



BEER MAT MENTORING MEETING NOTES

(4) Operating costs

You have the idea, you're done the research, laid out your business process and worked out your set up costs. Now you need to estimate operating costs. Then (and only then) you can pour yourself a stiff drink.

Fixed and variable costs

Some costs are 'fixed', the cost of simply existing as a business. You have to pay them even if you have no customers. Your rent, for example. Think of it as the cost of Being.

Some costs are variable, they increase in line with level of sales. Your ingredients cost for example, if you are making a food product. Think of it as the cost of Doing.

Annoyingly, some costs are either or both. Labour can be fixed (if you're paying a fixed salary regardless of the workload) or variable (if you're paying piece work or only need to buy the hours you actually need). A utility bill might have a standing charge (fixed) and a meter charge (variable).

The distinction may seem academic but it's important. A dog food company once approached me because they were losing money. It became apparent that the problem was high fixed costs and therefore we needed to increase volume, to spread these costs over more units. We did this through "own label" products for retailers and a partnership with another pet industry company with its own sales force. If the issue had been high variable costs, raising the price and accepting lower volume might have been more effective.

So list all your fixed costs and estimate the cost per month. Then list all your variable costs, decide on your unit of sale (per pack, per kilo, per serving, per hour, etc.), and estimate your cost per unit.

Realistic variable costs

Just when you thought it was all going swimmingly and the glass of wine was beckoning, there's a snag. You have calculated the "ideal" cost per unit. Unfortunately, some of the biscuits you are making will break, or the cream desserts go off, or the aromatherapy customer will be "no-shows". And goodness knows what damage the dog might do. So, out of every 100 units, how many will you actually get paid for (on average)? Then divide your cost for 100 units by the number of units for which you will actually be paid. This is your realistic cost per unit.

Revenue

Now for the nice bit: revenue. From your market research, what is the right selling price? Hopefully this is more than the variable cost per unit, with the excess contributing towards those pesky fixed costs. Also from your market research, how many units do you think you will sell per month, once you get going? You now have your total revenue (units sold x price) and total operating cost (fixed + variable costs for this output in a month). Does this suggest you will make an operating profit?

In session 5 we'll look at cash flow and we'll see if the business is viable and how much money you need.

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