For any further information regarding this article please contact Michael Norrish on 0408 914 051

DISASTROUS DISCOUNTING

Discounting is one of the most abused practices in the business world. Too many businesses are seriously weakened because the real cost of the discount has never been calculated.

In the real world many discounts simply do not exist. Retail's big boys use their carefully thought out "everyday low prices" strategy (EDLP) on certain categories of merchandise only. The approach is rarely used store wide.

Although tempting, discounting is really no substitute for adding value to products or finding more economical ways of achieving customer satisfaction.

Here is an example of the dangers of discounting.

Suppose your average gross profit margin is 35% but you have decided to discount by an average of 10% to meet new competition. How much extra business will you need to cover the drop in net profit caused by your discounting policy?

Let's say your sales are $1,000,000 pa and your net profit is 5% of sales, or $50,000 pa. Your average gross profit margin is 35%. Your trading statement would look like this: -

	$
Sales	1,000,000
Less Cost Of Sales (Variable Expenses)	650,000
Gross Profit	350,000
Less Overheads (Fixed Expenses)	300,000
Profit from Trading	50,000

You then offer a 10% discount across the board on all products.

Now here are the same figures after the application of discounts.

	$
Sales	900,000
Less Cost Of Sales (Variable Expenses)	650,000
Gross Profit	250,000
Less Overheads (Fixed Expenses)	300,000
Loss from Trading	(50,000)

Discounting is fraught with danger for small business because they probably lack the financial strength to attack a competitor who discounts in some areas but maintains or enhances margins elsewhere.

For small business it is often smarter to turn it right around and - rather than discount - **increase your prices and add extra value to your goods and services so your customers can see the benefit of doing business with you** rather than a competitor who can only offer lower prices.

If all businesses put their minds to it they would discover some "value-add" mechanism/spin that could be quite inexpensive but which would add some real value to their business and be a lure to recurring custom.

Let's say you increase your prices by 5% in order to add services elsewhere. Assuming sales volume is static, your bottom line (as per the above example) would be a profit from trading of $100,000 rather than the $50,000 loss from a 10% discount.

	$
Sales	1,050,000
Less Cost Of Sales (Variable Expenses)	650,000
Gross Profit	400,000
Less Overheads (Fixed Expenses)	300,000
Profit from Trading	100,000

By instituting a 5% increase in prices, the resultant gross profit margin goes from 35% to around 38% and the net profit outcome is enhanced considerably.

Of course the assumption that is made is that both your Variable Expenses ("Cost of Goods Sold") and Fixed Expenses ("Overheads") remain constant in the example provided.

It is also imperative that correct Costing and Pricing strategies are both understood and implemented. Too many businesses today are of the view that if you mark something up by (say) 45%, that that equates to a Gross Profit of the same magnitude. No, no, no, no, no!!!!

A "Mark-Up" of 45% only equates to a Gross Profit Margin of around 31%!!!

Call me if you want to understand how to price your product for "Profit" rather than "Mark-Up"!!!!