VOL. 27 NO. 7
ISSN: 2190-2099
DECEMBER, 2022

African Scholar Publications & Research International

African Scholars Journal of Business Dev. and Management Res. (JBDMR-7)

The Effects of Cost on the Profitability of an Organization (A Case of Grand Cereals and Oil Mills Limited, Nigeria)

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Abstract

The topic of this research is'The effects of cost on the profitability of an organization': (a case of Grand Cereals and Oil Mills Limited, Nigeria). The purpose of this study was to discover the relationship between cost and profitability in an organization, to identify the role of proper costing in the growth of an organization, to also identify the challenges of cost and profitability in an organization and to determine ways of reducing cost and maximizing profits in an organization. The design of this study was a cross-sectional survey method. The instrument of data collection was the records of Grand Cereals and Oil Mills Limited and it was analyzed using the Simple correlation as well as Analysis of Variance (ANOVA). The result of this research shows that there is a negative correlation between cost of production and profitability of Grand Cereals and Oil Mills Limited, there is positive correlation between sales and profitability and there is also a negative correlation between VAT and profitability of an organization. However, for adequate profit to be recorded from a business there is a need for adequate control of cost because a company with adequate cost structure possesses the higher chance of attaining its profit target.

Keywords: Profitabilty,Cost,Deveopment, Growth,Production, Maximizing Profit,Cost Reduction

Introduction

Cost and profit in business undertakings form part of what determines the financial position of a business concern (Adeyinka, 2015). Since management is concerned with profitability, which is a measure of business performance, especially in a manufacturing concern, the need for higher sales will arise and this will facilitate the need to increase production capacity, which in turn brings about increase in cost. Burns (2007) was of the opinion that corporate bodies should watch the cost and the profit will take care of itself. The implication is that cost should be controlled rather than embarking on unscientific cost reduction that may translate to lowering the quality of product. Management is normally forced to adopt various methodologies and techniques in order to regulate (control) rather than reduce cost. Cost increases as various production activities are embarked upon and the need to keep cost in check arises because standards for production will be set and actual production will be made thereby bringing about variances which can only be reduced or eliminated through effective cost control. Sikka (2013) was of the opinion that cost control system consists of methods and procedures that help to regulate the cost of operating an undertaking and ensures that cost do not go beyond a certain level. As profitability amongst others is the essence of any business, there will be the need to incur reasonable costs and management is to ensure careful and efficient use of resources so as to achieve the set standard or target. Cost control is operated by setting of standards and maintaining the performance according to standard because, as management aspires to increase productivity for more profit, there will be increasing cost and collection of cost will be made by each area of responsibilities (John, 2014).

The dynamic nature of our times has put so much on business that their survival can no longer be taken for granted but must be sort for. That business strength progressed or outpaced its competitors depends largely on the quality and strength of its management. People always make enquires pertaining to the issues that arouse their interests, How, where, when, how and what it will cost to get the necessary information, that will aid the attainment of the organizational goals. In all human transactions, we do talk of cost almost each minute of the day (Eze, 2016). All our daily expenses are been resolved in terms of cost-what cost, how cheap, how costly. In our offices we passively talk of cost savings, cost of materials, overhead service cost, labor cost and many others. In an economist's point of view, we visually hear the same song-marginal cost, opportunity cost, cost curve, total cost etc.

Therefore, this study examined the effect of cost on the profitability of an organization with specific reference to

Grand Cereals and Oil Mills Limited (GCOML).

METHODOLOGY

This work adopted a cross-sectional survey. According to Wakjissa (2011), cross-sectional survey is a type of research design which requires that data are collected at a particular time from a sample for the purpose of describing the population presented by the sample at that particular time. The reason for the choice of cross-sectional survey is because it helps to collect factual information from a specified sample and generalization of finding on the entire population.

The researcher used the financial records of Grand Cereals and Oil Mills Limited (GCOML) obtained from its headquarters in Jos as below:

Table 1: Cost of Production, sales, VAT and Profitability.

Years	Cost of Production	Sales	VAT	Profitability
2007	1.74	4.7	0.08	0.19
2008	1.86	5.1	0.10	0.23
2009	1.84	6.0	0.20	0.31
2010	2.97	6.2	0.15	0.40
2011	2.19	6.6	0.17	0.48
2012	2.99	7.0	0.24	0.52
2013	3.02	7.1	0.23	0.59
2014	3.23	7.1	0.29	0.66
2015	3.41	8.6	0.40	0.68
2016	3.56	8.0	0.38	0.74

Table 2: Cost of Production (Y) and Profitability (X).

Years	**Cost of Production (Y)**	**Profitability (X)**
2007	1.74	0.19
2008	1.86	0.23
2009	1.84	0.31
2010	2.97	0.40
2011	2.19	0.48
2012	2.99	0.52
2013	3.02	0.59
2014	3.23	0.66
2015	3.41	0.68
2016	3.56	0.74

Source: GCOML, 2017

Table 2 shows that N1.74 billion was expended on the cost of production and the profit of N0.19 billion was made. Similarly, in 2008, about N1.86 billion was expended and a profit of N0.23 billion made. In 2009 however, the cost of production slightly reduced to about N1.84 billion and the profit to N0.31 billion.
In 2010 however, the effect of the global financial crisis set it. The cost of production increases to N2.97 billion and the profit was N0.40 billion. This trend continues until 2016 where the cost of production stood at N3.56 billion and the profit at N0.74 billion

Table 3: Sales (Y) and Profitability (X)

Years	Sales (Y)	Profitability (X)
2007	4.7	0.19
2008	5.1	0.23
2009	6.0	0.31
2010	6.2	0.40
2011	6.6	0.48
2012	7.0	0.52
2013	7.1	0.59
2014	7.1	0.66
2015	8.6	0.68
2016	8.0	0.74

Source: GCMOL, 2017

Table 3 shows that in 2007, the sales of N4.7 billion contributes to the profit of N0.23 billion. In 2010, the sales of N6.2 billion contributes to the profit of N0.40 billion. Similarly, this trend continues until 2016 where the sales of N8.0 billion brought about a profit of N0.74 billion.

Table 4: VAT (X) and Profitability (X)

Years	VAT (Y)	Profitability (X)
2007	0.08	0.19
2008	0.10	0.23
2009	0.20	0.31
2010	0.15	0.40
2011	0.17	0.48
2012	0.24	0.52
2013	0.23	0.59
2014	0.29	0.66

2015	0.40	0.68
2016	0.38	0.74

Source: GCOML, 2017

Table 4 shows that in 2007, 0.08% of the N0.23 billion profit was giving as VAT to the government. In 2012, 0.24% of N0.52 billion was given. This trend continues until 2016 where 0.38% was taken out of the profit of N0.74 billion made for that year.

These secondary data were analyzed using simple correlation as well as ANOVA. This was used to test the relationship between the two variables in the research hypothesis. In doing this the researcher made use of SPSS to run the Analysis of Variance (ANOVA). The Analysis of Variance (ANOVA) attempts to find out if there exist any differences between cost of production and profitability or not. Here, if the critical value of F* is greater than the sig-value, we reject the null hypothesis. The sig-value here is the lowest significance level at which a null hypothesis can be rejected. As a rule, the smaller the sig- value, the stronger is the evidence against the null hypothesis.

STATEMENT OF THE PROBLEM

The main goal or objective of any business organization is to make and maximize profit while other secondary objectives include going concern, growth, corporate social responsibility, benefits to employees and so on. Though other objectives are also considered very important as listed above, but profit maximization is usually the ultimate because it maximizes the shareholders wealth which is the ultimate aim of investing in a business. People will naturally prefer to invest in a highly profitable business. Therefore, in the long run only the profit maximizers survive in the business environment. However, for adequate profit to be recorded from a business there is a need for adequate control of cost because a company with adequate cost structure possesses the higher chance of attaining its profit target

The cost of importing from and exporting goods to countries like China, Dubai, U.S.A, is high and the procedures at the border is also of high cost, exchange rate and government policies of different countries are also responsible for the high cost of international trade.

In a similar vein, bureaucracy has been singled out as a major contributor to the high cost of doing business in Africa.

The case is not totally different in Nigeria. Despite assurances by government at all levels to the promises of better operating business environment, manufacturers continue to lament high cost of doing business in the country, a development, they said, that has led many industries to either close down their operations or relocate to

neighbouring countries. Apart from the manufacturing sector, there is seemingly no other sector of the economy that is not bemoaning the high cost of doing business in the country. Experts have also said that infrastructure deficit in Nigeria valued at trillions of naira places about 15 per cent additional burden on the cost of doing business by manufacturing firms and service providers in the country, leading to high cost of products and services.

However, the rising cost of doing business in the country has been of utmost concern to business men and the entire citizens. This has even accounted for capital flight, closure of businesses and the movement of manufacturing companies to neighbouring countries, where cost of doing business is relatively low compared to what is happening in Nigeria. This study will therefore investigate the effect of cost on profitability of businesses in Nigeria.

Theoretical Review

This study is based on the following assumptions of the system theory.

Risk Theory of Profit

Risk taking was an inevitable component of dynamic production and those who took risk in business had a right to a separate reward known as "profit". According to Hawley, profit is the price paid by society for assuming business risk. A businessman would not take a risk without expecting compensation in excess of actuarial value i.e., a premium on calculable risk. The reason that expected profit must be more than actuarial risk is the assumption that risk gives rise to dis-utilities of various kinds. Therefore, assuming risk gives the entrepreneur a claim to a reward in excess of the actuarial value of the risk. Hawley stated that profit was composed of two parts: one part represents compensation for average loss incidental to the various causes of risk and the other part represents an inducement to suffer the consequences of being exposed to the risk. Hawley believed that profits arose from factor ownership as long as the ownership included risk. If the entrepreneur avoided risk by insuring against it, he ceased to be an entrepreneur and should not receive profits. According to Hawley profit arose out of uninsured risk. The uncertainty ends with sale of the entrepreneur's product. Profit thus is a residue. Hawley's theory is also known as the "residual theory of profit

Innovations Theory of Profits

This theory of profits explains that economic profits arise because of successful innovations introduced by the entrepreneurs. It has been held by Joseph Schumpeter

that the main function of the entrepreneur is to introduce innovations in the economy and profits are reward for his performing this function. Now, what is innovation? Innovation, as used by Schumpeter, has a very wide connotation. Any new measure or policy adopted by an entrepreneur to reduce his cost of production or to increase the demand for his product is an innovation. Thus innovations can be divided into two categories. First types of innovations are those which reduce cost of production. In this first type of innovations are included the introduction of a new machinery, new and cheaper technique or process of production, exploitation of a new source of raw materials, a new and better method of orgainising the firm, etc. Second types of innovations are those which increase the demand for the product. In this category are included the introduction of a new product, a new variety or design of the product, a new and superior method of advertisement, discovery of new markets etc. If an innovation proves successful, that is, if it achieves its aim of either reducing the cost of production or increasing the demand for a product, it will give rise to profits. Profits emerge due to successful innovations, either cost falls below the prevailing price of the product or the entrepreneur is able to sell more and at a better price than before. It is worth mentioning that profits caused by a particular innovation tend to be competed away as others imitate and also adopt it. An innovation ceases to be new or novel, when others also come to know of it and adopt it. When an entrepreneur introduces a new innovation, he is first in a monopoly position because the new innovation is confined to him only, He therefore makes large profits. When after some time others also adopt it in order to get a share, profits will disappear. If the law allows and the entrepreneur is able to get his new innovation e.g., new product patented, then he will continue to earn profits for a longer period. For example, Xerox Corporation made large economic profits because it successfully developed and marketed a superior copying technology. Xerox continued to make large profits until other firms entered the field to compete away these super-normal profits earned by it. Likewise, Bill Gates introduced Windows operating system and MS-office types of computer software and has become billionaire by making huge profit on his innovations.

Managerial Efficiency Theory of Profits

Lastly, this theory recognizes that some firms are more efficient than others in terms of management of productive operations and successfully meeting the needs of consumers. Firms with average level of efficiency earns average rate of return. Firms with higher managerial skills and production efficiency are required to be compensated by above-normal profits (i.e. economic profits). Therefore, this theory is also called compensatory theory of profits.

Kaizen Costing Theory

Kaizen a term with Japanese origin was launched by Masaaki Imai (Rof, 2012), the concept is a coinage of two Japanese words: KAI (Change) and ZEN (for better) (Rof, 2012). Thereafter, Yashuhiro Monden from Japan developed Kaizen Costing as the costing counterpart to the Kaizen approach (Industrial and Financial Systems, 2001). This concept refers to the process of 'continuous improvement' (Rof, 2012; Sani & Allahverdizadeh, 2012). The principle behind Kaizen Costing application is on achieving small, gradual but continuous improvements in the production process at minimal cost (Rof, 2012). Ellram (2000, cited in Modarress, Ansari, & Lockwod, 2004) observed that Kaizen Costing ensures that products meets or exceeds customer demands for quality, functionality, and prices in order to sustain the product's competitiveness. This according to Rof (2012) can be achieved through a sequential elimination of all the processes that would increase the product's cost of production without a corresponding increase in value. The philosophy emphasizes continuous improvement in our ways of life, social life and home life. This technique has made tremendous changes in management policies not only in Japan, but all over the word (Ogundele 2004). Blocher, Chen and Lin (1999), define Kaizen costing technique as the application of continuous improvement specifically to reduce costs; it focuses on making production and service delivery processes more efficient. Kaizen costing is used for making improvement to a process through small incremental amounts, rather than through large innovations. Unlike target costing, Kaizen costing is applied during the production stage of the product life cycle (Target cost is applied during the design stage). Adeniji (2011), asserted that Kaizen costing is the process of continuous improvement, encouraging constant reductions by tightening the 'standard'. The cost reduction objective is to set for each process, and then adopt value analysis and Value engineering to achieve the set objective. With target costing, the focus is on the product, and cost reductions are achieved primarily through product design.

Conclusion and Recommendation

Conclusion

The main goal or objective of any business organization according is to make and maximize profit while other secondary objectives include going concern, growth, corporate social responsibility, benefits to employees and so on. Though other objectives are also considered very important as listed above, but profit maximization is usually the ultimate because it maximizes the shareholder's wealth which is the ultimate aim of investing in a business. People will naturally prefer to invest in a highly profitable business. Therefore, in the long run only the profit maximizers survive in

the business environment. However, for adequate profit to be recorded from a business there is a need for adequate control of cost because a company with adequate cost structure possesses the higher chance of attaining its profit target. However, the rising cost of doing business in the country has been of utmost concern to business men and the entire citizens. This has even accounted for capital flight, closure of businesses and the movement of manufacturing companies to neighboring countries, where cost of doing business is relatively low compared to what is happening in Nigeria.

Recommendation

i. Effective cost control, including good responsibility accounting system, should be established by all business concerns in the country, this facilitates proper costing and enhances the growth of an organization.
ii. Cost control should be in place in all the departments, most especially the production department, in order to make sure that units of finished goods are properly accounted for, this will in turn reduce cost and maximize profits in an organization;
iii. Budget established should not remain fixed, but should be revised, when condition changes. This means that there should be attainable target, not the one that is beyond workers' capability given the resources at their disposal, this will enable the identification of the challenges associated with cost and profitability;
iv. Collection of costs should be made by each area of responsibility and reports thereon, which should indicate, in monetary terms, the effect of efficiency or inefficiency, given section by section and department by department;
v. For effective cost control to be achieved, there should be proper data collection, analysis and administration at all level of the business;
vi. There should be strategic cost control so as not to allow negative impact of other strategic variables, such as financial product, affect sales revenue and later profitability;
vii. Above all workers should be carried along at all stages of cost control strategies so as to buy into the process and ensure full compliance.

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