Workflow: Procurement

Toolkit 8.2
Assets and the Total Cost of Ownership

target audience

Farm owners and managers.

what it is

When procuring assets, the first considerations are quality, availability, and price. However, in some cases, the total cost of ownership is an equally important consideration.

The total cost of ownership, or TCO, includes the purchase price of a particular asset, plus operating costs over the asset's lifespan, including decommissioning if applicable. Looking at the total cost of ownership is a way of assessing the long-term value of a purchase to a company or individual.

When considering the TCO, you may reconsider your options and decided to lease or rent an asset to get the same job done rather than purchasing it. Obviously, convenience and availability also have a value, but this may become less important when you fully understand the TCO.

why it is important

Understanding and considering the TCO for significant purchases, particularly machinery, is important for two reasons:

- Firstly, even in instances where ownership is the only option, e.g., a tractor that is used daily, it is quite possible that a less pricey option may in fact have a higher TCO due to lower reliability, lifespan, service intervals etc. Furthermore, investigating the TCO issue will enable you think how best to fund the purchase (cash, financing through hire purchase, financing though an overdraft or bank loan, favourable government support schemes, etc.).
- Secondly, understanding the TCO allows you to consider alternative ways of deriving the same use/benefit, such as leasing, renting, sharing.

A good example on an individual level is owning a car which you use for about 10,000 km per annum on average. You may very well need a car because you need to use it frequently and flexibly, live in a rural or remote area, or often need to transport several people, etc. However, you may live in an urban environment, where you can use public or taxi services at a much lower annual cost than owning a car once you include car finance, insurance, fuel, services etc.

Farmers are often confronted with a dilemma when making purchasing decisions for specialised, yet seldom used equipment and facilities. Taking ownership of the equipment ensures availability when needed and for the duration needed. However, this piece of equipment might only be used in season and for a short period of time; but for the rest of the year it will still have to be maintained, securely stored, insured, licenced, etc., adding to the TCO. The risk also remains that such specialised equipment could break down when needed, requiring specialists to repair. Specialised equipment also sometimes requires specialised drivers or operators, which can become an additional cost element.

Understanding TCO allows a farmer to compare and select alternatives that would reduce implied cost whilst ensuring service availability when needed. Examples could include:

- Contracting with an OEM or a specialist company for the service.
- Farmer collaboration backed up by an agreement between farmers.
- Forming a services company with other farmers as shareholders.
- Jointly financing the development of infrastructure, e.g., irrigation dams and packhouses.

Farmers should however be aware of the potential downside of sharing resources, mostly in terms of service availability.

success factors

The success factors for assets and the total cost of ownership include:

- Clarify the need in line with business operations and perceived benefits.
- Distinguish between requirements and "nice to have" features.
- Create a clear specification.
- Understand the TCO process and logic.
- Keep an open mind to ownership alternatives that would require collaboration.
- Maintain a good relationships with co-farmers.

execution steps

1. Clearly establish or confirm the need for a particular service in line with business requirements.
2. Write a technical specification with minimum requirements to deliver against the service. For a tractor you might have to specify the power source (engine size), the dimensions (orchard work), ground clearance, GPS functionality, etc.
3. Consider the alternatives, which could be different brands or manual operations.
4. Source quotations from potential suppliers.
5. Do a TCO calculation on the alternatives considering initial financing, operating and residual costs.
6. Consider collaboration alternatives and the impact on farming operation and costs.

assessment questions

Please Note: There is no minimum / maximum amount of questions you can add

1.	Is there a clear asset replacement or acquirement plan based on business needs?
2.	Do you apply the principles of TCO when making a finance decision?
3.	Do you consider collaboration for specialised services?

resources

1.	Total Cost of Ownership (TCO) – The 3 Key Components