

Realized Cost Savings: How To Achieve and Track Them



Getting the best possible return on your business spend is a challenge for many businesses. Your procurement team and finance department both look for ways to increase the bottom line, improve accuracy and utility when budgeting, and protect cash flow while building value for your company. But even when your staff identify and pursue cost savings, the actual realized cost savings may not match your projections when the contract comes to a close.

Achieving realized savings that match the milestones you set requires a clear grasp of cost avoidance, cost reductions, and the importance of both process optimization and stakeholder education. Once you understand the obstacles that can prevent you from securing optimal realized savings, you can develop methodologies to help you overcome the roadblocks and maximize your savings—and value.

What are Realized Cost Savings?

Despite being two sides of the same savings-driven coin, the procurement and finance departments generally approach the idea of “cost savings” in two markedly different ways.

Finance traditionally looks for “hard savings,” through lowering specific existing costs or reducing the total costs that come with doing business—aka, *cost reductions*.

Procurement searches for what are sometimes called *soft savings*, using cost avoidance. They seek to avoid additional costs (via cost increases) or create savings opportunities via strategic sourcing and skilled contract negotiation. The *potential* cost savings they negotiate are referred to as *identified cost savings*.

Let’s say your company spent \$30,000 on shipping in a specific country last year. If the procurement team sees an opportunity to reduce costs by 15% over the course of the upcoming fiscal year by switching exclusively to a new logistics firm

for shipments in that country, the *identified savings* are 15%, or \$4,500.

However, those potential savings will only become *realized cost savings* (i.e., the actual measured and recorded savings that can be entered onto the company's financial statements with full confidence) if:

- All of your internal stakeholders adhere to the terms of the contract, using only the specified logistics vendor.
- The logistics vendor complies with the terms of the contract.

These realized cost savings are tracked over the course of the 12 months following the contract's execution, in order to verify that the projected savings are being matched by the actual ones.

Since there are many points at which either party could conceivably fail to meet their obligations—particularly in a system without adequate tools and technology to properly track spend, receive and pay accurate invoices in a timely fashion, and minimize the risk created by rogue spend, invoice fraud, etc.—it can be difficult if not impossible to achieve realized savings that match the identified savings negotiated in the contract itself.

Some of the potential roadblocks include:

- Inadequate or poorly optimized invoicing systems. Suppliers using paper invoices and manual workflows may send duplicate or incorrect invoices, which can create higher costs for the buyer in the form of work hours chasing exceptions or trying to track down lost or unsent invoices in order to pay them on time.
- Lack of internal controls. Without implementing measures to ensure contract compliance, companies may find their buyers:
 - Decide on their own to use alternative suppliers to pursue short-term cost reductions while actually creating cost increases due to contract violations.
 - Engage in maverick spend that can't be factored into budgeting or forecasting for resource allocation and hinders cash flow management.
- Insufficient strategic sourcing capabilities. Companies who lack the analysis and forecasting tools required to accurately estimate material requirements (or the supply chain flexibility to address unexpected

disruptions) may find themselves buying less than they'd planned, unable to buy at the volume discount rate, and therefore dealing with a significant price difference when the invoice arrives.

Whatever the reason, if the realized savings don't match the identified savings on the balance sheet, it creates difficulties for the company that extend beyond the bottom line.

To return to our logistics example, let's assume miscommunication led to the company's buyers regularly falling back on the original vendor to ship goods. The company no longer has optimal negotiated pricing with the original vendor, whose fees remain the same. Instead of reducing costs by \$4,500 over the course of the contract, the company saves only \$1,800, creating a sizable discrepancy with a direct impact on the data used for budgeting and negotiating next year's contract.

Conversely, if market conditions suddenly shift and the company begins shipping twice as much product to the area covered by the contract to meet demand, the actual savings will be higher than projected—and may throw off cash flow management in the other direction, since finance will find itself with extra working capital it should be putting to work, but hasn't planned for.

An accurate picture of company spend helps align finance and procurement goals to improve budgeting, cash flow, and supply chain optimization. The more accurately and efficiently your finance and procurement functions operate—and integrate!—the more effectively they can support organizational goals through strategic insights and process improvements.

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Achieving Optimal Realized Savings

Finance wants hard numbers they can record as cost savings to boost the bottom line. Procurement wants to build value, reduce total cost of ownership (TCO), and optimize the company's return on investment (ROI) while practicing cost avoidance. Both departments want to protect the company's business continuity

and provide strategic insights that improve everything from cash flow management to investment planning and product development.

For the best possible financial outcome, it's crucial to forge a strong connection between the two functions. You can maximize your procurement savings and achieve your budgeting benchmarks by changing up your approach to how you monitor and pursue cost savings opportunities.

1. Establishing Formal Cost Savings Practices

When they work together rather than seeing one another as rivals, finance and procurement can move mountains. To help the former pursue its cost reduction agenda while still recognizing the value of the latter's cost avoidance efforts, creating a formal system for connecting identified savings to realized savings on the final P&L sheet is essential.

1. **Identify the type of savings.** Is it an improvement on existing pricing? Cost avoidance through negotiated discounts or economies of scale?
2. **Specify the source of baseline data.** For example, historical spend data, industry trends, resource availability, etc.
3. **Record spend categories, general ledger codes, and relevant cost centers for all savings opportunities.**
4. **Provide detailed forecasted purchase volumes.** Especially important for negotiated spend requiring specific purchase volumes to realize cost savings.
5. **Include additional information related to cross-dependencies, assumptions (e.g., market trends), etc.**
6. **Secure finance approval for procurement savings opportunities.** This not only ensures complete transparency between the two functions and simplifies budget reconciliation (reducing the chances of conflict or dispute) but also establishes procurement and finance as strategic partners in building organization-wide value.

2. Implementing Procure-to-Pay (P2P) Software

The biggest challenge that comes with tracking and improving realized cost savings is the actual tracking at the invoice level. Manually tracking and verifying every single invoice can be difficult in the best of times; add in maverick spend and roadblocks such as paper-based approvals and snail mail invoices and payments, and you might find yourself struggling to avoid increasing your costs, let alone saving money.

A robust, cloud-based procure-to-pay (P2P) software solution like PLANERGY takes the pain out of tracking cost savings—and a lot more. Thanks to advanced automation, artificial intelligence (A.I.) and data analytics, you can:

- Collect, manage, view, and manipulate all spend data on a single, centralized platform that's mobile friendly and device agnostic.
- Use powerful contract management tools to leverage spend data at the negotiation table to secure the best possible terms and pricing.
- Enjoy full integration with supplier systems, including support for electronic invoicing and payments as well as punch-out catalogs.
- Establish and enforce guided buying protocols that ensure every purchase is made with a corresponding purchase order to the correct vendor, at the negotiated pricing and terms. This helps eliminate rogue spend and improve compliance across the board.
- Automate and optimize invoice processing (including automatic three-way matching).
- Take advantage of real-time, on-demand data analytics to identify potential compliance issues (for both internal and external stakeholders) so you can make swift, confident corrections.
- Use next-gen, machine-intelligence analytics to identify spend patterns, forecast expenses more effectively, and make more strategic sourcing and investment decisions.
- Integrate with finance to balance cost savings with cost avoidance when budgeting, forecasting, and making sourcing decisions.

3. Prioritize Strategic Sourcing

A streamlined, flexible, and resilient supply chain—one populated with vendors who share your vision and values, meet your standards for compliance,

performance, and price, and take advantage of technologies that support shared success—is key to achieving maximum realized cost savings.

This is another area where an effective P2P solution will prove invaluable, as you'll:

- Be able to onboard suppliers much more efficiently using a supplier portal.
- Have the data you need to identify your best suppliers (and potential partners).
- Eliminate redundancies while still including contingencies.
- Prioritize suppliers who support eInvoicing, compliance monitoring, and punch-out catalog integration to enrich your data stream and ensure you have the most accurate data possible when identifying cost savings opportunities *and* tracking realized cost savings over time.

Make Sure Your Cost Savings Opportunities Fulfill Their Potential

Don't let the chance to save money, reduce costs, and build value slip through your fingers. By forging a strong and strategic partnership between procurement and finance, investing in procure-to-pay software, and practicing strategic supply chain management, you can realize the cost savings you pursue, practice strategic cost avoidance, and ensure both internal and external stakeholders meet their compliance obligations.

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