What is Target Costing?

Worksheet

Target costing determines the maximum allowable cost of a product by subtracting the desired profit margin from the target selling price: Target Cost = Target Selling Price Desired Profit.

$$\text{Market Price} - \text{Desired Profit} = \text{Target Cost}$$

Questions

1. Target selling price is $150, desired profit is $30. What is the target cost?

A) $180
B) $120
C) $150
D) $30

2. Target costing starts with:

A) The factory's current production cost
B) The market price customers will pay
C) The CEO's desired salary
D) Last year's total expenses

3. If actual production cost is higher than the target cost, the company should:

A) Raise the price immediately
B) Ignore the gap
C) Apply value engineering to reduce cost
D) Increase profit margin

4. Target costing is best described as:

A) Cost-plus pricing
B) Market-driven cost planning
C) A tax accounting method
D) A depreciation schedule

5. A tablet maker wants to sell a new tablet for $300 and needs a $60 profit per unit. What is the target cost?

6. A car company sets a target price of $25,000 and requires a 15% profit margin on that price. Find the target cost.

7. A toy manufacturer's current production cost is $18, but the target cost calculated from market price is $14. What must happen?

8. Define: What is the target costing formula?

9. Define: What drives the price in target costing?

10. Define: What happens if actual cost exceeds target cost?

Answer Key

1. B) $120 - TC = 150 30 = $120.

2. B) The market price customers will pay - It's market-driven - the price comes first, then cost is derived.

3. C) Apply value engineering to reduce cost - Value engineering redesigns the product/process to close the cost gap.

4. B) Market-driven cost planning - It plans cost around a market-set price and desired profit, unlike cost-plus pricing.

5. TSP = $300 DP = $60 TC = TSP DP = 300 60 = $240

6. DP = 15% 25,000 = $3,750 TC = TSP DP = 25,000 3,750 = $21,250

7. Cost gap = current cost target cost = 18 14 = $4 This $4 must be eliminated through value engineering (materials, design, process) If it can't be closed, the product may not be launched at the planned price

8. Target Cost = Target Selling Price Desired Profit.

9. The market - what customers are willing to pay, not internal cost-plus markup.

10. The team applies value engineering to redesign the product and close the gap.