

Q. 7 & 11 - Page 37 & 40 :

Query : In Q.7, you have not considered the Opportunity Cost but in Q.11, you have considered the Opportunity Cost. Why so? Please explain.

Solution :

(1) In Q.7, the order is for fixed quantity i.e. 28,000 units. There is no loss of sales due to defective production. But we have to produce these units as extra units.

In this case, we have considered the variable cost of producing the defectives, by increasing the production quantity. In this question, we do not have any restriction on capacity. It means, there is no key factor.

(2) In Q. 11, if you read the first paragraph carefully, you will notice that we are running at full capacity and the market has a potential to absorb 20% more output. It means, if we produce more, we can sell it in the market. It means, we are losing an opportunity to sale in the market due to defective production. The defective production is consuming our production capacity, which is already limited.

Hence, opportunity cost (i.e. loss of contribution) is also considered.

Note : Opportunity cost is considered, only when the resources are in short supply i.e. the existence of key factor concept.