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Steinway & Sons: Activity Based Costing Candidate?



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"In a unique method used by Steinway for over a century, the inner and outer piano rims are bent into the shape of the rim as a single continuous piece. Before Theodore Steinway developed and patented this method in 1878, rims were made of separate pieces held together with joints. 18 hard-rock maple layers, each twenty-two feet long, are used to construct the rim of a concert grand piano. The layers are first coated with glue and stacked. The stacked layers are then glued into a single form of wood by bending on the rim-bending press, a giant piano-shaped vise. The rim-bending team centers the layers on the press and wrestles the wood into place with the aid of clamps." (Steinway and Sons)

Steinway and Sons are among the most prestigious builders of quality pianos in the world and can benefit greatly from Activity Based Costing (ABC) given that it would enable them to quantify cost drivers within each part of the factory process. Defining cost drivers will help to better understand the manufacturing process and spot potential bottlenecks, inefficiencies, and maximize craftsman productivity. Several dysfunctional decisions could be made using traditional cost allocation. That could lead to inefficiencies, inaccurate calculations of economies of scale, and misleading breakeven projections.

"A tone regulator listens intently to the piano's pitch and turns the tuning pins with a tuning hammer to adjust string tension. Once the piano has been regulated, it is ready for its final inspection." **(Steinway and Sons)**

Activity-based costing (ABC) is a methodology that facilitates allocating costs to products or services which otherwise would be classified as un-allocated overhead expenses. In so doing a company may identify smaller processes within larger ones known to be cost drivers. Based on their perceived resource utilization they may be attributed a percentage of the entire product development cost. There are limits to the ABC methodology. For example, a CEO's salary may be classified as a cost driver shared by elements within an entire product line.

"Activity-based costing is an accounting tool designed to break down in detail the costs of all of an organization's activities. The assumption is that such detailed information will give managers the information they need - and have historically lacked - to make sound business decisions." **(Saldarini)**

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It is important for Steinway and Sons to be aware of the breakdown of costs related to their manufacturing process. This initially involves separating sunk costs related to manufacturing machinery, factory up keep, etc. from variable/fixed costs. Once fixed costs are established further analysis is required to determine what costs are attributable to personnel and materials. The analysis of variable costs involves at looking at economies of scale related to material purchasing. Each portion of the manufacturing process should be broken down in how much time it requires. Furthermore, analysis should be done to determine differences in performances between different locations and teams.

"Activity-based costing is particularly helpful for large organizations, such as universities and government agencies, that administer multiple programs simultaneously, the report said. Traditionally, these organizations are run on funding-based accounting systems designed to insure legal compliance with appropriations law rather than better management decisions." (Saldarini)

The analysis provided by activity based costing provides with managers to spot potential bottlenecks and leverage synergies within the manufacturing process. It also can be used to derive benchmarks within the manufacturing process as well as a quality control mechanism. For example, if a particular cost driver were using up materials and time in an anomalous fashion it could be a point of concern in terms of quality or efficiency. ABC can be a potential manufacturing process and financial efficiency calibration tool if used wisely.

If Steinway were not to use ABC it is more likely that they would miscalculate personnel and material requirements. For example, if their production were to slow down they would not have the ready cost drivers necessary to ascertain the weakest link of the supply chain. In turn, they may out of haste implement misguided personnel and/or inventory remedies further weakening the production process.

Steinway and Sons are among the most prestigious builders of quality pianos in the world and can benefit greatly from Activity Based Costing (ABC) given that it would enable them to quantify cost drivers within each part of the factory process. Defining cost drivers will help to better understand the manufacturing process and spot potential bottlenecks, inefficiencies, and maximize craftsman productivity. Several dysfunctional decisions could be made using traditional cost allocation. That could lead to inefficiencies, inaccurate calculations of economies of scale, and misleading breakeven projections.



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