

# Discounts and sales don't always mean more profits for retailers and manufacturers

June 8 2005

---



Every week you see it: the local supermarket's specials include a discount on Brand X tuna fish. Common knowledge assumes that a sale on tuna fish will induce more people to buy Brand X, which boosts profits for both the manufacturer and the grocery store. However, a recent study by professors in the Olin School of Business at Washington University in St. Louis has found that discounts are not always in the best interest of the retailer or manufacturer. In fact, some promotions may end up hurting future profitability.

"Three things tend to happen to customers when an item goes on sale," said Chakravarthi Narasimhan, the Philip L. Siteman Professor of Marketing at Washington University in St. Louis, one of the study's

authors. "I could buy and consume more of Brand X; I could see the promotion and switch from Brand A to Brand X; or I could buy more Brand X and stockpile for future use."

By studying the tuna purchasing habits of 1,000 households over a two-year period, Narasimhan - along with Tat Chan, assistant professor of Marketing at Washington University in St. Louis and Qin Zhang, assistant professor of marketing at the University of Texas - Dallas, found that consumer behavior depends on whether or not a customer is brand-loyal and on what kinds of promotions he or she expects in the future.

"Both brand-loyal customers and brand-switchers consume more of Brand X tuna when it's on sale." Narasimhan said. "Increased consumption is a desirable result since it means sales of that brand have increased during the week of the promotion, which of course means higher profits."

But discounts can also trigger a different reaction from brand-loyal customers. When these consumers believe that a price reduction is temporary, they'll stockpile Brand X tuna for future use. Since stockpiling also results in increased sales, one would assume that it's good for the retailer, Narasimhan said. However, stockpiling ends up cutting into future sales and profits. Such promotions not only subsidize the current purchases of these loyal customers but also subsidizes their future purchases.

"If I sell 100 units and the majority of it is being stock-piled for future use, that might be good for that week's sale, but it cuts into my future profits," Narasimhan said. "But if it's only a smaller percent that's stock-piled and the rest is bought by brand-switchers, then that's good because I did manage to increase sales."

Manufacturers and retailers both need to rethink how they promote products, Narasimhan said. In general, firms need to reconsider how to reward loyal customers by providing them with better value rather than merely through a discount. The trick is to compete aggressively on price while providing a compensating value to the most loyal customers. Promotions could be done on the forms and sizes of products that are not commonly favored by the most loyal customers. Loyal customers could be rewarded for increasing their consumption or for continuing their patronage by having them send proof-of-purchases in return for future discounts or for some other related and valued products and services.

Narasimhan points out that these patterns of consumer behavior are probably applicable to most non-perishable items. However, it wouldn't make sense for customers to stockpile yogurt, for example, but a special on yogurt could increase consumption. At the same time, a sale on toilet paper probably wouldn't result in increased consumption, but it could encourage stockpiling. The researchers are currently studying other product categories to confirm their findings.

Source: Washington University in St. Louis (By Shula Neuman)

Citation: Discounts and sales don't always mean more profits for retailers and manufacturers (2005, June 8) retrieved 20 April 2024 from <https://phys.org/news/2005-06-discounts-sales-dont-profits-retailers.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.