

Unit contribution margin

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What is unit contribution margin? Unit contribution margin is the dollar quantity that a product's selling price exceeds its total variable cost.

Unit contribution margin = Sales Price Per Unit - Total Variable Cost Per Unit

How is it used in computing the unit breakeven point?

At break-even point, the Cost-Volume-Profit analysis equation is reduced to:

$$PX = xv + FC$$

Where p is the price per unit, x is the number of units, v is the variable cost per unit, and total fixed cost is FC .

Solving the equation for Break-even sales units

$$\text{Break-even Sales Units} = x = FC \div (p - v)$$

Since unit contribution margin (Unit CM) is equal to unit sale price (p) less unit variable cost (v) thus,

$$\text{Unit CM} = p - v$$

Hence,

$$\text{Break-even Sales Units} = x = FC \div \text{Unit CM}$$

$$\text{Break-even Sales Dollars} = \text{Price per Unit} \times \text{Break-even Sales Units}$$

; or

What is contribution margin ratio and when is it most useful?

The contribution margin ratio is the measure of sales, facility returns or selling price that residues after all variable costs and variable costs have been enclosed.

$$\text{Contribution margin ratio} = (\text{Sales} - \text{variables}) / \text{sales}$$

Contribution margin ratio plays a key role in;

Determining the profits that will rise from several sales levels

Assessing the influence on earnings of changes in sales. In particular, it can

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be used to estimation the decline in profits if sales drop, and so is an standard tool in the making of budgets.

How is the breakeven equation modified to take into account the sales required to earn a target profit?

Breakeven equation is found from the profit equation by substituting the profit side by zero.

$$SPx - VCx - FC = 0$$

To derive the target income from the break even equivalence we replace the zero value of the particular side with profit boundary and many board gain to fixed cost;

$$SPx - VCx - TFC = \text{Profit}$$

Suppose two companies are the same except that company A has more variable costs than fixed costs. Company B has more fixed costs than variable costs. When sales increase, which company will realize the greatest increase in profits?

Company A will realize more profits compared to B.

Reference

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