



Anna's Pricing - calculations

Total number of hours worked per year = 2,000

Number of hours worked on designing and making = 1,000

'Designing-making hours' worked per item = 10

Labour cost in each item = £150 (ten hours x £15 per hour)

Direct costs of each item (raw materials plus labour) = £200 (£50 + £150)

We also need to take into account the overheads of the business and each item sold needs to make a 'contribution to overheads' to support the indirect costs of the business.

Indirect costs (or fixed costs) of the business (excluding labour) = £5,000

Indirect labour costs (time Anna needs to be paid for, even when she is not designing and making) = £15,000 (£15 x 1,000 hours)

Total indirect costs (fixed costs), including labour = £20,000

The 'contribution to fixed costs' which must be paid by each item sold, to cover these business expenses = £200 (£20,000 / 100 items)

The total cost of each item, including all overheads = £400 (£200 + £200)

(This is the price Anna needs to sell each item for, in order to break even and pay all her costs, including her own labour)

Anna's twin sister, Ella, who runs an identical business, likes to be 'nice' to people and sells her annual production of 100 items to friends, family and local shops for £175 per item.

How much does Ella earn each year?

Total business income = £17,500 (£175 x 100)

Expenditure (excluding labour) = £10,000 (raw materials 5,000 plus non-labour overheads of £5,000)

Ella's personal income is the remainder, ie £7,500 (£17,500 - £10,000)

Before tax and other deductions, Ella's earnings = £7,500

(In contrast, Anna's earnings = £30,000)