



**Chapter Four: Short-term Decision Making**  
**Keep or Drop Decisions**

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## Keep or Drop Decisions

Often, a manager needs to determine whether or not a product line should be kept or dropped. Segmented reports prepared on a variable costing basis provide valuable information for these keep-or-drop decisions. Both the segment's contribution margin and its segment margin are useful in evaluating the performance of segments. However, while segmented reports provide useful information for deep-or-drop decisions, relevant cost describes how the information should be used to arrive at a decision.

# Chapter Four: Short-term Decision Making

**Example:** Almarai Company for the production of dairy has three product lines (A) Yogurt, (B) Milk and (C) Cheese. The following is income statement for each product line and the company for the last year.

Total	Product line (C) Cheese	Product line (B) Milk	Product line (A) Yogurt	Details
625000	150000	175000	300000	Sales Revenue
306000	82500	73500	150000	- Variable Cost
319000	67500	101500	150000	= Contribution Margin (CM)
227500	72500	70000	85000	- Fixed Cost
91500	(5000)	31500	65000	= Net Profit

Manager of the company believes that dropping the product line (C) will lead to increase net profit of the company by \$5000, so net profit the company will be \$96500.

# Chapter Four: Short term Decision Making

**Required:** As a management accountant, do you advise the company to drop the product line (C) under the following assumptions?

1- dropping the product line(C) will lead to reduce fixed cost by \$**51500**.

2- dropping the product line (C) will lead to reduce fixed cost by \$**51500** and the company can rent the capacity of the product line (C) at \$25000 annually.

# Chapter Four: Short term Decision Making

## Required 1 :

Differential Analysis	Drop	Keep	Details
150000	475000	625000	Sales Revenue
82500	223500	306000	- Variable Cost
67500	251500	319000	= Contribution Margin (CM)
51500	176000	227500	- Fixed Cost
16000	75500	91500	= Net Profit

**Decision:** The differential analysis shows that the right decision is to keep the product line (C) because dropping the product line (C) will lead to decrease net profit of the company by \$16000. Furthermore, the contribution margin of the product line (C) (\$67500) contributes in covering the avoidable fixed cost and the remain of contribution margin, which is \$16000, contributes in increasing net profit of company.

# Chapter Four: Short term Decision Making

## Required 2 :

Differential Analysis	Drop	Keep	Details
150000	475000	625000	Sales Revenue
82500	223500	306000	- Variable Cost
67500	251500	319000	= Contribution Margin (CM)
51500	176000	227500	- Fixed Cost
25000	0	25000	= opportunity cost
(9000)	75500	66500	= Net Profit

### Decision:

The differential analysis shows that keeping the product line (C) will lead to lose by \$9000, so the right decision is to drop the product line (C)