

There is no such thing as a free lunch



Sometimes common sense seems the rarest of things. Even among the great and the good of an industry common sense is in short supply. These days Tesco has the Midas touch. Everything it touches turns to gold. In the UK it has overtaken rival food retailers and is still gaining share. Currently the British public spends one pound in eight at Tesco, and the proportion is rising. Now it is enjoying equal success in non-food retailing, leaving Marks & Spencer and others in the dust. But it wasn't always like this.

In the 1970s Tesco's high street stores were small, and the Tesco brand was seen as cheap and cheerful. Leslie Cohen, Tesco's founder, famous for his 'pile it high and sell it cheap' trading philosophy, was in at the start of supermarket retailing in the UK. But times were changing. Newer rivals were setting up in large out of town stores and attracting more and more of Tesco's customers. Tesco was losing share, but it was determined to win them back. Its campaign ranks alongside Hoover's disastrous free holiday offers in the 1980s: a marketing 'how not to' classic.

Not good enough for Tesco

Tesco cut its prices, and advertised the cuts on prime time national TV. The campaign was a moderate success and it regained some lost share. Encouraged it reran the campaign the following year with even more dramatic reductions. It succeeded beyond expectations, but the small high street stores could not cope with the dramatic sales increases and store traffic that resulted. People were squashed in the aisles, and could hardly move. The shelves emptied faster than they could refill them, and many could not get what they came for. Long queues of people tailed

along every high street as people waited to get their share of bargains. Actual sales growth was astounding. Judged in those terms, the campaign was an enormous success. Tesco achieved total sales growth of 55% over the period, but it made a thumping great loss which nearly put it out of business. Breakeven sales was calculated later to be 67% higher than before, and only above that point would it make profit!

They only thought they knew their costs

Surprising as it may seem Tesco, who had built its business by 'piling it high and selling it cheap', had not calculated the effect of this its biggest promotion. They didn't know their costs – they only thought they did. The bad news emerged later when the loss was counted. Having learnt their lesson, and luckily survived this brush with corporate failure, Tesco adopted a highly successful change in strategy, moving upmarket with premium pricing and large out of town stores.

But Tesco was not unusual in not knowing its true costs. It was just front page news. Some continue to flirt with life and death pricing believing they can suspend basic arithmetic and the rules of accounting, or perhaps, like Tesco, they haven't done their sums before cutting the price, or haven't taken all costs into account. Others simply assume that if their rivals are selling product at very low prices and they are still in business then it must be safe for them to do the same. But everyone's costs are different, and sometimes it takes a while before the effect of price cutting works its way through and topples the company.

Clear and present danger

This year three window systems companies called it a day, and two pulled out of cellular foam because they weren't making what they thought they were. Costs were higher than they thought and the low prices they had been selling at did not cover

those costs. The discovery of this additional cost has been painful to their customers too who have had to switch suppliers. Many have had to buy at higher prices as a result and either pass those on to their customers or absorb the extra cost. But, perhaps they switched to another supplier who didn't get the message? One who still believes the sums add up, another casualty in waiting?

We all love a bargain and we go to great lengths to persuade ourselves that what we are offered is indeed a bargain, even when common sense suggests otherwise. If you are offered product at substantially lower prices, you owe it to your business to ask how they can do it. Sometimes the answer is obvious in hindsight. Some firms continued to use suspect material for fascias and soffits long after the causes of pinking were known, because it was offered for less. Occasionally you are offered a bargain with no comeback and no strings attached. But there is no such thing as a free lunch. Those who have been around the block a few times will smell a rat, and generally find it.

In your dreams!

Common sense says that if companies remain in business, and the price keeps falling and resin prices stay high for any length of time, then there are only a few possible answers. It could be that they are growing astonishingly fast and reaping true economies of scale. But often people haven't done the sums and assume that economies will somehow emerge after the event. There are economies of scale, but they are frequently less than people imagine. In most cases significant economies are hard to achieve. When raw material costs go up it's a bit like walking up the down escalator. It takes all your effort just to stay in the same place. They could be buying sufficiently cheaper than their rivals. It's unlikely, but that's a worrying thought when resin prices are high. Exactly what are they putting in to their PVC that makes it so much cheaper than others? Will there be a reckoning later, and just who is bearing the risk? Will it be you? The history of product failures such as

discolouration is not encouraging. Maybe they have slimmed down the product and cleverly removed some of the material, so it is hardly noticeable? And when might this come to light? If your customers see it and demand a discount, or buy elsewhere you'll lose what you'd hoped to gain by the deal. If the hidden cost savings have an effect on product performance you could be facing a far bigger bill in the future.

Too good to be true

We all know you don't get something for nothing, particularly if raw material cost trends point in a different direction, and some suppliers have already pulled out because their costs were not what they thought they were. There are going to be more casualties and many innocent stockists and installers who thought they had a bargain will be hurt. But the buck stops with installers if the supply chain breaks, if for example your stockist or the manufacturer folds, as has happened last year and this. And more of these breaks are expected.

Everything you've learned in life doesn't change because a few firms have lost sight of their costs and think they can buck basic economics. If it looks too good to be true, then it probably is. Someone will end up shouldering the risk. Don't let that someone be you.