

The Temptation to Discount

There is a common saying in business: “Live by Price, Die by Price.” Small businesses should be especially wary of this saying. The cost structure of smaller businesses rarely supports discounting as a long term strategy. Watching the “big boys” of business compete in weekly discount wars can be threatening, but only to the business who has no other strategy to attract and retain customers.

Price is an important part of a business’s marketing mix, but certainly not the only one. There are many possible dimensions of your product and service besides price. Researching your customer’s needs and providing solutions for them is more important now than ever. Revisit our previous articles in this series and continually ask yourself: What is the unique value that I deliver to my customers? Do I communicate it in my marketing messages and throughout my business? Avoid the temptation to compete only on price.

When the temptation to follow the trend and discount your prices becomes overwhelming, consider the mathematics behind pricing. If your gross profit margin is 50%, how much must volume increase to account for just a 10% decrease in price? If you sell a product for \$10 and your gross profit margin is 50% or \$5, this means your product cost is also 50% or \$5. If you reduce price by 10%, price becomes \$9. Product cost is still \$5, reducing your gross profit margin to 44%. To reach a gross profit of \$500 at the original 50% gross margin percentage, you would have to sell 100 units. To reach the same \$500 gross profit at a 44% gross profit margin, you would have to sell 125 units... a 25% increase in volume. Having to increase volume by 25% just to maintain the same gross margin you had under the higher price may be unproductive. Will your customers respond to the lower price enough to generate more than a 25% increase in volume? What expectation does this instill in your customers? The analysis here does not preclude the fact that there may be some situations which merit a discounting strategy. In any case, you should continually study your pricing strategy to make sure that you meet the needs of your business as well as your customer.

Your local Small Business Development Center at Longwood University provides free resources to assist you in assessing your business strategy and growing your business. Visit www.sbdc-longwood.com for more information.