



**19MCE401 - PROCESS PLANNING AND PRODUCT DEVELOPMENT**  
**STUDY NOTES**

**UNIT 3 – PRODUCT DEVELOPMENT**

**TOPIC 3 – Design and Functional Aspects**

**Handled by:**

Dr. T. Prakash M.E., Ph.D.,

Professor & Head,

Department of Mechatronics Engineering,

SNS College of Technology,

Coimbatore - 35.



## ***Product Cost Analysis:***

Product cost analysis is a fundamental aspect of the product development process. It involves evaluating and estimating the costs associated with designing, developing, manufacturing, and bringing a new product to market. This analysis provides crucial insights for decision-making, budgeting, pricing, and ensuring the profitability of the product. In this comprehensive guide, we will delve into the various aspects of product cost analysis in product development.

### **1. Product Cost Analysis:**

Product cost analysis is a systematic examination of all expenses associated with creating a product. It aims to provide a detailed breakdown of the costs incurred at each stage of the product development lifecycle. These costs are categorized into two main types:

#### ***a. Direct Costs:***

- Direct costs are expenses that can be directly attributed to the production of a specific product. These include:
  - Materials: The cost of raw materials, components, and any purchased parts needed to manufacture the product.
  - Labor: The wages and benefits of employees directly involved in production, such as assembly line workers and machine operators.
  - Manufacturing Overheads: Indirect costs associated with production, such as facility rent, utilities, equipment maintenance, and depreciation.

#### ***b. Indirect Costs:***

Indirect costs are expenses that cannot be directly traced to a single product but are incurred in the overall production process. These include:

- Research and Development (R&D): The cost of designing, engineering, and prototyping the product.
- Marketing and Sales: Expenses related to marketing, advertising, and sales efforts to promote and sell the product.



- Administrative Costs: General administrative expenses, such as salaries for management and administrative staff, office space, and utilities.

## **2. The Importance of Product Cost Analysis:**

Product cost analysis plays a crucial role in product development for several reasons:

- **Budgeting:** It helps in setting realistic budgets for product development projects by estimating the total costs involved.
- **Pricing Strategy:** Determining the product's price is closely tied to its cost. Understanding the cost structure helps in setting competitive and profitable pricing.
- **Profitability Assessment:** Product cost analysis helps assess whether a product is financially viable and whether it can generate the desired level of profit.
- **Cost Reduction:** Identifying cost drivers and inefficiencies enables teams to find ways to reduce production costs without compromising quality.
- **Decision-Making:** It assists in making informed decisions about resource allocation, investment, and whether to proceed with a product development project.

## **3. Stages of Product Cost Analysis:**

Product cost analysis is an ongoing process that spans the entire product development lifecycle. It involves several stages:

### ***a. Initial Cost Estimation:***

At the early stages of product development, cost estimates are based on preliminary designs and assumptions. These estimates provide a rough idea of the potential costs and help in initial budgeting and decision-making.

### ***b. Detailed Cost Analysis:***

As the product design matures, a more detailed cost analysis is conducted. This involves identifying specific components, materials, and production processes and obtaining quotes from suppliers.



*c. Prototype and Testing Costs:*

Costs associated with building prototypes for testing and validation are analysed separately. This includes the cost of materials, labour, and any specialized equipment or testing facilities.

*d. Production Cost Analysis:*

Once the product design is finalized, a comprehensive production cost analysis is performed. This includes evaluating the costs of setting up production facilities, acquiring machinery, hiring labour, and procuring materials for mass production.

*e. Lifecycle Cost Analysis:*

In some cases, product cost analysis extends beyond the initial production phase to consider ongoing expenses such as maintenance, warranty, and support costs throughout the product's lifecycle.

**4. Components of Product Cost Analysis:**

A thorough product cost analysis considers various cost components. Here are the key elements to include:

*a. Material Costs:*

Material costs make up a significant portion of a product's expenses. It involves determining the type, quantity, and price of raw materials, components, and purchased parts required for manufacturing.

*b. Labor Costs:*

Labor costs include wages, salaries, benefits, and overtime pay for workers involved in product development, manufacturing, assembly, and quality control.

*c. Overhead Costs:*

Overhead costs encompass all indirect expenses associated with production, such as facility rent, utilities, equipment maintenance, and depreciation.

*d. Research and Development (R&D) Costs:*



These costs pertain to activities related to product design, engineering, and prototyping. R&D costs can be significant, especially in industries that require complex or innovative solutions.

*e. Tooling and Equipment Costs:*

For mass production, tooling and equipment costs include the expense of designing, purchasing, and setting up specialized tools, moulds, and machinery for manufacturing.

*f. Quality Control and Testing Costs:*

Quality control and testing expenses cover activities to ensure the product meets quality and safety standards. This includes inspection, testing, and compliance testing costs.

*g. Marketing and Sales Costs:*

Marketing and sales costs include advertising, promotion, sales team salaries, commissions, and any costs associated with launching the product in the market.

*h. Administrative Costs:*

Administrative expenses, such as management salaries, office space, utilities, and general administrative overhead, are considered indirect costs.

*i. Distribution and Logistics Costs:*

These costs include expenses related to warehousing, transportation, and distribution of the finished product to customers or retailers.

**5. Tools and Methods for Product Cost Analysis:**

Several tools and methods are used to conduct product cost analysis effectively:

*a. Cost Estimation Software:*

Specialized cost estimation software, such as Costimator or a company's proprietary tools, helps in automating the cost estimation process. These tools rely on historical data, supplier quotes, and cost models to generate accurate estimates.



**b. Activity-Based Costing (ABC):**

ABC is a method that assigns costs to specific activities within the production process. It provides a more detailed and accurate breakdown of costs compared to traditional costing methods.

**c. Parametric Cost Estimation:**

Parametric cost estimation uses mathematical models based on variables such as size, weight, or complexity to estimate costs. It is particularly useful in the early stages of product development.

**d. Supplier Quotes and Vendor Negotiation:**

Obtaining quotes from suppliers and negotiating favourable terms can provide real-world cost data for materials and components.

**e. Benchmarking:**

Benchmarking involves comparing the product's costs to similar products in the market. It helps identify cost-saving opportunities and ensures competitiveness.

**f. Value Engineering (VE) and Value Analysis (VA):**

VE and VA are systematic processes that aim to optimize product functions and features while reducing costs. They involve cross-functional teams that evaluate design choices to achieve cost savings.

**g. Cost of Goods Sold (COGS) Analysis:**

COGS analysis focuses on the direct costs associated with producing a product. It helps determine the profitability of each unit sold.

**6. Challenges and Considerations:**

Product cost analysis can be complex and subject to various challenges. Here are some considerations:

**a. Data Accuracy:**



Accurate cost analysis relies on precise data. Inaccurate or incomplete information can lead to misleading cost estimates.

***b. Changing Variables:***

Costs can fluctuate due to changes in materials prices, labour rates, exchange rates, and market conditions. These variables need to be monitored and accounted for.

***c. Hidden Costs:***

Hidden costs, such as maintenance, warranty, or disposal expenses, may not be immediately apparent but can significantly impact the overall cost structure.

***d. Cost Allocation:***

Assigning overhead costs to specific products or projects can be challenging. Choosing an appropriate allocation method is essential for accuracy.

***e. Design Changes:***

Design changes can have a substantial impact on costs, especially if they occur late in the development process. Managing change effectively is crucial.

***f. Risk Assessment:***

Assessing the risks associated with cost estimates is essential. Contingency plans should be in place to address unforeseen cost overruns.

**7. Benefits of Product Cost Analysis:**

Effective product cost analysis offers numerous benefits:

***a. Cost Control:***

It provides a clear understanding of cost drivers, allowing teams to control expenses effectively.

***b. Profitability Assessment:***

It helps assess whether a product is likely to generate the desired level of profit and whether it aligns with business goals.



c. **Competitive Pricing:**

Understanding the cost structure enables businesses to set competitive and profitable pricing for their products.

d. **Decision-Making:**

It provides valuable insights for decision-making, allowing organizations to make informed choices about resource allocation and project viability.

e. **Continuous Improvement:**

Cost analysis identifies areas for cost reduction and process improvement, promoting efficiency and competitiveness.

f. **Risk Mitigation:**

It helps identify and manage risks associated with cost overruns, ensuring that projects stay on budget.

**8. Conclusion:**

Product cost analysis is a critical aspect of product development that spans the entire lifecycle of a product. It involves estimating, tracking, and controlling costs to ensure that a product is financially viable and profitable. Effective cost analysis requires accurate data, the use of appropriate tools and methods, and a proactive approach to managing cost-related challenges. By conducting thorough product cost analysis, organizations can make informed decisions, optimize resources, and ultimately bring successful and financially sound products to market.

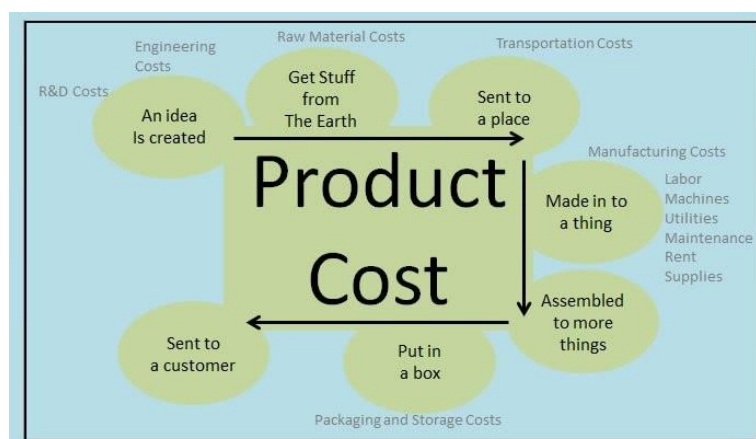


Figure 1. Source: <https://www.linkedin.com/pulse/1-what-does-your-product-cost-rich-buttrey/>