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THE TRUTH ABOUT DISCOUNTS

When it comes to retail pricing quotes we live in a world of half-truths, confusing pricing, lowest price guarantees, and bold statements such as “We won't be undersold!” The word “DISCOUNT” is such a part of our society that some brands actually use the word in their business name! But do we really know much about the world of discounts? Most people will tell you that a discount is an absolute must if one is going to purchase anything.

Many years ago I recall having lunch with a friend who suggested that he needed a new briefcase and wanted to check out a luggage store not far away, and on the way back to our office. We finished up lunch and headed to Chin's Chinese Luggage. When we looked over the briefcase selections, my

friend selected one that he liked and we headed for the checkout. The new briefcase was a very nice one and was priced accordingly. As the clerk was ringing up the sale, my friend totally surprised both the clerk and me with the question “Are there any discounts today?”



At the time I was mildly embarrassed to hear my classy friend even ask the question. But to my total surprise the clerk replied “I can offer you a ten percent discount.” My friend said that would be fine and we concluded the transaction and headed to our office.

Looking back on this experience I've often wondered what the real numbers were involving that transaction, or any discounted transaction for that matter. What impact do discounts have for the buyer and the seller when all is said and done? I did a little research on this topic and made some interesting discoveries. The truth about discounts is that they can be simple to calculate in the best scenarios, and totally confusing in the worst. What's more, discounts almost never work out in favor of the seller and are very seldom appreciated for what they represent to the buyer.

Let's create a make-believe scenario where I go into a business deal and see what the real truth about discounts boils down to...

I need to buy ten desks for our new office. I go online to see what is available and find several sources of new office furniture to choose from. So, I call the one closest to my office and chat about the type of desk I want and delivery times. I ask about different finishes, colors, main features and benefits, as well as the delivery to my office on the second floor of my building.

After I'm satisfied that I have selected the best choice for my needs, the most important part of the conversation takes place. How much is this going to cost me? I ask the nice lady on the phone about the price of this order and she starts by quoting the MSRP. (Manufacturer's Suggested Retail Price.) The conversation goes something like this: (C for customer and S for salesperson)



C So how much is this going to cost me with tax and delivery?

S Well Mr. Robertson, the MSRP is \$750 per desk so ten of them will cost \$7,500. The 8% tax will add another \$600 and the delivery is free. So the final invoice will be \$8,100 delivered to your office.

C Wow. That seems a little pricy. Since I'm buying ten all at one time can you offer me a discount on the order?

S Let me check with my manager... I have good news Mr. Robertson! We can offer you a 10% discount on the total order! That will reduce your invoice from \$7,500 to \$6,750. With tax and delivery you'll save \$750. How does that sound?

C Gosh... I thought there was more margin in office furniture and was looking for a 15% discount. Can you ask your manager about that please?

S Okay... let me see what I can do... I'm sorry Mr. Robertson the best we can do is offer you the 10% discount, but we'll cover the tax for you, and as I said, there's no charge for the delivery so, your final invoice will be for \$6,750. Will that be acceptable to you?

C Yes it will. If you can deliver the desks next Monday we have a deal.

S No problem Mr. Robertson and we thank you for your business!

Okay... now let's break down what just happened. On the face of it we can conclude that I got a pretty decent deal. The total purchase with tax was originally quoted to me as \$8,100. My final quote was \$6,750 but the 8% tax I do not have to pay on the \$6,750 added another \$540 to my benefit. Thus, the total savings to me is now the \$750 discount plus the \$540 tax I do not have to pay. This equals \$1,290 off the original \$8,100 price I was quoted. So for me this is now a 15.9% discount. I was happy with the deal at 10% discount but pushed to see what more I could get. I ended up feeling great about the tax being "thrown in" and jumped for the deal!



Now let's examine what happened to the office furniture store. They quote each desk at \$750. Their cost for each desk is 50% less than the MSRP to equal \$375 per desk. So, their cost for 10 desks comes to \$3,750. But there is an average overhead expense of %35 per sale. This overhead expense includes fixed and variable costs such as rent, utilities, insurance, regulatory costs, taxes, fees, security, cleaning, bookkeeping, freight delivery charges, customer delivery costs, and the commissions paid to the salesperson. This 35% is of the final retail price paid by me, the customer. Since the final invoice to

me is \$6,750 that 35% = \$2,362.50 added to the store wholesale cost of \$3,750 meaning that the store cost for this transaction is the sum of these two figures or \$6,112.50.

I sent them a check for \$6,750. After they take away their hard cost plus overhead averaging their net profit is only \$637.50.

So, what was the actual discount the store offered me? That figure is the 10% retail discount plus the 8% tax on the sale. On the surface of it one could state that my discount was 18% so the store is not out all that much. But in reality, we have a totally different outcome and it's not good for the store!

By allowing me to NOT pay the discount of \$750 plus the \$540 tax the store is out \$1,290 off the bottom line profits of the ten-desk sale. Since their cost for the desks was \$3,750, if they had sold me the 10 units at full retail they would have realized a gross margin of \$3,750 but with the \$1,290 discounts they allowed me, their gross margin (before adding the overhead averaging) is now $\$3,750 - \$1,290 = \$2,460$ gross margin.

So, what was the REAL discount to me from the store perspective? It is NOT 10% plus the tax. The total discount to me was 34.4%. What we have learned here is that the store gave away

34.4% of their potential full retail gross margin, and that's before they cover the average overhead costs as mentioned earlier.

If we wonder how stores can just go out of business when we thought they were doing great, this is how it happens. Retail stores work on margins so thin all it takes is a tiny shift in any of the cost dynamics surrounding their reality to put them under water. For example, Walmart is the largest retailer on earth. What would you guess their average margins are for their business at the end of any given year? It is 2.87% of sales. Because they are so big they can stand changes in the economy of their business. Most companies cannot.

In summary, what can any business do to reduce losses by quoting discounts?

1. Never quote a percentage discount. Offer dollar discounts instead. In this scenario, the salesperson could have asked if \$500 off the order would be acceptable. To me the \$500 is cash in my pocket while the 10% may not get considered at all had it not been suggested by the salesperson.
2. Next, never offer to cover the tax or any other fixed cost that has nothing to do with your business bottom line. Someone has to pay the tax no matter what other offers are part of the deal.
3. Finally, place a dollar value on anything that costs the store real money. Free delivery of the desks to my office involves a truck, driver, helper and all the costs associated with keeping that truck in operation (gas, maintenance, registration, labor salaries, etc.) My salesperson could have said the delivery is normally \$250 but the store will cover it. In my mind, I just scored another "discount."
4. Remember that anytime you quote a percentage discount; be very sure you've done your homework on what your real costs are first. There's no such thing as a 10% discount. It's always more than that to the business owner. While you might be able to "write off" the loss on your tax return, that's scant satisfaction to your bottom line.

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