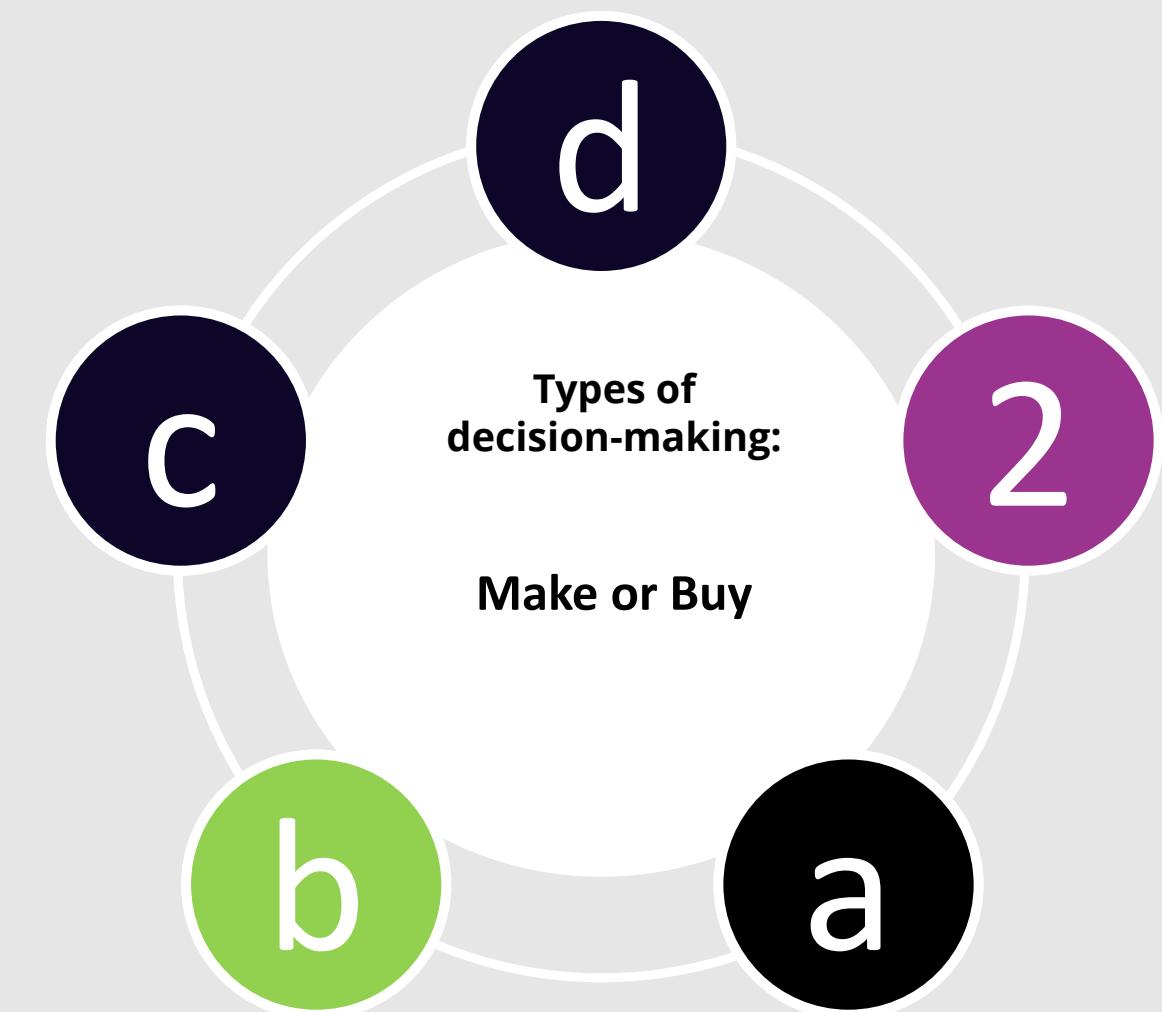


RELEVANT COSTS AND SHORT-TERM DECISION-MAKING

In **Make or buy** situation, the cost of making or buying is compared.

A business has to make a choice of whether to make or buy a component if the latter turns out to be cheaper. But, relevant cost has to be considered.



RELEVANT COSTS AND SHORT-TERM DECISION-MAKING

Mr. K manufactures several components for a clock radio and assemble these parts as well. Recently, he noticed that the amount of time and resources spent on making these individual components is too much.

The prod. Manager advised him that some components can be bought from a supplier, which will spare capacity for the production of more clock radios.

His company's information for the year ending 2018 is as follows:-

Cost of buying component R122	RM0.60
Cost of making component R122:	RM
Material	0.45
Labour	0.20
Overhead	0.10

Machine capacity is at an annual fixed cost RM10,000;

Required:

Advised Mr. K if component R122 should be manufactured or purchased.

RELEVANT COSTS AND SHORT-TERM DECISION-MAKING

Cost of buying component R122	RM0.60
Cost of making component R122:	RM
Material	0.45
Labour	0.20
Overhead	0.10

Machine capacity is at an annual fixed cost RM10,000;

Solution:-

	Make RM	Buy RM
Component R122:		
Buy		0.60
Make:		
Material	0.45	
Labour	0.20	
Overhead	0.10	
TOTAL	0.75	0.60

From the above, it can be seen that there is a saving RM0.15 if the component is bought. In addition, there is also a further saving on the machine fixed cost RM10,000 which will not incurred if the component is bought.

Therefore, it is better that Mr K buys the component as it is cheaper and this will in turn reduce the overall cost of production.