

### **Is activity-based costing the key to profitability?**

The increased business pressure to become customer-oriented and shareholder value oriented has led to the increased use of activity-based costing in order to understand the product, customer, and profitability better.

This trend has also been felt in the early 90's when managers aimed to develop a balanced scorecard by looking at the drivers of corporate profit. It was in this period that the development of key performance indicators, key success factors, and formulation of adaptive strategy were highlighted.

The similarity between scorecard and activity-based costing points to the importance of an enhanced understanding of the drivers of value in the business. Both emphasize the identification of the leading and lagging indicators of performance, the connection between the two, and how exactly to measure them.

As stated in several journals, the goal is not to improve customer satisfaction or employee satisfaction rather it is to manage these relationships so that one can improve the long term profitability.

So what exactly is done when doing activity based costing? There are five primary steps:

- Identify activities
- Identify inputs from the consumption of resources by the activities
- Identify outputs by which costs of a process vary most directly
- Calculate the driver rate
- Trace activity costs to cost objects such as products, processes, and customers based on usage of activities.

In many aspects, activity-based costing has evolved to a tool that provides valuable information other than just cost data. Activity based costing can show products, brands, customer groups, facilities, regions, distribution channels, etc.

Activity-based costing does not provide an all-in-one solution to all of the problems but the goal is for it to provide information that together with other management information can facilitate improved decision making.

Further, activity-based costing helps identify customer activities and track those costs that are allocated specifically to certain customers. Some of the many benefits of it include:

- Being able to spot customers that need nurturing
- Protecting existing highly profitable customers
- Being able to provide discounts to gain business with low cost to serve customers
- Negotiating win-win relationships that lower service costs to cooperative customers
- Being able to concede to permanent loss customers to competitors

It is through activity-based costing that analysts have often found that 20% of the customers generate 300% of the profits. Through the years, developing customer databases has improved the way decision makers make decisions regarding the costs of keeping existing customers.

As perhaps many managers are aware of today, the success of customer profitability analysis depends on the information reaching those who make the decisions.

[www.performancecanvas.com/is-activity-based-costing-the-key-to-profitability](http://www.performancecanvas.com/is-activity-based-costing-the-key-to-profitability) (on May 18, 2016)