

## VISIBLE COSTS AND HIDDEN COSTS IN THE BAKING INDUSTRY

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### **Abstract**

*Hidden costs are present in the activity of any company, hardly identified in the traditional administrative accounting. The high levels of the hidden costs and their unknown presence have serious consequences on the decisions made by the managers. This paper aims at presenting some aspects related to the hidden costs that occur in the activity of the companies in the baking industry and the possibilities to reduce their level.*

**Key words:** hidden costs, baking industry, accounting, cost detection

**JEL Classification** M40, M41

### **1. Introduction**

Performance, value and costs are the three concepts that dominate the management of any modern organization. Under the current economic circumstances, there are reciprocal relations between the three notions. The company's performance cannot be analyzed without taking into consideration its costs and value generated within it.

It is essential to know the costs in order to make the right decisions that would later on influence the accomplishment of the proposed objectives of the company and, implicitly, the performance obtained. „Considering the current market conditions, states E. Hlaciuc (1999), the production cost represents one of the synthetic indicators that reflect the work effort materialized and invested in a product, work or service, as well as the judicious use of economic means and the order in an economic unit” [5, p. 11].

C. Pirvu et al (2011) considers that „estimating the production costs constitutes one of the main problems in making decisions for a company, the information regarding the costs being the first to be considered in the decision making process” [11].

The production cost is a basic indicator that characterizes the entire economic activity of a company and represents the main element of the efficiency of the activity carried out by the company. Not knowing the production cost may lead to taking wrong decisions that could have serious consequences for the company.

As an instrument in costs control, the managerial accounting represents a strategic means that contributes to taking the optimum decisions and to improving the profitability.

Starting with the last decades of the 20th century, the financial models of assessing the results of the company have been more and more criticized, subsequently proven to be useless in mirroring its global performance. The company has to be efficient not only on the financial-economic level, but also on the social and environmental level. Thus, we have witnessed the emphasis of the social function of the company.

### **2. The baking industry in Romania – characteristics**

The baking industry is a sector of the food industry and comprises the companies that develop activities of making bread, biscuits and other baking products. It is one of the first industries, its evolution being related to the development of the human society and of the technological progress. Bread is one of the most common traditional food in the entire world, being made with relatively low production costs. Due to their nutritive content, the baking products occupy an important place in human nutrition.

The baking industry in Romania have developed in the last two decades in two main directions. On one hand, there are the traditional producers strongly represented by small companies with a distribution network at the national level. These companies sell their products both in their own shops and in the large chain stores. Companies such as Pan Group or Vel Pitar have created in the towns where their production units are settled, a selling network of shops in which they sell their own products as well as other food products. On the other hand,

there are also the small producers of in this industry, counting up to a few thousands, usually local bakeries that sell their products at the local or regional level, at lower prices than those of the large producers.

Taking into account the outstanding importance of the baking industry for the Romanian economy and the problems these have to deal with in the present, the organization of the managerial costs and the cost calculations, thus supporting the decision-making process, has had an increased importance. Considering the current acerbic competition, the organization of an informational system of managerial accounting that would meet the requirements of the managers could represent an advantage of the company, a competitive advantage.

### 3. Costs and their informational relevance

The definition of the cost given by M. Băbeanu (1993) as being “that part of the selling price of an economic commodity which compensates the expenses incurred by the companies for producing and selling that commodity” can be completed with the definition we found in IAS 2 “Stocks” which asserts that: “the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition” [2]-[18].

No matter how we define the cost, in its broad or narrow meaning, we notice the fact that from the content point of view this is related to the consumption of values, illustrated in the opinion of C.G. Dumitru and C.Ioanăș (2005), namely “the characteristics of the notion of cost are: resource consumption, its link with the realization and evaluation in moneyed expression” [4, p.9]. Therefore, the costs identify with the consumption of the production factors, the products and the services of the company represent realizations and bear costs, and the resource consumption and the realization are moneyed.

In accordance with the French General Accounting Plan from 1982, the cost is defined by three characteristics, independent from one another: the application domain, the moment of the calculation and the content. The production activity that is carried out in the baking industry implies the consumption of material, financial and human resources. Recording all the expenses on time and in whole is a premise for costs calculation and assessment of the obtained results.

The production cost represents an economic indication used on a large scale, its calculation being done at the level of all companies. M. Niculescu (2003) states that „regardless of the method and the context of the calculation, the complete cost of a product is the cost that incorporates all the resources consumed with its purchase, production and delivery” [10, p. 246].

The information regarding the cost influences the elaboration process of economic-financial decision within the company in several ways: the cost-price relation, the cost-profit relation and the cost-economic profitability relation. The information is offered to the users of managerial accounting. In our opinion, the role of the managerial accounting is not only that of calculating costs, but it has to allow the decision factors of the company to act upon the costs aiming at controlling them.

Cost control is the main modality of obtaining economic performance. One of the anti-competing strategies used by the economic agents that gave very good results is the cost strategy. This strategy, called “the Japanese strategy” consists in obtaining the supremacy on the market by practicing low prices, due to the reduced costs.

In the specialized literature, the cost is approached not only as an expression of the consumption of necessary factors in order to produce something, but also as a sacrificed chance, as the cost of something to be lost. Thus, the notion of cost of opportunity or cost of choice started to be used.

Traditionally, the administrative accounting is centered on the recording and monitoring the costs incurred by the company for unfolding its economic activity. In the last decades, however, the social function of the company has become more and more important, generating hidden costs, unexplained by the traditional systems of administrative accounting.

The companies in the baking industry are characterized by a diversified production. In the baking production even the smallest companies, with less than 10 employees, produce at least 5-6 types of products, while the larger companies can produce up to several hundreds of assortments.

Except for the basic product, which is bread, the other products have a more and more reduced life cycle. The increasing competition in this domain has made the companies launch other new products. Considering the structure of costs, there is the problem of establishing some prices that would allow for covering these costs and obtaining a favorable result out of selling that product. In the competitive economy, the price is assigned by the market. The calculation method should give the possibility to perform forecast analyses that would be the ground for making good decisions regarding the launch in production of a certain product.

The long-term presence of a company on the competitive market could not be realized without the continuous preoccupation for performance, achievement and success. The notion of performance is complex enough and has several façades. In the economic domain, the concept of performance, interferes with notions such as profitability, productivity, efficiency and growth. The costs level has a direct impact on the performance level obtained in the company.

A manager’s influence and power over the costs is conditioned by the possibility of knowing the

application field of the cost and of identifying the controllable and uncontrollable costs. From this point of view, we make the following distinction between the reversible costs and the irreversible costs, the controllable costs and the administered costs, the determined costs and the discretionary costs, the internal costs and the external costs, the visible costs and the hidden costs.

#### 4. The concept of hidden costs

Professor H. Savall from ISEOR (*Institut de Socio-Économie des Entreprises et des Organisations*) in Lyon, proposed and developed the method of hidden costs-performance. The method was tested in varied activity sectors and in companies of different sizes, having between 20 and 18.000 employees.

According to H. Savall and V. Zardet (2008), “a cost is said to be hidden when it does not explicitly appear on the company information system, such as the budget, financial accounting, and cost accounting, or in the usual ledgers and logbooks” [14, pp. xx-xxi].

However, the visible costs are those that can be successfully detected in these systems. The quoted authors define the visible costs as having three fundamental properties:

- Have precise, normalized and known labels;
- Are measured based on precise and known rules;
- Are regularly monitored with the purpose of checking their evolution based on a certain fixed

objective.

H. Savall and V. Zardet (1991) claim that any element of the cost that lacks one of the three properties mentioned above is, by definition, a “hidden cost” [12]. Other authors consider that the characteristic of the hidden costs is the fact that these are engaged outside any official procedure, reaching considerable levels [7].

The activity of the company is constantly disrupted by dysfunctions. The company reacts to correct the dysfunctions. These corrective actions generate certain costs for the company: losses due to low level functioning inferior to the programmed one, additional salary expenses for the employees that replace the absent ones, over consumption of energy, additional external services, low/quality goods a.o. Therefore, the hidden costs represent the monetary aspect of the corrective activity of the dysfunctions [12].

The costs caused by dysfunctions represent the difference between the real activity of the company and the ideal activity. The concept of ideal activity refers to realizing the objectives considering the social, psychological and physical constraints and limitations of the employees, both individually and collectively. Also in the category of hidden costs are listed the “postponed occasion costs”. These represent the lost profit as a consequence of not realizing a product, a service or a work in a timely manner.

At the origin of the hidden costs lie known phenomena. The results support the hidden costs, which are not isolated as such and are not reported with the phenomenon that generated them. For example, the cost for quality decreases in the production activity, resulting in a cost increase for returning the defective products in a control cost increase. For correcting the dysfunctions, the company bears additional costs. These are linked either to the human activity overtime, or to the use of additional material resources for correcting the dysfunction, with the personnel made to provide additional hours and activities that would not have been necessary during the normal production time of the company.

H. Savall and V. Zardet (1991) consider that the general dysfunctions are generated by abnormalities, perturbations of deviations between the ideal functioning and the ascertained one of the company and identify five items: absenteeism, work accidents, personnel shifts, quality defects and decrease of the direct productivity [12]. The dysfunctions may bring along hidden costs in six organizational domains: time administration, work conditions, work organization, application of strategies, integrated formation and communication-coordination-targeting of the objectives.

The choice of objectives that would determine the cost generally targets what is visible or palpable: fabricated products, exploitation means, responsibilities centres. According to the authors C. Iacob et al (2007) there is a number of costs which, although are of interest for the administrators, are not formalized: the waiting interval between two production lots, an inadequate design and poor quality, the absenteeism from a production unit or workshop etc [6, p. 45]. All these dysfunctions consume resources (the waiting interval generates financial expenses; reshaping the low-quality rejected goods mobilizes human resources and machinery that could have been used for production purposes; the absenteeism could lead to hiring additional personnel, or to decrease production). Even though separative measures have been taken of “subactivity cost”, of unproductive expenses and other costs that are not related to the production, these measures do not allow a cost determination of the dysfunctions in a visible way.

The hidden costs fall into two categories. The first category is formed of the hidden costs that are included in the visible costs. These are effective costs and correspond to the real losses of the company. The second category is formed of the hidden costs that are not included in the visible costs [7]. These are also called potential costs and are represented by absence in production caused by the presence of the dysfunctions. The hidden costs from this second category are virtual costs, corresponding to a sub-activity. The hidden costs may localized causes in the company, as well as have external causes, namely: strikes of public services or their defective function, the incapacity of the judicial institutions to solve the commercial litigations in a timely

manner.

## 5. Detecting and evaluating the hidden costs of the company

The evaluation of the hidden costs is done out of the accounting books and are based on very precise determination of the dysfunctions and their consequences, by those in charge. For the evaluation of the hidden costs, professor H. Savall (1997) claims that five components should be taken into consideration: excess salaries, overtime, over-consumption, non-production, non-creation of potential. In addition to these, there are the risks generated by the dysfunctions [13, p. 720].

Excess-salaries are represented by the salaries paid without providing an activity (absent titular and paid) and by the salary differences between the substitute (with a higher salary than the titular of that position) and the titular (absent and not paid). Excess-time represents the lost time generated by correcting the dysfunction (time for correction and control). Over-consumption is the additional consumption of goods and services generated by dysfunctions and by the correction of these dysfunctions (loss of raw materials caused by non-quality). Non-production is represented by the absence of production that causes the loss of margin on variable costs. Non-creation of potential represents the cost in human time of immaterial investment actions, which were temporarily abandoned by the company, because its decision-making factors are focused on correcting the dysfunctions and did not have enough time to deal with the strategy. Late investment could compromise the efficacy and, in this case, we deal with a strategic hidden cost [19].

Detecting the hidden costs is based on the examination of dysfunctions. The hidden costs are generated by a multitude of negative aspects, apparently insignificant, that appear in the company. Their financial effects on the results of the company is obtained by valuing and adding the hidden costs.

We present in Table no. 1 some possible causes for the hidden costs in the baking industry.

**Table no 1.**

**Possible causes for hidden costs in the baking industry**

No.	Activities	Possible causes for hidden costs	Effects	Reduction possibilities
1	Purchase of raw materials	Raw materials and materials of low quality	Low quality products, deterioration of the image on the market	Strict procedure for purchase and reception
		Deterioration of raw materials during transportation	Loss of value of the raw materials	Provision of transportation conditions. Partly, the cause is uncontrollable
		Transport delays	Over-consumption of fuel, lack of production, excess salaries	Draw up a rigorous purchase plan. Some delays are uncontrollable and thus inevitable.
2	Storage	Inadequate storage conditions	Loss of value of the raw materials	Create adequate conditions for storage
		Low rotation speed of stocks	Increase of storage costs for raw materials	Elimination of products with slow sale of the company's portfolio
3	Production	Losses of raw materials caused by inadequate handling	Increase of expenses for raw materials	Proper training of the personnel
		Defect machinery	Repairing expenses, non-production	Adequate maintenance of machinery, proper training of the workers
4	Marketing	Poor or inadequate advertising for the products	Sales below estimated level	Reshaping the marketing policy
5	Selling (in their own shops)	Slow sale	Expenses for storage, deterioration of the products	Elimination of products with slow sale from the company's portfolio
		Unsold products	Impossibility of recovering the	Correlation of the production volume with the market demand

No.	Activities	Possible causes for hidden costs	Effects	Reduction possibilities
			product cost in the price	
		Inadequate storage	Loss of value for the goods	Creating adequate conditions for storing the goods in the stores

Source: elaborated by the authors

The ways to detect the hidden costs are the following:

- observation techniques. Gh. Săvoiu (2011) considers that „in any contemplation there are two questions to be asked. The first refers to what it is contemplated/observed and the second to the way in which the contemplation/observation is done” [15, p. 31].

In our opinion, the most efficient method to detect the hidden costs is the direct observation in the company.

- discussions with the personnel for the identification of procedures for them to follow in reality, for a better assessment of the efficiency and efficacy;

- examination of the professional competence of the employees: it rarely happens that the employees’ professional training totally corresponds to the requirements they have to meet. Poor qualification of the personnel is generated by errors, production defects, wasted time for explanations, correcting the defects. Over-qualification generates frustration for the employees, and quite often they leave their jobs and choose another that is better suited to their training;

- analysis of data registered in the accounting system in the analytical accounts.

As far as the analysis of the data is concerned, a series of applications have been launched lately that help managers process and filter the data. L.Șerbănescu and C.Necșulescu (2012) highlight that „The old instruments can no longer come up to the new challenges. From a historical point of view, the problem was data finding; now the problem is at the opposite side: how these data can be filtered in order to have a meaning?” [16]. In order to solve this problem, the company must purchase these computational applications that are properly designed to meet fulfill their needs on processing, filtering and analyzing the data.

D. Budugan et al (2007) show that “the manager’s decision to collect additional information (caused by dysfunctions) will induce supplementary costs, incorporated in the company’s expenses” [3, p. 426]. Moreover, the quoted authors highlight the fact that even the income accounts may be affected, since the non-income is also evaluated. For example, we consider that the estimated budget of a company for a financial year is the one presented in table no. 2.

Table no. 2.

#### Estimated situation of income and expenses

Information	Amount (euro)
Estimated income	520.000
Estimated expenses	470.000
Estimated profit	50.000

Source: elaborated by the authors

During the financial year, there have appeared some dysfunctions. In order to solve the problem of the absenteeism, the company used substitutes for the absent employees. The persons that substituted the titular of those job positions were paid higher salaries and in accounting the value of the extra salaries is 5.000 euro. At the same time, because of the dysfunctions an over-consumption of energy and raw materials registered in amount of 10.000 euro.

In table no. 3, we present the real situation of the income and expenses of the company.

Table no. 3

#### Actual situation of the income and expenses

Information	Amount (euro)
Actual income registered in accounting	500.000
Non income (losses of income caused by non-production)	20.000
Total actual expenses, of which:	490.000
Excess salaries	5.000
Over-consumption	15.000
Profit	10.000

**Source:** elaborated by the authors

We assume that at the moment of the analysis of the expenses, the variables represent 70% of the turnover (g). The saved expenses (Se) are obtained in this manner:

$$S_e = g \times \text{Non incomes} = 70\% \times 20.000 = 14.000 \text{ euro} \quad (1)$$

Thus, there hadn't been the excess-expenses caused by dysfunctions, actual expenses (potential) would have been in amount of 456.000 de euro. This value is the result of the difference between the estimated expenses (470.000 euro) and the saved expenses as a result of non-production (14.000 euro).

Excess-expenses of the company (Ee) are calculated according the following formula:

$$E_e = \text{Actual expenses} - \text{Potential expenses} = 490.000 - 456.000 = 34.000 \text{ euro} \quad (2)$$

The total hidden costs of the company (The) are calculated by adding the hidden costs included in the visible costs (excess-expenses – Ee) with the value of the non-products (Np) (non income) generated by the absence of production as a result of the dysfunctions.

$$T_{hc} = E_e + Np = 34.000 + 20.000 = 54.000 \text{ euro} \quad (3)$$

The financial performance of the company is improved when this manages to reduce the largeness of its dysfunctions. The performance, obtained by diminishing the hidden costs, is not reflected separately in the accounting and that is why it is called hidden performance.

The method of hidden performance-costs, also called the socio-economic method, attempts at reconciling the economic and the social dimension of the company, aiming at a better and more efficient management system. Knowing all the costs of the company would help the decision-making entities from the company to measure and administer the performance accordingly. The identification of the hidden costs will grant the identification of the additional costs and the loss of benefits. Acting upon the causes that generate the hidden costs may have limited effects. For example, we can act upon absenteeism in order to reduce its excessive level, but the phenomenon could not completely eliminated, there always being the “natural” absenteeism.

The social responsibility of the company meets its internal and external requirements. An important component of the social responsibilities of the company is represented by the social and health security. A responsible company cares for the health and security of its employees in accordance with the legal provisions, but it also takes into account the external implications.

In our opinion, a solution for the elimination of the hidden costs that are caused by absenteeism could be externalization of certain services in the company. It involves services such as guarding, cleaning or transportation. In this way, the hidden costs generated by the dysfunctions that appeared in the externalized activity are transferred to the service providing company. In the case of absenteeism, excess-salaries may appears in case the person that replaces the titular of the job is paid more than the titular. In this case, the provider is paid with the same amount by the company, even if that expenses with the salaries are higher. Yet, the externalization has its own risks, that is to generate other hidden costs for the company. The visible costs and part of the hidden costs are considerably reduced, but other hidden costs may appear, because the company has to monitor the activity of the provider and getting information costs money.

## 6. Conclusions:

It is essential to know the costs in order to make the right decisions that would result in accomplishing the strategic objectives of the economic entity and in obtaining performance. By managing the costs, the administrative accounting represents a strategic piloting means that contributes to making the optimal decisions and to improve profitability.

Projecting a cost calculation system should begin with a thoroughly detailed study of the company's activity. The cost calculation system in the company must be adapted to the exploitation activity of the company and not the other way around. Any significant alteration of the processes within the company has to be immediately followed by the adjustment of the cost calculation system. The identification of the hidden costs is the starting point for establishing the caused that generated them and the solutions to eliminate or diminish their effects.

Although we agree with authors who claim that that the concept of hidden costs-performance allows the company to discover greater internal resources and margins of maneuver for increasing its economic performances, we consider that the detection of the hidden costs generates other additional costs (especially for the personnel involved in the analysis and improvement of the computational/informational system) that some companies, especially the small ones, could not afford. Most of the companies acting in the Romanian baking industry are small and medium-sized companies with limited human and financial resources and we reckon that the possibilities to apply a hidden cost-performance method are debatable. Instead, the large companies, with

considerable human and financial resources to act efficiently in order to reduce the hidden costs and to increase performance.

One way to act in order to reduce hidden costs is to obtain global performance (economic, social and environmental) as a fundamental objective of the company. A company that manages to be socially efficient can also greatly reduce the hidden costs. In our view, the hidden costs of the companies that apply this intervention method may be greatly reduced, but not totally eliminated. Thus, the company has the possibility to eliminate most of the dysfunctions, but it cannot act on the external causes that generated the hidden costs, such as the strikes of the public services or the slow-motion of the legal system.

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