The role of integrating ABC and EVA in improving the efficiency of performance measures in Egypt: An empirical study

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Abstract

This thesis presented a cost and performance measurement system that integrated activity based costing (ABC) with the economic value added (EVA). (ABC) system was implemented in numerous companies, and managers were able to manage costs more successfully through the removal of non-value added activities, process improvement, or outsourcing. However, (ABC) did not automatically imply an improvement in value creation; often the shareholder wealth remained unchanged or was reduced. This resulted from the fact that the (ABC) system was efficient in the calculation of overhead costs, whereas it did not consider the proper allocation of cost of capital to cost objects. In contrast, value-based financial performance measures, such as (EVA) focused on cost of capital and shareholder wealth. Nowadays, managers need a tool to help them manage both costs and capital. Therefore, in recent years, many researchers have proposed that (ABC) system could be integrated with (EVA) to improve and develop the cost information provided by (ABC) system. The proposed integrated system is more than a costing system. Besides it provides accurate and complete cost information that includes explicit costs (overhead costs) and implicit costs (part of cost of capital) that is consistent with the corporate objective of shareholders’ wealth creation. This integrated system is able to measure the company performance of specific cost objects, it shows which cost objects are not only able to cover overhead costs, but also satisfy shareholders’ expectations in the form of a reasonable rate of return on the company’s capital. Moreover, the integrated (ABC) and (EVA) system can identify value drivers. After implementing this integrated system, the management will be able to recognize which processes, products, or operations are the real value drivers that are greatly impacting a company’s value creation potential. The researcher conducted an empirical study in one manufacturing company in order to test the hypotheses and the implementation of the integrated (ABC) and (EVA) system. In chapter four, implementation steps were illustrated and changes to product costs resulted from the inclusion of cost of capital were demonstrated. An activity-capital dependence (ABC) analysis was used to determine the capital demanded by each activity. The impact of the increased reliability of cost information on the company’s decision making process, potential long-term company performance, and expected shareholders’ wealth creation were discussed. The result of this study was that, the company should change its costing system from the volume-based costing system to the integrated (ABC) and (EVA) system, because it was approved that the integrated system will provide more complete and accurate cost/financial information to management than the volume-based costing system.

Keywords

Activity-based Costing; Economic Value Added; The Integrated (ABC) and (EVA) System; Performance Measurement,