Total Cost of Ownership/ Total Life Cycle Cost Strategy

OVERVIEW

Organizations are required to make procurement decisions on the acquisition and ongoing use of different assets (i.e. equipment's, spare parts, chemicals, fluids, etc.). The initial capital (also known as First Cost) required is usually clearly defined and is often a key factor influencing the choice between alternative options. However, there are other future costs that should also be considered to achieve the best desired outcome for the organization. The process of identifying, documenting and analyzing all the costs levers involved over the life of an asset is termed as Total Life Cycle Costing (TLC).

TLC is a technique to establish the total cost of ownership. It is a disciplined approach that addresses all the elements of the cost and can be used to produce a cost profile of the product or service over its anticipated life-span. TLC analysis can be used to assist management in the decision-making process where there is a choice of options.

The visible costs of any purchase represent only a small proportion of the total cost of ownership. The responsibility for acquisition cost and subsequent support during operations are managed by different departments within an organization and, consequently, there is little or no incentive to apply the principles of TLC to procurement policy. Therefore, the application of TLC has a management implication because concerned departments are unlikely to apply TLC analysis unless benefits are visible.

Benefits of TLC:

- Visibility of all cost levers throughout the supply chain
- Better predictability and forecasting accuracy of required funding
- Leverage long term relationship with suppliers and help make the right decisions
- Evaluate alternative procurement strategies based on total cost
- Monitor actual versus forecasted cost, hence better control of the total cost

HOW CAN WE HELP?

We are bringing in expertize understanding the entire cost structure for major product service lines. We will work with our clients to build strategic directions for major spend categories, and help organizations make smart decisions during their major procurement decisions.

Factors Considered

- Acquisition Cost/ First Cost
- Operations & Maintenance Cost – fixed & variable
- Maintenance Cost – as a percentage of the first cost
- Scrap/ Disposal/ abandonment cost
- Depreciation
- Cost of Capital
- Inventory Holding Cost
- Average Inflation Rate
- Average tax rates
- Any additional tax – sales tax, excise duty, etc.
- Training expenses
- Estimated life of the asset
- Utility consumption
- Any additional known cost of doing business

Case Studies: Total Cost of Ownership/ Total Life Cycle Cost

Upstream Oil & Gas

Operational Profile:

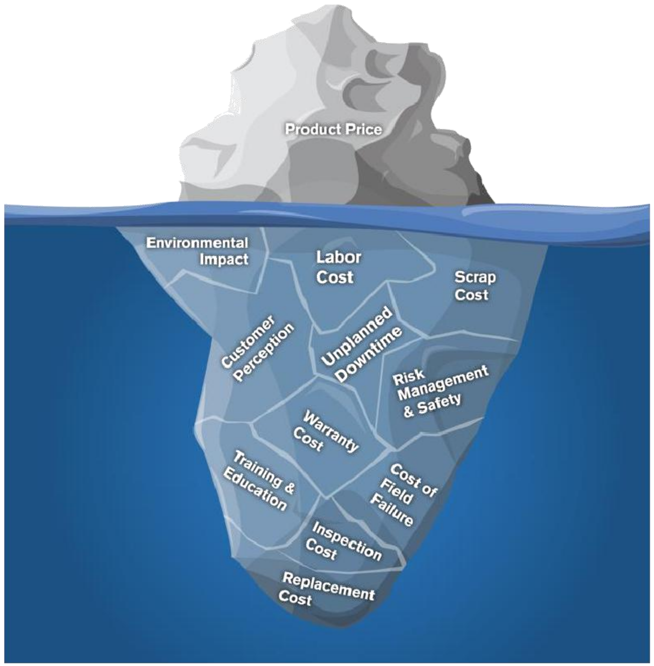
- Client International Major Oil & Gas (Confidential)
- Business Units: Enterprise wide effort
- Operations: Upstream
- Scope: OCTG Products & Services & Gas Turbines
- Estimated Inventory: $1.3B (OCTG) & $280MM (Gas Turbines)
- Estimated Spend: $1.2B / Year (OCTG) & $325MM (Gas Turbines)

Business Case

- OCTG – due to the complex supply chain operation, company doesn't see the actual total cost in managing this category.
- Gas Turbines are generally purchased through major capital projects, and EPC companies don't have full visibility of all the cost elements associated with this category. Also in a multi-billion dollar project EPC's focus is to keep the overall project cost within their total project cost, and they don't have the expertize in each strategic product service lines.
- Operations spares are also purchased as a part of the capital project purchase, hence lose track of all the operational materials.
- Most organizations do not have the knowledge to understand the holistic benefits of each strategic categories hence their focus will be so narrowed, leading to costly purchases.
- When crude price are high, oil and gas companies don't pay attention to their spend and working capital. However, for the organization to succeed in long term, they have to better understand every cost components and shall be willing to manage it properly.

Results

- OCTG: Reduction of Total Cost of Ownership by 44%
- Gas Turbines: Reduction of Total Cost of Ownership by 29%



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