BUDGETING WORST PRACTICES
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You Cost Too Much!

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"You cost too much!"

"Hey, wait a minute, Erik. According to the recent survey we got, our spending on IT as a percentage of revenues is at the low end for our industry."

"Did it ever occur to you that maybe those high-priced studies that tell you what you want to hear are part of why you cost too much!? The fact is, Peter, your IT department just isn't a good value. And I'm tired of your waste hitting my business unit's bottom line."

"Erik, look, I've done outsourcing studies. I know that, like for like, our costs are lower. What makes you think we cost too much?"

"I'll give you an example. I can get a PC on my desk for less than half of what you charge me each year, complete with maintenance."

"But you're comparing apples and oranges! Our desktops come with the standard software suite, virus protection, network connectivity, an email account, spam filtering…."

"And your telephone rates are outrageous!"

"Now, that's not fair either. Since everybody has to buy phone services from us, the CFO directed us to use that rate to distribute a bunch of corporatewide costs...."

"Which I don't understand, have no control over, and which pay for things I probably don't want to buy. But you charge me anyhow!"

"Erik, be reasonable. It's not up to you or me to decide whether to buy these things. These are corporate decisions, like architecture planning and business continuity planning."

"Peter, your developers are $150 an hour! I can get a contractor for $80."

"But you know that we house them and manage them. We equip them with desktops, CASE tools, and development cycles. The rate includes DBAs, project management experts, and other support services. You'd have to supply all that yourself if you hired a contractor. Plus, Erik, you know our people are much more competent than some contractor you hire off the street."

"Look, Peter, out here in the business, we don't understand your rates. We don't know why we're getting hit with costs we can't control. Whenever we compare you to outside vendors, you come out high. And basically, to tell you the truth, we don't trust you. I'd like my Finance guy to come over and do a full audit to see if he can decipher your charges."

The Root of the Problem

Whether or not IT costs are actually under control, clients will accuse IT of costing too much if its rates are anything less than transparent, controllable, and comparable.

This is true whether an IT department charges fees for services (chargebacks) or not. Whether clients are looking at rates (unit costs) or just the total cost of projects and services, they're very sensitive to IT costs.

IT costs aren't transparent if the process by which they're calculated is anything less than understandable, logical, well documented, and in conformance with standard accounting practices.

IT costs aren't controllable if the items that IT attaches costs to (essentially, the items in the product/service catalog) are bundled at too high a level – big "omnibus" SLAs that combine many distinct purchase decisions.

IT costs aren't comparable to external vendors if indirect costs (such as overhead) are spread inappropriately (such that one service subsidizes another).

Furthermore, costs aren't comparable if they include anything unrelated to the deliverable the client agreed to buy. For example, corporate-good activities (which outsourcing vendors don't have to do) should never be considered overhead and built into rates; rather, they should be funded separately by the corporation, as services in their own right.

Put simply, when a client buys something from IT, that client should pay all direct costs plus a fair share of indirect costs – no more, no less. And all cost calculations should be transparent and easy to audit.

The Way Out

All costs have to be assigned to the products and services that IT delivers to the business, and to the enterprise. The catalog has to be at the right level of granularity. The cost model has to be transparent and accurate. And the reports have to answer questions posed by a variety of audiences: business clients, the CFO, and the CEO, to name a few.

Product and service costs have to be produced for the entire budget, not just a project or service in isolation. That's the only way to apportion indirect costs such as overhead properly.

And costs should be available before the fact – when budgets are being negotiated – not after the fact when it's too late to do anything about them. Business leaders react to budgets and rates, and compare the total budget (or large chunks of it) to outsourcing. Isolated, after-the-fact invoices for services delivered (as in chargebacks or show-backs) do little to help them make funding decisions.

There are two views of costs: the budget, and rates (unit costs). Of course, they have to be consistent. These are simply two views of the same cost model, not separate analytical process.

Practicalities

Pragmatically, the perception that you cost too much often comes from a lack of understanding of all the value you deliver for a given level of funding. The answer is found in "investment-based budgeting" – a budget which shows the costs of the products and services you deliver (rather than the traditional view of general ledger codes by cost center).

With an investment-based budget, you can build an understanding of value. You can compare deliverables, like to like, with sourcing alternatives. You can calculate meaningful rates. And you can manage costs by managing demand, not just by pressuring IT to "do more for less" or micro-managing its spending.

As one executive who implemented investment-based budgeting said, "The facts are disarming." Until IT learns to portray the costs of its deliverables, discussions of cost will be political rather than factual. ❐

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.