Begging for Infrastructure

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"Hey, Joe, welcome! You don't know how glad I am that you agreed to join our company."

"Thanks, Ian. Glad to be here. You sure were convincing during the interview process. But now that you've got me, you're going to tell me the truth about what I'm walking into, right?" Joe laughed casually.

"As a matter of fact, Joe, I am."

Joe stiffened. "Ian, I was joking… wasn't I?"

"Well, actually, the reason we hired a top-notch guy like you, and paid the price…" *[Nervous laugh]* "…is because we've got some real problems in the data center."

"Oh, no sweat. I've run data centers since I was a kid just out of school. Let's hear it. I'll get it sorted out before you can say the word 'consolidation.'"

"Funny you should use the word 'consolidation'."

"Uh oh."

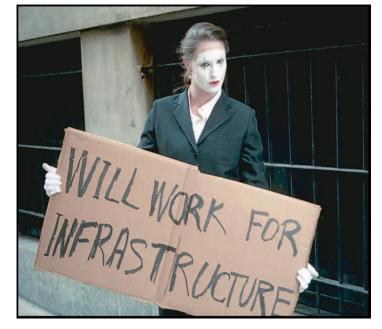"Yeh, well, you might as well know it up front…. We've got close to 200 servers on the floor."

"That's a big data center, alright."

"…with one application on each."

"Ah. Millions per year?"

"Yep, millions in savings by consolidation."

Joe considered for a half a moment. "Same operating environment?"

"Yeh, pretty much. That's not the problem, Joe. I'm sure you've seen it before…." *[Another nervous laugh]* "Technically, this isn't tough. But the business units won't let us consolidate the servers."

"Why not?" Joe looked puzzled.

"Well, they say that they paid for them; they own them; and they don't give a hoot that we're under cost pressures up here in corporate."

"They paid for them?"

"Well, it came out of our budget…."

"So they didn't pay for them." Joe looked even more puzzled.

"Well, you see, it's like this: We put the capital costs of a project in as part of the project justification, you know, to reflect the life-cycle costs. And we have a world-class portfolio-management process that takes total costs into account before funding projects."

"Ian, you know that capital depreciation is only a small portion of the life-cycle costs. There's all the support costs that are expensed year after year, the operating costs, repairs…."

"I guess we know that. But that's just the way it is. We get our capital for infrastructure as part of clients' project proposals."

"They think they own our servers? But they still hold us accountable for providing capacity, and for costs?"

"Something like that. We tried telling them that they paid for the servers but we own them and control them. That went over like a ton of bricks. So we do our best to negotiate with clients over infrastructure changes as, kind of, partners."

"I don't get it. What am I supposed to do about this mess you're handing over to me? It sounds like more of a finance problem."

"It's just our funding model, Joe. That's the way it is."

The Root of the Problem

Joe hadn't been up against this kind of challenge in the past. He called it "politics." But that wasn't quite right. It was a matter of money.

Clients were behaving rationally, given that they justified applications projects, and the infrastructure that it took to run them. Joe was thinking rationally, given that his just was to manage infrastructure costs and ensure adequate capacity enterprisewide. Why did they come up with clashing perspectives?

The resource-governance processes correctly got clients to defend their applications proposals. But they didn't provide a separate channel of funding for IT to buy infrastructure.

Instead, infrastructure was bundled into project proposals as a feeble attempt to recognize life-cycle costs. Of course, this is grossly inaccurate, ignoring all life-cycle costs but the cost of capital. And it undermines enterprise capacity planning and the significant cost savings that shared infrastructure can produce.

Note that this isn't how the real world works. Imagine getting your monthly bill from you phone company, and it reads: "Monthly subscription: $50. Your share of our new server: $1200!"

The way the real world works is this: The service provider (like your phone company) goes to the bank and borrows money for infrastructure. They get the loan based on a business plan, with market forecasts and enterprise capacity plans. (They certainly don't buy a server for each new customer!)

They pay the bank back, in their case both depreciation and interest. These mortgage payments paid to the bank are built into their monthly rates for services, as part of their operating costs.

When internal IT service providers have to "completely charge out," that is, allocate all their costs to business units, they lack that internal "bank" and, essentially, give away control of their infrastructure.

The Way Out

The right way to manage an internal service provider is to supply direct budget for these internal investments, and then amortize the costs of capital in the ongoing services that the organization delivers – just like any external service provider does. These internal investments are called "ventures," akin to venture-capital projects.

In other words, a budget should include both client-billable projects and services, and venture projects that are directly funded through the CIO's direct budget (not chargebacks).

These venture costs absolutely must not be built into rates or project costs. Of course, the depreciation on these ventures must be built into the rates for services, essentially paying back the loan from the corporate bank.

By the way, the same thought process applies to any significant investment in IT's capabilities, both capital and expense costs. Other examples include major process improvements, innovation projects, and new-service start-up costs.

Practicalities

To convince a corporation to adopt these sensible business practices, a leadership team must be able to believably assign its costs to both client deliverables and venture projects.

Of course, all indirect costs have to be amortized appropriately to both. And "corporate-good" and venture projects are distinct deliverables which must receive their fair share of indirect costs.

This requires a budget that estimates the costs of all projects and services (including venture projects), and assigns indirect costs and overhead appropriately throughout the entire organization.

In essence, it's flipping the budget on its side — adding up the cost of deliverables rather than general ledger accounts like compensation, travel, and training. This is called "investment-based budgeting."

Investment-based budgeting is the answer to many client-relationship challenges, such as managing expectations, perception of value, fair comparisons to outsourcing, and meaningful demand (portfolio) management. It's also critical to defending an explicit channel of funding for infrastructure and innovation. ❐

For a library of information and case studies on investment-based budgeting, the method, and the tool, go to fullcost.com. *And CIOs interested in a private sounding board on their resource-governance processes may enjoy a private consultation with Dean Meyer. Contact NDMA at 203-790-1100, or* info@ndma.com.