



Notes – Topic 2

Cost

- I. Definition
 - a. Profit – Revenues = Costs
 - b. Revenue belongs to the marketers. Cost belongs to the accountants.
 - c. Cost is a sacrifice of some kind.
 - d. Usually measured in resources used.
 - e. Done to achieve a specific end.
 - f. An expense is a cost incurred toward the goal of generating revenue.
- II. Functional Perspective
 - a. Product Costs
 - i. Relate directly to manufacturing
 - ii. Direct Costs
 - 1. Can be directly traced to a particular product
 - 2. Direct Material. Physically incorporated into the product.
 - 3. Direct Labor. Physically changes the product.
 - iii. Indirect Costs
 - 1. Indirect Material
 - a. Not directly incorporated in the product. Eg: Drill bits.
 - b. Some material is incorporated in the product but is still counted as indirect. Eg: fasteners.
 - 2. Indirect Labor
 - a. Supervisors
 - b. Material handlers
 - c. Anyone not actually working on the product.
 - 3. Other
 - a. Idle Time. Time during which labor is paid but where workers can't be productive. Eg: Changeover between production runs.
 - b. Overtime Premium. Amount paid above 'time'.
 - c. Depreciation. "Biggie!"
 - d. More automation shifts costs from DL to here.
 - iv. Direct costs called "Prime Costs"
 - v. Direct Labor + Indirect Costs = "Conversion Costs." Cost to convert raw material into the product.
- III. Cost Management Perspective
 - a. What do we want to know?
 - i. Current costs / cost structure
 - ii. Cost trends
 - iii. Controllable vs. Uncontrollable
 - iv. Which suppliers are competitive.
 - v. What financial resources are available
 - vi. Efficiency measures.
- IV. Types of Production Operations
 - a. Categorized by volume, level of customization, intensity of direct labor.
 - b. Job Shop. Low volume, high customization.
 - c. Batch. Still customized, but in batches of maybe 100 or 1000.
 - d. Assembly Line. High volume, low customization.
 - e. Mass Customization. High volume, high customization.
 - f. Continuous Flow. Each unit identical, high volume. (Eg: Oil)
 - g. Not all processes fit perfectly into one category!