



Yorkshire & Humber Regional Development Agency

■ Frameworks

Rapid Build Activity Based Costing

Traditional cost accounting provides little information beyond material and direct labour to assist management in controlling costs at the product and customer level and therefore fails to identify and quantify the range of activities performed within a modern business.

The arbitrary application of overhead, often one of the largest components of cost, means that there is little true knowledge of product or customer cost. Traditional cost accounting provides no guidance to the manager on the effect of research & development, sales, marketing, distribution and customer costs on product or product line profitability. For example, these cost systems tend to show two customers as having the same gross profit even when the customers' support costs differ widely.

Activity Based Costing (ABC) addresses this problem by allocating indirect and support costs to products, customers, or services based on the resources actually used to make and sell the product or serve the customer.

An ABC system focuses on understanding the activities performed within the business and their true costs. It is a powerful tool that helps in understanding the efficiency and effectiveness of the products and services delivered. It also provides insights into the 'value chain' at a strategic and operational level.

Effectively applied, ABC can:

- Identify the value contributed by activities, through a comprehensive understanding of costs and related dynamics, to help focus attention on target outcomes;
- Determine how much it costs to service customers;
- Differentiate between activities provided to customer segments;
- Provide information for the effective use of the company's resources;
- Identify incremental operating expenses to support growth;
- Identify cost management opportunities;
- Provide information to improve process efficiency; and
- Provide a robust infrastructure to support the planning process.

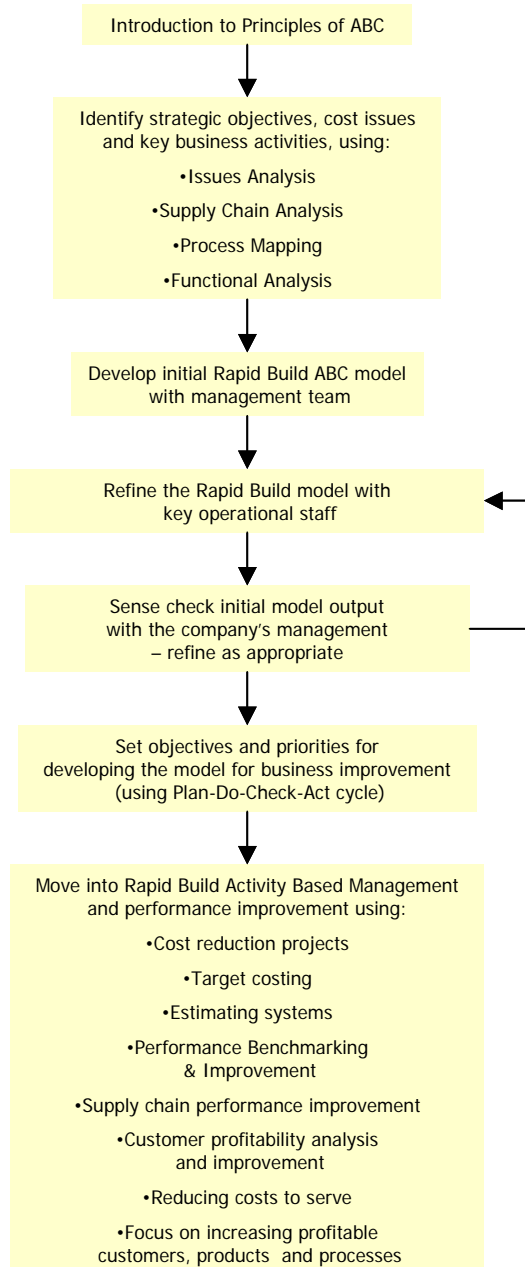
Armed with this cost information, management can make informed decisions on reducing costs, developing a more profitable product and customer mix, and take appropriate action to improve market share. This cost information will also improve and support:

- Research & development;
- Order estimating;
- Budgeting and forecasting;
- Target costing;
- Pricing of new products;
- TQM/EFQM systems;
- Business Process Re-engineering; and
- Other business and performance improvement initiatives.



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The Rapid Build ABC Process



Full-blown ABC systems are typically expensive to introduce and can take many months to pilot then implement. *Rapid Build ABC* was developed during a pilot study, working with SMEs in Yorkshire, on behalf of Yorkshire Forward, the UK Regional Development Agency. *Rapid Build ABC* has the following advantages:

- It is a practical solution, which is easy to understand and implement;
- In most cases financial information can be abstracted and prepared from a company's existing accounting system;
- It produces quick results enabling managers to analyse costs, and engage management buy-in;
- It can be developed incrementally into a complex strategic cost management system; and
- It operates in parallel with existing accounting systems.

The *Rapid Build ABC* process is illustrated in the adjacent flowchart. It starts with an introduction to the principles of ABC, then identifies the company's strategic objectives, cost issues, and key business activities using:

- Issues analysis;
- Supply chain analysis;
- Process mapping; and
- Function analysis.

The initial ABC model is developed with members of management and refined with input from key operational staff. Results are sense checked and agreed by the whole team and the business improvement plans are then defined based on their agreed importance and urgency. The Plan-Do-Check-Act cycle is used to set up a programme for improvement.

The system has greatest impact on business exhibiting the following characteristics:

- High indirect and support costs relative to direct labour;
- A wide variety and complexity of products and services; and,
- A wide variety of customer types, (e.g. some customers taking large volume standard products whilst some take small volume complex products, and corresponding variation in the levels of customer service required).

Rapid Build ABC is ideal for: the SME environment, quick analysis of strategic business units and setting out partnering goals for business improvement with key customers and suppliers. It is efficient, cost effective, quick and relatively easy to set up.

