Managing Financial Resources

Decision making

Short term DM (9)

Patrick Galig / HB41 / Henley Business School

Short-term decision making

Study guide chapter 7

Contribution analysis (Deckungsbeitragsanalyse)

- Relevant costs
  - just take costs yet to be incurred and not from past (sunk costs)
    - Important for make or buy decisions
    - Relevant in-house costs should be less than suppliers offer
  - Relevant costs or revenues are just those which are different for the new solution
    - future, differential, incremental
- Contribution to sales = C/S ratio analysis
  - not necessarily the best alternative even if C/S is the highest among a choice
- *Contribution = Amount which is available to contribute to fixed costs*

Structure of decision analysis

1. Clearly define exactly what the problem is for which a solution is sought
2. Consider all possible alternative courses of action that could lead to a solution
3. Discard those alternatives which on a common sense appraisal are "non-starters" for one reason or another
4. Evaluate the cost and benefit differences between each of the remaining courses of action
5. Weigh-up the non-financial factors related to each course of action
6. Take into consideration both financial and non-financial factors important to the decision, make the necessary trade-offs and decide

In- or outsource?

- Exchange of fixed and variable costs
- Ownership of assets --> no funding required

Pricing

1. **Standard costs**
   - summ up all existing costs & add margin
   - Estimation of time, cost, margin
2. **Full cost vs. marginal costs**
   - Just calculated on marginal costs as fixed costs are deemed as incurred anyway
   - If overheads are not covered, they must be covered somewhere else through profit
3. **What customers want to pay**
   - What will the customer save and what is that worth?
4. **Internal processes**
   - Approval based "Is this the business we want to be in?"
   - account manager have to present the bud and highlight why it might make sense to accept the bid
5. **Cash flow / Profitability**
   - Attach a profit & loss calculation
   - *Question of working capital*

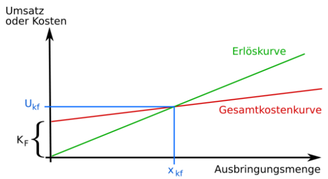
Through the lens of costs --> fixed costs are "fixed" in the short-term, so look at variable costs --> "relevant range"

Key question

How do revenue and costs differ if one course of action is adopted rather than another?

Break-Even Point = Cost-Volume-Profit (CVC) analysis

- Fixed costs / Contribution (=Price - variable costs) = Break Even in units
- Break Even in units x selling price = Break even in value
- Sales - variable costs = contribution - fixed costs = profit
- Difficulties are to allocate the "correct" amount of fixed costs to product or service



1. Deckungsbedarf feststellen:

Fixkosten total	1800
gewünschter Reingewinn →	300
= Deckungsbedarf	2100

2. Deckungsbeitrag feststellen:

Erlös pro Stück	12
minus variable Kosten (EP oder Herst.-Kosten)	8
= Deckungsbeitrag pro Stück →	4

3. Mindestmenge ausrechnen (mengenmässige Gewinnschwelle):

Deckungsbedarf dividiert durch Deckungsbeitrag → 2100 durch 4 = 525 Stück

4. Mindestumsatz ausrechnen (wertmässige Gewinnschwelle):

mengenmässige Gewinnschwelle mal Nettoerlös pro Stück → 525 Stück mal 12 = 6300

Best use of staff time or resources

- Total costs for a year (budget) / Number of chargeable staff x productive hours per person
- **Contribution per unit of the limiting factor (e.g. hours etc.)**
- **Consider how much costs are allocated to product which would be needed to be recovered by other products --> don't only keep an eye on the profit**

Opportunity costs

- *Opportunity cost is the foregone value associated with the current rather than next-best alternative use of a given asset*
- Opportunity costs are not "costs" but foregone sales