What is Special Order Pricing?

Worksheet

A special order should be accepted if the special price exceeds the variable cost per unit and any additional fixed costs specific to the order, generating positive incremental profit - assuming excess capacity and no effect on regular sales.

Questions

1. Special price $20/unit, variable cost $14/unit, order of 1,000 units, no extra fixed cost. Incremental profit?

A) $4,000
B) $6,000
C) $14,000
D) $20,000

2. Using the same numbers, but $2,000 in extra fixed costs are required. New incremental profit?

A) $2,000
B) $4,000
C) $6,000
D) $8,000

3. What must be true for a company to safely apply special order pricing?

A) It has excess/idle capacity
B) It is operating at full capacity
C) The order price exceeds normal price
D) Fixed costs will increase substantially

4. A special order's incremental profit is negative. What should the company do?

A) Accept it anyway for volume
B) Reject the order
C) Raise the special price after accepting
D) Ignore variable costs

5. A company has idle capacity and can accept a special order of 2,000 units at $18/unit. Variable cost is $12/unit, and the order requires no extra fixed costs. Should it accept?

6. Same offer, but accepting requires renting special equipment for $5,000.

7. A buyer offers $10/unit for 3,000 units. Variable cost is $12/unit, no extra fixed cost. Should the company accept?

8. Define: What is the key condition for special order pricing to apply?

9. Define: What cost is usually ignored in special order decisions?

10. Define: What's the accept/reject rule?

Answer Key

1. B) $6,000 - (2014)1,000 = 6,000.

2. B) $4,000 - 6,000 2,000 = 4,000.

3. A) It has excess/idle capacity - Without idle capacity, the order would displace regular, full-price sales.

4. B) Reject the order - A negative incremental profit means the order would reduce overall profit - reject it.

5. Incremental profit = (1812) 2,000 0 = 6 2,000 = 12,000 Since profit is positive ($12,000), accept the special order.

6. Incremental profit = (1812) 2,000 5,000 = 12,000 5,000 = 7,000 Still positive, so still accept - but profit falls to $7,000.

7. Incremental profit = (1012) 3,000 0 = 2 3,000 = 6,000 Negative result - reject the special order, it would lose $6,000.

8. The company must have idle/excess capacity so the order doesn't displace regular sales.

9. Fixed costs already being incurred regardless of the order (only additional/avoidable fixed costs count).

10. Accept if incremental revenue exceeds incremental (relevant) costs, i.e., incremental profit is positive.