

ARTICLE ON
GREENFIELD PROJECTS AND ITS FINANCING
(PART-II)

For setting up a project it is most important to work out the cost of the project along with the factors such as understanding the technology, marketability, competition, project site, suppliers of machinery etc. Here we will discuss how to assess a realistic cost of project so that financial viability of a project can be work out which is most important aspect for a successful implementation of the project. The major item of cost will be as following:

1. Land and site development

- a. Cost of land purchased and premium paid including registry charges & any other charges
- b. Lease rent in case the company has taken the land on lease say from Noida authority or Greater Noida authority. The lease rent paid and payable till the construction of the project will be capitalized and after that the lease rent is charged as revenue expenditure in profit and loss account.
- c. Charges paid for getting the land freehold
- d. Site development cost: it includes the expenditure on leveling the land, constructing the approach road and internal road, fencing, compound wall, gates, sewerage system, basic amenities, service line etc.

2. Buildings

Cost of building depends on the type and quality of structure require. A hotel building may be totally different from factory building and/or flats build-up by a builder for sale. Therefore while estimating the cost of building due weight-age should be given regarding cost involved. Detailed estimate of the cost of building under various sub-heads should be derived by the help of a civil engineer/architect to avoid any cost overrun at a later stage. Even the bank asks for the civil engineer/architect certificate/estimate as a basis to justify the cost of building. Building normally includes the construction of following structures:

- a. Factory building for the main plant and machinery
- b. Building for auxiliary services such as water treatment plant, laboratory, workshop, Genset etc

- c. Warehouses, Godowns, store room etc
- d. Office building, canteen, guest house, conference building etc
- e. Residential quarters for staff
- f. Temporary structures
- g. Other structure

The fees of civil engineer/architect will also be included while deriving the cost of building. Some time the construction of amenities, sewerage system, drainage, water system etc is also included in the cost of the building. The area of the each building along with each floor should be given. By doing so cost per sq. ft. or sq. meters is work out which is then compare with cost of the existing structures/buildings.

The structure should commensurate with the requirement otherwise the technical manager of the bank would object and will ask for proper justifications. Sometime the cost of the building is inflated to increase the cost of the project but proper justification should be there at the time of TEV study.

For example a hotel building cost may be Rs. 2500/sq ft to Rs. 5000/sq. ft against a factory building may cost Rs. 800/sq ft to Rs. 1500/sq. ft. But suppose the promoter wants to build-up a manufacturing facility for heavy machinery than the cost of the building may be very high.

Also the building should be approved from the concerned authorities such as Greater Noida Authority, Noida Authority, GDA, DDA etc. The structure should be in accordance to the building plan approved by the authorities.

3. Plant and machinery

The cost of plant and machinery includes the basic cost, excise/custom, sales tax, cost of transportation, freight, insurance, installation, commissioning etc. The cost of accessories, stores and spare parts are also included in the cost of machinery. The cost of erection and foundation charges are generally included in the cost of *building* but some banks prefer to include the same in the cost of *plant and machinery*.

Plant and machinery may be imported and/or indigenous depends on the technology, perception of the promoters, requirement of the product, availability of raw material, availability of bank finance, demand in the market etc. For example suppose the technology is new for India and hence machines must require being imported from the country which had developed it.

A brief write-up about the suppliers, their existing clients, market share, and other facilities and support should also be considered. For example suppose one has taken plant and machinery which requires foreign technical team every time for repair and maintenance than it might be very costly. If the supplier has back-up office in India than it may be less expensive. It is normally suggested to train two-three employees to understand the functions and processes so that cost of minor break downs and repairs could be handled in house.

Also banks normally ask for the reason of selection of particular supplier. Hence quotations, Performa Invoices, detail of agreement, comparison chart etc of 2-3 suppliers should be available which indicates the reason for selection of the supplier.

4. Technical know-how fees

If the company purchases the technology from some other company than it need to pay the technical knowhow fee. It also includes the payment made to foreign collaborators for JV or Collaboration, MOU etc signed with them for technology sharing.

Sometime the promoters need to pay the franchsis fees for using the brand name of some reputed organization. For example suppose the promoter has taken franchises of G D Goenka Public School and paid fees for goodwill or using G D Goenka name. This fee will be considered as a part of cost of project.

5. Expenses of foreign technicians and training of Indian technicians abroad

For installation, commissioning etc of plant and machinery which are purchased from overseas market, foreign technicians are called off as there is generally a clause for the same in the agreement with the suppliers. The reason might be that India technicians may not aware about the new technology or there is specific clause in the agreement with the suppliers that the company will take the help of the technical team of the suppliers only due to several reasons.

Another factor might be that the technicians will give the training to the local technicians regarding functions, processes, technique, how to handle the critical situations, minor repair and maintenance etc at the time of visits.

Also at the time of purchase of machines the companies send its key employees (technical staff) to suppliers place for training so that they can understand the basics, functions and all other systems about the machines.

The cost incurred in relation to above factors is included in the cost of the project.

6. Miscellaneous Fixed Assets

The expenses which are incurred before start of the project on the assets which has life of more than one year but may not be classified in above heads are clubbed under miscellaneous fixed assets. It normally includes the cost incurred for furniture's, genset, vehicles, lab equipments, water treatment plant, RO system, electrical wiring etc

7. Preliminary and pre-operative expenses (POP)

The expenses incurred on the formation of company, consultants fees, advertisements costs, bank upfront fees, processing fees, rent, rates and taxes, and all other items which are normally operational in nature but considered fixed as there is no revenue earned against the same.

POP are capitalized & distributed/ added back in the fixed assets or written off over the period of time.

8. Provision for contingencies

When the cost of the project is derived there is always a scope of cost overrun due to many reasons which are not in control. For example suppose company is purchasing the machines from overseas market and there is sudden change in the exchange rate. There might be chances that company has not fixed the price at the time of order of machines and causes a loss due to rate fluctuation.

Hence being a prudent approach a provision of contingencies are normally taken and added in the cost of the project. It is generally a percentage of fixed assets say 2% to 10% depending on the estimates made by the promoters and project appraising agency.

The provision for contingencies is made on the assets which will be purchased/ developed and not the already purchased/constructed fixed assets.

9. Margin Money for Working capital

Working capital means the capital require for financing the stocks, debtors and all other current assets. Initially the actual current assets cannot be assessed. But on the basis of existing trend and practices the working capital assessment is done and a notional requirement is works out.

Also the banks allow to use the working capital limits not exceeding the Drawing Power (meaning already discussed in the "Article on Working Capital") but actual DP is not possible

to calculate and hence one has to consider the notional amount. Further bank has first charge over stocks, debtors and all other current assets which do not exist at the time of sanctioning of limits.

Hence it is general accepted practice that a margin @ 25% of the limits proposed is taken as a part of cost of the project so that the requirement of immediate financing of the current assets could be meeting out from long term source of capital.

Margin money is calculated for both the fund based and non-fund based limits.

For any clarifications, assistance and suggestions please contact undersigned.

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