



- White Paper -

Cost Analysis: *Measurement and Informed Decisions*

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How can you manage what is not measured and make an informed decision? Knowledge of costs is needed to make intelligent managerial and financial decisions and help examine the effectiveness of cost incurrence. It helps define whether costs are excessive, how operations and activities are going, how to formulate pricing, how to analyse cost data for short-term and long-term decisions, how to manage and control costs, how to set realistic profit goals, and how to develop a better mix of products and territories. As such, cost information is needed for planning, control, and decision making.

Introduction to Cost Analysis

Cost Analysis looks at the different types of costs incurred and how they may be controlled from a functional, manufacturing and process perspective. Cost Analysis examines the costs associated with a particular decision and what may be done about those costs in the future.

By knowing what costs are and how they behave across inter-dependent functional departments, you can take steps to improve efficiency and engage in cost-reduction programs.

There are a few basic end-goals in wanting to manage cost, they include:

- ***Cost Reporting***: Classifying, summarising, communicating and interpreting cost data to various internal or external stakeholders;
- ***Cost Measurement***: Relating to specific products, services, or sub-unit within the organisation
- ***Cost Management***: Obtaining accurate product-costing data and managing it to assist managers in making critical decisions such as pricing, product mix, process technology, and largely a matter of choosing between alternative courses of action;
- ***Cost Analysis***: Analysing cost data, translating it into information useful for managerial planning and control, and for making short-term and long-term decisions.

Cost information is vital for all phases of management. In general, the work that management performs can be classified as:

- ***Strategic Planning***: Involves the selection of long-range and short-term objectives and the drawing up of strategic plans to achieve those objectives;
- ***Coordinating***: During the coordination function, management must decide how best to put together the firm's resources in order to carry out established plans;
- ***Controlling***: Controlling entails the implementation of a decision method and the use of feedback so that the organisation's goals and specific strategic plans are optimally obtained;
- ***Decision Making***: Decision making is the selection of the best alternative choice to accomplish the company's goals.



Which Costs?

There are different types of costs used for different purposes. Some costs are useful and required for inventory valuation and income determination. Some costs are useful for planning, budgeting, and cost control. Still others are useful for making short-term and long-term decisions. Costs can be classified into various categories, according to:

1. Management Function
 - 1.1. Manufacturing/Services costs
 - 1.2. Non-manufacturing/Services costs
2. Traceability
 - 2.1. Direct costs
 - 2.2. Indirect costs
 - 2.3. Activity costs
 - 2.4. Process costs (sequential, parallel, selective)
3. Timing of Charges Against Sales Revenue
 - 3.1. Product costs
 - 3.2. Period costs
4. Behaviour in Accordance with Changes in Activity
 - 4.1. Variable costs
 - 4.2. Fixed costs
 - 4.3. Mixed (semi-variables) Costs
5. Degree of Averaging
 - 5.1. Total costs
 - 5.2. Unit (average) costs
6. Relevance to Planning, Control, and Decision Making
 - 6.1. Controllable and non-controllable costs
 - 6.2. Standard costs
 - 6.3. Incremental costs
 - 6.4. Sunk costs
 - 6.5. Out-of-pocket costs
 - 6.6. Relevant costs
 - 6.7. Opportunity costs

Each of the costs above are inter-related amongst themselves and inter-dependent. Each one of these costs will vary accordingly based on the decision being made in a particular department.

Summary

One important aspect of cost analysis management deals with the problem of allocating costs to various segments of the organisation. The segments can be products, divisions, departments, or sales territory. Cost allocation is necessary to provide useful data for:

- Product costing and establishment of a selling price
- Evaluation of managerial performance and control
- Making special decisions

Many companies use a traditional cost system, such as job-order costing or process costing, or some hybrid of the two. This traditional system may provide distorted product cost information for



companies that sell multiple products making critical decisions about product pricing, making bids, or product mix based on inaccurate cost data.

Not all costs behave in the same way. There are certain costs that vary in proportion to changes in volume or activity, such as labour-hours and machine-hours. There are other costs that do not change even though volume changes. An understanding of cost behaviour is therefore helpful:

- For break-even and cost-volume-profit analysis
- To appraise divisional performance
- For flexible budgeting
- To make short-term choice decisions
- To make transfer pricing decisions

BvW Global can provide you with a cost management system necessary to support your management's needs for better decisions about product design, pricing, marketing, mix, and to encourage continual operating improvements. In addition, we use quantitative methods in various phases of cost analysis to determine costs and their financial effects, department correlation, and the financial feasibility of adopting alternatives.

About BvW Global

BvW seeks to reduce costs and increase profit across the entire business chain through its proprietary Revenue Management, Cost Management, and Trading Partner Management systems.

BvW delivers strategic, operational and tactical outcomes through tailored technology enablers. Our practitioners provide ongoing business mentorship through 'best of breed' expertise in local and international markets.

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