

ABC METHOD CONTRIBUTION TO BUSINESS PERFORMANCE

Alexandrina Maria PAUCEANU* and Mohamed Wamique Hisam*

Abstract: *In the modern business environment, the dynamic nature of business has compelled business managers to come up with various strategies to remain relevant in the industry. This is necessitated by the need by businesses to make profits, beat their competitors and importantly, satisfy the shareholders and customers. To achieve this, business leaders have recognized the role played by innovation in performance. Of late, activity - based costing (ABC) method has gained concern and interest among both scholars and administrative accountants, from the time it was introduced. Researchers and scholars believe that ABC is a new management accounting model that can improve the commercial orientation of administrative accounting and assist institution choices through regulating progressively cultured methods. In spite of the great concern shown by researchers, institutions appear to be unwilling to implement ABC model. Various examinations indicate that the spreading of ABC has not been penetrating as anticipated. The scope of the present research is to analyze the contribution of activity-based costing (ABC) method to business performance, how it was assumed and applied internationally and within Romanian institutions; establish the key encounters recognized when embracing and applying ABC; establish the key benefits and drawbacks of such a cost method. To attain this aim, the scrutiny of the prevailing literature in the field and earlier studies made at global standard started, then a survey – centered experimental research and exploration of ABC adoption within Romanian enterprises is paramount.*

Keywords: *administrative accounting, activity - based costing (ABC), business performance, Romania,*

INTRODUCTION

The evolution of business sector in the modern world creates the need for companies to ensure that they perform better than the competing firms especially customer satisfaction. Most companies set aside funds specifically for the market research so as to identify the opportunities and threats that may affect the performance of a business. (Pauceanu, 2016).

According to business analysts, while managing business, organizations have to align innovation with the business objectives that they have set for themselves. As such, the management has to ensure that it gives equal attention to innovation

* Department of Marketing and Management, College of Commerce and Business Administration, Dhofar University, Salalah, Oman, E-mails: mariapauceanu@gmail.com; apauceanu@du.edu.om; mhisam@du.edu.om

and business, and at the same time, foster the culture of creativity in business. Alterations in the business atmosphere like globalization and scientific revolution; new encounters concerning products, facilities, superiority, distribution conditions are having substantial effect on manufacturing procedures, administration, pricing and administrative accounting structures. In the current competitive business atmosphere, institutions have to pinpoint and remove actions and procedures that are worthless; they should be “client focused”; they require appropriate economic and non-economic, qualitative and quantitative data to direct their calculated choices; client gratification should be utmost concern. The traditional cost methods are considered to be incomplete as they do not offer detailed data to the company administrators; they can result to incorrect choices by disregarding the fact that compound products require more inputs than simple designed products. It may further lead to the majority of managements characterized by inefficiency and incapability of adapting to the needs of the fluctuating atmosphere (Anderson & Young, 2001).

Due to these challenges researchers have responded by turning to the managerial explorations and cost accounting incentives. Some management accounting methods, such as strategic management accounting, ABC, and aim costing among others were recognized and proposed. Several of them like ABC acquired great reputation amongst researchers and professionals. The inventors of activity-based costing suggested it for economic, formal, accurate and determinable motives; they argue that ABC target at helping business choices and regulating progressively cultured methods, and demonstrate to be a flexible and updated choice sustenance method that could tackle the challenge of growing operating cost and concurrently offer deliberate data. Lastly, ABC is considered for stimulating rationality, effectiveness and, finally, productivity, being the reason prospective utilizes express willingness. As seen today ABC has gained interest of researchers, scholars and professional at a significant rate in recent past, but regardless of the solid support approving activity-based costing the adaptability is not inspiring. Research indicated that majority of the companies and professionals appear to be unwilling to adopt the ABC model (Coners, 2007).

SIGNIFICANCE OF THE STUDY

To explore implementation of ABC method and suggest ways in which the rate of adoption might be increased among the companies. The research also expounds more on the slow rate of adoption of ABC method. The information acquired through the research can be used by companies when implementing ABC system.

OBJECTIVES

The aim of this research is to explore, investigate and show how ABC was received by organizations and professionals; the main encounters recognized when adapting

and applying activity-based costing: main benefits and drawbacks of such stylish cost method.

AN OVERVIEW OF ABC (ACTIVITY-BASED COSTING) METHOD

Activity-based costing method is considered amongst the most significant incentives in cost calculation and administrative accounting. It originated from the United States of America as an outcome of numerous theoretic and applicable explorations of the U.S researchers (the most notable were Robin Cooper and Robert Kaplan). Both of them wrote various literatures and articles concerning proposal, application, benefits and drawbacks of ABC method. ABC was established as a strategy to handle challenges related to outdated cost management structures that exhibited inability to correctly decide real creation and facility expenses, or give the necessary data for functional choices. With the increased overhead costs, old methods continually prove to be incorrect since the indirect costs were not mutually as a result of all products. Accordingly, when various products have mutual costs, there is a threat that one of the products funds the other, and being the reason managers were making choices established on incorrect information (Fei & Isa, 2010).

The ABC method is founded on the idea of the activity as well as on the notion that activities utilize resources, not products and numerous activities are utilized in the manufacturing practice. Implying that in any enterprise the subdivision of activities is more essential than the subdivision of products or roles. If the cost of particular activities is known, the cost of every activity is distributed among all products and to the degree the products utilize the activity. In this manner, ABC usually recognizes parts of major operating costs for every item and so focus on devotion to getting the best methods to minimize the costs or increase prices for costly products. ABC emphasizes on the origins of indirect costs assigning each product's cost into two step stages. Indirect costs such as rent, services, and indirect work are first included to the total costs. Later on, the costs are subdivided to individual product cost. In this manner, activity scrutiny is allowed, cost alteration is avoided, waste is reduced, and valueless activities are escaped (Hoozze & Hansen, n.d.).

Initially the ABC method attracted a lot of interest among both researchers and professionals. Many literatures were written praising it since most people believed it could be the best remedy towards solving companies' challenges and improve their business operations: promoting rationality, effectiveness, and gross profit. Others believed that ABC has a worth-increasing consequence on costing decision and income performance; enabling improved cost distinction between products, consumers and markets. In spite of the warm reception of ABC, the implementation extent of the system within companies is not pleasing. Study conducted indicated that, over the last ten years, there has been increasing

knowledge of ABC though the total rate of application is still low. In the 1990's the rates of application in the USA and Europe were very low. In US, only 18% had implemented the system while 58% were on the process. Ten years later, a research indicated that about 15% to 20% US organizations had adapted the system and a similar number regarded it as positive. In Europe, the rate was almost similar to the US in 1994; it was 19% while in 2000 it had shifted to 20%. Apart from France and Belgium, where adoption rates were about 20%, other countries recorded rates of less than 10%. In Finland, the rate of adoption shifted from zero in 1986 to 17% in 1995. The gradual change is attributable to mistrusting the traditional system of information and failure of it to meet modern administrative requirements. Asia recorded minimal ABC adoption rates of 13% in Singapore, 4% in Malaysia and 2% in China. The rates were comparatively high in India about 20%. The high rates in India were as a result of the need by companies to comprehend activities well and recognize activities that increases costs (Robinson-Backmon, 2011).

An online survey conducted by professional business managers and IT experts, in various countries, also indicated that ABC model is not highly adopted and implemented. The survey involved 628 companies from 33 countries. Among the main reasons for the low adoption and implementation in developing countries were the small sizes of companies, low competition, and inadequacy of resources. Some managers who were requested to participate exhibited low awareness of ABC or no information of it at all. The majority of the managers declined to participate; this was an indicator that they did not find the importance of ABC or it was a new term to them. However, all the managers of companies that implemented the ABC system praised the system of its effectiveness as compared to other old systems; however, they complained of it being expensive to implement and sustain (Anderson & Young, 2001).

ACTIVITY-BASED COSTING IN ROMANIA

There are several studies that scrutinize the development of administrative accounting in Romania; the administrative accounting procedures, tools and skills utilized within Romanian organizations; the significance, quality and utility of administrative accounting data in choice procedures. Study conducted in 2010 targeted to find the attitude of administrators of Romanian organizations concerning the data acquired by administrative accounting, and to recognize the exact calculation and reporting instruments employed for gathering and scrutinizing administrative accounting statistics. The data was obtained as follows: manufacture (17%), facilities (39%), delivery (37%) or other activity spheres (7%) (Wnuk-Pel, 2010).

RESEARCH METHODOLOGY

A structured questionnaire was designed and presented to the expert accountants who were members of Corpul Expertilor Contabili si Contabililor Autorizati din

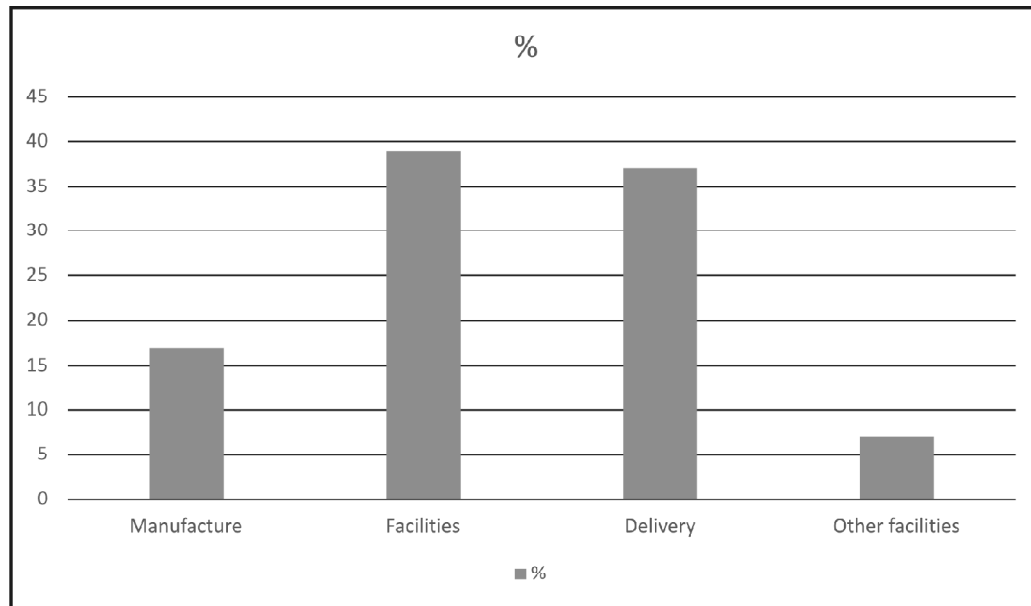


Figure 1: Graphical representation of sector involved in data collection.

Romania (The Professional Body of Expert and Authorized Accountants in Romania). During the study the respondent were required to show if the companies adopted old or modern administrative cost accounting procedures, tools and skills; determine the role of managerial accounting and cost systems within their businesses, and to determine to what degree they depended on data concerning administrative and cost accounting when deciding. A covering letter clarified the need of the research and guaranteed privacy of the statistics given. Instruction set required to fill the inquiry form appropriately was also included. The questionnaires targeted about 1879 skilled accountants. The mailing attempts accrued 202 replies, producing a reaction rate of 9.4%. Of 202 replies, 33 replies were excluded, remaining with 169 helpful reactions. The data acquired was administered using SPSS style and was evaluated with the assistance of elaborative information (Wnuk-Pel, 2010).

FINDINGS

The data obtained from the 169 experts indicated that 22.51% of the interviewed utilized the universal absorption process; 27.64% employed work costing; 9.69% used direct costing; 14.85% adopted ABC; 6.26% employed objective costing and 19.05% of the interviewed were not aware of the methods they utilized or they utilized none at all. The conclusion drawn from the data was that administrative accounting data is significant for Romanian administrators for corporate progress; for controlling and lowering costs; for determining the selling costs of products

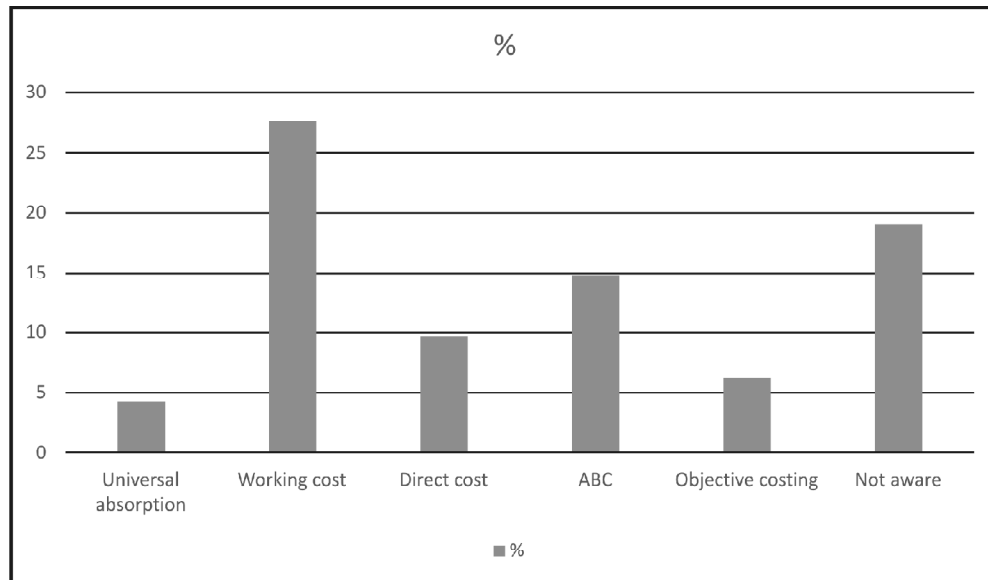


Figure 2: Graphical representation of methods applied by companies.

and services or to improve the worth of products and services but they too employed old administrative accounting procedures, tools, methods and cost structures to “produce” this kind of data (Robinson-Backmon, 2011).

The partakers of the research were derived from different industries: services, 52.4%, manufacturing, 27% trading, 12.8%, and the remaining 7.8% included activities sectors such as hospitals, schools, and banking among others. From the data, Romanian companies seemed to value the significance and need of administrative accounting and cost calculation since they adopted administrative managerial accounting processes. Despite adopting administrative accounting systems the companies did not follow the established technique; they preferred to develop their own means and practices. Furthermore, Romanian companies’ concentration on cost determination; they relate administrative accounting with cost determination, and the determination of production costs. Several companies consider that administrative accounting expands production procedures and internal operations as well as recognize and eradicate redundant actions. Due these features old managerial and cost accounting methods, such as procedure costing or overhead costing, were established to be more broadly implemented than the lately and modern established techniques (Khodadadzadeh, 2015).

RESULTS AND DISCUSSIONS

The results indicated that for modern cost techniques, only 15.5% of the participants had fully implemented the ABC system, 10.7% of the participants indicated that

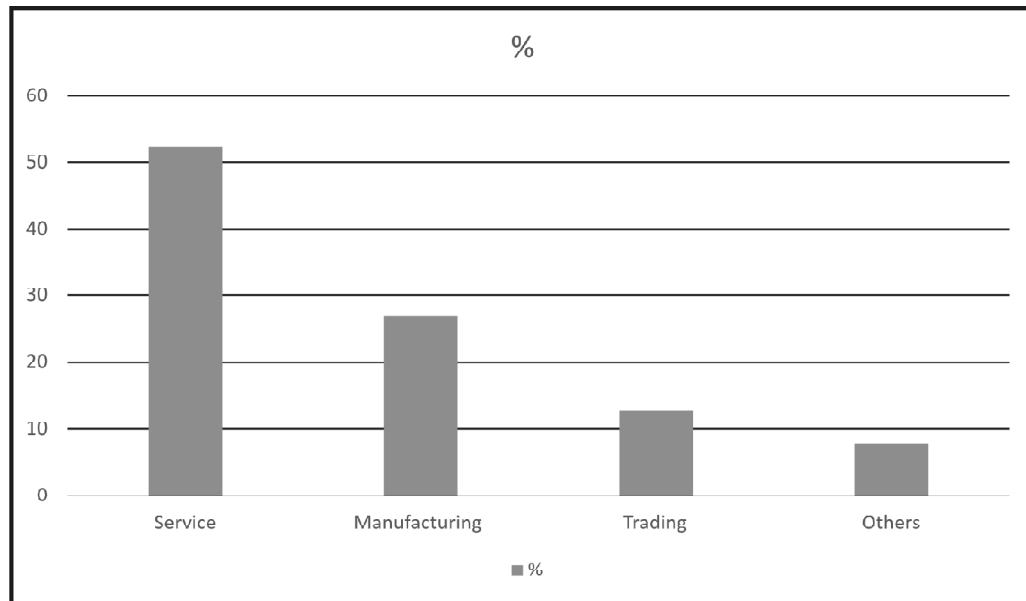


Figure 3: Graphical representation of sectors involved in data collection.

they had adopted ABC but later left it; while 74.8% of the respondents were either aware of existence of such system and ignored while others were not aware at all. The participants were requested to give the major reason for adopting ABC; while those who had not adopted it or were not aware of it were requested to give their reasons that made them not adopt the system. Among the given reasons for implementation included; to get more accurate costing data, proper distribution of overhead costs, and proper determination of clients' profitability, management requirement and progression of performance signs. Major drawbacks for the adoption included: high adoption and maintenance costs, lack of administrative and staffs' willingness and fulfillment of the current cost structures. The results indicated low implementation rates of ABC among Romanian organizations. Romanian organization still favor old cost structures; but it appears that the globalization, the development of international corporations requiring to get more accurate data on costs, economic and non-economic performances are aspects that cause the employment of current and advanced costing systems and skills. It is evidenced that the Romanian companies are at the initial level of the utilization of advanced cost structures such as ABC, but the fact that most companies are aware ABC system, they may employ it in the future (Robinson-Backmon, 2011).

The companies that apply ABC have two significant benefits. The first being the allowance of ABC to fully scrutinize the whole production progressions. The scrutiny analysis may lead to production progression, more effective resource utilization, cost decline, administrative performance, and profound planned choices

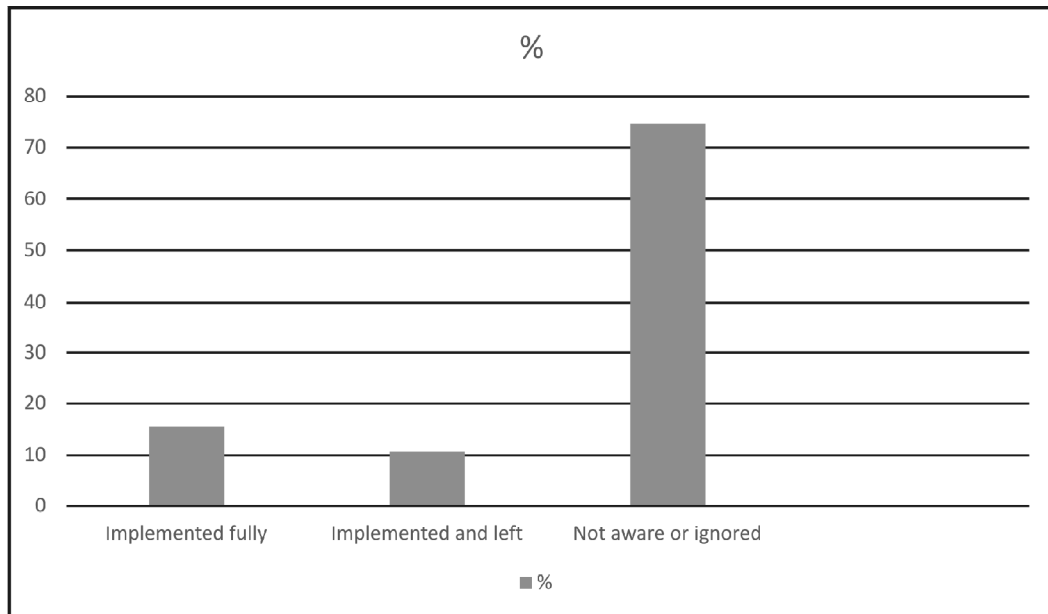


Figure 4: Graphical representation of ABC implementation.

on pricing, product specification and market fragments. Second, ABC enables corporations to alter the combination of products manufactured and clients attended, enabling them to concentrate on the gainful products and productive consumers. Furthermore, upgraded product costs enable profound estimations of work costs for cost setting, accounting and preparation. In addition, it enhances the correct cost data, managers can acquire non-economic information so as to improve the judgment procedure: enhanced product strategy choices, improved customer sustenance choices, and nurturing value development plans (Jones, 1996).

Despite the benefits, the administrators should know the system has some restrictions. At times it is hard to openly differentiate the various activities, resource utilization or product cost. Exclusion of any cost related to the product or service, is another challenge that might appear. Activities costs such as distribution, promotion, research and enlargement, product trade are also usually excluded in products' cost. Although these kinds of cost are direct, and can be attributable to certain product or service, ABC application is expensive and at times it may pose a challenge in appearance of several activities. ABC application is a combined course, it pools new cost control instructions and may result to the change of attitude and behavior. If the application procedure doesn't anticipate on the manner of perception of the staffs, the formations related to clients, and internal procedures, and then the outcome will just be a minimal enhancement of competence with no development in competitive benefits of the company (Kang, 2015).

CONCLUSION

From the research, the adoption and implementation of ABC system is low among the Romanian companies. The low adoption is attributable to ignorance, initial and maintenance of the system. For the purpose of increasing the rates, the awareness of existence of the ABC should be created. Also, providing data of companies that have succeeded by adopting the ABC will heighten adoption rate. It is clear from the research the companies that have implemented the system acquired benefits like product and client productivity scrutiny; progression of internal organization procedures. However, the companies with ABC system were also faced by various challenge such as lack of willingness and co-operation between management and staffs (Kang, 2015).

The research indicated that the Romanian organizations are on their initial stages of implementation. Romanian professionals appear to continue to work with the old methods; they appear to be satisfied with the old administrative accounting processes, methods, and skills regardless of the fluctuations in the economic surroundings. They also prefer work under costing or procedure costing instead of ABC since they have minimal or lack options; or because there is no willingness or assistance offered to them by the administrators or workers. The administrators should not be contended with unexceptional outcomes; they must be willing to adjust particularly when there is an opportunity to improve resource utilization and to progress products and internal organization procedure's effectiveness (Jones, 1996).

It is clear that the adoption and implementation of activity based costing varies among different countries; from company to company and do not give the same impression to all companies. However, inconsideration of the globalization, scientific advancement, and increased competition Romanian organizations' will be forced to adopt and implement activity-based costing so as to progress cost determination accuracy; to resolve major challenges, and to acquire organizational advantages at a multi-dimensional level (Nachtmann& Needy, 2001).

References

- Anderson, S., & Young, S. (2001), *Implementing management innovations*. Boston: Kluwer Academic Publishers.
- Coners, A. (2007), Time-Driven Activity-Based Costing. *CON*, 19(6), 343-346.
- Fei, Z., & Isa, C. (2010), Factors Influencing Activity-Based Costing Success: A Research Framework. *International Journal of Trade, Economics and Finance*, 1(2), 144-150.
- Hoozze, S., & Hansen, S. A Comparison of Activity-Based Costing and Time-Driven Activity-Based Costing. *SSRN Electronic Journal*. 1(6), 34-45.
- Jones, C. (1996), Activity based software costing. *Computer*, 29(5), 103-104.

- Kang, M. (2015), Activity-based Costing Research on Enterprise Logistics Cost Management. *Business and Management Research*, 4(2).
- Khodadadzadeh, T. (2015), A state-of-art review on activity-based costing. *10.5267/J.Ac*, 89-94.
- Nachtmann, H., & Needy, K. (2001), Fuzzy Activity-based Costing: A Methodology for Handling Uncertainty in Activity Based Costing Systems. *The Engineering Economist*, 46(4), 245-273.
- Pauceanu, A.M. (2016), Business Performance Management – An Innovative Approach, Lumen NAHSH 2016 Proceedings volume, Medimond - Monduzzi Editore, Italy
- Robinson-Backmon, I. (2011), An Activity-Based Costing Model For Dental Schools: Is ABC A Feasible Costing Alternative? *Journal of Business & Economics Research (JBER)*, 2(3).
- Wnuk-Pel, T. (2010), Application of activity - based costing in companies in Poland. *Comparative Economic Research*, 13(3).