

How To Manage Discretionary Costs



Cost management is critical during a financial crisis and may be the only way to keep a business sustainable.

High expenses mean that a company needs to generate a substantial amount of capital to reach the break-even point.

However, all costs aren't equal. Non-discretionary expenses or mandatory costs, can't be cut without running the risk of causing serious damage to the company. These are essential expenses which are integral to running the business.

Mandatory or non-discretionary expenses like salaries, rent, and insurance expenses must be paid to avoid legal ramifications or to avoid shutting down completely.

When it's necessary to reduce the budget, cost-cutting has to come from discretionary funds since cutting essentials costs is risky and often impossible.

A number of expenses can be cut without causing serious damage to a business that are discretionary or managed costs.

A discretionary cost, discretionary expenditure, is an expense that can be

forestalled or eliminated in the short-term without negatively affecting a business's short-term profitability.

A company may decide to reduce discretionary costs if it finds itself with cash flow difficulties, or if it wants to present more favorable financial statements.

Discretionary funds shouldn't be reduced for a prolonged period since this can present a number of challenges.

Managing discretionary costs wisely is important because it can't be a long-term strategy. While these costs can be paused they need to be paid to stay in business at a minimum.

Managing discretionary costs allows companies to pinpoint where they can make cuts to save money during financial difficulties. Discretionary costs will vary depending on the business and its specific needs.

Examples of Discretionary Costs

The most important thing to remember is that discretionary costs will not be the same for every company.

What may be discretionary to one company may be non-discretionary to another. In general, these are the areas where most companies can choose not to invest in for the short-term future.

Marketing

Although marketing isn't optional for the majority of businesses, it does encompass a large number of areas that can be examined for ways to reduce costs.

Some discretionary items found in the marketing budget include advertising, events, video production, agencies and freelancers, collateral, and public relations.

Deciding where to cut back can be challenging but make it easier by applying the Pareto Principle. 20% of a company's business comes from 80% of its customers.

Focusing the marketing team's efforts on these ideal customers will be crucial. Finding the events, social media sites, websites where they can be found and reaching them there will generate the highest ROI.

Investments

There are potential discretionary investments that a company may make to propel growth and diversify its income streams.

These may include real estate, mergers and acquisitions, research and development, and stocks.

If investing in R&D is profitable and key to positioning the company as an industry leader, then this would be an investment strategy worth keeping.

Investing in stocks is geared towards long-term gains, so this might be an area that can be put off until the company's financial picture improves.

The same can hold true for real estate investments. There may be some cases in which it makes sense for a company to purchase a piece of real estate, a warehouse, or office building because it's more cost-effective. In a buyer's market, this may be an instance where it would be prudent to go ahead with the deal.

Travel

Travel can be a necessary part of a company's initiatives. However, travel is still mostly discretionary. Company travel can include:

- Attending trade shows and conference
- Board meetings
- Client meetings
- Sales trips including cold calling for new clients
- Visiting branches, satellite offices, factories, warehouses, and production spaces

While these trips can be important they are not considered non-discretionary. Managing corporate travel effectively is essential for a profitable, well-run company.

There are many tools available that can serve as a substitute for travel. Conference calls, video conferences, and combining trips can be manageable and cost-effective ways to reduce a travel budget.

Subscriptions (SAAS)

Some company subscriptions are essential, for example, web hosting or payment processing software. But, there are often lots of subscriptions that can be considered discretionary.

Examples of services to review:

- Communication tools like Slack
- Sales and marketing customer relationship management services (CRMs)
- Business suites (Microsoft Office)
- Planning and project management tools like Trello, Asana, or Basecamp

Some of these services have become so commonplace that it may seem impossible to do without them. But there are lower-cost alternatives, and in reality, they are not essential in many cases.

Team Benefits and Perks

In order to attract top-tier talent and create a positive environment, many companies offer generous benefits. They may not be essential, but they have become a core part of company culture at many businesses.

Team building events, games, exercise classes, gym memberships, company cars, entertainment, parties, and food and drink are some typical examples.

Cutting back on some of these benefits may take a little bit of creativity, but it can be done. Possible solutions include finding lower-cost alternatives or being transparent about the reason the changes are being made.

It's important to navigate this carefully if your employees are in high demand by your competitors.

Building Maintenance and Office Improvements

On the heels of team benefits and perks comes providing a comfortable work environment. Some companies have set aside space for comfortable couches and video games for employee breaks, while others provide nap rooms.

And while those perks may not be common, plants, upgraded ergonomic chairs, well-appointed breakrooms, and replacing furniture are considered part of keeping employees happy and comfortable.

These are all wonderful ways to foster a positive work environment and cement the company culture. But, they are also the very definition of discretionary expenses.

On the other hand, routine building maintenance can prevent the need for costly repairs that can come at a time when you need to limit your expenses.

Spend Management Systems

A company's strategic spend which includes salaries, rent, insurance, raw materials, and other fixed costs are fairly predictable.

These payments are made on a regular schedule to the same people, in the same way.

Discretionary costs tend to be different from quarter to quarter and that makes managing them more difficult.

Setting up a centralized spend management system will allow the company to track all expenses, including discretionary spending.

There are several tools which are essential for proper and effective tracking:

- Approval tracking so it's clear who approved each expense
- Variable limits and budgets to simplify budgeting for each department or team
- User-friendly receipt upload so that receipts are located in a central location
- Payment logs for the ability to check every individual payment

- Flexible methods of payment (virtual cards for online, physical cards, invoicing software, etc.)

Important Takeaways

Cutting costs presents an enormous challenge because discretionary costs are harder to keep track of because they're so variable.

And because budgets for discretionary spending allow managers to spend the money at their discretion, it can be difficult to account for it.

Managing discretionary costs is the key to making the right cuts.

Here are some key things to consider:

- A good definition of discretionary costs is that they are not essential to the day-to-day operation of the business and can be reduced or eliminated in the short-term. They can be thought of as “wants” instead of “needs”.
- Discretionary spending includes a wide range of expenses across all departments and teams.
- Some expenses may still be completely necessary for a specific business even if they're not technically “essential”.
- Discretionary costs are so varied and are not fixed costs. This makes them hard to manage, even for a company's finance team.
- Adopting a spend management system will ensure that a business can account for all expenses, discretionary and otherwise. Once this system is in place, accountability will be easier to manage.

There are many reasons why a company may need to reduce expenses. A recession or economic downturn, or a few less than stellar quarters can make it necessary to protect the business.

Companies that sell non-essential products and services, or luxury goods can be cyclical. They have to be proficient at controlling their costs.

Learning how to manage discretionary costs by keeping track of expenses and analyzing which discretionary costs can be cut in the short-term without jeopardizing the company's stability, will give a business the breathing room it needs to recover.

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