Creating Win–Win Trade Promotions: Theory and Empirical Analysis of Scan-Back Trade Deals

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Manufacturer trade promotion spending is second only to cost of goods sold as a profit-and-loss item, yet manufacturers often lose money on these deals as a result of forward-buying by retailers. The search for more effective forms of trade promotion and the availability of scanners at cash registers has led to the emergence of a new type of trade deal—the scan-back—that gives retailers a discount on units *sold* during the promotion rather than on units *bought.*

We develop a theory to compare retailer pricing decisions and profitability under scan-back and traditional off-invoice trade deals. We show that, when the terms of the trade deal are identical, retailers prefer off-invoice trade deals and manufacturers prefer scan-backs. Manufacturers can, however, redesign the scan-back to leave the retailer weakly better off and leave themselves strictly better off. Using proprietary data from the beverage category, we conduct an empirical analysis and find that during the promotion period scan-back trade deals, relative to off-invoice deals: (1) Do not cause excess ordering and (2) generate higher retail sales through lower retail prices. Implications for researchers and managers are discussed.
(*Trade Promotion; Scan-Back; Off-Invoice; Forward-Buying; Empirical Analysis*)

1. Introduction

In March 1997, Procter & Gamble announced plans to eliminate 20% of its brands from trade promotion contracts (*Advertising Age* 1997, *Campaign* 1997); other major manufacturers were expected to follow (*Incentive* 1997). This desire to scale back trade promotions is a consequence of the well-known fact that whereas these promotions account for approximately two-thirds of all promotional spending, only 16% of them are profitable.[1] The underlying reasons for the poor performance of trade promotions can be traced to the following three factors: (1) forward-buying by retailers, (2) lack of pass-through to consumers, and (3) diverting. The combination of these three factors has led some manufacturers to lose faith in the trade promotion system—Durk Jaeger, the former head of Procter & Gamble's U.S. operations, calls it "impossibly inefficient" and suggests that it is being abused by retailers (*Economist* 1992). In this paper, we show how scan-back trade promotions can reduce or even eliminate these problems.

Although retailers have a variety of marketing tools at their disposal, they make extensive use of promotions[2] to generate store traffic, increase sales, and match or better the competition. Indeed, it is not uncommon for a supermarket retailer to have up to 3,000 stockkeeping units (SKUs) on a temporary price

[1] See, for example, *Economist* (1989), *Chain Store Age* (1996), and Blattberg and Neslin (1990) for a review.

[2] We use "trade promotion" to refer to deals that are offered to retailers by manufacturers and "promotion" to denote deals that retailers offer to consumers.

Marketing Science © 2003 INFORMS
Vol. 22, No. 1, Winter 2003 pp. 16–39
0732-2399/03/2201/0016$5.00
1526-548X electronic ISSN