After the Award #5
Don’t let indirect costs cost you profit (or worse)

Utilities. Office supplies. Technology. Marketing. Accounting. Payroll services. Employee benefits. Perk programs. Insurance. Depreciation.

All of these are considered “overhead”, the costs of running the company — as opposed to producing a product. Because they are not specific to creating your product or service, they are considered “indirect” costs. Unfortunately, they are too often ignored when setting the price for a product or service.

You can’t avoid indirect costs; they’re necessary for running your business. But if you don’t incorporate them into what you charge for what you do, you’ll be losing money from day one.

Indirect costs can be fixed or variable. For example, the rent you pay for your building will probably be the same every month. But your electricity or water bill can vary each month.

You need to add all of these overhead costs together, then allocate them on a per-unit basis to calculate your company's “overhead” price per product. This becomes the basis for your product's pricing before you add on your desired profit margin.

That’s why it’s incredibly important to correctly classify direct and indirect costs so you can determine the firm's profitability and efficiency, and recognize potential areas for cost improvement.

It also makes sense to keep track of and correctly classify these costs because overhead can be deducted on the company's tax return.

So, remember…don’t ignore your indirect costs. Make sure to review your indirect/overhead costs on a regular basis. And make sure they’re covered when pricing your product or service.