

Pricing & revenue architecture

What is a price promotion?

A price promotion is a temporary price cut announced to buyers. It lifts sales at once, and buyers who see it often may buy the brand less without it.

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Management summary A price promotion is a temporary cut in a brand's price, announced to buyers in advertising or in the store. This concept guide defines it (Kalwani and Yim) and separates consumer from trade promotions (Nijs et al.), explains how, in one laboratory experiment, frequent and deep deals lowered the price buyers expected and made some of them buy the brand less often without one, shows where the extra sales come from in the week of the deal and in the weeks after (Pauwels et al.), reports what happened when Procter & Gamble cut its deals and coupons in the early 1990s (Ailawadi et al.), and gives a one-page record for planning a promotion. All four sources study consumer packaged goods: one laboratory experiment, two scanner-data studies and one study of a single firm's policy change.

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What is a price promotion?

§ 1 of 7

A price promotion is a cut in a brand's price that is meant to end and is made known to buyers. Kalwani and Yim (1992)² use a working definition for their experiment: a brand is on promotion when “it is offered with a temporary price cut that is featured in newspaper advertising” or brought to shoppers' attention with a display sign in the store.

² Kalwani, M. U., & Yim, C. K. (1992). Consumer price and promotion expectations: An experimental study. *Journal of Marketing Research*, 29(1), 90-100.

Retailers and manufacturers can both run one. Nijs et al. (2001)³ “focus on consumer price promotions, which may originate with the retailer or the manufacturer”, and add that “Trade promotions, in contrast, are not considered in our study.” A trade promotion is a deal the manufacturer offers the retailer, which the retailer may or may not pass on; the studies in this guide are about the price the shopper sees.

³ Nijs, V. R., Dekimpe, M. G., Steenkamp, J.-B. E. M., & Hanssens, D. M. (2001). The category-demand effects of price promotions. *Marketing Science*, 20(1), 1-22.

In this guide, a price promotion is a temporary price reduction, with a stated or expected end, offered to all buyers who meet its terms and announced to them, whether the manufacturer or the retailer funds it. A permanent price cut is a different instrument, and so is a discount negotiated with one buyer.

How do promotions change the price buyers expect?

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In the experiment this guide draws on, they lowered it. Kalwani and Yim (1992)² treat the price a shopper expects to pay as the reference for judging a price, “the price they expect to pay prior to a purchase occasion”, which can also be called an internal reference price. In their laboratory experiment, 188 students first saw ten weeks of prices for two hypothetical brands of liquid laundry detergent. The target brand was on promotion in 1, 3, 5 or 7 of those weeks, at 10, 20, 30 or 40 per cent off, and each respondent then stated the price they expected in week 11 and chose one of the two brands: “Brand choice was obtained by requesting the respondent to select one of the two brands for purchase.” There was no option to wait or to buy nothing.

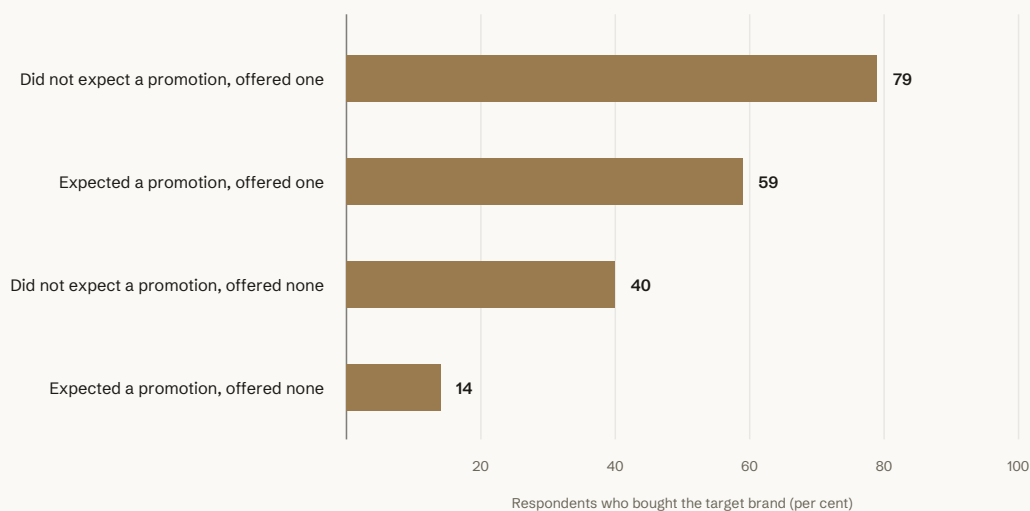
Both levers mattered. The results “provide support for the hypotheses that both the price promotion frequency and the size of price discounts have a significant adverse impact on a brand's expected price”,

although the authors could not reject a straight-line relationship for either. Small deviations from the expected price did not register as gains or losses: the best-fitting model had a region of price insensitivity reaching 6 per cent of the regular price on either side of the expected price, and “price changes of 5% or less of the brand’s average nonpromotional price did not produce a significant change in consumers’ price perceptions”.

Frequent deals also changed whether people chose the brand without one. The authors write that “consumers who have been exposed to frequent price promotions in support of a given brand may come to form promotion expectations and typically will purchase the brand only when it is price promoted”. They classed a respondent as expecting a promotion if the brand had been on promotion in at least half of the weeks seen, a threshold they chose because it fitted best. Figure 1 shows what followed.

Figure 1 Purchase of the target brand by promotion expectation

Respondents classed as expecting a deal chose the brand less often when it came, and far less often when it did not.



One laboratory experiment with students and hypothetical brands. Each bar is a share of 42 to 53 respondents.

Source Kalwani and Yim (1992), Table 3, p. 98. Share of respondents who chose the target brand in week 11: expected a promotion and was offered one, 30 of 51; did not expect one and was offered one, 33 of 42; expected one and was offered none, 6 of 42; did not expect one and was offered none, 21 of 53. A respondent was classed as expecting a promotion after seeing the brand on promotion in at least half of the ten earlier weeks. 188 student respondents, two hypothetical detergent brands, one laboratory experiment.

The missing deal weighed more than the surprise one, which the authors read as “a loss aversion phenomenon in the case of promotion expectations”: “consumers’ response to the loss of an expected promotion is stronger than their response to a surprise or unexpected promotion”. The authors’ warning is that “an increase in the use of price promotions could erode long-term consumer demand by lowering the prices that consumers anticipate paying for the brand”, and they stop short of recommending a schedule: “We cannot, from the findings of our study, make more definitive recommendations about the optimal price promotion schedule.”

Where do the extra sales come from?

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From three places, in proportions that change over time. Pauwels et al. (2002)⁴ decompose a brand's sales into "category incidence (the total number of panelists buying in the product category), brand choice (the share of these consumers buying the brand), and purchase quantity (the average quantity purchased by the brand's consumers)". A promotion can bring buyers into the category, win them from other brands, or make them buy more at once.

⁴ Pauwels, K., Hanssens, D. M., & Siddarth, S. (2002). The long-term effects of price promotions on category incidence, brand choice, and purchase quantity. *Journal of Marketing Research*, 39(4), 421-439.

They measured all three for canned soup, "a storable product that is not generally bought on impulse", and yogurt, "a perishable product that is often bought on impulse", using household scanner data from one US market between 1986 and 1988. In the week of the deal, brand choice was the largest of the three components in both categories: "Brand choice is the dominant factor in the immediate elasticity breakdown." For soup it was the largest single share without being a majority, as Table 1 shows.

The weeks after changed the picture. The adjustment period was short, "on average 2 weeks, at most 8 weeks", and once it was added in, "Although price promotions have a large immediate impact on brand choice, their total impact on brand choice is relatively low." In the authors' words, "the incremental brand-specific sales (selective demand) are partly borrowed from sales in" the weeks without a promotion, "whereas the immediate boost in category incidence is largely retained for several periods". The shares in Table 1 are shares of a promotional elasticity; the [price elasticity guide](#) explains the measure.

Table 1 Where the promotional sales came from, in the week of the deal and in total

In the week of the deal the largest share of the effect came from shoppers switching brands. Counting the weeks after, most of it came from extra shoppers buying in the category.

Product	Window	Category incidence	Brand choice	Purchase quantity
Canned soup, storable	Week of the deal	30%	48%	22%
Canned soup, storable	Total, with the weeks after	66%	11%	23%
Yogurt, perishable	Week of the deal	14%	73%	13%
Yogurt, perishable	Total, with the weeks after	58%	39%	3%

Two grocery categories in one US market. The pattern did not hold for private labels.

Source Pauwels et al. (2002), Table 12, p. 436, and p. 437. Shares of the promotional elasticity, averaged over brands and stores, attributed to each sales component; total means the immediate effect plus the adjustment effects, with no permanent effect found except for one yogurt brand in one store. ACNielsen household scanner data, Sioux Falls, South Dakota, 1986 to 1988. The authors' estimates, not a re-estimation.

Two qualifications follow from their own results. “Our main finding holds for different stores and categories, but not for private labels.” And the gain is not shared evenly: “in the long run and assuming profitability, price promotions may benefit the retailer (primary demand) more than the manufacturer (selective demand)”.

What happens to the category over time?

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In the market data, the effect fades. Pauwels et al. (2002)⁴ found that “permanent promotion effects are virtually absent for each sales component”. Across 560 Dutch supermarket categories over four years, Nijs et al. (2001)³ found the same at the level of the whole category, and the [discount essay](#) reports their figures. What Nijs et al. add here is what changed the effect: “More frequent promotions increase their effectiveness, but only in the short run.” By contrast, “the successful introduction of new products into a category is more frequently associated with a permanent” rise in category demand. Their summary, drawn for established brands in oligopolistic categories that promotions make “costly to enter”, is that “the power of price promotions lies primarily in the preservation of the status quo in the category”.

On this guide’s reading, the two kinds of evidence answer different questions. The experiment shows that respondents classed as expecting a deal chose the brand less often when the deal was missing; it had no option to wait, so what it shows is switching, not delay. The market data show that, in the mature categories studied, the effect of a deal fades within weeks, and Pauwels et al. (2002)⁴ draw the other half of that result as well: “the general absence of permanent effects reassures practitioners that promotional activity does not structurally damage any of the three sales components.” Nijs et al.³ (2001) explain the stronger short-run effect of frequent promotions by consumers who “are conditioned to look for, and rely on, future promotions”, and report that “this effect is completely dissipated in the long run”. Neither kind of evidence shows that promotions build a lasting gain in sales, and the market data show no lasting damage either.

What happens when a firm cuts its promotions?

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It can lose buyers. Ailawadi et al. (2001)¹ studied Procter & Gamble’s [value pricing](#), when “Starting in 1991–92, P&G instituted major reductions in promotion and increases in advertising in an effort to reduce operating costs and strengthen brand loyalty”. Across 24 grocery categories between 1990 and 1996, P&G’s deal frequency fell by 15.7 per cent and its coupon frequency by 54.3 per cent, its advertising rose by 20.7 per cent, and the net price paid by consumers rose by 20.4 per cent. Its competitors did not follow on deals, which rose by 12.6 per cent.

¹ Ailawadi, K. L., Lehmann, D. R., & Neslin, S. A. (2001). Market response to a major policy change in the marketing mix: Learning from Procter & Gamble's value pricing strategy. *Journal of Marketing*, 65(1), 44-61.

The result was a loss of share: “P&G lost approximately 18% of its share on average across these 24 categories (approximately five points per category).” The authors trace it mainly to fewer buyers: in their model, P&G’s penetration fell by a predicted 17 per cent, while share of category requirements and category usage were “virtually unchanged”. For the average brand, deals and coupons “increase market penetration and surprisingly have little impact on customer retention as measured by share-of-category requirements and category usage”. Taken on their own, the cuts and the higher net price did lower P&G’s retention measured that way, and the authors believe this “is due to the retention role of price promotions: In a competitive environment, an existing user is more likely to repurchase the brand when it is on promotion than when it is not.” Their conclusion is that “cuts in promotion, even if coupled with increases in advertising, will not grow market share for the average established brand in mature consumer goods categories”.

Share is not profit. Using assumptions about margins, they estimate that “it is plausible that P&G gave up share points in return for profits”, while writing that “we cannot make conclusive statements about the impact of the strategy change on profitability in the absence of data on P&G’s manufacturer price and cost data”.

How do you plan a price promotion?

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As one record per promotion: the offer, the baseline, where the extra sales are expected to come from, what buyers already expect, how rivals may respond, and how the result will be read. Pauwels et al.⁴ (2002) give the reading window for categories like theirs: “It suffices to monitor sales and profits during and up to two months after the promotion.” The [pricing architecture essay](#) counts a temporary promotion among the discounts between list price and realised price, and asks whether its reason, authority, duration and downstream effect are known.

Figure 2 A price promotion record

Write down the offer, the baseline, the expected source of sales, buyers' expectations, rivals' response and the read-out before the deal runs.

Offer	Baseline	Source	Expectations	Rivals	Read-out
How deep, how long, how often this year?	What would have sold without the deal?	Other brands, more buyers, bigger or earlier buys?	Do buyers already expect this deal?	Will competitors match or counter it?	Sales and margin during and two months after?

If buyers already expect the deal, count the weeks without it as part of its cost.

One row per promotion. A deal read only in its own week counts borrowed sales as new ones.

Source Author's decision worksheet. The offer and expectations fields follow Kalwani and Yim (1992), pp. 91, 94 and 98; the source field follows Pauwels et al. (2002), pp. 422 and 436 to 437; the rivals field follows Ailawadi et al. (2001), p. 49; the read-out field follows Pauwels et al. (2002), p. 437. The fields are reader inputs; no company data is supplied.

An illustration, with no company data: a distributor of laboratory consumables cuts the price of one product line by 15 per cent for four weeks every quarter. The record notes that the line has been on promotion in about a third of all weeks, less than the half at which Kalwani and Yim² classed a respondent as expecting a deal, and asks whether regular customers already time their orders to it. Because eight of the nine weeks between promotions fall inside the read-out window, it sets the baseline from the same calendar weeks in a year before the quarterly promotions began, expects the extra volume to come mostly from earlier orders by existing customers, notes that a competing distributor runs similar deals, and reads sales and margin over the four promotion weeks and the eight weeks after. These are the author's examples; the sources study shoppers in grocery categories, not business buyers.

Which buyers and markets do the studies cover?

§ 7 of 7

Shoppers buying packaged groceries. Kalwani and Yim (1992)² ran one laboratory experiment with 188 students and two hypothetical brands, and inferred promotion expectations rather than measuring them. Pauwels et al.⁴ (2002) studied two categories in one market and name as their own first limit that the data cover only 26 combinations of brand and store. Nijs et al. (2001)³ covered 560 categories in one country's supermarkets, and Ailawadi et al. (2001)¹ one firm's policy change in the US grocery channel, measured with aggregate data. None of the four studies business buyers, negotiated prices or contracts. The B2B illustration in this guide is the author's reasoning.

 End of essay

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