Topic 11

Pricing and Product Mix

Objectives

When you have completed this topic you should be able to:

- State and explain the three major influences on pricing decisions
- Set prices of outputs using market prices with or without target costing
- Set prices in a segmented market
- Set prices using cost-plus pricing
- Set prices for the long-run and/or the short-run
- Explain the impact of Australian law on pricing
- Explain differences in a company’s revenues across customers purchasing the same product
- Apply the activity-based cost hierarchy to customer costing
- Explain differences in customer-level costs across customers
- Analyse customer profitability
- Subdivide the sales-volume variance into the sales-mix variance and the sale-quantity variance.
- Subdivide the sales-quantity variance into the market-share variance and the market-size variance

Readings


Lecture Presentation

You should listen to the Topic11 presentation after pre-reading this topic study guide and the text (refer to the reading above) and then read the required reading again to reinforce the concepts.
Introduction

We conclude your study of this unit by looking at the pricing of products and deciding which products to make.

This topic first describes the relationship between pricing decisions and product costing. Three major influences on pricing decisions are customers, competitors and costs. The time horizon of the pricing decision needs to be considered, as there are different factors in play for short-term versus long-term pricing decisions.

The target-costing approach is explained and distinguished from a traditional cost-plus approach. Target costing starts with a market-defined target price and then works back to a calculated target cost. Traditional cost-plus pricing approaches add required profit to product cost to determine product price.

Market segmentation, price discrimination, peak-load pricing and the impact of anti-competition laws on pricing decisions are also discussed.

The concept of allocating indirect costs to customers to determine customer profitability is introduced through a discussion of customer-level costs.

We finish the topic by extending the variance analysis started in topic 7 to include the sales-mix variance, the sale-quantity variance, the market-share variance, and the market-size variance.

We can subdivide the sales-volume variance into the sales-mix variance, (which arises because actual sales mix differs from budgeted sales mix) and into the sale-quantity variance (which arises because actual total unit sales differ from budgeted total unit sales

We can also subdivide the sales-quantity variance into the market-share variance (which arises because actual market share differs from budgeted market share), and the market-size variance (which arises because actual market size differs from budgeted market size).
Influences on Pricing Decisions

We will make some simplistic statements that will set the scene for your reading.

There was a time when most manufacturers could work out their costs and just add a margin for profit to get the sales price. Customers could buy it or not according to their needs. We could call this a sellers’ market.

With increasing competition we have moved to a period when most products are in highly competitive markets and customers have many choices, so the customers have heavy influence in what they are prepared to pay and what selling prices are set. We can call this a buyers’ market.

In a buyers’ market producers can derive the product cost to see if they can afford to be in this market, not to set the price.

What a buyer is prepared to pay is largely determined by the features of the product and its quality. According to the principles of Life Cycle Management and Target Costing the features of the product and the quality determine the market for the product, which indicates to us the price people will be prepared to pay. (Aside: Target costing then suggests that you deduct your required margin from this revenue to find the cost, giving you three parameters within which you should design the product: features, quality and product cost.)

Now, these are fairly broad statements with a strong basis in truth. In your reading you will examine some of them and read more broadly about the influences on price setting.

Strategic Pricing and Bidding

When you launch a new product would you rather

a. set a high price (i.e. high margin with low sales) because while competition is lacking you would like to take the opportunity to get high margins then leave the market when copy products are launched? Or

b. set low prices (i.e. high sales with low margins) so that you can saturate the market before copy products come out?

Firms make these strategic decisions and apply them consistently, establishing their reputation in that chosen market.

Another form of price setting is the competitive bidding scenario. Again the pricing depends on the presence or not of excess capacity. Negotiating special order prices on the basis of absorption costs is normally a waste of time as there is little chance of being competitive. Similarly with bids, the bidder must have an understanding of the costs. You should also note that some bids are made in the knowledge that a loss will be made on the deal. This can occur of the bidder makes a strategic decision to win the bid at a loss to be able to establish a relationship with the client if such a relationship could lead to big benefits in the future.
**Self Study Activity**

You should attempt questions 9-1 to 9-13, on pages 363 to 364.
Exercises 9-17 on page 365,
Questions 11-16 to 11-20 on page 452

When you have completed this activity check your answer with the solutions provided on Learnline.

Access MyAccountingLab and work through the study plan for Chapter 9

Any issues you have with this chapter can then be discussed in the tutorial class.

**TUTORIAL ACTIVITY**


Note: Activities (a) to (f) will be done in class.
Be prepared to discuss your responses in class.
Students to post onto the wall at [https://www.polleverywhere.com/kevinclark720](https://www.polleverywhere.com/kevinclark720)
when the poll is active.

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1 Sydney and Melbourne students should have a collaborative (or similar) session in class as directed by the local lecturer.
Summary

This topic completes your study of the unit. In it we examined some principle influences on price setting, with a particular focus on strategic issues. We then adapted the use of contribution margin in decision-making to analyse data to find the most profitable product mix in the circumstance of scarce resources.

In your next unit of management accounting you will look in more detail at some of the issues raised in this unit, taking more of a management perspective than a costing perspective. For example, it will examine performance evaluation issues, especially as they relate to responsibility centres and the behaviour of their managers, and it will investigate the use of activity analysis in activity based management techniques rather than as the foundation of costing techniques.