Target Costing

1. The following statements have been made about target costing.

   (1) Target costing makes the business look at what competitors are offering at an early stage in the new product development process.

   (2) Cost control is emphasised at the new product design stage so any engineering changes must happen before production starts.

   Which of the above statements is/are true?

   A 1 only
   B 2 only
   C Neither 1 nor 2
   D Both 1 and 2

2. Given the following information, what is the target cost gap for product X?

Product X target selling price per unit	$10
Target profit	25% on cost
Current cost	$8.40 per unit

   A $0.40
   B $0.60
   C $0.90
   D $1.60

3. The following statements have been made about target costing.

   (1) Target costing is not well-suited for services that have a large fixed cost base.
   (2) Costs may be reduced in target costing by removing product features that do not add value.

   Which of the above statements is/are true?

   A 1 only
   B 2 only
   C Neither 1 nor 2
   D Both 1 and 2

Question 3

Great Games, a manufacturer of computer games, is in the process of introducing a new game to the market and has undertaken market research to find out about customers' views on the value of the product and also to obtain a comparison with competitors' products. The results of this research have been used to establish a target selling price of $60. This is the price that the company thinks it will have to sell the product to achieve the required sales volume.

Cost estimates have been prepared based on the proposed product specification.

Manufacturing cost	$
Direct material	3.21
Direct labour	24.03
Direct machinery costs	1.12
Ordering and receiving	0.23
Quality assurance	4.60
Non-manufacturing costs	
Marketing	8.15
Distribution	3.25
After-sales service	1.30

The target profit margin for the game is 30% of the target selling price.

Required

Calculate the target cost of the new game and target cost gap.

Question 4 – Life Cycle Costing

Fit Co specialises in the manufacture of a small range of hi-tech products for the fitness market. They are currently considering the development of a new type of fitness monitor, which would be the first of its kind in the market. It would take one year to develop, with sales then commencing at the beginning of the second year. The product is expected to have a life cycle of two years, before it is replaced with a technologically superior product. The following cost estimates have been made.

	Year 1	*Year 2*	*Year 3*
Units manufactured and sold		100,000	200,000
Research and development costs	$160,000		
Product design costs	$800,000		
Marketing costs	$1,200,000	$1,000,000	$1,750,000
Manufacturing costs:			
Variable cost per unit		$40	$42
Fixed production costs		$650,000	$1,290,000
Distribution costs:			
Variable cost per unit		$4	$4.50
Fixed distribution costs		$120,000	$120,000
Selling costs:			
Variable cost per unit		$3	$3.20
Fixed selling costs		$180,000	$180,000
Administration costs	$200,000	$900,000	$1,500,000

Note. You should ignore the time value of money.

Required

(a) Calculate the life cycle cost per unit. **(6 marks)**

(b) Briefly discuss the benefits of life cycle costing for pricing, performance management and decision-making. **(4 marks)**