



## Customer choices of manufacturer versus retailer brands in alternative price and usage contexts

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### ABSTRACT

This article offers a context-dependent theory of how price changes influence consumer purchase choice for fast moving consumer goods (FMCGs) for manufacturer (large household share) and retailer (small household share) brands. The theory proposes that the influence of price on demand is systematically very sensitive to context effects; more specifically, the theory includes the hypothesis that elasticity is much greater when the price change results in the manufacturer and retailer brands having the same price compared to when the price change keeps the manufacturer brand price above the retailer brand price. The implicit and/or explicit association with higher quality with the manufacturer versus retailer brand may be the main reason for buying the higher priced manufacturer brand. Decreasing the price of the manufacturer brand to equal the retailer brand's price takes away the primary reason for buying the retailer brand (i.e., saving money); increasing the price of the retailer brand to equal the manufacturer brand's price has the same effect. The empirical findings in the studies that this article reports support the hypothesis and confirm Scriven and Ehrenberg's [2004. Consistent consumer responses to price changes. *Australas. Mark. J.* 12(3), 21–39] major conclusion that relative order of price is more important than relative distance.

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### 1. Introduction

Gabor (1988) and others (e.g., Benson, 1955; Griffith and Rust, 1997; Pessemier, 1960; Scriven and Ehrenberg, 2004) question whether or not the proposition that a brand has a single elasticity at all times is in any way accurate. Using in-home consumer-simulated shopping trips at fortnightly intervals, Scriven and Ehrenberg (2004) report the elasticity of Maxwell House (a manufacturer's brand) instant coffee varying from  $-1$  to  $-4$  across ten studies. They ask, "Why is that? Are there consistent factors underlying such differences?"

Against this background, we are not aware of any study that looks systematically at variation in elasticities across brands and circumstances with a view to isolating conditions that may lead consistently to different levels of price response and which might eventually lead to conclusions about the hierarchy and magnitude of effects in general... Our broad hypothesis is that generalities can be found. (Scriven and Ehrenberg, 2004, p. 21)

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Pauwels et al. (2007) do provide a systematic examination of variations in price elasticities across brands and circumstances that supports and extends Scriven and Ehrenberg's (2004) findings. Pauwels et al. (2007) show that "*price thresholds do matter for the majority of the analyzed brands and categories.* Moreover, in the case of historical benchmarks, we find evidence for *asymmetric thresholds*, and for *different sign and magnitude* of elasticity transitions, signaling the need to consider a broad framework of threshold-based price elasticities. For historical benchmark prices, the threshold size is larger for gains (23%) than for losses (15%) and the assimilation/contrast effects for gains ( $-0.91$ ) are larger than the saturation effects for losses (0.32). For competitive benchmark prices, the threshold size is similar for gains (15%) and losses (17%), and saturation effects emerge both for gains (0.49) and for losses (0.63)." (italics in the original).

The present article extends the theory and insights of Scriven and Ehrenberg (2004) and others (Anselmsson et al., 2008; Bolton, 1989; Grewal et al., 1998; Krishnamurthi et al., 1992; Lowengart, 2002; Tellis, 1988; Pauwels et al., 2007; Putler, 1992; Zenor et al., 1998) for conditions where reference prices affect consumer brand choices. In their simulated consumer shopping studies, Scriven and Ehrenberg (2004, p. 28) report, "The biggest effect we found was when passing a locally defined reference price." They report that the average elasticity equaled  $-5.6$  for smaller brand shares when their prices pass the price of the brand leader (i.e.,

largest share) versus an average equal to  $-2.8$  when the price change does not pass the leader's price. Scriven and Ehrenberg (2004) also report elasticities were consistently bigger for smaller (i.e., retailer) brands: elasticities averaged  $-4.2$  for brands with shares less than 10% and  $-1.9$  for brands with shares 50%+. Similarly, Anselmsson et al. (2008) report that retailer brands' market shares do have a significant impact on consumer prices and expenditures. Using consumer panel data for 3000 Swedish households, Anselmsson et al. (2008) identify a statistically significant negative relation between changes in retailer brands' (RB) market share and price changes, implying that the more the RB market share increases within a category, the more the average prices decrease or are held back.

Using cross-sectional (non-experimental) data, Zenor et al. (1998, p. 31) demonstrate the substantial impact of baseline sales in moderating the influence of price on demand. "According to our framework, a brand's baseline sales is smaller in the face of a marketing policy that allocates large percentages of the budget to promotional activity. Hence, the traditional allocation rule's blindness to the impact of the allocation rule on future response can lead to a policy that drives out high margin, unpromoted sales... We have attempted to model the effects of marketing policy on promotional price elasticities and baseline sales. Due to data limitations and pending unresolved issues in intertemporal aggregation, we are unable to test our framework with time-ordered descriptors of causes and effects. This inability is a potential limitation of the study because cross sectional associations between variables do not rule out reverse causation or constant elasticities."

Using multiple treatment scenarios in a true experiment design, the study that this present article describes operationalizes reference price as it occurs during a purchase occasion within the context of the prices observed for manufacturer (large baseline sales) and retailer (small baseline sales) brands. Therefore, this study focuses on external reference prices as similarly done by Scriven and Ehrenberg (2004) rather than an internal reference approach since external reference price approach captures the cross-sectional effect of reference price among multiple brands (Mazumdar and Papatla, 2000).

The present article further probes the differential price change influences on consumer purchases of brands in different contexts. The goal of this article is to build and empirically test a theory of the impacts of price changes on demands for manufacturer versus retailer brands for FMCGs. The theory includes predictions of systematic effects for the relative brand pricing contexts of manufacturer (leading share) and retailer (small share) brands as well as systematic product use contingency effects for these brands. Empirical studies that this report includes support the theory.

Following this introduction, this article has the following organization. Section 2 describes the theory. Section 3 describes the method (between-group experiments) to test the theory. Section 4 presents the findings from the experiments. Section 5 provides a general discussion that includes an elaboration of how the findings and theory relate to relevant literature, limitations, and implications for theory, research, and pricing strategy. Finally, Section 6 offers conclusions.

## 2. Theory of context-dependent price change influences on consumer demand

For ease of discussion and empirically testing, the theory focuses on FMCGs for the context that includes a leading manufacturer brand competing against a smaller share retailer brand. While the theory is expandable to include more complex

market contexts, the main hypotheses are unaffected by such expansions.

**H<sub>1</sub>.** In consumer usage contexts that favor the manufacturer brand (i.e., household meal preparation for major manufacturer holidays), the biggest price change effect on demand for the manufacturer brand occurs when the manufacturer brand's (NB) price decreases from its higher reference price to a price equal to the retailer brand's (SB) price (see Fig. 1).

Saving money is the main reason for buying a retailer brand since a retailer brand's price is typically 30% below a manufacturer brand's price (Ailawadi et al., 2001). Because consumers usually associate higher quality implicitly and/or explicitly with the NB compared with the usually lower priced SB, equal prices for the two brands results in the ability of acquiring higher quality without paying more money when the two brands' prices are equal. Based on Pauwels and Srinivasan's (2004) findings demonstrating that manufacturer, premium brands maintain price sensitivity while second-tier brands experience increase price sensitivity when a retailer brand is present in a product category, the present study assumes equal price sensitivity of consumers for both consumers of NB and SB. Prior empirical evidence and theory provides an additional rationale: the extensive literature on reference prices hypotheses confirm that consumers related their response to price to some standard or reference point (Grewal et al., 1998; Krishnamurthi et al., 1992; Rajendran and Tellis, 1994). Scriven and Ehrenberg (2004) observe that the stimulus of other brands' displayed prices are clearly an important aspect of reference price effects; they report finding the biggest price change effect on elasticity ( $e$ ) occurred when a brand's price changed from below to above the price of the brand leader, or vice versa ( $e = -5.6$ ) and elasticities were lower, averaging  $-2.8$  (for the same average price change) when the change left the price leader still below or still above that of the brand leader. Such findings contribute to the findings of Tversky and Simonson (1993) on the context dependency of choice.

**H<sub>2</sub>.** In consumer usage contexts that do not favor the manufacturer brand (i.e., meal preparation for a regular weekend family dinner) versus usage contexts that do favor the manufacturer brand, the price change effect on demand for the manufacturer brand is small when the manufacturer brand's (NB) price decreases from its higher reference price to a price equal to the retailer brand's (SB) price. Rationale: the importance of the usage context (Belk, 1975) represents a moderating influence on the price change effect on demand. Relevant literature (e.g., Belk 1975) includes usage context as a relevant situational variable that may affect consumers' preferences. Here, usage context is operationalized similar to Belk's definition as "an intent or requirement to select, shop for, or obtain information about a general or specific purchase" (Belk, 1975, p. 159). Usage contexts perform as environmental restraints that contribute determining consumers' objectives and therefore limit the type of the products that can satisfy those objectives (Ratneshwar and Shocker 1991). The concern with using the best brands in preparing a meal served four times each month is less compared to the great concern of serving the best at major holiday meals—consequently, careful thought in selecting the NB as long as the price is the same or not too much higher than the SB is less likely to occur in the frequent meal preparation context; selecting the normally lower priced SB is satisfactory for such a usage context.

**H<sub>3</sub>.** For consumer usage contexts that favor the manufacturer brand (i.e., household meal preparation for major manufacturer holidays), the price change for the SB from lower to equal to the

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