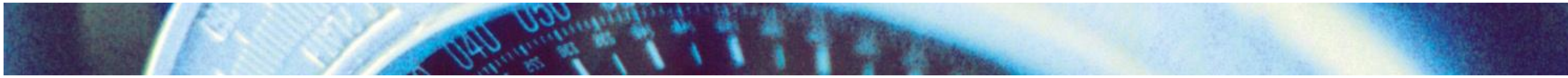


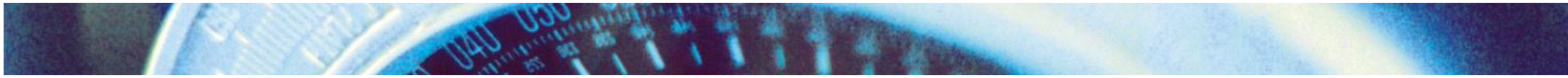
# COSTING & PRICING


Manivannan R.Rajan

Comtec Management Consultants

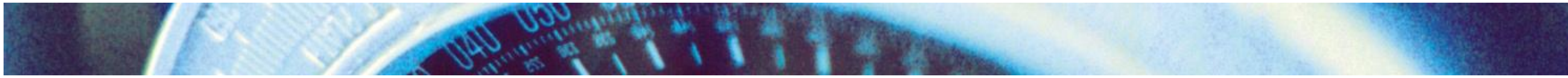

30th Aug.2019

# Objectives



- Understand the relationship between Cost and Price.
- Understand factors that affect pricing
- Learn how companies adjust their prices to take into account different types of customers and situations.
- Selection of a basis to Pricing
- How Costing can support Pricing

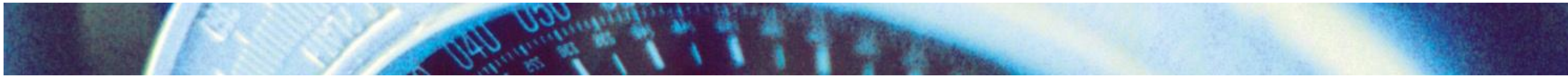
# The Basic Relationship

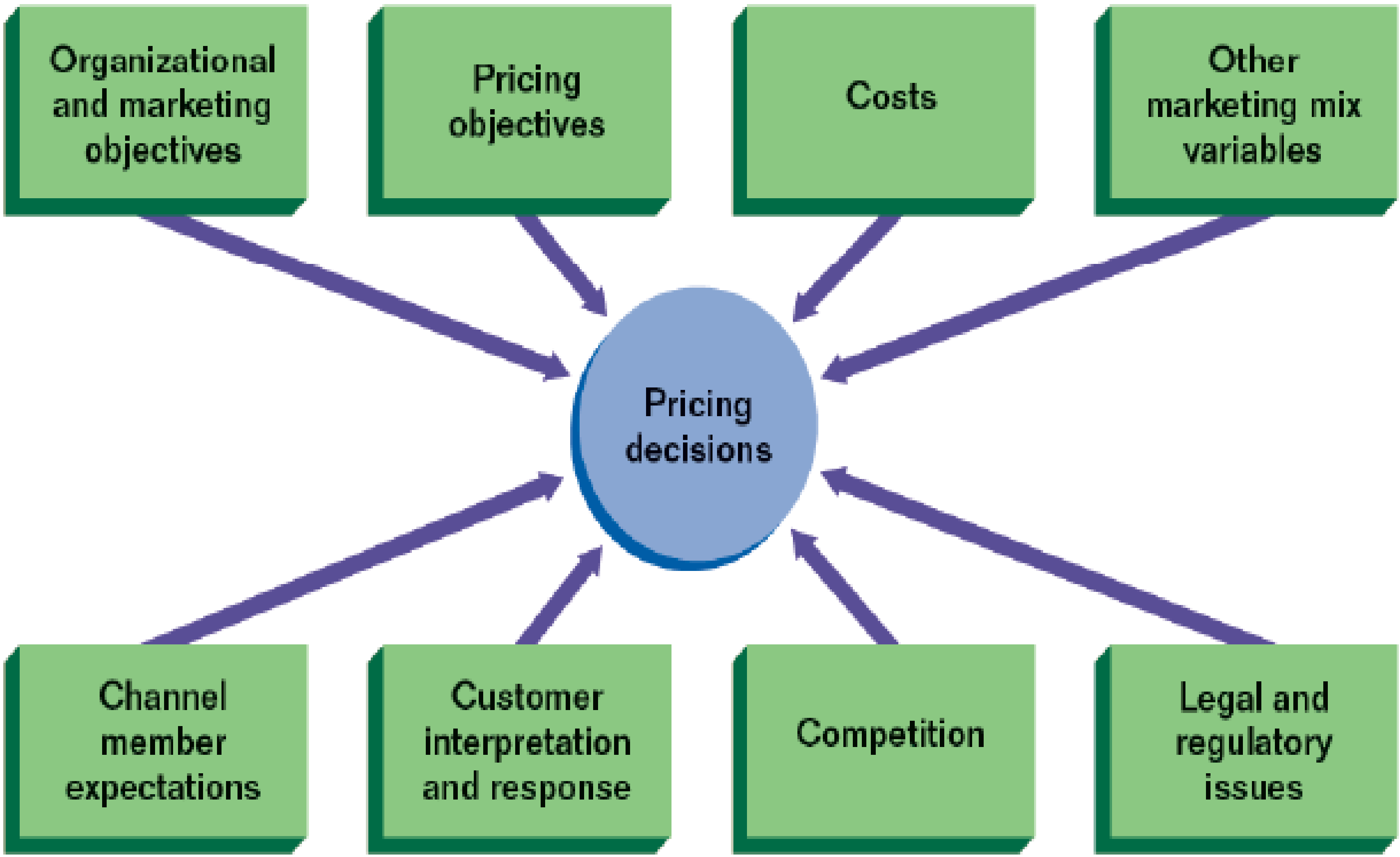


- Profit = Total Revenues – Total Costs

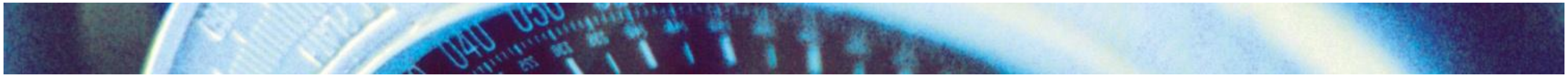
  =(Price x Qty. Sold) – (Fixed Costs + VC/Unit x Qty. Sold))
- Price = Value paid for a product in exchange
- Value = Customer Benefits – Customer Costs
- Has psychological dimensions: symbolic value to customers – value, prestige, quality, etc.
- Relates directly to generation of revenues, and quantities sold
- “Cost is a matter of fact, Price is a matter of policy”.

# Factors That Affect Pricing Decisions





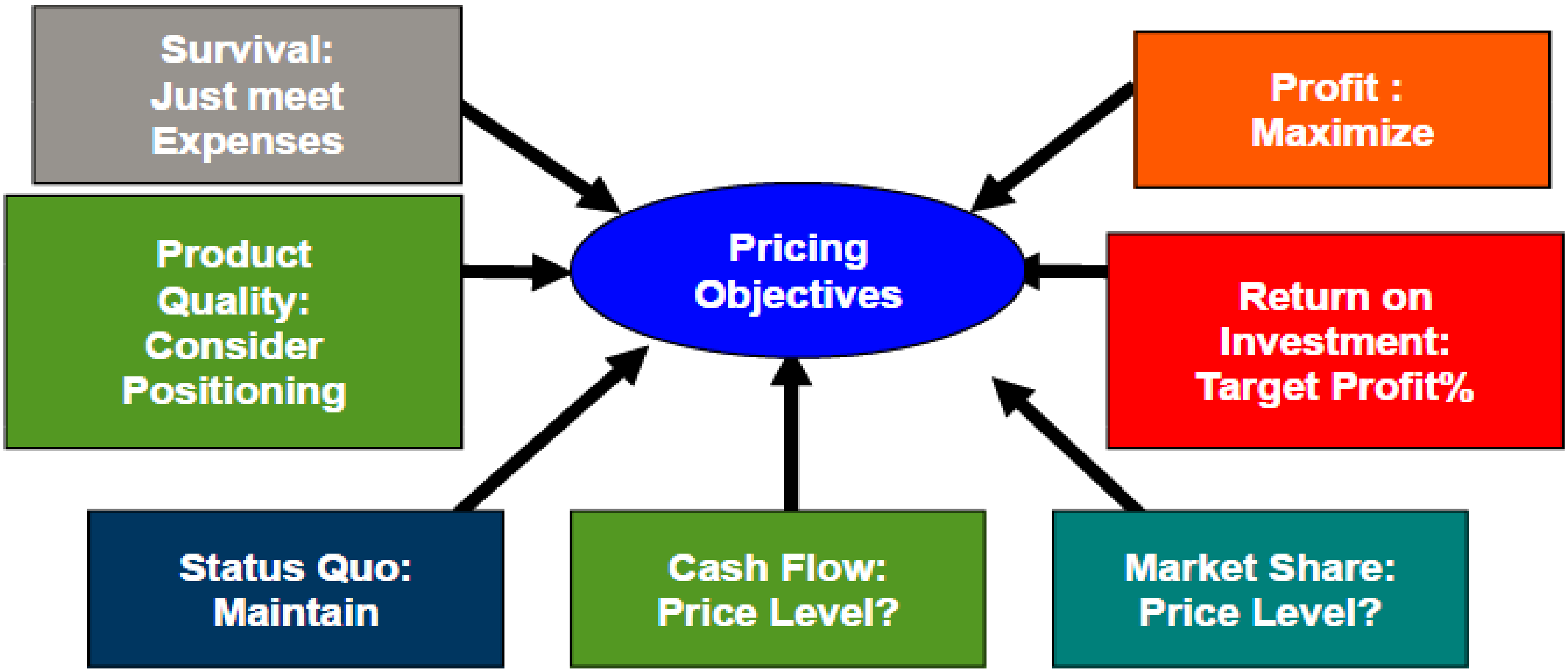
# Types of Pricing Objectives



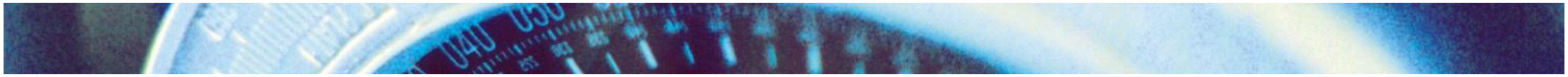
**Development of Pricing Objectives**

**Be Consistent with the firm's goals and mission as well as overall marketing objectives. What do you want price to do?**

**May be trade-offs – use multiple strategies – short-term and long-term**



# Selection of a Basis to Pricing



**Cost Based**

- Adding dollar amount or % to cost
- Cost-plus - % added to *SELLER* cost
- Markup pricing – a predetermined % of cost added to cost
- Focus on Supply Side issues.
- Markups usually reflect operating costs, risks, and stock turnovers

**Competition Based**

- Pricing influenced more by competitors' prices than by costs and revenue
- Can choose to price below, above, or at same level as competitors
- Frequent price changes required
- Importance increases if products relatively homogeneous
- Helps firm achieve objectives of increasing sales **or** market share

**Demand Based**

Based on the level of demand for a product

High price when demand is high; low price when demand is weak.

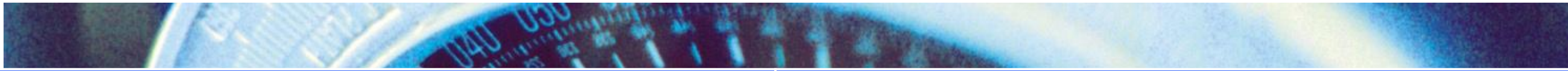
Effectiveness dependent on ability to estimating demand accurately.

Price differentials are a form of demand based pricing.

# **Customer-based Pricing**
# Pret a Manger, a coffee-shop chain

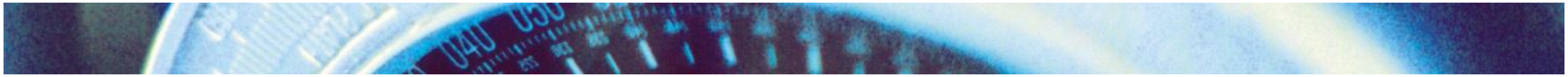
- Bostoners pay vastly more than Londoners for identical lunches.
- An egg sandwich, for instance, costs £1.79 ($2.15) in Britain and $4.99 in America, despite similar ingredient- and labour-costs.
- Many things go into pricing a menu, but most important is what people expect to pay.
- Bostoners, accustomed to $12 for a standard lunch at their local deli, might consider a $4.99 sarnie at Pret a bargain. Londoners, used to £3 ($3.6) meal deals that include a sandwich, crisps and a drink, would consider £4.99 for a sandwich exorbitant.

# Related Issues and Factors



| | |
|---|---|
| Hyper-competition, global competition | Sharing Economy / Aggregation |
| International trade issues, disputes and tariffs, trade dynamics | Forces of Competition |
| Technology | Business Models (e.g. Asset-light businesses) |
| Industry 4.0 (IoT, Robotics, Additive mfg.,.) | Regulations, Compliance requirements, design changes |
| Customer-Centric Pricing | Customer demands and expectations |
| Volatile consumer demand | Commodity cycles and volatility |
| Risk Factors / Risk Management | Global Supply chains |

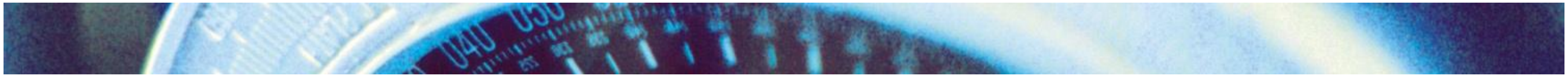
# Two Approaches to Pricing



1. **Target Prices are influenced by market conditions.**

2. **Cost-Based Prices are established using “cost” plus markup.**

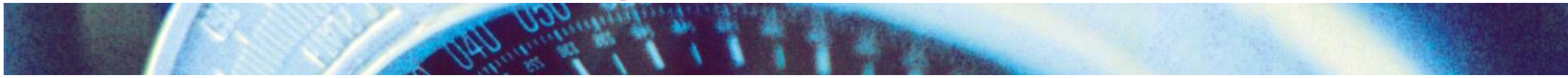
# Cost-Based Pricing



**What is the markup% under each method?**

- Variable Costing
- Absorption Costing
- Full Costing

# Advantages & Disadvantages of Variable Costing

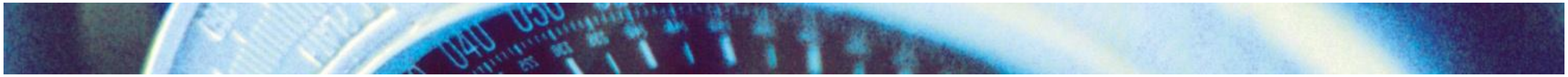


## Advantages:

- Does not bury fixed costs in the cost of goods sold calculation.
- Enables one to:
  - focus on fixed costs.
  - perform incremental analysis and assists in decision making.
  - perform segmented reporting.
- Net income under variable costing is highly correlated with changes in sales and production.

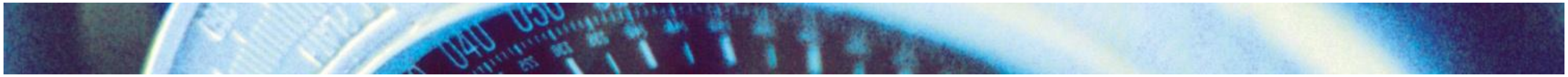
- **Disadvantages:** Too much focus on the short-run, May ignore the impact of fixed costs on decisions, Very expensive to install.

# Costs and Prices

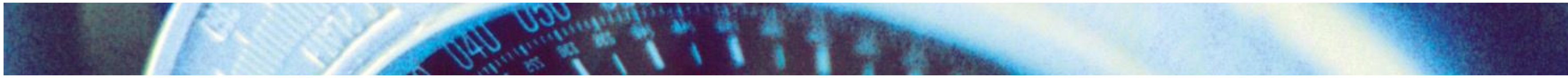


- Multiple Costing systems reqd. in today's business environment, for External and Internal purposes:
  1. Valuation of inventory and the measurement of the cost of goods sold for financial reporting.
  2. Estimation of the costs of activities, products, services, and customers. Cause & Effect relationship to be clearly established, through proper identification of resources and activities, appropriate drivers.
  3. Operational Control and Improvement.

# Relevant Costs for Decision-making



- Costs that are applicable to a particular decision.
- Costs that should have a bearing on which alternative a manager selects.
- Costs that are avoidable.
- Future costs that differ between alternatives.
- Measure Incremental cost and Incremental revenue
- Cost is an essential reference point for pricing.
- To exercise caution that such pricing does not impact other similar products / customers.
- To assess: System optimization vs. sub-optimal solutions



# THANK YOU!