



Total Cost to Own / Serve

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LESSON NO 1 –

So welcome to the course, Total cost to own. And let's start first of all by understanding what is total cost to own? When we talk about TCO or total cost of ownership, what does that mean? So total cost costs to own or the total cost of ownership. This is an approach to procurement and supply chain management that looks at all of the different aspects of costs along the supply chain or the procurement journey. It doesn't only look at the landed cost or the first cost. It also looks at other downstream costs and so on as well. Let us apply to an example in terms of the total cost of ownership. An example one, we have a purchase cost of \$9,000 and a free cost of \$1,000. If I add my \$9,000 to my \$1,000, that's a total cost of \$10,000 in example one, in the second part of this example, we have initial cost of \$8,000 and we have a freight cost of \$1,200. That is a total cost of \$9,200. So if we were to look at Do I buy it from vendor A or do I buy it from vendor B? We can see that obviously because of the different costs buying from vendor B of \$9,200 total cost, that makes more sense. So you're looking at \$10,000 in scenario one, \$9,200 in scenario two. Let's go with the vendor in scenario two. That is the traditional approach to procurement. However, if we're talking about the total cost of ownership approach to procurement, we may want to look at other factors, and those other factors can actually even sway us to change our decision from choosing supplier B to maybe choosing another supplier. So this is the principle of total cost of ownership, and this is what we're going to explore as we continue in our other lessons. Right. So continuing with lesson one in explaining what we mean when we talk about the total cost of ownership, let's look at another example to give us more clarity around what do we mean or what is the total cost of ownership example, let's add a layer of complexity on the purchase that we just went through where we chose supplier two or supplier B as the better option because they had a cost of \$9,200 versus supplier A that had a cost of 10,000. Traditional purchasing. That makes more sense. So we went with supplier B. If we look at the reality of, well, what was the purchase? We bought a piece of equipment. That equipment has a lifespan of five years. Let's start to look at some of the operational costs of running this equipment for five years after we made the initial purchase. Let's say in scenario one that we spent \$10,000 to buy the equipment and have it delivered to

our location. It's now going to cost us about \$60,000 to operate that equipment over the span of five years. And an example two, where we spent \$9,200 to buy the equipment and deliver it to our location over the same five year time period it's going to cost us \$75,000 to operate that equipment. If we add all of the cost elements together, the first cost which is the cost to buy the equipment, the cost of freight plus the cost of the five years or the cost over the five years we see a slightly different scenario in scenario one with vendor one we have \$9,000 plus \$1,000 plus \$60,000 so that's 60 plus \$10,000 or a total of \$70,000. In example two, we now have \$8,000 plus one, \$200 plus \$75,000. That gives us a much higher cost overall. Therefore, in the traditional person model where we chose supplier A now given the fact that we've added more costs that the company has to bear or enjoy over the entire five years we now have a different picture and a different decision. It now makes more sense to go with supplier A rather than supplier B. So this is just a simple example that shows you by considering different elements or all of the elements across the overall or entire procurement cycle we are able to make better and more informed decisions around should we buy from vendor A? Should we buy it from vendor B? Should we buy it from vendor C? So this simple illustration gives you an example or a good outlook on what we're looking at when we talk about total cost of ownership and how you should look at procurement especially in these times.

