(#150) Dear Management:

September 23, 2019

Why do we allocate overhead (OH) costs?  Stumped?

Two major reasons... (1) to properly match OH consumed, to the income streams using it and (2) to evaluate which income streams do it better or worse.

With an on-going company, the better you allocate the better the decisions to be had.  Now, there is a cost/benefit point on the effort to produce those numbers, so watch that.  But consistent usage will wash away small anomalies.

In evaluating "potential" locations... you may decide on a prorated % of OH, but whatever %  you choose, make it consistent for the comparison.  That way you're comparing everything on an equal footing.

Now, there is an alternative... to just pool the costs and evaluate on a (pre-OH allocation) level.  But with NO allocation, the numbers tell you NO story... That you can use to figure out why they aren't profitable, maybe fix them, or if they can't be fixed, replace them.

Example:  10 branches... all profitable in a (pre-OH allocation) world...  but due on inefficiencies, if you were to do some simple allocations, you'd see 5 are non-profitable based on usage.

Moral - Let the numbers tell you the real story... don't just read the headlines.

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