

UNDERSTANDING THE IMPACT OF TOTAL COST OF OWNERSHIP

INTRODUCTION

Consider this: external purchasing can often account for more than 60 percent of total cost for firms. As a result, your purchasing decisions are critical.

One of the most often overlooked factors in sourcing product is the concept of total cost of ownership (TCO). TCO is the cost of all activities related to purchasing a good or service. This is an important concept for your firm, so that these costs can be understood, managed and reduced without sacrificing important factors. The cost of a product is MORE than just per unit cost.

Consider these additional factors:

- Unit cost
- Ordering cost
- Logistics costs
- Inventory cost
- Quality cost
- Maintenance cost

In fact, one recent study identified 13 categories that drive the total cost of ownership (see categories below). Within the 13 categories, there are more than 100 different factors to consider.

Note that these may be built into a purchasing decision support system and you may want to consider urging your customers and potential customers to evaluate based on total cost.

Are you considering the right factors when making your purchasing decisions?

CATEGORIZATION OF IDENTIFIED TOTAL COST OF OWNERSHIP COST DRIVERS

Operations Cost

- Manufacturing
- Machine efficiency
- Labor savings
- Assembly cost
- Line speed
- Capacity utilization
- Equipment speed
- Cost in use
- Operating supplies
- Increase in production output
- Production to schedule
- Long-term operating costs

Quality

- Durability
- Replacement
- Field failure
- Customer downtime
- Inspection
- Cost of quality
- Calibration cost
- Rework
- Scrap
- Customer returns
- Rejection cost
- Quality improvement
- Unplanned downtime
- Out-of-service costs

Logistics

- Freight
- Packaging
- Customer service
- Availability
- Handling
- Instability in freight rates
- Outbound cost
- Tariffs
- Lead time
- On-time delivery
- Time to schedule
- Warehousing
- Duties
- Import fees
- Supplier-managed inventory
- Area of the country customer must order from
- Entry and harbor maintenance fees

Technological Advantage

- Design obsolescence
- Suitability for intended use
- Flexibility for new use
- Technology
- Changing technology
- Long-term advantage
- Supplier ability to change technology

Supplier Reliability and Capability

- Partnering costs
- Team costs
- Trust
- Supplier capabilities
- Payment terms
- Supplier R&D capability
- Supplier support
- Service by supplier
- Supplier ability to grow
- Stocking at supplier (quantity availability)
- Familiarity with supplier

Maintenance

- Supplies
- Training
- Downtime
- Costs
- Labor
- Repair costs
- Parts
- Spare parts
- Repair frequency
- Reliability
- Long-term maintenance costs
- Preventative maintenance schedule

CATEGORIZATION OF IDENTIFIED TOTAL COST OF OWNERSHIP COST DRIVERS CONTINUED

Inventory Cost

- Safety stock
- Storage
- Perishability
- Turnover
- Design/procurement for inventory reduction

Life Cycle

- Long-term usage
- Projected life cycle
- Life of product
- Life cycle stability
- Useful life
- Redesign cost
- Cost savings over life of product
- Life cycle obsolescence cost

Initial Price

- Unit cost
- Initial purchase price
- Long-term price stability
- Initial capital expenditure

Customer-Related

- User satisfaction
- Customer perceptions
- Customer specifications

Opportunity Cost

- Cost of money
- Overhead

Miscellaneous

- Taxes
- Value chain
- Warranty
- Product design
- Disposal costs
- Salary, benefits
- Indirect labor
- Product use
- Depreciation
- Lease or buy
- Safety
- Support costs
- Utility costs
- Installation
- Ease of operation
- Noise level
- Technical support
- Validation/registration cost
- Service costs
- Disposal value
- Direct labor
- Total installed price
- Lease rate factors
- Flexibility of the supplier
- Obsolescence cost
- Tooling and fixtures
- Overall competition
- Environmental issues
- Currency exchange rates
- Liability and indemnification
- Availability from a supplier
- Supplier cost drivers (from requisition to receipt)



IOWA STATE UNIVERSITY
University Extension

For more information, contact:
Mike O'Donnell
(515) 294-1588
modonnll@iastate.edu
www.ciras.iastate.edu