

Chapter 10

E10.8 Happycabs

(i)

Relevant costs

	£
Loss on net realisable value of the vehicle through using it for the contract £18,000 - £16,800	1,200
Costs in excess of the existing routine maintenance costs (£1,800 - £70) x 5	8,650
Total relevant costs	<u>9,850</u>

(ii)

	£	
Total relevant costs	9,850	
Profit [£9,850 x (100/85 - 1)]	1,738	15% of £11,588
Total charge to customer for contract	<u>11,588</u>	

E10.9 Yves-Andre

(i)

The relevant costs are the differential costs between making and buying, and they consist of differences in unit variable costs plus differences in directly attributable fixed costs. Buying will result in some fixed cost savings.

	D1	D2	D3	D4
	£	£	£	£
Variable cost to make a garment	180	220	90	160
Variable cost to buy a garment	<u>160</u>	<u>270</u>	<u>130</u>	<u>180</u>
	<u>(20)</u>	<u>50</u>	<u>40</u>	<u>20</u>
Garment numbers required over the next year	100	200	400	300
	£	£	£	£
Extra variable cost/(saving) to bu	(2,000)	10,000	16,000	6,000
Fixed cost saving from buying	<u>(3,000)</u>	<u>(6,000)</u>	<u>(8,000)</u>	<u>(9,000)</u>
Total extra cost/(saving) to bu	<u>(5,000)</u>	<u>4,000</u>	<u>8,000</u>	<u>(3,000)</u>

Yves-Andre Ltd would save £5,000 a year by buying garment D1 (the purchase cost would be £2,000 less than the marginal cost to make it internally and £3,000 would be saved on fixed costs) and would save £3,000 a year by buying garment D4 (the saving in fixed costs £9,000 less the extra cost £6,000 of buying each unit).

(ii)

The relevant costs for Yves-Andre Ltd are the variable costs of manufacture, the variable costs of buying the garments, and the savings in fixed costs.

Yves-Andre Ltd should also consider other factors:

The reliability of the cost estimates must be carefully checked. Buying D1 is clearly cheaper than making it. The decision to buy rather than make D4 is only financially beneficial if the fixed cost savings of £9,000 can really be achieved – in practice, such promised savings often fail to materialise.

If garments D1 and D4 are bought then the company will have spare capacity. It needs to consider how that capacity will be used. If it cannot be used then there may be lay-offs, followed by industrial disputes.

Yves-Andre Ltd must consider the reliability of the overseas supplier in terms of delivery, and quality either equal to or greater than garments produced in-house.

Yves-Andre Ltd would lose flexibility through obtaining garments from an overseas supplier. It may maintain better control over operations by making everything itself.