

Investigation of Applicability of Activity-Based Costing in the Airline Industry: An Empirical Research

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ABSTRACT

The airline industry is a capital-intensive industry with different types of fixed and variable costs and a high degree of competition. Controlling and reducing costs in the sector is important for maintaining competitive power. The deregulations and relaxation of regulations in the sector in the 1990s intensified the current competitive environment. In order to control and reduce costs, airline companies make derivative contracts against the increase in fuel costs, include newer and low-fuel aircraft in their fleets, create human resources policies, and make strategic alliances with other airline companies.

Southwest Airlines first developed a "low-cost carrier" business model to reduce the costs of airline companies, and this business model was started to be implemented by many American, European and Asian airline companies. LCC offers simpler, reduced and standard services to customers in its business model, and customers pay extra money for additional services requested during the flight. In addition to the airline companies that determine the business model known as LCC today, there are "classical" (legacy) airlines that are not LCC but adopt to approach the LCC business model for cost reduction and control.

Controlling and reducing costs also requires a more accurate and realistic calculation of costs. Basic elements of cost is direct material, direct labor and overhead expenses. In classical costing and activity-based costing approaches, direct materials and direct labor are traced to the goods and services directly, while overheads are assigned to the goods and services produced using various cost pools and cost allocation base. While in classical costing, overhead costs are assigned to the goods and services in a rough way (that is, the characteristics of the products produced and the amount of resources used in the production process are not taken into account, and only one or two cost distribution keys are used), in Activity Based Costing, all the works done within the enterprise are determined as a rational groups and large number of cost allocation base with compatible these groups. Then activity costs are assigned on goods and services that are more precisely and accurately. Thus, the costs of different goods and services produced in the enterprise can be calculated in a more accurate and real way. Otherwise, if the cost is miscalculated (under-costing or over-costing), the business may either make a loss or lose its market share.

Airline carrier companies that adopt the LCC business model generally provide standard service to all passengers in the cabin and since there is no class distinction, it will be determined as a result of the analysis that classical costing will be appropriate in such companies. As a result of the analysis, it will be determined that Activity-based costing will be a more accurate and realistic calculation due to the differentiation of services offered in airline companies that have class distinctions (Economy, Comfort and Business) for passengers that adopt the classical business model.

KEYWORDS Airline Industry; Low Cost Carrier; Activity Based Costing

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