

Incremental analysis essay



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What is Incremental Analysis? Basically, it's a managerial decision making process. Decisions are a huge part of being a manager. Decision making does not always involve lots of people and a set schedule, but decisions vary in their complexities and some involve a little research to see if they will work out. There are four steps to incremental analysis. They are very simple: 1. Identify the problem, 2. Determine and evaluate possible courses of action, 3. Make a decision, and 4. Review results of the decision. We, as the accountants, contribute the most to steps 2 and 4.

In step 2, we provide relevant data and cost data. These show the expected outcome of the effect on net income. In step 4, we read the internal reports that are the results of the review. There are three costs that are needed in order to prepare this type of analysis. The first is the relevant cost. These are the types of costs that can change from one alternative to another. Direct materials, direct labor, variable manufacturing costs, and even fixed costs can all change from one product, product line, and/or company every time an analysis is done. The second cost is an opportunity cost. This is a "choosing" concept.

In choosing one course of action, another is forfeited. In choosing the safety and health of my family I had to quit my babysitting job so that I can be the mom/wife that I need to be. The cost of that decision in dollars is only 75\$ a week, but in a community perspective it means a calmer, more relaxed, mommy that has time to teach (my kids), cook, clean, do homework and still have the energy to hang out with my husband a little in the evenings. The third cost is sunk cost. This is how much has already been put into the

venture. All the books, vitamins, toys and food that I purchased for the other kids is a sunk cost.

The benefit of that is, is that when Carson is old enough he can play with the toys, my husband and I can eat the food, and the vitamins I sent home with the kid. Hopefully her mother will continue to give them to her. There are many types of incremental analyses that are used widely in business management decisions. The decision to accept an order at a special price, the decision to make or buy a component part or finished product, the decision to sell products unfinished or process them further are three decisions that must be evaluated by incremental analysis.

In the manufacturing business, the decision to take on special orders must be made frequently. There are a number of factors that must be researched in order to make a good decision. First, compare the cost of the new venture. Will the business make money at it? How much can the business take out of its stores before it begins to affect normal operations (Direct Materials)? Will the business have to expand its production area in order to finish the special order? If the venture is coming out of storage, will it affect future supplies for the regular business?

Obviously, not having to purchase more supplies and not needing to expand would make the most money. Next, decide whether the new venture is going to be time consuming or whether it can be done while the current job is going on (Direct Labor). Next, figure out how much money must be spent (Fixed Cost), and how much could be 'not' spent (Variable Cost). Then,

compute the income off of this venture. Is it worth it? In this process, take the normal cost of supplies, time (labor) to make, and the equipment usage.

This will give a starting point to base the income of the project on. As long as the cost of the supplies, time (labor), equipment usage, and income all work out, then the venture can be accepted. If it doesn't work out even after all this is done, perhaps the product didn't sell as well as the forecast hoped. These jobs can create business in the neighborhood for the locals and also provides goods for the community. Another very important decision that is made frequently in the business world is the decision to make all the component parts or to buy them already finished.

The decision to buy them from other companies already made is called outsourcing. This can provide needed jobs for the community and inspires a sense of belonging in that community also. This decision is also based on direct materials, direct labor, variable costs, and fixed costs, but this time they are being used to compare one venture with another to see which one brings in more revenue. All the costs that it takes to make the product are added together in one column. All the costs that are needed to buy the item are added in another column.

Once this is established, the opportunity costs must be evaluated. These are the potential benefits that could come from a side venture of using the production space for something else while the components for the first venture are being bought. These costs are added to the 'make' column. Often this is the make or break point of the deal. Also, when choosing to buy, make sure that a reliable company is chosen. They have to be able to keep

up with the demand; otherwise the company will end up with not enough parts at a crucial moment.

This decision, to make or buy, can have huge effects on the community that the business belongs to, as well as, other surrounding communities. They will benefit from jobs, supplies, and the well-being that comes from being part of a well knit group. Being in a stable environment is very important when raising families and having a steady income helps to provide that. Another major decision that is done in business dealings is the decision to sell an unfinished product cheap, or to process further and sell at a higher price.

This comes with a risk: will the merchandise sell at the higher price, and how much more will it cost to finish the product? In this decision, management compares the cost of how much it would be to finish the product with the cost of not finishing it and selling cheaper. If the cost of finishing it is more than the total revenue would be, then usually the company will sell the cheaper item. This impacts the community in many ways. If the company chooses to finish the item it could hire more people in order to get the job done. This provides jobs, and more of that lovely security.

If the company decides to sell the product unfinished, cheaper, this helps the people be able to afford stuff with only minor assembly required. There are many more decisions that would use incremental analysis in the business place. These are only a few examples. Well thought out, documented, decisions frequently turn out better than hasty, abrupt decisions. If more people used these techniques in their home life their worlds would be more

stable and secure. All in all, this is an excellent technique that can be used in running personal finances as well as business' finances.