



White Paper

Developing the Business Case for ITIL®

*Learning to speak the language of business
and help our executives promote our ITIL initiatives*

By Mark A. Shell 
ITIL® Service Manager
ITIL® v3 Expert

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Executive Summary

Convincing the CFO of the value your ITIL initiative brings to the business may be the biggest challenge you face. It may also be the most important role you play as a leader in IT. Most organizations are not currently developing business cases or performing financial analysis to support their ITIL initiatives but Forrester Research suggests that lack of a solid connection between spending and return is causing executives to be reluctant to support ITIL-related spending. Research from Gartner suggests that spending initiatives are largely funded based on the value the initiative is expected to return to the business. We need to rethink the way we describe our vision and high-level business objectives for our ITIL initiative. The benefits are real. We just need to quantify them in terms of return to the business.

This white paper explores the use of Payback Period, Return on Investment (ROI), and Net Present Value (NPV) to show the tangible business benefits we expect to reap from our ITIL initiatives in order to gain the support of our company's leadership.

Your Most Important Role as an IT Leader

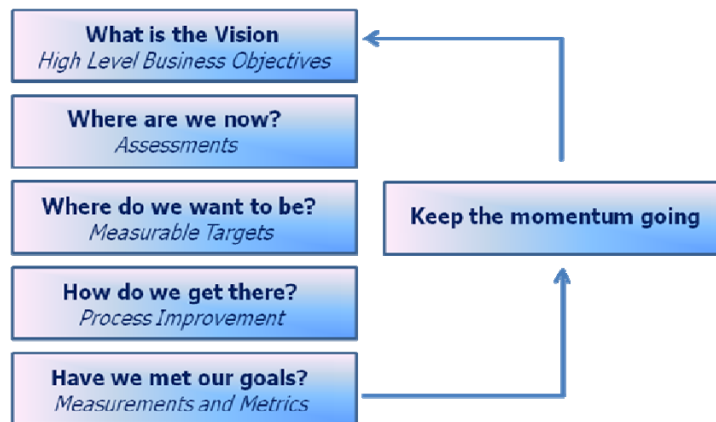
You've been to ITIL® Foundation training. You've read the books. You know implementing ITIL best practices could really help your organization in a number of ways, but you're having trouble getting anyone at the senior management or executive level to pay much attention. How do you explain the value of implementing ITIL to your company's leaders in a way that will have meaning for them and get them to buy into your plan?

Well, first of all, you're not alone. In the fall of 2004, the CIO Executive Council discussed the various professional challenges they faced. One of the professional challenges this group prioritized and determined to tackle was how to clearly explain the value of IT to the enterprise.

Convincing the CFO of the value your ITIL initiative brings to the business may be the biggest challenge you face. It may also be the most important role you play as a leader in IT. Research from Gartner suggests that spending initiatives are largely funded based on the value the initiative is expected to return to the business. While most organizations are not currently developing business cases or performing financial analysis, Forrester Research suggests that lack of a solid connection between spending and return is causing executives to be reluctant to support ITIL-related spending.

Revisiting the Continuous Improvement Model

Remember the ITIL continuous improvement model you learned about in Foundation class?



ITIL continuous process improvement model

We tend to think of the vision and the objectives in “IT techie” terms. We use terms like, reduce average speed of answer, improve first call resolution rate, or increase the percentage of incidents resolved at tier-1 to describe our high level objectives.

A 2004 Gartner report says “IT metrics often have no alignment with business metrics.” Identifying and aligning those performance relationships is crucial to demonstrating the IT organization’s contribution to business value.

We need to rethink the way we describe our vision and high-level business objectives for our ITIL initiative. We know that bringing ITIL best practices to our Service Desk function and Incident Management process will ultimately improve our first call resolution rate and/or increase the

percentage of incidents that are resolved by tier-1 support. The question is what value does this bring to the business? You're going to ask for money and other resources to implement the changes necessary to make these goals a reality but what are you going to promise in return for the investment the business makes in your plan?

Ziff Davis reports that a 2007 analysis of benchmark data from 2,100 companies found that world-class IT organizations, those that achieve peak efficiency and effectiveness, spend 7% more per end-user on IT operations than typical companies, but on average, earn that amount back fivefold in lower operational costs.

Think about what that says. We need to stop presenting our plans as simply initiatives to be funded (costs) but as investment opportunities for the business; Opportunities that have tremendous potential to pay a return on that investment (ROI). We need to begin to think of, and talk about, the business priority as the most important top or bottom line payoff our initiative is expected to provide. This must be a value that drives the success of the business and should be expressed in terms that matter to the CEO or board of directors like revenue growth, income growth, protecting future revenues, cost reduction, future cost avoidance, or regulatory compliance.

One way to figure out what is important to your board of directors or CEO is to read your company's annual report. Get to know the lingo that your CEO is using to describe the business and pick up on that language. It's likely you'll come across terms like profit growth, margin, market share, return on capital, cost of goods sold, and earnings per share.

The CEO, CFO, and board of directors at your company are likely to insist on metrics such as ROI and return on capital to justify spending. Return tends to be the driver for all their investment decisions. Why should your project be any different?

Tangible Benefits

Are there real, tangible benefits to be gained by implementing ITIL best practices that we can use to build a business case that shows a return? A 2006 Forrester Research report cited the following benefits were reported by companies that implemented ITIL:

- ◆ 70% said they experienced better quality of delivery from IT operations
- ◆ 52% said they experienced better process efficiency in IT operations
- ◆ 36% said they experienced better productivity of IT operations
- ◆ 19% cited costs savings in IT operations

The benefits are real. We just need to quantify them in terms of return to the business. Imagine putting together a short PowerPoint presentation for your executive management, typically the CFO, COO, or the executive sponsoring the ITIL initiative. You keep it short, allowing fifteen minutes for the presentation and fifteen for questions and answers. Start with an Executive overview. What are you trying to accomplish, why, and what are the anticipated benefits? Next, give a project summary. Describe (briefly) what the project entails. For example, *Implement ITIL Incident Management in order to more rapidly restore service to users, thus minimizing disruption to the business, and to increase the number of incidents resolved by tier-1 support, in order to reduce the costs to the business.* Describe how long you anticipate the project taking and give a high-level overview of the resources that will be required. Then, quantify the expected costs followed by the anticipated results (in business terms). It might look something like this:

Three-year cost of investment	\$1.9M
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Annual cost savings and/or increased revenue	\$13.2M
Payback period	12.4 months
Net Present Value of three-year savings	\$24.5M
ROI over three-year life of project	351%

Finally, close with a slide outlining your recommendations. “Based on the costs/benefit analysis performed, we recommend moving ahead with the ITIL implementation.” Close the sale!

Speaking the Language of the Business

Now you’re talking their language. But, how do you do the calculations? It’s really not that difficult. You just haven’t thought about things in this way before. Let’s take a look at Payback period, Return on Investment (ROI), and Net Present Value (NPV) in a bit more detail.

Payback period – The length of time required to recover the cost of an investment. This simply tells the business how long it will be before we get the money back and can use that money for something else.

Costs Annual cash inflows

All other things being equal, the better investment is the one with the shorter payback period. For example, if a project costs \$100,000 and is expected to return \$20,000 annually, the payback period will be \$100,000/ \$20,000, or five years.

There are two main problems with the payback period method:

1. It ignores any benefits that occur after the payback period and, therefore, does not measure profitability
2. It ignores the time value of money

Because of these reasons, other methods of capital budgeting such as net present value, return on investment, internal rate of return, or discounted cash flow are generally preferred.

Return on investment (ROI) – A performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment; the result is expressed as a percentage or a ratio.

$$\frac{\text{Gain}}{\text{Cost}} \times 100$$

Return on investment is a very popular metric because of its versatility and simplicity. If an investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should be not be undertaken.

Net present Value (NPV) – The difference between the present value of cash inflows and the present value of cash outflows. NPV is used in capital budgeting to analyze the profitability of an investment or project. NPV analysis is sensitive to the reliability

of future cash inflows that an investment or project will yield. Be conservative in your estimates.

$$\sum_{T-1}^T \frac{C_t}{(1+r)^t} - C_0$$

NPV compares the value of a dollar today to the value of that same dollar in the future, taking inflation and returns into account. If the NPV of a prospective project is positive, it should be accepted. However, if NPV is negative, the project should probably be rejected because cash flows will also be negative.

Putting it all Together

Let's put some numbers together for our hypothetical example above. We said we would *Implement ITIL Incident Management in order to more rapidly restore service to users, thus minimizing disruption to the business, and to increase the number of incidents resolved by tier-1 support, in order to reduce the costs to the business.* Let's work up some numbers assuming we could increase the number of incidents resolved by tier-1 support by even a small amount as a result of implementing ITIL best practices in the area of Incident Management. What would the financial benefits for the business be?

We'll use the *2007 HDI Practices and Salary Survey* for our example data.

Support tier that resolves incident	% of total incidents resolved by each tier	Average salary for each tier	Hourly cost by tier
Tier-1	56%	\$37,195	\$17.88
Tier-2	17%	\$45,425	\$21.84
Tier-3	8%	\$55,211	\$26.54

Let's assume this Service Desk handles 2,000 incidents a month.

Let's also assume we're not quite performing up to the average levels reported in the HDI survey. Our numbers look more like this.

Support tier that resolves incident	% of total incidents resolved by each tier	Number of incidents resolved by tier (based on 2,000 incidents a month)	Time spent at each tier (you'll need to determine this number for your organization)	Hours spent on resolution by tier (# of incidents x time spent)	Costs for incident resolution by tier (hours spent x hourly cost by tier from table above)
Tier-1	50%	2,000 x 50% = 1,000	½ an hour	1,000 x 0.5 = 500 hrs	\$8,940
Tier-2	20%	2,000 x 20% = 400	3 hours	400 x 3 = 1,200 hrs	26,208
Tier-3	15%	2,000 x 15% = 300	5 hours	300 x 5 = 1,500 hrs	39,810
Total					\$74,958

What would our costs look like if we could just improve to the average levels reported by HDI members in 2007? Note: We don't make any improvement in the amount of time spent at each tier. We just improve the number of incidents that get solved at lower levels without escalating to higher, more expensive tiers.

Support tier that resolves incident	% of total incidents resolved by each tier	Number of incidents resolved by tier (based on 2,000 incidents a month)	Time spent at each tier (you'll need to determine this number for your organization)	Hours spent on resolution by tier (# of incidents x time spent)	Costs for incident resolution by tier (hours spent x hourly cost by tier from table above)
Tier-1	56%	2,000 x 56% = 1,120	½ an hour	1,120 x 0.5 = 560 hrs	\$10,012
Tier-2	17%	2,000 x 17% = 340	3 hours	340 x 3 = 1,020 hrs	22,276
Tier-3	8%	2,000 x 8% = 160	5 hours	160 x 5 = 800 hrs	21,232
Total					\$53,520

Wow! That's a savings of \$21,438 a month or \$257,256 a year.

But what are the costs – There's one more thing we need to know. What's all this going to cost? Let's assume the following costs. (You'll figure your own actual costs but we'll use these for our example)

ITIL Foundation training for 20 staff	\$23,600
Consulting guidance	80,000
New or modified reports	10,000
Software modifications to enable the processes we develop	\$90,000
Total costs	203,600

Calculate the Financial Returns

Now let's use these numbers to calculate our payback period, ROI, and NPV.

$$\text{Payback period} = \frac{\text{Costs}}{\text{Annual cash inflows}}$$

$$\$203,600 / \$257,256 = 0.79 \text{ years} \times 12 \text{ months/year} = 9.5 \text{ months}$$

$$\text{ROI} = \frac{\text{Gain}}{\text{Cost}} \times 100$$

$$1 \text{ year ROI} \quad (\$257,256 / \$203,600) \times 100 = 126\%$$

$$3 \text{ year ROI} \quad ((\$257,256 \times 3) / \$203,600) \times 100 = 379\%$$

$$\text{NPV} \quad \sum_{T=1}^T \frac{C_t}{(1+r)^T} - C_0 =$$

You don't have to be a math whiz to do this calculation. You're going to use your trusty financial calculator. Check the instruction manual of your calculator to see how to calculate NPV. You'll need several inputs. Here are the values to match our example:

Cash flow 0 or CF ₀ – <i>this is your expense in year 1</i> <i>This is usually entered as a negative number to indicate cash going out</i>	-203,600
Cash flow 1 or CF ₁ – <i>this is the net savings or inflow in year 1</i>	257,256
Cash flow 2 or CF ₂ – <i>this is the net savings or inflow in year 2</i>	257,256
Cash flow 3 or CF ₃ – <i>this is the net savings or inflow in year 3</i>	257,256
Annual interest rate –	10.5%

The interest rate your business can expect to make on another investment of similar risk

When you put these numbers into the calculator, you should get an NPV of \$430,567.80

This is what you include on your anticipated results slide for your executive presentation:

Three-year cost of investment	\$203,600
Annual cost savings and/or increased revenue	\$257,256
Payback period	9.5 months
Net Present Value of three-year savings	\$430,567
ROI over three-year life of project	379%

You Can do This!

So, can you do this for your ITIL initiative? Sure you can! Just gather real data for your organization using the process outlined above. You may want to get some time with your CFO to discuss your numbers. He'll probably be impressed that you're thinking this way and will be more than happy to help you. Good luck!

About Propoint Solutions

Propoint Solutions was conceived out of the need for a balanced approach to achieving IT service excellence. We believe people, process and technology must all come together to address IT business drivers. We are committed to providing our customers with experience-based leadership and professional services to accelerate their business objectives. Enjoy the relief that comes from knowing the Propoint Solutions team is here to ensure your success. We can help you get from the data you have to the metrics you need. Propoint Solutions -- *elevating IT service excellence through people, process and technology.*

Contact us

Propoint Solutions, Inc.

9910 Palisade Ridge Drive
Colorado Springs, CO 80920-1490

phone: 888.264.0761 • fax: 719.785.5797

e-mail: info@propointsolutions.com

www.propointsolutions.com

