

## **\*RFHHA MANAGEMENT TIP OF THE DAY FOR HOSPITAL ADMINISTRATORS 1303\***

### **\*What is Activity-Based Costing in healthcare Part 1?\***

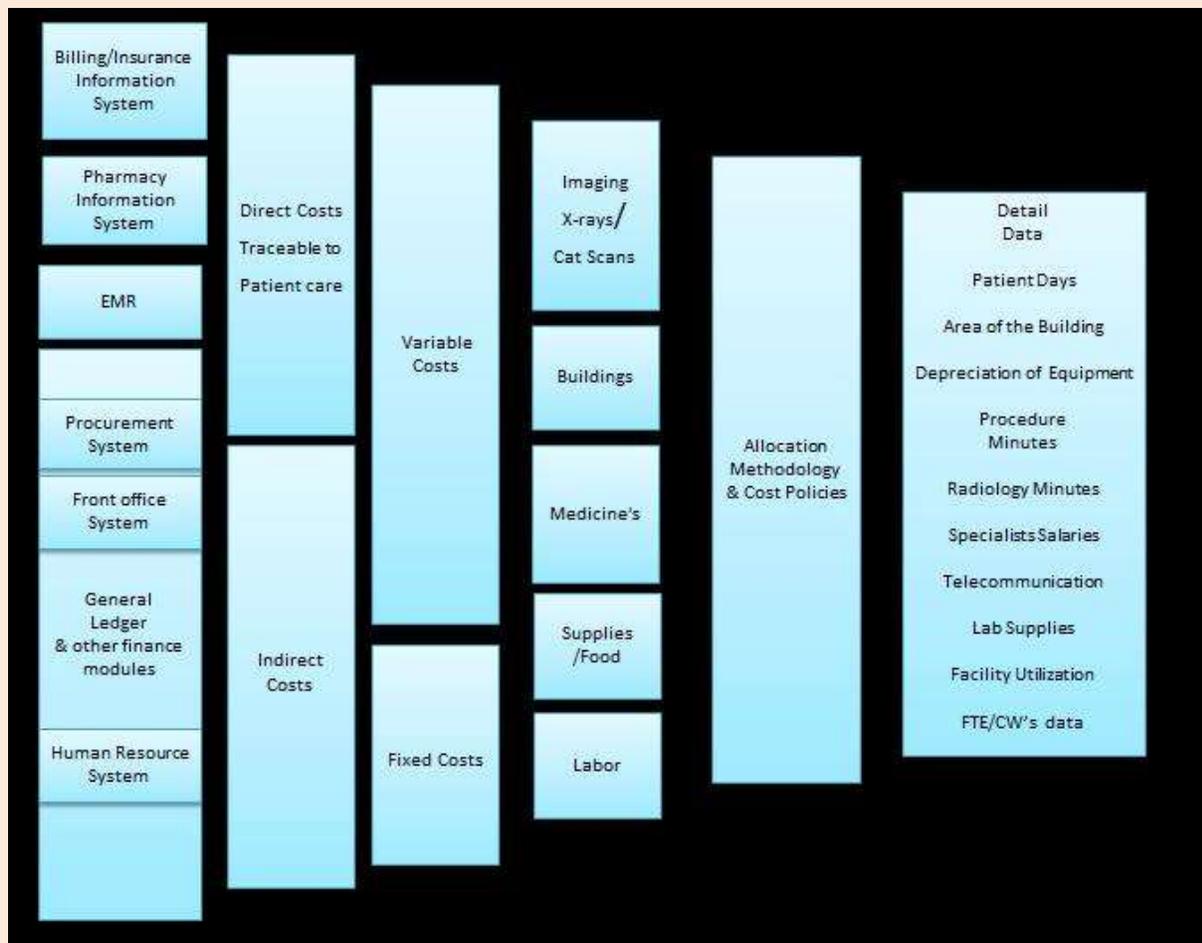
Activity Based Costing (ABC) is an **alternative to the traditional way of accounting**. Traditionally it is assumed that high volume customers are profitable customers. A loyal customer is also a profitable customer. And profits will follow a happy customer. Studies about customer profitability have unveiled that the above ideas are not necessarily true. ABC is a costing model that identifies the **cost pools, or activity centers**, in an organization. It assigns costs to **products and services (cost drivers)**, based on the number of events or transactions that are taking place in the process of providing a product or service. As a result, Activity Based Management can support managers to see how shareholder value can be maximized and how corporate performance can be improved.

Historically, cost accounting models related indirect costs on the basis of volume.

#### **Typical benefits of Activity-Based Costing:**

- Identify the most profitable customers, products and channels.
- Identify the least profitable customers, products and channels.
- Determine the true contributors to- and detractors from- financial performance.
- Accurately predict costs, profits and resources requirements associated with changes in production volumes, organizational structure and costs of resources.
- Easily identify the root causes of poor financial performance.
- Track costs of activities and work processes.
- Equip managers with cost intelligence to stimulate improvements.
- Facilitate a better Marketing Mix
- Enhance the bargaining power with the customer.
- Achieve better Positioning of products

With the costing now based on activities, the cost of serving a customer can be ascertained individually. Deducting the product cost and the cost to serve each customer, one can arrive at customer's profitability. This method of dealing separately with the customer costs and the product costs, enables the identification of the profitability of each customer. And Positioning the products and services accordingly.



## Continuous Improvement

The implementation of ABC can make the employees understand the various costs involved. This will then enable them to analyze the cost, and to identify the activities that add value and those that do not add value. Finally, based on this, improvements can be implemented and the benefits can be realized. This is a continuous improvement process in terms of analyzing the cost, to reduce or eliminate the non value added activities and to achieve an overall efficiency.

ABC has helped enterprises in answering the market need for better quality products at competitive prices. Analyzing the product profitability and customer profitability, the ABC method has contributed effectively for the top management's decision making process. With ABC, enterprises are able to improve their efficiency and reduce the cost without sacrificing the value for the customer. Many companies also use ABC as a basis for a balanced scorecard.

This has also enabled enterprises to model the impact of cost reduction and subsequently confirm the savings achieved. Overall, Activity Based Costing (ABC) is a dynamic method for continuous improvement. With Activity Based Costing any enterprise can have a built-in competitive cost advantage, so it can continuously add value to both its stakeholders and customers.

**\*Dr Madhav M Singh\***

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