

L1 APSC 221 - Cost Concepts

Cost Types

Fixed Costs

- Unaffected by changes
- Insurance, licenses, administrative salary

Variables Costs

- Will vary depending on quantity of output or activity level of operation
- Labour costs, materials

Incremental Costs/Revenues

- Additional cost/revenue from increasing output of a system
- Not associated with quantity of output, but rather a step change
- Overtime shift

Direct Costs

- Costs that can be reasonably measured and allocated to specific work/output
- Production labour, production materials

Indirect or Overhead Costs

- Costs that are difficult to allocate to specific work
- Utilities, rent, taxes

Cash Costs

- Costs paid in cash and have associated cash flow
- What we actually pay, like groceries

Book Costs

- Not involved in actual transaction, used for accounting purposes
- Recorded in the financial statements of a business
- Depreciation, interest on loans, insurance premiums

Life Cycle Costs

- Sum of all costs related to the life span of a product
- From purchasing to selling/using

Sunk Costs

- Costs from the past that has no relevance to a future decision

Opportunity Cost

- Costs incurred due to directing limited resources to a specific course of action
- Every action or inaction has costs in terms of what you could have done instead
- Every action is a trade-off, because there is always an opportunity cost

Life Cycle Phases and Costs

Two phases: acquisition phase and operation phase

Lines: Cumulative committed life-cycle cost, and cumulative life-cycle cost

Cumulative Committed Life-Cycle Cost

The decision to spend money is under the acquisition phase, which increases cumulative committed life-cycle cost

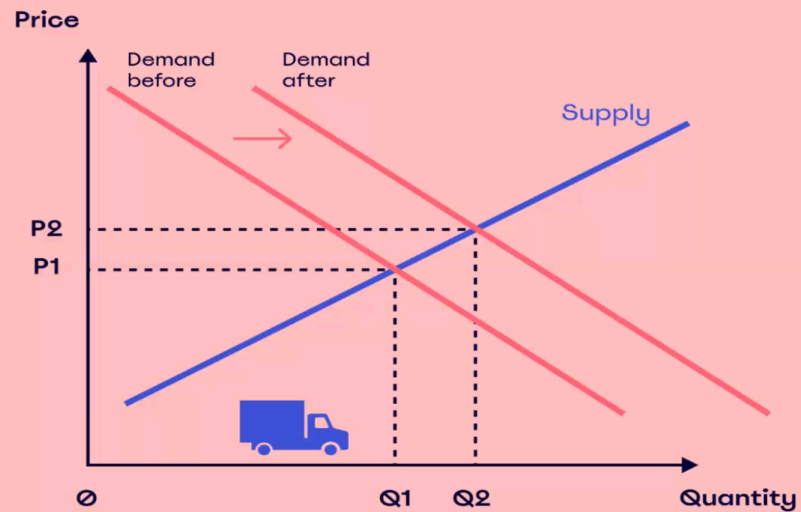
Cumulative Life-Cycle Cost

Construction and operating costs is under the operation phase, which increase the cumulative life-cycle cost

Supply/Demand

Naturally, as price decreases on y-axis, the quantity of demand increases on x-axis.

Relationship (blue line, supply): more production = more price



Ultimate Business Goal

The ultimate goal is to make profits

These graphs have:

Total revenue (TR): price x quantity

Fixed costs (CF) and total costs (CT) = CF + CV

When $TR < CT$, the business is operating at a loss

When $TR > CT$, the business is earning a profit, represented by the shaded grey region

Left: Revenue has a peak, and does not improve with more demand

Right: Fixed revenue stream

