

Nine Sources of Confusion about
Costs

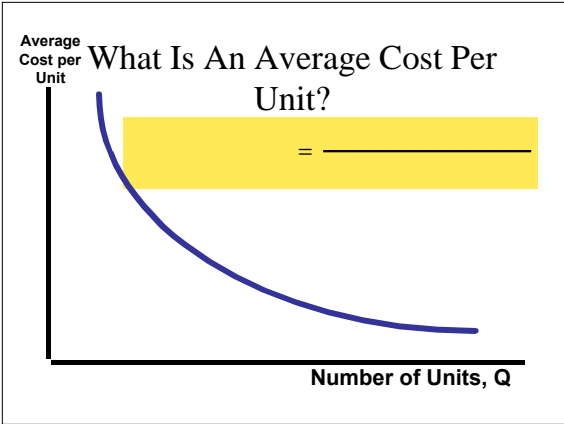
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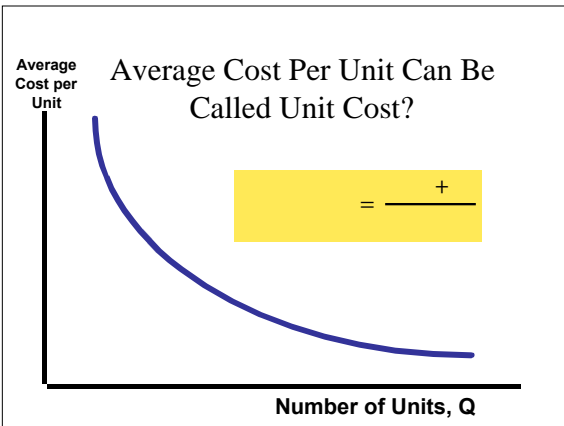
Six Sources Of Confusion

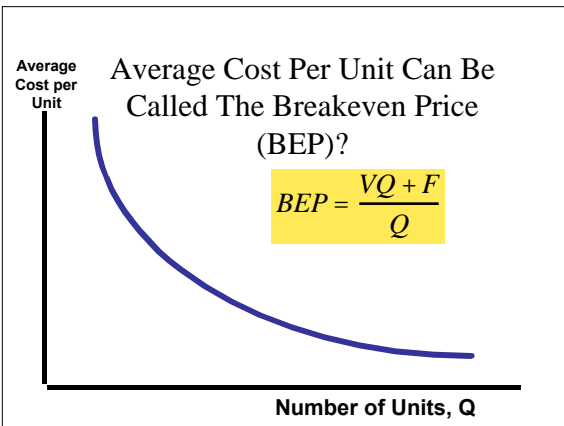
- 1 Average Cost Per Unit Is **Not** A Variable Cost
- 2 Fixed Costs Are Often Reported As Cost Per Unit
- 3 Unit Cost Is **Not** A Variable Cost

Six Sources Of Confusion

- 4 Variable Costs May Be Constant
- 5 Marginal Cost May Be Increasing
- 6 Average Marginal Costs Might Be treated As A Variable Cost







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Model K-50 Unit Costs of Production at 25,000 unit volume

Labor	\$3.18	
Material	1.48	
Plating	.08	
Maintenance charges	.48	
Depreciation allowance	1.60	
Overhead	1.06	
Total Production Cost		\$7.88
Selling and administration charges		3.94
Total costs per unit		\$11.82

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Depreciation is straight line basis over the life of the contract less residual value computed per unit of output.

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Allocation to cover fixed factory overhead burden, charged at the rate of 33.3% of direct labor.

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Depreciation allowance	1.60	
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Allocation to cover selling and administrative expenses, charged at the rate of 50% of total factory production costs.

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Model K-50 Unit Costs of Production at 25,000 unit volume

Labor	\$3.18	
Material	1.48	
Plating	.08	
Maintenance charges	.48	
Depreciation allowance	1.60 X 25,000 = \$40,000	
Overhead	1.06 x 25,000 = \$26,500	
Total Production Cost		\$7.88
Selling and administration charges		3.94 x 25,000 = \$98,500
Total costs per unit	\$11.82	

Fixed Costs are Period Costs!

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Variable Cost is Not the Same Thing as UNIT COST

$$UNIT\ cost = Variable\ COST + \frac{Fixed\ COST}{Quantity\ SOLD}$$

$$UNIT\ cost = V + \frac{F}{Q}$$

- Retailer's often talk about SKU's and units of inventory as the unit cost but are referring to the cost per unit which is a variable cost.

**Variable Cost is Not the Same
Thing as UNIT COST**

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$$UNIT\ cost = V + \frac{F}{Q}$$

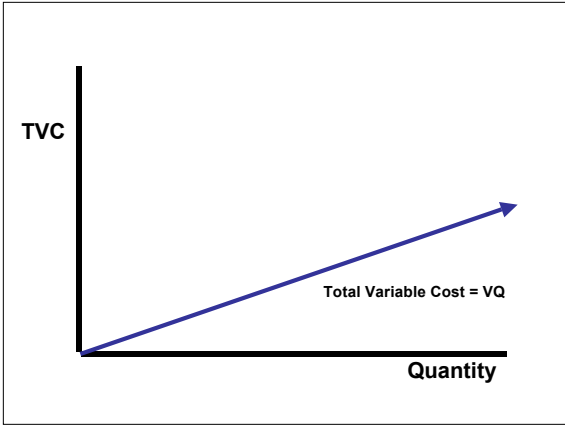
**UNIT COST COMBINES
AVERAGE FIXED COSTS
AND VARIABLE COSTS**

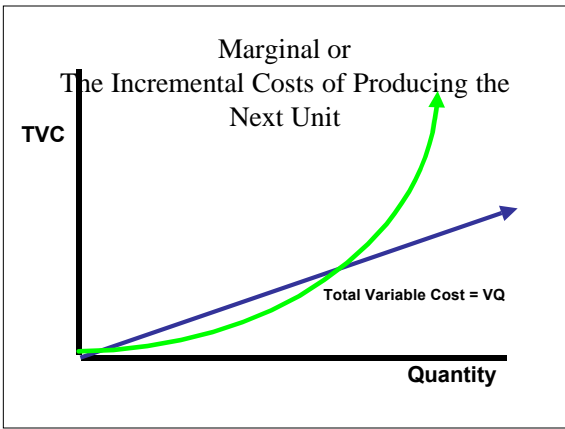
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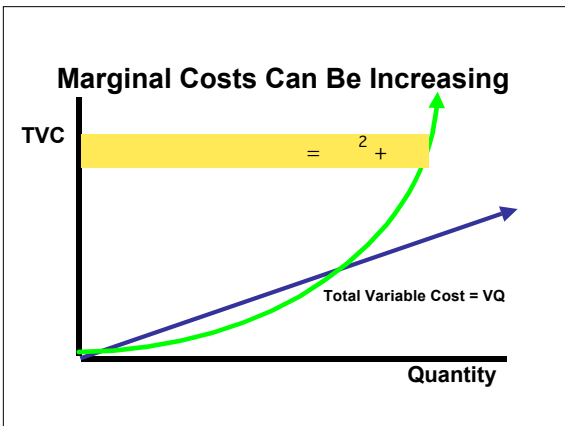
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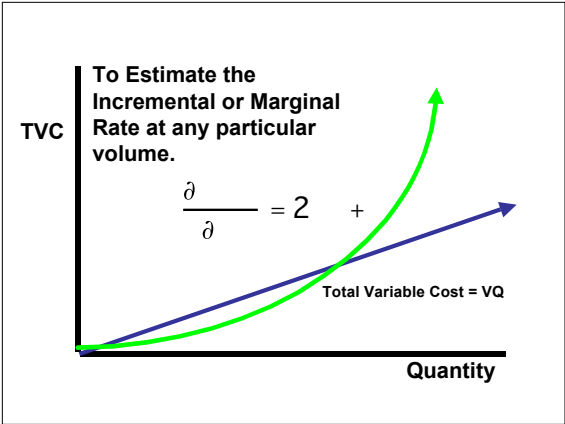
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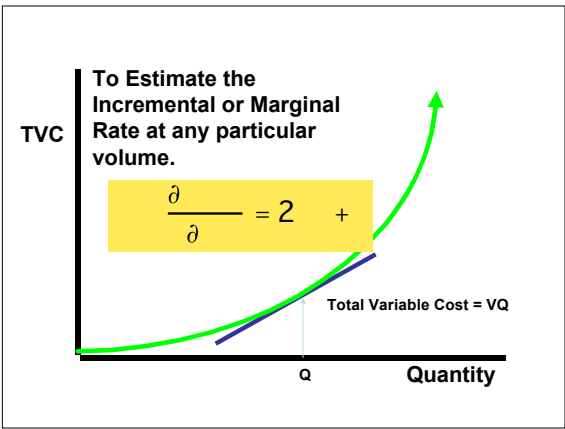
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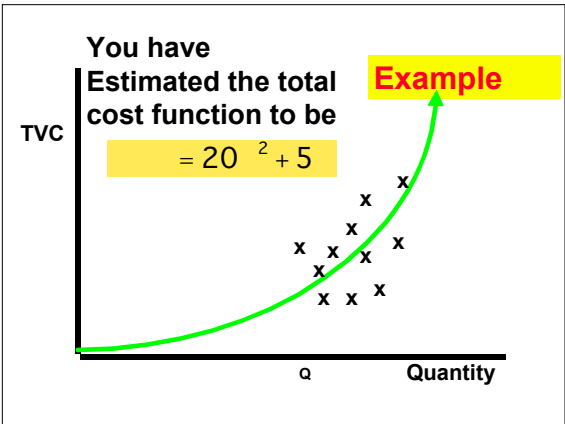


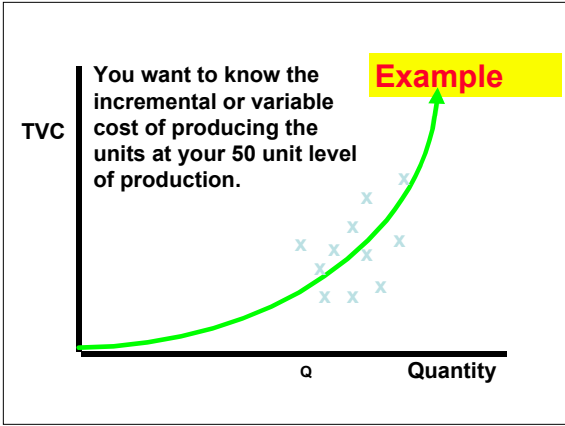


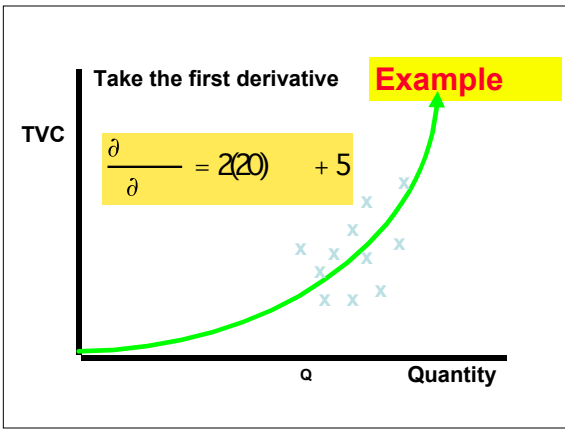


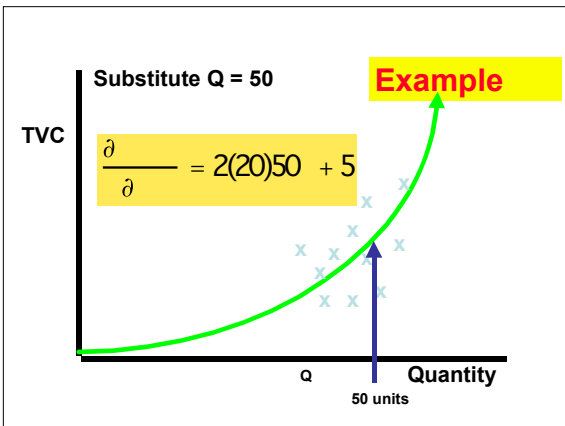


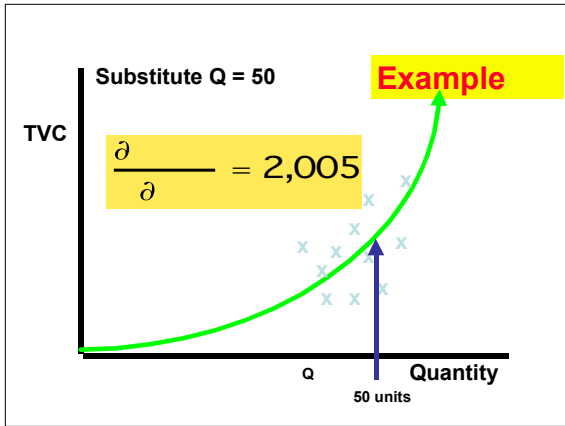


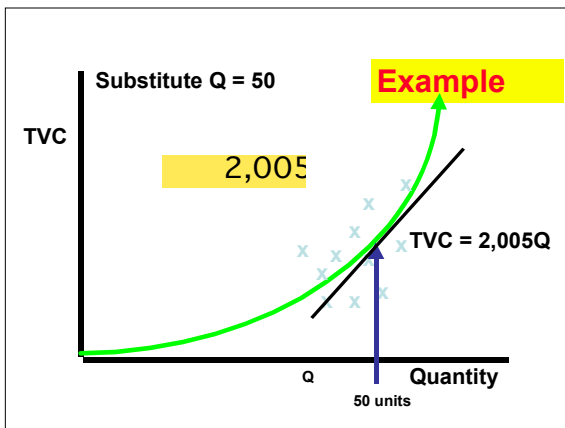






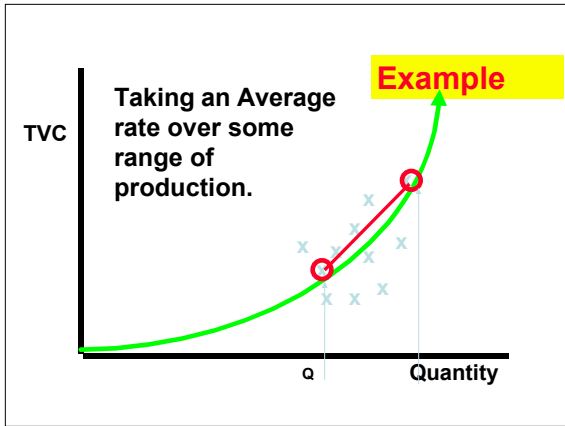






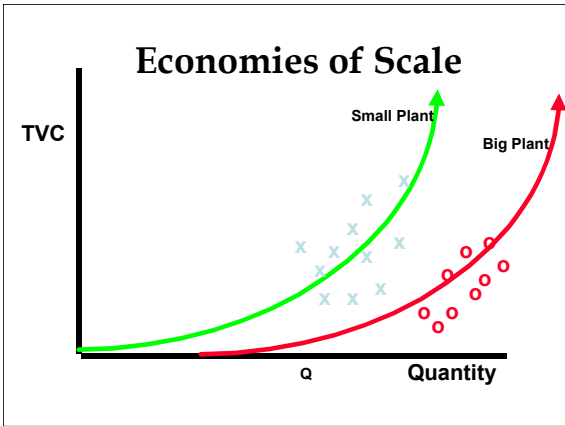
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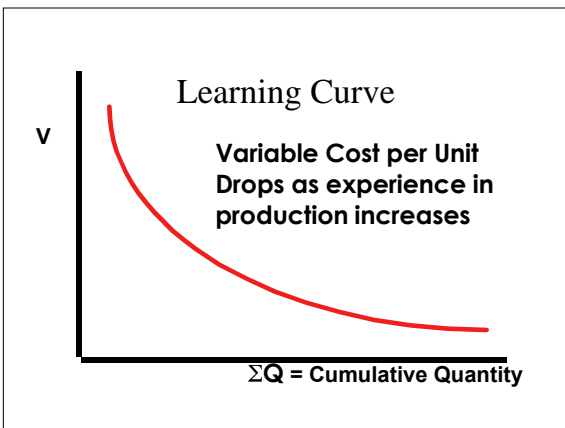
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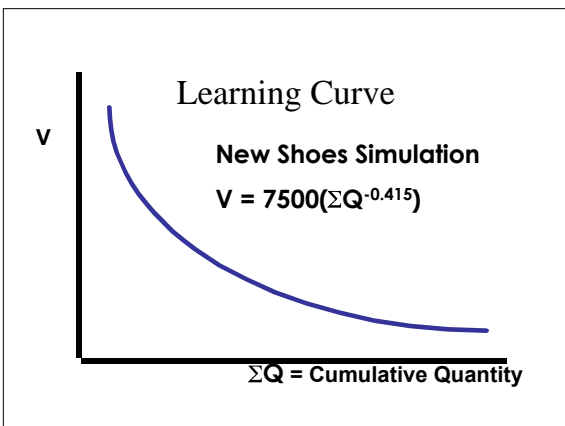


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- Three More Sources of Confusion
- Economies of Scale
 - Learning Curve
 - Accountant's desire to make managers use cost information designed for shareholders and/or tax collectors (e.g., absorption costing, depreciation) as Managerial Information.







A Basic Profit Equation

$$Z = PQ - VQ - cPQ - A - S - F$$

where

Z = Profit

Q = Quantity sold

c = Sales commission

S = Salaries

P = Price per unit

V = Variable costs per unit

F = Other fixed costs

Exam Question

Why is it necessary for marketers to understand the nature of variable, fixed and unit or average costs? Give examples. Solve a problem.
