

Essay on cost of producing one pair of skis plus binding

[Business](#), [Company](#)



Abstract

This work begins with a brief introduction of the Ski Pro Corporation's ability to make or buy the bindings. Computations to determine whether the company should buy or make the bindings then follow. As a matter of fact, cost incurred when making the 10, 000 skis without the avoidable cost is worked out. Also, avoidable cost of producing one pair of the bindings is computed so that a comparison of the cost of production can be established. The paper then highlights the maximum purchase price acceptable to the Ski Pro Corporation for the bindings. It ends with qualitative factors that the Ski Pro Corporation should consider in determining whether they should make or buy the bindings.

Introduction

The Ski Pro Corporation, which produces and sells to wholesalers a highly successful line of water skis, has decided to diversify to stabilize sales throughout the year. The company is considering the production of cross-country skis. As a result, paper highlights the total cost avoided as a result of either making the bindings or subcontracting. The amount then helps in determining the maximum purchase price acceptable to the Ski Pro Corporation for the bindings. The recommendation of the maximum price is dependent on the total costs avoidable or the contribution margin.

1. Cost incurred when making the 10, 000 skis without the avoidable cost

Direct labour \$35

Direct material cost \$30

Total overhead cost \$15

Total cost of production per skis \$80

Therefore, the total cost of producing the expected volume of 10000 skis.

Total production costs = \$800, 000

Cost incurred when subcontracting

Avoidable Cost of producing one pair:

Direct labour (10% of 35) = \$3. 5

Add: Direct material (20% of 30) = \$6

Add: Total overhead (10% of 15) = \$1. 5

Total production cost per skis = \$11

The total variable cost avoided as a result of subcontracting = \$11

Add; Avoidable total overhead cost which is obtained as total fixed variable per ski less fixed overhead per unit

Fixed overhead per unit = (100, 000 fixed charge) / (10, 000 units Expected volume to be produced)

= \$10

Therefore, avoidable overhead cost per unit= \$ (15 - 10) = \$ 5

Total avoidable costs= 11+5

=\$ 16 per ski

Thus the cost of subcontracting will be \$ 80 less \$ 16 giving a total of \$64 per ski because of the avoidable costs. The Ski Pro Corporation should buy the bindings because of the higher value of avoidable cost which reduces the

cost of production. However, best on the contribution margin computation; the profit realized as a result of making is higher.

2. The maximum purchase price acceptable to the Ski Pro Corporation for the bindings

Maximum purchase price acceptable to the Ski Pro Corporation for the bindings is determined by working out the total of the variable costs

The maximum purchase price = cost per ski made and bound times the expected volume

= 64 X 10, 000

=\$640, 000

As worked out in part one above, the avoidable costs must be examined and factored out to help arrive at the maximum purchase price.

3. Compute total cost of making (per unit variable plus fixed overhead) for 12, 500 pair.

Cost of making:

Direct labour \$35

Direct material cost \$30

Total overhead cost \$15

80

Add: fixed overhead per unit increment = increment of \$10000 in fixed cost divide by the increment in sales volume of 2500

= 10, 000

2500

= \$ 4 per unit

Therefore total cost of making will be equal to \$ 84

Cost of buying as a result of increment

The total avoided costs when the product is subcontracted will be

Direct labour (10% of 35) = \$3. 5

Add: Direct material (20% of 30) = \$ 6

Add: Total overhead (10% of 15) = \$ 1. 5

Total production cost per skis = \$11

Add: avoidable total overhead cost which is obtained as total fixed variable per ski less fixed overhead per unit

Fixed overhead per unit= 10, 000 fixed charge increment

2500 units increment

= \$4

Therefore, avoidable overhead cost per unit= \$ (15 - 4) = \$ 11

Total avoidable cost of fixed and current variable hence is \$ 11 + \$ 11= \$ 22

The Ski Pro Corporation should make the bindings even though there is higher value of avoidable costs as shown in the above calculations. Making bindings is beneficial in that more profits will be realized. Sales shall have increased in the third year while cost per pair would fall.

There are many non quantifiable factors that Ski Pro Corporation should

consider in addition to the economic factors calculated in the numbers above. The most important factor that needs consideration is the level of control on the process of manufacturing that will of course be given away in a situation that the bindings are bought from the outside suppliers or if subcontracted. In circumstances that delay in supply is experienced; Minnetonka's operations might greatly be influenced. Therefore such factors need consideration. Besides, buying the bindings may push the company to lay off some of its employees. Making the binders make the company have direct control and influence over their vendors, quality of materials as well as the workmanship. As a result the subcontractors who are not able to meet delivery times or present goods which are inferior are eliminated. Lastly, the quality of the materials to be used in making the bindings by the subcontractor needs to be considered before subcontracting. This is to ensure that the quality is of the required standard to ensure the value for money paid.

Conclusion

In conclusion, from the computations it is evident that the company should make the bindings due to the higher contribution margin. The company is in a position to make extra profit as a result of making the bindings. Even though the total avoidable cost is higher when subcontracted, the contribution margin when computed presents a better standing when the bindings are made. Lastly, the level of control on the process of manufacturing that will of course be given away in a situation that the bindings are bought from the

outside suppliers or if subcontracted should be the major factor that needs consideration before subcontracting.

Reference

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The given Case Study.