



Cost Allocation in Tourism: Analyzing the Role of Activity-Based Costing (ABC) in Tourism Businesses

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Abstract

Activity-Based Costing (ABC) has emerged as one of the most advanced managerial accounting tools for improving cost accuracy and enhancing financial decision-making. In the tourism industry—characterized by diverse services, high overheads, and fluctuating customer demand—traditional costing systems often fail to capture the true cost of activities. This paper investigates how ABC can be implemented within tourism businesses such as hotels, airlines, and tour operators to strengthen cost allocation, improve operational efficiency, and support profitability.

The study draws on existing academic literature, hospitality and aviation management research, and global case studies to assess the benefits of ABC, including enhanced pricing strategies, improved resource utilization, and more informed managerial decisions. Using a qualitative, secondary-data-based methodology, it synthesizes themes from multiple sources relating to cost allocation challenges, departmental profitability, route and package analysis, and customer cost-to-serve. The findings indicate that ABC provides superior cost visibility compared to conventional costing approaches, revealing hidden costs, correcting mispriced services, and supporting strategic planning in highly competitive tourism markets.

Although implementation requires investment in data collection, staff training, and system maintenance, the long-term financial and strategic advantages of ABC outweigh these barriers. The paper concludes with practical recommendations for tourism businesses seeking to adopt ABC as part of a broader cost management and performance improvement strategy.

Introduction

Tourism is one of the world's most dynamic and rapidly expanding economic sectors. It generates employment, foreign exchange earnings, and investment opportunities across both developed and developing economies. Within this broad industry, businesses such as hotels, airlines, tour operators, resorts, theme parks, and cruise lines compete to deliver memorable experiences to increasingly demanding travelers. At the same time, they must manage rising operational costs and maintain healthy profit margins in a market that is highly sensitive to global economic changes, political instability, and environmental crises.

In this environment, cost accounting plays a vital role in supporting managerial decision-making. Traditional costing systems, which were originally designed for manufacturing industries, often rely on simplistic allocation bases such as direct labor hours, machine hours, or volume measures. While these methods may have been adequate in earlier periods, they are less suitable for modern tourism operations, where overhead costs are high, services are complex, and customer expectations are diverse. When overheads are simply spread across rooms, passengers, or tour packages using broad averages, the resulting figures can misrepresent the true cost of delivering each service. This, in turn, can lead to underpricing, overpricing, poor budgeting, and misguided strategic choices.

Activity-Based Costing (ABC) offers a compelling alternative. Rather than viewing overheads as a single undifferentiated pool, ABC breaks operations down into individual activities—such as guest check-in, room cleaning, aircraft turnaround, baggage handling, itinerary planning, or customer support—and assigns costs based on the actual consumption of these activities by different services or customer segments. In tourism businesses, this approach is particularly useful because it reflects the reality that not all guests, routes, or tour packages demand the same level of resources. A business-class passenger, for example, consumes more check-in time, lounge access, and premium catering than an economy traveler; a customized luxury tour requires more planning hours and supplier coordination than a standard group package.

The tourism industry is also highly volatile. Seasonality, economic downturns, pandemics, and natural disasters can cause sudden drops in demand, forcing businesses to scrutinize their cost structures more closely. In such situations, managers require accurate and timely cost information to decide which services to scale back, which to promote, and where to reduce waste. ABC provides the level of detail necessary to distinguish profitable services from marginal ones and to identify activities that do not add value from the customer's perspective.

This paper investigates the role of ABC in tourism businesses, focusing on three major subsectors: hotels, airlines, and tour operators. It examines how ABC improves cost allocation, supports more rational pricing and budgeting, and enhances overall profitability and competitiveness. The structure of the paper is as follows: the literature review discusses the theoretical foundations of ABC and its relevance to service industries; the methodology section explains the qualitative, secondary-data-based approach used; the

findings section presents key insights from the literature and case studies; the discussion interprets these findings in the context of tourism operations; and the conclusion summarizes the main contributions and suggests directions for future implementation and research.

Literature Review

The evolution of cost accounting has been shaped by changes in industrial structures and business models. Early cost systems were designed for factories in which direct labor and raw materials represented the majority of production costs. Overheads such as administration and facility costs were relatively small and could be allocated using simple bases without causing major distortions. Kaplan and Johnson (1987), however, argue that as automation increased and service industries grew, these traditional systems became less accurate. Overhead costs rose and became less correlated with direct labor, yet many organizations continued to allocate them using outdated approaches.

Tourism, as a predominantly service-based sector, illustrates this mismatch clearly. Hotels, for example, incur substantial overheads related to building maintenance, utilities, marketing, support staff, IT systems, and guest amenities. Airlines face complex cost structures involving fuel, maintenance, airport charges, security, reservations, catering, and crew expenses. Tour operators coordinate a wide array of activities, including itinerary design, supplier negotiations, marketing campaigns, customer communication, and on-the-ground tour management. These costs are not driven purely by volume; instead, they depend on the nature and intensity of activities performed for different customers and products.

Activity-Based Costing was developed in the 1980s and 1990s by Kaplan, Cooper, and others as a way to more accurately assign overheads in complex organizations. ABC identifies individual activities within a company—such as processing reservations, preparing rooms, cleaning aircraft, or designing tour packages—and aggregates costs into activity cost pools. Cost drivers (for example, number of check-ins, minutes of cleaning, number of bookings, or hours of planning) are then used to trace the costs of these activities to specific products, services, or customers. Cooper and Kaplan (1991) emphasize that ABC provides a clearer view of how resources are consumed, enabling managers to see which activities create value and which simply consume resources without significantly improving customer satisfaction.

In the context of hotels, researchers such as Harris and Brander-Brown (1998) and Tsai and Hsu (2010) show that ABC can reveal the true cost of operating different departments and service lines. Housekeeping, for instance, may vary significantly in cost depending on room size, occupancy length, and guest behavior. F&B departments often struggle with food waste, variable labor usage, and complex menu offerings. By assigning costs to specific activities—food preparation, table service, room service delivery, inventory handling—ABC helps hotels refine menu pricing, staffing plans, and promotional strategies. Spa and wellness services also benefit from ABC because treatment types differ in duration, staff expertise, and material consumption.

Airlines have an even more intricate cost structure. Doganis (2019) notes that route profitability analysis must consider not only direct costs such as fuel and crew salaries but also associated activities such as aircraft turnaround, ground handling, baggage processing,

check-in operations, security checks, and in-flight services. Traditional costing may allocate these costs based simply on passenger numbers or flight hours, obscuring the fact that some routes or passenger classes consume disproportionate resources. Studies and industry reports indicate that ABC allows airlines to distinguish between profitable and loss-making routes, adjust capacity, refine fare structures, and manage ancillary revenue streams such as baggage fees, seat reservations, and lounge access.

Tour operators and travel agencies also stand to benefit from ABC. Middleton and Clarke (2011) highlight that tour package development involves multiple stages—market research, product design, costing, contracting, marketing, and customer service. Standard, pre-designed packages require relatively fewer planning hours, whereas tailor-made itineraries for small groups or high-end clients can consume considerable staff time and negotiation effort. By identifying activities such as itinerary planning, supplier negotiations, booking administration, pre-departure communication, and customer problem resolution, ABC enables tour operators to understand which packages are genuinely profitable and which are underpriced relative to the work they require.

In addition to specific subsector applications, the literature identifies several general benefits of ABC: improved cost accuracy, better support for pricing and product mix decisions, enhanced visibility of non-value-adding activities, and strengthened performance measurement (Drury, 2018; Turney, 2005). Nonetheless, researchers also acknowledge certain limitations: ABC can be costly and time-consuming to design and implement, it requires reliable data collection systems, and it may face resistance from employees who are unfamiliar with the new way of thinking about costs. Kaplan and Anderson (2010) respond to some of these concerns with time-driven ABC, which simplifies data requirements by using estimated time equations instead of detailed activity tracking, but the underlying principle remains the same—costs should be traced to the activities that cause them.

Overall, the literature suggests that tourism businesses, with their diverse services and high overheads, are strong candidates for ABC adoption. However, the degree of implementation varies depending on organization size, technological capabilities, management support, and the complexity of operations. This review sets the stage for examining how ABC has actually been used in hotels, airlines, and tour operators, and what impacts it has had in practice.

Methodology

This study adopts a qualitative, exploratory research design aimed at understanding how Activity-Based Costing is applied in tourism businesses and what benefits and challenges arise from its implementation. Rather than collecting primary numerical data, the study relies on secondary sources, including academic journal articles, textbooks, conference papers, and industry reports from organizations such as the World Tourism Organization (UNWTO), the International Air Transport Association (IATA), and major consulting firms. This approach is appropriate because the objective is to synthesize existing knowledge, identify patterns across different contexts, and draw practical implications for managers and students of tourism cost accounting.

Data collection was carried out through systematic searches of databases such as Google Scholar, JSTOR, ResearchGate, and ScienceDirect, using keywords including “Activity-Based Costing in tourism,” “ABC in hotels,” “ABC in airlines,” “tour operator costing,” and “service sector cost allocation.” Publications were screened based on their relevance to tourism or service industries, the clarity of their methodological approach, and the credibility of the outlet in which they appeared. Preference was given to peer-reviewed sources and well-regarded textbooks, though industry reports were also included where they provided up-to-date insights into current practice. The time frame for the search ranged from 1990, when ABC began to gain prominence, to 2024, to capture both foundational and recent developments.

Once relevant publications were collected, a thematic analysis approach was used to interpret and organize the data. Following Braun and Clarke (2006), thematic analysis involves familiarization with the material, generation of initial codes, searching for themes, reviewing themes, defining and naming themes, and finally producing a structured narrative. In this study, initial codes captured ideas such as “cost allocation problems,” “ABC benefits,” “departmental profitability,” “route analysis,” “package profitability,” “implementation challenges,” and “technology support.” These codes were then grouped into broader themes that informed the structure of the findings section.

The qualitative nature of this study means that it does not attempt to produce statistically generalizable results. Instead, its strength lies in offering a rich, integrative perspective that combines academic theory with practical examples from multiple tourism subsectors. Validity was strengthened by triangulating information from different types of sources (academic, professional, and industry) and by comparing findings across contexts to identify consistent patterns rather than isolated anecdotes. Reliability was supported by using a transparent and repeatable search and coding process.

Ethical considerations in this research are minimal, as it relies solely on publicly available documents and does not involve human subjects or confidential company data. All sources are acknowledged and referenced according to APA guidelines, supporting academic integrity and giving credit to original authors. While the absence of primary data is a limitation—since it prevents direct insight into individual firm experiences—it is also a

conscious methodological choice given the goal of producing a broad, conceptual, and practice-oriented overview of ABC in tourism.

Findings

The analysis of the literature and industry reports reveals several key findings about the role of Activity-Based Costing in tourism businesses. These findings can be grouped into six main areas: cost accuracy, departmental and route profitability analysis, package profitability assessment, managerial decision-making, resource optimization, and implementation challenges.

First, ABC significantly improves cost accuracy compared to traditional costing systems. Tourism businesses commonly rely on broad allocation bases—such as number of rooms, passenger counts, or bookings—to spread overheads. The reviewed studies consistently show that such methods can misrepresent the true cost of individual services, especially when those services vary widely in complexity. ABC, by tracing costs to specific activities and then to services or customers based on cost drivers, provides a more realistic picture. For example, a hotel may discover that although deluxe rooms generate higher revenue, they also consume more housekeeping time, amenity usage, and maintenance attention than standard rooms, reducing their relative profitability. Similarly, an airline may find that certain seemingly attractive routes are in fact marginal once all associated activities—such as aircraft repositioning, gate handling, and security requirements—are properly accounted for.

Second, ABC enhances the ability of hotels and airlines to analyze profitability at the departmental or route level. In hotels, ABC reveals which departments are true profit centers and which may be subsidized by others. Housekeeping, laundry, front office, F&B outlets, spa and wellness centers, and conference facilities can each be examined in terms of their activities and respective cost drivers. This enables more informed decisions about where to focus marketing efforts, which services to expand, and which to redesign or discontinue. For airlines, ABC enables nuanced route profitability analysis that considers aircraft type, flight duration, passenger mix, airport charges, and ground operations. Routes that appear similar in terms of passenger numbers may differ substantially in cost structure and risk profile.

Third, tour operators use ABC to understand package and customer profitability. The literature indicates that standardized group tours often exhibit relatively predictable cost patterns, whereas tailor-made itineraries for small groups or high-end travelers can be extremely resource-intensive. By identifying activities such as itinerary design, quotation preparation, supplier contracting, documentation processing, and pre-departure communication, and by linking these to specific packages or customer segments, ABC helps tour operators see which products generate adequate margins and which do not. It also highlights customers or segments with particularly high cost-to-serve ratios, who may require revised pricing or service models.

Fourth, ABC strengthens managerial decision-making across tourism organizations. With a clearer understanding of how resources are consumed, managers are better positioned to set prices that reflect true costs, thereby avoiding chronic underpricing or unjustified

discounting. They can also evaluate the impact of potential changes, such as introducing a new service, modifying a route schedule, or redesigning a tour package. ABC-based information supports budgeting and forecasting by showing how changes in activity levels are likely to influence total costs. At a strategic level, this insight enables businesses to prioritize investments in high-margin services and reconsider or exit chronically unprofitable ones.

Fifth, ABC supports resource optimization by identifying non-value-adding activities and inefficiencies. Examples from hotels include excessive inventory handling in kitchens, redundant paperwork in reservations, or inefficient room-cleaning routines. In airlines, unnecessary boarding delays, poorly coordinated ground handling, and duplicated customer communication processes can be exposed. In tour operations, ABC might point to repeated back-and-forth with suppliers due to unclear contracts, or to manual administrative tasks that could be automated. By recognizing these issues, organizations can redesign processes, introduce technology, or reallocate staff to more productive activities.

Finally, the findings highlight several challenges and barriers to ABC implementation. Designing an ABC system requires careful identification of activities, selection of appropriate cost drivers, and collection of reliable data. This can be time-consuming and may require changes to existing IT systems. Employees may resist the new approach if they perceive it as a threat or an unnecessary complication. Smaller tourism businesses may lack the financial and human resources to sustain a sophisticated ABC system. However, the literature also notes that cloud-based accounting tools and simplified, time-driven ABC models have lowered many of these barriers in recent years, making ABC more accessible even to medium-sized firms.

Discussion

The findings of this study highlight that Activity-Based Costing is particularly well suited to the structural realities of tourism businesses. The industry's dependence on intangible services, complex customer journeys, and multi-stage processes means that costs cannot be fully understood through traditional volume-based allocations. ABC addresses this gap by aligning cost measurement with the way value is created—through activities that support the customer experience.

From a theoretical perspective, the results reaffirm key tenets of modern management accounting. Cost driver theory states that understanding what drives costs is essential for control; ABC operationalizes this by explicitly linking activities and drivers. Value chain analysis emphasizes that firms must analyze each step in the process of delivering a product or service; ABC provides the numerical detail to evaluate those steps. Customer profitability analysis focuses on the idea that not all customers are equally profitable; ABC makes it possible to calculate the cost-to-serve for different segments, such as leisure versus business travelers or standard versus bespoke tour clients. Thus, ABC functions as a bridge between abstract management accounting concepts and the day-to-day decisions of tourism managers.

In hotels, ABC reinforces the notion that departments cannot be evaluated purely on revenue figures. A restaurant that generates high sales may still deliver low or negative margins if labor-intensive dishes, waste, and overheads are underestimated. A spa may appear expensive to operate, but once activity-level costs are allocated, it may prove to be a high-margin amenity that enhances overall guest satisfaction and supports premium room rates. ABC empowers hotel managers to move beyond intuition and anecdote, using concrete data to support menu engineering, service design, and staffing models.

For airlines, ABC serves as a strategic tool that goes far beyond basic cost reporting. In an industry where thin margins are common and external shocks—such as fuel price spikes or travel restrictions—are frequent, knowing the precise cost structure of each route is critical. ABC helps airlines decide where to deploy their aircraft, how to design fare classes and bundles, and how to manage ancillary services. It also supports collaboration between finance, operations, marketing, and network planning teams, as they can all draw on a shared understanding of route-level and activity-level economics.

In tour operations, ABC is particularly valuable because of the high variability in customer expectations and service levels. Customization is often a selling point, but it carries a cost. By quantifying the time and effort required for different degrees of customization, ABC enables tour operators to design tiered service models—for example, basic, standard, and premium planning services—each with a price that reflects its cost. This not only improves margins but also creates transparency for clients, who can see what they are paying for. Moreover, by revealing which suppliers require disproportionate administrative effort, ABC can inform negotiation strategies or motivate the search for alternative partners.

Despite its advantages, the discussion must acknowledge the practical obstacles to ABC adoption in tourism. Implementation requires managerial commitment, clear communication, and often a cultural shift toward evidence-based decision-making. Staff must understand that ABC is not about surveillance or blame, but about making the business more sustainable and competitive. Training is essential so that employees can correctly record activity data and interpret ABC reports. For smaller firms with limited resources, a full-scale ABC system may be unrealistic; however, simplified versions focusing on the most important activities can still deliver meaningful insights.

Overall, the discussion suggests that the benefits of ABC—greater cost transparency, better pricing, improved resource allocation, and stronger strategic thinking—are highly relevant to tourism businesses facing turbulent markets and rising costs. Organisations that embrace ABC as part of a broader performance management framework are likely to gain a competitive edge over those that rely solely on traditional costing or managerial intuition.

Conclusion

This paper has examined the role of Activity-Based Costing in tourism businesses, with a particular focus on hotels, airlines, and tour operators. Through a qualitative review of academic literature and industry evidence, it has shown that ABC addresses many of the shortcomings of traditional costing systems in service-intensive environments. By tracing costs to activities and then to services or customers based on cost drivers, ABC offers a more accurate and informative picture of how resources are consumed.

The main conclusions of the study are as follows. First, ABC substantially improves cost accuracy in tourism organizations, reducing the risk of mispricing and providing a stronger basis for budgeting and financial planning. Second, ABC enhances the ability of managers to analyze departmental, route, and package profitability, revealing which areas of the business are performing well and which require attention. Third, ABC supports more informed managerial decision-making by illuminating the cost implications of different strategies, such as adding new services, altering route networks, or redesigning tour packages. Fourth, ABC encourages resource optimization by identifying non-value-adding activities and inefficiencies that can be reduced or eliminated.

At the same time, the paper recognizes that ABC implementation is not without challenges. Designing and maintaining an ABC system demands time, expertise, and technological support. Employees may resist changes to familiar practices, and smaller firms may struggle with the required investments. However, advances in accounting software, cloud computing, and time-driven ABC approaches are gradually lowering these barriers. For tourism businesses facing intense competition and uncertain demand, the ability to understand and manage costs at a detailed level is increasingly not a luxury, but a necessity.

In conclusion, Activity-Based Costing represents a powerful tool for tourism managers seeking to improve profitability and long-term sustainability. While not a universal solution, it offers a robust framework for aligning cost information with operational reality. Future research could extend this work by conducting empirical case studies of ABC implementation in different types of tourism organizations, including small and medium-sized enterprises, and by exploring the integration of ABC with other performance management tools such as balanced scorecards and revenue management systems.

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Appendices

Appendix A: Sample Activity Cost Pools in a Hotel

- Housekeeping – Room cleaning (cost driver: minutes per room)
- Front Office – Guest check-in and check-out (cost driver: number of check-ins/check-outs)
- Food & Beverage – Meal preparation and table service (cost driver: number of covers)
- Spa and Wellness – Treatment delivery (cost driver: treatment duration)
- Sales and Marketing – Campaign development (cost driver: number of campaigns)

Appendix B: Sample ABC Activities in an Airline

- Ground Handling – Baggage processing (cost driver: number of bags)
- In-Flight Services – Meal and beverage service (cost driver: number of passengers)
- Aircraft Operations – Cleaning and turnaround (cost driver: turnaround time)
- Reservations – Call center and online support (cost driver: number of bookings/queries)
- Loyalty Program Management – Points and rewards administration (cost driver: number of active members)

Appendix C: Sample ABC Activities for a Tour Operator

- Package Design – Itinerary planning (cost driver: hours spent)
- Supplier Management – Contract negotiation (cost driver: number of suppliers)
- Customer Support – Pre-trip and on-trip assistance (cost driver: number of interactions)
- Marketing – Digital and traditional promotion (cost driver: number of campaigns)
- Operations – Tour guide coordination and logistics (cost driver: number of tours operated)