7 Discounts and Promotions

A common question when deciding marketing strategies is "Should we offer a discount?". The answer to this question is far beyond simple and straightforward. It involves the examination of many factors such as the competition, the elasticity of demand etc. One can use break-even analysis to answer the above question from a pure cost and profit perspective. If the discount offer is made with a final objective to increase profit through an increase in sales volume, caution should be exercised on the fact that the expected increase in sales (incremental sales) will be adequate to make up for the "lost" profit from the discount offer.

To illustrate, let us assume that the owner of a cinema in Alicante, Spain wants to increase the number of customers in August. His records indicate that his 500-seat hall, is typically less than 30 percent full during August (the lowest tickets sales among the twelve months of the year). He wants to increase the number of ticket sold beyond the average of 150 per day for that month (500 seats × 30%). In order to achieve that, he decides to offer a 20 percent discount to everyone who buys tickets during that month. To promote his offer his will run advertisements in a newspaper at a cost of €1000.

If the selling price, without the discount offer, is €10 and the variable cost per person is €2, how many additional customers must he generate in August through this promotion in order to break-even on the total expenses related to the promotion and the discount offer?

We can answer the above question by applying the break-even analysis. In particular, we should first estimate the total expenses related to the promotion and the discount offer (fixed costs). In this case, we have obvious costs of €1000 (advertisement) and a "hidden" cost. This "hidden" cost reflects the lost profit from the discount offer.

This is calculated as follows:
500 seats × 30% average ticket sales for August = 150 tickets per day
Lost profit per customer €10 × 20% discount = €2 per customer
Total Lost profit for August: 150 tickets × €2 × 31days = €9,300

$$\text{B.E.P.}_{\text{(tickets)}} = \frac{€\,9300 + €\,1000}{€\,8 - €\,2} = \frac{€\,10300}{€\,6} = 1{,}717 \text{ tickets (approx. 56 per day)}$$

Approximately 56 more tickets must be sold per day in August to cover the total cost of the promotion (advertisement and discount). In other words, 206 tickets must be sold on average per day to have the same profit as at the level of 150 tickets before the promotion. This represents an increase of 37.3 percent. The owner of the cinema can use this figure as an additional tool to decide whether this is a good idea or not. He might believe that a 20 percent discount might not be enough to attract 37 percent more customers (without any additional profit) and therefore reconsider his decision. On the other hand, he might believe that if he can break even on the cost of the promotion, the additional customers will generate more sales for the kiosk from buying pop-corn, drinks etc.