



# What makes deal-of-the-day promotions really effective? The interplay of discount and time constraint with product type



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## ABSTRACT

Deal-of-the-day (DoD) promotions are nowadays very popular. As a special form of a price promotion, they allow firms to offer products at substantial price discounts, usually at or above 50%, for a very limited period of time, usually between one and seven days. Conventional wisdom suggests that both characteristics, high discount levels and tight time constraints, should make DoDs an effective form of a price promotion. However, the two characteristics do not necessarily combine to increase DoD effectiveness. In particular, the authors propose that depending on the type of a promoted product (utilitarian vs. hedonic), the attention that consumers pay to the discount level relative to the time constraint varies, which leads to differences in promotional effectiveness. Two studies, a lab experiment and a field study using data from the DoD platform Groupon, mostly confirm these hypotheses: the time constraint increases promotional effectiveness more for hedonic than for utilitarian products, whereas the discount level increases promotional effectiveness for utilitarian more than for hedonic products. In the Groupon data, very high discount levels actually decrease promotional effectiveness for hedonic products. The results suggest that designers of DoD promotions should consider the type of a promoted product when choosing appropriate time constraints and discount levels.

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## 1. Introduction

The popularity of deal-of-the-day (DoD) promotions has increased substantially in recent years. New Internet startups use DoD promotions as stand-alone business models (e.g., dealadaysites.com), and traditional retailers and large incumbents integrate these models into their online shops (e.g., Walmart's "Value of the Day," Amazon's "Gold Box," eBay's "Daily Deal").

Conceptually, DoD promotions differ from other price promotions in two main ways. First, they offer products (goods or services) to consumers at substantial price discounts, usually at or above 50%. Second, they are valid only for a limited time, usually between one and seven days. As consumers typically enjoy saving money when purchasing products, the discount level (i.e., amount of savings) should enhance the appeal of an offer and increase purchase likelihood (e.g., Chandon, Wansink, & Laurent, 2000). This positive discount level effect is a well-established finding (e.g., Sethuraman,

1996; Srinivasan, Popkowski-Leszczyc, & Bass, 2000). Some indications (albeit fewer than the findings related to discount levels) suggest that a time constraint increases purchase likelihood too (e.g., Inman, Peter, & Raghubir, 1997), because consumers interpret it as a signal of a good deal. Consequently, the combination of these two characteristics—high discount levels and tight time constraints—should make DoDs an especially effective form of price promotion.

Yet in practice, benefiting from DoD promotions remains a challenge. Among Dholakia's (2011a,b, 2012) multiple studies on the topic, a survey of 150 businesses reveals that one-third suffered unprofitable DoD initiatives (Dholakia, 2011a). In another study with 324 businesses, Dholakia (2011b) indicates that 26.6% lost money. For businesses offering promotions through Groupon, a prime example of DoD websites, approximately 40% emerged as unprofitable (Dholakia, 2012). Initial research in this context implicitly points toward too high discounts as a potential reason for this finding (Dholakia & Kimes, 2011; Kumar & Rajan, 2012; Ong, 2015).

In view of the conflict between the promise and the outcomes of DoD promotions, we aim to provide a better theoretical understanding and empirical support to identify whether and in which conditions the high discount levels and tight time constraints of a DoD promotion contribute to promotional effectiveness. Drawing on information

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processing literature (e.g., Chaiken, 1980; Petty & Cacioppo, 1986), we argue that the evaluation of a DoD promotion by consumers is not only determined by the discount level and the time constraint but also is a function of how consumers process the information that these characteristics provide.

Specifically, depending on the purchase situation and thus the type of the promoted product (utilitarian vs. hedonic), the attention that consumers pay to the discount level *relative* to the time constraint should vary. In a utilitarian purchase situation, consumers are motivated to encode discount information systematically. In a hedonic purchase situation, they instead are more prone to use heuristic (non-price-related) cues, such as time constraints, to evaluate the attractiveness of the DoD promotion. With this reasoning, we offer differentiated predictions about how the type of the promoted product (utilitarian vs. hedonic) interacts with the discount level and the time constraint to determine the effectiveness of a DoD promotion.

We test our interaction hypotheses with both experimental (lab setting) and field (transactional data from Groupon) data. The time constraint increases promotional effectiveness more for hedonic than for utilitarian products. In contrast, the discount level increases promotional effectiveness for utilitarian more than for hedonic products. These results thus confirm that the promotional effectiveness of DoDs differs with the type of the promoted product.

We also find a notable unexpected result: Very high discount levels actually *decrease* promotional effectiveness for hedonic products in the Groupon data, an observation that we obtained by modeling nonlinearities. This result extends prior literature on the (generally positive) discount level effect in price promotions. As an explanation, we propose that the extremely high discount levels that sometimes appear in DoD practice may make consumers skeptical of the deal's value.

In the next section, we discuss how our research adds to existing literature on sales promotions (including DoDs). Then we develop a framework based on information processing literature to develop specific hypotheses about the respective effects of the discount level and time constraint in DoD promotions, depending on the type of the promoted product. We submit these hypotheses to empirical testing in a controlled lab setting (Study 1) and with Groupon data (Study 2). We conclude with a discussion of our findings and some avenues for ongoing research.

## 2. Previous research: discount levels and time constraints in sales promotions

With our focus on the discount level and time constraint of a DoD promotion, our study primarily relates to sales promotion research (including on DoD promotions) that deals explicitly with these characteristics.

### 2.1. Price discounts in sales promotions

Extant research on price discounts in sales promotions can be categorized into two main streams. The first focuses on how consumers process information included in a price discount. That is, consumers' perceptions of discounts generally increase with increasing discount levels (Berkowitz & Walton, 1980; Della Bitta, Monroe, & McGinnis, 1981; Mobley, Bearden, & Teel, 1988). In addition, consumers actively process and encode the savings that result from a discount, and the subjectively perceived discount level typically differs from the (objectively) advertised discount level (Blair & Landon, 1981; Dholakia & Kimes, 2011; Gupta & Cooper, 1992; Mobley et al., 1988). These findings are crucial for our hypothesis development.

The second stream seeks to estimate the impact of the discount level on various effectiveness measures, such as sales or market share. Consensus exists that increasing discount levels enhance effectiveness, at least short-term (e.g., Sethuraman, 1996; Srinivasan et al., 2000). In the specific context of DoD promotions, only a few studies estimate a

discount effect and indicate a relatively small (Byers, Mitzenmacher, & Zervas, 2011; Dholakia & Kimes, 2011) or even no (Park & Chung, 2012) effect. These researchers posit that discounts in DoD promotions may be already so high that any further increases have only relatively small impacts on demand. This reasoning is consistent with other studies that analyze the functional form of the discount level effect in sales promotions and note that the effect is subject to certain nonlinearities, especially saturation at particularly high discount levels (Van Heerde, Leeflang, & Wittink, 2001; Wisniewski & Blattberg, 1983).<sup>4</sup>

However, no prior studies explicitly control for the type of promoted product (utilitarian vs. hedonic), which we propose as an alternative explanation of small discount level effects. Moreover, in a DoD promotion, the low price elasticity could result from time constraints, which provide informational stimuli beyond the discount level. To disentangle these two effects, it is necessary to investigate both key characteristics simultaneously.

### 2.2. Time constraints in sales promotions

Time constraints have received some attention in sales promotion research, though far less than price discounts have. The related literature can be categorized in the same way we classified price discounts. A first stream focuses on how consumers process information provided by a time constraint stimulus, and the existing studies show that consumers use constraints (e.g., purchase constraint, time constraint) as heuristic cues to evaluate a promotion. These studies also argue that a time constraint improves consumers' evaluation of a promotion, by signaling that an object is valuable or desirable (Inman et al., 1997). Shen (2013) refines these results, showing that consumers use a tight time constraint to develop direct, positive product evaluations only if the advertising message confirms the positive signal exerted by the cue (i.e., when the message is strong). Again, insights from this research stream are crucial for our hypothesis development.

The second stream pertains to studies that concentrate on the impact of a time constraint on various promotional effectiveness measures. These studies provide empirical evidence that the presence of a time constraint accelerates purchases, decreases the likelihood of searching for better deals, leads to greater willingness to buy, as well as to a more favorable attitude toward the deal (Aggarwal & Vaidyanathan, 2003; Inman et al., 1997).<sup>5</sup> In the specific context of DoDs, only one study focuses explicitly on estimating a time constraint effect; Dholakia (2011a) shows that the number of days a deal is offered decreases the number of deals sold. However, this study does not explicitly control for different discount levels, which, as discussed before, also likely influence promotional effectiveness.

### 2.3. Contributions

Taken together, existing literature on price discounts and time constraints provide several valuable insights that can be applied to the specific context of a DoD promotion. But prior studies also are limited in their ability to understand and evaluate the precise, respective effects of the discount level and the time constraint on promotional effectiveness. With this study, we therefore contribute to existing research in four ways. First, no prior study has considered the time constraint in combination with the *high* discount levels that characterize DoD

<sup>4</sup> Some researchers also find that "too high" discount levels may harm promotional effectiveness (e.g., Krishna, Briesch, Lehmann, & Yuan, 2002), possibly because consumers interpret a too-high discount level as a signal of a lack of quality (e.g., Völckner & Hofmann, 2007).

<sup>5</sup> Inman et al. (1997) refine this view by showing that whether a time constraint increases purchase likelihood depends on the discount level of the promotion, such that the positive constraint effect is active only at high but not at low discount levels (these authors use 20% and 5% discounts). Because DoD promotions generally include high discount levels, such an interaction effect is unlikely to occur in a DoD context.

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