

Managing Money: Costing

“Whoever can be trusted with very little can also be trusted with much, and whoever is dishonest with very little will also be dishonest with much”

Types of Costs

Name	Definition	Examples
Direct Cost	A cost that relates to a specific activity and only occurs when you do that activity.	<ul style="list-style-type: none"> • Fabric used to make a dress • A hand bag you purchase that you will re-sell
Indirect Cost	A cost that does not relate to any specific activity and is incurred through the general running of the business.	<ul style="list-style-type: none"> • Rental for your shop • Staff salaries • Electricity from running your sewing machine all day
Fixed Cost	A cost that you incur regardless of how many units of product you make or sell	<ul style="list-style-type: none"> • Rental for your shop • Staff salaries • Advertising costs
Variable Cost	A cost that you incur only when manufacturing or selling products. If you make no products you will not incur this cost but, for every unit you make or sell, you incur an additional cost	<ul style="list-style-type: none"> • Thread used for sewing a dress • Electricity used to run your sewing machine • Wood used for making a chair • The paint used to paint the chair

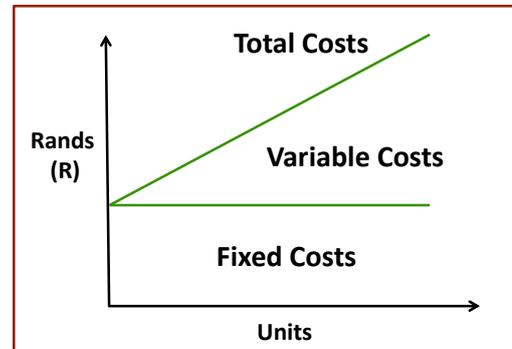
Knowing all of your costs will assist with accurate budgeting. So understanding which costs vary with production, and which costs are likely to go up as demand for a particular product increases, is of great importance when planning cash flow.

Also understanding the pattern and timing of your income is essential. How long does it take from the moment I purchase a product, or the raw materials to make a product, before I can collect the cash from my customer?

With each business cycle it is therefore essential to know:

- All of the variable costs you will incur
- Which fixed costs become due in each business cycle
- How long it takes to make each product (or source a product that you will re-sell)
- How long it usually takes to sell each product and collect the cash after it has been bought or made
- How much of your income is “cash on delivery” and how much is sold on credit for collection at the end of the week or month

- Understanding your total costs (variable plus fixed costs) is also important as this could limit the number of products that you can make before you need to go and sell



Group Exercise 1

A farm owner has given you the opportunity to run the milk bottling and selling activity of his dairy as your own small business. Before agreeing to take this on, you develop a list of all the costs that you expect to incur.

- Decide which of these costs are fixed cost and which are variable costs
- If you sell 500 litres of milk in a month, what is (a) your total cost and (b) what is your total cost per litre?

Question 1:

Item	Unit	Cost (Rands)	Fixed Cost (R/mth)	Variable Cost (R/Litre)
Milk Cost	R/Litre	3		3
Bottle Cost (1 litre bottles)	R/Bottle	2		2
Rent	R/month	1 000	1 000	
Wages (1 staff member)	R/month	3 500	3 500	
Electricity & Water	R/Litre	0.5		0.5
Telephone	R/month	250	250	
Petrol for delivery	R/month	200	200	
Advertising	R/month	300	300	
Totals			5 250	5.5

- The Cost of the Milk is a *Variable Cost* but it could also be referred to as *Cost of Sales*

Question 2:

Item	Unit	Calculations	Total Cost (Rands)
Milk Cost	R/Litre	= 3 x 500	1 500
Bottle Cost (1 litre bottles)	R/Bottle	= 2 x 500	1 000
Rent	R/month		1 000
Wages (1 staff member)	R/month		3 500
Electricity & Water	R/Litre	= 0.5 x 500	250
Telephone	R/month		250
Petrol for delivery	R/month		200
Advertising	R/month		300
Total Cost (Rands)			8 000
Total Cost / Total Litres	R / Litre	= 8 000 / 500	16.00