

Exercise 11-17 Dropping Or Retaining A Segment [L011-2] Bed & Bath, A Retailing Company, Has Two

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Understanding how a retail company evaluates its business segments is vital for strategic decision-making and financial reporting. In Exercise 11-17, we explore the scenario involving Bed & Bath, a retailing company that operates two distinct segments. This case provides valuable insights into the decision whether to retain or drop a segment based on profitability, strategic fit, and contribution to overall company value. This article aims to offer a comprehensive analysis of the situation, incorporating key concepts from managerial accounting and strategic management to aid in decision-making.

Overview of Bed & Bath's Business Segments

Bed & Bath is a retail company specializing in home goods, including bedding, bath accessories, furniture, and decor. The company operates through two main segments:

- **Segment A:** Premium Bedding and Decor
- **Segment B:** Budget-Friendly Home Essentials

Each segment caters to a different customer base, with distinct product lines, pricing strategies, and marketing approaches. Understanding the operational and financial differences between these segments is crucial for evaluating their continued viability.

Key Factors in Segment Evaluation

When considering whether to drop or retain a segment, management must analyze several factors:

1. Segment Profitability

- Contribution Margin: The segment's revenue minus variable costs.
- Segment Margin: Contribution margin minus traceable fixed costs.

- Impact on Overall Profitability: How the segment's profitability affects the company's net income.

2. Strategic Fit

- Does the segment align with the company's long-term strategic goals?
- Does it help in market positioning or brand expansion?

3. Revenue and Market Share

- Does the segment contribute significantly to sales volume?
- Is it vital for maintaining market share in a specific segment?

4. Fixed Costs Allocation

- How are fixed costs allocated to each segment?
- Are there avoidable fixed costs if the segment is dropped?

5. Customer Relationships and Brand Image

- Does the segment help attract or retain key customers?
- What is the impact on brand perception?

Analyzing the Financial Data of Bed & Bath

Suppose Bed & Bath provides the following simplified financial data for the current year:

Segment	Revenue	Variable Expenses	Fixed Expenses (Traceable)	Segment Margin
A	\$5,000,000	\$3,000,000	\$1,000,000	\$1,000,000
B	\$3,000,000	\$2,000,000	\$500,000	\$500,000

The company’s total fixed expenses allocated to segments are as follows:

- Segment A: \$1,200,000
- Segment B: \$600,000

Additionally, there are common fixed expenses not traceable to either segment, totaling \$400,000.

Note: The contribution margin for each segment is calculated as revenue minus variable expenses.

Calculating Segment Margins

- Segment A:
 - Contribution Margin = $\$5,000,000 - \$3,000,000 = \$2,000,000$
 - Segment Margin (before fixed costs) = $\$2,000,000 - \$1,000,000 = \$1,000,000$
- Segment B:
 - Contribution Margin = $\$3,000,000 - \$2,000,000 = \$1,000,000$
 - Segment Margin (before fixed costs) = $\$1,000,000 - \$500,000 = \$500,000$

Allocated Fixed Costs

The fixed expenses traceable to each segment are:

- Segment A: \$1,000,000
- Segment B: \$500,000

Remaining fixed costs are common and allocated proportionally or as a lump sum.

Net Operating Income

- Segment A: $\$1,000,000$ (segment margin) - $\$1,200,000$ (fixed costs) = -
\$200,000
- Segment B: $\$500,000 - \$600,000 = -\$100,000$

Total net operating income would be negative if fixed costs are fully allocated, but this doesn't necessarily mean the segments should be dropped, as some fixed costs may be unavoidable or non-avoidable.

Decision-Making: To Drop or Retain a Segment

The decision to drop or retain a segment hinges on a detailed analysis beyond just the bottom-line figures.

Considerations for Dropping a Segment

- The segment is unprofitable after traceable fixed costs.
- Fixed costs allocated to the segment are avoidable if the segment is dropped.
- The segment does not generate strategic benefits or future growth opportunities.
- The segment's removal would improve overall company profitability.

Considerations for Retaining a Segment

- The segment contributes positively to overall profit when considering

avoidable fixed costs.

- It supports strategic objectives or market positioning.
- Removing it might result in lost sales, customer relationships, or brand value.
- Fixed costs are mostly unavoidable or allocated to support shared resources.

Analyzing Bed & Bath's Scenario

In the case of Bed & Bath, the financial data suggests both segments are operating at a loss when fixed costs are fully allocated. However, a nuanced analysis would consider:

- **Avoidable Fixed Costs:** Are some fixed costs avoidable if the segment is dropped? For instance, marketing expenses specific to the segment, or administrative costs directly tied to segment operations.
- **Strategic Importance:** Does Segment A or B serve a strategic purpose, such as entering new markets or testing new products?
- **Customer Impact:** Would dropping a segment harm customer loyalty or brand reputation?

Suppose further analysis reveals that a portion of the fixed costs are unavoidable or shared costs that would remain regardless of the segment's fate. For example, corporate-level administrative expenses or rent that supports both segments equally.

In such cases, the relevant fixed costs for decision-making are only those avoidable costs directly attributable to the segment.

Recalculating Based on Relevant Costs

Assuming that:

- \$700,000 of fixed costs are unavoidable.
- The avoidable fixed costs for Segment A are \$500,000.
- The avoidable fixed costs for Segment B are \$300,000.

The revised net income impact:

- Segment A: \$1,000,000 (segment margin) - \$500,000 (avoidable fixed costs) = \$500,000 profit
- Segment B: \$500,000 - \$300,000 = \$200,000 profit

Based on this, both segments are profitable when considering only avoidable costs, implying both should be retained.

Strategic Decision

Even if one segment shows a modest profit or loss, management must weigh

qualitative factors such as market presence, customer loyalty, and long-term growth prospects.

Conclusion: Making the Final Decision

Deciding whether to drop or retain a segment involves a comprehensive analysis of financial data, strategic considerations, and operational implications. For Bed & Bath, a detailed assessment of avoidable versus unavoidable costs, along with strategic alignment, will guide the decision.

Key steps include:

1. Identify relevant costs: Focus on avoidable fixed costs.
2. Assess strategic importance: Consider long-term benefits.
3. Evaluate customer impact: Understand brand and customer loyalty implications.
4. Perform sensitivity analysis: Test how different scenarios affect profitability.

Final Notes

- Dropping a segment should only be considered if it leads to an increase in overall profitability.
- Retaining a segment may be justified if it supports strategic objectives or has potential for future growth.
- Transparent communication with stakeholders and careful financial analysis are essential.

In summary, Exercise 11-17 illustrates the importance of detailed segment analysis in managerial decision-making. For Bed & Bath, careful evaluation of costs, profitability, and strategic fit will determine whether to drop or retain each segment, ultimately aiming to maximize overall company value.

Keywords for SEO optimization:

- Segment analysis
- Dropping or retaining a segment
- Bed & Bath financial decisions
- Managerial accounting
- Segment profitability
- Fixed costs allocation
- Strategic business decisions
- Retail segment evaluation
- Profitability analysis
- Cost management in retail

Frequently Asked Questions

What is the primary focus of Exercise 11-17 in the context of dropping or retaining a segment?

Exercise 11-17 focuses on evaluating whether to drop or retain a segment within a company's operations, specifically analyzing its profitability and strategic importance.

How does Bed & Bath determine whether to drop or retain a segment in Exercise 11-17?

The company assesses segment profitability by comparing segment revenues and costs, considering the impact on overall company profit, and evaluating strategic factors before making a decision.

What role does contribution margin play in the decision-making process in Exercise 11-17?

Contribution margin helps determine if a segment covers its variable costs and contributes to fixed costs, guiding whether to retain or drop the segment based on profitability.

Are fixed costs considered when deciding to drop or retain a segment according to Exercise 11-17?

Yes, fixed costs are considered, especially whether they are avoidable or unavoidable, influencing the decision to drop or retain the segment.

What strategic factors might influence Bed & Bath's decision beyond just financial data in Exercise 11-17?

Factors such as market presence, customer loyalty, potential for future growth, and alignment with overall company strategy can influence the decision to drop or retain a segment.

How does Exercise 11-17 illustrate the concept of segment profitability analysis?

It demonstrates how analyzing revenues, variable costs, fixed costs, and contribution margins helps determine whether a segment adds value to the company.

What are the potential risks of dropping a segment as per Exercise 11-17?

Risks include losing market share, damaging brand reputation, and missing future growth opportunities associated with the dropped segment.

Can retaining a less profitable segment still be justified in Exercise 11-17?

Yes, if the segment provides strategic benefits, such as customer relationships or cross-selling opportunities, it may be justified to retain it despite lower profitability.

How might changes in the market environment affect the decision in Exercise 11-17?

Market changes, such as increased competition or shifting customer preferences, can impact segment profitability and influence whether to drop or retain a segment.

What is the overall learning objective of Exercise 11-17 regarding segment analysis?

The exercise aims to teach how to evaluate segment performance using financial data and strategic considerations to make informed decisions about dropping or retaining segments.

Additional Resources

Exercise 11-17: Dropping or Retaining a Segment—A Comprehensive Review of Bed & Bath, Inc.

In the realm of retail management and strategic decision-making, determining whether to retain or drop a product segment is a pivotal concern that can significantly influence a company's profitability and long-term sustainability. Exercise 11-17 presents a scenario involving Bed & Bath, Inc., a retailing company with two distinct segments, prompting managers and analysts to evaluate the financial and strategic implications of either dropping or retaining a segment. This detailed review aims to dissect the exercise thoroughly, exploring the concepts involved, the analytical methods employed, and best practices for decision-making in similar contexts.

Understanding the Context of Bed & Bath, Inc.

Before delving into the specifics of the decision-making process, it is essential to understand the company's background, its segments, and the nature of the exercise.

Company Profile and Segments

- Bed & Bath, Inc. operates primarily in the retail sector, specializing in home furnishings, bedding, and bath products.
- The company is divided into two key segments:
 1. Segment A: Focuses on high-end luxury bedding products.
 2. Segment B: Offers more affordable, mass-market bath accessories.
- Each segment contributes differently to the company's overall revenue, costs, and profitability. It is common in such scenarios to analyze whether each segment should be maintained or eliminated based on their individual and combined financial impacts.

Purpose of the Exercise

- The core goal is to evaluate whether dropping or retaining one of these segments will enhance the company's overall profitability.
- The exercise involves analyzing segment-specific financial data, considering fixed and variable costs, and understanding the strategic implications of each option.

Key Concepts in Segment Dropping Decisions

Deciding whether to drop or retain a segment involves a nuanced understanding of several financial and strategic considerations.

Contribution Margin and Segment Profitability

- Contribution Margin: The amount remaining from sales revenue after variable expenses are deducted. It indicates how much a segment contributes toward covering fixed costs and generating profit.
- Segment Profitability: Calculated as contribution margin minus allocated fixed costs. A segment with a negative or low contribution margin may be a candidate for dropping, but careful analysis is needed.

Fixed Costs Allocation

- Fixed costs can be:
- Traceable Fixed Costs: Directly attributable to a specific segment.
- Common Fixed Costs: Shared across segments, often allocated based on certain criteria.
- The decision to drop a segment depends heavily on the nature of fixed costs:
- If fixed costs are traceable and eliminated with the segment, dropping may be beneficial.
- If fixed costs are common and will remain regardless of the segment's status, the impact may differ.

Relevant vs. Irrelevant Costs

- Relevant costs are those that will change as a result of the decision.
- Irrelevant costs do not change and should not influence the decision.
- Proper identification of relevant costs ensures accurate analysis.

Impact on Company-Wide Profitability

- The primary goal is to maximize overall profit.
- The decision should consider not only the segment's standalone profitability but also its impact on the company's total profit.

Analytical Approach to the Dropping or Retaining Decision

To systematically evaluate whether to drop or retain a segment, managers employ a structured analytical approach.

Step 1: Gather Financial Data

- Sales revenue for each segment.
- Variable expenses associated with each segment.
- Fixed expenses, distinguished between traceable and common fixed costs.

Step 2: Calculate Segment Contribution Margin

- Deduct variable costs from sales for each segment.
- This provides a clear picture of each segment's ability to contribute toward fixed costs and profit.

Step 3: Analyze Fixed Costs

- Identify fixed costs that are directly attributable to each segment.
- Determine which fixed costs are common and would remain if the segment is dropped.

Step 4: Evaluate Segment Profitability

- Subtract traceable fixed costs from the contribution margin to find segment profit.
- Note whether the segment is profitable in isolation.

Step 5: Consider the Effect of Dropping the Segment

- Remove the segment's contribution margin.
- Remove the traceable fixed costs associated with that segment.
- Assess how this affects total company profit.
- Consider the impact on remaining segments, including potential cannibalization or sales shifts.

Step 6: Assess Strategic and Qualitative Factors

- Customer perception and brand image.
- Market position and competitive advantage.
- Long-term growth prospects.
- Employee implications and operational considerations.

Case Analysis of Bed & Bath, Inc.

Applying the above framework to Bed & Bath, Inc., the company's management would perform detailed calculations and qualitative assessments to guide their decision.

Financial Data Summary (Hypothetical)

Segment	Sales	Variable Expenses	Contribution Margin	Traceable Fixed Costs	Segment Profit
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A	\$500,000	\$300,000	\$200,000	\$150,000	\$50,000
B	\$300,000	\$180,000	\$120,000	\$80,000	\$40,000

- Note: These figures are illustrative; actual data should be used for

precise analysis.

Analysis of Segment A (Luxury Bedding)

- Contribution margin: \$200,000
- Traceable fixed costs: \$150,000
- Segment profit: \$50,000
- Observation: Segment A is profitable but with a relatively low margin compared to sales.

Analysis of Segment B (Mass-Market Bath Accessories)

- Contribution margin: \$120,000
- Traceable fixed costs: \$80,000
- Segment profit: \$40,000
- Observation: Also profitable, but with a narrower margin.

Implications of Dropping a Segment

- If Segment B is dropped:
 - Loss of sales revenue of \$300,000.
 - Savings in traceable fixed costs of \$80,000.
 - Overall impact: Loss of contribution margin (\$120,000) minus fixed costs saved (\$80,000) = net decrease of \$40,000 in profit.
- If Segment A is dropped:
 - Loss of \$500,000 in sales.
 - Savings in fixed costs (\$150,000).
 - Impact: Loss of contribution margin (\$200,000) minus fixed costs saved (\$150,000) = net decrease of \$50,000 in profit.

Based on these calculations, neither segment should be dropped purely from a financial standpoint because doing so would reduce overall profitability.

Strategic Considerations Beyond Numbers

While quantitative analysis provides a clear foundation, strategic factors often influence the final decision.

Customer Loyalty and Market Position

- Removing a segment may alienate certain customer groups.
- Maintaining diverse offerings can enhance brand perception.

Synergy Effects

- Segments might benefit from shared resources, marketing, or cross-selling opportunities.
- Dropping a segment could weaken the overall market presence.

Long-Term Growth Potential

- Some segments may be less profitable now but could grow in the future.
- Strategic investments might justify retaining a less profitable segment temporarily.

Operational and Logistical Factors

- Discontinuing a segment could streamline operations.
- Conversely, it could create logistical challenges or sunk costs.

Conclusion and Best Practices

The decision to drop or retain a segment is complex and multidimensional. The case of Bed & Bath, Inc. highlights the importance of a thorough financial analysis paired with strategic foresight.

Key takeaways include:

- Always distinguish between traceable and common fixed costs.
- Focus on relevant costs and revenues directly affected by the decision.
- Quantitative analysis should be complemented by qualitative assessments.
- Consider the long-term strategic implications, not just immediate financial outcomes.
- Use scenario planning to understand potential future impacts.

In summary:

- Exercise 11-17 demonstrates the importance of detailed segment analysis.
- Maintaining profitable segments generally aligns with the company's long-term health.
- Dropping a segment solely because of its current profitability can be shortsighted if strategic factors favor retention.
- Conversely, retaining a segment that drains resources without strategic benefit can hinder overall profitability.

By applying these principles carefully, managers can make informed decisions that balance financial performance with strategic growth, ensuring the company's competitiveness and profitability in the evolving retail landscape.

Final thoughts:

The exercise serves as a vital learning tool for understanding the intricacies of segment management and decision-making. It emphasizes the need for a balanced approach—blending rigorous financial analysis with strategic vision—to determine the best course of action for the company's future sustainability and success.

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