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Decision Making for Improved Profitability

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ABSTRACT

Decision-making is a fundamental process that drives business operations and directly impacts profitability. This abstract explores the importance of effective decision-making in achieving improved profitability and sustainable growth. It highlights the key factors and considerations that influence decision-making, such as market analysis, cost management, pricing strategies, investment decisions, and risk assessment. Additionally, it emphasizes the significance of data-driven decision-making, collaboration, and continuous evaluation in enhancing profitability and maximizing long-term success. In today's competitive business landscape, making informed decisions is essential for organizations to achieve and maintain profitability. Market analysis is a critical factor in decision-making, as it provides insights into customer needs, competitor strategies, and industry trends. Understanding market dynamics helps identify opportunities for product/service differentiation, target new market segments, and develop effective marketing strategies to maximize revenue and profitability.

KEYWORDS

Benchmarking, Break-Even Analysis, Cost Control, Financial Forecasting, Marginal Analysis, Pricing Strategies.

I. INTRODUCTION

Business Profitability Analysis

The discussion in this article will center on the variables that affect a product's profitability and aid us in making better judgments about these items. The following aspects of a product's profitability will be measured and evaluated:

1. product cost
2. Count of units sold
3. both fixed and variable costs
4. Profitability
5. Breakeven analysis is the term for the financial instrument used to attain these objectives.

We start out by taking a look at Raritan Manufacturing Company's operational budget. After applying the breakeven analysis ideas to study the firm, real performance is assessed as it happens. Analysis of variance is a common name for this. Variance analysis enables management to compare actual outcomes to what was anticipated when the budget was created. This promotes learning while also holding employees account for their performance. It makes it possible for management to identify who is and is not succeeding in achieving the intended objectives. Forecasts and budget assumptions may also be assessed in the past [1]–[3].

Accounts Chart

Almost all businesses use an accounting system with a numerical foundation that gives each department a set of code numbers. This is essential to comply with widely accepted accounting standards and is highly beneficial for analytical reasons. This approach makes sure that all comparable expenditures are documented uniformly. The business can be certain that all direct labor has been recorded in one account, all travel expenditures in another, and so on for trade exhibitions, advertising, and every other expense when accounting transactions are tallied up at the end of the month or the year. The amount actually spent in each category, which is unquestionably vital information, cannot be ascertained by any other technique. Consistency is another criterion of GAAP. That is also shown in the chart of accounts. It should be noted that the five categories used by Raritan Manufacturing Company in its budget are summaries of maybe 200 or 300 cost and expenditure codes. These are only samples. Your business will likely use various categories and maybe even somewhat different language. The accountants will evaluate each and every individual expense category once the chart of accounts has been produced to try to determine if the cost is constant or variable. They often draw oversimplified judgments.

Fixed Costs

Fixed costs are expenses that won't change no matter how many goods are produced. They occur often and again. If volume grows or decreases over the course of a certain length of time, the amount spent will remain the same. This category of expenditures also includes pay for management, rent, maintenance of equipment, and employee costs. Keep in mind that just because a cost is listed as fixed, it doesn't always follow that it cannot fluctuate. Rent, salary, employee perks, and even advertising are all subject to change. These expenses are set since they are not influenced by volume, despite the possibility that they are. It seems to reason that advertising and trade exhibits bring in money. If this is the case, an anticipated drop in sales may warrant an increase in these marketing expenditures. Other costs that could go up while company is slow include phone and travel. Customers could get additional calls and visits.

Creating Fixed Cost Estimates

Raritan Manufacturing Company is anticipated to spend a total of $135,000 on expenditures that have been classified as fixed throughout the budget year.

Variable expenses

These prices depend on volume. As the amount of production and distribution varies, they will either rise or fall. Direct labor, materials, and certain administrative and distribution expenditures are among the expenses in this category.

Creating Estimates of Variable Costs

With the aid of manufacturing and engineering assessments of the production facility and administrative departments, estimates of variable costs are created. The estimated variable costs, broken down by category and overall, are then calculated by multiplying each of the per-unit expenses by the anticipated number of units. Here is how this is explained.

Engineering requirements, some research of manufacturing efficiency, and product mix are used to create material estimations. Based on prior experience, levels of waste and quality rejections are subject to hoped-for and designed improvements [4]–[6].

Various Expenses

Factory overhead, administration, and distribution costs are the only expenditures not directly related to labor and materials that include both fixed and variable costs. The primary argument put out by the accounting division and others is that although a portion of these costs are constant, the balance will change according to the volume the firm experiences.

This result is seriously contested, especially when a certain budget year is involved and the managers in charge claim that their expenses are virtually set. The number of employees in the accounting department would not fluctuate from week to week based on how many invoices needed to be sent out. Regardless of whether they are fully or partly loaded, trucks must finish their delivery routes. Managers should look at the criteria that their organization uses and assess if the behavior that the cost system assumes is consistent with how they believe their expenses really behave.

At the bottom is a summary of the budget. At the bottom of the display, you'll see the per-unit cost, variable expenses, and profit. Contribution margin is the name for the unit profit.

Breakeven Analysis

Businesses should be aware of the volume need to break even. This data ought to be accessible by product, or at the very least by class of product. The breakeven threshold could be important strategically now or in the future, or it might just be of academic interest. For really new and, at the opposite end of the lifecycle range, extremely mature goods, it is especially important. Some theoretical knowledge will be useful before we begin with mathematical formulae.

In theory, Raritan would lose money if it didn't sell any products. The fixed cost commitment is $135,000. It makes $50 in cash for each unit that is sold. However, the $35 cost of manufacturing the item is required before it may be sold. The contribution margin is the difference between the selling price and the variable cost per unit. As a result, the number of "contributions" required to pay the fixed cost is equal to the number of units required to break even.

Comparing Incremental and Absorption

Even now, the outcomes of the debate between incremental decision-making and absorption accounting are still unresolved. When it comes to the debate between having too much and not enough inventory, some businesses have realized that they may preserve their brand while still selling extra inventory "off-market." Overstock.com, for instance, offers a sizable online selection of practically any kind of goods, some of which are branded. Branded goods are offered at great discounts by the retail companies Marshalls and T.J. Max. The products could be outdated or out of fashion, but the steep reductions provide buyers a great chance to save money and brand-name manufacturers a chance to get rid of surplus stock. It may also be claimed that the inventory was developed particularly for these bargain marketplaces and wasn't really excessive.

A high-end, luxury retail chain is Nordstrom. They operate a cheap chain that they have dubbed Nordstrom Rack. It's possible that some of these items are overstock from Nordstrom's own shops. Some could have been created especially for this platform. A network of stores selling upscale business attire is called Brooks Brothers. They offer outlet shops as well. The issue with branded outlet shops is that a lot of the merchandise is created especially for them, meaning that both the quality and the price may be "discounted," which is not always beneficial for the brand. Here is an illustration of how improper overhead allocations may force businesses to make bad choices.

Developed and produced by this firm is a series of highly engineered electrical goods. It also compensated for advisory help that it gave to its clients. It didn't recognize that advisory assistance assisted in product sales or that overhead applied to the whole company rather than to the two separate parts. Due to its refusal to run a firm at a "breakeven," it abolished the consultancy division, which resulted in a decline in cash flow. Sales of its products dropped. Because it had to offer products at retail prices as opposed to providing value-added service, its profits decreased. It had to start including value-adding counsel in sales for free in order to stop the fall in sales. All due to the non-divisible overhead it allocated.

Analysis #4: Opportunity for Outsourcing

Raritan is thinking about employing an outside company to handle its product storage since it is finding the service to be quite pricey. Warehouse Inc., the warehousing business under consideration, is a pro at doing that duty; it has a great reputation and is trusted to manage Raritan's product range. Raritan will also get the systems support and other services they need via outsourcing this task. The following details are given while keeping the s as basic as possible:

Cost of current warehousing. A $20,000 fixed expenditure for storage is included in Raritan's budget as part of the distribution budget. Raritan is doing well and can handle up to 12,000 units in contrast to its budget of 10,000 units suggestion from Warehouse Inc. Raritan will save the $20,000 fixed cost if it assigns this task to Warehouse. The proposed charge from Warehouse is $2 per unit, however.

Overarching Observations

Lessen Losses. The amount of the company's loss will be lower at low volumes the more variable expenses there are. If the warehouse cost is set at 7,000 units, there will be a loss of $30,000 as opposed to a loss of $24,000 if the cost is variable. When volumes are low, as they are during a recession, or when the business is still young and the breakeven level hasn't been reached, outsourcing is a certain option.

These are the business strategies that were used from 2007 to 2009. Sadly, throughout these years, millions of people lost their employment, and hundreds of factories and offices were shut down. Many of the tasks carried out by the fired employees are now handled by outsourcing companies. Numerous jobless people set up enterprises that provide the same services or get employment with these suppliers. These firms now serve the previous employers as clients. With fewer facilities to maintain, they were able to reduce fixed expenditures in favor of variable costs, generate a respect cash flow, and likely get better service since they are now consumers rather than employers. In this way, hundreds of thousands of people who were formerly jobless are finding new employment [7]–[10].

II. DISCUSSION

As we all know, technology is increasing both the difficulty and the opportunities in the corporate sector. As a result of favorable economic circumstances, outsourcing has significantly increased. Technology has increased the advantages of outsourcing by allowing and maybe even compelling businesses to look for the finest solutions available to address their product and business-related problems. Businesses are outsourcing the creation of databases and the storing of data to cloud-based solutions rather than doing it themselves. The idea of offering "solutions" to problems has liberated businesses from having to cope with locating several sources for their resources. Historically, companies who believed they could handle things better in-house avoided outsourcing. As businesses look for the finest solutions and resources available, regardless of where they originate from, vertical integration as a strategy is vanishing.

The outsourcing movement has been significantly influenced by the Internet. Due of their familiarity with prospective clients, local vendors used to provide the majority of outsourcing. The art of the "supply chain" has been created thanks to the global Internet, and we can now locate a huge number of suppliers of any kind of resource nearly anywhere in the globe. Breakeven. Less volume will be required to reach breakeven the higher the fraction of expenses that are variable. Raritan will need to sell 9,000 units in order to break even if the warehousing cost is unchanged. Outsourcing the warehouse function lowers the breakeven volume to 8,846 units. This is particularly more important if the planned project must reach financial sustainability within a certain time frame or be closed, or if the business has debt or cash flow requirements that call for a positive cash flow by a certain date.

the benefits of scale. When Raritan's volume exceeds 10,000 units, the advantages of size will start to be felt. At such time, opportunities to internalize tasks that have been outsourced may be investigated. To take advantage of the company's increased purchasing power, all outsourcing contracts should be renegotiated before any expenditures are made. Being the low-cost manufacturer is a constant goal for businesses. This may be accomplished by continuing to outsource while cleverly using increased buying power. The cost per unit of outsourcing will almost always be lower than the cost per unit if the same job is handled domestically, which is known as the breakeven point. This is due to the extra work and assistance that may be required if the tasks are carried out internally. When the amount of sales is breakeven, there are no economies of scale.

Financial Planning for Startup Companies

The financial approach that is sui for new company start-ups is directly related to the profitability effect of what we refer to as the fixed cost/variable cost mix. Watch how profits and losses alter when volume moves from the breakeven point to far above it. Consider the following truisms in relation to profitability behavior:

1. The new business's chances of success increase with the amount of money invested in its core competencies. This strongly advocates outsourcing as much of the tasks that fall outside of the company's core strengths as you can. By reducing expenses, outsourcing enables a business to only spend what is necessary. In these early phases, the more the firm tries to do on its own, the higher its fixed expenses will be and the bigger the unavoidably negative cash flows that will follow.

2. The startup may start delivering its product more quickly in the early phases of development the more services that are outsourced. An early-stage business that tries to meet its own requirements first must acquire equipment, employ and educate personnel, install the machinery, solve any issues, and only then can it start producing and delivering its goods. The business must establish partnerships with repu suppliers at fair costs in order to outsource many of its requirements. Once this is done, outsourcing in areas that may not be among the business' core capabilities proceeds considerably more quickly and has less risks. The outside merchants' firms are already effective and well-run. This enables the start-up to concentrate critically on the consumer.

3. Early-stage function outsourcing will result in extremely variable costs. At these early phases, having more variable expenses than fixed costs help to minimize cash losses at a crucial moment. This makes it possible to allocate more money to the company's core strengths and market prospects.

4. Early-stage outsourcing often yields a higher-quality end product. Outside suppliers have a proven track record of expertise and experience. The company's core capabilities and, hopefully, its marketing and sales of its knowledge are its sole areas of competence. Other duties should be left to outside professionals.

5. Early-stage expenses being a moving target speeds up reaching breakeven. Keep in mind that a greater degree of variable expenses translates in a lower breakeven point in the earnings for Raritan Manufacturing.

6. What happens beyond the first four or five years, when having a lot of variable expenses seems to be counterproductive? In our scenario, fixed expenses allow the business to see economies of scale after 10,000 units. Once breakeven volume has been permanently attained, this problem should be taken into account throughout the planning phase. Prior to that, concentrating funds and management attention on a start-up company's core strengths is the greatest financial approach. The best suppliers for all other tasks should be chosen since they can provide high-quality goods and services at competitive pricing. Let's take a look at how to create a management consulting company, from a fully established worldwide management consulting and training business to a business strategy.

The wrong method. Renting a huge office would be excellent; 15,000 square feet in a very attractive building would be nice. Hire a renowned designer to decorate it, and make sure the furniture is stunning and the walls are covered with elegant artwork. Ensure that there are several desks filled with computers connected to servers in the back room that are running the most recent versions of operating systems and applications. Hire 10 to 15 really exceptional individuals, and don't forget to provide them lots of support workers. Then, get high-priced experts to create some literature and create a cool website. When you are satisfied with everything, you start the process of finding customers. Analysis. In relation to past discussions of fixed costs and variable costs, you have now started a new firm with no customers and a monthly cash outflow of maybe $50,000 or more. If you don't have a significant quantity of money, you will spend it all before you have a chance to establish the firm.

The Correct Way. Consider your main competencies. What skill do you possess that businesses would pay you to share with them? S.W.O.T analyze your own situation. Find a customer who will employ you via networking. If other professionals can assist you complete the job, hire one or two of them. operate from home. Visit your customers in their places of business. Due to the fact that all of the project's important actors will be accessible for input and debate, it is a more effective approach to complete the task. Repeat the above with other clients. Only when you need a place, rent an office in a shared building with services.

Analysis

Before you have a consumer, who pays you money, your company is not legitimate. Therefore, get the client before making any serious financial commitments. You are working extremely hard to expand income more quickly than costs while minimizing cash outflows. Hire full-time workers with extreme caution. I ran a 15-person consulting firm without ever making a rent payment. For each job, I hired the finest professionals, paid them properly, and always had happy customers.

III. CONCLUSION

In conclusion, making better decisions is essential for increasing an organization's profitability. Organizations may make well-informed decisions that improve their financial performance and sustainability by taking into account aspects including market analysis, cost management, pricing strategies, investment choices, and risk assessment. Collaboration, data-driven decision-making, and ongoing review are crucial for increasing long-term performance and improving profitability. To succeed in changing business contexts, organizations need to cultivate a decision-making culture that values analytical rigor, strategic thinking, and agility. For decision-making to be successful, collaboration and cross-functional alignment are essential. A comprehensive approach to decision-making is fostered and ensured by including important stakeholders, such as management, workers, and external advisers. The quality of choices is increased by collaborative decision-making, which also encourages stakeholder support and fosters a culture of responsibility and ongoing development.

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