Impact of Administration Cost on Company Sales

(A Case Study of Leading I.T Company in Pakistan)

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Abstract

Administrative costs explained as the cost incurred in the administration of company directives are a very important expenditure. Two main types of costs exist: direct and indirect. While direct costs are incurred in the process of direct company operations (such as sales or distribution), indirect costs supports this. These indirect costs, including administrative costs, enable those directly involved in company operations to complete their tasks rather then being distracted by other tasks. The sales to administrative expenses ratio measures a company's ability to manage non-operating expenses and garner sales. Also referred to as the SAE ratio, the sales to administrative expenses ratio can help business managers and accountants determine how well their organization is maintaining operations using fixed costs. As the administration cost is increasing in the modern dynamics the sales is also elevating however this key study analysed the actual impacts of high administrative cost on sales of the company, other than elevation or increase. Interview based data collection utilized in this study. The administration cost possessed direct relationship with sales of the company. Partial sales costs have a significant effect on profitability. This means that profitability can be determined by sales costs at manufacturing companies of the basic industrial sector and chemical sub-sectors of ceramics, where Sales costs have a positive effect on profitability, meaning that the higher the cost of sales, the lower the level of profitability. Hence conclusively the sales increased by increase in administration cost but at the same time, profitability decreased for the company.

Keywords: Operating, Financial Expenses, Sales Revenue, FFC, Multiproducts, Pakistan, Information and Technology Sector.

Introduction

Administration Cost

Administration expenses include paying wages and salaries and providing benefits to non-sales personnel. They are one of three expenses that make up a company's operating expenses. The others are selling and general expenses. Administration expenses are categorised as indirect expenses on a company's income statement because they do not contribute directly to making a product or delivering a service. As they tend to remain stable even when production volumes change, administration expenses are described as fixed costs (as opposed to variable costs or semi-variable) (Shrank et al., 2019). Assessment of the magnitude of the administrative costs involved in policy implementation, their determinants and the implications of such costs for policy development would be a valuable contribution to policy debates. The view is often that administration activities should be minimized rather than having a productive economic function. However, in a world of scarce resources, organizational costs should be balanced with maintaining sufficient levels of conservation activity to fulfill the policy's objectives; it is net scheme costs that matter. A more complex, targeted scheme might bring more significant environmental benefits, but the link between targeting and benefits needs to be transparent. Given that administrative arrangements such as agri-environmental schemes can provide applicable mechanisms to resolve resource use conflicts about externalities or public goods, we need to know how agri-environmental expenditures relate to improving environmental quality and social welfare, as compared to the "policy-off" situation (Shankar et al., 2019). A better understanding of the factors that cause schemes to be more or less costly to run would enable policy-makers to identify where adjustments might be made in existing schemes to improve their efficiency, as well as provide lessons for the design of future schemes.

Moreover, Administrative costs explained as the cost incurred in the administration of company directives are a very important expenditure. Two main types of costs exist: direct and indirect. While direct costs are incurred in the process of direct company operations (such as sales or distribution), indirect costs supports this. These indirect costs, including administrative costs, enable those directly involved in company operations to complete their tasks rather then being distracted by other tasks. An example makes this evident: rather than putting each marketing cost in a company accounting system the marketing department spends the budget it has and keeps invoices. The accounting department, a section of the total administrative costs accounting for the company finances, then takes these invoices and compares them to company accounts (Campani & De Ridder, 2019). Administrative costs allow the maximization of effort in the expertise of each department: marketing, inventory, and even accounting. This particular research study highlighted the dimension of administration cost and its role in alignment with company sales.

Literature Review

Importance of Administration Cost

Many research studies highlighted the importance of Administration Cost in the dynamics of business portfolios. Yabroff et al. (2019), highlighted the importance of this cost that, An office does not run on its own. Your teams require a high-functioning ambience in which they can work comfortably without having to worry about trivial issues. A good ambience aids in the recruitment of quality employees who tend to stay for long with the organization. Small indulgences like comfortable seating, cheerful interiors add to the ambiance. Urban culture involves company meetings, project evaluation activities, and office meetings which are now held in cafeterias and open spaces. Every penny spent on these tasks is accounted for in the administrative budget. Moreover in another study Wu et al. (2019), indicated that most administrative costs may appear insignificant in contrast to other costs. The next question is whether or not we should account for them. When you add them all up, they have the potential to have a big impact on your total business. As a result, all such costs should be recorded and reported in the financial statement. These administrative expenses should be accounted for during the period in which they were incurred, not during the period in which they were paid, thus possessed a significant impact.

Furthermore, Karagiorgos et al. (2020), listed Some of the most frequent administrative costs; Salaries: Salary covers pay for corporate employees such as management, finance, accounting, custodial, and information technology, Rent: Another important expense is providing office space for your employees. This is one of the reasons why some businesses have chosen to work remotely rather than in an office. Remote culture has become the new standard in light of the current pandemic, Food, Drinks, and other Refreshments: It's easier for employees to show up and do their best work when they're pleased and comfortable. These are the costs of providing refreshments to keep staff at their peak performance, Other perks to employees: Aside from food and beverages, benefits might include anything from a team supper at a restaurant for new employees to a monthly yoga class, an annual Christmas party, or a paid gym membership, among other things, Work-related technical supplies: These include a screen, keyboard, batteries, and a mouse, among other things. There could be some contingencies like furniture breakage, air-conditioning replacement among others which are also considered as administrative expenses. All of these expenses are inevitable in the path of growth and development of the organization.

Sales to Administration Cost Ratio

The sales to administrative expenses ratio measures a company's ability to manage non-operating expenses and garner sales. Also referred to as the SAE ratio, the sales to administrative expenses ratio can help business managers and accountants determine how well their organization is maintaining operations using fixed costs. The two areas this ratio compares are; Total sales: This metric refers to the total amount of money your company received from selling goods or services during a set period of time, Administrative expenses; these are expenses that support the overall business, but that don't directly impact the production or delivery of the services or goods a company offers (Kim et al., 2022). Examples of administrative expenses include accounting fees, human resources expenses and salaries for executive team members or managers.

By comparing these areas, the sales to administrative expenses ratio shows how much a company earns for every dollar they spend on fixed operating costs. The higher the sales to administrative expenses ratio is, the better the company is at generating a profit. If a company continues to see an increase in their sales to administrative expenses ratio over time without changing their operations or administrative costs (Jevdjevic et al., 2019), it may also indicate that they have the right infrastructure in place to scale their business. Moreover in one of the study Krisnadewi & Soewarno (2020), highlighted steps to use the sales to administrative expenses ratio effectively; 1. Review your company's annual income statement, 2. Identify what your total annual sales are. This typically appears at the top of an annual income statement, 3. Determine how much you spent on administrative expenses, 4. You can typically find your administrative expenses on your annual income statement between the cost of goods sold and the operating profit sections, 5. Divide your total sales by your total administrative expenses to calculate your sales to administrative expenses ratio. Hence the relationship between the sales and administration cost is evident.

Administration Cost and Profitability of the Company

Administration and General costs are all costs associated with the generaladministration function, costs for coordinating the production and marketing activities of the product, for example accountant audit fees and photocopy costs (Hong & Thao, 2021).Classification of administration and general costs is costs incurred to coordinate the productionand marketing activities of the product. Administration and general costs are costs for coordinating the production and marketing activities of the product. Examples of salary costs for employees in the financial are accounting, personnel, and public relations departments of accountant fees, photocopy fees. Administration and general costs are incurred in the context of directing, running, and controlling companies to produce finished goods. Based on the results of research that have been done which explained the administration & general costs significantly influence profitability (Muhit, 2022). Hence the increase in administration cost forced correlative increase in the sales and profitability of the company.

Methodology

Qualitative Data Sampling

The qualitative study often relied upon the experiences of human beings. Qualitative Research studies are centralized over descriptive findings more than numerical data. The study is based on an investigation that further approves or disapproves of the research hypothesis or assumptions (Haven & Grootel, 2019). The qualitative research study is based on data that can be generalized to holistic views and principles. In this particular study, the data generated based on the facts and findings forming information that cannot be expressed in terms of numerical data, categorized as qualitative data. The qualitative data is often collected by using word clouds, graphs, and concept databases (Lowe et al., 2018). The Qualitative data of both types; Primary and Secondary collected in this research.

Interviews based Data Collection

In this study the data, the researcher will conduct interviews with managers from various international organizations in order to get information about the effects experienced by managers when working on company sales and administration cost. Interviews served as the best tool for human perceptions and observations (Natow, 2020). These interviews were semi-structured, as the researcher asked some particular questions about the relationship between Administration cost and Company sales but the questions were entirely open-ended.

Primary and Secondary Data Collection

In this study, the primary and secondary types of data were collected. With the aid of the interviews, primary data was collected. As, collection of data directly from the human subject is called primary data collection, which is a complex form of data collection

(DeJonckheere and Vaughn, 2019). Primary data collection requires formalities and other permissions that take about 90 days to 3 months. The Secondary Data also collected included articles and journals that have already been peer-reviewed. Secondary data collection is a convenient research method based on the available data collection (Kalu et al., 2019). The research study utilized both data types for the research findings. The topic and the research questions that have been developed require the primary data for addressing the research problem. Hence primary data has been collected along with secondary data. The results evaluated from the interviews have been justified through the published literature that justified the use of secondary data.

Results and Discussions

Sales Impacted under Increase in Administration Cost

The analysis of the interview based on the narrative inquiry, developed the results that the average sales volume at manufacturing companies of the basic industrial sector and chemical of the sub-sectors of ceramics, porcelain & glass listed on the Stock Exchange in 2016-2018 had a trendline that tended to increase. The companies experiences ups & downs so that it can be concluded that the selling costs that increase every year reflect the company's performance. The increased sales costs are caused by the increased production volume produced by the company and the production costs incurred by the company. The results of the study showed that the average promotional costs in manufacturing companies of the basic industrial sector and chemical of the sub-sectors of ceramics, porcelain and glass listed on the Stock Exchange in 2016-2018 had a fluctuating trendline. This happens because as long as the company carries out a significant promotion the company is already well-known or has an image to carry out advertisements reminding consumers. The decrease in promotion costs is because the company considers the promotion activities previously carried out to be on target and according to plan.

Discussions

The results of the current study firmed the importance of administration cost in the domain of company sales, and this results aligned with the findings of Lim et al. (2021), that, the sales to administrative expenses ratio is important for business managers and accountants to understand because it reflects whether the current infrastructure of a company is effective. If the sales to administrative expenses ratio is high, it typically means the company is allocating their resources in a way that supports growth. However, if the sales to administrative expenses ratio is low, the company may want to analyze what they're spending on overhead and how they structure their management team to improve their performance. Additionally Jevdjevic et al. (2019), also contributed towards it by stating that Calculating sales to administrative expenses ratio can benefit you by helping you; Allocate your resources properly, Ensure your company remains profitable, Scale your business up effectively, Reduce overhead costs, Develop more productive administrative processes, Conduct accurate cost analysis during acquisitions and mergers, Track changes in your efficiency over time.

The sales of the companies increased with the administrative cost because, Some companies merge Selling, General and Administrative Expense (SG&A) into one line in their income statement. In some cases, an analyst may take Selling Expenses out of this value and use General & Administrative Expenses instead when computing for the ratio. This is because the selling expenses would directly relate to product sales and not administrative expenses. While the results may differ between industries, a company should typically stay between 10% and 25% for their ratio. A lowSales to Administrative Expense Ratio may indicate a less-than-efficient system within their corporate structure. Such flaws may be related to process issues. These could include outdated systems and software. For instance, a company may still rely on manual accounting, which clearly demands a huge workforce. It requires a lot more man-hours, resulting in increased fixed costs. Ideally, management should be responsible for minimizing these costs, although the company might require additional cash flow to help make these improvements (Hartmann & Lussier, 2020), this provide ultimate balance to enhance the sale in the alignment with administrative cost.

Management based Analysis helped in Sales Elevation

Management usually relies on the sales to administrative expense ratio to predict the results of its corporate strategy and growth plans. Often, a fast-growth phase means drastically high administrative costs, complicated management structures, and redundant functions and departments. Analysts have to keep track of such changes carefully over a long period to assess the success of any changes. Firms considering a merger or acquisition should check their Sales to Administrative Expense Ratio to help them in decision-making. While studying a target, an acquirer weighs the synergies or potential financial benefits, that can come after a merger. A good way to attain synergies is by eliminating duplicate or overlapping back-office tasks (Sulaiman & Alhaji Zakari, 2019). The company might conduct a meticulous cost analysis to help the company understand a potential merger’s effects.

Additionally, these analysts should also consider this ratio from a historical and industry-specific perspective. If the number is going down from one year to another, then it could be a sign of a problem. This means the fixed costs need to be distributed across lower sales. Fixed costs also depend on the business sector of the company. Comparing different companies can help you understand where the company fits into the current market. When performing peer analysis, the size of the competition is also important to focus on. Theoretically speaking, bigger companies must have a higher sales to admin expense ratio (Schäuble, 2019). Specifically, a company that has been acquiring businesses through the years is expected to take on many additional costs, from audit fees to advisory fees, and so on. If these expenses are one-time costs, they should not be included in the ratio calculation. In contrast, if the cost is a consistent part of their strategy, these expenses must be included. Analysts should be ready to go through any capital expenses as well. These costs may come with opening a back-office and employing senior managers . This might require a sizable initial investment, which can lead to increased sales over a longer period of time (Chang & Ma, 2019). Usually, the sales to administrative expense ratio is expected to get better through time. However despite the fact the administration cost possessed direct relationship with sales of the company and increased the sales in the recent year but it is evident that the higher the administration and general costs will also decrease the level of profitability of the company. Administration & General Costs have an influence on profitability, every company has costs to coordinate the production and marketing activities of its products both goods or services companies (Ledley et al., 2020), companies must be able to minimize administration and general costs properly in order to maintain the company's survival.

Conclusion

The administration cost possessed direct relationship with sales of the company. Partial sales costs have a significant effect on profitability. This means that profitability can be determined by sales costs at manufacturing companies of the basic industrial sector and chemical sub-sectors of ceramics, where Sales costs have a positive effect on profitability, meaning that the higher the cost of sales, the lower the level of profitability. Administration and General Costs partially have a significant effect on profitability. This means that profitability can be determined by Administration and General Costs in manufacturing companies of the basic industrial sector and chemical of sub-sectors of ceramics, Administration and General Costs have a negative correlation to profitability, the higher the administration and general costs, the lower the level of profitability. Sales and Administration and General Costs together have an effect on profitability, meaning that profitability can be determined by Sales and General and Administration Costs in manufacturing companies of the basic industrial sector and chemical sub-sector of ceramics listed. Hence despite the positive relationship the dynamics of administration cost with sales and profitability is very complex.

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