Total Cost of Ownership

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1. Introduction

This chapter will explore the concept of total cost of ownership. Total cost of ownership is defined here as a philosophy for really understanding all relevant supply chain related costs of doing business with a particular supplier for a particular good/service. Total cost of ownership (TCO) considers total cost of acquisition, use/administration, maintenance and disposal of a given item/service. As will be presented later, TCO does not actually require precise calculation of all costs, but looks at major cost issues, and costs that may be relevant to the decision at hand.

2. How does TCO Compare to Other Approaches?

Price is one element of total cost of ownership, and often the largest single element, but still only one piece of TCO. Viewing cost from a supplier’s perspective focuses on how much it cost for the supplier to produce and deliver an item or a service to the consumer. It includes elements such as labor, packing, raw materials, overhead, transportation, and so on. Understanding such cost may be helpful when performing a sophisticated TCO analysis. They may also be relevant if the supplier is willing to work with the organization on reducing TCO. Such cooperation is growing in practice.

Cost – from a buyer’s perspective – is the same notion as TCO. Rather than simply buying based on price, the buyer should have a method for determining what a particular purchase really costs the organization – including more obvious issues such as transportation, duties and on time delivery, and more subtle issues such as supplier responsiveness and technical support. Total cost of ownership is not a new technique by any means. It is a philosophy receiving increased visibility and concern among organizations for a variety of reasons.

3. Why the Interest in TCO?

Many of the recent changes in the business environment have lead to increased interest and improved feasibility for TCO. For example, better computer systems have made it possible for organizations to access data in more flexible ways, to network systems, and retrieve and organize data in a more useable manner. This was very difficult with most legacy systems.

The changing nature of buyer/seller relationships has had a big influence on the desire to really understand total cost of ownership. In a CAPS study on strategic alliances, reduc-