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Pricing Sale Proposal for a Micro Retail Company Based in Absorption Costing

¹Aline Rachadel de Souza, ²Fabiano Maury Raupp, ³Everton Luis Pellizzaro de Lorenzi Cancellier

¹Graduate in Administration from the School of Administration and Management of Santa Catarina State University (ESAG / UDESC). Address: Santa Catarina State University, School of Administration and Management. Av. Madre Benvenuta, 2037 - Centro - CEP 88035-001, Florianópolis, Santa Catarina, Brazil.

²Doctor in Business Administration from the School of Administration of the Federal University of Bahia (EA / UFBA), Adjunct Professor of the School of Administration and Management at Santa Catarina State University (ESAG / UDESC). Address: Santa Catarina State University, School of Administration and Management. Av. Madre Benvenuta, 2037 - Centro - CEP 88035-001, Florianópolis, Santa Catarina, Brazil.

³Doctor in Business Administration from the Faculty of Economics, Business and Accounting of the University of São Paulo (FEA / USP), Adjunct Professor of the School of Administration and Management at Santa Catarina State University (ESAG / UDESC). Address: Santa Catarina State University, School of Administration and Management. Av. Madre Benvenuta, 2037 - Centro - CEP 88035-001, Florianópolis, Santa Catarina, Brazil.

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ABSTRACT

The study aims to compare the selling price due to the cost structure of a micro enterprise in the retail sector, in the real estate and automotive paints, with the price currently charged by the organization. To do so, we performed a descriptive, through a case study with predominantly qualitative approach. Data collection was made through interviews, document analysis and direct observation. The method chosen to structure the calculation of cost of goods and subsidize the training of the sales price was the absorption costing no departmentalization. It was observed that the lack of the actual cost structure of the company led the owners to making selling prices not compatible with the costs incurred by the company. It is believed that the choice of a simpler method of funding can support the company to maintain its control of costs in a long-term horizon.

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INTRODUCTION

According to the National Confederation of Commerce (CNC), data from the Ministry of Development, Industry and Foreign Trade (MDIC), published in 2008, revealed that the tertiary activity (composed of trade, tourism and service), worldwide, represents 50% of the production costs and about 50% of total jobs. When it comes to retail, according to the Brazilian Service of Support for Micro and Small Businesses (SEBRAE), this was the least affected sector in Brazil by the financial crisis of 2007. In 2009, according to SEBRAE, micro and small commercial businesses represented 54% of the total Brazilian companies, and 42% of the total jobs. However, it is worth noting that this sector also faces numerous challenges such as increased competition and a business environment in constant search for innovations and increased productivity. Companies are faced with certain obstacles, which, depending on their characteristics of size, activity, financial capital and human capital, can affect the development of the segments in a more or less severe form (CNC, 2008). This set of features affects even more the management of micro and small businesses (MPE), which by nature of its composition are structurally small, with few employees and usually with a restricted financial capital.

In micro businesses the operation basically is not dissociated from the management. Many times the owner himself performs the activities of operation and routines of the business daily, thereby devoting less time to the management activities, which makes the decisions be made, generally, in an emerging manner, and with analyzes inherent to the business based more on his experience than in structured data. By these factors, we stress the importance of structuring the management processes in micro companies to subsidize them in the decision making. Among the various areas of knowledge involving the management of an organization, cost management stands out as an important tool to support decision making, since it allows the manager to analyze the costs involved in the activities of his organization and how they impact on results. Leone (2009) states that the cost accounting is an area of accounting that is intended to produce information to the various management

Corresponding Author: Aline Rachadel de Souza, School of Administration and Management of Santa Catarina State University, Santa Catarina, Brazil.
E-mail: linerachadel@hotmail.com

levels of an entity, as an aid to the roles of performance, planning and controlling of operations and decision-making.

The calculation of costs in retail is "of fundamental importance for the retailer to have domain over the business, to know if he is making profit or loss and also to have the power to make decisions on the composition of the sales price" (Bernadi, 2004 apud Junior and Merlo, 2007, p 24). According to Wernke (2005), the pricing has become one of the strategic marketing tools to ensure competitiveness and profit for the companies. For small businesses, especially the retail ones, the selling price formation can be performed from the accounting of all monthly expenses already including the acquisition cost of the goods. Based on these assumptions, the study seeks to compare the selling price resulting from the cost structure of a micro business in the retail sector, in area of house and automotive paints, with the price currently practiced by the organization.

Theoretical Review:

Cost Management:

The Cost Accounting has two main roles: control and decision. While 'control' has the role of providing data for establishing standards, forecasting, budgeting, and allow monitoring the progression of values, the 'decision' plays the role of providing information relevant to making decisions about cutting products, selling price formation, purchasing analysis, among others (Martins, 2003). For the present study it is important to highlight the concepts presented in Table 1.

Table 1: Expenditure nomenclature

Expenditures	Describes instances in which the company spends resources or contracts an obligation to third parties for obtaining any goods or services.
Costs	Expense regarding goods or services used in the production of other goods or services.
Expenses	Good or service consumed directly or indirectly to obtain revenues.
Losses	Good or service consumed abnormally and involuntarily
Investment	Due to its useful life or benefits attributable to future periods.

Source: adapted from Martins (2003) and Wernke (2005).

It is also worth mentioning the existence of different classifications under the Cost Accounting, regarding the composition of expenditures and their relationship with the object of the cost. Table 2 identifies classifications that support the empirical object.

Table 2: Classification of expenditures

Fixed Cost	Costs that do not change when the volume changes, within a relevant range of activity.
Variable Cost	Costs which change in direct proportion to the change in volume, within a relevant range of activity.
Direct cost	Any cost that can be directly related to an object of cost
Indirect Cost	Any cost that cannot be directly related to an object of cost
Fixed expenses	Expenses that do not vary according to the volume of sales in the month
Variable expenses	Expenses that vary according to the volume of sales in the month
Direct expenses	Can be easily quantified and appropriated in relation to revenue from sales and service.
Indirect expenses	Cannot be accurately identified with the revenue generated.

Source: Adapted from Maher (2001).

The structuring of a cost system, based on the concepts and classifications presented in Tables 1 and 2, respectively, occurs through specific costing methods or the integration of different methods. There are several costing methods, among which stands out the Absorption Costing, methodology used to support the proposal undertaken.

Absorption Costing:

The absorption costing is the method in which "both fixed costs and variable production costs are considered product costs" (Maher, 2001, p. 360). This is the method adopted by the Financial Accounting, and, therefore, accepted for Balance Sheet and Income Statement, and in most countries - including Brazil - for Balance Sheet and Profit Tax (Martins, 2003). The method basically consists of separating costs from expenses, appropriating direct costs to products, and, finally, appropriating, through apportionment, the indirect costs to products (Martins, 2003). "The apportionment of costs represents the allocation of an indirect cost to an object of cost, according to a certain base. An object of cost, in turn, represents anything to which the cost is assigned" (Maher, 2001, p.231). In absorption costing, the apportionment can be done in two ways: with or without departmentalization.

When there is no departmentalization, the absorption costing happens as described above, costs are separated from expenses, allocating direct costs to products, and, finally, the indirect costs are apportioned to products. When there is departmentalization, the indirect cost is first appropriate to the department that originated it, and then be allocated to the product. Department is understood as "minimal administrative unit, represented by people and machines (in most cases), in which homogeneous activities are developed" (Martins,

p. 65, 2003). The departments are further subdivided into service departments and production departments. The production departments are those in which the product physically goes through. In this case, the costs of the production department are directly allocated to the products. The service departments are those in which there is the provision of services to other departments, and, therefore, generally do not have their costs directly appropriate to the products, so the costs of these departments are transferred to those which benefit from their services (Martins, 2003).

The apportionment of costs in the departmentalization can be done from three different methods: direct method, progressive method and reciprocal method. In the direct method, the costs of the departments of service are distributed to the user departments, with no apportionment among the departments of service, i.e., the costs are apportioned directly to end users of a service, ignoring the intermediate users, constituting a criticism to this method. In the progressive method, there is the recognition of a part of the services provided by the department of services to other departments of services. The apportionment in this case usually begins with the department of service that provided the highest proportion of its services to other departments of service. After receiving the apportionment of costs of a department, it does not receive more apportionment of other departments, i.e., the recognition of costs of one department to the other occurs only once, thus not recognizing the reciprocity that can occur among departments. In the reciprocal method, the apportionment of costs among the departments of services recognize all services provided to each other, reflecting the process of trading services that occur among the departments in the organizations, being this the most complete method among the three presented (Maher, 2001).

Costs in Retail:

The tertiary sector, since the 80s, has shown significant growth, even surpassing the secondary sector in terms of importance for the economy. This relevance justifies the attention that the cost area must give to it in order to give management information to the managers of this company (Wernke, 2004).

In the context of cost formation in retail, in its majority there is not a transformation of raw material into finished product, but only the purchase and resale of goods, simplifying the overall process control (Junior and Merlo, 2007, p. 24). In this sense, for any commercial activity, costs refer to expenses incurred in the purchase of goods, commercialization object, which will generate sales and the company's result (Bruni and Famá, 2011).

As in other sectors of the economy, commerce has also been affected by the magnitude that the global economy is taking, being, therefore, subject to several challenges, such as declines in profit margins. That being said, the correct formation of the sales price becomes essential to an organization's survival (Wernke, 2004).

Formation of Selling Price from Cost Management:

"A decision-making process in which the costs play a fundamental role is represented by the price formation of products that will be sold or commercialized" (Bruni and Famá, 2011, p. 267). In determining the selling price it is important that the organization find a value that maximizes profit, enable achieving the sales targets with such a price, the optimization of the invested capital and provide efficient utilization of production capacity. The most common method used in business practice is the method based on the cost of the goods, which consists of adding a fixed margin to a base-cost, known as mark-up rate (Wernke, 2004).

In small retail businesses, the formation of selling price can be done from the accounting of all the monthly expenses, including the cost of goods acquisition, commonly called method based on full cost. These expenses are apportioned to products in order to price them according to the company's cost structure (Wernke, 2005). According to Padoveze (2000), despite some known disadvantages, this method is widely used, especially by the simplicity of its methodology. In this method, according to Bruni and Famá (2011, p. 268) "prices are set based on the full or whole costs - total cost of production plus selling expenses, administration expenses and the desired profit margin."

It is important to mention that, besides the costs, the formation of selling price is also related to market factors, to the level of activity and return on invested capital. Thus, the calculation of the selling price is expected to reach a value that maximizes the profits of the company, keeps the quality, meets the desires of the consumer market and make the most of the production levels (Bruni and Fame, 2011).

Methodological Procedures:

Conducting the study, a research with qualitative approach was performed, aiming at better understanding a phenomenon from the context in which it is inserted, analyzing it from an integrated perspective (Godoy, 1995). Regarding the goal, this research is characterized as descriptive, which, according to Gil (2007) has the objective of describing the characteristics of a population, a phenomenon or an experience. The research method used was the case study, which, according to Godoy (1995, p. 25), "[...] is characterized as a type of research whose objective is a deeply analyzed unit".

The unit of analysis is a micro retail company in the sector of automotive and house paints Florianópolis. Data collection was done through semi-structured interviews with the two partner-owners. Besides the

interviews, data were collected from the accounting and financial documents, and the management systems currently used by the company, and also from direct observation.

The technique of content analysis was used for the analysis of the data. According to Mozzato; Grzybovski (2011, p. 734) "the content analysis is a set of communication analysis techniques whose objective is to overcome the uncertainties and enrich the reading of the data collected".

This intent of this research is to analyze the data of one month of company's operation, since they do not show significant changes throughout the year. The scope of the analysis was also reduced to a line of products, given the diversity of products currently commercialized by the company. Thus, only the line of automotive paints, including some supplements, was analyzed

Presentation and Analysis of The Results:

Company Presentation:

The company object of study is a micro retail family company in the sector of automotive and house paints. It is located in Campinas, São José, Santa Catarina and was inaugurated 28 years ago. The focus of the company is the line of automotive paint. Care in manufacturing the paints is considered as essential in the company, having a testing room in its facilities, so as to minimize errors and maintain the originality of the paints color.

Considering the need to improve its management practices in order to have at hand structured data for the currently necessary strategic decision-making, and that due to the lack of important information are not being made, the company studied showed the need for analyzing its cost structure to determine the selling price of its products.

Proposal of Products Cost Calculation:

The method chosen to structure the products cost calculation and support the formation of the selling price was the absorption costing with no departmentalization. Allied to the fundamentals, such a choice is justified by the company's structure, which even having its administrative activities separate from the operation, yet there is no division of labor, as all employees are involved in production activities. In addition, as the company does not have any cost structure, it is believed that the method will suit the current needs of the company, in addition to being a simpler method, which the company's owners can become familiar with more easily, so in the future they may evolve in the company's cost management.

Identification and Classification of Expenses:

The survey of the company's expenses was conducted through interviews with the owners and through data collection from the tax documents of the company. It was observed that these expenses are not formally registered for the organization control. The purchase price of the goods is the only expense that is formally registered through the inventory who updates the accounting records, information which, again, are not used by the company. Table 1 shows the company's expenses incurred in September / 2013, with its proper classification.

Table 1: Classification of Expenses

Classification	Nature		Expenses in September	
Expense	Fixed	Indirect	Water	90,00
Expense	Variable	Indirect	Changing social contract	745,00
Expense	Fixed	Indirect	Rent	4.262,50
Cost	Variable	Direct	Acquisition of goods	36.240,64
Expense	Fixed	Indirect	Car / motorcycle	65,50
Expense	Fixed	Indirect	CDL	64,00
Cost / expense	Fixed	Indirect	Cell phone	400,00
Cost / expense	Variable	Indirect	Fuel- gasoline	200,00
Cost	Variable	Indirect	Fuel- motorcycle	160,00
Expense	Fixed	Indirect	Accountant	734,50
Expense	Fixed	Indirect	Depreciation	496,67
Expense	Fixed	Indirect	Banking fees	123,00
Expense	Fixed	Indirect	BNDR loan	1.394,54
Expense	Fixed	Indirect	Bank loan	12.800,00
Cost	Variable	Direct	Freight	556,62
Cost	Variable	Direct	Brazilian state excise tax	3.049,88
Expense	Variable	Indirect	Tax on invoice issuance	5.800,00
Expense	Fixed	Indirect	Infrastructure	1.688,86
Cost	Variable	Direct	Brazilian federal excise tax	1.074,00
Expense	Fixed	Indirect	Property tax	144,17
Expense	Fixed	Indirect	Newspaper	18,00
Expense	Fixed	Indirect	BNDR interest	11,99
Expense	Fixed	Indirect	Delayed duplicates interest	350,00

Expense	Fixed	Indirect	Interest loan	153,60
Cost	Variable	Indirect	Electricity	345,00
Cost	Fixed	Indirect	Maintenance system	240,00
Expense	Variable	Indirect	Kitchen supply	70,00
Expense	Fixed	Indirect	Christmas gifts	132,92
Cost	Fixed	Indirect	Remuneration	13.376,29
Expense	Fixed	Indirect	Car Insurance	141,67
Cost / expense	Fixed	Indirect	Adm rate of credit card	70,00
Expense	Variable	Indirect	Phone	244,60
Grand total				85.243,95

Source: Primary data (2013)

Allocation of Costs To Products:

As explained previously, the allocation of costs to products was performed using the absorption costing with no departmentalization. As apportionment criterion, the quantity of units of each product purchased was chosen due to the low complexity of the activities involved in the company, and also because there isn't a significant variation in the working hours. The individual apportionment value, therefore, was obtained by dividing the monthly amount of each expense by the total quantity of goods purchased in September / 2013. The main information resulting from this analysis, for the company's management, is to know its actual cost structure in order to act more effectively in managing its expenses, so that it is possible to reduce them. Table 2 presents the allocation of costs to products, and the final result of the product cost, which includes all the expenses of the organization and the acquisition cost of the goods. As the amount and variety of goods purchased is very wide, a sample with leading automotive supplements marketed by the company was selected (Polish Mass, Plastic Mass, Universal Primer, Thinner, Varnish Polyurethane) and a mix of automotive paints (seeking contemplate varied brand and product lines). It is thus attentive to the fact that the total value of goods purchased constant in the last column refers to the total amount (basis on which to calculate the assessment was conducted), not only the amount of goods presented in Table 2.

Table 2: Total Cost of merchandise

Product	Quantity	Acquisition Value	Cost received from the apportionment	Total cost of the goods
Polish Wax 900 ml	6	12,28	16,87	29,15
Polyester Putty 500g	240	6,80	16,87	23,67
Universal Primer 900ml	24	9,89	16,87	26,76
Thinner PU 900ml	40	6,46	16,87	23,33
Matte Black Spray 300ml	36	5,30	16,87	22,17
Polyurethane Varnish 900ml	12	10,80	16,87	27,67
Universal Black VW 94 900ml	6	18,62	16,87	35,49
Polaris Met Silver GM 05 900ml	6	16,95	16,87	33,82
Synthetic White Frost 900ml	6	11,10	16,87	27,97
Lazzumix Ruby Red polyester 900 ml	3	46,96	16,87	63,83
Lazzumix Pure White polyester 3,6l	4	71,14	16,87	88,01
Lazzumix White nitro lacquer 3,6l	8	63,25	16,87	80,12
Lazzudur White Crystal PU 675ml	6	12,00	16,87	28,87
Lazzudur met Grey Steel III 900ml	6	11,74	16,87	28,61
Lazzudur Smooth Black Liszt 900ml	12	11,19	16,87	28,06

Source: Primary data (2013)

Formation of The Automotive Line Selling Price:

From the cost allocation shown in Table 2, it was possible to know the total cost of the goods. As previous owner expectation, the value of the costs is greater than believed. Currently, the company's selling price formation is done by adding up 30% (thirty percent) to the cost of the goods, as shown in Table 3.

The suggested selling price was formatted based on the total cost of the goods obtained in Table 2, without adding the desired profit margin. Although not being the most sophisticated method for the formation of the selling price, the owners understood it as the most suitable method to the current context of the company. Still, a selling price was projected from the cost and considering the profit margin, as shown in Table 3.

Table 3: Current selling price and suggested selling price

Product	Current selling price	Suggested selling price based on the cost	Suggested selling price considering the margin
Polish Wax 900 ml	15,96	29,15	37,89
Polyester Putty 500g	8,84	23,67	30,77
Universal Primer 900ml	12,86	26,76	34,79
Thinner PU 900ml	8,40	23,33	30,33
Matte Black Spray 300ml	6,89	22,17	28,82
Polyurethane Varnish 900ml	14,04	27,67	35,97

Universal Black VW 94 900ml	24,21	35,49	46,14
Polaris Met Silver GM 05 900ml	22,04	33,82	43,96
Synthetic White Frost 900ml	14,43	27,97	36,36
Lazzumix Ruby Red polyester 900 ml	61,05	63,83	82,98
Lazzumix Pure White polyester 3,6l	92,48	88,01	114,41
Lazzumix White nitro lacquer 3,6l	82,23	80,12	104,15
Lazzudur White Crystal PU 675ml	15,60	28,87	37,53
Lazzudur met Grey Steel III 900ml	15,26	28,61	37,19
Lazzudur Smooth Black Liszt 900ml	14,55	28,06	36,48

Source: Primary data (2013).

Thus, it was possible to compare the current price of the product, the suggested selling price based on the cost and the suggested price, considering the margin of profitability. It was possible to observe that most of the products are priced below its total cost; and for the products that have a higher cost of acquisition (in this sample, the products: Lazzumix Pure White polyester and Lazzumix White nitro lacquer 3,6l) the current selling price is above the total cost.

Conclusions:

The importance of the information presented by the costs management is evidenced by the results of the research. It was observed that the unawareness of real cost structure of the company led the owners to set selling prices not compatible with the costs incurred by the company. In few cases, the practiced selling price was above the total cost of the goods.

This study was developed from the analysis of the company's tax documents and interviews with owners. It was evident that the company has no control over their costs. The financial management boils down to controlling payables and receivables, and it is on the accountant to perform the accounting management. The data survey conducted and the cost management proposal presented to the company made the owners raise awareness about the importance of this control.

It is important to highlight that, even so, the use of these values to determine the selling price should be done with caution, since, even if some products havening being priced below its cost, it is known that the market wouldn't absorb the price suggested by the allocation of costs, which should also include the profit margin desired by the company, which from the cost structure, now known, can be lower than that that has been practiced.

The knowledge and experience gained in the 28 years of the company's existence give the owners the possibility of joining them to the data now structured, and then take the most appropriate decisions to their context. Thus, it is believed that the use of a method of costing and selling pricing, combined with the skills and competences already acquired by the owners, can help them make more assertive decisions, based on the strategic information of the company.

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