

Understanding Cost Structures with Pappu Bhai G Chandigarh: A Friendly Guide for Entrepreneurs

Welcome to Cost and Cost Classifications

Hey there, entrepreneur! Let's dive into the world of costs. You know, those pesky monetary values we assign to resources like materials, labor, and overheads to make products or deliver services. Understanding and managing these costs is key to running a successful business. This guide will help you get a grip on different cost structures, classifications, and some related terms. Ready? Let's go!

What Exactly is a Cost Object?

A cost object is anything you want to measure costs for. Think of it like this: it's something you spend money on that you want to keep track of separately. Here are a few types:

- **Output:** This is the stuff you produce or the services you offer. You want to know how much it costs to make each unit of this output.
- **Operational:** These are costs related to specific departments or processes in your business. For example, the cost of handling a customer service call.
- **Business Relationship:** Costs associated with entities outside your business, like suppliers or customers.

Meet Pappu The Chaiwale Bhaiya

Imagine Pappu, a street vendor selling tea on his tea stalls in Chandigarh. His cost objects could be different types of tea amenities like tea packs, milk, or gas cylinders. If he decides to sell baked items too, he can categorize costs for baked items and tea amenities separately. This real-life study inspired me to start Cheema : The StreetHawk, Cheema Chai, *Chai Cheema Chai Cheema Chai!*

Direct vs Indirect Costs

Let's break it down. Costs can be either direct or indirect, depending on how easily you can trace them to your cost objects.

- **Direct Costs:** These are easy to trace. For Pappu, the cost of milk, tea leaves he buys and sells is a direct cost. When we started our business under diginabled FSSAI. we did it on a *supply-on-demand* blending with cloud kitchen model in a small town named as pathankot; managing remotely from amritsar and chandigarh in connection with the locations in pathankot i.e. family and friends. The direct cost in this was negligible as compared to our profits which we further diverted to non-profits for the sake of the locals out there.
- **Indirect Costs:** These are trickier. They can't be easily traced to a specific cost object. For example, the cost of tea and nimbu paani pappu drinks while working can't be traced directly to the vegetables or fruits he sells. So, these costs need to be allocated for sure. Our only challenge was to understand the tea delivery costs for which we connected with the local vendors with our company teabacks

Fixed vs Variable Costs

Understanding how costs change with your output is super important.

- **Fixed Costs:** These stay the same no matter how much you produce. Pappu Chaiwala costs are fixed, as it doesn't change whether he sells a lot or a little.
- **Variable Costs:** These change with your output. The cost of the tea backs and rusk packets pappu sells varies with how much he sells.

Expired vs Unexpired Costs

Now, let's talk about where costs show up on your financial statements.

- **Expired Costs:** These are fully used up, like the cost of sold tea cups, and they appear on the income statement as expenses.
- **Unexpired Costs:** These still hold some value and show up as assets on the balance sheet. For pappu chaiwala in Chandigarh, unused milk and tea stocks are unexpired costs.

Pappu's Example

Pappu's sold rusk packets and thela are expired costs (cost of goods sold on the income statement), while unsold milk and unutilized gas in the gas cylinder are unexpired costs (inventory on the balance sheet).

The annual depreciation of his stall is an expired cost, while the stall's value minus depreciation is an unexpired cost.

Degrees of Conversion

Most businesses transform inputs into sellable outputs. The cost of conversion depends on how much transformation happens.

1. **Low Degree of Conversion:** Minimal physical changes. Pappu just provides convenience by bringing veggies closer to his customers.
2. **Moderate Degree of Conversion:** Some visible changes. Pappu might wash and pack his cups and glasses.
3. **High Degree of Conversion:** Major transformation, like a company turning raw materials into finished products.

Product Costs

Product costs are key to figuring out your cost of goods sold (COGS). They include:

1. **Direct Material Costs:** Costs of materials directly used in production. For a two-wheeler, this would include the engine, wheels, etc.
2. **Direct Labor Costs:** Costs for people making the product or delivering the service.
3. **Overheads:** Indirect costs that still need to be included, like glue and screws in manufacturing.

Cost Allocation

Indirect costs (like overheads) need to be allocated to cost objects. Here's how you do it:

1. **Cost Pool:** The total indirect cost.
2. **Cost Objects:** The items you're allocating costs to.
3. **Cost Driver:** A measurable attribute for each cost object.

4. **Allocation Volume:** The total amount of the cost driver across all cost objects.

Example: Cost Allocation for Pappu Bhai G

Pappu Bhai G spends ₹20 daily on tea or nimbu paani. He allocates this cost based on kilograms sold. If he sells 10 kg of fruits and 15 kg of veggies, the allocation volume is 25 kg. The overhead rate is ₹0.80 per kg ($₹20/25$ kg). So, ₹8 is allocated to fruits and ₹12 to veggies.

Key Takeaways

1. **Cost Objects:** Items or entities you want to measure costs for.
2. **Direct and Indirect Costs:** Direct costs are easily traced; indirect costs need allocation.
3. **Fixed and Variable Costs:** Fixed costs stay the same; variable costs change with output.
4. **Expired and Unexpired Costs:** Expired costs appear on the income statement; unexpired costs appear on the balance sheet.
5. **Product Costs:** Include direct material, direct labor, and overheads.
6. **Cost Allocation:** Distributes indirect costs across cost objects using a cost pool, cost drivers, and allocation volumes.

Understanding these concepts will help you make smart financial decisions, optimize your resources, and ensure your business thrives. Happy entrepreneuring!

Moreover, if you want to connect for real with Pappu Bhai G chandigarh, you can click [here](#) to text him. Just take my name as Amninder Sir (Shiva Sir Safeshop India) and He will help you understand the iceberg behind the tip of this icetop.

Thanks .