[The Controversy of Chargebacks in the Cloud](http://leanit.apptio.com/general/the-controversy-of-chargebacks-in-the-cloud/" \o "Permanent Link to The Controversy of Chargebacks in the Cloud)

[**Bernard Golden**](http://www.hyperstratus.com/about-us) recently wrote an excellent article in [**CIO Magazine**](http://www.cio.com/article/633513/Cloud_Computing_Why_You_Can_t_Ignore_Chargeback) on the brewing controversy of [**Chargeback for Cloud Services**](http://www.cio.com/article/633513/Cloud_Computing_Why_You_Can_t_Ignore_Chargeback?source=CIONLE_nlt_datacenter_2010-11-10#readerFeedback) and the challenge that comes with “charge for consumption.”  He nailed it:

*“One of the most controversial issues in cloud computing is chargeback: pricing consumed resources on a granular basis. [This] is not, perhaps, for the reason you might expect….”*

Bernard goes on to state that it’s not because business units don’t want to be charged for IT—that happens already. Rather, they want to know that the chargeback allocation system is fair.  This is no simple task.

In our experience, business users aren’t afraid of being charged for what they use.  Almost to the contrary — they are screaming for transparency so they can make better decisions about how they use IT. They want to know exactly what IT costs and that they are being charged fairly.  Ideally, they want to be charged only for what they actually consume.  Any business manager worth their salt recognizes that the business pays for IT one way or the other Indeed, usually the business unit VP controls and  manages their own IT budget.  Consequently, business leaders want an allocation policy that is fair AND communicates the value (cost & quality) they receive from internal IT services that can be benchmarked against IT services available on the open market (the public cloud.)

This is, of course, exactly what **[Apptio TBM solutions](http://www.apptio.com/products/index.php" \t "_blank)** were designed to provide—a system of record that provides granular and activity-based costing of IT services, transparency to all stakeholders (business and IT), and the analytics to make more educated decisions based on that data.  The trick, as Bernard points out, is to blend an allocation model that is both accurate (based on consumption) and flexible enough to change with the dynamic nature of IT, and then automate these data feeds so that consumption and cost data are updated in near real-time.  To overcome the charge-by-consumption complexity that Bernard lays out, Apptio ties into existing systems that track consumption (i.e., VMware vCenter chargeback, storage management systems, help desk systems, PPM, etc.) and marries consumption data with the cost data (which usually resides in a different set of systems.)  Through this process, IT departments can create chargeback strategies that are fair, flexible, relevant with up-to-date data, and transparent across business units, IT and financial departments.

On the issue of **[showback](http://www.apptio.com/solutions/it-initiatives/it-chargeback-and-demand-management.php" \t "_blank)**, I have to respectfully disagree with Bernard.  We have seen that showback is an excellent and almost necessary stepping stone to chargeback.  Most people we talk to define chargeback as the actual exchange of funds based on consumption of IT resources—the critical element is that funds are actually changing hands based and thus requires proper accounting.  “Showback” then demonstrates a baseline level of transparency—a “[**Bill of IT**](http://www.apptio.com/products/bill-of-it.php)” showing how much business units are being billed based on how much they are consuming (including the service itself and the service rate) but without the accounting system in place to actually transfer funds.

Showback actually does work well to drive proper behavior in IT consumers because the business unit leaders are ultimately responsible for their IT budget (usually with a desire to reduce cost) and will hold their people accountable for any misuse of an expensive IT resource.  We have seen this play out time and time again, and it’s a wonderful thing as it means that IT and the business units are aligning on the most effective way to leverage IT resources.  Under the guise of “Transparency” business units are very accepting of a “Bill of IT.” This serves as a proving ground for the allocation strategy, the development of new business processes on demand alignment and billing and works out any kinks in the IT Financial Management system of record before going to true Chargeback.

Now, on to Bernard’s last point akin to the “[**Industrialization of IT**](http://blogs.forrester.com/glenn_odonnell/10-04-21-it_industrializing_%E2%80%93_what_does_mean_me)”.  I could not agree more with this point.  Just as Activity Based Costing gave the manufacturing industry a way to parse out the key cost drivers in their factories to reduce the cost of products through better analytics, so too will IT.  With deeper insight into the unit cost drivers of IT services, IT will be not only be able to reduce the cost of delivering IT services (cost of operations) but also push back on suppliers to “design for Total Cost of Ownership.”

Here’s a couple of real world examples: A large cloud provider with hundreds of thousands of servers in their operations leveraged Apptio’s activity based costing to understand the cost of power in each of their IT services.  For the first time ever, they were able to provide real cost justification data to the application developers, illustrating that if they designed applications that used less power they would save the company hundreds of millions of dollars in IT operations.

Additionally, a large retail organization was about to refresh their entire desktop inventory based on a certain laptop vendor and model—they had contracted a very nice acquisition price.  But after analyzing the total four year cost to own and support various laptop models, they found that (1) 60% of users could actually use desktop systems at half the cost, (2) the chosen laptop was the most expensive model to support and would have had a greater three year TCO than an alternative model, and (3) based on an analysis showing when annual support costs exceed the cost of a new laptop, it was cheaper to delay the refresh another year, which ultimately saved the company millions of dollars.

Bernard is right: proper service costing and transparency (chargeback *or*showback) will enable unheralded gains in cost efficiency.  As witnessed in manufacturing with Lean and Total Quality Management (TQM), cost efficiency will come with an actual improvement in quality and service delivery as well.  I have no doubt that done properly, Technology Business Management can bring about cost efficiency gains of more than 40% over a three-year period.  We have already seen 10%-15% annual cost savings across many customers, and this is just scratching the surface.  The Cloud is forcing IT to develop proper chargeback/showback systems, but the real benefit will be that IT organizations run more cost efficiently and with better alignment with their business priorities.

I’ll close with Bernard’s quote, as I couldn’t have said it better myself:

*“… chargeback is going to become a more important issue in the near future and pressure will build on internal IT groups to truly reflect — with great granularity — the fully loaded cost of delivering specific resources. The chargeback controversy will soon shift from whether it’s important or not to how soon it can be implemented — and I wouldn’t want to be the CIO who responded with a “we’re thinking about it.” “*