Programme: Bachelor of Commerce (Honours)(Third Year)

Subject : Cost Accounting

Semester : V

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Paper Title : Major III Cost Accounting III

Title of the Unit: Unit II Application of Marginal Costing in Decision Making

Module Name: Make or Buy

Module Number: 11

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Outline

- Decision making using Marginal Costing
- Make or Buy
- Reasons to Make
- Reasons to Buy
- Summary
- References

Learning Outcomes

After completion of Module 11 students will be able to:

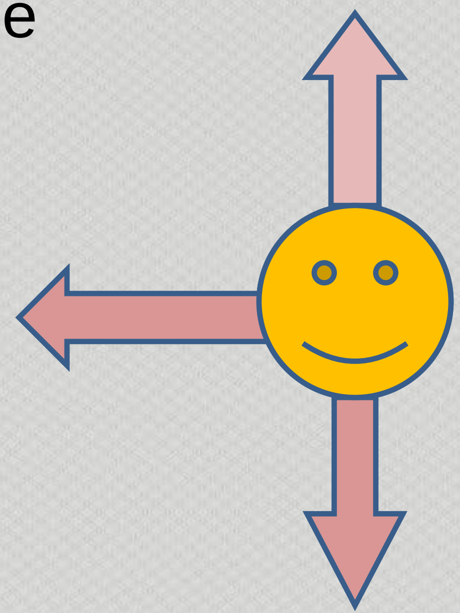
- Explain application of Marginal costing technique in decision making.
- Enumerate Reasons to Make In-House v/s Buy.
- Apply the Procedure in Make or Buy Decision Making.

Decision making using Marginal Costing

What do you understand from the

term Decision Making?

- Selection
- Course of Action
- Alternatives



Types of Decision

- Two Types Of Decision : Strategic *and* Tactical
- Strategic decisions : Long term decisions

  Top level management
- Tactical decisions : Short term decisions

  Middle and Lower level

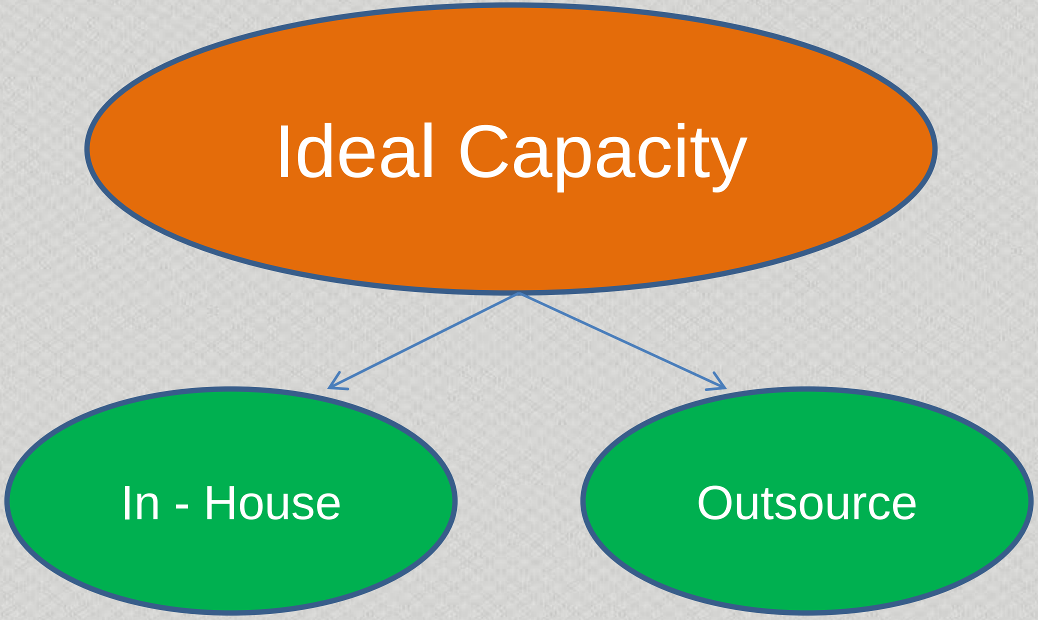
  management

Application of Marginal Costing Technique

Short term Decision like:

- Introduction of new product
- Fixation of Selling Price
- Product Mix/Sales Mix
- Make or Buy etc.

Make Or Buy



When do you chose to Make In House?

- Variable cost of manufacturing is less than quoted price of supplier.
- Design or Processing is confidential.
- In –House availability of technology and know-how.
- Skilled manpower.
- Safety of the product.

When do you chose to Buy ?

- Buying cost is less than in-house manufacturing cost.
- Don’t have an idle capacity.
- Non availability of technology and know - how.
- Wants to concentrate in core area.

Procedures

- Calculate the relevant cost of manufacturing the component.
- Calculate the relevant cost of buying the component.

Take Decision:

1) Buy the component if relevant cost of buying is less than that of manufacturing.

2) Make the component if relevant cost of making is less than that of buying.

Illustration No. 1

- Viraj Ltd. is producing a part at a cost of Rs. 12 per unit. The composition of the cost is as follows:

		Rs
Materials		4.00
Wages		4.00
Overheads:	Variable	2.50
	Fixed	1.50
		12.00

Presently, the firm has been incurring a total fixed cost of Rs. 10,000 for manufacturing the current production of 1,000 units.

An outsider is offering the same component, in all aspects identical in features, for Rs. 11 per unit.

(A) Should the offer be accepted?

(B) Would your answer would be different, if the outside firm reduces the price to Rs. 10 after negotiation.

(C)What is the impact of the fixed costs in the decision-making process?

Solution

- The variable cost of the product is as under:

	(Rs.)
Materials	4.00
Wages	4.00
Overheads–Variable	2.50
Total Variable Cost	**10.50**

(A) Should the offer be accepted?

- Relevant Cost of Manufacturing = 10.50
- Relevant Cost of Buying = 11.00
- **Manufacturing Cost is less than Buying = 00.50**
- Hence the offer should be rejected

(B) Decision if the outside firm reduces the price to Rs. 10.

- Relevant Cost of Manufacturing = 10.50
- Relevant Cost of Buying = 10.00
- Relevant cost of Buying is **less** than Manufacturing = **00.50**
- Hence the offer should be accepted

C) Impact of the fixed costs in the decision-making process?

- Fixed costs Rs. 10,000 would incur, whether the firm makes the product itself or buys it outside.
- In other words, the existing fixed costs are not to be considered, while taking a decision.

Summary

- Marginal Costing Technique is applicable in case of short term decisions.
- Make or Buy Decision Depends on Relevant Cost.
- Make in house if Relevant Cost of Manufacturing is less than buying .
- Buy if Relevant Cost of Buying is less than Manufacturing.

References

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