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Univerzita Tomáše Bati ve Zlíně
Fakulta managementu a ekonomiky

# The Economy of Language Teaching

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# Introduction

- **Doc. Ing. Boris Popesko, Ph.D.**
- Works as a vice-dean at Faculty of Management and Economics at Tomas Bata University Zlin
- Supervised the several research projects focused on the field of Management Accounting Practices
- Professional focus: Cost Management, Performance Measurement, Management Accounting.
- 13 years of experience in management consultancy

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# Aim of the Presentation

- Current business environment brings a many turbulent changes which affect the traditional business of service organizations and requires the introduction of **new business models**.
- **Traditional** vs. **New Business model** and **Organizational change** (change of practices and ways in which the new business is operated)
- Increased competition – pressure on prices
- Increase of the costs and changed cost structure
- In some business fields prices stagnate due to the „comoditialization“ of the product

# Agenda

1. Price theory
2. Management of costs
3. Cost calculation
4. Project Harmony
5. Questions and discussion

# 1. Price theory

# Pricing decisions

There are several critical factors of pricing decisions:

- **Effective cost information** – I need to know the costs related to the product
- **Value perceived by the customer** – How the customer see the value of my product
- **Target markets** – the strategies for different markets could be different. Prices for private person could differ with prices for corporations.
- **Competitors activity** – there is different activity of competitors in various markets, some of them are highly competitive, some of the less.
- **Pricing strategies** – how the customers see my product? Am I focusing on the lowest possible price or on high value of my product?

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# Basic Approaches to the Pricing

- In current business environment in many business fields the **market price** is used. This means, that company doesn´t have a freedom to voluntarily set the price, but accepts the price on market with focus on the brand, perceived value of the product and other features.
- Traditionally used method of pricing is based on **profit surcharge**. Company identifies its costs and the profit is added using predefined profit surcharge, which is based on the desired profitability level.

Costs + profit = Market price

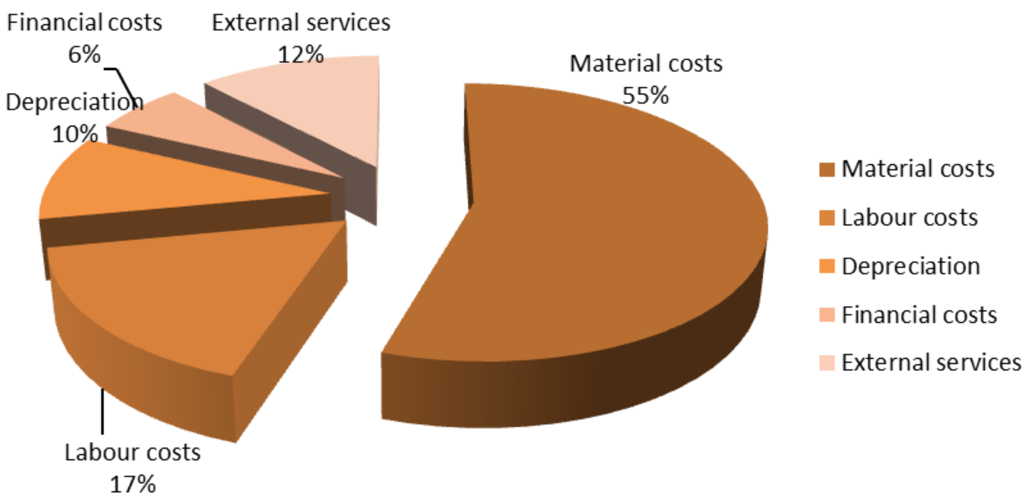
# Pricing principles

- Price value of the product/service must be in accordance with two principles: Must be acceptable for the customers, and must be sufficient to cover the costs of supplier. There are three basic **pricing principles**:
- **Price based on the product costs**, uses the information about the product full costs and additional profit surcharge
- **Price based on the customer demand,** uses the information about the price elasticity.
- **Price based on prices of competitors**. Uses the information about the prices and product properties of the competitors and the average prices on the market.

# 2. Cost analysis and cost management

# Natural types of costs

- Natural types of costs is the most common approach to the cost classification, traditionally used in financial accounting.
- This cost classification gives the managers information about what external inputs have been consumed, but gives no information about the purpose of consumption



# Direct and Indirect costs

- Costs that are assigned to cost objects can be divided into two categories: direct costs and indirect costs:
- **Direct costs** are those costs that can be specifically and exclusively identified with a particular cost object.
- In contrast, **indirect costs** cannot be identified specifically and exclusively with given cost object.
- Sometimes term **overhead** or **overhead costs** is used instead of indirect costs.

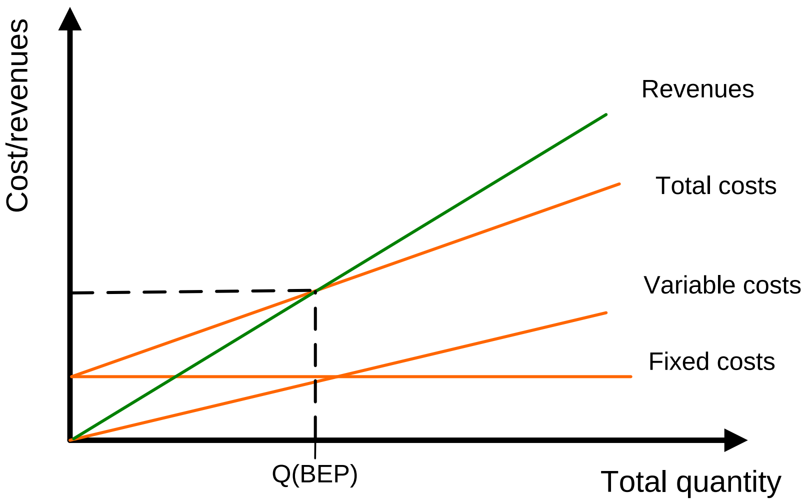
# Cost behaviour in relation to volume of activity

- **Variable cost** vary in direct portion of the volume of activity (salaries of the lecturers)
- **Fixed costs** remain constant over wide ranges of activity for a special time period (rent, salaries of the administrative staff)
- In practice, there is very difficult to distinguish between variable and fixed costs.
- Most enterprise costs have variable and fixed part, this type of costs are called **semi-variable costs** (e.g. Energy and water consumption)
- Sometimes fixed costs are changing in steps according to volume of production, this type of costs are called **semi-fixed** of **step-fixed costs**

# Cost-Volume-Profit Analysis

- **Cost-volume-profit analysis** is a systematic method of examining the relationship between changes in activity (i.e. output) and changes in total sales revenue, expanses and net profit.
- Elementary question which is asked within this type of tasks is: “what is the **minimum output** volume which will ensure the refund of fixed and variable costs?”.
- This output volume is defined as the **break-even point**.
- Until the break-even point is reached only the costs have been covered.
- When the output volume surpass the break-even point, the profit is generated.

# Cost-Volume-Profit Analysis




- Difference between the price and unit variable costs is known as **contribution margin** and could be calculated as follows:

$$cm = price - vc$$

- Break-even point (BEP) shows how many unit contribution margins have to be generated to cover total fixed costs.

$$q(BEP) = \frac{FC}{price - vc}$$

# Cost-Volume-Profit Analysis (Exercise)

- **Cost-Volume-Profit** Analysis is very important in situations where the portion of the fixed cost is very high**.**
- **Exercise Coffee House**
- Rent 800 EUR per month
- Energy costs 250 EUR per month
- Salaries 1950 EUR per month
- Price of the one cup of coffee 2 EUR
- Coffee variable costs are 0.5 EUR
- What is the minimum volume of production?

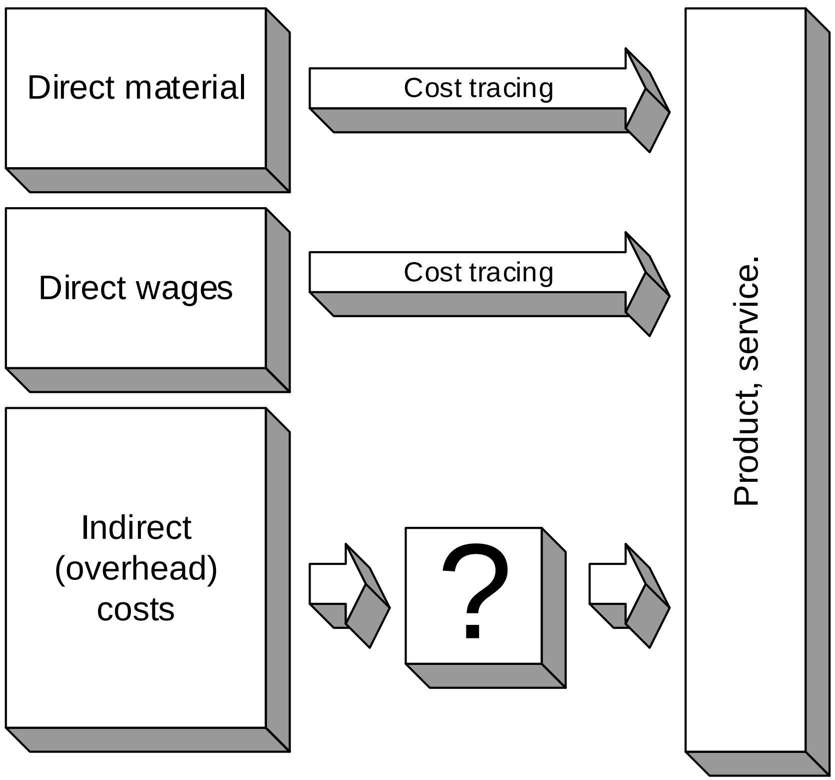
# 3. Product costing

# Cost allocation

Cost allocation is based on cost assignment of the cost to the specific product or service.

**Direct costs** could be directly traced to the product or service.

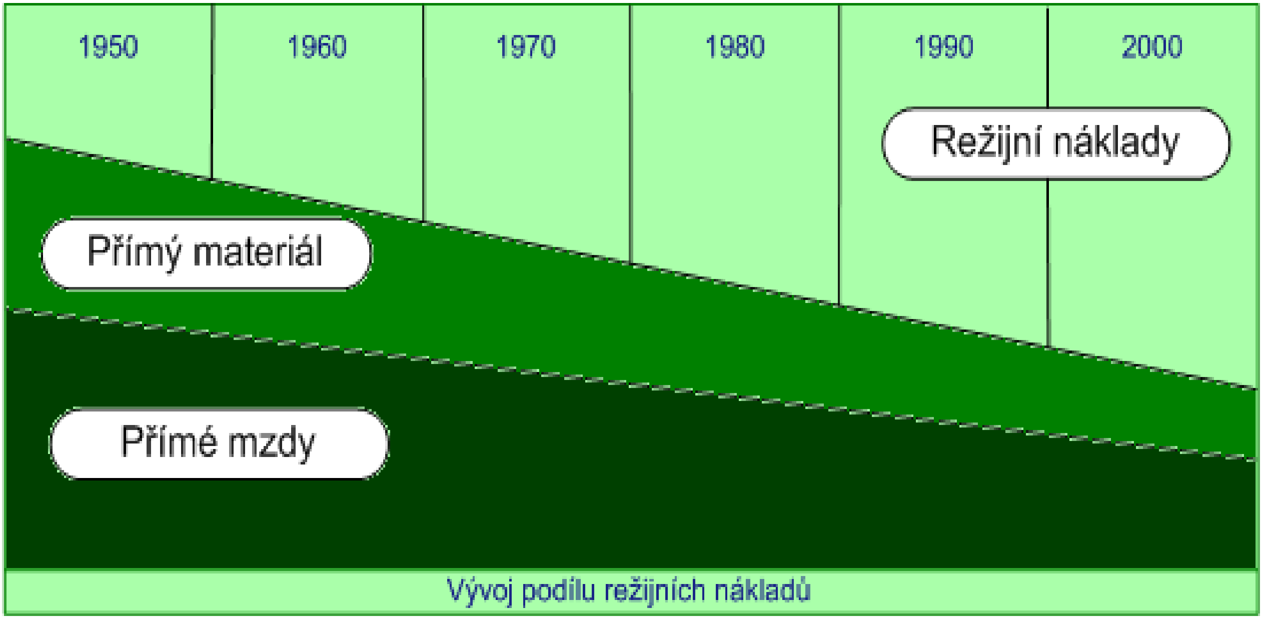
Problems brings the allocation of the **indirect (overhead) costs**, where we usually cannot find the causal relations between costs and product or service.



# Historical changes in the firm´s cost structure

100%

0%




- 1930s approx. 10%
- 2000s approx. 40-50%
- IT/services: up to 80%

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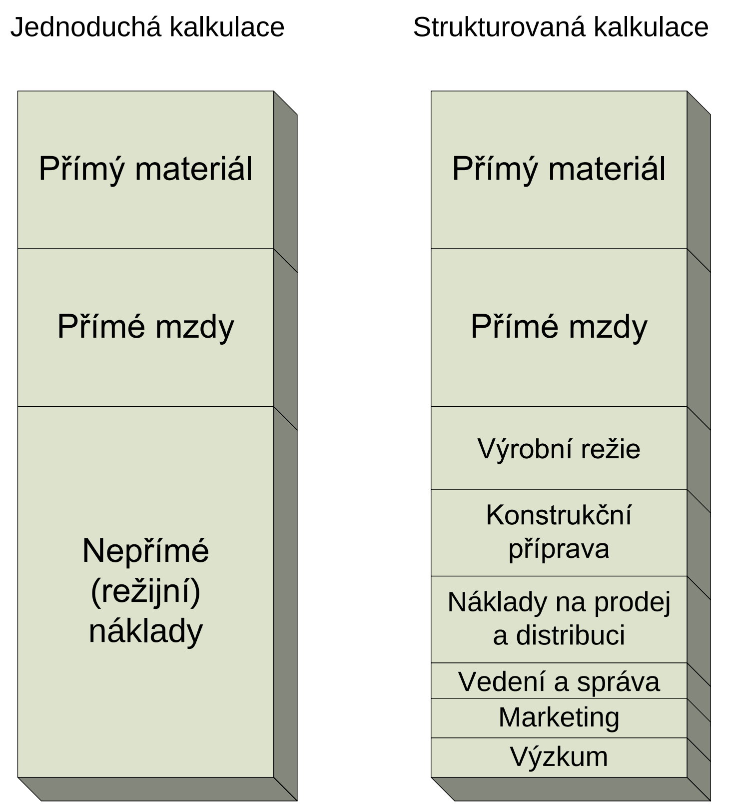
# Product´s cost structure




- Product´s cost structure is different in every enterprise
- Cost structure is depicted in **Calculation formula**.
- Calculation formula includes the list of the individual cost groups and describes method of their allocation

# Absorption costing

- **Absorption costing** method is most frequently used costing method.
- Its most important advantage is, that this type of cost calculation could be used in all types of organizations.
- On the other side, the absorption costing is also very simple.
- Absorption costing calculates the costs assigned to the individual product using **allocation or recovery base** and consequently determined **absorption rate**.
- **Allocation base** represents the measure, which is used for allocation of overhead costs to cost object. Absorption rate than represents the recalculated relation between the volume of overhead costs and volume of allocation base.
- Also known as **Full cost method**
- Calculates the full cost of product, which includes the all firm´s cost.

# Excercise

- Calculation of hour rate (price) in language school
- Direct cost:
  - Direct wages (salaries of lecturers)
  - 10 EUR per hour
- Calculation of the overhead
  - Offices and classrooms rent
  - Salaries of the administrative staff
  - External services
  - Advertising
  - 150,000 EUR / 10,000 hours = 15 EUR per hour

10 + 15 = 25 EUR per hour

# Variable costing

- Alternative system, which assigns only variable manufacturing costs to products, should correctly be referred to as **variable costing**, although the terms direct costing and marginal costing are also frequently used.
- Because the fixed costs are not assigned to the unit, the unit profit cannot be calculated.
- The fixed costs are common for whole organizations, because they have no relation to produced units.
- The fixed costs has to be calculated at the end of calculation process, when the total profit of the organization is calculated.
- **Price – variable cost = contribution margin**

- 25 EUR – 10 EUR = 15 EUR

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# What must be paid from the product price

- Product price = direct cost + indirect cost (overhead) + profit
- Sufficient profitability comes from the price of own capital
- Indicators:
- **ROS – Return on sales**
- profit/sales
- **ROA – Return on Assets**
- profit/total assets
- **ROE – Return on Equity**
- profit/own capital

# 4. Harmony case

# Profitability analysis

- **Identify** the **types of products** – language school, firm´s courses (L1, L2, L3), translation services etc.
- Assign the **direct cost** (wages)
- Allocate the common **overhead costs**
- Calculate the **profit** and **profitability** of individual product types

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# Thank you for your attention!!!

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