

# IB Business Management – Operations Management

## 5.5 Production Planning – Make-or-Buy Decisions Worked Example



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### MAKE-OR-BUY DECISIONS WORKED EXAMPLE

The estimated costs of producing 6,000 units of a component are:

	Per unit (\$)	Total (\$)
Direct material	\$10	\$60 000
Direct labour	\$8	\$48 000
Additional variable costs	\$9	\$54 000
Indirect costs (factory over heads - \$1.50 per direct labour dollar)	\$12	\$72 000
	<b>\$39</b>	<b>\$234 000</b>

The same component can be purchased from market at a price of \$29 per unit. If the component is purchased from market, 25 per cent of the fixed factory overhead will be saved.

Should the component be purchased from the market?

**Solution:**

**5.5 Production Planning – Make-or-Buy Decisions Worked Example**

	Per unit		Total	
	Make	Buy	Make	Buy
<b>Costs:</b>				
Purchase price		\$29		\$174 000
Direct material	\$10		\$60 000	
Direct labour	\$8		\$48 000	
Additional variable costs	\$9		\$54 000	
Indirect costs (factory over heads - \$1.50 per direct labour dollar)	\$3		\$18 000	
<b>Total relevant costs</b>	<b>\$30</b>	<b>\$29</b>	<b>\$180 000</b>	<b>\$174 000</b>
Difference in favour of <b>buying</b>		<b>\$1</b>		<b>\$6 000</b>