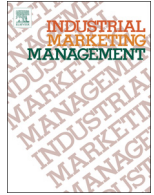




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National brand's local advertising and wholesale-price incentive under prior versus no prior information

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ABSTRACT

We study the context of one private label (PL) competing against one national brand (NB) through a unique retailer. We propose a novel utility-demand function that includes the consumer's brand valuation, the retail prices, and the brands' qualities. We investigate the effect of the NB local advertising strategy on supply chain players' profits when either one of the players supports the advertising. Also, we explore the role of prior information about the manufacturer's incentive function on supply chain players' behaviors. We show that although the support for advertising from either the manufacturer or the retailer is Pareto improving, the manufacturer prefers to incite the retailer to invest in local NB advertising through profit sharing instead of using its money to counter the threat of the PL. Furthermore, we also show that the wholesale price incentive motivating the retailer to invest further in advertising is not preferred as expected, and all supply chain players are better off without prior information about the manufacturer's behavior in the context of branding competition and advertising-level dependent incentive.

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1. Introduction

The relationship between manufacturers and retailers has been evolving between wars, negotiations, control of power, and collaboration (Dawar and Stornelli, 2013). There is more than ever a need for mutual understanding and balance of power to reach win-win results. Dawar and Stornelli (2013) suggest that manufacturers should learn from retailers' business models and adapt the model to their needs in order to improve the interrelationships with retailers. They describe four business models namely the information model (e.g., Tesco), the private label model (e.g., Loblaws), the margin model (e.g., Wal-Mart), and the working capital model (e.g., Costco) knowing that some retailers could use a mixture of approaches. In our paper, we focus on the first three business models and the crucial research question becomes: how supply chain players could use the advertising collaboration and the wholesale price incentive in the context of national and private labels in order to rebuild and enhance their relationship? Besides, we investigate the role of information sharing as a tool to impact the behaviors of both supply chain players.

Private labels (PL) play a key role for retailers by offering more variety to consumers, and a negotiation basis to deal with national brands'

(NB) manufacturers. The PL has reached a tremendous growth in many countries. For instance, the PL shares of value sales have reached 51.8% in UK with the strongest penetration and around 38% in France and Germany in 2015 (IRI, 2016). In US, the unit share of the PL is 23.1% in supermarkets and 17.3% in drug chains (PLMA, 2015). According to Surveylab conducted for PLMA, 50% of consumers shopping for groceries buy every time or frequently a PL (PLMA, 2016). Consumers' perception about the PL has progressed over time. While in the past consumers were looking for good deals based mostly on price, nowadays more consumers are looking for the overall value based on quality rather than just on price (IRI, 2013). Hence, retailers are proposing a variety of PL concepts focusing on the quality dimension. Generics and distinct-second tiers have very low quality (e.g., Saving Plus Line and Smart Price from A&P; Great Value from Wal-Mart and Basic Red from Safeway). Me-too brands are copycats to NB and have close quality to the NB (e.g., Chipz of Tesco imitating Pringles; Choco Rice of Aldi imitating Coco Pops of Kellogs and ChipMates of Kroger imitating Chips Ahoy!). Premiums have a high quality and a distinct positioning from the NB (e.g., Up & Up brands of Target; Sainsbury's Taste the Difference and President's Choice from Loblaws). Super-premiums have higher quality than NB (e.g., O Organics brands of Safeway and Game Day of 7-Eleven). Value innovators propose functional quality and value for money (e.g., IKEA and H&M). The PL quality becomes so important to the point that some retailers are exporting their own brands. For instance, the Italian retailer Conad is exporting its premium PL Saporì & Dintorni to US (IRI, 2013).

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While retailers use the PL as a strategy to put more pressure on manufacturers, the latter invests heavily in advertising and that investment helps increase store traffic. Ultimately, consumers often purchase PL instead of NB (IRI, 2013), and this incites manufacturers to rethink strategically when they advertise their brands and look for innovative ways to promote them. Hence, cooperation becomes a must for the manufacturer in order to reach a win-win situation. According to NRP and Trade Management Associates (2011), investment in cooperative advertising reached \$520 billion worldwide, and worth \$50 billion in US alone each year according to SproutLoud. Examples in the auto industry are Volvo and Ford, in the home improvement industry are Jenn-Air and GE, and in the HVAC industry are Trane and Lennox (www.makethunder.com). There are two categories of cooperative advertising (www.buzzle.com) either horizontal between players at the same channel level (e.g., two retailers who want to endorse the same product), or vertical between supply chain players at different levels of the channel (e.g., a retailer and a manufacturer or a manufacturer and a wholesaler). We focus in this paper on the vertical category of coop-advertising. This type of arrangement could come in different forms such as product flyers, direct mail campaigns, trade shows, sports events, and giveaway items (www.inc.com). More specifically, there are 4 types of plans under this category: 1/ the full cover of the advertising costs by the manufacturer, 2/ the shared costs where both partners split the costs based on a pre-determined percentage, 3/ the unlimited plan where the manufacturer pays a fixed percentage of the costs, and 4/ the fixed plan where the manufacturer offers a fixed budget for the costs per year (www.cpcstrategy.com). One solution that will be analyzed in this paper is a form of collaborative advertising where the manufacturer versus the retailer supports fully the NB local advertising in order to boost the retail sales instead of sharing the advertising costs. The rationale of such investment is to increase the category demand instead of favoring one specific demand. While cooperative advertising based on cost sharing between the manufacturer and the retailer has been widely studied by the literature (e.g., Berger, 1972; Berger and Magliozzi, 1992; Dant and Berger, 1996; Huang and Li, 2001; Li et al., 2002; Yue et al., 2006; Yan and Bhatnagar, 2008; Karray and Zaccour, 2006, 2007; Xie and Neyret, 2009; Xie and Wei, 2009; He et al., 2009; Yan, 2010; SeyedEsfahani et al., 2011; He et al., 2011, 2012; Aust and Buscher, 2012; Zhang et al., 2013; Aust and Buscher, 2014; Jørgensen and Zaccour, 2014), none of the existent papers investigated the role of a full support for local advertising from each part of the supply chain, and specifically, in the context of NB and PL competition. For example, when the retailer has to pay upfront all the advertising investment, it will block important funds to do other marketing efforts (Deshpande, 2015).

We propose a game-theoretic model consisting of a retailer and a manufacturer in a distribution channel where the manufacturer is the leader and the retailer is the follower. We investigate different contexts: 1/ the manufacturer offers full support for local advertising, 2/ the retailer supports totally the local advertising, 3/ the manufacturer proposes a wholesale-price incentive to boost the advertising level of the retailer under the condition that the latter has no prior information about the manufacturer's behavior in terms of incentive reaction function, and 4/ the manufacturer proposes a wholesale-price incentive to boost the advertising level of the retailer under information sharing and that will lead to prior information about the manufacturer's behavior in terms of incentive reaction function. The research questions, that we will try to answer, are then:

- When the retailer adds the PL to the shelf and sells both brands (the PL and the NB), what is the role of each brand quality in impacting strategies and profits of both supply chain players?
- Is it better for the retailer to support fully the NB local advertising or let the manufacturer bear those costs when both brands are offered on the shelves?

- Why is it important for the manufacturer to motivate the retailer to invest in local NB advertising instead of using its own money to promote its brand?
- What incentive mechanism can the manufacturer use to motivate the retailer to support fully the NB advertising, boost its advertising investment level, and ultimately, create better results for both supply chain players?
- Considering the importance of information process and sharing, what is the effect of having prior information about the manufacturer's incentive reaction (compared to no prior information) on both supply chain players' decisions and performances?

The main results show that the full support of the manufacturer or the retailer for NB advertising is a Pareto improving. This means that each supply chain player's profit increases following the implementation of that strategy compared to the benchmark scenario where there is no NB advertising, and hence the total supply chain profit increases. Comparing both support contexts, the retailer could have lower profits by advertising the NB, but the manufacturer always benefits from the retailer's full support in advertising compared to the scenario where the manufacturer is the one investing in NB advertising. In other words, the manufacturer will never lose profits if the retailer invests in NB advertising. Thus, the manufacturer prefers to motivate the retailer to invest in NB advertising instead of using its own money to counter the PL threat. In other words, the manufacturer will opt for a partnership strategy. To examine further this strategy, we study the scenario where the manufacturer tries to push the retailer to invest further in this advertising using the wholesale price incentive without sharing information, then the scenario where the manufacturer uses the wholesale price incentive and shares some information.

We find that the retailer prefers to have prior information about the manufacturer's behavior in terms of incentive reaction function because that allows extracting some incentive from the manufacturer which was not the case without prior information. However, the manufacturer will avoid that option because it lowers its profits following a lower advertising investment. The whole supply chain performance is also not improving if information sharing takes place and an incentive is provided compared to the case where only the retailer is advertising the NB. As a result, these two scenarios (using a wholesale price incentive) do not add value to the supply chain players, and thus we conclude that the overall preferred strategy is to let the retailer advertise the NB without offering an incentive as a reduction on the wholesale price and without providing any information sharing that could reflect the manufacturer's behavior in terms of incentive allocation (as a function of the advertising level invested by the retailer). To convince the retailer to do so, the manufacturer does need to share the surplus of profit using "profit sharing mechanism".

Many prior researches studied shared cooperative advertising in the context of a single brand, and some studies (e.g., Karray and Zaccour, 2006) investigated its effect in the context of competitive brands (NB vs. PL) and showed that the retailer will accept such a cooperative program only if the NB competes strongly with the PL. Thus, we need to examine the scenario of a fully supported NB advertising either from the manufacturer side or the retailer side to see if this strategy also can help supply chain players achieve a Pareto result and if this strategy is optimal to implement. Our results show that, although the fully supported NB advertising can help the supply chain players achieve a win-win result, the optimal strategy is to motivate the retailer to fully support the NB advertising through profit sharing mechanism. Our research derives a novel finding that no prior research ever shed light on. In other words, prior studies showed that the manufacturer and the retailer should employ the shared cooperative advertising strategy conditionally in order to improve their respective performance, however, our study shows another good option which is to motivate the

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