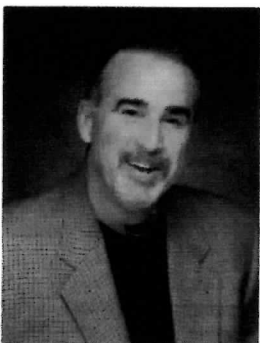


Activity-Based Management: A Fresh Look *at a* Mature Tool

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Through years of experience, ABM has proved itself as a way to a more efficient business. As ABM expert John A. Miller explains, new innovations in technology have only enhanced ABM's value to modern companies competing in the global arena.

Executives in all industries and leaders of government face global competition. No industry on the planet can escape, and global winners are organizations that efficiently and effectively convert resources into competitive products and services that customers want to buy.

Activity-Based Management (ABM) is a foundational tool that provides executives, directors, managers and decision makers with cost and performance information for products, services, processes, activities and even for individual customers/customer segments. It's the information needed to make fact-based, intelligent business decisions and to drive, improve, monitor and control organizational performance. ABM systems provide a common language for all levels of the organization to keep focus on profitability, cost control and performance.

The reason for ABM is fundamental. In a global economy, everyone has access to the same raw materials, capital, technology, equipment, machinery, vendors, suppliers, labor pools, customers and markets. In this global world, it's all about execution. It's a world where competitors differentiate on the basis of performance and competitive advantage is achieved at the activity level.

ABM EVOLUTION

In its June 6, 1988, special report issue titled "The Productivity Paradox," Business Week magazine cited existing cost measurement and performance management systems as a barrier to improving productivity in the United States. The business issues at the time were lagging productivity and competitiveness of U.S. companies serving U.S. markets. Today the issue is the competitiveness of global companies and global markets.

Business Week identified the American Productivity & Quality Center (APQC) and the Consortium of Advanced Management International (CAM-I) as leaders in developing cost measurement and performance management tools to drive productivity and improvement initiatives. Shortly thereafter, the APQC, CAM-I and I began a journey together to a new frontier of cost and performance management that continues to this day.

Today, tens of thousands of organizations have implemented ABM, including

service companies, government agencies and non-profit organizations. Since 1993, Bain & Company has conducted an annual global survey of the top 25 management tools and ABM has consistently been included on the list. In the 2005 report, ABM scored 3.74 (scale of 1 to 5, where 1 is dissatisfied and 5 is extremely satisfied) for usage and satisfaction rates among the 960 executives surveyed worldwide.

More than anything else, IT advances, specifically in operational and financial system applications, have given a fresh look to the ABM tool. Beginning in the late 1990s and driven by the Y2K issues at the time, most organizations substantially upgraded the capability and capacity of their operating systems. These improvements often included a single, worldwide, integrated (financial and operational), enterprise-wide solution. Because ABM information is data driven, these advancements have significantly reduced the ease of implementation, the ongoing cost of system maintenance and the cycle-time to get ABM information out to users.

Another reason for the new face of ABM is the new face of the user. Leaders and managers today are skilled in the use of technology and systems. They understand the complexity of the global world and the need for information and data. These new ABM users are analytical and require accurate, timely, useful and factual data as a basis for their decisions.

BIG BENEFITS

The information provided by ABM helps the organization understand, at all levels, exactly what organizational resources are being used, how they are being used, why they are being used and the financial consequences of their use. In addition, ABM gives the organization's employees a means to better understand the work they do and its impact on the financial performance of the company.

ABM methods link the consumption of activities directly to those customers or

customer groups that consume the activity. Understanding this allows the organization to make fact-based decisions that assist in modifying activities that encourage growth, enhance revenue and increase productivity.

GROWTH WHERE IT COUNTS

Long-term business success requires sustainable and profitable revenue growth. Accurate cost information is needed to determine whether that growth is profitable. Activity-based information provides an organization with the means to identify, create, and retain profitable customers, segments, markets or channels.

With accurate and timely information, organizations can stabilize their workforces, create extra capacity and improve their competitive position in the marketplace. With strategic, operational and financial information available to all levels of the organization, employees can identify and eliminate activities that do not add value to the organization and its customers. ABM provides information to reduce and redeploy non-value added costs and activities to fund activities important for growth.

KEEPING CUSTOMERS PROFITABLE

For many companies, and especially the financial services industry, customer profitability analysis is a dominant ABM application. A better and more accurate understanding of the resources consumed in meeting a customer's needs leads to a better understanding of customer profitability. Customers with special handling or delivery requirements, significant service after the sale or other unique demands might use a lot more of the organization's resources than the customer who orders less, but also demands less.

Activity-based information clearly quantifies the costs associated with various levels of customer service and support. It allows an organization to focus on

profitable customers to enhance revenue and profitability. In looking at customer profitability, sales and marketing executives can use the information to define a profile of the kind of customers that are most profitable for their company. With this information, advertising and marketing campaigns can be targeted to reach potential customers who fit the profile.

What about the less-profitable customers? If customer behavior is driving costs up through special orders, special packaging, more frequent deliveries, faster deliveries and other unique demands, is there a solution? ABM information can also be used to influence changes in customer behavior. It would not be unusual to use ABM information to work with customers to change the conditions causing the costs, such as method of ordering (fax, voice, electronic), order size, order frequency or delivery practices.

GETTING THE MOST FOR YOUR MONEY

ABM initiatives can be used at both ends of the supply chain to improve productivity. Suggestions for improvements in product design, distribution methods and delivery quantities can save money for both parties and lead to better business relationships and increased sales. When costs are associated with activities, there are objective measures to analyze changes. It allows both the company and suppliers to increase productivity by identifying partnering opportunities in order to reduce supply-chain costs.

By using activity cost information, organizations can improve their competitiveness by developing more cost-effective supply chains. Change can be as simple as the way a delivery truck is loaded or as complex as certifying suppliers.

GETTING STARTED

Since 1987, the APQC has worked to research, design, develop, test and implement ABM and performance measurement systems that drive and support process improvement initiatives.

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Thousands of people have attended seminars and conferences that included an Eight Step Implementation Approach jointly developed with the APQC and myself.

In the last 20 years, scores of implementation approaches have been developed and used by a wide variety of ABM implementers, consultants, consulting firms and ABM software vendors and providers. While the approach and steps vary from firm to firm, they all contain elements of the work required to implement ABM:

- Planning and project management
- Process/activity analysis
- Definition and documentation of cost objects, including product/service line structure and customer grouping/segments, as appropriate
- Development of resource and activity drivers (cost tracing methodology)
- Identification and analysis of activity attributes such as cost drivers and performance measures
- Design and development of a model/system for the ongoing reporting of activity-based information

While the steps are similar among systems, the intensity of the steps and the detail required are driven by application and use. The key step in developing the ABM system is activity analysis and getting activities defined at a level that is appropriate for the purpose, application and use of the ABM information.

BOOSTING VALUE

ABM manages activities to reduce costs and to improve customer value. It throws a spotlight on those aspects of a business where action can directly improve both business performance and

organizational productivity. ABM translates business activities into financial terms and helps the organization to concentrate on managing its activities to reduce the cost of operations and to increase value for the customer.

Identifying and understanding the relationships between activities, cost drivers, customers, suppliers and the organization's products and services enables companies to increase efficiency, reduce costs and improve profitability and the effectiveness of strategic and operational decision making.

In the Bain & Company report referred to at the beginning of this article, 76 percent of respondents believe that a growing percentage of the goods and services they offer behave like commodities. We're not likely to see the end to this. In the decade before us, execution and activity performance, measured on a world-class scale, will be the driving forces behind the success or failure of global competitors. ■

About the Author

John A. Miller is a internationally recognized expert and leading authority in the area of cost and performance management. His landmark work, *Implementing Activity-Based Management in Daily Operations*, is the definitive work on cost management and measurement and has been published in four languages. His most recent book, *ABM Passport*, will be published by the APQC in fall 2006. John has over 35 years of experience, and in 2002, he established Arkonas, a solutions-based management consulting firm specializing in strategic and operational cost management and performance measurement (www.arkonas.com). John will conduct a seminar/workshop on *Activity-Based Management* in collaboration with the University of Abu Dhabi, June 17-24, 2006. For information on the seminar, contact Joanna Lynch (joanna.lynych@adu.ac.ae). Mr. Miller's e-mail address is jmiller@arkonas.com