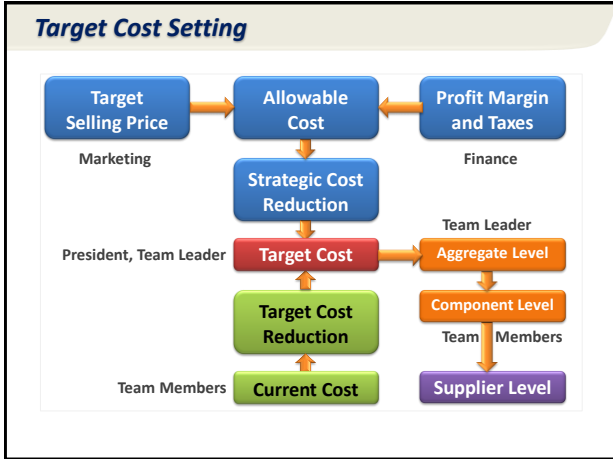


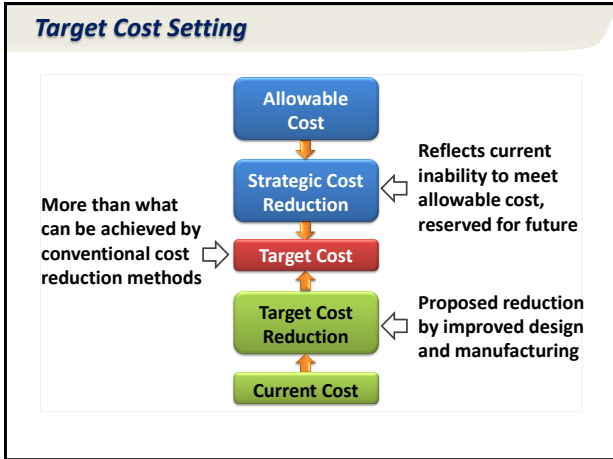
### Design to Cost - Philosophy

- Conventional approach:**
  - $Actual\ costs + Profit = Price$
  - Minimize the costs to the extent possible
  - Fuzzy goal, no clear measure of success
- Target Costing approach:**
  - $Target\ price - Target\ profit = Allowable\ cost$
  - Set and achieve a specific level of cost reduction by iterative design of product and its manufacturing process



### Allowable and Current Cost

- Allowable cost** (cost at which customers will buy the product)
  - = target selling price – target profit margin
  - (sales tax + excise duty + cess) – (dealer margin + freight)
  - warranty provision – (selling + promotion expenses) / units
- Current cost** (cost at which the product can be currently produced, with existing level of technology, facilities and manpower).
  - = material costs + conversion costs + development costs + depreciation on new equipment



### Example

	ITEM	Rs.
1	Target price (cost to customer)	300,000
2	Sales tax, excise duty, freight, dealer margin	57,000
3	Warranty provision	3,000
4	Target profit margin	30,000
5	Product level allowable cost	$[1 - (2+3+4)]$ 210,000
6	Strategic cost reduction challenge	$[7-5]$ 5,000
7	Product level target cost	215,000
8	Target cost reduction objective	$[9-7]$ 10,000
9	Current cost (based on detailed estimation)	225,000

*This example is based on old data from a leading tractor manufacturer*

**Example**

10	Product level target cost	[7]	215,000
11	Product level target cost reserve	[10-(12+13+14+15)]	4,000
12	Product development expenses		8,000
13	Depreciation on additional facilities		5,000
14	Aggregate level target cost for A1	[16+17+18+...]	100,000
15	Aggregate level target cost for A2		98,000
16	Component level target cost for C1 in A1	[19+20]	1,200
17	Component level target cost for C2 in A1		300
18	Component level target cost for Cn in A1		500
19	Material cost for component C1		920
20	Conversion cost for component C1		280

**SUMMARY**

- Target costing approach: work backward from market price
- Plan specific quantum of reduction: immediate, future
- Key step: set the target cost from allowable and current cost
- Identify opportunities for cost reduction