

Total Cost of Ownership (TCO)

... a management concept using an estimate of all the direct, indirect & long term costs that can reasonably be anticipated when purchasing a product, system or service.

Item Price \$\$

- + Acquisition cost
- + Other Direct Costs
- + Operating Costs
- + Indirect Costs
- business-process changes
- strategic impact
- residual value / liabilities

Common TCO Examples

- ▶ Printers and copying machines
 - + printer cartridges and ink costs vs output
- ▶ Automobiles
 - + mileage and maintenance costs
- ▶ ERP and Procurement Software
 - + implementation, subscription, technical support
- ▶ Smartphones
 - + calling plan data costs
- ▶ Refrigerators & Appliances
 - + energy consumption (Energy Star Rating)
- ▶ Major Machine tools
 - + productivity improvements vs maintenance

Process

- ▶ Use a chart or checklist when planning an acquisition of products, equipment or services
- ▶ Add relevant negotiation elements
- ▶ Ensure all significant elements are evaluated, mitigated, avoided or considered before making a final purchase decision
- ▶ Included significant elements in a comprehensive contract
- ▶ Start with this list:

www.mltweb.com/tools/articles/what.htm

Exercise

Seller's Price		Acquisition Costs		Ownership Costs		Business Impact
\$\$\$	+	\$\$\$	+	\$\$\$	+	\$\$\$
1. Competition		1. Freight		1. Spare Parts		1. Longevity & replacement
2. Timing		2. Packaging		2. Maintenance		2. Dependencies
3. Payment/Financing		3. startup		3. Training operators and maintenance staff		3. Future enhancements
4. Fair Profit		4. Risk of Loss		4. Warranty		4. Repurchase
5. Contract Terms & conditions		1. Setup		5. Tooling		5. Records & data
6. Termination & cancellation				6. Scrap & wastes		
				7. Performance specs.		
				8. Staffing & admin.		

> = Items I can influence in negotiation * = Supplier/product differentiators
 ① = Significant items to include in contract

Checklist

- ✓ Which elements are relevant to the acquisition of this specific product or service?
- ✓ Have I covered them all in my solicitation?
- ✓ Which elements have the potential for the largest long-term ownership cost impact? (e.g. lease or support fee with no end date)
- ✓ Which elements are candidates for negotiation?
- ✓ Which can be used as criteria to differentiate suppliers? (e.g. seller offers free installation)
- ✓ Which elements can be leveraged and addressed during the supplier selection process? (e.g. spare parts seller could provide at no/low cost)
- ✓ Have I evaluated and considered all the significant elements in the source selection process? (e.g. assigned a weight or included cost impact)

Practical Application

*Now that we understand TCO....
How can we use TCO concept
when negotiating an acquisition?*

- ▶ Differentiate offers & products
- ▶ Negotiation Leverage
- ▶ Obtain reductions & discounts
- ▶ Mitigate TCO costs
- ▶ Plan future acquisitions and replacements
- ▶ Plan accounting system savings

Write a more complete & valuable contract

TCO Negotiation Strategy

Ask questions **BEFORE** soliciting proposals

- ▶ Have requestors considered TCO?
- ▶ Does Management Care about Costs?
- ▶ Talk to sellers:
 - *What differentiates your product?*
 - *What are typical usage costs?*
 - *How can costs be mitigated?*
 - *What can you offer to reduce TCO?*

TCO Negotiation Strategy

- ▶ Use the solicitation to prepare for inevitable changes, reorders, and cancellations
- ▶ Require a breakdown of significant elements included AND EXCLUDED as part of proposal
- ▶ Obtain specific costs when available
- ▶ If not, get relevant contribution
(– e.g. stainless model adds ~10%

TCO Negotiation Strategy

- ▶ Ask offerors to include specific elements in pricing
- ▶ Normalize disparate offerors by requesting a quote for a common factor. e.g.: 5-year maintenance
Even if I don't want/need it
- ▶ Evaluate and write a separate contract for long term support, disposal, etc.

Key Thoughts

- ▶ Use a checklist and get everyone involved in identifying significant TCO elements
- ▶ Address TCO elements in the solicitation
- ▶ Give suppliers a chance to be creative and supporting in their proposals
- ▶ Get help evaluating TCO when needed
- ▶ Make sure important elements and decision factors are covered by contract
- ▶ Enhance accountability by writing separate contracts for separable elements as part of one award. E.g. installation, support, training

My Mantra

*I consider more
than just the selling price –
and seek all opportunities
to negotiate a better deal for
my organization's
long term benefit....”*

References

www.mltweb.com/handouts

Cost presentation & handouts

www.mltweb.com/tools/tools.htm

Negotiation & Cost articles