



The Two Piece Suit and Costs

Step by Step Guide to Variable Costs

more money for shoes

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Variable costs are those expenses which change depending on the amount of production or sales activity you produce. In other words, the more you produce, the higher these costs are. Variable costs are more common for production based businesses or retailers as they incur costs for each unit they make or sell.

In a service business, there are usually fewer variable costs. Often the main variable cost in providing a service is the cost of wages for an employee working directly in providing the service. Other variable costs in a service business would be anything directly 'used up' during the provision of the service such as massage oil for a massage therapist or petrol for a taxi driver.

To help identify the variable costs in your business, follow the steps below using the table in the Variable Costs Analysis guide.

1. Print a profit and loss statement for the previous 12 months from your accounting software program. If you are new to business you will need to make a list of all the expenses you think you will incur.
2. For existing businesses, highlight those expenses on your profit and loss statement that will change depending on the amount of goods you produce or the services you provide. These will almost entirely be in the Cost of Goods Sold section. They may include:
 - Purchases
 - Freight
 - Electricity
 - Wages of factory staff
 - Commissions
3. Update the Variable Cost Analysis table to include all those expenses you highlighted above or that you listed
4. Using your last year's profit and loss statement as a guide (or using your costs that you have written down that you think you will incur if you are a new business), write down the amount of each fixed cost into the corresponding column. Of course, if you are using last year's profit and loss, be aware that these amounts are as per the previous year so they are a guide only. If your costs will increase this year then you will want to increase any of these expenses for the increase. If you are a new business you should have done some research into what these costs will be and you can estimate them here
5. Total the amounts of all the variable costs listed.
6. Write down in the next row the amount of hours, goods produced or items sold that this figure is based on. For example if you are using last year's profit and loss as a guide and you produced 1,000 units, then you would write down 1,000 units here. If you have already worked out your costs on a per unit basis then simply put 1.
7. If you are a service based business, you might use the number of kilometres travelled (taxi), the number of vehicles (hire car), the number of houses sold (real estate business), the number of professional staff, the number of clients serviced, the number of hours or simply a sales figure.
8. Divide the total variable costs by the number in the row below to determine your cost per unit/hour/ other method