

THE HIDDEN COSTS OF AN ECONOMIC ENTITY

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Abstract: The increase of competitiveness, the maintain and improve of the efficiency of an economic entity, implies a strong control over the management of all the categories of resources utilized in the economic process. Therefore, the management and financial accounting have an important role with regards to the control and measurement of the components of manufacturing costs.

An essential internal reserve that any enterprise owns when refers to the decrease of the manufacturing cost are the hidden costs. This issue reveals the importance and the necessity of researching this matter.

The hidden costs are produced by the following actions: malfunctions (work conditions, labor management, communication, R&D, time management); different behaviors (individual, activity groups, collective, and pressure groups); structure typology (physical, technological, organizational, demographical, mental). In other words, the hidden costs are the consequence of absenteeism, work accidents, personnel traffic and fluctuation, products quality, low productivity). Thus, the hidden costs consist in either over-expenses or non-production and are composed of historic and opportunity costs.

The accounting is needful as it manages all activities of an economic entity, regardless of its size or complexity. As a mean of describing the reality, accounting is a real optical tool used for illustrating and surveying the universe of economic values movement.

The accounting is not just a tool but a social phenomenon. Its general characteristics define the area of manifestations which is usually reserved: the application field is formed by the organization, the accounting entry method is double-entry and the products are: trial balance, profit&loss account, cost determination and its appendices. At the enterprise level, the accounting answers to its own requirements, as: the need to inform the third parties, the management necessities, the control needs of the owners.

The cost accounting is necessary as it allows opting out for different optimal development and/or economic growth options. The impact of accounting information over the entities' economic growth can be observed in Figure 1.

The classical analytic accounting has the assignment and mission to determine the involved costs, which is the enterprise effort, in order to accomplish its economic function namely to produce and sell goods and perform services. At the same time, the analytic accounting has to mark out the social performances of public and private organizations. In order to perform an accurate determination and commensuration of the costs covered by the economic organizations (private enterprises, public institutions), the analytic accounting is enrolling and engaging on a very difficult path namely to research, mark out and determine the sum of total costs, to identify those categories of

costs that are easily determinable, as well as those that are more difficult to localize, separate and measure (as in the case of hidden costs).

Competitiveness improvement, profitableness preservation and amelioration, economic and social efficiency of an enterprise can not be obtained only throughout the accumulation of financial resource, technical means and human resources. The economic reality requires a deeper and stricter control over the management of all the categories of resources. On the other side, there is a urge necessity of marking out and measurement of certain components of the organization and social costs, that contains the whole expenses related to the presence and life of the personnel within the economic entities.

Under the light of the above information, the social analytic accounting has to identify and individualize its express tasks.

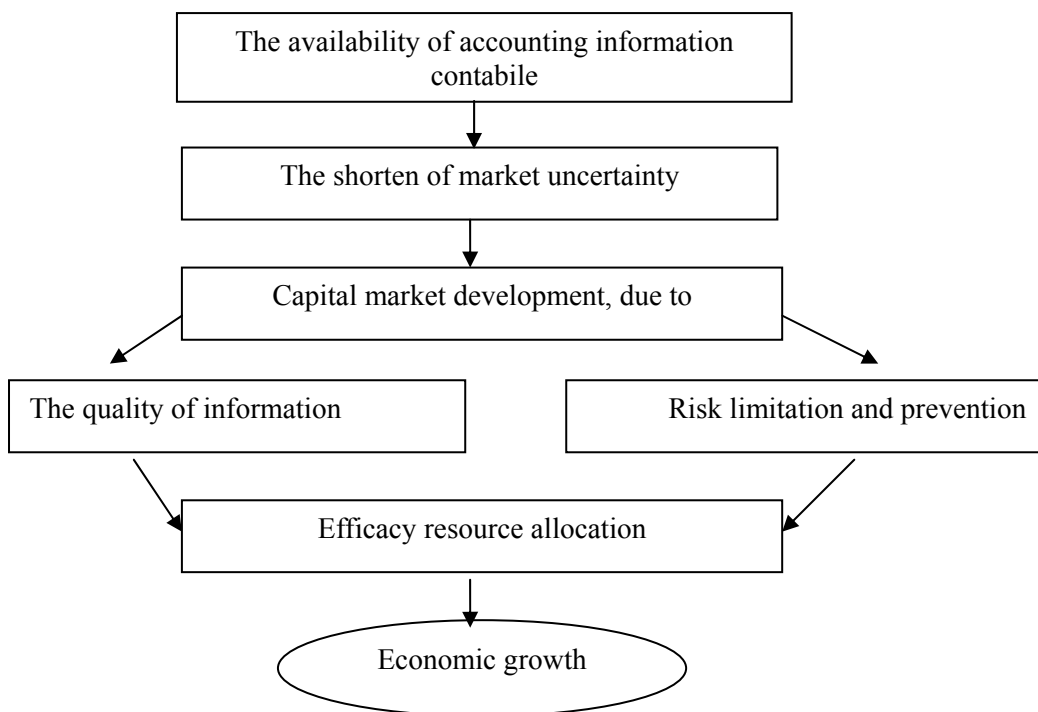


Fig. 1: The role of the accounting information

The social costs are related to the:

- personnel matters (the cost of employment, employee rotation, the renewal of the work force, braking the terms of the work agreement);
- personnel training (the cost of a training);
- work conditions (the cost of a work accident, the cost of absenteeism, the cost recovering the work force);
- hygiene and health conditions.

The activities performed by the economic entities do not always generates positive results but also produces material, human and financial losses. Part of these losses are less identified, measured and tracked by the classic analytic accounting.

Therefore a more complex and complete approach of the importance of the human factor within the enterprise economy, becomes a must.

Citizen, consumer or producer, the human being wishes to be taken into consideration during the management and organization activities. When the principle of professional consideration is not respected or even neglected, the organization gather abnormal functionalities and low performances such as: excessive maintenance expenses, unsatisfactory economic efficiency and productivity. Supplementary costs appear and they are characterized by singularity which means that they are nit generated at individual’s level but by the whole employee collectivity. As active participant to the social production, the employee in association with the other employees concur to hidden costs appearance.

Due to the complexity and diversity of the causes that generate the hidden cost, not always the accounting information system nor the management tools are well adapted to measure the above mentioned type of costs. This situation is also generated as the hidden costs are well spread within the organization and are generated by the activity of the employers from all work sectors, departments, work units, functional services and other places. The economic practice marks out that the measurement means are not always created to identify the economic and social phenomenon, as analytic as individual level. Most often, they are limited to collecting the proper information from either the organization hierarchical levels or certain individual group level.

The origin of hidden costs is a very important matter, worth to be studied. In order to pursue such a research, the economic and financial literature must be studied as, according to it, the organization is considered to be an assembly of interactions between different structures and behaviors types. Thus, at the level of economic agent, the following types are frequently used: physical, technological, organizational, demographical and mental (see Table 1) as well as types of individual human behaviors, activity groups, affinity and collective groups.

Table 1

The structure typology

Physical	Technological	Organizational	Demographical	Mental
1. Physical space 2. Places configuration 3. Perturbatory factors: - noise; - excessive heat; - toxicity; - excessive light;	1. The level of depreciation and equipment age 2. Complexity, automatization rank 3. Equipment adaptability to manufacturing requirements 4. The concordance of incidents between the formation and the workplace	1. Organization chart 2. Social chart 3. Division of labor 4. Operational methods 5. Schedule and work types 6.Procedures 6. The research, coordination and communication system 7. Operational and functional information	1. Personnel adjustment 2. Ages pyramid and the workforce structure 3. Permanent formation 4. Qualification structure 5. Promotion and professional channel 6. Recruitment policy	1. Management style 2. Enterprise microclimate 3. Socio – cultural conceptions

There are permanent and complex interactions within the organization and they are characterized by variability. During the activity of the organization, along with the normal aspects, disturbances and anomalies also appear and they are known as malfunctions. These negative aspects generate financial incidents or hidden costs that don't always have the same treatment with the normal phenomena such as: factors consume sales, income, and financial results.

In economy there are often found situations that can generate supplemental costs, as: absentee (indemnity received by employee which committed absentee), those related to the time consumed for reorganization of a plant or department, the wages related to products refurbishment, wages received by employees that didn't accomplish their tasks due to their lack of professionalism.

From the above mentioned ideas, the hidden costs are generated by events similar to: absentee or absenteeism, work accidents, work mobility or fluctuation within an organization (entries, output, and internal movements), low products quality (goods and services), low productivity (decrease of labor productivity). In figure 2 are shown the sources that generate hidden costs.

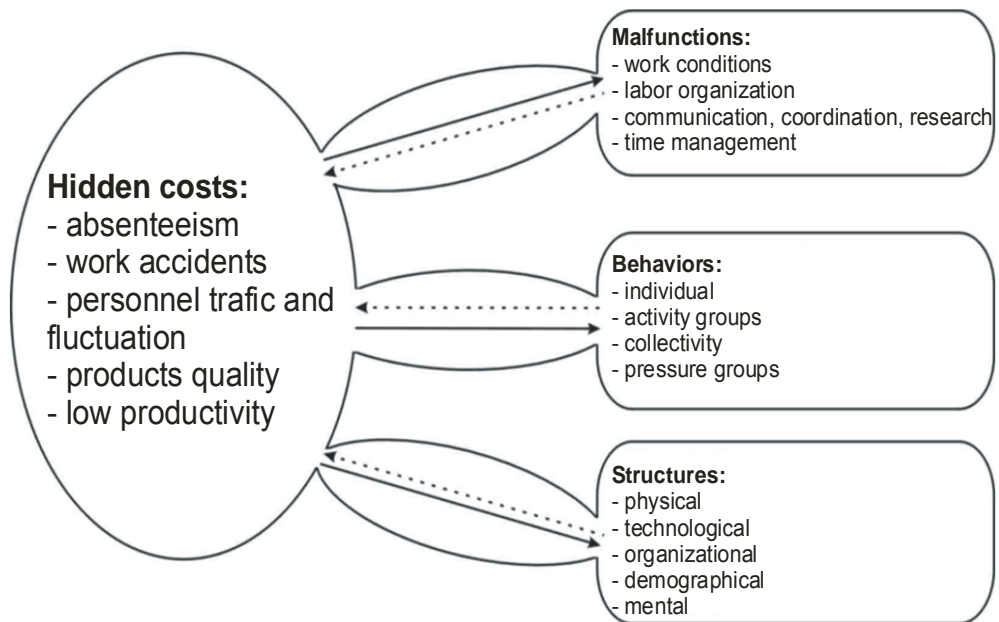


Fig. 2: The origins of hidden costs

The hidden costs contain five elements, different in nature; the first three elements represent the enterprise historic costs and they are formed by:

- additional wages (or over-wages) - related to the wages unjustified received by some employees which didn't accomplish their assignments(due to absenteeism or work accidents);
- supplemental work time (or over-time) – related to the unjustified received remuneration of the employee involved in the process of refurbishing rejected products;

- supplemental expenses (or utilities over-consume) – energy, power fuel, water and raw materials generated by the existence of malfunctions and especially due to their's dismiss.

The three above mentioned costs are organization's expenses whose avoidance is related to the lower level of malfunctions.

The last two elements do not belong to the manufacturing expenses but rather to the opportunity expenses. They don't generate supplemental costs but losses that the enterprise has to cover. This losses are generated by the products non-quality or by the manufacturing decrease due to low productivity (non-manufacture).

- the fourth component is, in fact, the loss that the organization is covering as its products do not suit the quality requirements. The actual loss is generated by the decrease of sales, in term of volume and, as a result, the income and profit equally decreases.

- the fifth component is still an opportunity cost; a decrease of the productivity implies a shrinkage of invoiced products therefore, the profit is equally diminished.

Due to the above explanations, a different vision over the hidden costs is created and is made of both the components and the generating causes as illustrated in Table 2.

The approach of this economic category offers the possibility to depict de following ideas:

- the hidden costs are partially researched and the difficulty of approaching the subject resides in the fact that they cannot be comprehend beforehand, even though the existing experience should allow it;

- the issue of determination of hidden costs is of great importance with the now-a-days business environment. The higher level of such costs, implies a higher level of internal reserves that can be mobilized for the reason of either surviving or future development;

- the hidden costs are generated by the following malfunctions : absenteeism, work accidents, labor circulation and fluctuation, low product quality, productivity deviation. A separate evaluation of the hidden costs is possible but it is dependent on the manner in which each enterprise is organizing and managing the accounting information systems on one hand and, on the other hand, it also depend on the complexity of its activity.

- as an economic reality, the hidden costs contain over-expenses which are in fact historic costs, or losses generated by the low product quality and productivity deviations ;

- the hidden costs, from a manifestation and materialization point of view, have a triple signification: quantitative, qualitative and financial nature.

Table 2

Hidden costs determination model

Hidden costs Causes	OVER-EXPENSES			NON MANUFACTURING		Total hidden costs
	Wages	Time supplements	Over-consume of utilities	Non Quality	Profitableness decrease	
Absenteeism	*					*
Work accidents	*					*
Personnel mobility		*				*
Disfunctionalities decrease			*			*
Products quality				*		*
Productivity deviation					*	*
TOTAL	*	*	*	*	*	*
	Historic costs			Opportunity costs		*

In conclusion, it can be asserted that, the actions regarding the economic and social improvements of the organization points out the management responsibility due to the frequently causes that support the hidden costs. Any action that has the meaning of determine and analyze the hidden costs is considered to be an important managerial action.

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