

Do you know what it actually costs to run your business and what drives these costs?

It is no secret that every decision maker is expected to deliver more output with less resources in today's economy. Effective leverage of technology and improved operational efficiency are some of the traditional focus areas, but how can finance contribute to this never-ending drive to deliver more with less resources?

Knowing what the true cost drivers are, and measuring the actual cost in detail is a very powerful management tool that can be used to improve the bottom line. The ability to use these actual costs from the identified cost drivers in order to model different scenarios empowers decision makers to make more informed decisions.

For those unfamiliar with the management practice, **Activity-Based Costing & Management (ABC/M)** is a discipline that focuses on the efficient and effective management of activities as the route to improving the value of the product or service.

Activity-based management (ABM) can be defined as the method of identifying and evaluating activities that a business performs. ABM then draws on Activity Based Costing (ABC) as its primary source of information to carry out a value chain analysis or a re-engineering initiative.

Activity Based Costing

Under Activity Based Costing, resources are assigned to activities and then activities are assigned to cost objects, based on the use or consumption of activities.

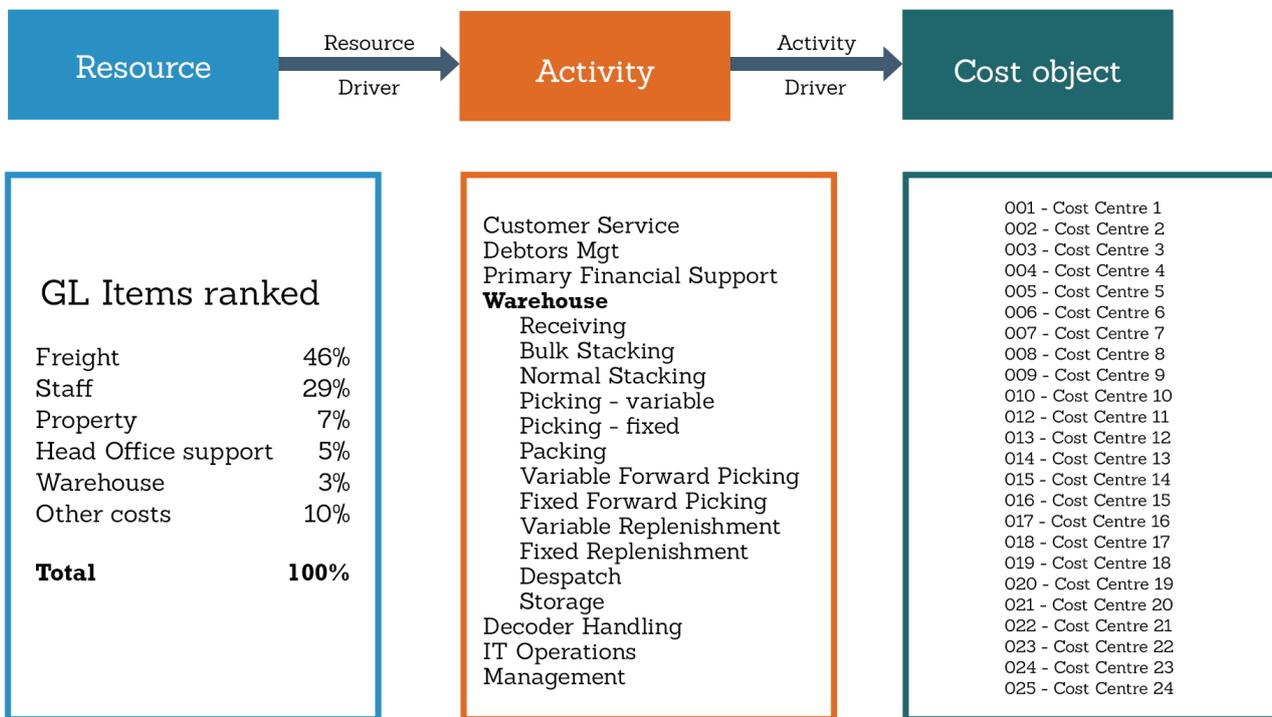


The first step under Activity Based Costing is to allocate the costs contained in the General Ledger to resources supplied.

The second step provides a view of the activities and their costs based on the resources used to create those activities.

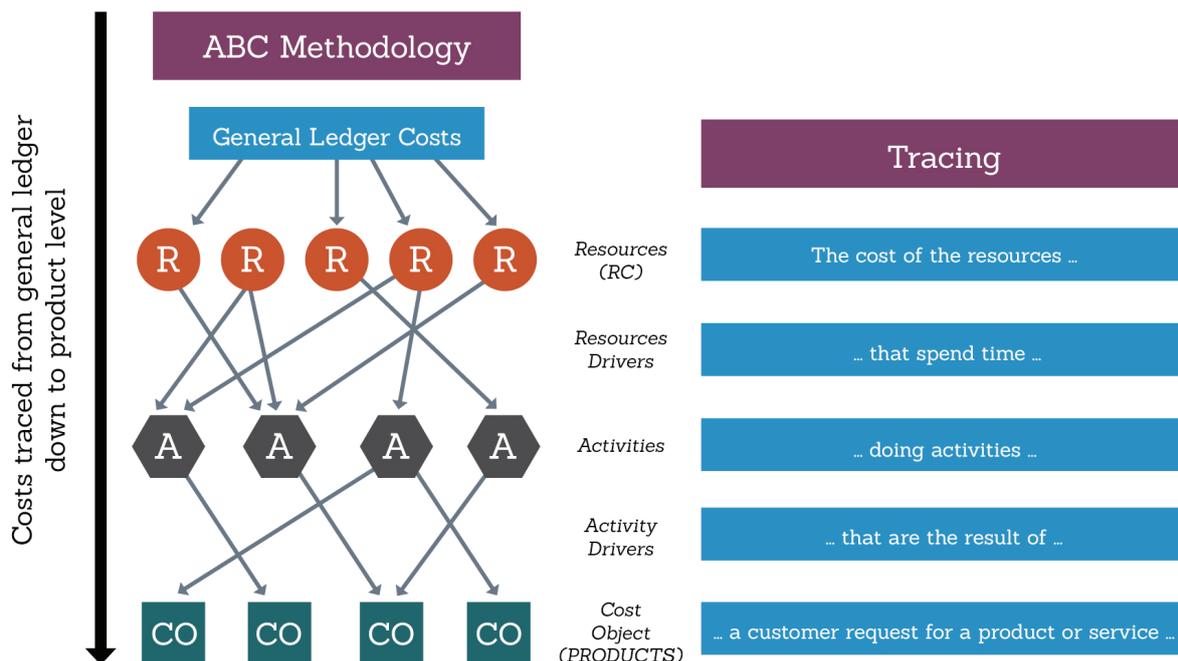
The third step is to assign costs to products/services based on their share of the activities.

The following diagram illustrates how this might look in practice.



An alternate way of visualising this could be as a flow of costs in the business in a vertical waterfall, where the \$'s flow from one segment to the next in a logical sequence.

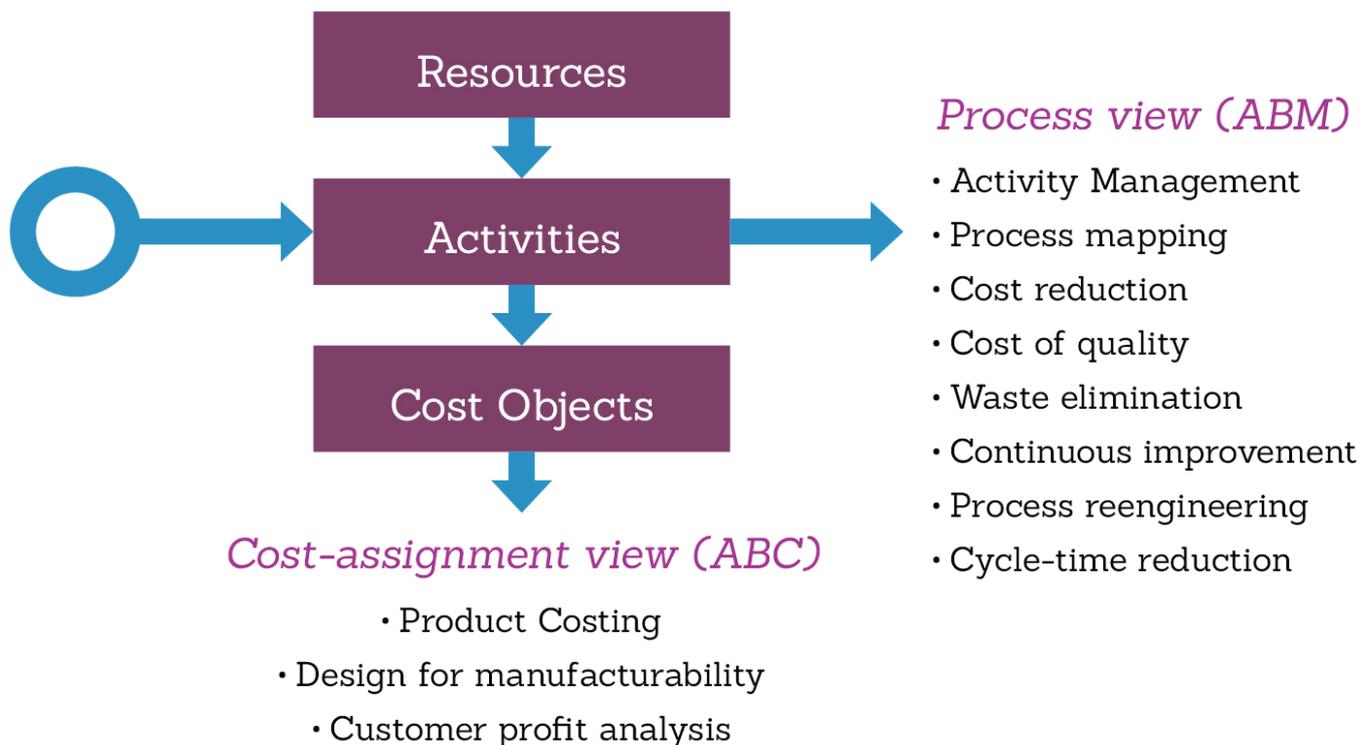
The Vertical View of ABC: Five key segments that are clearly linked and follow a logical sequence



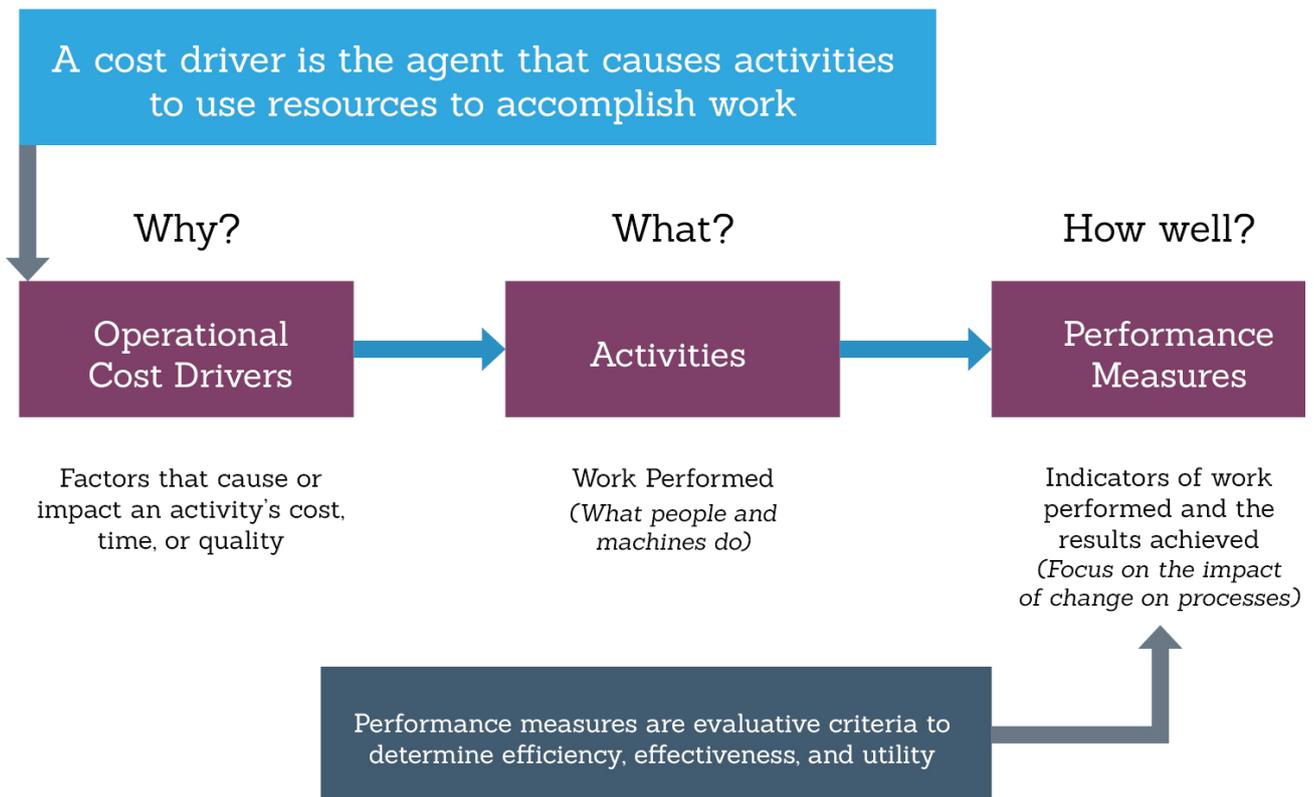
The result of an Activity Based Costing exercise is the categorisation of costs according to the resources deployed in the business and defined business activities, with the costs being determined by the consumption of resources by these activities.

The Relationship Between ABC and ABM

The relationship between Activity Based Costing and Activity Based Management is built on two axes - the vertical view representing ABC provides a snapshot view, while the horizontal view representing ABM shows the cause and effect of costs.



ABM provides information about the work done in an activity and the relationship of this work to other activities. In essence ABM provides the 'Why, What and How Well' of operational intelligence in relation to the workings of the organisation.



ABM delivers a very clear understanding of the root causes and influences of the activity costs and provides a level of fact based insight that enables organisations to identify strategic, organisational and operational improvement opportunities.

Leveraging ABC/M enables the finance function to contribute significant value to the organisation by providing more accurate analytic information - providing answers to a range of business critical questions, including:

- Which of my products/customers are unprofitable?
- What are the main cost drivers?
- What are my supply chain costs?
- What are my support costs?
- What are my cost pool build up per product/process/channel/customer?
- What is my transport cost per SKU?
- What are the costly processes?
- How can I identify non-value adding activities?
- How can I optimise activities?
- How is funding utilised?

ABC/M, provides organisation with a greater insight into how costs behave in their organisation and which activities create a significant amount of costs. Once organisations understand that they can take the appropriate action to control costs based on activities, rather than just on the 'single view' of the story provided by Profit and Loss reports.

The value of ABC/M comes from the output of Profit & Loss statement per product, per channel, per client, per time period, or any other business dimension.

The danger in any ABC project is getting stuck in an agreement around what the Resources/Activities/Cost Objects are. An ABC project requires accurate data but don't, for example, get stuck asking employees to record timesheets to an exact degree to work out some driver values. Implementing ABC successfully is enabled by embracing the 80/20 rule i.e. its 20% of allocations that gives you 80% of the benefits. Don't sweat the small stuff but instead ensure you have strong stakeholder buy in to the ABC project to ensure you can push through the small stuff.

Key Outcomes of Successful ABC Implementations

- Fine-tuning of your strategy to improve profitability by optimising product or customer mix
- Providing a clear insight of where to control costs
- Changing organisation behavior with clear views and communication across Lines of Business

Every organisation whether a Manufacturer, University or Government Department can use ABC/M to great benefit. The most important factor in considering an ABC/M solution is recognising that each organisation has different Resources, Activities and Cost Objects, which need to be appropriately reflected in any proposed ABC/M solution.

Contact Tridant to discuss your ABC/M requirements

1300 737 141

About Tridant

Tridant is a specialist Information Technology firm focused on providing technology consulting services and the design and implementation of technology solutions optimised for planning, reporting & analytics, customer experience serving Public, Private and Government organisations throughout Australia and Singapore.

We help our customers leverage their data assets to improve profitability, increase revenue, reduce risk and make their businesses more responsive to customer expectations and market dynamics.

Our solutions are tightly integrated with key business processes and source systems, which help our customers to make the most of their investments in data, technology and people.

To learn more about Tridant please visit www.tridant.com.au or contact us on 1300 737 141

Written by:

James Wakefield

Director of Solutions - Tridant Pty Ltd

Rossouw Koegelenberg

Managing Director - Venn Cubed Pty Ltd

David Meadway

Practice Area Lead - Tridant Pty Ltd



TRIDANT
data driving decision making