Cost and Earning Dynamism: The Financial Relationship to Growth and Survival

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Abstract

The study examines the relationship between cost and earning and the survival effect on growth and long term net return. The secondary data from the financial reports of Cadbury Nigeria Plc was adopted for the study from year 2001 to 2010. The multiple regression analysis was adapted. The study revealed that while distribution expenses and administrative expenses impacted on net return of the firm, distribution expenses have more per unit influence on earning than all other cost. It was recommended monitoring and cost reduction strategies should be adopted by the firm as this will increase the capital earning of the firm.

Introduction

Cost remains a strong factor in the process of price determination and turnover generation. Most firms who made lost do so for poor cost management and effective material management. In manufacturing operational cost are divided into administrative and distributive cost, directly related to production is the cost of goods sold or cost of sale, Which must be deducted from turnover to give gross profit all these costs produce his business risk of the firm others not production. Record cost result in financial risk namely interest paid on debt (loans and advances). Thus, for effective management of the firm financial risk related cost and business risk related cost must be well managed for survival and growth. Thus, it incumbent on the firm to examining the various financial risk and business risk related costs and its impact on any of the firm. The growth and survival problem in most firms are cost management related, the inability to assess the efficient of cost on earning to leave his firm open to several operational risk and survival costs. Thus, this study examines the relationship between organization costs of production and administration to earning performance of the firm using Cadbury Nigeria plc as study.

Cost define

The term ‘cost’ means the amount of expenses [actual or notional] incurred on or attributable to specified thing or activity.(yusuf,2009 ) In accounting, costs are the monetary value of expenditures for supplies, services, labor, products, equipment and other items purchased for use by a business or other accounting entity
The term cost is used in reference to production or manufacturing of goods and services, cost refers to sum total of the value of resources used like raw material and labour and expenses incurred in producing or Manufacturing of given quantity. (Econedlink, 2013. Kehinde, 2011)

The Institute of cost and work accountants (ICWA) defined Cost as ‘measurement in monetary terms of the amount of resources used for the purpose of Production of goods or rendering services. In relation to production Cost include the value of raw material, amount paid to labour and cost of overhead of production (ICWA, 2012)

**Cost concept**

Cost concept allows the cost of producing the good to be stated in term of the absolute cost of producing the good called the total cost. The total cost is the sum of all costs in generating a good it can be stated in term of a unit produced or in term of all product or unit term of a batch or contract done. Yusuf (2009) said cost can be classified according to function, element, responsibility, definition and behaviour. In relation to function total cost include production cost, marketing cost, selling cost, distribution cost, research cost and development cost, according to element, cost is classified as material cost, labour cost and overhead cost in relation to responsibility can be controllable cost and uncontrollable cost, by definition cost can be stated as total cost standard cost, opportunity cost, direct and indirect cost incremental cost, fixed cost, variable cost and semi-variable cost. (Baker, 2000).

Kelly (2002) stated that Direct Cost is the cost assigned specifically to a given or particular service. And A cost necessary for the functioning of the organization as a whole is known as indirect Cost. Total Cost is the sum of all costs, direct and indirect, associated with the provision of a given or particular service or in production of a certain good.

A fixed cost is a cost that does not change with increases or decreases in the amount of service provided (e.g., rent) over time while the cost that increases or decreases with increases or decreases in the amount of service provided or good is called Variable Cost

**Concept of avoided cost**

Avoided cost is the cost a producer would incur to generate a product it did not purchase product from another source it is therefore the opportunity cost of not purchasing a product but produce it directly conversely it would be the cost at which a producer would rather have purchase a product rather than produce the item.

Avoided cost provides the basis of the rate required to be paid for a product or a unit of a product. it deal mostly with direct cost of a product (Beecher, 2011). The concept of avoided cost relate to the selection of the least cost in recourses planning, it is a centre characteristic of integrated recourse planning (IRP). It has the benefit of avoiding unnecessary cost. Avoided costs can be used to evaluate the benefits of resource alternatives on the supply side. it also relate to the incremental cost approach in the context of IRP for units of a product, avoided costs are the incremental savings associated with not having to produce additional units of the product or service while demand requirements is still being met (Beecher, 1995).
Opportunity cost, also referred to as economic cost, is the value of the best alternative that was not chosen in order to pursue the current endeavor—i.e., what could have been accomplished with the resources expended in the undertaking. It represents opportunities forgone. Total cost is the sum of all costs, it is the total amount expended on production of goods and services. In addition, total cost can be a useful concept in comparison of the organization’s service delivery efficiency with either the private sector or other governments. The firm’s ability to determine the total cost of a service, however, is of limited value; understanding total cost should always be the goal.

Understanding total cost by examining its components can provide the information necessary for informed decision making. It allows an organization to focus its actions where it will be most effective.

Yusuf (2009) classified cost according to functions, elements, responsibility, definition, and behavior. Every one of these concepts is applicable to situations in which cost is a central focus. Cost according to definition can be stated as total cost, standard cost, opportunity cost, direct cost, indirect cost, and incremental cost. Direct and indirect are useful concepts whenever a service charge is being evaluated because it is concerned with the measurement of the total organization effort required to deliver a service.

The concepts of direct and indirect costs provide one of the basic approaches to cost analysis, an approach that stresses the organizational structure of the jurisdiction.

Cost according to function can be stated as administrative cost, production cost, selling cost, distribution cost and development cost (Yusuf, 2009).

It is useful to distinguish between two types of indirect costs: indirect service costs and indirect administrative costs. Indirect service costs are those that might be performed by a service unit by and for itself, but which are centrally controlled—usually for reasons of efficiency, control, or economies of scale, a centralized data processing operation or a purchasing function fall into this category.

Indirect administrative costs are associated with activities that must be incurred by the organization, but which do not directly benefit any service delivery function.

Total cost concept

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**Research problem**

In many an organization the performance of the firm is mostly viewed in relation to business risk represented by administration and distribution cost and not in relation to some other costs that are deemed not to be directly related to the organization performance this are cost relating to the financial risk of the firm represented by the interest paid to debt holders of the firm the problem also lies in relating earning performance only to distribution cost and not to administrative expenses with the notion that administrative cost is firm-wise and also fixed in nature.

**Research method**

The study was carried out using the secondary data sourced from the annual financial reports of the firm. The study firm is Cadbury Nigeria plc. The ordinary least square regression model was adopted for the study. The study covered a period of 2000 to 2010. The variables were tested for presence of unit root using the Augmented Dickey Fuller (ADF) unit root test,

**Model Specification**

Netprofit  = (Dexp, Aexp, interest )
Nprofit = a_0 a_1Dexp + a_2Aexp + a_3Int + u 
Where
Nprofit = Net profit
Dexp = distribution expenses
Aexp = Administrative expenses
Int= Interest paid

<table>
<thead>
<tr>
<th>Table1</th>
<th>t-statistics</th>
<th>Decision rule</th>
<th>Asymp.prob</th>
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<tbody>
<tr>
<td>Csales</td>
<td>2.747676</td>
<td>I(1)</td>
<td>0.0629**</td>
</tr>
<tr>
<td>Dexp</td>
<td>2.416274</td>
<td>I(1)</td>
<td>0.0521**</td>
</tr>
<tr>
<td>Aexp</td>
<td>-2.700907</td>
<td>I(1)</td>
<td>0.0355*</td>
</tr>
<tr>
<td>Interest</td>
<td>2.793676</td>
<td>I(1)</td>
<td>0.0234*</td>
</tr>
</tbody>
</table>

(*)(**) two asterisks denote rejection of the hypotheses at 0.01 and one asterisk at 0.05
The study test for the relationship between net profit and various costs in the organization, to ensure the stationarity of the variables, the unit root test using the Augmented Dickey Fuller (ADGF) was carried out on the variables the result is presented in table 1.

Table 1 shows the result of the ADF unit root test for the variables cost of sales (Csales), distribution expenses (Dexp) Administrative expenses (Aexp) and interest (paid on loan) were all stationary at first difference using the Mackinnon (1996) one sided P-value at 10% for cost of sales and distribution expenses and 5% for administrative and interest paid.

Table 2

<table>
<thead>
<tr>
<th></th>
<th>Coefficient</th>
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<tr>
<td>C</td>
<td>376509.7</td>
<td>0.03599</td>
</tr>
<tr>
<td>Dexp</td>
<td>-0.45560</td>
<td>0.0126</td>
</tr>
<tr>
<td>Aexp</td>
<td>0.989280</td>
<td>0.055</td>
</tr>
<tr>
<td>Interest</td>
<td>-0.166786</td>
<td>0.0305</td>
</tr>
<tr>
<td>R</td>
<td>0.98048</td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td>0.961340</td>
<td></td>
</tr>
<tr>
<td>adjusted R²</td>
<td>0.922679</td>
<td></td>
</tr>
<tr>
<td>Prob(f-stat)</td>
<td>0.012754</td>
<td></td>
</tr>
</tbody>
</table>

Dependent variable = Nprofit

Sources: analysis by author

Table 2 shows the least square regression result of the model expressing Nprofit as the dependent variable on dexp, aexp, interest the regression revealed a correlation coefficient (R) of 0.98048 or 98% . the determinant variable have high effect on the Nprofit. there exist a every high relationship between the deterministic or the explanatory variables and the dependent variable .the coefficient of determination stands at 0.922 or 92% which suggest that 92% change in net profit id due to interest paid , distribution expenses and administrative expenses and the remaining 18% change is due to other factors, it is also observed that a negative relationship exist between distribution expenses , interest and net profit while a positive relationship exist between net profit and administrative expenses . a unit change in distribution expenses, administrative expenses and interest paid will yield -0.04550,0.989280, -0.166786 of net profit

The study also revealed that a significant relationship exist between distribution expense and net profit at both 10% and 5% significant level with value of 0.0126 and the relationship between net profit and administrative expenses is significant at 90% confident level and not at 5% at a value of 0.055 while interest paid is significant at both 5% and 10% confident level with a value of 0.0305. Using the asymptotic probability of f-statistic all the independent variables are of significant value on the dependent variable at 90% confident level with a value of 0.012754 or 0.01 by way of estimate.
Conclusion and recommendation

The study shows that there is a close relationship between net profit and the three costs of operation and administrative cost, distribution cost and the interest paid constitute significant factor that influence net profit, however, distribution cost remain the most influencing factor. Moreover, the various costs are stable in the short run except net profit that is not stable in the short run it should be noted that although cost of sale was tested for stationary but was excluded from the model for the fact that it inclusion in the model would not produce any significant effect and would not influence the net profit of the firm. Also the loan volume of the form is far in the past it inclusion in the model is the test the probable effect it will have on the net profit of the firm in the years of it occurrence. It effect also on the result is due to the fluctuating nature of the net profit itself which made it not really stable.

It is recommended that the management of the firm should pursue cost reduction strategy and ensure that the administrative cost should be monitored for effectiveness

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