

# Costing and Pricing

public sector services

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Second  
Edition

essential skills  
for the public sector

*Costing and Pricing Public Sector Services*

**Costing**  
and  
**Pricing**  
Public Sector  
Services

Second Edition

Essential Skills for  
the Public Sector

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# Chapter 1

## Introduction

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Costing and pricing public services is fundamental to achieving value for money, an objective now required by most public sector organisations seeking to work within increasingly constrained budgets. Many countries are currently facing budget deficits which are often curtailed by reducing public expenditure. This in turn has presented challenges in ensuring that important public services are still delivered, but at a reduced cost, and minimal compromise to quality

The identification of the true cost of a service is often the first stage in being able to establish whether or not the existing service delivery process is providing value for money. It enables costs to be compared with similar services elsewhere, and in some cases may provide justification for out-sourcing a service to a third party, and greater local accountability.

Some public services are very difficult to cost and compare due to their unique nature. However, despite this, knowing the cost of a service is the real starting point to efficient, effective and economic service delivery.

Certain public services may also need to establish a price. This may be as a result of being in a competitive market place, or it

may be for re-charging purposes to internal customers. The approach to developing a price can be very similar to that adopted in the private sector, depending on the nature of the service and the objectives of the organisation.

This book has been developed to assist those working in the public sector to understand the concepts of costing and pricing, and how these concepts can be applied to their service areas. It is also relevant to those working in a voluntary sector or other non-commercial environment. It has been designed as a reference text and development tool which can be used by the reader as part of a self-development programme. It covers important concepts such as establishing the cost of a service; calculating unit costs; controlling costs; and pricing.

In order to make the contents of this book accessible to all, a simple format has been adopted with the emphasis on practical application as opposed to theory. At the conclusion of each chapter are exercises which help the reader to focus on the key issues covered. Suggested solutions have been given in the last section of the book, where appropriate.

This book is one of a series of “Essential Skills for the Public Sector” titles. The series aims to assist public sector managers become more efficient and effective in carrying out their important management responsibilities. We consider this book to be an important part of the tool kit for public sector management development.

# Chapter 2

## Establishing The Cost of a Service

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### *Service Definition*

In order to establish the cost of any type of service, there must first be a service definition. This definition sets out the content of the service in terms of its **description**, **quantity** and **quality**.

#### *Service Description*

The service description will outline the content and scope of the service. For example, a hospital will offer patient care for people of different ages, with a variety of ailments, along with a range of other supplementary services which may include crèche facilities, shops, a café, and so on.

#### *Service Quantity*

Quantity covers all issues to do with size, opening hours, number of service units, number of users, etc. Service quantity in the case of a hospital will include the number of beds available for public and private use, the number of outpatients that can be seen, the visiting hours, etc.

#### *Service Quality*

Quality has to be defined and made known to staff and customers/users. The organisation has to ensure the quality standards stated are met at all times and this will have an impact on resources. What is deemed to be an important quality issue will vary depending on the nature of the



service. For example, in a hospital, waiting times may be a key quality standard to be adhered to.

The description, quantity and quality are all inter-related and have an impact on the resource requirements of the service.

The next stage is to identify exactly how the service definition can be fulfilled in terms of the necessary resources and their cost. These issues will be covered in the following section, "elements of service cost".

## ***Elements of Service Cost***

In order to deliver any service, there is a need to input a variety of resources. These will generally include the following elements:

- ❖ *Staffing*
- ❖ *Accommodation*
- ❖ *Goods and Services*
- ❖ *Fixtures, Fittings, and Equipment*

These resources will normally have a cost which is expressed in financial terms. Examples of resource inputs with related cost implications include:

### ***Staff Related Costs***



Salaries and wages (including on-costs)  
Overtime  
Temporary/Agency fees  
Travel and subsistence

***Property Related Costs***



Rent and Rates  
Services (cleaning, security, etc.)  
Utilities (electricity, telephone and gas)

***Goods and Services Costs***



Materials  
Printing and stationery  
Postage  
Training  
Professional fees  
Insurance  
Support service costs (e.g. central cost of personnel, legal, finance, etc.)  
Interest charges (reflecting the cost of any borrowing the service incurs)

***Fixtures, Fittings and Equipment Costs***



Office furniture  
Computer hardware and software  
Repairs and renewals

In order to calculate the actual cost of each element required to deliver the service, there is a need to “capture” costs.

## ***Capturing Costs***

The concept of capturing costs refers to the process which ensures all the correct costs, in their respective proportions, are included as part of the overall cost of a given service. This is essential if an accurate service cost is to be calculated. For example, if two distinct services are managed by the same individual, in order to properly reflect the manager's salary costs, it will be necessary to **apportion** the manager's salary between the two services.

Other costs that may need to be correctly captured include items such as the shared cost of accommodation, reception areas, insurance policies, central support service costs, and so on. Having captured all the costs relating to a particular service, or part of a service, a total or partial service cost can be established.

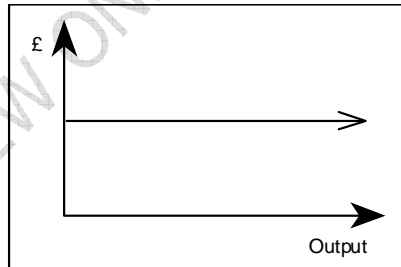
For most public sector organisations, staffing costs usually represent the most significant cost of service delivery. Where elements of staffing cost have to be apportioned, such as the manager described above, there is a need to identify an appropriate method of apportionment. In the case of staff, one method of apportionment is time (i.e. the amount of time spent undertaking elements of the service). Where time apportionment is deemed appropriate, then implementing a time recording system may be useful. The use of time recording is commonplace in the private sector and is becoming more common in the public sector.

The apportionment of costs, particularly overheads, is an important area of discussion. A number of techniques which may be applied to overhead apportionment are discussed in chapter 3.

In order to calculate the unit costs of a service, (which is discussed in chapter 4) there is a further need to split the total service cost between fixed and variable costs. Fixed and variable costs are discussed below.

### ***Fixed Costs***

A fixed cost is one that does not vary with service output in the short term. This means the cost of the resource will remain constant, regardless of the amount of service activity undertaken. This is illustrated in the following graph:



The vertical axis of the graph identifies the service cost in monetary terms, and the output or productivity of the service is represented by the horizontal axis. The output is identified as a number of units of service, which in turn is usually expressed in the most appropriate unit depending on the nature of the

service, e.g. number of hours, number of interviews, number of applications, number of enquiries, number of people, etc.

The fixed cost line shows a consistent cost regardless of the number of units. A good example of a fixed cost is rent and rates as these costs are fixed for a certain level of accommodation. It does not matter how often the accommodation is used or the level of output produced, the rent and rates will remain the same. Salaries can be seen as another fixed cost. If an employee is paid a fixed salary for standard terms and conditions, then their salary will be the same regardless of the effort they put into their jobs, i.e. it will not be affected by their productivity or the number of hours spent working.

Fixed costs will normally only remain at the same level for a period of time, i.e. they will not vary with output in the short term. However, in the longer term the level of these costs may change, as the activity and scope of the service changes. For example, rent and rates are fixed costs, but if the service grows to a size where the current accommodation is insufficient, there may be a need to increase the amount of space used. Hence, the cost of rent and rates will increase to reflect the new accommodation requirements, and will result in a step up in fixed costs.

The following graph shows the step effect of changing fixed costs over time.

## Exercise 9

### Cost Control -v- Budgetary Control

Using the list of organisations shown below, identify whether you consider cost control or budgetary control should be more important to the manager stating your reasons why.

| Case                    | Cost Control | Budgetary Control | Reason |
|-------------------------|--------------|-------------------|--------|
| Leisure Centre          |              |                   |        |
| School                  |              |                   |        |
| Meals on Wheels Service |              |                   |        |

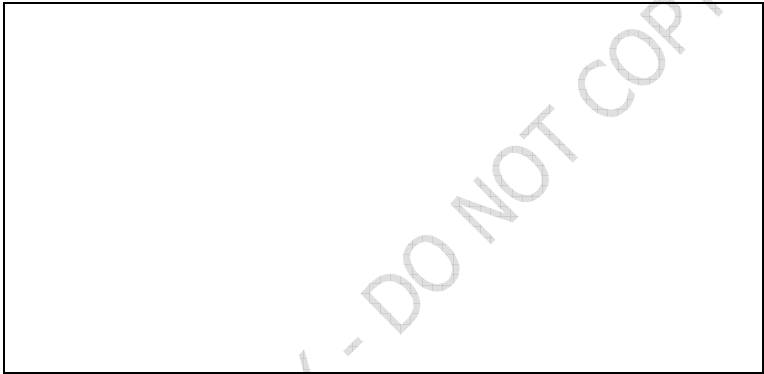
| <b>Case</b>                        | <b>Cost Control</b> | <b>Budgetary Control</b> | <b>Reason</b> |
|------------------------------------|---------------------|--------------------------|---------------|
| <b>Central Personnel</b>           |                     |                          |               |
| <b>Architectural Services</b>      |                     |                          |               |
| <b>Payroll Services</b>            |                     |                          |               |
| <b>Legal Services</b>              |                     |                          |               |
| <b>Housing Management Services</b> |                     |                          |               |

*Suggested solutions can be found on page 131*

## Exercise 10

### Your Own Cost Control

- a) List the cost control processes you currently adopt (e.g. time recording)



- b) Referring to the contents of this chapter, consider further actions that could be taken to enhance cost control for your service

