KLOX LIMITED
t/a Klox Business Solutions
021 027 50930 | www.klox.co.nz

Business Coaching · Bookkeeping · Administration

The tools, tactics and advice on profitable discounting

It's been a tough year for Ecommerce merchants, with demand structurally higher than supply – leading to delays, shortages and ultimately rising costs.

As a result, small businesses everywhere are experiencing margin squeeze from inflationary pressures.

The crazy thing is, most brands I speak to are not increasing prices to compensate for this...in fact – their plan is to still offer discounts over BFCM.

So the million dollar question is: **how much are you going to discount?**

If you're like most Ecommerce founders and operators, you'll just make it up.

"15% discount? Hmmmm....nah, feels a bit too low."

"How about 30% off storewide?"

...yeah that feels a bit better."

"What about 50% off?"

"...yeah, let's do it!"

The problem when most Ecommerce founders set discounts, they focus on top line sales - **but pay little attention to gross profit.**

While you might be meeting your top line sales targets with record high monthly sales, you could be left with no actual profit to show for your Black Friday campaign if you're not generating a healthy contribution margin.

So, here's how to protect your gross profit while discounting.

If you're one of those brands that likes to discount on Black Friday Cyber Monday, there's a good chance you're selling products at a loss.

Sure, some marketers might tell you that it's okay to sell your products at a lower margin if you're doing it in exchange for their data and a potential future customer down the track. But that's assuming you can actually get repeat orders, and that your customers aren't rebuying from you through paid ads.

The reality is that unless your business is a subscription model, calculating lifetime customer value is near impossible. You have to rely on assumptions which are just that – assumptions. The truth is, you don't actually know.

And I don't know about you, but I like to make money from each product I sell.

Here's the thing: if you are knocking 30% - 40% off your retail price...you are probably losing money on every sale.

Discounting is the most destructive lever in your business, yet so many founders flippantly discount just to make sales.

So much time and effort is put into ads, email funnels and landing pages, but not enough thought is put into the financial strategy of their discount campaigns.

I've seen soooo many brands lose tonnes of money with aggressive discounting strategies...so much so that they play catch up for months afterwards.

They are discounting themselves into oblivion.

Everyone needs to take a breath, take a step back and consider the following:

- Discounting is the most destructive lever of profitability. If you don't intimately understand your unit economics, you could be selling your products at a loss. You can't make up losses with volume with negative contribution margin...

- CAC will be higher over this period as every other retailer on the planet will be burning their money on advertising. If you don't set a ROAS budget for your sales campaign, you could kill any chance of margin with a double whammy of insane CAC and Discounting. Not good.

- Your marketing agency may tell you that 'selling your products at a loss' is OK because of "lifetime value". Don't listen to them, because your business might be bankrupt before you realise that "value". Make a profit on every sale...

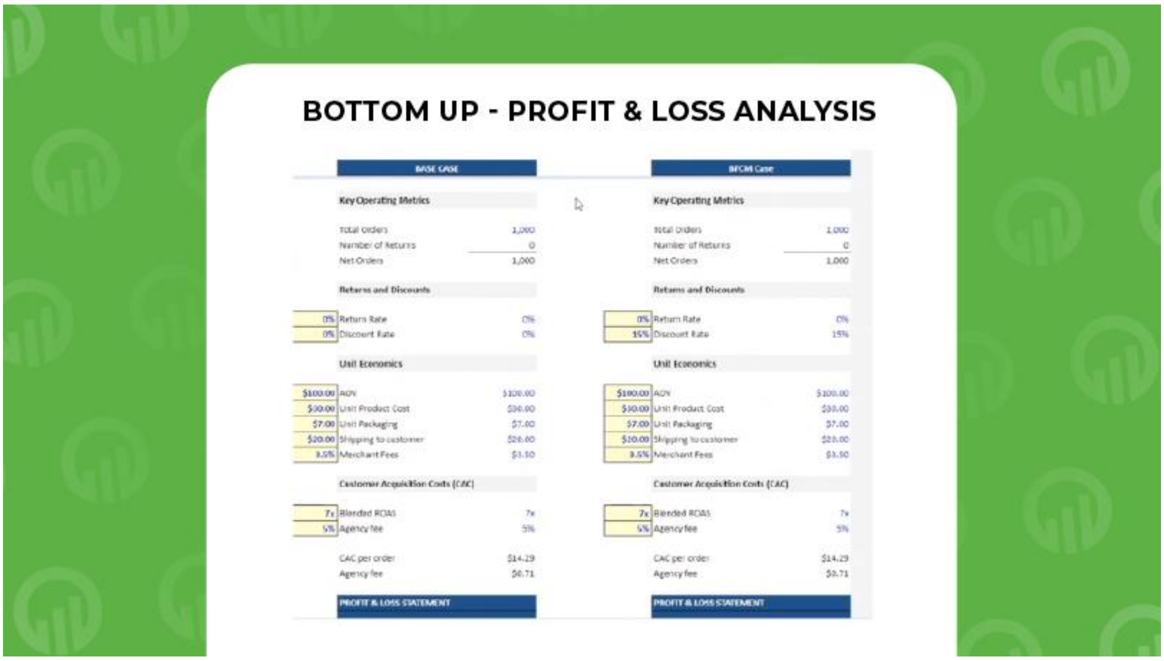
- You need to establish a discounting budget (in $) before whacking a 30% - 50% storewide sale on your entire catalogue and destroy all the hard work you did stocking up and building your brand.

- You should make a profit on every sale. Period.

How to calculate the unit economics of your product

Below is a simple economics demonstration of an ecommerce business comparing two situations – the Base Case (aka the business in its current form) and a BFCM case (aka what the business looks like if you give away your margins through discounting).

Unit Economics Analysis



BOTTOM UP - PROFIT & LOSS ANALYSIS

	BASE CASE			BFCM Case	
	Key Operating Metrics			Key Operating Metrics	
	Total Orders	1,000		Total Orders	1,000
	Number of Returns	0		Number of Returns	0
	Net Orders	1,000		Net Orders	1,000
	Returns and Discounts			Returns and Discounts	
0%	Return Rate	0%	0%	Return Rate	0%
0%	Discount Rate	0%	15%	Discount Rate	15%
	Unit Economics			Unit Economics	
$100.00	AOV	$100.00	$100.00	AOV	$100.00
$30.00	Unit Product Cost	$30.00	$30.00	Unit Product Cost	$30.00
$7.00	Unit Packaging	$7.00	$7.00	Unit Packaging	$7.00
$20.00	Shipping to customer	$20.00	$20.00	Shipping to customer	$20.00
3.5%	Merchant Fees	$3.50	3.5%	Merchant Fees	$3.50
	Customer Acquisition Costs (CAC)			Customer Acquisition Costs (CAC)	
7x	Blended ROAS	7x	7x	Blended ROAS	7x
5%	Agency fee	5%	5%	Agency fee	5%
	CAC per order	$14.29		CAC per order	$14.29
	Agency fee	$0.71		Agency fee	$0.71
	PROFIT & LOSS STATEMENT			PROFIT & LOSS STATEMENT	

Let's assume the business does about 1000 orders per month, with a gross profit of around 40 per cent (after considering the costs of goods sold and other fixed costs), leaving you with a 12.5 per cent profit margin.

Now if you are giving away a 15 per cent storewide discount, you can see this will directly reduce your gross profit margin – and as you've now given away your profit, you're actually losing money.

You could be crushing sales, but if you're selling your products at a tiny margin, or even at a loss, you are probably going to lose money.

But Jason, can't I just sell more volume to make up the loss in margin?

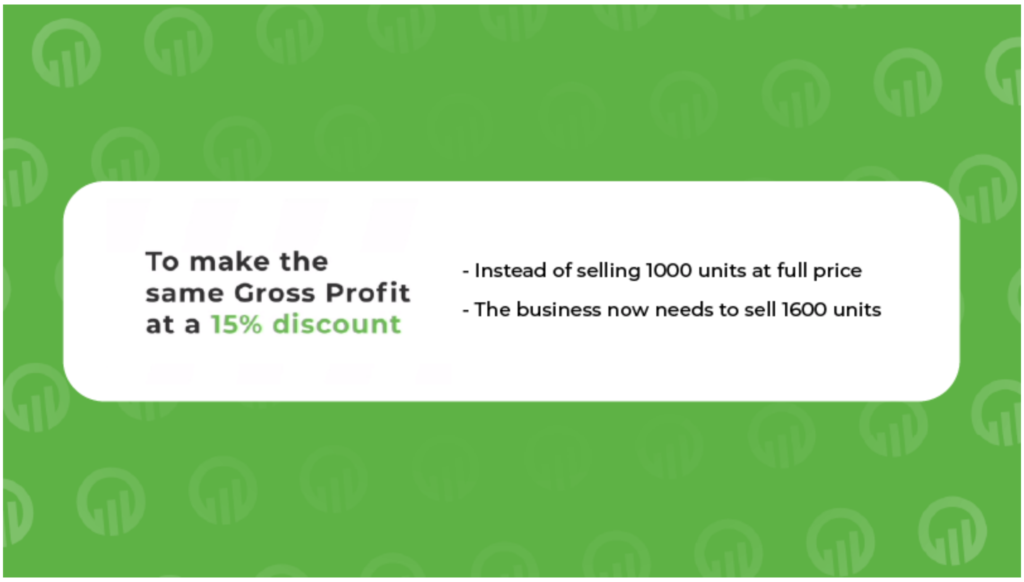
Ahh, yes. The common argument with discount tactics is that a business can make up its loss in margins by increasing sales volume.

That is 100 per cent correct. But this raises the question… how many extra sales do you need to make for every discount?

Let's assume the business sells 1000 units of product per month at a 40 per cent gross profit margin.

If you discount the product by 15 per cent, this means the company needs to increase their sales volume by an additional 60 per cent just to make the same gross profit dollars then if they charged full price.

In other words, instead of selling 1,000 units at full price, the business now needs to sell 1,600 units to make the same gross profit dollars at 15 per cent discount.



How to protect your gross profit while discounting

If you're going to discount, use tactics to ensure you can maximise your AOV (average order value) and protect your gross profit as much as you can.

One way to guarantee AOV is through a tactic called ‘bundling’, where you can build campaigns that are centered around forcing a higher AOV to cover the cost of discount.

For example, ‘spend and save’ campaigns are an excellent way to ensure your customers are achieving an AOV hurdle before getting any sort of discount from your store.

The next time you’re thinking about putting a blanket 20 per cent discount across your entire store, consider setting AOV hurdles for your customers so that you can discount profitably.

In summary, if you’re running a Black Friday campaign, set yourself a discount budget so that you’re not left with lots of sales but no profit to show for it.

Source: https://sbo.financial/?__s=wjfftiwypqwrmfoinbhv