**Instructor Notes–Chapter 06. Preformance, Segments, etc.**

1. As companies have added more product lines, more services, and more locations, “management from the top” has become more difficult.
2. One answer has been decentralized management. Typically an executive is given responsibility for a “segment” (a single store, a geographical area, a product line, etc.).
3. Many decisions are made by executives working at the segment level, because they understand the business operations, the customers, etc. Executives are evaluated (and rewarded for success) based on profitability and other measures of success for their segments (such as market share, customer satisfaction).
4. **Example**. You are CEO of **BEST SHOES.** Best Shoes owns 1,000 retail shoe stores.

You reward individual store managers based on profitability of their individual stores. The income statement for each store shows revenue from sales of shoes and “local” expenses of the store, such as cost of shoes sold, salaries, utilities, local advertising expense, store rent, etc. If the store building is owned by Best Shoes, the individual store will record depreciation expense.

1. You have: (1) a **central purchasing department** with buyers representing 1,000 stores, rather than (2) an executive in each store responsible for purchasing. The annual cost of operating the “purchasing department” is $50,000,000, including salaries of the buyers, utilities, and office rent.
2. When computing a store’s profit (and store manager’s bonus), **will you** include an allocation of some of the costs of operating the central purchasing department?
If you allocate the cost evenly, you will allocate $50,000 to each store – the income statement for each store will show the “local” expenses described above, and also $50,000 management expense allocated by the home office.
Assume the store (that you manage) has annual results as follows:
Annual sales $900,000
Cost of sales 400,000
Gross Profit 500,000
Salaries and other store expenses 300,000
Net income (considering local expenses) 200,000

Allocated purchasing department costs 50,000
Net Income $150,000

1. A store manager may agree with having a bonus based on profitability, considering local revenue and local expenses, because the store manager has **day-to-day control** of those items.
The manager may be uncomfortable seeing an allocation of home office expenses.
See analysis in preceding paragraph:
 Should the manager’s bonus be based on net income of $200,000 or net income of $150,000.

1. Note the difference between traceable fixed costs and common costs on page 241.