

Activity-based Costing (ABC) and Activity-based Management (ABM) Implementation – Is This the Solution for Organizations to Gain Profitability?

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A*bstract.* Adherents of ABC/ABM systems claimed traditional management accounting systems generated misleading costs in a contemporary, tumultuous, often changing business environment and implementing ABC/ABM would remedy this. That is why activity-based costing (ABC) and activity-based management (ABM) represents the symbol of improved competitiveness and efficiency in every organization.

The purpose of this article – after analyzing the existing literature in the field – is to emphasize that new cost systems such as ABC and ABM could be a strong couple that assures competitiveness and efficiency for each company. Another objective is to present that, besides its disadvantages, firms implement the ABC/ABM system because it permits better tracing of costs to objects, superior allocation of overheads to cost objects, financial and non-financial analysis and measures useful to managers and management accountants in the decision-making process.

Keywords: ABC, ABM, implementation process, profitability

JEL Classification: M41, M10, M49

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Introduction

Changes in the business environment, triggered by global competition and technological innovation, have led to innovations in the use of financial and nonfinancial information in organizations. The new environment demands relevant information and data about costs and performance within the organization's activities, processes, products, services and customers.

Usually, leading companies are using their cost systems to (Kaplan & Cooper, 1998:5):

- Design products and services that both meet customers' expectations and can be produced and delivered at a profit;
- Signal where either continuous or discontinuous improvements in quality, efficiency and speed are needed;
- Assist employees in their learning and continuous improvement activities;
- Guide product mix and investment decisions;
- Negotiate about price, product features, quality, delivery and service with customers;
- Efficient and effective distribution and service processes to targeted market and customer segments.

Still, many companies are not gaining competitive advantages from these enhanced cost systems because they rely on information from a cost system designed for a simpler technological age when competition was only local instead of global, and companies were producing standardized products and services and when speed, quality and performance were less critical for success. Using these systems managers doesn't have timely and relevant information to guide their improvement activities and they don't have accurate and valid information to shape their strategic decisions about processes, products, services and customers.

Nowadays companies and managers need cost systems to perform three primary functions (Kaplan & Cooper, 1998):

- Valuation of inventory and measurement of the cost of goods sold for financial reporting – because of the external circumstances with investors, creditors, regulators and authorities;
- Estimation of the costs of activities, products, services and customers – because of the internal managers needs to understand and improve the economics of their operations;

- Provide accurate and timely cost information and economic feedback to managers and operators about process efficiency to make both strategic decisions and operational improvements.

Under these conditions managers need to rethink their managerial practices and in close relation to this they need to reshape their existing accounting systems, especially the managerial accounting systems. As a response to this changes researchers turned into the study of changes and innovations in managerial accounting, and nowadays we are witnesses of a re-evaluation of managerial accounting in terms of developing new techniques and systems (Yazdifar & Tsameny, 2005). Traditional managerial accounting techniques such as absorption costing, budgeting and profit-based performance measures were replaced with such things as strategic management accounting, activity-based costing (ABC), strategic cost management, non-financial measures, balanced scorecard (BSC) and target costing. Some of them, for example, ABC and BSC, have also gained a degree of popularity in practice” (Jarvenpaa, 2007:100). Moreover, the most notable contribution is considered to be activity-based costing.

Activity-based cost (ABC) and activity-based management (ABM) systems emerged to meet the need for accurate information about the cost of resource demands by individual products, services and customers and these system also enabled indirect and support expenses to be driven first to activities and processes and then to products, services and customers. In this way managers have obtained a clearer picture of the economics of their operations and could improve their decisions.

These changes, the intense debate and high interest coming from researchers, at international level, made us to turn into the study of managerial accounting changes and new managerial accounting practices, tools and techniques. Contributing to the managerial accounting literature, the paper examines how activity-based costing and management evolved over the years; how the ABC/ABM couple was received, adopted and implemented by organizations and practitioners over the years.

Research methodology

Recent years have witnessed significant changes in both management accounting research and practice. For both management accounting researchers and management accounting practitioners these are changing times (Scapens, 2006:329).

Still, how can we create good management accounting research? According to the existing literature in the field (Zimmerman, 2001; Lukka & Mouritsen, 2002) there is a need for more rigour, more testing and more theory. According to them “theorizing can be a liberating effort, an attempt of making sense in our world in a more abstract level than that of merely describing the immediately perceived practice. Testing can be viewed as seeking to find out the connections that hold in the world. Rigour again can be about seriousness in finding this out. These propositions offer one set of qualitative criteria to create knowledge – good knowledge, relevant knowledge, insightful knowledge” (Lukka & Mouritsen, 2002:806).

Qualitative researchers, unlike their quantitative counterparts, do not intend to test hypotheses at the beginning of their research process. Theory is used not to obtain predictions but to gain understanding of a certain phenomenon. Data analysis is a process of reality construction whereby the researcher, the theory, and the method used in the research, together with the data derived from the research, are all interdependent and interrelated (Siti-Nabiha, 2009:43).

The purpose of our research was to lecture in the field of management accounting, analyze and understand the cost systems. We paid special attention to new and contemporary cost systems, tools and techniques, especially to activity-based costing and activity-based management. We analyzed the implementation process of ABC/ABM, underlined both the advantages and disadvantages of these systems. We also analyzed and tried to present the results of the studies and surveys made, at international and national level, about the implementation and adoption of ABC and ABM in practice. That is why this paper relates mainly to the data analysis. The methods used were: grounded theory and comparative analysis.

Literature review

Activity-based costing/management have attracted high levels of interest from both academics and practitioners since its emergence in the late 1980's (Bjornenak & Falconer, 2002: 481).

ABC was developed as an approach to address problems associated with traditional cost management systems, which tend to have the inability to accurately determine actual production and service costs, or provide useful information for operating decisions. With these deficiencies managers can be

exposed to making decisions based on inaccurate data. The higher exposure is for companies with multiple products or services.

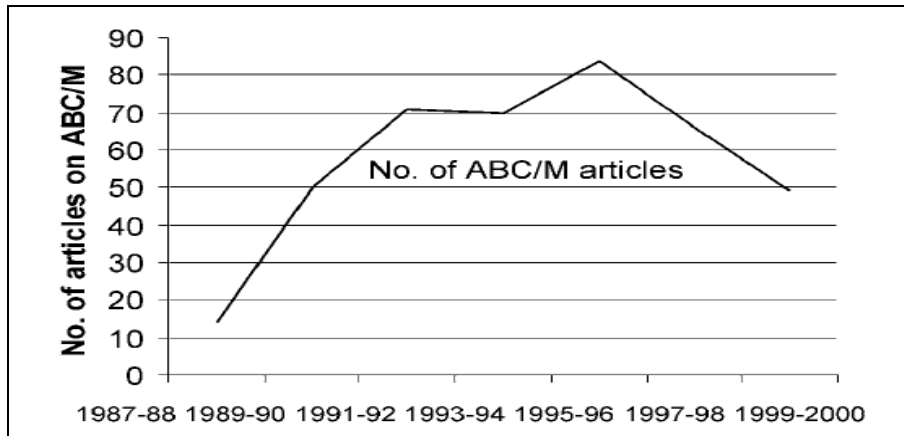
The origins of ABC are in the United States of America and it is the result of multiple theoretical and practical research and works. It is also considered one of the most important innovations in cost calculation and managerial accounting.

In 1963 Peter Drucker draw attention on the fact that the characteristic of traditional cost calculation methods is the lack of pertinence and relevancy and this leads to mutual subsidy between products and their costs. Later in the 1970s and 1980 American and French researchers – Cooper, Kaplan, Porter, Lebas, Lorino – formulate, elaborate and crystallize the method through articles, publications and works. In these years, CAM-I (The Consortium of Advanced Management, International), an international consulting group, had an important role during the research, financing various works and projects, and it also provided a formative role for studying and formalizing the principles that have become more formally known as Activity-Based Costing.

In the late 1990's and early 2000's Bjornenak and Falconer conducted a study about the development of ABC/M journal literature between 1987 and 2000. They began their research in 1987, the year when the first accounting journal publication on ABC/M appeared and stopped at the end of 2000, the latest practical data for the authors. The literature of two countries – UK and USA – formed the basis of their study and they analyzed only the accounting literature on ABC/M both in applied/practitioners' journals (Management Accounting – UK; Management Accounting – USA; Journal of Cost Management – USA and Journal of Accountancy - USA) and academic research journals (Management Accounting Research, Accounting and Business Research and Accounting Horizons in UK and Journal of Management Accounting Research, Accounting Horizons, Accounting Review and Critical Perspectives in Accounting in the USA).

The mentioned survey shows that after a take-off period in the late 1980's a high and consistent volume of papers on the topic of ABC/ABM has been evident. Moreover, these articles are spread across thirteen of the seventeen journals included in the study. Indeed, the breadth of exposure through the accounting journals occurred relatively quickly because as early as 1990 almost half of them contained materials on ABC/M.

Figure 1 – The development in the number of articles on ABC/M, 1987-2000



Source: Bjornenak & Falconer (2002:489).

According to Bjornenak's and Falconer's study the specialist management accounting journals predominates in publishing articles about ABC/ABM. They account for 358 (89%) of the 404 published papers. In particular, the three professional journals contribute 325 (80% of total) of the papers with all three providing a major portion: Management Accounting (UK), 98 (24% of total); Management Accounting (USA), 87 (22% of total); Journal of Cost Management, 140 (35% of total). The two management accounting research journals contain other 33 papers (8% of total).

We noticed that there still is an interest in ABC/M in the last years (2002-2010), evidenced by papers and articles published. This pattern of publication has been characterized by a high proportion of authorship from the accounting practitioner and, in particular, from the consultancy constituencies. While much of this has been positive and promotional it has also been subjective and anecdotal in substance.

Writings about ABC were theoretical and prescriptive (Hopper, 1994; Lukka & Granlund, 2002). Others considered that ABC promotes rationality, efficiency and ultimate profitability (Jones & Dugdale, 2002; Cohen et al., 2005; Hooper & Major, 2007).

However, ABC/M has, in addition, attracted an academic research interest which has brought a wide range of research methods to bear on the topic. Analysis of this work indicates a US-based predilection for quantitative approaches to

research and a greater propensity for theory development as opposed to the UK where reviews and field studies have been more common. There is also some indication of temporal clustering in the use of specific research methods and the use of empirical methods relatively late in the research cycle (Bjornenak & Falconer, 2002: 503-504).

ABC and ABM – Together or separate?

Activity-based costing (ABC) is defined as a methodology that measures the cost and performance of activities, resources, and cost objects. Specifically, resources are assigned to activities, then activities are assigned to cost objects based on their use. ABC recognizes the causal relationships of cost drivers to activities (Institute of Management Accountants, 1998).

ABC begins (Hughes & Gjerde, 2003) with the companies' products, determines the activities used in the production and delivery of those products, and computes the costs of various activities. The costs of the activities used in the production of a product are then assigned to that product in a manner that approximates a causal relationship. As a result, advocates insist that ABC systems provide more useful information for cost management purposes than traditional systems do. These differences are significant for companies with large amounts of overhead, multiple products, and high product diversity.

In today's competitive environment organizations require a reliable cost system and relevant cost information to survive. By implementing an ABC system managers will obtain accurate information about the true cost of products, services, processes, activities, distribution channels, customer segments, contracts, and projects.

Needy et al (2003) suggests that the implementation process of an ABC system should rely on the following four steps: (1) cost system evaluation; (2) ABC design; (3) ABC implementation; and (4) system evaluation and validation. Moreover, the ABC process should not be a "one-off" event; it demands a fundamental mind shift by the management, it should be a process of "relentless and continuous improvement" (Hughes, 2005).

ABC's originators recommended it for economic, normative, realistic and deterministic reasons – that is, it represents best value, accurately represents financial events and aids rational decision making and contracting. Alleged benefits include: increased cost awareness and understanding; better tracing of costs to objects; superior allocation of overheads to cost objects; and financial

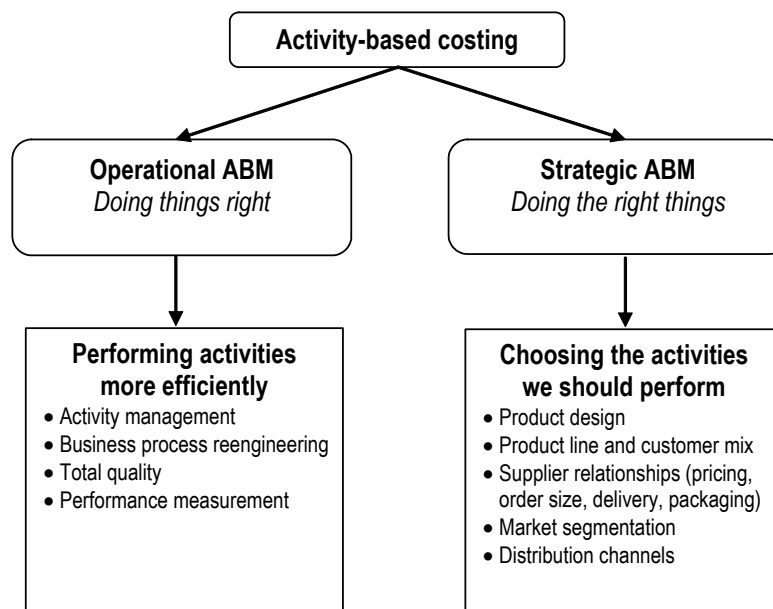
(cost driver rates) and non-financial (cost driver volumes) measures for cost management and operational decision (Hopper & Major, 2007:61).

The clearer picture from ABC systems led naturally to activity-based management (ABM). ABM enables the organization (Kaplan & Cooper, 1998) to accomplish its outcomes with fewer demands on organizational resources.

Activity-based management (ABM) is subsequently defined by CAM-I (Consortium for Advanced Manufacturing-International) as a discipline that focuses on the management of activities as the route to improving the value received by the customer and the profit achieved by providing this value. ABM includes cost driver analysis, activity analysis, and performance measurement, drawing on ABC as its major source of data. Using ABC data, ABM focuses on how to redirect and improve the use of resources to increase the value created for customers and other stakeholders.

ABM accomplishes its objectives through two complementary applications: operational and strategic ABM.

Figure 2 – Using ABM for operational improvements and strategic decisions



Source: adapted by Kaplan & Cooper (1998).

Operational ABM – works to enhance efficiency, lower costs and asset utilization. It can increase the capacity of resources by reducing machine downtime, improving or eliminating entirely faulty activities and processes and increasing the efficiency of the organization's resources. The benefits from operational ABM can be measured by reduced costs, higher revenues through better resource utilization and cost avoidance.

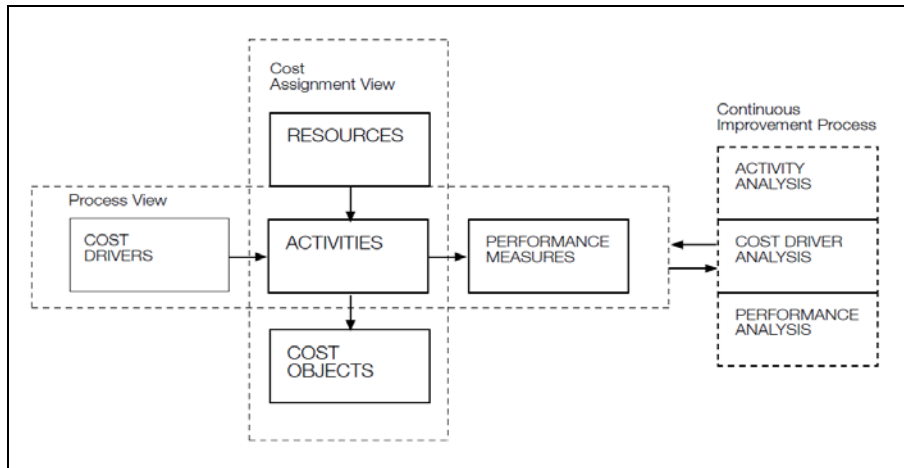
Strategic ABM – explores various ways a company can create and sustain a competitive advantage in the marketplace. ABM attempts to alter the demand for activities to increase profitability, encompasses decisions about product design and development where the biggest opportunity for cost reduction exists, improves relationships with suppliers and customers.

Some of the specific uses of ABM in organizations today include attribute analysis, strategic decision making, benchmarking, operations analysis, profitability/pricing analysis, and process improvement. ABC/ABM systems can use (IMA, 1998) many different attributes or "data tags" for a specific cost. Data attributes allow a company to perform analysis on many different dimensions of a management problem using the same basic store of data.

Organizations that are designing and implementing ABM will find there are five basic information outputs:

- relevant information about the cost of activities and business processes;
- the cost of non-value-added activities – in order to identify activities that do not contribute to customer value or the organization's need and make improvement efforts;
- activity-based performance measures – to provide scorecards, to report how well improvement efforts are working;
- accurate product/service cost (cost objects) information – this is vital for selecting the segmented markets where an organization competes;
- cost drivers – in order to identify factors that can cause changes in the cost of an activity.

Figure 3 – Outputs of the ABM model



Source: Miller (1996:236) CIMA (2001).

The shift from ABC (for product profitability assessment) to ABM (for more general managerial control and decision support) has been supplemented by the broadening of ABC/M application to different types of business, to different functional specializations within business and to the complementarities of ABC/M to other new high-profile management and accounting techniques (Bjornenak & Falconer, 2002: 504).

Together, ABC and ABM methodologies provide the tools and the knowledge base for making informed decisions - decisions that relate to the pricing, management, and improvement of products and services. They are utilized to gain fuller understanding of the real cost dynamics and cost structures involved in business operations. ABM together with ABC principles can enable managers to better understand (a) both product and customer profitability, (b) the cost of business processes, and (c) how to improve them.

ABC and ABM are a continuum of value. ABM is the application of ABC data to manage product portfolios and business processes better. ABC becomes ABM (management) when it is used to (CIMA, 2001):

- design products and services that meet or exceed customers' expectations and can be produced and delivered at a profit;
- signal where either continuous or discontinuous (re-engineering) improvements in quality, efficiency and speed are needed;

- guide product mix and investment decisions;
- choose among alternative suppliers;
- negotiate about price, product features, quality, delivery and service with customers;
- employ efficient and effective distribution and service processes to target market and customer segments;
- improve the value of an organization's products and services.

ABC/ABM systems are very effective means for improving company performance on many fronts. An organization can realize the power of ABC and ABM when the right individuals access the right information in the best format for improving performance

The role of managers and management accountants when implementing ABC/ABM

“There has been a lively academic and professional debate on the changing role of accountants, particularly management accountants, during recent years. The propagated role shift has essentially meant transition from being oriented around number crunching and maintaining the overall functioning of the accounting systems to an increasingly business-oriented role” (Jarvenpaa M, 2007:99-100).

Management accountants can perform an important role in the design of an ABC system. Based on their skills and training, they can help identify what is appropriate for analysis (product, customer, process, etc.) and explain the probable causes of an existing cost system's deficiencies. In addition, based on their detailed knowledge of the information in their company's costing information systems, they are uniquely qualified to judge the level of aggregation appropriate to the ABC costing system. They can use their understanding of costing methods to recommend appropriate methodologies for the assignment of costs to activities and cost objects. Finally, they will be able to use their understanding of the information and cost relationships to support the system once it is implemented (IMA, 1998:4).

As with any new management technique or tool, an effective change management process must be in place when implementing an ABC/ABM system. An objective of this process should be to ensure that there is support for the system at all levels of an organization. This includes having a top-level manager to champion the initiative, as well as acceptance by lower-level managers.

Besides management accountants and managers, the organization's information technology (IT) systems play an essential role in the implementation process. Information Technology (IT) refers to information systems and the organizational planning of resources required, acquiring, implementing, delivering and monitoring them. For many years, information technology (IT) has been playing an important role in the operations of organizational, strategic and managerial systems. It is often difficult, however, for generalists - who most board members are - to keep up with the rapid changes taking place in IT and, therefore, to know what questions to ask to ensure that IT issues are being properly addressed (The Canadian Institute of Chartered Accountants, 2004). IT systems must provide data that measures the outputs. Collectively, the organization's IT systems should contain information about most of the cost objects and the resource and activity cost drivers.

All and all effective communication - at all levels of an organization is essential. An organization needs to communicate the deficiencies of its existing costing system, the effect of this distortion on managerial decision making, how ABC costing principles can be used to provide information that is more relevant for managerial decision making, and the effect of the new system on the evaluation and rewarding of individual employees. Communication is a multi-way process, and employees', managers', accountants' concerns need to be addressed.

After this process, thanks to the existing communication the managerial accounting function and management accountants' role changes from being the scorekeeper and watchdog to being the active advisor of management and an increasing participant in decision-making (business partner) (Jarvenpaa, 2007).

ABC/ABM adoption and implementation – What does the practice say?

As presented in previous paragraphs, ABC/ABM has attracted the interest of both researchers and academics to a considerable extent in recent years. Researchers (Jarvenpaa, 2007; Akarany&Yazdifar, 2007; Askarany et al., 2007) consider that ABC and ABM are the most discussed and popular accounting innovations in last two decades because they are largely linked to the notion that information provided is more accurate and detailed than that provided by traditional costing systems. Moreover, these new managerial accounting techniques have aimed at helping business decision and taking control in an increasingly sophisticated way and with this they enhance the business orientation of managerial accounting.

However, despite the strong advantages of these techniques, survey evidence suggest that the take-up of ABC and ABM has been low in practice (Askarany & Yazdifar, 2007); over the past decade there has been a growing awareness of ABC and ABM, but the overall rate of implementation has been low (Cohen et al., 2005).

In the early 1990s the implementation rates of ABC and ABM were low both in the USA and Europe. In 1999 Groot find out that only 18% of the investigated companies have implemented ABC, while 58% of the respondents were considering the possibility to implement the method. In Canada around 23% of the surveyed companies implemented ABC/ABM, 18% considered to adopt, 4% considered to adopt in the near future (Bescos et al., 2002). In Europe the adoption rates were similar. In France and Belgium the adoption rates were around 20%, in Netherlands around 12%, while in other countries less than 10% (Clark et al., 2002; Bescos et al., 2002). In the early 1990s researchers (Innes et al., 2000) reported low adoption rates of ABC (around 10%) in the UK, but few years later the same survey showed more companies implementing ABC, adoption rates reaching 20%. As for the public sector 54% of local authorities, 17% of government agencies and 55% of healthcare organizations were using ABC/ABM techniques (Baird, 2007). A survey conducted among German companies (services, insurances, banking, retail and manufacturing) shows that only 7% of the respondents are using ABC as a stand-alone system, while 24% of the respondents combine ABC with other cost systems, tools and techniques (Friedl et al., 2009).

Few years later, findings from Australia and Asia present a mixed picture. Adoption rates of ABC and ABM varies between 12%-56%. Japan was represented with low adoption rates but with considerable interest regarding the examination of the possibility of such an adoption; while in India researchers identified adoption rates around 20-23% of ABC (Cohen et al., 2005). Australia reported considerable variation in ABC adoption rates, with many reporting low rates of adoption between 10%-17% in the private sector (Baird, 2007).

In 2005 a dedicated team of professionals, Better Management Team, with business management experience conducted an empirical study among companies all over the world do determine the state of ABC and ABM. The respondents came from various industries, like manufacturing, financial services, communication, consulting, IT, healthcare or public sector. The main conclusion of the study conducted is that the implementation of ABC varies by industries. Companies that implemented and are actively using ABC/ABM are represented

by the communication (58%) or financial services sector (46%), followed by the public sector (29%), manufacturing (24%) and other industries (32%).

The examined surveys show that the reasons to implement ABC/ABM are driven by the need to improve customer profitability, to gain accurate and relevant cost information for pricing or budgeting, to modernize cost systems, improve cost control and improve business processes, to meet current managerial needs, to improve product profitability. However the implementation process has also disadvantages and faces difficulties such as resistance to change in firms; uncertainty about the implementation costs and about the risk of the implementation; absence of technical conditions required to successful implementation; the reluctance of employees or managers; uncertainty about the support from top management; difficulties in identifying and selecting activities; problems when collecting data for these new systems (Bescos et al., 2002; Cohen et al., 2005).

Besides ABC adopters there are companies that consider ABC implementation as a future target and companies that do not consider adopting ABC. According to the findings of relevant researchers (Bescos et al., 2002; Cohen et al., 2005, Askarany & Yazdifar, 2007) the main reasons for rejecting the implementation process of ABC/ABM might be: satisfaction with the existing traditional cost systems, lack of management support and interest, implementation process associated with high costs, consumption of time and resources.

In Romania managerial accounting has a different and slower evolution, being influenced by the political, social and economical regimes and business environment of our country. For many years managerial accounting in Romania was associated with cost calculation and budgeting, only at the beginning of 2000, influenced by the international literature, Romanian researchers experienced a modern approach to managerial accounting. Literature in the field (Jinga et al., 2010; Cardos, 2010) shows that within Romanian companies' contemporary practices, tools and techniques are still widely adopted than recently developed ones. Romanian practitioners seem to be satisfied with the existing cost systems; the adoption rates of ABC are low and vary between 6% and 12%; while the majority heard about the method but never considered implementing it. Resistance and lack of interest and support from the management, high implementation costs and complicated work processes were considered to be the main challenges identified within companies coming from industries like manufacturing, services or trade.

We can conclude that, on international level, over the years the managerial accounting literature has witnessed a growing interest in the study of new and contemporary managerial accounting practices and techniques; there has been a high interest and intensive debate on the importance, adoption and implementation, advantages and disadvantages of ABC and ABM from both researchers and practitioners. The literature shows a mixed and various picture of ABC/ABM. Variation might be attributed to the manner in which ABC has been operationalized in the studies presented in the literature, with many different terms used and ambiguity surrounding the definition of the terms (Baird, 2007). Others (Askarany&Yazdifar, 2007) consider that ABC and ABM have not been highly diffused among practitioners and that is why practitioners are having doubts in terms of replacing traditional techniques. This might be the reason why ABC is not so known to Romanian companies and practitioners. On national level the managerial accounting literature is relatively poor; little is known about managerial accounting practices, tools and techniques, especially about contemporary and recently developed ones.

Despite this variation identified we consider that new managerial accounting practices like ABC and ABM can cope with today's managerial needs and with the requirements of technological changes.

Conclusions

The main conclusion of this paper is that the literature and the practice show a mixed picture of ABC and ABM. Successful implementation of ABC/ABM is not the same in every organization or follows the same path. Tailored to the unique strategy, structure, capabilities, and needs of the firm, ABC/ABM is a universally useful concept and system that can take on a multitude of shapes and uses. ABC/ABM data should meet the needs of the company's decision makers and support their efforts to create value for all stakeholders.

We are sharing Hughes's (2005:14) opinion, according to which the successful implementation of ABC and ABM requires the following issues to be considered:

- (1) top management commitment – the need for the senior managers to be fully conversant with the principles of ABC/ABM, to show commitment to the process, to advise on strategic and day-to-day operational problems;
- (2) ABC/ABM implementation training by universities, researchers and academics through workshops and seminars;

- (3) Education, training and learning highlighting the principles, capabilities, goals and objectives of ABC/ABM for all employees.
- (4) Analysis of critical activities and monitoring the process, ensuring the results of implementation are rolled out into effective decision making.

Based on the existing literature in the field we can conclude that companies use the ABC/ABM couple with varying results, suggesting the successful application of them requires the mastery of new management tools and techniques as well as a management mind shift. Analysis, not control, must become the focus of managers using financial and nonfinancial information in a process-driven, customer-centered organization. Defining, measuring, and improving the ability of an organization to create value has to become the stimulus shaping management information systems, as well as the actions and decisions they support. Achieving this goal lies at the heart of ABC/ABM systems.

Still, the best system will be useless if no one understands how to use the information. As important as it is to design and implement a theoretically sound and properly maintained system, it is just as important to ensure: (1) management has been trained in the concepts and use of ABC/ABM; (2) management receives reports that are not only useful but understandable; and (3) the ABC information is kept current.

Technical doubts about ABC/ABM, about its definition, terminology, methods and usage exist and vary (Jones&Dugdale, 2002; Hopper&Major, 2007). Even the ABC originators are wondering whether ABC provides relevant costs for decisions under stringent conditions or the implementation process isn't excessively costly. Even though these questions exist, the benefits of the ABC/ABM implementation are stronger. Moreover, given the escalating speed of recent technological innovations, the changes generated by globalization and intensive competition organizations from all over the world, from all industries could cope with the current needs of a changing environment only if they put a great emphasis on new managerial accounting tools and techniques such as the ABC/ABM couple. This is also emphasized by a planning manager working at a Portuguese telecommunication company:

"ABC implementation is directly linked to the information request of the telecommunications regulator.... But I am sure that sooner or later we would have adopted ABC, especially if we had known that other companies were using it successfully." (Hopper & Major, 2007:77)

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