

A Report To The Directors of Berry Phones Limited On the Price for Berry's Phone products and the company's pricing model

Executive Summary

- A value chain analysis could help Berry Phones identify key activities that go into changing the inputs for a product or service, into an output that is valued by the customer.
- Blueberry lifecycle cost is \$408 and profit is \$92 per unit and Raspberry lifecycle cost is \$281.5 and profit is \$93.5 per unit
- Target costing Concentrates on cost reduction during the design and development phase and Kaizen costing concentrates on cost reduction during the manufacturing stage
- Customer-driven cost for the Raspberry phone is \$276 this is below the lifecycle cost per unit of \$281.5.
- Customer-driven cost for the Blueberry phone is \$412 this is greater than the lifecycle cost per unit of \$408.
- The team at Berry phone has overestimated the cost of Raspberry phone (lifecycle priced at \$375 whilst market priced at \$345) and Underestimated the cost of Blueberry phones (lifecycle priced at \$500 whilst market priced at \$515).
- Berry phone should charge the market price for phones at \$345 for Raspberry phones and \$515 for Blueberry phones.
- Berry phones should use Target costing (determining the target market price and cost that needs to be achieved in order to price the good or service competitively) in the future it would prevent disappointment in profitability when introducing a product to the market.

INTRODUCTION

Initial analysis of Blueberry phone sales reveals that it has not been as profitable as Billie was expecting and she is worried that this lack of profitability may also be an issue when the Raspberry phone is released. Billie asks you to use your management accounting knowledge and analyse whether this will be the case.

MAIN REPORT

Explain how Berry-Phones might use their level 2 major processes value chain to strengthen their strategic position.

Value chains are a set of value-producing activities stretching from suppliers to final customers. A value chain analysis could help Berry Phones identify key activities that go into changing the inputs for a product or service, into an output that is valued by the customer.

These activities can be compared to those of competitors in the mobile phone market, allowing Berry Phones to identify opportunities where it may be able to "reconfigure the value chain" by vertical integration, outsourcing activities in value-chain that are not making good returns or treating suppliers/buyers as partners to seek mutually beneficial process improvements.

Prepares a product life cycle budget for the Raspberry phone that includes the net profit, return on sales and cost structure (percentage of total costs in each cost category).

Lifecycle Budget for Raspberry Phones

	In total	Per Unit	Cost Structure (%)
Price per	375	375	
No. of phones over lifecycle	1000		
Lifecycle revenue	375000	375	
Lifecycle Cost			
Research and Development	48,000	48	17.05%

Design	20,000	20	7.10%
Manufacturing	66000	66.00	23.45%
Marketing	92000	92	32.68%
Distribution	18000	18	6.39%
Customer Service	37500	37.5	13.32%
Total costs	281500	281.5	100.00%
Profit	93500	93.5	
ROS	24.93%		

Calculates the lifecycle cost and profit per unit for the Raspberry and the Blueberry phones.

	Blueberry	Raspberry
Cost per unit	408	281.5
Profit per unit	92	93.5

Blueberry lifecycle cost is \$408 and profit is \$92 per unit

Raspberry lifecycle cost is \$281.5 and profit is \$93.5 per unit

Explains the difference between target and kaizen costing AND calculates the appropriate customer-driven cost for the Raspberry and Blueberry phones.

Target costing Concentrates on cost reduction during the design and development phase this is achieved by determining the target market price and cost that needs to be achieved in order to price the good or service competitively.

Kaizen costing concentrates on cost reduction during the manufacturing stage this is achieved by setting a target cost reduction, conducting activities to reduce cost, calculating variance and measuring effectiveness and then determining corrective action to achieve target reduction (if necessary).

Berry-Phones require a 20% return on sales (ROS).

	Blueberry	Raspberry
Price	515	345
Required profit	103	69
Target cost	412	276

Customer-driven cost for the Raspberry phone is \$276 this is below the lifecycle cost per unit of \$281.5 You will therefore need to look at ways of reducing your lifecycle costs by \$5.50 (the drift cost) or accept an ROS of 18.41%.

Customer-driven cost for the Blueberry phone is \$412 this is greater than the lifecycle cost per unit of \$408. You do not need to reduce the lifecycle cost of Blueberry phones and with current cost (lifecycle report) the blueberry phone will achieve a ROS of 20.77%.

Alternatively, the blueberry phone could be priced lower than expected and thus be more competitive in the highly competitive phone market this may allow Blueberry phones to gain more market

shares - thus becoming more profitable (Initial analysis of Blueberry phone sales reveals that it has not been as profitable as Billie was expecting)

Compares and contrasts the lifecycle and customer-driven financial information in parts (b), (c) and (d) and the Table 1. Lifecycle Report for the Blueberry phone. Specifically comment on and explain the difference in profitability of the two phones.

B. Lifecycle Report

>We can observe from the life cycle report that Blueberry phones have a higher investment in research and development 34.3% than Raspberry phones 17.05%. This means that berry phone has made significant investment into ensuring a strong differentiation strategy for Blueberry phones and a Cost leadership strategy for Raspberry phone.

>It is unusual for raspberry and blueberry phones to have the same expected quantity sold of 1000. From the implemented strategy used for each product we should expect Blueberries phone to have a higher cost and a higher selling price but lower number of sales whereas Raspberries phone should have a lower cost and price but a higher number of sales.

>Raspberry phones have a higher ratio of marketing cost when compared to Blueberry phones, this is again indicative of the different strategy the team has used for each product. For raspberry phones that are competing in a more competitive market (products more similar) it is important to use marketing to gain market shares.

>Higher investment in research and development tends to decrease customer service cost later (more satisfaction with function of product), we may observe that Raspberry phones may have a higher Customer service cost than budgeted by the lifecycle report.

>From life cycle costing we can observe that Raspberry phones are more profitable than Blueberry phones when using the price set by Berry Phones.

C. Lifecycle cost and profit

>Blueberry lifecycle cost is \$408 and profit is \$92 per unit and Raspberry lifecycle cost is \$281.5 and profit is \$93.5 per unit.

>Blueberry phones have a higher cost overall as a lot of investment is required during the research and development phase, this is indicative of Berry phone differentiation strategy used for the blueberry phone that competes using its unique characteristics.

>Regardless of its higher price Blueberry phones are less profitable than Raspberry phones due to the higher cost associated with developing the blueberry phone.

D.

>The team at Berry phone has overestimated the cost of Raspberry phone (lifecycle priced at \$375 whilst market priced at \$345) and Underestimated the cost of Blueberry phones (lifecycle priced at \$500 whilst market priced at \$515).

>To be effective in entering the market Berry phone will therefore need to look at ways of reducing the lifecycle costs by \$5.50 (the drift cost) for raspberry phones.

>It also has the option to increase the price of its Blueberry phones as customers are willing to pay \$515 for blueberry phones or maintain cost for a higher ROS.

RECOMMENDATIONS

Makes final recommendations, with supporting reasons, regarding what price Berry-Phones should charge for the Blueberry and Raspberry phones; whether Berry-Phones should change its general approach to costing phones; and how the profitability of future phone products might be improved.

Berry phone should charge the market price for phones at \$345 for Raspberry phones and \$515 for Blueberry phones.

Blueberry phone sales has not been as profitable as expected this is likely due to the product differentiation strategy used for the product which is associated with a higher selling price and lower selling quantity. Because the blueberry phone has been underpriced Berry phone has been missing out on potential profit.

The team should look into decreasing drift cost for raspberry phones before introducing it to the market as the current price is above the market determined price. As the product has already been designed the team would look into using Kaizen costing to reduce the drift cost of \$5.50 per

unit during the manufacturing phase. This may be achieved by using the value chain to determine opportunities to reduce cost with manufacturer/buyers by seeking mutually beneficial process improvements.

Berry phones should use Target costing (determining the target market price and cost that needs to be achieved in order to price the good or service competitively) in the future it would prevent disappointment in profitability when introducing a product to the market. The current strategy has caused lost in profitability due to underpricing of blueberry phones and may have negatively effected profits by overpricing raspberry phones.