

Analysis of the Effect of Activity Based Costing on Financial Performance

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ABSTRACT

This study examines the impact of Activity-Based Costing (ABC) on corporate financial performance, focusing on its ability to improve cost management in a competitive global market. ABC allocates overhead costs more accurately by identifying activities driving expenses, enabling better decision-making and operational efficiency. The research utilizes a literature review to analyze studies on ABC's implementation across various industries, with data gathered from academic journals, books, and other relevant sources. The findings show that ABC positively influences financial performance by enhancing cost control, operational efficiency, and profitability. It provides valuable insights for strategic decisions such as pricing and resource allocation. However, challenges such as high implementation costs and the need for organizational change may impede adoption. Despite these barriers, the benefits of ABC, including improved competitiveness and profitability, outweigh the costs.

INTRODUCTION

In today's modern era, the contestation between companies is getting tighter, companies are required to improve efficiency and effectiveness in cost management. One of the increasingly popular methods in cost accounting is Activity-Based Costing (ABC). This method is designed to reveal more precise data about the cost of a product or service by identifying activities that affect costs. ABC is an approach that uses activity-based accounting rules in obtaining more precise estimates of basic production costs. Based on a managerial point of view, more than just cost of goods data is provided by this approach. Moreover, according to Wirabhuna (in Aini and Septiana, 2012), ABC is also designed to provide data for all participating departments when the process of determining policy (personnel) and utilizing members (informing and empowering) takes place as an effort to shape organizational competition through cost leadership strategy. Competitive conditions also make companies must be able to compete. Because the economic sector in Indonesia continues to develop every year (Fadhil et al., 2021). In order to compete in the free market, company management should be able to manage every potential of the company effectively and efficiently. The higher the potential for managing costs, the better the products and services offered to customers in terms of quality or price (Suryam Dora, 2017).

The challenges faced by companies in managing their business are quite large, especially in managing costs (costs) such as increasing production costs, price fluctuations, determining the cost of production and others. Activity-based costing can help companies in reducing their problems. Companies can implement the ABC method so that management can more easily identify non-value-added activities so that cost efficiency can be carried out (Andini et al., 2021). ABC analysis is a method for classifying goods in order of value starting from the highest to the lowest value, and classified into groups: A, B, and C. By understanding the criteria for each group, companies can determine which items require special attention and which are only enough to check occasionally. Based on this, inventory control is very important in the company's operational activities in order to anticipate the risk of stopping production and losing customers due to lack of inventory (Pratiwi et al., 2021).

Wirabhuna (2011) states that ABC aims to provide data to participating parties when determining policies and empowering members as an effort to support organizational competition with cost leadership strategies. According to Tandiontong and Lestari (2011), the ABC method has a role in measuring and evaluating the organization's profitability. This is because the conventional approach has a lower level of calculation accuracy than the ABC approach so that it can optimize the quality of policy determination. Dicky and Martusa (2011) revealed that through the ABC method, goods that were previously considered to have low profits can actually have greater profits than other goods. Utilization of this approach can reduce the cost of making goods so as to increase the percentage of profit. Carolin and Wokas (2016) also confirmed that the estimated cost of manufacturing goods through the ABC approach is more precise than target costing or the traditional approach.

The application of ABC is considered to provide significant benefits to the company's financial performance. Several studies have shown that this method helps management in making strategic decisions, such as pricing, cost control, and increasing profitability. However, its application also has barriers, including the need for accurate information and support from top management. In the current era, most organizations are under pressure to compete in the context of the international economy (Andini et al., 2021). The competitive situation requires organizations to continuously improve competitiveness, especially since the economic sub-section in the country is always growing every year (Fadhil et al., 2021). In order to be able to compete in the free market, organizational managers must manage potential effectively and efficiently. The better the cost management, the better the quality of the goods or services provided to the recipient of the goods or services, starting from the quality part and the price (Suryam Dora, 2017).

The obstacles that organizations face in substantial business management, especially when managing expenses, include the increase in the cost of goods manufactured, cost imbalances, and basic costing of goods manufactured. Activity-based pricing can help organizations overcome these problems. The implementation of the ABC approach allows managers to analyze non-profit activities, so that cost efficiency can be implemented (Andini et al., 2021). ABC identification is an approach that categorizes products based on price suitability, starting from the highest to the lowest price, which is grouped into A, B, and C. Through understanding the characteristics of each part, the organization can understand the characteristics of each part. Through understanding the characteristics of each part, organizations can determine products that require more attention and items that are checked occasionally. Based on this, stock management becomes crucial to maintain the smooth running of organizational activities, while handling the risk of manufacturing stoppages or buyers disappearing due to stock shortages (Pratiwi et al., 2021).

Vetchagool et al. (2019) put forward ABC as a sub-sector of accounting financing theory and managerial accounting that can optimize company performance. This method provides core data services as labor management, price control, company performance improvement, price addition, and long-term policy making. In addition to focusing on analyzing the financing of goods with precision, the ABC method is also used as a price control by providing relevant data on activities (Kaukab, 2019). Thus, the application of this method is expected to support effective cost management and improve overall company performance.

LITERATURE REVIEW

The application of ABC is considered to provide significant benefits to the company's financial performance. Several studies have shown that this method helps management in making strategic decisions, such as pricing, cost control, and increasing profitability. However, its application also has barriers, including the need for accurate information and support from top management. In the current era, most organizations are under pressure to compete in the context of the international economy (Andini et al., 2021). The obstacles that organizations face in substantial business management, especially when managing expenses, include the increase in the cost of goods manufactured, cost imbalances, and basic costing of goods manufactured. Activity-based pricing can help organizations overcome these problems. The implementation of the ABC approach allows managers to analyze non-profit activities, so that cost efficiency can be implemented (Andini et al., 2021).

METHODOLOGY

The approach used when this research took place was a literature review with a descriptive method. This research collects and analyzes the results of previous studies that discuss the financial performance of organizations affected by Activity-Based Costing (ABC). Data sources were obtained from journal articles, books, and other relevant publications that examine the implementation of ABC in various industries. The analysis was conducted by comparing the available research results to draw conclusions regarding the impact of ABC on financial performance. Literature study was used as the main method in collecting information and data, which came from sources directly related to the research topic, including books, scientific articles, articles, research reports, and other sources.

The main focus in the context of this research is a literature review that discusses the effect of ABC implementation on the company's financial performance. The literature search was conducted by identifying and selecting relevant and recent scientific works, especially those published in recent years, in order to obtain a comprehensive picture of the development, benefits, and challenges of implementing this system. The data collection process involved searching academic journals and related documents that discussed the relationship between ABC implementation and company financial performance. The data collected included technical aspects of ABC implementation, managerial benefits, and its impact on the efficiency and effectiveness of the company. All identified literature was critically analyzed to understand the implementation of ABC in various sectors, as well as the factors that influence its success.

The main focus in this method is to analyze the effect of ABC on corporate financial performance, especially in terms of operational efficiency, internal control, and strategic decision-making. Through an in-depth analysis of the existing literature, this study seeks to present findings relevant to the context of applying ABC in improving corporate financial performance. In addition, the literature study is also utilized to identify knowledge gaps in the existing literature, as well as offer recommendations for future research. This method was chosen because it allows understanding of the topic from multiple perspectives, and provides flexibility for the researcher to draw conclusions based on a variety of existing findings.

RESEARCH RESULTS AND DISCUSSION

Application of Activity-Based Costing (ABC)

Based on existing literature, the application of Activity-Based Costing (ABC) provides a number of advantages. The ABC method allows organizations to manage overhead expenses more precisely to goods or services by identifying and analyzing activities that incur costs. Through more accurate expense data, companies can reduce unnecessary expenses and improve operational efficiency. Proper implementation of ABC can contribute to improving the company's financial performance. Research by Vetchagool et al. (2020) in Thailand shows that extensive ABC implementation improves organizational performance. Better organizational performance results in high work motivation, so that the company's operational productivity increases. This high productivity then drives better financial performance. Therefore, the implementation of ABC can improve the company's financial performance through improving overall organizational performance.

Marlina et al. (2018) found that the application of ABC to 39 universities in Pekanbaru improved institutional performance, which then had an impact on increasing competitive advantage. This finding is in line with Kennedy and Affleck-Graves (2001), which show that ABC significantly contributes to optimizing organizational performance. Organizations with good performance are considered to have a higher competitive advantage. ABC is understood as a more accurate method than traditional methods for calculating product or service costs, especially in companies with a wide range of products and significant non-unit costs (Yuniawati, 2018). This method helps companies better represent the accuracy of costs, making it easier to manage and analyze cost drivers. Therefore, organizations can reduce production prices, determine lower selling costs, and increase competitiveness. The application of ABC also provides an opportunity for organizations to determine more precise standard procedures, ensure optimal resource allocation, and obtain optimal financial performance. A case study at PT Setia Bersama shows that although the Return on Equity (ROE) ratio is still negative, the value is still better than when using traditional methods (Audina & Lestari, 2021). From the results of the analysis conducted, the Activity Based Costing System (ABC System) can be used by every manufacturing company as an alternative method in determining the cost of production and relevant cost drivers. The results of this study also have a more

tangible impact on the accuracy of product cost calculations. So that it can help managers in making decisions Romadhan, S and Savitri (2023).

Impact on Financial Performance

Research reveals that the implementation of ABC has a positive influence on the company's financial performance. Kusumaningtyas and Haqqi (2017) reported that the application of ABC in the ikat weaving industry in Kediri resulted in significant cost savings and increased profitability. Marlina (2017) also found that ABC has a positive impact on competitive advantage and college performance, demonstrating the relevance of this method in various sectors.

Vetchagool et al. (2020) found that the implementation of ABC in Thai companies improved organizational performance, which in turn led to increased productivity and financial performance. Another study on PT Mayora Indah Tbk showed an improvement in financial performance, as seen from short-term solvency comparisons such as current comparison and quick comparison, as well as activity comparisons such as fixed asset turnover, total assets, and inventory. This increase shows that the application of ABC can improve the efficiency and effectiveness of the company's operations. The effect of ABC was then further researched by Sekarsari et al (2021) who found that the implementation of ABC has a direct effect on financial performance through the operational performance of MSMEs. This system can reduce product costs and increase gross profit without reducing product quality so that business performance is getting better. This system can also provide more accurate and efficient accounting information. By using ABC calculations, performance measurement is seen from the profits obtained by the company. However, due to the lack of allocation of funds by the company for factory overhead costs, the calculation becomes smaller than the traditional calculation. However, the ABC calculation is more detailed for each costing of each activity that can make employees more loyal to the company. This is because the company's management is well followed.

The impact of ABC on SMEs also varies. For example, a study on SMEs in Zimbabwe found that ABC had a negative effect on reducing cost control, indicating an insignificant relationship between ABC and financial performance Paradzal, L., Wadesango, N., & Sitsha, L. (2023). In contrast, small companies with adequate financial resources and those experiencing declining growth were shown to benefit from ABC, which facilitated subsequent growth and profitability Jänkälä, S., & Silvola, H. (2012). The integration of ABC with other systems, such as information systems, can result in improved financial performance. Research shows that although ABC alone may not have a significant main effect, its combination with the integration of internal and external information systems can produce positive interaction effects, leading to higher financial performance Maiga, A., & Hersinger, A. (2016). The impact of Activity-Based Costing on financial performance is generally positive, especially when used in conjunction with other strategic initiatives and in environments where cost control is critical. However, the effectiveness of ABC may vary based on contextual factors, industry specifics, and the degree of integration with other systems. While some studies report mixed results, the overall evidence suggests

that ABC can be a valuable tool for improving financial performance when applied under the right conditions.

Implementation Challenges

Although it offers many advantages, the implementation of ABC addresses some barriers. Some of the main barriers are the need for accurate and comprehensive data, as well as full support from management to ensure successful implementation. In addition, the high initial cost of implementing ABC is often an obstacle, especially for small companies. A detailed ABC calculation based on the main production activities requires significant investment, both in terms of finance and time (Lendrasari, 2015). This process takes longer than traditional methods to track cost drivers and estimate production costs. Greater implementation costs often lead to smaller profit margins in the early stages (Kaukab, 2019; Kusumaningtyas & Izzatul, 2017).

Management needs to set an equivalent cost of sales to the cost of goods manufactured and cut inefficient activities to optimize the benefits of this method. If these challenges can be managed well, ABC implementation will provide great benefits to the company, including increased cost efficiency and better financial performance. Research results from Gultom (2024) show that management understanding and commitment are the main factors that influence the success of implementation. The constraints of high implementation costs and the long time required are of particular concern in the implementation of ABC in Indonesia. Technological support and staff skills determine the smoothness of the implementation process. ABC implementation requires activity mapping, identification of cost drivers, and proper cost allocation to optimize resources and improve company performance. However, if this ABC method is applied in the public sector, it has few obstacles, or the implementation process is not easy (Sarumaha, 2023) The adoption and implementation of ABC in government organizations is certainly not easy. Many obstacles and challenges are faced by organizations. In fact, it is not uncommon for managers to reject the application of ABC. Detailed cost driver and activity information will certainly provide information support for good management decision making. However, the wider the scope of input data, the more complicated the process required (Pokorná, 2016). Another challenge is that ABC implementation is expensive and time-consuming (Chea, 2011; Oseifuah, 2014; Pokorná, 2016). Arnaboldi & Lapsley (2003) and Pokorná (2016) say that the cost of ABC/M implementation is considerable, especially when involving external consultants. Apart from the technical side, it turns out that the barriers and challenges of ABC/M implementation also come from within the organization itself.

CONCLUSIONS AND RECOMMENDATIONS

The Activity-Based Costing (ABC) method has been proven to make a significant contribution in improving the company's financial performance. By providing more accurate cost information, ABC supports managers in making long-term policies and increasing company profitability. The application of this method allows a more detailed allocation of overhead costs, so that companies can have better knowledge of the systematics of production prices. In addition, ABC also supports the improvement of operational efficiency by analyzing non-profit activities. Thus, companies can make cost savings and increase productivity by focusing on activities that support the achievement of business goals. Accurate cost information from ABC implementation enables management to make more informed decisions, especially regarding pricing, profitable product selection, and more effective resource allocation. Overall, ABC contributes to increased profitability through cost reduction, better operational efficiency, and management of competitive selling prices, so that companies can sustainably improve their competitiveness.

However, the implementation of ABC is not free from various challenges. One of the main obstacles is the high cost of implementation, which includes investments in time, human resources, and technology. The complexity of the ABC system, which is higher than traditional methods, also requires specialized expertise to ensure effective implementation. In addition, the successful implementation of ABC requires a fundamental change in the organization's work culture, which requires full support from top management and active involvement of employees at all levels. Nonetheless, the benefits gained from implementing ABC generally outweigh the obstacles faced. Therefore, companies are advised to consider implementing ABC, especially if they have diverse products, complex production processes, or the need for more accurate cost information. Before deciding to adopt this method, companies need to conduct a thorough analysis of internal and external conditions, and develop a thorough implementation plan. Such plans include training for employees, development of adequate technology systems, and communication strategies that support changes in organizational culture.

ADVANCED RESEARCH

Further research is urgently needed to explore the application of ABC across different industry sectors and company sizes, and analyze its long-term impact on financial performance. With the right approach, the application of ABC can not only improve the efficiency and effectiveness of company operations, but also provide a significant competitive advantage in the long run, thus supporting overall business sustainability.

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