

TARGET COSTING AND CHANNEL ECONOMICS

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 Wharton
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Financial Sustainability – making and selling something

$$Q(p - c) > F$$

where

Q **quantity** sold per unit time (e.g., 30,000 openers/year)

p **price** per unit (e.g., 25.00 USD/opener)

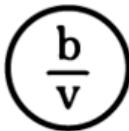
c **cost** per unit (e.g., 13.44 USD/opener)

F **fixed costs** to operate the business per unit time (e.g., 300,000 USD/year)
 rent, advertising, salaries, etc.

Key Idea

- Set price based on market logic.
- Work backwards from price to set cost target.
- Check your *cost of goods* against the cost target.



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Bottle Opener \$50.00

Quantity:

[Order](#)

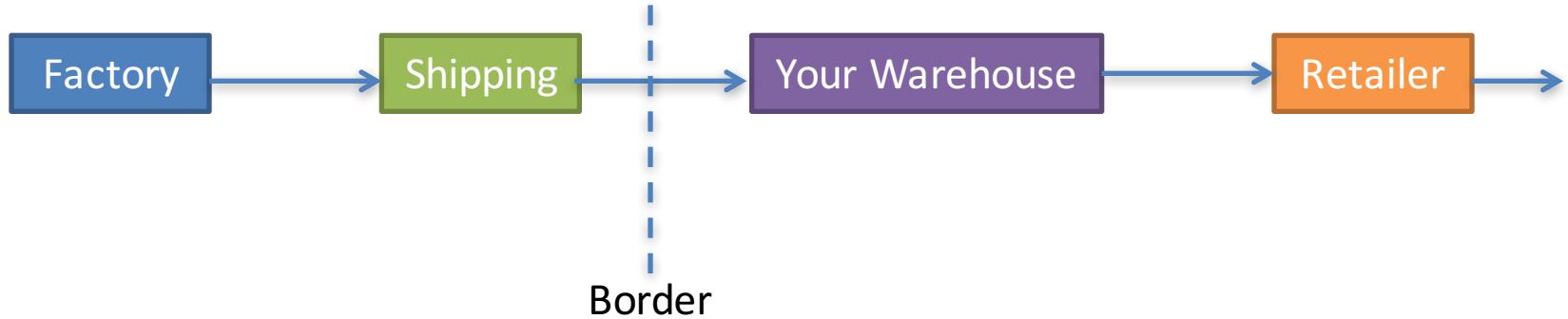
The Belle-V Bottle Opener adds style to any bar. The “business end” of the opener features a self-centering lip to make removing bottle caps a cinch. The curved upper surface feels great against your palm and elevates the opener above your bar, table or counter to make it easier to pick up. The product is made from stainless steel for strength and durability and is finished and polished by hand.

Bottles have needed openers ever since William Painter invented the first pleated metal bottle cap in 1892. Typically stamped metal, utilitarian bottle openers have functioned adequately but are so visually uninteresting that users are barely aware of them during use. They are usually uncomfortable and not ergonomic in their design.

The Belle-V Bottle Opener’s beautiful design instantly forges an emotional connection with the user, who can quickly, easily and comfortably remove a bottle cap. Investment-cast stainless steel provides corrosion resistance and the thick walled durable construction imbues the bottle opener with an heirloom quality.



Supply Chain











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Example Target Cost Calculation for a Physical Good Sold Through Retailer

50 USD retail price (the price the end consumer pays)

50% retailer gross margin

Implies...

25 USD wholesale price (the price the retailer pays you, the *brand owner*)

40% brand owner gross margin

Implies...

15 USD (maximum) cost of goods (COGS)

Gross Margin (Retailer Example)

Gross Margin is

$$\frac{\text{Price} - \text{Cost}}{\text{Price}}$$

That is,

$$\frac{\text{Price to Consumer} - \text{Price Retailer Pays You}}{\text{Price to Consumer}}$$

For example,

$$\frac{50 - 28}{50} = 44\%$$

“Mark Up” is Defined Differently

Mark Up is

$$\frac{\text{Price}}{\text{Cost}} - 1$$

For example,

$$\frac{50}{28} - 1 = 0.79 = 79\%$$

Mark up and Gross Margin are related as follows:

$$\text{Mark Up} = \frac{\text{Gross Margin}}{1 - \text{Gross Margin}}$$

For example,

$$\frac{0.44}{1 - 0.44} = 0.79 = 79\%$$

Typical Gross Margins for Retailers

- What determines margin?
 - Volume (higher volume → lower margin)
 - Price point (higher price → lower margin)
 - Differentiation (less differentiation → lower margin)
 - Retailer's costs: seasonality, lifecycle, returns, sales effort
 - E.g., construction materials vs. luxury cosmetics

- Typical ranges
 - Fashion apparel 60%
 - Building materials 20%
 - Typical consumer goods 35 – 50%



Typical Gross Margins for “Manufacturers” (i.e., “Brand Owners”)

- What determines margin?
 - Volume (higher volume → lower margin)
 - Price point (higher price → lower margin)
 - Differentiation (less differentiation → lower margin)
 - Manufacturer’s SG&A and R&D costs: Software vs. Cleaning Supplies
- Representative values
 - Luxury Cosmetics 75%
 - Apparel 50%
 - Automobiles 20%
 - Typical consumer goods 30 – 50%

Note: You can find average values in your industry by studying financials of public companies.

Cost of Goods

Factory Price (price you pay the factory)		12.00
Duties	3.40%	0.41
Freight		0.90
Landed Cost		13.31
Scrap and Shrinkage	1%	0.133
Cost of Goods		13.44

Illustrative only – your values will be different