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Understanding TARGET COSTING in Simple Terms

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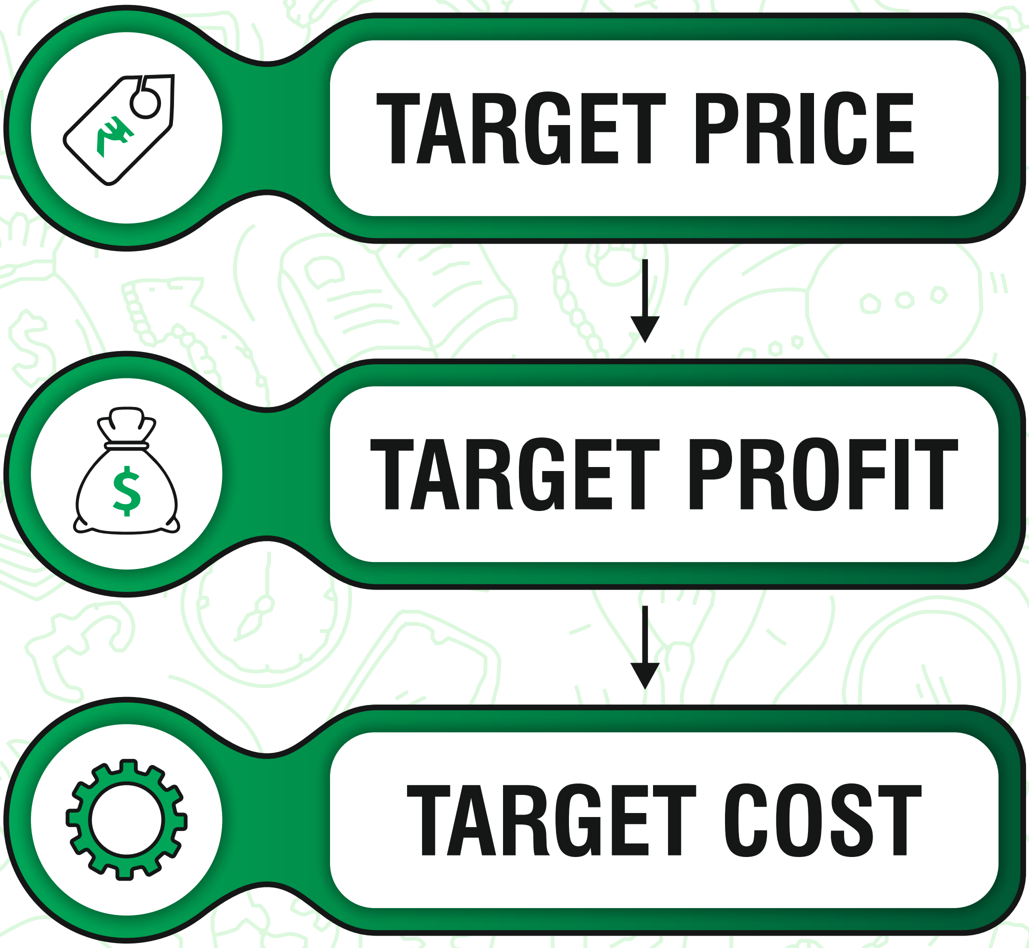

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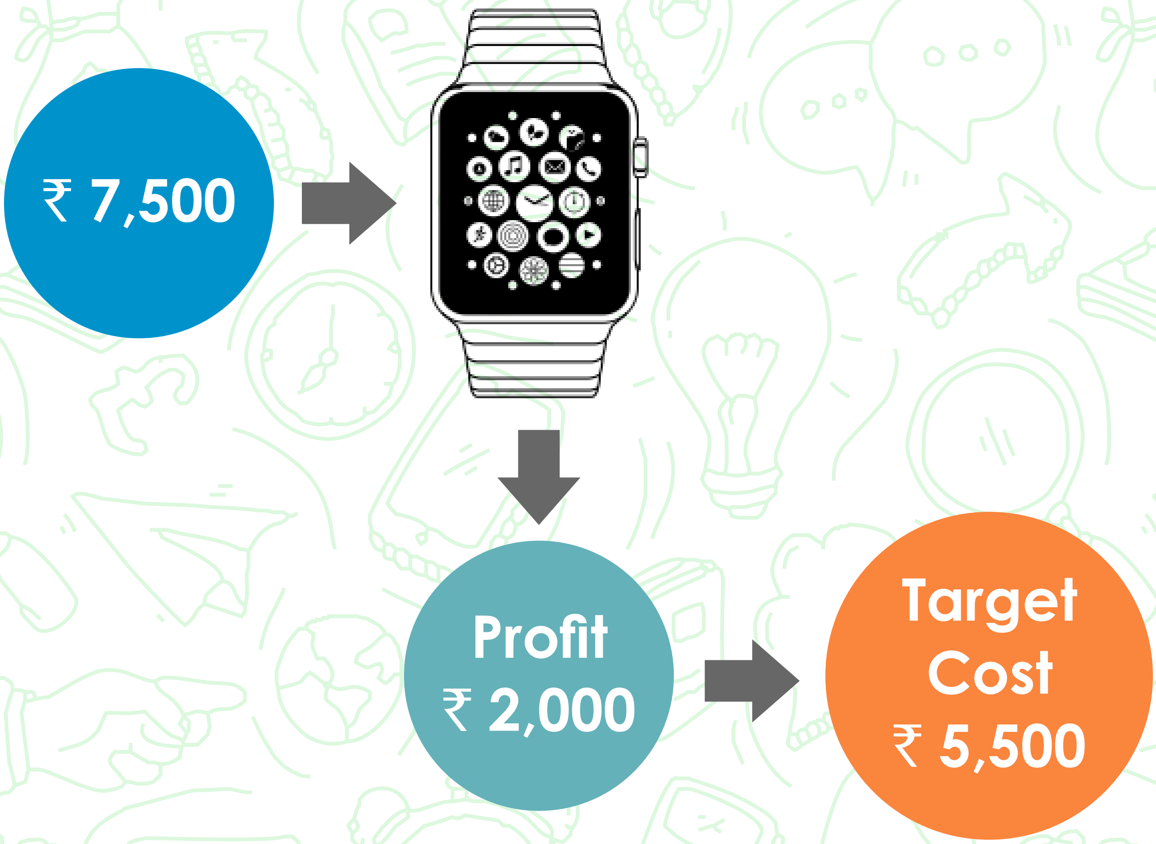
What is Target Costing ?

A process in which businesses plan the costs of a new product along with pricing strategies and profit margins for each transaction.

Example of Target Costing.

Suppose your company is about to introduce its new smartwatch in the market.

Your Objective is to sell the item at ₹7,500 with a desired profit of ₹2,000.



Example of Target Costing.

That means :

The **calculation for target cost** requires deducting the desired profit from the selling price.

= ₹7,500 - ₹2,000 = ₹5,500

After designing and manufacturing your watch, your target price should be less than 5,500.

That's Target Costing. Price makes the starting point, while cost comes later.

Formula of Target Costing.

Here's the 3-step formula :

1. **Target Price** (what the customer is willing to spend).
2. **Target Profit** (what you want to earn from the product).
3. **Target Cost** (what you can spend making it).

So instead of asking "how much will this cost ?", ask :

"How much should this product cost to generate business profits ?"

Target Price (₹) – Target Profit (₹) = Target Cost (₹)

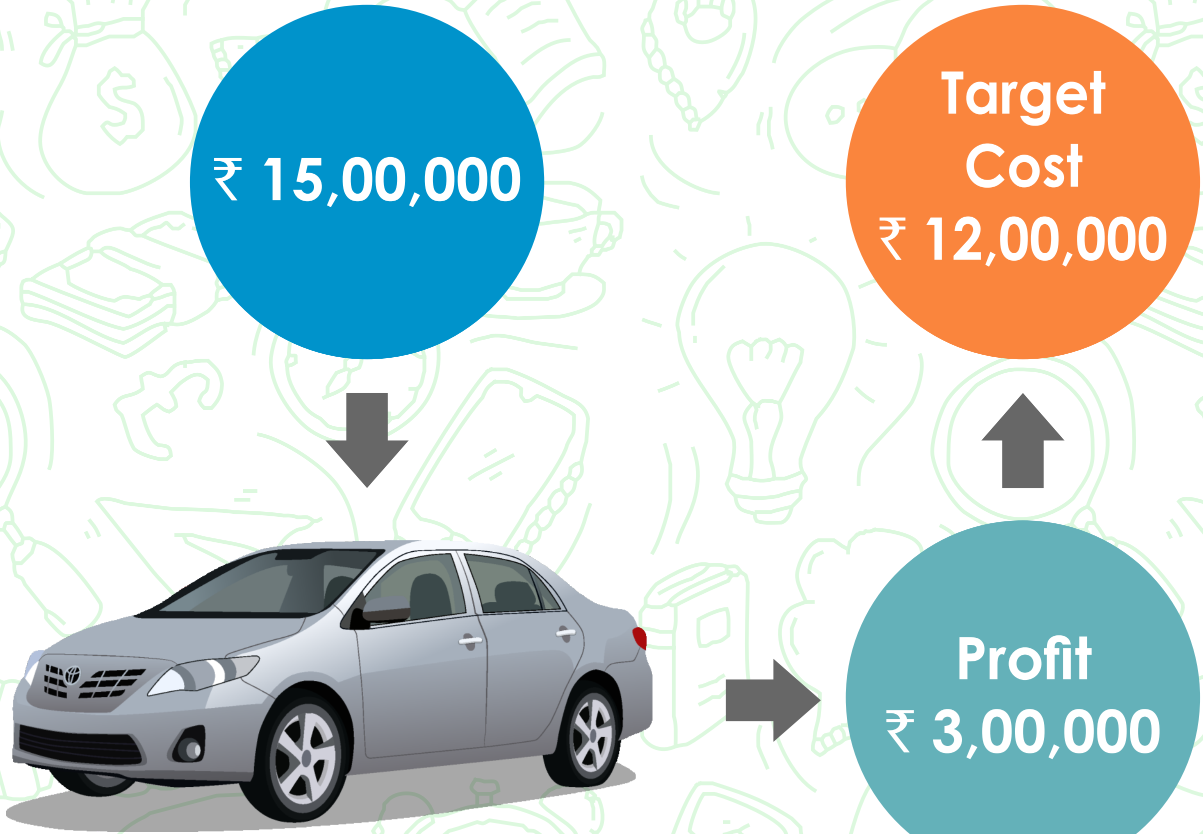
Old mindset: "How much will it cost?"

New mindset: "How much should it cost?"

Real Life Example - Toyota

Objective : To Sell a car at ₹15,00,000 with a ₹3,00,000 profit.

Target Cost Formula :
Selling Price - Desired Profit = Target Cost
₹15,00,000 - ₹3,00,000 = ₹12,00,000

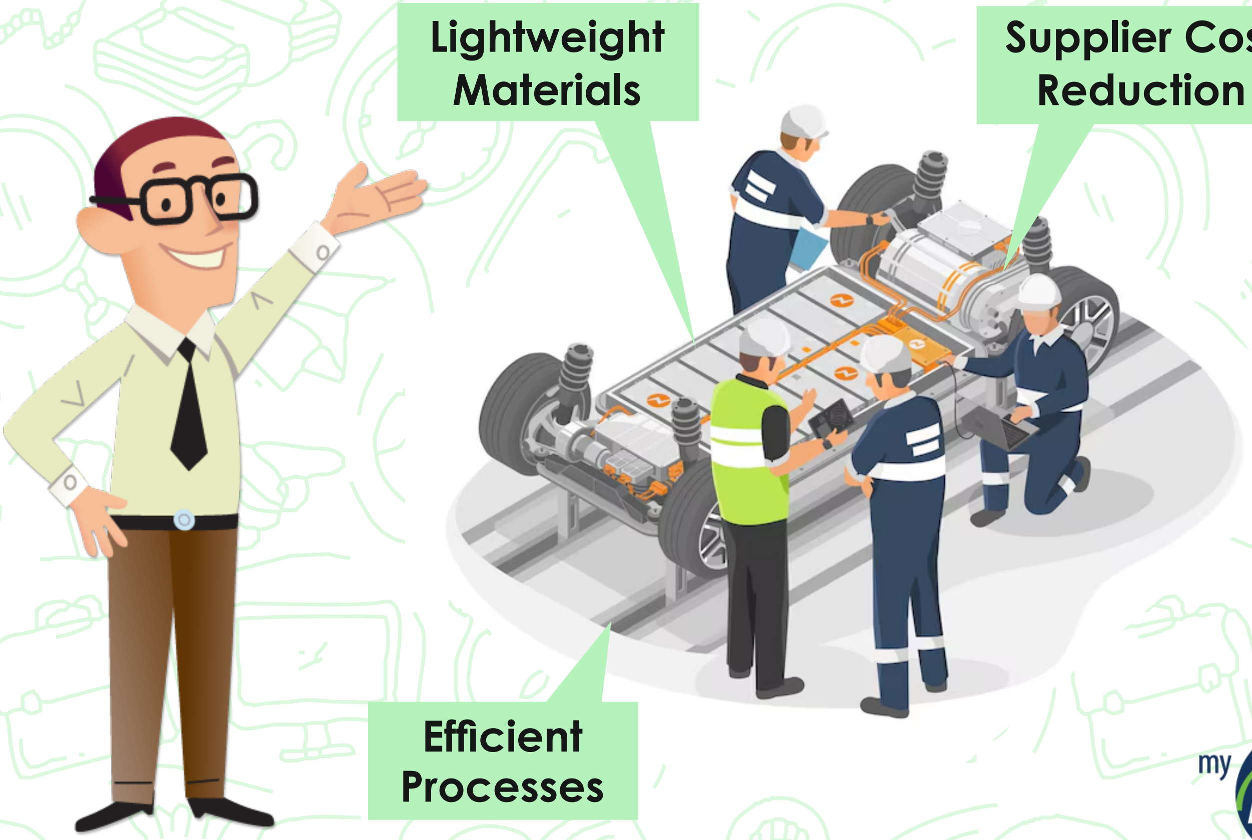


Real Life Example - Toyota (Execution)

Engineers team up with suppliers to create a vehicle which costs ₹12,00,000.

Cost reduction Initiatives: Lightweight materials, Efficient manufacturing procedures, & Supplier Cost Reduction

Ensures affordability without compromising quality.



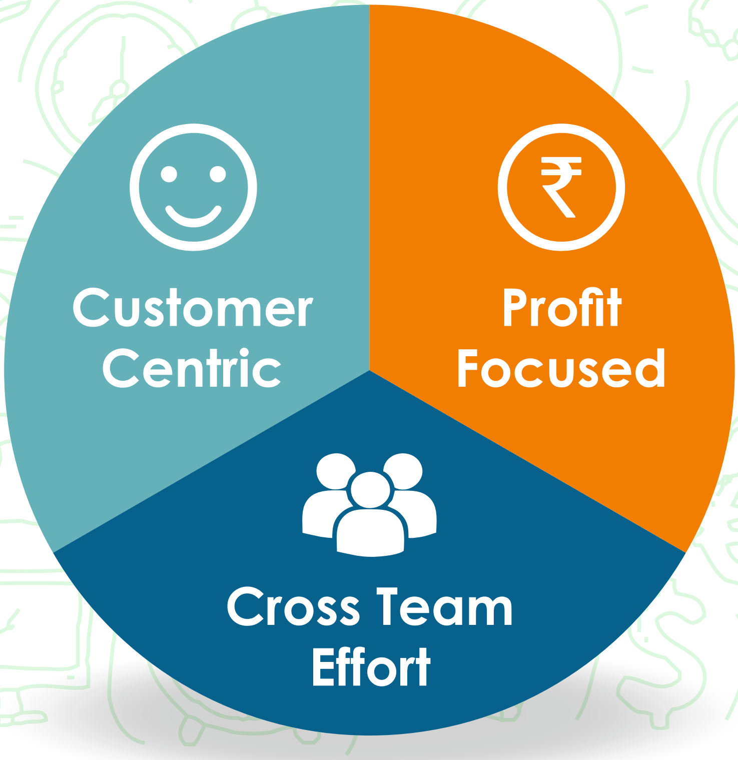
Real Life Example - Toyota

Benefits for Toyota :

Customer-Centric : Price structures at Toyota follow what customers are willing to pay in the market.

Profit-Focused : Guarantees margins by controlling costs.

Cross-Team Effort : Design, finance, and suppliers work together.



Objective of Target Costing

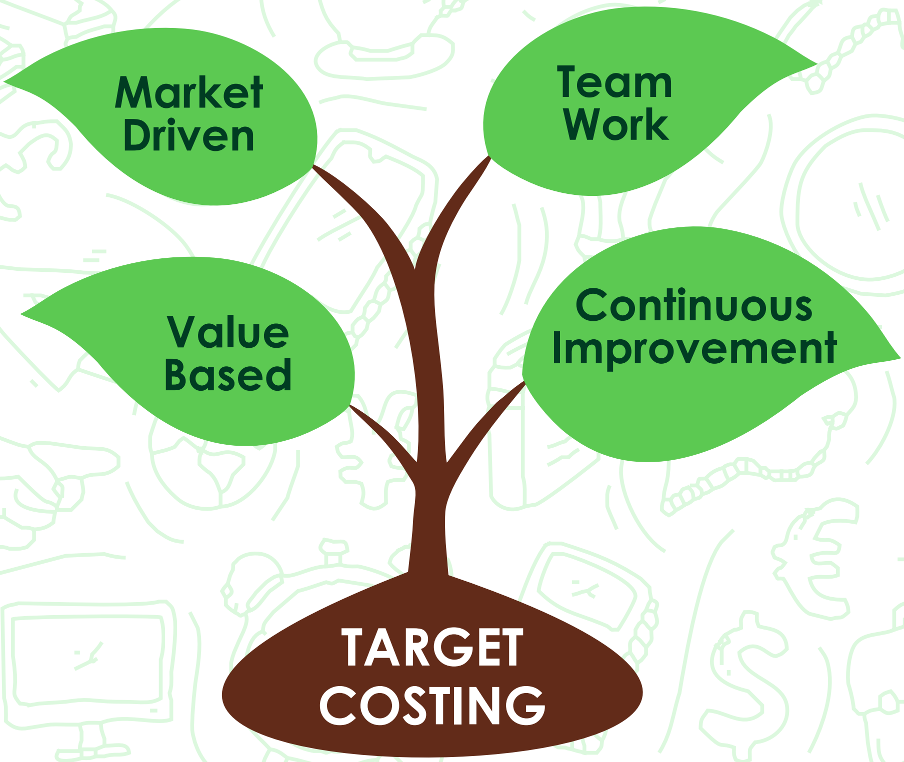
Why do companies use this ?

1. Offer affordable products.
2. Stay profitable in competitive markets.
3. Avoid cost overruns.
4. Keep customer needs first.
5. Companies should integrate design, finance, & marketing together from DAY 1.

The concept involves both **cost-saving measures & effective pricing strategies**.

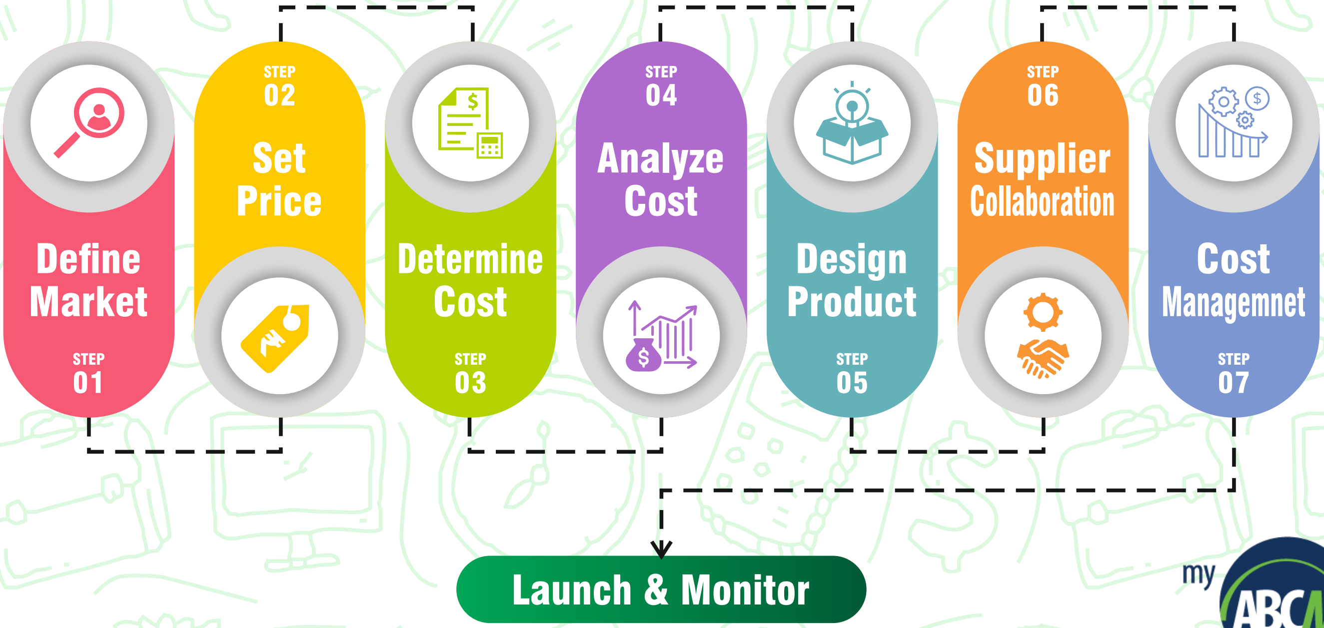
Principles of Target Costing

1. Market Driven.
2. Customer is the boss.
3. All teams work together.
4. Continuous Improvement.
5. Start early, Save more.
6. Value-Based.
7. Flexibility & Adaptability.



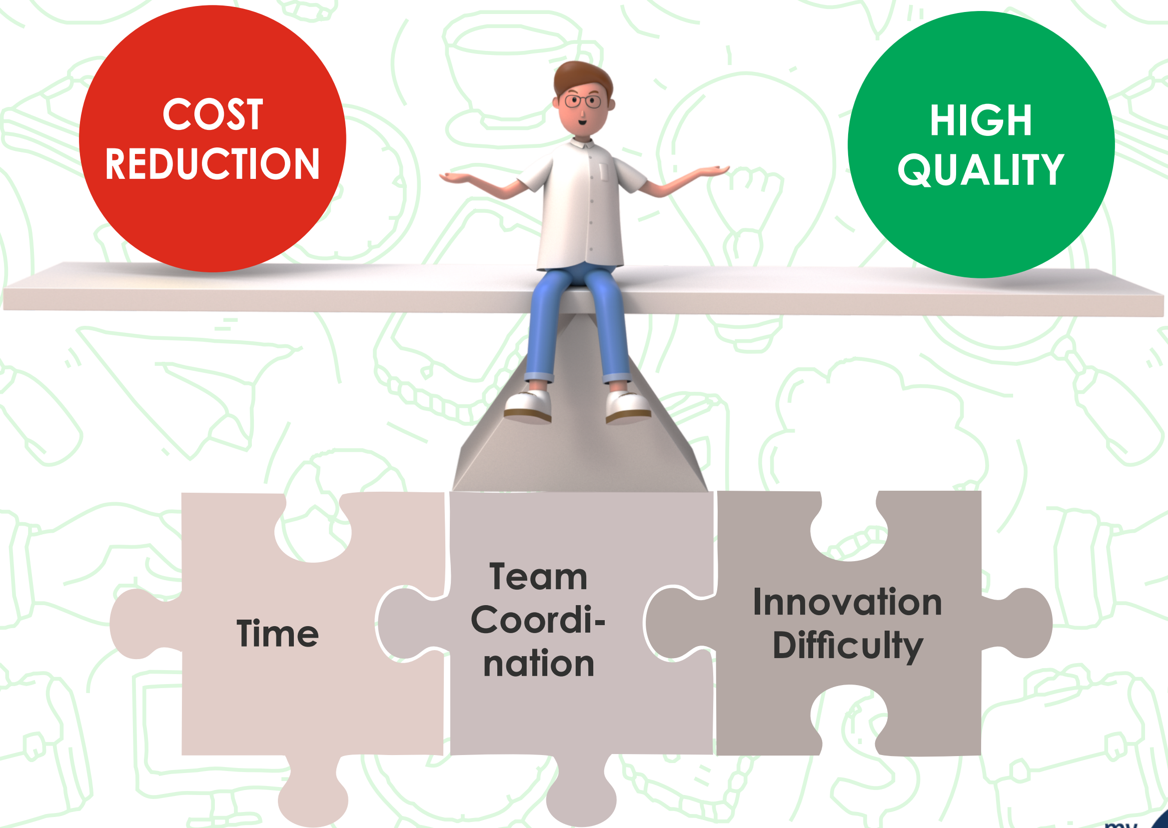
Process of Target Costing

1. Define Market Requirements.
2. Set Target Selling Price.
3. Determine Target Cost.
4. Conduct Cost Analysis.
5. Design and Development.
6. Collaborate with Suppliers.
7. Implement Cost Management Strategies.
8. Finalize Product Cost & Pricing Strategy.
9. Launch & Monitor Performance.



What are the Challenges of Target Costing?

1.
2. Cost Reduction becomes challenging when quality standards need to remain high.
3. Needs strong coordination between teams.
4. Not ideal for new, innovative products.
5. Takes time.



Traditional Costing vs. Target Costing

POINT OF DIFFERENCE	TRADITIONAL COSTING	TARGET COSTING
Starting Point	Product is designed first	Market price is studies first
Formula	Cost + Profit = Price	Price - Profit = Target Cost
Market Focus	Less market - Focusred	Strong market and customer focus
Cost Control	After product is made	From the beginning of product design
Team Involvement	Mostly production & finance	Cross functional (design, marketing, etc.)

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