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COMPARATIVE CHARACTERISTICS OF INDUSTRIAL AND TRADING COMPANIES

Abstract

Production and non-production costs must be clearly distinguished from one another. The classification of production and commercial costs makes it possible to determine total production cost. This is necessary so that, when finished goods are transferred to the warehouse as completed products, the transfer is carried out at a value that reflects the total production costs incurred in their manufacture.

Administrative, selling, commercial, and financial costs are not related to the production process (they are not localized within the production facilities); therefore, they do not belong to the category of production costs.

Keywords: industrial company, production cost, non-production cost, operating expense, gross profit.

Industrial and retail companies are similar in many ways: for both, sales volume is the primary source of income; both include items such as cost of goods sold and operating expenses, among many others, in their income statements. However, there are also differences. The most important one is that a retail company purchases and sells finished, marketable goods, while an industrial company produces them internally. Consequently, the cost of goods sold (COGS) for a retail company is determined by the costs of purchasing and transporting products, while for an industrial company, it is determined by production costs. This difference is reflected in the COGS indicator in their income statements:

Store A

Income Statement
For the year ended 31 December 2022
Sales Volume ------------------------------ 95,000
Cost of Goods Sold
Opening Goods for Sale ------------ 5,500
Net Purchases ---------------------------------- 4,800
Cost of Goods Sold 10,300
Less: Ending Goods for Sale --- 3,780
Cost of Goods Sold ----- 6,520
Total Sales Profit 88,480

Manufacturing Firm B

Income Statement
For the year ended December 31, 2022
Sales volume ----------------------------- 89000
Cost of goods sold
Beginning inventory of finished goods --------- 55000
Cost of goods manufactured ---- 30000

Cost of goods sold -------- 85000

Less: Ending inventory of finished goods ------------ 35000

Cost of goods sold ------------- 50000

Total profit from sales 39000

The above excerpt from the income statement shows that instead of net purchases, as presented in the income statement of a retail company, the income statement of an industrial company includes the line item "cost of goods manufactured." This line item represents the sum of all expenses incurred by the company in producing finished goods.

An industrial company purchases raw materials and processes them into finished goods. For example, for an aircraft manufacturer, raw materials include parts made of aluminum, iron, plastic, and other materials, jet engines, electrical and other devices, etc. The company processes these raw materials into finished goods—jet aircraft. Raw materials and finished goods are arbitrary concepts defined for a specific company. For example, an engine, which is a raw material for an aircraft manufacturer, is considered a finished product for an engine manufacturer. The cost of a finished product is determined by the sum of the production costs incurred in its production.

Production costs consist of three main elements: raw materials consumed; direct labor; and manufacturing overhead.

Consumed (used) raw materials—this element of production costs represents the cost of materials, products, and other elements consumed in the production of finished goods. Raw materials are classified as production costs after they are consumed. Raw materials remaining in the warehouse and not yet consumed are considered a current asset—raw materials inventory. The cost of consumed raw materials is calculated as follows:

Raw materials consumed:

Beginning raw material inventories --------------------- 2590

Purchased raw materials ----------------------------- 15990

Raw material procurement costs ---------- 1500

Raw material cost consumed ------ 20080

Less: Ending raw material inventories ---------- 2100

Raw material cost consumed – 17980

The above method for calculating raw material consumption is used with a periodic inventory system and is similar to the formula for calculating the cost of goods sold. With a perpetual inventory system, the quantity of raw materials consumed for any period is equal to the sum of the credit transactions made with raw materials during that period (credit turnover).

Direct labor costs (labor costs) are the second main element of production costs. They are the wages of factory workers directly involved in the production of products. This category of workers includes mechanics, turners, assemblers, painters, and other factory workers who manually or with tools transform raw materials into finished products.

The wages of factory workers not directly involved in the production of products are reflected in production overhead costs. This category of workers includes shop foremen and shift foremen, managers, shop security guards, safety engineers, etc.

Production overhead costs – this category of production costs includes all production costs except raw materials and direct labor.

Production overhead costs include:

Indirect labor costs – shop foremen and shift foremen; factory cleaners; factory medical personnel; factory safety engineers, etc.

Production building costs: depreciation of the production building; insurance of the production building; property taxes on the production building and land; maintenance and repair of the building; electricity, lighting, water supply, and other utility costs of the production building.

Production equipment and machinery costs include: depreciation of the production equipment and machinery; insurance of the production equipment and machinery and property taxes; maintenance and repair of the production equipment and machinery; Consumable spare parts, lubricants, and other materials, etc.

Costs incurred to comply with regulatory requirements include: occupational safety, wastewater and exhaust gas treatment, etc.

Total production cost is the marginal cost of production (total direct costs) plus any fixed production overhead. It is important to clearly define the total cost of production for a specific product, and this is necessary so that when finished goods are transferred to the warehouse as finished goods, they are transferred at a cost that reflects the total production costs incurred in their manufacture.

Selling, administrative, distribution, commercial, and financial expenses are not related to the production process (they are not localized in the production building) and therefore are not classified as production expenses.

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