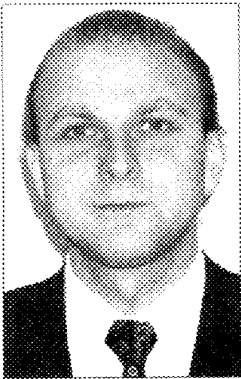


# Activity-based management: its purpose and benefits



**Mark Hixon BSc, PhD attempts to resolve the confusion surrounding ABM**

The advent of business process re-engineering (BPR) has led to a resurgence of interest in performance-improvement techniques. Unfortunately, the marketplace is now cluttered and confused, with an abundance of TLAs (three-letter acronyms). This has in turn led to companies embarking on initiatives only to find that the product purchased has not fulfilled their expectations. To some extent this can be attributed to clever marketing by consultants but it is unfair to assign the blame solely to the consultants—a certain amount of blame must be shouldered by 'uneducated' purchasers. The issue is still one of how to make potential purchasers aware of the different emphases and nuances of the various products in the marketplace.

This article aims to clarify the purpose and benefits of ABM.

There are numerous definitions of ABM and this is possibly why there is some confusion surrounding ABM. It seems that people treat ABM and BPR as synonyms—but ABM covers all aspects of the organisation whereas true BPR only affects the core processes; ABM should be ongoing whereas BPR is generally 'one-off'. 'Activity-based management is the management and control of enterprise performance using activity-based information as the primary means of decision support.' This definition may appear to be all-embracing but true ABM involves the use of activities in planning, budgeting, costing, modelling and performance measurement. It is therefore of fundamental importance for organisations to have a clear *vision* of how they want their ABM system to look and to define the information such a system should deliver. *This vision should be agreed prior to implementing such a system!*

Very few organisations have undertaken *true ABM* since more often than not it is used as a one-off performance-improvement tool. The most common approaches commence with some kind of activity analysis followed by activity-based costing (ABC) which is then used to generate performance improvement ideas. *ABC is not ABM.* [ABC is the tracing of activity costs onto cost objects. These cost objects can be products, services, projects, customers, distribution channels etc.]

## **Current malpractice**

ABM is fundamentally different from the way in which we manage today. In fact the way we manage today can actually hinder performance improvement. Consider the following common current practices:

### *1 Budgeting by cost element*

Problem: work is not visible. All cost centre statements appear similar—only the numbers against the cost types change. For example, every cost centre could have the following cost types in its budget—staff costs, local purchase, communications, information technology, travel and subsistence etc. However, an outsider cannot see what the cost centre actually does! Imagine the benefits of seeing a cost summary where all work is visible.

### *2 Organising functionally*

Problem: there is optimisation within individual departments, internal competition and little or no cross-functional co-ordination. This can be a recipe for disaster.

Imagine the case where the sales team promotes new products without liaison with the service providers. The service providers are then forced to create/adapt new products regardless of the overall effect on the business.

ABM allows all activities to be linked to business processes and hence encourages managers to take a cross-functional view of the organisation. Some organisations have even taken the step of appointing 'process owners' in order to promote the importance of process management.

### *3 Incremental budgeting*

Problem: wasteful activities are hidden. Managers assume that activities performed during previous years are all adding value to the department—this is fundamentally incorrect. ABM involves a review of every activity within a department.

### *4 Hierarchical organisations*

Problem: improvement is seen as management's responsibility. Staff do not feel empowered to make decisions and communication channels are long and complex. ABM encourages people to focus on business processes and hence eliminate the need for complex management structures often associated with functional organisations.

### *5 After-the-event reporting*

Problem: variances are not prevented and by the time that they are reported it is often too late to take corrective action. ABM provides a performance-management system which, like statistical process control, provides 'feedforward' as opposed to 'feedback'. ABM is especially powerful if integrated with total quality.

### *6 Fixed and variable costs are separated*

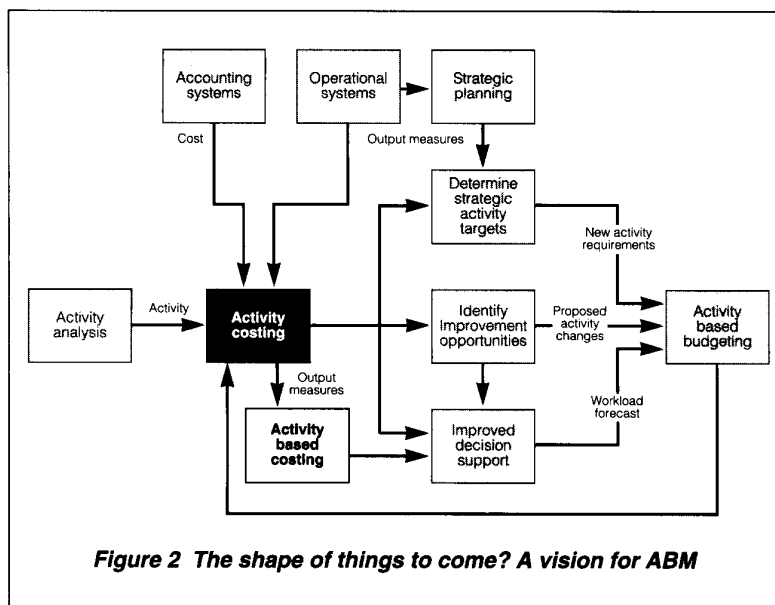
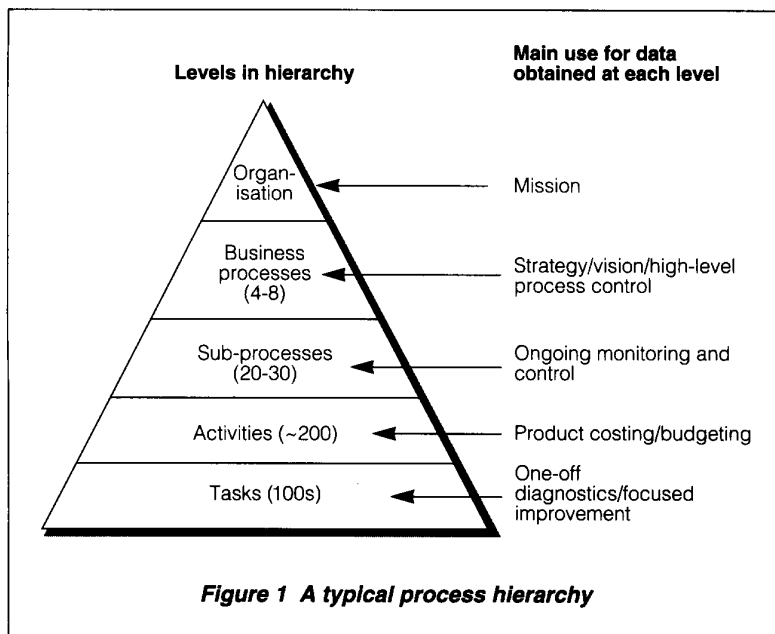
Problem: a 'fixed' cost is a cost we cannot change, therefore we shall ignore it! We must move towards the concept of used and unused capacity. For example, do not apportion all your property costs across all departments. ABM identifies how much space you really need and highlights the rest as excess capacity.

This approach removes the 'mind set' of fully utilising assets with the sole aim of recovering overheads.

### *7 Improvement is the responsibility of the accountants*

Problem: no one else in the organisation 'signs up' to the improvement initiative. Managers feel bitter, staff lose commitment and the improvement initiative fails. ABM requires company-wide involvement.

ABM has evolved to alleviate many of the above problems but in order to succeed there are a number of steps that must be followed.



### The ABM approach

The ABM approach can be broken down into several steps.

**1 Planning**—this is not to be overlooked. Planning should involve developing a detailed project plan and should include an implementation phase. All too often companies embark on an ABM assignment and lose many of the benefits by not committing enough resource to the implementation phase.

**2 Education and awareness**—are key to the success of ABM. ABM is company-wide and ALL those involved need to be included in training. Training should be fun and preferably should include realistic simulation exercises that demonstrate the benefits of ABM. ABM is a tool for management and not to be undertaken by accountants in isolation.

**3 Process/activity definition**—should be done 'top down' and in a workshop environment. The aim of this phase is to define a structure for your activity database. A simple model linking activities to business processes is all that is required (Figure 1).

High-level process mapping should be undertaken prior to defining activities.

**4 Data collection (activity analysis)**—should exploit technology. Use standard packages for tracing general ledger costs to activities (especially during pilot studies or trials). Remember for ABM, 'it is better to be approximately right than precisely wrong!'. A good activity analysis should be flexible enough to be used for ABM, BPR, benchmarking and total quality.

**5 Performance improvement techniques**—should include *cost driver analysis*, *activity classification*, *performance measurement* and *activity-based costing (ABC)*. A *cost driver* is the root cause or reason for an activity to occur. It should not be confused with an *output measure* which is a volumetric measure quantifying how many outputs an activity produces. It is the output measure that should be traced to the cost object.

Activity classification should always include some kind of value-added/non value-added (VA/NVA) analysis and more importantly all staff involved in classifying activities should understand these definitions. A simple definition of NVA (in a TQ environment) is 'anything that can be eliminated without detriment to the final product or service'. Remember, activity classification is subjective—it is only a tool to assist with performance improvement.

Performance measures should be defined at process level and for key activities. They should be used to measure and control activities/processes and must be used to promote continuous improvement. Remember, if business processes are under control then the activities will also be under control.

All of the improvement techniques are consistent with the total quality philosophy of 'Right first time/zero defects', 'Conformance to customer requirements' and 'Continuous improvement'.

**6 Planning the ongoing system**—is probably the most challenging step, since few organisations have ventured this far. Some have 'done ABC' but few have implemented true ABM. Figure 2 illustrates a possible ABM system. This system is a fully integrated planning, budgeting, costing, modelling, reporting and performance-management system. The 'vision' of such a system should be defined as early as possible and the information requirements should be specified by all potential users. Failure to involve users will lead to the construction of a 'dinosaur'. This dinosaur will be extinct before it evolves!

**7 Implementation**—should be well planned and care should be taken to address 'change management' issues. A sponsor and owner should be identified for each major change. These people should be held responsible for the successful implementation of the change.

ABM is therefore a fundamental shift in emphasis. People do activities and activities consume resources—so controlling activities allows you to control costs at their source.

*Mark Hixon is a Senior Associate with Coopers and Lybrand. He speaks on CIMA Mastercourses on activity-based management and is a lead facilitator of Coopers and Lybrand's ABM business simulation exercise. He and his colleagues Jim Brimson and Keith Williams will be presenting a one-day seminar on 'Activity-Based Management' in London on 6 July. For further details contact CIMA Mastercourses on 0171 917 6588.*