

Profit centres and cost centres

The difference between profit centres and cost centres

A company can prepare two types of budget. The first is for areas of the business that generate both revenue and costs, which are called profit centres. The second is for areas of the business that generate costs but no revenue, which are referred to as cost centres.

A single business may have many profit centres or cost centres depending on how it is organised. For example, a typical school will be split into academic departments. None of these departments generates revenue. But each department will have costs such as purchasing equipment and paying staff. Therefore, these departments will be classified as cost centres. The school shop or the school canteen, however, have both revenues and costs. These are classified as profit centres.



Figure 1. A school canteen is considered a profit centre.

Credit: SDI Productions, Getty Images

Profit centres are any part of the business that contributes to the business's overall revenue. Areas of a business that have both costs and revenues are referred to as profit centres. The name makes sense as it would be hoped that costs would be less than

revenues, so that a profit can be made. Profit centres are mostly used by large businesses that have a broad product portfolio. Each centre has a manager responsible for its operations who may produce an independent statement of profit or loss. Each profit centre contributes profit to the overall profits of the business.

Carrefour, for example, is a French multinational company; the eighth largest supermarket and hypermarket retailer globally by revenue. Each branch, however, is accountable for its own profit and loss account. Profit centres are common in businesses that are decentralised.



Figure 2. A school science department is considered a cost centre.

Credit: Hill Street Studios, Getty Images

A cost centre is responsible for predicting and managing its own operational costs. For example, school departments will each have a budget where costs are outlined for the coming school year. These will need approval from the school administration to ensure that revenues from other areas of the business can cover the costs.

Non-profit social enterprises also tend to use cost centres.

Exam tip

When analysing questions in the exam, it is important to remember that businesses can have both profit and cost centres. Large retailers such as JD.com, Walmart, Inditex and others operate profit centres for each of their branches. They also operate cost centres in their head office, market research teams and advertising departments.

How cost and profit centres are organised depends on how the business as a whole is organised. You learned about organisational structure in [Subtopic 2.2 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39353\)](#). Both profit centres and cost centres can be organised in a business by:

- **Function.** Each department in the business (such as marketing, finance, HR, IT or legal) is a specific cost centre.
- **Product.** Businesses that produce a variety of goods and services are mostly organised by products. For example, Adidas produces a range of sportswear and a range of sports equipment. Each product category is responsible for its own costs.
- **Geography.** Multinational businesses can be organised by their branches in different countries. For example, Samsung and Apple can organise their profit and cost centres by their geographical location.

The role of profit and cost centres

Profit and cost centres have a number of roles in the business.

Financial role

It is important for a business to have a clear view of how different departments are performing with regard to their revenues and costs. Separating out the profit centres by department, and the cost centres from the rest of the business, gives a clearer picture of the relative performance of different parts of the business. Managers can use this information to make budgets for the business as a whole with greater accuracy.

Motivational role

Separating profit and cost centres, and providing local discretion over financial managements, can provide teams of employees with a greater sense of autonomy over budgets. As you learned in [Subtopic 2.4 \(/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39054\)](#), autonomy can improve motivation. Those employees on the ground in the different profit centres probably have a better sense of how to allocate funds than managers in an office far away. This can lead to greater efficiency and problem-solving on the ground. Departments that are successful at staying within their budgets can be rewarded.

Organisational role

With separate information on the relative importance of different profit and cost centres, managers can make better decisions about future strategy and where to invest. The business may choose to devote more time, money and energy to build on the profit successes of certain departments or units. Or it may decide to direct its attention and funds to those departments or units that are struggling. In any case, knowing the relative performance of the different parts of the business informs decision-making.

Activity

Learner profile: Knowledgeable

Approaches to learning: Thinking skills (transfer)

GEMS Education is a major private school provider operating in a number of countries. Founded in 1959 in the UAE, the network of schools has grown to 44 schools in the UAE and Qatar alone, with other educational institutions in south-east Asia, Europe, India, Africa and North America. GEMS schools use a number of curricula to provide their education, including many schools with the International Baccalaureate.

- Given the number and diversity of schools in the GEMS Education group, discuss with a partner or as a class why it would be beneficial for the company to treat each school as a profit centre.