Cost Accounting

GROUP ASSESSMENT

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Question (1): Cost Accountant Toolkit

Cost accountants are responsible for planning and collecting data to analyze business’s activity costs, analyze changes in products and maintain a system of cost accounting. In order to perform these responsibilities, cost accountants use a variety of techniques for costing, such as Marginal costing, Standard costing, Historical costing, Absorption costing and Uniform costing. These costing techniques are used in analyzing a company’s costs, in order to provide the related analyzed information to the company’s management, which will consequently help the management in making better decisions regarding costs (Accounting Jobs Today, n.d.).

<table>
<thead>
<tr>
<th>Techniques of Costing</th>
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<tr>
<td><strong>Marginal Costing</strong>: A costing technique that aims to ascertain the effects of changes in costs, price and volume on the profitability of a company and its stability, and providing the relevant data to the management for enabling it to take managerial decisions by dividing total costs into fixed and variable cost (Macmaster, n.d.).</td>
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<td><strong>Standard Costing</strong>: A technique that determine the efficiency of an operation by comparing the standard cost with actual cost of each product, in order to take any necessary remedial action. This type of technique is potentially used for inventory costing, price formulation, budgeting and overhead application (Accounting Tools, n.d.C.).</td>
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<td><strong>Historical Costing</strong>: A technique that determine and record actual cost when they incur. It is possible to use this technique to compare between periods, although its use is limited (Rajasekaran &amp; Lalitha, 2010).</td>
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<td><strong>Absorption Costing</strong>: Also known as Full costing or Orthodox costing. A technique that consider allocating all the variable and fixed costs to products or operation processed (Techniques of Costing, 2013).</td>
</tr>
<tr>
<td><strong>Direct Costing</strong>: A technique that charge all direct costs, including some fixed and all variable costs, to products or operations, while the indirect costs are written off from the profit of the period (Techniques of Costing, 2013).</td>
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<td><strong>Uniform Costing</strong>: is not a distinct costing technique. In fact, an organization is said to follow a uniform costing technique when many organizations in a similar industry are applying a unified costing principle, method or procedure. This technique is mainly used for better comparison of costs, eliminate unhealthy competition, improve efficiency, and ensure standardization (Institute of Chartered Accountants of India, n.d.).</td>
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Beside the techniques of costing, there are two main costing methods that cost accountants use, which are: (Khan & Jain, 2005)

### Methods of Costing

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<tr>
<th><strong>Job Costing:</strong> a method of costing that accumulates and collects costs according to contracts, jobs and products, in which each job is treated separately.</th>
<th><strong>Process Costing:</strong> This method is applied for goods or services that go through many conversion process until converted to finished goods. This method is widely used in sugar, cement, textiles, and chemical industries.</th>
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<tr>
<td><strong>A. Contract Costing:</strong> it is applied when the job work is large such as building work contract. This method collects cost according to each contract work.</td>
<td><strong>A. Operation Costing:</strong> this costing method determines the cost of each operation instead of process. It allows to calculate the unit operation cost by dividing total operation cost by total output.</td>
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<tr>
<td><strong>B. Cost plus Contract:</strong> These contracts include payment of the contracted actual manufacturing cost plus profit margin or markup, because in this type of contracts it is difficult to estimate a reasonable manufacturing costs.</td>
<td><strong>B. Multiple Costing:</strong> This method combines two or more costing methods, it is done by combining different sections of production cost after calculating all the parts manufacturing costs. Multiple costing is suitable for motor cars, tractors, engines and aircraft industries.</td>
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<tr>
<td><strong>C. Batch Costing:</strong> is using many similar units as cost units for ascertainment of costs. The batch costing is divided by the number of units in a batch to the cost per unit. This costing method is mainly used in ready-made garments, drugs, electronic components industries.</td>
<td><strong>C. Output Costing:</strong> This method is used for continuous and mass production of a single unit or few similar products. Cost per unit is calculated by dividing the total cost by number of units. Also, this costing method is mostly used in cement, cigarettes, pencils and quarries industries.</td>
</tr>
<tr>
<td><strong>D. Operating Costing:</strong> this method is similar to process costing and it is applicable in service industries such as transport, hotels, hospitals and canteen.</td>
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In addition, cost accountants must have a variety of skills that enables them to study the company’s costs and provide an effective advice to the management. These skills include good analytical skills, Organizational skills, Communication skills, attention to details and technological skills. First, the analytical skills are important for cost accountants because it enables them to analyze the results of the techniques and method applied, analyze how different costs will affect the company’s performance and operation, and finally to give an opinion regarding a cost to the management that is based on the analysis. Second, organizational skills are essential for cost accountants in order to be organized; especially since they will be dealing with vast amount of information regarding costs; thus they have to
be organized to avoid data loss (Suttle, n.d.). Third, communication skills are also vital to communicate effectively with other cost accountants and departments to gain information as well as communicate recommendations to managers. Fourth, attention to details is one of the most important skills as it enhance the quality of the opinion and advice that will be provided to the management after analyzing the results. Finally, technological skills or IT skills, which are very important in the 21st century as most operations and tasks are done using computer software’s (Accountemps, n.d.).

Due to the list of necessary costing techniques, methods and skills, it is clear that cost accountants are using ‘a toolkit of techniques’. But, however, to prove the first part of the description about professionalism, a definition of ‘profession’ is needed. According to Oxford dictionaries, A profession is ‘A paid occupation, especially one that involves prolonged training and a formal qualification’. From the definition, two main elements of professionalism can be derived that are a prolonged training and a formal qualification, which should be included in cost accounting occupation as a profession (Oxford Dictionaries, n.d.).

First, regarding formal qualifications, cost accounting job requires a Master Degree in Accounting or Master of Business Administration (MBA), and it is preferable to be a Certified Management Accountant (CMA)\(^1\) for senior cost accountants (Education Portal, n.d.). Second, regarding prolonged training, it is preferable for cost accountants to have an average period of 4 years of experience in accounting field, as this period provide the accountant with a full knowledge of companies operations and accounting cases (Accrue Partners, 2013).

From another angle, a job can either be a normal occupation or a profession. According to Santosh (2011), specialized knowledge (e.g. professional or higher qualification) in the occupation field is not needed for a normal occupation, whereas it is required for a profession. As a consequence, the description of ‘Cost accountants are professionals with a toolkit of techniques’ is fairly describing the cost accountant and their profession.

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\(^1\) A professional certificate in management accounting provided by the largest Management Accounting enhancing association (IMA)
Question (2): Cost Minimizers or Cost Maximizers

Cost accounting is collecting, analyzing, and summarizing financial information within the company. It is not only allocating costs using the various methods, but rather analyzing the different variables and recommending the most efficient way to carry out business (Agarwal, Harmon & Viertler, 2009). Likewise, managers demand cost accountants to make recommendations to increase the profit; which can be done either by reducing cost or by increasing prices. Minimizing costs is a huge principle of the cost accountant job, so much so that it became criteria of cost accountants competency. Cost accountant usually chooses to minimize their costs; something they have been criticized in the recent years (Horngren, Sundem, Stratto & Teall, 2006).

It is unfair to criticize cost accountant for focusing on minimizing costs in general because it is always beneficial to reduce wastage and keep cost at a minimum level. However, it is fair to criticize them for minimizing cost solely to increase profit; which is known as “Cost cutting”. This concept involves taking extreme measurements to reduce the company’s costs such as lay-offs, salaries reductions and even downsizing the company if necessary (Investopedia, n.d.A). At the same time, cost accountants usually follow the cost plus pricing (Boyd, n.d.) where they calculate prices by adding a profit margin (usually a percentage of the total cost of the product) to the product cost itself. Because of this pricing method, cost accountants firmly believe that reducing cost will translate into more profits; because lower cost will allow them to add the profit margin and still have lower prices; which attract customers and increase revenues.

In our opinion, cutting cost have deeper implications. It will decrease prices but it will cause negative effects as well. It will make the company focus on maintaining the status quo rather than focusing on expansion. If it is used to lay off staff or reduce salaries. It will also affect the morals of the staff thus lead to less innovation and quality output; which will lead to less revenue (Denning, 2011). For example, to increase profit in a law firm, cost accountant may easily be willing to lay off back-office staff because they believe this will result in better profits than keeping the staff. This will reduce cost and will allow for lower prices but back-office staffs are essential for quality (they are responsible for things such as research and customer service) and laying them off will lead to lesser service quality and thus less revenue. Not only that, but the remaining staff would be demotivated; which will reduce their productivity. The criticism has reached high level to a degree that people such Steven Denning, a known management and innovation consultant, said that “cost accounting is a disease of which it purports to be the cure” (Denning, 2011). He added that companies should move from cost accounting as a whole because it limits them.

This is, however, an extreme statement because minimizing cost if done correctly can lead to positive results; this can be done through gaining through understanding of the company and its operations. Cost accountants has the tool, known as activity based costing (ABC), that allows them to focus on maximizing revenue. This costing system is very accurate in cost allocation where it allocates both manufacturing and nonmanufacturing overheads using cost drivers. These drivers are the occurrence that will lead to incurring costs of the companies’ activities. It assigns cost to each activity using the cost drivers and then allocates the activities to the related product; leading to cost allocated to areas based
on their activity not only by the produced output (Accounting tools, n.d.B). This is very beneficial in reducing cost because it makes the costly and non-costly elements in the organization more visible, allowing cost accountant to detect and then reduce/eliminate wastage; which decrease deficiencies. Furthermore, thus, in our opinion this will also lead companions to reducing the cost and charge lower prices using the cost-plus pricing. This is an example of how cost accountant can be proper cost minimizers.

However, as for why don’t cost accountants shift focus to increasing revenue (i.e why are not they revenue maximizers). This is because cost accountants do not want to experiments with increasing pricing as this might lead to customer’s dissatisfaction. Thus, to them, reducing cost is easier and safer than focusing on increasing revenues (Agarwal, Harmon & Viertler, 2009). This is somewhat valid point as usually customers are put off the more costly the product. Nonetheless, focusing on cost cutting is not beneficial as the company need to expand and grow. Thus, it is recommended that cost accountant start expanding in how they use their tools. In reality, cost accountants are guilty of reducing costs simply to keep them at a controlled level. However, there costing systems, specifically, the ABC can help them find deficiencies and maximize revenue. Thus, it is unfair to say that cost accounting in general is a “disease”.

To elaborate, since ABC allows for accurate detection of deficiencies, Cost accountant should not use it solely to keep cost level under control. But rather they should use it to minimize waste and then use the extra saved resources in expansion (CGMA, n.d). Thus, cost accountants should not be cost-reduction minded but rather expansion-minded. Reducing cost to increase revenues “cost cutting” might lead to a short-term revenue increase, but in the short term the company will suffer from quality and lack of innovation and will be at the same financial position. On the other hand, reducing cost to be efficient and then re-invest in the company will lead to a growth and thus more revenues in the long term. This way they can be proper revenue maximizers. This philosophy has proven its worth in the real world. Companies such as Aldi, the global supermarket chain, have adapted this philosophy. This company focuses on efficiency for the purpose locating wasted resources and re-invest them, which allowed the company to grow to 7000 stores worldwide while still providing products with cheap attractive prices to gain competitive advantage over competitors (Business Case Studies, 2013). The lesson to be learnt here is that cost accountant should think of increasing profit as a result of being efficient and being keen to invest resources in good expansion rather than focusing on reducing their baseline for cheaper prices. This way, cost accountant can be proper cost minimizers and revenue maximizers.
Question (3): Traditional Systems in Knowledge & Service Based Economies

Service and knowledge-based-economies are quite different than the production-industry as they do not necessarily produce a tangible product to provide. Knowledge-based-economy consists of the knowledge and information (Intellectual Capital) that the employees in the company can provide to customers, such as law firms (Investopedia, n.d.B). Service-based-economy is by providing a service to the customer, such as car cleaning service or barbershop (Business-Dictionary, n.d.)

Generally speaking, Traditional-costing method can be used on service or knowledge-based-industries as many companies are using it already (Freedman, n.d.). The method basically allocates costs directly to the service itself, rather than allocating them to the activities first and then to the services provided to the customers. An issue could be related to the direct machine hours as those industries do not necessarily have machines. Also, by using this method, the company would be assuming that there is only one cost driver that is the direct labor hours. This is a limitation for the method as it excludes the idea that the service or knowledge provided to the customer could vary from one to another, which would incur different costs.

Despite that, this method remains a valid method to use when the company is determining the overhead rate because the method is still capable of allocating different costs to the services done. Though, having only one cost driver limits the accuracy of the results as every cost that the company incurs is distributed based on the labor hours, rather than the actual amount used on the specific service. The accuracy is the main issue with the whole traditional costing method that is why the activity-based-costing (ABC) was created. The main difference is that this method allocates different cost drivers for different costs. The table below, compares the traditional-method with the ABC (Schmidt, 2014):

<table>
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<tr>
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<th>Traditional Costing</th>
<th>Activity Based Costing</th>
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<tbody>
<tr>
<td>Depth of Data Needed</td>
<td>Simple: Requires total overhead cost and simple allocation rules.</td>
<td>Detailed: Requires detailed knowledge of activities and resources that are classified as Overheads.</td>
</tr>
<tr>
<td>Overhead Components</td>
<td>Aggregation: This method aggregates all the overhead and uses a simple allocation rule to divide it.</td>
<td>Differentiation: This method differentiates each overhead cost to each service.</td>
</tr>
<tr>
<td>Direct &amp; Indirect Measurements</td>
<td>Total overhead is known, and is then distributed into individual service indirect costs.</td>
<td>Approaches costs as direct costs and then estimates the overhead of each service based on cost drivers.</td>
</tr>
<tr>
<td>Accuracy</td>
<td>Less Accurate.</td>
<td>More Accurate &amp; close to truth.</td>
</tr>
<tr>
<td>Costs</td>
<td>Less expensive.</td>
<td>More expensive.</td>
</tr>
</tbody>
</table>
Traditional-costing-method nowadays is considered to be outdated and insufficient/problematic in making decisions to all industries, not only service or knowledge-based-economies (Johnson, n.d.). An example on its inaccuracy is when the cost of a service is understated, creating abnormal losses that the company did not expect. For that reason, and even though this method is still a conventional and satisfactory way of costing, many companies decided not to apply it. Famous companies such as HP, Tektronix and Caterpillar shifted towards ABC (Rasiah, 2011). In my opinion, traditional-costing-method is insufficient and I encourage adopting the ABC-method because its accuracy would be a great help with the Activity-Based-Management (ABM) in making managerial decisions regarding the company and its operations.

The ABC-costing is widely used nowadays among companies in the service-industry such as Global-Insurance-Company (Insurance-Services), Major-Investment-Bank (Banking-Services) and Multifoods-Distribution-Group (Food-Service-Provider). First of all, Global-Insurance-Company benefited from the ABC-costing mainly for tax allocation purposes. Major-Investment-Bank, as well, benefited from ABC as they made significant changes to their internal pricing and performance measures. As for Multifoods-Distribution-Group, ABC’s accuracy saved them from acquiring more customers which would have made them lose money (Chea, 2011). These 3 examples show how effective ABC-costing could be in service-industry, though it still has its limitation due to the difficulty of identifying appropriate cost drivers for the cost pools. Not to forget about ABC takes longer time and is more expensive than the traditional-costing (Johnson, n.d.).

Therefore, as explained above, the traditional-costing-system has major problems with accuracy despite it being a valid way of costing for service and knowledge-based-industries, making the ABC-system a good replacement for it. Using either one of them will depend on the company itself and their preference of whether they prefer a simple method or a more accurate one. In my opinion, ABC is the better choice for service and knowledge-based-companies than the traditional-method due to the high level of accuracy in cost allocation. Having more accurate data would allow the company to make more appropriate and effective decisions regarding their services.
Question (4): Continuing/Discontinuing Operations

Negative contribution of products, variable costs exceed the selling price, could force companies to discontinue them. The following arguments occur when a company is about to decide whether to discontinue a product or not.

<table>
<thead>
<tr>
<th>Why not to discontinue?</th>
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<tbody>
<tr>
<td><strong>Fixed Costs Absorption:</strong> Even if a product has a negative contribution, it may still be absorbing the fixed costs of the company (Hoyle &amp; Heisinger, 2012). Therefore, having a loss-making product could save the company from making bigger losses without the product. Chrysler and General Motors, for example, noticed that their cost per car was increasing when they were producing less cars, meaning that the fixed costs of the cars not produced were divided over those produced, making their costs higher (BMaskell, 2013).</td>
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<tr>
<td><strong>Potential Contribution Reverse:</strong> A company should investigate into the negative contribution and try to reduce costs or inefficiencies rather than simply discontinuing it. Rusal, the Russian and world’s largest aluminum company, were able to revolutionize their loss-making aluminum smelters into profit-making by signing a memorandum with Vnesheconombank (known as VEB, Bank in Russia), which then attracted investors such as OMEN (automotive company). The smelters are now running with high technology and help improving the company (Interfax, 2013).</td>
</tr>
<tr>
<td><strong>Closing Deals:</strong> Company could offer the product for free as a part of a deal only if is more beneficial than selling it (Pragmatic-Marketing, n.d.). A form of closing deals occurs when selling cars, BMW for example, as they offer oil changing and services for free as part of their sale of cars (Beir, 2012). These extra offers help in making the sale and help the company make profits.</td>
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<tr>
<td><strong>Market Penetration:</strong> Having a product with negative contribution might help the company sell more of that specific product possibly due to high demand on low price, and thus helping the company spread widely in the market as Amazon is doing with their new E-Reader, and trying to compete with Apple’s iPad in the market (Stewart &amp; Stark, 2012).</td>
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<tr>
<td><strong>Loss Leader:</strong> The company might be selling profitable complementary goods for a loss-making product, allowing the company to increase sales and profit despite the loss making product (Stewart &amp; Stark, 2012). HP for example, the computer giant, as they tend to sell their printers at loss, while making significant profits from the sale of their inkjets (Hoffman, 2013). This examples illustrates that making a loss in a product does not mean that the company is doing poorly overall.</td>
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<td><strong>Possible Price Increase:</strong> Some product prices could vary depending on the situation of the market, forcing it to increase to create positive contribution or decrease for a negative one. I believe this aspect would not apply on all kinds of products, it still may work for those with fluctuating pricing, like construction material.</td>
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### Why to discontinue?

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<tr>
<th><strong>Profit-Taker:</strong></th>
<th><strong>Availability of Replacement:</strong> Discontinue certain products with negative contribution due to having replacements to offer customers from their product range. Redken, for example, discontinued Color-Extend-Line and provided a replacement to customers (Body-Full-Line) (Michelle, n.d.). This is a very effective way for companies to keep their current customers rather than push them away.</th>
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<tbody>
<tr>
<td>Product no longer generates profit and is decreasing the total profits of the company. Discontinuation would help the company focus on the profitable products, as Clairol did with their Daily-Defense Tender-Shampoo (Michelle, n.d.). In my opinion, it is the most used reason because the whole idea of a business is to make profit, and if something is not generating that, it is no longer beneficial for the company.</td>
<td><strong>Decrease Variable Costs:</strong> Since products with negative contribution have variable costs higher than their selling price, companies tend to discontinue them to decrease the total variable costs and keep the profits high. Sony, for example, after making losses with the product, decided to cut down on costs by quitting the LCD screen televisions (The-Guardian, 2012).</td>
</tr>
<tr>
<td><strong>Decrease Variable Costs:</strong></td>
<td><strong>Keep Competing:</strong> A reason to have product with negative contribution might be because of its low price in its declining phase of lifecycle where the product is less wanted by customers (Susmita, 2014). Re-innovation is necessary to keep competing with other companies rather than producing a low-demand product.</td>
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<tr>
<td>By producing a loss-making product, the company could be wasting their resources on products that harm rather than benefit them (Susmita, 2014). With discontinuation, resources could be better aligned with the business’ priorities as Conde-Naste decided to do with their Home &amp; Garden Magazine (Ferrell &amp; Pride, 2010). Another example is when Sony decided to stop producing the Playstation2 in 2012 to focus their resources more on producing the Playstation4 (BBC-News, 2012).</td>
<td><strong>Product Lines Reduction:</strong> Focusing on few specific products rather than having many product lines to increase competitiveness and reduce production complexity and fragmentation as P&amp;G decision to discontinue over 100 of their product lines (Chernev, 2014). Therefore, discontinuing products with negative contribution would help the company.</td>
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These are some of the different reasons and decisions that companies make regarding discontinuing a product or not, though the situation would differ from a company to another. Each company needs to examine all the aspects related to a product with negative contribution to determine whether discontinuing is the right option or not because, as illustrated above, having a negative contribution does not necessarily mean that the product is bad for the company. Generally thinking in the case of Rusal, negative contribution and making loss is the obvious indication that their smelters are no longer beneficial for the company. In other simpler words, if the Rusal has 2 products, Gallium smelters being profitable and Aluminum smelters being unprofitable, the logical thinking of running a business is to produce and sell more of Gallium to make more profits. Furthermore, a more in-depth thinking of the situation would clarify that if Rusal stopped their Aluminum activities, they would be missing out on great profit opportunities, making improving their current situation a better option than discontinuing it. Therefore, there is no ideal reason or decision to whether or not to discontinue a product and the decisions should be based completely on the company and its current situation.
Question (5): Make Or Buy?

The “Make-or-buy decisions” are the strategic decisions made by where the company chooses to either buy the products from “outside” suppliers or produce themselves from the “Inside”. This issue arises due to factors, internal or external, that has affected the production cycle and will affect the business. In addition, these decisions can affect the company both on short or long-term. Thus, this creates for the company the need to decide on the “Make or buy decisions” in order to affectively achieve their goals affectively. Cost is the most common factor, however, over important factors include but not limited to quality, capacity, core competency and suppliers competence.

Quality Controls

In some cases, the company may find that producing the product under their supervision is better than “Outsourcing” the production or buying it. This is because the company will be able to monitor all production and all factors contributing in the final product. Buying the products, however, will not enable them to supervise thoroughly. Furthermore, needed suppliers may not have sufficient quality controls to supply the quality needed. If they used such suppliers, the company will have a low quality product, which affects profit negatively. On the other hand, “Outsourcing” can be better in terms of quality when the company does not have appropriate manufacturing processes or production equipment to produce higher quality goods compared to suppliers or if the company products are not unique and can be produced with lower costs if they are outsourced.

Thus, companies must evaluate the quality of their productions in comparison to suppliers to decide whether to “Make or buy”. An example of that happened in 2011 with the London police. The commissioner needed to focus on the increasing rate of the cyber fraud crimes and update the system to detect such crimes. He decided to use external supportive body that consisted of experts in IT to investigate and enhance the police system of fraud detection with a cost of £650 million. It can be concluded that current police experts did not have the need knowledge or skill to enhance the system and thus the decision to outsource the process was made (Drury, 2012). This example is applicable in the business word because companies must consider their ability to produce quality output through suitable analysis of the company’s capabilities and outsourcing qualities, just as the commissioner did, before making the decision.

Core Competency

The company would have a unique production process, that outsourcing will lead them to loss this quality if they chose to outsource. This unique competency might be of nature that differentiates the company from their competitors and thus losing it means losing the competitive advantage. In this case, it is likely that the company will continue to produce the product themselves even if it is not cost effective but can also outsource parts that are not unique. To illustrate, Honda the Japanese car manufacturer gained competitive advantage over competitors for their unique design of the engine. Thus, it is not favorable for them to outsource engines production, while they could outsource headlights for example because they do not have a core competency over it (Nmims-optumiz, n.d). This way Honda could retain their core competency in their products and still outsource standards.
components if it is more beneficial. This approach is beneficial for companies that would like to outsource and keep their products unique.

**Insufficient Capacity**

Another important factor is that if companies are faced with a shortage of their products in the market and have limited production capacity. This decision is related with whether the company has enough production capacity to produce amounts to meet demand or not. If they do then they should produce, if they do not they most likely will have to buy the excess amount they need. Thus, either they buy products from suppliers in order to avoid customer dissatisfaction that can be created in case of the company’s product supply shortage and may lead customers to switch the company’s competitors. This is a problem faced by many companies, such as Reebok that had insufficient production plants to meet all customers demand. Thus, they depend vastly on the suppliers to make their products such suppliers are in Asian countries like China and Taiwan (Nmims-optumiz, n.d). Thus, they prefer incurring more cost rather than losing customers’ demand and negatively affecting their revenue. This example shows that companies must not always have to focus on cost of manufacturing or supplying, as they must consider the consequences of them not having sufficient capacity on their demand and revenue as well.

**Suppliers’ Competency**

Companies who face the choices of outsourcing or producing face the risk of having issues with their products due to suppliers’ incompetence meeting the companies’ requirements (both in quantity and quality). For example, Apple decided to have a sapphire display for the IPhone 6 and IPhone 6 plus, however, the smartphones were released without having the sapphire display due to the GT Advanced Technologies (Supplier) incompetence as they were not able to produce the screens based on Apple’s requirements on the amount of Sapphire (Farooqui, 2014). This example shows clearly how this factor can affect the decision as Apple have lost a good feature due to the Supplier’s fault. Apple was able to avoid the issues related to using the sapphire displays but some the issue will be related to core products and thus companies will suffer crucial consequences if the suppliers are incompetent. Thus, it is highly important that companies evaluate the suppliers’ competence before making the-buy-or-make-decision as it sometimes better to not buy even if the company could not produce.

It is deduced from all the above that the company must consider their production quality, their ability to produce sufficient quantities and above all the suppliers competence. Thus, through understanding of suppliers is vital. Even if the company is in need to outsource, they must think of the consequence they can suffer and the benefits they will gain from either outsourcing or producing to make informed decisions, as it is not always solely about the cost.
References


