Lecture notes on Managerial Economics for students academic use only By Dr Neha Mathur ma'am

Process of Profit Planning and Control –

Profit is considered as a significant element of a business activity. According to Peter Drucker, “profit is a condition of survival.

It is the cost of the future, the cost of staying in a business.” Thus, profit should be planned and managed properly.

An organization should plan profits by taking into consideration its capabilities and resources. Profit planning lays foundation for the future income statement of the organization. The profit planning process begins with the forecasting of Les and estimating the desired level of profit taking in view the market conditions.

steps involved in the profit planning process:

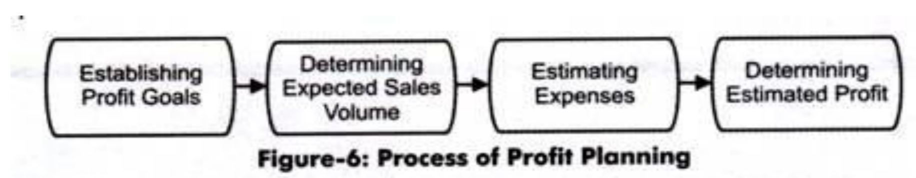

Figure-6: Process of Profit Planning

The steps involved in profit planning process (as shown in Figure-6) are explained as follows:

1. Establishing profit goals:

Implies that profit goals should be set in alignment with the strategic plans of the organization. Moreover, the profit goals of an organization should be realistic in nature based on the capabilities and resources of the organization.

2. Determining expected sales volume:

Constitutes the most important step of the profit planning process. An organization needs to forecast its sales volume so that it can achieve its profit goals. The sales volume can be anticipated by taking into account the market and industry trends and performing competitive analysis.

3. Estimating expenses:

Requires that an organization needs to estimate its expenses for the planned sales volume. Expenses can be determined from the past data. If an organization is new, then the data of similar organization in same industry can be taken. The expense forecasts should be adjusted to the economic conditions of the country.

4. Determining profit:

Helps in estimating the exact value of sales.

It is calculated as:

Estimated Profit = Projected Sales Income – Expected Expenses

After planning profit successfully, an organization needs to control profit. Profit control involves measuring the gap between the estimated level and actual level of profit achieved by an organization. If there is any deviation, the necessary actions are taken by the organization.

Profit control involves two steps, which are as follows:

1. Comparing estimates with the goal:

Involves comparing the estimated profit with the expected profit. If there is a large gap between the estimated profits and the expected profits, the measures should be taken.

2. Using alternatives to achieve the desired profit:

Includes the following:

a. Making changes in planned sales volume by increasing sales promotion, improving product quality, providing better service, and providing after sales support to customers.

b. Reducing planned expenses by minimizing losses, implementing better control systems, improving product quality, and increasing the productivity of human resource and machines.