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ACTIVITY-BASED MANAGEMENT

Arthur Andersen's Lessons from the ABM Battlefield
Second Edition

Edited by
Steve Player
and
David E. Keys



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Dedication

*This book is dedicated to Lydia, David, Emily,
and Cole Player and to Diana Keys.*

*This book could not have been completed
without their patience and support.*

*Their love and understanding sustains and encourages us to
victory on any battlefield.*

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FOREWORD

Since writing *The 7 Habits of Highly Effective People* and the follow-up books, *Principle-Centered Leadership* and *First Things First*, I've seen literally millions of people and thousands of organizations experience serious improvements in their effectiveness by focusing on principles and the character ethic. But as I observe this, particularly over time, often I am concerned that people only see a portion of the message.

Management techniques in recent decades have been so heavily skewed toward the personality ethic and heavy authoritarian control that many readers and listeners are left feeling trapped in a lose/win, work-centered relationship with their organizations. Many have a deep thirst for a principle-centered work and personal life that brings them to a more balanced, harmonious way of living.

These seemingly competitive forces—demand for business results on one hand and the need for a rich, satisfying personal and family life and a positive, supportive professional environment on the other—have set in motion a massive corporate motivational pendulum. This pendulum swings to the traditional heavy-handed control approach that forces results. But then it responds to the resulting low morale and declining productivity by swinging over to the soft, permissive approach, only to then come crashing right back through the wall to authoritarian win/lose because management has the sense it's losing control and moving toward chaos. With these continual pendulum shifts, the culture is consumed in constantly surveying the political winds and becoming increasingly cynical and fatigued. Then decision making relies more on the current read of the mood in the executive offices than it does on real information.

Principle-Centered Leadership and the *7 Habits* sometimes are viewed superficially and written off as a soft, touchy-feely approach that has no regard for real bottom-line issues. Nothing could be further from the truth. Those looking deeper will find that principle-centered leadership is an approach that is not only kinder but much tougher and results-oriented.

Similarly, some might make the mistake of seeing Arthur Andersen's activity-based management (ABM) system as a technical, narrow focus on accounting and costs. Both kinds of thinking remind me of the long-standing debate between leadership and management. Is it visionary leadership or is it rigorous management that produces a healthy, growing, profitable enterprise?

The fact is that no organization is going to survive and thrive without real strength in both areas.

Those who look deeply into the process of activity-based management will find that it is an area of management that will empower them with the solid information about their organizations that *enables* them to exercise leadership and wisdom in decision making. As Max DePree taught, “The first responsibility of a leader is to define reality.” ABM is not just mere theory. It points with laser clarity to the practical. ABM gives you the operational guts to meet the leadership challenge and to see and seize your opportunities.

Because we at Covey Leadership Center have focused so much on the leadership dimension, we’ve needed this kind of management strength and insight. We’ve needed to more deeply understand the relative costs and value of our activities. We are obtaining it by implementing an activity-based management system with the assistance of Arthur Andersen. It is helping enormously.

These *Lessons from the ABM Battlefield* provide not only vital tools but also key insights into the painful pitfalls others have made and how they can be avoided. They will be powerfully helpful to those just beginning the process or those on the ABM battlefield trying to get back on the right track.

There is tremendous strength in seeing and understanding the *details* that this process provides. They enable one to step back and holistically see in context all organizational activities—both leadership and management. In a sense, it answers a vital piece of one of *the* great leadership questions: “Is the ladder we’re all climbing leaning against the right wall?”

STEPHEN R. COVEY

PREFACE

Cost management has been a cornerstone of the Arthur Andersen philosophy for over 85 years. Implementing and improving cost systems was one of the services specifically identified in the original announcement of the opening of the firm. In 1913 Arthur E. Andersen challenged management not only to understand figures but also to understand what is *behind the figures*—to understand the activities and nature of work as well as how it creates value.¹

The first edition of *Activity-Based Management: Arthur Andersen's Lessons from the ABM Battlefield* sought to record the reasons why ABM is a winning strategy and to explore the root cause of the losses. This second edition includes all of the rich content from the first edition, including the 30 pitfalls typically encountered when trying to implement ABM, plus the 12 success stories of leading companies harnessing the power of cost management.

For purposes of this edition, the case studies are repeated in the original form with company names, authors' work titles, and employers listed as they were presented when the first edition was released in late 1995. In some cases the company divisions, people, titles, and/or employers have changed since the original release. We have elected to leave them as originally presented to preserve the case studies in the context in which they evolved.

Part Three on future weapons has been greatly expanded to include chapters on customer profitability (by Joe Donnelly and Chuck Marx), growing revenues (by Jim Gibson and Max Locke), and on the elements of performance management systems (by Craig Collins and Marieta Gundova). The reporting and target costing chapters have also been enhanced.

This book is designed to give the reader access to strategies and practical tips for deploying ABM. *Lessons from the ABM Battlefield* helps the reader understand what kind of an organization should implement ABM, how a company can implement ABM effectively, and how ABM can link with other improvement initiatives to enhance a company's management performance. Part One consists of three chapters and synthesizes what we discovered about getting started, developing a pilot, and converting that pilot into the mainstream systems of a company.

Part Two features 12 case studies that illustrate the successful implementation of ABM and activity-based costing (ABC). These cases come directly from the multi-industry experiences of members of Arthur Andersen's cost management practice.

Part Three covers advanced cost management topics such as customer profitability, revenue enhancement, and performance management. Many of the cases documented in the book highlight experiences with these subjects; this last part was designed to provide readers with a solid understanding and framework to put practices to work in their company.

We believe the results of this work deliver up some valuable lessons for any company thinking about ABM, about to start ABM, or recovering from a failure with ABM. And we've learned that the long-term success of ABM—like any new management method—depends on how well everyone in the organization understands both the benefits and the risks of deploying ABM. We hope our views on the pitfalls that impede successful implementation of ABM help the reader and that, by book's end, readers will be as convinced as we are that ABM can be a key weapon in today's competitive battlefield. If you would like additional information, you should also read the companion title *Arthur Andersen's Global Lessons in Activity-Based Management*.

STEVE PLAYER and DAVID KEYS

Note

1. Arthur E. Andersen, "Behind the Figures," *System: The Magazine of Business* (January 1913): 1–13.

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ACTIVITY-BASED MANAGEMENT

PART ONE

30 Pitfalls of ABM and How to Overcome Them

GETTING OFF TO THE RIGHT START: PITFALLS NO. 1 TO 10

Steve Player and David Keys

Dr. Stephen Covey often reminds us that: “How fast you are going is not as important as making sure you are going the right direction.” This is especially true in understanding the management of costs and how to implement activity-based costing (ABC) and activity-based management (ABM) systems.

In the early 1990s many companies were trying to grasp the elements of ABC. Today many have had some experience—often painful or frustrating. For example, a food processor on the Gulf Coast has abandoned its ABC effort because it took the model eight hours to update. A hospital goods manufacturer produces ABC reports but the operational personnel are not interested.

In many companies an ABM pilot proves interesting but fails to move forward. Implementation teams are left to determine what went wrong. (Note: We have chosen to omit the specific company names in each example because the related project teams have suffered enough already.)

While this could happen with any ABM project, we are here to report that the number of successful implementations in companies is growing. Implementation teams are receiving compliments, like those given to the Hewlett-Packard North American Distribution Organization teams by Controller Steve Robbins: “I felt like the man who discovered the microscope. The information has always been there. . . . now I am able to see it.”

Furthermore, chief executive officers are being converted and are speaking out about ABM. R. A. Pritzker, president of The Marmon Group, a \$6 billion association of 65 manufacturing and service companies operating worldwide, says, “ABM has done more in the past two years for our companies’ understanding their costs than I have been able to achieve in the last 40 years.” Companies are using ABM to reengineer operations, improve benchmarking, and increase revenues. Many are approaching this on a worldwide basis.¹

To understand the process that will lead to success and avoid any of the pitfalls that lead to failure, we begin with a definition of ABM and ABC.²

Activity-based costing (ABC) is a methodology that measures the cost and

performance of activities, resources, and cost objects. Resources are assigned to activities, then activities are assigned to cost objects based on their use. ABC recognizes the causal relationships of cost drivers to activities.

Activity-based management (ABM) is the broad discipline that focuses on achieving customer value and company profit via the management of activities. It draws on ABC as a major source of information.

In this book “ABC” is employed most often to describe the use of activity analysis to improve the costing process. While ABC typically is used to determine product costs, it is equally applicable to determining customer costs, channel costs, and so on. ABC focuses on determining “what things cost.”

Benefits typically derived from ABC include:

- More accurate product costs
- Determining the costs of services
- Evaluating customer costs and related profitability
- Identifying market or distribution channel costs
- Tracking project costs accurately
- Quantifying contract costs
- Strategic analysis of what products, customers, or channels to emphasize
- Postsales review of direct mail catalog profitability
- Supporting measurement of economic value analysis
- Supplying rich detail for contract negotiations
- Growing revenue by helping customers understand their cost reductions through the use of a firm’s products and services
- Serving as a fundamental input to target costing
- Providing benchmarking measurements
- Communicating appropriate charge-out amounts for shared services at various service levels

The broader use of activity-based approaches inherent in ABM revolves around using activity-based information to manage operations. ABM focuses more on “how to change and improve costs.”

Benefits typically derived from ABM include:

- Identification of redundant costs
- Analysis of value-added and nonvalue added costs
- Quantification of the cost of quality by element
- Summarizing customer focused activities

- Measuring the cost of complexity
- Providing process costs and supporting process analysis
- Tracking the impact of reengineering efforts
- Better understanding of cost drivers
- Evaluation of manufacturing flexibility investments
- Activity-based budgeting

While both ABC and ABM are new terms, their underlying techniques have a long history. It is helpful to remember that Peter Drucker also noted that, historically, it takes 35 years for an innovation to move into widespread use. So if we use Drucker's time frame, ABM's time has come.

For those who want to see the principles of ABM deliver results in less than 35 years, we can offer hope through the case studies in Part II. But first, it's best to know up front what could go wrong.

In conducting an ABC pilot project and roll-out within a company, it is likely to encounter bumps along the road. Don't feel alone. Implementation of ABC/ABM within any company rarely occurs without any glitches. The challenge is to address appropriately and promptly the challenges and issues encountered as the system is implemented. We have helped clients across a wide variety of industries deal with many of the same challenges likely to be encountered. This chapter and the following two list the major pitfalls that are typically encountered in planning for and implementing ABC/ABM. In addition to describing the potential issues and situations that may be encountered (the symptoms), we also have included a description of some of the efforts that can be put in place to either completely avoid or effectively resolve these problems.

In analyzing ABC/ABM projects across many industries, numerous comments from project teams were focused on how to get projects off to the right start. The pitfalls encountered can be easily grouped by the direct comments from implementation teams. These are summarized in Exhibit 1.1.

Pitfall No. 1: “We can't get the top guys to buy it”

The decision to begin any improvement effort usually takes time. The way that many executives approach change has a great deal to do with how they endorse and implement new management initiatives. It helps to understand how most executives “get to” change. This is depicted in the Awareness, Buy-In, Ownership Continuum³ shown in Exhibit 1.2.

EXHIBIT 1.1 Pitfalls in Getting Off to the Right Start

EXHIBIT 1.2 Arthur Andersen's Awareness, Buy-in, Ownership (ABO) ContinuumSM

The ABO Continuum alludes to the number one pitfall in ABM projects: lack of top management buy-in. In our research, this was the most commonly cited reason ABM does not achieve its full potential. If top management does not fully support application of ABM, no one in the organization can own it.

Supportive top management includes not only top management of a company but also top management of the location, plant, or facility in which ABM is implemented. One company that has been using ABM since the mid-1980s has implemented it in only 60 percent of its locations, largely because some location managers did not want to use ABM in their facilities. While they may be aware of ABM, they have not bought in to the idea that its benefits exceed its costs. They may not yet understand its benefits or may be seeking those benefits through other improvement methods.

A lack of management buy-in and ownership usually manifests itself in managers' failure to supply their time, dedicate people, or devote the funding necessary to implement the project. While leaders may be aware of potential

benefits, they're not paying a lot of attention to ABM or playing the role of champion.

Management support has to exist before anyone attempts to apply ABM methods. One way to increase the degree of top management buy-in is to explain ABM's benefits—results like targeted information for process costing and activity analysis and more accurate information about cost objects (distribution channels, services, products, and customers).

Look at the defense industry. Lack of top management support has crippled its ability to implement ABM. While many defense companies have had successful pilots showing the benefits of changing business practices, very few result in permanent ABM systems. Why? Top management already owns a different view of the business, a view that is focused on viewing costs as required by the Cost Accounting Standards Board and other government procurement regulations. More than one ABM project has been stopped at the end of the pilot phase because of fear of creating cost and pricing data subject to government disclosure. Top management teams sometimes believe that the government would require cost reductions on contracts for which the ABC cost turns out to be less than the cost using traditional methods and, conversely, would not allow increases on those contracts for which the ABC cost proves to be higher.

While the Defense Contract Audit Agency (DCAA) has encouraged ABC implementations and promised understanding and support, defense contractors are wary. Many have shifted their focus away from ABC for product costing (and its inherent DCAA risks) to activity analysis. In this shift, the goal is to reduce overall overhead costs. These cost reductions appear to be much more appealing to top management. Symptoms and treatment of challenges to ABM implementation include the following.

Symptoms

- Lack of enthusiasm or encouragement from top management.
- Difficulty in getting approval for necessary resources such as full-time team members, funding for equipment, or outside resources.
- Failure of management to spend time understanding the initiative or failure to attend briefings.

Treatment

- Link the initiative to key business objectives. Clearly articulate how improvement will be delivered in the area specified in the company's key strategic issues.

- Find an executive who owns the initiative, who will help to develop it, and showcase the benefits of using ABM. Then use the benefits to convince more people to buy in and own the approach. If successful, this creates a groundswell of support that overwhelms ABM opponents.
- Expose top management to the potential benefit of ABM through visits to other successful companies and via benchmarking reports and anecdotes.
- Find competitors who are using or experimenting with the approaches; competition often spurs management into action.

Pitfall No. 2: “Okay, tell me again why we’re doing this”

An effective process begins with objectives to which everyone agrees. Mutually defined objectives are, incidentally, of great help in promoting ABM to top management in the first place. Setting mutually agreed-upon objectives establishes awareness as well as drives the process.

Without objectives that highlight the very definitions of ABM, the scope of the method will not be understood, much less implemented. Many people in the awareness stage misunderstand ABC terms such as cost driver, cost object, and even the word “activity.” Others mistakenly believe that using ABC information for customer costing and for activity analysis are the same thing. In searching to understand what ABM is, the focus shifts (often aided by “experts” selling products) to the specific features of various approaches. These features could be taken from packaged software, a consulting firm’s methodology, an article, or a book. In any event, what is lost is the purpose of why ABM is being implemented in the first place.

For example, the controller of a petrochemical plant on the Gulf Coast was reviewing three proposals to assist his implementation of ABC. He stated that he liked Arthur Andersen’s approach to the project but wondered why the firm’s representative had not brought along a software program to demonstrate. In response, the firm’s representative offered to demonstrate three off-the-shelf ABC packages as well as two custom-developed packages. But first he wanted to clarify if the controller was interested in buying software or addressing a business problem. The controller thought for a moment, refocused on his business objective, declined the software reviews, and recommended Arthur Andersen to help solve the business issue. He did the right thing by refocusing on the company’s business objective.

Similarly, a manufacturer in the Pacific Northwest requested assistance conducting an ABM pilot in one of its development operations. When asked

about their business objective, the company's pilot team stated that they were doing the project because it was in their individual Management by Objectives (MBO) plans for the year. Unfortunately, the engineering group running the development operation did not have it in its MBO, so the pilot did not happen. Why? There was no link to a clear business objective.

Ask the Five Whys

If there is a question about whether an ABM initiative has a clear business objective, the planning team should articulate why it is doing the project. Then "why" should be asked four more times.

1. Why is this project being performed?
Because it will make us a better company.
2. Why will it make us a better company?
Because we will better understand costs.
3. Why do you need to understand costs?
Because we do not understand what causes costs.
4. Why do we need to understand what causes costs?
Because we need to understand how we can reduce and avoid costs.
5. Why is reducing and avoiding costs important?
To meet our strategic objective of being the low-cost, high-quality provider.

Answering "why" five times yields the objectives and ensures there is consensus regarding what outcomes the company is seeking from the project (or demonstrates that the project should not go forward). Get everyone to agree on the objectives, and the initiative is ready for launch. Symptoms and treatment for lack of clear objectives include the following.

Symptoms

- Confusion among project team members or management as to the benefits expected from ABM.
- Belief that ABM will equally and adequately support strategic customer costing and operational cost reduction. (Also see Pitfall No. 3.)
- Inability to articulate what will be achieved.
- Confusion over how ABM links to key strategic goals.

Treatment

- Ask management and project teams the “five whys” in order to focus on the project objectives.
- Write down the project objectives, circulate and review them until consensus is reached. Specify how the initiative will deliver on key objectives. State the quantifiable benefits that will be achieved.
- State how the project objectives relate to and support key strategic goals.
- Identify any inherent conflicts in objectives. (Specifically, an ABM system cannot be used for both strategic product costing and also for operational cost reductions.)

Pitfall No. 3: “What do you mean, there are three views of cost?”

Cost management systems can serve at least three distinct purposes:

1. financial
2. operational
3. strategic⁴

These three views involve different users, purposes, levels of aggregation, reporting frequency, and types of measures. (See Exhibit 1.3.) The simple truth is that it’s very difficult for a single system, even an activity-based one, to meet the requirements of all three of these different views simultaneously.

Some hype over ABC and ABM asserts that ABM can satisfy all internal customers if the method is tailored into a custom process for the company in question. But ABC begins with understanding and articulating the kinds of financial, operational, and strategic information the company expects. Then the ABC project can be designed to provide the type of information most desired.

For example, some companies attempt to develop an ABC system that fulfills strategic product costing and financial reporting purposes at the same time. Evaluation of strategic product costs normally includes some costs that are not product costs under generally accepted accounting principles (GAAP), such as selling and administrative. Also, strategic product costs may not include some factory overhead costs (e.g., plant security and plant manager’s salary) because they cannot be assigned accurately to individual products. Moreover, strategic product costing may defer certain costs, such as research and development costs, to future periods. Likewise, it may currently

EXHIBIT 1.3 Three Views of Cost

recognize costs that will be incurred in the future. For example, environmental costs may be estimated and included in strategic product costing for the current year, even though GAAP may not recognize these costs until future years. Consequently, strategic product costs may not be close to GAAP costs.

Therefore, strategic product costs typically have to undergo a major revision before they can be converted back for use in financial reporting. To avoid this, some companies follow GAAP rules when calculating costs to be used for strategic purposes. The result, however, is costs that are not as relevant as they should be.

Companies can attempt to implement systems intended to present multiple views of costs, but there will be trade-offs. The conflicting roles and reasoning behind each view's purpose, users, time focus, and types of measures can compromise these differing views. These trade-offs can be mitigated by showing multiple presentation (i.e., both a GAAP view and a strategic life-cycle view). However, trying to present multiple views within a single system means a geometrically more complex system requirement due to the widely varying levels of aggregation and reporting frequency.

To avoid both compromise and complexity, we recommend that legacy systems feed a common data repository (or warehouse) as noted in Exhibit 1.4. This exhibit illustrates how a company can build a modular system supporting multiple user needs. It reduces cutoff issues by using common data sources while allowing the flexibility of customized user workbenches that focus on each required view of cost. The detail provided for each view can be tailored to its need. For instance, the operational view of costs uses the operations analysis workbench, which can be tailored to the detailed area under review.

The following symptoms and treatments aid implementation teams that fail to understand the three views of cost.

Symptoms

- Belief by management that one cost system is meeting everyone's needs.
- Belief that the monthly financial statements are what everyone needs to manage the business.
- Lack of understanding of the role of nonfinancial (physical) performance measures.
- Desire to have an ABM system that efficiently does both product costing and process improvement simultaneously. (They seldom do, no matter what the consultant said.)
- Belief that traditional variance explanations are still the most efficient way to explain operations.

EXHIBIT 1.4 Illustrating the Overall Analytical Reporting Vision

Treatment

- Search out and identify the other cost systems currently being operated. Identify who uses them, why they exist, and the benefits they provide.
- Track the amount of time spent on special projects because the financial statements did not provide adequate information.
- Educate managers on the use of both physical and financial performance measures.
- Conduct this exercise: Give management financial statements from the last four quarters. Ask them to describe what has happened to customer satisfaction, quality, and on-time delivery over that period. Require them to show their support analysis.
- Document the mental steps required to explain traditional variances, then show all the steps eliminated if physical measures are used.

Pitfall No. 4: “The accountants are changing the allocations again”

Financial department personnel are not the only ones qualified to conduct an ABM project, nor should the ABM team consist only of financial people. If only financial people make up the team, the project is likely to be viewed as an accounting project. While number crunching is necessary, ABC numbers must accurately model the organization if they are to be used for decision making.

Putting someone from marketing, operations, or engineering in key project roles such as team leader will help ensure that activities and costs are viewed from a horizontal process perspective. Instead of perceiving ABM as an accounting project, staff thus will perceive it as a management tool that is required for management decision making. Seeing the key linkages of business processes is often the most insight-awarding benefit of the project.

In a recent review of a Midwest manufacturer, Arthur Andersen consultants analyzed the manufacturer’s cost management practices. During the review, the consultants identified five separate cost management systems (financial, purchased material, plant 1 operating, plant 2 operating, and quality cost) in use. This information was a revelation to cost accounting department staff, who knew only about their own system.

Had an ABM project been implemented using only financial personnel, the four existing nonaccounting systems would have been overlooked. Another critical issue, however, is the fact that the needs of users in operations would not have been understood or addressed if these departments had not been

represented on the project team. Systems capturing similar data often exist across a company because users have acted to meet their own information needs. If these additional, nonaccounting systems are present, redundant tasks can be eliminated by implementing an ABM system that includes information supporting the tasks while making the new system different from the cost accounting system it replaces. This is particularly true in companies in which the traditional cost accounting system focuses on a financial view of cost accounting, on accountants rather than accounting's customers, and on past information rather than forward-looking strategic and daily management operational information. The ABM system must overcome these prior limitations.

With a financial person heading the project, the following symptoms and treatments are important.

Symptoms

- The project team is comprised solely of financial personnel.
- Sales, marketing, and operations personnel exhibit no interest.
- Plan fails to address operational or strategic issues.
- Team struggles to understand horizontal linkage of processes.

Treatment

- Select a project leader from operations, engineering, management information system (MIS), marketing, or some other functional area.
- Choose most team members from nonfinancial people.
- Survey personnel in operations, engineering, and marketing as to what they need. Record their responses, incorporate them, and get their concurrence on the plan.
- Ensure that the initiative links with and supports key business initiatives.
- Use financial people to explain how the tools work. Use operating personnel to apply the tools to business problems.

Pitfall No. 5: “We’ll tell the employees about this later—maybe”

Employees must be involved in creating, implementing, and continuously improving the ABM system. The identification of activities and cost drivers should be undertaken mainly by nonaccountants. Accountants or outside consultants may facilitate this process, but the activities and related cost driv-

ers must be identified by those most knowledgeable about the work: those who do it. Accountants are not experts in knowing what work people are doing, nor are they experts in knowing what causes the work. Therefore, employee involvement is critical to success.

Moreover, if nonaccountants are more active in creating the ABM system, they are more likely to use the ABM information and to make suggestions for improving the ABM system. Nonaccountants can spot errors and suggest changes to ensure that the ABM system accurately models operations and tracks operational behavior.

ABM should be viewed as a continuous process in which improvements are normal rather than exceptional. Moreover, ABM must evolve to model organizational changes accurately over time. If ABM is viewed as a one-shot project, any benefits received may be temporary. To ensure that the ABM model evolves, the following steps are essential:

- Integrate activity analysis with the annual planning cycle.
- Link departmental performance measures with departmental activities.
- Include an evaluation of specific critical activities in employee performance appraisals.
- And, most important, tell the employees.

Lack of employee involvement can be identified and corrected using the following guidelines.

Symptoms

- Employees are unaware of pilot development efforts.
- Employees are aware of but do not support the efforts.
- Survey and data requests go unanswered.
- Review meetings are poorly attended.
- Employees resist using the pilot systems.
- Team is criticized for not understanding the business.

Treatment

- Explicitly link the objectives to achievement of key business goals.
- Select employees who will operate the system to be part of the project team.

- Use “rifle group” meetings instead of surveys to gather data. In a rifle group, all the people to be interviewed are brought together at the same time so all can have the same level of understanding and any issues can be clarified quickly.
- Set specific measurable targets for deadlines and hold people accountable for delivery.
- Create focused time frames for projects. Some key goals should be reached in three months or less.
- Make sure the team includes people who indisputably do understand the business.

Pitfall No. 6: “We can do this without spending any money”

The creation of a successful ABM system can mean a significant investment in dollars, time, and energy. Money is often required to hire ABM expertise either in the form of outside consultants or new permanent employees. Someone must be responsible for leading and managing ABM. Full-time resources are typically required. A high degree of energy will be expended as this is a significant organizational change tool.

Failure to recognize this cost factor is a significant pitfall. For example, one midwestern manufacturer concluded that due to demands on existing personnel, the company would approach the ABM implementation using a part-time project team. This company spent more than a year preparing to launch its ABM effort. In reviewing its costs, the company concluded that a dedicated 60-day effort would have been far less expensive, not to mention the dramatically accelerated payback from improvements generated by the project.

Software is another money issue. Whether packaged software is purchased or a custom system is developed, costs for ABM software can be substantial. Typical project costs range from a low of \$30,000 up to more than \$1 million. Packaged software typically runs from \$2,500 to \$10,000 per site with discounts for multiple site licenses.

Project duration can begin from six to 16 weeks for pilots, depending on the depth of analysis and the scope of the business being analyzed. Enterprise-wide systems take from a very aggressive six months to many years.⁵ A company that believes an ABM system will provide information that leads to making better decisions should estimate the *value* of those better decisions. For example, an estimate of the number and magnitude of unprofitable cus-

tomers could be made before initiating the pilot. Developing these estimates as a “call to action” is critical to getting the resources needed to move forward on a rapid and focused basis.

While financial support is necessary, a company also must avoid falling prey to the big-bang syndrome. This is when a company realizes that the right ABM system can yield tremendous benefits. Management gets so excited that they agree to spend astronomical funds on ABM.

With that kind of financial commitment, development efforts take on lives of their own. Consultants are brought in to develop various parts of the system. Software vendors vie to get included in the design. Users lobby even harder than usual to ensure that their needs are addressed. Ultimately more personnel may be brought in simply to manage the complexity of project management.

The risk of the big-bang syndrome is that it is often more noise than results. Many things can happen during a long development cycle—users change, business needs change, funding priorities shift. All of these changes can minimize the impact of any system, no matter how much it costs. An ABM system can easily provide the information needed to save \$10 million to \$20 million per year; the key is to start saving while the investment is being made.

To achieve this, a gradual approach is recommended. Take a step toward the long-term direction, but take one that pays an immediate return. The faster the paybacks, the faster the next steps can be taken. Many companies find that this incremental approach results in a better-used system that has more broad-based support, which is critical to a sustained level of funding.

Lack of monetary support ends a project. The following symptoms and treatments are useful for a successful implementation.

Symptoms

- Top management is reluctant to fund the project.
- Manpower, space, and equipment are difficult to acquire.
- Expansion efforts receive lukewarm support.
- Company attempts to use only part-time resources, thus dramatically lengthening the time frame.

Treatment

- Link initiative to key business objectives.
- Articulate a written cost/benefit statement that calculates the cost of per-

manently lost earnings from not moving forward (i.e., savings opportunities forgone).

- If payback is positive, outsource parts of the project or other duties to free up project resources.
- Seek to determine why management is lukewarm and whether their concerns can be addressed.
- Be creative in finding quick hits, low-cost ways to improve (e.g., use off-the-shelf software and sample cases).
- Identify a self-funding approach whereby project savings fund further developments.

Pitfall No. 7: “We don’t need training—this isn’t brain surgery”

ABM may not be brain surgery, but it requires new ways of thinking and adjustments to established routines. People need training.

Usually outside experts lead initial training. They can lead subsequent training as well, but the right internal people will do just fine. While internal training may not be as efficient as outside training, company trainers know more about the firm and can integrate this knowledge into their training methods, which often makes the training more effective.

Both the ABM implementation team and the people using ABM information need training. Much of this training should be done early in the implementation process; however, some training needs to take place after completion of the installation to ensure that users know how to use the resulting systems. In addition to grounding in the general concepts used under ABM, some managers will need specialized training. For example, salespeople should be shown in detail how to use the ABM system to improve customer profitability; design engineers should be trained in how to use the ABM system to cost new products.

While this training may require a significant expenditure, ABM may be easier to understand than the old cost system. One company found that while the old cost system used only one overhead base and the ABM system used 11, the old cost system did not model the factory accurately. Top management wanted its managers to understand the cost system so that better decisions could be made. This goal was easier to achieve under ABM because the company managers had never been able to fully understand the old cost system.

After the initial burst of activity, a periodic follow-up should be conducted to see if this training was effective. Training effectiveness can be ascertained by asking some basic questions.

- Are managers using the ABM system the way it was intended?
- Are managers using the activity information as well as product or customer information?
- What difficulties are managers and other users encountering?
- Do managers understand the ABM information?
- Are there mistakes in the ABM system?
- How can the system be improved?

Training has other benefits. ABM may be outside the comfort zone of many nonaccountants. These people may feel threatened by financial information. Extensive training in ABM helps by allowing them to see how the activities and related costs are determined.

Symptoms and treatment to ensure proper levels of training include the following.

Symptoms

- Team is unclear about members' roles or analysis that needs to be performed.
- Management does not understand how work will change as a result of the new system.
- Frustration is evident; people do not understand the terminology.
- People resist (either passively or actively) using the new approaches because they are unsure of the effect on their jobs.

Treatment

- Conduct orientation training for all who are reluctant to use the new approach. Communicate the business issues being addressed and how the techniques will deal with them.
- Document existing approaches and how they are changing.
- Do a force-field analysis comparing what factors will influence successful implementation. (This involves identifying the forces that are driving and those that are opposing successful implementation.)

- Videotape the orientation and training sessions to create on-demand training for new employees and refresher courses.
- Communicate, communicate, communicate. (Explain objectives and project status in articles in company newsletters, on a display board, and in a voice-mail hot line, for example.)

Pitfall No. 8: “It’s the consultant’s fault”

Steven M. Hronec, the author of *Vital Signs*, says that there are three reasons to hire a consultant:

1. The person doesn’t have the time to do it him- or herself.
2. The person doesn’t know how to do it him- or herself.
3. The person wants someone to blame when things go wrong.

The third scenario is no good for anyone, and there are ways to prevent it.

A consultant’s role is to help the company be successful, a role that includes a healthy dose of knowledge transfer from the consultant to company management and users of ABC/ABM information. If the team members do not have time or do not know how to implement an ABM system, a consulting approach can help implementation move forward. At some point, however, the skills and ability to run the ABM system must be transferred to the company. Experience dictates that this is more effective if it occurs at the beginning rather than end of the project. If jobs must be back-filled, bring in help to handle the stable workload rather than the new development.

If there is concern about someone to blame before the project begins, there needs to be more buy-in and understanding of the benefits to be gained by ABM.

There are some potential problems with having a consultant-dominant project. Companies should be wary of the warning flags of this occurring. The first warning flag that there may be problems is a consultant dictating answers rather than soliciting them. Some consultants try to apply answers used in previous projects rather than finding answers that are appropriate in the current circumstances.

The second warning is an ABM model that reflects something other than the stated objectives. An ABM system reflecting the consultant’s perception of management’s goals, and the consultant’s perception of the organization may be ineffective. The consultant should help management take ownership of the ABM system, not set a new agenda.

Another variation on this pitfall is purchasing ABC software to “lead a company through an implementation.” Under this variation, the software takes the role of consultant as “someone to blame when things go wrong.” While there may still be a scapegoat, the business objective has not been met.

ABM is not a mass product that a person can walk into a store and buy off the shelf. Nor is it prepackaged software that produces a successful ABM application upon installation. ABM is a management approach enabled by a deep understanding and quantification of processes and activities through the use of technology.

The following guidelines will help identify if a consultant has been assigned ownership and alternatives to place company members in ownership roles.

Symptoms

- Initiative belongs to the consultant: “Joe Consultant’s Cost System.”
- Consultants prescribe rather than describe solutions.
- Company is forced to fit the consultant’s model of ABM rather than ABM fitting the company.
- The software, not the company’s information needs, drives the initiative.

Treatment

- Place company people on the project full time. Insist on full knowledge transfer; by the end of the project, project team members should be as knowledgeable as the consultant.
- Ensure the consultant’s attitude is supportive, not dictatorial. The consultant should offer tools that tie the initiative’s success to teamwork with employees and executives.
- Pick an appropriate name for the project and communicate it.
- Use consultants as facilitators so company employees can implement ABM themselves.
- Consultants should be flexible enough to model what company personnel want rather than what the consultants did on their last project.

Pitfall No. 9: “We don’t need resident experts”

As recommended under Pitfall No. 6, at least one permanent employee should be an ABM expert. This person may be self-taught but generally will need to collaborate with others. The person may have implemented ABM for another company, may have served as an ABM consultant, or may have

learned the necessary skills through experience. In any case, someone needs to be permanently responsible for the functional and technical aspects of the ABM system. This individual does not have to be, and often is not, from a company's MIS department. If a company does not have a resident ABM expert, expect a great deal of frustration and many mistakes.

For example, the finance organization of a coal company sought to use ABM to streamline its accounting activities. For two weeks, each of the 20 employees kept detailed time logs in 15-minute increments. Unfortunately, this resulted in a pile of useless data. Why? The company lacked experience in performing ABM analysis. It failed to establish and use a common activity dictionary and numbering scheme before data collection. Without this step, the activity logs could not be summarized or compared. Employees performing the same tasks described them differently. In the end, making sense of the data was impossible, so the project was scrapped.

Initially, cost management expertise can be acquired in the form of outside consultants, work groups, or participation in research groups, such as the Consortium for Advanced Manufacturing-International. However, when the outsiders leave, someone at the company needs to be able to understand and operate the system. Knowledge transfer should be required in all projects. This expertise requirement applies to each operating unit as well as to each company. One company that adopted ABM does not plan to put ABM in all of its operating units because some of those units do not have the necessary cost management expertise.

A successful implementation depends on a thorough understanding of and experience in cost management. Key symptoms and treatments to pinpoint depth include the following.

Symptoms

- Cost accountants display little understanding of business operations and cost management techniques.
- No cost accounting is being done—there is no cost accounting system, no cost accountants.
- Cost management issues are not understood. Staff does not know how to answer management questions.
- People are lost as to where to begin or what process to use.

Treatment

- Run the company through a cost management diagnostic to understand key costs, such as material, labor, and overhead; the relative importance

or key components of costs such as payroll, facilities, communications, and so on; and the degree of customer complexity.

- Select and train a traditional cost accountant or a financial accountant to become a cost management expert.
- Hire cost management expertise.
- Have consultants train company personnel. Start personnel with broad training about ABM and how it will be applied.
- Benchmark cost management practices against global best practices. For example, Arthur Andersen's Global Best Practices Knowledge BaseSM allows a company to compare its target costing practices to Toyota's, which is considered to be the best in the world.⁶
- Start a cost management library.

Pitfall No. 10: "This doesn't link to other initiatives"

Most companies that implement ABM are also adopting other initiatives such as just-in-time (JIT), total quality management (TQM), and business process reengineering (BPR). Rather than implementing ABM in isolation, ABM should be linked with each of these initiatives.⁷ ABM provides valuable cost information for JIT, TQM, and BPR decisions. For example, ABM may support ISO9000 certification by comparing the ISO9000 process maps to the activity dictionary and identifying gaps. The result can be consistent activities across all branches, common definitions, and data available for internal benchmarking. Or ABM may support BPR by showing that each standard part, rather than a new part, used in a product design will save \$1,000. This cost information can be used to encourage actions that are consistent with other improvement objectives. Even if ABM cost information indicates that a decision to achieve these objectives will be costly, it is still valuable information. All of these approaches are cost sensitive. For example, actions to improve response time or quality should be taken only if the benefit to the customer exceeds the cost.

Recently, an aircraft manufacturer had a face-off or competition of improvement efforts. The company simultaneously conducted an ABC project, an engineering project, and a theory-of-constraints project. The goal was to see which one worked best. A better approach would have been to perform all three projects together. Having improvement efforts work together instead of competing is analogous to using multiple horses to pull a wagon. The wagon will travel farther and faster if the horses are pulling in the same direction.

Linking ABM with other initiatives leverages the power of each project and enhances the overall benefits. Symptoms and treatments to determine if a project does not link are included below.

Symptoms

- The initiative is isolated from other efforts.
- ABM is viewed as a one-time project.
- Product champions of JIT, TQM, and BPR see ABM as a threat (or as unimportant) rather than as a vital information source.

Treatment

- Use ABM to develop performance measurements for initiatives such as JIT or TQM.
- Use ABM to generate ideas for continuous improvement in all improvement initiatives.
- Compare ABM objectives and expected benefits with those of other improvement efforts to identify commonality.
- Include people from other improvement efforts on the ABM steering committee.

NOTES

1. For more detail on how companies are being successful with expanded scope, see Steve Player and Carol Cobble, *Cornerstones of Decision Making: Profiles of Enterprise ABM* (Greensboro, NC: Oakhill Press, 1999), and Steve Player and Roberto Lacerda, *Arthur Andersen's Global Lessons* (New York: John Wiley & Sons, 1999).

2. All definitions are taken from the *CAM-I Glossary of Terms*, version 2; see Glossary.

3. Steven Hronec, *Vital Signs: Using Quality, Time and Cost Performance Measures to Chart Your Company's Future* (New York: American Management Association, 1993), 57–61. ABO Continuum is a service mark of Arthur Andersen.

4. This concept was developed originally by Steven Hronec, Arthur Andersen LLP, for an internal training course in 1993. It is touched on briefly in H. Thomas Johnson and Robert S. Kaplan, *Relevance Lost: The Rise and Fall of Management Accounting* (Boston: Harvard Business School Press, 1987),

28, and in Robert S. Kaplan, “One Cost System Isn’t Enough,” *Harvard Business Review* (January–February 1988), 61–66. It is further discussed in Hroniec’s, *Vital Signs*, 44–45 and 130–134.

5. For more information on enterprise-wide ABM systems, see Player and Cobble, *Cornerstones of Decision Making*.

6. The Global Best Practices Knowledge BaseSM was developed by Arthur Andersen. The information is cataloged on CD-ROM, classified by process.

7. See also R. Steven Player and Ken Euske, “Leveraging Management Improvement Techniques,” *Sloan Management Review* (Fall 1996): 69–79.