Sub: Entreprenuership Development programme.

Topic: Estimating Cost of Production And Profiability

Estimating Cost of production and profitability refers to all costs involved in acquiring goods and services required as input for producing a product. The four major components of cost of production and profitability are –

- ♦ Material Cost
- ♦ Labour Cost
- ♦ Cost of Utilities
- ♦ Factory Overhead Cost
  - Marketing of Products and its sale to increase profits

(i) Material cost – It includes cost of raw material, chemicals, components, and other inputs required for production. These costs may be determined on the basis of theoretical consumption norms, industry experience or specifications provided by machinery suppliers. The following points must be kept in mind when estimating the cost of material inputs –

(a) The total requirement of various materials inputs can be obtained by multiplying *Requirement per unit of output* by *Expected output during the year*

b) The price of material input are defined in terms of CIF (cost, insurance and freight)

(c) While determining the present value of material inputs, inflation factor must be ignored.

(d) There may be seasonal fluctuations in the prices of inputs which must be considered.

(ii) Labour cost – It includes cost of all manpower employed . It is a function of number of employees and rate of remuneration. Manpower includes the number of operators for operating various services, number of Supervisors and Administrative staff.

Remuneration may be calculated on the rate prevailing in the industry. It must include basic pay, dearness allowance, conveyance allowance, travel concession, provident fund contribution, medical, bonus etc. Payment related to vacation, overtime, night work, work on holidays must also be included.

(iii) Cost of Utilities – It includes Cost of Power, Water and Fuel. The requirements for fuel, water and power are determined on the basis of norms specified by collaborators, consultants etc.

The Cost of power includes bought out power estimated on the basis of charges of the concerned electricity board.

♦ The Cost of water includes charges paid to local authorities.

♦ Cost of fuel consists of cost involved in buying coal, fire, wood, bio gas etc.

(iv) Factory overhead cost – It includes expenses on repairs and maintenance, rent, taxes, insurance on factory assets. It is low in initial years high in later years.

(v) Marketing of products and Its sales to earn Profits- it includes sales of products and its marketing in the right marketing to sell it to right customers and to earn profits.

Estimates of sales ,production and Profitiability.

In order to determine profitability of a project the first task to be carried out is the forecast of sales revenue. While estimating sales revenue the following things must be kept in mind –

(i) It is not advisable to assume a high capacity utilization of machinery level in the first year of operation even if the technology is simple and company does not face any technical problems. Due to constraints like raw material shortage, limited power, marketing problems etc.

(iii) The Selling Price considered should be the price realizable by the company net of excise duty. It shall however include dealer`s commission.

(iv) The Selling Price used may be the present selling price. It is assumed that change in selling price will be matched by change in cost of production. Therefore, if a part of production is saleable at controlled price, sell that part at the controlled price.

In order to make estimates of Sales and Production the following details must be furnished for each product and until the maximum capacity utilization of the plant –

1. Installed Capacity
2. Number of working days
3. Number of shifts
4. Estimated production per day
5. Estimated annual production
6. Estimated output as a percentage of plant capacity
7. Sales after adjusting stocks
8. Value of sales

If there are good sales then the company will get good Profits.