

# CHAPTER 1

## INTRODUCTION

### 1.1 Definition of sales promotions

Sale promotions are a diverse collection of incentive tools designed to stimulate faster and / or larger purchases of products or services by consumers or the trade (Kotler 1997, p.664). The core difference between advertising and sales promotion is - advertising offers a reason to buy, sales promotion offers an incentive to buy. Both advertising and sales promotions are instruments in the marketing communication mix. This mix also includes personal selling, direct marketing tools, public relations, and publicity.

Sales promotions consist of tools for consumer promotion, trade promotion, and sales force promotion. Consumer promotions are aimed at final consumers. These promotions are initiated by either manufactures or retailers. Well-known examples include temporary prices cuts, discounts, volume offers, buy x get y free, sweepstakes, free trials, and coupons. Trade promotions are aimed at retailers by manufactures. Examples of trade promotions are price reductions, advertising and display allowance, and free goods. Sales force promotions are aimed at the sales force of manufacturers. An example is a contest for sales representatives.

This thesis focuses on measurement of consumer promotion effects. Specifically, we measure aggregate consumer response, at the store level, to sales promotions offered by retailers. “Sales Promotions” should be read as “consumer Promotions” in the remainder of this thesis. We also use ‘promotions’ and “sales promotions” interchangeably. Consumer promotions are often paid at least partially by manufactures. That is, retailers pass a certain amount of the trade promotion through to consumers. Thus, the trade promotion allowances offered by manufactures to retailers may be converted to temporary price cuts, special displays, etc. in the stores.

Sales promotion as a technique of promotion has been developed to supplement and coordinate advertising and personal selling efforts of a firm. It is any short-term incentive used by a firm to increase the sales of its product. It consists of all those promotional activities that help in enhancing sales through non-repetitive and one-time communication. It

is aimed at stimulating market demand and consumer purchasing. It focuses the selling efforts on a selected small group of people. **A firm undertakes sales promotion with the following objectives:-**

- To introduce new products and to acquaint the customers how to use the product
- To acquaint the customers about the utility of the product
- To effect spot buying and to attract new customers
- To increase sales during slack periods and to increase profits of the firm
- To improve the public image/goodwill of the firm

**The important sales promotion methods are:-**

- **Distribution of free samples:** - is an expensive but powerful tool of sales promotion used to gain consumer acceptance and to popularize the product. It is an effective device of sales promotion as the consumers can test the product before buying it. The sample may be delivered door to door, offered in retail stores or fairs. This device is suitable for introducing new products such as soaps, drugs, cosmetics, perfumes, tea, etc.
- **Coupons:** - is a certificate that entitles its holder to a specified saving or discount on the purchase of a particular product. The customers present their coupons to retailers and get the product at a much reduced price. Coupons may be issued by the manufacturers either directly by mail or through the dealers. They are also issued through newspapers and magazines.
- **Premium:** - is the offer of an article free of cost or at a nominal price on the purchase of a specified product. It helps to increase the immediate sales.
- **Trading or bonus stamps:** - are issued by retailers to customers who buy goods from them and its purpose is to increase customer loyalty. The number of stamps given to a buyer depends upon the amount of purchases made by him.
- **Point of purchase materials:** - include banners, signs, photos, posters and other in-store promotional tools. They are demonstrated or displayed at the place where the customer makes actual purchases as they remind them about the brand name and promote impulsive buying.
- **Prize contests :-** under it, consumers are given rewards for analytical or creative thinking about the products in the form of slogan writing, sentence completion,

problem solving quiz, etc. It helps to create consumers' interest in the products, provide new ideas for advertising and may reveal buying motives.

- **Trade fairs and exhibitions:** - are an important technique of sales promotion as they have wide appeal. These help in introducing the firms and their products to the public at large. Under this, business firms are allotted stalls wherein they display or demonstrate their products.
- **Merchandising aids:** - refers to the services provided to induce commercial buyers to purchase goods in large quantities. It includes training in stores layout and inventory control, advertising, product demonstration, etc.
- **Clearance sale:** - at reduced prices may be organized on important festivals or other occasions. Such sales attract a large number of customers and help to clear accumulated stocks.

## 1.2 Reasons for increased focus on sales promotions

The absolute and relative growth in promotional activities can perhaps be explained by the following considerations (Blattberg and Neslin 1990, pp. 15-17, Bradley 1995, pp. 835-836, Foekens 1995, Kotler 1997, p.666):

- The number of brands has increased. For manufacturers, it becomes more difficult to draw attention from consumers, marketing intermediaries, and retailers. As a result, manufacturers make greater use of promotions to attract the attention of target groups;
- Competitors use promotions frequently. It is difficult for one manager to stop offering sales promotions, since consumers may switch to other brands that continue offering deals. As a result, many manufacturers face a prisoner's dilemma (see section 1.2);
- Many brands are in parity; hence, it is difficult to position brands with advertising messages only. Therefore, sales promotions are employed to support or supplement advertising campaigns;
- Sales promotion are frequently used to introduce new products, i.e., to obtain shelf space for these products. With the large increase in new-product introductions in recent years, there has been a similar growth in sales promotion activity;
- Consumers are more focused on sales promotions (see also section 1.3.3);

- The trade has demanded more deals from manufacturers. Greater concentration of channel power in the hands of retailers has increased the pressure on manufactures to provide broader and wider sales promotion support and allowances;
- It is more difficult to forecast demand for new brands. Retailers and manufactures often find themselves with excess inventory. As a result they must offer more inventory- clearing promotions;
- Advertising efficiency could have declined because of rising costs, media clutter, and lead constraints, i.e., the time it takes before an ad can be placed. Nevertheless, the amount of money spend on advertising it still increasing, but at a lower rate than the sales promotion expenditures
- The effects of advertising are much more difficult to determine. Failure to measure advertising effects adequately leads to an underestimation of its impact (Jones 1986). This is a probable reason for the steady switch of marketing expenditures from the long- terms brand building offered by advertising, to the short-term, but apparently easily measured, sales promotions (Magrath 1988 and Leeflang et al.1999, Chapter 6);
- Simultaneously, many product mangers are under greater pressure to increase their current sales. Perhaps independent of the profit consequences, managers who are oriented towards increasing short-term sales for their brands believe that promotion activities are very effective. We show in this thesis that this thesis that this may be a myopic perspective.

We note that the growth in promotional activities may affect the applicability of Varian's (1980) theory for the existence of promotions (Occasional unpredictable discounts will make informed customers happy than the usual uninformed customers). Specifically, if the timing of promotions for a specific item becomes predictable, the fraction of "informed consumers" may increase. For infrequently purchased items consumers will choose the store with the lowest price so that high-priced store will lose their customers and be pushed out of the market. Similarly, consumers will purchase frequently purchased goods only at the time a given store offers a discount for this item.

On the other hand, the abundant use of sales promotions for many items makes it very difficult to track activities in many categories. Consumers may then select specific categories

in which to specialize such that Varian's theory continue to apply. It is understandable, however, that the growth of the internet will allow independent agents to provide new service that capture information for all categories efficiently. The resulting consumer power would change the attractiveness of promotional activities to both manufactures and retailers.

### **1.3 Joint manufactures and retailers sales promotion programs**

Manufactures and retailers may co-operate in the development of special sales promotion programs. We mention two of these programs: Efficient consumer Response (ECR) and tailor- made promotions. ECR is defined as the cooperation of trade partners, aimed at satisfying consumer needs at the lowest cost for the integrated distribution chain (Van de Griendt et al.1997). The concept was introduced in 1992 in the USA in a joint effort by manufacturers and retailers. The prime operating objective of ECR is to integrate trade parties work together to fulfill customer wishes better, faster, and at lower costs.

The concept of ECR includes “demand management”, supply management”, and “enabling technologies”. “Demand management” is aimed at commercial processes in the distribution chain. It includes activities categorized as “efficient promotions”, “efficient assortment”, and “efficient new-product introductions”. Retailers and manufacturers cooperate to optimize these three elements using so-called enabling technologies (such as scanning and electronic data interchange). For “efficient promotions” the ECR concept requires promotions that simultaneously maximize category revenue / profit for the retailer and brand revenue / profit for the manufacturer<sup>4</sup>. “Efficient promotions” requires descriptive and normative models of promotion effects. For “supply management”, ECR requires accurate forecasts of effects of sales promotions on sales to both retailers and to consumers, in order to manage production and logistics based on these forecasts. For “supply management” we need predictive models of promotion effects. The ECR concept is becoming increasingly popular.

Tailor – made promotions are sales promotions that are specially developed for a particular retail chain by a particular manufacturer, and such promotions are developed to suit this retail chain's customers. Tailor – made promotions now command a larger share of promotion expenditures

The increased importance of tailor-made promotions can be explained by the increased power of retail chains. If retail chains want to distinguish themselves from others, they may demand tailor –made promotional offers from manufacturers. Similarly, separate retailers (within retail chains) may want to obtain special promotional offers from manufacturers, based on their specific retail environments. This would be a form of micro-marketing, i.e marketing tailored to a micro-environment.

#### **1.4 Importance of sales promotion effect measurement**

The importance of the measurement of sales promotion effects stems from the increased focus of manufactures, retailers, and consumers on sales promotions.

- Manufacturers spend an increasing amount of money on sales promotions both in an absolute and in a relative sense.
- The percentage of revenue for retails obtained through sales promotions is substantial
- Consumers decide their purchase behaviour to a larger extent based on sales promotions
- And finally, given the increasing importance of joint sales promotion programs, it becomes important to quantify sales promotion effects for both manufacturers and retailers.

To summarize, sales promotions play an increasing role in today's market place. The question is whether this role is warranted.

The management of promotional activities can be improved through careful measurement of the effects of sales promotions.. *source: Foodmagazine (September 1996, pp.23-27).*

### **1.4.1 Effect measurement in practice**

The measurement of sales promotion effectiveness in practice is very limited. Exact figures are not available.

Due to difficulty in determining the effectiveness of sales promotion, the optimal amount for the measurement of effects has received far less attention in the practice of marketing.

There are several reasons why the role of sales promotion effect measurement is limited in practice (based on Buck and Gupta 2000):

- Managers neither have the time nor have the required skills to build (econometric) models that can measure sales promotion effects. Today's marketplace is characterized by rapid changes which leave managers little time for evaluations. In addition, the measurement of sales promotion effects (or the effects of any marketing expenditure) requires knowledge about model buildings, data handling, and so forth. Managers typically lack these skills.
- The software for building marketing models may not be suitable. Some packages are used friendly (i.e., one can estimate any model) but are inflexible. Others are flexible (i.e., one can estimate any model) but requires the user to write complex computer codes;
- Managers may not want to measure sales promotion effects, since the outcome may be negative. For example, they may prefer not to know that the effectiveness of past promotions has been minimal;
- Managers may not have access to data of acceptable quality for measurement. The collection of data has reached a high level of precision and detail in some fields (such as in the fast-moving consumer goods branch) due to the use of scanning. On the other hands, in other fields that available data are still quite sparse. Examples include the service industry, areas of industrial marketing, and international marketing;

- Managers may lack data. For instance, they may not maintain databases with characteristics of past promotion campaigns. They are even less likely to have information on the characteristics of past sales promotions by competitors;
- Managers may decide it is too costly to let external market research companies (e.g., AC Nielsen or IRI/GfK) do the analyses.

*Source : H. Stegenga at Price Waterhouse Coopers consultants, the Netherlands.*

*Source : A. Boonman at AC Nielsen, the Netherlands.*

*Source : Promo magazine, July 1997, p.S29*

### **1.4.2 Effect measurement in the marketing literature**

There are many studies on sales promotion effect measurement in the marketing literature. Chandon (1995) refers to hundreds of articles on sales promotions. About 80-100 marketing scientists around the world are believed to develop models based on scanner data, either at the store level or at the household level (Bucklin and Gupta 2000). Many of these scientists focus at least partially on sales promotions.

We do not provide an overview of the complete literature on sales promotions. Instead, we refer the interested reader to publications that do give an overview.

1. Blattberg and Neslin (1990); this book is devoted to concepts, methods, and strategies in the field of sales promotions. It summarizes all important publications on sales promotions up to 1990;
2. Blattberg and Neslin (1993); this chapter provides an overview of sales promotions models;
3. Foekens (1995, Chapter 3); this chapter provides another overview of sales promotions models;
4. Blattberg, Briesch, and Fox (1995); this article summarizes the key findings in the literature up to 1995, provides research issues with conflicting empirical results, and also identifies issues without empirical research. This article has a strong management focus, and it provides a basis for this thesis;



5. Chandon (1995); this overview article has a strong consumer focus. It summarizes consume- oriented studies aimed at identifying heavy users of promotions and at tracking their purchases strategies involving the choice of a promoted brand;
6. Van Heerde, Foekens, and Leeflang (1997), Foekens, Van Heerde, Leeflang (1998), Foekens et al. (1998), and Campo (1998); these articles discuss the sales promotion literature in Dutch.

Based on more than fifty articles on sales promotion effect measurement, Blattberg, Briesch, and fox (1995) provide the following empirical generalizations.

- *Temporary price reduction substantially increase sales.* Empirical research has found that temporary retail price promotions cause a short-terms sales spike. This result is fundamental to virtually all research done in the area of promotions;
- *Higher Market-share brands are less deal (temporary price discount) elastic.* This, higher share brands have lower deal elasticities, even though higher share brands may reach a larger proportion of switchers from other brands than lower-share brands do;
- *The frequency of deal changes the consumer's reference price.* This observation is important since it offers and explanation for the loss of brand equity when brands are heavily promoted. A lower consumer reference price reduce the premium, that can be charged for a brand in the marketplace, which results in less "equity";
- *The greater the frequency of deals, the lower the height of the deal spike.* Foekens, Leeflang, and Wittink (1999) find this effect based on varying parameter models. It is likely to be caused by (1) consumer expectations about the frequency of deals, and / or (2) changes in the consumers' reference prices;
- *Cross-promotional effects are asymmetric: the promotion of higher quality brands reduces sale of weaker brands (and private label products) disproportionately.* One possible explanation is that asymmetry is primarily due to differences in brand

equity. Other explanations, such as prospect theory, have been offered in the literature. An extension of this finding focuses on asymmetries in brands' qualities. It predicts the impact that promoting a brand in one quality tier is likely to have on consumers who switch from brands in other tiers. Promoting higher-tier brands generates more switching than does promoting lower-tier brands;

- *Retailers pass less than 100 percent of trade deals through.* Because retailers are the vehicle for pass – through of trade promotion allowances to consumers, it is important to recognize that brands differ in the amount of pass- through;
- *Display and feature advertising have strong effects on items sales.* Displays are special or separate locations for products. They provide additional in-store attention. Feature advertising means outside store attention. Feature advertising is the inclusion of product names and prices in store fliers or newspapers advertisements;
- *Promotions can affect sales in complementary and substitute categories.* Although this possibility is recognized by practitioners, the magnitude of this effect is rarely understood. The sales effect of promoting an item in one category on items in a complementary category is likely a function of the characteristics of the categories. For example, the promotion of a spaghetti sauce may also increase the sales of some spaghetti items. On the other hand, the promotion of an ice cream brand may reduce the sales of other dessert items.

### 1.4.3 Research issues in sales promotion effect measurement

Blattberg, Briesch and Fox (1995) enumerate a number of issue with conflicting, litter, or no empirical results in the marketing literature on sales promotions:

1. *The shape of the deal effect curve:* The deal effect curve shows the relationship between the percentage promotional price discount and the sales of the brand that is price promoted. Is the deal effect curve linear, concave, convex, or S-shaped? Little is known about the shape of the deal effect curve, even though the shape is critical for the determination of ‘optimal’ dealing amounts. For example, if the shape is convex (i.e., deals have increasing returns), then the firm will run deeper discounts than if the effect is concave (i.e., decreasing returns), everything else being equal. Some argue that the curve has an S-shape, with increasing returns over some range and decreasing returns at higher deal discounts. The argument is based on the belief that consumer can stockpile only a certain amount, after which their storage and holding costs are too high;
2. *Checking for troughs after the deal.* This effect has been surprisingly difficult to find. The early literature (Blattberg et al. 1981, and Neslin, Henderson, and Quelch 1985) found evidence of purchase acceleration and stockpiling, but later studies of aggregated purchased data do not seem to find a “post promotion dip”.
3. *The majority of promotional volume comes from switchers.* Totten and Block (1987) and Gupta (1988) find that the majority of promotional volume comes from switchers. However, Vilcassim and Chintagunta (1992) and Chintagunta (1993) find that more promotional volume comes from category expansion than from switchers. The latter results are consistent with observations that the sum of cross-price elasticities is much smaller than the absolute value of own-price elasticities (Bemmaor and Mouchoux 1991) which implies that much promotional volume is not gained at the expense of other brand;

4. *Effect of category expansion of deals:* With increasing importance being placed on category management, this question becomes critical for practitioners to understand. Manufacturers and retailers are very interested in the circumstances under which category expansion occurs and what causes it;
5. *The magnitude of impact of display, feature advertising and price discount on sales promotion:* In the marketing literature, few empirical results have been generated regarding the synergies between feature advertising, displays, and price discounts. This is very important for both retailers and manufacturers because (a) they should determine the trade spending of manufacturers, and (b) they should influence the way retailers allocate display and feature advertising space. If there are synergies, then manufactures should focus on obtaining joint merchandising with the retailers, and retailers should focus on using these merchandising tools to maximize their returns.

Bucklin and Gupta (2000) identify important issues in the area of sales promotion based on interviews with marketing practitioners (managers and researchers). They study the commercial use and adoption of state-of-the-art methods for analyzing scanner data by packaged consumer goods manufactures in the USA. They conducted wide-ranging in-person interviews with 41 executives from 10 data suppliers, packaged goods manufactures, and consulting firms. They conclude that the application of analytical methods to scanner data has yielded some notable successes in marketing mix decision making, particularly in consumer and trade promotions. However, the interviewees suggest that the following research issues in the area of sales promotion and pricing remain:

1. *Price threshold.* If a brand has an own-price elasticity of -2, a 10 percent decrease in its price should increase its unit sales by 20 percent. Many managers, however believe the such effects are unlikely to occur unless the price decrease crosses a certain threshold. In other words, response to price changes are “sticky” over certain ranges of price;
2. *No post promotion trough.* Most practitioners indicated that they do not find post promotion dips in their data. Many therefore believe that promotions do not have negative effects in subsequent time periods;

3. *Baseline and incremental sales.* Research is needed to develop simple, robust models that will produce better estimates of sales that are truly incremental for the manufacturer, not borrowed from the future, from another store, or from a sister brand;
4. *Need for account-level analysis.* The managers indicate they prefer analyses at the account level rather than analyses at the market level, since the account level is used for many decisions.