CHAPTER 05

Pricing

Following figure sets out how the total cost of a product (ie. cost unit) is built up and how the selling price of the same product is arrived at.

	Rs.	
Direct Material	X	
Direct Labour	X	
Other direct expenses	X	
∴ Prime Cost	X	
(+) Fixed production O/H	$\boxed{X}$	Costing
∴ Production / Factory Cost	X	
(+) Selling & distribution O/H	X	
(+) Administrative O/H	X	
∴ Total Cost	X	
(+) Profit (Note)	X	Pricing
∴ Selling Price	X	

Note: Profit may be either a mark-up or a margin.

As shown in the above figure, the process of ascertaining the cost of a product is known as "Costing", while "Pricing" is the technique to fix/set a price for the product.

1.1 Mark-up and Margin

When the profit of a product is calculated as a percentage (%) of it's cost, (cost of sales) it is referred to as a "Mark-up".

Eg:

ABC PLC is a manufacturing company and its pricing policy is to add a 25% of the product's cost. Total cost of product "P" is Rs. 80/-. Calculate the selling price of product 'P'.

	Rs.
Total Cost	80
(+) Mark-up (25%)	20 ← $\left[80\ x\ \frac{25}{100}\right]$
	100

In contrast, if the profit of a product is calculated as a percentage (%) of selling price, it is called a "Margin".

Eg:
In above ABC PLC, if the pricing policy was to add a margin of 20%.

	Rs.
Cost	80
(+) Margin (20%)	20 ← $\left[80\ x\ \frac{20}{80}\right]$
	100

If the profit is expressed as a percentage of the cost of the product (ie. mark-up), you can assume the cost is as 100. If the profit is 25% of the cost, the selling price could be assumed as 125. Then the profit, as a percentage of selling price, would be 20%. $\left[{}^{25}/_{125}\ x\ 100\right]$

Exercise (1) – MCQ
A shirt which costs to the retailer Rs. 1,500 is sold at a profit margin of 25% on the selling price.

You are required to calculate the profit and the selling price.

(A) 500 ; 2050
(B) 375 ; 1875
(C) 500 ; 2000
(D) 300 ; 1800

Calculations:
Since the profit is a percentage of selling price, selling price should be assumed as 100. So, the cost would be assumed as 75.

Rs.

Cost $\longrightarrow$ 1500

$\therefore$ Profit Margin 500 $\left[1500\ x\ \frac{25}{75}\right]$

$\therefore$ Selling price 2000

$\therefore$ Answer is (C)