

DECISION MAKING TOOLS

SHORT TERM DECISION MAKING

- **Relevant cost analysis**
- **Garrison Chapter 14 (read)**
 - Not capital budgeting / long term decision making (in FM)
 - Will do risk management here only
 - Short term decision making
- **Cost Volume Profit (CVP) analysis**
 - Break even, target profit, margin of safety, decision making

RELEVANT COST ANALYSIS

- **Garrison Chapter 14 Read chapter**
- **Short term decision making**
 - **What is the difference?**
 - **Committed cost / production based / slacks / constraints / make or buy**
 - **Short term decisions**
 - **Make or buy**
 - **Close division**
 - **Short term contract**
 - **Capacity analysis**
 - **Theory of constraints / limiting factor analysis / throughput accounting**

COST VOLUME PROFIT (CVP) ANALYSIS

- **Garrison Chapter 3 on cost behavior**
- **Garrison Chapter 4 on CVP analysis**
- **CVP classified cost as fixed or variable**
- **Fixed costs cannot be avoided in the short run hence should be considered as IRRELEVANT COSTS**
- **Fixed capacity / fixed labor availability**

COST VOLUME PROFIT (CVP) ANALYSIS

- **Information**
 - Break-even analysis in sales and in units using contribution margins
 - Expected profit
 - Target profit in sales and in units
 - Margin of safety as risk measurement
 - Cost structure and operating leverage
 - Multi-product CVP

COST VOLUME PROFIT (CVP) ANALYSIS

- **Decisions:**
 - **Fixed salary versus commission based compensation**
 - **Fixed cost advertising / variable cost promotions versus sales increase**
 - **High quality input and variable cost versus increase in sales due to better quality**
 - **Purchase of fixed cost machine to replace variable cost human input versus change in revenue and costs**
 - **Comparison to break-even and expected profit with different version of potential equipment purchases**
 - **Direct sale to wholesaler under wholesaler brand name (outsourcing)**