Reduce total cost of ownership

Ever since knowledge economy appeared and technology developed, many organizations find their current price strategies far too inadequate in coming to terms with changes that occur in the market. As far as business with customer markets is concerned, consumers have more disposable incomes and are better educated. They have become more diverse, more demanding, more quality conscious and generally more sophisticated (Robert C. Appleby 1994) Obviously, the leverage has fallen away from price elements. Even though suppliers can offer the lowest price, it is still hard to attract buyer's attention.

Probably since humans began organized trade, people have realized that the purchasing price of an item is not the only cost involved in buying a product, and may not even be the largest factor (Borsoli, 1927; Stewart, et al. , 1939). On the other hand, due to business to business markets, purchasing has become one of the most critical functions within a company according to Degraeve, Z. and Roodhooft, F. (1999), and globalization has significant impacts on contemporary business environments. There have been more competition and uncertainty. There is variety of resources available to buyers' choices.

Each impact element is using the leverage principle to balance the advantages and disadvantages of products before making company decisions. Even then, businesses may be tempted to base buying decisions solely on a product's purchase price but, although not as obvious, the product's total cost of ownership (TCO) may prove to be a more important consideration. For many years, purchasing agents have been aware of the importance of considering “ all-in-costs,” “ life cycle costs,” “ total costs,” and “ total cost of ownership” (Dobler & Burt, 1996).

In the recent decade, the total cost of ownership concept is attracting people’s attention again. Especially in the competitive electronics industry, market competition causes shortened product lifetime, which forces a change or reduction in the service year of the assembly system. Due to mutative business environments, the companies have to look for a solution to reduce product costs and get Return of Investment as soon as possible. A part of the management’s strategy is the optimizing asset ownership, which is often the inclusion of new equipment and technology.

Factories also want to increase productivity while maintaining profitable margins on their operations. Although throughput is the key to keeping production costs competitive, the real work of optimizing total cost begins at a much earlier stage. Outsourcing and reduction of internal costs of companies have become main operations in business. Sourcing from low-cost regions of the world has become big business and cost savings. Improved deals with suppliers and lower running costs in procurements were the two benefits that firms most expected outsourcing to have.

Most of the companies take outsourcing to reduce costs, Paul Snell’s (2007) statement shows that according to the latest research from Everest, the contracts for outsourcing were slower for the previous year compared to the number of deals signed in 2007. However, the financial values managed by outsourcers are now more than $25 billion (£25. 7 billion). There are big advantages to sourcing from low-cost countries. As YiJiang Li (2007) has mentioned, the three main reasons for outsourcing are: cost, quality and product range.

While a growing number of companies use outsourcing to reduce costs, they ignored the impact of uncertain external factors. First, companies will lose control of products or services by using outsourcing because companies rely on feedback from front product line. Second, environmental protection and oil prices were additional impact factors. Based on the commodities News by Jake Kanter (2007), buyers should assess their fleet and delivery policies after the price of oil has reached more than $100 a barrel. Logistics providers are being forced to monitor the price of their services in line with fluctuating fuel spend.

The freight transport association (FTA) believes that extra cost will almost certainly be passed on to customers, which means that the previously cheap product cost will be increased. On the other hand, according to a survey by Snell (2007), the most common reason for not outsourcing was that purchasing was a core competency of the business. Other firms believe they already have the systems in place to drive saving and successful procurement. There are many advantages in outsourcing, however, the uncertain factors will increase risk for company profit.

The purpose of this article is to use the TCO model to help companies reduce cost. The method of addressing this issue is fourfold in its attack. First, this paper will explain why the total cost of ownership (TCO) concept is important for companies, and how the TCO concept has evolved. Second, the benefits and barrier of adopting a TCO perspective will be discussed. Next, we will explore, on a limited basis, the magnitude of the adoption of the TCO concept in purchasing practice, and also how and where the TCO concept could be used in the purchasing function.

Finally, this paper will discuss what steps need to be taken in order to implement a TCO approach that is workable within the purchasing function. Assuming that companies do have insights into the TCO of product, do purchasers then still have a preference for offerings with a lower purchase price and higher costs in use as opposed to offerings with a higher purchase price and lower costs in use? Which factors determine the direction and strength of their preference?