**Total Cost of Ownership as a Marketing Strategy for Enhancing Consumer Brand Value and Relationship Profitability**

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**Executive Summary**

Most companies think about ways of signing up customers quickly by reducing the upfront cost of doing business. An alternative way of marketing to customers is to provide an offering with a lower Total Cost of Ownership, in other words, to make explicit all the costs of ownership in comparison to competitors’ offering. Using a TCO approach, a variety of strategies become more visible, including the development of Total Cost of Relationship (TCR) models that can be exceptionally motivating to consumers.

**Introduction**

Information technology departments have, for years, used the concept of *Total Cost of Ownership* or TCO to analyze the real cost of an information technology (IT) decision. IT departments have understood that developing or purchasing a piece of software or hardware triggers a set of costs that extend beyond the purchase price. For example, a piece of software may require training of employees, a set up process, on-going maintenance fees to the supplier, and in some cases upgrade costs to move to a next generation or expanded version of the software. And in addition, there is the End of Life or EOL cost when the system is terminated or transferred to another piece of software.

TCO is rarely talked about when selling to *consumers*. Most suppliers prefer to focus on the small up-front costs. Mobile phone carriers will emphasize the low and subsidized cost of a smart phone (typically in the range of $200 or less for a two year cell phone commitment). They rarely talk about the cost of the two year commitment, which may run in the range of $50-100 per month or $1200-2400 over two years. In other words the typical up-front cost of around $200 for a smart phone only represents roughly $200÷$2600 or 8% of the total commitment.

Clearly, consumers are not stupid, but behavioral economics tends to suggest that how you set up an economic problem will change the behavior of otherwise rational consumers. Forcing consumers to opt out of a savings program for example, tends to produce higher rates of savings participation than an opt-in approach. Organ donation rates are higher when opt-out decisions are required, i.e. where agreeing to donation is the easy decision to make.

A marketer might well conclude that if concealing the TCO of a purchase produces higher sales, then who would be so foolish as to reveal the TCO of a purchase decision to a prospect? But consumers do catch on, and sophisticated consumers are often opinion leaders, whose advice and product/services choice is a powerful form of referral. As a result, companies have the option of using TCO revelation as a powerful means of differentiating their product and encouraging positive social marketing activities.

Two successful examples of companies that directly or indirectly focus on TCO demonstrate different ways of dealing with TCO:

1. **Toyota**: over the past two decades, Toyota has gained market share in the US by offering an extremely reliable product. Reliability means lower service and parts costs over the life of the vehicle, in other words, lower total cost of ownership. And as reliability over an extended period of time affects resale value, Toyota TCO also benefits from higher resale values.
2. **Netflix**: Netflix is a well known success story. The basis for its initial growth was the dislike of consumers for late fees, endemic to those who rented from traditional video stores. But a secondary reason for lower TCO was a fixed price, all you can eat model. Netflix, recognizing that subscribers had an upper limit to their time available for viewing movies, offered a fixed rate plan, so subscribers had certainty about their monthly costs.

The difference between Toyota and Netflix is that Toyota operates in a business where fixing TCO is difficult. Its objective is to offer superior *relative* TCO. Netflix, in contrast, is able to *fix* the total cost of ownership.

**Differentiating Based Upon TCO**

A successful TCO-based strategy often trades off higher rates of initial business for lower rates of churn, higher rates of satisfaction and customer referral. Because most companies focus more easily upon adding customers, using a TCO based strategy requires more work and new measurement approaches.

Because churn (customers switching from one supplier to another) and referral can take time to change, measuring attitude change and referral/word of mouth activity is important to maintaining internal support for a proposed messaging, business model and pricing change. Test markets will also be important.

One side benefit of a TCO approach is that it can motivate employees and increase their influence with their personal and social networks. Knowing that you offer a superior value proposition is a compelling reason to be proud of an employer.

**Changing the Rules of the Game: the Analogy with TVO**

Not all businesses and IT departments focus upon TCO. Others focus on a new metric, *Total Value of Opportunity* or TVO. There is an analogy here for consumer marketing as well. Some purchases have both cost and value or outcome implications. In the closest parallel to a corporate TVO, a consumer purchase may enable a consumer to earn new revenues. For example, a writer may purchase a computer and spend extra for an ergonomic keyboard to enable income earning projects.

But a more common situation for consumers is a purchase that enables a consumer to obtain a new value or feature or avoid a significant cost. Insurance products or features are an example of this second type of benefit.

Given that offerings can provide different value propositions or have features that are valued differently by consumers, different TCOs can be associated with different value propositions. For example, when purchasing a Kindle reader, a consumer can choose between versions that work well in well lit rooms or outdoors, versions that work in poorly lit environments, each with the option of using an existing WiFi network or having free 3G connectivity.

**Responding to TCO Strategies and Opportunities**

Most companies are likely to ignore TCO issues and focus upon up-front costs. But in highly competitive markets, response is often required.

In the luxury automobile market, many high end brands without category-leading quality offer extended warranties with extended service plans in an attempt to reassure buyers of a fixed cost of ownership over the most visible and expensive part of automobile ownership. Certified second hand cars are an attempt to reassure buyers of the quality of their purchase.

In the cell phone market, T-Mobile US is attempting to differentiate itself from its larger competitors by unbundling the hidden subsidy in the initial smart phone purchase. It provides a phone with a financing plan attached, which guarantees it will not lose money due to subscriber cancellation. And as compensation to the consumer for the financing charge for the phone, they can offer a lower priced monthly plan.

This slight shift in packaging provides a consumer with the option and psychological comfort of being able to cancel a service plan (a relatively unlikely event given the importance of mobile service to most consumers). While no different in reality than a change to the cancellation penalty, the perception of the pricing model may be quite different and allows T-Mobile to compete with pre-paid carriers (who typically don’t subsidize their phones).

**Indirect TCO Issues**

In a digitized world, knowledge has value and affects the experience, rate of learning and availability of support for a product or service. As a result, indirect costs, though difficult to include in a TCO calculation often represent significant opportunities for differentiation.

Consider, for example, the advantage of buying a well known car brand with an extensive service and parts network. When driving cross-country it is extremely comforting to know that your automobile is so popular that service mechanics and parts will be easily found to fix problems you may run into. Quantifying the value of the network is often hard, but definitely possible. In the car example, one could quantify the cost of towing the car to a distant city, time spent staying in a hotel while parts are shipped or the value of lost days.

With cell phones, the purchase of a popular model such as an iPhone or a Samsung Galaxy will result in more cases and other compatible accessories being available. While the cost of searching for a supplier or a particular may be hard to quantify, there is a clear cost both with respect to time spent, the variety of choice and local availability for hands on testing.

**Not Every Consumer Focuses on TCO**

It would be foolish to think that every consumer is an economically rational decision maker focusing exclusively upon TCO. There is a long history, going back to the 19th century of new and expensive products being financed with monthly payments. The adoption of a technology such as the sewing machine in the 19th century, computers and automobiles in the 20th century and cell phones in the 20th and 21st century has clearly been aided by period-based pricing.

There are, therefore, four common strategic situations:

1. An expensive and often innovative product whose adoption requires financing and period payment business models (e.g. sewing machines, computers, autos).
2. A service that targets the poor and those without credit, sometimes seeking usurious financing profits (e.g. furniture and TV rental stores).
3. A blended strategy where different groups of customers may be segmented based upon their understanding and perception of TCO (e.g. video rental stores vs. Netflix).
4. A disruptive strategy where a TCO-based business model can be a meaningful means of reshaping a market (e.g. prepaid cellular programs, high quality automobiles).

**Total Cost of Relationship (TCR)**

A key idea behind measuring TCO is that all the costs of purchase and ownership are taken into account. But TCO innovation can also be highly targeted to great effect to cement the *overall relationship* with the consumer. In this case the TCO analysis is extended to relationships and can be thought of as an economy of scope. One could consider this valuation as the Total Cost of the Relationship (TCR) to the customer which in turn permits calculating the Total Value of the Relationship (TVR) for the consumer.

Purchasing products from e-commerce vendors is a particularly hard area to achieve differentiation. The most successful companies have identified areas in which they can address highly visible components of the relationship, perhaps with the underlying assumption that other aspects are roughly equivalent or commoditized.

Amazon offers a program called Amazon Prime which essentially eliminates shipping costs and is easily justifiable for a frequent purchaser. And in an unusual value proposition, it also offers free streaming video content and borrowable e-books as part of the offering. Three marketing goals are achieved. Frequent purchasers reduce their cost of purchase by eliminating shipping costs and Amazon becomes a preferred supplier for the customer. Amazon lays a foundation for video streaming competition with its major competitor, Netflix. And the value proposition of the Kindle e-readers and tablets is enhanced.

REI, the delightful outdoor equipment store is not only a member owned co-op, typically repaying 10% of purchases as a dividend it has also integrated forward into financial services, offering a credit card that adds an additional 5% discount for most purchases. It attempts to reduce the risk and cost of poor purchases for members though knowledgeable purchasing and staff, product reviews, articles on what to buy for different sports and skills levels, an unconditional guarantee of satisfaction and a wide product selection made possible through an inventory strategy of allowing on-line ordering of slow-moving products or unusual sizes to stores at no charge.

Both these retail examples focus on TCR by addressing areas of cost uncertainty and high visibility to their purchasers.

**Using Timing as a Pricing Strategy**

Customers have different amounts of disposable income available to them at different periods of time. As a result, the structuring of payments can offer the same TCO but a cash flow that fits more closely with customer needs. Adobe’s Creative Suite (Photoshop, Illustrator, InDesign, etc.) is an expensive suite of software, which is updated regularly. The TCO is very high and probably not justifiable for many consumers. Adobe has added a period based pricing model ($49 per month) to reduce the cost of staying up to date. While this approach reduces barriers to entry, Adobe has built up a significant brand loyalty that likely provides adequate protection.

The most straightforward approach to analyzing costs when one can specify the TCO of the product or service. A slightly more complex situation is illustrated by Amazon’s sales of Kindle readers and tablets at cost or close to cost. The initial purchase enables future but unpredictable transactions that will both generate profits for Amazon and save readers money (because most e-books are less expensive than physical books). Evaluating this type of opportunity for a company has to be based on a more probabilistic modeling approach but over time and with access to data, refined forecasts of profitability and benefit to customers can be made.

**Summary**

Building a great brand often means putting yourself in the shoes of the consumers. Business offerings and pricing models that make consumers feel good about their relationship with a company or individual purchases represent an excellent way of enhancing relationship profitability and brand value.