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CIRCULAR

Sub: Guidelines for Implementation of Benefit Chart

This is in continuation to the Circular No: RID/KRDP/MVofMDA(PI)/2010-11 dated 28/04/2011 on market linked pricing of Khadi and Khadi products, allowing the KIs with full flexibility in pricing of Khadi and its products. With the introduction of market linked pricing, the Khadi products, with certain improvement in quality, design and packaging and targeted promotion, can be sold at a price higher than the cost.

2. KVIC has already instituted a Market Research Study through a professional organization. The study will also collect information from market about the prices that Khadi products are capable to fetch. The results of MR study will be shared with the KIs so that they are better informed about consumer preferences, competitive pricing and market acceptability of Khadi products.

3. The surplus generated from selling the products at market linked prices needs to be utilized for enhancing artisans' and

karyakartas' earnings and undertake production and marketing reforms.

4. KVIC introduces the 'Benefit Chart' which will form the guiding principle for utilization of the surplus generated from selling the products by the Khadi Institutions to customers, whole sellers and other alternate marketing channels, including Marketing Organization, at the market linked prices.

5. With the introduction of market linked pricing, the pricing system shall be independent of the cost of the product and shall be guided by the market acceptability and demand.

6. Product costing shall be used as a tool for making product segmentation strategies and taking decision with respect to selection of products to be produced.

7. Khadi Institutions are required to adopt the marginal costing principles for making strategic decision on selection of product for manufacture. Under marginal costing principle variable cost is compared to the product price to calculate the contribution of each product. Products which give the maximum contribution should be produced most. Fixed cost of the institution shall be deducted from the total contribution to find out the total surplus generated by the KIs. The surplus so calculated shall be used for the purpose of the Benefit Chart.

8. The Guidelines for Costing and Benefit Chart as formulated based on the concept approved by the Commission in its special meeting held in March 2011 is enclosed as Annexure to this circular.

9. All State/Divisional Directors are requested to take necessary action to communicate the contents of this circular and guidelines to all the KIs under their jurisdiction for implementation of Benefit Chart and costing based on marginal costing principle enumerated in the guidelines.

Encl: as above

Chief Executive Officer

To

1. All State/Divisional Directors
2. All Chief Executive Officers / Secretaries / Managing Directors of State / UT KVI Boards

Copy for favour of information:

1. All Members of the Commission.
2. Chairman, Central Certification Committee
3. All Members of Central Certification Committee
4. Chairman of the Zonal Certification Committees (North Zone, East Zone, North-East Zone, South Zone, West Zone and Central Zone)
5. Zonal Dy. Chief Executive Officers (North Zone, East Zone, North-East Zone, South Zone, West Zone and Central Zone)
6. All Members of the Zonal Certification Committee
7. Director (KPM & KC)
8. Director (CCC)
9. All Programme / Industry Directors in the Central Office

10. Secretary to Hon'ble Chairperson
11. O.S.D. to Chief Executive Officer.
12. Accounts Officer to Financial Advisor
13. P.A. to Chief Vigilance Officer
14. Director (Information Technology) for placing the circular on web site.
15. Director (Publicity) with a request to publish the same in the ensuing issue of 'Jagriti' and also arrange to organize appropriate publicity to the scheme so as to reach the information to the targeted beneficiaries of the scheme.
16. Circular file.

Director (RID)

Guidelines for Costing & Benefit Chart

1. Background

- 1.1. The costing system followed by Khadi institutions is based on guidelines given by KVIC, in the "Khadi Certification Guidelines". The said system is called Cost Chart. The objective of the cost chart is to ensure economically sustainable earnings to artisans and make available Khadi at an affordable price to the customers.
- 1.2. The production activity for Khadi commences with the conversion of cotton/wool/silk and goes through the various stages of processing. Since it involves various processes such as slivering, roving, spinning/reeling, weaving, bleaching, dyeing, printing and tailoring etc., – therefore process costing principles are being applied to derive the cost of the finished product.
- 1.3. The raw material procured goes through various conversion processes. At each stage value is added to the input. The output of one process becomes the input for the next process.
- 1.4. Various elements of cost in production and marketing of Khadi are given below:
 - 1.4.1. **Raw Material:** The institutions record the raw material cost purchased from CSP at the cost chart rate. The difference between the cost chart price and actual price is adjusted in the "Price Fluctuation Reserve". If the raw material is purchased from other than the CSPs, the raw material has to be recorded at actual rates or the cost of production if the sliver is produced in-house. In case of wool it is rate of wool fibre or tops and in case of silk it is the cost of cocoon.
 - 1.4.2. **Conversion Charges:** The Cost Chart is based on the Standard Costing Principles. The **conversion** charge at each stage is fixed. At each stage the conversion charges is added to the cost of the input as per the cost chart

mechanism. The conversion charge consists of the following components.

- a) Artisan Wages: The spinning/reeling and weaving wages are paid as prescribed in the cost chart to the artisans and the payments are recorded in the artisans' passbooks that are to be maintained by them. These passbooks have quantity entries of raw material supplied to artisans and number of hanks and weight of hanks or meters of cloth taken back & wages paid.
- b) Artisan Welfare Fund: AWF is calculated @ of 12% of the artisan wages. The AWF is to be remitted to the Offices of Artisan Welfare Fund Trust.
- c) Incentive: An incentive of 10% of the artisan wages is given to the artisans. The incentive wage is given at the end of each quarter/year.

1.4.3.**Provisions:** In addition to the above, various provisions are also prescribed periodically. These are provisions for

- a) Trade margins at 3% of the prime cost
- b) Insurance at 1% of the prime cost
- c) Bank interest at 4% of the prime cost
- d) Depreciation at 15p per hank
- e) Supervision charges 10p per hank
- f) Maintenance 10p per hank

1.4.4. In addition to the above provisions, standard margin of 25% of the prime costs are prescribed for meeting establishment expenses.

1.4.5. These provisions are **determined** by the Central Certification Committee (CCC) and enforced through State level cost charts.

1.5. **Pricing of Khadi based on cost chart:** The pricing of the products is done on the basis of the cost as prescribed in the cost chart. Though, after the introduction of the MDA, the pricing of the products at the fabric conversion stage has been delinked from the cost chart, the pricing of the product up to the fabric stage is still determined on the basis of the cost chart.

2. Issues with the existing cost chart mechanism

- 2.1. The material Cost accounted does not reflect the current actual cost paid for the raw material. The material cost should be determined at periodical intervals, say at least once in a quarter, and should be adopted for making any pricing decisions.
- 2.2. It is observed that majority of the artisans; specifically spinners are not earning adequate for their sustenance and are low compared to the earnings available in other avenues of employment.
- 2.3. The provisions allowed in the cost chart are in the nature of administrative and selling overheads incurred by the institutions. These are included as a standard % of prime cost across all KIs, irrespective of the size of the KIs. Also, these principles need to be revised periodically in line with the actual costs incurred by the KIs.
- 2.4. Product pricing is done on the basis of the cost chart which does not take into account the marketability of the product.

3. Requirement for Benefit Chart

- 3.1. KVIC is conducting an extensive market survey. The market survey also includes the assessment of price range of the products similar to Khadi, sold by private organization. Based on the results of the market survey, KVIC shall circulate the price range of the various product categories within which the products of KIs could be sold in the market. This will enable the KIs to appropriately price their product in the market.
- 3.2. With the introduction of market linked pricing the Khadi products, with certain improvement in quality, design and packaging and targeted promotion can be sold at a price higher than the cost.
- 3.3. The surplus generated from selling the premium products needs to be utilized for enhancing artisan and karyakartas' earnings and undertake production and marketing reforms.
- 3.4. KVIC envisages introducing the benefit chart which will form the guiding principle for utilization of the surplus generated from selling the products by the Khadi Institutions to customers, whole sellers and other alternate marketing channels, including Marketing Organization (under set-up) at market linked pricing.

- 3.5. The difference between selling price, at which the products are sold to customers, whole sellers and other alternate marketing channels, including Marketing Organization at market linked pricing and actual costing of Khadi is surplus. Such surplus shall be utilized for distribution of incentives amongst the artisans and karyakartas, undertaking production and marketing reforms and capital formation for ensuring long term sustainability. This system is termed as 'benefit chart'.
- 3.6. The under lying objective of KRDP is to ensure self sustainability of khadi activities and provide maximum financial benefits to the artisans.
- 3.7. The current system of cost chart pricing does not allow the KIs to explore the possibility of generating surplus to meet the aforementioned requirements.
- 3.8. Benefit Chart is an attempt to offer scope to the institutions to achieve self sustainability by generating possible surplus through selling of products at market linked price.

4. Revision of the costing mechanism for pricing decision

- 4.1. Currently, standard costing system is followed for making pricing decision. The standards set for the purpose of costing, does not take into account the scale of operation of the institutions. Standards are set across the nation and KIs, irrespective of the size of operations. Also, the pricing decision is not based on the market demand and acceptability.
- 4.2. The pricing system should be independent of the cost of the product and be guided by the market acceptability and demand.
- 4.3. Product costing should be used as a tool for making product segmentation strategies and taking decision with respect to selection of products to be produced, including phasing out of the unviable products.
- 4.4. It has been decided by KVIC to adopt marginal costing principles for pricing. A model cost sheet under marginal costing system is placed at **Appendix I**.

- 4.5. Under marginal costing principle variable cost is compared to the product price to calculate the contribution of each product.
- 4.6. Products which give the maximum contribution should be produced the most.
- 4.7. Fixed cost of the institution should be deducted from the total contribution to find out the total surplus generated by the KIs.
- 4.8. The surplus so calculated should be used for the purpose of the Benefit Chart.
- 4.9. A suitable IT system is being developed by KVIC for distribution among KIs to facilitate calculation of the contribution generated by each product and total surplus generated by the khadi institution.

5. Framework for utilization of surplus under benefit Chart

- 5.1. The surplus so calculated should be utilized for the following purposes:

Sr.No.	Purpose of Utilization	% of Surplus
1.	(a) Enhancement of Earnings of artisans (spinners, weavers and other artisans)	30%
	(b) Enhancement of Earning of Karyakartas (including sales persons)	10%
2.	(a) Skill Development of Artisans and Karyakartas	30%
	(b) Product Design and Development	
	(C) Marketing Reform	
3.	Capital Formation	30%

- 5.2. **Enhancement of earnings of artisans' and Karyakartas'**: A fixed portion of the surplus should be distributed amongst the artisans and karyakartas.

- 5.3. **Skill development of artisans' and Karyakartas'**: For improvement of market acceptability of the Khadi products, it is very important to improve the quality. This would require training of the artisans and Karyakartas on quality improvement. The KIs should also try to switch over from the unviable product segments to the better and remunerative product segment. This would require training and skill development of artisans and

Karyakartas currently engaged in production and sale of such products.

- 5.4. **Product design and development:** The KIs have to develop and design products based on market requirement and trends. The products which are not able to compete with the other similar products in the market are required to be developed and redesigned for making them acceptable in the market so that they are at least able to recover their cost.
- 5.5. **Marketing reforms:** It is difficult for Khadi to compete with the other sectors of the textile industry on cost only. Khadi needs to be positioned in the product differentiation segment (eco friendly, handmade, social cause, etc.) rather than the low cost segment of the textile industry. This would require major sales promotion, marketing interventions. The KIs may also utilize the Benefit Chart for appointment of expert agencies for market development and strategies and use of alternate marketing channels.
- 5.6. **Capital formation:** The fund left after achieving the aforementioned objectives may be used for capital formation to be utilized in future for expansion and mitigate risks and contingencies.

Appendix I – Model Cost Sheet under Marginal Costing Technique
Step 1 – Calculation of Contribution per Unit (khadi product)

The contribution per unit is calculated by deducting the per unit variable cost of producing and selling a product from its selling price. All cost items which vary with the increase and decrease in production and selling shall be termed as variable costs. It shall be required to ascertain the per unit (Khadi Product) cost incurred in producing and selling a particular product. Contribution per unit shall be calculated for each product as given in the table below:

Particulars	Rs. Per unit	Rs. Per unit
Selling Price		XXX
Variable Cost		
Prime Cost		
A) Direct material	XX	
Less: Credit for Wastages	XX	
Net Material Cost	XX	
B) Direct Labour Cost (This includes wages paid to spinners, weavers and other artisans engaged in pre spinning, pre and post weaving processes etc and the incentives paid to them who are directly working under production)	XX	
C) Direct Expenses		
Other Material like Processing Charges	XX	
Other direct expenses paid if any	XX	
I) Total Prime Cost (A +B +C)	XXX	
Variable Production Cost		
a. Power	XX	
b. Repairs and Maintenance (Production)	XX	
c. Water, Steam, Fuel and other variable Costs	XX	
d. Any other production expenses which varies according to the number of units produced	XX	
II) Total Variable Production Cost (a+b+c+d)	XXX	
Variable Selling Cost		
a. Transportation	XX	
b. Commission/ Incentive etc paid on Sale.	XX	
c. Any other Selling Expenses which varies according to number of units sold	XX	
III) Total Variable Selling Cost (a+b+c)	XXX	
Total Variable Cost (I+II+III)	XXX	(-) XXX
Contribution = Selling Price – Total Variable Cost.		XXX

The contribution per unit khadi product shall be calculated for all the products sold/produced by the KIs. The contribution per unit for all products should be compared. The KIs should make efforts to produce those products more where the contribution per unit is maximum. The KIs should also try to shift the production of those products where the contribution per unit is least.

Step 2 – Calculation of Total Contribution

The contribution of each product shall be calculated separately. Total contribution shall be calculated by multiplying the contribution per unit khadi product as calculated in the table above with the total number of units sold as given in the table below

Sl. No.	Particulars	Product A	Product B	Product C	Product D	Total
1	Contribution Per unit (khadi product)					
2	Number of units (khadi product) sold					
3	Total Contribution (Sr. 1 X Sr. 2)					

Step 3 – Calculation of Surplus

Surplus shall be calculated by deducting fixed cost from the total contribution as calculated in the table above. The elements of fixed cost shall be as given below:

Fixed Cost

- a. Other Indirect Employees Cost including Salaries to Administrative Staff. [H.O., Store, P.C. and show room etc.)
- b. Rents, Rates & Taxes
- c. Depreciation
- d. Insurance Premium
- e. Repairs & Maintenance (Building & Other Assets)
- f. Interest on Loans
- g. Other Administration/ Establishment Expenses of all centres/branches.

Surplus = Total Contribution – Fixed Cost

Definition of terms used in the benefit chart guidelines

I. Prime Cost

- a. **Direct Material Cost** is the cost of material which can be directly allocated to a product.

Raw materials consumed for production for a product which are identifiable in the product form the direct material cost. Direct Material cost includes cost of procurement, freight inwards, taxes & duties, insurance, etc directly attributable to the acquisition. Trade discounts, rebates, and other similar items are deducted in determining the costs of direct material. While calculating direct material cost the standard wastage should be deducted.

While determining the material cost, the realizable value of wastages obtained in the process should be credited and the net cost of direct material should be considered for cost.

- b. **Direct Labour Cost** is the cost of wages of artisans who are directly linked with the production process of the khadi products. Here, the wages of the artisans include the wages, incentives and Artisans Welfare Fund of the spinners, weavers, other artisans and karyakartas involved in the production of Khadi.

- c. **Direct Expenses** are the expenses other than direct material or direct labour which can be identified or linked with the cost object.

Examples of direct expenses are

- Hiring charges for tools and equipments for a cost object.
- Job processing charges paid to outside agencies for processing of yarn/cloth
- Dyes and chemicals, sizing materials, packing materials and other direct expenses which can be identifiable to a particular product.

- II. **Variable Production Cost** means, indirect cost involved in the production processes which changes according to the production activity, if more production is involved these costs will also be more. If no activity, then the cost will be nil. The examples of variable production cost are:

- Power/ Electricity – used, if any, in the production process and processing of cloth or yarn.
- Repairs and maintenance of charkas, looms, and other machinery used in the production activity
- Water, steam, fuels such as coal, wood, etc consumed.

- Wages and other benefits paid to the supervisors and other artisans directly involved in the production activity.

Variable Production Cost also includes indirect material consumed like oil, grease etc, these expenses could be collected by means of pooling of indirect items of expenses from books of accounts, and supportive records and to be allocated to all the products manufactured based on the prime cost.

III. **Variable Selling Expenses** consists of transportation, commission or incentives paid on sales, and any other selling expenses which increases or decreases according to activity.

IV. **Fixed Cost** is the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.

Examples for fixed cost : salaries, rent, audit fees, depreciation, repairs and maintenance of office building and other asset, interest on loans, insurance premium, other administrative / establishment expenses, etc.

Fixed production and selling expenses like rent, salaries, insurance, freight and forwarding charges etc for the Production Centre and showroom and advertisement relating to sales and sales promotion.

The basis of allocation of fixed costs to various products manufactured should be on the basis of the sales value. This can be allocated based on the sale value of the product. The fixed expenditure based on the profit and loss account can be allocated to different products based on the budgeted sales value of the products manufactured.

Selling price – is the price at which the products are sold in the market, after deducting discounts, rebates etc. which is the net realizable value of the product.

Contribution is the difference between the net realizable value less the total variable cost (prime cost consisting of direct material, direct labour and direct expenses + variable production and selling overheads).
