# ACCOUNTING AND CHANGE IN THE FINANCIAL SERVICES SECTOR: THE CASE OF ACTIVITY-BASED COSTING IN A PORTUGUESE BANK

***Rui Vieira***
*Warwick Business School (Coventry, UK)*
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***Abstract***

*The research on which this paper is based traces the development of management accounting systems in a Portuguese bank, where an activity based costing system is being trialled for implementation, as a means to improving the economy, efficiency and effectiveness of employee activity. The culture of banking in Portugal has changed significantly over the last 25 years, but at the same time there are older traditions which remain powerful. It will therefore be significant to study how an imported management accounting system (MAS) like ABC is developed and disseminated within a Portuguese banking context.*

*The project is a study of a managerial innovation, which hopes to help generate a new kind of empirical understanding of how accounting change works in practice in different cultures, and so to contribute to deepening our theoretical understanding of accounting's roles in modern management. The research can be classified as a longitudinal study of organisational change using a single case study, and is justified on the basis of seeing case studies as contributions to our understanding of the differences between organisations and cultures. It can also be seen as a descriptive/exploratory case, given the extension of analysis to a new cultural context, and its objective may be taken as identifying possible reasons for the ways accounting practices change across time and space.*

**Keywords:** activity based costing, implementation of change, banking sector.

## Introduction

Management accounting is at a critical stage in its development. Many of the recent debates and criticisms concerning management accounting systems (MAS) are related to the recognition that the competitive environment is changing in major ways: e.g. through technological developments and the globalisation of markets. This has increased competition and led to shorter product-life cycles. These changes demand a more flexible approach to organising the activities of a company (Bromwich and Bhimani, 1989). It is argued that these changes have led to important modifications in cost structures and cost behaviour in a way that means that conventional management accounting techniques fail to provide relevant data for companies (Johnson and Kaplan, 1987; Howell and Soucy, 1988). Furthermore, we are now familiar with the claim that conventional management accounting data is 'too late, too aggregated and too distorted to be relevant for planning and control decisions' (Johnson and Kaplan, 1987, p.1).

This paper has four main sections. In the first section, a theoretical framework developed by Fligstein (1991) is presented to form the basis for the proposed research methodology. The second section considers the evolution in the ABC literature from a focus on activity based costing (ABC as product cost system) to activity based management (ABM as system which focuses on process management) and moves to a discussion of the criticisms of ABC and ABM. In the third section, the economic context and current situation of the organisation studied are presented. The context in which the ABC system is being implemented, and also the implementation process itself, are analysed. In the final section, issues bearing on the future development of the research are raised and some preliminary conclusions are provided.

## Theoretical Background

MAS are an important element in managing internal and external interdependencies (Otley, 1994; Euske and Riccaboni, 1999). To ensure growth and profitability, owners and managers must make sure that organisation processes are performed smoothly and predictably. Internal interdependencies are arguably constructed primarily through processes of hierarchy and motivation. Typically three types of internal control problems are identified: the relationship between management and workers, the separation of ownership and control, and the division of labour between different levels of management. External interdependencies are largely constructed through interactions with competitors, suppliers, capital markets and the state (Fligstein and Freeland, 1995). In order to study external interdependencies the work of Fligstein (1991) is drawn on here, thus explaining change from the perspective of institutional theory.

Fligstein's work can be seen in part as a response to the theoretical approach developed in DiMaggio and Powell (1983). They had argued that management typically tries to make an organisation isomorphic with the prevailing institutional logic of the organisational field[1] since powerful forces emerge that lead organisations to become more similar to one another. Isomorphism is a 'constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions' (p. 149). This institutional perspective helps in explaining the apparent homogeneity of organisational forms and practices, however organisations and organisational fields change. Fligstein (1991) provides an institutional theory to explain that change process.

Euske and Riccaboni (1999, p. 464) claim that Fligstein focuses on 'the factors that fashion the organisational field and the role of actors in influencing change'. So Fligstein (1991) argues that the ability to change the course of an organisation depends on a complex set of actions, both internal and external to the organisation. He claims that there are three relevant institutional contexts in which 'rules are created, meaningful actions occur, power relations are formed, and concrete forms of social organization are set in place' (Fligstein, 1991, p.312). The three contexts are the set of organisations included in the organisational field, the state and the existing strategy and structure of the organisation.

First, organisations are embedded in larger groups of organisations, which are called the organisational field. The other organisations are most frequently competitors but they can also be suppliers or distributors. These fields can be thought of as the result of the mutual recognition by actors in different firms of their interdependence. Second, the state sets the rules for any given organisational field that define what organisations can do and what the limits of legal behaviour are. Third, individual organisations have in place a set of strategies, structures, technologies, and physical limits that shape and constrain their action.

Looking at each of these contexts more closely, we can say that the function of *organisational fields* is, above all, to promote stability (Fligstein, 1990). They are set to benefit their most powerful members. The relative size of organisations gives their actors differential power to dictate the actions of others, but from the point of view of actors in less powerful organisations in the field, the reason to support the dominant organisations all revolve around survival. 'Being a member of the field, albeit a dependent one, is one way to survive. While competition continues to exist, it is no longer predatory' (Fligstein, 1990, p. 6). For these reasons, once a set of relationships and rules are established (as a stable organisational field), it is in the interest of all organisations in the field to maintain that situation, maintaining some distribution of power and resources. However, if a shock is perceived, actors will probably take actions to adapt.

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[1] DiMaggio and Powell (1983, p.148) defined organisational field as 'those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products'.

Secondly, the **state** is made up of organisations, institutions and practices. Each organisation has agendas settled by the political actors that control them and the economic and social forces that influence the political process. The state is an important force in the economy because it defines the rules by which actions in the economy are carried out, as it regulates industries, sets tax and employment laws, etc. It also affects the economy by consuming products/services, influencing the business cycle, and redistributing income through its taxation and social expenditure policies. Although the relationship between the state and large organisations often ends up serving the interests of the companies, the state also acts in its own interests, and as a mediator between interests.

Thirdly, actors who are in control in organisations, base that control on existing *organisation strategy and structure*. Organisations therefore frequently experience an internal power struggle over their objectives and resources. Those who control the resources use them to impose their view. At the same time, change in an organisation requires taking huge risks. Fligstein (1991) claims that because environments are murky, actors must interpret their environment, both internal and external to the organisation. They have to propose a solution bounded by the internal logic of the organisation, the knowledge of those actors, how they perceive the world, and what they conceive as appropriate organisational behaviour. For the solution to be carried out, the actors must have the power to act (Fligstein, 1991). He also argues that actors have their own view of the world, and unless some shock occurs that changes their world, they will continue to act in a consistent fashion. But this also means that the source of ideas for change can emerge from the position an actor has within the organisation, which might provide arguments or interpretations that would alter the organisation's course by offering a particular construction of a crisis and a new kind of solution to that crisis. The individual manager who leads the organisation is extremely important in this conceptualisation of the institutional perspective.

## ABC: Relevance Lost and Regained?

During the 1980s, Kaplan published several polemical papers on the state of management accounting. One strand of this critique was crystallised in Kaplan and Johnson's book, Relevance Lost: *The Rise and Fall of Management Accounting* (1987), where they described the historical development of management accounting, and its failure to be effective, in variety of ways. Four major criticisms were made (Roslender, 1996) First, there was limited evidence of technical developments being used within MAS in response to competitive environment changes. Second, MAS were seen as too dependent on financial reporting demands, e.g. quarterly earnings per share. Third, much research had been based on 'simplistic economics-based models of the outside world' (p.535) rather than studies of best practice. Finally, *managing by the numbers* had developed into a perversion of the role and nature of MAS[2].

### *Activity Based Costing*

According to Kaplan's general line of argument, management cost systems should address three different functions: inventory valuation for financial reporting purposes, operational control for performance and productivity evaluation, and individual product cost measurement. He recognised that 'no single system can adequately answer the demands made by the diverse functions of the cost systems' (Kaplan, 1988, p.66). At the same time, he argued that, while the first objective is arguably fulfilled adequately by conventional MAS, such systems could not explain what the shop floor

[2] This analysis did not go unchallenged. For instance, Ezzamel et al. (1990, p.164) claim that 'managing by the numbers is the essence of accountability, and the manifestation of the power of the new knowledge' (some form of accounting is unavoidable). They also criticise Kaplan and Johnson historical analysis. Ezzamel et al. have a different analysis of the development of MAS and believe that managerialism's origins can be traced to the early 19th century. Finally, they criticise the importation of techniques, which have been successful in Japan as the solution to the problems of MAS.

manager should do to improve performance, and they tended to distort product costs for strategic and marketing purposes, particularly in high overhead contexts (Johnson and Kaplan, 1987).

As we know, conventional product-costing systems (cost centre method) are based on a two-stage procedure. First, the consumption of direct resources is traced to products (direct costs) and cost centres (indirect costs). In the second stage indirect costs are allocated to products by methods such as direct labour hours, machine hours or materials consumption. Kaplan argued that, in a complex, multi-product environment, the allocation of such indirect costs could be significantly improved, thus leading to a reduction in the distortions in product cost calculations, if an ABC system was adopted.

ABC is also based on a two-stage procedure. However, overhead costs are first charged to cost pools, based on the activities seen as causing such costs. Then, these costs are attached to product lines by using cost drivers which reflect the way each particular product line draws on the activity whose costs are collected in the particular cost pool. The main accounting argument behind this proposal was that conventional MAS, which allocate overhead costs on the basis of a product's consumption of direct activities (e.g. Direct Labour Hours or Machine Hours) will tend to *overcost* high volume products and *undercost* low volume products, where the consumption of indirect activities follows markedly different patterns (Cooper and Kaplan, 1991).[3] Another, more managerial, argument for adopting ABC or perhaps ABM (Activity Based Management) is that, regardless of getting product costs 'right', new financial and non-financial performance measures are now needed to control processes and quality effectively (Maskell, 1989 a-d). At the same time, this need may combine with a greater need to cost a product right over its life cycle since, given the changing business environment, life cycles are tending to become shorter, leaving less time to recoup a bad pricing decision (Brimson, 1986).

Now certainly, if we compare ABC with traditional costing, there is a similar approach in both systems, since both use a two-stage process. However, according to its proponents, ABC provides a framework for 'achieving the two overhead costing objectives of cost pool homogeneity and a cause/effect relationship between absorption bases and costs' (Innes and Mitchell, 1988, p.24). Accordingly, ABC has been put forward as the solution to many of the problems of modern businesses in competitive environments. This is because a conventional MAS gives 'too little attention to internal cost controls, matches revenue and expenses improperly, and emphasises conservative inventory valuation at the expense of management reporting' (Peavey, 1990, p.31).

Activity analysis has therefore been widely adopted.[4] But while it makes overhead activities visible and provides managers with new performance measures (Raffish and Turney, 1991), there are several objections that have been raised against it. For instance, it has been argued that there is little evidence of increased accuracy through implementing ABC (Bromwich and Bimanhi, 1989) and that the new approach to attributing costs is still troubled with arbitrary allocations (Wells, 1994). Again, it can be argued that ABC is just a refinement of the conventional MAS because it has more absorption rates but applies them in exactly the same way as conventional costing (Horngren, 1989; Shillinglaw, 1989; Kennedy, 1996).

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[3] It is further argued that recent competitive environment changes have tended to raise overhead costs and decreased direct costs, thus exacerbating the effects of any distortions in product cost calculations made using direct allocation methods. This can be catastrophic in a world where it 'is more accurate to say that overhead drives labour costs than vice-versa' (Nanni *et al*., 1988, p.43).

[4] Such analyses typically involve the following facets: study an organisation or a department in order to find what activities are done, how many people perform those activities, how much time they spend, and what resources are required.

*Activity Based Management*

As just noted, ABC was initially presented as a new way to establish more accurate product costs. A number of case studies were undertaken to dramatise the kind of improvements that could ensue.[5] However ABC research entered a second phase, in which it became known as Activity Based Management (ABM). The ABM phase can perhaps be seen as a 'logical' development of ABC, in which it now focuses on the *management* of indirect activities, at various levels beyond direct production/activity, in order to improve the value received by the customer and the profit achieved by providing this value. ABM however continues to draw on ABC as its major technical accounting basis.

In one early version of ABM, Johnson argued that companies should manage activities – not costs as such (Johnson, 1988; Ostrenga, 1990). The principle was that activities consume resources and products consume activities. He maintained that 'activity-based information would focus managers' attention on underlying causes (drivers) of cost and profit unlike the distant, often distorted financial echoes of those causes that appear in traditional cost and performance reports' (Johnson, 1988, p.p. 24-25). Turney (1992, p.p. 20-21) voiced a similar opinion when he suggested that ABM seeks 'two goals, both common to any company. The first is to improve the value received by customers. The second is to improve profits by providing this value. These goals are reached by focusing on managing activities'.

Brimson (1991, p.11) provides a methodology for promoting accounting-based activity management:

1. 'Determine enterprise activities.
2. Determine activity cost and performance. Performance is measured as the cost per output, time to perform the activity, and the quality of the output.
3. Determine the output of the activity. An activity measure (output) is the factor by which the cost of the process varies most directly.
4. Trace activity cost to cost objectives. Activity costs are traced to cost objectives such as products, processes, and orders based on the usage of the activity.
5. Determine corporate short-range and long-term goals (critical success factors). This requires an understanding of the current cost structure, which indicates how effectively operating activities deliver value to the customer.
6. Evaluate activity effectiveness and efficiency. Knowing the critical success factors (step 5) enables a company to examine what it is now doing (step 4) and the relationship of that action to achieving those goals'.

Steps 1 to 4 could be considered the ABC method. The expansion through steps 5 and 6 describes the broader scope of ABM methodology, which allows managers to use the information from ABC for decision making.

However there are two sorts of problem here. First there is a problem implied by locating the determination of goals at Stage 5. This suggests a tendency to starting from current practice. Yet current practice may be highly dysfunctional in terms of implementing an activity-based approach. It is not clear in the presentation how this is overcome. The second problem concerns the degree to which contextual issues are recognised as a problem in implementation (whether firm-specific or more

[5] The book *The Design of Cost Management Systems: Text, Cases, and Readings* (Cooper and Kaplan, 1991) includes several cases, now well-known. Brinker (1991,1993,1994) and Lyne (1996) also provide examples of companies using activity-based techniques with relative success. Marshall (1995, p.28) summarised a successful implementation as follows: 'ABC has become a part of Wavin's day-to-day management culture. Whilst it is not a perfect science it does offer a sense of financial pragmatism to the wider management process. In this respect it is seen as a management tool and not a solution in its own right, a factor which has led to its gradual acceptance throughout the company'.

general, e.g. cultural, issues are in view). In this particular research literature, even where cases are provided illustrating the implementation of the new system, such firm-specific or more general behavioural and organisational consequences of the implementation are seldom raised as a significant issue. Consequently certain crucial factors, which can make or break a potentially radical innovation such as this, remain unexplored, with the possibility remaining unexamined that they could cause dysfunctional reactions.

*Relevance Regained*

An attempt to address this danger was made, by substituting a different control technology for accounting, by Johnson, as he rethought the general adequacy of accounting-based attempts to engineer organisational improvement. He came up with a radically different approach in *Relevance Regained – From Top-Down to Bottom-Up Empowerment* (1992a). Here he claims that accounting can only provide a top-down control and in a related article (1992b) argues that ABC improves cost information by using activities to allocate costs but does so, without providing information about the way customers are satisfied or the way processes are stable and efficient. He now puts the focus on three features: customers, quality and employees. He argues that 'what matters in business is to create fulfilling jobs and survive by profitably satisfying customers' wants (without harming society or the environment)' (Johnson, 1992b, p.28).

Johnson then argues that 'relevance was not lost by using improper accounting information to manage. It was lost by improperly using accounting information to control business operations' (Johnson, 1992a, p.31). The problem is that managers manage results - not processes. It is vital to understand "customer power" and "worker power". Companies should stop managers and employees from attempting to manipulate processes in order to achieve accounting targets (Johnson, 1992a), and managers should understand the differences between managing by remote control and practices that will lead to flexibility and customer satisfaction. He argues that the solution is TQM, which involves teamwork and "empowered" workers. It is also important to change education. ABC now, for Johnson (1994), is part of the problem, not the solution.

We may contrast this view sharply with the position that his former collaborator, Kaplan, has evolved. Kaplan (1992) does concede that ABC is not magic, but only one of many information systems to help managers. However, he maintains that this system has several advantages. Firstly, it can be part of the improvement process. It gives a cost/benefit analysis, when it is necessary to achieve quality or other improvements. Secondly, it can be linked to performance measurement. After having identified the process drivers for a critical activity, it is possible to put measures in place to improve those process drivers in terms of efficiency. In addition, it can help understand operating cost consequences and improve supplier relationships. For Kaplan, it is vital to distinguish between low-price and low-cost suppliers. The cost of receiving, inspecting, storing and moving the materials should be linked with the supplier price. Finally, ABC can help identify the segments and customers that can be satisfied profitably. Kaplan claims that attempting to meet all customer needs, without taking into consideration economic consequences, brings problems to companies.

*Beyond the 'Relevance' Debate*

In recent years, the context of debate has widened, and old ways of seeing, which treated changes in MAS as purely technical or accounting-bounded questions, have become increasingly open to reformulation. So just as Johnson has opened the field by proposing TQM as an effective alternative to accounting-based control systems, so others have responded by seeing a more complex role, and significance, for accounting. Ezzamel (1994), for instance, challenges Johnson's claim that management accounting systems are irrelevant to the context of decision-making, because of their emphasis upon managing results rather than improving processes. Instead he argues for a deeper appreciation of what it is that accounting is doing, in which it is important to build a critical

understanding of accounting's power effects. Accounting, as form of exercising power within organisations, may *never* have been irrelevant, and may have a deeper relevance than that raised in the debate so far, even now. On this basis, he disagrees with Johnson's contention that TQM can be a solution where accounting fails. On the contrary, he argues, the TQM literature has neither been sufficiently reflective or critical, so this is at best a 'problem-solution' approach, which tries to give quick solutions to problems that may not yet have been fully articulated. As such the approach fails to grasp that it may just be an inferior, or less effective, way of exercising the kind of power that accounting has exercised. So, for instance, he argues that many of the techniques used by TQM are similar to those used by accounting (in that they still impose a 'managing by numbers', but one that is now based on non-financial numbers), and that consequently 'TQM does not promote any real concern for understanding and managing organisational processes' (p. 276). Finally he suggests that 'while the limitations of MAS are increasingly, but slowly, being recognised, those of TQM have for the most part been masked by uncritical exhortations of what TQM is capable of delivering' (p. 279). In which case, accounting approaches may be more realistically placed to engineer significant change in the future.

*The future of MAS development*

Kaplan and Cooper (1998), who had claimed before that one cost system is not enough, claim now that the next stage is to design and integrate ABC systems and systems for operational learning and improvement. They present a four-stage model of MAS evolution. In stage I, MAS are not even adequate for periodic financial reporting because of poor internal controls that do not record, or record incorrectly, transactions. Most companies have MAS best described as stage II, where cost information is available for valuing inventory and calculating the cost of goods sold for financial reporting[6]. They had advocated that companies should develop stage III MAS, retaining their existing stage II MAS to prepare financial reports, but implementing ABC systems for process improvement activities, and to provide useful information for strategic decisions. However, they now claim that ABC systems are not sufficient to ensure the twin goals of strategic vision and effective short-term operational decision and control. Another MAS is necessary to provide feedback on operational learning and improvement. The stage IV MAS will enable cost and performance measurement information to become integrated.

They therefore recommend that management should 'calculate product and customer costs with standard activity cost driver rates and actual activity cost driver quantities. In parallel with the ABC system, the operational control system monitors the efficiency with which activities are performed and the actual prices of resources used to perform activities' (p.300). When changes are detected, the operational control system can send a signal to the ABC system to update activity cost driver rates. The ABC system can then be used to establish the budget for supplying resources to perform activities. The operational control system uses this budget for monitoring spending in responsibility centres. The data from both systems can also be used for periodic financial reports.

Therefore, according to Kaplan and Cooper, the future of MAS development involves an upgrade of ABC systems to incorporate additional features, namely 'measurement of resource and activity capacity, accurate assignment of all business -and corporate- level expenses through the use of secondary and primary activities, incorporation of the cost of capital, and comprehensive measurements of life cycle costs and profitability' (p.322). The operational improvement system monitors the company's resource consumption but also, the efficiency, quality, and responsiveness of departments and processes. The ABC system reports the cost of activities and processes, and the cost and profitability of products, services and customers.

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[6] These are the systems that Johnson and Kaplan criticised as allowing a continued dominance of financial reporting rules, thus rendering MAS information irrelevant to managerial purposes.

This is very interesting, but at this point it remains unclear, how in practice the new operational improvement system is supposed to identify activities at all levels in a way that is both comprehensive and discrete (e.g. controlling for the interactions between activities) and to measure 'life cycle costs and profitability' effectively when the changing and competitive environment renders cycles so unpredictable. In such ways it remains unclear how the expanded cost and activity control system is supposed to produce 'numbers you can trust' (to quote an earlier Kaplan and Cooper phrase), and how it can be effectively integrated, in real time, with the ABC system. Perhaps these details will be forthcoming in future publications by Kaplan and Cooper. However so far this remains, in my view, a hope deferred, and at best an intriguing suggestion. It will also be particularly interesting to see how Kaplan and Cooper reconcile this new approach with their earlier views, which have tended to argue that this kind of reconciliation between operating information and cost systems is not yet feasible[7].

**The Research Case: Background and Issues**

The empirical research undertaken in this study is taking place in a large family-owned Portuguese bank, named here as 'Banco Alpha', whose foundation dates back to the last century. The bank was nationalised following the fall of the Salazar regime in the 1970s, but reprivatised in 1991/2, at which point the original family regained control. This was part of a general privatisation of financial houses, and this economic shift led, as in other countries, to a greater focus on profitability, cost control and efficiency and effectiveness of client services than hitherto. In this respect, an old business culture (dating back before nationalisation, but artificially prolonged by it) was suddenly confronted with new economic demands.

**The evolution of the Portuguese financial system**

Before the 1960s, Portugal's banking sector was, like the economy in general, relatively underdeveloped. During the 1960s, there was some expansion in banking activity, but it was mostly the large private groups that dominated the general economy who benefited. Consequently, they were the major presence in the banking sector until the fall of the Salazar regime. The banks were therefore a natural target for nationalisation in the following years.

*A state-owned banking sector: 1975-1983*

After the Revolution in 1974, the majority of the financial sector was nationalised[8]. One result was that the bank sector had less freedom of action and consequently, much less economic power, over those years, with expansion taking place at only a slow rate, even though bank holdings continued to grow, as savings poured in from various sides, including émigré families. However, unlike other nationalised sectors, where existing private firms were typically consolidated into state monopolies, the commercial banking system and the insurance industry were both left with a degree of competition. But this was not full-blooded commercial competition, as there was a 'soft budget' policy, where social and political objectives were given precedence over market-led criteria (such as profitability or earnings per share) for bank lending. Banks indeed were required by law to extend preferential credit to non-profit-based public entities, as well as financing at below market rates the government's deficit. Political interference affected bank solvency leading to an increase in non-performing loans and to an insufficient capitalisation of banks. In such a setting, banks also accumulated involuntary excess

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[7] As referred before Kaplan (1988, p.66) claims that 'no single system can adequately answer the demands made by the diverse functions of the cost systems'.

[8] On September 1974 the issuing banks were nationalised both in Portugal and its ex-colonies. In March 1975 all credit institutions with head offices in Mainland Portugal and the autonomous regions of Madeira and Azores were nationalised, with the exception of the Saving Banks, Agricultural Mutual Credit Co-operatives, the Crédit Franco-Portugais and the Portuguese branches of the Bank of London & South America and the Banco do Brasil.

liquidity, which was then invested with the Central Bank at below market rates (Ministry of finance, 1998).

*The period 1984-1990*

Substantial change then followed with the change of government in the mid 1980s, as the financial system entered a phase of liberalisation and innovation. Portugal became a member of the EC (now EU), and under the new centre-right regime a series of policy measures, aiming at greater liberalisation of the economy, were undertaken. The Stock Exchange was modernised, and trade in new money market instruments was sanctioned. Legal authorisation was given for the establishment of domestically and foreign-owned private banks, and their number multiplied quickly[9]. Credit ceilings were abolished for commercial banks, and the public sector banks that had been nationalised were now privatised.

*From 1991 onwards*

The financial sector again became a major source of investment and interest for the leading private groups, many of them being continuations of old groupings. In the initial phase of liberalisation, the activity and profitability of the financial sector increased significantly. In the early 1990s, the banking sector was contributing 8.5% to GDP, a comparatively high percentage as an international comparison. However, profit margins have now fallen back, even though activity remains high, as the market has filled up with participants competing in both domestic and foreign markets, chasing lower costs and higher market share. As the 1990s unfolded, new financial conglomerates were created. These included banks, finance companies and insurance companies. Foreign banks, particularly from Spain increased their presence. Recently the state intervened to prevent a Portuguese financial group being sold to a Spanish bank. This episode raised problems with the European Commission but in the end an agreement was settled whereby part of the group was sold to the Spanish bank and the other was sold to a Portuguese private group, following the intervention and support of the state-owned financial group. This underlines how the state is a very important player in the sector, especially as it continues controlling the most important financial group in the country.

**Banco Alpha**

In the 1990s the bank was re-privatised and the Alpha group (the financial group of the Alpha family which had controlled the bank prior to its nationalisation in 1975) obtained a 50 per cent voting control of the bank shares and of the bank board of directors (Pohl and Freitag, 1994). The bank's ownership was therefore looking for competitive advantage in a new economic climate for the Portuguese banking sector, and looked to such internationally-adopted innovations as diversification of services and growth through merger and acquisition, all designed to maintain a healthy balance sheet and P & L account. The pursuit of these goals has continued up to the present, and Banco Alpha has secured its position as one of the country's leading banks, with a range of overseas interests as well. Banco Alpha has set up subsidiaries and representative offices in cities where there is a significant Portuguese community and entered the Spanish and Brazilian markets. The financial Group covers a range of business areas ranging from Banking to property and equipment leasing, insurance, investment and pension fund management, credit cards, stock brokerage, among others.

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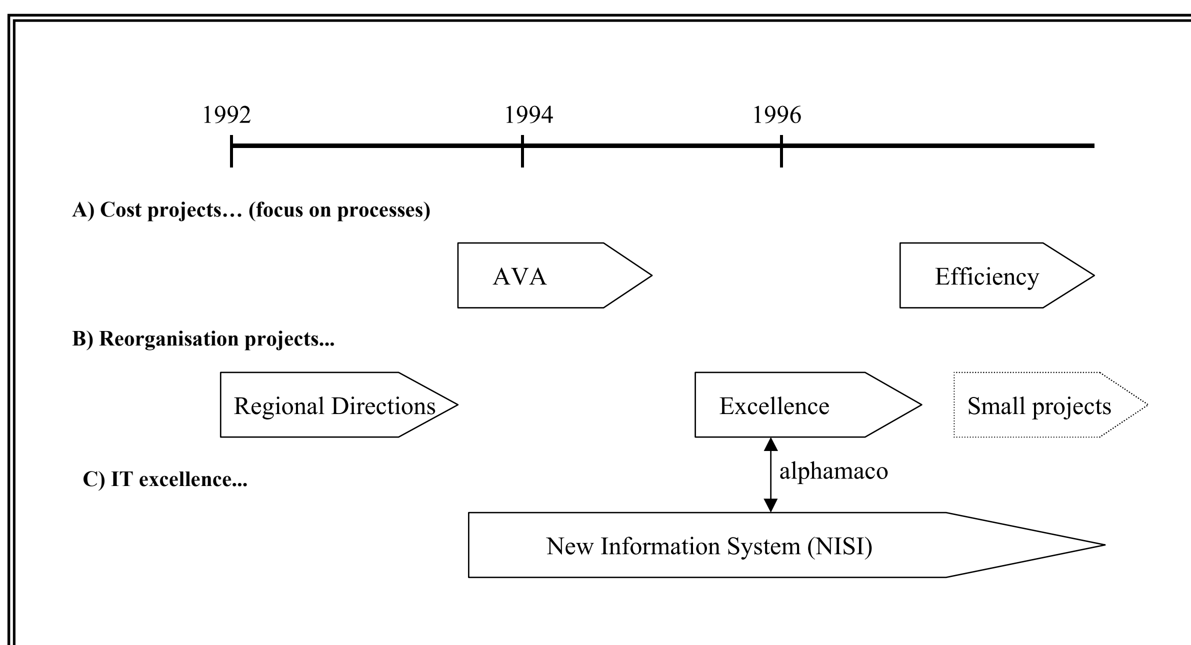
[9] Barriers to entry protected state-owned banks, which had been highly undercapitalised after more a decade of mismanagement. New entrants, once entry occurred, also benefited from these barriers as their growth was made easier in this protect environment.

*Change initiatives*

Since the bank was newly committed to profitability and cost control, one major concern that began to emerge was over head-count. Naturally this was not necessarily something that the bank's top management wanted to broadcast. But from 1992 on there were a number of initiatives undertaken, with the help of a leading consultancy firm, where in retrospect it can be seen that a major objective was reduction in head count, and associated with that, an improvement in the *cost to income* ratio. With the growing adoption of internationally used financial performance measurement systems, this ratio increasingly became a major concern to banks and to financial sector analysts, as a proxy for efficient and profitable operations.

Consequently, the bank undertook a series of 'efficiency-focussed' projects (see figure 1), the first in 1993, the next in 1995-6 and the most recent in 1997-8. Over the same period, head count has reduced from approximately 6325 in 1992 to 4962 in 1998, while the *cost to income* ratio improved, from 67.7% in 1995 to 57.5% in 1998.

Figure 1 – Change initiatives




As this happened, there was arguably a change in the 'discourse' of the bank (i.e. the range of things said in official documents) towards a more internationally recognisable kind of 'financial management' phrasing and vocabulary. Terminology stressing profitability, unit cost reduction, quality, rationalisation and radical change became widespread, where before they had been relatively absent. So in the Report and Accounts for 1997 we find such observations as the following:

'The plans for change are clearly coming together, as on the one hand we increase our ability to generate business and hence earnings, and on the other hand, as we reduce our unit costs of production'

The Excellence Project was put into operation with the aim of improving the quality and competitiveness of the Group's services, 'directed mainly toward the distribution network, the segmentation of our clientele, and adapting the customer service to that segmentation'.

The Efficiency Project was ‘ designed to reduce transformation costs through slimming down the logistical support services, to reduce costs and redesign processes, bearing in mind the changes introduced by the NISI’. With the Efficiency Project ‘we simplified, rationalized and redesigned the circuits, and automated and centralized processes, while linking Group companies more closely to the process of monitoring customer satisfaction on a continuing basis’.

The New Information System (NISI) was ‘designed to make radical changes in hardware and software, in order to respond to the needs of running the organization in an up-to-date way’.

As a process of organisational and discursive change has gathered momentum and been maintained now for the best part of a decade, bank employees have not been slow to realise what has been happening. Unsurprisingly there has been a considerable increase in insecurity and suspicion of the motives of top management when initiatives promoting ‘improvement’ have been set up, particularly among older employees. At the same time, a new spirit of competitiveness has begun to spread along with the setting of targets, both financial and in terms of such objectives as increasing the percentage of ‘high-value’ customers. In this process, there has been some considerable reorganisation of the bank’s structure. In the mid 1990s, there was a geographically-based reorganisation of the management structure below top management, with the introduction of regional divisions, and with a related focus on revamping the work patterns in branches, so that branches became more of a ‘one-stop shop’ for a range of services, and the first point of call for most services that the average customer might want, or be persuaded to consider. There was also a separate ‘personal banking’ division set up for high net worth customers.

This was not the extent of the change. In order to capture efficiencies, the IT function was outsourced (although, as has frequently occurred, it is not clear that this has been a total success). Certainly within the bank, many employees see problems, such as bottlenecks and lack of timely information, as due to the outsourcing of the IT function. The situation has certainly not been helped with a changeover in the software used, which has sometimes led to ‘black holes’ in the provision of data to departments.

Predictably in the light of the experience of managing IT change generally, software has frequently not given the expected answer, as a director explains, referring to the complaints he is used to hearing:

‘I am working with the same or worse means than I had and I am not being compensated (it is not true but it is what people are assuming)’.

Thus, the 1990s were a decade of major transformation, with all the new opportunities and the associated problems that such transformation brings. It was in this context that an ABC initiative was suggested, influenced by the consultancy firm involved previously in innovations. The basic idea was that it should be piloted initially in one operational sector of the bank. Beyond the initial trial, which was due to begin in 1998, the intention was that, if it was successful, it should rolled out across the bank as a means of enhancing efficiency and effectiveness still further. It was not completely clear to many bank employees why they wanted to implement ABC. However, it was apparent to top management that there was no product cost information and at the same time there was a strong price pressure from the increasing competition between banks driving a perceived need to cut margins. There were also widespread concerns about the lack of ‘information’ for management (especially about profitability), the lack of comparability between information from different sources and the lack of timeliness of the information that was available.

*The ABC project*

It was at this stage that I approached the bank as a possible site for research, because of my background in Management Accounting and my particular interest in observing how an ABC initiative might develop, in a non-US/UK business environment. The bank proved willing to give me access, and the access has been excellent, with a full range of materials being made available to me (under usual terms of confidentiality where appropriate) and with interviews being granted with a wide range of relevant bank employees.

*Pre-implementation*

Earlier field research (1998-1999) included written material and interviews with those involved in proposing the ABC project, plus others in central administrative departments of the bank, where there have been certain conflicts or 'turf wars' over who should 'own' innovative initiatives. I have also been able to interview people in a range of operational departments, both at regional and branch levels. Not all such employees are necessarily aware of the ABC initiative, in part because it had not been implemented as yet, when I was undertaking my earlier field research.

There were various reasons advanced for the delay of the implementation over the past couple of years, including such factors as the currency switch to the Euro, and the Y2K 'millennium bug' problem. But at this point in my research I would suggest that there may have been other more deep-seated reasons. There were manifest power or 'turf' problems between departments especially between the accounting department and the organisation and quality department. The later department was in line to mount and co-ordinate the implementation of ABC, were it to go ahead, and this clearly precipitated a boundary dispute over who owned 'accounting' within the firm (and also in prospect who owned the 'significant' accounting). A manager from another department sums up the dynamics of the situation:

'There are two forces and two different interpretations of control, definitions of costs and information systems. (…) that also has to do with the history of the bank. Till a few years ago the accounting department was the structure of planning and they intervened almost on everything. Today, the bank is facing great change, that is not as clear as it would be desirable, it also has to do with an historical issue, let things run…'

There was also, until recently, a noticeable lack of commitment to the proposal from senior management, as a manager involved in proposing the ABC project observed:

'They know much about banking, they are bankers in the real sense of the word, but they are not too sensitive to efficiency. They have a feeling that control efficiency it is important but as they do not know the basic concepts they are not too demanding in that subject'

The presence of such factors militating against change is in line with the findings of previous work into the factors affecting the successful implementation of ABC (e.g. Shields and Young, 1989; Innes and Mitchell, 1990; Cobb et al, 1993; Argyris and Kaplan, 1994; Anderson, 1995; Player and Keys, 1995 a-c; Krumwiede, 1998).

Shields and Young (1989) and Argyris and Kaplan (1994) identify a range of factors that may help promote the successful implementation of an ABC system. Shields and Young present a model that requires a change in corporate philosophy from *managing by the numbers* to *managing by commitment to continuous improvement*. Argyris and Kaplan suggest three phases are required to reduce resistance to change. First, informing managers about the internal consistency and external validity of ABC, through seminars and publications. Second, ensuring that influential individuals become sponsors and champions of ABC. Finally, aligning the incentives that will result from internal

commitment to the new system and promoting external ways of persuading individuals to use it.

Anderson (1995) and Krumwiede (1998) expand a factor-stage model of information technology implementation proposed by Cooper and Zmud (1990). Anderson (1995) studies the ABC implementation process at General Motors, concluding that success factors differ and vary in importance during the stages of implementation. Krumwiede (1998) uses the model to develop an ABC implementation model. Furthermore, he tests two sets of factors that affect success or failure of ABC implementation: contextual and organisational. Contextual factors are related to the user, organisation, technology, task and environment. Organisational factors are related with "humans" involved. His findings also support that the impact varies during the stages of implementation[10].

*Implementation*

In January 2000 the bank decided to start the implementation of ABC. The formal reason is that ABC could be a relevant data provider for the Management Information System (MIS). Another reason that contributed to its selection was a potential merger and the necessity to have a better understanding of the costs before get involved in the merger.

Although the implementation process is still ongoing there are some critical issues that require further attention, including such factors as the way costs are allocate to activities, to the cost objects or throughout time, and the impact and uses of ABC within the organisation. How costs are allocated raises several issues. First, which costs are going to be allocated and what cost drivers are going to be used to allocate those costs? The majority of the team argues that they should allocate all the costs to the cost objects, however this raises issues of subjective judgement, and a residual arbitrariness in the decision-making process. There are problems defining the appropriate cost drivers for some types of costs, and once defined there are difficulties knowing the volume of outputs, since the IT systems have not been designed to give that kind of information. Second, when are costs to be allocated to the cost objects? The team argues that reports about costs should be monthly. However there is no intention to apportion all costs to appropriate periods (i.e. on an accruals basis). So for instance, with the costs of an advertising campaign, the idea is not to allocate the costs across the whole period of its duration. Another example is that the bank considers the costs associated with bonuses payments to workers when they were paid, instead of the period they refer to. Finally, there is the problem of how to deal with costs emanating from other companies in the group since there is no system of internal transfer prices.

All these issues create serious concerns over the subjective nature and lack of accuracy in the cost information generated by the management accounting system. Consequently, the real impact and value of ABC are not clear, and as a result there are different levels of involvement and commitment to the project. To date it appears that the bank departments involved have not discussed the uses to which the information would be put to any great extent, and the contradictions between the positions held on the new system are evident to all involved. So on the one hand, the organisation and quality department has clearly indicated that their objective was to develop an ABM focusing on managing activities. However, the accounting department has to date revealed little about the uses that they see the system serving, which at this moment remain unclear.

This research is clearly valuable to identifying key factors that may be found in a more longitudinal and 'contextually rich' sort of case study. That is the kind of study that is being attempted here, recognising that this type of research project is more time-consuming and less immediately 'generalisable' than some other approaches, precisely because it is so intensive within one

[10] It is important to consider that surveys are limited by a lack of contextual information and verbal exchange, outputs are based on the opinions of the respondents rather than more objective data, and some bias may arise from the fact that the respondents are mostly controllers and accounting managers (Krumwiede, 1998).

organisation. One similar study that has attempted to contextualise the introduction of an ABC 'solution' within the financial services sector is Soin's research carried in an UK clearing bank (Soin, 1996). Like this study, that research involved a longitudinal examination of organisational change focussing on a single organisation, and as here, that organisation was a leading player in the banking sector. Both studies therefore can be seen as contributing by developing a 'rich description' approach where archival materials from within the organisation are combined with interview data, thus covering people's understandings both of past developments and of ongoing innovations.

In my own study the process of data collection is ongoing, on a principle of 'triangulation', where a variety of data sources is used for data collection, so as to minimise the risk of having errors and ambiguities. In more detail, I have had access to documentary materials such as annual account reports, consultant project files and several internal documents. In-depth semi-structured interviews have been held with several central department managers and commercial managers, and more of these are scheduled. There have also been a number of more informal or unstructured interviews with other employees within the bank. The objective throughout has been to contribute to understanding the complexity and unpredictability of life, even within well-ordered organisational contexts, by examining and recording and then reflecting on what people do *in practice*.

*Limitations of the study*

At the same time, I am aware that there may be other factors that need to be considered in attempting to make sense of what is taking place in Banco Alpha. For instance, it would be improper to conclude without referring to the limitations that this kind of longitudinal case study research, like all methods, necessarily has. Scapens (1990) identifies three particular problems of case study research. First, there are difficulties of drawing boundaries around the subject matter of the case. Second, there is no such thing as an '*objective*' case study. Social systems are not natural phenomena, they 'must be *interpreted* by the researcher and, thus, case studies represent interpretations of the social reality' (p.277). The last problem is related to confidentiality. Often access or subjects views only are possible if confidentiality is assured. This situation may prevent the researcher from presenting a full picture of what has been seen in print, as well as sometimes making it difficult to check the validity of evidence, where recourse to relevant material held in confidence is denied.

Nonetheless, there is a considerable value to case studies, and certainly I would argue that the longitudinal case study method is the most appropriate for the study under development here, if one is to key into the complexities involved not just in developing innovations but in negotiating their implementation, handling conflict and differences of opinion, etc.

**Preliminary conclusions**

The state, although has reduced its own power in the sector during the last 15 years, still maintains an important role. For instance, just a few months ago it intervened in the sale of a financial group to a Spanish group. Its influence is also important as it still has a controlling interest in the country's most important financial group. This state-owned financial group also intervened helping the process of selling one of the banks to a Portuguese group, as part of the agreement reached with the Spanish group. The sale of that bank was very important – the group that bought the bank became the biggest private bank in the country.

Thus the organisational field has, as Fligstein observes, become redefined over time and importantly, relations between banks have become more competitive (particularly in the form of a battle for market share). Product lines have become more diversified and managers now concentrate on differentiating their products. Yet, as Fligstein (1990, p.302) argues, managers rarely know what is economically efficient.

‘They have a sense of controlling a market or markets share and to some degree they can control costs. But the driving force for managers, just as it is for any kind of social actor, is to preserve their organizations and further their individual and collective interests. To do so they must define their situations, including what constitutes a market. In that process, they construct a conception of control that includes strategies and structures and helps to define their organizational fields’.

In that respect, change processes are shaped by a combination of random, systematic and inertial forces (Burns and Scapens, 2000).

‘Much research remains to be done concerning how a firm should integrate corporate strategy, cost driver analysis, and life cycle costing into its cost/management accounting system’ (Ferrara, 1990, p.52). My study to date tends to confirm the validity of this statement. Arguably there has been a tendency to offer quick solutions to problems that have not been fully analysed and understood. Arguably, when one looks at the complex nature of change in an organisation such as Banco Alpha, the evolutionary four-stage model presented by Kaplan and Cooper (1998) can be seen as too schematic, and insufficiently contextually aware. Arguably it is a crystallisation of earlier one-off technical innovations, focused on the term ‘activity’, which are now presented as an integrated solution to large-scale management problems. It is not clear, as yet, that this whole is greater than the sum of its parts.

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