Sales Promotion

MKT 6301
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Types of Sales Promotion

- Consumer Promotions
  - Product Based
    - Generate Awareness (free trial)
    - Generate Volume (buy two get one free)
  - Price based
    - Advertise low price
    - Coupons: in-,on-pack, cross-ruff
    - FSI etc.
  - Premiums
  - Sweepstakes (Volvo)
  - Placed Based Promotions (End of Aisle Displays)

Types of Sales Promotion

- Trade Promotions
  - Free Goods
  - Price based (more than 91%)
  - Place based
    - Slotting Allowances
  - Advertising and promotion based
    - Co-op Advertising
  - Sales based
    - Bonuses and incentives

Types of Sales Promotion

- Retail Promotions
  - Retail discounts
  - Displays
  - Features
  - Coupons
  - Other – Reward programs etc.

Why Offer Price Promotions?

- Charge regular price or sale price?
- If sale price yields higher profits than charging regular price – why ever charge regular price?

Brand-Level Price Promotion: Rationale for Hi-Lo Pricing

- Competitive Explanation: Hi-Lo pricing as a means to mitigate the intensity of price competition
  - Two competing brands with some brand-loyal consumers e.g. Coke and Pepsi
  - A significant segment of "switchers" or price-shoppers who care only about price
  - In order to get the switcher segment, each firm has incentive to undercut the competitor
  - No equilibrium retail price pairs
  - Promotional pricing as mixed pricing strategy

Brand-Level Price Promotion: Rationale for Hi-Lo Pricing

- Competitive Explanation: Hi-Lo pricing as a means to mitigate the intensity of price competition

  Example:

  Coke Loyal Consumers = 50 % of the market
  Pepsi Loyal Consumers = 20 %
  Switchers = 30 %
  Consumer Reservation Price = $5
  Marginal Cost = 0

Brand-Level Price Promotion: Rationale for Hi-Lo Pricing

- Example:

  Will Coke& Pepsi price at $5 (monopoly price)?
  No.
  Why? Competition for "switchers"

  Will Coke & Pepsi price at $0 (perfect competition)?
  No.
  Why? Coke can earn $2.50 (0.5*$5) and Pepsi can earn $1.0 (0.2*$5) at $5

  => Neither ($5,$5) nor ($0,$0) prices are Nash equilibrium. In fact, there is no Nash equilibrium in pure pricing strategies.

Brand-Level Price Promotion: Rationale for Hi-Lo Pricing

- Example:

  Will Coke price lower than $3.12?
  No.
  Why? Because even if it gets both Coke-loyal & switchers (0.8*$3.12) it will earn less than $2.50

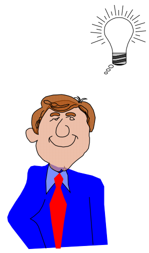
  => Both Coke & Pepsi will charge in the price range $3.12 - $5

  If Pepsi charges slightly below $3.12, it could get all the switchers => a profit of $1.56 > $1.0 (profit at monopoly price)

  => Weaker brand gains due to price competition over brand switchers => Weaker brand will promote more frequently

Brand-Level Price Promotion: Key Learning Points

- *Manufacturers follow Hi-Lo pricing as a means to mitigate intensity of price competition.*
- *Brands which enjoy more "brand loyal" customers promotes less frequently than a brand enjoying less "loyal" customers.*



Brand-Level Price Promotion: Rationale for Hi-Lo Pricing

- Price Discrimination Explanation: Hi-Lo pricing as a means to price discriminate
- Assume that the loyal customers in the Coke-Pepsi example are uninformed about prices
- Switchers know which brand is priced lower – relatively lower costs of acquiring price information
- Price promotions arise because firms want to discriminate between informed and uninformed customers
- Want to prevent customers from forming a high price store image

Coupons

- Can help price discriminate
  - Enables firms to charge higher prices to price insensitive customers while charging lower prices to price sensitive customers
  - Better than lowering prices store-wide
  - Costly because of imperfect targeting
    - Redemption rates (~2%)
  - Redemption rates, repeat purchase and trial can be increased by type of coupons:
    - On-pack, In-pack, Cross-ruff

Trade Promotions

- Why offer trade promotions?
  - Double-Marginalization problem (will discuss in more detail next week)
  - Retail prices too high
  - Insufficient market coverage
  - Offer lower wholesale price to retailers to increase market coverage

Problems with Trade Promotions

- Retail Opportunism
- Forward Buying
- Inventory problems and Demand Spikes

- Why not eliminate trade promotions?

Why does the retailer act opportunistically?

- Retailer's clientele:
  - Quality sensitive customers (X)
    - Willing to pay a high price (v_H)
  - Price sensitive customers (Y)
    - Willing to pay a low price (v_L)
  - Retailer's options:
    - Charge p_H and serve only the Quality sensitive customers
    - Discount price to p_L and serve all customers

Customers' Options

- Buy at the retailer if price at the retailer is less than their EV = price at a competing retailer + shopping costs
- Relationship between customers' EV and retail opportunism?
    - More often the retailer cheats the lower the EV
    - Retailer balances these two effects and passes through at least some of the time

Promotions that can help Trade Promotions

- Manufacturers' advertising ongoing trade promotions
    - McDonalds advertising ongoing promotions at participating retailers etc.
- Manufacturer's rebates
    - Can help decrease the difference between v_H and v_L and therefore increase the retailer's incentive to discount price

Other Promotional Practices

- Why offer Slotting Allowances?
- Co-op Advertising Subsidies?