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## **RETAILER PRICING STRATEGY: DIFFUSE COUPONS EFFECTS CONTINGENT ON STORE FORMAT**

### **Abstract:**

Retail promotion strategies have become an increasingly prominent topic of research due to innovations aimed at helping the management attract customers to their online and offline sales channels. Various promotional and technology tools are being tested to select the ones that will facilitate multi-channel sales. Stores no longer use the model “the same price for everyone” because sophisticated marketing software enables pricing to be tailored to customers with a view to keeping them engaged. Special offer and discount coupons (i.e. POS coupons, FIS and e-coupons) have become a vital part of the retail pricing strategy and a widely used promotional tool in which retailers invest significant marketing resources to create a competitive effect. The paper sets out the concept of promotion pricing and identifies the role of diffuse promotional coupons designed to help retailers attain their marketing and profitability goals. An empirical analysis is performed to determine the effects of coupons in a dynamic Every-Day-Low-Prices (EDLP) strategy employed by a large retail chain using a customer basket records. A univariate statistical analysis (GLM) is carried out to analyse cart data from nearly 25,000 transactions recorded in the course of one year in seven stores. The results of the analysis reveal the effects of most common three types of coupons on basket operational profitability in different store format context. The empirical results obtained from this research and insights gained into the effects of this type of promotion can help retail managers form reasonable expectations regarding the introduction of coupons in retail chain organizations.

### **Keywords:**

retail; pricing strategy; promotional coupons; basket margin; store format

**JEL Classification:** M30, D12

## Introduction

Customers today are more eager and inventive in search of more advantageous and better deals owing to the increasing use of the Internet and mobile technologies in the process of selecting, ordering and purchasing products and services. They are looking for distinctive products and deals, and are finding ways to acquire them on economical way at the best price possible. The main factors in attracting customers to stores are prices and promotions (Kopalle et al, 2009). However, deciding on these is a challenging task for retailers knowing that they have to consider the profitability of promotions (Neslin and Shoemaker, 1983), the impact on their image, customer loyalty, sales and competitors' offer (Lal and Rao, 1997). The strengthening of price competitiveness among retailers affects the development of new pricing and promotional strategies in which CRM systems play an important role.

Today, retailers are using a wide range of promotional tools to generate frequency and increase customer basket value. One of the popular and widespread methods used by retailers to attract customers to stores promoting a certain article, category or brand is by giving away coupons that provide a variety of benefits and advantages for customers (see Walters and Rinne, 1986; Swaminathan and Bawa, 2005; Jung and Lee 2010; Su et al, 2014; Kumar and Rajan, 2012). By obtaining and using coupons, customers can get discounts, i.e. obtain direct financial benefit, or get a free sample or a complimentary service. Recently, multi-channel environment has become an increasingly attractive context for coupon distribution and redemption.

Promotions have a positive marketing effect because they attract customers and drive sales; however, they also create a negative impact on the margin which consequently affects the category and store profitability on the whole. Operational efficiency and competition vary across different store formats, and more often than not, also intra the same store formats (Dekimpe et al, 2010) causing variance in the pressure on the prices, margins and profitability. Anderson and Song (2004) find that coupon marketing efficiency increases when there is a lower retail price. Some retailers have decided to introduce discount store formats in their retail network in order to achieve price competitiveness without compromising other store formats in their portfolio. According to Pandey and Maheshwari (2016), among a plethora of couponing research, the majority of papers focus on coupon design, redemption and the impact on sales increase, whereas only a few of them deal with profitability.

To avoid costly profit-eroding discounting practices, retailers have to take a different approach to pricing and promotions. A study by Nielsen (2015) indicates that 59% of all global promotions do not break even. For instance, 61% of promotions in France, 52% in Spain, 46% in Italy, and 45% in Germany are not profitable. If one looks at the profitability of promotions by category, the study shows that, for example, promotional management in Germany shows the lowest performance in food categories (as much as 58% of promotions do not break even), while homecare is the best performing category (only 28% of promotions are not profitable). The problem is that the lowest-ranking categories are those whose sales volume is the highest.

Every Day Low Price (EDLP) retail price promotion strategy involves offering consistently low prices on many brands and categories to give the impression of constant discounts (Span et al, 2015). This strategy is mainly used by hypermarkets and supermarkets, as well as other store types, which makes it very attractive in a dynamic pricing environment (Grewal and Roggeveen, 2011). Large stores require a much greater coordination of promotional activities which, expectedly, provide greater benefits. The possibilities for and the intensity of the implementation of promotional activities depend on the margin that represents the main limitation to the extent of price cuts (Sivakumar, 1995). Thus, the effect of promotion depends on the level of prices and store format. The management seeks to create a promotional context in which the customer is provided with an opportunity to use coupons in online or offline store formats without any restrictions. Coupons with such features can be described as diffuse. The question arises as to the effect of diffuse coupons on the basket margin of some of the common retail formats. The aim is to investigate whether there is a statistically significant difference in the effect of a particular type of diffuse coupon depending on the format of the store in which redemption takes place. This can help marketing managers in making couponing decisions because, in addition to the positive impact, an undesirable negative impact on margins can be created in some store formats with low prices. Different sizes of store formats are associated with different prices, margins, competitors (Dekimpe et al, 2010), consumer preferences (Rootman, 2016), loyalty (Sällberg, 2013; Dunkovic and Petkovic, 2015), and basket value (Ziliani and Ieva, 2014). The paper describes the effects of coupons, develops a research hypothesis and conducts empirical research into the effect of coupons in different retail formats.

### **Effects of coupons in retailing**

The advancement of technology and changes in lifestyle have paved the way to new coupon delivery vehicles such as mobile devices and applications (m-coupons) or the Internet (online or e-coupons) that facilitate coupon distribution and redemption (Nielsen 2015). BusinessWire (2013) reveals the results of GfK research which indicate that heavy digital coupon users (defined as the top 1/3 of redeemers) are among the most desirable shoppers, spending 50% more per shopping than average shoppers. In 2012, the digital coupon holders spent 42% more in supermarkets than the average shoppers. According to The Connected Consumer report, Planet Retail (2016) asserts that customers no longer think about where and how to use the available promotional prizes but rather about how to get them. This shows that customers expect to be given diffuse coupons and take them for granted, and therefore retailers have to adapt their promotional price strategies to an omni-channel environment in which a coupon can be redeemed in any of the existing channels.

Describing the situation in the retail market, Kantar Retail report (2016) states that e-coupon apps are becoming increasingly popular among the top 25 most valuable global retail brands (i.e. Amazon, Alibaba, Ikea, Lidl, Tesco, Carrefour), which, along with smartphones, are routinely used to compare prices, get information and make purchases. Retailers who want to improve the results of their promotional activities

have to face the reality of their current capabilities, processes, incentives and cultural capacity. Before distributing coupons, retail managers have to take several important decisions in order to make couponing effective. They must decide on the couponing vehicle, coupon face value, number of coupons to be distributed, price discounts and timing (Neslin and Shoemaker, 1983). Given that retail chains today often operate through many different formats, it is important to decide in which store formats customers will be able to redeem coupons and measure the profitability of the activity.

Coupons continue to be an important form of promotion for many consumer goods categories. Many consumers are also making good use of coupons to take advantage of discounts for dining out, going to the cinema or on an excursion. Previous studies have investigated customer affinity for coupons and ways of measuring it (Levedahl, 1988; Chiou-Wei and Inman, 2008), coupon attractiveness (Swaminathan and Bawa, 2005), profitability (Su, Xiaona, and Sun, 2014), and the behaviour of coupon users in online and offline channels (Jung and Lee, 2010). When a retail chain manager managing multiple different retail formats has to make a decision on what kind of coupons to offer to his/her customers, he/she takes into account, *inter alia*, the effect of coupons on the profitability of different stores and channels. Shopping goals vary across different retail formats and determine the structure of consumer basket and the amounts spent. Formats that offer products at lower prices, e.g. hypermarkets, are more sensitive to price cuts than supermarkets, neighbourhood stores or online stores. It is essential to investigate whether marketing management should limit couponing to certain retail formats to ensure profitability. Limiting the usage of a coupon to a specific location can have a negative impact on the store attractiveness and retailer brand.

Pricing is the key factor in managing profitability and attracting customers. As part of their marketing strategy, retailers must develop a model for pricing products and services to distinguish themselves over the long term (Walters and Rinne, 1986). The pricing strategy affects the positioning of the retailer in the market. The choice of pricing strategy is largely influenced by the store format. Pricing strategies (i.e. EDLP) that are common to food and consumer goods stores are far less frequently used by specialised stores. Some strategies are traditionally used for certain products (i.e. promotional pricing or HiLo).

The findings of research into the habits of mobile food shoppers presented at Omnishopper Conference 2016 in Chicago reveal that 47% of consumers use mobile devices, mainly before entering a store. One reason for using mobile devices is to search for coupons and download them. Since these methods of coupon distribution are increasingly used by shoppers, managers need to seriously consider adjusting their pricing strategies to such customer preferences and allowing free coupon use across channels. Omni-channelling changes the operation of loyalty programs which need to be operational across all channels. Loyalty programs usually consist of encouraging and rewarding customers for using the channel in which retailers have invested most and which, in their opinion, can bring them the greatest competitive advantage (Kopalle et al, 2009). The operation of loyalty programs is becoming

increasingly sophisticated because customers can now get a discount or benefits that are not available to other customers based on data stored on their loyalty cards scanned at a POS device, which is exactly why they value loyalty program membership (Dunkovic and Petkovic, 2015). Many large retail chains do not use loyalty cards, and even those that have traditionally been using them, have begun to include coupons in their marketing activities more and more often (Montgomery and Chester, 2009).

### **Hypothesis development**

This study aims to explore two major effects of couponing. Firstly, the aim is to determine how diffuse coupons with different distribution vehicles, face values and unlimited usage affect the margin. Secondly, the aim is to determine how the pressure on margins changes across different store formats (i.e. price levels), especially in an online format. Our target retail chain operates with a large number of stores and the management does not have a clear picture of the effects of a particular promotional activity on margins over a long term (i.e. 52 weeks). Coupons are more likely to appeal to buyers looking for discounts; however, it is important to understand how customers react to price cuts in a neighbourhood store in comparison to a hypermarket (Sivakumar, 1995). It is obvious that customers can get more out of their coupon if they use it in a larger store with greater range of products and lower prices. In these circumstances, it is to be expected that the consumer basket will be more valuable, and the coupon margin pressure caused by coupons will be lower. The justification for allowing customers to use the same coupon in a small store where the basket has a lower value lies in higher prices and margins.

Few authors (Dhar and Hoch, 1996; Venkatesan and Farris, 2012) have measured the effects and compared the profitability of coupons against the usual promotions with in-store price cuts. They have concluded that coupons are an effective promotional tool because they boost sales and profits. No study thus far has shown how margin changes as a result of couponing in different store formats. At the end of the coupon campaign, the management needs to assess its overall performance.

EDLP strategy enables greater price dynamics than other pricing strategies. In store formats that have a higher margin (i.e. supermarkets), the negative impact of coupons on profitability is smaller than in formats with lower margins (i.e. hypermarkets). It is necessary to adjust the value and quantity of coupons to individual customer profitability (Kumar et al, 2009) i.e. customer basket because otherwise the financial effect will be offset by the marketing effect. For example, personalized coupons distributed at checkout alter consumer behaviour and the optimal design of these coupons with respect to the product category, face value, expiration date, and so forth (Kopalle, et al 2009). A study undertaken by Walters and Rinne (1986) explores the role of loss leaders and double coupon promotions in three stores over 145 weeks using store traffic, store grocery sales, and store grocery profits as dependent variables. The study has found that consumers respond differently to different portfolios and formats.

Su et al. (2014) have shown that coupon trading affects consumer purchase and firm profits. If couponing significantly reduces profitability in a particular store format that means that it should be limited to certain formats.

Since promotional activities have different goals, coupon redemption conditions need to be set out, where the face value, which is crucial for retail margin management, plays an important role (Johnson et al, 2013). Different coupon face values and redemption conditions may give an impression to the management that different types of coupons can create a different impact on the margin in different store formats. Often retail chain marketing management that operates through various store formats is uncertain whether it should limit the use of coupons to certain formats. This paper attempts to show that there are no significant differences in coupon effects; however, empirical research will be limited to the mass use of three types of coupons frequently offered by target retailer over a long period of time. The following hypothesis is proposed:

H<sub>0</sub>: In the context of EDLP pricing strategy, different types of promotional coupons produce different effects on the profitability of the basket; however, these effects do not depend significantly on the store format (price level).

### Study design and methodology

For the purpose of empirical research, data on customer transactions were requested from a large food retail chain. Many authors have used the CRM data on customers and transactions in their research (Jung and Lee, 2010; Venkatesan and Farris, 2012; Toedt, 2014; Span et al, 2015). The stores were marked with codes so that their locations are not revealed to the authors; however, information about the store format and transactions relating to the online store were available. The data were requested from the management in May 2015 and received in April 2016. The dataset covers the period from 31 March 2014 to 29 March 2015 (52 weeks in total). Seven stores were included in the research (i.e., s1, s2, etc.) as follows: two hypermarkets, two supermarkets, two neighbourhood stores and one virtual store (see Table 1). Four different formats guarantee a good basis for comparison of different contexts of marketing and promotional activities and transactions.

**Table 1: Empirical data**

	COUPON VEHICLE (N)		
	POS coupon	FSI coupon	On-line coupon
s1	667	2,124	206
s2	1,067	5,725	186
s3	0	373	208
STORE* s4	664	619	0
s5	530	4,020	690
s6	5,018	1,275	0
s7	0	0	1,525
Total	7,946	14,136	2,815

\*independent variables: s1, s2: hypermarket store; s3, s4: supermarket; s5, s6: neighborhood store; s7: on-line store.

Source: Own research

The transaction database also includes information on the type of coupon used. Transactions with three types of promotional coupons without any restrictions in terms of the store format in which they can be redeemed have been examined: POS coupon, Free Standing Inserts or FSI and digital coupon. 24,897 customer transactions were identified in which one of the three types of coupons was used. The first type is percent-off coupon distributed through POS devices with a 15% discount on the next purchase exceeding HRK 200 (25 EUR). Thus, the minimum discount offered to the customer was HRK 30 (4 EUR). The second type of coupon was FSI which gives a discount on a certain product category or an individual item within a defined category ranging from 10 to 40% depending on the category. The third type of coupon was a promotional coupon containing a promotional code downloaded from a website. A requirement for the redemption of these coupons is to purchase one item from the selection of items at a discount of 10% or 20%. The data were clustered into 16 groups, because in 5 clusters no transactions were recorded.

In total, 3,836 different customers (represented by codes) accounting for 15,194 transactions have been identified. The remaining 9,703 transactions have been made by customers who do not have a profile in the database (NULL). Note that all online customers have a profile in the database.

A special parameter of basket operational profitability needed to be defined which will be compared to determine the couponing effect on margin. Thus, a unified *profitability effectiveness* indicator was modelled after the method shown in Table 2.

**Table 2: Calculation method of *profitability effectiveness* indicator**

	<i>Format A</i>	<i>Format B</i>
Basket Value (incl. VAT)	162.50 kn	172.50 kn
Sales Price	130.00 kn	138.00 kn
COGS	100.00 kn	100.00 kn
Margin (%)	30%	38%
Basket margin (Kn)	30.00 kn	38.00 kn
Coupon Clearance	15%	15%
Net Sales Price	110.50 kn	117.30 kn
Couponing margin	10.50 kn	17.30 kn
<i>Profitability effectiveness*</i>	35%	46%

\*Couponing margin / Margin

Source: Own research

As expected, it was not possible to link the transaction in the database with the operating costs. Therefore, the study does not examine the relative or absolute profitability of the basket but rather the relative effect of the price cuts on the margin expressed as *profitability effectiveness* indicator. This parameter compares the basket margin in a couponing context to regular price basket margin. A higher percentage of basket profitability effectiveness (i.e. 46% vs. 35%) indicates that the same couponing has had a more favourable impact on the margin in format B than in format A, in which a more intensive EDLP strategy has been used because of the lower price level.

Statistical analysis was used to assess to what extent this indicator varies depending on the type of coupon used in various store formats.

The data were processed in MS Excel and SPSS. Univariate analysis (GLM), with *profitability effectiveness* of basket margin as a dependent variable and store type and coupon type as factors, was used to test the hypothesis. Finally, the deviations among seven treatment groups of transactions (stores) and three independent variables (coupon type) were compared.

## Results and discussion

Based on the developed indicator of profitability effectiveness, the results show the impact of coupon use on basket margin in various store formats. The question that needs to be answered is whether the marketing management should restrict the use of certain coupons to certain store formats to ensure profitability. To answer it, the data on individual transactions involving three types of coupons used for 24,897 baskets in seven stores of food retail chain in the period of 52 weeks were analysed. If a coupon is redeemed in an EDLP store with lower prices (i.e. in a hypermarket), that purchase creates more pressure on the profitability of the basket than a purchase made in a store format with higher margins (i.e. in a neighbourhood store). The data on operational expenses were not available. Hence, the bottom-line cart profitability could not be determined and a special indicator had to be used to measure the impact.

There are statistically significant differences in the impact of coupon type on basket profitability ( $t=11.955$ ;  $STD = .103$ ;  $p=.007$ ) because the face value depends on the goals of promotion (Table 3). It is evident that the transactions in which POS coupon was used had the biggest impact because they have reduced basket profitability to 60.7%, on average. In addition, this type of coupon was found to entail the biggest risk due to the greatest variability of transactions ( $SE = .051$ ) of all types of coupons under observation. Cart discount coupons offer the greatest financial benefits for customers and therefore have the strongest appeal (Kumar and Rajan, 2012), which is why the management expects that a planned increase in investments in this type of promotion will bring about greater effects.

**Table 3: Couponing effect on average basket margins**

CouponType	Mean	SE
POS coupon	.607	.051
FSI coupon	.713	.042
Digital coupon	.813	.046

*Source: Own research*

Research conducted by Dinesh (2013) shows that pricing strategies and promotions also affect store productivity. The larger the store format, the greater the impact of promotions on productivity (for example, supercentres vs. supermarkets). If couponing creates greater basket margin deviations in some store formats, this could have not



only an unexpected negative impact on earnings but also a negative effect on store productivity.

Data results presented in Table 4 confirm the hypothesis because, despite different margin levels in various store formats and different coupon discounts, there are no statistically significant differences in the effect on the basket margin. Nevertheless, the data indicate that this difference is not always negligible. The biggest difference of 20.4% in the average margin achieved was found between stores s1 and s3. By closely investigating the structure of transactions in supermarket s3, it was found that POS coupons that would reduce this difference were not used there. The same is true for a quite difference between s2 and s3. Despite differences indicated no statistically significant differences have been found in the effects of POS or online coupons on basket profitability effectiveness between hypermarkets, supermarkets, neighbourhood and an online store. The data also show that there is no statistically significant difference in the effect of online coupon use in offline channels.

The parameter estimation analysis shows that the effect of coupons in the given conditions was most significant in store s5 where coupons put the lowest pressure on the margin ( $\beta = .103^*$ ,  $p < 0.05$ ), in contrast to the low price store s2 where the pressure was highest ( $\beta = -.013$ ,  $p < 0.1$ ) which, as expected, was caused mostly by POS coupons ( $\beta = -.152$ ,  $p < 0.1$ ).

**Table 4: Results of multiple comparison**

*Dependent Variable: ProfitEffectivennes*

(I) Store	(J) Store	Mean Difference (I-J)	SE	p
s1	s2	-.017	.092	.924
	s3	-.204	.091	.075
	s4	-.092	.092	.951
	s5	-.187	.092	.111
	s6	-.121	.101	.793
	s7	-.177	.096	.175
s2	s3	-.188	.092	.118
	s4	-.076	.093	.983
	s5	-.171	.093	.187
	s6	-.105	.102	.840
	s7	-.161	.097	.234
s3	s4	.112	.092	.786
	s5	.017	.092	.924
	s6	.083	.101	.982
	s7	.027	.096	.970
s4	s5	-.095	.093	.947
	s6	-.029	.102	.973
	s7	-.085	.097	.976
s5	s6	.066	.102	.995
	s7	.010	.097	.981
s6	s7	-.056	.106	.967

*Source: Own research*

These results have important practical implications for marketing managers in retail chain organizations. Under the conditions of fierce competition, low margins and search for innovative promotional strategies, it would be very useful for decision makers to be familiar with the effects the management can expect from certain promotions without coupon usage restrictions. When coupon usage is limited in terms of the location and store format in which they can be redeemed, customers will not experience couponing in the same way as they would if they were under the impression that coupon use is unrestricted. These results support the concept of diffuse coupons that can be acquired in different ways and used across different channels and retail contexts without any limitations in redemption process for customers. The assumption is that a retailer carries out EDLP pricing strategy that entails daily price dynamics. The research, which covered a period of one year and included several couponing campaigns, has revealed that the management using EDLP pricing strategy should be more confident in planning couponing because the study results show that store formats do not cause significant differences in profit efficiency.

This is an exploratory study whose purpose was to determine the effects of some sensitive marketing decisions. By introducing additional variables in the statistical analysis, the scope of the study could be extended in several directions. The data used are reliable enough for the purpose of making valid empirical conclusions. However, the study needs additional variables related to customer transactions that could help corroborate the implications of the research findings (items in the shopping cart, customer frequency, etc.). The research would be more useful if the customers and stores were categorized by demographic characteristics and locations, respectively, because then it would be easier to explain why certain types of coupons are used in some store formats significantly more frequently than in others. Without this data the link with the profile and purchasing power of customers who visit the stores under observation cannot be established. A further limitation of the study could be addressed by using a more advanced statistical method of data processing, e.g. linear regression model, which would not only include the store format but also enable a more accurate assessment and comparison of other EDLP pricing strategy effects such as profitability effectiveness of sales promotions using coupons. This would provide more useful and practical information and thus help the management in identifying activities that should be given preference in certain store formats and contexts.

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