

Activity based costing analysis essay



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Minnetonka has approached a subcontractor to discuss the possibility of purchasing the bindings. The purchase price of the bindings from the subcontractor would be \$5.25 per binding, or \$10.50 per pair. If the Minnetonka Corporation accepts the purchase proposal, it is predicted that direct labor and variable-overhead costs would be reduced by 10% and direct-material costs would be reduced by 20%.

1. Should the Minnetonka Corporation make or buy the bindings? Show calculations to support your answer.

* Minnetonka should buy the bindings as it costs less per pair to buy them (\$79.50) rather than to make them (\$80.00):

make Discount Calculation buy

Direct Labor \$ 35.00 -10% \$35 - (\$35 * .1) \$ 31.50

Direct material \$ 30.00 -20% \$30 - (\$30 * .2) \$ 24.00

Overhead \$ 15.00 -10% \$15 - (\$15 * .1) \$ 13.50

subtotal \$ 69.00

+ bindings \$ 10.50

Total \$ 80.00 \$ 79.50

2. What would be the maximum purchase price acceptable to the Minnetonka Corporation for the bindings? Support your answer with an appropriate explanation.

* Perfectly competitive companies maximize profits by producing the quantity where the cost is less than or equal to the revenue generated. In this case, each pair costs \$69 to buy. The optimal cost for the bindings should not exceed the price per pair (\$80.00). Therefore, the maximum allowable price for the bindings should not exceed \$80.00 (sale price) – \$69.00 (bought manufacturing) = \$11.00

3. Instead of sales of 10,000 pair of skis, revised estimates show sales volume at 12,500 pair. At this new volume, additional equipment, at an annual rental of \$10,000 must be acquired to manufacture the bindings. This incremental cost would be the only additional fixed cost required even if sales increased to 30,000 pair. (This 30,000 level is the goal for the third year of production.) Under these circumstances, should the Minnetonka Corporation make or buy the bindings? Show calculations to support your answer.

* So long as the price per pair costs less to buy than produce, the company should always buy. This becomes especially true if the company has to incur additional expenses during production such as rent. Below are the calculations that show the difference in price if the firm buys or produces 12,500 units, and 30,000 units, respectively:

Qty make buy

12500 12500 * \$80 = \$1M 12500 * \$79.5 = \$993,750

+ \$10k (rent) no rent

= \$1.01M = \$993,750

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$30000 \times \$80 = \$2.4M$ $30000 \times \$79.5 = \$2,385,000$

+ \$10k (rent) no rent

= \$2.41M = \$2,385,000

4. What qualitative factors (i. e. issues with vendors, customers, or within the product itself) should the Minnetonka Corporation consider in determining whether they should make or buy the bindings?

* Miscellaneous factors include a percentage of allowable defects, employee turnover affecting production rates, the actual production rates and the efficiency of them meeting consumer demand.