

How To Use Cost Savings Ratios & When

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Can Cost Savings Ratios Make Reporting Easier?

Reporting cost savings is easiest when you negotiate a lower price and buy the same quantity of goods or services from one year to the next. Then, your cost savings is equal to the reduction in spend.

Things get a little trickier when volume changes. For example, if you paid \$10 for an item last year and bought 100,000 units and you pay \$8 this year and will buy 150,000 units, your spend will actually increase to \$1,200,000 from \$1,000,000 despite a price reduction. In these cases, you have to communicate your savings on a per unit basis: "we saved \$2 per unit."

But it becomes even more difficult when both volume and the exact composition of a category of goods or services changes. Airline travel is a good example because the number of flights, destinations, number of days in advance tickets are purchased, and other factors will change from one year to the next.

How do you report cost savings in these types of categories? "There's just no good way to do apples-to-apples based on a total spend," says Jim Nelles, Partner with Roland Berger Strategy Consultants. Instead, Nelles finds cost savings ratios to be a solution.

For airline travel, Nelles suggests using a cost savings ratio such as cents per mile flown and striving for a year-over-year reduction in this ratio. But this type of cost savings ratio is not just limited to airline travel.

"For something like office supplies, again you're rarely ever going to buy the same market basket of goods from one year to the next," according to Nelles. "But if you can calculate office supply spend by...employee, it's a nice way to demonstrate that [you] were spending \$50.00 per employee last year and now that number has gotten down to \$47.50 this year."

So rather than tracking the spend on every single pen or line item – especially when items are routinely discontinued – you can use cost savings ratios to demonstrate your contribution. Nelles contends that "it is by coming up with these interesting ratios and these different ways to demonstrate savings that people will start to believe what you are doing."

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