Frequent price promotions threaten quality brands, study shows

December 8 2008

Frequent price cuts can have a major adverse effects on brand equity, even for well respected brands, according to a study published in a journal of the Institute for Operations Research and the Management Sciences (INFORMS).

"A Dynamic Model of Brand Choice When Price and Advertising Signal Product Quality" appears in the current issue of the INFORMS journal Marketing Science. The study is by Tülin Erdem of NYU; Michael P. Keane of the University of Technology Sidney, Australia and Arizona State University; and Baohong Sun of Carnegie Mellon University.

Recurring price promotions that reduce the perceived average price of a brand can feed back and adversely impact perceived quality. Simulations of the authors' model imply that approximately one quarter of the increase in sales generated by a temporary price cut represents cannibalization of future sales due to the brand-equity-diluting effect of the promotion.

The authors tested quality with Nielsen scanner data for ketchup brands. "It may seem unglamorous," the authors write, "but this category is well suited to the analysis. One dominant brand (Heinz) is generally perceived as being high quality. It is also higher priced and has substantially higher advertising expenditure than its name-brand competitors, Hunt's and Del Monte. In fact, the lowest-priced name brand (Del Monte) does not engage in any TV advertising. Thus, there is scope for consumers to use price and ad expenditures as signals of quality in this market."

The model sheds light on the importance of different information sources in influencing perceived quality.

For instance, the authors predict that a 10% permanent price cut for Heinz would increase sales by 26%. But if the price cut could be implemented without reducing perceived quality (and, hence, brand equity), the increase in sales would be considerably greater – 32%.

The implications of the authors' results would be much more pronounced in high-end product categories. For example, a Cunard Line promotion that employed aggressive push strategies reducing fare prices by half before Queen Elizabeth 2 left port could severely damage Cunard brand equity.

Whether the brand is Cunard, BMW, or a similar company, high-end brands will be better off if they target price promotions at micro-levels rather than through generic price reductions; integrate sales promotions in a consistent manner with the rest of their communications; and refrain from using price promotions frequently.

In their paper, the authors develop a structural model of household behavior where there is uncertainty about brand attributes, and both price and advertising signal brand quality.

The authors maintain that four quality signaling mechanisms are at work: (1) price signals quality, (2) advertising frequency signals quality, (3) advertising content provides direct but imperfect information about quality, and (4) consumer experience using a product provides information about quality.

They show that price is the most important signal of brand quality. The role of advertising frequency in signaling quality is also significant, but less important quantitatively.

Source: Institute for Operations Research and the Management Sciences