

Make or Buy



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Make or Buy

- Make or Buy is not just a financial decision.
- When you control manufacturing you control vendors, quality assurance, production, disposal of refuse, packaging, and labor as well as other factors.
- When you purchase you need to trust the vendor and ensure that the vendor complies with your desires, ethics, morals, etc.

Make or Buy

- Several years ago exploited labor was a big news item and several companies were identified not because of their own labor practices but the labor practices of their vendors.
- Repeatedly hazardous material handling and disposal by vendors has hurt the purchaser.
- Make or buy is a tough decision.

Make or Buy

- This is the setup for our company.
- Our cost of manufacturing is \$8.15 per unit and a vendor has offered the item for \$7.55.
- If we purchase fixed costs will drop by \$25,000.

Cost of manufacturing:	\$8.15
Purchase price:	\$7.55
Fixed costs if manufacturing:	\$375,000.00
Fixed costs if purchasing:	\$350,000.00
Total number of units:	75,000
Rental income from unused space:	\$135,000.00

Make or Buy

- We need 75,000 units.
- If we purchase we can rent the idle space out for \$75,000.

Cost of manufacturing:	\$8.15
Purchase price:	\$7.55
Fixed costs if manufacturing:	\$375,000.00
Fixed costs if purchasing:	\$350,000.00
Total number of units:	75,000
Rental income from unused space:	\$135,000.00

Make or Buy

- Here is our table to address the issue.
- Our 75,000 units cost \$611,250 to produce.
- It will cost us \$566,250 to purchase the 75,000 units.
- This starts our savings at \$45,000.

	Make:	Buy:	
Manufacturing costs:	\$611,250.00		\$45,000.00
Purchasing costs:		\$566,250.00	
Fixed costs:	\$375,000.00	\$350,000.00	\$25,000.00
Total cost of units:	\$986,250.00	\$916,250.00	\$70,000.00
Less rental income:		(\$135,000.00)	(\$135,000.00)
Net cost:	\$986,250.00	\$781,250.00	\$205,000.00

Make or Buy

- The reduction in fixed costs from \$375,000 to \$350,000 saves us another \$25,000.
- The rental revenue of \$135,000 can be applied as a credit to the purchase price reducing it.

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Make or Buy

- Putting it together, making the 75,000 units costs us \$986,250.
- Purchasing the 75,000 units costs us \$781,250.
- Purchasing the item saves us \$205,000.
- Sounds like a good idea.

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Make or Buy

- Financially it looks like we should purchase the item.
- Other things we need to consider:
- What about our workers no longer employed?
- What about quality?
- What about the social issues?
- The decision is not just financial.
- Textbooks usually go by the financial solution.

Make or Buy

The end.