

## Can You Afford the Lowest Price?

By Rebecca A. Morgan  
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*“Low price” may sound appealing, but you’ll do better to think of the total cost of ownership (TCO), which could include hidden costs down the road.*

Costs are important to your business. You constantly remind employees to shop around and compare prices, because you can’t afford to pay too much. The last salesman who came in assured you that his is the lowest price and it seems to be. You’ve met with several other potential suppliers and the price quoted by the last salesman is below the others.

But is he really the low-cost supplier? For many goods and services, the price on the purchase order is just the tip of the iceberg when evaluating alternatives. Other considerations can easily make the lowest price supplier a high cost supplier. The difference: The Total Cost of Ownership (TCO).

While the specifics may vary by type of business and by the nature of what you’re buying, considering the following four aspects of TCO for each alternative will facilitate cost effective decision-making.

**What are the costs of getting it (“acquisition costs”)?** The purchase order price is certainly one aspect of acquisition cost, but it is only one. Taxes, freight, and insurance are additional costs of getting the item to you in usable condition that may vary by supplier. The relative impact on the business processes of receiving and payment processing efficiencies can make a huge difference in the analysis of alternatives. Consider this example: one supplier delivers on time an accurate count of the right item(s) of reliably good quality with an invoice that is correct; the other supplier isn’t nearly as reliable, requiring follow up calls to check on delivery status, examination of incoming quality and count, and subsequent follow up to rectify invoice and inventory discrepancies taking hours of office time each month. You can afford to pay the first company a little more on purchase price to avoid all the other acquisition costs of doing business with the second supplier.

**What are the costs of having it around (“carrying costs”)?** These costs are incurred because you have the money tied up instead of having it

available for other investments. If a supplier can deliver smaller quantities more frequently, without increasing your acquisition costs, he can reduce your carrying costs. Obsolescence and damage are other forms of carrying costs. A supplier willing to work with you closely to reduce those risks can be valuable.

**What are the costs of using it (“usage costs”)?** Differences between suppliers in usage costs are typically due to inherent differences in the product or packaging, and are often yield related. For example, you could be considering buying paint from two different companies. One supplier’s product might take two coats to get the same coverage, and as a result your painting labor costs could skyrocket or your practical capacity could be diminished. One supplier’s toner cartridges may last longer than another’s because the ink flows better or empties more completely. You may pay less, but it takes more to accomplish the same purpose.

**What are the costs of getting rid of it when you’re done with it (“disposal costs”)?** The days of tossing empties and leftovers in the trash or rinsing chemicals down the drain are long over. Sustainability has become a consideration in many business transactions; it is frequently worth asking potential suppliers about environmental issues related to their product and how they can help you address concerns.

The concept of TCO applies to the purchase of services as well as to the purchase of goods. Just as with any other supplier, the check you write to them is only part of the cost of the relationship. One company may require much more of

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your time and oversight than another. Another may have higher turnover that results in inconsistent service to you. It is reasonable to work with a service provider to improve how and/or when services are provided to maximize the value and minimize the total cost to your organization.

When you're getting ready to spend company money, becoming familiar with current market conditions is usually a good idea. Just remember that the lowest price is not always the lowest cost.



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