
Activity Based Costing: How ABC is Used in the Organization

September 2005

Background

In July 2005, a study was conducted among BetterManagement members to determine the state of Activity Based Costing. An on-line survey was completed by 528 participants from companies across various industries, sizes, geographies and job levels. The specific objective of the research was to determine how Activity Based Costing is used in the organization.

Findings

The Respondents

Industry. The participants in the study came from a variety of industries. The manufacturing industry had the highest representation with 24%, followed by financial services at 18%, public sector at 16%, and communications at 8%. Other industries accounted for less than 5% each. (Figure A, Appendix)

Revenue. Small business under \$100 million in revenue accounted for the largest group in the survey sample (42%). Midsized businesses (\$100 million to \$1 billion) made up an additional 33%, while enterprises of \$1 billion or more in revenue accounted for 25%. A good portion of the respondents (10%) reported annual company revenue over \$10 billion. (Figure B, Appendix).

Status of Activity Based Costing

Over half of the respondents (55%) indicated that their companies are currently using Activity Based Costing either actively or in a pilot, with another third (32%) considering use. Only one in ten (11%) has not considered use of ABC. A very small portion of companies (2%) are no longer using Activity Based Costing. (Figure 1)

Not surprisingly, the use of Activity Based Costing increases with company size. While only 42% of small businesses are using or piloting Activity Based Costing, 58% of midsized and 71% of enterprises use some form of ABC. Overall, roughly nine in ten companies of all sizes are spending money on ABC or considering it. (Figure 2)

Figure 1: "What best describes the status of Activity Based Costing in your company?"

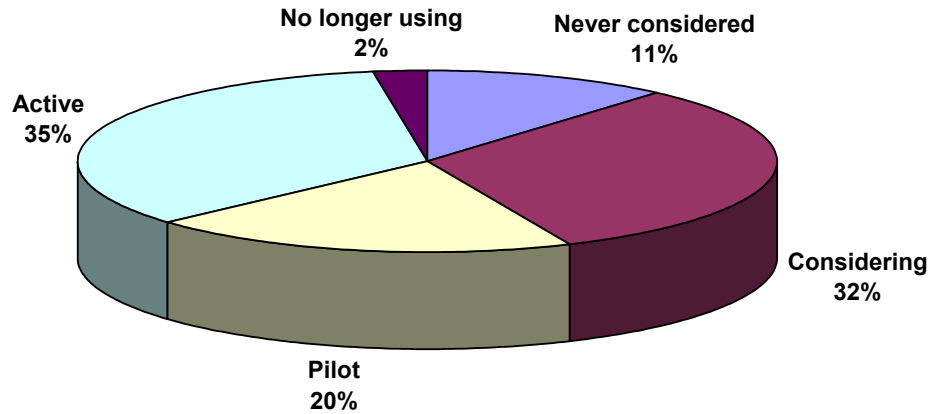
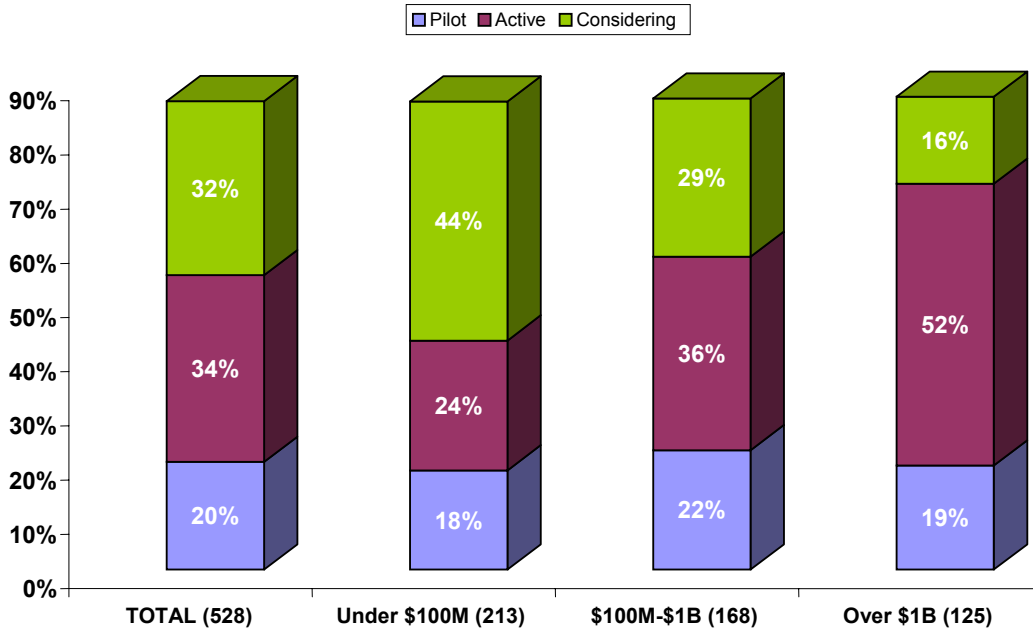


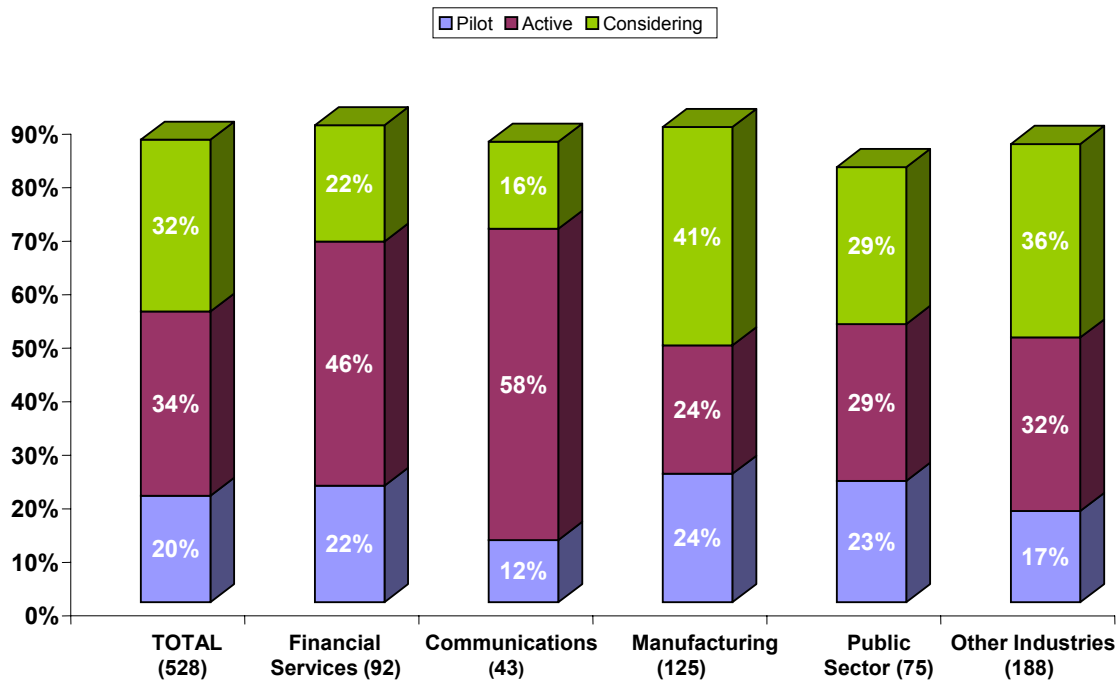
Figure 2: Currently Using or Considering ABC (by company size)



Use of Activity Based Costing also varies by industry, as reported by respondents in this study. Communications and financial services entities are much more likely than other industries to have active Activity Based Costing programs in place. Manufacturing companies seem to be lagging behind others in their adoption of ABC, with equal proportions in pilot phase and active (24% each). However, many in this industry appear to be in the market for Activity Based Costing, and a strong percentage are considering it (41%).

Firms in the public sector appear to be somewhat more tentative. While 52% currently report using some form of ABC, 19% of the public sector organizations are not considering ABC and are apparently not in the market. (Figure 3)

Figure 3: Currently Using or Considering ABC (by industry)



Primary Uses of Activity Based Costing

Survey respondents were asked how they use Activity Based Costing and were given the opportunity to provide one response. The primary use of ABC among just over four in ten companies (43%) is costing and cost control. Fairly equal percentages use Activity Based Costing primarily for process improvement (17%), product profitability (17%) or customer profitability (14%). (Figure 4)

Figure 4: Primary Use of ABC

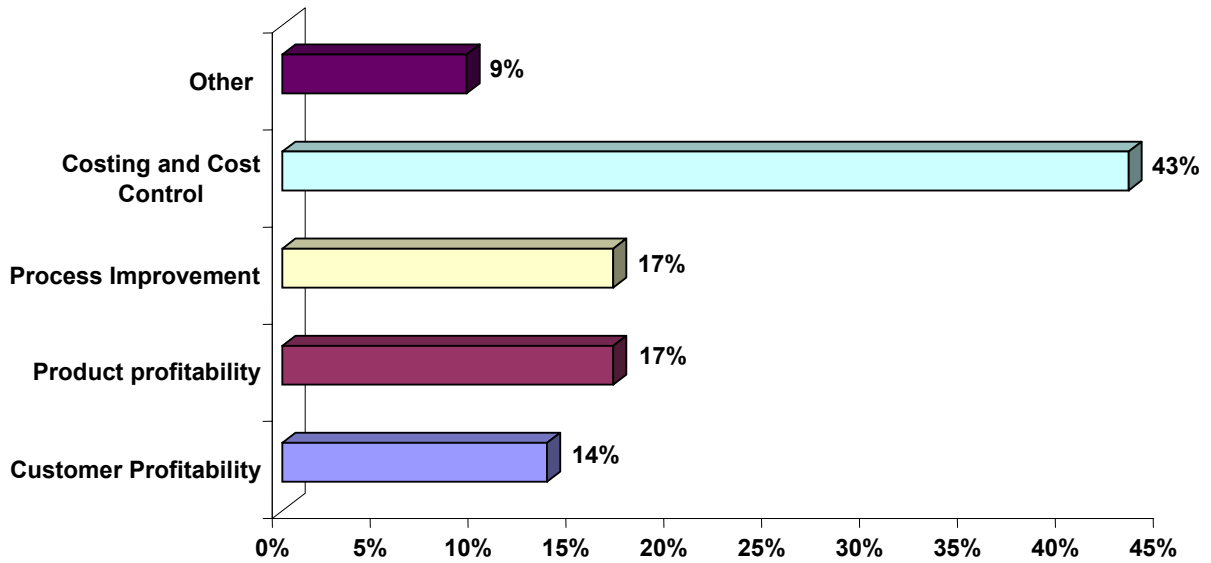
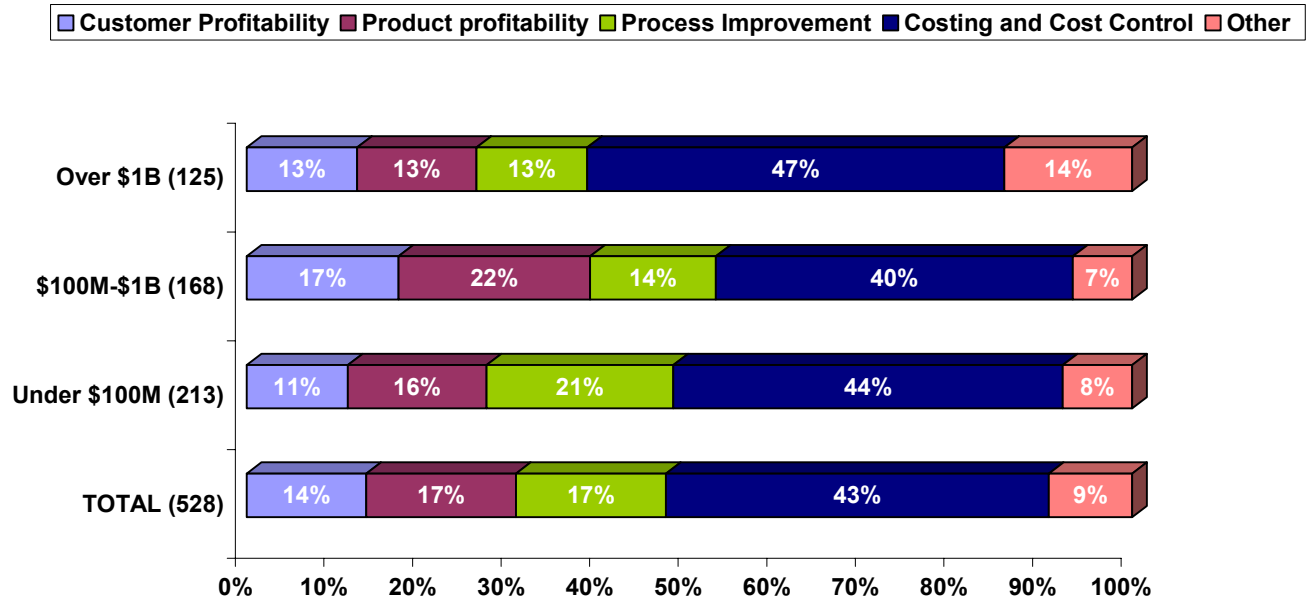


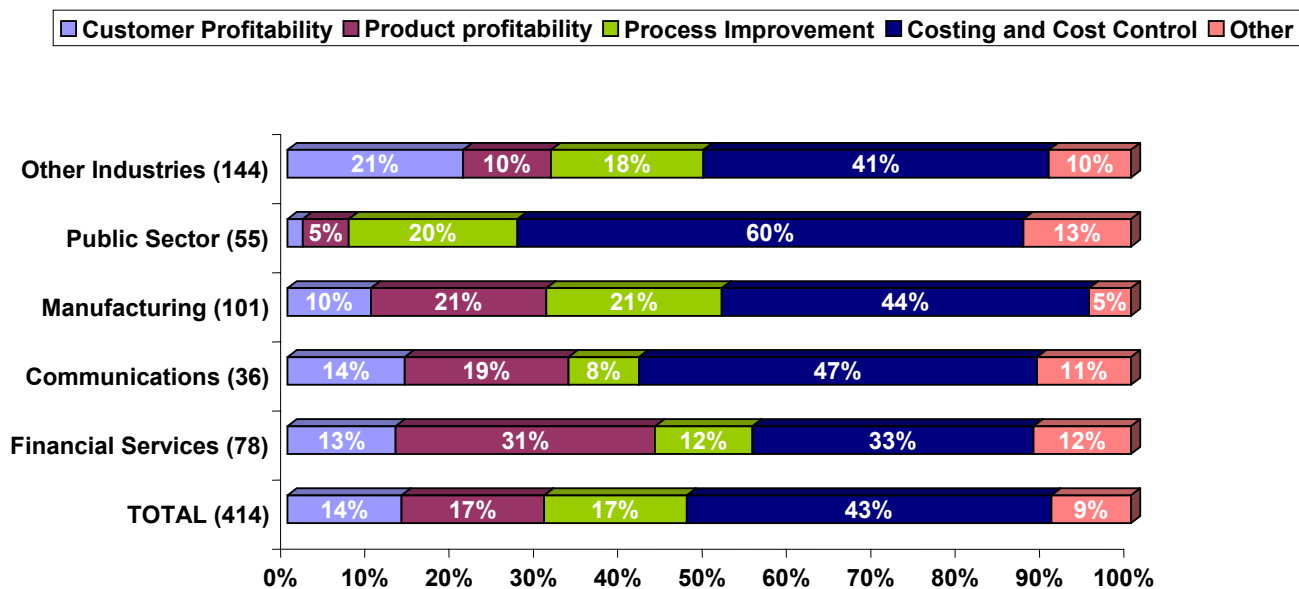
Figure 5: Primary Use of ABC (by size)



The survey revealed some slight differences in primary uses of ABC by company size. Costing and cost control were mentioned by more respondents than any other use despite company revenue. However, a higher portion (22%) of mid-sized businesses than other sized businesses cited product profitability as the primary use. Smaller businesses are more likely than their larger counterparts to use Activity Based Costing primarily for process improvement (21%). (Figure 5)

Primary use of Activity Based Costing differs widely by industry. In the public sector, the key focus is on costing and cost control (60%) and, as would be expected, no emphasis on profitability. Among manufacturing firms, the chief use of ABC is costing and cost control at 44%, but process improvement and product profitability are the main uses by equal numbers (21%). Among communications firms, process improvement is less of a focus than it is for other industries (8%). The two primary uses in the financial services industry are costing and cost control (33%), and, not surprisingly, product profitability (31%). (Figure 6)

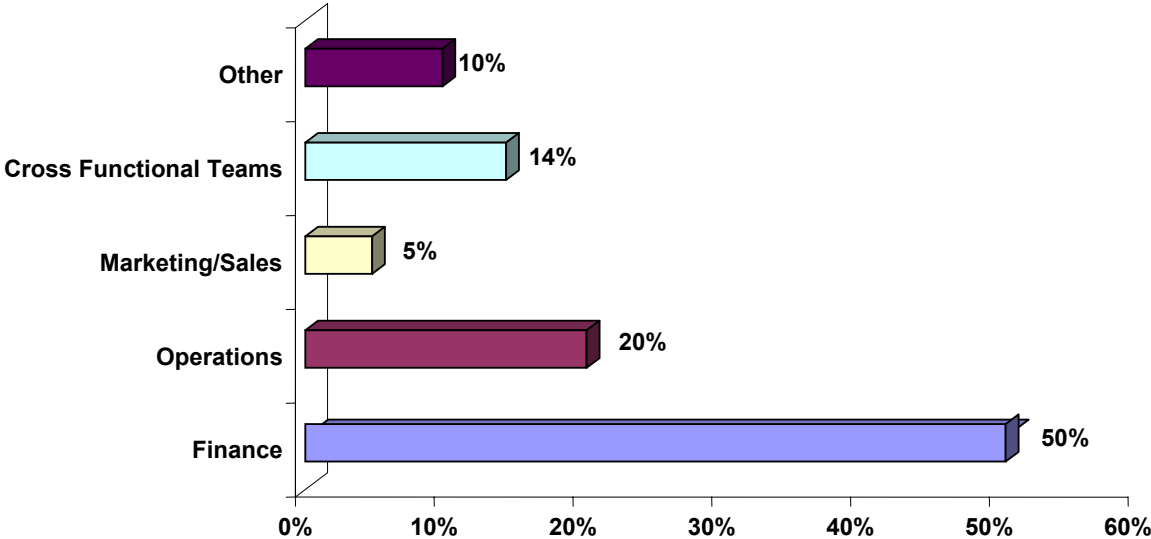
Figure 6: Primary Use of ABC (by industry)



Group Responsible for Initiating Activity Based Costing in Organization

The finance area initiated Activity Based Costing in half (50%) of the companies participating in this survey. Operations was responsible in one in five (20%) and cross functional teams account for 14%. Marketing or sales divisions initiated ABC in a very small number of companies. (Figure 7)

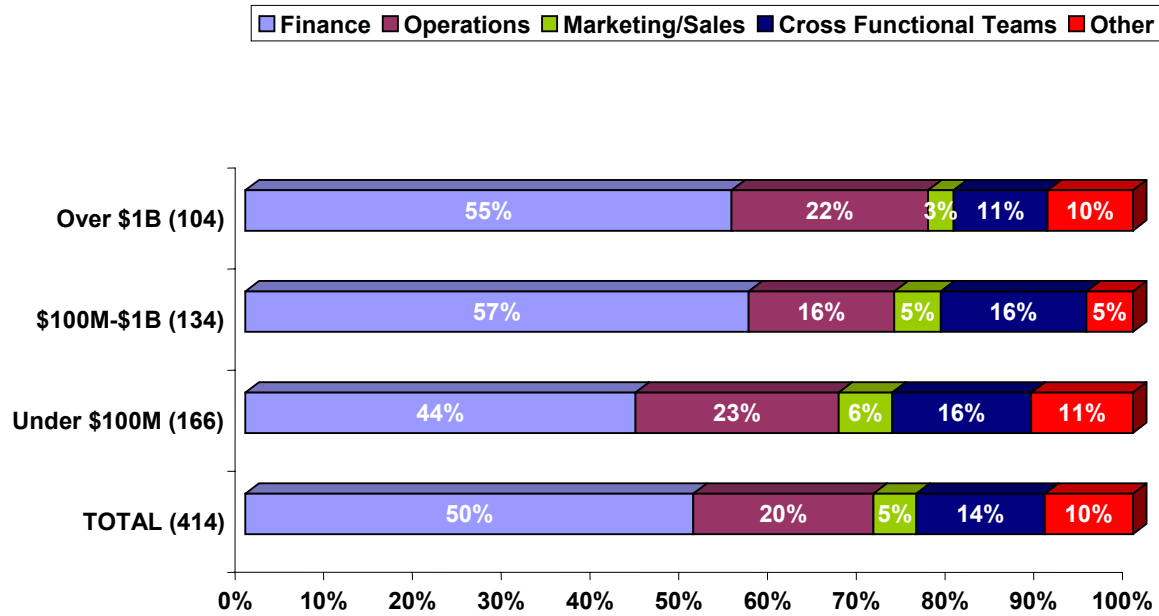
Figure 7: Which functional group initiated ABC in your organization?



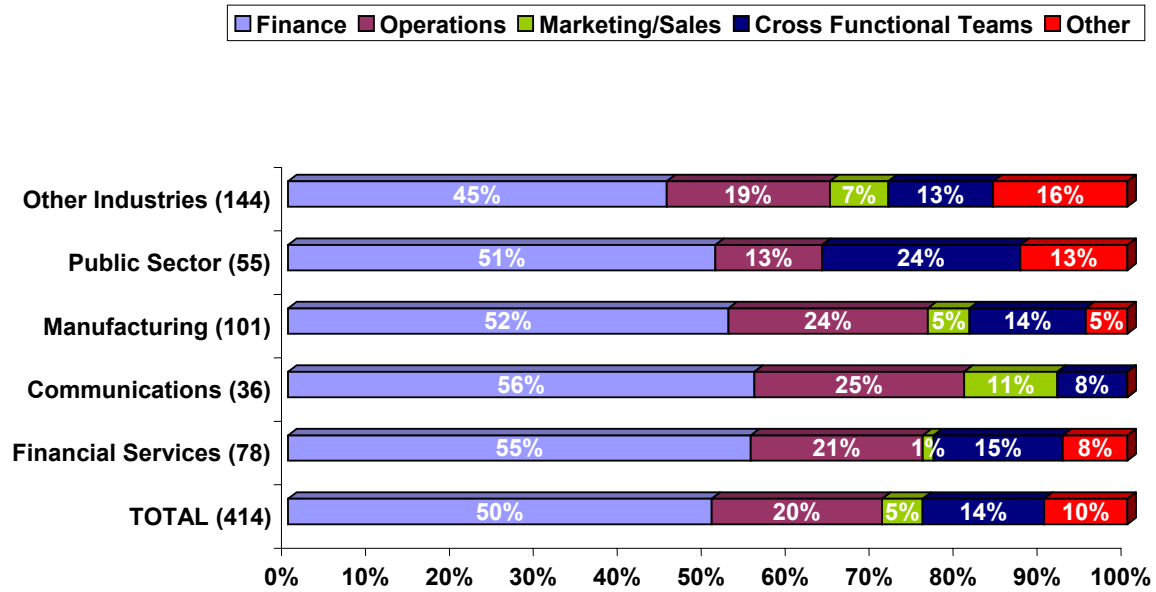
The responsibility for initiating Activity Based Costing in a company does not differ greatly by company size. The finance area was responsible for initiating ABC in fewer smaller companies versus their larger counterparts. (Figure 8)

Small differences are present across industries. The finance area initiated ABC in roughly four out of five companies in all industries. In the public sector, cross functional teams played a more important role than in other industries (24%), and operations areas a less significant role (13%), with marketing areas, of course, not being a factor among these organizations. The marketing area initiated more Activity Based Costing programs than in other industries (11%) (Figure 9)

**Figure 8: What functional group initiated ABC in your organization?
(by company size)**



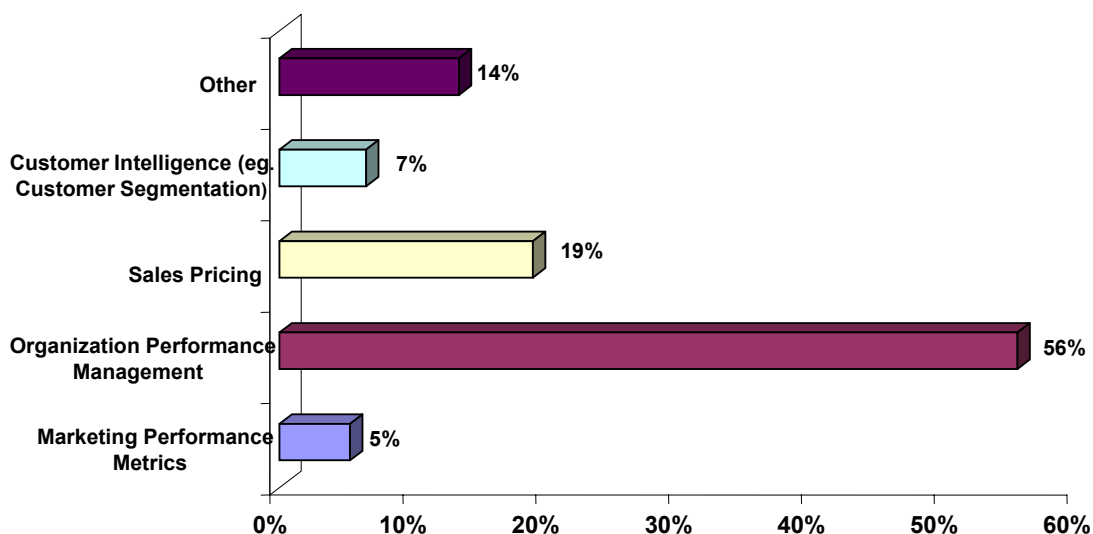
**Figure 9: What functional group initiated ABC in your organization?
(by industry)**



Primary Outputs Supported by ABC

Respondents were asked what their ABC outputs currently support and they were given the opportunity to provide one response. Six in ten respondents indicated that their ABC output supports organization performance management, which correlates with the use of ABC for costing and cost control. One in five companies (19%) reported that the output supports sales pricing. Fewer companies indicated that the primary output supported was customer intelligence or marketing performance metrics (7% and 5% respectively). (Figure 10)

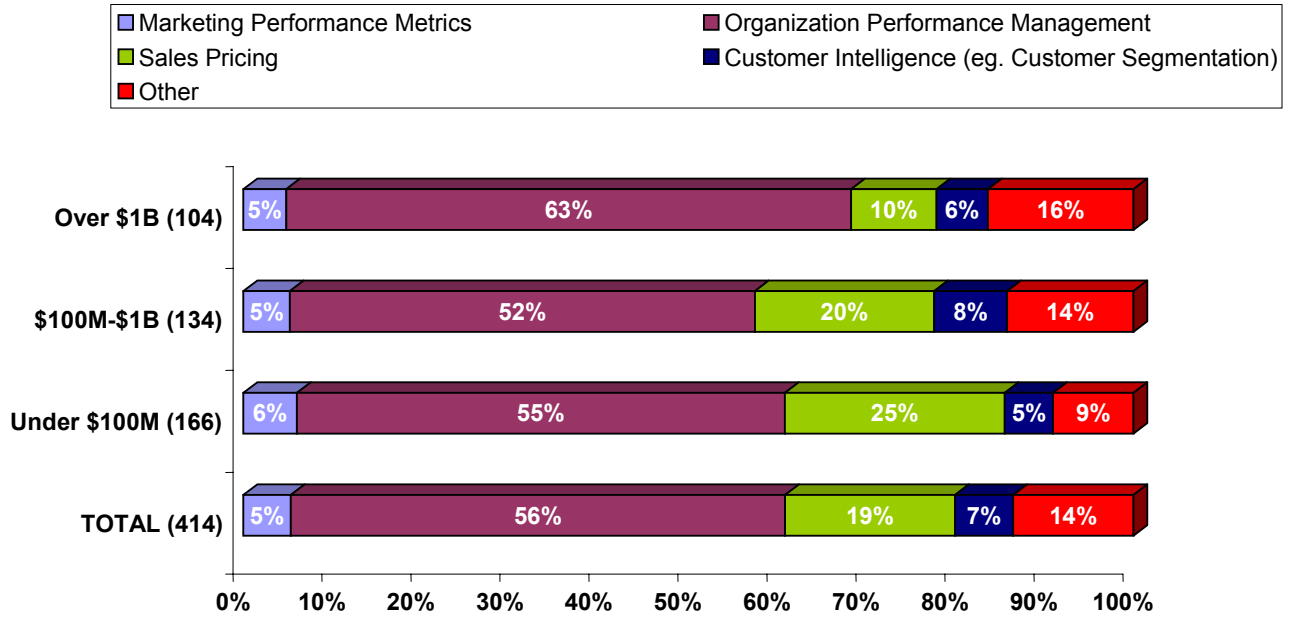
Figure 10: What do your ABC outputs currently support?



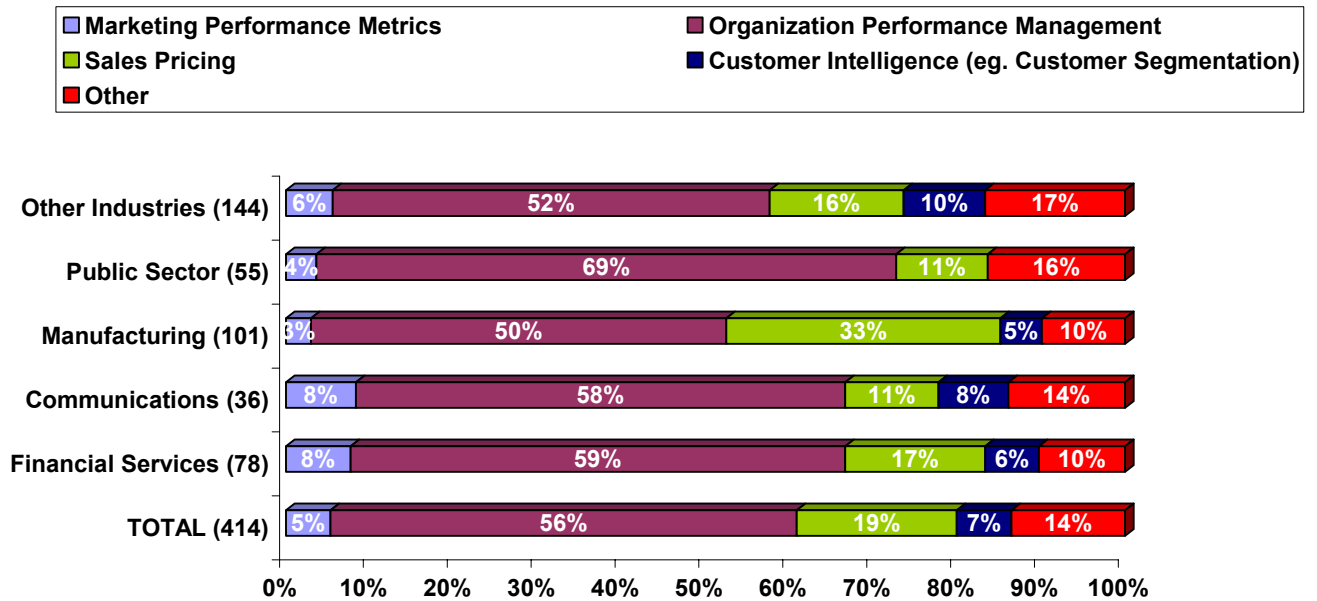
Across company size, the biggest difference in the primary output supported by Activity Based Costing is in the enterprise sized businesses. Organization performance management is the primary output supported among more large businesses (63%) than mid-sized or small entities, and sales pricing output is the primary output supported among fewer of these businesses (10%). (Figure 11)

Across industries, the biggest differences in primary outputs supported are in the public sector arena and manufacturing. Organization performance management in the public sector is the primary output supported by a larger percentage than in other industries (69%), while sales pricing was less frequently cited as the primary output supported among this group. Conversely, only 50% of the manufacturing companies reported organization performance management as the primary output supported, while sales pricing was significantly higher (33%) among this industry versus others. (Figure 12)

**Figure 11: What do your ABC outputs currently support?
(by company size)**



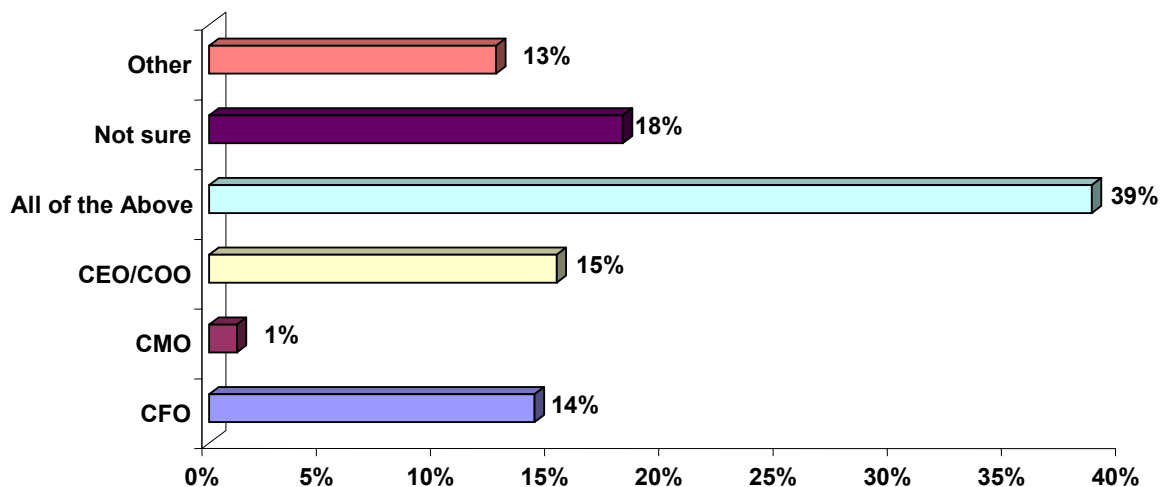
**Figure 12: What do your ABC outputs currently support?
(by industry)**



Reliance on Activity Based Costing to Make Decisions

In four out of ten (39%) businesses represented in this research, it appears that all C-level managers are relying on the information from ABC. The CEO or COO is the primary user of the information among 15%, followed by the CFO at 14%, and a very small reporting of the CMO at 1%. Interestingly, 18% of the respondents did not know who relies on ABC to make decisions, and 13% report others.

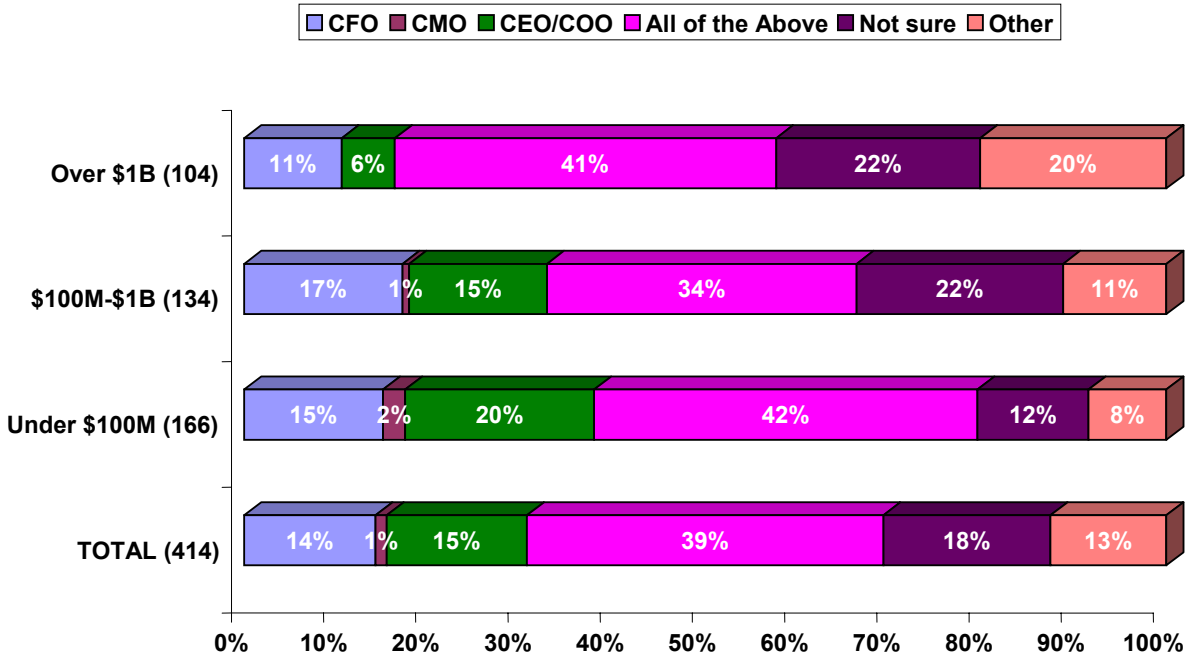
Figure 13: Who is relying on ABC information to make business decisions?



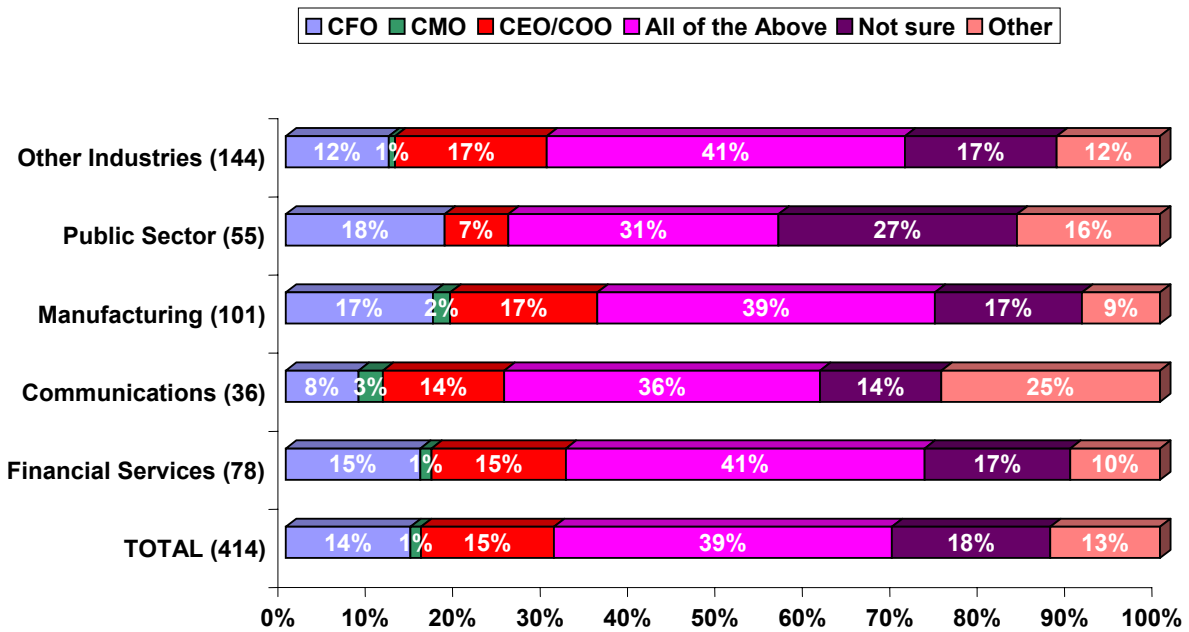
There are very few notable differences in the reliance on ABC information across different sized organizations, but the most significant is that as company size increases, the reliance on ABC information by C-level management declines. This is likely due to the personal involvement of C-level parties (sometimes owners) in small businesses. Small companies under \$100 million are also more likely to know who is relying on ABC information. (Figure 14)

Across industries there are slight differences in who is relying on ABC. In the public sector, fewer C-level individuals are reported as relying on ABC, and a considerably larger percent of the respondents did not know who was relying on the information. In the communications industry, a smaller percentage of C-level managers are relying on ABC information, and a larger number responded "other." Many of these "other" responses are individuals across the company, suggesting that the use of ABC is not necessarily strictly a C-level function. (Table 15)

**Figure 14: Who is relying on ABC information to make decisions?
(by company size)**



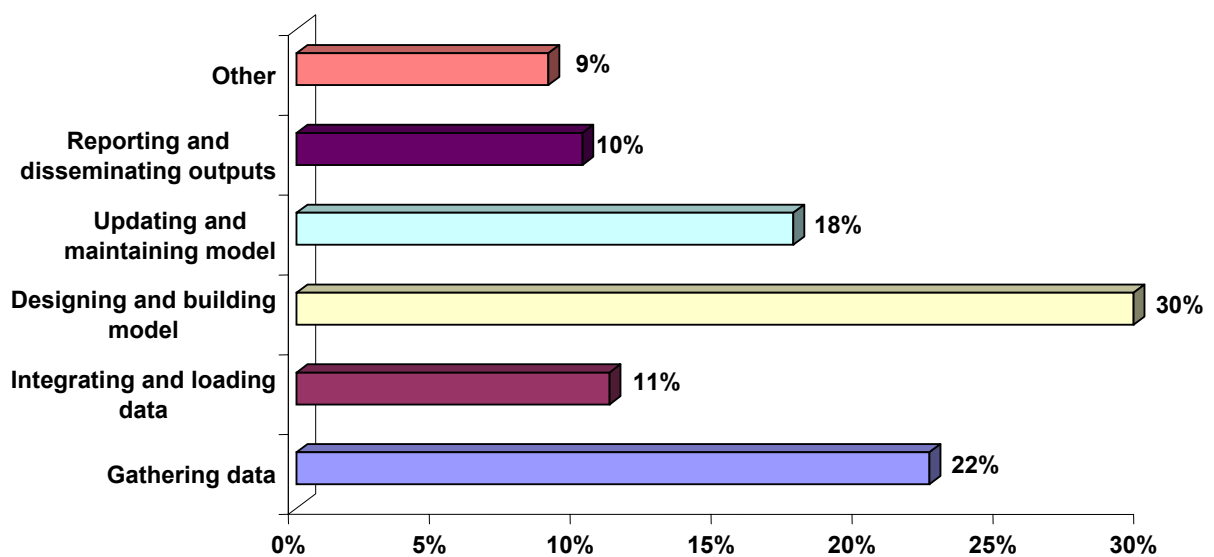
**Figure 15: Who is relying on ABC information to make decisions?
(by industry)**



Main Challenge in Implementing Activity Based Costing

The main challenges companies face when implementing ABC vary. Just under half of the respondents reported challenges dealing with the model: designing and building the model (30%) or updating and maintaining the model (18%). A third of the respondents suggested that their greatest challenge is data related: gathering data (22%) or integrating and loading data (11%). Only one in ten (10%) identified reporting and disseminating reports as their main challenge in implementing ABC. (Figure 16)

Figure 16: What is the main challenge in implementing ABC?



Challenges implementing Activity Based Costing vary by company size. The most frequently cited issue among respondents in enterprise size businesses is gathering data (28%). In mid-sized businesses, the primary challenge appears to be designing and building the model (37%), and small businesses struggle with both gathering data and designing and building the model (31% and 27%, respectively). (Figure 17)

Among public sector entities, fairly equal percentages reported facing challenges with designing and building the model (35%) and gathering data (33%). The challenge cited most often by companies in manufacturing is designing and building the model (43%). In communications, the main issues reported were designing and building the model as well as maintaining the model (25% each), followed closely by gathering the data (22%). In financial services, designing and building the model is cited most often at 26%. (Figure 18)

Figure 17: What is the main challenge in implementing ABC (by company size)

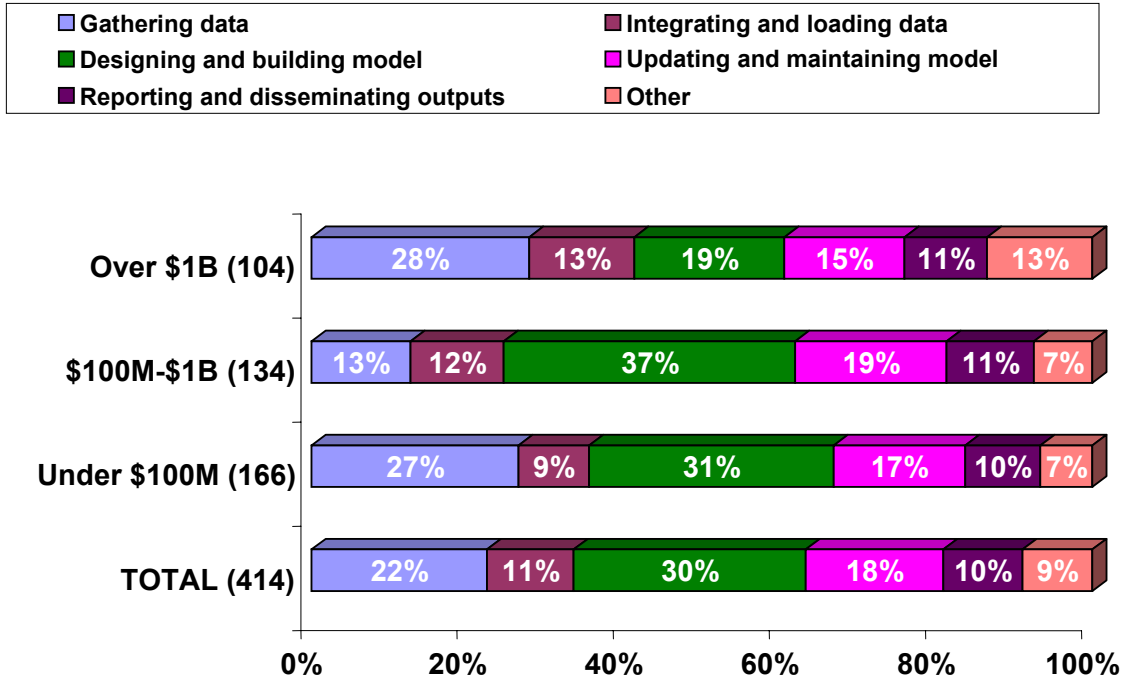
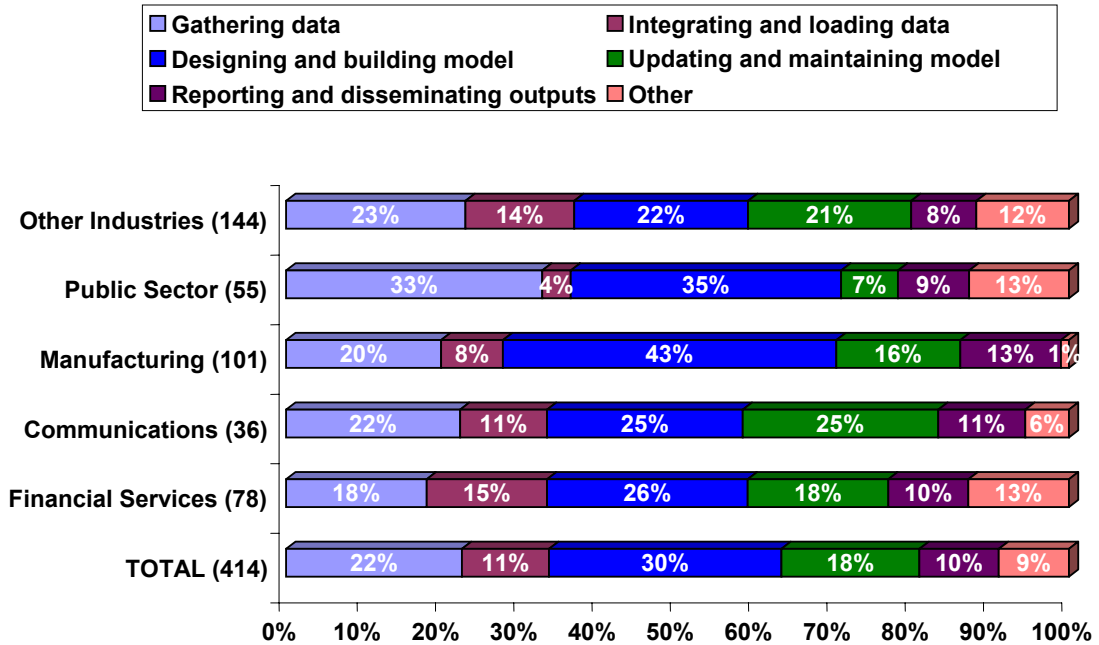


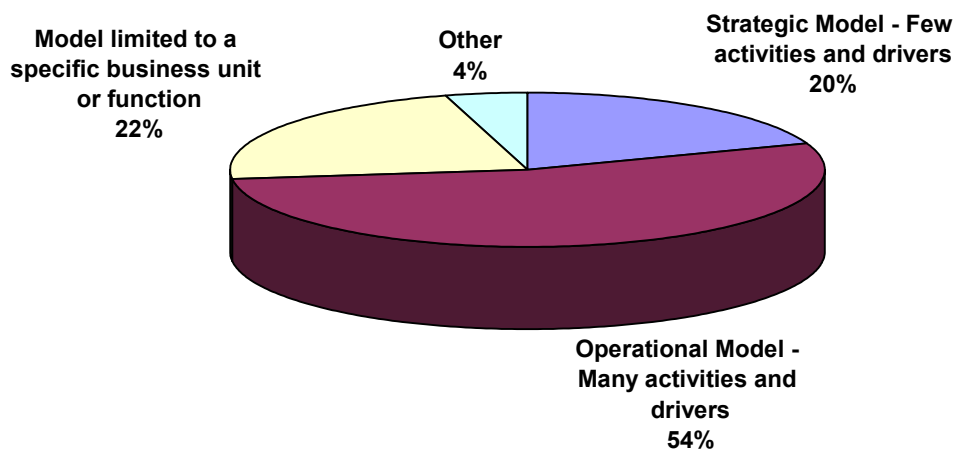
Figure 18: What is the main challenge in implementing ABC? (by company size)



Modeling Approach Used for ABC

The operational model including many activities and drivers is most frequently used for Activity Based Costing (54%). Just over one in five companies (22%) reported using a model that is limited to a specific business function or unit, and slightly fewer (20%) use a strategic model with few activities and drivers. (Figure 19)

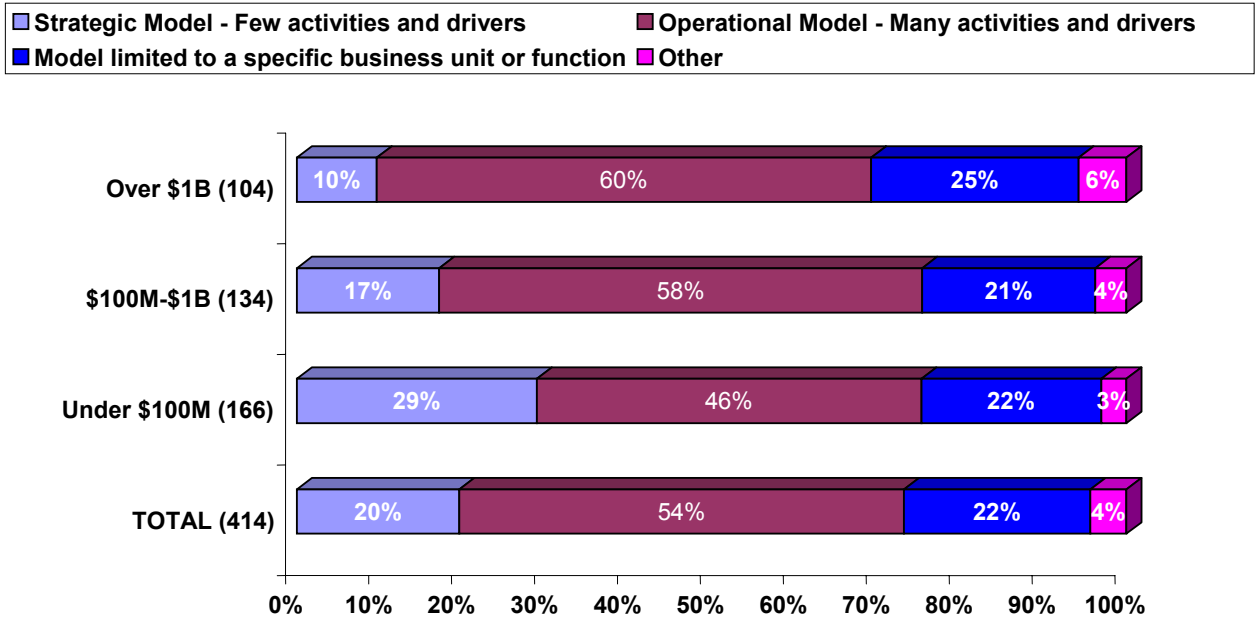
Figure 19: What modeling approach do you use in ABC?



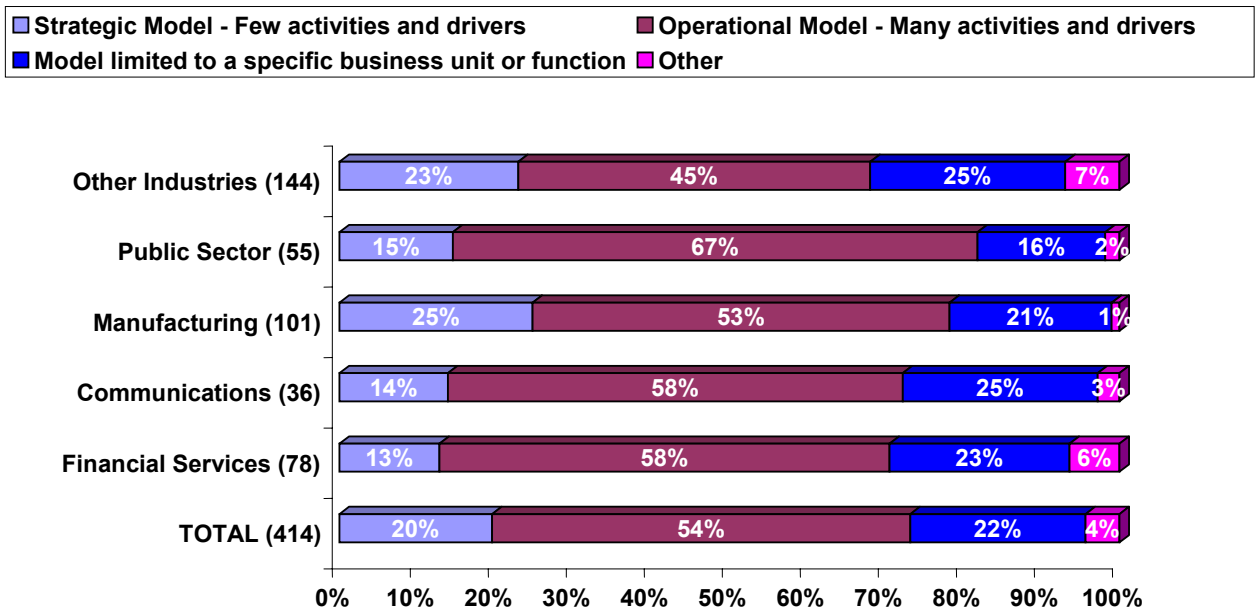
Modeling approaches vary slightly across entities of different sizes. While businesses of all sizes report most often that they use an operational model, this decreases with company size as use of a strategic model increases. (Figure 20)

Across industries, the most significant difference in use of modeling approaches is in the public sector. Two-thirds (67%) of the companies in this industry use an operational model, significantly more than in any other industry. These organizations are also less likely to use a model limited to a specific business unit or function (16%) (Figure 21)

**Figure 20: What modeling approach do you use in ABC?
(by company size)**



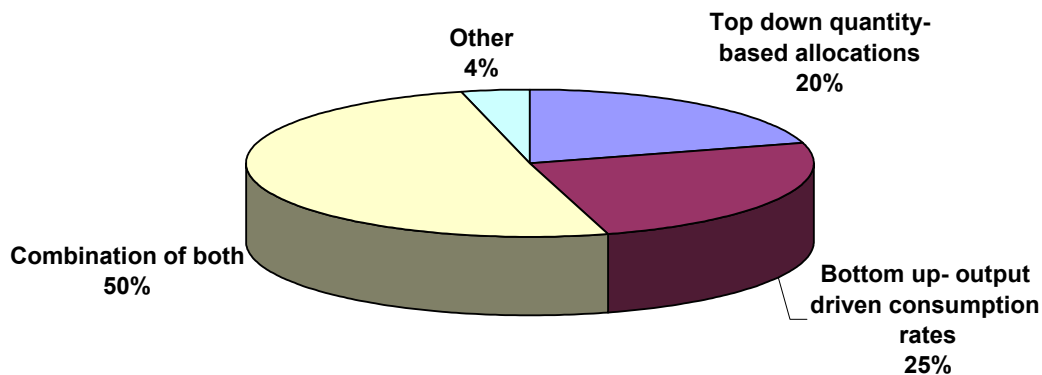
**Figure 21: What modeling approach do you use in ABC?
(by company size)**



Cost Assignment Methodology Used

Half of the participants in the study reported using a combination of top down/quantity-based allocations and bottom up, output-driven consumption rates method. One in four (25%) uses the bottom up approach, and one in five (20%) uses the top down approach. (Figure 22)

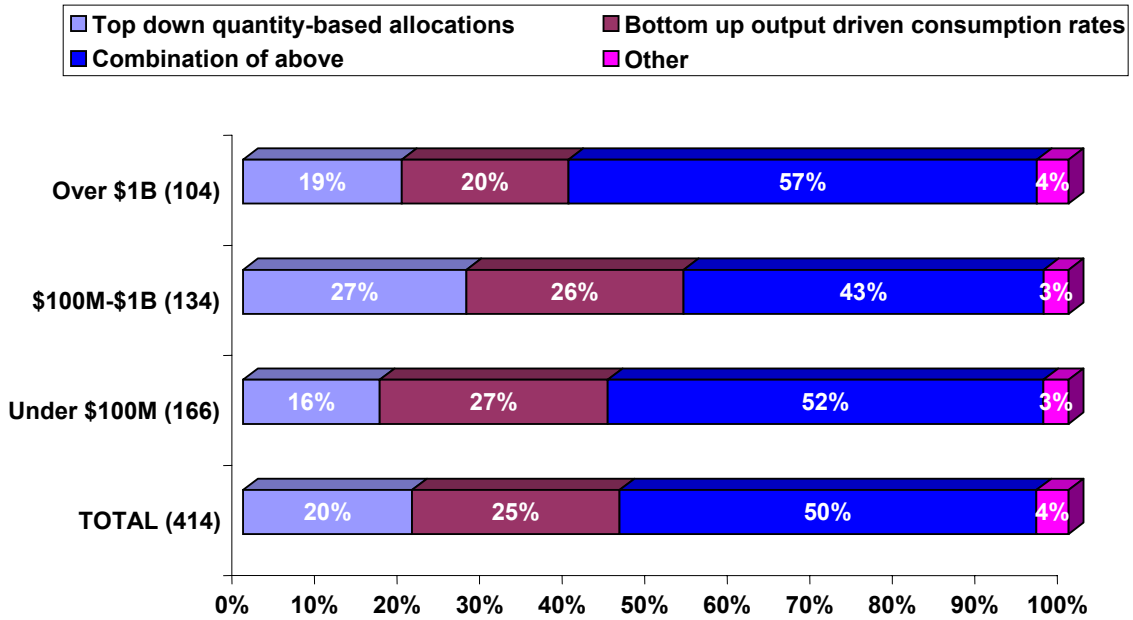
Figure 22: What cost assignment methodology do you use in ABC?



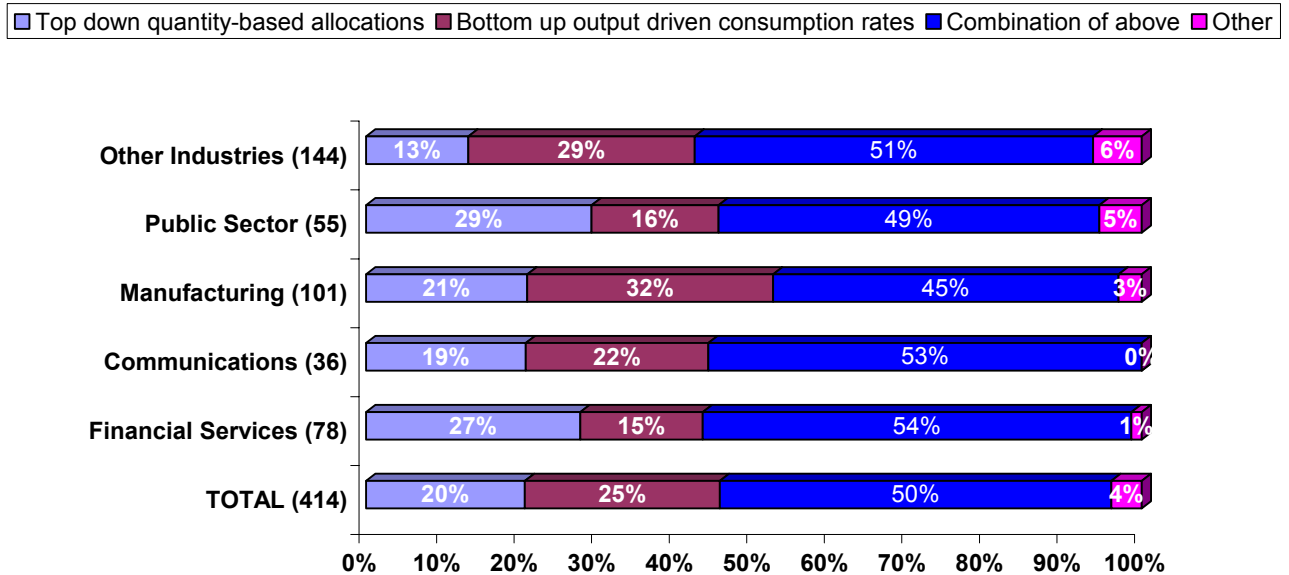
Cost assignment method varies slightly by company size. Large companies are more likely than others to use a combination of top down and bottom up methods. Those who use one or the other, do so in nearly even proportions (top down, 19%, bottom up, 20%). Small business are more likely than mid-sized businesses to use a combination of methods (52% versus 43%), but their use of bottom up assignment is greater than top down (27% versus 16%). (Figure 23)

There are subtle differences in cost assignment across the various industries. Among all industries, a combination of top down and bottom up was reported as the most frequently used cost assignment method. Companies in the public sector and financial services arena are more likely than those in other industries to use a top down method, while less likely to use a bottom up. Manufacturing concerns reported a higher use of a bottom up approach than their counterparts. (Figure 24)

**Figure 23: What cost assignment methodology do you use in ABC?
(by company size)**



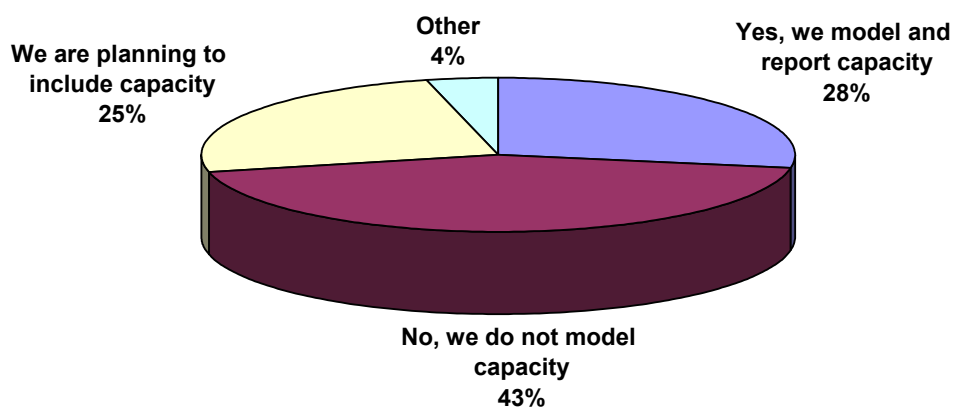
**Figure 24: What cost assignment methodology do you use in ABC?
(by industry)**



Capacity in Implementation

While just over four in ten respondents (43%) reported that they do not model capacity in their ABC implementation, 28% indicated that they do model and report capacity and an additional 25% are planning to include it. (Figure 25)

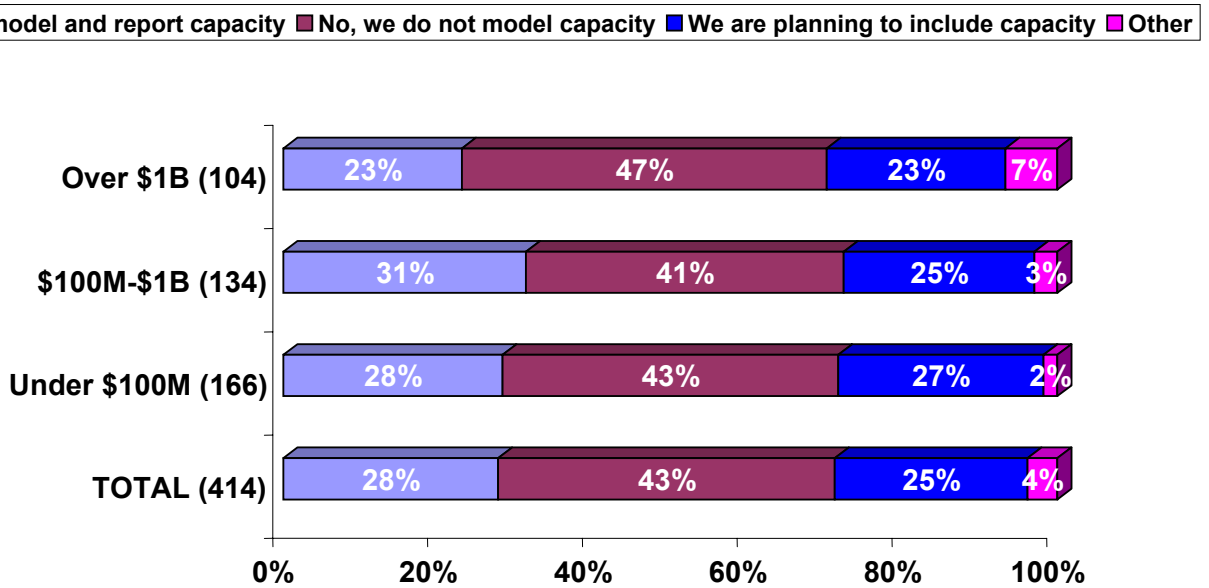
Figure 25: Have you included capacity in your ABC implementation?



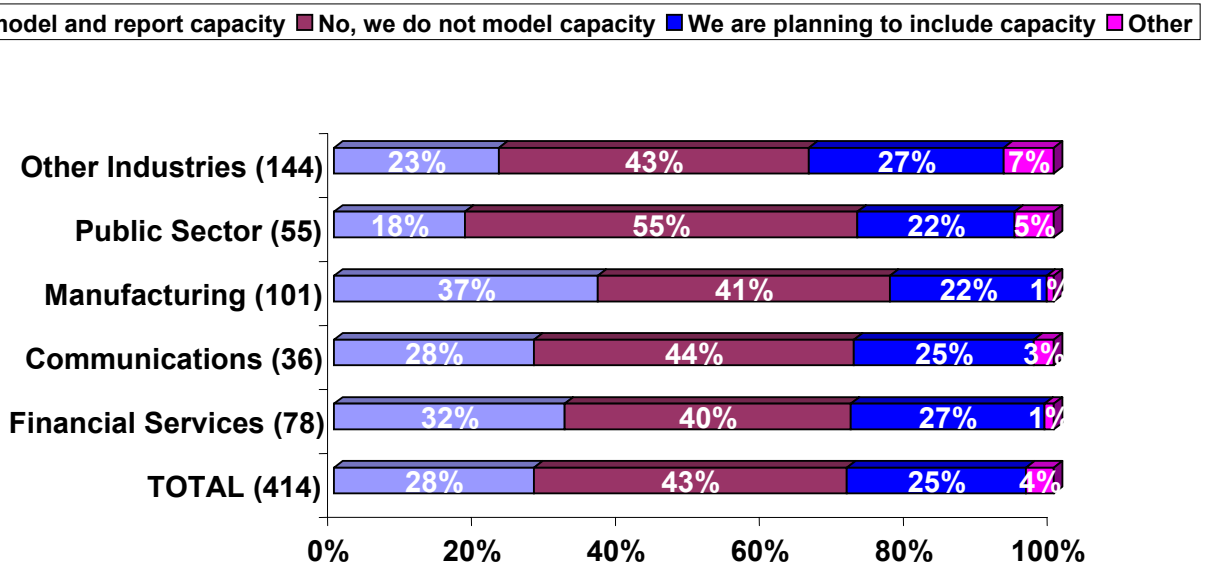
By company size, the only difference is among large businesses who are, interestingly enough, less likely than smaller organizations to model and report capacity. (Figure 26)

On the industry front, the public sector group is less likely to model and report capacity than other industries (18%), while the manufacturing industry is more likely (37%). (Figure 27)

**Figure 26: Have you included capacity in your ABC implementation?
(by company size)**



**Figure 27: Have you included capacity in your ABC implementation?
(by industry)**



Appendix

Figure A: "What industry are you in?"

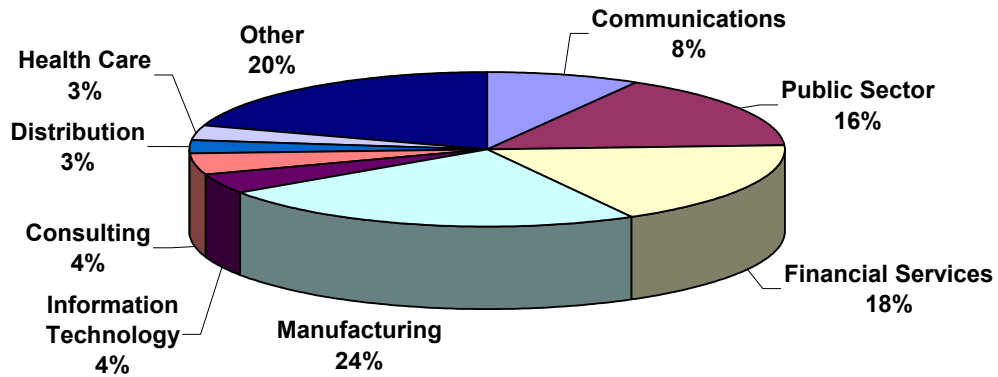


Figure B: "What is the size of your organization?"

