Cost savings avaru

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In procurement, both cost savings and cost avoidance are strategies used to reduce expenses. Indeed, both are part of a holistic approach and are often used as procurement KPIs. But, when it comes to differentiating between cost savings vs cost avoidance, a lot of questions arise.

In this blog, we''ll endeavor to answer these questions and more. To begin, we''ll define both terms and offer an overview of how to calculate them. Next, we''ll compare cost savings vs cost avoidance -- highlighting the differences. And finally, we''ll explore specific, everyday examples of each so you can see how they might apply to your organization.

Cost savings is when you take action to reduce spend, saving your organization money. Because cost savings is actualized, quantifiable and verifiable, it is sometimes referred to as "hard cost savings".

Often, procurement teams achieve cost savings through negotiation of fees, bulk discounts, renewal contracts and so on. You can also increase cost savings through partnerships, predictive forecasting and supply base rationalization.

To calculate cost savings, simply take the pre-negotiated cost (or use the market rate if a pre-negotiated cost isn''t available) and subtract the final contracted cost. The result is the amount of your cost savings.

While the equation can certainly become more complex, this is the foundation for all cost savings calculations. Additionally, it''s worth noting that some procurement teams prefer to report cost savings as a percentage rather than a dollar figure. In that case, you should subtract the final contracted price from the initial proposed price. Then, divide the result by the non-negotiated price.

As mentioned in our introduction, cost savings is often used as a procurement key performance indicator (KPI). Procurement teams carefully track, manage, report and optimize cost savings. Often, teams will have benchmarks and goals based on this metric.

Additionally, organizations report cost savings in financial statements and budgets. Furthermore, according to a Deloitte study, 79 percent of chief procurement officers (CPOs) consider it their main priority. So, it''s important to ensure accuracy. Many organizations use the RFP software to centralize and document the vendor selection and negotiation process while also ensuring auditability of cost savings.

Cost avoidance is a proactive action taken by an organization to reduce or eliminate future expenses. Because this calculation is based on theoretical, intangible expenses, cost avoidance is considered a "soft cost savings".

You can achieve cost avoidance by performing preventative maintenance, reducing contract renewal rates, making substitutions and securing warranties. Admittedly, cost avoidance is nuanced. Cost avoidance often means investing in a solution or spending money now to save more in the future.

To quantify the value of cost avoidance you must estimate the projected cost of not taking action. Then, subtract the cost of the proactive solution. The result is the amount saved by cost avoidance. Similar to calculating cost savings, you can calculate this metric as a percentage using a similar, simple equation.

While cost avoidance figures aren''t included in financial reports, it is important to keep the practice in mind. Indeed, cost avoidance ensures that you can mitigate and manage large unexpected expenses and annual cost increases. Proactive cost avoidance is particularly important and effective when renegotiating or renewing contracts in high-inflation markets.