Forethought

Who Benefits from Price Promotions?

by Shuba Srinivasan, Koen Pauwels, Dominique Hanssens, and Marnik Dekimpe

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RESEARCH

Who Benefits from Price Promotions?

Price cuts boost sales and traffic. So where are the long-term gains?

by Shuba Srinivasan, Koen Pauwels, Dominique Hanssens, and Marnik Dekimpe

Retailers and manufacturers have come to rely on price promotions, routinely using coupons, two-for-one offers, and temporary price cuts to lure customers into stores and boost sales. But most promotions have only fleeting effects. Research clearly shows that after a promotion runs its course, customers quickly return to their old buying patterns and sales drop back to normal levels. And for retailers, promotions can often do more harm than good. A Coke promotion, for instance, may actually depress a supermarket's overall soft-drink revenues as Pepsi drinkers temporarily shift to the cheaper brand. Or an electronics retailer may find that buyers refuse to purchase a heavily promoted television once it returns to its higher price.

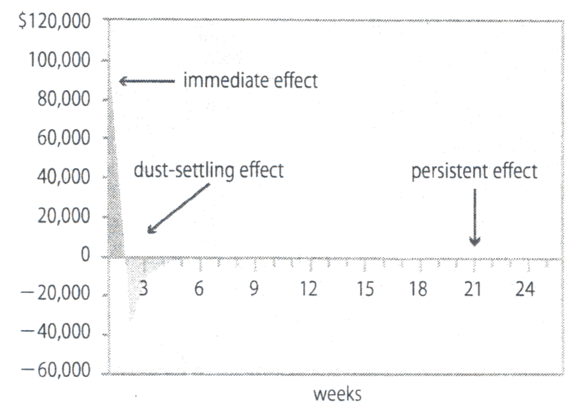
So do price promotions pay off? To answer that question, we analyzed seven years of scanner data, covering 25 product categories and 75 brands, from the Chicago area's second-largest supermarket chain, Dominick's Finer Foods. Previous research showed that price promotions tend to have little long-term effect on sales volume. Our new research found that the same is true for revenues and margins: They quickly snap back to baseline. But in the short-to-medium term, promotions can have very strong positive and negative effects that can hit retailers and manufacturers in very different ways.

A typical cheese promotion offers a good example. For a week, the retailer reduced the price of a branded cheese product by ten

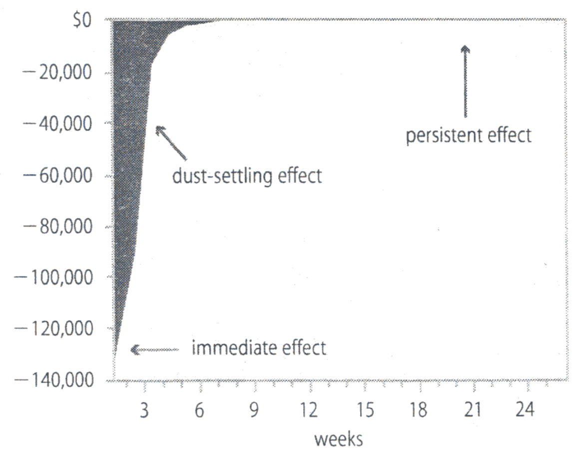
Cheese Log: A Promotion's Fleeting Effect

A one-week price cut of ten cents per ounce on a national brand of cheese produces short-term revenue effects that differ markedly for retailers and manufacturers. But when the promotion ends, revenues quickly snap back to baseline, where they remain.

Change in manufacturer's revenue



Change in retailer's revenue



cents an ounce. We tracked the economic impact of the promotion through three periods: immediate effects, measured during the week of the promotion itself; "dust-settling" effects, which continued until about the sixth week; and persistent effects, which we measured out to 26 weeks. (See the exhibit "Cheese Log: A Promotion's Fleeting Effect.")

During the one-week promotion, the cheese manufacturer enjoyed an immediate $95,000 revenue increase as customers bought more of its brand. But the retailer saw a $130,000 loss, because gains from increased sales of the promoted brand were more than offset by defections from regularly priced brands. During the dust-settling weeks, two through six, the manufacturer saw a negative impact on revenue as customers migrated back to their usual brands and toward competing brands that had launched their own promotions. Meanwhile, retailer revenue for the cheese category gradually moved toward baseline as the promotion effects tailed off. By week six, manufacturer and retailer revenues had returned to their prepromotion levels and remained stable through week 26.

This sequence of events is common: A promotion increases manufacturer revenue and depresses retailer revenue in the short term but has no persistent effect for either party. However, different types of promotions can affect revenues and margins in other ways. Promotions of frequently promoted brands, for example, tend to have a positive short-term effect on both retailers' and manufacturers' revenues but a negative impact on retailers' profit margins. Thus, the interests of manufacturers and retailers may well be aligned for one financial metric, such as revenue, but not for another, such as profit.

Our research shows that every promotion should be viewed and evaluated as a separate marketing event. Promotions are tactical, not strategic, and they need to be managed that way. Only then will both retailers and manufacturers be able to reap the benefits of promotions while limiting the potential downside.

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