

Unit F: Effectively Managing Business Transactions

Lesson 1: Understanding Business Expenses

Terms

- Board of Directors
- Break-Even Quantity
- Cooperative
- Fixed Costs
- Marginal Cost
- Marketing Cooperative
- Service Cooperative
- Supply Cooperative
- Variable Costs

Business Expenses

- I. A business has numerous production expenditures that are called costs.
 - A. **Fixed costs** are those costs that are constant regardless of level of production.
 - 1. Examples of fixed costs include land, buildings, equipment, and tools.
 - 2. No matter how much product is produced, these items cost the same.
 - a. For example, two farmers raise cucumbers. Farmer A and Farmer B both own $\frac{1}{2}$ hectare, each farmer paid 25,000 Afghani for his land. Farmer A raises 10 kilograms of cucumbers per year, and Farmer B raises 50 kilograms of cucumbers per year. Even though they produce different amounts of cucumbers, their fixed cost is the same because the land

Business Expenses

- b. The fixed cost is divided by the number of units of production to find the fixed cost price per unit.
 - i. Fixed costs per unit of production decreases as more product is produced.
 - ii. The lower the fixed cost per unit, the more efficient the business is.

Business Expenses

B. ***Variable costs*** are those costs that change as production levels change.

1. Examples of variable costs include fertilizer, seed, feed, fuel, and hired labor.
2. As more units are produced, variable costs will increase.
 - a. For example, two farmers raise cucumbers. Farmer A raises 10 kilograms of cucumbers per year, and Farmer B raises 50 kilograms of cucumbers per year. Farmer B will have higher variable costs because he will have to purchase more seed to plant more cucumber vines in order to produce more cucumbers.
 - b. Total variable costs increase as production increases.

Business Expenses

- C. Total cost is variable costs plus fixed costs. Total cost increases as variable costs increase.
- D. Average variable cost is calculated by dividing total variable costs by total output at any given point.
- E. Average fixed cost equals total fixed costs divided by total output at any given point.
- F. Average total cost equals total cost divided by total output at any given point.

Business Expenses

- G. ***Marginal cost*** equals change in the total cost divided by the change in output. It is the cost of producing one additional unit of product.
1. The level of production that maximizes profits is where marginal costs equal the price received for the product.
- H. ***Break-even quantity*** equals the total fixed costs divided by the price per unit minus the variable costs per unit.

Minimizing Expenses

II. Every business that exists has expenses as well as income.

- There are two main reasons for minimizing, or reducing, a business's expenses: to earn more profit and to become more efficient.

A. As businesses operate, the profit that is made is used to pay expenses.

- The net profit can be used to expand business operations or can be paid to the owner of a business.
 - When expenses are reduced, more net income can be earned allowing for greater expansion of the business. If further expansion is not desired, the owner of the business may choose to use the money for his personal and family expenses.

Minimizing Expenses

- B. When expenses are minimized, the business become more financially efficient. The more financially efficient a business is, the healthier it is.

Cooperatives

III. A ***cooperative*** is a business that is formed to provide goods and services to members at a low cost.

A. A group of businesses or individuals with similar interests join together to form the cooperative. These businesses and individuals are considered the members of the cooperative.

Cooperatives

1. Being a member of a cooperative is voluntary. Some cooperatives may require that members pay a small fee per year. The fee collected by the cooperative may be used to transact business that provides each member with benefits.
2. Cooperatives are controlled by their members. The members make decisions regarding the cooperative.
 - a. Large cooperatives may elect a **board of directors**. A board of directors is made up of members of the cooperative that are selected to represent all the members. Additionally, the board of directors is responsible for making decisions and policies for the corporation.
3. Cooperatives may transact business, but do not exist to earn a profit. Any profits that are made are paid back to the members of the cooperative.

Cooperatives

- B. There are three types of cooperatives: supply cooperatives, marketing cooperatives, and service cooperatives.
1. A **supply cooperative** purchases supplies, such as feed, seed, fertilizer, and fuel, in large amounts to be resold to their members.
 - a. Because supplies are bought in such large quantities, the cooperative may receive a better (lower) price.
 - b. A major advantage to members is that they can lower their own variable costs for production. If they were not members, they would be forced to purchase their supplies from a company. The cooperative, however, was able to purchase the large amount of supplies at a lower price, the cooperative will resell these supplies to its members at the low price. As a result, members are able to save money.

Cooperatives

2. A ***marketing cooperative*** assists farmers and business owners by marketing their agricultural products. These cooperatives strive to find the buyers that will pay the highest price for the product.
 - a. Marketing cooperatives sell products directly to consumers or to stores who will resell the products.
 - b. Some marketing cooperatives also process agricultural products, such as milk and almonds, and place them in packages or containers to be resold.

Cooperatives

3. A ***service cooperative*** provides its members with a specific service that they might not be able to afford without the cooperative.
 - a. Some service cooperatives may be made up of members that live in rural areas and provide them with electricity, telephone, or other communication services.
 - b. Other examples include farm credit (loan) services, irrigation cooperatives or artificial breeding services.

Review

- What is the difference between fixed and variable costs?
- Why minimize business expenses?
- How does a cooperative work?