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Managing Advertising and Promotion for Long-Run Profitability

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Abstract

In recent years, manufacturers have become increasingly disposed toward the use of sales promotions, often at the cost of advertising. Yet the long-term implications of these changes for brand profitability remain unclear. In this paper, we seek to offer insights into this important issue. We consider the questions of i) whether it is more desirable to advertise or promote, ii) whether it is better to use frequent, shallow promotions or infrequent, deep promotions, and iii) how changes in regular prices affect sales relative to increases in price promotions. Additional insights regarding brand equity, the relative magnitude of short- and long-term effects, and the decomposition of advertising and promotion elasticities across choice and quantity decisions are obtained.

To address these points, we develop a heteroscedastic, varying-parameter joint probit choice and regression quantity model. Our approach allows consumers' responses to short-term marketing activities to change in response to changes in marketing actions over the long term. We also accommodate the possibility of competitive reactions to policy changes of a brand. The model is estimated for a consumer packaged good category by using over eight years of panel data. The resulting parameters enable us to assess the

effects of changes in advertising and promotion policies on sales and profits.

Our results show that, in the long term, advertising has a positive effect on "brand equity" while promotions have a negative effect. Furthermore, we find price promotion elasticities to be larger than regular price elasticities in the short term, but smaller than regular price elasticities when long-term effects are considered. Consistent with previous research, we also find that most of the effect of a price cut is manifested in consumers' brand choice decisions in the short term, but when long-term effects are again considered, this result no longer holds. Last, we estimate that the long-term effects of promotions on sales are negative overall, and about two-fifths the magnitude of the positive short-term effects.

Finally, making reasonable cost and margin assumptions, we conduct simulations to assess the relative profit impact of long-term changes in pricing, advertising, or promotion policies. Our results show regular price decreases to have a generally negative effect on the long-term profits of brands, advertising to be profitable for two of the brands, and increases in price promotions to be uniformly unprofitable.

(Long-Term Effects; Promotions; Advertising; Price Sensitivity; Scanner Data; Choice; Purchase Quantity; Switching Regression)