

## **AN EXPLANATION OF HOW WE'VE GONE ABOUT RECOVERING THE COST OF MILK TRANSPORT**

March 2007

The full cost of running the milk collection fleet is calculated using the trucks actually used and the actual daily kilometers traveled. This amount has to be paid to the milk transporter.

The problem now is on what basis to collect this money from each supplier.

Transport costs are divided into fixed cost - also called standing costs - and into variable costs, which are the running costs.

The fixed costs are the costs of owning the fleet. These are depreciation, labour, management fees, insurance, licenses, etc. - all costs that are there even if the truck does not travel one kilometer. Our thinking is that these costs should be recovered on the basis of how much of the fleet each supplier utilizes. The more milk you produce, the more of the truck you use, so to speak. Hence we've charged the fixed costs on a per litre basis.

The variable or running costs are where our problems come in. Remember, the actual kilometers done per month were used to calculate the total cost of running the fleet. But now, how to recover or charge that. Our thinking here has been that irrespective of how much milk is finally collected at a destination, it costs the same to get the truck to that destination. Whether you go out and collect 1,000 litres at a specific farm, or even 10,000 litres, it'll cost exactly the same amount in fuel, tyres etc. etc. to get the truck there. In other words, the running costs seem to have to be allocated on a per kilometer basis.

Because one does not want to get into debate about various possible routes, shortcuts and so forth, we came up with the idea of using a straight line distance - there's no argument about what that is. We then added all the farmer's straight line distances together and allocated the running costs on what an individual's share of that total would be. So for example, if the total running costs are say R200 per day and we have 10 suppliers with a combined radius distance of 100 km, then where supplier A is 5 km from the factory, he will pay  $5/100$  of R200 or R10. His neighbour would also pay about the same.

So, the transport costs would be allocated on a per litre basis for fixed costs and on distance in the case of variable costs. Neighbours would pay about the same for the variable costs of transport irrespective of how much milk they produce. If the one has twice as much milk as the other, when expressed as per

litre, the one's cost is twice that of the other's, although in reality they are paying exactly the same number of Rands.

I believe a valid analogy would be the following: a bar of soap costs R2.00. If my income is R10,000 per month, that's only 0.02% of my income. However, if my income drops to only R1,000 per month, that same bar of soap - still costing R2.00 - now costs 0.2% of my income: it appears to be 10 times more expensive for me now!

The variable costs of transport is the only place in the milk formula where volume plays a role; everywhere else it's on a per litre basis.

We have complete understanding for the situation of a smaller producer. However, the fact of the matter is that it just is more expensive to run a truck to collect a small amount of milk than to collect a large volume. This difference in actual cost - Clover call it "cost to serve" - is reflected in the running costs section of the transport tariff.

Collecting a lot of milk at a destination means that running the truck to that farm is cost effective. Conversely, its expensive in terms of running costs to pick up a small amount of milk. This then is why a smaller supplier appears to have a higher cost for transport - when expressed on a per litre basis.

We would really welcome any suggestions you may have on other equitable means to allocate transport to different suppliers. One could always look at charging the same amount per litre, irrespective of locality. However, it is true that the value of milk will differ depending on its locality - a buyer will never be prepared to pay the same for milk that is far away from his factory if he has to go and fetch it.

Have you any other suggestions?

Allan Penderis  
Midlands Milk