

Benefits of IT Service Pricing

Purpose

In the ongoing quest to increase the efficiency and effectiveness of IT, a number of large organisations have engaged 4sl to help develop financial and business management processes to underpin enterprise service delivery and support functions.

This has typically been a result of the recent economic climate where many organisations have had to question their IT spend as well as the more fundamental issue of quantifying the business value associated with that spend.

From the experience gained within a number of financial institutions, 4sl has seen a general positive impact in the adoption of service pricing techniques (alongside other service management practices) - i.e. the means by which the organisation's total IT operating costs are allocated and recovered.

This paper aims to explain the benefits that can be gained through the development and adoption of an appropriate service pricing in the management and delivery of IT services.

Background

Historically, managing IT costs in most organisations has had two common features:

- one of fact - the IT departments carried the total budget for the IT costs of the company, and
- one of perception - IT costs were viewed as if they were incurred by the IT department itself rather than initiated and driven by the business served by the IT department.

This was often exacerbated through the mechanism by which the costs were passed on to the business, often by a relatively crude, broad-brush method based on headcount allocation, which often created more confusion rather than offering clarity.

The view persisted that IT costs were too high, that there was lack of clarity of what the charges were for and most tellingly as an indirect cost, business managers felt that unlike the majority of the P&L account they were responsible for, they were unable to influence the costs and simply had to 'bear the burden'. The most corrosive effect of these factors combined was that the lines between accountability for, and ownership of, IT costs often became blurred.

More recently cost of IT services, particularly in large global organisations, have tended to grow year by year whilst IT systems and networks have become an integral component in the competitiveness of the core Business itself. The IT infrastructure is no longer used merely to process data or connect offices to each other, it is now the key enabler to being able to do business in a certain way, or in a certain global region.

These themes have resulted in fundamental questions being raised over how to establish greater control over the cost of IT services, how to allocate the costs to the point of consumption

and how to align the costs in such a way as to enable each Business Unit to understand, influence and account for the IT related costs of running its business processes and products.

A new approach

The objective of most organisations is to have significant or business-critical costs managed and reported such that the following can be satisfied:

- Clear descriptions of each service line for which charges are being incurred
- Composite charges which encompass the total costs of delivering a service
- The ability to affect the charges by increasing or decreasing their consumption of a service
- An equitable allocation of enterprise-wide service costs
- The ability to accurately estimate service costs when considering future growth/shrinkage

In short, these requirements can be summarised by a need for a higher degree of granularity of costs and more critically a much higher level of transparency of charges. Before costs can be effectively managed they have to be clearly understood, logically collated, equitably allocated and accurately reported.

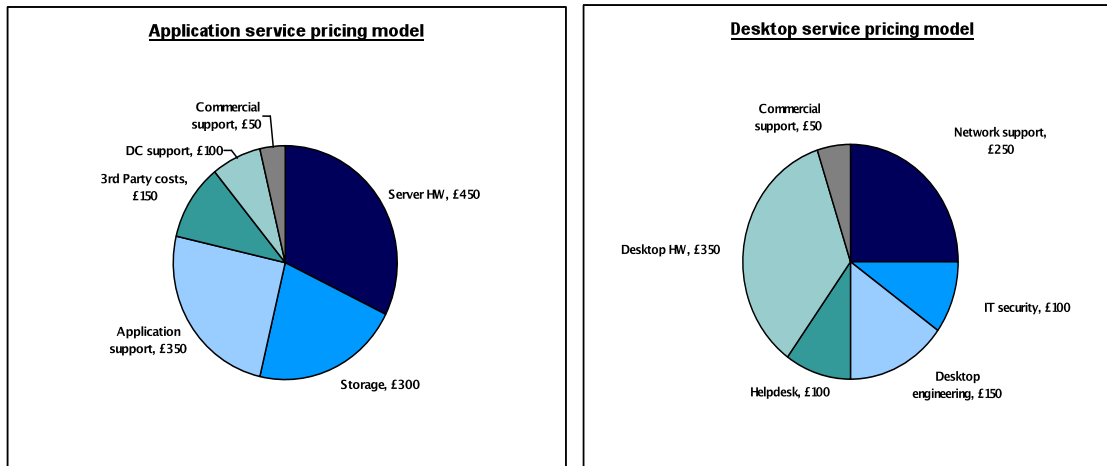
There is one other fundamentally important element in effective cost management, the application of charges to the point of consumption. Only then can the consumers assess the costs and an informed decision made on the likely impact in their business environment of any planned reduction in services and the associated costs.

Understanding Fully Loaded IT Costs

Various forms of service or unit pricing have evolved in a lot of organisations, although they may not have been universally adopted across all service classes. For financial institutions, one function often targeted is the way Market Data Services (MDS) are charged to each business unit, and typically down to the individual user level. This works reasonably well at a basic level in that the costs are visible to the business managers who then are able to determine changes to those costs by either the quantity of devices their departments' use or the quality of the services. For example decisions can be made around sharing of MDS devices for non-critical use or dependant on the nature of an individual's role, a decision can be taken to take delayed data feeds as opposed to real-time feeds which come at a premium price.

However, this is an overly simplistic view in that the fees which the MDS providers charge are only part of the total costs that are incurred by an organisation in getting a particular service to each of its user's desktop. Usually an integrated infrastructure of dedicated communication lines is required as well as ring-fenced servers and firewalls together perhaps with support resources and contracts.

The essence of Service Pricing is to identify the **total** costs related to the delivery of a service (often known as 'fully loaded') and allocate the costs in a unitised way (e.g. via desktops, servers, business systems/applications) directly to the consumers of the service.



The delivery of Application and Desktop based services are the two key areas of service provided by IT to the business. The above examples illustrate the type of costs that would normally be built into the delivery of these services.

In understanding service-pricing, it is key to note that the costs relating to the delivery of the desktop service, for example, are more than just the capital cost of the PC itself. The fully loaded cost includes all associated services that are required to operate and support each individual PC. A service-pricing model, therefore, requires analysis of each of the service lines within IT, in order to understand which areas contribute to the delivery of the services outlined above.

Ultimately the objective is to charge out all IT costs, that are required to support the above services, in a manner that the Business can understand and can reconcile to their consumption levels.

Attributes of Service Pricing

A mature and robust service-pricing model addresses the demands that exist in most organisations, for better management and accounting of IT costs because it:

- Provides simple and easily understood definitions for the various IT service classes – typically grouped in categories and maintained in a service catalogue (e.g. Network services, Storage services, Market Data services, Application support services, Data centre services, Desktop support services etc.).
- Groups all costs related to the delivery of a service line and the price via a ‘unitised charging vehicle’ be it desktops, servers or business applications. Typically the prices are fixed for a period anywhere between 3 and 12 months giving the Business managers the ability to budget and predict their exposure to IT costs.
- Gives business managers the option to influence their IT costs by reducing the volume of a particular line of service they consume or indeed increase their consumption but know the impact of that decision on their costs. The immediacy of escaping charges as a result of a lower consumption of a particular line of service will depend on the underlying cost components; are they fixed or variable. For example there is a direct correlation between costs relating to the provision of data circuits and the savings achieved if a business manager identifies redundant circuits. However the costs relating to the operation of a Data Centre are more difficult to reduce if a business manager decides to reduce the number of servers on which his applications run. It’s worth noting that if there was a company-wide efficiency drive in regards to the utilisation of servers which led to the reduction of the total server estate in the organisation then the costs of

running the Data Centre could be reduced or sizeable headroom created for genuine business growth.

- Allows costs for enterprise-wide services such as email systems or large storage systems to be clearly identified and allocated to each 'unitised charging vehicle' on a logical and equitable method.
- Enables an organisation to assess the IT costs of running a specific business system and estimate the impact of a wholesale termination or calculate the effect on the exponential costs if the number of users are increased or decreased.

Benefits of Service Pricing

The core features of a service-pricing model will generally yield the following benefits:

Direct

Granularity of costs – all the component cost elements that go towards delivering an IT service to a desk have to be known and validated in order for the model to have any integrity.

Transparency of charges – business users will be able to clearly see the reason they are being asked to pay for the services they are consuming both directly i.e. the PCs, servers and business systems they utilise or indirectly as a reasonable allocation of enterprise-wide systems i.e. email and storage systems.

Equity of allocation – knowing precisely which costs are discretionary to each business area and which costs are mandatory will enable charges to be raised which are based on an equitable distribution of enterprise-wide costs that are needed in order 'to do business'.

Indirect

Cost savings – This benefit has been grouped as an indirect benefit because a Service Pricing model does not in itself lead to savings but rather it articulates the costs of the services in such a way as to enable decisions on cost reductions to be made with all the consequences understood in advance.

Operational Efficiencies – Once costs are identified down distinct lines of service and across business units, decisions on streamlining, sharing or aggregating of operational processes can be considered. Such reviews are also likely to lead to financial savings for an organisation as it looks to maximise the use of its current estate of IT hardware and software assets and re-cycle wherever possible instead of funding new investment.

Pre-requisites for success

To ensure the benefits of a Service Pricing model can be realised several factors will need to exist before the initiative is successfully implemented:

- Executive Management Sponsorship – the project will need to have the active sanction of the business executive management as the impact of the deployment and the requisite change management should not be underestimated.

- Demand from the Business – clearly there is little point in implementing a ‘solution’ if there isn’t a widespread sentiment within the business units that there is a problem! There has to be an audience for the attributes of Service Pricing outlined above.
- Participation by the Business – in order to translate the attributes of Service Pricing into benefits the Business managers have to commit to applying the necessary time and resources required to review the presented charges and influence their IT costs.
- Joint initiative between IT and Finance – the IT costs of a large organisation tend to be significant items on the balance sheet and therefore such a project must have the buy-in and active contribution from the Finance division.

Implications of Service Pricing

Each organisation will have some unique methods, by which it conducts its business so the specifics in regards to the impact of implementing Service Pricing, will be different in each case but there are some generic aspects:

- Moving costs from below the line to above the line – the financial implications, of moving costs which are largely indirect, and translating them into direct costs which will sit on business units P&L accounts are significant and clearly the gains in obtaining transparency of charges has to outweigh the potential costs.
- Service Pricing Governance function – in addition to a dedicated team to undertake the detailed analysis required before a service-pricing model can be deployed, the benefits can only be properly exploited if a Governance function which monitors the overall model is established.
- Inventory management systems – investment will need to be made in inventory systems and processes of an appropriate level of complexity, which will cope with collating and allocating out what will be a complex matrix of financial data.

Next steps in the adoption of Service Pricing

4sl employs a service-oriented approach to the delivery of IT change and has developed a maturity model to help accelerate the benefits of a service pricing as below.



We have developed a rapid assessment method to help determine the most appropriate change agenda and process improvement initiatives for a range of service management solutions. For a pragmatic view on how to realise the benefits described in this paper, run a short financial management assessment through our on-line profiling tool¹.

¹ [IT Landscape Profiling™](#)