

## Contextual Factors Influencing the Implementation of Activity Based Costing In Iraqi Banking Sector: A Research Framework

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**ABSTRACT:** Activity-Based Costing (ABC) has been widely identified as a sophisticated cost management technique that is used to manage and reduce cost and improve organizational performance. As such, many organizations from different industries, including the banking industry have focused their attentions towards the implementation of ABC due to the ability of ABC to provide accurate costing information and enhance organizational performance. Also, a sizable number of contingency-based studies have examined the impact of certain contingency factors also known as contextual factors on the process and success of ABC implementation. Although, most of these previous studies have focused on the manufacturing industry little studies have paid attention to the effect of contextual factors in the implementation of ABC in the service sectors, such as banking institutions. Meanwhile, ABC is a costing system that is more pertinent to the service sector and particularly the banking industry. To this end, this paper reviews previous studies on the role of contingency factors such as: organizational culture, information technology, organizational structure, and competition on the implementation of ABC. Subsequently, a conceptual framework is proposed and future researchers are recommended to validate the hypotheses proposed in this research empirically.

**KEYWORDS:** Organizational culture, Information Technology, Organizational Structure, Competition, ABC Implementation

### 1. INTRODUCTION

Activity-Based Costing (ABC) has been widely identified as a sophisticated cost management technique that is used to manage and reduce cost as well as improving organizational performance (Cravens & Guilding 2001; Soljakova, 2012; Kumar & Mahto, 2013). ABC is more than just a sophisticated cost management technique, rather, it is also a strategic tool that helps in business survival, competitiveness and ultimately, influence organizational performance (Abdul Majid & Sulaiman, 2008 and Yi & Ruhana, 2010). ABC is explained by a large number of authors (for example, Careny & Sales, 2008; Alsaïdi & Gowda, 2014; Fei & Isa, 2010; Kongchan, 2013) as a strategic tool that ensures accurate product costs as compared to traditional costing system. As such, many organizations from different industries, including the banking industry have focused their attentions towards the implementation of ABC due to the ability of ABC to provide accurate costing

information and enhance organizational performance. In this regard, a sizable number of contingency theorists have studied the impact of certain contingency factors also known as contextual factors on the process and success of ABC implementation (for example, Anderson, 1995; Askarany, Smith, & Yazdifar, 2007; Gosselin, 1997). Although, most of these previous studies focus on the manufacturing industry little studies have paid attention to the implication of adopting ABC in the service sectors, such as banking institutions (Wetherite & Kim, 2006; Hao, 2009). Consistently, Hussain & Gunmasekaran, (2001) reviewed that ABC is a costing system that is more pertinent to the service sector such as the banking industry. Previous researchers such as: Alsaïd & Gowda (2014), Baird, Harrison and Reeve, (2007), Kongchan (2013) and Fei & Isa (2010) unanimously recommended that future studies should consider the importance of empirically examining the effect of contingency factors such as: organizational culture, information

technology, organizational structure, and competition on the implementation of ABC, being an important innovation with regards to costing strategy. Subsequently, this paper seeks to review the importance of the aforementioned contextual factors on the implementation of ABC in the Iraqi banking sector.

## 2. LITERATURE REVIEW

### 2.1 *Iraqi Banking Environment*

The banking industry generally, pay an important role in economic development of every country (Tan & Floros, 2012). Similarly, the Iraqi banking industry has a significant impact on Iraq's economic stability and development. Meanwhile, sequel to the military invasion of Iraq in 2003, the economy of Iraq suffers an obvious downfall which caused viral closedown of banks in many regions in the country. The banking industry in Iraq continued to be unstable until 2009 when most of the banks resume operations. In other words, the entire banking industry in Iraq is currently facing a myriad of challenges which have resulted into an obvious decline in bank performance. The Central Bank of Iraq (CBI) admitted to the detriments of military invasions of Iraq and is arguably committed to revamping the overall banking system, establishing safe, sound, competitive and accessible banking environment and lastly, to improve performance banking services (CBI, 2014).

Considering the importance of the Iraqi banking sector on the Iraqi economy. The government of Iraq represented by the Finance Committee from Iraq Council of Representatives (FCICR) is committed to improving bank performance. In other words, FCICR is concerned with the mitigating hindering factors of improving the performance of the Iraqi banking industry. Therefore, there is an important need for theoretical propositions with the contemplated attention on improving Iraq banking performance and productivity.

The banking sector in Iraq is currently the most important sector of the financial system. Meanwhile 75 percent of assets and ownership of the sector is from the government ownership (Nasr, 2013). Out of the whole 36 banks in Iraq, seven are owned by foreign operations, eight of them are Islamic banks. Rafidain Bank, Trade Bank of Iraq (TBI), and Rasheed Bank are the three state owned banks that dominated the banking sector with 91.3% of assets (Byblos Bank, 2013). The Central Bank of Iraq is the mother bank of the entire banking sector in Iraq. The CBI is accorded the exclusive responsibility to license, regulate and supervise all the 36 operating banks in the Iraqi banking sector. The CBI is an important factor in the banking sector of Iraq as it's in charge of enforcing guidelines and directives to all banks (USAID|IRAQ, 2007). According to a white paper reported published by Sanser Capital (2013),

the Iraqi banking sector has been under an efficient control with a feasible hope of making significant earnings and reaching impressive assets growth. It is revealed that the Iraqi banking environment is witnessing an increase in credit penetration and continuous improvement of security situation. As a result of this, it has been forecasted that Iraq GDP will grow with 151% between the years 2011 to the year 2020. Needless to say that improving the performance efficacy in the Iraqi banking sector has a direct impact on the banking environment and by extension also have a significant impact on the economic stability and the development of the state of Iraq.

In a study published by the World Bank, it is reported that, although the banking sector is steadfast and improving but administrative and technical challenges are hindrance to the development of the sector (Nasr, 2012). The report added that the uncertain security situation and the chaotic political milieu in the country have drawn the banking sector aback. It is reported that the government is currently prioritizing on the modernization of the banking sector in Iraq as a tactical means of rescuing the economic downfall in the country. Overall, it is indicated that performance of banks in Iraq is relatively improving and considering their current impressive profitability (2012).

In summary, the Iraqi banking sector have certain strengths which include; under-banked population, high levels of foreign exchange reserves, high GDP growth over medium-term, large financing dependency from several other sectors with high growth potential. Meanwhile, the banking sector of Iraq is not without certain weaknesses which includes underdeveloped banking sector, the dominance of state-owned banks, weak financial infrastructure, still weak supervision, slow pace of reforms and challenging operating environment. Like some other developing countries, the level of ABC adoption in Iraq is yet unknown (Fadzil & Rababah, 2012). Although few study studies have reported that, ABC is currently initiated across industries in Iraq. Other studies on ABC evolving from Iraq affirmed that, ABC is used as a tool for planning, control and decision making in service management. In addition, the government of Iraq and the Central Bank of Iraq have also issued strong recommendations to Iraqi banks to consider initiating ABC due to its influence of reduction cost (CBI, 2014). The concern over improving the current performance of banks in the Iraqi banking sector is domineering. Therefore, it is imperative for researchers to consider examining the importance of ABC implementation in improving the performance of Iraqi banks.

### 2.2 *Contingency Theory*

Contingency theory is a behavioral theory that proffers the multidimensionality of organization

and leadership (Fiedler, 1964). Hence, contingency theory is a relevant theory in the realm of management accounting that help in explaining the impact of contextual variable on management accounting practices (Banker & Mashruwala, 2007; Lee & Yang, 2011). These contextual factors are in another words known as contingency factors (Otley, 1980).

ABC was introduced at the end of 1980s as a new costing technique that provided more accurate cost information than traditional costing systems. The introduction of ABC led to changes in costing systems in international organizations and since 1990 Contingency Theory has been used to study the factors influencing its implementation (Kongchan, 2013). Predicated on this construct, current management accounting practices have changed to meet conditions faced by firms (Donaldson, 2006). The changes to practice have been shaped by contextual and organizational factors and are described as contingency factors (Chenhall & Morris, 1986). Therefore, researchers use this theoretical framework to explain the reasons for and effects of contingency factors on management accounting practices (Abdel-Kader & Luther, 2008; Otley, 1980). Previous studies have found that contingency-based factors such as information technology (Askarany et al., 2007), organizational structure (Kallunki & Silvola, 2008; Liu & Pan, 2007), organizational culture (Baird et al., 2004; Fei & Isa, 2010) and competition (Abusalama, 2008; Drury, 2000) affect the implementation of ABC in organizations from different sectors.

### 2.3 Gaps from Previous Research

Studies have reported that contingency factors such as organizational culture, competition, IT, and organizational structure play significant role in explaining the organizational performance of banks (Islam & Hu, 2012; Vidovic, 2010). For instance, Deshpande & Farley (2004) found a significant impact of organizational culture on the performance and sustainable competitive advantage processes. In the same vein, Baird et al. (2007), revealed that organizational culture have a significant impact on the success of ABC implementation. Zhang et al, (2010) lamented that, little studies have paid attention to examining the impact of contingency factors on the success of ABC implementation. In addition, Zhang and Isa (2009) reviewed previous research on factors affecting ABC success and they found that only one empirical study by Baird et al. (2007) examined the relationship between ABC success implementation and organizational culture. In addition, only one research by Gosselin (1997) investigated the association between ABC implementation and organizational structure. Zhang and Isa (2009) also called for more empirical efforts in determining the role of contingency

factors on ABC implementation, especially from developing countries such Iraq.

Apparently, only a few studies have exerted their empirical attention to understanding factors that revolve around the implementation of ABC (Fei & Isa, 2010; Liu & Pan, 2007; Majid & Sulaiman, 2008). AL-Rababh, (2012) and Rababah, (2013) reiterated that lesser amount of these efforts originated from the Arab world and Iraq in particular. Hence, it is imperative to examine the effects of contingency factors on ABC implementation from Iraq.

Extant literature is conceptually replete on the importance of ABC (Alsaïdi & Gowda, 2014; Banker, Bardhan & Chen, 2008). Meanwhile, studies on the implementation of ABC in the manufacturing sector has been exhaustive, little studies have focused on the effect of ABC implementation from the service sector (Ajibolade, 2013; Kongchan, 2013; Rbab'h, 2013; Fei & Isa, 2010).

In the contingency-based paradigm, it is widely believed that different strategies from different organization yield different effects and outcomes. According to Siti Zaleha, et al., (2013), technology, organizational structure and environment are the determining factors of the design and functionality of accounting design on organizational performance. Meanwhile, Yi Fei and Isa, (2010) also found that organizational structures and organizational culture significantly affects the success of implementing ABC in organization. Therefore, it is imperative to understand the interconnection between contingency factors such as organizational culture, information technology, organizational structure, and competition and the implementation of ABC.

## 3.CONTEXTUAL FACTORS (ORGANIZATIONAL CULTURE, INFORMATION TECHNOLOGY, ORGANIZATIONAL STRUCTURE AND COMPETITION) AND ABC IMPLEMENTATION

### 3.1 *Relationship between organizational culture and ABC*

Several studies have indicated the significant influence of organizational culture on the implementation of ABC (Macarthur, 2006; Henri, 2006; Abusalama, 2008). The study of Macarthur (2006) examined the impact of organizational culture on the influence of national culture and the management accounting practices to provide explanation on the differences between the U.S and the German organizational practices of management accounting. The study revealed that organizational culture play a significant role on the implementation of management accounting practices. The effect of organizational culture on the design and use of management accounting techniques such as ABC was examined by Henri (2006). It was argued that culture is an ever present

factor affecting virtually all organizational interactions. Hence, it is necessary to understand his contingent factor from a holistic point of view. The result shows that the concept of organizational culture has been crucial on organizational behavior.

In the same vein, Abusalama (2008) reported that organizational culture play a significant determining factor on the implementation of Accounting Based-Costing system. The result of Abusalama (2008) is consistent with the findings of Fei and Isa (2010) on the relationship between organization culture and ABC implementation success. The study reported that organization culture, precisely outcome orientation and attention to details are the most significant dimensions of organization culture that have strong predictive impact on the success of ABC implementation among China's manufacturing companies. Similarly, using a survey methodology with questionnaire and structured interview for data collection, Charaf & Bescos (2013) found that organizational and cultural factors affect the implementation of ABC among Moroccan firms. The study of Erserim (2012) considered organizational culture as one of the predictive factor to the implementation of management accounting practices such ABC in organizations.

### *3.2 Relationship between Information Technology and ABC*

Information and communication technologies are highly embraced and invested in the financial sector because of its nature of high information intensity (Zhu, et al., 2004). In order to remain competitive in the market, technology is required to keep the services and operations of the financial sector going (Shanmugam and Guru, 2003). Information technology is basically used in the financial sector in executing and recording of the transactions between the company and their customers, whether the transaction is operated in person or with the technology such as ATM or online transaction (Zhu et al., 2004). Hence, there are implications of the technology used by companies on the information required by the Management Accounting system such as the ABC of the company (Siti Zaleha, et al., 2013). Thus, large amount of information planning and future orientation trend of information of a firm is needed to cope with the rapid changes in the technological use of a company (Nanni et al., 1992). One of the studies that have examined the role of information technology on the adoption of ABC among financial banks is the study of James (2013). The study conducted in Jamaica revealed that information technology such as availability of supporting software is an important factor in determining the success and the implementation of ABC in banks. Also the study conducted by Ajibolade (2013) revealed that the more the complexity of technologies such as the higher level of mechanization and automation have a significant

impact on the adoption of sophisticated management account system, hence ABC.

### *3.3 Relationship between organizational structure and ABC*

The capacity to receive and execute a development can be influenced by organizational structure (Damanpour, 1991) because it is a critical determinant in the dispersion of managerial role and process (Gosselin, 1997). Organizational structure can be classified into mechanistic structure and natural structure (Burns and Stalker, 1961). Mechanistic has more elevated amounts of centralization than that of natural structure, and mechanistic associations dependably formalize its guidelines, policies and makers, while natural associations favors casual control frameworks (Gosselin, 1997). Gosselin (1997) suggests that ABC is less demanding to embrace in organization with mechanistic attributes, on the grounds that in mechanistic associations, once beat management settles on choices to commit them to another framework, they would contribute and utilize every one of the assets on that new framework to ensure fruitful execution of the new framework and oversee the procedure of usage (Gosselin, 1997).

Execution of any advancement in an organization can be isolated into two separate procedures. The principal stage is start stage, and the following level is execution (Zhang & Isa, 2010). Damanpour (1991) characterizes start stage as "comprising of all exercises relating to issue discernment, information gathering, state of mind development and assessment, and asset fulfillment prompting the choice to embrace. The usage stage comprises of all occasions and activities relating to changes in a development and an association, beginning use, and proceeded with utilization of the advancement when it turns into a standard element of the association" (Zhang & Isa, 2010). The dichotomous model proposes that with natural attributes, association can receive development effortlessly, and the execution phase of an advancement can be encouraged in mechanistic association (Gosselin, 1997). Gosselin (1997) likewise inferred that mechanistic associations more inclined to execute ABC effectively when they are either concentrated or formalized. In the same light, Fei & Isa (2010) found organization structure has a significant factor on the success implementation of ABC in organization. Also, Erserim, (2012) considered both formalization and centralization part of the important factors that affect the adoption of management accounting practices such as ABC in an organization.

### *3.4 Relationship between Competition and ABC*

Drury (2000) contends that competitive strategy depicts how an organization chooses to contend in its business sector and tries to accomplish a competitive advantage with respect to its rivals. Indeed, expanding rivalry has prompted two outcomes. From one viewpoint, it has

prompted the development of cartels, whereby organizations have casually collaborated to accomplish more noteworthy security in the commercial center. Then again, it has supported administration bookkeeping practices, for example, ABC and target costing, whereby organizations try to reference their execution to that of their rivals (Otley, 1980).

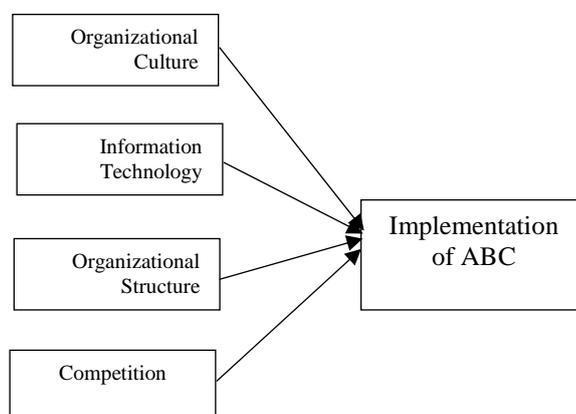
Sequel to the surge of competition in banking sector had provoked an increasingly greater importance to the planning and control of both financial and non-financial costs in the banking sector (James, 2013). In this regard, several studies have examined the relationship between the implementation of Activity Based Costing and the intensity of competition (Simons, 1990; Libby & Waterhouse, 1996). The results of these studies suggest that firms facing intense competition tend to employ relatively more sophisticated Activity Based Costing. Additionally, Cooper and Kaplan (1988) have identified that firms facing severe competition should implement ABC. It is argued that firms operating with more competition have a greater need for complex cost systems that increase the probability of assigning costs to products, services and customers more accurately (Ismail & Mahmood, 2012). In highly competitive industries, mistakes made from relying on inaccurate cost information are more likely to be exploited by competitors. Firms facing intensive competition have a greater impetus to pursue more actively their chosen cost strategy. Impliedly, competition is a significant factor in adopting ABC in an organization.

Even though Ismail and Mahmood (2012) in their study on the influence of organizational and environmental factors on cost system design in Egypt found that the intensity of the competition facing a country does not have any effect on the cost system of the companies. The study was conducted in the manufacturing sector in Egypt. The finding of Ismail and Mahmood (2012) was also supported by the Drury and Tayles (2005) and Pavlatos and Paggios (2009) who found that the intensity of competition is not a significant factor

in influencing the choice of cost systems. Apparently, there is inconsistency in the findings reported by previous studies on the impact of competition in adopting ABC. In other words, further attention is needed in the regard of establishing the role of competition on ABC implementation in organizations.

#### 4. PROPOSED RESEARCH FRAMEWORK

According to Sekaran (2003), the theoretical framework of a research form the basis upon which the research structure extends the boundary of knowledge. It is also the foundation on which the hypotheses of a research are developed (Sekaran & Bougie, 2010). Hence, it represents the relationships among the variables of the study. A framework is different from theory because a framework provides a description of phenomena relating to the study's variables in order to develop a theory (Miles & Huberman, 1994). A framework is either descriptive or prescriptive framework. In descriptive framework, the general attributes of variables are explored, while the process of implementing the concept in the variables within an organization is explored in a prescriptive framework. Subsequently, this study proposes a framework that explains the effects of contingency factors (organizational culture, information technology, organizational structure and competition) on the success of ABC implementation in the banking industry in Iraq. The study conceptualizes contingency factors (organizational culture, information technology, organizational structure and competition) as the independent variables and the implementation of ABC is regarded as the dependent variable. The relationship between the contingency factors and ABC implementation signifies the importance of those factors on the successful implementation of ABC in the banking sector of Iraq. In the other words, banks in Iraq should pay serious attention to the contextual factors reviewed in this research to allow them enjoy a successful implementation of ABC in their banks. The proposed framework is presented below.



*Figure 1: Theoretical framework of the Study*

## PROPOSED HYPOTHESES

*H<sub>1</sub>: There is a significant relationship between organizational culture and ABC implementation*

*H<sub>2</sub>: There is a significant relationship between information technology and ABC implementation*

*H<sub>3</sub>: There is a significant relationship between organizational structure and ABC implementation*

*H<sub>4</sub>: There is a significant relationship between competition and ABC implementation*

## 5. CONCLUSION

Subsequent to the drastic change influenced by globalization in the modern business environment, ABC was initiated and introduced as a more sophisticated costing system (Kumar & Mahto, 2013). ABC is a more or less a strategic and managerial technique imbued with principles of improving organizational performance (Plowman, 1998). Furthermore, researchers have

not paid much attention to contextual factors that determines the successful implementation of ABC especially from the Arab corporate world perspectives (Elhamma & Yi Fei, 2013). Like some other developing countries, the level of ABC adoption in Iraq is yet unknown ( Fadzil & Rababah, 2012). Although few study studies have reported that, ABC is currently initiated across industries in Iraq. Other studies on ABC evolving from Iraq affirmed that, ABC is used as a tool for planning, control and decision making in service management. In addition, the government of Iraq and the Central Bank of Iraq have also issued strong recommendations to Iraqi banks to consider initiating ABC due to its influence of reduction cost (CBI, 2014). Thus, this study recommends future researchers to pay serious attention to the role of the contingency factors reviewed in this study on ABC implementation in the Iraqi banking sector.

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