Optimal Promotion Effort Allocation:
Interaction among Trade Promotion Pass-Through, Customer Response to Promotion, and Competition in a Market

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Abstract

Promotion is a critical strategic tool for businesses to remain profitable in a highly competitive market. Manufacturers have two promotion strategies: one is consumer promotion that targets end customers directly. The other is trade promotion that targets retailers by expecting them to use the offered promotion budget to encourage end customers to buy the manufacturer’s products. A manufacturer can perfectly control consumer promotion, whereas trade promotion inherits an agent problem, since a retailer usually pockets some of the promotion money received.

Formulating a two-stage supply chain model of a retailer and a manufacturer, we explore how a manufacturer should allocate its promotion effort between trade and consumer promotion by balancing control of promotion effectiveness and competency in a market. We also analyze how an optimal promotion decision will interact with several key business factors. Finally, we propose business implications regarding promotion strategies for a supply chain.

Key Words: Supply Chain, Trade Promotion, Game Theory, Brand Competition.

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