

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

Price set by market

Cost is residual after price + profit margin

Cost control is key

Other costing Methods

Price set by firm

Price is residual after cost + profit margin

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



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