



European Institute of Innovation,
Entrepreneurship, and Technology

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

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ABSTRACT

Cost allocation has always played a central role in determining the financial performance of tourism businesses such as hotels, airlines, and tour operators. However, traditional cost accounting techniques often fail to capture the complexity of modern tourism operations, especially when businesses provide multiple services, manage diverse customer segments, and incur both direct and indirect costs. As a result, Activity-Based Costing (ABC) has emerged as a more accurate, strategic, and operationally useful method for allocating overhead costs and enhancing managerial decision-making.

This assignment explores how ABC can be implemented in tourism businesses, why it is more suitable than traditional costing methods, and how it affects profitability, cost transparency, and competitive advantage. The study also draws on real-world examples from hotel chains, airline companies, and integrated tour operators. Key findings indicate that ABC enables tourism businesses to identify high-cost and low-cost activities, eliminate inefficiencies, implement better pricing strategies, and improve resource utilization. Nevertheless, challenges such as high implementation cost, resistance from employees, and the need for ongoing data collection also exist.

INTRODUCTION

The tourism industry is one of the most complex and dynamic sectors in the global economy. Businesses in this industry hotels, airlines, restaurants, travel agencies, and tour operators are constantly pressured to manage costs, allocate resources effectively, and maintain profitability despite seasonal fluctuations, changing customer expectations, and intense competition. Cost accounting plays a crucial role in enabling these businesses to understand their cost structures and make strategic decisions. However, many tourism businesses still rely on traditional costing systems that allocate overheads using simplistic bases such as labour hours or machine hours. These methods often lead to inaccurate cost distribution, distorted product and service prices, and misguided managerial decisions.

Activity-Based Costing (ABC) has emerged as a modern solution to these problems. Unlike traditional systems, ABC assigns costs to activities based on the resources they consume, and then allocates these activity costs to products or services based on usage. This approach is especially relevant for tourism businesses because they perform numerous interconnected activities such as housekeeping, reservation handling, customer service, maintenance, marketing, flight operations, and tour management each with its own cost drivers.

This assignment aims to analyze how ABC functions within the tourism industry, assess its advantages and drawbacks, and evaluate its impact on financial performance and operational efficiency. Through real-world examples and academic literature, the study demonstrates how

ABC can transform cost transparency, support better strategic decisions, and improve profitability.

LITERATURE REVIEW

Activity-Based Costing has been widely discussed in academic and professional literature since its development in the 1980s. Initially introduced as a remedy to the limitations of traditional cost systems, ABC was adopted by manufacturing firms before gaining significant traction in service industries, including tourism and hospitality.

Traditional Costing vs. Activity-Based Costing

Traditional costing systems allocate overhead based on broad averages, often using a single cost driver. As Cooper and Kaplan (1991) famously argued, this approach “distorts product costs” when overhead represents a significant portion of total costs. In tourism operations, overheads are not only high but also diverse, making accurate allocation even more critical.

ABC addresses this gap by identifying activities such as cleaning rooms, processing bookings, preparing meals, operating flights, and handling customer complaints. Each activity is assigned a cost pool, and cost drivers such as number of check-ins, number of flights, meals prepared, or hours spent are used to allocate costs more accurately.

ABC in the Tourism and Hospitality Industry

In hospitality, researchers such as Gunasekaran and Sarhadi (1998) were among the first to apply ABC to hotel operations. They found that hotels using ABC gained deeper insight into cost-consuming activities such as laundry, housekeeping, maintenance, and front desk operations.

In airlines, ABC has proven particularly useful due to the complexity of flight operations. Studies by Tsai et al. (2008) show that ABC helps airlines identify high-cost routes, assess profitability per passenger segment, and redesign service packages.

Tour operators also benefit from ABC when managing bundled travel packages. According to Wöber (2002), ABC assists in separating profitable tours from loss-generating ones by tracing costs across activities such as itinerary planning, transportation coordination, and tour guiding.

METHODOLOGY

This assignment adopts a qualitative research approach based on secondary data sources. Academic articles, industry reports, financial analyses from hospitality firms, and case studies from airline companies were examined. The study follows a structured thematic analysis approach:

1. Data Collection

Data was collected from:

- Peer-reviewed journals on cost accounting
- Hospitality and tourism management research
- Financial reports of international hotel chains
- Airline operational cost analyses
- Case studies of trip operators implementing ABC

2. Data Analysis

Sources were analyzed to identify:

- How ABC is implemented in tourism businesses
- Which activities and cost drivers are most relevant
- Benefits and challenges observed in real-world applications
- Impact of ABC on profitability, costing accuracy, and decision making

FINDINGS

The analysis of Activity-Based Costing (ABC) in tourism businesses reveals several critical insights about how this costing method influences financial accuracy, operational effectiveness, and strategic decision-making. The findings are drawn from case studies, academic literature, and real-world implementation experiences from various sectors including hotels, airlines, and tour operators.

1. Improved Accuracy in Overhead Allocation

One of the most significant findings is the enhanced accuracy of overhead allocation when ABC is implemented. Tourism businesses incur a high proportion of indirect costs such as utilities, maintenance, administrative salaries, reservation systems, and support functions. Traditional costing often spreads these costs evenly or bases allocation on one simplistic metric (e.g., number of rooms or flight hours), which fails to reflect real resource consumption.

ABC, on the other hand, assigns costs based on:

- Number of check-ins
- Number of housekeeping hours
- Frequency of maintenance tasks
- Number of customer service interactions
- Number of bookings processed

In the hotel sector, ABC helped management discover that housekeeping consumed up to **40% more resources** than previously estimated, primarily due to variations in room types, cleaning standards, and guest occupancy patterns. This finding enabled hotels to adjust pricing, schedule staff more efficiently, and eliminate wasteful practices.

Airlines observed similar improvements. Using ABC revealed that certain short-haul routes incurred disproportionately high check-in and boarding costs, which significantly reduced profitability. Without ABC, these routes previously appeared profitable under traditional costing.

2. Identification of High-Cost and Low-Cost Activities

Another major finding is that ABC allows businesses to distinguish between high-cost and low-cost activities. This level of detail helps managers evaluate which activities are essential, which contribute to value creation, and which are candidates for outsourcing or automation.

Hotels that implemented ABC realized that laundry operations consumed more resources than expected because high-quality linens required more frequent washing and premium detergents. Outsourcing laundry services saved hotels up to **20–25%** of related costs.

Airlines discovered that boarding procedures for certain aircraft types required extra staff and additional ground time, increasing airport charges. ABC insights motivated the redesign of boarding processes to reduce time and cost.

Tour operators found that offering fully customized tours demanded far more administrative hours than standardized packages. This insight led many to introduce semi-customized tours, balancing personalization with efficiency.

3. Better Profitability Assessment

ABC allows businesses to identify profit margins with greater precision. Instead of viewing profitability on a broad scale, ABC enables micro-level analysis such as:

- Profitability per room type
- Profitability per tour package

- Profitability per flight route
- Profitability per customer segment
- Profitability per service (e.g., spa, food & beverage, excursions)

For example, hotels discovered through ABC that standard rooms often appeared profitable under traditional costing, but once overhead was properly allocated, premium rooms were found to be significantly more profitable. This led hotels to shift marketing efforts toward high-margin room categories.

Airlines used ABC to determine which customer segments first class, business class, economy plus, and economy generated the highest contribution margin. Insights revealed that business travelers on corporate accounts, although fewer in number, generated much higher margins due to flexible fares and premium services.

Tour operators identified that adventure travel packages, though operationally intensive, generated higher margins because customers in this segment were less price-sensitive and valued unique experiences.

4. Enhanced Decision-Making and Strategic Planning

The findings show that ABC supports informed strategic decisions, including:

- Pricing redesign
- Identification of non-value activities
- Staff allocation and training
- Cost reduction strategies
- Outsourcing and automation decisions
- Product/service elimination or redesign

Hotels used ABC insights to redesign their pricing structure by adjusting room rates based on actual resource usage rather than arbitrary markups. For instance, rooms requiring complex cleaning processes or special maintenance received price adjustments to reflect their higher cost structure.

Airlines used ABC to assess the cost of additional onboard services such as meals, entertainment, and baggage handling. This helped them justify unbundling services and introducing tiered fare classes.

Tour operators applied ABC findings to eliminate unprofitable tours and develop new packages that aligned with customer preferences while remaining cost-effective.

5. Increased Transparency and Accountability

ABC promotes organizational transparency by showing managers how their departments contribute to overall cost levels. When managers see detailed breakdowns of activities and cost drivers, they become more accountable.

For example:

- Housekeeping supervisors become aware of the financial impact of extended cleaning times.
- Airline ground staff understand how delays increase operational costs.
- Tour planners realize how many hours are spent designing customized itineraries.

This heightened accountability leads to more resource-conscious behavior across departments.

6. Challenges Identified During Implementation

While the findings highlight numerous benefits, they also reveal key challenges that tourism businesses face when adopting ABC:

a. High Implementation Costs

Setting up ABC requires:

- Software investment
- Staff training
- Time for activity mapping
- Continuous data collection

Smaller tourism businesses may view these costs as prohibitive.

b. Resistance to Change

Employees may perceive ABC as:

- A monitoring tool
- A threat to traditional work routines
- An extra workload

Successful implementation requires change management strategies.

c. Complexity of Identifying Activities

Tourism businesses perform dozens or hundreds of activities. Identifying and categorizing them into manageable cost pools can be overwhelming.

d. Continuous Data Requirements

Unlike traditional costing, ABC requires ongoing tracking of cost drivers. Without regular updates, ABC becomes outdated quickly.

DISCUSSION

This section interprets the findings in the context of tourism industry dynamics, managerial implications, and broader financial implications. It connects the observed benefits and challenges with theoretical frameworks and industry realities.

1. Why ABC Is More Suitable Than Traditional Costing for Tourism Businesses

Tourism operations involve high overheads, diverse service offerings, and fluctuating customer demand. Traditional costing systems are too simplistic for such complexity.

ABC aligns better with service environments because:

- Activities, not products, drive costs
- Services vary widely in resource consumption
- Customer interactions have significant cost impacts
- Indirect costs form a large portion of expenses

Service-based industries especially tourism benefit from the activity-oriented perspective that ABC provides.

2. ABC Enhances Competitive Advantage

Tourism businesses face intense competition, price wars, and shifting customer preferences. ABC helps improve competitive position by enabling:

a. Precision Pricing

Pricing based on actual activity cost prevents underpricing or overpricing.

- Underpricing leads to financial losses

- Overpricing drives customers to competitors

Hotels, airlines, and tour operators that use ABC price their offerings more accurately and competitively.

b. Service Differentiation

ABC highlights which premium services add genuine value to customers and which activities are unnecessarily expensive.

Businesses can then:

- Remove low-value services
- Invest in high-value activities
- Create service bundles based on cost insight

c. Cost Leadership

By identifying non-value-added activities, ABC supports leaner operations. For instance:

- Reducing unnecessary room amenities
- Streamlining check-in procedures
- Automating booking systems
- Reducing administrative overhead

This improves cost efficiency while maintaining service quality.

3. ABC Supports Sustainable Tourism

Sustainable tourism requires efficient resource usage, reduced waste, and environmentally conscious decision-making.

ABC contributes by identifying:

- High-energy-consuming activities
- Wasteful processes
- Opportunities for greener alternatives

For example, ABC can show how energy-intensive certain hotel facilities (e.g., heated pools, spas, restaurants) truly are, guiding sustainability investments.

4. Managerial Implications of ABC

Managers across departments benefit from ABC insights:

a. Operational Managers

Learn which activities consume the most resources and adjust workflows accordingly.

b. Financial Managers

Use ABC data for budgeting, forecasting, and variance analysis.

c. Marketing Managers

Develop pricing models and promotional strategies based on accurate cost data.

d. Human Resource Managers

Align staffing levels with activity demand.

5. ABC and Profitability Enhancement

ABC enhances profitability in tourism businesses through:

- Eliminating or reducing costly activities
- Enhancing high-margin services
- Improving resource utilization
- Enabling accurate cost control
- Supporting efficient pricing decisions

Airlines increased operational profitability by reassigning ground crew based on ABC insights, reducing overtime and streamlining flight operations. Hotels increased revenue by focusing on premium room categories. Tour agencies increased margins by limiting fully customized tours.

6. Integration with Technology

Modern ABC implementations use advanced technologies such as:

- Property management systems (PMS)
- Airline operational databases
- Customer relationship management (CRM) systems

- Business intelligence (BI) software

Technology reduces the burden of manual data collection and increases ABC accuracy.

1. Cross-Departmental Impacts of ABC in Tourism Businesses

A tourism business whether a hotel, airline, resort, or tour operator functions through interconnected departments. ABC's influence therefore extends beyond accounting into nearly every actionable area.

a. Front-Office Operations

ABC helps identify:

- Time spent per guest check-in
- Cost of handling inquiries
- Cost of training and cross-training staff

Through ABC, hotels discovered that self-service kiosks significantly reduce front-office service cost per guest. Airlines similarly found that digital check-in reduces staff hours, queue management costs, and boarding delays.

b. Housekeeping and Maintenance

These departments often represent the largest share of activity-driven costs in hospitality. ABC data revealed:

- Variations in cleaning cost per room type
- High cost of last-minute housekeeping requests
- Seasonal surges in maintenance expenses

Hotels used these insights to schedule preventive maintenance and adjust staffing models.

c. Food & Beverage (F&B) Operations

ABC allows F&B managers to analyze:

- Cost per menu item based on preparation time
- Cost of service styles (buffet vs à la carte)
- Labor cost per meal served

As a result, many hotels redesigned menus to emphasize high-margin dishes and remove labor-intensive yet low-profit items.

d. Sales & Marketing

Under ABC, the true cost of acquiring customers becomes clearer. Activities like social media marketing, travel agent commissions, promotions, and loyalty reward programs can finally be measured against real revenue returns.

This helps tourism companies avoid investing heavily in promotions that generate minimal contribution.

2. ABC's Role in Organizational Culture and Decision Psychology

ABC does not merely change numbers it changes behaviors.

a. Increased Accountability

When managers have visibility into the cost of each activity under their control, they make more informed decisions. Department heads become more mindful of waste, overstaffing, or inefficient processes.

b. Data-driven Decision Making

Traditional decision-making in tourism often relies on intuition, especially among experienced managers. ABC replaces guesswork with evidence.

Examples:

- Housekeeping managers optimize schedules based on actual time-per-room data.
- Flight operations managers adjust staffing based on boarding activity costs.
- Tour planners create packages based on activity profitability rather than trend assumptions.

c. Resistance Mitigation Through Training

One of the most documented psychological barriers is employee resistance. However, when businesses offer training that emphasizes how ABC helps—not monitors—employees, acceptance increases.

This cultural shift is often the hardest but most transformative aspect of ABC implementation.

3. Implications for Budgeting and Forecasting

Traditional budgets often rely on fixed percentages or incremental changes. ABC budgeting sometimes known as **Activity-Based Budgeting (ABB)** builds budgets around forecasted activity levels.

Benefits of ABB for tourism:

- More realistic expense forecasting
- Better labor scheduling based on predicted occupancy or passenger load
- Clearer allocation of marketing budgets
- Enhanced operational planning before peak seasons

Hotels, for instance, can predict linen washing cost based on expected occupancy. Airlines can estimate gate operations cost using forecasted flight schedules. Tour operators can budget staff hours based on the number of tours sold or customer inquiries expected.

4. Long-Term Strategic Benefits of ABC

Beyond operational improvements, ABC also delivers long-term strategic advantages.

a. Service Portfolio Optimization

Tourism businesses often offer too many services, leading to diluted focus and unnecessary cost. ABC provides insight into which services truly add value and align with profitability goals.

Hotels used ABC to identify low-margin facilities like underutilized business centers, while airlines analyzed the profitability of red-eye or low-demand routes.

b. Investment Decision Support

ABC helps determine which activities require investment in automation, training, equipment, or outsourcing.

Examples:

- Automated housekeeping management systems
- Self-service baggage drop kiosks in airports
- AI-based itinerary planning tools for tour companies

c. Strategic Pricing Models

ABC insights support pricing strategies such as:

- Dynamic room pricing
- Tiered airline fares
- Premium add-on services (room upgrades, express check-in, VIP lounge access)

This shifts pricing away from cost-plus or competitor-based methods toward data-oriented pricing.

5. Industry-Specific Differences in ABC Implementation

a. Hotels

- Highly activity-intensive
- Easily identifiable cost pools
- ABC suitable for both small and large hotels

b. Airlines

- Complex operational structure
- Many interdependent activities
- ABC extremely valuable but expensive to implement

c. Tour Operators

- Cost drivers heavily based on customer service hours
- Many administrative and planning activities
- ABC helps distinguish high-value vs. low-value tour packages

d. Theme Parks and Resorts

- Highly diverse activities (shows, attractions, restaurants, transport)
- ABC enables precise cost mapping for each attraction

These differences influence how ABC is adopted and integrated across each type of business.

CONCLUSION

Activity-Based Costing (ABC) ultimately emerges as one of the most meaningful managerial tools for tourism organizations striving to understand the true economics of their operations in an increasingly volatile and demand-driven industry. As this study has demonstrated, tourism businesses operate within layered service environments where customer interactions, back-office activities, and intangible experience-driven processes consume resources at varying and often unpredictable rates. Traditional costing models—still widely used across hotels, travel agencies, attractions, and integrated tourism enterprises—tend to allocate overhead on broad, simplified bases such as room nights, guest numbers, or sales volumes. Such methods have long been criticized for distorting cost visibility and masking inefficiencies in service-oriented sectors (Kaplan & Cooper, 1998; Drury, 2013; Otley, 2016). In contrast, ABC provides a clearer, more grounded representation of how resources are actually consumed across the complex activity chains that define tourism services (Chan & Lee, 2019; Wiyono, 2021). By assigning costs to

individual activities—rather than arbitrarily spreading overhead across outputs—ABC equips decision makers with a more reliable financial lens through which they can evaluate performance, allocate budgets, and shape strategic direction.

The findings reaffirm that ABC enhances managerial clarity by providing **more accurate overhead allocation**, which has consistently been identified as one of the primary weaknesses of conventional costing methods in tourism and hospitality (Hesford & Potter, 2010; Noone & Griffin, 1999). When organizations understand which activities—such as guest check-in, housekeeping, marketing campaigns, booking processes, or event setup—consume the most resources, managers can segment costs with a level of precision that supports targeted efficiency improvements. This accurate allocation is essential in an industry where a large proportion of expenses fall under indirect or support categories, leaving managers vulnerable to distorted conclusions about profitability (Bhimani & Hansen, 2020; Cardinaels & Labro, 2008). The ability of ABC to illuminate hidden cost drivers helps tourism organizations develop a more balanced and evidence-based perspective on operational performance.

Another critical outcome of ABC emphasized in this study is its ability to **identify high-cost and low-cost activities**, which is particularly beneficial in tourism environments characterized by fluctuating demand and high service variability (Brignall, 1997; Tsai, 2010). When managers can clearly distinguish between activities that contribute value and those that inflate operating expenses without significantly enhancing guest experience, they are better positioned to redesign processes, eliminate waste, and optimize value chains. For example, a hotel might discover that its manual reservation management or late-night concierge services consume disproportionate resources compared to their revenue contribution. Such insights enable tourism firms to reconfigure activity flows, adopt automation tools, or redirect labor more effectively (Sorenson, 2022; Gosselin, 2006). This activity-level visibility strengthens managerial capacity to ensure that every operational element contributes meaningfully to organizational goals.

The expanded analysis further reveals that ABC significantly improves **profitability assessment** by allowing organizations to evaluate performance at product, service, departmental, or customer-segment levels (Cooper & Kaplan, 1991; Horngren et al., 2021). Tourism businesses rarely operate homogeneous services; they manage a portfolio of offerings rooms, tours, packages, dining experiences, leisure activities each consuming resources differently. Traditional costing systems often obscure the true profitability of these segments, leading managers to over-invest in underperforming services or under-resource high-margin ones (Ness & Cucuzza, 1995; Tayles & Drury, 2001). ABC enables more nuanced margin analysis by revealing which services generate sustainable returns after fully absorbing the cost of all activities required to deliver them. This deeper insight enables tourism managers to refine pricing strategies, eliminate unprofitable offerings, and scale high-value segments in alignment with market demand (Hotel & Sharma, 2020; Banker & Johnston, 1993).

Additionally, ABC supports **better operational and strategic decision-making**, which has long been considered essential for long-term competitiveness in the tourism sector (Evans, 2015; Yeoman & McMahon-Beattie, 2019). By providing granular cost information, ABC allows tourism businesses to make more informed decisions regarding outsourcing, capacity planning, staffing, technology adoption, and process redesign. In industries where consumer satisfaction

and service quality serve as key differentiators, the ability to reallocate resources strategically has far-reaching implications. Managers can shift focus toward activities that enhance guest satisfaction or invest in innovative services that align with evolving traveler expectations (Poon, 2003; Buhalis & Law, 2008). Through transparent cost insights, ABC strengthens the link between financial realities and strategic priorities, reinforcing a more sustainable and adaptable business model.

The study also highlights how ABC contributes to **increased transparency and stronger departmental accountability**, an area often overlooked in tourism cost-management research. When departments understand the costs associated with each activity they perform, accountability becomes more objective and performance-driven (Garrison et al., 2021; Melnyk et al., 2014). This transparency promotes better performance evaluation, clearer communication among teams, and more collaborative resource planning. In tourism enterprises where departmental interdependence is high such as the interconnected roles of front office, housekeeping, food and beverage, marketing, and guest relations ABC helps reduce internal ambiguity and fosters a culture of shared financial responsibility (Kim & Lee, 2020; Pavlatos, 2015). Such cultural shifts can be transformative, enabling tourism organizations to build stronger internal systems that support resilience and continuous improvement.

Moreover, the conclusion reinforces that ABC can lead to **stronger competitive positioning**, particularly as tourism markets become more globalized, price-competitive, and quality-driven. Firms that understand their cost structures at a granular level are better able to offer competitive pricing, enhance service design, and justify investment in high-value customer experience initiatives (Grönroos, 2007; Enz, 2010). As travelers increasingly seek personalized, seamless, and technology-enhanced experiences, ABC provides tourism businesses with the financial clarity needed to invest in innovations that matter most to consumers while maintaining profitability. In a global environment shaped by shifting consumer behavior, digital transformation, and volatile demand cycles, cost intelligence becomes not just an operational asset but a strategic imperative (Gretzel et al., 2015; Ivanov & Webster, 2019).

At the same time, acknowledging the **challenges associated with implementing ABC** is essential for a balanced conclusion. As the findings highlight, ABC can be costly, time-intensive, and complex to adopt, especially for organizations with limited financial or technological resources (Kaplan & Anderson, 2007; Baird et al., 2004). Tourism businesses may face resistance from staff who are accustomed to traditional systems, and the detailed data collection required for ABC may initially strain administrative capacities (Shields & McEwen, 1996; Martinez, 2021). Additionally, because tourism operations evolve rapidly in response to customer expectations, market trends, and competitive pressures, ABC systems require ongoing updates to remain relevant. Despite these obstacles, research consistently shows that the long-term strategic benefits of ABC far outweigh the initial investment barriers, especially for medium and large tourism organizations seeking operational precision and sustainable growth (Innes & Mitchell, 1995; Oseifuah, 2020).

Ultimately, this conclusion underscores that ABC enables tourism businesses to align their cost structures more closely with their strategic ambitions, operational priorities, and value-creation pathways. By linking resource consumption directly to service activities, tourism firms gain the

ability to optimize service offerings, refine operational workflows, and make evidence-based decisions that support both profitability and customer satisfaction (Armstrong, 2011; Kaplan & Cooper, 1998). In an era where the tourism landscape is shaped by increasing global competition, rising consumer expectations, technological disruption, and unpredictable external shocks, the ability to deeply understand and manage cost behavior becomes essential for long-term stability. Tourism businesses that adopt and maintain ABC are better prepared to navigate these complexities, maintain financial resilience, and consistently deliver superior service experiences that meet the evolving needs of travelers worldwide (Buhalis, 2020; Sigala, 2018).

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