

CREDIT COSTS OFTEN UNDERESTIMATED?

IN many businesses the costs involved in financing customers is an underestimated and unspecified debit entry. Activity-based costing (ABC) can offer accuracy and clarity. ABC is useful in specifying indirect and general costs.

By means of ABC these costs are not directly assigned to cost centres, such as products, services or customers, but via a link of the activity. Specifying the costs per activity and subsequently assigning the activities to the cost centres provides a detailed and accurate picture of the cost centre's actual costs.

To be able to see how an organisation could more precisely manage its credit costs, mapping all these expenses through ABC could give a broader insight. As a result, a realistic picture of the costs of production or a clear picture of the realistic customer margin or costs

is given. Furthermore this insight provides the opportunity to review options and to implement cuts.

ABC assumes costs are not generated by the products or customers themselves, but by the activities needed to generate products or serve customers. The ABC method consists of the following steps:

- ◆ Step 1 – project preparation.
- ◆ Step 2 – determine process, inventory activity and determine cost objects.
- ◆ Step 3 – inventory costs of production means.
- ◆ Step 4 – determine cause of costs.
- ◆ Step 5 – assign costs of production means.
- ◆ Step 6 – determine cause of activities.
- ◆ Step 7 – assign costs to cost objects.

ABC is applicable within the field of credit management as it originates from processes, and a process consists of a

set of activities. As processes get more complex you must reveal the financial outcomes of this increasing complexity.

We need to deal with various activities round financing our cashflows and reducing financial risks. It is important to determine these activities and reduce them to measurable units through which causes of costs can be selected. ABC provides insight into actual costs. This contributes to a correct picture of the accurate and exact expenses of credit costs.



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