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Retailers' and manufacturers' price-promotion decisions: Intuitive or evidence-based?

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ABSTRACT

Consumer price promotions account for more than half of many manufacturers' marketing budgets, and require a significant time investment to manage. Amidst the considerable research on price promotions, little academic attention has been paid to how manufacturers and retailers make price-promotion decisions. Based on in-depth interviews with a broad range of managers, this study investigates factors that influence price-promotion decisions in durable and consumer goods industries. Findings suggest that (1) intuition and untested assumptions are the main inputs into these decisions; (2) practitioners lack solid empirical evidence to guide their actions, and their beliefs are often in stark contrast with academic knowledge about the effectiveness of price promotions; and (3) price promotions are typically not evaluated against the objectives according to which they were justified, impeding appropriate feedback for future decisions. Research priorities are outlined to advance evidence-based decision-making in this area.

1. Introduction

Consumer price promotions occur daily in many types of stores, especially supermarkets (Bogomolova, Dunn, Trinh, Taylor, & Volpe, 2015; Nielsen, 2015; SymphonyIRI Group, 2013). Price promotions are an efficient lever to deliver short-term sales increases (Bijmolt, van Heerde, & Pieters, 2005; Blattberg, Briesch, & Fox, 1995; Blattberg & Neslin, 1990; Neslin, 2002), which are a key performance indicator (KPI) for both manufacturers and retailers (Shankar, Inman, Mantrala, Kelley, & Rizley, 2011). Today, price-promotion expenditures account for more than half of many manufacturers' marketing budgets (Ailawadi, Beauchamp, Donthu, Gauri, & Shankar, 2009; Bolton, Shankar, & Montoya, 2010; Nielsen, 2015). This trend continues despite growing evidence that price promotions have detrimental long-term business effects (Ehrenberg, Hammond, & Goodhardt, 1994; Gedenk, Neslin, & Ailawadi, 2010; Sharp, 2010), including heightened consumer price sensitivity (Kopalle, Mela, & Marsh, 1999; Mela, Jedidi, & Bowman, 1998), decreased brand loyalty (Blattberg & Neslin, 1990; Jedidi, Mela, & Gupta, 1999), and decreased base price elasticity (Ataman, Van Heerde, & Mela, 2010). Understanding why manufacturers and retailers persist with price promotions despite these drawbacks, as well as what factors they consider when negotiating within the manufacturer-retailer power conundrum (Ailawadi, 2001; Shankar et al., 2011), is of considerable interest for industry and academia (Ailawadi et al., 2009).

Current knowledge in this area primarily comes from conceptual frameworks (Ailawadi et al., 2009; Shankar et al., 2011) and proprietary industry studies such as those commissioned by the Promotion Marketing Association (PMA) Shopper Marketing Center of Excellence at Nielsen or the Point of Purchase Advertising Institute (POPAI). These sources point to a potential disparity between manufacturers' and retailers' approaches to decision-making. They also indicate a lack of transparency or common understanding, which could lead to suboptimal decisions. Indeed, recent Nielsen reports have contended that more than 60% of grocery promotions in the U.K. and about 70% in the U.S. are unprofitable (Nielsen, 2015; Nielsen UK, 2015). Without a clear understanding of how manufacturers and retailers approach price-promotion decision-making, the industry will find it difficult to converge toward win-win-win outcomes for manufacturers, retailers and consumers (Shankar et al., 2011).

Furthermore, academic work on broader managerial decision-making in marketing has suggested that excellent prospects exist for improvements in this area, if more research is devoted to understanding how marketing decision makers actually make specific decisions and how to optimize them (Wierenga, 2011). More precise insights into which knowledge is actually used and how, and what the value of this knowledge is, is needed (Wierenga, 2002). Advertising and Promotions (A&P) budgeting research is the one area where concerted efforts have focused on the processes that managers use (or claim to use) to set A&P budgets and why they do so. Despite being framed as A&P research, however, most of the emphasis seems to have been on the advertising component (e.g., West, Ford, & Farris, 2014), thus leaving a gap to improve price-promotion decision-making knowledge. Descriptive studies are needed here because an understanding of current decision-

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making can help improve the quality of future marketing decision-making (Van Bruggen & Wierenga, 2010).

In line with this special issue on the micro-foundations of pricing, this article contributes to the area of manufacturers' and retailers' price-promotion decision-making by (1) providing insights on how retailers and manufacturers make price promotion decisions; (2) uncovering managers' beliefs and assumptions that underpin price promotions decisions; (3) examining the degree of alignment between the objectives of running price promotions and how managers evaluate promotion success; (4) comparing the information that underpins promotion decisions with academic knowledge in the domain, and (5) offering explanations for why managers make the decisions they make. The findings identify substantial gaps between industry practice and academic knowledge, suggesting a need for better dissemination of the available evidence and a cultural change towards encouraging evidence-based decision-making. This research also identifies gaps between industry goals and evaluation practices, which hinder feedback to improve future performance.

The article starts with a brief overview of the existing (limited) studies on price-promotion decision-making as well as some of the broader literature on managerial decision-making. Second, this paper describes the research method and data collection procedure. Third, this paper reports the main objectives that managers say they pursue by means of price promotions and considers the findings from academic literature regarding the feasibility of each goal. This paper concludes with a discussion of theoretical and managerial implications, outlining under-researched areas for future research and acknowledging limitations of the study.

2. Background

2.1. Disparity in the priorities of manufacturers and retailers

Researching interactions between manufacturers and retailers regarding price promotions is difficult because of the commercially sensitive nature of these negotiations (Ailawadi et al., 2009). For this reason, knowledge on the topic is either scarce or requires further validation. For example, Howard and Morgenroth (1968) developed a model of a price-decision process based on the decisions of just one executive. A more recent conceptual framework proposed by Ailawadi et al. (2009) indicates a potential difference in the priorities that manufacturers and retailers might pursue: manufacturers aim to maximize profits for their brands and company, whereas retailers aim to maximize store, category, and private-label profits as well as shopper satisfaction. Ailawadi et al. contended that these different end goals translate into disparities in the tools and measures used to judge a price promotion's success. Whereas manufacturers use market share, margin, ROI, and brand equity, retailers focus on store traffic, sales per square foot, store share and profits, and shopper satisfaction. The differing perspectives hinder communication and trust between the two parties rather than building harmony to achieve common goals. Cognitive-appraisal theory (Lazarus, 1991; West et al., 2014; White, Varadarajan, & Dacin, 2003) recognizes that the interpretation of the same event (here a price-promotion negotiation) is modified by the assessment of how the event affects the individual, with different cognitive styles and organizational cultures influencing how individuals interpret the same situation.

Ailawadi et al. (2009) concluded there is a "sore need for research on the impact of trade promotions negotiations and post-audit activity on the relationships between manufacturers and retailers" (p.46). In a more recent review, Shankar et al. (2011) highlighted the importance yet scarcity of research into manufacturer and retailer price-promotion decision-making, describing in their article just one relevant source: the industry surveys by the Promotion Marketing Association (PMA) Shopper Marketing Center of Excellence with Nielsen Business Media in 2009. That proprietary survey of 318 retailers, manufacturers, and agencies documented the disparity between retailers' and manufacturers' objectives and KPIs in setting and evaluating price promotions. The study hinted at a mismatch in price-promotion scheduling and reported that only a minority of both manufacturers and retailers are satisfied with their relationships with their counterparts. Shankar et al. (2011) concluded their review with a call for more research into the price-promotion negotiations between manufacturers and retailers in order to improve collaboration between the parties and achieve mutually beneficial outcomes for manufacturers, retailers, and consumers. The present research responds to this call.

2.2. Human factors vs. evidence-based managerial decisions

Substantial research in the management and marketing literature has demonstrated that business decision makers often favor intuitive styles over technocratic or fact-driven approaches (Covin, Slevin, & Heeley, 2001). Meaning that soft factors, such as managers' beliefs, knowledge, cognitive biases, personal factors such as the gender and professional experience of the individuals involved (Duke, 1998), and levels of trust and mutual dependence in personal relationships with business partners (Vermillion, Lassar, & Winsor, 2002; Zippel, Wilkinson, & Vogler, 2013) play a significant role in managers' decisions.

Furthermore, the literature highlights that the information underpinning decisions is often incomplete, rather than objective or evidence-based, and comes from personal experience or conventional wisdom. Past research has also shown that time pressure (Thomas, Esper, & Stank, 2010) and the cost of obtaining further information (Azar, 2014) could prevent managers from using objective evidence and robust data to support decision-making. Moreover, a firm's level of technological advancement can impact the quality of data underpinning managerial decision-making (Covin et al., 2001).

With specific reference to pricing decisions, prior research has found that managers use short-cuts or heuristics, as suggested by the bounded rationality framework (Gigerenzer, 2004; Kahneman, 2003, 2011). A recent study examining managerial decisions about regular (non-promotional) prices showed that 'passivity' or keeping the prices constant was the prime strategy of UK and US retailers (Watson, Wood, & Fernie, 2015); this is consistent with the 'default' heuristic (Kahneman, 2011). As retailers grow in size and influence, retailer pressure will continue to influence these decisions (Low & Mohr, 2000).

In discussing heuristics used in budgeting, West et al. (2014) identifies two types of behaviors that are relevant to price-promotion decision-making: (1) isomorphic behavior (colloquially known as tit for tat), which involves cooperating, keeping a memory of the outcome, and then imitating the partner's last behavior (in this context the retailer or manufacturer as partners); and (2) isomorphic (imitation) behavior, which transpires either by examining the majority or looking at the most successful examples and following them (in this context copying competitors, both for manufacturers and retailers).

However, the use of heuristics in pricing decision-making could result in inferior policies, such as overpricing and product quality–price incongruences, which could lead in turn to consumer rejection (Rusetski, 2014). The use of heuristics in managerial decisions regarding media budgeting can lead to poor decisions, such as overspending (West & Crouch, 2007; West et al., 2014; West, Prendergast, & Shi, 2015; West & Prendergast, 2009). In contrast, the use of heuristics in forecasting decisions can result in improved predictions, where those heuristics are evidence-based (Armstrong, Green, & Graefe, 2015; Green & Armstrong, 2015).

Given the frequently large gap between the inputs into managerial decisions and evidence-based information, the present research pursues the following objectives: (1) to document the beliefs and assumptions that underpin manufacturer and retailer managers' price promotions decisions; (2) to assess the alignment between the objectives of running price promotions and the methods used to evaluate