



# **Service Costing: *Managing Overhead & Shared Costs***

***ITFMA 2018 San Francisco***

- **Session Abstract**

- As you begin to build your cost modeling processes, you will inevitably come across many forms of overhead and shared costs. Organizations have various definitions and naming conventions for these types of expenses. In this session we will discuss different types of overhead and the various methods for incorporating them into your cost of IT services.

- **Outline**

- ITFM Framework
- Cost Modeling Methodology
- Allocation Method Examples for Overhead and Shared Costs
- Socializing Fully-Loaded Rates
- Recommendations & Take-Aways
- Q&A



MarketWatch

@MarketWatch

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The cost to make a Margherita pizza: \$1.77  
 How much restaurants charge on average for a pizza: \$12  
 Markup: 580%

### How much does it cost a restaurant to make a pizza?

Cost of each item in the dish versus the actual price you pay

Meat pizza	
Item	Cost
Mozzarella	\$0.60
Parmesian	\$0.35
Pepperoni	\$0.24
Italian sausage	\$0.18
Flour ("00")	\$0.15
Olive oil	\$0.09
Black olives	\$0.08
Mushrooms	\$0.05
Green bell pepper	\$0.05
Flour (AP)	\$0.05
Tomato sauce	\$0.05
Red onion	\$0.02
Kosher salt	\$0.01
Active dry yeast	\$0.00*
<b>Total cost .....</b>	<b>\$1.90</b>
<b>Price (average) .....</b>	<b>\$14.00</b>
<b>MARKUP .....</b>	<b>636%</b>

Margherita	
Item	Cost
Mozzarella	\$0.90
Basil	\$0.48
Flour ("00")	\$0.15
Olive oil	\$0.13
Flour (AP)	\$0.05
Tomato sauce	\$0.05
Kosher salt	\$0.01
Active dry yeast	\$0.00*
<b>Total cost .....</b>	<b>\$1.77</b>
<b>Price (average) .....</b>	<b>\$12.00</b>
<b>MARKUP .....</b>	<b>580%</b>

\* Cost is less than one cent per meal







**Becky Quick**   
 @BeckyQuick

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This is stupid. Doesn't include cost for labor, rent, electricity, etc.

**MarketWatch** @MarketWatch

The cost to make a Margherita pizza: \$1.77  
How much restaurants charge on average for a pizza: \$12  
Markup: 580%

How much does it cost a restaurant to make a pizza?		at each item in the dish versus the actual price you pay	
Ingredient	Cost	Ingredient	Cost
tomato	\$0.05	mozzarella	\$0.50
onion	\$0.05	bell	\$0.05
spinach	\$0.05	flour (100%)	\$0.15
olive oil	\$0.10	cheese	\$0.10
garlic	\$0.05	tomato sauce	\$0.05
egg whites	\$0.05	water salt	\$0.05
additives	\$0.05	olive oil	\$0.05
egg yolk	\$0.05	total cost	\$1.77
egg white	\$0.05	total average	\$12.00
egg yolk	\$0.05	markup	580%
total cost	\$1.77		
total average	\$12.00		
markup	580%		

4:43 AM - 21 Apr 2018

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109 41 601



**Jill Johnson** @tripwill\_jill · Apr 21

Replying to @BeckyQuick

You can't even make a home-made pizza for \$1.77.



**Steve Kelley** @capecodger · Apr 21

Replying to @BeckyQuick

Time to put tariffs on pizza!!



**Barry Minster** @bkminster · Apr 21

Replying to @BeckyQuick

Amazing how many people feel that the cost of raw materials is the cost to produce the product. 😂



**Parry Singh** @SparkTe · Apr 22

Replying to @BeckyQuick

Fixed costs and variable costs should all be in there!



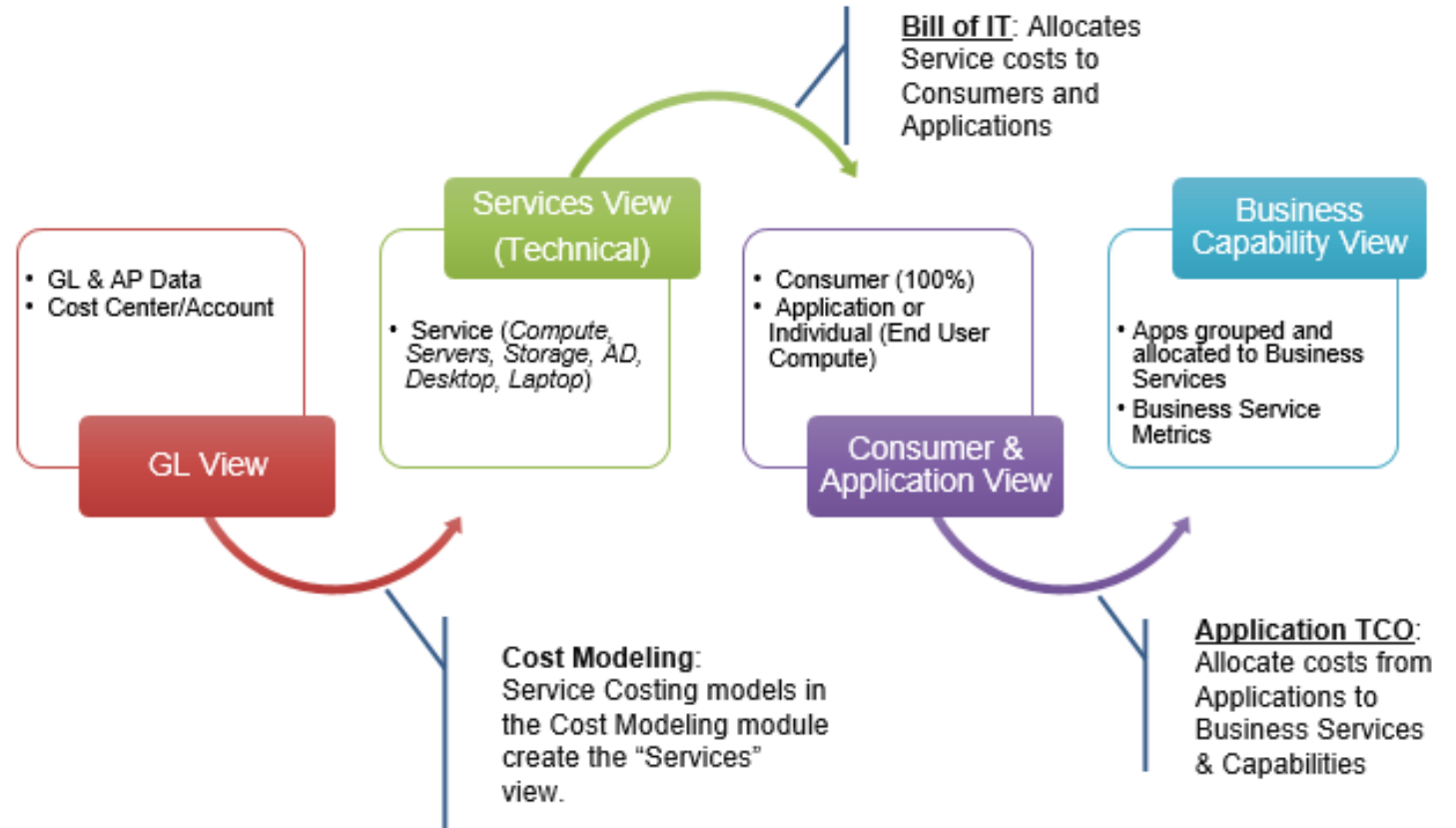
**Jake** @EconomPic · Apr 21

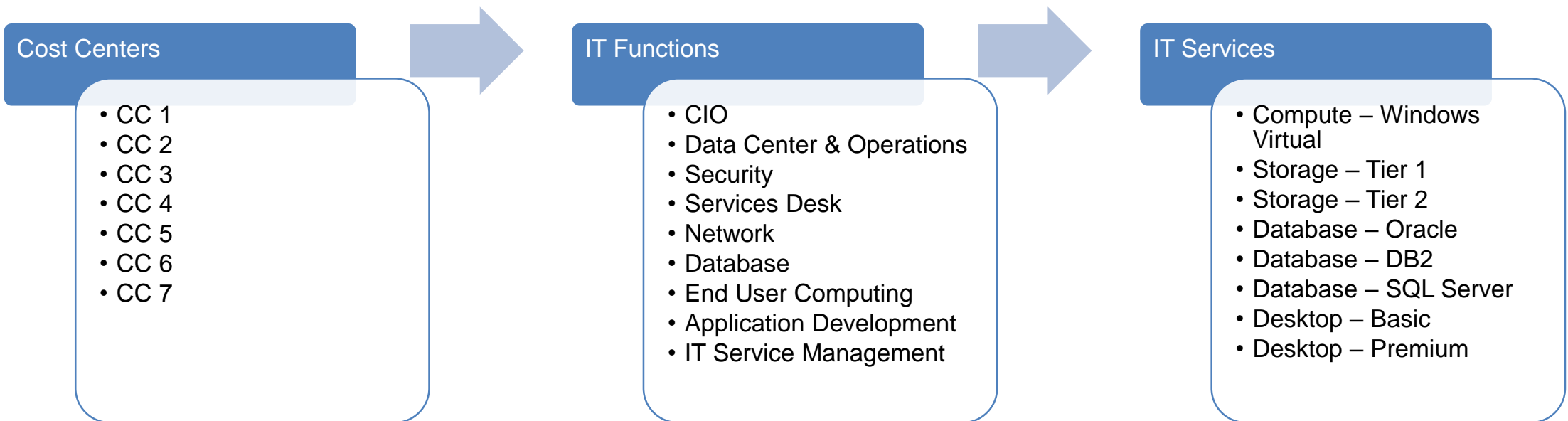
I always assumed they made their 💰 laundering 💰

## ITFM 101:

- ITFM is basically *allocated* views of IT spend
- Each view is generated by a separate module
- Each view provides value to key stakeholders
- Services View:** Provides insight into technology service costs and unit rates. Enables Service managers to *drive down unit rates* and *benchmark* against outside suppliers and peers
- Consumer View:** Provides insight into what organizational entities benefit from IT and helps the CIO demonstrate value
- Application View:** Provides the Total Cost Ownership (TCO) of Applications and *enables application rationalization* exercises
- Business Capability View:** Provides insight into costs to support business capabilities. Helps the CIO *align existing spend* and new IT investments more directly to business functions

## Key IT Spend Viewpoints

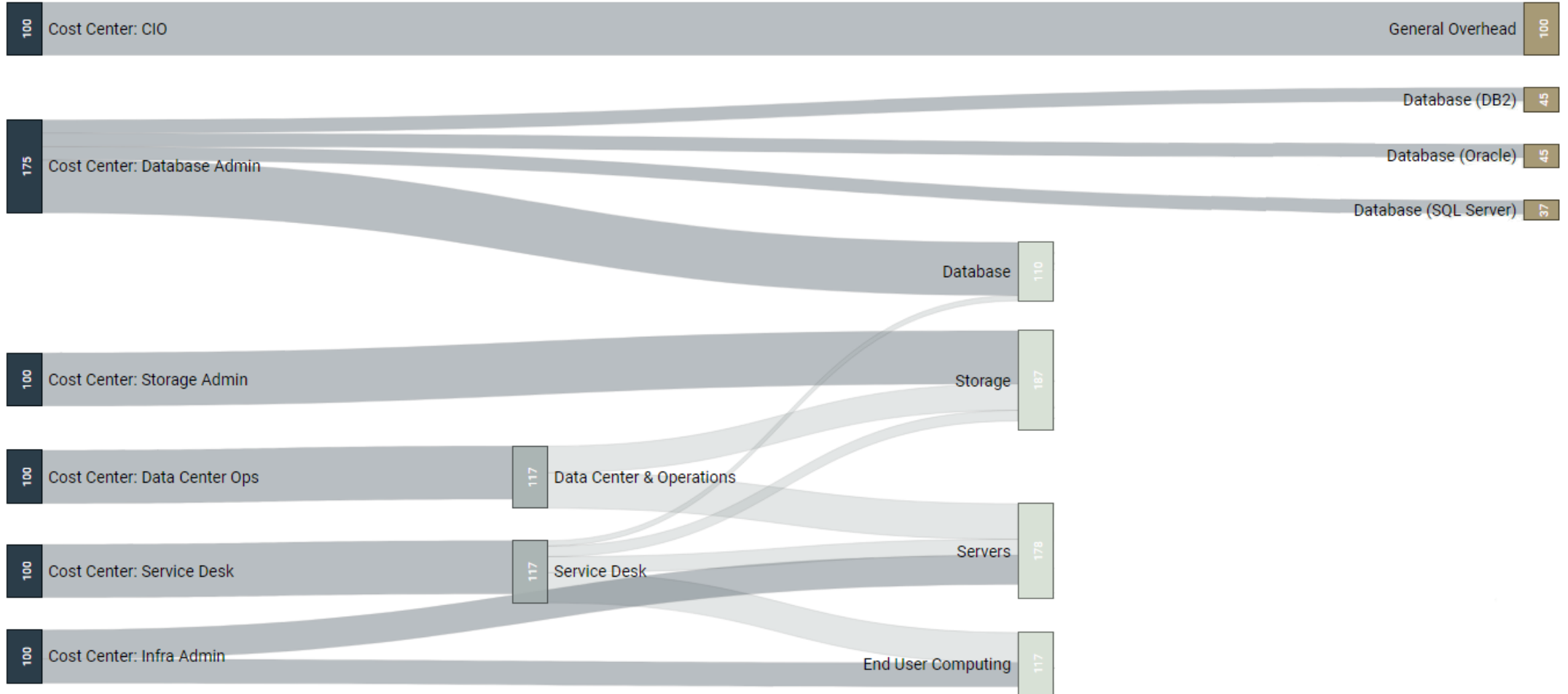


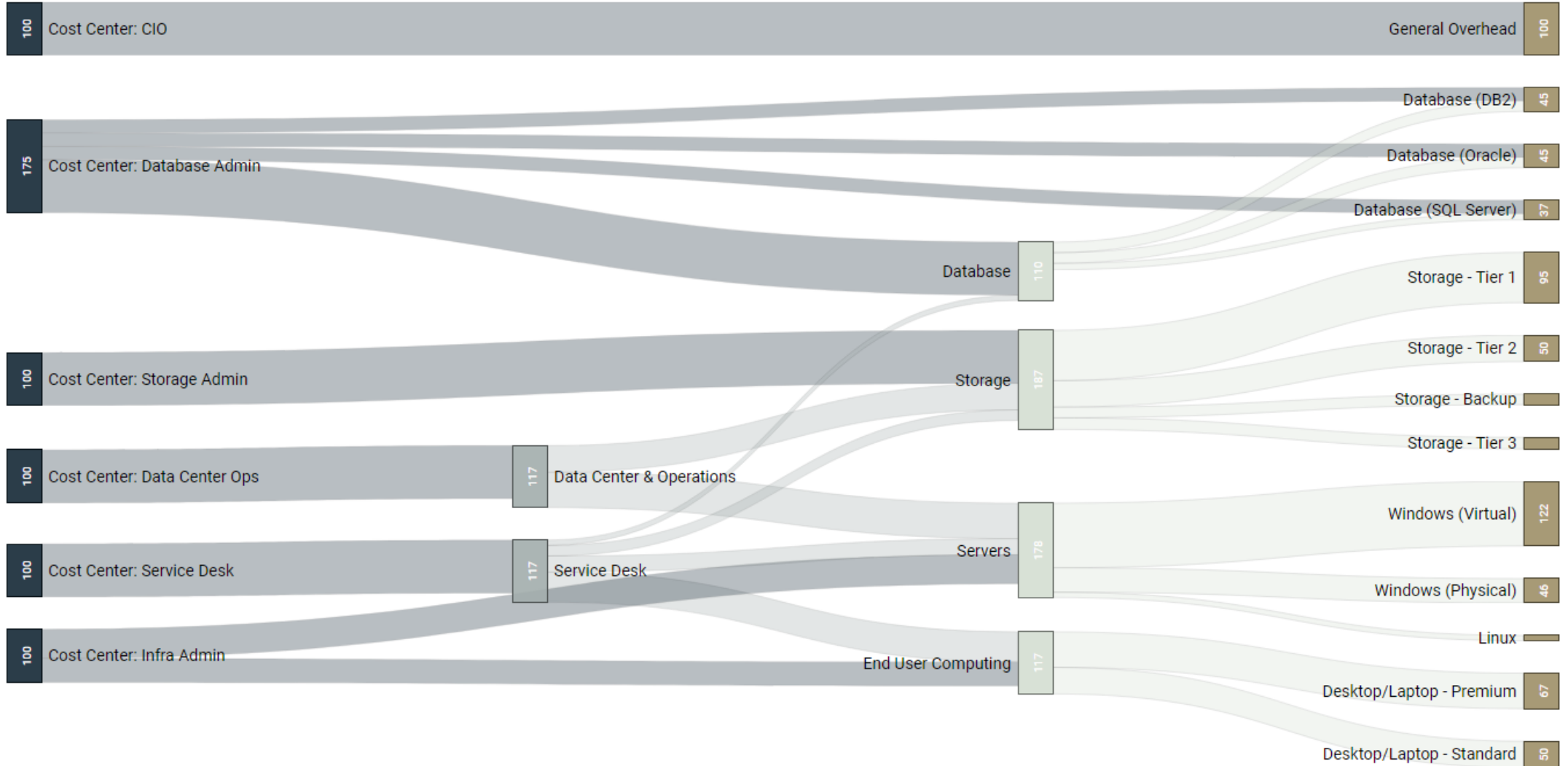


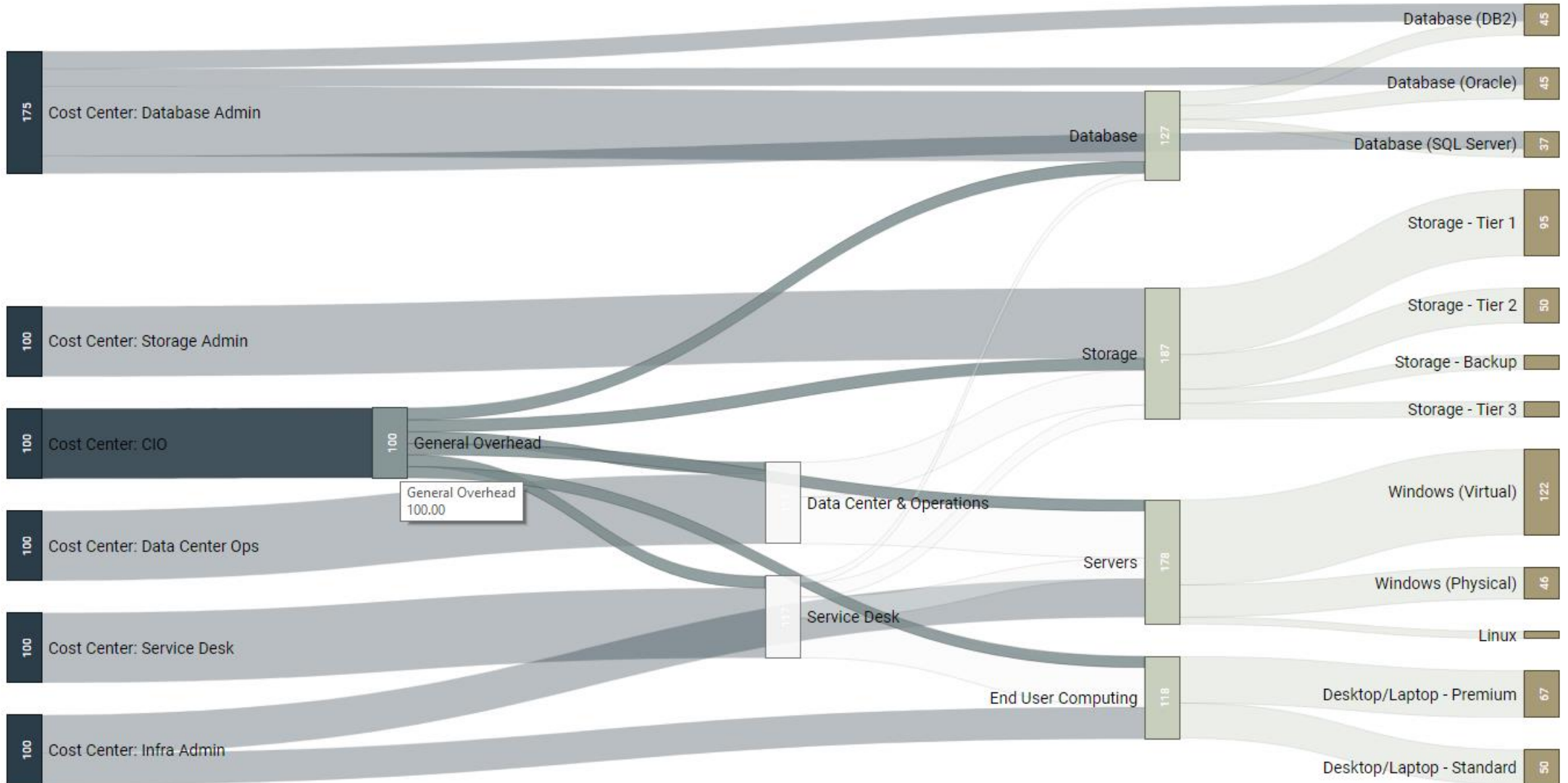
- **Definitions**

- **IT Function** – A shared IT function supporting several (or all) IT services (e.g. Security).
- **IT Service** – A product “*sold*” to an internal consumer (e.g. Storage or a Desktop).
- **Cost Object** - The term Object refers to the Object that holds the costs at a point in time.
- **Source Object** –Source Objects are those Objects whose costs are distributed to Target Objects. At each Level of a Model, Source Objects are allocated to Target Objects.
- **Target Object** - Target Objects are those Objects who receive costs from a Source Object. At each Level of a Model, Source Objects are allocated to Target Objects.
- **Quality Driver** – Allocation data used to execute an allocation, that is repeatable, defensible, and understood.
- **Proxy Driver** – An intermediate set of data used in place of a Quality Driver due to the lack of quality data. Results of cost models using a large volume of proxy drivers should not be used extensively.









Source Object	Target Objects	Quality Driver(s)	Proxy Driver(s)
Service Desk	Security Desktop/Laptop E-mail Server Database <i>More...</i>	Incident Counts	% of Costs in Target Objects
Data Center	Server (Windows) Server (Unix) Mainframe Compute Storage Tape Drives <i>More...</i>	Floor Space Floor Tiles Power/Cooling	% of Costs in Target Objects

Source Object	Target Objects	Quality Driver(s)	Proxy Driver(s)
Database – Labor <ul style="list-style-type: none"> <li><i>Includes all salary, benefits, and other staff-related costs; and department manager</i></li> </ul>	Database – Oracle Database – DB2 Database – SQL Server <i>More...</i>	Estimated % split of staff (DBAs) across each database platform	N/A
Database – Non Labor <ul style="list-style-type: none"> <li><i>Includes hardware, software, other non-labor</i></li> </ul>	Database – Oracle Database – DB2 Database – SQL Server <i>More...</i>	Direct mapping of line items is often required.  <u>Examples:</u> <i>Oracle License Cost</i> <i>DB2 License Cost</i>	Use Database - Labor allocations

Source Object	Target Objects	Quality Driver(s)	Proxy Driver(s)
Network – Back End (WAN)	Physical Address/Locations	<p>Direct mapping of line items is often required</p> <p><i>Example: Mapping individual circuits to each address</i></p>	<ul style="list-style-type: none"> <li>• Apportion all back end network costs into Network – Local</li> <li>• Combine with Data Center costs</li> </ul>
Network – Local (LAN)	Desktop/Laptop Network Connectivity <i>More...</i>	Device inventory (active only)	Head count

Source Object	Target Objects	Quality Driver(s)	Proxy Driver(s)
Overhead <ul style="list-style-type: none"> <li>• <i>Office of the CIO</i></li> <li>• <i>IT Service Management</i></li> <li>• <i>Vendor Management</i></li> <li>• <i>More...</i></li> </ul>	All Objects	% of Costs in Target Objects	N/A

Cost Component	Rate Component	Status
Non-Management Labor	\$79.00	Included
Management Labor	\$22.00	Included
Non-Labor Costs	\$19.00	Included
Overhead	\$17.00	Included
Rate	<b>\$137.00</b>	

## Fully-Loaded Rate:

- Quality service TCO
- Leverage for benchmarking
- Compare to outside suppliers
- **May not be competitive rate**

Cost Component	Rate Component	Status
Non-Management Labor	\$79.00	Included
Management Labor	<del>\$22.00</del>	<del>Excluded</del>
Non-Labor Costs	<del>\$19.00</del>	<del>Excluded</del>
Overhead	<del>\$17.00</del>	<del>Excluded</del>
Rate	<b>\$79.00</b>	

## Partial Rate:

- Not a service TCO
- **May be competitive rate**



- **Recommendations & Take-Aways**

- Limit inventory of IT Functions and IT Services – *A high volume of cost objects will invariably require more inter-function and inter-service allocations; thus overcomplicating the model*
- Right-Complexity
- Proper sequencing is critical
- Education & Sharing – You will need to share your model and educate consumers on how costs were derived
- Primary Purpose – Enable Decision Making – Keep in mind your primary purpose is to enable decision making. This thought should be at the core of every modeling decision you make.

# Q&A