product	72%
Sales from In-House Processing	1%
Membership Fee Charged	
To Vendors	28%
To Customers	15%

Almost three quarters of the hubs take ownership of the product during the course of the value chain, as opposed to operating on commission. This allows hubs to brand the product under their name to establish a marketplace identity that connotes a certain expectation of location-specific freshness and quality. That leaves one quarter that operate a brokerage relationship for their suppliers.

Less than 1 percent of the hubs process value-added products, such as turning tomatoes into sauce or salsa. Instead, the hubs concentrate on aggregation and distribution of fresh product and value-added products produced elsewhere. These value-added products typically yield a higher markup and have a longer shelf life. Resale of value-added products purchased from farmers or other local vendors may expand product lines and maintain sales through seasons when fewer farm products are available. The hubs that did track sales of value-added product (for example, salsa bought from a farmer and resold) reported that made up only 4 percent of their sales. Though this is a small portion of the business model now, it may be an area of future growth as competition pushes innovation in product development and offerings.

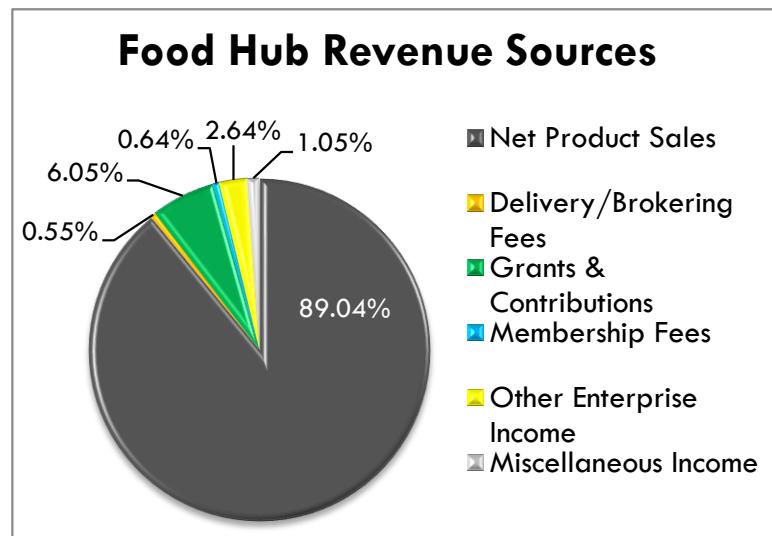
Another organizational structure and revenue stream is membership. Twenty-eight percent of hubs charge a membership fee to their vendors, and 15 percent charge a fee to their customers. This was not limited to hubs that provide direct-market sales, though they are more likely to charge membership fees. Wholesale and hybrid hubs may also charge membership fees, but at about half the frequency of their retail-focused peers. For some hubs, this revenue helps offset administrative costs. While this model might not work for every hub, this benchmark study is an opportunity for hubs to evaluate a membership scenario. The study can also help develop industry standards. For instance, customers are trained to expect to pay admission to a county fair. Some fairs charge for parking. If a fair has lagging revenue but doesn't charge for parking, that could be an additional source of earnings. Using ideas from different models is a good way to find potential additions to business—ones that have already had basic testing elsewhere in the market.

Sources of Revenue

Revenue reflects all sources of income to a food hub, from sales to government grants to interest income on a savings account. The vast majority of food hub revenue comes from net product sales (sales of products, less discounts and returns). This accounts for 89 percent of the income for our study hubs. On average, about 6 percent of operating income is from grants, with other enterprises (such as equipment rental or events) adding almost 3 percent. Membership fees, delivery fees, and miscellaneous income (including interest and dividends) each account for less than 1 percent of the total.

Any business that relies on another source for funding (such as grants) assumes more than the typical market risk with its customer base. A solid business with many customers relies on the business to succeed by, for example, producing a quality product customer's want, delivering as promised, executing new ideas, and running a sound financial operation. When the business is also funded by grants, it must meet these same goals. In addition, it is at the mercy of political processes, government funding pools, philanthropic focus, and the economic climate. All of these can change unexpectedly, which can affect availability of grant funding, regardless of the company's performance. Grant funding also comes with requirements on how the money can be used, often limiting funds for a particular purpose and time period.

For some hubs, grant income constitutes much more than 6 percent of total revenue. While this may be by design in some cases, hubs in general can minimize financial risk by striving to replace grant revenue with earned revenue. When managers know how much business income from sales or service would be needed to replace grant money,



Scope of Operations	2013 (48 hubs)
Age of Hub	7 years
Total Revenue	\$2.83 million
Product Sales	\$2.53 million
Enterprise Income*	\$108,241
Annual Operations (Days Open)	276
Facilities	
Square Footage	6,936
Number of Loading Docks	2
Mileage Driven by Delivery Fleet	40,315

* Enterprise Income includes all business ventures other than the sale of products, including but not limited to delivery charges, brokerage fees, membership fees, event fees, equipment rentals.

they can forecast earnings and develop a marketing plan to earn that revenue. Replacing 6 percent of revenue is a feasible goal for a coming year's budget. If a business can achieve that, it has not only done a better job managing risk but has also put itself in a position to achieve more—more growth, more investment, more jobs, more impact—and be self-sustaining.

Financial Position

Analysis of the hub balance sheets shows typical net worth of 68 percent of the asset base. Some liquidity exists. A typical current ratio is 2.39:1. The current ratio compares a business's current assets (those that are cash or will be turned into cash within the next 12 months, including accounts receivable, inventory, and prepaid expenses) to current liabilities (those that will come due in the next 12 months, such as accounts payable and accrued expenses).

Financial Position	2013 (48 hubs)
Net Worth	68%
Current Ratio	2.39:1
Blended Debt Term	23 years
Blended Effective Interest Rate	3.68%
Number of Hubs with No Term Debt	22

This ratio is a leading indicator of how easily the company can pay its bills in the coming year. A current ratio of 2.39:1 means the company has 2.39 times the amount of current assets (those readily convertible to cash) on hand than it does current liabilities (those to be paid in the next year), and is in a decent position to pay these liabilities from normal working capital cycle

as they come due. A current ratio of 1:1 means a business is barely able to cover its current liabilities with the more liquid assets on hand. If costs were to rise, that company could quickly find itself short of liquidity.

A current ratio of less than 1:1 (for instance, .75:1) means the company will very likely have trouble paying its bills in the near future without an additional source of liquidity. It is not a sustainable practice to liquidate intermediate-term or long-term assets to pay current liabilities, though this is often what happens when a company runs short and does not have the ability to borrow.

While there are no hard and fast rules, it is good practice to aim for a current ratio of at least 2:1. Owners and managers should also consider the volume of working capital on hand (current assets minus current liabilities). A current ratio of 3:1 can be achieved with \$3 in cash and \$1 in payables. But the remaining \$2 isn't much of a cushion for a year's operations.

On average, the blended debt term (a measure of the length of time it takes to retire debt at the current total level of principal reduction) is 23 years. Typical terms are 30 years for residential real estate, 10 to 20 for commercial real estate, and 3 to 5 years for equipment and vehicles. This indicates that the food hub financing has been longer-term in nature, likely for real estate assets, or shorter-term loans with

interest-only periods. The blended effective interest rate of 3.68 percent shows favorable terms have been extended to hubs, which could be from any number of sources. Twenty-two of the hubs (46 percent) had no term debt, which means they have no obligations other than those incurred in current operations. Such a conservative financial position, when combined with slow, manageable growth plans, sets the stage for these typically low-margin businesses to be sustainable in the long run. They have the opportunity to work on margins as they target manageable growth.

SUCH A CONSERVATIVE FINANCIAL POSITION, WHEN COMBINED WITH SLOW, MANAGEABLE GROWTH PLANS SETS THE STAGE FOR THESE TYPICALLY LOW-MARGIN BUSINESSES TO BE SUSTAINABLE IN THE LONG RUN.

FOOD HUB CUSTOMERS AND VENDORS

Customers

The study showed that 39 percent of products were sold through food hub direct retail channels. Grocery and food stores accounted for 28 percent, followed by restaurants/caterers (15 percent) and other distributors (14 percent). Sales to institutions, processors, and other customers round out the rest.

Customer Concentration

Concentration is an important factor because it reveals potential vulnerability in a business model. The typical food hub reported its largest single customer accounted for 13 percent of sales. Almost 40 percent of a food hubs' sales go to their top 10 customers. What does that mean for risk management? How would a hub replace 13 percent of revenue if it lost its best customer? What if it lost its top two customers? How would it handle non-payment from a customer?

Food Hub Customers	2013 (48 hubs)
Grocery/Food Stores	27.6%
Restaurants and Caterers	14.9%
Other Distributors	13.6%
Direct Retail	38.2%
Institutions(School, Hospital, Government)	2.8%
Processors/Other	1.9%
Total	100.00%

Where there is such concentration, developing and maintaining close customer relationships is essential and should be reinforced by risk mitigation strategies, including robust credit policies to ensure timely payment from customers and pre-arranged access to working capital.

Food hubs that have a large number of small customers are not in an ideal situation either. Every time a truck makes a stop, it takes time (winding around smaller roads, parking in tight spaces, finding the receiving party, retrieving the hand truck). Food hubs with individual customers who buy only a small amount per order may struggle to maintain the efficiency needed to cover costs, but good, active relationships with many buyers requires a larger sales staff. Finding the balance between managing the risk of too few buyers and the inherent inefficiency of many

Concentration-Customers	2013 (48 hubs)
Average Number of Customers	408
Product Sales to Largest Customer	13%
Product Sales to Largest 10 customers	35%

smaller buyers pays off in the long term, but will likely take several years, and will need constant rebalancing.

Vendors

Concentration-Vendors	2013 (48 hubs)
Average Number of Vendors	55
Farmer Vendors	40%
Food Safety Certification Required	31%
Purchases from Largest Vendor	9% of sales
Purchases from Largest 10 Vendors	29% of sales

While a food hub counts on customers for business, it also counts heavily on vendors to keep the supply chain moving. All the normal risks, from availability to weather have an impact here. That is exacerbated when there's only 'one game in town.' The need for backup plans in the supply chain increases proportionate to how crucial the product is. One asset of the food hub's value chain approach to supply (approaching vendors as partners rather than as purveyors of easily replaceable commodities) is that vendors are usually willing to participate in production planning with the hub. This allows the hub to adjust its supply actively to meet buyers' expected demand. Although not all producers are perfectly reliable, and weather and other unplanned events occur,

FOOD HUBS ARE ABLE TO COME CLOSER TO OPTIMIZING VALUE TO ALL PLAYERS IN THE SYSTEM DUE TO THE TRUST THEY HAVE DEVELOPED AS PARTNERS... AS A BONUS, PRODUCERS APPRECIATE THE COMMITMENT AND GUIDANCE OF A FOOD HUB THAT IS WILLING TO PLAN AHEAD TO SECURE THEIR PRODUCT.

food hubs are able to come closer to optimizing value to all players in the system because of the trust they have developed as partners. A bonus is that producers appreciate the commitment and guidance of a customer (such as a food hub) willing to plan ahead to secure their product.

Almost one third of food hubs use the risk management strategy of requiring their vendors to hold a third-party food safety certification. This provides an additional layer of good practice and oversight for a significant area of risk to any food-related business.

LABOR

Full Time Equivalents (FTE)

Labor is frequently one of the top two expenses for a business. In an effort to boost profits or reduce losses, managers often think first about cutting back on labor. But all too often, it is the labor that makes the business work. It is important to look at the right labor metrics and look at them in context to understand what they indicate.

A key labor analysis factor is a worker equivalent, also known as a full-time equivalent (FTE). This labor analysis adds up all hours worked by all participants in a business (salaried and hourly workers, full- and part-time, seasonal and temporary, and volunteers) and divides by a standard work year. Using 2,040 hours (40 hours per week for a 51-week work year), the typical hub used the work of more than 6 FTEs and issued an average of 11 W-2s. This is a good indicator that most food hub employees are less than full time.

Good risk management practice dictates that food hubs track volunteer hours. (Several have volunteer labor but don't track the hours.) Food hubs will one day likely need records of who performed what duties and when. The number of actual labor hours is critical in planning crops and sales because labor (paid or volunteer) is necessary to handle and distribute the product. Most important, tracking volunteer labor gives managers an idea of what it really takes to run the business, which is necessary for planning for seasonal staffing needs and budgeting for that time when volunteers want to become paid staff. A business must position itself to pay market rates for its inputs and resources (even if there's a better deal now, such as volunteer labor) to be sustainable when times change and those resources now must be paid for.

Labor Costs

Paid labor at a typical food hub costs 18 percent of sales or 16 percent of total revenue. When analyzing labor metrics, all labor costs should be included, not just wages. Social Security and Medicare taxes, unemployment taxes, workers' compensation insurance, and company-paid benefits are all part of the cost of a worker.

Employee Role	Full-Time Equivalents 2013
Production/Growing	0.8
Sales	1.3
Delivery/Distribution	2.0
Management	1.0
Office/IT	0.9
Marketing	0.2
Volunteers	0.4
Total	6.6
Number of W-2s Issued	11

While high costs are generally undesirable, the relevant question is why costs are high. If a business pays a lot of employees to do repetitive work at minimum wage, they might not be overpaid. It could be that it's just very inefficient and the work takes too long to complete. In that case, it's worth assessing the costs of mechanizing and the annual return from such an investment.

Labor	2013 (48 hubs)
Labor as a % of Sales	18.3%
Labor as a % of Revenue	16.4%
Revenue per Worker Equivalent	\$431,872
Product Sales per Worker Equivalent	\$387,204

The stage of the business and what that labor is doing are key pieces of the analysis. If a new employee is hired in anticipation of significant growth, particularly if that person is accountable for that growth, it makes sense to hire when the right person comes along. But adding labor in advance of the volume needed to support it presents a challenge. Businesses that are efficient with their labor think about how to make existing practices better and yield more before they add more labor. This is especially important because generally a

business can't hire 'half' a person. Jobs can be part-time, but then may not attract the same caliber prospective employees.

PAID LABOR AT A TYPICAL FOOD HUB COSTS THE COMPANY AROUND 18% OF SALES, OR 16% OF TOTAL REVENUE. THE TYPICAL FOOD HUB WORKER EQUIVALENT GENERATED SALES OF \$387,204.

Finally, efficiency of staff labor is a factor. Sales per worker equivalent is a great way to measure labor efficiency in a food hub, because it compares productivity across similar activities. The typical food hub worker equivalent generated sales of \$387,204. (Not every employee is in sales, but they all contribute to the end product). If a hub's labor costs

appear high, this is a good place to look to make an educated decision about cutting or changing labor versus focusing on increasing sales.

BENCHMARK PROFIT & LOSS

Financial Reporting

All hubs submitted their financial information for the 2013 calendar year. For the businesses that operate on a fiscal year, every effort was made to obtain calendar-year data to cover the same period and to include them in the final benchmark analysis. Although the study requested accrual financial information, if cash reports were provided, extra analysis was performed to convert them to the accrual method. Finally, earnings were reconciled to net worth changes in a process that verifies if the company's equity growth was related to earnings or extraordinary activity.

In the manufacturing world, reporting income in the "gross margin format" has been common practice for many years. Small businesses, particularly agricultural ones, tend toward compliance-based reporting (strictly for IRS tax reporting) simply because most agriculturists want to be outside, rolling up their sleeves and getting their hands in the soil. Food hubs are no different—owners and managers would rather be distributing local food to as many consumers as possible than doing paperwork. Yet good management records will yield as much profit as any new truck or equipment purchased.

This study separates expenses into two categories:

- Variable costs that increase with the amount of production and sales, and
- Fixed costs that are incurred no matter how much business is transacted.

From every sales dollar, cost of goods and of sales are subtracted to yield gross margin. Gross margin is a measure of efficiency in turning raw materials into sales dollars. Fixed costs are then subtracted from gross margin, which yields the profit from operations. Profit is the most important line of the financial statement because it speaks directly to economic sustainability. For further information, please refer to the *One Page Business Plan and One Page Financial Plan* (www.foodshedguide.org/planning/)

Business income taxes, which come after profits, must be factored in. In addition, several hubs receive federal, state, and private grant funds. Grant revenue is included below the net income line to show that these operations are supporting themselves with these additional funding sources rather than from operations. The grant funding is still included, because it is part of the actual financial picture of a particular hub and does help offset an operational deficit. However, it should not be counted on as a source of continued sustainable earnings.

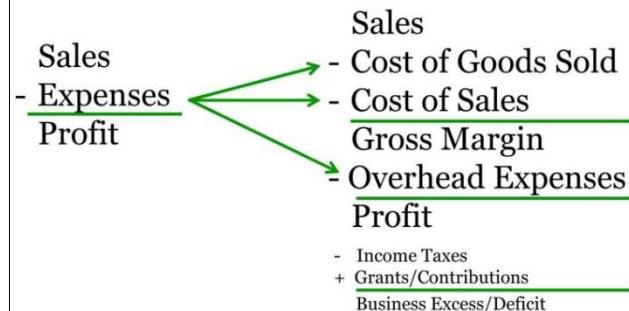
Profit

Profit is important in any business, even in those that have chosen to operate under a 'not-for-profit' tax status. Not-for-profit simply means there are business goals, often charitable, other than building wealth for the business owners. It does not mean that the business can't, shouldn't, or doesn't have or need profits. (In fact, two of the top 25 percent of hubs in this study were not-for-profits.)

Profits are important for many reasons.

- Profits allow for building and equipment updates, when physical assets wear out or become inefficient or obsolete.
- Profits provide funding for growth and expansion.
- Profits allow one generation to transfer a business to the next without a mountain of debt.
- Profits allow for investment in savings accounts, whether business or personal, for retirement or a rainy day. Working capital is one of the most underestimated needs in a small business, particularly a start-up.
- Profits pay back the principal portion of loans.
- Profits, and the ability to handle debt service, position a business as a better risk when seeking credit.
- Profits show the company is doing a good job and is stable. No one wants to work for a company that might not be in business in a few months. Vendors don't want to sell to a company that might not be able to pay the bills much longer, and customers like knowing their suppliers are going to be around.
- Profits allow the business to attract—and afford—the kind of talent they want to work with.
- Profits allow the business to be economically sustainable and to make the ultimate decisions about how the business is and should be operated.

Typical Income Statement converted to Gross Margin Format



TWO OF THE HIGHEST-PERFORMING 25% OF HUBS IN THIS STUDY (BASED ON THEIR NET MARGIN AS A PERCENT OF SALES) WERE NOT-FOR-PROFITS.

Income Statement	Benchmark	Top 25%
Sales	100.00%	100.00%
(Less) Cost of Goods Sold	71.95%	69.41%
(Less) Cost of Sales	13.56%	14.51%
=Gross Margin	14.49%	16.09\$
(Less) Overhead costs	16.28%	12.32%
= Net Operating Margin aka Profit	-1.79%	3.76%
(Less) Income Taxes	0.52%	0.66%
+ Grants/Contributions	6.45%	0.07%
=Overall Excess	4.13%	3.18%

Profit (also known as net margin) in the benchmark study is calculated after depreciation. The typical food hub's depreciation expense amounts to 2 percent of sales. Depreciation is an overhead cost; assets wear out or become obsolete, regardless of the amount of sales generated. While things may wear out faster with more use, most depreciation, or decline in value, is related to aging.

The typical food hub, then, runs at a break-even level before depreciation, which means it can usually pay its operational expenses. However, that leaves no room for debt service, new investment, or a hiccup in the supply or sales chain. Depreciation is a real number managers need to

take into consideration in financial analysis and budgeting. If this is ignored, the hub will not be able to replace aging equipment.

One constructive use of a benchmark study is to guide underperforming aspects of individual businesses to higher levels of performance. Though a study will not outline the steps for each business, it does provide focus and show areas that need attention to build stronger operations. With this in mind, the study breaks out the top performers in some key areas. The top 25 percent of hubs are isolated for comparison, based on their net margin as a percent of sales as opposed to raw dollars of profit. In other words, volume is not a factor in this selection.

In the top 25 percent of hubs:

- **Cost of Goods Sold (COGS):** These costs are for the acquisition (and production, if applicable) of goods destined for resale. The top 25 percent of hubs spend 3 cents less of every sales dollar on cost of goods. While this could mean better buying, that is not always the case or the intent. Many hubs pledge to provide their farmer-vendors with a better price than they might otherwise see in the market. It is very likely that these hubs have done a better job marketing their product and its value compared with commodities available in the marketplace, and are able to charge more for this value.
- **Cost of Sales:** The top hubs spend 1 percent more (of total sales) on selling costs than the average. While 1 percent of sales may be negligible in some businesses, it's a big dollar amount. In the aggregate, it's almost \$70,000. The next step is further analysis to see if this means top hubs hire more workers or pay them more.

THE TYPICAL FOOD HUB RUNS AT A BREAK-EVEN LEVEL BEFORE DEPRECIATION, WHICH MEANS IT CAN USUALLY PAY ITS OPERATIONAL EXPENSES.

Where Your Sales Dollar Goes



- **Overhead:** The top hubs spent 12 percent of every sales dollar on overhead, compared with 16 percent for the benchmark. Two main strategies can be employed to minimize overhead costs. A business might simply find ways to spend less money on infrastructure. The other is that a business which does purchase infrastructure can minimize the overall financial drag from that investment by substantially increasing sales. This reduces the percentage of each sales dollar needed to support the infrastructure.
- **Labor:** The top hubs spend 15 percent of sales on total labor; the average is just over 18 percent. Further analysis is needed to determine if this describes less labor per sales dollar or less pay per worker, as either can result in a lower cost. Efficiency could also be a factor. In this case, the top hubs hired 11 FTEs; the typical hub had 6.5. The larger size of the top hubs requires more labor. Future studies that cover multiple years of data will shed light on the question of size versus efficient and sustainable.

HIGHEST-PERFORMING HUBS PAY MORE FOR THEIR LABOR... BUT GET EVEN MORE PERFORMANCE FROM THAT LABOR.

One interesting finding was that the cost of the average FTE was 39 percent higher in the top hubs (comparing cost per FTE), and those workers outperformed their peers by 56 percent (comparing sales per worker equivalent). This means the model hubs pay more for their labor and gets more work from their staff. Think of a deli: at minimum wage of \$9 an hour, an employee is expected to make an average 60 sandwiches

correctly per hour (15 cents per sandwich). If that deli finds an employee who can make 90 sandwiches correctly per hour, is it worth it to pay more (say \$12 per hour, or 13.3 cents per sandwich) to attract and retain that person? This example shows two labor options: the basic, lowest-cost model, or an alternative, paying 33 percent more for 50 percent higher productivity. The model hubs appear to use this second philosophy, paying a little more to get a lot more. That's not to say an owner or manager should go out and give everyone a raise; it simply highlights that the lowest-cost option might not be the optimal one.

Production, sales, and processing labor are included in Cost of Goods Sold. Office, management, IT, marketing, and owner labor are included with overhead costs. The more overhead labor a company adds, the higher the volume of sales it will need to generate. However, the smaller the gross margin, the harder it will be to make up those margin dollars with volume. A low-margin business must be efficient because there isn't room for waste.

- **Profit:** The top 25 percent of hubs earned 4 cents of every sales dollar in profit, which covered debt service and new investment, among other uses. The typical hub lost 2 percent after depreciation. Overall, profits ranged up to 25 percent of sales, showing what is possible in this industry. The top 25 percent paid slightly more income taxes and received far less in grants and contributions.

OVERALL, PROFITS RANGED UP TO 25% OF SALES, SHOWING WHAT'S POSSIBLE IN THIS INDUSTRY.

Operational Efficiency

A **markup multiple** is a cost-based measure that compares the cost of product with the price at which it is sold. For example, a business purchases a tomato for \$1.00 and sells it for \$1.24. The markup is 24¢, or 1.24 times the original cost.

THE GROSS MARGIN IS A SALES-BASED MEASURE THAT RELATES THE AMOUNT LEFT OVER AFTER SELLING THE PRODUCT TO THE PRODUCT'S SALES PRICE. THE GROSS MARGIN OF THE TYPICAL FOOD HUB WAS ONLY 14.5% - NOT ENOUGH TO COVER OVERHEAD OR LEAVE PROFIT.

The **gross margin** is a sales-based measure that relates the amount left over after selling the product to the product's sales price. In the tomato example, the difference between the sales price of \$1.24 and the \$1.00 cost of the product—24 cents—is related to the sales price (not the cost): $24\text{¢} \div \$1.24 = 19.3\%$ gross margin.

1.17. This represents the aggregate of the whole business, so it includes income from sales of all products (reflecting any discounting) and the cost of all products (including those not sold due to shrink). This is a very low markup, even for perishable wholesale products. Increasing the markup multiple could be an opportunity for the sector to generate revenue. However, this decision needs to be balanced with a hub's business goals which in addition to being financially viable often include paying their farm suppliers a fair price and making local food affordable for all communities.

The **gross margin** of the typical food hub was only 14.49 percent. That means that only 14.5 cents of every sales dollar was left to cover overhead and profit. Though overhead in this sector is on the low side, a 14.49 percent gross margin is not enough to cover overhead or create profit.

Pricing decisions are not easy, but hubs can use their good management records to see what products didn't sell well, or sold only at a discount (or at a low markup to begin with). Weeding out the losers will create room for winning products.

By Size

Because of the robust sample size, hubs were divided into smaller groups for further analysis. The study assessed size, to see where a hub would be economically sustainable. While there were profitable hubs at all levels, those that were often used a unique operating structure that allowed them to minimize overhead, charge a higher price, or capitalize on efficiencies that might not exist in other hubs.

The larger hubs (more than \$1.5 million in sales) are able to spread their overhead costs over much more revenue, thereby reducing overhead to only 12 cents of every sales dollar. These larger hubs do pay more for the product (as a percent of their sales) than many smaller operations, suggesting an opportunity, but the economies of scale work in their favor.

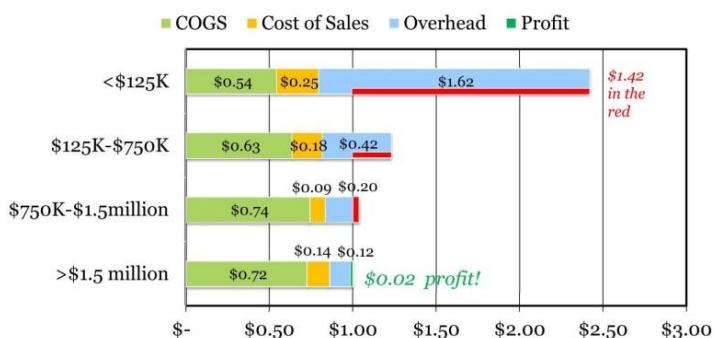
As new hubs start and existing hubs scale up, they need a solid financial and marketing plan not only to reach an

The overall **markup multiple** of the typical hub in 2013 was

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Size Matters



AS NEW HUBS START AND EXISTING HUBS SCALE UP, THEY NEED TO HAVE A SOLID FINANCIAL AND MARKETING PLAN TO NOT ONLY REACH A SIZE THAT WILL BE ECONOMICALLY SUSTAINABLE FOR THEIR BUSINESS MODEL, BUT TO WEATHER THE TIME IT TAKES TO REACH THAT SIZE.

economically sustainable size for their business model, but also to weather the time it takes to reach that size. This requires adequate working capital, of which grants can be a source.

By Location

With 48 hubs, there were enough participants to divide them into regions to tease out noticeable contrasts. For 2013, the cost of product in western hubs was much less (as a percent of sales) than for hubs in the middle of the country or in the East. However, sales and distribution costs were almost double that in the East and four times that in the Midwest. Distance to markets likely plays a role, as does sales competition, which can depress prices.

Overhead was similar in all regions, and resulted in break-even performance in the middle of the country and a 2.5 percent operational deficit in the East and West.

By Age of Hub

Hubs were stratified by age of business. Start-ups of any kind have a steep learning curve; performance tends to improve as the business matures. This held true for hubs in the 5- to 10-year range, showing profit at 1 percent of sales. However, the oldest hubs, on average, broke even.

While one year is not indicative of a trend, nor of ongoing performance, consumers generally have a positive reaction to products that are new and different, as long as they are good. As a business matures, owners and managers need to keep reinventing the business to keep it fresh and exciting to existing customers and to capture new customers as tastes change.

By Seasonality

One important business strategy is a hub's decision of when to operate. Some choose to be open year-round, to capture more of the market, keep in constant contact with their customers, and retain good employees. Others shut down in the off-season, (usually the winter). Still others follow the harvest season in their region. All have to cover monthly overhead, whether they are open for business or not. Those open longer are able to spread overhead costs over a greater volume of sales, as the larger hubs do, so they break even at a lower margin.

By Location



By Age of the Hub



By Seasonality



By Profit Goal

A not-for-profit business has business goals, often charitable, other than building wealth for its owners. Despite common belief, this does not mean that the business can't, shouldn't, or doesn't have profits, or doesn't need profits. Comparing financials between for-profit and not-for-profit businesses revealed a significant difference: for-profit hubs yielded 1 percent profit; not-for-profits posted a 7 percent loss. For not-for-profits there is often grant support to fill in the operational deficit, but along with this comes the grant maker's expectation that the hub is providing services up and/or down the value chain such as building the capacity of its farm suppliers or helping communities access healthy locally produced foods.

By Sales Channel

Another big question is the sustainability of different marketing channels. To answer this, food hubs were examined by channel: mostly retail (80 percent or more of product sold directly to end consumers), mostly wholesale (95 percent or more), and hybrids (significant quantities to both direct-to-consumer and wholesale channels). Hubs naturally fell into one of these categories and each group was large enough for analysis. In other sectors businesses tend to follow a similar pattern of grouping naturally by sales channel. Although retailers sometimes sell excess production wholesale, wholesale business rarely do much retail marketing.

As the chart shows, the mostly retail hubs have a much smaller proportion of cost of goods to sales. It isn't so much that they are buying better (they are likely buying at the wholesale price—the market or selling price wholesale hubs charge). Retail hubs could be capturing some additional value from in-house production, but it is unlikely this accounts for the entire difference. It is more likely that the retail-focused hubs command a much

higher markup on their products, which is typical of retail establishments. They also have higher overhead costs, as retail customers expect certain amenities or services. Wholesale customers are used to lean, mean operations and aren't willing to pay for extras.

WE COMPARED THE PERFORMANCE OF FOOD HUBS THAT WERE MOST DIRECT-TO-CONSUMER, MOSTLY WHOLESALE, AND A THIRD GROUP THAT EMPLOY A HYBRID APPROACH.

Goals Matter!



By Sales Channel



USING THE BENCHMARK AS A TOOL

The true power of the benchmark is in using the data along with good management records to focus on improvements for the coming year. The following hypothetical example looks at labor analysis to pinpoint an area that could benefit from a solid action plan.

In this hub, the cost of wages from all business functions is added to payroll taxes, unemployment insurance, workers' compensation insurance, and benefits the company pays on behalf of employees. This can include (but isn't limited to) health insurance, stipend, medical reimbursements, housing, life insurance, and fuel. Total labor cost is \$273,614.

Hub Labor Costs	Example
Wages Production/Growing, Sales, Delivery / Distribution, Management, Office / IT, Marketing	\$218,350
Payroll Taxes (FICA/Medicare)	\$16,704
Unemployment Insurance (Federal and State)	\$9,826
Workers' Compensation Insurance	\$8,734
Benefits	\$20,000

Example Step 1: Analysis

A good analysis of the percent of sales numbers permits comparisons across time, across different sizes of business, and across different locations. The benchmark is a useful reference point to interpret what these numbers mean.

Example Step 2: Comparison

Participants in the benchmark have access to some interesting information. They can compare themselves with the average, with others in the same size range, and with the top 25 percent (because average really isn't the goal).

Using the sample hub, it is clear that labor costs are the highest of all, exceeding the benchmark average by almost 2.5 percent of sales for a total of \$32,579. The next step is to figure out where the opportunity lies—on the cost side, on the sales side, or on the efficiency side.

Labor Comparison	Hub	2013 Benchmark	Sales \$750K-\$1.5M	Top 25%
Labor (% Sales)	20.7%	18.3%	17.6%	13.9%
Labor (% Revenue)	20.65%	16.45%	16.7%	15.2%

First, cost considerations. What is the average cost of a worker at this hub? Since there are full-time, part-time, year-round, and seasonal employees, the full-time equivalent (FTE) measure comes in very handy. $\$273,614 \text{ of total cost} \div 5.96 \text{ FTE} = \$45,908$. That's total cost; employees are actually paid less than that. Looking at the records, wages make up 80 percent of this, so the average employee's annualized salary is \$36,726.

Is this too much or too little? That depends on where the business operates. In some areas, that is a comfortable living wage. In others, it wouldn't cover basic needs, so a business couldn't attract the kind of talent needed. Compared with the average median income from the US Census, this isn't an exorbitant salary, so cost doesn't seem to be the biggest issue.

Next is an assessment of the sales side.

- **Revenue/Worker Equivalent:** \$222,982 at the sample hub, compared with the benchmark of \$431,872
- **Product Sales/Worker Equivalent:** \$221,304 compared with the benchmark of \$387,204

This shows that the workforce could generate an additional \$165,900 in sales per FTE. That's a lot of additional business—almost twice what the business is doing now—so executing a good plan to increase productivity in this area is promising.

Example Step 3: Improvement

Analysis enhances understanding, which can inform a strong action plan. In this example, the sales end has a lot of potential. Questions to consider include:

- Should we be doing more or different marketing?
- Do we have the right people doing the right jobs?
- Can we give our staff sales training?
- Do we do performance evaluations on key personnel?
- Where can we improve sales efficiencies or remove bottlenecks?
- Is our pricing appropriate?
- Have we built a marketing plan with a sales goal?
- Does our entire team know the plan?

CONCLUSION

Counting Values provides foundational business performance metrics to support the growth and development of regional food hubs. The study is based on 2013 financial and operational data provided by 48 of the more than 300 regional food hubs nationwide. The purpose of the study is to 1) understand factors affecting the profitability of regional food hubs, and; 2) provide hub managers and owners with a business planning tool to clarify pathways to their increased efficiency and prospects for economic sustainability.

Study findings demonstrate that food hubs—like most conventional wholesalers dealing in perishable commodity products—are low-margin businesses. This finding underscores the importance of profitability to achieve food hub goals. Profits, and all the good things they can do, are going to make the difference in the long run. Owners, managers, and good employees work hard, every day, and need to be compensated for it. Food hub profitability is the springboard to achieving the broader mission-related goals.

Here are several key factors to control and watch:

- It is important to remember that “good food” is not a commodity; food hubs add value every step of the way. Food hub owners and managers need to make sure their hubs are compensated for adding that value.
- The combination of a strong financial position with slow, manageable growth plans sets the stage for long-term sustainability.
- Efficiencies are key to being profitable. Consider this with particular regard to delivery and distribution, labor, shrink, and markdowns or discounts.
- Watch the markup. Make sure all products are priced with the objective of capturing the value that is delivered.
- Highest-performing hubs pay more for their labor...but get even more performance for that labor. (The typical food hub full-time worker equivalent generated sales of \$387,204.)
- Grow smarter. Work on markup before pursuing volume, and make sure payment is received for the product. If one has to work twice as hard to sell twice as much product but doesn’t make any more money, that’s not sustainable growth.

Food hubs that use the benchmark data in combination with sound financial, operational, and marketing practices will enhance their capacity to optimize value to all players in the regional food system. Farmers, food producers and communities will benefit. So will lenders, investors, and grant makers. Effective use of the study’s business metrics will show how to minimize risks for each stage in the food value chain and for the sector as a whole. Sustained profitability for regional food hubs is critical to the emergence of this new force for community economic development throughout the United States.

Appendix A:
Questionnaire for Food Hub Participants

- 1) What year was the food hub established?
- 2) How many days per year is your food hub open for business?
- 3) How big is your facility (square footage)?
- 4) How many loading docks do you have?
- 5) Is your Food Hub a 'Not-For-Profit' organization? Yes or No
- 6) What do you consider 'local'? (From how many miles away?)
- 7) From how far away do you source your products? (miles)
- 8) Do you sell ONLY organic products? Yes or No
- 9) Do you have a food safety certification requirement of your vendors? Yes or No
- 10) Do your customers require your HUB to be food safety certified? Yes or No
- 11) Do you grow any of your own produce? Yes or No
- 12) Do you buy from your own incubator farmers? Yes or No
- 13) How many miles were driven by the delivery fleet?
- 14) Do you take ownership of the products you sell? Yes or No
- 15) Can your customers order online? Yes or No
- 16) How many vendors do you buy from?
(A vendor is an outfit that you, the Food Hub, buy something from.)
- 17) How many of these vendors are farmers?
- 18) How much do you spend (\$) with your largest vendor?
- 19) How much do you spend (\$) with your largest 10 vendors?
- 20) Do you charge a membership fee to your vendors? Yes or No
- 21) How many customers do you sell to?
(A customer is an outfit that buys something from you, the Food Hub.)
- 22) What are the \$ sales to your biggest customer?
- 23) What are the \$ sales to your 10 largest customers?
- 24) Do you charge a membership fee to your customers?
- 25) What were your sales (\$) to: Restaurants and caterers, Grocery/food stores, Institutions (school, hospital, gov't)
Your own direct retail, Processors, Other distributors
- 26) What are the \$ of sales of items you process in-house?
- 27) What are the \$ of sales of value added product you buy to resell?
- 28) What is the value (\$) of purchased product that was thrown away (spoiled, damaged, non-salable, stolen, etc.)?
- 29) How many W-2s were issued?
- 30) How much did you pay for workman's compensation insurance and where is that expense recorded?
- 31) How many payroll hours were paid for each of these departments: Sales, Delivery/Distribution, Office/IT Management, Production/Growing, Marketing

Appendix B:
Range of Key Performance Indicators

	Net Operating Margin	Business Excess (Net Income Including Grants and Contributions)	Gross Margin	Cost of Goods Sold
High	25%	45%	462%	111%
75th	2%	8%	64%	82%
50th	(6%)	3%	29%	77%
25th	(22%)	(2%)	16%	64%
Low	(425%)	(181%)	(34%)	0%*

* A food hub that does not take ownership of product (and does not grow or produce the product itself) does not incur these costs.

	Labor as a % of Sales	Labor as a % of Revenue	Full-Time Equivalents	Sales per FTE
High	336%	70%	41.06	\$ 688,307.00
75th	37%	23%	6.12	\$ 338,314.00
50th	20%	17%	2.45	\$ 248,342.00
25th	10%	8%	0.67	\$ 118,993.00
Low	0%	0%	0	\$ 28,906.00

Counting Values

	Overhead Costs as a Percent of Sales	Facility Size (Square Feet)	Sourcing Distance (Miles)	Age of Hub
High	471%	73000	4000	58
75th	40%	8735	300	6
50th	22%	4000	150	5
25th	16%	1825	100	2
Low	6%	150	30	1

	Number of Customers	Number of Vendors	Percent Retail	Net Worth
High	4700	174	100%	100%
75th	461	60	86%	88%
50th	175	48	22%	61%
25th	64	30	0%	25%
Low	1	3	0%	(133%)