Service Management: Supporting Competitive Service Delivery

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The last decade brought with it a multitude of technological developments that have enabled businesses to achieve exponential productivity growth. Enterprise-wide tools have been developed for everything from transaction execution to budgeting and planning. There is more information available to managers regarding their customers, market trends, resource levels, etc. than in any other time in history. With all of these tools available, most internal service providers still struggle with 'providing value' to corporate customers.

In order to add true value for customers, service organizations must be able to deliver services that 'beat the market' regarding price and quality. All internal service providers are competing with the external marketplace, either directly or, at least, by perception.

We believe strongly in focusing on customers and managing the business at the individual service level: a 'Service Management' approach for service providers. Therefore, the 'Service Catalog' (list of services offered) should be:

- market-focused (comparable to the external marketplace)
- customer-focused (easily understood and identified by the consumer)
- competitive (price, quality, cycle time, etc.)

In order to enable the required 'beat the market' competitive behavior, certain management tools should be implemented:

- service level planning and budgeting
- Service Level Agreements (SLA)
- service unit cost knowledge and understanding in order to develop pricing
- billings (quantity x price) matched to SLA and/or service request
- customer satisfaction feedback
- service-focused performance metrics

Currently, most internal management support systems/processes are resource-focused. In other words, we plan and budget resources, we manage resources, we measure resource performance, and we practice resource costing. Simply put, we manage our internal service business at the resource level, which is a few times removed from the customer.

An effective approach to service management begins to move management focus from the far left (resource level) to the far right (customer level) as shown in Figure 1. This change cannot take place if management support systems/processes continue to focus on resources. A move in focus away from resources to customer would allow for assessing the service delivery activities and processes and aligning them in order to reduce costs and drive prices (even if these are notional) downward in order to maintain customer focus. If the service organization wishes to 'beat the market,' then internal providers must transform their thinking from a resource-based view to a customer-focused view.

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This view is reinforced by recent work by Gartner Group and others regarding 'Service Management' for Information Technology. IT experts are now focused on moving the management systems/processes from 'left to right.' New process design concepts, such as Information Technology Infrastructure Library (ITIL), are also focused on service delivery and management processes. Internal service providers would be well-advised to follow this thinking.

The Costing Engine

One of the most essential components of the management platform is the costing engine. This activity-centric costing engine enables service managers to understand the true 'per unit' cost of providing services to customers. Without a thorough understanding of 'fully-loaded' service costs, and the drivers of these costs, there is no basis on which to manage costs, compare service costs externally, and assign costs or create billings to customers.

More importantly, without this information, managers remain in the dark about how they can affect unit costs through their organizational decisions.

Achieve Transparency in Costing

The principles of Activity-Based Costing/Management (ABC/M) provide an excellent approach to understanding the unit cost of services. We believe it to be the best method to assign costs to the customers who consume the service; this results in a multi-dimensional 'cost-of-service' view of the business.

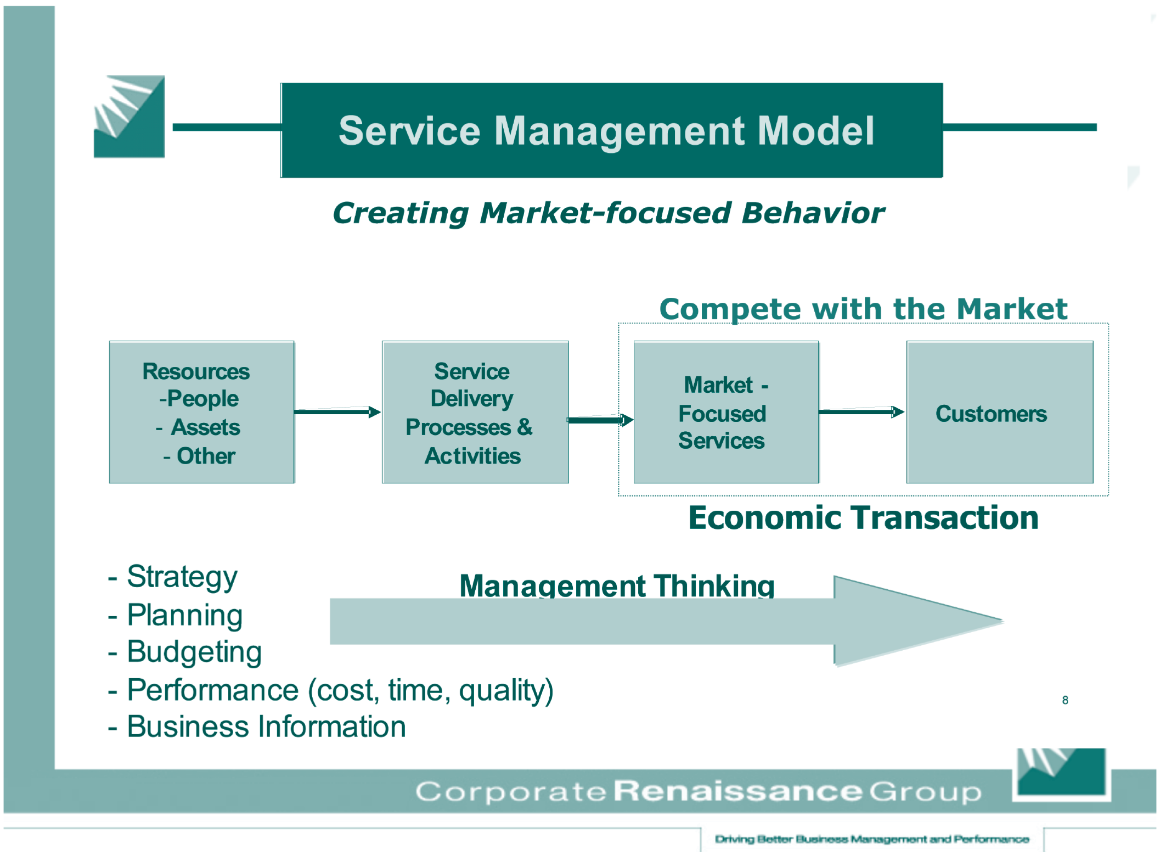

Figure 1

Under this framework, costs are assigned to processes/activities and services/customers by defining and employing quantifiable 'cost-causing' relationships (commonly referred to as cost drivers) between the organizational resources and the activity/process, or the activity/process and the service (i.e. number of paychecks, number of hours, number of CPU seconds, etc.).

The result of this robust costing framework encourages managers to uncover the relationships that cause them to utilize additional resources in the course of providing a service. The multi-dimensional information at their disposal allows them to re-apportion their resource levels and utilization, and drive their unit costs downward.

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In the costing model, every attempt should be made to include the costs associated with all resources that service organizations employ, including their consumption of other internal 'service' offerings. For example, Human Resources provide IT employees with benefits and pay checks. Facilities provide IT employees with the workspace they use to provide their services. Property Accounting keeps track of all of the assets IT employs in providing their services. All of these service providers consume IT services by their use of computers, software, telephones, etc. The ABC/M approach takes these costs into account, using tangible, objective drivers (number of FTE, number of accounting transactions, number of square feet) to re-assign services costs to all consumers.

By taking all costs into account, and tracing their cause-and-effect pathways through processes to services to customers, service providers develop an accurate and visible mechanism with which to understand the unit cost of their services.

Planning and Budgeting

Probably the most important enabler of service level management behavior is the planning and budgeting process/tool. For the most part, the current planning/budgeting annual event is an effort to estimate the financial results of a future business period. We may call it an operating budget, but the focus is on resources and general ledger accounting.

Under our preferred approach, planning/budgeting is a perpetual management process that includes understanding the consumption demands of our product/service offerings for the upcoming (x) number of months, and understanding what the external market will be dictating from a price, cycle time and quality view. In essence we are moving away from the traditional 'x% more than last year' budget process to a consumption based planning/budgeting process. If we know these factors and if our business model dictates that we recover 100% of our operational spend, we can simply calculate our required spend by multiplying the perceived market price (or unit cost target) times the estimated consumption for the planning period. This is called 'driver-based budgeting.' As service managers, we must then make the resource utilization decisions that will maintain the quality and cycle times of our delivery process at a unit cost that is at least equal to the planned market price (unit cost target). If our goal is to 'beat the market' then we have all of the information to plan to achieve it.

Driver-based budgeting at the service level will change management behavior faster than any other single action. Once we get into a perpetual management planning rhythm and are always looking ahead regarding market competitive price, cycle time and quality, we can compete, and probably beat external providers. If we can't, then it's time to think about contracting with the service provider that will provide greater value for our customers. We owe it to them!

Service Level Agreements and Billing

In order to support a competitive mindset, service contracts (Service Level Agreements) integrated with monthly billing is an important management tool. Customers need to be charged for the services they consume, just as if they were purchasing them from an external provider. The most important factors for the successful implementation of Service Level Agreements (SLA) and monthly billings are 1) a standard pricing policy, and 2) a set of governance rules over the contracting/charging process.

Pricing of services can be one of the most sensitive and 'behavior-modifying' topics an internal service provider can face. Two basic viewpoints are generally discussed when determining a pricing strategy for internal charging: cost-based pricing and market-based pricing. The former method prices internal services strictly according to unit cost. Prices can be updated every time the costs are updated, so as to immediately reflect operational efficiencies, or cost-based prices can remain constant for pre-determined periods of time, and updated periodically. In both cases, updated prices will reflect operational efficiencies and cost-reduction actions taken by the service provider.

The other pricing method is market-based. Under this scenario, service providers determine what the market price would be for services similar in nature and quality to what they provide. Market prices are based on what external providers would charge for comparable services to the organization. The charge to the internal customer is calculated by multiplying the volume of service consumed times the market price.

As stated above, the Service Level Agreement is the sales/purchase contract between the service provider and service consumer. Both parties in the transaction must understand that unexpected increases or decreases in demand for services or the performance expectations of the service provider could result in price (unit cost) adjustments. The Service Level agreement must specifically state the actions to be taken if this happens, so that accountabilities throughout the corporation are documented, and can be enforced.

Once the service pricing strategy has been developed, the provider-consumer contract (SLA) is approved and the consumption of services is known, the service provider has a basis for invoicing customers, both internal and external. Although we recommend formal invoicing to internal customers, just as we would for external customers, there are options for internal charging of services. The first is termed a 'shadow bill' or a 'showback' (versus chargeback). A shadow bill or showback is simply a report created that demonstrates to the internal customer what they would have been charged, had they been formally invoiced. Shadow bills can be supplied in either 'hard' or 'soft' copy formats, depending on customer preferences. The second option is to formally charge the internal customer, in other words, create receivable/payable and revenue/expense accounting transactions from the invoice. Internal customers then see these charges on their monthly cost reports, just as any other direct cost.

Customer Surveys

Have you ever heard the phrase "perception is reality"? Remember all of those performance expectations that we discussed as part of the SLA? We could be nailing those targets consistently, but if a customer has the perception that we are not creating value, then customer satisfaction still suffers. So, how do we get an understanding of customer perceptions? Ask!

A web-based customer feedback tool is effective to gather customer perception information and/or other customer satisfaction indicators. Don't ask customers about the performance metrics that you can track; but there is an intangible component of value which can only be evaluated through customer feedback. Satisfaction metrics should be included in everyone's performance scorecard, so results of surveys are extremely important in evaluating performance achievement.

Use a centralized process for gathering internal (or external) customer feedback. The results can then be sent to the balanced scorecard in order to report against satisfaction targets.

Balanced Scorecards

An effective service management performance model provides metrics at the service delivery level and has links to strategic goals and expectations. The service provider must implement the performance metric reporting tools in order to demonstrate the actual and perceived value to internal and/or external customers.

In order to effectively manage service delivery from a market and customer focus the performance management model must include unit cost, quality, cycle time and quantity of service metrics for each service. This should match up with the performance expectations documented on the SLA. Other performance dimensions, such as higher-level financial results, customer

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satisfaction, demand changes, process efficiencies and execution, and productivity, retention and development of employees are also important metrics in a balanced scorecard model. A multi-dimensional, balanced approach to performance management enables the organization to make decisions that affect cost, while understanding any positive or negative impacts that decision may have on other areas of the business. By accounting for all performance dimensions, service providers can measure its past performance, as well as develop indicators of future performance.

We can use the following Performance Model to create the metrics required to achieve financial and other value. In this balanced performance "House", the ultimate goal is to increase financial value (see also Figure 2). In order to accomplish that:

- we must have satisfied, loyal customers and increase market share. In order to have satisfied loyal customers...
- we must have very efficient service delivery, customer support and company growth processes. In order to maximize the efficiency of our processes...
- we must have satisfied, educated employees and current technology. This is the foundation of the "House". In order to continuously 'beat the market' and provide on-going, long-term business success...
- we must minimize our business risk. In other words, we must ensure a safe, secure business environment on which to build the "House".

We believe in "open book management". There is no reason to hide service level performance metrics from anyone in the provider or consumer organizations. Web-based performance 'dashboards' provide an effective view of achievement versus SLA expectations/targets. These can be distributed widely via the Internet for very little cost.

Conclusion

Today's service business environment moves quickly; there is no doubt about it. The service business landscape has become more productive and competitive over the course of a decade. Technology has been, and remains, the enabler of innovation and progress. Service provider managers and professionals have been charged with

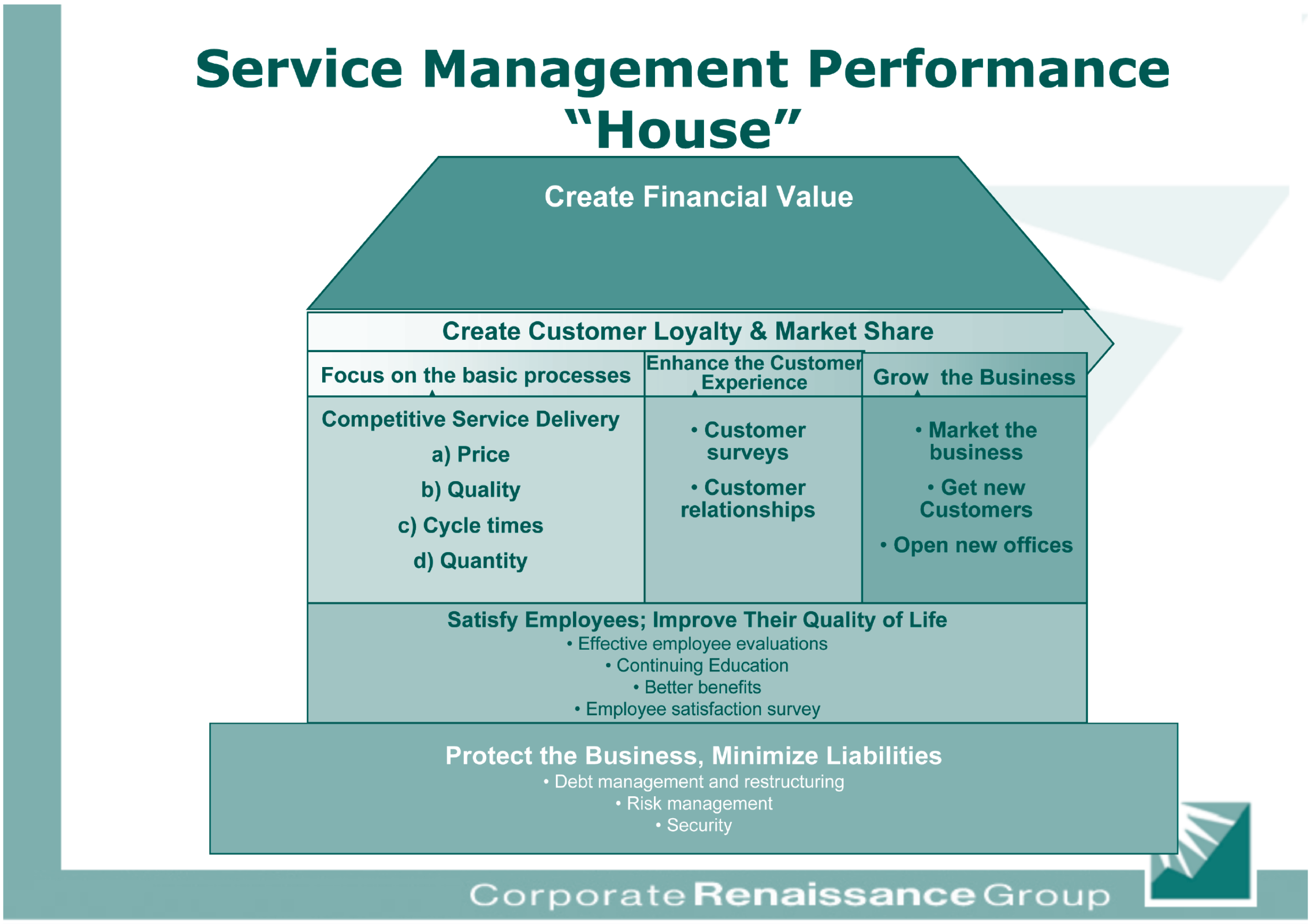

Figure 2

providing 'value' for their internal customers. They are also accountable for the amount of annual spending required to fulfill their 'value-add' responsibility. It is a delicate balance, but one that competitive businesses face every day. By focusing the entire service provider organization on the value proposition of delivering services to customers, we can create 'beat the market' results. This will lead to improved employee satisfaction, customer satisfaction and financial value.

About the Author

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Ron Bradley specializes in developing business solutions through performance management, financial accountability, process redesign, business system design and strategic cost and profitability models. Mr. Bradley has extensive experience in developing business solutions, was Director of Activity-based Costing and Performance Management for a large utility prior to his consulting career, and has hands-on knowledge of process redesign methodologies.