

# Can You Really Know Your Full Cost of Service? Riverside County IT Found the Way.

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By Cinda Daly

**I**n the very recent past, Riverside County IT faced some complex, but not uncommon, challenges with their approach to customer service, cost recovery, and business management.

This “corporate” level IT organization faced inflation in their salaries and vendor costs, but was constrained by mandated caps on rates. While they knew quite well what they spent, they had no clear idea of how much any of their products and services really cost. Customers paid their allocations and chargebacks but didn’t know what they were paying for, often being charged for services they didn’t even use. And, those services were not priced on a level playing field with outside service providers.

All these realities collided to create budget and decision-making confusion, outsourcing and decentralization threats, overworked staff, and internal distrust.

Today, Riverside County IT is a very different place. The IT organization runs like a business, focusing on the customer’s requirements. Business decisions are based upon clear service definitions and accurate costs. Rates are based upon the full cost of each service, so chargebacks are clear, explainable, and fair. Customers pay for the services they use, and nothing more. And, as a result of all these changes, customers now see IT as a business partner, not as a second-rate service provider and a “black hole” for money.

It seems like it would take a generation to transform an organization from one scenario to the next. It could. And, it often does. But, in just six months, this IT organization transformed itself into a business-within-a-business, completely changing the way it plans, budgets, and works with customers.

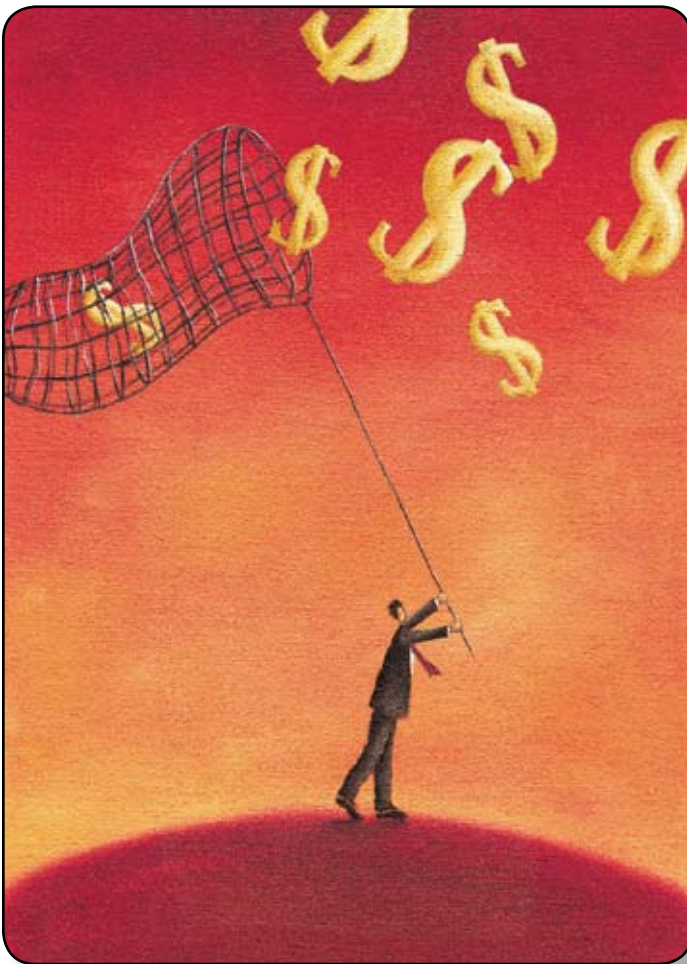
How did they do it? With some work on their culture already in full swing, a new business planning process and a new costing tool were the centerpiece of the transformation. That, combined with a little luck of timing and an understanding that the transformation would evolve over time, made a seemingly impossible leap happen.

## Getting to the Root Cause

Under the leadership of Matt Frymire, CIO, and Greg Stoddard, CTO, Riverside County IT (RCIT) provides centralized services to 38 different County departments, many of which have their own decentralized IT units and also buy directly from outsourcing and IT product vendors.

RCIT services include networking, email, voice and radio telecommunications, data center operations, and help desk support. County departments are required to use RCIT for these services, which are funded through an internal service fund and chargeback system.

Of course, the surest way to lose a monopoly is to behave as a monopolist. RCIT leaders took this to heart, and even when customers throughout the County were mandated to buy services from



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RCIT, they set out to create an organization that would earn customers' business as if they were competing with outside vendors.

RCIT also provides optional services, such as applications development, applications hosting, and special projects, to its County customers on a bid basis, competing with outside vendors for the business.

Enter problem one: RCIT rates were not fully comparable with outside bids, and often were not competitive.

It didn't take much searching to uncover why. The IT budget was traditionally built around very broad activities. The service rates that fell out of the budget covered the cost of the entire network, for example, not broken out by the individual services that the network provided.

Case in point. When the Sheriff's department acquires a new server and wants RCIT to support it, that server must reside in the data center. That's still a requirement. But before the transformation, once that server fell under RCIT's dominion, the Sheriff's department was also charged for the full range of data center services, including 24 X 7 support, whether they needed them or not. The result: Rates were unfair, and seemed very high compared to outsourcing.

"They were providing services, but not necessarily the services that our department was looking for," says John Naccarato, department information technology officer in the Riverside County Sheriff's Department. "That caused us to go outside, seek bids, and [by paying vendors a profit] pay more for those services in the long term."

RCIT appeared even more expensive when the Board of Supervisors issued Countywide IT mandates that went unfunded. RCIT

had to embed the costs of delivering those unfunded mandates – costs that outside vendors and decentralized staff didn't bear – in their rates. In fact, RCIT rates were artificially inflated by many unfunded activities like policy facilitation, standards setting and compliance, and services to County offices that weren't required to pay RCIT through chargebacks.

The bottom line: "Our customers didn't know what was included in the rates. And, to be quite honest, we didn't either," says Frymire. Since rates were not based upon cost, customers lost trust in RCIT's rate structure and in the department.

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Frymire and his leadership team realized that they needed to operate more like a business and become more customer-focused. Beginning in 2004, RCIT began a process that would totally revamp its approach and shift its focus from technology-for-technology's-sake to leveraging technology as the means to help business partners achieve business goals.

RCIT created a customer services division, formed account management teams, met regularly with customers to discuss business needs, and established service level agreements (SLAs). Enter problem number two. Customers did not embrace the SLAs. Without clarity on IT's specific products and their costs, customers felt that the agreements offered no value.

What customers wanted was a service catalog with clear rates associated with each service – which didn't exist at the time – and the flexibility to pick and choose the services they wanted. Re-enter problem one: services were defined in big bundles; the rates weren't right; no one understood them; and customers were paying for services they did not use.

## Draining the Swamp

At this point in the transformation, Frymire came across Dean Meyer, author of the Full-cost Maturity Model and developer of the FullCost™ software and planning method. He invited Meyer to Riverside to introduce his leadership team to the FullCost planning method and software, and explain how it would guide RCIT to a service catalog, uncover the full cost of its services, and realign the business so that the services and the rates matched customers' needs.

The proverbial pot of gold sounded very enticing to Frymire and his management team. FullCost looked like it was designed to do exactly what they needed. The skeptics, however, asked, "If this is so good, why isn't everyone racing to it?" Meyer's response was candid, "To define your products and services and understand their

full costs takes a lot of hard work, clear thinking, and open-mindedness. Not every leadership team has what it takes to drain the swamp.”

Furthermore, the move was politically risky, according to most everyone on the team. But, they understood that they could not let the risk or amount of work keep them from moving forward. The leadership team knew that if they were going to achieve accurate, fair, justifiable rates and build trusted relationships with their customers, they needed to completely redo the way they conducted business. So, it was a fairly quick decision to take the challenge.

Beginning in the spring 2005, the RCIT management team – 30 people from supervisors up – spent an average of two days a week together and 10,000 hours beating the process to a pulp. FullCost is more than software. It includes a structured planning method that takes managers through the process of making business decisions and planning estimates, and filling in data a step at a time.

The team began by identifying each of the products and services – the deliverables – and who the customer was for each. In addition to thinking about what they do for clients, the team documented internal support services and overhead expenses.

It didn't take long to discover that they had a poor understanding of how much time and cost were associated with supporting each other internally, and the impact that would have on the rates. And, once the group identified all of the cost elements, service line by service line, they uncovered some other glaring business problems.

For example, Frymire learned that supporting the Microsoft servers required many hours each month just to apply security patches, which all had to be done after business hours, on overtime pay. Understanding this forced the team to examine how patches were being applied, ways to improve the process, and even question whether they had the wrong technology in place to begin with.

Next, they analyzed their available staff, and set aside hours for critical – but “non-billable” – tasks such as training, product research, and customer relations. This caused them to think about what they needed to reinvest in their business to ensure its sustainability.

Then, they estimated the time each deliverable would take. They learned that it's not wise to sell FTEs (people); instead, they sell billable hours and assign the appropriate staff to each project.

Finally, they entered their vendor costs, both project costs and indirect costs that were spread across numerous deliverables.

FullCost took care of all the calculations, including the amortization of indirect costs like internal support services and overhead. It produced a service catalog identifying the prime contractor for each service, the total costs of all budgeted deliverables, as well as other deliverables the customers wanted but wouldn't fit within the budget. Finally, FullCost generated a clearly documented set of rates and produced reports for internal management cost scrutiny, review with customers, and uploading into the accounting system.

“The FullCost toolkit makes activity-based budgeting (ABB) practical,” says Meyer. “It allows an internal service provider, like IT, to

present a budget in terms of the full cost to shareholders/taxpayers/donors of each and every product and service offering, rather than the traditional budget that describes cost factors such as compensation, travel, and training. Then, rates come right out of the same planning data.”

## The Challenge of Change

As they worked through the process, everyone agreed that the method was sound. But that didn't mean that it was easy. At each step in the planning process, Meyer taught them both the business concepts and the technical skills, raising dozens of questions that caused them to re-evaluate fundamental concepts like: What services do we offer? Do we need to offer it? Who owns that line of business, and what support do they need from other groups within RCIT? And where does every cost – including every hour of staff's time – go?

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Change is tough when you've done business one way for a very, very, very long time. When tensions grew, there was a temptation to attack: “Where did you come up with that? I don't need to depend on you; I'll do it myself.”

“These were huge battles,” added Stoddard. “Internal stakeholders were very tenacious, and tensions were high.”

However, the group had a strong commitment to make the changes and drain that swamp. Through the FullCost process, they all came to adopt a more open culture and learned new phrases like, “I need to subcontract with you for that, and I'll leave it to you to figure out how to produce those deliverables.”

“Getting the trust issues worked out was a tremendous benefit of the process; and as a result, teamwork was really enhanced,” says Frymire.

According to Frymire, it helped greatly to have a change agent like Dean Meyer there to assist – someone who was willing to take the punches on their behalf. “The change agent's role was critical because he had to drive us to continuously challenge and rethink our business. This process required the department's leaders to change their understanding of how business was conducted, give up and take turf, and make decisions on how we could either reduce expenses to cost-effectively operate a line of business or outsource

it. We have over 80 lines of business that went through this process.”

Meyer guided the leadership team through a series of workshops and watched over their data inputs. He pushed the team to think clearly about products and services versus tasks; to focus on teamwork, distinguishing clearly between prime contractors and internal subcontractors, and decide where each of the costs should go.

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## Gaining Consensus and Approval

In parallel with working through the process, RCIT wisely engaged external stakeholders along the way. They presented the plan to the CFO and controller, sharing the rationale, and came to a strong consensus that the rates needed to be revamped. The CFO agreed that focusing all efforts on customers’ specific requirements was the right approach, and RCIT gained support for empowering customers to choose what they buy from RCIT.

Periodically, they invited the auditor to check their progress, validate intermediate decisions, and anticipate the impacts on customers budgets so that the final outcome would be as everyone expected it to be from an accounting perspective.

In some cases, they got more than they had hoped for. For example, FullCost accounted for the true cost to taxpayers of the mandated “corporate-good” deliverables. With this evidence, the auditors became allies in gaining funding for these so-called “unfunded mandates.” This was an important victory, one RCIT leaders never thought they’d win.

The RCIT account managers also kept an open line of communication with their customers, explaining what they were doing, why they were doing it, how the rates would change, and what the impacts would be.

According to John Naccarato, one of RCIT’s customers in the Sheriff’s department, the new process makes it clear where RCIT’s services can best be used, and when it makes more sense for the Sheriff’s department to look outside for services. “When we ask about a certain rate, our RCIT account manager can explain it now,” says Naccarato. “We can judge if prices are competitive or not; so we’re in a much better position to make sound business decisions.”

When the new service catalog and rates came out, it wasn’t without a couple of surprises, however. Some rates went up; others went down.

According to Naccarato, there was some shock at first over the increased rates, impacted in large part by higher personnel costs. And it appeared that some people were paying much less for services, while others were paying more. The up-front communication paid off, however, and they were able to work through the differences. The approval of the auditors and the Board also helped convince customers to accept the new rate structure.

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Naccarato agrees that the rates are justifiable and that the new process is fair overall. The Sheriff’s department continues to use the RCIT services they had been using, even though some of the costs went up.

## The Transformation Continues

All of these efforts reinforced the cultural changes RCIT began back in 2004. Generating a service catalog and getting the rates right were absolutely essential to the transformation. The combination of cultural change with the very tangible process of defining and transparently costing its products and services shaped a customer-focused organization.

For RCIT, the rewards clearly outweighed the struggles. “It took courage and dedication to make it work,” says Stoddard. “Now, we understand what goes into every rate; we can explain it and look our customers square in the eye when we do.”

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In the annual customer satisfaction survey, one key metric is how easy it is to do business with RCIT. A very poor rating in the past, ease of doing business is now the second highest source of satisfaction, just behind staff professionalism.

Thanks to their transformation, RCIT has garnered \$470,000 in new business this year – services that customers previously either did themselves or chose outside contractors to deliver. Frymire explained that the new rates and new customer focus turned around the way other departments view them. “They see us as a business partner, and that’s reflected in the new business we’re getting,” he says.

RCIT continues to improve as it scrutinizes its lines of business more closely in ways they never could before. Having accurate rates fully comparable with outsourcing, RCIT can benchmark their costs against the private sector. If the rates are out of line, they can determine the best path: outsource or improve their processes to deliver a service more effectively.

FullCost turned out to be more than a once-a-year planning process. Throughout the year, when they have to decide whether to offer a service or to eliminate one, and when they estimate new projects, Frymire’s team runs the concept through the FullCost software so that they understand its full cost and implications for the customer and their organization.

The FullCost planning process also had some side benefits. The process uncovered opportunities to restructure the organization. For example, they found groups within RCIT providing both system support and monitoring functions. In many cases, the systems support responsibilities demanded engineers who commanded a high rate of pay. But a significant portion of their time was going into job functions that should have been performed by system operators at a much lower rate of pay. Frymire explained, “Reassigning these functions to the appropriate area reduced our service costs, and freed up the higher paid staff to focus on functions more in-line with the skills – such as security, disaster recovery, and performance management.”

RCIT has successfully made the transformation, and is entering its second full budget year using the FullCost approach. Frymire reports that the 2008 RCIT fiscal year budget, soon to be approved, reflects a 5.1% budget increase due to increased salary and infrastructure lifecycle costs. In contrast with rates that had been frozen for four years, this year they could clearly justify the increase.

And their planning processes continue to evolve. “Along the way, there was a temptation to try to fix all the broken things at once,” says Stoddard. “We recognized that the transformation would be an iterative process and resisted that temptation, choosing instead to tackle one major challenge at a time.”

Stoddard’s modesty belies the fact that RCIT has reason to be proud of their accomplishments. “We operate like a business now, not only from a financial standpoint, but also how we approach and support our customers,” concludes Frymire. □

## Know your cost of services with FullCost™

Whether you’re a shared-services organization, an internal service provider, a budget director implementing activity-based budgeting or chargebacks, or simply want to run your organization in a businesslike manner, you need a reliable method and tool-kit to identify and cost your products and services.

After two decades of research and practical application in organizations like Riverside County IT, NDMA has developed FullCost, a software solution – overlaid on a set of Excel-based spreadsheets – that makes activity-based budgeting and rate setting straightforward. FullCost includes a detailed, step-by-step manual that walks an organization through the budget planning and rate-setting process.

This tool is not the typical financial system that feeds corporate accounting. It’s used during the budget preparation and negotiation process, prior to finalizing the numbers that then feed the accounting systems.

For more information, visit:  
[www.FullCost.com](http://www.FullCost.com).

## Begin your transformation with the Full-cost Maturity Model

The concept of budgeting for products and services is not new. It's been envisioned in discussions of zero-based budgeting (circa 1980s), activity-based budgeting (circa 1990s), and portfolio management (circa 2000s). However, the practicalities have been challenging.

Research over the course of the last decade, in over two dozen diverse public, private, and not-for-profit organizations, has resulted in a comprehensive understanding of the mechanics required to plan an organization's costs of products and services.

While the research was done primarily within IT organizations, it applies to any organization that provides services to clients within its corporation, allocates its costs or employs a chargeback system to pay for those services, and/or is evaluating the practicalities of outsourcing its services to an external provider.

Now, these requirements have been sorted into levels of capability – the *Full-cost Maturity Model*. The Full-cost Maturity Model (FMM) is a standard metric of an organization's capability to plan the full costs of its products and services. It addresses the processes by which an organization develops its operating plan, budget, allocations, and rates.

The FMM scale describes five levels of accuracy and validity in forecasting the full cost of an organization's products and services. The scale ranges from simple budget cost transparency to, at the highest level, the calculation of budgets and full-cost-based rates in a manner completely comparable to outsourcing.

The Riverside County IT transformation was rapid. Although RCIT had been using a chargeback system, which meant that it should have been at FMM Level 5, the rates were not based upon knowing the full cost of products and services. The foundation for Level 5 was not in place, and RCIT had to build that foundation through the FullCost process. RCIT essentially moved from Level 0, traditional budgeting without cost clarity, to Level 5, rate setting and a chargeback system based on full cost clarity, in just six months. This fast-track process was stressful for the management team, but now they're enjoying the benefits.

For more information, visit: [www.FullCostMaturityModel.com](http://www.FullCostMaturityModel.com)