Cost Analysis

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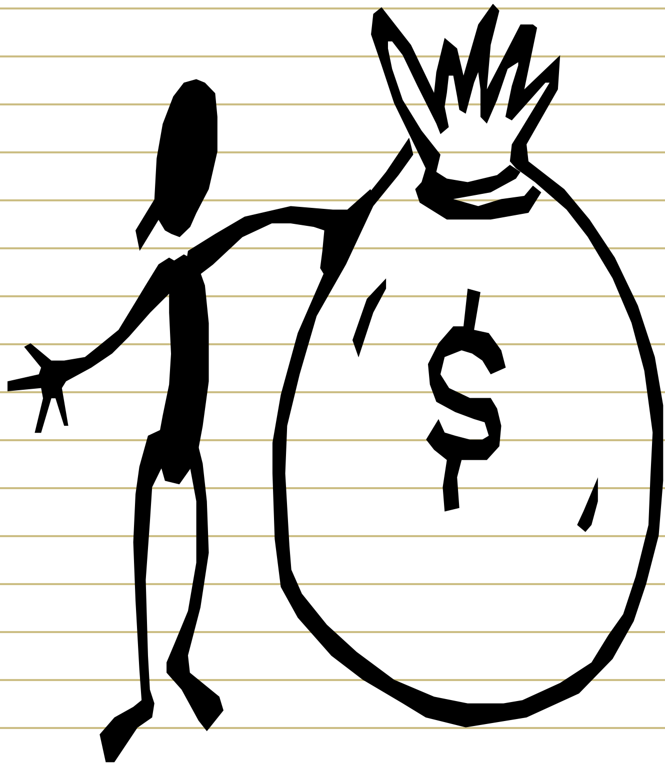
ECONOMIC DESICIONS

- Their goal is - maximum profit
- They are being determined based on the deference between income and expanses



PRODUCTION COSTS

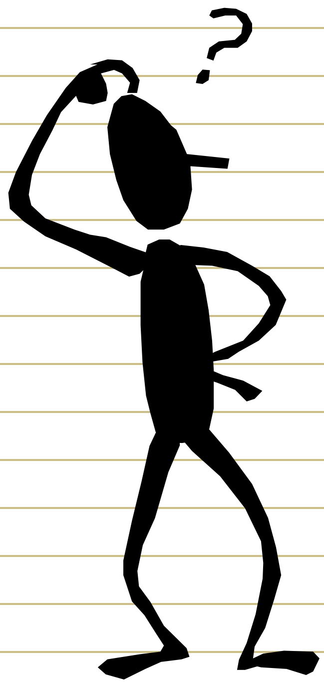
- The cost of all the production factors that enable the production of the output

The costs include:

1. Production factors that are used fully in the production process like: water, fertilizers
2. The service cost of production factors that serve the production process like tractors
3. The price charged for factors which the the exact price is unknown like owners’ labor

Avoidable and Unavoidable Costs

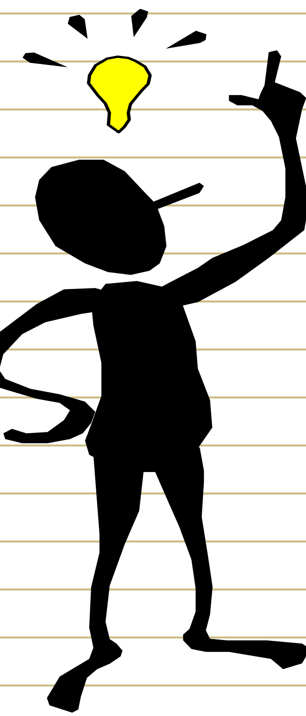
- Avoidable (variable) Cost - A cost that will exist only if an activity will take place
  for example:
  fixing an existing machinery
  buying fertilizer
- Unavoidable (fixed) Cost - A cost that will exist even if the activity will not take place
  like: the cost of infrastructure that already exist
  Payments for a loan that was already taken



GROSS MARGIN - The Criterion for Production Profitability

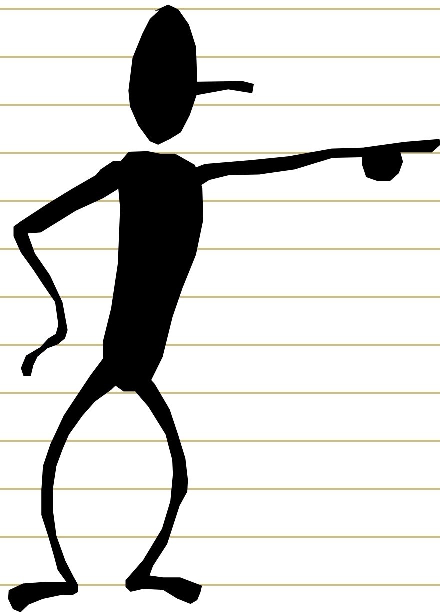
- The value that shows how much the profitability will rise (fall) as a result of the activity that we examine
- Gross Margin=Income minus avoidable costs

  This is the sum that the activity leaves to cover the unavoidable costs and for profit



Steps in Calculating Gross Margin

- Classifying the expenses to avoidable (variable) and unavoidable (fixed).
- Calculating the difference between total income and avoidable costs.



ALTERNATIVE COST
(Opportunity Cost)

- The alternative cost of a resource is the lost return that could have been realized from the best alternative use of the resource
- Avoidable cost - are costs that have an alternative
  Opportunity cost exist only for needed resources that are limited

Planning context: Short Run and Long run

- <u>Short run</u> - decisions about output which do not involve changing the unavoidable (fixed) costs. In this case it is better to cover some of the fixed costs then not to cover at all
- <u>Long run</u> - all cost elements, including fixed cost elements, are considered variable. In the long run if the price does not cover all costs production should not start at all