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Activity-Based Management principles and implementation opportunities of the ABM system

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Abstract

This article describes the principles of Activity-Based Management and treats the implementation stages of it in enterprises from steel industry of Romania. The ABC method becomes the main tool of providing information for the ABM method. Thus, the ABM method becomes an important tool of obtaining performances in business.

Key words: *Activity-Based Management, Activity-Based Costing, principles, activities, performance.*

Multidimensional approach of cost-behaviour analysis

The specialists have defined the Activity-Based Management (ABM) as a systematic method to plan, control and improve activities and related indirect costs. The ABM method is based on principle “*activities consume costs*”. ABM method uses the ABC method information for controlling the activity’s cost based on fundamental assumption mentioned above. ABM method has been proved to be efficient for activity’s control both in services and enterprise’s production.

The extension of cost-behaviour analysis from two-dimensional to the multidimensional approach of cost drivers in the enterprises has provided to the ABM method a vast background and extremely useful for understanding and controlling the costs in most of the enterprises, including the steel industry enterprises. According to the ABC, the fix cost has a single cost driver as output, but it become variable to other cost drivers as output series or product range. In other words, the cost is not fully fix or variable, but its behaviour depends on its connection with the cost inductor. The principles of ABM can be used for regrouping different activities into activities with unique cost inductor which is able to facilitate the cost control.

The principles of ABM (Activity-Based Management)

The basic principles of ABM and ABC methods have been developed based on a research project sponsored by fifty organizations through the world under direct guidance of CAM-I director, Tom Pryor, the current chairman of Integrated Cost Management Systems (ICMS) during the course of three years (1986-1988). The result of his research was made public in 1988 by publishing an article in “Business magazine” which announced the launch of software, some books and providing training in the ABM quality field for all organizations regardless of their sizes.

1. The principle of identification of activities causes

According to this principle, the “*root*” of activities causes is found very rarely under control of staff and elimination of a part of the employees can not resolve the problem of costs generated by those activities. ABM is based on principle that “*activities consume costs, products and services and they are consumed by the customers*”.

2. The principle of identification of customer related to activity / process

According to this principle, it is proceeding to evaluation of customer satisfaction degree about costs, quality, and services level and product delivery time. After identification of satisfied customers, they pass on to identification of specific value activities. To carry out improvement activities and to meet the requirements of customers it can be used the ABM method closely connected with TQM (Total Quality Management), BRP (Business Process Reengineering) or benchmarking.

3. The principle of jointly management

According to this principle, it is proceeding to establishing of manager responsibilities by creating managerial teams (communities) which will lead functional activities synchronized through functional connections. These will create simple, efficient and flexible managerial processes whose purpose is to satisfy multiple requests of the customers.

4. The principle of culmination performances

According to this principle, the benchmarking activities related to best appropriate methods in the area may contribute to obtaining of high performances and the limit (culmination) of performances can be

reached by usage the methods from previous year in the recent year, and even improve of the actual performances.

5. The principle of elimination of non-value

According to this principle, it is proceeding to minimize and even eliminate of those non-value activities. As a result, it will proceed to reallocation of resources for increasing and improving performances (profit) of activities.

6. The principle of cooperation and disciplinary liability

According to this principle, it is proceeding to cooperation between departments in order to detect deviations (errors) and the roots of activity causes and establishing of disciplinary liability. To avoid the reiteration of negative deviations or variable planning it will be considered: defining the causes and settlement of negative deviations related to non-value activities, excessive costs and low quality.

7. The principle of permanent improvement of activities

According to this principle, the competitiveness is maintained through permanent activity improvement of an enterprise. This is a continuous analysis of the process, action and counting of all obtained results during the conduct of activities and search for those ways to improve the performances of an enterprise.

8. The principle of updating information

According to this principle, all information must be updated and avoided any irrelevant statistical data, any unfounded comparisons. Performances measurement should be based on updated data to enable effective decision making.

9. The principle of objectives identity

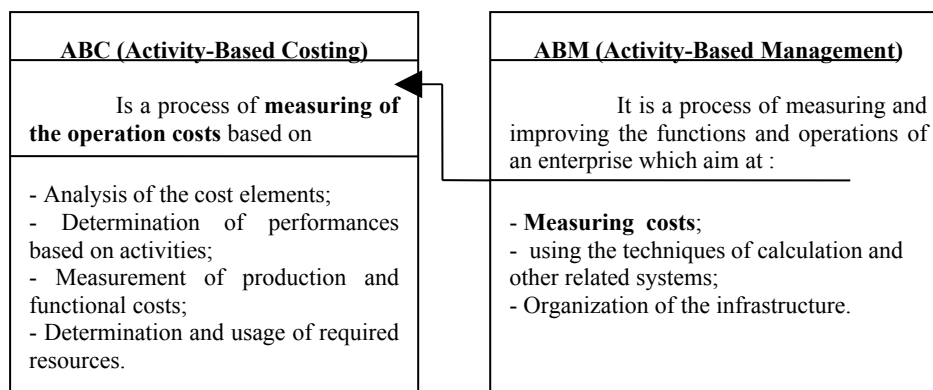
According to this principle, it refers to keeping check those activities that enhance the performances and correspond to the established objectives of the enterprise. It is defined as the measurement units of activities necessary to achieve a strategic plan and budget activities.

10. The principle of professional satisfaction

According to this principle, the staff of an enterprise will make an effective activity as long as their work will be rewarded and awarded properly to obtained results. They will provide to the employees all the tools necessary to obtain the desired results to increase effective the add-value activities. All these will lead to keep a favourable climate and will contribute to increase performances of the enterprise.

ABM method – tool of ABC method

Is the Activity-Based Management (ABM) a tool of Activity-Based Costing method (ABC)? The opinions are divided. Some specialists consider that the base of extension of the ABC method relies in the ABM method, meanwhile another part of the specialists consider that ABC method has undergone a separate evolution of ABM. Starting from the definitions of those two concepts we are submitting to your attention the next scheme meant to facilitate the proper understanding of them:



As it can be seen on the scheme above, the ABC method (Activity-Based Costing) represents in fact, an *instrumental extension* of the ABM method (Activity-Based Management). The Activity-Based Management method (ABM) is an excellent way to improve the quality of managerial decisions mostly based on information provided by the ABC method. The ABM method permits the proper allocation of the resources to activities, helping to improve production and reduce their costs, based on analysis done through ABC method.

The objective of ABC method is not to influence the level of costs (as with the method of cost centre costs, for example), but rather the allocation of effective action on activities that determine the cost: "People can not manage costs, they can only manage activities that determine costs". So, the ABC method acquires a new dimension: Activity-Based Management (ABM). The calculation aspect doesn't constitute the main element of the method, but by adding a strategic and managerial dimension, it is increased.

The ABC method consists in providing some informational costs more relevant, obtained with accuracy far greater than through traditional approaches. In this new approach, cost calculation is still considered a significant tool of the management, but doesn't constitute an end in itself. Once again, we must perform an activity analysis of the enterprise.

Taking actions over activities, the ABM method enables possible direction of the actions concerning the long term objectives. All costs that present the characteristic of being variable become useful in the process of making decisions. This is the terminology origin of the Activity-Based Management. These statements call for a definition of the movement of the circulation process of the resources through activities and variety products of the enterprise, which is very close to the reality. So, it becomes possible to measure the resource consumption for each activity and its value determination.

Also, it becomes possible to measure the consumption resource for each component process of activity. All these information makes it possible to achieve both pro-value¹ activities and non-value activities. The "chain value theory" sustained by Michael Porter can be applied after that on a large scale. The business policy become orientated to optimization between created value and costs, then to be limited to a simple minimization of costs as it is done in the traditional approaches.

As any other method, the ABM method presents a series of traps due especially of inexact identification of main activities, interpretation of information from incorrect data in extrapolation of taking managerial decisions in absence of a detailed analysis of existent processes of the enterprise. In addition, the ABM method is useful because it provides reporting and control of activities related to relevant costs from identification level of the enterprise point of view, in measuring of overhead of the activities, separation of value added activities from the non-value added activities etc.

An ABC/ABM analysis requires a detailed modelling of analyzed processes of the enterprise. It must be described with accuracy the processes, activities and resources involved in the analyzed system. This approach is transversal in to the enterprise and is not concerning the structural aspects of it. Before, the biggest efforts of cost reduction were focused over product unit activities because those costs were the most visible. Kaplan and Cooper argue that exist significant opportunities for cost reduction on levels and production sustaining activities.

The Activity-Based Management method is extremely useful to improve performances of the enterprises on many fronts. An enterprise becomes consciousness of ABM importance only when the right person or persons are accessing the right information for making right decisions and improvement performances of the enterprise. After interviewing a group of specialists from the steel industry enterprises of Romania regarding implementation and maintenance in function of an ABM system has resulted the following stages:

1. **Training and motivating staff.** From the moment that the people are selected to do some activities into the enterprise they become employees of it, they must become familiar with the functioning way of the ABM system and involved in this way in correct implementation of it, being in the same time and motivated by the system advantages. It is recognized the fact that the implementation success of the Activity-Based Management produces a clear connection among the operational side and represents more than a simple recording of score. They represent the true heart of the organization. They indicate how managers can meet their specific costs and productivity objectives helping them and their departments to obtain bonuses and targets (purposes).

2. **System selection corresponding to the enterprise's goals.** When the ABM method becomes a part of an operational culture of the enterprise, the existent management systems must be evaluated separately to identify the need for further improvement goals. After initial testing of the ABM system implementation and preliminary conclusions, it should be taken into account that these results will serve as the main direction for the successful implementation of the ABM system.

3. **Choosing the team for maintaining operational ABM system.** To ensure continuity of their activities, it is recommended use of full-time employees. For correct implementation and maintenance service in function of the ABM system we can appeal at two categories of consultants: internal and external. The internal consultants is referring to internal employees which is counting the most to the development of the ABM system, meanwhile the external consultants (*specialized firms*), accrued from outside the enterprise can add to consolidation of the ABM system: their inestimable experience, power of

the additional personal, advantages of techniques and tools necessarily for reduction of implementation time of the ABM system and qualitative improvement of the initial tested system. The final responsibility for implementation and maintaining in function of the ABM system pertain to the implementation team which can bring a new vision over management performances.

4. Maintenance of the ABM system. Maintenance of the ABM system requires a large volume of data supplied for the most part by the ABC. Some data are manually introduced meanwhile other data are automatically processed using computers. To ensure the successful operation of the ABM system and ensure the effectiveness of the system is appropriate to maintain a balance between the amount generated by the system and required continuous maintenance thereof.

5. Communication and supervision of the ABM system. During the course of implementing the ABM system it should establish an intense communication between management and staff involved in implementation and maintenance operational the ABM system. Regular results of ABM system must be understand and carefully analyzed to ensure the successful implementation of the ABM system.

To ensure the successful implementation of the ABM system should rely primarily on a change in the culture, the way in which management uses the information type cost to make better decisions and secondly to develop programs very easy to maintain in the long term. Each company must also focus on the profitability of relationships with customers which can be achieved by:

Activity-Based Pricing method (ABP);

- Interconnection of ABC method information with the ABM method information;
- Providing information based on improvement opportunities of the value added activities and reduction of activity costs, respective customer's relations profitability.

Based on Activity-Based Management and identification of the implementation stages of it in the steel industry of Romania, we think that performances of the enterprises will increase in the near future; all depend on the capacity of the managerial team and ABM implementation method.

Notes

¹ Pro-value activities = value add activities.

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