

ABBY

P R A C T I C E

Newsletter

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Discounting – Beware; it can be very dangerous to your wealth!

Many of us in small business receive publicity information from businesses discounting the cost of their goods and services to us. This month we wish to provide a timely warning on the dangers of discounting, just in case you think this may be the answer to your cash flow woes.

On Boxing Day each year there is a frenzy of activity as giant red sale signs pop up in shop windows all over town. While it is gratifying to see sales volumes and revenue reach their annual peaks, many small businesses would be far better off if they had fewer sales and less discounting.

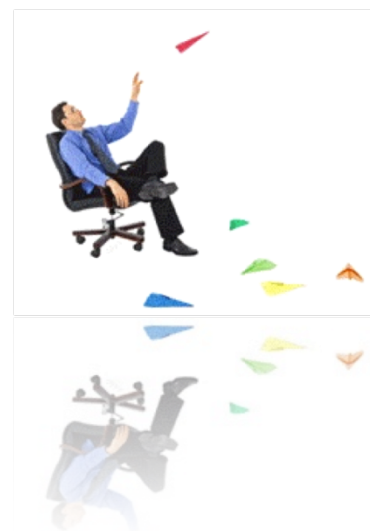
How can selling more at a discount be so bad? Here's why. Your business has a mark up on cost of 25% (Cost of 8,000 per month plus 25% mark-up = \$10,000). You decide that in January 2006 you are a bit short of cash so you decide to give your customers a 2.5% discount on the retail price.

The effect this has on your profit is:

	<u>Normal price</u>	<u>Discount price</u>
Sales	10,000	9,750
Cost of sales	8,000	8,000
Gross profit	2,000	1,750
Other overhead	1,500	1,500
Net profit	\$500	\$250

This example clearly shows that a tiny discount of 2.5% will halve your profit. To maintain your profit of \$500 you would have to achieve sales of \$20,000, is this possible? Take it a step further, a 5% discount would wipe out your profit altogether.

Instead of discounting, what many small businesses can offer is the adding of value. You cannot compete with the big boys on price but you could offer quality after sales care, additional warranties, training in the use of your product or perhaps open at times when your competitors are closed. Another useful strategy employed by many organisations is to up-sell items such as accessories that have better profit margins.



As always, if you would like to discuss any personal, business, accounting or tax issue, the first consultation is free, so call Sid Edwards at Abby Practice on 9476 0399.