**Sales promotion**

Capstone Marketing Topic 3

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| Maastricht University | |  |  |  |
| School of Business & Economics | |  |  |  |
| Place & date: | Maastricht, 24.06.16 |  |  |  |
| Name, initials: | Lumi, K |  | For assessor only |  |
| ID number: | I6071789 |  | 1. Content |  |
| Study: | International Business Economics |  | 2. Language structure |  |
| Course code: | CAP-3018 |  | 3. Language accuracy |  |
| Group number: |  |  | 4. Language: Format & citing/referencing |  |
| Writing tutor name: | Han Zhang |  | Overall: |  |
| Writing assignment: | Capstone Marketing Topic 3 |  | Advisory grade |  |
|  | Assessor’s initials |  |

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1. **Introduction:**

The 21st century marketing and sales environment can be described by an increased consumer focus and the constant need to develop and innovate. We currently live in a world with millions of different products and services all easily available to basic consumers. Growing amount of goods has increased competition amongst producers. As supply exceeds demand, the sellers and producers of these goods are forced to find ways to make their products stand out from the rest and appeal to consumers. One method to boost sales and increase demand for a certain product or service is to engage in sales promotion - a marketing activity used by manufacturers and retailers to boost sales of a good or service (Gedenk, Neslin and Ailawadi, 2006). The importance of using this tool in the marketing mix has increased in recent years and it plays an essential role in the marketing program of retailers as different studies have shown that a high percentage of retailers’ sales are made on promotion – mostly due to the fact that these promotions guide consumers at the location and time when an actual purchase is made.

The purpose of this paper is to analyze whether and what kind of effects promotions have in the short-, medium-, and long term and if they are financially profitable to both retailers and manufacturers. The first part of this paper describes sales promotion in general and explains the different types of sales promotions. Moreover, the effects of promotions to both retailers and manufacturers are inspected. In the following section, the comparison of two snack chip category products, Pringles and Lay’s, is conducted and the promotional effects analyzed. The paper will continue to investigate whether promotions affect retailers and manufacturers financially and whether these effects are permanent. Furthermore, some recommendations to managers creating promotions are given. Finally, the general results of chosen empirical findings are described and the conclusion is drawn.

1. **Sales promotion**

As already mentioned, sales promotions are often used by retailers and manufacturers to boost sales of a certain product or service. An important decision a retailer must make is to decide which form of price promotion to use in order to achieve the desired results.

There are two types of sales promotions – price promotions and non-price promotions. The most common type of price promotion is a temporary price reduction where the price of the product is decreased in order to increase customer traffic and awareness for an item. In addition, there are different kinds of promotion packages where a consumer can either get an extra amount of the product for free when purchasing an item, or when a consumer purchases a certain amount of the product, he will receive another unit for free. In recent years, using rebates and coupons has become more popular among retailers. With rebates, a consumer has an opportunity to get a discount after the purchase of an item has been made, whereas with a coupon, consumer can get a discount before buying the good or the service.

Another option for the retailers is to use non-price promotions, where instead of focusing on the price cut, the main idea is to promote a certain brand or the store. One method to alert a consumer about a significant brand or the store itself is to organize events and contests. Another method is to use sampling and premiums, however, the two latter methods are mostly used by manufacturers, not retailers. Nevertheless, it could potentially be an option for the retailer as well if, for example, there is vertical integration between the retailer and its manufacturer. In addition, supportive non-price promotions such as features, point of sale advertising and displays are often used to draw attention to other promotion instruments.

A retailer needs to consider the fact that promotions can lead to different effects: brand-, category- or store switching, stockpiling or increased consumption. Moreover, retailers need to take into account the trade policies of the manufacturers and its impact on their own margins before making a promotion decision. The impact of promotions is further discussed in the next section.

1. **Effects of promotions:**

The overriding thought when it comes to sales promotions is that they increase sales and therefore result in a higher profit to retailers and often as well to manufacturers. However, that is not always the case. Besides considering the cost of the promotions, the effect promotions have on consumers and their purchasing behavior in both short and long term have to be taken into account.

Firstly, retailers can benefit from consumer store switching, where increased sales of the product come from the consumers who would normally shop in a different store. Nevertheless, it is important to know whether the store switching is direct or indirect. Direct store switching is considered to be more beneficial to the promoter as it results in a decrease in the overall sales of competing stores, whereas the latter, indirect store switching, is not necessarily as profitable. Many consumers engage in cross shopping where they purchase items in different stores, but a promotion in one store pre-empts a purchase that would have otherwise taken place in a different store. This increases the sales of the promoted good but not necessarily the sales of additional products which are one of the main goals to retailers. In addition, consumers can engage in category switching where they purchase the promoted category product instead of another one. Similarly, additional sales can occur from brand switching which means that as a result of the sales promotion, a consumer is buying the promoted brand instead of his usual choice or another brand.

Secondly, sales promotions can obviously introduce benefits by resulting in sales to new users who have never tried the promoted product before. If the new users receive utility from the item purchased, there is an opportunity for an increase in future sales which is favorable to both retailers and manufacturers. Finally, purchase acceleration can occur – that means consumers move their purchases forward in time by either stockpiling or increasing their consumption rate. All these effects are considered immediate effects as they take place in the short term – during the promotion.

However, both sales to new users and stockpiling can also be considered medium-term effects or long-term (permanent) effects as their impact might still be seen after the promotion. Stockpiling effects can be seen as a decrease in sales of the product in the upcoming weeks after the end of the promotion, whereas the effects resulted from gaining new users should result in an increase in sales – therefore it can be said that some effects are contradicting and might be crossed out by each other.

Other long-term effects are brand-, category-, and store loyalty. Even though consumer loyalty is expected to increase in all cases, that is not necessarily the actual outcome. Lower prices caused by promotions might leave an impression to the consumers that the store is expensive at their next shopping trip. It is important to convince consumers that this is not the case and make sure they return to the store for future consumption. Moreover, it is necessary that consumers, who come to the store for the promoted item, also purchase non-promoted items in order for retailers to get the full benefit from promotions.

Increase in category consumption that results from gaining new users, higher consumption rate or category switching is beneficial to both retailers and manufacturers whereas increase in sales caused by consumer store switching is only beneficial to the retailer and not the manufacturer. The reason behind it is simple – manufacturers generally supply many stores in the area and an increase in the sales of the product in one store that is caused by the loss of sales in another store does not result in additional benefits to the manufacturers. On the contrary, brand switching is valuable to the manufacturer but not necessarily to the retailer – it depends on the profit margin a retailer gains from each product. Similarly, the positive or negative effects of stockpiling also depend on the profit margins to retailer.

As seen, promotions can have both positive and negative effects on both retailers and manufacturers; therefore, all promotion decisions have to be thoroughly thought through before engaging into either price- or non-price promotion activities.

1. **Effects of promotions on the snack chip category**

According to Gedenk, Neslin and Ailawadi (2006), retailer promotions typically cause a large bump in immediate sales of the promoted brand. By observing the Lay’s chart, which shows the sales of the promoted brand (Figure 1), this prediction can clearly be seen – in week four the sales of Lay’s reach their highest point and are well above the baseline indicating a high gross lift in sales. This gross lift means that the sales increase has been caused by the switching from other brands and stores in the same period and switching from the same or other brands in the same or other stores in future periods. Additionally, the gross lift can be caused by an increase in the overall consumption rate which either originates from the higher usage rate of the existing consumers or the consumption of a product by new users.

Figure 1 shows an increase in sales of several hundred percent, however, this is not an unusual observation as in many cases short term effects result in huge increase in item purchasing. Narasimhan, Neslin and Sen (1996) add additional support to this finding as according to their research, promotional elasticities are higher for categories with a small number of brands, shorter interpurchase times and consumer propensity to stockpile. This is the case for Lay’s and Pringles – we compare only two rather mature brands and since both of them are not vastly perishable, they can easily be stockpiled by consumers. Furthermore, according to Ailawadi, Harlam, César and Trounce (2006), if the gross lift is purely caused by the switching from other items in the category, there should be no increase in total category unit sales. By observing Figure 3, it can be seen that there is an increase in category sales. In other words, the gross lift of Lay’s is not caused only due to the lost sales of Pringles potato chips, but there are other causes for this increase such as store switching or the purchasing effect resulting from new users.

The research on adjustment effects, which is the transition period between the immediate response and long term equilibrium, is ambiguous: some authors say that there is a negative relationship between promotions and brand loyalty (Ailawadi, Lehmann and Neslin, 2001), whereas others say that the opposite is true (Gedenk and Neslin, 1999). As seen from Figure 1 and Figure 2, after the promotion, the sales of Lay’s significantly decrease whereas the sales of Pringles somewhat increase. That is due to the fact that consumers of Lay’s have become more price sensitive as they might have gotten used to the low “promotion” price and expect this price all the time. When the promotion ends, consumers might consider the price of Lay’s too expensive, which explains the high decrease in purchases, and the consumers will switch to buying Pringles chips instead – that justifies the increase of sales for Pringles in weeks after the promotion of Lay’s.   
Consumers’ stockpiling the product affects sales as well in the medium term. This behavior affects the gross lift of Lay’s as stockpiling takes some part of the future category sales in the store (Ailawadi, Harlam, César and Trounce, 2006). This medium term effect can be seen on Figure 3 during weeks five and six where unit sales are well below the baseline.

In support of the earlier discussion regarding different promotional effects, the brand switching behavior by consumers is clearly seen in Figures 1 and 2 where in week four, the consumers switch from Pringles to Lay’s – causing the sales units of Lay’s to significantly increase and the sales of Pringles to sharply decrease. As already mentioned, this is beneficial to the manufacturer of Lay’s, however; the profit to retailer depends on whether one makes more money from the promotional sales of Lay’s or the usual sales of Pringles.

As seen from Figure 1, 2 and 3, there are no long term effects on sales caused by the promotion of Lay’s. Even though long term effects are not visible in this case, there are some potential causes that could lead to changes in sales and set a new trend in the long run. Firstly, constant promotions can lead to loss of reputation in the consumer minds. If customers observe persistent sales promotion in a certain category, they might start to question the quality of the product and switch to buying a different item. Secondly, similarly to creating medium term effects, constant promotions might also lead the consumer to postpone the purchasing of an item until it is on sale again which eventually results in lower profit margins for retailers.

Most academic research shows that in general there are no long term effects caused by price promotions. On one hand, these findings might discourage retailers from engaging to promotions as they know that there are no permanent benefits. On the other hand, it might be stimulating for retailers to know that competitive promotions do not create permanent damage to their sales either.

1. **Financial benefits to retailers and manufacturers:**

Even though the interests of manufacturers and retailers are not necessarily always aligned, well elaborated promotion can lead to positive results for both of them. The financial impact on the retailer depends not only on the increase in sales, but also on the increase in store traffic and category dependencies. Similarly, the effect on the manufacturer depends on the primary demand expansion and additionally also on the brand switching.

The main results of the promotion to retailers depend on the gross lift – category sales shifted from current and future periods and increased category consumption (Ailawadi, Harlam, César and Trounce, 2006). The sources of this lift are also important when assessing the effects of the promotion. Moreover, the retailer has to make sure that the decrease in profit margins due to the promotion is offset by the long term positive margins. In other words, the loss of profit that the retailer occurs due to lowering the price of an item on the week of its promotion has to be returned in the long term not only due the increased sales to new users, but also due to increased brand, category and store loyalty that is expected to happen in the long run. The best outcome for the retailers is the increased store traffic which not only leads to the increase in promoted item sales, but leads to the consumer purchasing other items in the store as well – “the positive halo effect”. With that, a retailer can boost the sales of different products and increase its overall profit margins. Even though Ailawadi, Harlam, César and Trounce (2006) find evidence that the positive halo effect is especially apparent in beauty and general merchandise departments, one could argue that this effect could apply to the case of potato chips as well. In general, people purchasing these snack foods engage in buying complementary items such as dip sauce, soft drinks and in many cases also additional snack category products. Consumers engaging in the purchases of the latter is also defined as the secondary demand effect which is the net effect of a promotion on the sales of nonpromoted brands in the same week, category and store (Van Heerde, Leeflang and Wittink, 2004). Therefore, promotions in snack categories definitely have the potential to increase the sales of the snack chip category in general as well as other categories, especially creating benefits for the retailers.

Another consideration to retailers is the importance of gaining consumer loyalty and making sure the consumer does not enter the store just to cherry-pick a certain item because that can lead to a decrease in profit for them. Moreover, a positive financial effect to the retailer occurs when the promotion leads to an increased consumption – for example, a consumer entering the store wanting to buy items for an upcoming party decides to buy more Lay’s potato chips because they are on sale and he knows that the chips will be consumed shortly. However, if the consumer buys these chips in order to stockpile and not to buy the item for the next upcoming weeks at all (medium term effects), that is not beneficial for the retailer as he will lose sales in the future period.

Additional way of analyzing the financial impact is by classifying the net profit impact. According to Ailawadi, Harlam, César and Trounce (2006), if the retailers’ promotional margin is close to the regular margin, a high increase in sales should result in high net profit impact. In other words, if the promotion is fully funded by the manufacturer, the profit impact is obviously higher for the retailer and not so beneficial for the manufacturer. However, if the retailer is funding the promotion partly himself, the net profit margin is not necessarily positive even if the increase in sales has been significant. Similarly, high competition between retailers decreases the individual profit margins and the store has to engage in promotion which is not funded by the manufacturer. The authors also state that even though the discount depth is positively related to the net unit impact, it is negatively associated with promotional margins. Logically, it makes sense as the more money retailers or manufacturers have to spend on promotions, the less profit they make even with increased number of sales.

As reported by Srinivasan, Pauwels, Hanssens and Dekimpe (2004), price promotions generally do not have long term financial impact on neither the retailer nor the manufacturer. However, there are certain criteria’s that influence the size of profit margins. On one hand, retailer’s margins are usually higher for small share brands and for brands that have infrequent and shallow promotions. On the other hand, manufacturer’s margins increase if the promotion is conducted for a small share brands, frequently promoted brands or a national brands. The effect of an increased margin is stronger for products in impulse good categories with low degree of private label items. Based on these results, it is not possible to make an overall conclusion about the analyzed snack chip category promotions and their effects on retailers and manufacturers. First of all, it cannot be concluded that retailers benefit from the promotion because there is a lack of information about the frequency and size of the promotion. Furthermore, even though it is known that potato chips are an impulse product, there is as well missing information about the degree of private labels and the overall brand shares in the snack chip category, making it difficult to analyze the effect to manufacturers. Therefore, in order to understand the financial impact caused by promotions, all short-, medium-, and long term effects and their impact on profit levels needs to be considered and investigated.

1. **Managerial implications:**

Although it is difficult for managers to predict the exact effect a certain price promotion creates, managers can evaluate the past promotions in order to improve the future decisions. By overlooking which impact the promotion created, managers can either favor price promotions that brought in the most new users, promotions that resulted in the highest number of store switching or even promotions with the strongest category expansion effects. Managers can as well evaluate whether adding different promotion types to the overall marketing mix resulted in higher consumer loyalty. Besides the ability to weigh profit implications of the created sales promotions alternatives and accounting for product cannibalization, managers must consider the actions of the competitors. The net benefit of promotions is affected by competitive actions and might decrease the expected profits of the promotion. Worst case scenario, retailers do not only engage in competitive promotions but further actions might eventually lead to a price war between the parties. Additionally, managers need to be careful with promoting brands too frequently as consumers might get used to constant promotions and adjust their purchase quantities accordingly in order to benefit from future promotions. Therefore, it is very important that managers consider all the effects promotions might have when trying to make future decisions regarding sales and marketing actions.

1. **Empirical findings:**

After having analyzed different effects of promotions and their financial impact to retailers and manufacturers, empirical results about their influence are discussed in this section. There have been many studies investigating the effects of sales promotion and even though there are many short term effects, there is generally no evidence for permanent impact.

Some previous researches show that promotions tend to increase the price sensitivity of the consumers and decrease the brand equity over time. Other findings confirm that promotions provoke consumers to not only buy more but to also consume the products at a faster rate. Pauwels, Hanssens and Siddarth (2002) were the first authors to quantify the total promotional effects as the sum of immediate, adjustment and permanent effects on each given sales component – category incidence, brand choice and purchase quantity. The results show that even though there are positive immediate effects on sales, the permanent long term promotion effects are in fact absent for all these components. Moreover, the negative effects caused by the adjustment period do not exceed the total promotional effects.

Similarly, Srinivasan, Pauwels, Hanssens and Dekimpe (2004) research about revenue and margin impacts of promotions to retailers and manufacturers shows that there are no permanent consequences to neither of them. Even though there are initial benefits to both retailers and manufacturers, after the adjustment period, the sales simply return to their pre-promotional mean, resulting in no long term effects.

Van Heerde, Leeflang and Wittink (2004), who also consider the initial effects, report that there are large short term primary and secondary demand effects caused by the promotions. Their most outstanding finding is the fact that jointly pursued promotion by manufacturers and retailers that results in category expansion effect, is the most desirable and beneficial. The substantial part of this effect comes from the store switching by consumers which indicates that in order to succeed, managers should try to find ways to increase not only store traffic but also store switching.

Additionally, the authors take into account different types of predictor variables that are used together with the discount. The evidence shows that discounts with the support of only a display result in higher cross-brand and category expansion effects. This is somewhat surprising and contradictory to the findings of Ailawadi, Harlam, César and Trounce (2006), who say that additional advertising is positively associated with the net unit impact on sales. By using different types of displays, features and additional advertising options together, the purchasing rate or brands and categories should increase. Therefore, it can be said that further research is required to investigate which amount of advertising yields the best promotional results.

Finally, it is of course interesting to know what empirical evidence says about the quantifiable effects of promotions. Ailawadi, Harlam, César and Trounce (2006) have tried to quantify the net unit and net profit impact of promotions to retailers. Their findings show that there is indeed a positive halo effect on sales of products from other categories, however; in general, the net profit impact seems to be negative. That happens when the promotional margin of the item is substantially less than the regular margin which is usually the case if promotion is fully funded by the retailer alone. That being said, research shows that retailers are often faced with the decision of trade-off. They have to decide whether to increase their overall revenue or to increase their profit.

As seen, there has been a substantial research with respect to the effects of the promotions. Regarding the fact that this paper tried to investigate the effects of snack chip category, some future research in this area would be useful. For example, in order to analyze the effects on the snack chip category more in detail, it would be interesting to know whether there is a difference in the effects of promoting a mature brand such as Lay’s compared to promoting an entirely new brand. Moreover, knowing the effect of promotions to store brands is useful to different shareholders. As already mentioned, these are only a few of the areas where further information could be useful and where future research should be conducted.

1. **Conclusion:**

Increased competition together with pressure to grow and innovate has pushed retailers and manufacturers to find new ways to appeal to consumers. One way of attracting customers is to use sales promotion. There are different types of sales promotions which lead to various short-, medium-, and long term results. This paper examined how adding promotional activities to the marketing mix affects the performance of retailers and manufacturers.

Firstly, promotions lead to different effects such as brand-, category-, or store switching by the consumers which, at least in the short term, have an impact on the sales of the promoted item. Moreover, promotions lead consumers to change their usual shopping behavior by creating tendencies to stockpile or to simply increase their consumption rate.

Secondly, not all these effects influence manufacturers and retailers in the same way. Although increased consumption rate and sales to new users are beneficial to both retailers and manufacturers, there are effects that are only beneficial to one of the parties. In general, store switching due to promotion is only beneficial to retailers as it creates additional positive halo effects. Regarding manufacturers, the gain in one shop is often contradicted by the loss of sales in another store, which leads to neither a loss nor gain regarding profits. Similarly, brand switching might also result in adverse outcomes. Even though it is useful to manufacturers, the positive or negative effect on retailers depends on the profit margin they earn. If the profit earned from promoted product exceeds the margin from the nonpromoted product, retailer gains from brand switching. Therefore, the financial impact to both retailers and manufacturers depend on the effects promotion creates.

Thirdly, most academic research reveals that temporary price promotions increase short term sales for the promoted goods and services, whereas in the long term, promotions tend to not significantly affect the amount of sales and their profit margins to neither retailers nor manufacturers.

In order to investigate whether the previous results and effects are visible in real life, a snack chip category comparison was conducted. The examination of provided graphs indeed supported the empirical findings regarding the short-, medium-, and long term effects of sales promotion.

With that in mind, the paper offered some advice to managers considering the use of promotions in their marketing mix. Even though managers are encouraged to use price promotions, they must be cautious and keep in mind as well the possible negative effects and the reaction of the competitors.

To conclude, sales promotion is definitely a useful tool to include in the marketing mix of the companies. When applied correctly, it can result in financial benefits to retailers and manufacturers as well as increase the brand loyalty towards certain brands and products.

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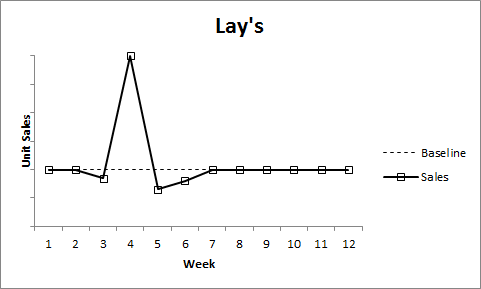
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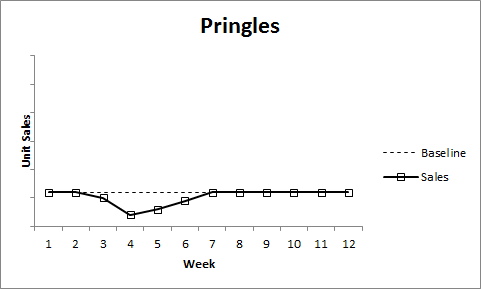
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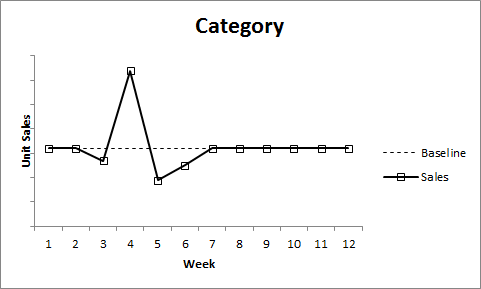
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**Appendix:**

  
*Figure 1: Sales chart for Lay’s potato chips*

  
*Figure 2: Sales chart for Pringles potato chips*

  
*Figure 3: Sales chart for the snack chip category*