Pricing Cheat Sheet

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Pricing

Price should cover costs + profit margin

In competitive market, price determined by supply and demand

Target Cost = Market Price - Desired Profit

Target Costing Steps

1 - Find Market Niche

2 - Find Target Price

3 - Determine Target Cost

4 - Assemble team to design product & meet target

Target Costing / Other Methods

Target Costing	Other costing Methods
Price set by market	Price set by firm
Cost is residual after price + profit margin	Price is residual after cost + profit margin
Cost control is key	

Total Cost-Plus Pricing

When there is little or no competition

Cost base = DL + DM + OH + S&A

Calculation:
- Markup % = Desired ROI Unit / Cost Base
- Target Selling Price = Cost Base + Markup x Cost Base
- Selling Price = Cost Base Unit + Desired ROI Unit

Advantage:
- Easy to calculate

Disadvantage:
- Does not consider demand side
- FC Unit vary with volume change
- Lower sales volume = Higher price

Variable Cost-Plus Pricing

Cost base = DL + DM + VOH + VS&A

Calculation:
- Markup % = (Desired ROI Unit + FOH + FS&E) / Cost Base
- Target Selling Price = Cost Base + Markup x Cost Base

Advantage:
- Help management decision maker
- Variable cost unit doesn't vary with volume

Disadvantage:
- Price may be set too low
- Requires higher markup %

Absorption Cost-Plus Pricing

Cost base = DL + DM + OH

Calculation:
- Markup % = (Desired ROI Unit + S&A) / Cost Base
- Target Selling Price = Cost Base + Markup x Cost Base

Time-and-Material Pricing

Cost-plus pricing variation with 2 rates:
- One for DL (labour + benefits)
- One for DM (material + handling costs)

Widely used in services

Calculation:
- Labor Hourly Charge = (Wages+OH) / Hours
- Material Loading Charge = (Estimated purchasing, receiving.../Estimated cost of part) + Desired Profit Margin on materials

Job Charge= Labor + Material + Material Loading

Transfer Pricing for Internal Sales

Vertically Integrated Companies

Minimum Transfer Price = VC Unit + Opportunity Cost

Transfer price policy objectives:
- Promote Goal Congruence
- Maintain divisional autonomy
- Provide accurate performance evaluation

No excess capacity:
- Lost CM is opportunity cost of transfer

Excess capacity:
- No opportunity cost

Other Techniques for Transfer Price

Negotiated transfer price:
- Agreement between division
- Conceptually best method
- Problems: Mistrust, different pricing strategy btw divisions

Cost-based transfer price: *(most used)*
- Cost incurred by the producing division as cost base
- Based on VC or VC+ FC
- Can result in improper transfer prices, easy to use

Market-based transfer price:
- Based on actual market prices
- Considered best approach
- Can lead to bad decisions if excess capacity