Full cost verses marginal cost

Definition:

Full cost pricing is a practice where the price of a product is calculated by a firm on the basis of its direct costs per unit of output plus a markup to cover overhead costs and profits. The overhead costs are generally calculated assuming less than full capacity operation of a plant in order to allow for fluctuating levels of production and costs.

Context:

Full cost pricing is often used by firms as it is very difficult to calculate the precise demand for a product and establish a market price. Empirical studies indicate that full cost pricing methods are widely employed by business firms.

What is a full cost pricing?

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marginal-cost pricing, in economics, the practice of setting the price of a product to equal the extra cost of producing an extra unit of output. By this policy, a producer charges, for each product unit sold, only the addition to total cost resulting from materials and direct labour.

marginal-cost pricing, in economics, the practice of setting the price of a product to equal the extra cost of producing an extra unit of output. By this policy, a producer charges, for each product unit sold, only the addition to total cost resulting from materials and direct labour. Businesses often set prices close to marginal cost during periods of poor sales. If, for example, an item has a marginal cost of $1.00 and a normal selling price is $2.00, the firm selling the item might wish to lower the price to $1.10 if demand has waned. The business would choose this approach because the incremental profit of 10 cents from the transaction is better than no sale at all.

In the mid-20th century, proponents of the ideal of perfect competition—a scenario in which firms produce nearly identical products and charge the same price—favoured the efficiency inherent in the concept of marginal-cost pricing. Economists such as Ronald Coase, however, upheld the market's ability to determine prices. They supported the way in which market pricing signals information about the goods being sold to buyers and sellers, and they observed that sellers who were required to price at marginal cost would risk failing to cover their fixed costs

administered price, price determined by an individual producer or seller and not purely by market forces. Administered prices are common in industries with few competitors and those in which costs tend to be rigid and more or less uniform. They are considered undesirable when they cause prices to be higher than a competitive standard, when they are accompanied by excessive non-price competition (efforts to

increase sales without enhancing the value of the product), or when they add to inflationary tendencies—either by failure to lower prices in response to cost reductions or by increasing prices to maintain a given margin of profit in the face of rising costs.

Full-cost pricing is a common strategy that factors the entire overhead into the product pricing, while marginal cost pricing is designed to move inventory without necessarily turning a profit. Both approaches are useful under the right circumstances, and each serves an entirely different purpose for the business.

Marginal-Cost Pricing Strategy

Marginal pricing is designed to move inventory quickly. The pricing strategy places the price right at the margin. In some cases, pricing just ahead of the margin is also considered a marginal-cost pricing strategy.

When the price and margin are the same, there is no profit left over for the business. This strategy is unsustainable and is designed primarily to move old inventory off the shelves. It recovers the initial overhead cost incurred against that inventory so the store can acquire new product to price with a profitable strategy.

Most margin-cost pricing occurs during year-end sales and other sales or when an updated product is released. For example, when a new phone model is released, retailers may price the older model phones on a marginal cost to move them out and make room for the new models.

This pricing strategy is not used frequently, and it exists solely to push inventory out the door when turnover is needed in the business.

Full-Cost Pricing for Profits

Full-cost pricing strategies are designed to return a maximum yield profit. In many pricing strategies, the product margins are set against the overhead for each individual unit. For example, if a unit costs $5 to acquire, the price is set against this cost.

Full-cost pricing, however, incorporates the entire business overhead into the pricing strategy. The same $5 unit is priced based on the acquisition plus the necessary business overhead costs such as retail space and electricity. The price is based on the entire or full cost of the efforts that are used to sell the unit.

The full cost is distributed across all the inventory throughout the entire year or individual sales event. If a business is selling crafts at a fair, it distributes the price of booth space and

transportation across the inventory being sold through the booth. The costs are absorbed by the customer using this method.

Other Common Pricing Strategies

Full-cost pricing is effective for maximizing yield while ensuring all business costs are accounted for in the sales process. The strategy does not account for competitive pricing, however. When one business is using a full-cost pricing strategy and a competitor selling similar products undercuts its pricing, the ability to move inventory becomes increasingly difficult.

Full-cost pricing is ideal when competition is limited, and control over pricing is acceptable. In a highly competitive market, however, margins are often reduced, and pricing is based on turning over more inventory on a smaller margin with the hopes of making back the overhead. That overhead is not accounted for in the pricing model.

The exception to this rule occurs with a luxury-based pricing strategy. This entails a higher price point despite having a similar product to competitors with much lower prices. The idea with a luxury-pricing model is that value is attached to the brand. In this case, the business is selling its brand or a higher level of warranty and service to justify the additional costs.

Welfare Effects of Monopoly

Nobody likes monopolies. We all have an intuitive sense that monopolies are "bad". But what's the economic argument against monopolies, and what can we do about them? In Lecture Note 3, we saw an equation for the monopoly's price markup: $p * - MC\ MC = - 1\ 1 + \varepsilon$ As long as ε 6= $-\infty$, a monopolist charges a markup over marginal cost. Unlike a price-taking firm, a monopoly has market power—the ability to set a price above marginal cost without losing all of its customers. When a monopolist exercises market power, society is worse off. • By cutting back on output, a monopoly can drive up the price. • Doing so is profit-maximizing, up to a certain point. • We therefore see higher prices and lower quantities under monopoly than under perfect competition: $pm > pc$ and $Qm < Qc$. • As a result, some socially desirable transactions don't happen. These missing trades are missed opportunities to expand the economic pie. Defining total surplus as the sum of consumer and producer surplus, we'll see that monopoly reduces total surplus: producer surplus goes up, but consumer surplus falls by even more. This creates deadweight loss. Note: in addition to "total surplus", I sometimes use the terms "social welfare" or "social surplus". All of these terms mean the same thing. Also: whenever we have either taxes or subsidies, we redefine total surplus as the sum of consumer surplus, producer surplus, and the government's net budget surplus (tax revenue collected minus subsidies given out).

Why is welfare economics important?

Welfare economics are focusing on the optimal allocation of resources and goods and how it affects individual in society. Welfare economics related to public goods which implies anything from a group of individuals to a locality or region, country or group of countries.

How does welfare affect the economy?

Government economic security programs such as food assistance, housing subsidies, and working-family tax credits — which bolster income, help families afford basic needs, and keep millions of children above the poverty line — also have longer-term benefits, studies find: they help children to do better in school and

What are the benefits of welfare?

- A social welfare system provides assistance to individuals and families in need. ...
- Available benefits generally cover assistance for food, housing, child care, and medical care. ...
- Some available housing benefits go beyond locating suitable and affordable properties and providing housing cost assistance.

What is social welfare PDF?

• Social welfare is the condition or well being of a society. • It can be considered as a state or condition of human. well-being that exists when social problems are managed, when human needs are met and when social opportunities are maximized.
High monopoly prices lead to a deadweight loss of consumer welfare because output is lower and price higher than a competitive equilibrium. High prices mean some consumers are priced out of the market because of a fall in effective demand.