Allocating Fixed Costs (Product Profitability)

Allocating fixed costs to products, in order to more fully assess product profitability, can be determined in different ways with different outcomes.

In the following example, the firm has allocated its fixed costs equally each of its products - what impact does this have?

Key Financials	Product A	Product B	Product C	Product D	TOTAL
Gross profit	$4m	$1m	$2m	$3m	$10m
Share of fixed costs	$1.5m	$1.5m	$1.5m	$1.5m	$6m
Net profit	$2.5m	-$0.5m	$0.5m	$1.5m	$4m

Student Discussion Questions

1. In the above table, Product B is unprofitable when taking into account fixed costs. What should the firm do with this product; keep it or withdraw it?
2. If the firm was to withdraw Product B, how would that affect its overall profitability and the profitability of each product?
3. Other than allocating fixed costs equally, what other approaches could be used? What approach would you recommend in this case?

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