Cost Plus Pricing

Theoretically, a firm maximizes its profits if it sells at the point where its marginal revenue equals it marginal costs. Whatever price results at that marginal revenue is the price the firm should charge its customers.

In practice, it is very difficult to determine marginal revenue and marginal costs with great accuracy. So many businesses simply calculate their costs per unit and then charge a markup above their costs per unit to determine the price they should charge.

In a free market, competition usually drives the price of a good or service down to almost the level of the cost of that good or service anyway. Therefore, many firms try to lower their costs per unit as much as possible and then charge a price slightly higher than that cost per unit.