SAP Practice White Paper - Total Cost of Ownership (TCO)

**Purpose**
To educate client’s on the importance of knowing their SAP product’s Total Cost of Ownership (TCO).

**Perspective**
Once the Business Case has been written and approved, most time and effort for an SAP implementation evolves around scope, schedule and budget of the project. While these items are very important they are only points in time and short term metrics. What is more important than understanding project cost is the understanding of future costs required to maintain a sound and stable SAP environment that delivers business value.

Trying to understand the total cost and benefit of an SAP implementation is often an afterthought once an organization moves past the “Go-Live” phase. Companies are best served if they can envision what the implementation will look like and what it will take to keep it running efficiently and effectively.

The ability for an organization to improve its SAP processes and cost structure is contingent upon how well the processes are managed and the costs crystallized. You can’t effectively manage what you can’t measure nor can you effective make decisions around costs you cannot see.

**Featured Content**

**The Concept of TCO**

Total Cost of Ownership (TCO) was a concept that the Gartner Group created many years ago. The intent was to focus clients on the notion that true cost of the software product lifecycle start with the planning stages, continuing with the annual operating cost and ending with its decommissioning. This has been referred to as the “Cradle to Grave” approach. Unfortunately most organizations do not employ processes that enable them to track cost in this manner.

For those who choose to follow some sort of TCO methodology, there are usually very distinct approaches to capturing SAP lifecycle cost. This makes comparisons of TCO difficult to do because of the narrow or broad treatment by clients. Some capture detailed cost while others only allocate the cost. Which method is best? It all depends on your operating model and the capability to drive out SAP cost while increasing its value to the organization. Remember it is very difficult to drive out cost that you cannot see or is managed by someone else. I have seen examples where vendors may be getting paid for things they no longer provide because of poor cost control and accountability. Or contracts are not adequately reviewed and renegotiated.

**The Business Case**
The evolution of potential cost for the project and future operating cost start here. In most organizations the art of compiling a Business Case usually makes or breaks the potential for a project. If there is a low cost / benefit or Return on Investment (ROI), most projects will never see the light of day. However for the creative business case composer, elements of huge productivity gains and savings are prevalent because in most cases they do not have to manage the cost structure once implemented. Nor do they have to come back a couple years later and report on how the actual ROI met the one in the business case. The reality is that most ROI’s do not contain adequate TCO cost from day #1.

One can surmise that this occurs because those associates charged with the task of writing a business case are not fully aware of what TCO involves. In other cases, they cannot justify the project on a true TCO basis so they use whatever works, which is usually a cost / benefit analysis that paints a rosy future. In either case the corporation is going down a path that will add more annual expense to their bottom line than forecasted.

The Project

Not all projects go according to plan and most fail to meet schedule and cost goals. In most implementations there are an assortment of reasons why that happens, with the most common ones related to inadequate planning and poor project management. Inadequate planning will lead to an inaccurate scope and true buy in by leadership and key stakeholders. This leads to scope creep and customization. Both of which can add tremendous additional cost to the project. Poor project management will result in inefficient uses of resources, re-work and ineffective vendor management. All of these also lead to additional project cost.

So how does a project get on track for its budget? Through the usual true and tested methods such as cutting change management and training budgets. Another favorite is to use “creative accounting” by charging project related cost to corporate overheads.

The Accounting Treatment

How much did the SAP implementation cost? The potential to get an answer to this question is usually driven by the client’s accounting treatment and accounting policies.

An accounting treatment will provide guidance on what segments of the SAP project cost structure can be capitalized or expensed. In general, most organizations will try to limit their short-term exposure by capitalizing as much as possible and then amortizing or depreciating these costs over specific periods of time. Accounting policy will dictate which cost can be capitalized, the proper general ledger accounts to use and the requirement to capture detailed cost against the project. If the requirement for specific cost detail is open-ended, then there is a good chance that not all cost will be captured against the project.
So what did the SAP implementation actually cost? Usually it is more than what was shown in the Business Case or captured by the project accounting structure. Usually the following items are not included as part of the implementation cost:
- Activity related to developing and presenting the business case
  - Involvement of Steering Committees and Operating Committees,
  - Part-time resource support for the project
  - Activity related to client testing and validation
  - Training provided by Process Owners.

The Day-To-Day Operations

How many organizations really know what it cost them to run SAP annually? Sadly, not enough because of the complexity and depth of an SAP implementation or the lack of a central organization design in place to support it. Getting the true cost is contingent upon how the organization manages and tracks cost and assigns accountability. There are organizations that do not treat SAP as a product and thus do not track cost specific to it. Other organizations are decentralized and capture only direct cost as is the case with a Center of Excellence structure. Payment to vendors can be done through multiple organizations and never aligned, resulting in potential cost reduction synergies being missed. Unless there is a very programmatic approach to capturing SAP cost on a daily basis, corporations are usually relegated to a periodic special study that tries to interpolate and allocate cost. Neither serve to drive cost out. In most organizations they do not capture cost associated with day to day users, power users, process owners, etc. Annual software maintenance fees, depreciation, amortization, hardware maintenance, telecommunications and direct labor are usually what most organizations focus upon. Most labor costs are treated as overheads and subsequently allocated or charged to a process owner.

Upgrades, Enhancements and Other Costs

It is only a matter of time before an upgrade is needed, more functionality is required to support business processes or support packs need to be applied. Again, depending upon how the organization treats this cost from a tracking methodology, they may or may not get included properly into the TCO analysis.

Conclusion

To effectively and efficiently run an SAP implementation, an organization must make an effort to get understand its true cost structure starting from the planning stages leading to the business case. The good news is that at any given point, TCO analysis can be improved if management decides to implement the proper policies and procedures in place to identify, track and manage cost. TCO should be a key metric at the senior executive level because it can lead to a better bottom line.

About the Author
Nicholas J. Kaminsky is a Senior Vice President with Solomon Page Technology Partners and their SAP Practice Manager. Mr. Kaminsky joined our team in 2005 and has provided strategic thinking, planning and deployment to our processes. Mr. Kaminsky has 27 years of business leadership experience that has spanned accounting and finance, benchmarking, best practices, business operations, performance measurement and strategic planning. Mr. Kaminsky, most recently was accountable for the overall planning, cost and operations of the SAP Product at one of the nations largest energy companies. Mr. Kaminsky has made presentations at numerous industry group sessions. His most recent presentation was on SAP Total Cost of Ownership (TCO) at the Gartner Best Practices meeting in December, 2004. Mr. Kaminsky holds an BSCE degree from New Jersey Institute of Technology and an MBA-Finance from Seton Hall University. He is a member of the NJIT Sports Hall of Fame.

**About the SAP Practice**
We are one of several practices that are part of the SPG Technology Solutions division. Our SAP Practice placed its first consultants in 1999. Since then we have grown to be a $15m practice. In 2005, we revamped the SAP Practice’s footprint to grow with our client’s needs through the expansion of services and the creation of several strategic alliances. We have built a database of 6,000 consultants, maintain a global presence and have opened direct access to C-level executives in a variety of industries. We offer a premium service at a valued price and are dedicated to building relationships around the world!