Ag Decision Maker

File A2-06
November 2009
www.extension.iastate.edu/agdm

Cost Terms

Activity-cost analysis - Assigning costs to the various value-creating activities of a business.

Agency costs - Costs associated with slack effort by employees and the costs of administrative controls designed to deter slack effort.

Common costs - Costs that must be allocated among two or more functional areas.

Cost drivers - Economic forces that cause costs to vary across different organizations.

Cost of capital - The rate of return needed to entice investors to provide financial capital to the business.

- **Weighted cost of capital** – The cost of capital computed by weighing the percentage borrowed and the percentage from investment sources.

Direct costs - Costs that are traceable to the production of a specific product or enterprise.

- **Direct labor costs** - The costs of labor that are physically traceable to a specific product or enterprise.
- **Direct materials costs** - The costs of all materials and components that can be physically traced to a specific product or enterprise.

Indirect costs – Costs that are not directly traceable to a specific product or enterprise.

- **Indirect labor costs** - Salaries of production workers whose efforts usually are not directly traceable to the finished good, including personnel, quality-control workers, and inspectors.
- **Materials overhead** - The costs of indirect materials (supplies, such as glue or solder, that are used in small quantities in many products); also includes the costs related to the procurement and movement of materials, such as the salaries of purchasing, receiving, and stockroom personnel.

Managerial costs – Costs that are categorized so they can be used in decision making.

- **Fixed costs** - Costs that are incurred regardless of the level of output. This includes costs such as depreciation of facilities, administration and other overhead costs.
- **Variable costs** - Costs that change in direct proportion to output. For example, the cost of livestock feed is a variable cost because the amount of feed used varies in direct proportion to the number of livestock.

Opportunity cost - The economic cost of using a resource for a specific activity is equal to the income foregone by not using it for an alternative activity. For example, the opportunity cost of using an acre of land in your farming operation is the income foregone by not renting it to a neighboring farmer.

Sunk costs - Costs that have already been incurred and cannot be recovered. For example, once a facility has been built, it is a sunk cost.

Switching costs - Costs incurred by a buyer (seller) when switching to a different supplier (distributor). This involves costs like identifying, investigating and negotiating a contract with a new supplier (distributor), the risk of quality problems, etc. The switching cost for a differentiated or unique produce can be substantial while the switching cost for a commodity can be very small or non-existent.

Transactions costs - The costs of using the market (buying and selling) such as the cost of organizing and transacting exchanges.

. . . and justice for all
The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

IOWA STATE UNIVERSITY
University Extension

Don Hofstrand
extension value added agriculture specialist
co-director Ag Marketing Resource Center
641-423-0844, dhof@iastate.edu