

Why Use Activity-Based Costing (ABC)?

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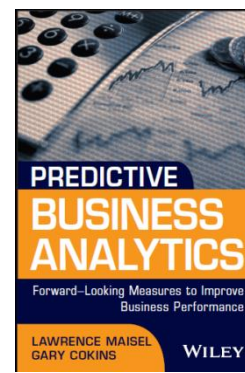
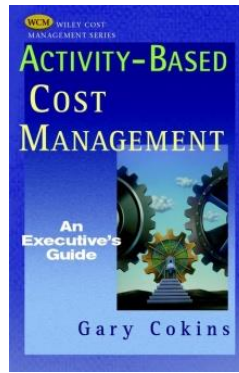
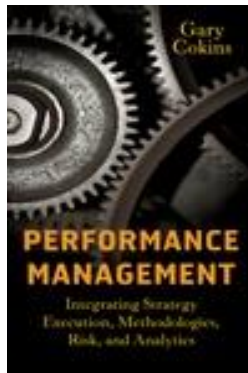
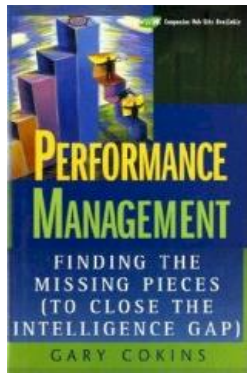
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About Gary Cokins

Founder, Analytics-Based Performance Management LLC

B.S. Industrial Engineering & Operations Research;
Cornell University, 1971

M.B.A. Finance & Accounting; Northwestern University,
Kellogg School of Management, 1974



Previous Associations:

- FMC Corporation
- Consultant with: Deloitte, KPMG, Electronic Data Systems [EDS, now HP]
- SAS

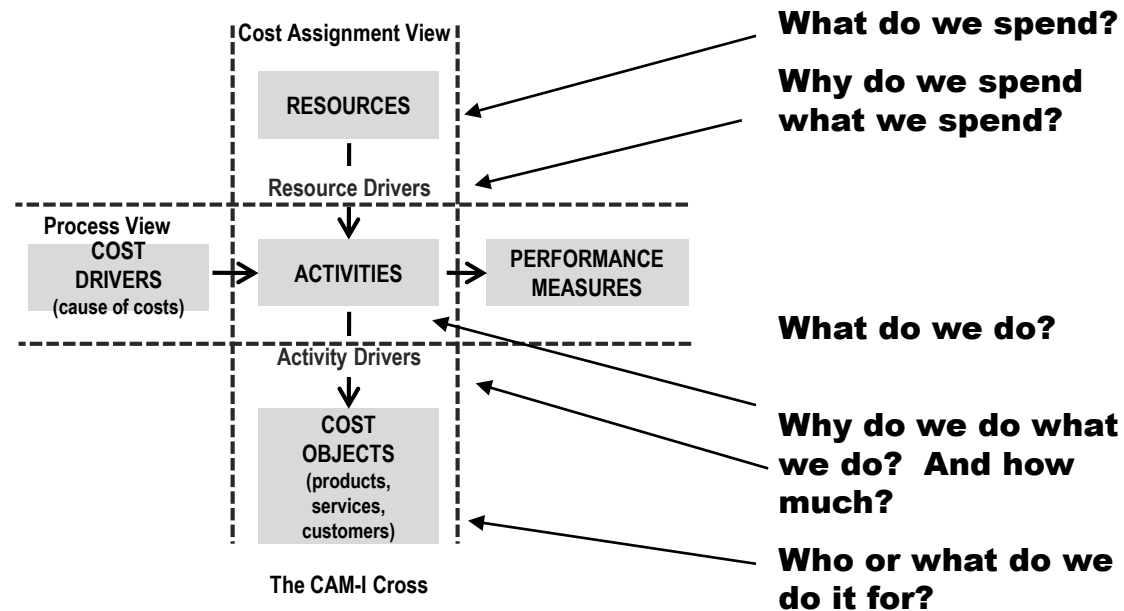
Traditional Overhead Cost Allocations are Flawed and Misleading

When CFOs “allocate” indirect expenses (i.e., overhead) to products and standard service-lines, they spread it like “butter across bread”.

CFOs violate cost accounting’s universal “causality principle.

Activity-based costing (ABC) resolves this by “tracing and assigning” expenses based on cause-and-effect relationships for how products *consume* work activities, which in turn *consume* the expenses.

The ABC Framework – The CAM-I Cross



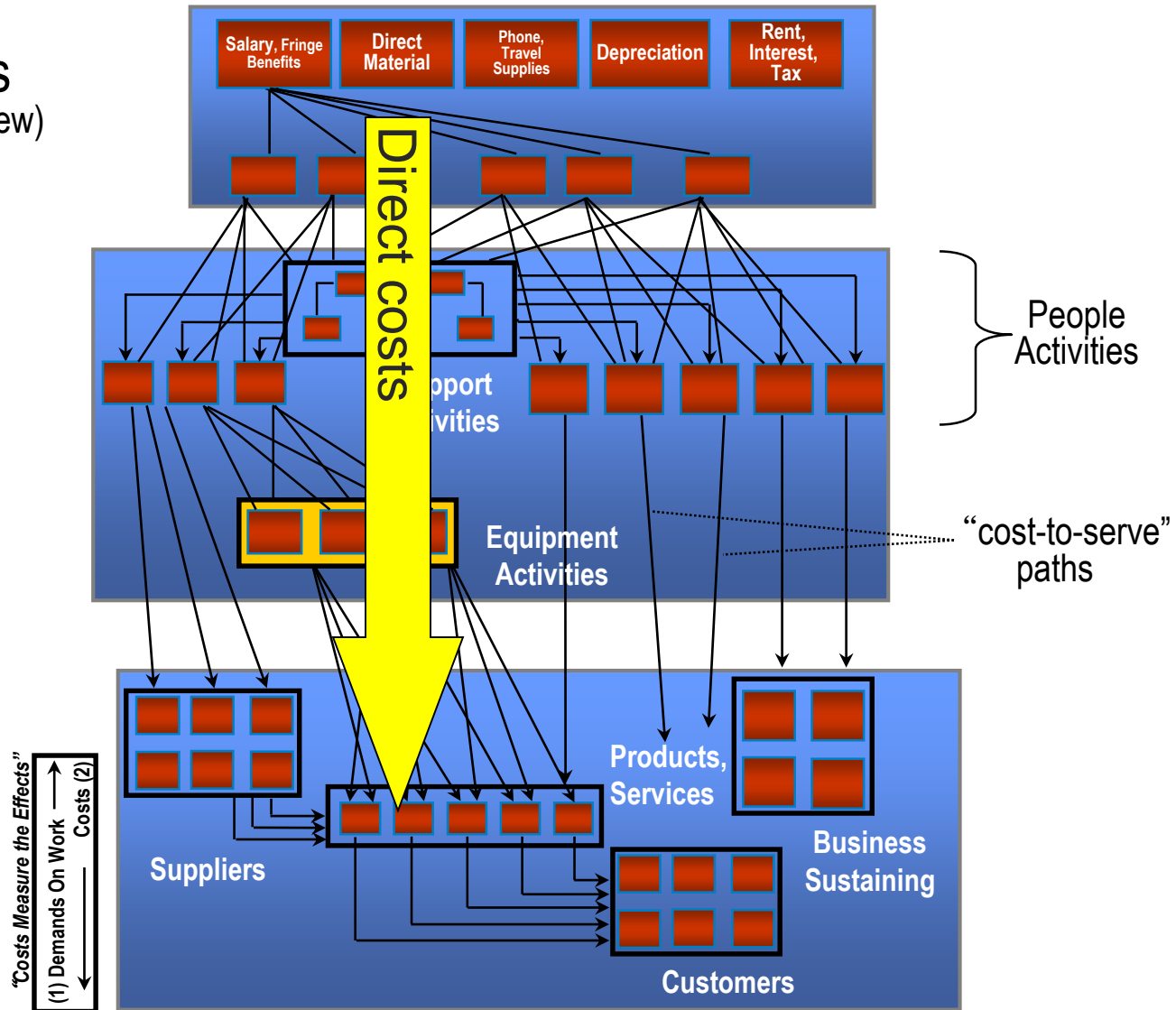
Source: The Consortium of Advanced Management International (CAM-I).

ABC Cost Assignment Network

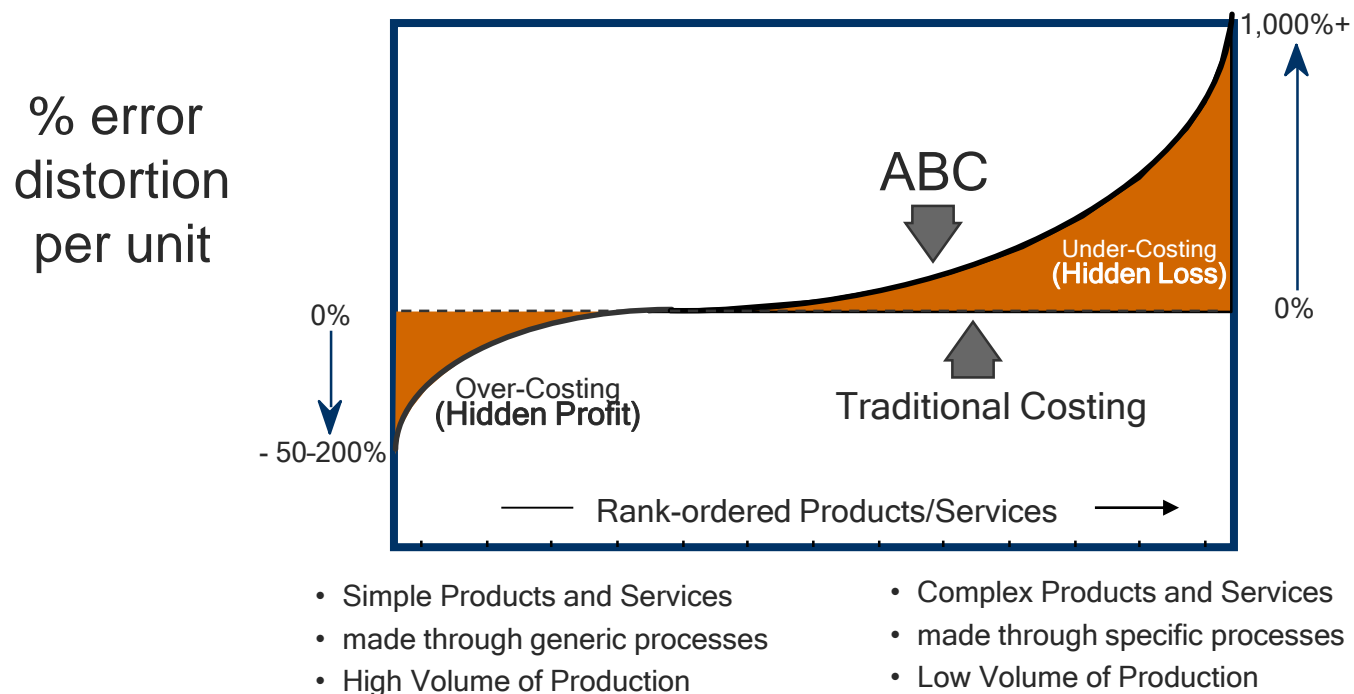
Resources
(general ledger view)

Work
Activities
(verb-noun)

Final
Cost
Objects

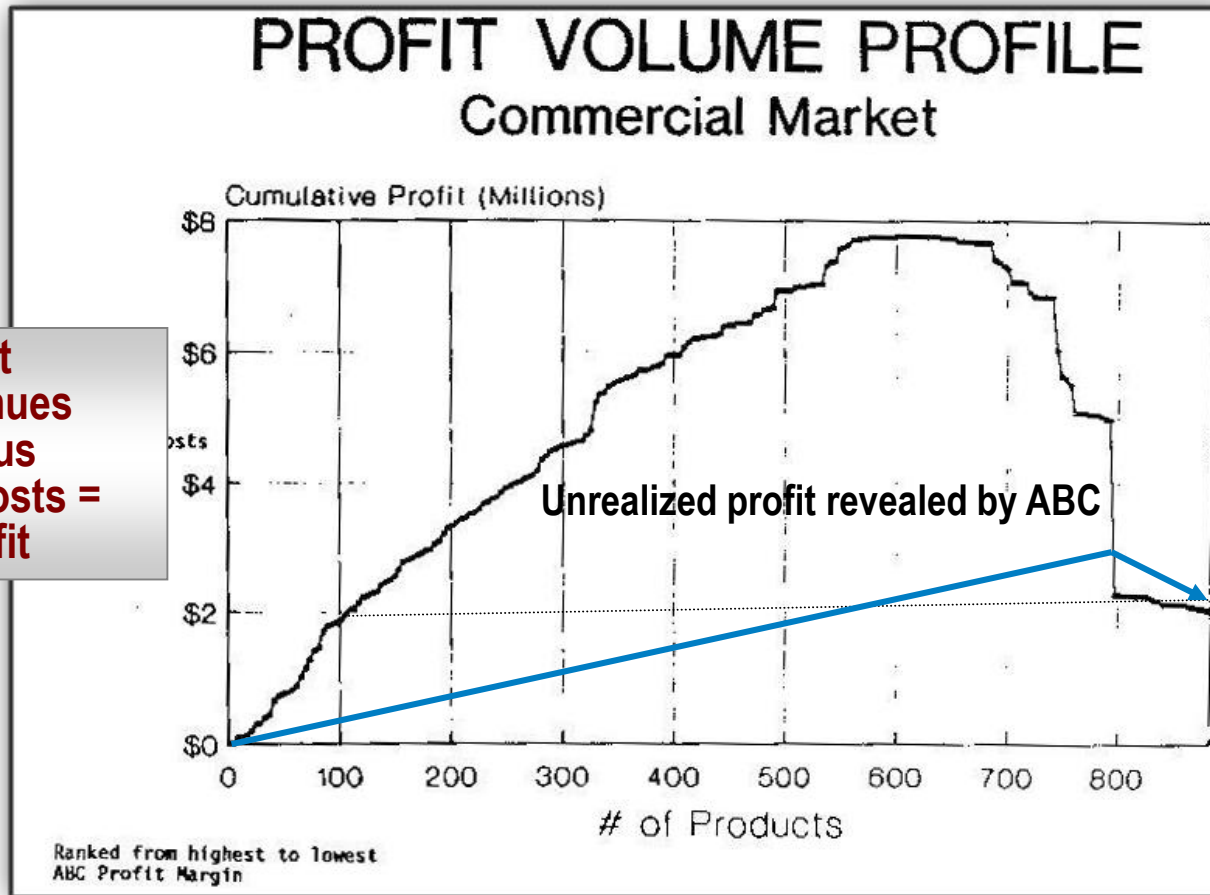


Standard Costing Over- and Under-Costs Products



Source: Alireza Sarraf; permission to use granted

Organizational shock from the truth



Net
Revenues
Minus
ABC costs =
profit

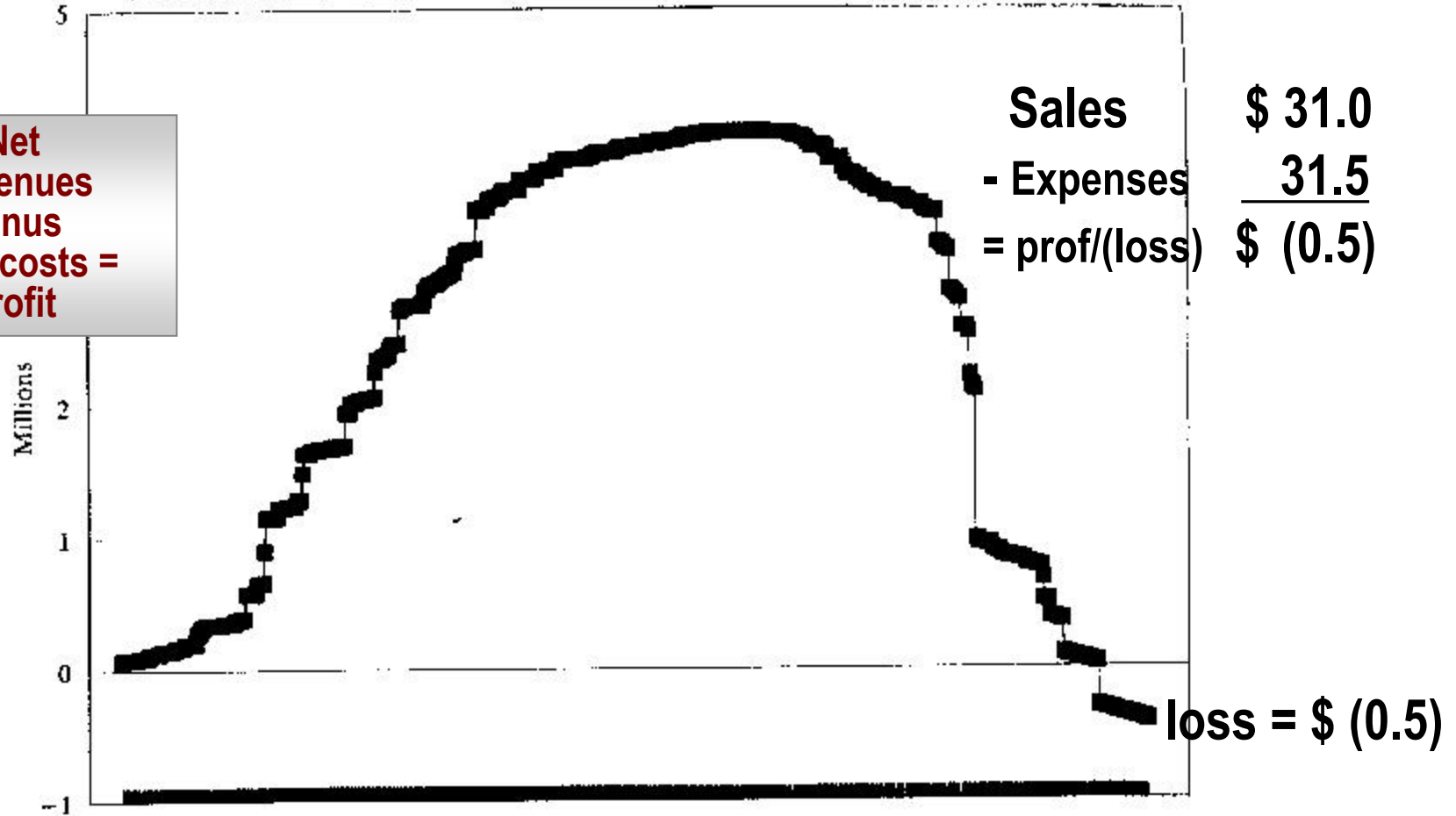
$$\begin{array}{r} \$ 30 \text{ sales} \\ - 28 \text{ expenses} \\ \hline = \$ 2 \text{ profit} \end{array}$$

← \$ 2 profit

More important than a better costing method are its results.

CUMULATIVE NET MARGIN ANALYSIS

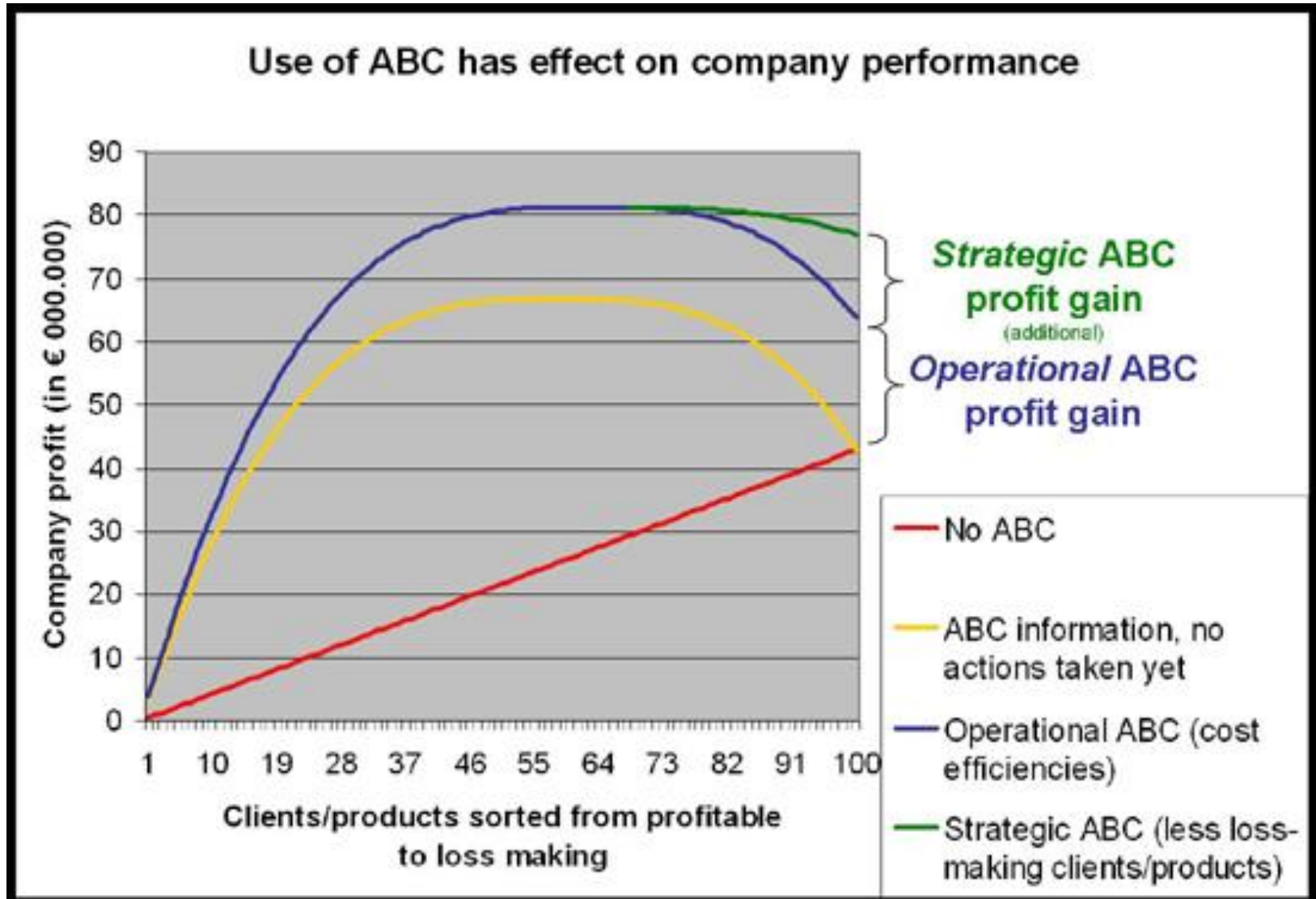
Net
Revenues
Minus
ABC costs =
profit



PRODUCTS RANKED BY ABC NET MARGIN

■ CUMULATIVE ABC NET MARGIN

Take Actions to Raise the “whale curve”



Source: Alireza Sarraf; permission to use granted

ABC Quotes

“It is better to be approximately correct than precisely inaccurate !”

“In the land of the blind, the one-eyed man is King.”

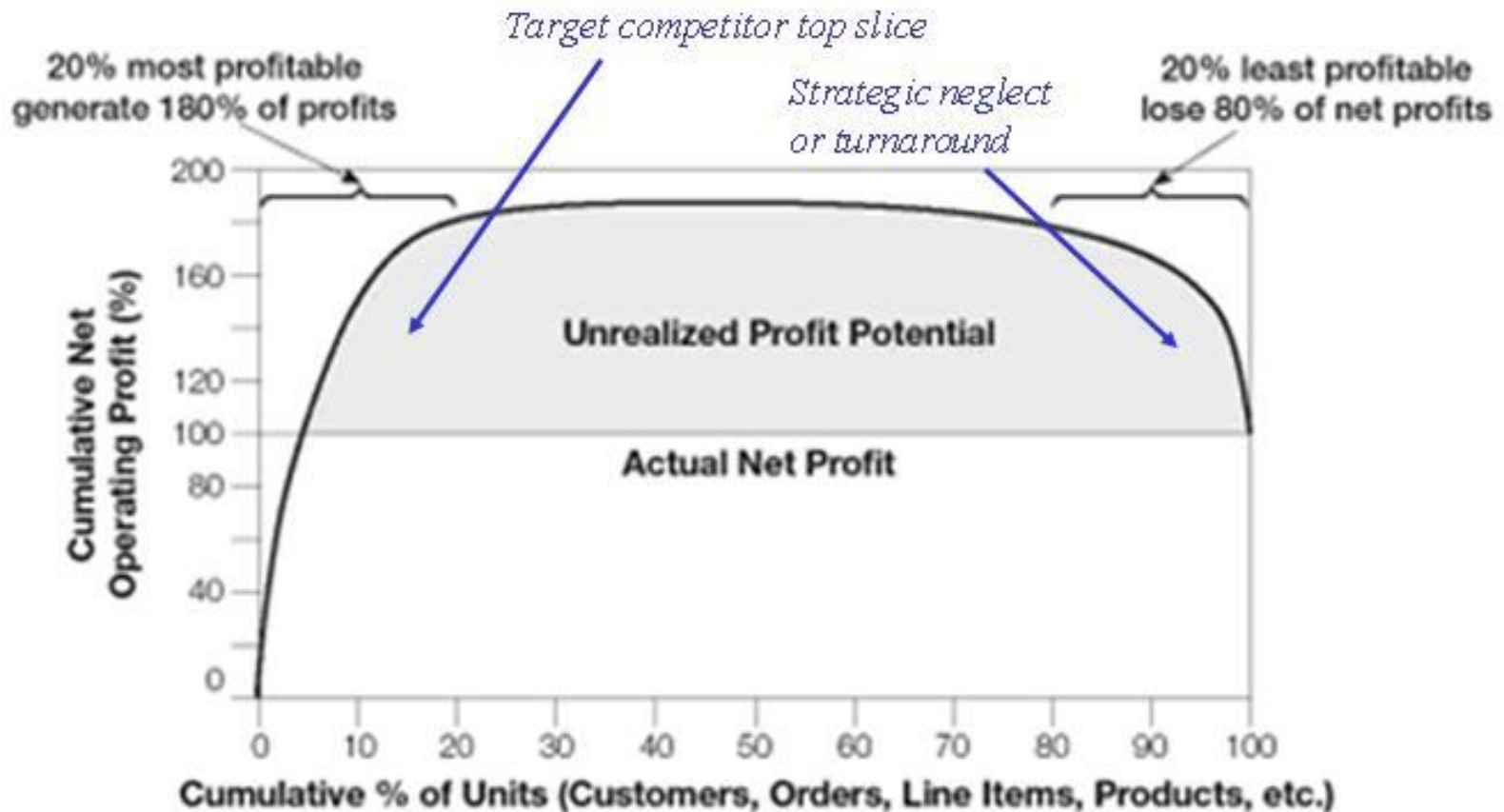
Value of Company = f(Value from Customers)

The only value a company will ever create is the value that comes from its customers – the current ones and the new ones acquired in the future.

To remain competitive, one must determine how to keep customers longer, grow them into bigger customers, make them more profitable, serve them more efficiently, and acquire relatively more profitable customers.

A “whale curve” of Customer Profitability

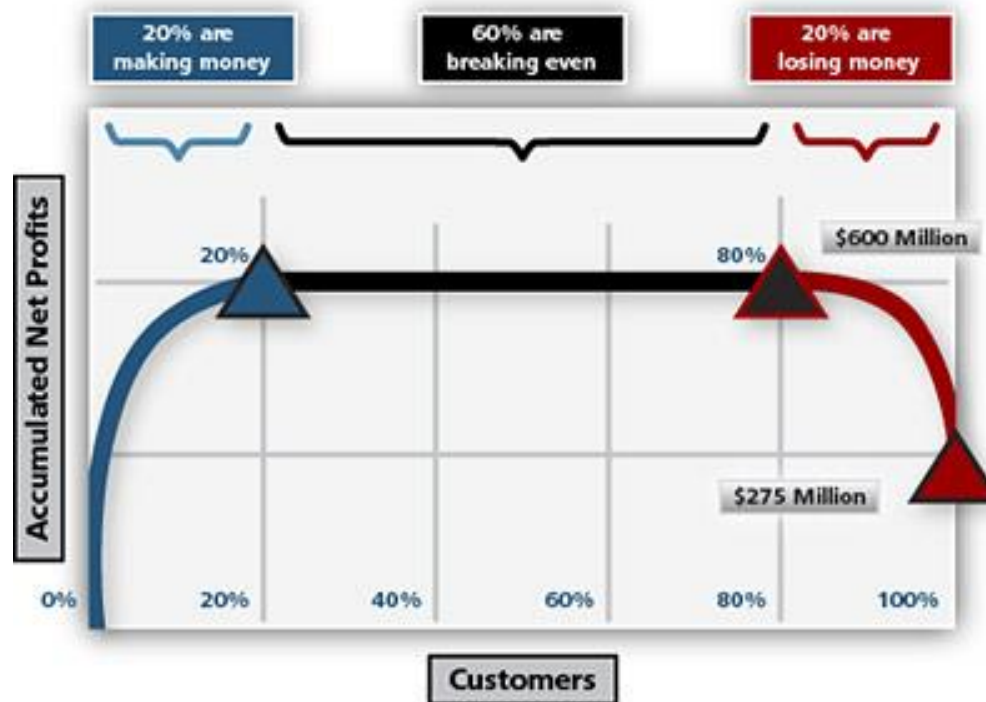
Cumulative Customer Profitability (Whale Curve)



Source: Kaplan

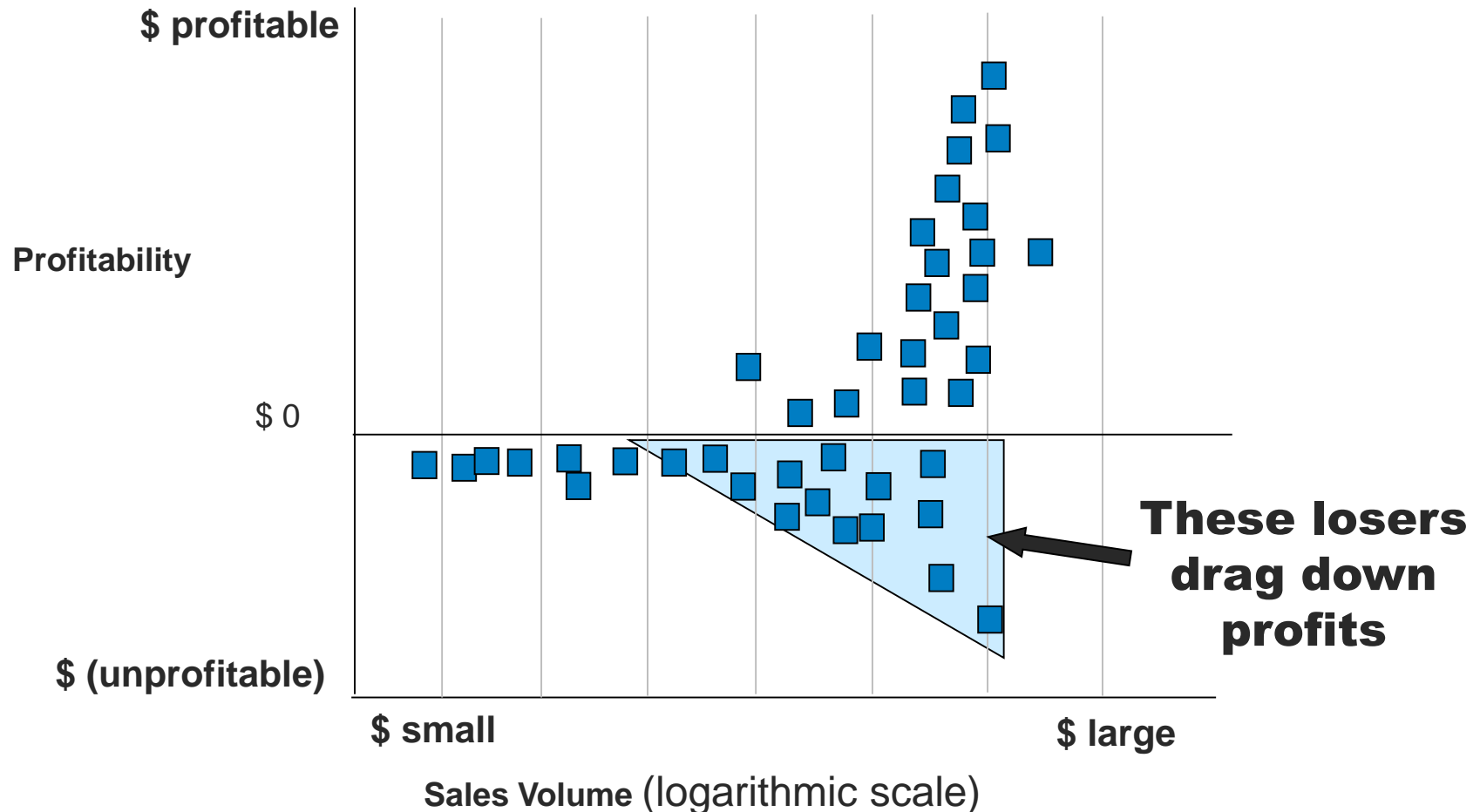
A “whale curve” of Customer Profitability

In this graph 17% of a supplier’s customers generate 93% of their profitability.

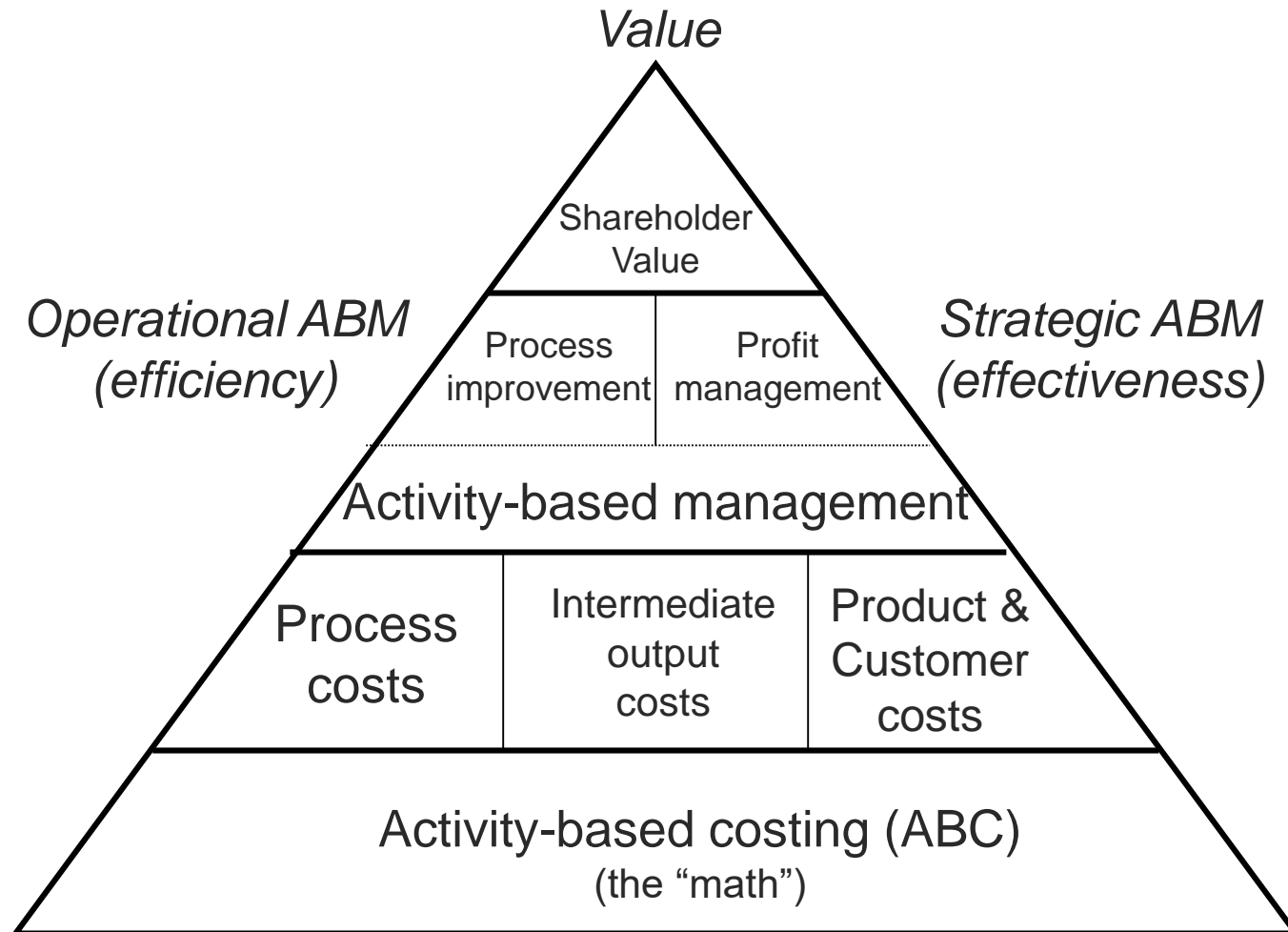


Customer Sales Volume Versus Profits

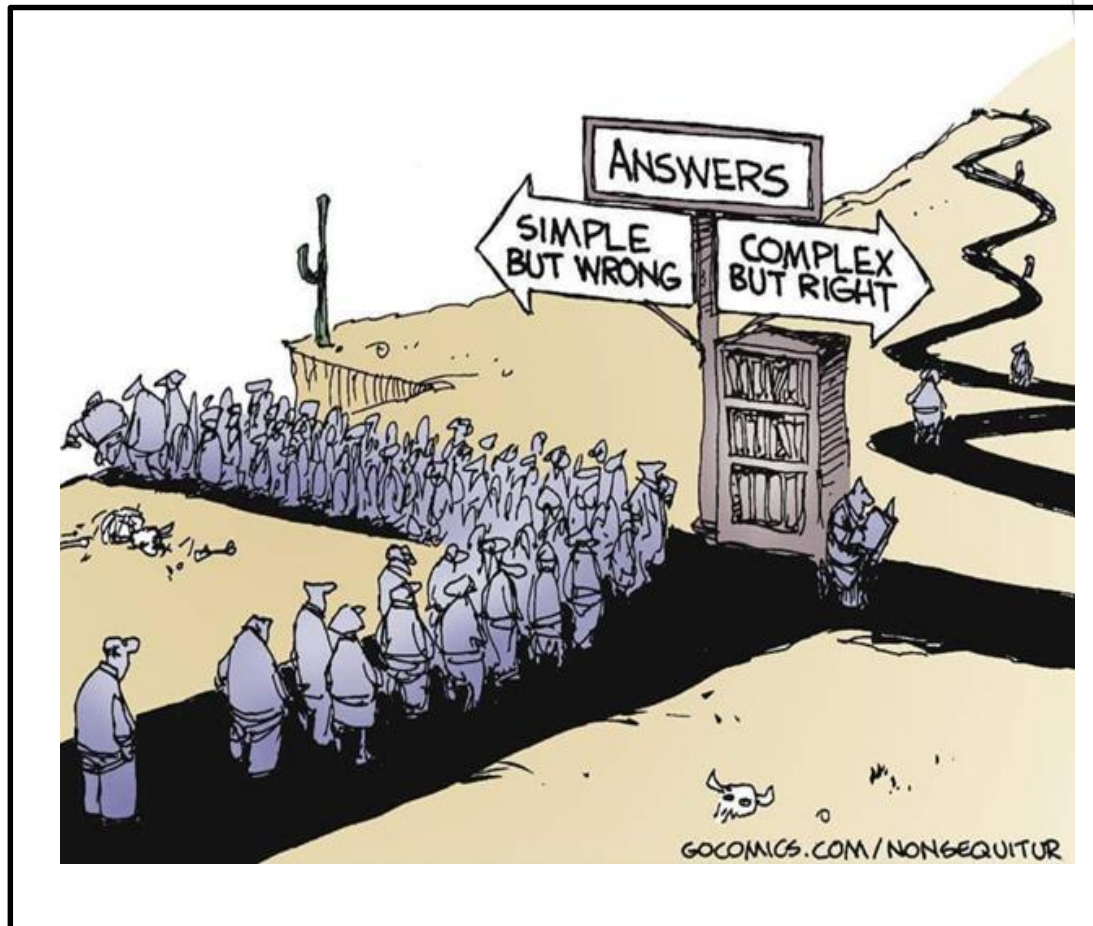
Customers tend to cluster. Medium-volume customers can be much more profitable than large-volume customers!



ABC Provides the Data for ABM



Most CFOs take the left-side path!



Typical Excuses Preventing Being Progressive

We are profitable, so why does it matter?

We will purchase software that will fix our problems.

We already know our “true” costs from our general ledger financial reporting system.

We have done it this way forever. And we don’t do that here. We already know everything. It is in our heads.

We are a small organization. We’ll worry about better methods when we get larger.

All this hype is just made up stuff from highly paid consultants.

No one looks at the reports I create, so there is no point generating better reports.

We cannot afford better software to fix our problems.

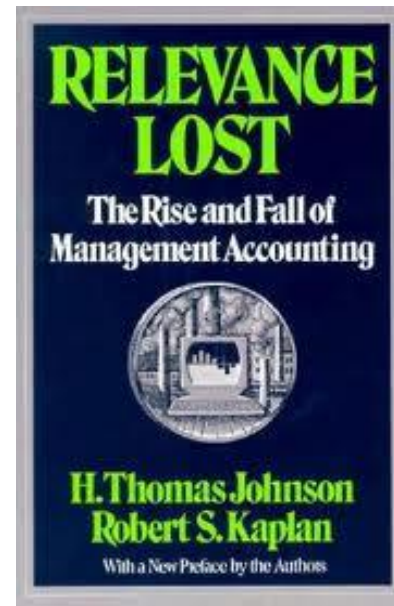
We are way too busy doing other things.

We don’t know where to start or how to get started.

Source: William Vaughn Company CPAs; IMA conference, June 20, 2019

How I became an expert with ABC

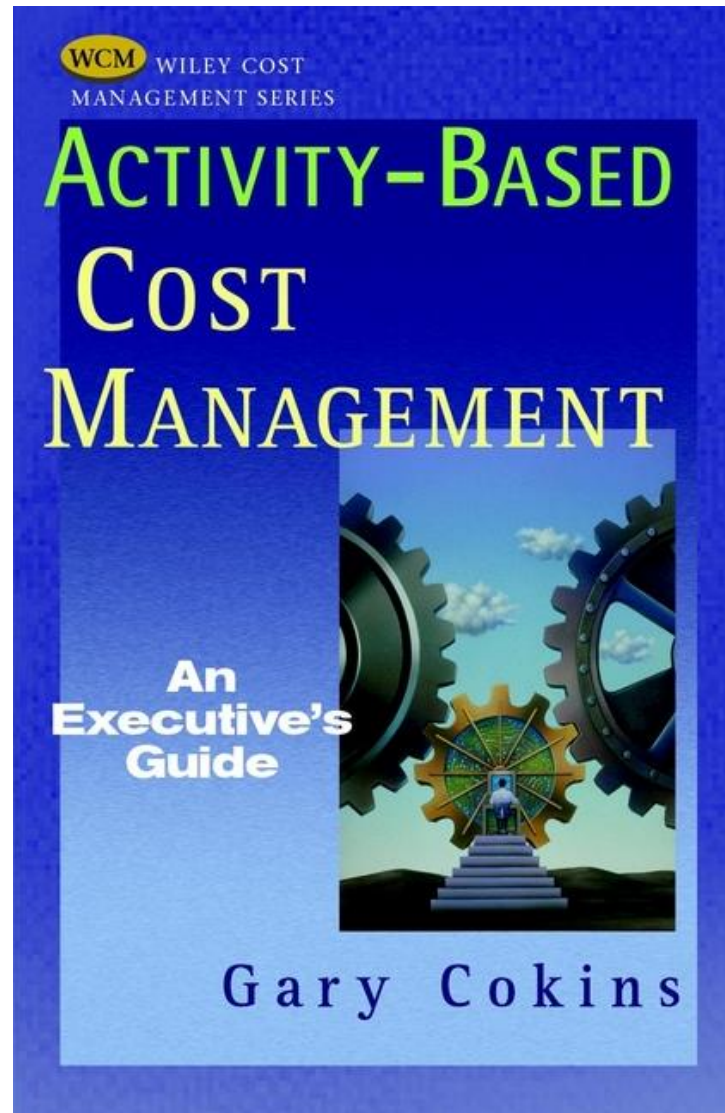
In 1988 KPMG contracted Harvard Business School Professor Robert S. Kaplan to train KPMG consultants on ABC. They were short on qualified consultants, and I was recruited from Deloitte consulting.



For 5 years I implemented ABC which led to my writing books and articles on ABC ... and subsequently on EPM/CPM methods.

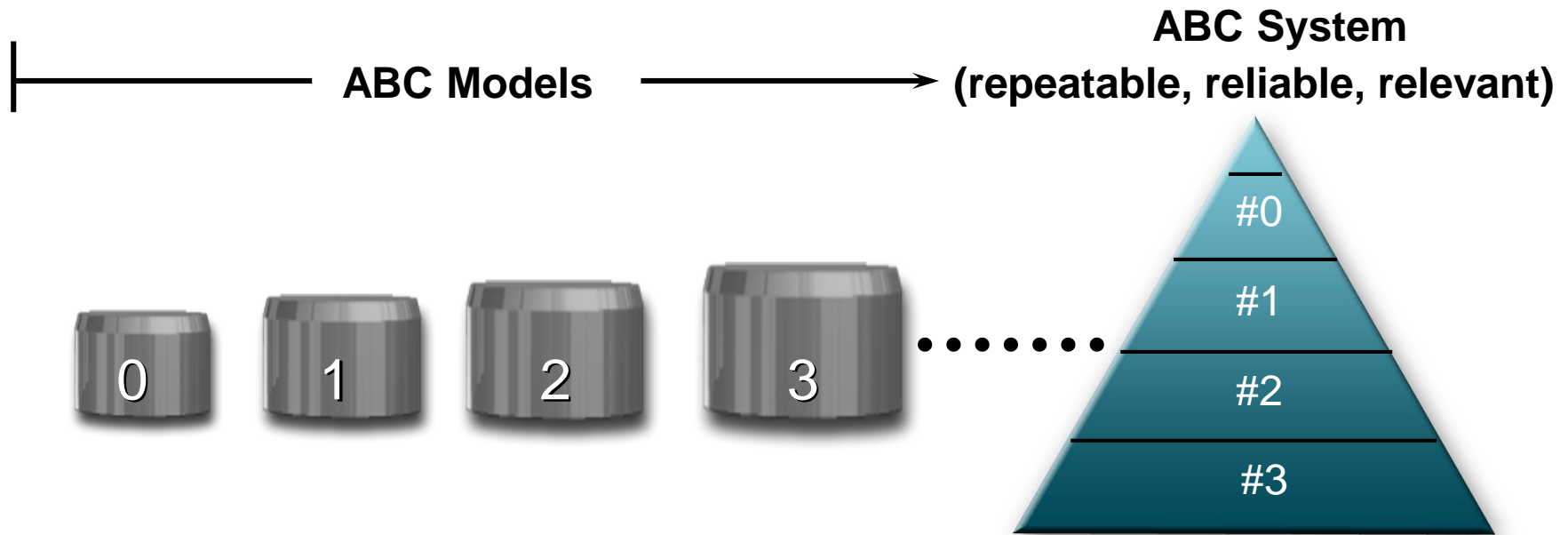
Gary Cokins' Best-Selling ABC Book

<https://www.wiley.com/en-us/Activity+Based+Cost+Management%3A+An+Executive%27s+Guide-p-9780471217275>



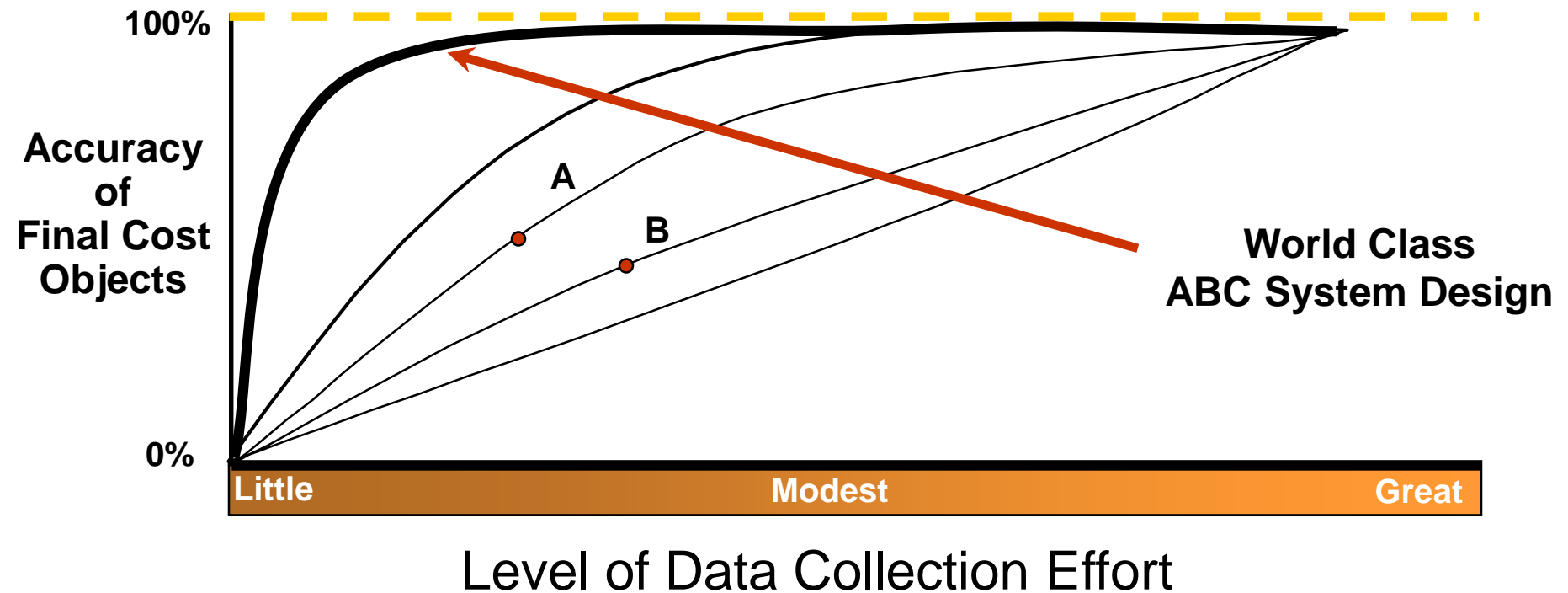
Rapid Prototyping with *Iterative Remodeling (crawl, walk, run, fly)*

Each iteration enhances the use of a ABC system.



Make your mistakes early and often, not later when the system is too hard to change.

Balancing Levels of Accuracy with Effort



Is the higher climb worth the better view?

Links to a few of my ABC Articles

“A Passionate Appeal for Activity-Based Costing (ABC)”

<http://www.fpa-trends.com/article/passionate-appeal-activity-based-costing-abc>

“Measuring and Managing Customer Profitability”

<http://sfmagazine.com/wp-content/uploads/sfarchive/2015/02/Measuring-and-Managing-Customer-Profitability.pdf>

“Beware of Misguided Accountants”

<https://cfo.university/library/article/beware-of-misguided-accountants-a-case-for-improving-your-costing-system-cokins>

“Are Accountants Homo Accounticus?”

<https://cfo.university/library/article/are-accountants-homo-accounticus-cokins>

Thank You

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