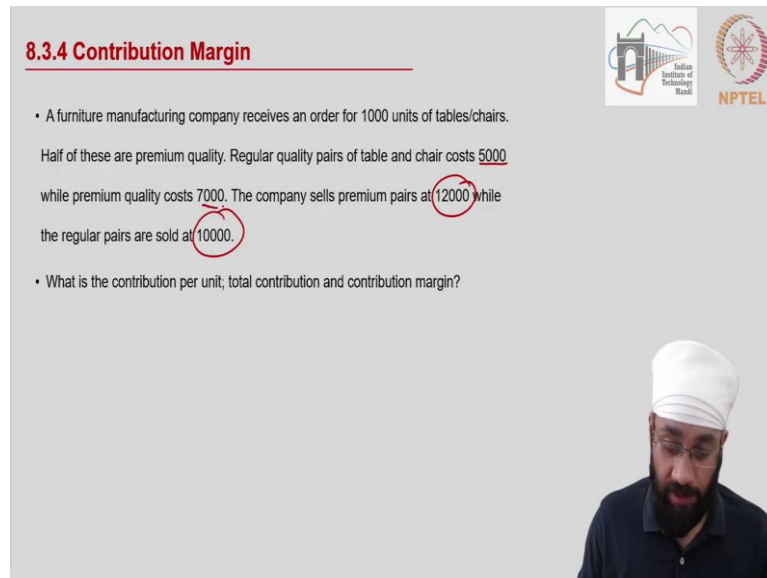


Financial Accounting
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Lecture – 110
8.4 Tutorial – Contribution

(Refer Slide Time: 00:16)



8.3.4 Contribution Margin

- A furniture manufacturing company receives an order for 1000 units of tables/chairs. Half of these are premium quality. Regular quality pairs of table and chair costs 5000 while premium quality costs 7000. The company sells premium pairs at 12000 while the regular pairs are sold at 10000.
- What is the contribution per unit; total contribution and contribution margin?

The slide includes logos for the Indian Institute of Technology Mandi and NPTEL in the top right corner. A video inset in the bottom right corner shows Dr. Puran Singh, a man with a beard and glasses wearing a white turban and a dark blue shirt.

I will take an example to illustrate the contribution margin further. You can pause the video and read the question. I am going to just write here. So, we have number of units, we have two types of units.

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8.3.4 Contribution Margin



Quality	Units	P	VC	Revenue	TVC	Contribution
✓ Regular	✓ 500	✓ 10000	5000	50,00,000	25,00,000	
✓ Premium	✓ 500	✓ 12000	7000	60,00,000	35,00,000	
Total	1000			110,00,000	60,00,000	50,00,000

$$\text{Contribution} = \text{Revenue} - \text{TVC} = 50 \text{ lakhs}$$

$$\text{Contribution Margin} = \frac{50}{110} \times 100 = 45.4\%$$

$$\text{C/P U} = \frac{P - VC}{10000 - 6000} = 5000 \text{ per unit}$$

$$\text{CM} = \frac{5000}{11000} \times 100 = 45.4\%$$

Let me say quality. So, we have a regular quality and we have a premium quality and then there are units, we have 500 each. So, total units are 1000: this is total. We have to figure out the price per unit, the variable cost per unit and then we can figure out the revenue and the total variable cost and then the contribution can be figured out here. So, the price of premium is 12,000 and regular is 10,000 per piece, the variable cost is 5,000 and 7,000.

The revenue, hence, from the regular comes out to be: units multiplied by the price. So, this comes out to be 50,00,000. On the other hand, for premium this comes out to be 60,00,000. Here the total variable cost comes out to be this, multiplied by this. So, this is 25 and you have 500 multiplied by this. So, you have 35,00,000 here.

The contribution of each of the units can be calculated; however, we will do the overall contribution calculation. So, I am going to skip the last column because I will do that later. So, the total revenue that we are making here is 110,00,000 and the total variable cost here comes out to be 60,00,000 here. Now, the contribution therefore, is 50,00,000: this is the contribution that we have at the top of the revenue.

So, the contribution which is equal to the sales minus total variable cost comes out to be 50,00,000; this is the contribution. Now the contribution margin, contribution margin is equal to the contribution which is 50,00,000 divided by the total revenue which is 110 multiplied by 100, that is it. That is how you calculate the contribution margin.

We could also take the contribution per unit and figure this out. How will we do that? In order to figure out contribution per unit now you have to do an average because you have two different qualities of the products.

So, the average price comes out to be 11000. So, P minus variable cost per unit, average price is 11000 minus average variable cost is 6000 which gives you 5000 as the contribution per unit. And now if you have to figure out contribution margin all you have to do is to take 5000, you divide this by the 11000 which is the price per unit and multiply this by 100 and you have the contribution margin.

In both the cases this comes out to be 45 percent, 45.4 percent actually. So, this is the contribution margin. So, what we are saying here is that out of the total revenue, the revenue that we generate, 6,00,000 have to be spent on basically producing the product and then you are only left with 50,00,000 worth of rupees to cover the fixed cost. So, that is how contribution margin is calculated.

I will see you in the next video.