“The Effects of Price Promotions on Consumption”

Daniela Schmitt, Florian Stahl, Raghuram Iyengar

Abstract

A critical determinant of the success of any business model and in particular of contract-based business model is customer value management on individual level i.e., a careful assessment of the acquisition of new customers and retention of current customers. Sales promotions form an important means to acquire new customers. A large stream of literature has investigated the impact of promotions on customer behavior for the grocery category. However, relatively less work has considered the effect of such promotions on the access to and consumption of services. The objective of this research is to investigate if and how far customers acquired via price promotions are valuable for companies that employ both subscription- and advertising-based business models. Furthermore, we explore how far price promotions meant for new customers have a negative impact on the value of current customers who could not avail them. We do so in the context of a large digital news publisher that offered temporarily lowered prices for digital subscriptions. Specifically, we analyze the effect of temporarily lowered prices of subscriptions on customer retention and consumption for both new and existing customers. We find that new customers who are attracted by a price promotion can be more valuable to the company in terms of consumption, retention, and total revenues (considering subscription and advertising revenues together) than regular customers. Furthermore, existing customers who just missed out on the price promotion reduce their consumption dramatically in the short run. Thus, the total effect of a price promotion is less positive than when only considering new customers. Finally, a field experiment reveals an important managerial insight and shows that the drop in usage can be prevented, if the firm gives its existing customers the opportunity to switch to the promoted price and communicates that directly.