


Sambuddha Management consulting (SbMC)

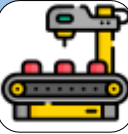
Make Vs Outsource (Buy) Decision process



**Processing cost Optimization-
Make Vs Outsource (Buy) decision**



Manufacturing entity with 95% MTO(Made to Order) products



Business Challenge ->

- Inhouse capacity not fully utilised
- Outsourcing cost is high



Decision Criteria for Make vs Outsource?? (Cost benefit analysis + Other operation factors)



BRAINSTORMING SESSION TO DECIDE ON MAKE VS OUTSOURCE

IMPORTANT POINTS



1 Compare total cost of in-house production vs vendor price

2 Compare only in-house variable cost with vendor price

3 Compare in-house capacity to decide

4 Other influencing factors

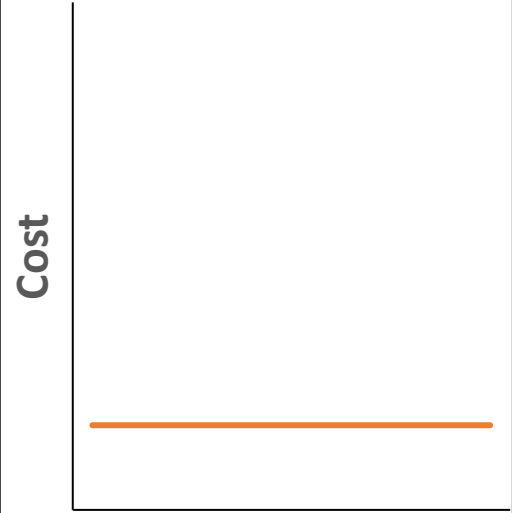
5 Any other parameters to be looked at

Case Study- Decision making process on Make vs Outsource

Underlying facts:

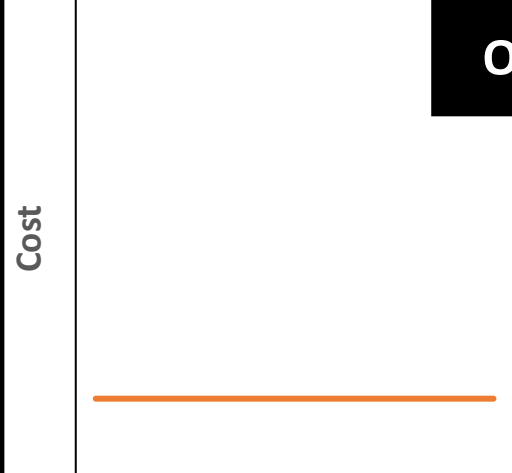
- a. In house capacity available to bring the load inhouse
- b. Vendor is comparable with the inhouse process in Quality & technical aspects

Sunk Cost



Volume of Production

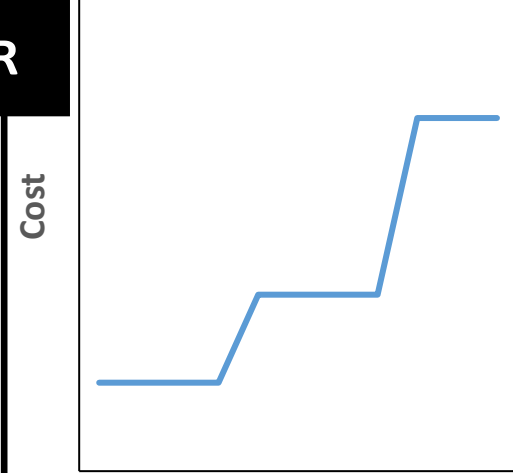
Fixed Cost- Type.1-
Flat fixed cost
irrespective of volume



Volume of Production

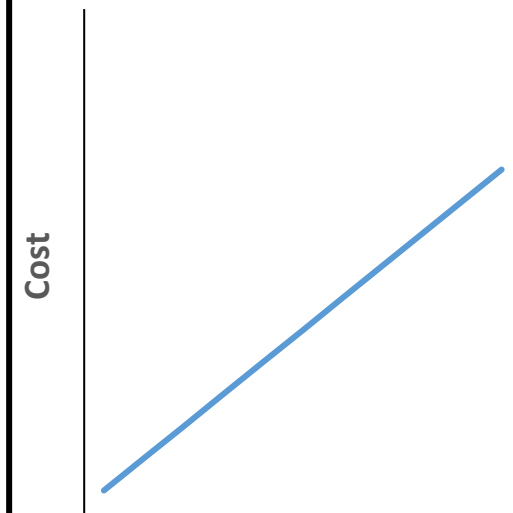
OR

Fixed Cost- Type.2
Step jump in fixed cost
with volume



Volume of Production

Variable Cost



Volume of Production

Basic Cost types in a discrete manufacturing set up

WHAT COST COMPONENTS TO BE USED TO DECIDE ON MAKE VS OUTSOURCE???

Should we compare 'Fixed + Variable + Sunk cost' with Vendor price??



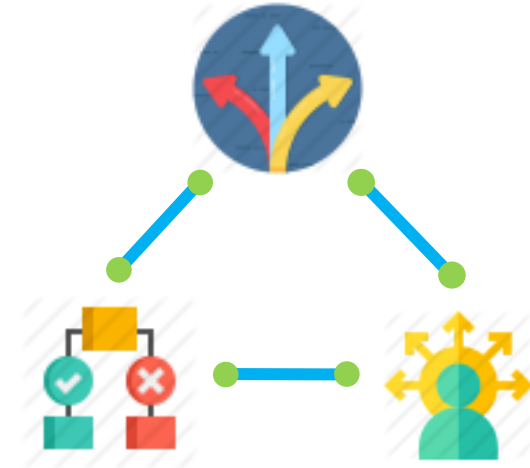
Should we compare only the Variable cost with Vendor price?



Should we compare Fixed + Variable Cost with vendor price??



Any other Cost comparison method??



COST CRITERIA FOR MAKE VS OUTSOURCE DECISION

OPTION 1

Compare FIXED + VARIABLE+ SUNK Cost with Vendor Price

Sunk cost, by definition the cost has already been incurred and not part of current cash flow. So, it may not be a correct if Sunk cost is part of comparison to decide on Make V/S Outsource



OPTION 2

Compare VARIABLE Cost with Vendor Price

Since Fixed cost is also part of net cash out flow, it would not be a correct to compare only the Variable cost to decide on Make V/s Outsource



OPTION 3

Compare FIXED + VARIABLE Cost with Vendor Price

Both Fixed and Variable costs are part of current cash flow. So, Comparing Fixed + Variable component with Vendor price would be a correct way for Make Vs Outsource Decision



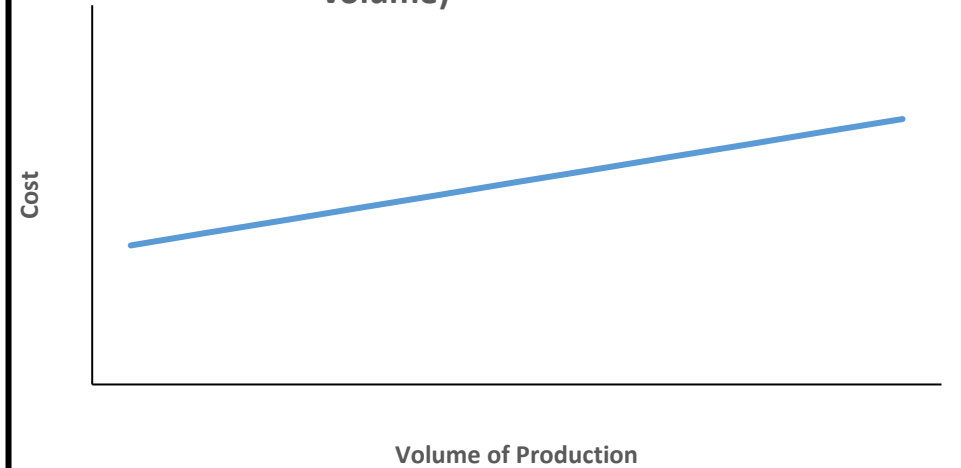
CRITERIA FOR DECISION ON MAKE VS OUTSOURCING MODEL

Fixed + Variable Cost of In-house Manufacturing = Total Cost

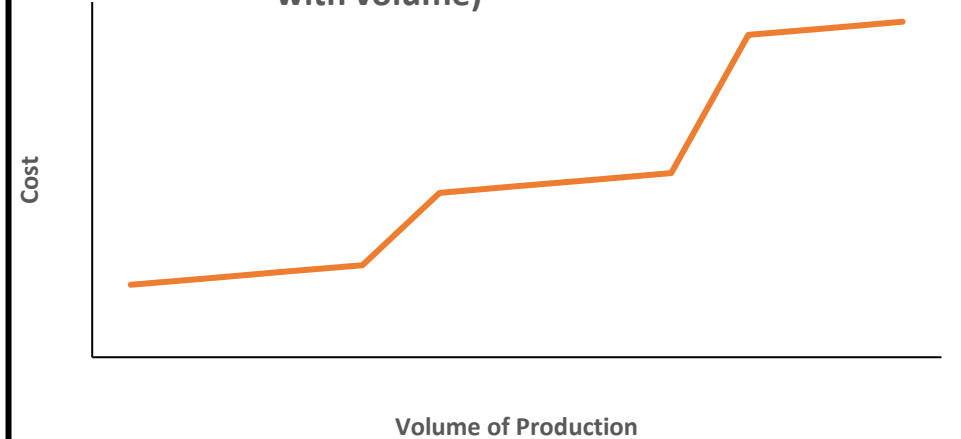
V/S

Variable Cost

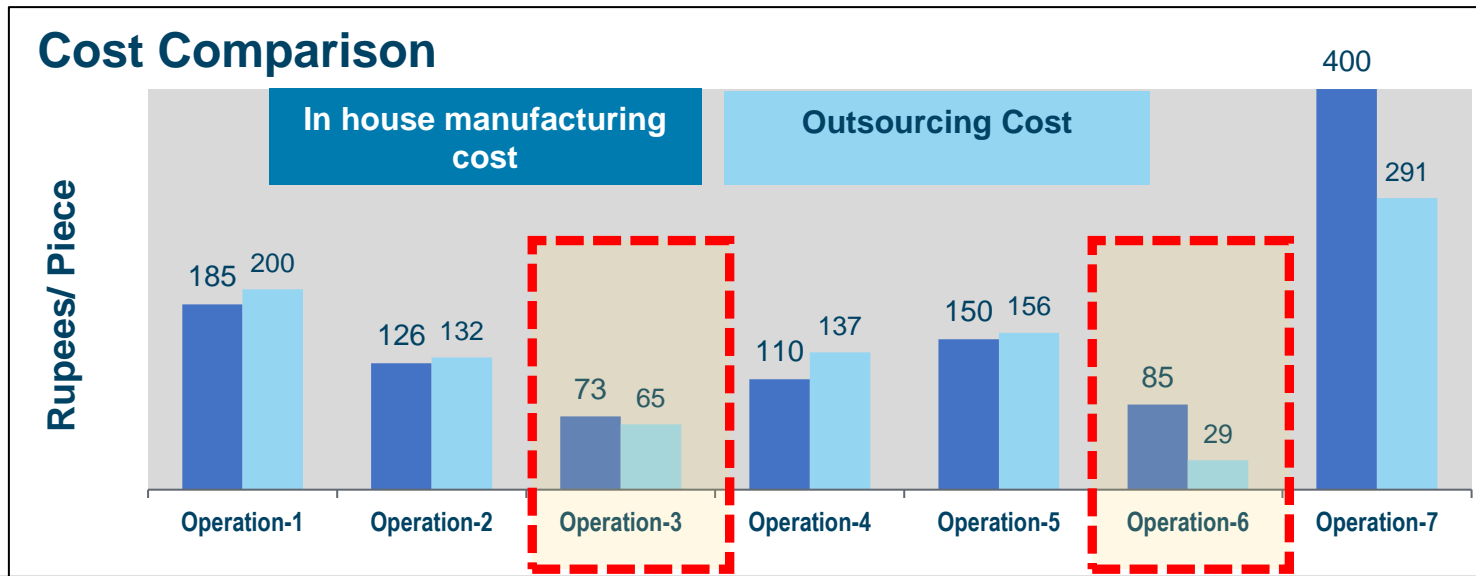
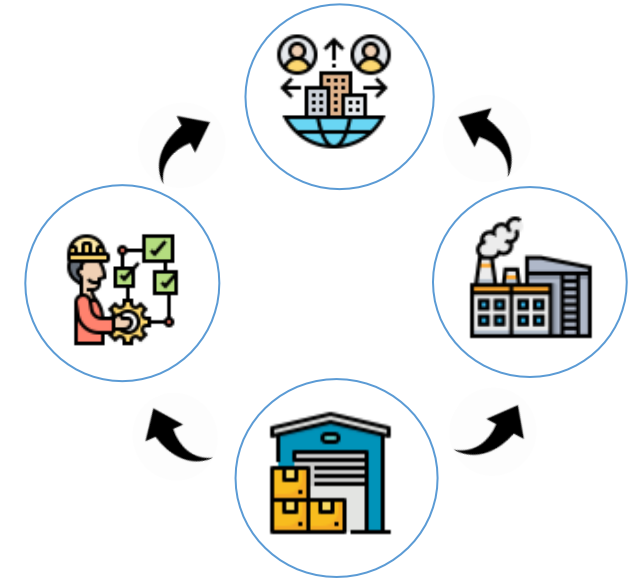
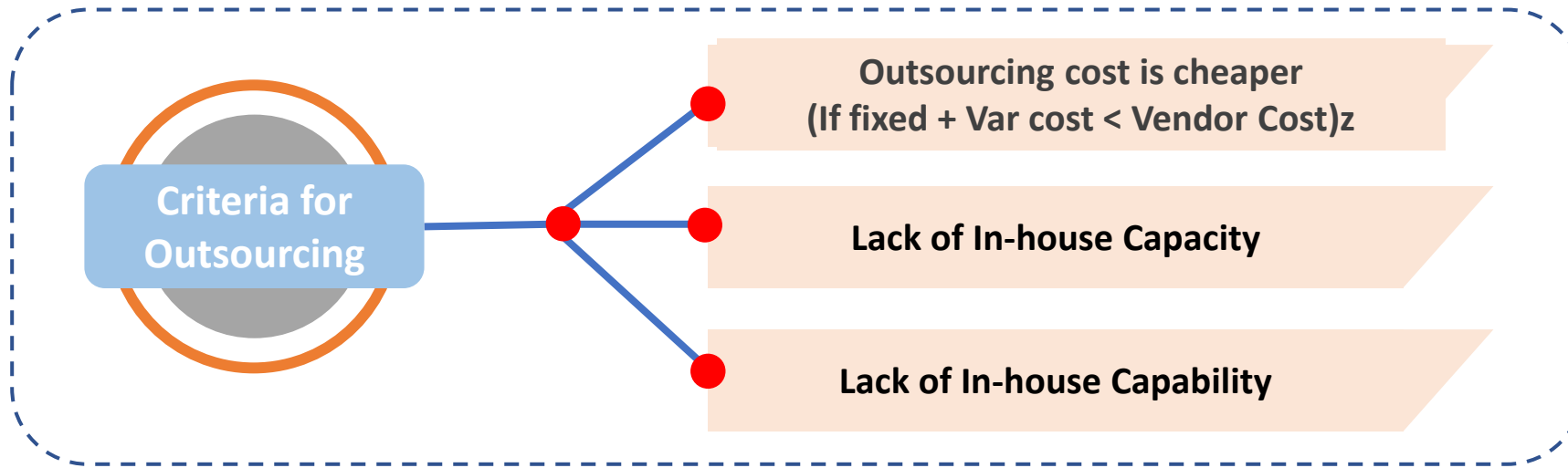
Total cost- Type.1 (if fixed cost is flat across the volume)



Total cost-Type.2 (if fixed cost takes step jump with volume)



OUTSOURCING V/S INHOUSE MANUFACTURING ANALYSIS FOR OUR CLIENT OPERATIONS



In 2/ 6 processes, Outsourcing process is more economical than Inhouse manufacturing

ANNEXURE- COST COMBINATIONS TO BE CONSIDERED IN OTHER SCENARIOS

Gross
Margin
Calculation

Variable Cost Only

Profitability
in a period
(PAT)

Fixed + Variable + Sunk cost
**(Sunk cost--- May appear as
depreciation cost)**

Profitability
trend

Fixed + Variable Cost

Decide on
continue/
junk a
product
line

Fixed + Variable Cost

.....Cost Metric we need to use, depends on the purpose... One formula fits all purpose doesn't hold good

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*Thank
you!*