

# APPLIED ACTIVITY BASED MANAGEMENT IN ORGANIZATION AND CONTINUOUS IMPROVEMENT

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**Abstract:** Activity Based Management is a procedure that originated in the 1980s for analyzing the processes of a business to identify strengths and weaknesses. Specifically, activity-based management seeks out areas where a business is losing money so that those activities can be eliminated or improved to increase profitability. ABM analyzes the costs of employees, equipment, facilities, distribution, overhead and other factors in a business to determine and allocate activity costs. Activity-based management can be applied to different types of companies, including manufacturers, service providers, non-profits, schools and government agencies, and ABM can provide cost information about any area of operations in a business. In addition to improving profitability, the results of an ABM analysis can help a company produce more accurate budgets and financial forecasts.

**Keywords:** Activity Based Management, Organization, Continuous Improvement

## ACTIVITY BASED MANAGEMENT

ABM focal point is managing activities and reducing costs and improving customer value. ABM is a distinctive model and ABM is not a technique, it is process of performing management. Activity-based management is classified into 1) Operational and 2) Strategic ABM.

**Operational ABM** is about “doing things right”, using ABC information to improve efficiency. the product can be identified and improved. Activities that don’t add value are the ones that need to be reduced to cut costs without reducing product value.

**Strategic ABM** is about “doing the right things”, using ABC information to decide which products to develop and which activities to use. This can also be used for customer profitability analysis, identifying which customers are the most profitable and focusing on them more.

A risk with ABM is that some activities have an implicit value, not necessarily reflected in a financial value added to any product. For instance a particularly pleasant workplace can help attract and retain the best staff, but may not be identified as adding value in operational ABM. A customer that represents a loss based on committed activities, but that opens up leads in a new market, may be identified as a low value customer by a strategic ABM process. Managers should interpret these values and use ABM as a common, yet neutral, ground.

## DEPLOYMENT THROUGHOUT THE ORGANIZATION

ABM needs to be understood and applied at different function levels of the organization so its power can be unleashed and the benefits can be obtained from this model. ABM goals for managers will ensure alignment and focus on reducing non-value added activities and waste from the organization.

ABM has evolved over time and is now considerably applied in manufacturing, service companies, logistics, utilities, government bodies, telecommunications and many more sectors. Dramatic improvements are achievable in measuring process and product costs, and more critically customer profitability.

The Hewlett-Packard North American Distribution Organization teams and acronym itself has evolved from ABC to ABCM (activity-based cost management) to ABM, and the application of ABC evolved from a manufacturing product costing orientation to a management philosophy of activity management applied in industries and organizations other than manufacturing. It has also played a role in today’s fast paced world, organizations are moving from managing vertically to manage horizontally. It is a move from a function orientation to a process orientation. Total quality management (TQM), just-in-time (JIT), benchmarking and business process reengineering (BPR) are all examples of horizontal management improvement initiatives. These initiatives are designed to improve an organization’s work processes and activities to effectively and efficiently meet or exceed changing customer requirements.

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

1. the cost of activities and business processes;
2. the cost of non-value-added activities;
3. activity-based performance measures;
4. accurate product/service cost (cost objects);
5. cost drivers

Use Activity Based Management to improve service by reducing complexity many organizations struggle with operations that are too complex to manage effectively. This is not usually due to true product or process complexity, but rather to a lack of management attention to details, such as order fulfillment strategy, part and product proliferation, and unmanaged customer service commitments. In such environments, it is helpful to use activity as a way to identify the critical components (products, parts, customers, etc.) on which to focus improvement efforts. Without such focus, organizational energy is wasted battling a never-ending series of exceptions and problems. Too many organizations seem to believe that being “customer focused” means never saying “no” to a customer request. Never saying no is a sure way to end up with too many customers, too many parts and too little control over your own operation, which leads to increased complexity and cost, and poorer service to all customers. Thinking creatively and logically about how to satisfy customer order fulfillment requirements is critical to operational and financial success.

Our client manufactured commercial refrigeration systems. As a premier supplier with a broad product line, they were losing sales to smaller, more focused competitors who could supply certain products to customers more quickly, at lower prices. Each end item was unique, incorporating considerable customer input regarding performance, component selection, and other design features. Customers resisted the idea of “standard products,” so products could not be produced in advance and sold from stock. A standard eight-week lead time was used to buffer long component lead times. Additionally, the long lead time gave customers more time to reconsider and change designs, often late in the design/production cycle. The challenge was to reduce lead time and simplify the business, which required high overhead levels to support all the variety. Analysis indicated that although there was no demand predictability at the end-item (final design) level, there was solid predictability at the major component level.

The implications of this strategy were striking: Sales and application engineering now had more leverage with

customers. While the company would always build what the customer specified (a perceived strength), lead time and price advantages could be offered if standard components were used. Manufacturing could focus operations around products using standard components and designs that would flow through the plant quicker and more

## **ABM AND ORGANIZATIONAL**

### **Improvement**

This study sets out to prove that Activity-Based Management is still a relevant instrument to facilitate effective management decision-making and organizational improvement. In the light of all the latest techniques and methodologies that currently exist to measure and rectify organizational performance, the obvious question might be “but why Activity-Based Management?”. Whilst certain techniques and methodologies concentrate on either input, outputs and / or on the entire process, Activity-Based Management was selected because it specifically analyses the activities (transformation component) of a business, plus the fact that this methodology has been refined and tested with great success in large organizations such as Eskom. Given the selection of management tools available, an instrument such as Activity-Based Management is usually not implemented alone, but may be supported by one or more other approaches. For this reason, Activity-Based Management is contrasted with several other popular instruments in the literature review. If properly applied, Activity-Based Management can provide management with a sound decision-making platform for correctly aligning resources and work activities.

It produces cost information by linking human resource costs to activities and then tracks these human resource costs (inputs) by activity (transformation) and traces them to the point where products and / or services (outputs) reach their destination / customers (result). It also serves as a useful base to improve strategic and operational decisions and for reviewing and updating the organization structure of a business. This study reworks and researches previous data related to a project carried out by Eskom (exploratory research) with the purpose of testing the primary research objective. Based on a predetermined dictionary of activities and an associated data collection form, a census was used to collect the data.

A failure to accommodate these beliefs can set the project up for failure. To reach the conflicting goals of controlled scope and organizational commitment to the ABM effort, it is useful to run a series of group brainstorming and problem solving meetings. During these meetings, individuals who actually perform specific activities can

negotiate and compromise openly to arrive at a set of activities, processes, and definitions acceptable to all. Granted, these meetings will consume implementation resources and may lengthen the project, but the ultimate benefits will greatly outweigh any up-front costs. Another way to address problems surrounding identification and definition of core activities is to ask the management team or a similar group to think about the organization from the customer's perspective. What things are done to service directly, or indirectly, the needs of current and future customers? What activities are critical? Analyzing Data and Documenting Results At this point in the ABM implementation, new information becomes available to managers at all levels of the organization. It is a "moment of truth," one that brings with it its own unique challenges and pitfalls, including:

- managers do not take action on the ABM information;
- no activities are eliminated;
- cost drivers are not evaluated;
- some parties are adversely affected by the ABM information; and

a high degree of disbelief in the new numbers develops. Prior to the data analysis and documenting results phase, the ABM system is an abstraction, a concept. As the costing phase is completed, though, the system begins to operate in a very visible way. Given that the output is good news, bad news, or old news, it is very important to actively address the implementation pitfalls at this stage. Failure to do so can result in an implementation that is in name only. Some ways these pitfalls can be addressed are:

- require managers to justify inaction as well as action on ABM information;
- focus ABM not just on cost and cost reduction but also on value and value creation;
- monitor the number of changes made using the ABM information;
- ensure that a large number of people are receiving and using the information;
- hold training and information sessions to discuss the system and its reports; and
- hold feedback sessions to gather criticisms, concerns, and problems with the ABM system from affected managers.

Personal resistance to change is the major behavioral barrier facing any change effort. ABM is not immune to this problem. Inertia, the tendency of a body at rest to remain at rest, is as common a problem to human organisms as it is to a rock. It takes energy to move away from the status quo, to embrace a new way of thinking about and doing work. With this newness comes the risk arising from fear of the unknown, lack of understanding of the new system, and uncertainty regarding how ABM will affect their job, performance, and standing in the organization. In many ways, ABM leaves managers feeling they are playing the same old game with a new set of rules.

Accounting is the language of business, a dialect that defines success and failure, objectives and results. ABM changes this language in many subtle and not so subtle ways. The impact of these changes hits hardest the people who knew the old game well, the former "stars" of the organization. These stars normally have significant personal power and influence; when they are uncomfortable, major barriers to change are created. At the departmental level, ABM meets another implementation challenge. ABM does not focus on departments and functions; it is defined on activities that are often cross-functional in nature. To managers accustomed to a functional structure, it is very difficult to understand what ABM really means and how it can be used effectively.

## CONCLUSION

ABM contributes to management improvement initiatives and improved decision making by providing cost and operating information about the activities of the organization. Activity-based management depicts the key relationship between ABC, and the management analysis tools that are needed to bring full realization of the benefits of ABC to the organizations.

Activity based management is a methodical analysis for improving operational systems and control so as to enhance value deliverables to clients and boost corporate profitability. Merits of Activity Based Management It increases effectiveness of key business processes, activities and tasks by keeping costs at barest minimum while increasing value to clients. It improves management focus through allocation of resources to value added activities, customers, products and continuous improvement system for maintaining competitive advantage. An organization's ABM success depends not on the number of activities or drivers it uses but on how relevant that number is to a specific business objective. On the other hand, Caterpillar uses multiple cost systems, many cost centers, and several overhead bases. Both companies are leaders in their respective industries and

have been successful in competing against foreign competition.

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