Cost Management at AFLAC IT

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Overview

American Family Life Assurance Company of Columbus (AFLAC) is the number one provider of guaranteed-renewable insurance in the United States and the largest foreign insurer in Japan. Insuring more than 40 million people worldwide, AFLAC is the principal subsidiary of AFLAC Incorporated, an international holding company based in Georgia. At year-end 2002, the corporation's total assets were more than $45 billion, with annual revenues of more than $10.3 billion.

A Fortune 500 Company, AFLAC is a leader in guaranteed-renewable insurance sold at the worksite in the United States, offering policies to employees at more than 260,000 payroll accounts. *Fortune* magazine named AFLAC to its list of "The 100 Best Companies to Work for in America" for the fifth consecutive year in January 2003 and to its list of "America's Most Admired Companies" in the life and health insurance industry in March 2003.

Our 400 IT employees support the technical needs of the AFLAC business units and approximately 40,000 field agents. Until recently, cost management, like in many other IT organizations, resided in an internally focused budget monitoring process. We have a fairly robust forward-looking budget outlook system and a project management system that we have expanded into more of an overall "work management" system.
Even with these management tools, we had no way to share the burden of managing our costs with the ultimate consumers of IT's services. We wanted to understand more about the ongoing cost to provide our services to the AFLAC business units, and we wanted to be able to communicate those costs to them. We were already charging back telephone charges, but we had no way of communicating the full cost of providing all of IT's other services.

The Solution

After speaking with and getting proposals from a few external consultants and attending an IQPC Conference in New Orleans in April of this year, we decided to hire Corporate Renaissance Group to assist us with our requirements. We started out thinking that we would only use their integrated Activity-Based Costing (FlexABM) and Billing solution, but after our CIO saw the other tools included in their Shared Services Manager (SSM) toolset, we decided to also implement electronic Service Level Agreements, Performance Scorecards and Customer Feedback. We already had some initiatives planned in these areas, so the full SSM toolkit was a perfect fit.

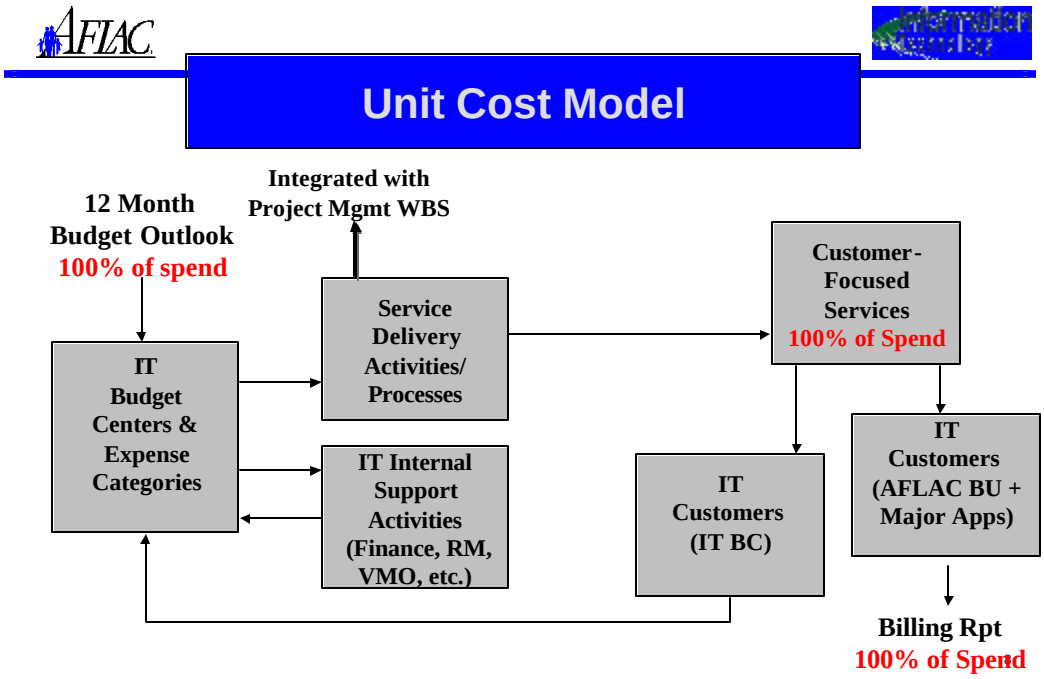
The Vision for the Cost Management solution for AFLAC IT Services included:

- Developing a customer-focused set of service offerings.
- Enabling advanced cost management capabilities, that is, the ability to understand and affect the cost drivers.
- Developing a "shared accountability" solution, where IT customers are more accountable for the quantity of services they demand/consume and IT Service providers are accountable for the unit cost/price of the service.

The Cost Management solution was designed to include all IT customers, services, activities, and budget centers (BC). The first "full-cost" model completed during the 8-week project included the latest 12 months of financial outlook information (cost) at the Budget Center and Expense Class (a summarized set of GL Accounts) level (May 2003 Outlook) and the most recent (or estimated) driver volume information. This calculated a forward-looking, annualized unit cost for each service in order to populate SLAs with an annualized price.

Our cost management solution has the capability to get prices from the SLAs or a calculated unit cost from FlexABM and to create a Quantity x Price invoice. We made a decision early on in the project not to formally charge for our IT Services at this time. We will continue the small amount of charging that we were doing prior to the cost management solution and may decide to extend the formal charging sometime in the future. We decided that the AFLAC business culture is not currently a good fit for "100% cost recovery" chargebacks. Another reason for this is that we needed some time to understand our new cost management tool ourselves and improve the data driver precision within the solution before we would be ready to justify our costs to our customers. However, we designed and constructed the cost model and the resulting cost report as if we were going to actually invoice and charge back for our services. This way, we can have discussions with our internal customers concerning the volumes that they are demanding and the unit costs (prices) that we are currently experiencing. At this time we feel that providing the information alone will be a sufficient incentive to effect change in behavior where needed.

Below is the design of the IT business model that we used to construct our FlexABM / Billing solution. As you can see, we designed the solution to achieve a "100% cost recovery of IT Spend" from our business unit customers.



IT Customers

Since one of our goals is to be customer-focused, it was important to define who our IT customer would be for cost management purposes. Even though every employee or every AFLAC budget center manager could be considered a customer, we chose to define our internal customers at a fairly high level in the corporate organization. We decided that each AFLAC business unit that consumes IT Service volumes is a customer.

In addition, we think it is important to understand the annual owning cost of a few of the more visible major applications. We have chosen to include these at the customer level, because these applications consume most IT services. Through this design, we can produce monthly invoices for these applications if we so desire. Keep in mind, that we are able to assign a single AFLAC business unit as the owner of each of the major applications. So the business unit owners will see in their monthly invoices the total charges for the applications as well as all the other IT services consumed.

Furthermore, IT budget centers consume many of their own services. The cost management model includes the reassignment of IT services to IT budget centers so they can see what they have consumed of their own services as well. Keep in mind that the goal of the cost model is to assign 100% of IT costs to its AFLAC business unit customers, so the cost associated with those services consumed by IT budget centers eventually are included in the unit cost to the BU customer.

"Customer-Focused" Services

We feel that it is very important that our services be comparable to what our customers could buy in the external market place. We did not want to impose our internal complexity on our customers. To this end, we ended up with a list of 15 bundled services. We are convinced that it is extremely important to start out as simply as possible or the entire effort will fail. The objective of this approach is that customers will be able to affect the volumes of services they are demanding if they can understand the service being received and the volume being consumed. By customers actively managing their consumption and IT actively managing the cost to deliver, total costs should begin to decrease.

Many IT groups charge back a large set of complicated work outputs in the form that is typically organized by IT. We feel that that level of complexity would be meaningless to our customers. We designed a cost model that not only calculates the unit cost of the 15 services, but also presents them as items so that the customers can understand their consumption and, more importantly, how to control that consumption. If more detail is desired, the tool calculates the unit cost of the many technical, complex activities that support our services within the main 15 services.

Activities

The services that IT provides to its customers are made up of work activities. We utilized FlexABM to calculate the costs of IT activities, which in turn gave us the costs of the IT services. We divided our activities into two groups: those that directly support customer oriented service offerings and those internal activities that support other IT budget centers. The internal activities were then reassigned to the customer-oriented service offerings within the cost model. This created a full distribution of the costs.
In working with our consultant, we began to understand that the activity dimension is where we will manage the cost of our IT business, versus the service dimension that the customer sees. So we were able to define a larger set of more technical activities for internal cost management purposes. Most IT organizations have implemented project and/or work management applications to enable better resource management. Our project management application uses very customized work breakdown structures (WBS) to define the work involved in projects. About 90% of our 400 employees are entering 100% of their time into our project management system for some project at some level of detail. Therefore, we decided to integrate project/work management (which houses all hours worked) with FlexABM that utilizes hours worked to define cost relationships between resources and the activities that they perform. By doing this, we discovered that we either needed more WBS standards in our project/work management system or needed to define our activities at the higher project level. After attempting to define our activities at the WBS level, we have now shifted gears and are defining our activities by project.

Budget Centers and Accounts (Resources)

Over the last year and a half, we have developed a sophisticated budget outlook process, whereby all budget center managers monthly update our original budget, based upon the most recent information. These 12-month outlooks consist of historical actual results (which we get from our GL) plus our outlooked or forecasted results for future months. We also use a summarized set of GL Accounts, called Expense Classes. We decided to use a recent budget outlook for our first cost model in order to give us a forward-looking unit cost result. This unit cost then became a good forward-looking price for our SLAs.

We are in the middle of our next year budget preparation. Once we determine a preliminary 2004 budget, we can actually run the budgeted costs through our cost model to calculate a 2004 budgeted unit cost for our services. Based on the 2004 unit costs, we can analyze where our costs have increased and decreased and make any necessary adjustments or provide any reasonable explanations.

Conclusion

We designed and constructed an activity-based cost management model, integrated with a service-level billing mechanism in eight weeks. In this period we also designed and implemented first-pass versions of electronic SLAs, IT service-level performance metrics, and sample Customer Feedback surveys. Are we done? Not by a long shot!

Our first results are in the ballpark, but need some precision. Because we have never captured activity and service output volumes, except in certain instances, we were trying to manage costs without the benefit of understanding customer-demanded work volumes. We have some work to do in cleaning up our data in order to improve the precision of our unit cost calculations. However, we feel that we have implemented the processes and now have the cost management tools in place to achieve our goals of improving the communication of IT costs to our customers.