



How well do you know your cost structure and the profitability of your products?

It is critical to the success of your business that management knows the exact cost of every component of the company's products and/or services. An efficient business effectively monitors its costs and tightly controls any elements that impact their products and services to insure that they are produced efficiently and at such a level that profits are possible. Three of the main causes of business insolvency are:

- Costs that get out of control
- Costs that no one understands
- Costs that no one is aware of

Highly efficient business owners are meticulous with their capital and attempt to monitor and control their costs at all times. They practice efficiency and cost effectiveness in all business areas and are constantly searching for ways to reduce the costs of their business's operations. If you want your business to be a success, it is imperative that you know the precise cost of each of its products and/or services. As a result of a deficient cost control, numerous companies lose money on many of the products they sell. Analyzing a business's costs should be an ongoing project that is a key responsibility of management.

Costs are broken down into several distinct categories. Each of which can have an impact on the cost of your business and must be thoroughly understood:

- **Fixed Costs** – These are the costs which for a given period of time and range of activity, do not change in total but become progressively smaller on a per unit basis as your company's volume increases.
- **Variable Costs** – These are the costs you incur each time you make a sale. Typically, this is a cost which is uniform per unit, i.e. labor, raw materials, costs of goods sold, sales commission, postage, and shipping.
- **Semi-variable Costs** – These are the costs that are partially fixed and partially variable, i.e. utility costs and advertising. They will increase or decrease with sales and business activities, but not necessarily in an exact proportion.
- **Sunk Costs** – These costs represent an outlay of funds, made in the past that can't be recovered, i.e. training for employees, education costs, or equipment costs. Essentially this is time and money spent that the company can't get back.
- **Opportunity Costs** - These are the maximum alternative earnings that the company might have been able to obtain if the productive goods, services or capacity had been applied to some alternative use.

If your company provides multiple products or services, you should establish the precise profit level for each one. Management should conduct a complete cost analysis of each product or service and include a percentage of all fixed costs that are attributable to

each item that the company sells. Also include the exact amount of variable and semi-variable costs per item and include such things as an allowance for returns, bad debts, shrinkage, breakage and other related costs. Establish exactly how much it costs, and how much the company earns, from the sale of each of the company's products or services.

Highly profitable businesses constantly examine each line item cost and look for ways to effectively reduce them. The more management develops the company's ability to accurately analyze and establish the precise costs of its products and services, the more profitable the business can become. GBQ Partners has the resources to assist your company in the analysis of its costs and profitability of its products and/or services. Our professionals have many years of experience in working with manufacturing and service industry clients and we look forward to sharing that value-adding experience with you.