Includes a case study

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IT Operations Financial Management Helps The Business Control Its Service Consumption

Case Study: Service Management Financials At Nationwide Mutual Insurance

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EXECUTIVE SUMMARY

A new and urgent imperative is emerging in IT operations. As business users' expectations of IT continue to rise, many IT operations groups lack the business maturity to effectively demonstrate the business value of IT investments. Business users are demanding greater IT cost transparency and financial analysis in order to understand the true cost of service operations. They believe this transparency and analysis is critical in enabling them to intelligently manage demand for IT services and participate in cost management decisions. IT cost transparency and financial analysis is a natural next step in parallel with BSM projects. Forrester examined one organization that is already addressing these challenges to find out how to organize for IT operations financial management and what process, analysis, and report automation is required. The project at Nationwide Mutual Insurance demonstrates that good transparency and analysis of IT operating costs, if presented in an intuitive way to business units, helps drive better business decisions for IT cost optimization — and that the business and IT can jointly make these decisions.

IT OPERATIONS FINANCIAL MANAGEMENT TURNS "IT" INTO A BUSINESS OPERATION

The introduction of business service management (BSM) results in an IT operations organization that is more industrial, founded upon repetitive and documented processes, and able to report service quality within the context of business services.[1] It helps CIOs transform the IT organization into a value-added supplier to its business stakeholders, so that the focus of discussions around IT moves from simple cost-cutting to issues like IT's ability to improve bottom-line profits, enable new products and services, drive top-line growth, and effectively penetrate new markets. This requires IT to link its activities and capabilities to business value and communicate this value effectively to stakeholders.[2]

So far, IT operations continues to operate as a cost center; it prioritizes fast responses to problem resolution as its principal improvement. But inquiries from mature BSM clients indicate that IT operations organizations are increasingly expected to do financial management as well. IT operations groups also face a more general demand to better understand the financial implications of the infrastructure they leverage in order to answer questions around green IT, virtualization strategies, or just plain cost efficiencies. All of these enterprises see the need to improve processes and tools for the financial accounting of IT services, so that they can calculate the total IT running costs per service, use that data for continual service improvement, and report or allocate (chargeback) variable service charges to the business based on service usage. Forrester suggests calling this practice IT operations financial management (see Figure 1).[3]

Figure 1 The Progression Of IT Operations Financial Management Models

Financial models for IT operations	Business/IT alignment
Reactive cost center	
IT operating costs are not transparent. IT can only display spreadsheets with estimates. IT costs may be allocated but at fixed levels, unrelated to consumption.	Business units regard IT with skepticism, as spreadsheets imply guesswork to a business person. Some feel unfairly treated, as the allocation key is not an accurate measure of service consumption.
Proactive cost center	
IT operating costs are allocated based on reasonable criteria. Flexible chargeback is used instead of purely fixed allocations.	Business units accept the model. Executives feel more fairly treated, as allocation is not just a fixed number disconnected from their consumption.
Collaborative business partner	
IT costs are fully transparent and based on consumption.	IT is viewed as a true business contributor.

48166 Source: Forrester Research, Inc.

The Requirements For IT Operations Financial Management

IT operations financial management is not a trivial task; collecting financial data to support activity-based accounting in IT operations requires integrating additional processes and data. The service management systems that IT runs have to link to and collate data from enterprisewide human resources and financial systems. The financial reports also have to feed back into the enterprise financial system to invoke cross-department allocations or chargebacks.

Enterprises that want IT operations financial management must therefore invest in process, application, and data integration solutions; they must also embed new personnel into IT that can provide a greater business analysis of IT's own operating processes.

> "Companies should be investing 0.25% to 0.5% of their IT budget in people (IT finance professionals), processes, and automation tools to measure and optimize IT costs. Only then can they achieve a true business ROI." (William Miller, Finance AVP for IT, Nationwide Mutual Insurance)

CASE STUDY: NATIONWIDE MUTUAL INSURANCE

Forrester talked to one enterprise about the challenges and best practices in its introduction of IT operations financial management. Nationwide Mutual Insurance is a full-service financial services and insurance company headquartered in Columbus, Ohio and has 36,000 employees worldwide. It uses Digital Fuel's ServiceFlow software for business service and financial management; it manages the calculation of and visibility to the actual service costs — including infrastructure equipment costs, maintenance, operating headcount, and other activity-based costs in support of the service. It is now expanding the project so that it can analyze the service costs in even greater detail across the company's entire applications portfolio.

Nationwide's William Miller works within IT as its finance AVP; he is not an IT alumnus but has considerable finance experience; and he reports through the IT finance VP to both the CIO and the CFO. The infrastructure portion of the IT organization has been a shared service function since 1999, and it runs mainly bespoke insurance applications on a variety of platforms, including mainframe systems. Since its inception, the shared services function has continually improved IT service unit costs each year through a series of consolidation and process improvement projects within IT operations. The improvements typically focus on lowering service costs and enabling IT operations to shift more of the annual budget to new initiatives that improve Nationwide's business capabilities. Nationwide has integrated its approach to IT operations financial management into this continual improvement process. It has found that even a coarse analysis of IT costs — if presented in an intuitive and transparent way to business units — helps drive better business decisions that optimize IT costs for improved business results. Nationwide now plans to drive further optimization of its IT investments by expanding the current cost model beyond infrastructure services into total application costing. Exposing the true costs of applications enables the business units consuming them to invest in their business priorities with greater IT cost insight and intelligence.[4]

The agreement between IT and the business units is that business services costs are allocated to the consuming units on the basis of a formula — <p*q>; <p> is the calculated unit cost of a specific service, and <q> is the consumption volume of the service. IT sets a fixed cost (price) for <p> each budget year and guarantees to reduce this cost each year through its own efficiencies. By exposing the value of <q> to the business in each reporting period, IT can help the business make its own decisions about how to control its service consumption. This new cost visibility helps each segment of the business see how its actual IT spend, based on consumption, is trending compared to its budget. It can then analyze the root cause and play out other "what if" scenarios to help adjust future IT consumption for optimized business benefits.

Miller reports that Nationwide is currently moving from being a "proactive cost center" to a "collaborative business partner" via an IT financial management application platform that enables it to allocate activity costs to each business service. The measure of success for this project is that the business units should have full control over how and how much they consume the business services that IT supports. The following objectives are in place:[5]

- **Reduce unnecessary or underutilized IT spend.** IT's own financial experts will analyze asset usage and identify opportunities to better leverage their assets.

- **Reduce service costs through better visibility and collaboration.** Business executives can use the consumption reports to examine their service consumption patterns and set business-based priorities for the future.

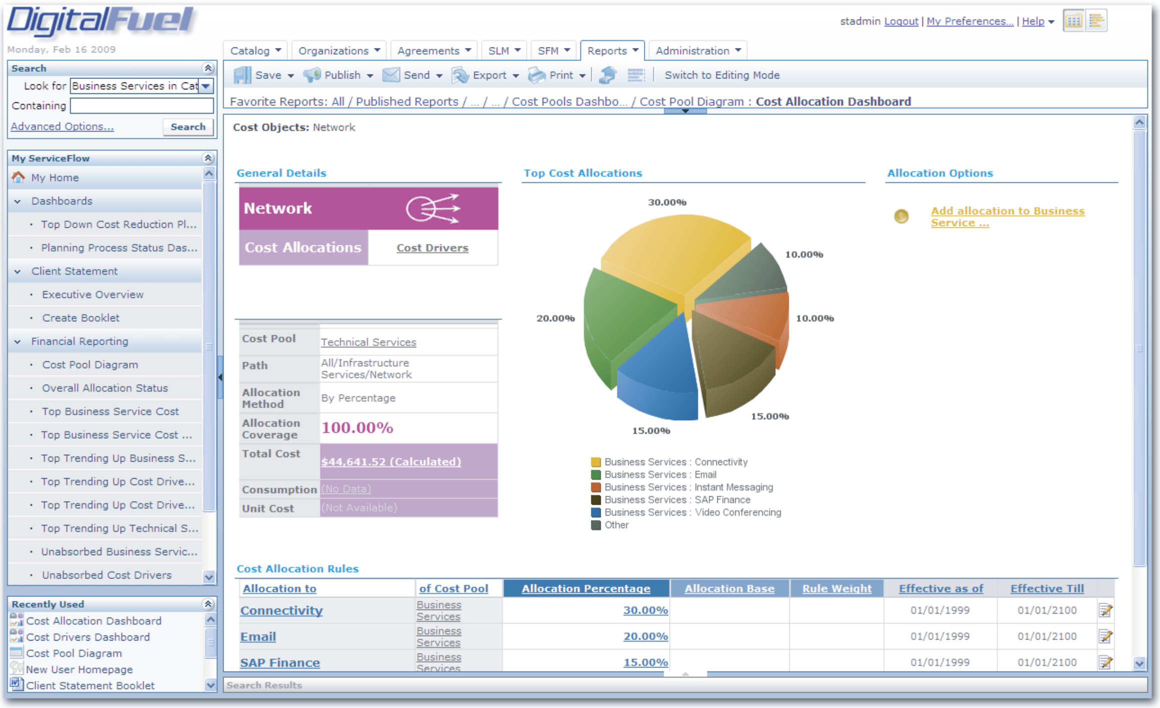
- **Establish programs to continually reduce the unit costs of services.** IT must continue to implement process improvement or automation programs to reduce unit costs; this will make them behave more like their business peers, who have always had to do this.

- **Automate cost allocation/chargeback/showback.** The true cost of business services becomes transparent to each business unit that consumes them. They will know that they are only paying for what they use, not subsidizing other business units. Some enterprises may not be ready to implement a full variable chargeback process. In these cases, even a "showback" process is valuable to business units, as IT cost transparency is the important factor.

- **Streamline the budgeting process.** Historical, current, and planned IT operating costs — including projects — become an integral part of the budgeting process between IT and the business unit. Business unit managers can make more informed decisions about and plans for these costs.

To achieve these goals, Nationwide integrated Digital Fuel's ServiceFlow Finance solution with other ServiceFlow modules for service portfolio and catalog management. As a BSM solution, ServiceFlow had already helped set up service definitions in business terms that map to all the infrastructure components. It also collects cost and consumption data from its links to the various IT infrastructure monitoring systems, financial/human resources, and other systems in place to support the Nationwide data centers. With ServiceFlow Finance, Nationwide has implemented an IT operations financial management collaboration platform between IT and the consuming business units to continually improve the way it streamlines and automates the processes to cost, price, bill, charge, and control services spend and usage — and can base these on complete cost transparency (see Figure 2).

Figure 2 Sample IT Operations Financial Management Dashboard (Simulated Data Values)



Source: Digital Fuel, Inc.

48166 Source: Forrester Research, Inc.

RECOMMENDATIONS

SERVICE MANAGEMENT MUST EVENTUALLY INCLUDE FINANCIAL DATA

Forrester has always described BSM as a strategic journey, with organizational and process maturity improving through various stages and with each stage revealing the next summit that forms the new goal. Remember this big picture when making tool and process decisions. Enterprises are demanding clearer connections between IT operating spend and the value delivered to the business. This demand will increase after BSM is established, but it is probably already latent among business users. IT operations professionals looking at IT operations financial management must:

- **Consider the full life-cycle ROI, as more is . . . well, more.** BSM, IT operations financial management, and even service desk projects are effectively enterprise applications. Deploying enterprise applications requires effort, with implementation times ranging from weeks to several months depending on the complexity and scope of the app. Implementation costs for licenses, process engineering, training, project management for deployment, hardware, and configuration are all in addition to the ongoing costs of maintaining the production environment — and the full-time-equivalent (FTE) requirement for financial reporting is incremental. Nationwide states that ServiceFlow decreased costs in this case through better and more informed cost control, so it still achieved a positive ROI.

- **Ensure that the solution fits your overall strategy.** If your BSM strategy is based more on a configuration management database (CMDB) or configuration management system (CMS), rather than the service catalog, you will expect to collect the relevant financial data into the CMS. An IT operations financial management solution like Digital Fuel would then use the financial data in the CMDB/CMS along with relevant data from other sources. No single application is a magic bullet, particularly for something as complicated as managing business services. Digital Fuel is not the only vendor out there: Other vendors that may be well worth a look offer service management (such as Compuware), service catalog (such as newScale), and contract management functionality (such as alfabet and Planview).

ENDNOTES

1 The rate of adoption among enterprises of BSM projects is even faster than previously anticipated. As a result of vendor hype — continually tempered by pragmatic advice within the IT community — a new mantra of "whose service is it anyway" is being sung in almost all new process improvement projects that affect IT operations. It has become clear that IT has been too preoccupied with its own processes in the past — even calling them services — and it must now pay more attention to the performance of the business services that it ultimately supports with technology. See the June 30, 2008, "Business Service Management Market Update" report.

2 Many IT organizations struggle to demonstrate the value of IT to the business. Business stakeholders find IT to be impenetrable, a black box. Much of this is a result of IT's culture of acquiring and operating assets (e.g., servers, storage, networks, etc.), being inwardly focused, and speaking a different language. Implementing service portfolio management (SPM) helps CIOs transform IT assets and their associated costs into business services that they can price and link to business value. See the November 3, 2008, "Service Portfolio Management Links IT Capabilities To Business Value" report.

3 Enterprises with mature business service management (BSM) systems are able to measure and report quality of service at the business level; they can also assign sensible, business-centric prioritization to service performance events and other incidents. Their next requirement is to add financial analysis elements to the service management reports so that the business can understand the true cost of service operations and become involved in demand management decisions. This cost-of-service measurement requires a technical solution that maps business services to cost centers, such as operation infrastructure and resources. New chief information officers (CIO) and IT operations executives often target this phase, as they wish to understand where 60% to 80% of their IT budget is going and how they can rationalize those costs. See the January 6, 2009, "What's After BSM? Understanding The Financials" report.

[4] A vital prerequisite of this stage is the fact that Nationwide can discuss service management at the business service level, so business executives understand and control their consumption in their terms rather than simply being told to "use less storage."

[5] Ironically, there was some initial resistance from the business units, which preferred to leave the responsibility at IT's door. That would make their (the business units') lives much easier.