



# Application of the Concept of Target Costing in Hospitality

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**Abstract:** *In recent decades, the service sector has become a fast-growing world economic activity, and hospitality organizations are a key element of the service sector. Providing high-quality services in this sector at lower prices than the competition is an important factor and the basic goal of companies' business success. In order for hospitality organizations to achieve this goal, it is necessary to find an adequate way to calculate costs and determine the cost price of services provided. The application of modern costing methods enables hospitality organizations to increase profits, increase labor productivity, shorten service delivery time and reduce costs. One of the concepts of cost management in a given business environment is target costing. The concept is focused on reducing costs, primarily in the product design phase to the target amount. The paper analyzes the possibility of applying the modern concept - target costing in a hospitality company.*

## 1. INTRODUCTION

The competitive advantage of a company can be seen as the superiority of a particular market participant, resulting from the proper use of resources and the use of key competencies that are reflected in the creation of required or higher value for customers than other market participants. The required value is usually shown through lower prices or unique product/service characteristics that will best bring customer satisfaction. It should be borne in mind that the notion of competitive advantage has changed over time and has encompassed different product and service characteristics. Initially, the emphasis was on low costs, quality and fast delivery, but later it included reliability, flexibility, speed of response to requests, the time required to place a new product/service, quality of after-sales services and the like. Such an upgrade of the concept of competitive advantage is a result of changes in customer needs over time as well as the sector that provides the product/service.

In order to achieve and maintain a competitive advantage, company managers in both the manufacturing and service sectors formulate a company strategy that will be a kind of guide to achieving all aspects of competitiveness in production and service delivery. For these needs, they need appropriate information support coming from concepts, tools and techniques of modern management accounting. The reason for looking for new information support is that the traditional approach has shown its shortcomings in a modern business environment with pronounced local and international competition, rapid technological progress, different customer requirements, short product life cycle. One of the concepts of modern management accounting that aims to rationalize costs and provide greater value for customers by integrating activities performed primarily in the product design phase, but also in other phases of the product life cycle is target costing (TC).

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Target costing as a market-oriented concept is aimed at integrating strategic variables within the product concept. It is the difference between the target selling price and the target profit. The target selling price is formed during product planning in a market-oriented manner and reflects product specifications or features that the customer expects and evaluates (product functionality), while the target profit is determined during product planning, and is aligned with the planned corporate strategic plan, meaning that future product/service should generate a profit that correlates with the company's long-term profit plan. If the target cost is less than the allowable cost amount, management must find a way to reduce the cost, thereby moving the amount of actual cost to the amount of the target cost that will be competitive. Finding ways to reduce these costs is a strategic challenge of cost reduction, i.e. the main challenge of the concept of target costing.

The research subject in this paper is to examine the possibility of applying the target costing concept with special emphasis on calculating and achieving the desired amount of cost in service organizations in order to achieve a competitive price of the product/service.

This paper aims to consider the possibility and highlight the importance of applying the concept of target costing in the service sector and emphasize the importance of its application.

In that sense, the work is divided into three parts. The first part points out the specifics of doing business in the service sector. The second part of the paper deals with the concept of target costing and target cost management. Finally, a hypothetical example shows the application of the concept of target costing in a hotel.

## **2. SPECIFICS OF DOING BUSINESS IN THE SERVICE SECTOR**

In the past decades, structural changes in the field of economy and technology have strengthened the importance and role of the service sector. The twenty-first century is characterized by a slowdown in the growth of the primary and secondary sectors, a decline in labor productivity in material production, and a change in the structure of world trade by increasing the share of trade in services at the expense of reducing trade in goods. The service sector has become the key to the development of a country's economy, as it generates large revenues and participates in GDP. The development of the service sector contributes to economic growth and increased employment. What is more, three-quarters of the gross domestic product in the EU countries comes from the service sector, with on average 50% in developing countries. Over three-quarters of employees in the European Union work in the service sector. No country can prosper without an efficient and developed service infrastructure, so the existence of services is the basis for economic success. According to National Employment Strategy for the period 2011-2020 the relative share of employment in the service sector in total employment increased from 51.4% in 2010 to 52.1% in 2020.

However, defining the term "service" precisely is not at all simple. From the period in which the criterion for defining the concept of services arose, there is also a difference in definitions. In the 1930s, Allen Fisher and Colin Clark defined services. Fisher (1939) defines services as something that is different from a tangible good and provides direct customer satisfaction. He singles out an intangible property as a criterion for defining services, which a large number of authors also use. Clark (1960) points out that the term "services" should include production services such as product transportation services, maintenance of business facilities, business services, etc.

A service is any activity or benefit that one party offers to the other and that is essentially intangible and does not result in ownership of anything. Its production may or may not be associated with a physical tangible good (Vargo et al., 2005). Kotler (1997) means by service activity or performance that one participant can offer to another, which is essentially intangible and does not result in ownership of something.

We note that the term “service” encompasses a range of heterogeneous and intangible products and activities that are difficult to encompass within a single definition. Therefore, a distinction should be made between services and products using the following characteristics (Kalač et al., 2010):

- *Intangibility of services* – means that the service is physically invisible, and cannot be felt in space, touched or tried, as is the case with products. Based on tangibility, we distinguish between services of a purely intangible nature, services that provide added value for tangible products and services that make a tangible product available.
- *Indivisibility of service provision and service use* – services have short or almost no distribution channels. The customer must come to the service center or the service provider will go to the customer.
- *Heterogeneity of service* – implies diversity in the quality of services, because the quality of service varies from company to company.
- *Inability to own services* – is the basic difference between services and products. The customer only has access to or can use the capacity (hotel room, the seat on the plane, swimming pool within the hotel, etc.) so that he pays for the use.

How to achieve the desired or required quality is a common topic in modern theory and practice, which has contributed to understanding the nature of services and customer satisfaction. Customers have the final say and assess the quality of services which is a means of meeting service needs. Two approaches to quality were identified in the 1990s. One approach is technical and product-oriented, and the other is customer-oriented. On the one hand, the manager in a service organization wants to adhere to the set standards, but on the other hand, to achieve appropriate customer satisfaction. The technically oriented approach implies the least possible involvement of employees who are directly involved in the delivery of the service. In this way, we can achieve maximum efficiency, but it is necessary to establish good coordination and control. The second approach is customer-oriented. Specifically, customer expectations are the basis for satisfaction. The customer can predict service standards in line with their expectations and their expectations determine their satisfaction. So the customer satisfaction rating is actually his feeling after the purchase.

In order to provide the quality that today’s purchasers/customers expect, we must distinguish between two aspects of quality (Oakland, p.10 quoted according to: Gržinić, 2007): quality of design and quality of compliance with design. Design quality implies the presentation of a product/service that is geared to the needs of customers. The hotel industry can meet the requirements of customers only if customers are included in product design or customer requirements should be “embedded” in the product/service that the hotel provides. For the aforementioned requirement, it is necessary to conduct a good and quality market analysis. Quality in line with the design actually complements the first aspect of quality, because it means the level to which the product/service satisfies the market. In order for hotels to maintain the required quality and meet the requirements of customers, they need to, in line with their capabilities, constantly look for opportunities for improvement.

To ensure the required quality service, an approach that increases the competitiveness, efficiency and flexibility of the whole company is needed (Oakland, quoted according to: Gržinić, 2007). Quality of service is a way of managing business processes to ensure customer satisfaction. Good quality enables better market positioning, as shown by the results of a survey conducted in the United States on a sample of 2,600 companies. It revealed a direct connection between the level of service quality and financial performance, i.e. different indicators of company performance (market share, return on investment, asset turnover ratio) show a higher value for companies with a higher level of services (Grove et al., 1997, p.63). Quality is a very complex concept that requires analyzing customer requirements, defining and controlling business processes, but also implementing continuous improvement. It consists of several criteria and elements (Holjevac, 2002) (availability, guarantee, communication, expertise of employees, standard products and services are at the level of prescribed standards, kindness to clients, flaws, duration, employee engagement to the client, customer self-esteem, expected effects of the product/service, reliability of the service, responsibility for the duration of the product/service and safety – services do not cause risk or danger, so they are provided safely) which are equally important because the absence of one element jeopardizes full quality. In addition to the main elements, the product/service should also include elements that are in line with customer needs, new technology, competition and market globalization.

Today, hospitality, its basic and specific services encourage the development of tourism. The provision of services in the hospitality industry requires a large number of employees and uses the products of a large number of industries, which enables greater participation in the overall economic and social development of the areas in which it operates.

Hospitality is an economic activity that organizes, provides and meets the needs of guests for accommodation, food and drink (Ćerović, 2003). Hospitality can be viewed as a manufacturing and service industry. Food and beverage preparation is a manufacturing industry, while providing accommodation and serving prepared food and beverages is in the service industry (Ratkajec, 2008). Hospitality is an economic activity that differs from others not only in the scope of business entities (providing accommodation, food and beverages), but also in its specifics. Hospitality has a special technological and production and service process, a separate organization, special ways, content and form of service (Pirija, 2003). Based on the above definitions, we notice that hospitality is a complex production and service activity that, in addition to accommodation, food and beverages, offers a range of complementary and ancillary services in order to meet the modern needs, requirements and desires of tourists.

The concept of hospitality gives rise to the hospitality service because it is realized in the hospitality system through catering hospitality and activities. An important element of the hospitality service are the costs because the offer of the service at the right price is a monetary expression of the incurred hospitality costs that are included in that price.

To have a more complete view of and assess the quality of services, employment in accommodation and food services should be considered regarding quality, because we have applied the selected method to hotels. Hotel management is a complex economic and production activity because, in addition to accommodation, food and beverages, it offers a range of complementary and ancillary services to meet modern customer requirements. Customers' need for safety and preservation of health has been growing in recent years, with an emphasis on ecology and healthy food, staying in nature, adventure activities, congress facilities, and various city tours.

Wellness and all-inclusive spa hotels are just some of the trends of successful hotels. For each new trend, the hotel management examines and creates a development policy in accordance with the new requirements and needs of the market. The trend of changes in the number of employees in accommodation and food services in the Republic of Serbia in the period from 2017 to 2019 is given in Table 1. We notice that employment in accommodation services records a continuous growth, while employment in food and beverage preparation and serving is also growing.

**Table 1.** Employees in accommodation and food services

Type of service	Employees		
	2017	2018	2019
Accommodation and food services	71.744	78.487	82.459
Accommodation	14.222	15.492	16.561
Food and beverage service activities	57.522	62.995	65.898

**Source:** Statistical Yearbook of the Republic of Serbia (2020).  
Statistical Office of the Republic of Serbia, Belgrade.

In support of this, we add data on the growth rate of gross value added and gross domestic product in the activity of accommodation and food in the Republic of Serbia (Table 2). The growth rate of gross value added and gross domestic product increased in 2017 (10.6%), in relation to 2016, while in 2018 (6.8%) and 2019 (6.0%) it decreased compared to 2017.

**Table 2.** Gross value added and gross domestic product

Type of service	Real growth rate in %		
	2017	2018	2019
Accommodation and food	10.6	6.8	6.0

**Source:** Statistical Yearbook of the Republic of Serbia (2020).  
Statistical Office of the Republic of Serbia, Belgrade.

Thus, the service sector has growing importance and increasing participation in the national economy. The basic task of service organizations is to provide differentiated services of high quality at an appropriate price with minimal costs. The service sector is becoming the dominant sector offering products/services in line with customer needs.

### 3. TARGET COSTING AND TARGET COST MANAGEMENT

The beginning of the application of the concept of target costing (TC) is related to the third decade of the 20<sup>th</sup> century (Antić et al., 2019). Most authors point out that target costing originates from the Japanese manufacturing industry in the 1960s. Target costing was established by Toyota to manage car costs in response to customer demands for lower market prices (Kato, 1993; Ansari et al., 1997). After World War II and due to a lack of economic resources, General Electric adopted the principle of improving product quality and reducing production costs, a principle known as value engineering. The authors of texts in English on this concept were Hiromoto (1988) and Sakurai (1989). Hiromoto identified target costing as a technique used by Japanese companies to align strategies with cost reduction programs, while Sakurai defined the main steps in applying the concept of target costing.

Target costing is a cost management concept that aims to manage the costs of all products through the design phase. At the same time, by calculating the target cost, it is ensured that the product is profitable enough to justify its production. In this sense, it can be used as a profit planning mechanism. Target costing is much more than a cost accounting system, because it

respects the wishes and requirements of customers, focuses on product design, involves the cooperation of employees from different fields and departments not only within the company but throughout the value chain to minimize costs throughout the product life cycle.

The concept of target costing can also be well applied to reduce the cost of new products as well as products that are already in the production and sales range of the company. This is because there is a whole set of tools and techniques that can be applied separately or in combination to achieve the desired goals. Some of the techniques are value engineering, value analysis, kaizen costing and quality function deployment.

Atkinson et al. (1997) point out that target costing is a cost planning method that deals with products with discrete production processes and reasonably short life cycles. During the production phase of the product life cycle, companies would gradually improve processes through kaizen costing.

Cooper and Slagmulder (1997) focus on the application of target costing as a profit management technique. The concept of target costing is defined as a process that allows a new product to be produced at a price that will enable the realization of the planned level of profitability. The authors assume that the company sets long-term sales and profit goals and structures product lines accordingly.

Computer-Aided Manufacturing International's concept of target costing is a set of management methods and tools that allow the inclusion of cost objectives, design activities and planning of new products to provide a basis for control during the operational phase and to ensure that these products achieve profitability targets in the life cycle.

In addition to the above, numerous researchers have identified the concept of target cost, which can be explained in five groups:

- *The first group of authors* points out that target costing is a tool that provides support and manages new and future products, focused on the design phase (Feesler & Fisher, 2000) or process of price estimates at the design stage, while the company undertakes to produce within the target cost in order to make a profit when selling at the desired target price.
- *The second group of authors* views the concept of target costing as part of a strategic cost management system per unit of product or service. Horngren (2006) defines the target cost per unit of product and presents an accurate estimate of the prices of components or related parts in each unit of product/service. The target cost is used to achieve the operating target revenue per unit when the sale is made at the target price, while the target cost is realized through all phases of the product life cycle.
- *The third group of authors* defines the concept of target costing as a tool for determining the price of a product based on the price defined in the market with a focus on customer needs because Drury (2008) defines target cost as a customer-oriented technique used as a cost management tool to improve pricing decisions and reduce costs.
- *The fourth group of authors* says that the target costing method includes all product life cycle costs (Sakurai, 2004). Costs should be managed to reduce the total cost of the product life cycle and contribute to the following categories: manufacturing, manufacturing engineering, product research and development, marketing and accounting.
- *The fifth group of authors* points out that the concept of target costing improves company profitability and reduces costs. Garrison & Noreen (2008) define the concept as the

process of determining the maximum allowable costs for a new product or developing an original product in order to achieve sales growth and make a profit that is greater than the maximum amount of the target cost.

Based on the previously presented definitions, we can single out the following characteristics of the concept of target costing (Ansari & Bell, 2006):

- *Customer focus* – the concept of target costing is focused on customers and their requirements. It implies continuous communication between the company and customers as well as “trade off” between costs and value.
- *Focus on reducing costs in the early stages of product development* – requires detailed financial analysis at the earliest stage of product development, which eliminates the risk and uncertainty of introducing a new product/service.
- *Consideration of the entire product life cycle* – costs should be managed at all stages of the life cycle.
- *Interoperability* – implies the involvement of all sectors in cost analysis and decision making. The most important role is played by finance, procurement, research and development, production, engineering, sales and distribution sectors.
- *Involvement of the entire value chain* – active participation of suppliers of materials and raw materials requires the concept of “expanded enterprise” which allows locating suppliers in the immediate vicinity, which facilitates cooperation and forms inter-company teams.
- *Iterativeness* – the concept of calculating the target cost is an iterative method of reaching the set goal by achieving a balance between functionality, price, volume, cost and investment.

A large number of authors have examined the process of establishing the concept of target costing. Cooper and Slagmulder (1997) identify different stages of this process as follows: market level, product level, and component level. For the needs of this paper, we have opted for the approach proposed by Zengin and Ada (2010). According to them, there are three key levels in establishing the target cost: determining the amount of the target cost, reaching the target cost and continuous improvement for the needs of future cost reduction.

The beginning of target costing is the specification of the wishes and requirements of customers. Customers often have a wide range of desires and requirements, and all of them need to be turned into goals when designing products. At this level, the cooperation of sales managers with designers and engineers is required. A very useful technique at this level is quality function deployment (QFD). This technique transforms customer requirements in terms of product quality and functionality into technical product attributes. QFD takes into account customer data, showing the relationship between competitive offers, customer requirements and technical attributes of products using a matrix that summarizes information on product function and customer rankings. (Al-Qady & El-Helbawy, 2016). Given that there is a wide range of wishes and requirements of customers, it is necessary to rank them by importance. In this way, the value that customers are willing to pay will be added to the products. At the same time, this value will become the basis for defining the target selling price. This pricing approach can be defined as value-based pricing. Based on the determined selling price, the target profit margin is established. The target profit is determined by applying the target profit margin to the target selling price. Of course, the target profit should be in line with the strategic plans of the company, and as such must receive support from the top managers of the company (Novičević Čečević, 2016). It is important to emphasize that the target profit at the level of the company and the level

of individual products is not constant. Following the changes of other relevant factors, the target profit can change, both in the phase of product development and later during the following phases of its life cycle (Novičević et al., 2013, p.132). The difference between the target selling price and the target profit is the amount of allowable product cost. Allowable cost is the cost at which the observed product must be produced, in order for the company to reach the target cost limit and achieve the target profit. It often does not represent a realistically achievable value, because when determining it, the current possibilities and potentials of the company and its suppliers to reduce costs are not taken into account (Antić, Stevanović, & Novičević Čečević, 2019).

The second level is reaching the target cost. In order to achieve the target cost, the current information base must first be analyzed in terms of product costs, design, capacity and the like. For these purposes, it is best to apply a cost matrix that will contain detailed cost estimates of materials, equipment, technology and other resources needed for production. This current cost matrix will show how achievable the cost level is for a specific product. Compiling this cost matrix is important because in most cases the allowable target cost is lower than most businesses can achieve. For this reason, the allowable amount of target cost in a particular company is replaced by the term achievable target cost. The difference between the higher achievable cost and the allowable target cost represents the cost gap to which managers must pay attention because it represents the current inefficiency and inability of the company to achieve a long-term profit goal. The cost gap can be divided into two parts: achievable and unachievable parts of the target cost reduction (Cooper, 2002). Achieving the achievable part of the target cost reduction depends on the ability of designers and suppliers to find ways to eliminate unnecessary costs. Establishing relationships with suppliers aims at an early assessment of product selling prices, and if possible, a change in product design while maintaining quality and functionality at a reduced cost. The unachievable part of the target cost reduction is called the strategic cost reduction challenge. The strategic challenge of cost reduction shows the inability and inefficiency of the company in achieving competitive advantages and taking a leading position. A suitable technique for application at this level is value engineering. In this sense, we can say that value engineering is a systematic and multidisciplinary approach for examining the factors that affect product costs, in order to find ways to: reduce them, while maintaining the same level of quality and functionality; maintained at the same level, with improved product quality and functionality (Sekerez, 2005, p.169). Value engineering is focused primarily on production functions, and only then on product costs. The task of this technique is to ensure that the product achieves primary functionality that will satisfy customers at an acceptable cost. Thus, value engineering reduces costs by identifying those parts of products or services that do not add value. The value consists of use-value (the ability of a product or service to satisfy its function) and esteem value (the status that ownership or use gives). For example, if we sell perfume, we assume that the packaging design is important. The perfume can be kept in an ordinary glass or plastic bottle so as not to reduce the use-value of the product, as well as the value of esteem. In this case, the company must not reduce the cost of packaging.

The last level is continuous improvement. This step is especially important when reaching the target cost because the concept of target costing is a continuous process. When a product enters the production phase, efforts are still made to identify potential opportunities for product quality improvement and cost reduction with the application of the Kaizen technique. Kaizen implies small, incremental improvements at every step before making major innovations. It is better to improve the company's business immediately by 10% than to wait for the moment when the business can be 100% improved. Waiting for the moment to come when the business can be



fully improved requires a lot of time, and market conditions are relentlessly changing so that the company can be late with reactions to demand and thus lose the race with the competition.

The application of the concept of target costing results in the following advantages (Applicability of target costing):

- Leads to cost reduction;
- Focus is on end-users;
- Promotes teamwork between different departments;
- Increases the skills and expertise of staff for the application of new costing methods;
- Demonstrates management's commitment to improving process and product innovation to gain a competitive advantage;
- The product is created based on customer expectations, and the costs are in line with that. So, the customer feels a higher delivered value;
- Over time, the company's business improves by achieving economies of scale;
- The company's approach to product design and production is becoming market-oriented and
- New market opportunities can be turned into savings to achieve value and lower costs.

The concept of target costing can and should be applied in the hotel industry. Specifically, uncertainty in business and the presence of risk in the hotel industry are high. Customer behavior is also changeable and unpredictable (Kocsoi, 2009, p.47). Today's competitive environment, construction of new hotels, expansion of the range of services, new management system, and increasing responsibility require the hotel industry to maintain its competitive advantage, which requires directing accounting activities to cost management. Efficient use of costs as a factor of competitive advantage is possible only by identifying and controlling costs. Costing methods applied in the hotel industry should be based on customers' ability to pay and their expectations. Applying the concept of target costing in the hotel industry will enable production and services at lower costs (Ansari, 1997). Since the price of the hospitality industry is determined by the market, the target cost can be achieved by reducing the profit margin. It is necessary to continuously consider the requirements and expectations of customers. The design must be market-oriented because the investment costs are high and can be influenced in advance. It is necessary to establish long-term cooperation with suppliers, travel agencies and service providers, i.e. develop good relations with all members of the value chain (Avlonitis & Indounas, 2006, p.54). However, the application of the concept of target costing in the hotel industry is enough to lead to business success. There is a small number of papers and research in the academic literature on this topic. Therefore, the paper aims to indicate the relevance of the application of the concept of target costing.

#### **4. APPLICATION OF THE CONCEPT OF TARGET COSTING IN A HOTEL**

The extremely competitive market of the hotel industry and the high costs of hotel services make it difficult for hotels to achieve the planned rate of profit while providing services to customers at affordable prices and expected quality. Application of the concept of target costing, as one of the modern and efficient cost management techniques, could help hotels meet the previous requirements.

The application of the concept of target costing as a basis for cost reduction in the hotel industry will be shown on a hypothetical example of a hotel as a service provider (adapted according to Ansari et. Al, 1997). We assume that the hotel has three stars, and provides excellent quality

of services, but that users of hotel services always opt for a competitive hotel because their hotel has four stars (due to the pool within the hotel). Accordingly, the hotel management has decided to provide a new service to customers – the use of the hotel pool. Using the pool requires: cleaning the pool; water maintenance chemicals; water heating (appropriate pumps) and electricity. The planned profit from the provision of pool services is 10% of the selling price, while overhead costs amount to 590 monetary units (monetary unit – m.u.).

For the hotel management to determine the target price of the new service, it is necessary for the employees in the marketing department to conduct market research to come to the conclusion of what customers expect from the provision of the new service. We assume that the marketing analysis has been performed and that marketing employees have come to the following characteristics of the pool (large number of pool functions, design, dimensions, economic characteristics and ease of use) which are ranked according to importance when making hotel selection decisions. The users of the hotel services agree that the decision to choose a hotel with a pool is influenced by: the design of the pool and a large number of different pool functions (they have a special section for children, a mini-bar within the pool, the possibility of organizing celebrations, etc.). Through the research, they conclude that users will allocate 2,950 monetary units for such a service that meets their requirements and expectations.

The amount of the target cost must cover all costs incurred in the production or purchase of the product. Per the formula for calculating the target cost, it is necessary to determine the target price. As mentioned earlier, the target price is the result of market research by the marketing department. So, information on planned costs of products or services does not affect the target price. Cooper (1997) points out that the determination of the target selling price is influenced by a large number of internal and external factors. Internal factors should focus on the positioning of the new model in the matrix, the company image, strategic and profitable goals of top management for the observed model. External factors include customer loyalty, the expected degree of quality and functionality of the model compared to the competition and the expected price of the competition model.

In addition to the target price, to calculate the target cost, it is necessary to determine another element – the target profit. Cooper (1997) lists two ways to determine profits:

- The target profit for a particular product/service can be determined based on the actual margin percentage of its predecessor, but then we have to adjust the profit to changes in the market.
- Determine the average revenue of a product line with a margin that we then increase or decrease depending on market conditions.

When setting the target price, care should be taken to cover all costs over the life of the product or service, while the target profit varies depending on market conditions. The introduction of standard costs when applying the concept of target costing is an important category because standard costs show how much the costs in a given business environment should amount to. They are determined per unit of performance following standards (ideal standards, standards based on past performance, normal standards, standards based on future performance and standards based on achievable performance). Standard costs show how much the actual cost of direct material, labor, and overhead costs should be under normal conditions. Standard costs make sense of actual costs, because the deviations that occur are an indicator of loss or potential savings. The amount costs incurred when using the pool are given in Table 3.

**Table 3.** Amount of direct costs

Components	Functions	Standard costs (m.u.)	Share in the overall standard costs (%)
Pool cleaning	Tidiness	1.328	20,30
Water maintenance chemicals	Maintenance of pH value	2.375	36,31
Water heating	Ensuring adequate temperature	1.065	16,28
Electricity	Ensuring consumption	1.773	27,11
<b>Total</b>		<b>6.541</b>	<b>100,00</b>

\*m.u. – monetary units

**Source:** Authors based on: Ansari et al. (1997). Target Costing: the next Frontier in Strategic Cost

We will calculate the target price of the product using the net selling price defined on the market. We calculate the target cost as the difference between the net selling price, the target profit and the overhead cost. We compare the obtained target cost with the amount of standard costs and measure the deviation (Table 4).

**Table 4.** Target costing

Elements	Amount
Net selling price	2.950
Target profit	295
Overhead costs	590
Target cost	2.065
Standard costs	6.541
Deviation	4.476

**Source:** Authors based on: Ansari et al. (1997). Target Costing: the next Frontier in Strategic Cost

The deviation between the amount of standard costs and the target cost is 4,476 monetary units, and as the standard costs are above the target cost, appropriate measures need to be taken to achieve savings and reduce service costs. The reduction process should focus on components that are important to customers. The data in Table 5 is the basis for the analysis of the impact of individual components on customer satisfaction.

**Table 5.** Influence of individual components on customer satisfaction.

Service characteristics	Components			
	Pool cleaning	Water maintenance chemicals	Water heating	Electricity
Wide choice	25	35	28	12
Design	38	20	22	28
Dimensions	70	33	12	32
Economic characteristics	27	30	18	28
Ease of use	22	23	0	0

**Source:** Authors based on: Ansari et al. (1997). Target Costing: the next Frontier in Strategic Cost

The influence of components on product characteristics and market assessment of the importance of certain pool characteristics are shown in Table 6. The obtained results show that according to the answers of potential service users, the most important component is pool cleaning (35.67%) and water heating (17,53%).

**Table 6.** Influence of individual components on customer satisfaction

Service characteristics	Components			
	Pool cleaning	Water maintenance chemicals	Water heating	Electricity
Wide choice	7,47	10,45	8,36	3,58
Design	9,55	5,03	5,03	7,04
Dimensions	12,13	5,72	5,72	5,55
Economic characteristics	2,34	2,60	2,60	2,43
Ease of use	4,18	4,37	4,37	0
<b>Total</b>	<b>35,67%</b>	<b>28,17%</b>	<b>17,53%</b>	<b>18,60%</b>
<b>Ranking</b>	<b>1</b>	<b>2</b>	<b>4</b>	<b>3</b>

**Source:** Authors based on: Ansari et al. (1997). Target Costing: the next Frontier in Strategic Cost

The analysis of components conducted in this way allows managers to come to a conclusion about which components should be used in order to reduce costs. The manager can conduct a more detailed analysis for decision making and realization of the target cost by measuring the deviations of the target costs from the standard costs at the component level. The target cost per component is calculated by multiplying the percentage value of their contributions (Table 6) and the amount of the total target cost (Table 4).

**Table 7.** Target cost per component and deviation

Components	Target cost	Standard costs	Deviation
Pool cleaning	736,59 <sup>4</sup>	1.328	-591,41
Chemicals	581,59	2.375	-1,793,31
Water heating	362,03	1.065	-702,97
Electricity	384,00	1.773	-1,389,00
<b>Total</b>	<b>2.064,31</b>	<b>6.541</b>	<b>-4,476,69</b>

**Source:** Authors based on: Ansari et al. (1997). Target Costing: the next Frontier in Strategic Cost

We conclude that the application of the concept of target costing in hospitality companies allows a clearer determination of resources and costs. Calculating costs in this way is a good basis for making strategic and operational decisions. Decisions made at the design stage can affect the price of the product (Garrett): product characteristics; switching off “over design”; number of required components; whether the components are standard or specialized; complexity of machining and construction; where the product can be produced; what to produce in the company and what outside it (i.e. to include outsourcing activity); product quality and size of the batch in which the product can be produced.

The application of the concept of target costing in hospitality shows that it is justified to use it in this sector as a basis for encouraging cost management. It also enables the reduction of service costs and in that way, better positioning in the market is achieved. So, a well-established concept of target costing allows for teams inside and outside the hotel to work together to meet customer demands, thus increasing hotel value and performance. Therefore, it is very important to consider in detail the business process as a whole, and identify the key processes and their resources.

However, there may be limitations when applying the concept of target costing (Banham 2000): lack of understanding in the corporate community; cultural barriers against cross-functional cooperation; organizational barriers to teamwork; the existence of irrelevance regarding the effects, the process of developing a new product/service takes a long time because the design

<sup>4</sup> 2.065 (total target cost)×0,3567 (percentage value of contribution).

team implements several changes to meet the amount of the target cost; reducing the amount of costs can affect employee morale; it is difficult to achieve balance because a large number of people are involved in the decision-making process; if the estimated costs are low, an unnecessary burden is created on the production team; sometimes a company may opt for quality and lower-rank design to achieve the target cost and errors in the calculation of the target cost can lead to financial loss to the company.

## 5. CONCLUSION

Hospitality is a specific economic activity because, in addition to food and beverage services, it offers various social, cultural and health services to meet the wishes and needs of customers. New needs, requirements and wishes of customers have brought new trends in design. Continuous market research is a basic prerequisite for creating new services, achieving customer satisfaction and competitive advantage in the market.

The concept of target costing manages product costs through the design phase but ensures that the product/service is profitable enough to justify its production. The concept of target costing takes into account customer wishes and requirements and emphasizes product design and cooperation of employees from different fields

Managers should focus on the cost and quality of services provided. One way to manage costs is the concept of target costing. Given the concept of target costing, managers in service companies can:

- Define what characteristics the product should have in order to meet the requirements of customers.
- Define the selling price of a product/service at a level that can provide them with a competitive advantage.
- Plan profit and rate of return.
- Identify and manage costs at all stages of the process, not just the production phase.
- Develop close partnerships between hotel employees, but also with other hotels in the supply chain.
- Assess the market share of the product/service.
- By what advantage will the product/service differ from the competition?
- Identify product/service features to differentiate them from competitors.
- Identify resources a company can save without jeopardizing the competitive advantage of the product/service.
- Reduce business risk and encourage innovation.
- Provide a basis for strategic decision making

Thus, the concept of target costing has replaced traditional methods for determining market prices of services. It enables the reduction of service costs while maintaining the required quality. It is mainly aimed at reducing or eliminating costs that do not affect the value of products/services.

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