Chapter

5

DISCOUNTS

INTRODUCTION: DISCOUNTING IN A RATIONAL WAY

Clearly, we live in an age of discounts, deals, weekend sales, price promotions . . . you name it. Anyone who pays full retail for almost anything these days is either incredibly wealthy or out of touch with reality. Consumers expect discounts and marketers are delivering them.

The question is: How to discount your products or services in a way that is attractive to consumers, channels, dealers, or whomever you want to sell your product to without going broke in the process. Anyone can cut the price. The question is how to do it so that it moves more products more profitably.

The first thing to understand about discounting is that *promotional discounts must be selective and directive*. That simply means the same discount on the same product doesn't have the same effect on every person in the market. Some customers are influenced and react; some don't. So if you cut the price on your product, don't expect people who have never used it before to rush in to buy. There are probably other reasons they haven't responded in the past. Simply

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changing the price-value relationship for a short period of time won't overcome those objections.

Remember, there are *only three things consumers can do if they respond to a price promotion:* (1) use more of the product through increasing their consumption, (2) use the product in different ways and also use more of it, or (3) stockpile or inventory it for future use. So the second thing to consider before you decide on a discount or reduced price or sale or whatever is to think through what you want customers to do and which groups you want to influence. That will help you identify the level of the discount you are willing to offer, when or where it should be offered, through what channels, and the like.

The third important issue in discounting is that *some products react better to price promotions than do others*. That is, most people have a mental group of products to which they respond when the price is reduced. And they don't respond to others. For example, retail food chains, using extensive price promotion testing programs, have discovered that only about 25 to 30 percent of the products in a store respond to a price cut. You know what they are: bread, milk, colas, ready-to-eat cereals, and the like. Things like canned tuna, charcoal briquettes, floor mops, and canned vegetables just don't generate the interest or enthusiasm that other products do. So don't think by reducing the price you're going to double or triple your business. In some categories you will, but in a large majority of the other, more mundane categories you won't.

The fourth issue is to *exercise moderation in your discounting program*. Being continuously on price discount will, at some point, convince consumers there really is no full retail price—that the discounted price is what they should always be paying. The soft drink companies have gotten themselves into that fix by continuous price promotion. Consumers have learned that if Coke is on sale this week, chances are Pepsi will be on sale the next. So just wait for the promotion. Similarly, there has been so much and such continuous discounting in the category that $4.98 per 24-can case or 99¢ per liter has become the "regular" price in the cola category. When marketers return the price to its traditional shelf price, consumers simply ignore the product and the brand.

Finally, *discounts work best if you promote them*. That seems obvious, but it's not always done. For example, price reductions on the shelf work but not

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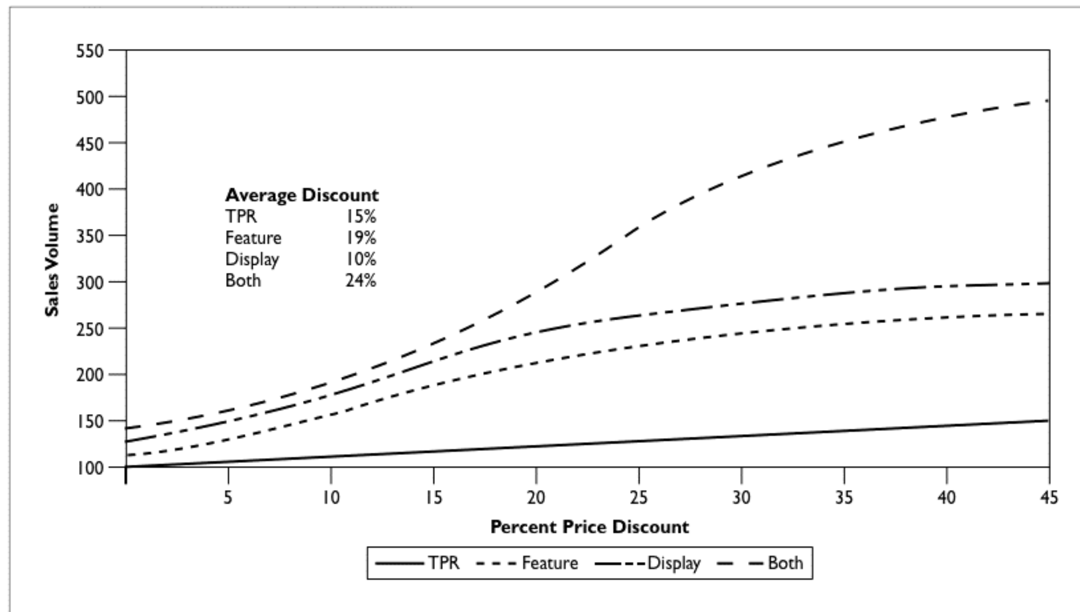
FIGURE 5.1 *Price Promotion Response Model*



nearly so well as when the discount is promoted through a feature or a display. The chart above shows the typical response rates for four types of price promotions in retail food stores.

Figure 5.1 has been derived from a large number of price promotions in supermarkets over a long period. Although it is not specific to any one product or category, it illustrates the typical response that a price promotion achieves depending on how it is promoted and merchandised.

On the base of the figure, we show the percent discount from the regular price. On the vertical axis, we show the sales volume. Clearly, the greater the percent discount, the greater the volume increase. But the increases are not linear—that is, each of them has a bit of a curve in the response rate. Thus, certain points on the curve are more effective and efficient for the marketer—points where the greatest sales volume occurs with the lowest promotional discount.

The second important thing about Figure 5.1 is that if the price discount is promoted through a feature in the retailer's newspaper ad, circular, or whatever, the increase is greater than simply reducing the price on the shelf. An

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in-store display added to the price reduction performs better than do the price reduction and advertising feature. And when we combine the price reduction with a feature and a display, sales really soar. The point of the chart in Figure 5.1 is clear. You can generate different sales volume impacts with the same price reduction or discount depending on how you promote it in your store or other facility.

Discounting works and it can be profitable. But you must be rational about how you discount and reasonable about your expectations. —Don E. Schultz

OVERVIEW

Isn't discounting a self-defeating proposition? Why reduce your profit if your product's worth the price? Why encourage consumers to wait for discounts? You know the old joke: "We'll sell it below cost and make up for it in volume."

The fact is that discounting is a complex *and* profitable business. You need to factor how much to discount your products, when, how, and, perhaps most important, how to protect your brand's quality image.

Some higher-priced brands position themselves as discounts. The Men's Wearhouse isn't cheap and it isn't even a warehouse. And Wal-Mart isn't necessarily a bargain.

This chapter describes the many forms of discounts (beyond coupons and refunds in separate chapters). It even describes how to sell a car for $1 over invoice.

Insight

The Lowest Bidder—"It is unwise to pay too much, but it is worse to pay too little. When you pay too much, you lose a little money—that is all. When you pay too little, you sometimes lose everything, because the thing you bought was incapable of doing the thing it was bought to do. The common law of business balance prohibits paying a little and getting a lot—it can't be done."

—John Ruskin
1819–1900

"The more you spend, the more you save!"

—Virgin Records point of sale

DEFINITION

Discounting is motivating purchase of a product or service by temporarily lowering the price to distributors, the trade, and/or consumers. (Again, this definition excludes coupons and refunds.)

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COMMON DISCOUNT OBJECTIVES BY TACTIC

(Also see itemized tactics below.)

TACTIC	OBJECTIVES (Beyond Purchase)
Bartering	Clear out merchandise; flexibility in discount amount; discount on a per customer, opportunistic basis
Trade-in	Increase consumer awareness and motivation to replace existing model
Storewide	Broad-based traffic and storewide shopping; boost slow periods; share of peak periods
Temporary price reduction (TPR)	Traffic generation on high-demand items without discounting other products
Voucher	Encourage purchase of high-ticket items
Future purchase dollars	Apply discount to future visit and purchase; amortize discount with additional purchase; possible vendor tie-in
Member card	Loyalty and frequent shopping; increased transactions per customer; promotional vehicle; database
First 200 shoppers/ First two hours	Drive early traffic to store (when wallets are full) while limiting liability
Fill this bag	Encourage volume shopping with diverse products for wide appeal while limiting liability
Value pack	Load customer—lower demand for competitor; high-dollar value at low cost of goods; increase usage
Twofers (BOGOs)	High-dollar value at low cost of goods; retailer participation with vendor
Bundling	Add discount value while sharing costs with partners; promote usage; move/ liquidate slow partner product
Financing	Encourage major purchase decision; long-term purchase (financing) requirement; overcome financial burden/depressed times; move overstocks; profit from interest
Contract prerequisite ("Club")	Trade up-front discount for extended purchase commitment at higher markups
Loss leader	Customer traffic and additional impulse purchases
Trade allowance	Additional stocking, sales, and promotion by trade, particularly during consumer promotion

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ITEMIZED TACTICS

49. BARTERING

Definition

Buyer and seller offer and counteroffer price and terms often in business to business and vendor to retailer; limited in U.S. consumer applications—auto dealers, retailers clearing merchandise, Internet

Advantages

- Allows seller and buyer flexibility in sales process
- Allows creative deals, negotiating options for mutually rewarding terms
- Seller can liquidate unwanted product

Disadvantages

- Time-consuming practice
- Inefficient compared with established pricing
- May alienate buyer and seller
- Complex accounting plus contract
- May project cheap and shady image

50. TRADE-IN

Definition

Marketer offers value on a new model in exchange for old model often for creative topspin

Advantages

- Reminds consumer of deficient unit
- Helps contrast superior new unit
- Purchase incentive
- Provides means of disposing of old unit
- Trade-in units may be refurbished, provide parts, or be donated to charity (goodwill and further trade-in motivation)

Disadvantages

- Extra effort—prospect may opt for a simpler offer
- Trade-in item may have secondary usage, negating motivation to trade in—spare TV, hand-me-down, etc.
- Neglects those with no trade-in item
- Dealer must accommodate trade-in units
- Insurance liability concerns

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51. STOREWIDE (DAYS OR HOURS DURATION)

Definition
Items throughout store are discounted—for example, "everything reduced 10%" or "red tag" items in every department

Advantages
- Wide appeal—all departments
- Encourages one-stop, cross-store shopping versus "cherry picking" in different stores
- Encourages impulse purchases
- Consistent percentage discount easily administered
- Retailer and vendor may tie in
- Can boost traffic in slow or peak sales periods

Disadvantages
- Cuts into margins on numerous items
- Susceptible to competitor with deeper discounts on fewer items (see "Everyday Low Price (EDLP) versus High-Low Retail Philosophy," page 140)
- Discounts items that may sell at full markup
- May discourage shopping prior to and after sale
- Consumers may limit shopping only to anticipated storewide sales
- May dilute image
- Storewide select items require repricing execution
- Sale items overlooked in scanner programming cause shopper frustration

52. TEMPORARY PRICE REDUCTION (TPR)

Definition
Short-term price reduction—one week, specific hours, etc.—may apply to one or several items throughout store; items often alter each week

Advantages
- Limited item(s) and time frame limit liability, allows deeper discount
- Short "fuse" encourages prompt response
- Retailer may take credit for vendor discounts (and maintain margins)
- Impulse purchases, possibly throughout store
- Consistent TPR offers build learned behavior for shoppers to visit and look for TPR signs
- Enhances shopping experience with surprise price reductions

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- More value perception but less discount for retailer
- Can liquidate undesirable inventory prior to deep clearance discounts

Disadvantages

- Requires constant pricing changes throughout system
- Consumers may shop only the discounted brands within the category—cereals that are on sale—reducing margins and eroding branding
- "Cherry pickers" may purchase only each store's discounted items
- Possible out-of-stock, upsetting shoppers (and sales)
- Discounts limited to specific size/extension can cause confusion and checkout delays
- Competes with "everyday low price" retailer (see "Everyday Low Price (EDLP) versus High-Low Retail Philosophy" on page 140)

53. VOUCHER

Definition

Discount credit certificate toward specific product purchase; similar to a coupon but typically a much higher value and for noncouponing retailers, products, and services

Advantages

- "Free down payment" encourages purchase of high-ticket items
- Gives discount a more prestigious, exclusive inference
- Allows controls, like timing, accounting, product offering, etc.
- More immediate incentive than refund and less expensive to administer
- Numerous targeted mediums

Disadvantages

- Limited to sales avenues that accept the voucher
- Requires training and processing to handle voucher payment
- Susceptible to mistakes and misredemption
- Unlike refunds, no slippage and fewer sales avenues
- Typically requires significant discount amount

54. FUTURE PURCHASE DOLLARS

Definition

Purchase earns dollar value toward future purchase, such as a free gift card or voucher

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Advantages

- Motivates immediate purchase
- Discount dollars are applied to a future visit and purchase
- Amortizes discount over additional purchases
- Manufacturer/retailer tie-in opportunity
- Clean, simple, motivating, and economical
- Can introduce consumer to gift card concept—particularly during holidays

Disadvantages

- Manufacturer tie-in limited to one retailer, and similar value programs must be offered to other retailers (See "Robinson-Patman Act," page 139.)
- Delayed reward, limited to retailer's selection may lose out to competitor's immediate discount
- "Qualified" discount may not be as appealing as competitor's unqualified discount
- Requires system to match and deliver reward according to qualifying purchase

55. MEMBER CARD

Definition

Magnetic-strip card entitles shopper to current discounts activated at checkout; may be part of relationship marketing program; "no-tech" card may simply be presented to cashier for on-sight discount

Advantages

- Rewards and motivates loyal shoppers, particularly fickle coupon users
- Can tie in vendors
- Easy execution for both shoppers and retailers
- Collect and get extension strengthens program with additional long-term rewards (see "Continuity," Chapter 6)
- Can provide valuable database benefits
- See advantages of temporary price reduction (TPR) on page 129

Disadvantages

- Considerable up-front and ongoing planning, communication, education, and enrollment programs
- Competitor discounts (like TPR above) invite everyone, not members only

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- Enrollment hassle discourages consumers who may prefer no-strings discounts
- Electronic card requires up-front operational commitment, risk, and ongoing maintenance; consumers grow wary of so many similar programs and cards to carry
- Exit plan necessary if program fails

56. FIRST 200 SHOPPERS/TWO HOURS/200 UNITS

Definition

Discount limited to the first customers to participate for typically high-volume period, such as Thanksgiving Friday

Advantages

- Captures determined shoppers early on a peak sales occasion
- Attracts "full wallets" prior to spending at other locations
- Limits liability—accountable
- Limited number allows exceptional offer
- Opportunity for fun, in-store PR event

Disadvantages

- Limited in scope to the number of shoppers
- May upset those who don't arrive early enough; consider consolation offer
- Neglects many who cannot or will not arrive early
- Often results in long lines long before doors open, alienating many and driving them to competitors
- Subject to poor weather conditions
- "Rush" to enter could get ugly
- Cherry pickers defeat purpose

57. FILL THIS BAG

Definition

Discount on everything shopper fits into promotional shopping bag

Advantages

- Attention-getting format showcases large savings potential yet limited to bag restraints
- Cross-store selection, shopping, and appeal
- Attracts heavy purchasers

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- Boosts traffic
- Can target key consumer at prime period, like Halloween or Thanksgiving

Disadvantages

- Requires system and training to register discounts
- Difficult to tie in with vendor for cofunding
- Small, high-profit items can defeat purpose—consider limitations
- Custom bags and distribution may be costly
- Limited to those with bags
- Shoppers may feel uncomfortable or hassled carrying bag, preferring competitor's discount
- May discount many popular items that sell at full markup
- Competes with "everyday low price" positioning

58. VALUE PACK

Definition

Consumer receives 00 percent more product in a bonus package size for the same price as the traditional pack

Advantages

- Offers consumers a good value at a low cost to manufacturer—the actual product cost
- Discountlike incentive without a discounting image—maintains brand integrity
- Allows the powerful word "Free!"
- Manufacturer can pass value directly to consumer without retailer or redemption issues
- Retailer offers value at full markup
- May trade up consumers' purchase behavior
- May extend usage (i.e., more recipe occasions) and family consumption

Disadvantages

- New package size has manufacturing concerns
- Doesn't move current product inventory
- May require additional shelf space and plan-o-gram
- Retailer may favor competitor's sale price with flyer advertising or coupon support (package-delivered promotions don't drive traffic)

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59. TWOFERS/SERVICE EXTRA (Buy One–Get One Free = BOGO)

Definition

Value on purchase of additional package(s) or services (may be a threefer, etc.)

Examples: buy two and third is free; buy one, get second at half price; clean two room carpets, get third cleaned free

Advantages

- Good, motivating value, possibly at a low cost for goods, though retailer may demand consideration
- Discountlike incentive with less of a discounting image
- Reaches heavy users
- Manufacturer can pass multipack value directly to consumer without retailer or redemption issues; retailer offers value with markup
- Can help load consumer, lowering competitor demand
- Can reduce inventories
- May be less costly than value pack's packaging
- Can be account specific with custom-banded inventory
- May extend usage (i.e., more recipe occasions)

Disadvantages

- Marketer concedes high-margin repeat purchase
- May be less efficient than similar value pack tactic
- Retailer may feel it's a lost sale and desire compensation for "free" item
- Lost "next purchase" for manufacturer
- Multipack a costly manufacturing concern that requires more shelf space
- Consumers may learn to shop only for twofer specials (common with pizza restaurants)
- Must somehow be accounted for at cashier level

60. BUNDLING

Definition

Tying related products or services together into one bundled offer for consumers.

Examples: Long distance, Internet, and cell phone services; flashlight and batteries; hotel, rental car, and airline; may also be used to move/liquidate slow partner product (See tie-ins on page 102.)

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61. FINANCING (0%, No Money Down, Payment Grace Period)

Definition

Purchase incentive based on financing, such as low/no interest financing, no down payment, or delayed payment requirement; typically for exceptional purchase commitment—auto, home improvement, major appliances, etc.

Advantages

- Encourages considerable purchase decision, possibly with long-term interest profits
- Low monthly payments make price appear more feasible
- Encourages purchase that may otherwise be a financial burden, particularly in poor economic climate
- Can be used to trade up purchase amount
- May allow higher price point rather than a discount
- Can help move overstocks
- May lead to aftermarket purchases

Disadvantages

- May limit profitable financing
- Payment delay disrupts business cash flow
- Susceptible to bad credit risks
- Price remains high, especially with principal
- Some buy-on-credit retailers considered exploitive

62. CONTRACT PREREQUISITE

Definition

Consumer receives considerable value up front by committing to prolonged purchase agreement

Examples: CD club with first few CDs for pennies; free cell phone with yearlong contract

Advantages

- Exceptional motivating offer
- Value built into economics of long-term sales
- Future sales can be full margin
- Long-term consumer commitment locks out competition and may build consumer affinity
- Database relationship marketing opportunities

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- Additional sales opportunities in billing statements
- Tie-in opportunities with other marketers

Disadvantages

- Susceptible to bad credit risks, relocation problems, unexpected payment difficulties, contract jumpers, etc.
- May attract less reliable customers—mobile students, lower-income bargain hunters, etc.
- Technology increasingly makes obsolete long-term programs; CD clubs versus Internet downloading; book clubs versus amazon.com
- Consumer may feel conned once full-margin sales kick in
- Requires substantially risky up-front and long-term legal considerations, considerable paperwork, operational systems, computer tracking system, etc.
- Offers often considered exploitative

63. LOSS LEADER

Definition

Product offered below cost to draw traffic to retailer in hopes of additional profitable purchases

Examples: 10¢ bag of apples in produce section; half price introductory porcelain collectible to vest collector; $1 compilation CD hits to all shoppers

Advantages

- More motivating offer than traditional discounts and coupons—more traffic
- Offer expense may only be cost of goods (possibly cofunded by manufacturer)
- Can limit liability (e.g., first 500 shoppers)
- Sampling opportunity for discounted product

Disadvantages

- Sale actually loses revenue
- Traffic limited by item's appeal, small number of discounted choices, and brief time
- Lesser discounts on more items may drive traffic to competitor
- Cherry pickers defeat proposition
- Repeat visitors/purchases defeat proposition

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64. TRADE ALLOWANCE

Definition

Discount from manufacturer to retailer or distributor for orders or performance (such as price feature or POS placement); a case allowance may deliver a free case for every four purchased; an off-invoice allowance is a credit for specified up-front purchases; allowance may be applied specifically to co-op advertising, logoed premiums, fixtures, etc.

Advantages

- Motivates distributor/retailer to order and stock product
- Can motivate distributor/retailer performance—flyer ads, displays, etc. (which improve everyone's sales)
- Improves distributor/retailer margins
- Case allowance is cost of goods for manufacturer and high margins for retailer/distributor
- Can address slow or peak period objectives
- Off-invoice allowance rewards retailer/distributor for purchase *after* purchase

Disadvantages

- Distributors and retailers may "forward buy"—purchasing discounted products in one region and forwarding to affiliate in another
- Distributors and retailers may stock up during promotion, avoiding future marked-up purchases
- Discounts may not be passed on to consumers, possibly backing up inventory
- Consignment offers run risk of returns and difficult reconciliation
- Distributors/retailers may only purchase product on allowance
- Can be parity with competitor's offers, a mere cost of doing business

WHY DISCOUNT?

Discounts may lessen margins and set undesirable precedents, but following are several good reasons for a discount strategy.

- *Traffic:* Usually, customers purchase more once they're in the store. (Two-thirds of grocery sales are unplanned.)

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- *Sales bump:* Sales bumps are key in prime selling seasons—for example, early winter snowblower sales, when sales volume can offset reduced margins, and share of sales is crucial.
- *Discouraging brand switching and new product launches:* Timely discounts can keep consumers from trying a new brand or can take the wind out of a competitor's grand opening. If discounts load consumers, demand falls when the competitor arrives.
- *Retailer placement and features:* A coupon drop or allowance can motivate a retailer to stock and feature a product.
- *Trial:* Motivating consumers to try a product or switch is crucial to conversion.
- *Off-season sales:* Generate sales before or after consumers would normally buy.
- *Trade-up:* Economy sizes can increase buying habits plus usage levels, and it's only cost of goods.
- *Liquidate stock:* Move out the old and make room for the new.
- *Offset price increase:* Ease the initial blow and increase sales with a coupon, refund, or "last chance" discount.
- *Simplicity:* Price reductions are simpler for consumers than are other tactics, so consumers are more likely to respond.

DISCOUNT LAW—SALES MUST BE SALES

Advertising a sale? Check with the Federal Trade Commission (FTC) as well as with your state regulations first. FTC guidelines are general and often unenforced, but they do help establish a benchmark to differentiate legitimate from fraudulent discounting practices. For example, the FTC's official guideline regarding sale prices advises:

> One of the most commonly used forms of bargain advertising is to offer a reduction from the advertiser's own former price for an article. If the former price is the actual, bona fide price at which the article was offered to the public on a regular basis for a reasonably substantial period of time, it provides a legitimate basis for the advertising of a price comparison. Where the former price is genuine, the bargain being advertised is a true one. If, on the other hand, the former price being advertised is not bona fide but fictitious—for example, where

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an artificial, inflated price was established for the purpose of enabling the subsequent offer of a large reduction—the "bargain" being advertised is a false one; the purchaser is not receiving the unusual value he expects. In such a case, the "reduced" price is, in reality, probably just the seller's regular price.

An individual state regulation, for example, may be more specific:

- Price-offs may be utilized only by brands with an established retail price. A 30-day period must be allowed between each of the price-off offers on the brand.
- No more than 50 percent of the total volume of a brand may be generated through price-offs in any 12-month period.
- Only three price-off promotions per year are allowed on any one brand size.
- A price-off must be accompanied by communication that gives the following information clearly:
  - Brand name
  - Regular price
  - New price

Don't mislead consumers. Exercise caution if you're touting such claims as, "Retail Value $15.00, My Price $7.50"; "Half Price Sale"; "1¢ Sale"; and even the word *Free* if it requires the purchase of another product. The spirit of the law: Announce your offer, but don't mislead the consumer. Say *Free* as long as you clearly specify "with purchase of___."

Robinson-Patman Act. Don't favor one retailer over another. You must offer all same-size retailers the same discount structure or promotional value. When you offer different promotions to different retailers, they simply have to wind up being of equal value by year-end. So one grocer may get a $100,000 NFL promotion, whereas another grocer gets a series of local market promotions that total $100,000. You can tier retailer discounts or promotional funds based on order volume. You may sidestep the law short term if your program is a limited test.

Insight

Some industries are highly regulated. Six examples: Those engaged with alcoholic beverages, tobacco, gasoline, dairy products, financial services (i.e., financial institutions), and insurance. Consult a legal expert in these areas.

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EVERYDAY LOW PRICE (EDLP) VERSUS HIGH-LOW RETAIL PHILOSOPHY

EDLP retailers, like Wal-Mart, claim consistently low prices on all products. They position themselves as straightforward, value stores that don't play pricing games and are vulnerable to high-low retailers' select deeper discounts.

High-low retailers regularly rotate discounts, such as Coke this week, Pepsi the next. This may allow deeper discounts but on fewer products. These retailers are vulnerable to EDLP's greater selection of values, lowest-prices image, and cherry pickers.

Both rely heavily on manufacturer discounts.

SHELL GAMES AND FUNNY MONEY

How do you sell a car for a dollar under invoice? How do you sell cosmetics at half price when ideal margins are 40 percent? How do you offer a $5 refund on motor oil when the margin is less than $2? Here's how:

- *Manufacturer year-end rebates:* Rebates based on a retailer's yearlong sales offer a pricing loophole. An auto dealer can legitimately post a car's current invoice cost and coyly price it below that invoice, because the car will ultimately cost less with the year-end rebate.
- *Refund/rebate slippage:* People purchase for the refund, but usually never get around to the paperwork. See "How *Not* to Get Redeemed—Slippage" in Chapter 4, page 105.
- *Points and breakage:* Collector point programs are funny money by nature, in which a lot of points ultimately aren't redeemed—left behind like spare change. See "Breakage and Slippage" in Chapter 10, "Premium Programs," page 272.
- *Artificial price points:* Some marketers inflate regular prices so they can post major discounts later. (See "Discount Law" on page 138.) One way to establish a high price point is to post it in the annual product catalog. Once done, seasonal flyers announce the drastic price cut.
- *False multiple purchase requirement:* A retailer may offer "Six Acme Cereals For $12," when, in fact, each box is $2. Shoppers are misled, thinking they must purchase all six for the discount. (However, sometimes retailers really do require multiple purchases through their scanning sys-

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Insight

In addition to *save*, one more powerful word that gets a response is *hurry!* Give your sale a sense of urgency.

tems, especially for BOGO—buy one–get one free—offers.)

- *Perceived price cut:* Studies show that shoppers who see a product prominently displayed believe it's on sale. Often it isn't. Manufacturers often pay retailers for that premium floor space.
- *Mix and match discount tactics:* Use different discounts to build behavior. For example: (1) Lead with a buy-one-get-one-free offer at the shelf for all shoppers—generous offer at cost of goods for trial and repeat trial; and (2) later, offer a lesser discount at the shelf on single purchase plus an in-pack coupon for the next purchase; still gets trial and a repeat purchase and builds on triers of the first tactic. It's less discounting image and doesn't establish a costly pattern.

OPTIONS TO DISCOUNTING

Consider these alternatives to cash discounts:

- *Tie-ins:* Look for a partner who needs something you've got, such as a way to deliver communications or samples, a retail presence, the same target, distribution, and so on. (See Chapter 11, "Tie-ins," page 283.)
- *Value added:* Offer additional products or services that cost you less than the amount consumers would pay. Depending on your business, offer free delivery, or free tire rotation with lube and oil change, or a free premium inside the cereal box, and the like.
- *Upsizing/value packs:* Twenty-five percent more product free. It may not cost much more to add more product, but the consumer value is high.
- *Premium packs:* Make the package itself valuable—a decorative tin, decanter, storage box, or collectible images.

HOW TO HANDLE POTENTIAL PROBLEMS

Consider potential problems before implementing a discount. Following are several:

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 141.

- How will the cashier ring it up? Fast food may have a register button that triggers the discount, but how will you reply to: "Can I substitute milk for the Coke?" Anticipate situations on a tip sheet.
- With "scan-downs," the bar code generates the discount, but the programmer may miss one. Give cashiers discount sheets, including how to manually keypunch in the discount.
- Franchise networks often can't control pricing. Mike's True Value is truly Mike's store, and Mike will sell his Stanley Tools for whatever he can get. So the franchise company's "Annual Spring Cleaning Tools Blowout" advertising may say, "Great Deals Throughout the Store," even though the company qualifies specific offers with "at participating retailers." Local franchise groups may agree on specific deals for their market's advertising.
- Scan-downs cost more than the discount. A manufacturer may need to factor in up to 25 percent more to a scanned discount because of rain checks or overlapping sale days. (The retailer sales period may be Thursday through Wednesday, for example, whereas the manufacturer's is Monday through Sunday.)
- Get distributors and retailers to pass discounts on to consumers. Make the consumer offer part of the distributor's or retailer's discount package. Consider the following:
  - Offer retailers a discount in exchange for "price features" in their advertising and displays. You may have to pay extra for flyer space.
  - Offer more co-op funds when retailers provide advertising tear sheets—newspaper reprints proving they promoted your discount.
  - Advertise the promotion in consumer media with the tag "at participating locations." Do the same in trade publications so retailers hear about your deal even if the distributors don't tell them.
  - Tie retailers in with your advertising. Put a five- to ten-second tag at the end of your broadcast ad: "Available now at Acme stores."
  - Offer a complete incentive program—include the regional sales manager, salespersons, retailer, and consumers. (See Chapter 12, "Performance Programs," page 311.)

Beware forward buying. Central buyers may reroute your discount: If you earmark discounts for one region or chain, they may purchase that discounted product and forward it to another region/chain. Or they may stock

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 142.

up on the discounted product and warehouse it to avoid future full-margin prices. Is this really a bad thing? If so, put terms in your program that can limit quantities or specify the region or retailer.

Combo discounts yield greater profits. Fast-food combo orders save diners money and increase profits. The add-on item(s) may cost pennies but represent dollar values.

One side order	Combo "deal" w/two side orders
$1.29 sell price	$2.58 sell price ($1.29 × 2)
.05 cost	– .10 cost
$1.24 net	–1.00 discount (50¢ per side order)
	$1.48 net

Net Net: 24¢ incremental profit over two-item full-price order.

Combo menus and features speed up sales *and* lines. Customers need time to ponder several order choices. If you make it easy with five large feature items, they say, "Number 3, please," and the next customer can order. It speeds up the crew too. One theater chain implemented a combo signage program backed with a crew incentive, and its sales doubled—crucial in the brief window between features.

"Suggested retail." This ploy and guideline lets manufacturers and retailers offer a profitable price with a lot of wiggle room for discounting. Manufacturers can't dictate retailer prices, but they can provide their suggested retail price as a guideline, which typically represents a high margin. So if either or both want to discount, there's plenty of fat to trim and show consumers generous savings.

SELLING IN A DISCOUNT TO THE RETAILER

Arm salespeople with a sell sheet that outlines the benefits of a product and why it's good for the retailer's business. Include a profit calculator that lets the salesperson calculate the retailer's bottom-line profits. Here's an example of one from the distilled spirits business:

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 143.

Acme Whiskey	Cost/ Case	Discount	Net Case Cost	Sell Price	Profit/ Case	% Sales Increase	Incremental Profit/Case
1.75 Liter							
Liter							
750 ML							
500 ML							
200 ML							

(Also see page 351.)

Consider "turns/month" for a monthly and yearly profit figure. Also include helpful specifications like case weight, case cube size, cases per pallet, and case dimensions. You're closing the sale!

GUIDELINES

Discounting factors. If you can generate sales without discounting, do it. But occasionally, you may have to combat competitors or simply grab more share in a prime sales period. Discounts may also increase usage so that loyal customers become bigger customers. Factor in how many *new customers* you can target with a sale. They may come back for more at full price. (See "Calculating volume increase requirements" below.)

Insight

"The grocery store manager complains it loses money every time our soft drinks are on deal," says a soft drink route driver. Soft drink companies barter in advertising, display allowances, custom displays, and more—as well as in price. Create a sheet that shows the value of all the program allowances combined.

"We'll make up for it in volume." A discount can substantially increase sales, but at what cost? Refer to the Price Promotion Response Model on page 125 and to the formula under "Budgeting Guidelines" (below) to calculate how large a volume increase you'll need to make up for the pricing decrease.

Make pricing a strategy, not a reaction. Discounting should be a promotional marketing tactic, not a knee-jerk solution to slow sales. Review the above tactics with a strategic perspective.

How much should you discount? It's all relative. Some say discounts must be a minimum of 15 to 20 per-

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 144.

cent off the regular price to have much effect. Retail-generated discounts are frequently 10 percent, often storewide, or for a large family of products. High-margin products like jewelry and apparel may discount 80 percent! Commodities, like sugar, use very low-value coupons. Lower-selling brands probably need larger reductions than do sales leaders. Balance your objectives: Larger discounts tend to attract new triers, whereas smaller discounts help maintain current users. If the vendor and retailer partner, they can offer a larger discount than their respective competitors acting alone. If you need to get rid of old inventory, breaking even may save money on overhead.

Confirm stocks and timing. If you're having a sale, stock more, and make sure your supply chain is stocked and can deliver on time. Use historical data for projections. Also, there's often a residual effect after the sale. Have a backup plan, such as similar merchandise ("of equal or greater value") or rain checks.

Selling out is safe, but be prepared. Many marketers prefer to sell out of a product than to be overstocked, but consumers may complain it's a bait and switch. Have a rain check system, making it clear when the new stock is expected. Train the staff for rain checks and delegate authority to the store manager for tough customers. For substitute products, specify "equal or greater value" product substitutions.

Are your discounts reaching consumers? The 2003 Cannondale Associates Trade Promotion Spending & Merchandising Study reveals that 63 percent of retailers claim they are passing money directly through to consumers, but only 55 percent of manufacturers agree. Try to verify, or at least encourage, performance by hiring a scanning verification or other auditing service, requesting feature advertising tear sheets, or demanding other proofs of performance.

Source: Cannondale Associates Trade Promotion Spending & Merchandising Study.

"While Supplies Last." This disclaimer does two things: It alerts consumers there are no guarantees, alleviating potential complaints. Second, it gives a sense of urgency to hurry up and buy. Still, have a backup plan so you don't upset consumers.

A discount posted on your package has a long journey. You'll need to do a lot of coordination if you plan to advertise a package-delivered offer that

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 145.

coincides with the package arriving on the shelf. Consult manufacturing first about packaging lead times. Then review the distribution process to determine when the product actually reaches the shelf.

A discount costs more than a discount. Factor in advertising, signage, sales materials, package labels, allowances, misredemptions, and so on. See "Calculating volume increase requirements" below.

Don't be shy about discounts. Your ad agency may object to a prominent "Sale!" announcement, but if oblivious shoppers fail to see the offer, you've lost the sale.

Leave a blank price spot on retail signs. Vendors should allow retailers room to boldly write in their special price on the display sign. Leave a prominent blank price circle or square on the sign (without varnish). Try making it 20 to 30 percent of the sign's size.

Don't discount your image. Discounting too much may give a perception of poor quality. Many fast-food operations have actually lowered volume through discounting, while simultaneously lowering their margins—"If it costs that little, I'm afraid to eat it." What's more, consumers may anticipate and wait for discounts, so you reduce your ongoing higher margin sales—Coke this week, Pepsi the next. Consider giving a reason for your discount "event," even if it's as pedestrian as a President's Day Sale. Some retailers make the discount appear rare: "This sale only comes once a year!" doesn't mean you don't have other sales. You can make the discount require a higher transaction size—second item is half price. Direct mail or the Internet can announce something like "Exclusive pre-Thanksgiving offers only for our Special Customers." It's hoped those special customers e-mail the coupons to their friends.

BUDGETING GUIDELINES

Calculating a markup percentage. Markups are usually expressed as a percentage. If you know the dollar increase you want, use this calculation to reveal a percentage:

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 146.

Dollar markup amount ÷ sell = Markup percentage
Example: Markup = 42¢. Cost = 99¢. (Therefore, sell = $1.41)
$0.42 ÷ $1.41 = 30% markup
Proof: $1.41 × 30% = $0.42 markup

Calculating a markup dollar figure. If you want to mark up a cost by a percentage, use this calculation to determine the marked-up sell price:

Cost ÷ [1.00 – Markup %] = Marked-up sell price
Example: Cost = $0.99. Markup = 30%
$0.99 ÷ .7 (i.e., 1.00 – .3) = $1.41 sell price
Proof: 30% × $1.41 = $0.42 $1.41 – $0.42 = $0.99

Calculating volume increase requirements. Budgeting a discount program requires a balance of the costs of media, point-of-sale materials, and other communication; any sales incentives; the margins lost in discounting; and incremental profits gained through greater sales volume.

Before you discount, calculate how much volume you need to make up for the margin loss. A simple formula reveals your breakeven volume requirement:

1. Current volume/period × current margin = x
2. Increased volume (v) = x ÷ new margin

   Example: You've decided to lower your margin from 40 percent to 35 percent, and your current volume is 90 units a month. (*v* stands for the volume you need to achieve a breakeven at the lower margin.)

   1. 90 units/month × 40% = 36 (*x* in above formula)
   2. v = 36 ÷ .35 (new margin)

      v = 103

      You have to sell 103 units at a 35 percent margin to break even with selling 90 units at a 40 percent margin.

      Proof: 90 × 40% = 36
      103 × 35% = 36

      (The above numbers are rounded.)

However, you'll incur additional promotion and communication costs. Consider the following:

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 147.

- Project all the costs for advertising creative, media, point of sale, training, rain checks (redeemed during unpromoted period), sales incentives, and so on.
- Divide that number by the dollar profit margin per discounted sale to determine the volume necessary to cover those costs.
- Add this communication and promotion volume requirement to the previous calculation for volume increase/margin loss.

Example:
Total program cost: $100,000
Discount margin: $2 (profit per discounted sale)
100,000 ÷ $2 = 50,000 unit sales to break even with program cost
Proof: $2 × 50,000 = $100,000

Adding the two volume numbers from the formulas above reveals the total volume your discount must generate to break even. However, consider such other factors as the impact of loading the consumer with product and a subsequent sales decline.

Use sales history for projections and consider these variables:

- Advertising mediums
- Advertising reach and frequency
- Advertising creative effectiveness
- Selling season
- Seasonality (which varies regionally if you're selling clothes, air conditioners, ice cream, lawn and garden items, etc.)
- Regionality—right down to neighborhoods and demand
- Retail traffic (during promotion period subject to many variables)
- Retailer participation, such as flyers and product placement
- Promotional point of sale (a huge factor)
- Discounting tactic—card program versus storewide versus contract versus value pack versus rebate, and so on
- Amount of discount
- Competitive activities
- Weather
- And a lot more

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 148.

Insight

Discounting may sound like a low-profit proposition, but the largest retailer in the nation, Wal-Mart, built a brand on "Always low prices."

TRACK RESULTS!—BUILD A LEARNING CURVE

Create a spreadsheet for all the above variables every time you run a discount. You'll gradually build a database that will make your projections better and better.

TRADE DEALS—PROMOTIONAL ALLOWANCES

The bartering system is alive and well when it comes to wheeling and dealing with manufacturers' sales reps and retailers. (See "Trade Programs," Chapter 13.)

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Chicago, IL, USA: Dearborn Trade, A Kaplan Professional Company, 2004. Page 149.