ITIL® Poster Series #37

Service cost model – Financial Management

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Introduction

Financial management is a key process in the service lifecycle, and applies whether the organization is commercial or not for profit.

All service providers should be aware of the need to provide a breakdown of costs associated to the services they deliver. The service cost model provides a simple breakdown, based on understanding individual costs for service components, and how they are allocated.

By developing a cost model, the service provider can demonstrate a sound financial understanding and professional approach. Types of cost model include:

- **Service cost model**
- **Cost by location**
- **Cost by customer**
- **Hybrid cost model**

Here we look in detail at the "cost by service" model, one of the more commonly used approaches. Future downloads will examine the other approaches.

COST BY SERVICE

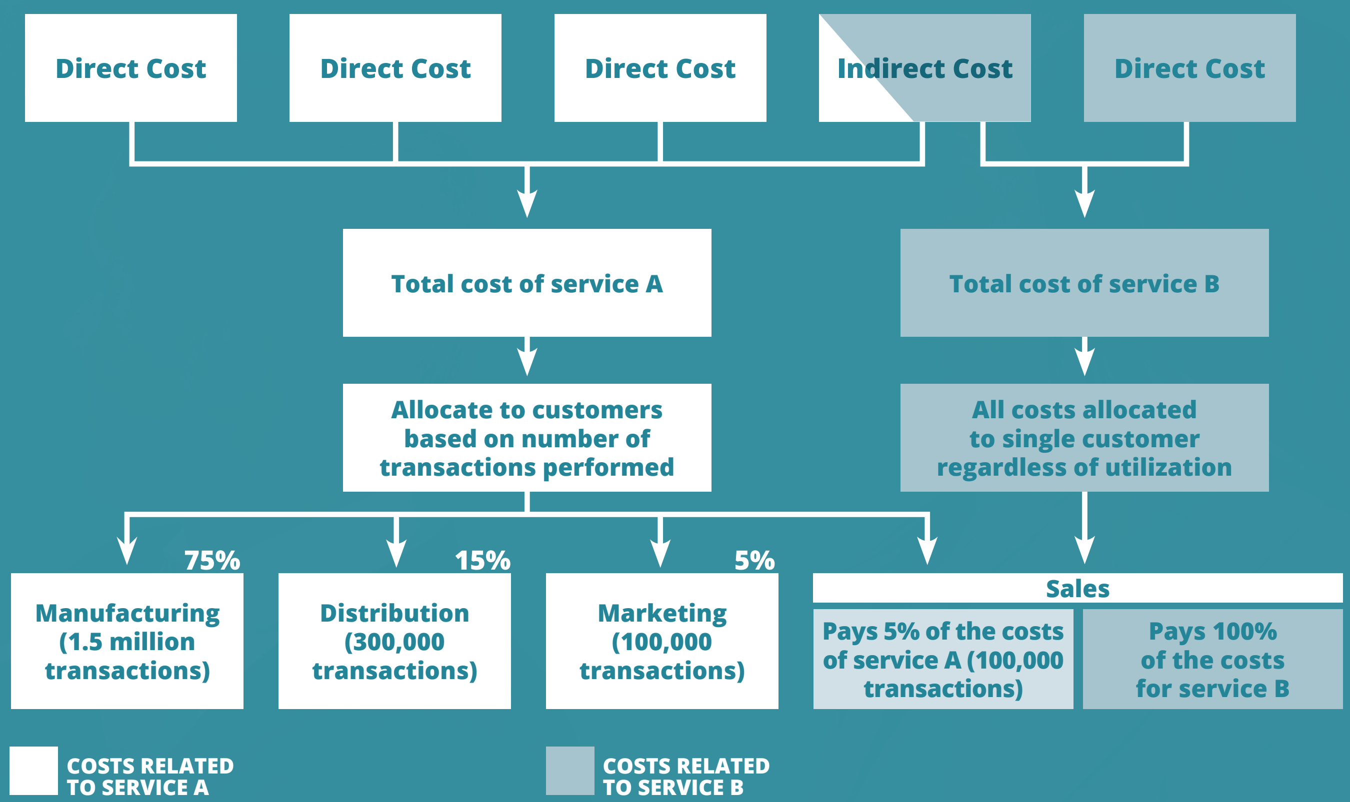
This type of cost model is essential for Type III service providers (third party providers), especially those that position themselves using differential offerings to sell services. However, it is also one of the most valuable types of cost model for internal service providers.

In this type of cost model the costs of IT are reported according to service, which makes it possible to inform customers about the cost or price of a specific service. The customer is able to use this information to determine if the service will add value to them or whether it is too expensive for the outcomes they are trying to achieve.

'COST BY SERVICE' COST MODEL DIAGRAM

The diagram above shows an internal service provider offering services to a number of business units in an organization. Costs are accounted for according to the services offered by the service provider. Service A is shared by three business units (internal customers), while service B is dedicated to only one business unit. Direct costs are any costs that are incurred when delivering a single service (for example, a specific application that is only used to provide a single service). Indirect costs are costs that are shared across multiple services (for example, the cost of a server that is used to support more than service; and the cost of its server administrator).

Once the total cost of each service has been calculated, it is allocated to the business unit. In the diagram service A is provided to four different business units and the cost is allocated to each, based on how much they used it during the accounting period. Service B is provided to a single business unit, sales, which pays the total cost of providing the service. At the end of the accounting period, the IT service provider will report the allocated costs of all services that each customer uses. Sales uses two services, covering 5% of the costs of service A (based on utilization) and 100% of the cost of service B (since they are the only customer).



ADVANTAGES OF THE 'COST BY SERVICE' COST MODEL INCLUDE

- Customers are able to understand the balance between the cost and quality of a service. This will assist in deciding what investment is appropriate for the type of business outcomes they wish to achieve.
- It is easier to set customer expectations about the level of service they will receive, as there is a transparent approach to demonstrating costs. This should result in greater levels of customer satisfaction.
- The service provider is able to quantify the necessary funding to provide the agreed levels of service.
- Both the service provider and the customer are more easily able to assess the value of the service and the contribution it makes to the business.
- Knowing the costs of IT services that are used to create and deliver services and products to external customers can help business units to price these services or products correctly. This will assist in ensuring that the organization does not make an unintentional loss.
- This approach will assist with the assessment of the impact and quantification of changes to existing services.

DISADVANTAGES OF THE 'COST BY SERVICE' COST MODEL INCLUDE:

- It may be more expensive to use this cost model; it relies on specialized cost-accountancy skills and tools. It also requires a clear understanding of configuration items and a mature process of service asset and configuration management.
- The allocation of indirect costs can be quite difficult, and could require sophisticated measurement tools to ensure that costs are correctly apportioned to cost centres.
- There is always the risk that allocating costs to services may influence the utilization of the service. This may create difficulties in the short term. This is because the costs do not simply disappear when a user stops using a service.

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