

50/25/10/ 2 net 10 / net 30 . . . What? Understanding Discount Structure July 2003

This is no doubt one of the more challenging articles I have attempted to edit. We all understand 10% off or a 'two for one' sale. What about those figures in the title of the article? Board member and marketing agent Lizette LaForge provided the information for this article. She deserves credit for putting up with my questions and providing simplified explanations. First, a few terms need to be defined..
Gary H. Nelson

Discount refers to "the amount taken off the **retail** price." Both the "**retailer**" (store) as well as the "**distributor**" (wholesaler) receive discounts. Two key factors determine the magnitude of a discount: how much is purchased (volume) and whether or not the merchandise will be resold to yet another seller (e.g.- a distributor selling to a retailer who will in turn resell to you, the customer). The "**retailer customer**" (consumer or end user) is the person who walks into a store to buy items and put them to use.

A large retailer like a **super center** may purchase large volumes of merchandise directly from a manufacturer (producer) without a middleman (distributor). Large chains benefit by having their own **distribution centers** (DC) set up around the region or country to receive stock supplies for further distribution throughout the chain's vast network of stores. Super centers have been known to avoid doing business in excess of 20% of a vendor's total business believing if they stop buying, the vendor could go out of business.

A **small manufacturer** has the option of selling directly to large stores and shipping to their DCs or to independent distributors who represent expansive lines of products from numerous small manufacturers. It is unfeasible for a small manufacturer to sell small quantities to individual stores and a **single product company** (like an inventor with one product) is more likely to sell through a distributor rather than directly to a retailer. The big stores prefer doing business with larger product line distributors. Independent distributors may also be requested to perform **service work** involving stocking of the merchandise on the floor. The discount would reflect compensation for service work.

Manufacturers need someone to approach the distributor for them. That's where the **sales representative** ('Rep') provides an invaluable service. To complete the cycle, the Rep gets paid a commission by the manufacturer based on a percentage of the discounted price of merchandise sold. Currently, if the Rep sells to a distributor, the commission is usually 5-10% with most being in the 5-7% range. If the rep sells to the retailer (store) then the commission is usually 15%, though this can vary.

Net may be understood as the price of merchandise when paid within a specified period of time. Net 30 means pay in full within 30 days and you get the benefit of the agreed upon discounted price. Net 10 . . . pay within 10 days of receiving the merchandise. If both are offered, there is incentive to pay sooner for an additional discount. Straight **Net Pricing** may be used by some manufacturers to sell merchandise without using a progressive # / # / # discount.

Time to try some discounting examples. Get a calculator out and do the math along with the examples. You will get a better grasp of what is going on if you do this. (Get out that calculator NOW.)

Using the theory of the whole, think of *an apple pie with different sized slices being cut out of it*. Whenever a distributor requests an unusual discount on an item, the Rep (in this case YOU) wants to figure out the 'discounted price' to see if the manufacturer you represent can afford it. Each discount number represents a **percentage** without showing the (%) symbol. You take the retail price (*the whole pie*) and **multiply it by the inverse number of the discount** (100% less the discount % or *what is left of the pie after removing whatever size slice is requested*.) For example, if the discount appears as **50/25**, multiple the retail price by the **inverse of 50% which happens to be 0.50**. Then multiply the first discounted price by **0.75 (the 'inverse' of 25%)**. Continue to multiply in sequence throughout the whole "discount" for the price.

Let's say the **discount** appears as **50/25/10/ 2 net 10 / net 30** and the retail price is **\$12.43**: (1st) **12.43 x 0.50 = 6.215**. (2nd) Multiply 6.215 by **0.75** (inverse of 25%) = **4.66125** (3rd) Now multiply by **0.90** (inverse of 10%) leaving you with **4.1951**. (4th) to apply **2 net 10**, multiply 4.1951 by **0.98** (inverse of 2%) which gives you a final figure of **4.11**. All that means is that for an item that retails for \$ 12.43, the

distributor (wholesaler) is paying either \$ 4.11 within 10 days or 8.51 cents more at \$ 4.1951 if paid by 30 days. The extra 2% discount is for early payment.

Now, who wants to do all that math if there are 100 different retail prices to work with? It's just a pain in the neck. So a simple thing to do is figure out the **multiplier**. Using a discount of 50/25/10. $0.50 \times 0.75 \times 0.90 = 0.3375$. Now take any retail price and multiply it by .3375 and you will automatically know what the end cost is. Using this system, you can easily see what discounts are actually costing you as a manufacturer.

The additional discount %'s pertain to added incentives for a number of reasons like new product launches or for higher volume buys. In some industries multiple discount numbers are just the accepted way of stating what their price will be. Don't ask why they don't just say you are getting 62.5 % off the Retail price instead of 50/25. They just don't.

(Try these multipliers: $50/10 = 0.45$; $50/15 = 0.425$; $50/20/10 = 0.36$; $50/25 = 0.375$; $50/30/5 = 0.3325$; $50/40 = 0.3$)