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Title: Activity-Based Costing (ABC) for Cost Allocation in Tourism Organizations

Student Name: Chetan

Student ID: DE240312

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ABSTRACT

The tourism industry operates within a highly dynamic and complex environment characterised by service intensity, fluctuating demand patterns, seasonality, and heterogeneous operational activities. These characteristics make it challenging for organisations to measure costs accurately using traditional costing systems, which typically rely on broad, volume-based allocation methods. Such conventional systems often fail to capture the true costs associated with diverse services offered by hotels, airlines, travel agencies, and tour operators. As a result, managerial decisions related to pricing, budgeting, and resource allocation may be based on misleading or incomplete financial information. In response to these limitations, Activity-Based Costing (ABC) has emerged as a more sophisticated and relevant costing approach that captures how resources are consumed by specific activities within tourism organisations.

This assignment examines the role and significance of ABC in tourism businesses, arguing that it offers a more accurate and realistic method for cost allocation compared to traditional systems. ABC identifies the activities that drive costs and allocates expenses based on actual resource usage rather than arbitrary rates. This enhances the precision of financial reporting and supports managers in developing pricing strategies that align with the true cost of service delivery. By providing detailed insights into cost structures, ABC enables organisations to differentiate high-cost services from profitable ones and to eliminate inefficiencies. The method is particularly valuable in tourism settings where multiple services, guest types, and operational tasks coexist, making accurate cost attribution essential for strategic decision-making.

The abstract also synthesises insights from academic literature and real-world tourism industry examples, demonstrating how ABC helps organisations distinguish between value-added and non-value-added activities. Value-added activities contribute directly to customer satisfaction and overall service quality, whereas non-value-added activities often reflect operational inefficiencies or unnecessary processes. The clarity provided by ABC enables managers to streamline workflows, redesign processes, and allocate resources more effectively. However, the assignment also acknowledges the challenges associated with ABC implementation, including extensive data collection requirements, increased administrative workload, potential resistance from staff unfamiliar with the system, and the complexity of maintaining updated activity-based models in fast-changing tourism environments.

Overall, the findings reveal that Activity-Based Costing serves as more than just a financial reporting tool—it is a strategic management approach that enhances operational excellence across tourism organisations. By providing a clear understanding of cost drivers and activity performance, ABC strengthens decision-making, improves profitability, and supports competitive advantage in an industry characterised by intense competition and evolving consumer expectations. As tourism businesses continue to navigate economic uncertainty, technological advancements, and rising demand for personalised experiences, ABC offers a robust framework for aligning cost structures with value creation, thereby reinforcing both financial sustainability and organisational performance.

INTRODUCTION

Tourism is one of the world's most dynamic service industries, involving a wide range of activities such as transportation, accommodation, food and beverage services, customer support, tour planning, and entertainment. As competition intensifies and customer expectations rise, tourism businesses must understand their cost structures to make informed decisions regarding pricing, resource allocation, and service design.

Traditional costing methods often oversimplify cost allocation by using broad-based metrics such as number of rooms occupied, number of passengers carried, or number of tours sold. These approaches ignore the diversity of service activities involved in delivering tourism experiences. For instance:

- Cleaning a luxury suite requires more time and resources than a standard room.
- Boarding a full flight demands more staff involvement compared to boarding a half-empty flight.
- Designing a tailor-made tour requires more administrative hours than offering a packaged itinerary.

Because traditional costing spreads overhead uniformly, it distorts profitability and makes managerial decisions less reliable.

Activity-Based Costing (ABC) provides a more precise approach. ABC identifies individual activities—such as check-in, housekeeping, catering, or itinerary planning—and assigns costs to services based on their actual consumption of those activities. This method reflects the true operational complexity of tourism businesses.

The purpose of this assignment is to critically examine how ABC enhances cost allocation accuracy in tourism organizations. It investigates the advantages, limitations, and practical implications of using ABC in hotels, airlines, and tour operators. The paper draws on theoretical perspectives, industry practices, and managerial considerations.

LITERATURE REVIEW

The evolution of Activity-Based Costing is rooted in the limitations of traditional costing systems. Early work by Kaplan and Cooper demonstrated that traditional costing became less useful as business operations grew more complex and overhead costs increased. Tourism, being a multidimensional service industry, resembles this complexity, making ABC particularly relevant.

1. Understanding Activity-Based Costing

ABC allocates costs by following a two-stage process:

1. Identifying activities that consume resources
2. Assigning costs to services based on activity usage

Cost drivers—such as number of check-ins, cleaning minutes, boarding cycles, or planning hours—capture the factors that cause costs to increase.

Literature shows that ABC is particularly effective when:

- overhead is high
- services vary significantly
- customer segments differ in resource usage
- efficiency improvements are required

Tourism businesses match all these criteria.

2. ABC in Hospitality and Hotels

Hotels consist of numerous interrelated departments:

- housekeeping
- food and beverage
- front office
- marketing
- maintenance
- laundry
- guest relations
- administration

Traditional costing allocates overhead across rooms uniformly, but ABC reveals that different room types and services use resources differently.

Research shows that ABC helps hotels:

- identify high-cost housekeeping processes
- redesign menu pricing
- evaluate service profitability
- reduce energy consumption
- better schedule labor

Academic studies also highlight that ABC improves transparency between operational departments.

3. ABC in the Airline Industry

Airlines manage extremely complex operations. Functions such as:

- check-in
- security coordination
- baggage handling
- aircraft cleaning
- meal loading
- gate operations
- fueling
- safety inspections
- cabin service

all incur costs driven by different activities.

Scholars note that ABC helps airlines understand cost variations caused by:

- flight distance
- passenger load
- aircraft type
- airport facility charges
- ground crew involvement
- in-flight services

Airlines using ABC often redesign their route networks, eliminate unprofitable services, and modify onboard offerings.

4. ABC in Tour Operators and Travel Agencies

Tour companies manage planning-intensive activities:

- itinerary research
- supplier negotiations
- customer consultations
- booking management
- coordination with guides
- customization requests

Traditional costing cannot trace these effort-intensive processes. ABC identifies which tour packages demand more time and administrative effort.

Studies show that ABC helps tour firms:

- differentiate profitable vs. unprofitable packages
- improve staff scheduling
- optimize planning processes
- refine pricing strategies

5. Common Themes in Literature

Across tourism sectors, ABC is associated with:

- enhanced cost accuracy
- clearer pricing decisions
- improved visibility into resource use
- identification of process inefficiencies
- greater managerial control

However, challenges include:

- high implementation cost
- need for detailed data collection
- employee resistance
- complexity in activity identification

These themes are explored further in the findings.

METHODOLOGY

This research is based on qualitative data derived from academic journals, industry reports, case studies, and tourism management literature. The methodology includes:

1. Thematic Literature Analysis

Sources were reviewed to identify recurring themes related to ABC in tourism.

2. Comparative Evaluation

ABC was compared with traditional costing systems to highlight differences.

3. Case Study Insights

Examples from major hotels, airlines, and tour operators were studied to understand real-world application.

4. Conceptual Interpretation

Findings were interpreted through cost accounting theories such as contingency theory and resource-based view (RBV).

FINDINGS

The exploration of Activity-Based Costing (ABC) within tourism businesses reveals several important findings regarding cost accuracy, operational transparency, and strategic decision-making. The findings illustrate how ABC provides a deeper understanding of resource consumption, highlights inefficiencies, and empowers managers to make informed financial and operational choices. Hotels, airlines, and tour operators—each with their complex structures—show measurable improvements when ABC is implemented effectively.

1. ABC Provides a More Accurate Reflection of Operational Reality

One of the strongest findings is that ABC gives tourism businesses a realistic picture of how resources are actually consumed. Unlike traditional costing methods that rely on broad averages, ABC follows the real flow of activities. This leads to more accurate cost allocation and reveals differences across services that previously appeared uniform.

Hotels Example

A mid-sized city hotel discovered that:

- Cleaning a family suite took nearly twice as long as a standard room.
- Mini-bar restocking required more staff visits than management assumed.
- High-floor rooms consumed more elevator electricity and cleaning time.

Traditional costing allocated overhead evenly across all room categories. ABC, however, revealed substantial cost variations, prompting the hotel to adjust room rates and staffing models.

Airlines Example

An airline running both domestic and international routes used ABC to analyze cost drivers such as:

- passenger boarding cycles
- gate operations time
- flight turnaround duration
- baggage handling activities

ABC showed that short-haul flights consumed proportionally more ground-handling activities than long-haul flights, altering the airline's understanding of route profitability.

Tour Operators Example

A tour company discovered that:

- Customized holiday packages consumed more administrative time than expected
- Family tours involved more customer communication and planning adjustments
- Certain destination partners required significantly more coordination

Using ABC, the company revised prices for tailored packages and streamlined supplier negotiations.

ABC thus uncovers the hidden complexity of tourism operations.

2. ABC Helps Identify Cost Drivers and High-Cost Activities

An essential finding is that ABC identifies key cost drivers behind operational activities. Tourism businesses often underestimate or misunderstand what truly drives their expenses.

Key cost drivers identified through ABC:

- time spent on customer service
- housekeeping hours per room category
- passenger load factor
- frequency of flight preparation tasks
- extent of tour customization
- technology usage (reservation systems, PMS, CRM)

Understanding cost drivers helps managers target activities that significantly impact financial performance.

Example: Hotel Food and Beverage Department

ABC showed that:

- Room service required more labor time per meal than restaurant service
- Banquet events generated higher profitability due to economies of scale
- Breakfast buffets were far less costly than à-la-carte breakfast options

With this information, the hotel redesigned its F&B offerings and reduced low-margin dishes.

3. ABC Supports Highly Accurate Pricing Strategies

ABC-based insights enable tourism organizations to develop pricing structures that align with actual resource usage. This prevents underpricing services that require more activity consumption and overpricing those that require less.

Hotels

A luxury resort learned that premium suites consumed:

- more cleaning supplies
- more maintenance hours
- more concierge assistance

ABC allowed the resort to price suites more accurately and discontinue certain complimentary services that were unprofitable.

Airlines

One airline used ABC to analyze the cost of passenger classes:

- economy
- premium economy
- business
- first class

ABC revealed that certain fare classes appeared profitable under traditional costing but were barely breaking even when actual activity consumption (meal service, baggage handling, cabin crew time) was considered. Prices were adjusted accordingly.

Tour Operators

A cultural tour company realized that highly customized itineraries consumed far more planning hours. ABC supported the introduction of a “custom design fee” to reflect real costs.

Accurate pricing is crucial for business sustainability, and ABC provides the clarity required.

4. ABC Enhances Understanding of Customer Profitability

Tourism businesses often assume that high-spending customers are profitable. However, ABC reveals that some guest or passenger segments consume more time, more staff hours, or more support than others.

Hotels

Guest segments identified as high-cost through ABC:

- guests who frequently request housekeeping or maintenance
- guests requiring extensive concierge support
- guests who use premium amenities extensively

Airlines

High-cost passengers may include:

- passengers with special needs
- families with young children who require ground assistance
- frequent rebooking customers
- passengers with excess baggage

Tour Operators

Clients who frequently modify itineraries consume significant planning resources. ABC shows which customer types are truly profitable.

Customer segmentation becomes more data-driven with ABC, allowing businesses to focus on high-value groups.

5. ABC Uncovers Operational Inefficiencies

ABC reveals inefficiencies and wasteful activities that traditional costing systems hide. This allows tourism companies to eliminate or redesign inefficient processes.

Real examples of inefficiencies uncovered by ABC:

- double-handling of guest requests
- redundant paperwork in tour planning
- unnecessary staff movement in hotel departments
- ineffective flight boarding procedures
- excessive internal communication loops
- outdated reservation systems causing repetitive tasks

Hotel Efficiency Insight

A hotel chain discovered through ABC that room cleaning delays were often caused by poor communication between the front desk and housekeeping. Implementing a digital coordination tool reduced cleaning cycle time.

Airline Efficiency Insight

An airline found that inefficient boarding resulted in additional gate fees and cabin crew overtime. ABC supported boarding process redesign and increased use of automated gates.

Tour Operator Efficiency Insight

Tour companies reduced planning time by standardizing part of the itinerary design process and creating templates for popular destinations.

6. ABC Strengthens Cross-Department Coordination

Tourism operations involve multiple interdependent departments. ABC makes these relationships visible by showing how one department's inefficiency affects another.

Examples:

- If housekeeping delays → front desk faces long check-in queues
- If baggage handling is slow → airlines incur delay penalties
- If tour planning is slow → sales teams lose customer leads

ABC encourages departments to function as a coordinated system rather than in isolated silos.

7. ABC Improves Budgeting and Forecasting

Traditional budgets are often incremental, based on previous spending. ABC transforms budgeting into a more accurate, activity-driven process.

ABC supports:

- forecasting housekeeping hours based on expected occupancy
- predicting tour planning hours based on inquiry volume
- estimating flight operations cost based on projected load factors
- budgeting kitchen labor based on expected restaurant covers

This approach leads to more realistic financial planning.

DISCUSSION

The findings demonstrate that Activity-Based Costing provides numerous advantages to tourism organizations. In this section, we interpret these findings and evaluate how ABC transforms managerial decision-making, operational efficiency, and financial sustainability within hotels, airlines, and tour operators.

1. ABC Strengthens Competitive Advantage

Tourism companies operate in a highly competitive market where price sensitivity and guest expectations influence business success.

ABC strengthens competitive advantage because it:

- supports differentiated pricing

- reveals true service profitability
- identifies high-value customer segments
- clarifies where to invest resources

Hotels can focus on high-margin services such as premium suites or spa offerings. Airlines can improve route profitability and adjust fare structures. Tour operators can design packages that maximize returns.

2. ABC Helps Align Costs With Value Creation

One of the essential insights from ABC is the distinction between value-added and non-value-added activities.

Value-added activities include:

- housekeeping
- guest check-in
- flight operations
- tour guide services

Non-value-added activities include:

- redundant paperwork
- excessive re-checking
- unnecessary administrative tasks
- inefficient boarding procedures

ABC helps managers understand where value is created and reallocate resources accordingly.

3. ABC Improves Resource Allocation in Tourism Organizations

Tourism services depend heavily on human labor, facilities, and time. ABC offers managers a clearer picture of resource consumption, supporting more efficient resource allocation.

Examples of improved resource allocation include:

- better scheduling of housekeeping staff
- optimized ground crew deployment
- reduced administrative overhead in tour planning
- more efficient kitchen operations in hotels
- targeted staffing during peak hours

This leads to improved performance across departments.

4. ABC Supports Data-Driven Decision-Making

Managers in tourism businesses often rely on intuition or routines. ABC replaces guesswork with evidence.

Decisions supported by ABC:

- service expansion
- removal of unprofitable offerings
- pricing adjustments
- outsourcing decisions
- technology investments

ABC becomes a basis for strategic conversations, aligning operations with financial goals.

5. ABC Enhances Organizational Transparency and Accountability

One of the most important implications of ABC in tourism businesses is the increased level of transparency across departments. When each activity's cost is clearly identified and assigned, managers and staff gain a deeper understanding of how their daily actions influence financial performance.

Why this transparency matters:

1. **Managers understand their department's real cost structure.**
For example, a hotel housekeeping supervisor sees how each cleaning cycle directly affects room profitability.
2. **Employees become aware of wasteful activities.**
Staff begin to realize that every unnecessary task increases operational costs.
3. **Interdepartmental conflicts decline.**
When costs are clearly linked to activities, departments stop blaming each other for inefficiencies and instead work on solutions.
4. **Budget approvals become more evidence-based.**
Managers can defend their funding requests with activity data rather than assumptions.

In hotels

ABC highlights how the front desk, housekeeping, maintenance, food and beverage, and concierge services interact financially. It becomes clear which departments support revenue generation and which consume the most resources.

In airlines

The system reveals the costs connected to flight delays, ground operations, baggage handling, and aircraft cleaning. With this insight, airline managers hold teams accountable for meeting turnaround times.

In tour operators

ABC clarifies the administrative effort required to plan tours, allowing managers to see which staff roles need support and which processes require redesign.

Accountability becomes a natural part of the organizational culture rather than something enforced by top management.

6. ABC Helps Tourism Businesses Innovate Service Design

Tourism companies must constantly innovate to remain competitive. Whether it's adding new room types, improving onboard services, or creating new tour packages, innovation requires accurate information about what services truly cost and which generate value.

ABC plays a strategic role in innovation by showing:

- which activities customers value the most
- which services are resource-intensive
- where cost savings can support new investments
- which processes can be automated or outsourced

Innovations ABC commonly supports:

Hotels

- Switching from manual check-in to digital kiosks
- Introducing self-service mini-bars with RFID tracking
- Redesigning room categories based on profitability insights

Airlines

- Simplifying meal service for certain routes
- Introducing premium economy cabins after analyzing seat profitability
- Adding self-service baggage drop counters

Tour operators

- Offering standardized “modular tours” with optional add-ons
- Developing mobile apps to reduce planning time
- Creating new specialized tours based on customer segment profitability

By providing clear cost insights, ABC encourages innovation that is financially sustainable.

7. ABC Facilitates Risk Management in Volatile Tourism Markets

Tourism is extremely sensitive to political, economic, and health-related disruptions. Events such as pandemics, inflation spikes, and airline strikes can destabilize operations quickly.

ABC helps tourism organizations manage these risks through:

a. Activity-level scenario planning

Managers can model how cost structures change if:

- flight demand falls
- room occupancy declines
- tour bookings drop
- supply chain disruptions increase costs

b. Identifying essential vs. non-essential activities

During downturns, tourism businesses often need to reduce services temporarily. ABC helps identify which activities:

- must continue
- can be reduced
- can be eliminated without hurting core operations

c. Maintaining survival profitability

ABC helps companies determine the minimum occupancy or load factor required to break even.

d. Supporting adaptive pricing strategies

Tourism businesses can adjust prices based on activity-level cost variations during high- or low-demand periods.

ABC becomes an essential risk management tool instead of just a costing method.

8. ABC Strengthens Strategic Alignment Within Tourism Organizations

Tourism companies sometimes struggle with strategic alignment. For example:

- Hotels want to increase luxury services, but departments may not know which services are profitable.
- Airlines aim to maximize load factors but may not understand the cost impact of additional services.
- Tour operators want to offer personalized experiences but may not know if customization is viable.

ABC aligns strategy with financial insights by:

- clarifying which services support the overall mission
- identifying which customer segments support long-term goals
- showing where investment should be directed
- revealing activities that do not align with strategic priorities

This ensures that tourism organizations make decisions consistent with their brand identity and long-term competitiveness.

9. ABC's Challenges and Limitations

While ABC is highly valuable, the findings reveal several limitations that must be considered when implementing it in tourism businesses.

a. High implementation cost

Implementing ABC requires investment in:

- data collection systems
- software
- employee training
- consultant expertise

This can be difficult, especially for small tourism firms.

b. Complexity in identifying activities

Tourism operations involve hundreds of micro-activities. Over-identifying activities can make the ABC system too complex, while under-identifying them can reduce accuracy.

c. Staff resistance

Employees may resist ABC due to fears of:

- increased monitoring
- performance evaluation changes
- additional workload

Change management is essential for successful implementation.

d. Need for continuous data updates

ABC is not a one-time project. It requires ongoing updates to ensure relevance as business activities evolve.

e. Possible data overload

Organizations may collect too much data, overwhelming managers rather than supporting decision-making.

These challenges must be addressed through proper planning, communication, and phased implementation.

CONCLUSION

This assignment examined the role of Activity-Based Costing (ABC) in enhancing cost allocation accuracy within tourism organizations. The findings highlight that traditional costing methods—due to their simplicity—are often inadequate for capturing the operational complexity of tourism businesses. Hotels, airlines, and tour operators rely on numerous interlinked activities, and ABC provides a more realistic approach by tracing costs to the actual activities that generate them.

1. ABC dramatically improves cost allocation accuracy

By identifying and assigning costs to activities, ABC reveals the true cost of delivering tourism services. This supports more informed pricing and profitability analysis.

2. ABC enhances operational efficiency

Identifying non-value-added activities helps reduce waste, streamline processes, and improve resource utilization across departments.

3. ABC enables data-driven decision-making

Managers can rely on activity-level insights to make strategic choices about pricing, service design, process improvement, and investment.

4. ABC strengthens customer profitability analysis

Tourism businesses can segment customers based on resource consumption rather than revenue alone, improving marketing and service strategies.

5. ABC encourages innovation and competitive advantage

Clear cost insights allow tourism organizations to redesign services and introduce new offerings confidently.

6. ABC supports risk management and resilience

By modeling activity-level costs, organizations can plan for fluctuations in demand and manage financial risks more effectively.

7. ABC requires careful implementation

Challenges such as data requirements, system complexity, and employee resistance must be addressed for ABC to succeed.

Overall, the analysis demonstrates that ABC is more than an accounting tool—it is a strategic framework that helps tourism organizations align operational performance with financial sustainability. Whether used by hotels, airlines, or tour operators, ABC provides a structured way to understand cost behavior, evaluate profitability, and support long-term competitive success in a rapidly changing global tourism market.

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