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The Promotion Paradox: Avoiding the Discount Trap

In the fight for shelf space, although a short-term sales boost through a discount strategy may seem tempting, often it is likely to do long-term harm to the brand. In the face of competition, there is a better way to enforce pricing strategies and maintain profit margins, as the author explains. Oskar Toerneld is VP Pricing and Portfolio Solutions with SKIM, an international research firm specializing in pricing, price promotions and customer decision behaviors. They can be reached via www.skimgroup.com. This article was originally published in "Campaign" Asia.

In the face of competition, CPG brand managers can easily fall into a 'discount trap.' What seems like an easy appeal to price-sensitive consumers can quickly become a slippery slope. Instead, brand managers should ask themselves which strategies will drive market share, not only in the short term but also over the long haul. A short-term sales boost can actually wind up being detrimental to a brand's financial health, and certain pricing promotions perform better with fewer side effects.

Better promos, fewer long-term side effects

When it comes to products that consumers buy regularly, such as food, household, personal care and other staple supermarket items, there are two basic types of promotions:

- Explicit discount on a product as a percentage (e.g. 15 percent off) or a direct monetary price reduction (e.g. $2 off)
- An offer of a larger "value" pack, or a BOGO (buy one, get one) promotion

A meta-analysis of recent pricing studies reveals the short-term and long-term effect of these two types of promotions, and the conclusions are clear. The discount strategy is effective at generating short-term benefit. When products are offered with an explicit discount, one does get the highest share boost, and that is certainly good for cash flow. However, in the long term, most brands end up worse off.

Here's why:

1. Discounts often trigger a price war
Price discounts educate the buyer to focus on the lower price of the product, and this negatively impacts the perceived value. Consumers become more price sensitive and cost conscious. They no longer evaluate the brand on its own merits. Instead they gravitate to the cheapest product. This will eventually lead to a form of price war, and that is something all producers want to avoid.

> Effective alternatives to discounts include larger packs and BOGO (buy one, get one) promotions.

2. Trial and repeat?
Brands offer discounts in order to capture more permanent market share, but does it work? **Ideally, once a consumer has been lured by a trial discount, one hopes they will return at the full price when the promotion is over. In reality, this is not often the case.** Many consumers simply move on to the next competitive offer in pursuit of the lowest price at all times.

3. Loyal customers are already loyal
Price promotions encourage consumers to stockpile products—particularly personal care items that don't expire quickly—whether they are a new user or an existing loyal user. In this scenario, the ultimate effect of a price promotion comes at the expense of future revenue from loyal customers who were already willing to pay full price.

A better way to build loyalty

If a brand is losing market share or entering a new market to gain market share, it should not be shortsighted. Effective alternatives to discounts include larger packs and BOGO (buy one, get one) promotions. These lead to more consumption without devaluing a product, because the promotion is implemented indirectly. Inevitably, increasing the size or volume of a product (e.g. four more dishwasher tablets or 50ml of extra shower gel) leads some consumers to stockpile—but at less cost to the brand's present and future bottom line. Because they buy more, they have more time to become loyal to the brand, and the chance of a repeat purchase is increased.

In today's fight for shelf space, it's tempting to discount, but the first question should always be: Does this strategy really help build the long-term strength of the brand? If the answer is "no," don't do it.