

# Chapter 2

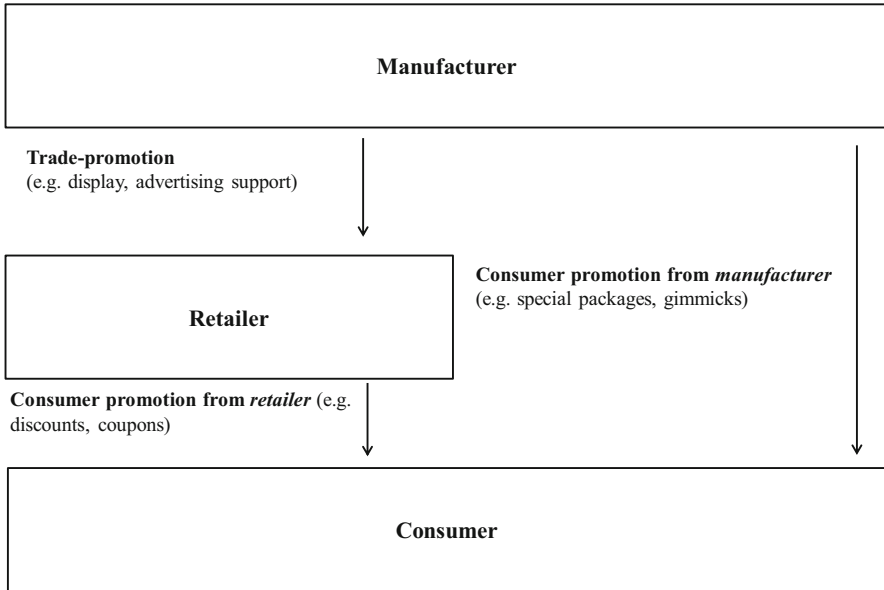
## Conceptual Framework

### 2.1 Pricing Strategies and Definitions of Price Promotions

“Nothing is more important in business than getting the pricing strategy right” summarizes the importance of choosing and implementing the right pricing strategy and tactics for a retailer (Tang et al. 2001). Generally retail managers can decide between two core pricing strategies, the *every-day-low-price* (EDLP) strategy or the *HiLo pricing* which together make up for over 56 % of pricing strategies used in the US, with other strategies (often derivatives of the two) such as *exclusive pricing*, *aggressive pricing* and *moderately promotional pricing* being used by ~44 % of US retailers (Bolton and Shankar 2003; Hoch et al. 1994; Lal and Rao 1997; Tellis 1986). In the following this thesis focuses on introducing EDLP and HiLo pricing.

When implementing an *every-day-low-price* strategy, the average price for every article is selected to be between a regular market price and a promotional price. By offering below regular market prices on all items, the EDLP-strategy aims at attracting price- and time-sensitive customers, who want to combine an attractive offering while not visiting multiple shops to hunt for the cheapest bargain (Lattin and Ortmeyer 1991; Seiders and Voss 2004). This strategy is very common as according to Bolton and Shankar (2003), approximately 45 % of US retailers, among them industry leaders such as WalMart, HomeDepot, Costco and Aldi, have implemented this strategy (Bolton and Shankar 2003). In its pure form, no additional temporary price promotions would be granted to the customer.

The *HiLo pricing* strategy is defined as offering higher non-promotional prices mixed with temporary discounts on individual brands or categories to customers. These temporary discounts or variance in prices are a distinct characteristic and difference to EDLP-strategy. In contrast to the EDLP, the HiLo strategy attracts cherry-pickers, who are willing to invest additional effort in finding and visiting the stores with the cheapest price for a brand, even if this would require them to visit multiple stores (Bell and Lattin 1998). The HiLo strategy is less common than the EDLP strategy, as in the US only 11 % use this strategy, among them retailers like Lion, Safeway and Vons (Bolton and Shankar 2003). Within the HiLo pricing



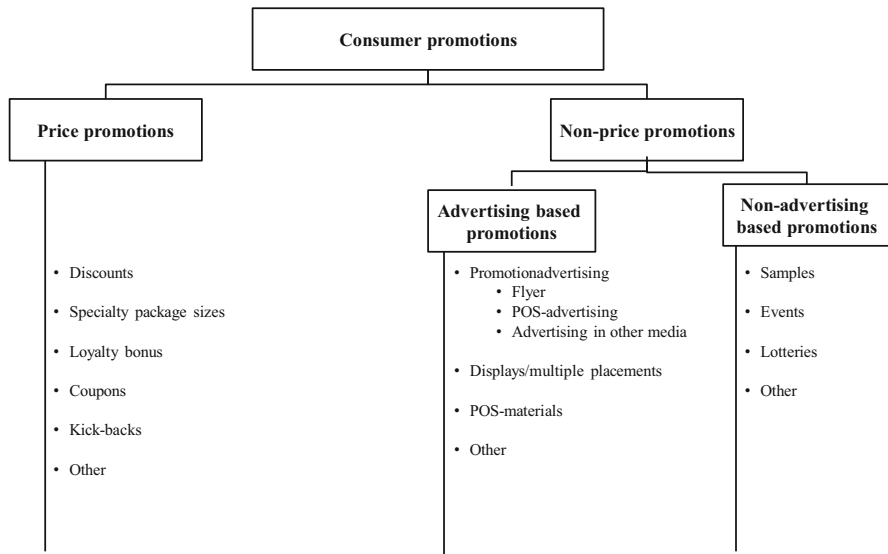
**Fig. 2.1** Overview of promotion types

strategy, retailers (as a matter of fact also manufacturers/wholesalers) are free to choose among various different designs of price promotions.

### ***2.1.1 Definition of (Traditional) Price Promotions***

For sales promotions one differentiates promotions targeted at the retailer and promotions targeted at the consumer. Sales promotions that are directed towards retailers are called trade promotions, and promotions that are directed towards consumers are called consumer promotions (Blattberg and Neslin 1990; Gedenk 2002, p.14) (Fig. 2.1).

Consumer promotions can further be classified as price promotions or non-price promotions. Non-price promotions are for example free samples, special packaging or promotion games, while price promotions are for example discounts or coupons (Gedenk 2002, p. 19) (Fig. 2.2). Price promotions can be defined as (1) temporary limited discounts to the regular market price, (2) sometimes supported by additional marketing measures (3) to increase sales for a retailer, wholesaler or manufacturer (Diller 1984; Gedenk 2002). Sales promotions and price promotions alike, do not necessarily have to focus on reaching short-term goals, such as the immediate increase in sales, but can also be targeted at e.g. increasing a retailer's image or increasing long-term sales (Gedenk 2002).



**Fig. 2.2** Overview of consumer promotions

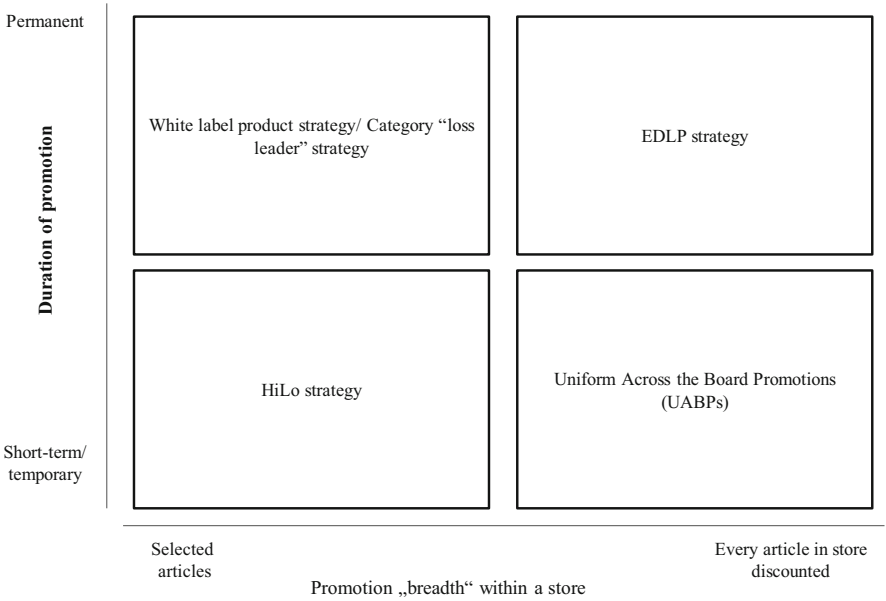
### ***2.1.2 Definition of Uniform Across the Board Promotions (UABPs)***

Uniform Across the Board Promotions, which is a term introduced to the literature with this thesis, are part of the broader category of *consumer price promotions*. As Uniform Across the Board Promotions have not been defined in the marketing literature before, this thesis introduces a definition, which is based on a qualitative pre-study further described in Chap. 3. For the avoidance of doubt, all other price promotions in this thesis are referred to as *traditional* or *other* price promotions.

Uniform Across-the-Board Promotions can be defined along four characteristics:

*“Uniform Across the Board Promotions (1) are store-wide promotions on the entire assortment, that grant the customer (2) an undifferentiated discount on the entire assortment, i.e. no bigger or smaller discounts on any article. (3) This discount is only valid for a limited time period and (4) is expressed relative to the article prices, i.e. as a percentage to the absolute value.”*

Particularly the breadth of the promotion combined with the undifferentiated discount are differentiating criteria, as (a) other promotions are normally not applied to the entire assortment and (b) retailers generally do not offer the usually a bit cheaper white label products or the subsidized “category loss leaders” along the entire assortment. Even during sales periods, some articles are normally excluded from promotions or the depths of the discounts vary. As for traditional price promotions, UABPs can be supported by other forms of promotion and advertising, such as coupons, TV campaigns etc. Relative to the pricing strategies described in Sect. 2.1, UABPs combine elements from the EDLP strategy and the



**Fig. 2.3** Classification of UABP among pricing strategies

HiLo pricing strategy and are hence targeted at efficient shoppers and cherry pickers alike. The fact that the price promotion is applied on the entire assortment is an EDLP characteristic, while the temporary restriction is an element used in HiLo pricing (Bell and Lattin 1998; Hoch et al. 1994). Figure 2.3 further displays the characterization of UABPs compared to other pricing strategies.

**2.2 Theoretical Background**

In the following some cornerstone theories and concepts from research in social psychology, micro-economics, and behavioral economics will be introduced, that form the basis for the empirical research conducted later in this thesis and provide explanations to the observed results. Concepts and theories discussed include:

- *Prospect theory/reference price concept (2.2.1)*: Theory that goes back to adaption-level theory, that e.g. discusses, how promotions alter the price expectations of consumers and how this affects future buying behavior.
- *Price search and search cost (2.2.2.)*: Concept with background in microeconomics, which states that consumers are always putting the search for better offers in context to the actual and opportunity costs related to the search.

- *Behavioral learning* (2.2.3): Theory from social psychology, stating that consumers are constantly learning and adapting their behavior, especially if they are conditioned to change through facing continuous stimuli.
- *Attribution theory and self-perception theory* (2.2.4): Has its background in social psychology and states that consumers always try to find an explanation for a specific state, meaning they e.g. put price promotions in a certain context. This context influences their attitude and behavior towards the observed state.

### 2.2.1 *Prospect Theory and Reference Price Concept*

The reference price concept states that consumers do not just evaluate observed prices on a stand-alone basis and as absolute but rather evaluate them in a relative context. This concept goes back to the prospect theory (Kahneman and Tversky 1979) and eventually the adaption-level theory (Helson 1964).

According to the adaption-level theory (Helson 1964), consumers compare a state, i.e. an observed price to a personal reference-level or an adaption-level. These adaption-levels are formed by the individual response to three classes of cues: focal, contextual and organic. Focal cues are stimuli that a consumer is directly responding to (i.e. the observed price), with the contextual cues describing everything in the background to those cues (i.e. comparison with prices of other products). Organic or residual cues are built through previous experiences of the consumer (i.e. past prices that consumers have paid) (Helson 1964). Building on the different cues used to form adaption-levels or reference prices, there is however a discussion that different types of consumers form different reference prices. While more brand-loyal customers focus on their internal reference price, which is built from previous experiences, brand switchers (deal seekers) focus on external (contextual) reference prices (Puto 1987; Rajendran and Tellis 1994).

Kahneman and Tversky (1979) have built on this concept when formulating the prospect theory. According to the prospect theory, which then forms the basis for the reference price concept, consumers do not just look at the actual prices of goods or services but, in line with the adaption-level theory, always put this price in context relative to a personal reference price. The price perception of a brand or retailer depends not only on the actual price of products offered but also on their reference price and the relationship between the two. A positive deviance of the actual price from this adaptation-level or reference price, i.e. a lower actual price than the reference price would in terms of mental accounting be considered a “profit” and lead to a positive price perception, while a negative deviance would be booked as a “loss” (Monroe 1973).

Kahneman and Tversky (1979) found that the utility function for those profits and losses is concave for profits and convex for losses. Moreover the curve is steeper for losses than it is for gains. This means that consumers are in general risk-averse and in absolute terms losses are more negative than the same profit would be positive. In terms of promotions this means that a temporary discount (promotion),

with an observed price lower than the reference price will be considered a profit, while the return to the actual price compared to the “new reference price” would be a loss—with the net of the two effects being negative.

As consumers adjust their expectations to past experiences, e.g. promotions, the response of a consumer to a certain type of promotion can change over time, given the changed reference prices (Anderson and Simester 2004). Regarding promotions and in particular UABPs, historic experiences, and the increased predictability of finding an article at a lower price in the future, could make non-promotional prices less attractive and even provide a lower incentive to act on future promotions, given that the observed promotional price and the new reference price are converging (see Sect. 2.3.2 for a detailed discussion on long-term promotional effects).

Despite a general acceptance of this theory, the concept of the reference price and the rational consumer has come under some scrutiny as empirical research has shown that consumers often have little price knowledge and their internal reference price is often not very precise (Buzas and Marmorstein 1988; Dickson and Sawyer 1990). In reality, rather than having precise price knowledge, consumers use external cues while remembering whether a price was cheap or expensive. This heuristic is in most purchase situations sufficient for making purchase decisions or forming a view about a retailer and brand (Krishnamurthi and Raj 1988; Mazumdar and Monroe 1990).

For the applicability of the reference price concept on UABPs, it can be assumed that the “x percent promotion on everything” claim forms a strong enough external claim itself, so that the relative discount can be viewed as “reference” to what is normally charged for a product. This would mean that consumers do not compare the actual prices paid but rather use the heuristic of the existing “x percent promotion on everything” UABP discount as a reference value. This could lead to consumers expecting a certain (type) of discount rather than a precise price for an article.

### 2.2.2 Price Search and Search Costs

The behavioral pricing research differentiates between three phases of how consumers deal with prices. The first phase sets out how information on prices are obtained, the second one how those information are processed and the third one how the processed price information is stored by the consumer (e.g. Homburg and Koschate 2005). The *price information search*, i.e. the first phase, herein sets the basis for the processing and acting on the information.

The *interest in price* information, describes the general desire of a customer to search for price information and to consider these information in their decision making process. The greater the interest in price, the higher is the importance of price and the lower the willingness to pay an above average price (Diller 1999). The *interest in price* is increased through promotions, as they put the focus on the price

of a product which can also be tactically used by retailers, aiming at increasing the interest in price (Dickson and Sawyer 1990; Naik et al. 2005).

While the interest in price describes the original intention to search for prices, the *price search*, which is the undertaken effort to look and compare prices, influences the actual purchase process. In general price search can take place either between-stores (*between-store-search*), i.e. comparing prices across different stores for comparable products or within-stores (*in-store-search*), which refers to comparing prices for comparable products and brands within one store (Urbany et al. 1996). The promotion aspect of within-store search is less relevant for Uniform Across Board Promotions, which is why the focus will be more on *between-store* search elements. Understanding the factors influencing the intensity of between-store search will help to better understand in which retail settings UABPs might work better than in others (see also Chap. 3). Various older research studies conclude that regardless of the degree of price variability, consumers tend to put only relatively little effort in the actual process for price search (Beatty and Smith 1987; Grewal and Marmorstein 1994). However price search is influenced by several influencing factors such as:

- Value of the product
- Observed price range
- Price guarantees
- Price knowledge
- Search costs
- Promotions

Regarding the influence *value* has on the price search intensity the existing evidence is mixed. Darke and Freedman (1993) argue that there is a positive effect of a higher value on the price search intensity, as the same relative discount leads to bigger absolute savings, if an article has a higher base price. Grewal and Marmorstein (1994) have found different evidence in the retail market for electronic goods, as the same absolute promotions gives a higher relative benefit to the customer if the article has a lower value. They hence conclude that value has a negative correlation with price search intensity.

Consumers normally have a general idea of the *price range*, meaning the lowest and highest price, to which a certain product can be purchased. Similar to the reference price theory, consumers compare the observed price with this price range and hence try to form an opinion on the probability to shop for a lower price (Urbany 1986). The wider this price range, i.e. the “perceived price dispersion”, the higher the chances of finding a cheaper price and the higher the price search intensity (Duncan and Olshavsky 1982).

*Price guarantees*, which are given by certain retailers, aim at stopping the price search of customers, as they are offered the difference between the price spent for a product and a potentially cheaper price in a different store. This reduces the uncertainty for the customer, and hence has a negative effect on the price search intensity (Jain and Srivastava 2000; Srivastava and Lurie 2001).

The literature concludes that *price knowledge* and the price search efficiency positively impacts price search intensity, potentially also because it indirectly lowers the price search costs (Alba and Hutchinson 1987; Urbany et al. 1996). However this is only valid, if consumers are generally still searching for prices and have not yet “subscribed” to only one particular brand or store (Alba and Hutchinson 1987).

*Search costs*, which includes all incurred and opportunity costs associated with finding the best price, impacts the price search intensity. Information economics, which focus on utility maximization, argue, that price search is conducted as long as the expected savings are still as high as or higher than the cost incurred by an additional shopping trip (Stigler 1961; Metha et al. 2003). However the subjective utility from the satisfaction of having found a lower price, which is one motivation of bargain hunters, also has to be considered (Marmorstein et al. 1992). As research in the area of psychology states, consumers prefer the heuristic processing of information (over the systematic processing), as decisions are made based on simple decision rules, which reduce their mental effort (Chaiken 1980). *Price promotions* in a store can be seen as such an easy decision rule, as the subjective probability of finding a lower price elsewhere is reduced and consumer hence terminate their price search. Promotions hence have a negative impact on the price search—the higher the absolute discount, the more negative the impact (Darke and Freedman 1993; Darke et al. 1995).

According to the theory of information economics, customers always put the *search costs* in relation to the expected savings (e.g. Metha et al. 2003; Stigler 1961) and one could expect that customers incur higher relative search costs if the expected savings are higher or if the expected relative savings are more certain. Regarding the relative promotion depth, UABPs in our example are generally comparable to other types of price promotions (compare e.g. Chap. 4, Table 4.14), while the certainty of finding the desired article (in a particular size, color and style) on sale and available during UABPs is significantly higher, as the promotion is applied to *every article* in the store. The hypothesis is that rationale consumers would hence be willing to incur higher search costs to shop during UABPs than they would occur for other types of promotions. In theory this could result in UABPs attracting more customers that are willing to incur higher costs to visit a store, e.g. a commute from further away, and hence lead to higher promotional increases than for regular promotions. Part of this will be further analyzed in Chap. 3, when discussing the optimal retail settings for UABPs.

### 2.2.3 Behavioral Learning Theory

The central concept behind behaviorism or behavioral learning theory, introduced by Skinner (1953) and Thorndike (1911), states that positively reinforced behavior is more likely to reoccur than non-reinforced behavior. Nord and Peter (1980) as well as Rothschild and Gaidis (1981), have summarized the general concepts and

applied them to the field of marketing. Applied to marketing the behavioral learning theory suggests, that a transaction or purchase (response) takes place once a product (stimulus) is favorably received by the customer. If the customer is satisfied with the product (positive reinforced), the probability of repeat purchases increases. Marketers enhance the value of the product through additional stimuli, like adapting price, distribution or promotional variables. Such positive reinforcement, through favorable variables, further increases the purchase probability of the product. In the following some core components of behavioral learning in marketing will be quickly introduced and their potential impact on the purchase behavior for Uniform Across the Board Promotions.

The first step is called shaping, which derives a new behavior, such as choosing a new brand or store. This first step is essential as positive reinforcement, i.e. learning, can only occur, once behavior has already occurred. Rothschild and Gaidis (1981) suggest that shaping occurs through rewarding many small existing patterns, out of which a new, more complex behavior can occur. For example by advertising and promoting one can attract a consumer to a specific store once she already has the intention to buy in a certain product category. However the visit to the store is in this instance closely connected and reinforced by the specific additional stimulus (promotion, advertising). To ultimately achieve a change in behavior that is linked to the store rather than the additional stimulus, the ancillary incentives, such as the promotions and advertising need to fade out.

A common problem and significant risk in the use of those promotions stimuli is either the improper fading out or the over-usage of promotions/UABPs. If promotions/UABPs are not fading, i.e. being decreased over time, store sales may decrease significantly the moment those promotions are eventually dropped (see also Praktiker example and analysis in Chap. 4). This is caused by people switching back to a different store as the stimuli has become the main cause for choosing a certain store, rather than the store's products, features etc. Moreover an over usage of promotional or advertising aids may causes the consumer store choice to be contingent upon and overshadowed by those tools—once these aids are dropped, consumers might also switch back to a different store. To cause a long-term change in shopping behavior, promotional tools, hence also the UABPs can only be used to draw customers to a store, while continuously removing the correlation between the response (store selection) and the reward (UABP), to put the inherent store benefits back in focus (Rothschild and Gaidis 1981).

### ***2.2.4 Attribution Theory***

Attribution is a concept from the research in social psychology stating that individuals try to explain the causes for certain observed behavior and events. This concept has also been applied to marketing or more specific pricing research, arguing that consumers try to understand the reasons why a certain article or brand is on promotion (Folkes 1988; Lichtenstein et al. 1991). Consequently a

price promotion can, depending on the reason consumers expect behind it, be seen as positive or negative (Folkes 1988; Weiner 2000). For example the attitude towards a retailer and the value of a promotion is viewed more positively, when the customer thinks the promotions aim at winning market share and attracting customers rather than just for clearance of stock (Lichtenstein and Bearden 1989).

When consumers face unexpected promotions they try to assess whether this has something to do with the product (quality) or the store (Lichtenstein and Bearden 1989). A promotion which consumers cannot explain could be perceived as unfair even if beneficial for the consumer (Xia et al. 2004; Ordóñez et al. 2000). When consumers are facing very large discounts, they are discounting the promotion unless they are familiar with the brand (Moore and Olshavsky 1989). Regarding UABPs it will be interesting to see whether consumers are discounting the price promotion, impacting e.g. image of the brand, not just because of the actual depth but also because of the breadth (*“promotion of every article in the store”*) of the promotion. Especially in the long-term the impact of very deep discounts or very broad promotions, such as the UABP, has to be assessed as beyond a certain level the perceived value of a promotion is higher if the type of discount is rare—very frequent UABPs should hence lose in efficiency (Lichtenstein and Bearden 1989). The impact of UABPs on the brand and how they are perceived in general will be discussed in Chap. 5, where a connection to the attribution theory will be drawn.

## 2.3 Literature Review Related to the Impact of UABPs

### 2.3.1 *Short-Term Sales Impact of Price Promotions*

When addressing the impact of promotions on short-term consumer behavior, the marketing literature differentiates between two general effects: sales bump and promotional dips. The sales bump or immediate effect of price promotions refers to the increase in sales during a promotion campaign. Potential adjustment effects or pre- and post-promotion dips are understood as the “troughs” prior or post a promotion, during which sales are below the usually observed sales level, as consumers adjust their behavior to the promotions.

This topic was first analyzed in the late 70s, when promotional effects were decomposed and the first evidence for purchase acceleration was empirically observed. Research found, that consumers make sophisticated decisions and increase the quantities of consumer goods purchased (soap, coffee and orange juice) during promotions compared to non-promotional quantities (“sales bump”). Those purchases are often made at the expense of later purchases (“post-promotion dips”) (Ward and Davis 1978). In the following the existing literature on the three short-term promotional effects will be reviewed and the potential implications for UABPs will be derived.

### 2.3.1.1 Immediate Effect of Price Promotions

This paragraph focuses on the immediate effect of price promotions, also called “sales bump”, which refers to the increase in sales caused by a (temporary) reduction in price. The paragraph will summarize a review of the respective literature regarding key aspects of the immediate effect of price promotions and derive potential implications for Uniform Across the Board Promotions on:

- Category incidence, brand choice/switching, purchase quantity
- Store choice
- Complementary effects (e.g. impact on customer mix, complementary products)

#### Effect on Category Incidence, Brand Choice and Store Switching

Earlier research has usually analyzed the promotional impact on brand choice (e.g. Guadagni and Little 1983), quantity decisions (e.g. Blattberg et al. 1981) and category incidence as separate topics. Gupta (1988) has then been among the first to measure the impact, each of those components have on sales simultaneously, as this helps to better understand the overall effectiveness of a promotion. For this reason this paragraph discusses the impact price promotions have on *category incidence*, *brand choice* and *purchase quantity* together.

*Category incidence* is the likelihood of consumers purchasing in a certain category, while *brand choice* is the impact promotions have on the selection and switching to a certain brand. Purchase quantity, which is often discussed together with acceleration of purchases or inter-purchase time, refers to consumers buying more (and earlier) of a product due to the product being on promotion. Especially for purchase quantity (and acceleration) it is important to understand, that those effects cannot be seen as stand-alone but are closely related to pre-and post-promotion dips, which will be further discussed in the following chapter.

It is undisputed, that store-sales generally respond positively to short-term price promotions, while the effect can be decomposed into within-category brand switching (e.g. Gupta 1988) or category expansion (e.g. Chintagunta 1993; van Heerde 1999). While within-category brand switching does not increase sales of a category but rather shifts those sales to a different brand, category expansion increases the demand for a certain category. Various researchers have further explored these effects, by decomposing the short-term sales increase into primary demand effects: purchase acceleration and increase in purchase quantity and secondary demand effects: brand switching.

As Table 2.1 shows, the elasticity decomposition of promotional impact as measured from household level data shows a broad range of results, for different categories. The average shows, that 74 % of the increase in sales can be attributed to secondary effects and more specific: brand switching (Bell et al. 1999; Bucklin et al. 1998; Chiang 1991; Gupta 1988). Van Heerde et al. (2003) who have analyzed

**Table 2.1** Decomposition of promotional sales elasticities

Study	Category	Brand switch.	Timing accel.	Quantity accel.
Gupta (1988)	Coffee	84 %	14 %	2 %
Chiang (1991)	Coffee (featured)	81 %	13 %	6 %
	Coffee (display)	85 %	5 %	10 %
Chintagunta (1993)	Yogurt	40 %	15 %	45 %
Bucklin et al. (1998)	Yogurt	58 %	19 %	22 %
Bell et al. (1999)	Various	49–94 %	1–42 %	0–45 %
<b>Average</b>		<b>74 %</b>	<b>11 %</b>	<b>15 %</b>

store level data have only found this effect to account for 33 % of the short-term sales increase (see also Table 2.1, as inspired by van Heerde et al. 2003).

Walters (1991) in an earlier article has found that the negative impact of a promoted brand on its substitutes, depends firstly on the brand or category but also on the similarity of the perceived attributes of the two brands—this can likely explain some of the variance related to the degree of brand switching shown in Table 2.1. For retailers it is important to understand the brand switching effect, as the within store substitution might be desirable from a manufacturer point of view, however it might not increase overall store sales for the retailer. Based on the average results above (Table 2.1), 26 % of the sales increase is due to primary demand effects, i.e. short-term sales increases for the retailer, that are caused by customers buying more and buying earlier. Whether over a longer period of time, this leads to a net increase in sales for the retailer or causes post-promotion dips will be discussed in more detail later (see Sect. 2.3.1.2 for post-promotion dips). Especially if consumption rates react positively to promotions, i.e. customers consuming faster if they have bought an article at a reduced price, the category incidence increases and the net promotional effect for the retailer is likely even higher (Ailawadi et al. 2007; Bell et al. 1999).

When discussing the sales impact of UABPs against this background, it is important to note, that UABPs are targeted exactly at those primary demand effects, as there is usually no significant within-store substitution expected, given that the promotion is applied to every article in the store. On the contrary UABPs are not a mean to influence secondary effects or specifically brand choice but rather store choice and category incidence as will be discussed in the next chapter.

### Effect on Store Choice

Part of the sales bump caused by promotions can be attributed to store switching. As stated before, UABPs are retail driven consumer promotions, i.e. unlike trade promotions or manufacturer driven consumer promotions that target an incremental increase in sales of a specific brand or product, UABPs aim at increasing overall retail store sales. They are hence an important marketing tool from a retailer's

perspective. The following summarizes, how and if price promotions generally affect consumer store choice.

Keng and Ehrenberg (1984) show, for a grocery retail setting, that consumers generally have low store loyalty and little segmentation between different stores and retail chains, when it comes to selecting a certain product. This is an indication, that consumers can theoretically be lured into switching stores by offering them attractive promotions.<sup>1</sup> This has been supported by work from Kumar and Leone (1988) and Walters (1991) that have found that pricing activity for a specific brand in one store has negative effects on sales in its competing stores or more specifically that price promotions of a brand in one store has a negative effect on the brand or its substitutes in a competing store. Bucklin and Lattin (1992) introduce two concepts of competition, direct and indirect, between retail stores that have different implications on the promotional sales effects. *Direct effects* are the influence promotions have on the actual store choice, i.e. that consumer switch stores to profit from a certain promotion. *Indirect effects* are the influence that promotions have on the sales in another store, without causing store switching. This is caused by consumers visiting various stores and increasing their sales for a certain brand in store x (caused by a promotion), with the subsequent decrease for the same brand when they visit store y (Bucklin and Lattin 1992). Direct store switching occurs especially when households use outside store-cues which leads to decreases in sales for competing stores (as opposed to „indirect “autonomous cross-shopping where results are mixed). While both effects help the retailer to increase sales without causing within-store substitution, direct effects are more favorable, as they drive more customers to a certain store, increasing the overall store’s market share instead of just the market share in a certain (promotion supported) category.

As Uniform Across the Board Promotions are affecting the entire product portfolio of a store, they generally cause outside-store cues, and are hence likely to also cause direct store switching. While various studies agree that promotion induced store switching exists, they differ on the magnitude of this effect, which can partly be attributed to category specific effects. Kumar and Leone (1988) find that within-store substitution rates are by a factor of between two and three times higher than promotion induced store switching, while Ailawadi et al. (2006) find that store switching only makes up for 45 % (Ailawadi et al. 2006) of a brands temporary sales increase (with the rest coming from within-store substitution) (Ailawadi et al. 2006; Kumar and Leone 1988).

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<sup>1</sup> In the case analysed in this thesis this might be somehow different, as products from the vertically integrated retailer are not available in any other store or chain.

### Other Effects of the Short-Term Sales Increase

In addition to the impact on the actual size of the sales bump, promotions also affect the consistence of the “sales bump”, i.e. what products will be purchased and by whom.

One general notion in retail, which also highlights the advantages of direct versus indirect effects in store switching, is that price promotions of a certain brand or category also stimulate the purchases of their non-promoted complements. Examples in research point to how for example promoted spaghetti sauce causes an increase in sales of the non-promoted spaghettis (Walters 1988). The degree of this effect varies strongly by brand or category (Mulhern and Leone 1991). Related to overall store sales, the promotional bump hence consists partly of incremental sales from the promoted brand but partly also of sales from the complementary products (net of less sales for the substitutes as previously discussed).

Another particularity of the sales bump is that sales in promotional periods can not necessarily be attributed to the regular and established customers a store, as promotions affect the customers mix visiting a store (e.g. more cherry pickers, less repeat purchases). Understanding the impact of the promotion on the customer group, will be important when discussing the long-term impact of price promotions (Anderson and Simester 2004).

#### 2.3.1.2 Post-promotion Dip

The post-promotion dip or the questions whether “there is a trough after the deal” (Blattberg et al. 1995, p. 127) is one of the central topics in short-term promotional research and closely related to the previously discussed “*sales bump*”.

When discussing post-promotion dips, this section focuses on four core questions:

1. Do post-promotion dips really exist (and what is the post-promotion dip paradox with regards to store-level data)?
2. What causes post-promotion dips?
3. What influences the degree of post-promotion dips?
4. What is the role of post-promotion dips for Uniform Across the Board Promotions?

#### Do Post-promotion Dips Really Exist?

The existence of post-promotion dips have among others been empirically shown by Gupta (1988) (*also discussed in paragraph on sales bumps*), who has decomposed the sales increase during a promotion and has found that 14 % of it is due to purchase acceleration, while 2 % is due to consumers buying more during a promotion (stockpiling). Hence 16 % of the promotional sales increase would be at

the expense of other period's sales. Others such as Grover and Srinivasan (1992) find this effect to be up to 25 %. While Bell et al. (1999) on average find a similar degree (26 %) for sales being shifted from non-promotional to promotional periods, they observe a wider range of results among the 13 product categories they have observed (6–51 % of sales increase were attributable to stockpiling or purchase acceleration) (Bell et al. 1999; Grover and Srinivasan 1992; Gupta 1988). These findings support earlier research, which shows that consumers are doing sophisticated planning of purchases and adjust their buying behavior accordingly (Blattberg et al. 1981; Krishna 1992).

Even-though above research has found evidence for post-promotion dips in household-level data, earlier results analyzing store-related data is mixed. In addition to the above mentioned research from Neslin et al. (1985) as well as Jain and Vilcassim (1991) have found a dip following promotions, while Vilcassim and Chintagunta (1995) have found no trough.

Interestingly, Grover and Srinivasan (1992), who had found acceleration effects on household level data, have not found any effects on store-level data. Understanding this paradox and showing post-promotion effects also for store-related data, which is the type of data more managers base their analysis on (Bucklin and Gupta 1999), is important, in order to understand, whether the acceleration and stockpiling phenomenon really exists (on an aggregated basis). Neslin and Schneider Stone (1996) provide arguments, why post-promotion dips might not be observed in store-level data and why even the observation in household-level data might be complicated.

Later research addresses some of those issues, by adjusting the methodology to account for several of those factors hiding post-promotion troughs. Van Heerde et al. (2000) introduce three possible models, with which even complex post-promotion dips can be detected (see Chap. 4 for more details). These results are supported by later research from van Heerde et al. (2004), Macé and Neslin (2004) and van Heerde and Bijmolt (2005) who all find post-promotion dips in store-level data.

### What Causes Post-promotion Dips?

Post-promotion dips could occur due to purchase acceleration, which can assume two forms: consumers buying *more* during a promotion ("*stockpiling*") or them buying *earlier* i.e. shortening inter-purchase time. Neslin et al. (1985) have found that purchase acceleration is more often shown through stockpiling than through shortened inter-purchase time (e.g. Blattberg et al. 1995; Macé and Neslin 2004; Neslin et al. 1985).

### What Influences the Degree of Post-promotion Dips?

The effectiveness of promotions and also the degree of acceleration and hence post-promotion dips can vary according to different product, category, promotion, store and customer characteristics (see e.g. Bell et al. 1999; Hoch et al. 1995; Macé and Neslin 2004). Related to product and category characteristics, post-promotion dips are greater for higher value and more established products with a higher general market share, which is explained by Macé and Neslin (2004, p. 346) as consumers “use promotions to ensure inexpensive supply (and consumption) of their favorite brands”. Furthermore the storability of products and general selection within one product category (availability of different sizes) are positively related with the size of post-promotion dips (Macé and Neslin 2004). For products or categories with higher inventory holding costs and lower stock-out costs, consumers tend to hold fewer inventories, causing smaller sales bumps and also smaller post-promotion dips (Gönül and Srinivasan 1996).

Under the term *promotion characteristics*, the type of price promotion, advertising support and the general promotion schedule of a retailer, category or brand is summarized. Advertising of price cuts can increase quantity purchase and decrease inter-purchase time (i.e. accelerate purchases), leading to stronger post-promotion dips. Coupons also cause post-promotion dips, while those are smaller than those for advertised price cuts, as purchases are generally not accelerated through coupons (Neslin et al. 1985).

Krishna et al. (1991) have found that consumers form expectations on the future availability of coupons and promotions, which influence their purchase behavior. Results on the impact of predictability of promotions on the post-promotion dips are mixed. More frequent promotions have according to Macé and Neslin (2004) a positive impact on post-promotion dips as the consumer may learn to stockpile and decelerate purchases (deal-to-deal buying), which is contrary to earlier research, in which less predictable promotion schedules lead to the notion that there is a need to stockpile in order to make it to the next promotion (and ensure low cost availability of the product) (Meyer and Assuncao 1990). A possible explanation for this is, that consumers are conditioned to “lie-and-wait” for even more attractive promotions (Jacobson and Obermiller 1990; Mela et al. 1998) and that the two possible effects, stockpiling only during promotions and foregoing promotions hoping for more attractive ones, lead to the mixed empirical results.

Regarding customer characteristics especially older customer with bigger families that possess a car cause the largest post-promotion dips (Macé and Neslin 2004). One potential reason is that the availability of a larger car decreases inventory costs while bigger families might increase stockout costs, which would then be in line with the findings of Gönül and Srinivasan (1996). Customer loyalty does not necessarily lead to higher post-promotion dips, as findings have shown that this depends on the product category (Neslin et al. 1985).

### What is the Role of Post-promotion Dips for Uniform Across the Board Promotions?

As for traditional promotions, post-promotion dips decrease the net effectiveness of UABPs. There is no evidence, why the mere existence of post-promotion dips should be different than for traditional promotions, while the degree, to which they occur, could be affected by the breadth of the promotion. The claim that “every article is discounted” could increase the predictability of the promotion or rather the predictability of finding the desired article on promotion. Consumers could hence as per Macé and Neslin (2004) learn to stockpile and decelerate purchases, especially when frequently confronted with UABPs. Due to the generally higher predictability (of finding the desired article on promotion) of UABPs compared to traditional promotions, the post-promotion dip should be larger. This deal-to-deal buying for UABPs which is favored by the storability of goods will be closer analyzed in Chap. 3, using a dataset from a value fashion retailer.

#### 2.3.1.3 Pre-promotion Dip

Even though the marketing literature has covered post-promotion dips i.e. anticipatory effects of promotions as early as the late 70s, pre-promotion dips or deceleration is not as well studied. Doyle and Saunders (1985) have been among the first, to stress the importance of lead effects when evaluating sales promotions and have found that those lead effects can be as important as lagged effects.

The marketing literature shows, that consumers form price expectations. When consumers anticipate marketing changes, e.g. if they expect significantly lower prices in the future, they react by adjusting their behavior and potentially deferring their purchases which will cause a pre-promotion dip (Kalwani et al. 1990; Winer 1986; van Heerde et al. 2000). Gönül and Srinivasan (1996), conducting research using house-hold level data for disposable diapers, find that consumers might defer purchases when they expect a coupon or promotion to be available in the next period. The likelihood of the deceleration and hence also the degree of the pre-promotion dips depends on the level of stockout-cost. When there is sufficient inventory and stock out costs are comparably low (e.g. when there is a reasonable substitute for a good), the purchase probability in a pre-promotion period decreases further.

Furthermore consumers assign a higher probability to coupon and promotion availability if there is no coupon available in the current period (Gönül and Srinivasan 1996). Mela et al. (1998) have found in household panel data for frequently purchased non-food products, that the formation of expectations is further influenced by the number of promotions. An increased availability of promotions (promotion rate) lets consumers decrease their baseline purchases in non-promotion times, as they expect to be able to purchase at even lower prices in the future. This holding-out further contributes to the existence of pre-promotion dips. In line with their findings when analyzing store level data for the existence of

post-promotion dips, van Heerde et al. (2000) also find that pre-promotion dips exist.

As for their work on post-promotion dips, Macé and Neslin (2004) have found that pre-promotion dips are larger for frequently promoted products that have a higher share of wallet for the consumer. Moreover, they have found that storability and availability of different sizes has a positive impact on pre-promotion dips. Pre-promotion dips are further negatively correlated with age and income, which are the only relevant demographic effects for pre-promotion dips. As for post-promotion dips the degree to which pre-promotion dips exist for UABPs will be further discussed in Chap. 3.

### ***2.3.2 Permanent/Long-Term Effects of Price Promotions***

As stated earlier, the original Uniform Across the Board Promotions have been very successful in increasing short-term sales for the DIY retailer Praktiker. However they proved less efficient in the long-run and even worse, various experts claim that UABPs have caused severe problems for the retailer.

When assessing whether a certain type of price promotion campaign is beneficial for a retailer, it is hence critical to also understand the permanent effects on sales and consumer behavior. Specifically it is important to understand three interdependent areas of promotional impact. (1) whether the impact promotions have on sales and purchase incidence changes over time, (2) whether consumers become more price sensitive over time, which also affects their non-promotional buying behavior. This chapter will first review the literature on permanent effects on sales and purchase incidence and second discuss the impact price promotions have on brand or store loyalty. Last past research on how promotions affect the long-term price sensitivity and hence likelihood to stockpile of consumers is being reviewed. These topics give a direction, on how UABPs likely influence the expected mid-term sales bump, potential adjustment effects as well as consumer's attitude towards a brand or retailer and subsequently their long-term behavior. All aspects will be specifically discussed for UABPs in later chapters of this thesis (see Chaps. 4 and 5).

#### **2.3.2.1 Impact on Long-Term Baseline Sales and Purchase Incidence**

Overall the research on the long-term effects of price promotions is an area which according to Blattberg et al. (1995) is “the most debated in the promotional literature and one for which the jury is still out” (Blattberg et al. 1995, p. 127). The starting point in this discussion is what can be considered as “long-term”, noticing, that the definition of long-term effects and adjustment effects are often quite similar. Mela et al. (1998) define long-term promotional impact as “the cumulative effect of previous promotional exposures (over quarters or years)”

(Mela et al. 1998, p. 250), while Dekimpe et al. (1999) find in their research, that long-term effects on sales can be defined as mostly stationary effects. Stationary effects assume that lagged effects exist but sales will eventually return to their pre-promotion mean, i.e. sales cannot be permanently affected by promotions (Dekimpe et al. 1999). When discussing the long-term impact on sales in this thesis, both a long-term non-reverting mean effect on sales and consumer behavior (Mela et al. 1998) will be discussed as well as a more mid-term adjustment effect that might eventually prove to be mean reverting (Dekimpe et al. 1999). The empirical evidence on whether long-term promotional effects exist is however regardless of the definition of the time-frame, mixed.

### Long-Term Negative Impact of Promotions on Baseline Sales

The theoretical background sits close to the before mentioned prospect theory (Kahneman and Tversky 1979), adaption-level theory and the concept of reference prices. The reference price theory suggests, that (noticeable) promotions should have a negative impact on longer term (non-promotional) sales, as consumers get used to a lower price and hence expect to purchase at this price in the future (e.g. Greenleaf 1995; Jacobson and Obermiller 1990; Lattin and Bucklin 1989).

Depending on the type of promotion the promotional gain is separated from the price in a different mental account (Mazumdar and Yun 1993). Non-price promotions (e.g. lotteries) are booked as a separate gain, whereas price promotions are combined with the respective price and are booked as a loss reduction (Diamond and Johnson 1990). Only the later influences the reference price for a product. For UABPs, the discount is not directly applied to the product but rather as a bonus on the check-out on the entire basket, which is why it would be unclear, whether this would be considered as a direct gain or rather a loss reduction. For price promotions, an increased promotional exposure decreases the reference value for the product category during non-sales periods and hence the difference between category value and reference value increases which reduces the likelihood of category purchase incidence (Bell and Bucklin 1999).

According to Kalwani and Yim (1992) the promotion frequency and the depth of price discounts have a significant effect on the price expectations of consumers. They have found that frequent and sizeable promotions change the reference price, while infrequent or small, i.e. only around the current reference price, do not change price expectations of the consumers (Kalwani and Yim 1992). Frequency is hence important for promotions as they are a moderator in the degree to which promotions might change the reference price of the consumer. Reducing the once introduced frequency of promotions can have a negative effect on market shares as the net price to consumers is increased (Ailawadi et al. 2001).

In addition to the reference price concept discussed above, future price expectations or expectation about coupon availability also make consumers defer purchases to subsequent periods (Gönül and Srinivasan 1996), which is why the effect a long-term promotion exposure of a household has on purchase incidence is

significantly negative (Mela et al. 1998). These findings are in line with earlier research that has found that promotions have a negative effect on long-term consumer behavior, i.e. purchase probability (Blattberg and Neslin 1990). During promotions, the average quantity bought increases, which affects future incidence rates and provides further evidence to the “sit and wait” attitude induced by promotions, that negatively affect long-term baseline sales (Mela et al. 1998).

### Long-Term Positive Impact of Promotions on Baseline Sales

A second stream of research however suggests that promotions make consumers buy more and consume faster, which indicates a positive long-term impact (Ailawadi and Neslin 1998). While Blattberg and Neslin (1990) had found an overall negative impact, they recognize in line with learning theory, that promotion-induced trial purchases, or trial visits to retail stores, might increase familiarity with a brand or store and result in future repeat purchases, which would have a positive long-term impact (Blattberg and Neslin 1990). This is in line with research stating that promotions can be used to shape brand loyalty, which increases repeat purchases and hence baseline sales (Rothschild and Gaidis 1981). However as the self-perception theory suggests, consumers who have bought during promotions are likely to attribute the purchase to the presence of the promotion rather than their actual brand or retailer preference (Dodson et al. 1978).

### Long-Term Neutral Impact of Promotions on Baseline Sales

Dekimpe et al. (1999) are among a group of researchers who argue that permanent effects of promotions do not structurally change the overall baseline sales of a brand or retailer and even if such effects exist for selected categories, they are usually very small (Dekimpe et al. 1999; Lim et al. 2005; Nijs et al. 2001). However the composition of sales, i.e. how much is bought at what point in time might be affected, as Mela et al. (1998) argue that customers will buy more at fewer occasions. This has been reiterated by Pauwels et al. (2002) who see the issue in measuring net impact in the different promotion induced effects cancelling each other out. In line with previous research, they argue that there is a negative impact on incidence and a positive one on quantities, which is why long-term impact has been difficult to measure in articles that can be stockpiled. In case that this argument holds, promotions can in the long-run be attractive for brand managers as consumers stay out of the market for competitive products—but also out of the market for other complements (which is bad for the retailers)—given the reduced frequency of shopping trips (Bell et al. 1999).

### Summary of Impact of Promotions on Baseline Sales

As stated initially, one cannot definitely conclude whether promotions have a long-term effect on baseline sales, nor can one pass judgment on the direction such an effect would have. While overall more literature exists, suggesting negative long-term effects of promotions, various studies find positive or negative effects for one product category, which does not hold for other categories. For example the positive effect from promotion-induced repeat purchases (Blattberg and Neslin 1990), would be small or non-existent for mature categories and would only likely occur for new product categories or customers new in an area with different retail stores (Gijbbrechts 1993; Mela et al. 1997).

Overall the conclusion is that one has to (1) carefully analyze the type of price promotion run (*see detailed discussion on UABPs*), as well as the extent (depth and frequency) to which it is run. These factors impact the search costs for the consumer as well as the possibility to anticipate the promotion and the likelihood of a change in reference prices. Furthermore, the (2) category characteristics and (3) customer characteristics will have to be considered to pass a definite judgment on whether a promotion campaign has an impact on the future baseline sales of a brand or retailer.

#### 2.3.2.2 Impact on Promotion Sensitivity and Promotion Effectiveness

This chapter discusses whether the long-term exposure to price promotions has an impact on the customer's decision to act on future promotions, i.e. whether their promotion sensitivity increases. Derived from the reference price theory, the general concept of consumers comparing an observed price to a reference price holds for regular sales periods (baseline sales) and promotional periods. The delta between those two prices is the perceived value for the consumer. If increased promotions lower this reference price and hence the price delta, even a lower price observed during promotions, is less "special" than it might have been if no previous promotions had been run. This reduces the purchase probability also during promotions and hence increases promotion sensitivity (e.g. Helson 1964, Sawyer and Dickson 1984).

As stated above reference prices are not just influenced by the absolute amount of a promotion (see Sect. 2.2.1 Prospect theory/reference prices) but also by the frequency of a promotion. Krishna et al. (1991) have found that consumers are good in assessing the frequency of regular promotions. This finding is important as empirical research has found that the impact of a promotion is significantly larger, if the promotion is unexpected (Kalwani and Yim 1992; Lattin and Bucklin 1989).

Empirical research supports this theory, as Mela et al. (1998) find, that in the long-term an increased use of promotions makes consumers more promotion sensitive, which means that consumers are less likely to react on a promotion as they "sit and wait" for an even better deal to come by. This is in line with Gönül and Srinivasan (1996), who find that also as a function of current consumer inventory

levels, consumers might forego current promotions if they expect to receive future coupons that give them the same or even higher promotional benefits (Gönül and Srinivasan 1996). This entire line of research suggests that if consumers can form a view on future promotions, they might adapt their future shopping behavior accordingly, making promotions less effective. It is hence important to make promotions, or specifically Uniform Across the Board Promotions, as random as possible.

### ***2.3.3 Summary of Theoretical Background and Literature Review and Outlook of Research Contribution***

The focus of this was on two general topics: First, is the discussion of the theoretical background (Sect. 2.2), that sets the basis for many of the hypotheses developed in Chaps. 3, 4, and 5. The second focus was the review of existing pricing literature (Sect. 2.3) to introduce and position UABPs accordingly and put the later results into context. The research described in Sect. 2.2 are mostly findings based on experiments carried out in various fields of research, while Sect. 2.3 consists mostly of empirical studies that are based on relatively large data samples, mainly in the FMCG category and based on individual brands/categories.

The theoretical background (Sect. 2.2) dealt with four core concepts of which the highlights will be recalled in this paragraph:

- Prospect theory and reference price concept (Sect. 2.2.1): Which states that consumers compare prices to an internal or external reference price. Subject to the deviation of the observed price and reference price, the consumer forms a view on whether she likes an offer or not. This reference price can change when the consumer is confronted with promotions or the UABP.
- Price search and transaction costs (Sect. 2.2.2): This theory that stems from the field of microeconomics, suggests, that a consumer continues to look for a cheaper price, as long as the search costs are lower than the expected savings from finding a better deal. Expanding this to transaction costs states that consumers are making trade-offs between higher transaction costs and a potentially lower price. This becomes relevant, when the flexibility and breadth of UABPs will be discussed.
- Behavioral learning (Sect. 2.2.3): A concept from the field of social psychology which discusses whether consumers learn to adapt their behavior if repeatedly being confronted with a similar stimulus. A concept very relevant for the evolvement of the consumer's behavior and long-term impact of UABPs.
- Attribution theory (Sect. 2.2.4): This theory also has its background in social psychology and claims that individuals try to explain the causes for certain observed behavior and events, which will become relevant when discussing whether the UABP might change the attitude consumers have towards a retailer (Chap. 5).

In addition to the theoretical background, the literature review (Sect. 2.3) focused on how promotions influenced the short-term purchasing behavior (Sect. 2.3.1), specifically whether sales bumps are being caused by promotions and how promotions affect store choice, category choice or brand choice. Furthermore the adjustment effects around any potential sales bumps have been discussed, i.e. whether consumers adopt their purchase behavior through stockpiling and anticipation (Sect. 2.3.1.1)—both short-term and adjustment effects will be separately discussed for UABPs in Chaps. 3 and 4. The literature review concludes with discussing any potential long-term effects that might arise from promotions (Sect. 2.3.2) and that will be touched upon in Chap. 4.

The literature review mainly discusses the impact traditional promotions have on store sales and consumer behavior, while up to this point no study has particularly addressed the impact of Uniform Across the Board Promotions, which is a field that will be addressed by this study. Specifically the following three chapters will deal with this and related questions:

- Chapter 3: What is the impact of UABPs on the short-term sales performance of a retailer? In which type of stores and locations do they work best and how does this compare to other types of promotions?
- Chapter 4: How do UABPs affect any potential adjustment effect, i.e. do they cause pre-and post-promotion dips and what is their impact on the long-term sales performance of a retail store?
- Chapter 5: What are the antecedents of UABPs on a household-level, i.e. what type of consumers are more or less likely to shop during UABPs? Apart from impacting sales—what else is impacted (e.g. customer satisfaction and loyalty) and do households change their purchasing.

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