

Naga College Foundation, Inc.
COLLEGE OF BUSINESS & MANAGEMENT

Member: Philippine Association of Collegiate Schools of Business (PACSB) PACUCOA Level 2 Accredited Business Programs

COSTING AND PRICING STRATEGY

Midterm Quiz and Recitation, 2nd Semester, AY 2023-2024

Question 1: The following are the causes of market failure (externality, public goods, market control, and imperfect information in the market). Your task is to briefly identify each and describe its significance effect to the costing and pricing strategy of a certain enterprise or company. (40 pts.)

-Here's how the different causes of market failure can impact the costing and pricing strategy of a company:

Externality

- *Description:* Externalities occur when the production or consumption of a good or service affects a third party who did not choose to be involved. Externalities can be positive (beneficial) or negative (harmful).
- *Significance:* For a company, externalities can impact costing and pricing by introducing unaccounted costs or benefits. If a company produces negative externalities (e.g., pollution), it may face regulatory costs or public backlash. On the other hand, positive externalities (e.g., education) might lead to underpricing as the full societal benefits are not internalized.

Public Goods

- *Description:* Public goods are non-excludable and non-rivalrous, meaning that individuals cannot be excluded from their use, and one person's consumption does not diminish the availability for others.
- *Significance:* Pricing public goods is challenging for companies as they cannot easily exclude non-paying customers. In such cases, government intervention or alternative revenue streams (e.g., taxes, subsidies, or complementary private goods) may be necessary to cover costs and ensure profitability.

Market Control

- *Description:* Market control refers to situations where a single buyer or seller, or a small group, has significant influence over the market price and quantity of a good or service.
- *Significance:* In markets with limited competition, the dominant firm(s) can set prices and control supply, affecting both costing and pricing. For companies, this

could mean adjusting strategies to exploit market power, or for regulators, it may involve antitrust measures to promote fair competition.

Imperfect competition

- *Description:* Imperfect information occurs when buyers or sellers do not have complete knowledge about a product or market conditions, leading to suboptimal decision-making.
- *Significance:* Companies may face challenges in setting accurate prices and determining costs when information is incomplete or asymmetrical. This can lead to market inefficiencies, with prices not reflecting true values. Strategies for enterprises involve efforts to improve transparency, educate consumers, and adapt pricing models to mitigate the impact of imperfect information.

Question 2: What are the effects of transfer pricing in achieving the goals and purposes of the company's costing and pricing strategy? (20 pts.)

Allocation of Profits:

Profit Maximization:

- Transfer pricing allows a company to allocate profits among its various subsidiaries and divisions. By strategically setting transfer prices, a company can optimize its overall profit, ensuring that each segment contributes efficiently to the organization's profitability goals.

Tax Planning:

- Companies often use transfer pricing as a tool for tax planning. By setting transfer prices at levels that maximize profits in low-tax jurisdictions or minimize taxes overall, a company can enhance its after-tax profitability. This is particularly relevant in a global business environment with varying tax rates.

Cost Allocation and Performance Measurement:

- Transfer pricing aids in allocating costs among different divisions or subsidiaries. This ensures that each unit is accountable for its costs and allows management to assess the performance of individual segments accurately. Effective cost allocation contributes to informed decision-making and resource optimization.

Risk Management:

- Transfer pricing strategies can be designed to manage risks associated with currency fluctuations, market uncertainties, or changes in regulatory environments. By adjusting transfer prices, companies can adapt to external factors, protecting their overall financial stability and achieving their risk management goals.

Competitive Advantage:

- Transfer pricing can be leveraged to gain a competitive advantage. By adjusting transfer prices strategically, a company can influence its competitiveness in

different markets. This may involve setting prices to be more competitive in specific regions or market segments to capture market share.

Legal and Regulatory Compliance:

- Companies need to adhere to transfer pricing regulations to ensure compliance with tax laws and international regulations. Proper compliance helps the company avoid legal issues and penalties, contributing to the overall stability of the organization and its ability to pursue its goals.

Resource Allocation and Investment Decisions:

- Effective transfer pricing assists in making informed investment decisions by providing accurate cost and profit information for each business segment. This aids in resource allocation, allowing the company to focus on areas that contribute most significantly to its overall objectives.

Stakeholder Relations:

- Transparent and fair transfer pricing practices contribute to positive stakeholder relations. Investors, regulators, and the public often scrutinize a company's financial practices. Ethical and well-managed transfer pricing can enhance the company's reputation and relationships with stakeholders.

In summary, transfer pricing plays a crucial role in achieving a company's goals and purposes related to costing and pricing strategy, particularly in the allocation of profits. It allows for strategic decision-making, tax optimization, risk management, and overall financial stability.

Question 3: What is the benefit of having a master budget in business operation. Expound. (10 pts.)

Comprehensive Allocation

- A master budget involves the integration of various operational and financial plans, including sales, production, cash flow, capital expenditures, and more. This comprehensive approach helps align the entire organization toward common objectives and ensures that all departments are working in harmony.

Goal Alignment

- By consolidating individual budgets into a master budget, organizations can ensure that every department's goals are aligned with the overall strategic objectives of the company. This promotes a unified vision and

helps employees understand how their individual contributions contribute to the broader organizational goals.

Resource allocation

- The master budget serves as a tool for effective resource allocation. It helps businesses allocate resources such as capital, labor, and materials in a manner that optimizes efficiency and supports the achievement of financial targets. This ensures that resources are utilized in the most cost-effective way.

Performance Evalion

- Master budgets provide a basis for comparing planned financial outcomes with actual results. This facilitates performance evaluation at various levels of the organization. Deviations between planned and actual performance can be analyzed to identify areas for improvement and to take corrective actions.

Decision Making

- Companies can use the master budget as a decision-making tool. By assessing the financial implications of different scenarios and considering the potential impact on the overall budget, management can make informed decisions regarding investments, expansions, cost-cutting measures, or changes in business strategies.

Communication and Coordination

- The master budget serves as a communication tool that facilitates coordination among different departments. It provides a common financial framework that enables departments to understand each other's needs, timelines, and dependencies, fostering better communication and collaboration across the organization.

Cash flow management

- One of the key components of a master budget is the cash flow budget, which outlines the expected inflows and outflows of cash over the budgeted period. This helps businesses manage their cash flow

effectively, ensuring that they have sufficient liquidity to meet their obligations and invest in growth opportunities.

Benchmarking

- The master budget can be used as a benchmark for comparing actual performance against planned performance. This not only helps in identifying areas for improvement but also provides valuable insights for setting realistic and achievable goals in subsequent budgeting cycles.

Investor and creditor confidence

- Having a well-structured master budget can enhance confidence among investors and creditors. It demonstrates that the company has a clear financial plan and is committed to achieving its financial goals. This can positively influence the perception of stakeholders and attract investment or favorable credit terms.

Question 4: Enumerate the steps in strategic budgeting. (10 pts.)

Strategic budgeting involves the development of a financial plan that aligns with an organization's overall strategic goals and objectives. The process aims to allocate resources effectively to achieve desired outcomes. Here are the key steps in strategic budgeting:

Define Strategic Objectives:

- Clearly articulate the organization's strategic goals and objectives. These should be aligned with the company's mission and vision, taking into consideration long-term plans and competitive positioning.

Environmental Analysis:

- Conduct a thorough analysis of the external environment, considering economic conditions, market trends, regulatory changes, and other factors that may impact the organization's financial performance.

SWOT Analysis:

- Assess the organization's internal strengths, weaknesses, as well as external opportunities and threats (SWOT analysis). This analysis provides a basis for understanding the internal and external factors that may influence the budgeting process.

Long-Term Planning:

- Develop a long-term strategic plan that outlines the steps required to achieve the defined objectives. Consider factors such as market growth, technological advancements, and industry trends that may impact the organization over an extended period.

Budget Guidelines and Policies:

- Establish budget guidelines and policies that align with the organization's strategic priorities. These guidelines should provide a framework for budget development, ensuring consistency and coherence across different departments.

Engage Key Stakeholders:

- Involve key stakeholders, including department heads, managers, and other relevant personnel, in the budgeting process. Solicit their input to ensure that the budget reflects the realities and challenges faced by different parts of the organization.

Departmental Budgets:

- Develop departmental or functional budgets that align with the overall strategic plan. Each department's budget should support the achievement of specific strategic objectives and contribute to the organization's success.

Resource Allocation:

- Allocate resources (financial, human, and other resources) based on the strategic priorities identified. Prioritize initiatives and projects that are most critical to achieving the organization's long-term goals.

Financial Modeling and Projections:

- Use financial modeling and projections to estimate the financial impact of strategic initiatives. This involves forecasting revenues, expenses, and cash flows, taking into account different scenarios and potential risks.

Performance Metrics:

- Establish key performance indicators (KPIs) and metrics to measure the success of strategic initiatives. Define benchmarks and milestones to assess progress and adjust the budget as needed throughout the fiscal year.

Continuous Monitoring and Evaluation:

- Implement a system for continuous monitoring and evaluation of the budget against actual performance. Regularly review financial reports and performance metrics to identify variances and take corrective actions as necessary.

Adaptability and Flexibility:

- Maintain flexibility in the budget to adapt to changes in the business environment. Strategic budgeting is an iterative process, and organizations should be prepared to adjust their budgets based on evolving circumstances.

Communication and Transparency:

- Communicate the strategic budget to all relevant stakeholders, fostering transparency and understanding. Ensure that everyone in the organization is aware of the strategic priorities and how their contributions align with the overall goals.

Feedback and Learning:

- Encourage feedback from stakeholders and use the budgeting process as a learning opportunity. Assess the effectiveness of the budget in supporting strategic objectives and use insights gained to improve future budgeting cycles.

By following these steps, organizations can create a strategic budget that serves as a dynamic and responsive tool to achieve long-term goals and navigate the complexities of the business environment.

Question 5: Site five (5) importance of management controls system to the (a) company's gathering and usage of information, (b) managers behavior, and (c) employee's behavior. (15 pts.)

Data Accuracy and Reliability:

- A management control system helps ensure that the information gathered by the company is accurate and reliable. By establishing control mechanisms, such as regular audits and verification processes, the system enhances the quality of data used for decision-making, planning, and performance evaluation.

Timely Information Flow:

- Effective management controls facilitate the timely flow of information within the company. This is crucial for making informed decisions and responding promptly to changing circumstances. Timely access to relevant data enables the company to stay agile and adaptive in a dynamic business environment.

Strategic Alignment:

- Management controls contribute to aligning the information gathered with the company's strategic objectives. By focusing on key performance indicators (KPIs) and critical success factors, the system ensures that data collection and usage support the organization's overarching goals, improving strategic decision-making.

Performance Measurement and Accountability:

- Management control systems establish performance metrics and benchmarks, providing managers with clear standards against which their performance is evaluated. This fosters accountability and encourages managers to align their behavior and actions with organizational goals, enhancing overall performance.

Incentive Alignment:

- Through the use of performance-based incentives and rewards, management controls influence managers' behavior. These systems link managerial performance to organizational success, motivating managers to make decisions that positively impact the company's financial health, efficiency, and effectiveness.

Goal Clarity and Alignment:

- Management control systems communicate organizational goals and objectives to employees, fostering goal clarity and alignment. When employees understand how their tasks contribute to broader organizational success, they are more likely to exhibit behavior that supports the achievement of those goals.

Performance Feedback:

- An effective management control system provides regular performance feedback to employees. This feedback helps employees understand how well they are meeting expectations and where improvements can be made. It encourages a continuous improvement mindset and aligns employee behavior with organizational standards.

Fairness and Equity:

- Management controls contribute to creating a fair and equitable work environment. By establishing consistent performance standards and evaluation criteria, the system ensures that employees are treated fairly. This fairness fosters positive employee behavior, motivation, and commitment to the organization.

In summary, a robust management control system plays a pivotal role in shaping the gathering and usage of information within a company, influencing managers' behavior by emphasizing performance measurement and accountability, and guiding employees' behavior through goal clarity, feedback, and fairness. These aspects collectively contribute to the overall success and sustainability of the organization.

Question 6: What is the significance of efficient management of economies of scale to costing and pricing strategy of firms in an industry? (15pts.)

Efficient management of economies of scale holds significant implications for the costing and pricing strategy of firms in an industry. Economies of scale refer to the cost

advantages that arise when a firm increases its level of production or output. Here's how the efficient management of economies of scale impacts costing and pricing strategies:

Cost Reduction:

- Significance: Efficient management of economies of scale allows firms to spread their fixed costs over a larger production volume, leading to a lower average cost per unit.
- Impact on Costing: Lower average costs result in reduced production costs per unit. This can positively impact the firm's overall cost structure, making its products or services more cost-effective.

Increased Profit Margins:

- Significance: Lower costs due to economies of scale enable firms to maintain or improve profit margins, even in competitive markets.

Impact on Pricing Strategy: Firms can adopt competitive pricing strategies while still maintaining healthy profit margins. This can lead to a more competitive position in the market, attracting price-sensitive customers.

Market Competitiveness:

- Significance: Firms that effectively manage economies of scale can often offer products or services at lower prices than their competitors.
- Impact on Pricing Strategy: Lower prices can be a competitive advantage, attracting more customers and increasing market share. This is particularly important in industries where price sensitivity is high.

Barriers to Entry:

- Significance: Achieving economies of scale can create barriers to entry for new competitors, as they may struggle to match the cost efficiencies of established firms.
- Impact on Pricing Strategy: Established firms can use their cost advantages to set prices that new entrants may find difficult to match. This helps in protecting market share and sustaining profitability.

Flexibility in Pricing:

- Significance: Efficient management of economies of scale provides firms with flexibility in their pricing strategies.
- Impact on Pricing Strategy: Firms can choose to adopt different pricing strategies, such as penetration pricing to gain market share, or skimming pricing to capture higher margins initially. The ability to choose from various pricing strategies enhances the firm's adaptability to market conditions.

Investment in Technology and Innovation:

- Significance: Achieving economies of scale often involves investments in technology and innovation to increase production efficiency.
- Impact on Costing: While initial investments may be required, the long-term cost savings from improved efficiency contribute to lowering the average cost per unit.

Supply Chain Efficiency:

- Significance: Economies of scale can lead to more efficient supply chain management, benefiting from bulk purchasing and streamlined logistics.
- Impact on Costing and Pricing: Reduced supply chain costs contribute to overall cost efficiency. Firms can pass on some of these savings to customers or improve profit margins.

In summary, efficient management of economies of scale plays a crucial role in shaping the costing and pricing strategy of firms. It provides cost advantages, enhances competitiveness, and influences the ability of a firm to set prices strategically in the market, ultimately contributing to its long-term success and sustainability.

Question 7: Why natural monopolies often regulated? Site a specific business situation. (10 pts.)

Natural monopolies are often regulated due to the inherent characteristics of their market structures, which can lead to concerns about market power, limited competition, and potential negative effects on consumers. One specific business situation that illustrates the need for regulation in a natural monopoly is the case of utility companies, such as water or electricity providers.

High Fixed Costs:

Electric utility companies often have significant fixed costs associated with building and maintaining infrastructure, such as power plants and transmission lines. These costs make up a substantial portion of the total cost structure.

Economies of Scale:

Electric utilities benefit from economies of scale, meaning that the average cost of production decreases as the quantity of electricity generated and distributed increases. This results in a situation where a single large provider can produce electricity more efficiently than multiple smaller competitors.

High Barriers to Entry:

The initial capital requirements and technical expertise needed to enter the electric utility market can be substantial. This creates high barriers to entry, making it challenging for new competitors to enter the market and compete effectively.

Question 8: A transfer price is the price charged by one segment of the company for goods and services provided to another segment. Be able to show and describe through example the perfect business time and situation to apply the transfer price methods namely: (a) market-based, (b) cost based, and (c) negotiated. (30 pts.)

from the internal design team.

Passing Score is 75pts. out 150

“Viderunt omnes fines terrae salutare Dei nostril”