Cost Avoidance vs Cost Savings: What's The Difference?

In business, taking action to keep costs down and avoiding spending more money than you need to is just smart.

The more you can keep in revenue and cash flow, the better your profits will be.

However, in some businesses, you may hear the phrases "cost avoidance" and "cost savings" used interchangeably.

The reality is the two phrases have different meanings, and understanding how they differ can make a big difference in overall business operations.

What is Cost Avoidance?

Cost avoidance focuses on actions that avoid incurring costs in the future. In business, this means taking measures to lower potential increased expenses so that a company doesn't have as many costs in the future.

With cost avoidance, all actions are taken to reduce future costs. For example, spending money regularly to properly adhere to maintenance schedules on fleet vehicles and equipment is a cost avoidance strategy.

Failure to address maintenance and keeping everything in good working order could lead to needing to make more expensive repairs or replacements in the future.

Letting employees operate vehicles and equipment in poor conditions could also increase the chance of an accident which would go far behind the cost of simply repairing the vehicle.

Anything that is a preemptive action to avoid prospective cost increases in the future is cost avoidance. It’s not something you can see or measure in an organization’s budget or financial statements.

Because cost avoidance measures may require spending money as a temporary additional cost, in the short run, expenses may appear elevated. However, the additional amount of money now serves to lower costs in the future, ultimately bringing the total cost down.

Let’s say a company is planning to increase sales volume by entering markets in new geographic areas beyond the corporate headquarters.

It’s possible the company currently doesn’t have the sales team that could support the plan. In this situation, the company may opt for incremental spending to increase its salesforce with additional staff.

Or, the company may make a one-time investment to purchase the latest technology to allow its sales force to work from home, spending more time in the field.

Investing in new technology is the winning choice because it eliminates spending on compensation costs now and in the future.

Another example of cost avoidance is to look for value-added services. These services are available at little or no cost to the business, but help it in the long run.

For instance, when a company purchases those fleet vehicles, the dealership may offer an extended warranty, or free oil changes for the life of the lease, etc. that saves the business money in the long run.

Making an effort to keep service costs down improves indirect spending.

> *Cost avoidance means not having to spend money in the future. Cost savings reflect the money you didn't have to spend on something now.*

Hard and Soft Costs

Hard Costs

Hard costs refer to the purchasing price of hard assets. It's a direct cost, typically any tangible asset, that holds some kind of intrinsic value.

For example, purchasing inventory, equipment, facilities, or land is all considered hard costs. A hard cost is easy to estimate because the cost is as-is when it is incurred.

Soft Costs

Soft costs are those that are associated with intangibles. They are indirect costs, including legal costs, accounting, banking, and so on.

They are more difficult to quantify because they are difficult to forecast. Growth in soft costs may be a part of keeping a project going successfully until it is finished.

Soft saving is the "intangible benefit of continuous company improvement." Soft savings cannot be seen on invoices, receipts, or financial records.

They are reflected in capacity enhancements and in cost avoidance measures.

Examples include improving workplace safety, better employee satisfaction, better customer satisfaction, compliance with changes in legislation, and reducing the need for working capital.

Cost Savings

Unlike cost avoidance, cost savings are reflected in both the company budget and financial statements.

Cost savings can also be referred to as "hard savings", and associated with actions that reduce debt levels, current spending, or investment.

An organization's buffet and financial statements should always highlight any savings achieved through cost savings.

Planned cost savings should be part of the budget, too. Cost savings in comparison to previous periods should also be added to financial statements, so the company effectively measures cost savings in regard to profit over the year.

Cost saving measures refer to any action that produces tangible financial benefits reflected in the company budget and financial statements.

Example of Cost Savings

Partnerships

Partnerships help companies reduce their costs.

Partnering with a cloud service provider, for example, eliminates the need to build and maintain a computing infrastructure on-premise.

New Contracts and Contract Renewals

Each time a contract is negotiated, either as the initial contract or renewal, there's potential for cost savings.

Whether it is from a reduced overall price for a longer contract or through value-added services, procurement staff can work with potential vendors to get the best possible deal.

Contracts can help you avoid price increases in the long run by locking in a discount for several years.

Price Negotiations

This is another area where procurement can make a huge difference in the overall budget.

For instance, if you've been buying a fixed amount of something, but need to increase volume, you may be able to negotiate with the vendor to get a lower price per unit.

When the procurement department is able to lower current spending with a new price, reflect that in next year’s budget.

Calculating Cost Savings

Original Price

Determine the price of the product or service that you are potentially saving from. It is the original price you use throughout the rest of the calculations.

New Price

Next, turn the new price of the product or service that you will be saving from. This is the price after a sales promotion, discount, deal, or after negotiation.

Price Difference

Next, determine the difference between the original price and the new price. Subtract the new price from the original price.

Division

Divide the price difference by the original price.

Cost Savings Percentage

Multiply the price difference by 100 to get the percentage, which is your cost savings percentage.

Maximizing Cost Savings

Reducing Marketing Costs

Thanks to social media and search engines, both paid and unpaid advertising can reach millions of people in a fraction of the time and cost it used to take.

Working with social media professionals can help you market your business without needing to hire a full marketing agency, so you save money and improve your returns.

Outsourcing

Outsourcing opens your company up to talent from all over the world and can be useful to fill roles that you need on a part-time basis.

There's no reason to hire an in-house writer for a few blog posts every week and pay them a salary, but having a current employee write the content may mean work suffers elsewhere.

Instead, working with a freelancer keeps your overall costs down and ensures your employees are working on tasks they enjoy and excel at.

Technology Investments

Technology can decrease operational costs and maximize cost savings. Evaluate your organization's current administrative processes and make process improvements where possible.

Look for areas that can be automated with technology. Keeping current with the latest technology keeps you competitive and has the potential to significantly reduce operational costs.

Reducing the daily manual efforts your employees must make improves productivity because they can focus their efforts on other valuable tasks.

Not only this, but you can produce cost savings by reducing the time and money wasted as a result of human error.

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