How to grow a premium brand without killing its cachet? Outlet stores can help

July 12 2017

Credit: Institute for Operations Research and the Management Sciences

Managers of premium brands face a perennial dilemma. How do you grow a premium brand without killing its soul - the unique brand cachet that attracts its core high price paying customers - even as you seek to expand sales to the masses by offering lower prices? In recent years, outlet stores located hours away from glitzy shopping districts, selling off-season and lower tier merchandise at a fraction of regular retail prices, have proliferated and become significant sources of revenues. The conventional wisdom is that relying on revenues from outlet stores can destroy the brand's cachet over time. But according to a forthcoming

study in the INFORMS journal *Marketing Science*, a leading scholarly marketing journal, outlet stores may actually help improve the brand's cachet.

The study, "Why outlet stores exist: averting cannibalization in product line extensions," was authored by Donald Ngwe of Harvard Business School.

Ngwe analyzed five years of customer sales data covering over 16 million customers and 27 million transactions from a major U.S. high end fashion firm with hundreds of regular and outlet stores around the country. He found that the brand's core customers are picky about wanting the latest products and are willing to pay premium prices, but are unwilling to travel very far to buy the brand. In contrast, the larger mass of customers who aspire to consume this brand, but are price sensitive, are not only willing to travel the long distances to outlet stores, but are also not very picky in their tastes for the latest products and willing to tolerate lower quality. Therefore outlet stores expand revenues with limited cannibalization of revenues from the core high paying customer base.

Taking into account this strong negative correlation between taste for quality and new products and willingness to travel for shopping among the core and mass segments, Ngwe modeled the firm's product introductions in regular and outlet stores. He found two key results. First, the availability of outlets for selling older products to mass consumers means that firms can take more risk and introduce more new products at faster rates at its regular stores. Second, as outlet stores absorb the customer base of price conscious customers who need less service, the firm can invest in greater service at regular stores. New product introduction at regular stores increases by as much as 16 percent. Ngwe said, "Here is the kicker. Even as outlet stores generate significant revenues from the masses, they help the brand increase its cachet among

its core customers through more new products and higher service."

The conventional wisdom that outlet stores can be detrimental to a premium brand's health arises from failing to recognize the positive spillovers from outlet stores on regular retail stores. Ngwe noted, "For the brand we studied, there is little cannibalization of regular store revenues by outlet stores. Moreover, outlet stores have positive spillovers in terms of higher service and more frequent new products in regular stores. So the net effect of outlet stores is to increase brand cachet."

However, Ngwe cautioned, "Critical to our conclusion is that core customers would not shop at outlet stores due to their aversion to traveling long distances. This may not be true for customers of other brands, particularly lower end ones. Also, pure online brands cannot use travel distances to separate their core and mass customer segments. Online premium brands will need to find other means to differentiate their upscale and mass offerings."

More information: Donald Ngwe. Why Outlet Stores Exist: Averting Cannibalization in Product Line Extensions, *Marketing Science* (2017). DOI: 10.1287/mksc.2017.1031

Provided by Institute for Operations Research and the Management Sciences

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