Accounting

[Finance](#)

There are two proposed pricing strategies outlined in the case study detailing as to how the transfer pricing between divisions may take place in case one division deals with another division.

Reading Company's overall price quote is based upon charging full price less of variable selling and distribution expenses. This is approximately $11. 80 per unit however; it is greater than the bid price of $7. 60 as prepared by Millwall. Under this arrangement, if Reading accepts the proposal of Millwall, it may be incurring a loss of $4. 12 per unit. The calculations are as under:

Selling Price offered by Reading = $11. 80 per unit

Counter offer made by Millwall = $7. 68 per unit

Total Difference = $4. 12 per unit

If Reading takes up this option, it may face a per unit loss of $4. 12 however, increased number of orders from Millwall can result into better utilization of its excess capacity. In order to consider this option, Reading therefore may need to assess as to whether the overall revenue and profitability of the division will increase if this transaction is carried out.

The key influence of this on the attitude of Reading on intra-company business will therefore be reshaped by the way its profitability as well as the revenue is increased besides registering a substantial increase in the overall capacity.

Another important aspect of this whole transaction may be based on the assumption that during the intra-company business, Reading may not have to incur any selling expenses therefore this may result into substantial savings for it in terms of cost reduction.

If Reading adapts the second option of charging the standard full manufacturing cost plus 15%, as proposed by the Finance Manager, the overall loss will be approximately $1. 68 per unit. The calculations are as under:

Selling Price offered by Reading = $11. 80 per unit

Offer made by Finance Director = $10. 12 per unit

Total Difference = $1. 68 per unit

The above option therefore suggest that adapting the option of standard manufacturing cost plus mark-up can certainly reduce the overall per unit loss when compared with the market price of the component. This option clearly reduces the loss per unit for Reading (if compared with the market price of the component) therefore adapting such option may offer more leverage to Reading in terms of its ability to further increase its profitability while at the same time reducing the costs. If this option is carried out, Reading will further be able to sell its variable selling expenses therefore this cost reduction may further allow to become more profitable.

It is also important to note that the overall selling price of the component, as offered by Reading, is $13. 00 therefore if compared with the original market selling price, the per unit loss will be $2. 88. This will however, be lower than the loss which could be incurred under first option.

Considering above, the suggestions proposed by the Finance Manager therefore may significantly increase the overall profitability for the firm while at the same time increasing the capacity utilization.