

Costs - Are you in control?

In many business environments, the focus can be on sales, with the belief that so long as you are selling, then the business will be fine. However, without good cost control and an understanding of where the break-even point is, then the business can find itself not maximising their returns, or worse, in financial trouble very quickly.

This is particularly the case in a manufacturing environment, where there are many different parts of the overall final cost. These should all be reflected in any cost analysis, and include;

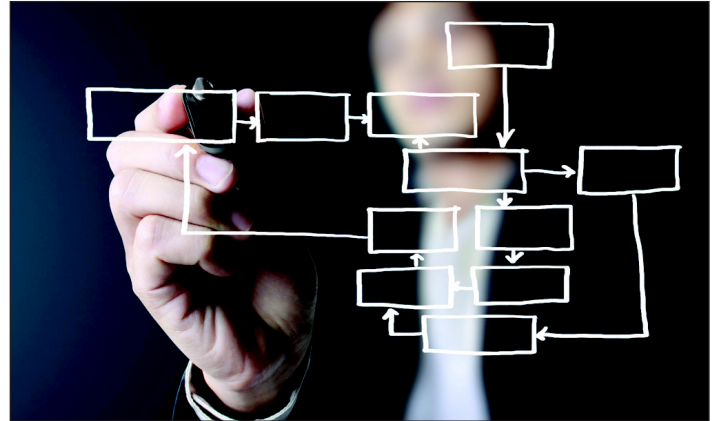
Materials; this is not only the basic material used in the production process, it is also the additional stages which it may have to go through, such as the paint shop, galvaniser, shot blasting etc, as well as various fixings and fastenings. All these materials need to be taken into account to get the true material cost.

Wages; this usually consists of direct labour on the factory floor, who process the materials through various machines and stages of production. Each employee should be accounted for in any cost calculation, based upon hours spent and hourly rate.

Sub-contractors; many manufacturing operations outsource parts of the final product, with key components being manufactured offsite. This cost needs to be accurately reflected.

Transport; all sales will have delivery costs, whether that be shipping or road haulage. This needs to be known and in many cases may be borne by the customer directly. However, where the customer does not pay for transport, then this needs to be absorbed into the product costs.

Overheads; each business should know what costs have to be incurred on a weekly, monthly and annual basis for insurance, rent, rates, telephone, electricity, indirect office wages etc and these should be included within the cost calculation.



Waste, idle time and holidays; while job costings look at what it should cost to manufacture a product, there will be instances of waste, idle time and holidays. An allowance should be made for this also.

Rework and warranty; quality and getting it right first time can have a significant impact upon costs and profitability.

Currency; this can also be a factor with respect to cost and should be reviewed regularly.

Before anything is sold, the cost to the business (the point at which no profit is made) should be known, to ensure that the product is not loss making. It may be the case that the price is the “market price”, and the business cannot get anything more than that. However, if this is not more than the minimum cost price, then the business would be better without the sale, as it will only reduce any profits already made to date.

Businesses also need to understand the difference between the “one off” job and the established product — the hidden costs of learning and defining the ‘one off’ job may often have significant negative impact on costs.

Accurate, timely and relevant management information, including a comparison of budgets within actual costs, is essential to any business. Costs should be updated with any price changes to materials and wages, and any other changes within the organisation. Monthly reviews should be carried out to ensure that the company is trading profitably and not simply working at a loss.