

Price and Types of Costs

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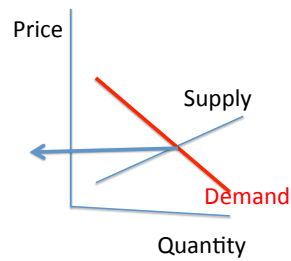
Price

- In the competitive theory of economics who sets the price of a product.
- A) The producers/sellers
- B) The consumers/customers
- C) The Government
- D) Nobody chooses the price

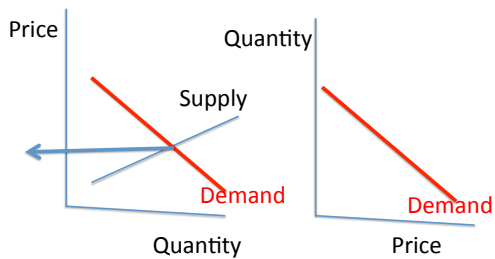
The Correct Answer is

- In the competitive theory of economics who sets the price of a product.
- A) The producers/sellers
- B) The consumers/customers
- C) The Government
- **D) Nobody chooses the price**

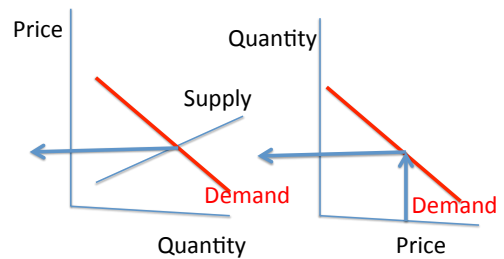
Supply and Demand



Marketing Management



Choose the Price and The Market Buys a Quantity



In Marketing Management

- Managers set the selling price of the things we sell and the things we buy are considered costs
- We have the cost of buying inventory from our suppliers
- We have the cost of making products
- We have the cost of buying advertising

Accountants think in terms of price being a cost

- The price of our inventory is the cost of goods sold
- I bought case of soup for a price of a dollar a can that is a 10% saving on the normal cost per can

Marketing Management

- The price is something we set and our customers see it as the amount they have to pay.
- Our selling price is the monetary cost to our customers.
- The price is our sales revenue per item sold.
- When marketers buy something it is a cost and when they sell something it is a price.

Two Types of Costs in Marketing Management.

- 1) **Fixed costs** or period costs (monthly rent, sales force salaries, heating, advertising). They may vary from month to month but they are not variable costs.
- 2) **Variable costs** are costs that vary with the number of items produced and sold (direct labor and materials used in making a product, the amount of inventory purchased and sold, the sales force commissions, etc.)

Identification of Costs as allocated fixed costs or as direct variable costs

- **Direct Variable Costs** are usually discussed as a cost per unit (\$20 dollars per unit for labor used in construction, \$5 per unit for materials used in construction, 10% commission for selling each unit)
- **Fixed costs** are usually discussed as rent for \$1,000 per month, salaries are \$4,000 per month However, sometimes they are reported as the average cost per unit. Power bill is \$13 per unit, storage is \$5 per unit, security and insurance is \$2 per unit, supervision is \$4 per unit, billing services are \$1 per unit

Know the difference between Variable and Fixed Costs

- Variable costs can be **directly traced** to the purchase of individual things we sell, individual things we make, and the means used to sell each individual sell. If we make and sell more things, the total cost of producing and selling more things goes up.
- The total cost of goods sold goes up when the amount of stuff we sell goes up and the **total cost varies directly with the amount of stuff we sell**
- The total check we write for commission payments goes up when they sell more stuff and the total cost varies directly with the amount of stuff they sell

Know the difference between Variable and Fixed Costs

- Period and Fixed costs can vary from month to month or from quarter to quarter
 - Our rent and our power bill might change from year to year
- Fixed or period cost may vary at our discretion such as storage cost, advertising expense, dealer promotion expense, but they are not considered variable costs. The period costs **can not** be directly traced to the production and sale of individual items

- Fixed and Overhead Costs **are allocated** over the quantity produced and/or volume sold in a period of time to establish an average storage cost per item or an average advertising expense per item sold
- The allocation process results in **a fixed cost per unit sold** and it sounds like a variable but it is **NOT** a variable cost, it can not be traced to the individual unit
- \$10 of advertising per unit
- \$20 of overhead per unit

Exam Question

- Your business is selling 5,000 units per month at \$10 per unit. The costs per unit are
 - \$1 per unit for labor
 - \$2 per unit for factory supervision
 - \$3 per unit for sales commission
 - \$2 per unit for materials
 - \$0.50 per unit for storage and insurance
 - \$0.75 per unit for advertising
- **How much is the variable cost per unit?**

Exam Question

- Your business is selling 5,000 units per month at \$10 per unit. The costs per unit are
 - \$1 per unit for labor
 - \$2 per unit for factory supervision
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 - \$2 per unit for materials
 - \$0.50 for storage and insurance
 - \$0.75 per unit for advertising
- **How much is the variable cost per unit?**
- Answer
- **\$6 per unit**
- (\$1 labor, \$3 for commissions, \$2 materials)

Why do you have to know the difference between Variable Costs per Unit and Average Costs per Unit?

- Variable Costs are impacted by the learning curve phenomena
- Variable Costs Impact the Markup and Gross Profit
- Variable Costs are Used in Markup Pricing
- Fixed Costs Impact Net Profit
- Fixed Costs are Used in Return on Sales Pricing

- Direct Costing is more important in Calculating Managerial Performance inside the firm
- Full Costing is more important in calculating the firm's performance for shareholders

- Any Questions?