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Why Did ABC Fail at the Bank of China?

BY ABED AL-NASSER ABDALLAH, PH.D., AND WEI LI

**UNLESS TOP MANAGEMENT LENDS ITS SUPPORT, EMPLOYEES UNDERSTAND THE PURPOSE
OF USING ABC, MODELS ARE TESTED, AND COSTS/BENEFITS ARE DETERMINED, ABC
IMPLEMENTATIONS COULD FAIL.**

EXECUTIVE SUMMARY Few authors have explored the implementation of activity-based costing (ABC) in East Asian companies. This study investigates factors that led to the failure of an ABC implementation at a major Chinese financial institution—the Bank of China. Interviews with 18 employees at one branch revealed six factors that blocked the implementation: the lack of clear business purpose, a lack of education about ABC, poor model design, a lack of participants, individual and organizational resistance to change, and the fact that few outsourcers were available. The study represents a real example of why ABC implementation might fail in an organization.

The key purpose of the Bank of China's strategic plan is to generate, process, track, and close its leads in the Chinese financial market. As part of the plan, the bank aimed to introduce an activity-based costing (ABC) system across all of its regions in order to reduce costs and increase management control. The implementation failed, however, and the traditional costing system is still employed. We investigated factors that blocked the implementation of activity-based costing and management (ABC/M) in one provisional bank branch, the name and location of which are not disclosed for confidentiality reasons.

Our interviews with 18 of the branch employees revealed six factors that blocked the implementation of

ABC. These are:

- ◆ Lack of a clear business purpose about the implementation,
- ◆ Lack of education about ABC,
- ◆ Poor ABC model design,
- ◆ Lack of participants,
- ◆ Individual and organizational resistance to change, and
- ◆ Few outsourcers available.

Although some or all of these factors have been mentioned in previous studies, our work is new in terms of its application to the bank sector in China, which allows us to contribute to the knowledge of ABC in practice.

Today, Chinese banks are facing strong competition, especially from foreign banks that have entered the

Chinese financial market. Those foreign banks, which had opened in Shanghai earlier, have started to expand their business into Jiangsu and Zhejiang provinces. They grabbed a large number of giant clients from their Chinese counterparts, causing a decrease in bank loans in the provinces, according to a 2002 press release by the People's Bank of China, Nanjing Branch, in eastern Jiangsu province.

To eradicate such problems and prevent the situation from getting worse, Chinese banks needed to apply more effective management methods and technologies to improve their competitive advantage. Furthermore, the government of the People's Republic of China decided to turn state-owned banks into publicly listed ones to enhance the banks' self-controllability and flexibility that help them react to market conditions in a timely and effective manner.

As one of the big four state-owned banks, Bank of China Ltd. had started to restructure itself and tried to implement management accounting in order to manage its costs. The implementation of such management accounting techniques in China is difficult, however, because of the varied economic, institutional, and cultural settings.

An interview with the general manager of the branch revealed that it tried to implement ABC three years ago, but the effort was unsuccessful. The failure to implement ABC cost the organization money, and there is a need to reduce these costs by identifying and analyzing factors that blocked the ABC implementation. If those barriers cannot be resolved, this may continue to obstruct the application of new management accounting techniques and further influence the organization's capabilities.

Although most of the existing literature extols the benefits of ABC and, in particular, the benefits of ABC/M, few authors have explored its implementation in East Asian companies, especially financial institutions.

ABC vs. TRADITIONAL COSTING SYSTEMS

Before we describe the results of our study, let's look at the conflicting views about ABC. Ronald W. Hilton, among others, defined ABC as a two-stage model.¹ In the first stage, overhead costs are allocated into differ-

ent activity-based cost pools with respect to their classifications. In the second stage, using a series of cost-driver-based rates, the pooled costs are allocated to product lines. Gary Cokins argued that, compared to the two-stage model, a traditional costing system is like a "checkbook" where one can read the total amount spent but can never know the purpose and results of each check.²

Traditional cost systems are always employee payroll related, which hinders a manager's ability to judge and improve employees' activities and performance. Furthermore, the payroll-related costs do not indicate the interaction and relationships between one activity and others or products and customer services. Managers will not be able to identify which events cause activity costs to vary. Based on managers' views, however, an organization's activity costs could be the most controllable part that managers can influence. Nonetheless, without knowing the costs' drivers, managers are virtually unable to organize a company's production costs efficiently.

In contrast, ABC concentrates on activities involved in the work process that help managers operate a business or an organization. "ABC/M is work-centric, whereas the general ledger (traditional costing system) is transaction-centric."³ Nonetheless, both systems have their points: The traditional cost system is easy and inexpensive to implement, but the information obtained could be too raw to be analyzed. ABC solves that problem but is expensive and very time-consuming.

ABC IN PRACTICE

A.L. Friedman and Stephen R. Lyne gave a number of reasons explaining why ABC has become so popular despite its cost.⁴ First, they argued that manufacturing overhead costs increased sharply during the 1980s, mainly due to the rapid growth in implementing advanced manufacturing technologies. Traditional cost management became less and less efficient in providing accurate information to the manufacturers. Second, the development of information technology offered a great opportunity for ABC, which requires complex processes to record its data; this can now be done by the more advanced information systems. Therefore, ABC attracted more attention, and manufacturers started to give up

the simpler but less accurate traditional costing systems. Third, the increasing complexity of financial reporting requirements, such as the accounting standards in the United Kingdom and United States, forced companies to choose a more complex, but accurate method to calculate their overhead. Fourth, the authors said that the growth of management accounting since the 1950s benefitted a large number of people who later became accountants or high-level managers and who understood the importance of implementing a new costing system rather than a traditional costing system. Finally, Robert S. Kaplan argued that a traditional costing system provides inaccurate information that distorts product costs and has little value to short-term operational control.⁵ Having said that, and according to Friedman and Lyne, it is obvious that the traditional cost systems do not work in today's competitive environment.⁶ This is due to many reasons that completely changed the rules of the marketplace, such as global competition, rapid increases in technology, the development of information systems, and the growth of management accounting.

Many researchers have explored the implementation of ABC techniques, finding that they proved to be applicable to both the service and manufacturing sectors. John Innes, Falconer Mitchell, and Donald Sinclair discussed ABC in practice by comparing their 1994 and 1999 surveys of the U.K.'s largest companies.⁷ In 1994, there were 352 out of 544 companies using ABC, whereas between 1994 and 1999 there were 177 ABC users out of 348 companies. The researchers found that adoption has stayed significantly higher among large firms and financial institutions. Despite the fact that there was no significant increase in ABC adoption between 1994 and 1999, the researchers reported that companies that implemented ABC found it a valuable investment. Their results also revealed that the overall success of ABC is associated with budgeting, cost modeling, cost reduction, cost management, activity performance measurement and improvement, customer profitability analysis, product price and design, and stock valuation. Some of this was also emphasized in Mohan Nair's 2000 *Management Accounting Quarterly* article, "Activity-Based Costing: Who's Using It and Why?" which analyzed the survey of Market Trends

Inc., of Seattle, Wash.⁸ Nair concluded that the demand for ABC/M was growing since it assists managers in planning, budgeting, and performance evaluation.

FACTORS LEADING TO THE SUCCESS OR FAILURE TO IMPLEMENT ABC

Despite its growing popularity, a number of companies started to experience difficulties with ABC implementation that blocked them from taking it further.⁹ A series of factors has been found to be related to the success and/or failure of addressing ABC. Michael Shields identified six "behavioral and organizational" factors that make ABC successful.¹⁰ They are:

1. The support of top management;
2. Integration between ABC and competitive strategies such as total quality management (TQM) and Just-in-Time (JIT);
3. ABC's relation to performance evaluations and managers' compensation;
4. Adequate training during design, implementation, and use;
5. "Nonaccounting ownership"; and
6. The availability of adequate resources.

Annie S. McGowan and Thomas P. Klammer, as well as George Foster and Dan G. Swenson, confirmed factors 1, 3, 4, and 6.¹¹ According to Innes, Mitchell, and Sinclair, this is consistent with the findings of U.S. studies of ABC in practice.¹² Based on the results of their 1994 and 1999 surveys, however, they found that the support of top management is strongly associated with the success of ABC. On the other hand, Ian Cobb, John Innes, and Falconer Mitchell suggested that the lack of adequate internal resources, particularly staff time and computer resources, are major factors.¹³ Furthermore, Chris Argyris and Bob Kaplan explained ABC failure by providing a "behavioral model of why and how employees resist ABC."¹⁴ The origin of this model came from Argyris, who pointed out that "barriers to change arise from the defensive routines that participants trigger to protect themselves from experiencing embarrassment and threat from the new ideas."¹⁵ Robin Cooper, Bob Kaplan, Lawrence Maisel, Eileen Morrissey, Ronald Oehm, and M. Lynne Markus further argued that resistance to new information systems can be understood in terms of organizational power and politics.¹⁶

Different researchers see different factors that strongly affect ABC implementation. All in all, Anthony Atkinson, Rajiv Banker, Bob Kaplan, and S. Mark Young discussed them in terms of five factors:

1. Lack of clear business purpose,
2. Lack of senior management commitment,
3. Delegating the project to consultants,
4. Individual and organizational resistance to change, and
5. Poor ABC model design.¹⁷

OUR RESEARCH METHOD

We relied on interviews as our research tool in order to

gather information about why our provisional branch of Bank of China failed to implement ABC. We chose this bank based on the following factors: First, Bank of China once tried to implement ABC but failed, and the case perfectly matched our research task. Second, Bank of China is one of the top four banks in China and represents the flagship of Chinese high-performance financial institutions. Studying the difficulties of ABC implementation in the Bank of China can offer insights about similar problems that may exist in other institutions (see Table 1).

Interviews were conducted with 18 current employees and followed a strict process order. Two accountants

Table 1: Interview Questions

General Information

Sex: _____ Age: _____
Job Title: _____ Department: _____
Interview Time: _____ Interview Day: _____

1. How long have you been working in this branch?
2. Why did you decide to work in this branch?

Part 1: Type of Costing Systems

3. What kind of costing system is this branch currently using?
4. Why do you think it is good/bad?
5. Have you heard about ABC before?

If YES, to what depth do you understand this system?

Part 2: Implementation of ABC

6. What were the key factors you thought might influence the implementation of ABC at that time?
 - Did you have a clear purpose about the implementation?
 - Have you had any education about ABC?
 - Which ABC model was used to introduce ABC?
 - Who you think is in charge of ABC implementation?
 - Have you had any support from colleagues/managers?
7. Do you like the current costing system?
8. Did you like facing the challenge of implementing ABC?
9. What are your recommendations regarding the branch's costing system in the near future?

were interviewed first, then employees from the corporate banking department, and finally two managers. The order was set for a logical reason. According to the existing literature, in a case of a failed implementation, regular employees usually have different views about ABC than managers do. Interviewing accountants first offered us more objective information and data about the implementation failure. Then, by comparing the data collected from the corporate banking department and managers, differences and conflicts could unfold and be highlighted, thus providing us the base for this research analysis.

Each interview lasted about 30-40 minutes. Most of them were conducted via telephone because of the distance and time limits. We conducted the interviews over three weeks. We did three or four interviews per week and then spent several days analyzing the results.

We strongly believe that the data we obtained from the interviews is reliable. Each group had at least two respondents who provided similar results and data. For example, both accountants gave details that were quite consistent and that had no big differences. Furthermore, different observers provided parallel answers to some crucial questions. For example, all of the respondents believed that lack of education was an important factor that led to the failure of the ABC implementation.

BANK OF CHINA

Bank of China is one of the biggest financial institutions in China. Founded in 1912, it has operated for 96 years and has served as a core bank for Chinese economic and social progress. Its major business mission is to attract foreign investors and develop the Chinese foreign market. In the domestic area, the Bank has more than 1,000 branches.

The branch we explored has an existing costing system, the mechanism of which is quite simple and easy to understand. The Bank sets a limit for costs for every department at the beginning of the year, and the designated amount is tightly linked with the previous year's profit of each department. For example, the corporate banking department's profit was recorded as RMB9.8 million (\$1.404 million) in 2003. Therefore, the maximum limit of the department spending for 2004 was nearly 39% of RMB9.8 million (\$1.404 million), or

about RMB3.822 million (\$547,000).

Thirty-nine percent is the standard ratio that the branch uses to calculate costing amounts. This ratio was prescribed by the Bank of China head office, and it has not been changed for the last five years. The general manager of the branch believes that such a ratio was set based on the bank's operating experience. Thirty-nine percent is a large proportion, but this amount allows each department to have sufficient expenses. If the ratio were to be reduced, some of the bank's departments might not maintain their current profit-expense balances, thus leading to a diminution of profitability.

ABC IMPLEMENTATION

Bank of China is always looking for effective costing systems. About three years ago, the head office decided to implement an activity-based costing system in order to achieve more efficient cost control. There were several reasons for this decision: First, the Bank had been facing tough competition since the mid-1990s, when well-developed foreign banks started taking market share from Chinese banks. Second, the Bank was preparing to become a listed company. Third, the fast development of the Bank's foreign branches required better management performance to gain competitive advantage. All these factors called for an effective costing system, which ABC was originally designed to provide. The implementation was slow, however, and has ceased in most branches.

Further contacts were made with 16 other local branches in Shanghai City and in Jiangsu and Zhejiang provinces. None reported that it had launched ABC successfully, and only two are still considering how to implement it. One of the general managers we contacted revealed: "No successful implementations (of ABC) have been reported to me within the Jiangsu province, and I believe rare branches are still considering implementing ABC, at least within Jiangsu range."

WHY IMPLEMENTATION FAILED

Here is a closer look at the six factors that interviewers identified as obstacles to ABC implementation.

No clear business purpose. The ABC project was initiated by the accounting department, and a basic ABC

model was designed, but no one from the management level or from each individual department showed an interest in the work. People from the accounting department were disappointed and lost their motivation. On the other hand, employees from each individual department felt confused about ABC. They did not know its purpose, and some guessed that it was a tool to limit their daily spending. Others thought it might help to redesign the work process, while a few believed it would redesign their current department structure. From the view of the general manager, ABC should be an instrument that would increase the transparency in management control. Therefore, no clear business purpose was initially designed for the implementation.

“The purpose of implementing ABC was to introduce a more effective costing system to BOC,” respondents from the accounting department said. “However, the term ‘effective costing system’ was too general to be followed. All employees had different ideas about ABC. People felt confused and lost interest in ABC. We then felt bored when no one looked at our work; the project stopped at this point.”

Lack of education/knowledge. The interviews revealed that few employees understood ABC. Despite the accounting department’s efforts, one respondent from the corporate banking department revealed that he had heard about ABC but did not understand its key points. Two managers mentioned that they knew about ABC, but only one of them could provide details about the system. In the accounting department, accountants learned about ABC from books rather than real experiences. In other words, none showed confidence in building an ABC model that could apply to that branch. The interviews further indicated that employees required systematic education about ABC. Fourteen out of 18 respondents agreed to study ABC if they were offered a chance.

Poor ABC model. An accurately designed model is important for ABC implementation. No one could find the original file of the ABC model, but, according to feedback from respondents, it was considered “too complicated to build and maintain” and “too complex

(for managers) to understand and act upon.” Furthermore, the initial model designed by the accounting department was rough and needed further redesigning. Because of the lack of education and knowledge about ABC, however, employees could not provide valuable suggestions about the initial model. One line manager described the situation when people were introduced to the ABC model: “The system seemed very complicated, and I could not understand it. My colleagues had the same feeling. Therefore, we all stayed there but had no comments. Without corresponding benefits, the model soon collapsed.”

Lack of participants. A pitfall arose when the accounting department undertook the project without gaining senior management support. The rest of the Bank saw the project as one done by and for the accounting department, so no one outside the department paid attention to it. As a result, because the accounting department was not able to make decisions about the process and had a limited knowledge about other departments’ functions, no actions were followed to improve the project.

Respondents in the accounting department said, “We knew the general process in a department, but that’s not enough for us. We require more details from senior and line managers, who could provide operational information and valuable suggestions.”

Respondents from the corporate banking department said, “We thought the system should be taken by the accounting department rather than us. We were asked to give suggestions, but everyone was so busy, and no one had time to analyze a project which did not belong to them.”

Resistance to change. The interview results also revealed that managers welcomed a new technical costing system, but individuals resisted new ideas and changes. Managers believed that a new system would increase their control over operating costs. Thus, they encouraged it through an ABC presentation about profitability, but they continued to behave just as they had in the past. Individuals were afraid of ABC, especially fearing the new system could reveal unprofitable processes and problems in their daily work. Further-

more, individuals preferred the current system, which allowed them to use the surplus money available in their department in any way instead of returning it to the general account in order to be counted as part of the Bank's annual profit.

Few outsourcers available. Poor outsourcing was another factor that limited the development of ABC. When the implementation was called off, the Bank tried to look for other solutions from outside. Contacts were made with other banks, but none had relevant experience with ABC implementation. Some employees suggested retaining consulting companies who might have the rich experience to design the system, but the local management consulting companies did not show a sufficient capacity to accept such a project. The developing business support institutions still cannot satisfy the demand of financial sections.

SOME ADVICE

The framework for implementing an ABC system into a provisional branch provides a valuable experience for the other branches within the Bank of China system or other Chinese banks. We suggest that a company teach its employees about ABC, provide sustainable resources from both internal and external sources, encourage employees to participate, and consider employees' resistance when applying ABC. We recommend that a pilot test be run on a small scale, such as in a department or a subunit, to examine the effects of the implementation. The implementation is costly and time-consuming, and an organization is advised to take it step by step in order to allow employees to understand the new system and, hence, offer valuable feedback to enhance the process.

To ensure its accuracy, however, an ABC model needs to be tested and continually improved. The long-term effects of implementing ABC in Chinese financial institutions are still not clear, and further investigation is still required in the near future to see if ABC implementations are feasible.

By reflecting the view of employees of one of the biggest Chinese financial institutions, Bank of China, this study contributes to the existing knowledge about ABC in practice. It represents a real example of why

ABC implementations might fail, which should benefit both academics and practitioners. ■

Abed AL-Nasser Abdallah, Ph.D., is an assistant professor of accounting in the School of Business and Management of American University of Sharjah in the United Arab Emirates. He can be reached at abedabdallah@aus.edu or 971-6-515-2594.

Wei Li holds a master's degree in management with finance from the School of Management at the University of Bath.

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