

Net Direct Costs

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### Net Direct Costs

The costs incurred in establishing an enterprise are varied and diversified both in nature and source. For instance, contingency plans in business may require funding and costs that are associated with it. From this variety, costs can be distinctively classified by their nature into two different categories, namely direct and indirect costs. Within these major categories, there are subdivisions that specifically underpin the relation of the costs to the use within the production of the products and services of a company. Such divisions can be based on whether these costs are fixed or variable in nature in the time that they are used in running the operations of the business. Net direct costs is one of the most vivid examples of a subdivision cost, associated or measured by a given cost unit.

In creating or setting the price of commodities, the prime cost is used as a basis of setting the prices with the aim of profiteering and the commodity prices have to offset them. The prime costs are calculated from the total of the overall production costs that are direct in the production of commodities. In an explanation of a cost unit, Weetam (2010) explains that the service or commodity in its entirety should have all the costs associated with its development. The weakness of this method is that it fails to capture overhead that are incurred in the same process of production.

An advertisement cost is an example of overhead expenditure that is not covered by the prime costs. The reason for this is the adverts and promotions are not initially budgeted and are as a result of the market dynamics such as competition. The use of advertisements could be to increase the level of product awareness with the aim of improving the level of sales. At the stage of budgeting, this could not have been factored in especially in the case of a monopoly (Atrill &

McLaney, 2010). There is no need to put in advertisement or marketing costs since there is no competition within the market.

One criterion of classifying costs depends on the level or time of input and the time taken for the cost to impact. For instance, advertisement costs are one of the very last costs to be incurred in the production of commodities. However, its impact is the first to be experienced in the volume of sales (Dyson, 2010). As such the last in first out method allows for the advertisement costs to be classified as an indirect cost. At the point of an introduction of a new product, the advertisement of the products can be considered as a direct cost. This is because the market has to be informed of the new product through marketing communication channel, and this makes advertisement an initial priority (Dyson, 2010). The market can be made aware of the product even before the official launch and customers who are willing to utilize it can preorder. In this case, the advertisement or marketing costs are the first to come and can be classified as direct costs.

Paying out costs is another example of net direct costs. These costs are those that a member of an organization incurs in the line of duty and are to be refunded to the member or not. The result of these costs is a harmonized running of the organization with potential supplementary or ancillary benefits. The benefits of this expenditure could be direct to the member of the organization or to the organization itself (Atrill & McLaney, 2010). An example of such expenditure or costs can be expenses incurred by a marketing executive in accommodation while marketing the products of a company in a given location. These costs are of benefit to the individual doing the marketing because they serve to make his living conditions good. The company receives ancillary benefits resulting from the ability of the same individual to perform the designated task. Dyson (2010) argues that in some accounting standards, the

cost of advertisement is treated purely as a direct cost. This type of costs cannot be direct costs since the cost is as a result of contingent measures taken as a resort to avoid failure.

Quasi fixed labor costs are also an example of indirect costs incurred by a firm (Dyson 2010). These include factors like employee training, the cost of recruitment, and the non-wage benefits that employees receive. Within a firm, a safety and health training program cannot be linked to any specific product. Moreover, the training is not conducted at each instance when a firm wants to produce a given product. As such the quasi-fixed costs incurred by a firm are majorly classified as indirect costs. However, during the introduction of a new product, the cost of training and recruiting new expertise become a direct costs (Weetam, 2010). This is because costs are the primary necessity input in order to receive the final product.

In rebranding, a company would require to make the customers have a specific relation or experience with its customers. This experience could mean a particular differentiation strategy that will require either the firm to use a brand personality or identity improvement exercise for a brand's equity purposes. In a bid to improve a brand's image, costs that relate to the identity and personality can be treated as indirect expenses depending on the portfolio of products that the brand has (Atrill & McLaney, 2010). The difference comes in due to the absence of a variety of product base brands within a firm. As such the single product that the firm is marketing becomes the creator of the identity image and personality of the same firm. There is a need of enacting measures of ensuring that the brand is successful (Atrill & McLaney, 2010). Thus, the success of the brand is a dimension of a success of the product in the market and must be budgeted in the initial stages.

Knowledge about net direct costs is crucial for maintaining one's accounting books for small business, receive tax deductions, and make business decisions. Net direct costs can shift

position depending on the case at which the cost is validated or employed. For effective accounting of the resources utilized for the production of a resource, it is essential to note the nature of the net direct source. A proper split between the two types of costs if well done by the accountant, will simplify pricing and costing of cost units.

## References

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- Weetam, P. (2010). *Financial and management accounting: An introduction* (5<sup>th</sup> ed.). London, UK: Pearson Education.