

ACTIVITY BASED MANAGEMENT – IS IT A SUITABLE APPROACH FOR CURRENT CRISIS BUSINESS ENVIRONMENT?

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Abstract: Activity-based management is a management control technique that focuses on the resource costs of organizational activities and processes, and the improvement of quality, profitability and customer value. This technique uses activity based costing information to identify strategies for removing resource waste from operating activities. Main tools employed include: strategic analysis, value analysis, cost analysis, life-cycle costing, and activity based budgeting. As well, activity based management uses activity-based cost information for a variety of purposes, including cost reduction, cost modeling, and customer profitability analysis. But is it a suitable approach to solve problems of organizations in such a business environment as the current one? Thus the main aim of this paper is to define what a business crisis environment is and establish the extent to which the usual problems that business organizations are confronted with in a crisis environment find suitable solutions with a full scale use of ABM.

Key words: activity-based management, activity-based costing, crisis management

WHAT DOES ABM PROVIDE MANAGERS WITH?

Activity-based management (ABM) can be defined as a method of identifying and evaluating activities that a business performs using activity-based costing to carry out a value chain analysis or a re-engineering initiative to improve strategic and operational decisions in an organization. Activity-based costing establishes relationships between overhead costs and activities so that overhead costs can be more precisely allocated to products, services, or customer segments. Activity-based management focuses on managing activities to reduce costs and improve customer value. ABM can be divided into operational and strategic:

- Operational ABM is about “doing things right”, using ABC information to improve efficiency. Those activities which add value to 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 ... this provides the basis for negotiation” [2]. ABM can give middle managers an understanding of costs to other teams to help them make decisions that benefit the whole organization, not just their activities' bottom line.

ABM is a fundamental shift in emphasis from traditional costing and performance measurement. People undertake activities which consume resources – so controlling activities allows you to control costs at their source.

The real value and power of ABM comes from the knowledge and information that leads to better decisions and the leverage it provides to measure improvement. Some other characteristics of ABM are:

- ABM enables management to make informed decisions about lines of business, product mix, process and product design, what services should be offered, capital investments, and pricing.
- ABM is more than an accounting tool; it's a system for continuous improvements. It is not a single answer but merely one of the many tools that can be used to enhance organizational performance management.
- ABM will not reduce costs, it will only help you understand costs better to know what to correct.
- The process of ABM does consume resources, and the manpower costs can be significant.

Companies considering or already implementing ABM should realize that although certain product or market factors might make it potentially beneficial, those same factors might not lead to a successful implementation. ABM gives us a much better chance of establishing a useful costing for outputs. But there is a price to pay. It can be difficult to find out what costs apply in a particular activity, and those involved may be suspicious of others charged with finding out. Some areas of activity overlap and are difficult to separate. And, of course, ABM is a costly exercise in its own right.

Other priorities, top management commitment, IT capabilities, and integration with financial and budgeting systems should be considered before implementation.

Organizations have begun to look at ABM for a variety of reasons. Among the most commonly cited are:

- top-down pressure to reduce costs;
- competitive pressure/market conditions;
- the introduction of benchmarking;
- regulatory issues;
- seeking world-class status through process management.

Some of the most important outputs of ABM are:

- The cost of activities and business processes; since activities form the very core of what a business does, the basic output of the ABM system must be to provide relevant cost information about what a business does. Instead of reporting what money is spent for and by whom, costs are assigned to activities.
- The cost of non-value-added activities; some activities add value to a product or service, while some do not. A non-value added activity is an activity that is considered not to contribute to customer value or to the organization's need. This is defined as waste. Identification of waste is valuable to management. This crucial information output provides a focal point for improvement efforts.
- Activity-based performance measures; in addition to cost information for business processes and activities, the ABM system must report information and data on activity performance. Knowing the total cost of activity is insufficient to measure activity performance. Activity measures of quality, cycle time, productivity and customer service may also be required to judge activity performance. Measuring the performance of activities provides a

scorecard to report how well improvement efforts are working and is an integral part of continuous improvement.

- Accurate product/service cost (cost objects); products and services are provided to markets and customers through various distribution channels or contractual relationships. Because products and services consume resources at different rates and require different levels of support, costs must be accurately determined. Accurate product and service cost information is vital for selecting the individual and segmented markets where an organization competes and for pricing in those markets. Accurate product and service cost information is a key information output of the ABM systems.
- Cost drivers; the final output of an ABM system is cost driver information. A cost driver is any factor that causes a change in the cost of an activity. An activity may have multiple cost drivers associated with it.

2. BUSINESS CRISIS ENVIRONMENT – PROBLEMS AND SOLUTIONS

Crisis management is the process by which an organization deals with a major unpredictable event that threatens to harm the organization, its stakeholders, or the general public. Three elements are common to most definitions of crisis [4]:

- a) a threat to the organization;
- b) the element of surprise;
- c) a short decision time.

Some researchers [5] argue that "crisis is a process of transformation where the old system can no longer be maintained." Therefore the fourth defining quality is the need for change. If change is not needed, the event could more accurately be described as a failure or incident

It is not in question that the world around the companies is changing in terms of the economy and their markets. What is questionable is how business organizations address the challenges that face them.

Focusing on immediate or short-term survival is crucial. But coupled with that is the need to have mid-range and long-term, at least five to ten years long, views that will ensure a balanced strategic approach moving forward. Too often long-term growth, or even sustainability, is sacrificed for short-term survival or gain. To take actions to keep the doors open now, only to close down in 12 months time does not make good business sense. A strategic approach would be to address immediate issues, together with long-term concerns, so the two strategic action plans are implemented simultaneously. Thus, strategic thinking should trigger company's actions, not fear.

An economy under pressure does not automatically mean financial difficulties for every organization. In some cases it can mean assured growth, especially in market share for certain lines.

If in survival mode, a company has to take all the necessary measures quickly and decisively in order to ensure that the immediate pressing needs are met, especially with regard to access to capital and the presence of positive cash flow. The retention of existing customers becomes pivotal.

If a company is in maintenance mode, it does not mean it can continue with business as usual. There needs to be constant striving for continuous improvement; whether that means focusing on cost reduction, taking customer service to the next level, enhancement to technologies or processes, optimization of resources, or finding the next new idea.

Sometimes in a downturn, there is the opportunity for an organization to be in a growth mode. This is the time to test new ideas, create strategies to greatly differentiate your company and its products or services in the marketplace, go after market share, or manage the risk while pursuing new approaches.

To fully navigate through the tough times, the focus needs to be both outward and inward. Looking outside your company means focusing on your customer base, choosing new markets, creating strategies, and following through with communication.

Retain your customers during this time. Work hard to ensure customers experience added value from your product or service. Link your value proposition to customer expectations - wanting either the comfort of the familiar or the surprise of something new. Do customers feel that you are supporting their mission or need during these times? Sometimes this may even mean fostering a partnering relationship with your customer. Make it pleasurable for your customer to do business with you. Work all your networks as well. Make sure current customers remain satisfied; you cannot afford to lose them.



Figure 1. Managing external issues

Build breadth and depth with existing customers. Explore ways to extend what you can provide them. Use your solid relationships to cross-sell products or services, as well as using current points of contact to sell you further into a client organization. The closer your partnering relationship with a customer is, the more a customer feels understood by you and the more your points of contact are with the customer, the less likely that the customer will be able to break off a delivery relationship with you. With existing products and on offer, within an existing marketing base you would focus on ideas for market penetration. Because you are staying with the familiar, costs for this approach can be minimized and current knowledge maximized. Cutting prices is not always the best strategic decision to make.

Create new customers for your products or services. This could entail positioning yourself in different markets, or with different customer demographics. In order to do this, different features of, and benefits from, what you offer would need to be highlighted as a good fit for different customer needs that are identified. Different distribution and access routes may need to be established. Sometimes looking beyond the obvious uses for your products or services may open up new opportunities for market penetration. Look for ways in which your products or services can be different from competitors in the market. Remaining with your current knowledge base, expertise, or technology allows you the opportunity to concentrate on expanding your reach in new markets.

Revisit your strategy and more adeptly to the current environment. Flexibility, adaptability and faster response times are essential during tough times. Sometimes it is about having an interim strategy that will still align with your long-term strategy that is a good five to ten years out, but is primarily focused on navigating through the changing circumstances successfully. Sometimes it is about taking an innovative approach, one that precludes increased money spend. However, this does not mean that you neglect innovation efforts; you need to remain ahead of the competition.

Now is the time to keep communicating – with your customers, your managers, your staff, and your suppliers. Fear is always elevated during these times and having real facts presented, feelings acknowledged, and a pathway to follow can go a very long way to mobilizing your people and helping them to deal with the stress of the times. Address the elephant in the room in a judicious way. Ensure that rumors do not become the primary source of information. Create a communication plan concomitant with your strategic plan. Determine key leverage points when a message will have maximum impact and then design the appropriate format and content for the different audiences in your organization. Don't neglect your external communications either. Make sure the communications strongly reinforce your brand and build marketplace confidence in your product or service, and the organization. Communicate carefully and often – keep connected!

Align the organization to the environment in which its operating, then align the overall strategy of the organization to all its internal operations. Looking inward in the organization entails managing the internal alignment and focusing on consolidation of efforts, reducing costs, chasing cash flow, aligning the culture to the strategy, enhancing competencies, and championing the changes that need to occur.

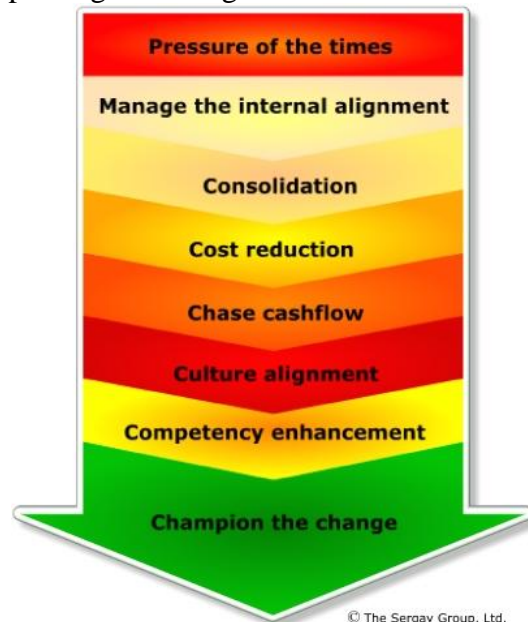


Figure 2. Managing internal issues

In tough times, positioning the organization in the marketplace is crucial and strategies need to be devised accordingly. However, not to focus on increasing internal efficiencies would be negligent. Challenge the existing processes. Question if the processes are even essential to effectiveness – should they exist? Then, check the process flows to ensure that no obstacles exist throughout the process flow – are there pain points, wasted effort, redundancies, unnecessary complexities, or excessive resources required? If any, or

all, result in negative outcomes, you know where to focus your efforts to streamline your processes.

Other questions to ask are as follows. Are the existing systems adequately supportive of the processes? Does the structure easily enable the processes and the interfacing required? Is the operation appropriately equipped? Can the people and their competencies be more effectively utilized? How can procurement be optimized? Can inventory and waste management be improved? Is resource allocation being effectively handled?

Track the financial numbers and ensure the costs are minimized while still ensuring that the money that is spent is done so in alignment with the strategy. Reduce unproductive expenditure. But remember that successful growth does not come from reducing costs – so keep your cost reduction efforts in perspective.

You need financial stability to sustain your operations through an economic downturn. Without cash flow to roll over operating costs and with limited access to capital, the ability to focus on what needs to be done is severely constrained. This, in turn, may present the very real threat of having to close the doors of the organization. Plot the profitability of projects, don't spend more than its projected return (in actual revenue or in value), work within a realistically set operating budget, resource correctly and improve efficiency so as to release resources for revenue producing work, and aim for annuity business if possible. Ensure the decisions you make allow for sound cash flow management.

Culture, as a learned system of meanings that inform the way we do things around here, is a strong force within any organization. Tough times definitely call for a re-examination of the current culture to determine those aspects of it that will help us move forward and those that will hold us back. Having done the external environment analysis and establishing the strategy that is best suited to penetrate the market, meet customer needs, and ensure the organization's profitable longevity, then it becomes essential to ensure that the culture is aligned to the strategy to enable it to be realized. Define the required behaviors. Strong moves need to be made by the leaders to embed desired behaviors into teams throughout the organization. This can be achieved through role modeling, leadership practices, performance management, communication, and reward and recognition. The aim is to continually reinforce desired behaviors.

The core competence of the organization needs to be clearly defined. It must be one that ensures the organization can fulfill its mission, be competitively positioned in the marketplace, and achieve its vision. Available capacity needs to be established throughout the organization and opportunities to improve on employees' competency levels need to be made available. This could involve ensuring cutting edge capabilities, building skill sets that allow for multi-tasking, and providing generic competencies that are required across the organization at different levels to embed a culture and to mobilize optimum performance for the future. Invest in competencies now that are required to fulfill your strategies moving forward. You cannot afford not to invest in your people – even during tough times. Assist your employees to cope with the stress of dealing with uncertainties in their lives. Provide them with the skills to navigate their way through all the changes they are facing. Often times, when focus is placed on employee development during tough times, it can allay fears and emphasize the organization's commitment to, and belief in, its people.

Determine the changes that will be required from the formulated strategy. Think through the entire change process in a systemic way so that all implications are thought through and all possible consequences are noted. These would be the consequences for

every stakeholder. All changes need to be integrated. Create action plans to bring the changes about. Do so in a manner that ensures all stakeholders are involved, responsibilities are set and people are held accountable for them. What employees are going to lose by the change should be acknowledged. The realities of the difficulties must be faced. Most importantly, the change efforts required to move through the tough times must be championed strongly from the top of the organization. A positive, committed voice needs to be heard, a visible presence must be seen, and support must be felt for employees to navigate a change without feeling isolated, alone, and fearful. People need to be propelled by a positive view of the future and feel confident in the strategy that is formulated to get there.

Think through as many scenarios as possible so that you can proactively formulate a plan of action that can be adapted as circumstances change. Facilitate the alignment necessary within the organization. Engage your employees in the process. Seek out sustainable growth opportunities. Make sure you are well positioned to forge ahead when the economic conditions improve. Finally, have the courage to lead in this challenging environment.

3. CONCLUSIONS

Thus there some needs for an organization to fulfill in order to overcome the crisis, of both internal and external nature. External issues and how these are addressed by ABM are as follows:

- maintain and improve customer focus; ABM is based upon value creation; in a crisis environment how value is defined by customers is the main way a company should think in order to steer its own processes;
- choose new markets, continuously search for new business opportunities in light of ever shifting level of organization's products and services profitability; crisis cuts profit margins so precise profitability information is crucial to establish the moment of moving on to new markets;
- develop and implement suitable strategy; ABM could deliver the basis to put a strategy in place, a strategy that is activity oriented, with business decision solidly based upon precise accounting information and no gambling involved;
- efficient communication within the organization is the basis for avoiding amplification of crisis effects on the company. People should be communicated what management expects, and management should be communicated what are the real situation within the organization.

Internal issues to be solved in a crisis environment are:

- cost reduction; this is one of the most important features and outputs of ABM, although it does not directly cuts costs but points out where cost cuts are possible;
- cash flow improvement; profitability of products and clients is as well related to cashflow by adding a new dimension to products and clients performance – that of ease and duration of converting receivables into cash inflows;
- culture alignment; implementation of ABM usually is accompanied by more or less profound changes in the way organization does its business and people around the organization complete their jobs; thus some changes in its culture are inevitable; these changes might as well be redirected to incorporate “best practices” in different areas;

▪ competency enhancement; without ongoing improvement of people's competencies ABM will not generate expected results; these competencies are both the cause as well as the effect of ABM.

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