

# Enterprise Theory : Costs



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## CONTROLLING: Costs

- Basic cost groups consist of:
  - operating costs:
    - ❖ material consumption
    - ❖ Power or energy consumption
    - ❖ consumption and use of external works and services (production cooperation, telecommunications, consulting, repair, etc. services)
    - ❖ personal expenses (wage expenses including health and social insurance)
    - ❖ depreciation of long-term tangible and intangible assets
  - financial costs (interest, insurance premiums, taxes)
  - extraordinary costs (shortage, damage, natural disasters)

## **Example**

Decide whether it is an operational, financial or extraordinary expense:

- car depreciation
- paper consumption in the production of magazines
- consumption of office supplies
- shortfall in the cash register
- insurance premiums against natural disasters
- internet service fee
- exchange rate loss
- social insurance

## **Breakdown of costs according to place of origin and responsibility (unit and overhead costs)**

- Where did the costs occur and who is responsible for their occurrence?
- Classification by internal company departments:
  - Production costs:
    - ❖ technology costs:
      - unit costs (directly related to the performance unit (t, kg, piece,...), proportional dependence on production volume)
      - overheads
    - ❖ costs of service, provision and management - overhead costs
  - Non-production costs:
    - ❖ sales management
    - ❖ administrative overhead
    - ❖ supply overhead etc.

### **Cost breakdown (direct and indirect costs)**

- what the costs were spent on (which products and services)
- very important for the business world, because it can find out:
  - profitability (profitability) of individual items of products and services provided
  - how individual products or services contribute to the creation of the economic result (profit) and thereby influence the range of products and services on offer
  - whether to operate the given service in-house or rather to buy the given service (outsourcing)
  - the minimum price for the business area
- we monitor costs depending on the method of assigning costs to cost bearers (per performance, so-called calculation unit):
  - direct costs (unit costs and overheads that are directly related to a certain product)
  - indirect costs (common to a group of products, i.e. overhead costs that cannot be assigned to a specific product)

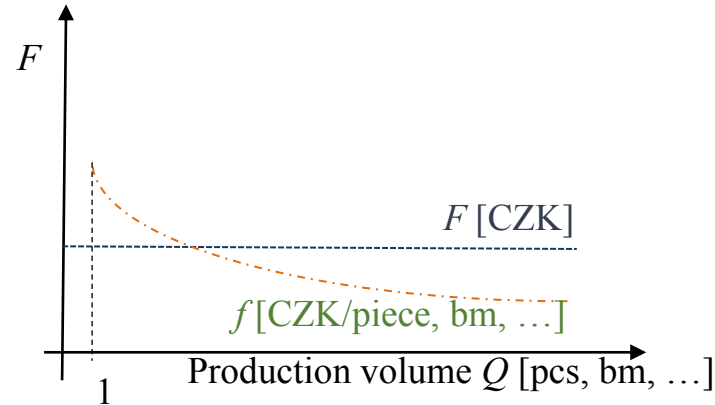
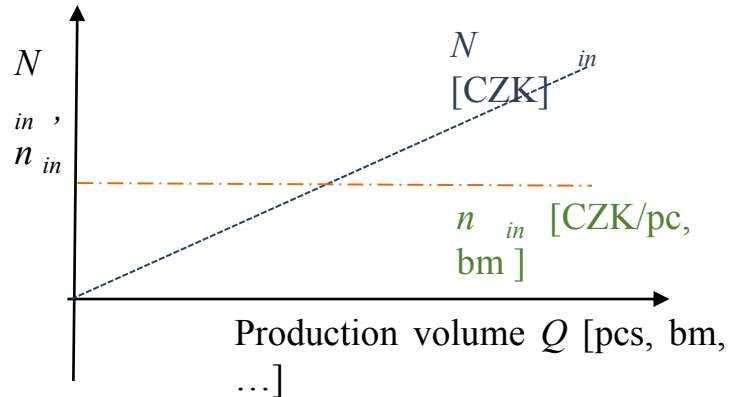
## **Example**

Determine whether it is a direct cost or an indirect cost:

- paper consumption in book production
- company management salaries
- consumption of office paper
- brand promotion
- power consumption
- material warehouse cleaning costs
- social insurance
- water, sewage, waste disposal

## Breakdown of costs depending on changes in production volume

- it makes sense when managing costs for a period of less than 1 year
- variable costs – their amount depends on the volume of production
- fixed costs – their amount is not tied to the volume of production



**Example**

Decide whether it is a fixed or variable cost in each of the following cases:

- monthly wages of company management
- paper consumption in book production
- gas consumption for heating the production hall
- cost of purchasing goods (store)
- brand promotion
- electricity consumption in an office building
- internet connection fee
- petrol consumption of a taxi car
- gasoline consumption in a car used for the needs of executives



## Reaction coefficient:

- It indicates the degree of cost variability when production volume changes
- The starting point when classifying costs between fixed and variable

$$k = \frac{((N1/N0)*100)-100}{((V1/V0)*100)-100}$$

$k = 1$  are proportional

$0 < k < 1$  are degressive (decrease in costs with growth in volume)

$k > 1$  are progressive (faster growth than volume)

$k < 0$  are regressive (decrease in level, reduction of variable costs)

Note For the same units (in CZK):  $k = (N1/N0)/(V1/V0)$

### **Example:**

The amount of energy costs in 2014 was 55,600 CZK, in 2015 this amount was 29,300 CZK. Sales in 2014 amounted to 820,500 CZK, in 2015 they amounted to 865,000 CZK. Calculate the reaction coefficient.

### **Example:**

The amount of energy costs in 2014 was 55,600 CZK, in 2015 this amount was 29,300 CZK. Sales in 2014 amounted to 820,500 CZK, in 2015 they amounted to 865,000 CZK. Calculate the reaction coefficient.

### **Solution:**

$$k = (N1/N0)/(V1/V0)$$

$$k = (29,300/55,600)(865,000/820,500) = 0.527/1.054 = 0.5$$

### **Breakdown of costs from the point of view of internal cost management**

- primary costs – arising from the consumption of economic resources from the external environment of the enterprise
- secondary costs:
  - they arise from transfers of intra-company services between cost centers within the company
  - they arise from the center that receives in-house services created by the supplying center of the same company

### **Example:**

In the company, the transport plant will ensure the transportation of material for the production plant, then the performance of the transport plant is a secondary cost of the production plant. However, if the transport is provided by an external carrier, it will be primary cargo.

### **Costs by business function**

- according to the activity (function) with which the arising costs are connected, the following can be distinguished:
  - acquisition costs (negotiations on material supplies, ordering materials, transportation of materials, ...)
  - storage costs (storage of material in the warehouse, suitable conditions for storing the material, inventory records, issue of material from the warehouse)
  - costs consumed within the production process
  - the costs of the activities of administrative departments
  - costs associated with removal of finished products (sales)

## Managerial concept of costs

- in contrast to the accounting concept of costs, it works with economic (real, relevant) costs , which, in addition to costs, also include so-called opportunity (alternative) costs (costs of sacrificed (lost) opportunities ) – lost income that is lost when the production resource is not used for the best option
- we define economic profit - the difference between total revenue and economic costs
- ATTENTION! Zero economic profit does not mean that the accounting shows a taxable base of 0!

## **Example**

Libor Holub is currently employed as a truck driver and his annual gross salary was CZK 300,000. When he starts a business, he can no longer drive a truck. If he is going to run a business, he will need a barn, which he has been renting out for CZK 10,000 a year. He assumes that he will earn 540,000 CZK per year, while he will use materials and energy for 122,000 CZK, depreciation of equipment will amount to 40,000 CZK, other costs will be 60,000 CZK. Find out if Mr. Holub's business will pay off.

# For a correct assessment of costs, you need to know:

- **Total cost** as a function of production volume  $CN = f(Q)$ 
  - It should be true that as production increases, total costs should also increase
- **Average cost of  $CN / Q$**
- **Business result: Revenues-total costs**
- **Cost effectiveness** : profit/cost
- **Profitability of sales** : profit/sales
- **Cost efficiency** : sales/costs .... should be greater than 1
- **Cost h**: costs/revenues (sales) ... opposite ratio, should be lower than 1
- **Percentage change (PZ) of costs per crown of revenues**:
  - $PZ = (h_1 - h_0) / h_0 \times 100$ ,
  - $h_0$  is the actual cost achieved in the previous year
  - $h_1$  is the planned or expected cost in the current year





Thank you for your  
attention 😊

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