

## IS IT A MARKDOWN OR A DISCOUNT?

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One of the more important concepts that we want in a retail system relates to the ability to differentiate how a price reduction is reported to the merchandising system - - as a markdown or discount. Due to the looks of confusion we saw on a couple of vendors' faces, we thought it was worthwhile to review these topics again.

A markdown is a devaluation of a product. It is an attempt to sell it a lower price than originally planned because we bought too many, it is the wrong color, size, style, etc.

A discount is a reduction in the price of an item or transaction based upon the purchaser. These include discounts for frequent buyers, employees and senior citizens. A discount is a benefit to the purchaser.

As an example of how this can impact evaluations of merchandise performance, a markdown would be recorded in the following method:

Original selling price:	\$ 100	Cost	\$ 50
Markdown	<u>-20</u>		
Selling price	\$ 80		
Gross profit	\$ 30	(\$ 80-\$ 50)	
Gross profit %	37.5%	(\$ 30/\$ 80)	
Markdown %	25%	(\$ 20/\$ 80)	

If this transaction had been a discount, the profit margin would have been 50% and the gross profit 50%. The \$20 discount would have posted to a separate non-merchandise department so that the store totals would accurately reflect the profits of the store. It is necessary to assume that the product would have sold at full price if the discount had not been given. We should not unfairly judge the buyer due to the impact of a "customer benefit" as opposed to a buying decision that resulted in a markdown.

A few years ago, I received a call from a friend who oversaw both a resort operation and the buyer responsible for the retail shops. The controller had expressed concern about the retail profit margins. In reviewing the procedures, it was discovered that both markdowns and discounts were being handled as a markdown because of limitations of the POS system.

Since the buyer's career was on the line, I recommended that they needed to be absolutely sure of the true margins of the buyer by removing the discounts from the calculations. Since historical information was inaccurate, it was necessary to start fresh. Employee discounts were removed from POS transactions, moved to manual procedures and entered through a separate method. As it turned out, employee discount dollars were much more significant than markdown dollars. Gross profits were actually above planned levels!

Imagine what the costs could have been to dismiss a valuable employee through inaccurate information. Imagine how the buyer's career and self-esteem would have been impacted.

Whenever I meet with a software vendor who downplays the need for properly accounting for markdowns and discounts, I remember the personal and financial havoc that could have occurred in this instance. The vendor who downplays a need usually just does not fully understand the problem.

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