

Cost of Production

- Profit = Total Revenue (amount sold x price paid by customer) - Cost of Production
- Cost of Production = Sum of every input cost needed to produce a product or service; the lowest amount you can sell your product or service for and still pay expenses

Input Costs – Fixed vs. Variable Costs

- Variable costs" - increase directly in proportion to the level of sales in dollars or units sold. Examples would be cost of goods sold, sales commissions, shipping charges, delivery charges, costs of direct materials or supplies, wages of part-time or temporary employees, and sales or production bonuses.
- "Fixed costs" - remain the same regardless of your level of sales. Examples would be rent, interest on debt, insurance, plant and equipment expenses, business licenses, and salary of permanent full-time workers.
- “Combination costs” or “Mixed Costs” – combination of mixed, e.g., salary and commission; technically could be divided into two categories

Examples

- Fertilizer
- Bottling Machine
- Tax preparation
- Plant starts
- Labor – loading and unloading
- Labor – management
- Land Leasing
- Electricity
- Advertising
- Continuing Education
- Taxes
- Travel time/cost
- Shipping

Opportunity Costs

The cost of an alternative that must be forgone in order to pursue a certain action. Put another way, the benefits you could have received by taking an alternative action.

- Your Time
- Your personal resources, i.e., home, car, etc.

Who Cares

- Determining where the money is going
- Controlling costs
- Evaluating price being offered,
- Determining the price,
- Managing the business
 - Can you afford excess capacity? What is the tradeoff between acquiring capacity at today's rate vs. acquiring capacity at a later date? Is it worth it?
 - Determine how much would the cost-of-goods-sold change if the output level increases by five percent
 - Evaluating land yield – need for soil amendments vs. need for water

In order to calculate costs, you will need to decide on:

- unit, e.g., fish, lb. of fish, 8 oz. bottle, per 8 oz. serving, per hour of service
- for farming, units per acre, units per water tank
- length of time – day, month, year; planting cycle, “run”
- space, e.g., per acre
- degree to which fixed costs are shared with other products or services

Exercise

How is your product or service sold? By the lb., hour, unit?

How is your product or service produced? By the acre, by the run?

Using the worksheet, brainstorm the major fixed and variable expenses for your business.

- Present it to the group for their feedback.