

5 components of realistic project cost estimate



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**WHAT MAKES
OR BREAKS
A BUSINESS**

**Realistic development cost
&
Appropriate working capital allocation**

In this insight, we would like to highlight the importance of project cost budgeting. We find that for many entrepreneurs, it is hard to properly estimate total project cost. This can happen regardless of the business type and size, from carwash opening estimates to wind site cost projections.

There are five key components that form the total project cost. These are virtually standard across any business or industry and include:

1. Development
2. Construction and commencement
3. Third party agency
4. Financing
5. Working capital

Construction cost, third party agency fees and financing cost are the most straightforward and are generally outsourced. For example, financing during the construction phase often refers to repayment of interest charges on drawdown debt. Construction cost estimates should be carefully selected from preferred contractors and could refer to installation cost, commencement cost, or a combination. Third party agency fees are often paid upon project commencement.

What makes or breaks a business is the first and last components: development cost and appropriate working capital allocation:

- **Development cost** is the total expenses for everything from initial economic studies, technical documentation, legal, financing advice, licensing cost, responding to objections and up to due diligence cost. Project development is complex and hiring a project manager is a pre-requisite for efficient execution in order to remain on time and within a realistic budget.
- **Working capital** must be set aside to secure initial operations. Cash is required to pay for any personnel costs (PEX), operating expenses (OPEX), financing arrangements, tax deductions, and unforeseen costs such as legal disputes or business interruptions. Working capital may be required for as little as three months or as long as 24 - 36 months. There is strong evidence to suggest that many businesses fail due to an underestimate of development costs and/or an inability to meet daily business costs.

Never underestimate the cost and time required for project development and the need for realistic working capital. The most beneficial approach is to budget for high cost scenarios and assume that income will not become available in the first six to 12 months after starting operations.

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