

Research on Mechanism of Distributors' Frequent Ordering Intention: A Prospect Theory Perspective

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Abstract

This article is to carry out in-depth mechanism exploration of influences of three different price promotion strategies on Distributors' ordering intentions. This research finds out that Distributors have stronger intentions of determining ordering in the case of reward promotion rather than in threat promotion. However, among Distributors who have decided ordering, threat promotion can lead to stronger frequent ordering intention. Promotion intensity has strong adjustment effect on Distributors' ordering intention both in reward and threat promotions. Rebates strategy has positive influence on Distributors' intentions of both determining ordering and frequent ordering. The study reveals different price promotion strategies' different influences on Distributors' ordering intentions. This study provides a good reference for guiding enterprise managers' application of price promotion.

Keywords

Mechanism, Ordering Intention, Prospect Theory

1. Introduction

Gupta (1988, 1992) holds that price is an important influence factor to Distributors' purchasing decisions and that it has crucial influence on Distributors' decisions such as whether, when, what and how much to buy [1] [2]. More than 50% of the product's total sale comes from price promotion (Blattberg and Neslin, 1990) [3]. Recently, along with fiercely competitive market, as an important promotion tool for motivating sales growth, the application of price promotion in promotion practices is in a rapid growth. In our daily lives and enterprises' pro-

motion competition practices, various kinds of activities including discount, promotion, price reduction and gift are everywhere and become white-hot. In the meantime, academic research on price promotion gets more and more focuses of scholars of promotion. However, reviewing literatures in the field of price promotion, there are quite a number of researches on price promotion of consumers, but there is rare research on price promotion in B2B field.

According to our interview survey of domestic new construction material industry, as market competition goes more and more fierce, manufacturers apply broad application of price promotion, aiming at distributors and retailers. In addition, the survey shows that 87% marketing managers and above senior enterprises managers think that price promotion has a significant effect on B2B marketing and that “customer’s frequent purchasing of enterprises’ products is the source of enterprises’ sales and profit”. Thus, it can be seen that Distributors’ frequent purchasing is vital to enterprises. In addition, Tony Haitao Cui *et al.* (2008) [4] study on that manufacturers apply price promotion strategies to implement price discrimination for different types of retailers and the resulting effect, etc. Therefore, concerning price promotion’s wide application in enterprises’ practices, research on price promotion strategy and its influence on Distributors’ intention of frequent ordering will have great theoretical and practical significance.

On the basis of previous researches on price promotion strategy and its influence on Distributors’ intention of decisions, and relevant theories, this paper takes Chinese market marketing as the source, compares influence of different price promotion strategies on Distributors’ intention of frequent ordering, and provides beneficial suggestions to enterprises managers on rational and effective application of price promotion strategies.

2. Theoretical Foundation and Conceptual Framework

2.1. Price Promotion Strategy Theory

According to objects being motivated, promotion can be divided into three kinds, consumer promotion, trade promotion and sales team promotion. In accordance with price allowance, it can also be divided into price promotion and non-price promotion. Trade promotion refers to promotion, of which strategies is the research target of this paper. In terms of price promotion, Raghbir and Corfman (1999) believe that price promotion is an integral part of enterprise marketing combination [5]. It is a very critical marketing means to improve the customer value and stimulate the customer purchase amount by lowering the brand or product price or increasing the goods quantity under the same unit price at some certain period by manufacturers or channel participants. Michel *et al.* (2001) [6] defined it as an important method of enterprises to promote sales growth, and pointed out that its characteristic is motivating consumers and distributors purchase specific products or services faster and more through providing short-term price reduction incentives, like discount, sale price, discount coupon and cash rebate, etc. [7]. Li Xianguo (2001) thought that price promotion is a form of sales promotion, which is defined as a promotion activity that enterprises apply various short-term incentives to encourage purchasing or selling the enterprises’ products and services. Both definitions indicate price promotion’s two essentials being an important marketing motivation approach: applying price strategy and promoting Distributors’ purchasing.

2.2. Prospect Theory: The Key Elements

In general, researches based on expected utility theory is mainstream of researches on behavior decision (Hastier, 2001) [8], of which the main theoretical foundation includes expected utility theory and prospect theory that is proposed by Kahneman and Tversky, Nobel Prize winner in economics in 1979 [9]. Prospect theory is recognized as the most representative theory for descriptive decision research. It mainly includes four aspects:

1) “Framing effect”. This effect fully explains decision makers’ different responses to two information frameworks, “profit” and “loss”. For example, in A supermarket, the price of each bottle of mineral water is RMB 2 yuan. The Distributors here are told that “buying two bottles at once can save them 0.2 yuan for each bottle and 0.4 yuan for two”. IN B supermarket, the price of one bottle of same mineral water is 1.8 yuan, and the Distributors here are told that “they have to pay 0.2 yuan more for each bottle without buying two bottles of mineral water at once”. Actually, the economic cost of buying same mineral water in two supermarkets is same, but most of Distributors would consider A supermarket more attractive than B supermarket. This is because that A supermarket’s expression approach of price makes customer perceive “profit”, when B supermarket’s makes them think that buying one at once even adds loss. This is a practical example of framing effect in promotion and pricing.

2) “Reference point dependence”. According to the theory, decision makers generally set a price for reference, which is called the reference point, and they will compare the future decision-making result with the reference price, so as to judge the gain or loss.

3) “Value function”. The value function in prospect theory refers to the “S” shape curve including “gain” and “loss”. The value function of “gain” shows the concave shape, and that of “loss” shows the protrude shape. The reference point is the inflection point of the curve, but Distributors’ response towards anticipated “loss” is often more sensitive than that towards anticipated gain, that is, Distributors’ response towards the fact that price is higher than the reference point is more fierce than the fact that price is lower than the reference point. It is also pointed out by value function that people’s decision-making behavior under uncertain risks is often characterized by risk avoidance, reference point effect and margin effect reduction.

4) “Decision-making weight”. It is the later developed “accumulated prospect theory”. According to the theory, the transfer of value is not about the final asset, actually, it is to transfer the “interest gains” and “interest loss”. The value of each result is not affected by probabilities, but by the “decision-making weight” empowered by people in making decisions, which makes the prospect theory more suitable for the study on dynamic changes.

Thaler (1985) [10] studied on price factors’ influence on consumers’ purchasing decisions. He proposed that in one transaction the total utility that consumers get is the sum of “obtained utility” and “transaction utility”. The former one is dependent on the comparison of interest and costs brought by the gained products of Distributors, which is directly affected by the final product price, while “transaction utility” relies on the contrast of the actually paid cost and the reference price of the product, which is also known as the perceived cost saving. In terms of price promotion, different promotion strengths can directly affect the actual cost expenditure of Distributors, affecting their “acquisition utility”. Under the same promotion strength, different promotion expression ways (promotion framework) can affect Distributors’ “transaction utility”, which is a kind of perceived utility by Distributors in the transaction process.

2.3. Conceptual Framework

As mentioned above, the first two sentences of this paper are from price promotion information of one large-scale construction material corporation aiming at its Distributors. The first kind is the certain proportion or amount of price reduction preference for some product designated by manufacturers that can be enjoyed by dealers during the promotion period. This is called the “award-based price promotion”; the second kind is with certain proportion or amount of price raise for products designated by manufacturers after certain time, which is called “threat-based price promotion”. The expression way of the two price promotion strategies is different, which will lead to different “framework effects” on dealers.

Besides, in enterprise practices, most of enterprises implement “rebate strategy”, In rebate strategy, manufacturers set a target quantity (target amount) of specific products that specific Distributors should order in certain time, and Distributors can have certain proportion of rebate of ordering amount of the specific ordered products in that time when they fulfill the set rebate task. In general, in enterprise practices, there will be strategies that make rebate proportion influenced by task. In other words, different task levels correspond to different rebate proportion or amount. The higher the tasks are fulfilled, the higher the rebate proportion is. In addition, this rebate strategy generally covers most Distributors. The below chart is the conceptual framework of this study (See Figure 1).

3. Analysis on Mechanism of Distributors’ Frequent Ordering Intention

3.1. Analysis on Mechanism of Different Promotion Strategies on Distributors’ Frequent Ordering Intentions

Based on expected utility theory and prospect theory, viewing from the “framework effect” of manufacturers’ price promotion strategy expression, reward promotion is direct price reduction and Distributors’ perception of it is “profit” earned from ordering specific products in promotion period; threat promotion uses the expression of noticing Distributors advance in price in certain proportion or range since one date in advance and makes the Distributors think that there would be “loss” if ordering that product since that day. Therefore, when facing reward promotion strategies, most Distributors would incline to determining to order. From the point of “reference

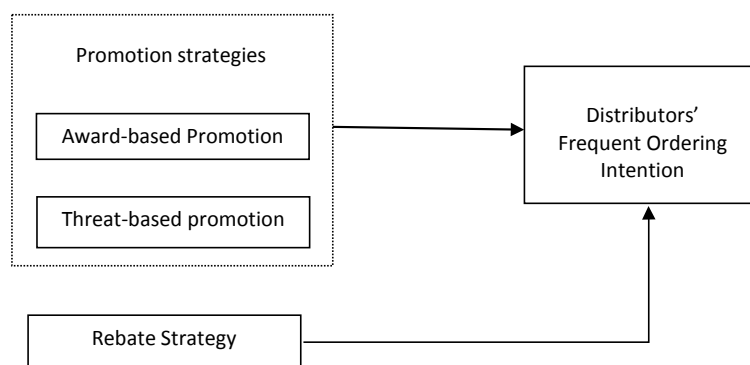


Figure 1. Conceptual framework.

point dependence”, in reward promotion strategy, if the ordering price of specified product would be lower than reference price and Distributors feel more utility and profitable transaction, there are more chances for them to determine to order. However, in line with prospect theory, at least ten researches show that Distributors’ responses under “profit” and “loss” are dissymmetry. In general, people give stronger responses to price rising than to price reduction (Kalyanaram and Winer, 1995) [11]. Because of effect of reference point, Distributors have different experiences of “profit gaining” and “profit loss”. For profit gaining, people would incline to choose determinate results; for profit loss, they would incline to risk more. Therefore, for reward promotion, Distributors’ prospect of future is “profit gaining”; and “profit loss” for threat promotion. In this case, once Distributors decide to order, they must have stronger reaction to threat promotion. It is quite possible that Distributors more frequently order. Based on the above reasoning, we think that Distributors have stronger intention of determining to order under reward promotion than under threat promotion. Among Distributors choose to order, they have stronger intention of frequent ordering under threat promotion than under reward promotion.

Turner (1998) [12] pointed out, if Distributors had stronger willingness of acquiring more profits when they are engaged in one activity, the possibility that they decide to involve in this activity is more. According to “reference point dependence” and “decision weight” principles, since Distributors enjoying rebate strategy is certain to get payment rebate (namely, obtaining expected “profit”) in certain proportion after completing rebate task, and Distributors certainly want more profit, through motivation of this expected “profit”, their ordering decision and ordering behavioral inclination are ought to be stronger. Based on the above reasoning, we think that rebate strategy’s influence on Distributors’ intentions of both determining to order and of frequent ordering is positive.

3.2. Analysis on Mechanism of Promotion Intensity’s Regulatory Effect on Promotion Strategy’s Influence on Customer Frequent Ordering Intention

It was pointed in Hardesty and Bearden’s research (2003) [13] that promotion intensity, or promotion benefit level influences different consumers’ achieving function inception on different promotion types, and further influences the overall level of transaction function. Moriarty’s research (1985) [14] found that, Distributors are intended to buy a lot more discounted items once shop owners launch big sales. Similarly, Krishna (1994) also found that under large sales, Distributors buy too many discounted items in stock. In that way, Distributors’ ordering intention varies when the promotion intensity varies, and it applies to both reward promotion and threat promotion. When the promotion intensity increases, or the discount range rises under the reward promotion, Distributors’ expected “benefit” also increases. Therefore, the Distributors’ intention of determining to order also increases; while under the threat promotion, the Distributors’ expected loss also rises when the promotion intensity increases or expected rise in price increases. In that case, the Distributors’ intention of determining to order becomes weaker. But once Distributors decide to order, they tend to make more orders or produce stronger intention of frequent ordering due to higher risks. Based on the reasoning, Promotion intensity has a regulatory effect on both reward promotion and threat promotion’s influence on Distributors’ intention of determining to order: the stronger the reward promotion is, the stronger intention of determining to order Distributors will have; the stronger the threat promotion is, the stronger intention of not determining to order Distributors will have. Promotion intensity has a regulatory effect on both reward promotion and threat promotion’s influence on Distributors’ intention of frequent ordering: the stronger the threat promotion is, the stronger intention of frequent

ordering Distributors will have; the stronger the reward promotion is, the weaker the intention of frequent ordering Distributors will have.

4. Discussion

4.1. Conclusions

This research has looked at that: the reward promotion, compared to the threat promotion, is more likely for the Distributors to make decisions to order; on the other hand, the threat promotion, compared to the reward promotion, brings a larger number of orders; the rebate promotion features competitive regulatory effect on the two decisions of whether to order and the number of order made, both are positively affected. Meanwhile, the promotion intensity has a strong effect. It is found based on the discoveries that, from the perspective of marketing, former researchers' studies on price to customer behaviors of order making and determining to order are verified.

However, different from former studies, this research analyzes price promotion strategies based on. We find that although reward promotion and threat promotion have influences on Distributors' intention of ordering, they feature different emphasis. Based on the model of Distributors' influences on intention of ordering posed by different promotion strategies, it is revealed that different promotion strategies produce different intention of ordering of Distributors. That is also magnified in the model based on promotion intensity's regulatory effect on promotion strategy's influence on customer frequent ordering intention, which focuses on the influences of promotion intensity. In terms of decision to whether making order or not, the reward promotion plays as a greater incentive than the threat promotion. The gap grows even larger cases with higher promotion intensities. On the contrary, the threat promotion plays as a greater incentive in number of Distributors' determining to order, and both strategies also see bigger difference when the promotion intensity fluctuates. Confronted with varied Distributors' intention of ordering, the deeper reasons or behavioral forms are worth trying to discover and study in the future.

4.2. Managerial Implications

Throughout a former interview featuring owners and marketing managers in the sector of new building and decorating materials, we find that despite the price promotion is widely used by a growing number of manufacturers, it still serves as an "expensive" and "reluctantly adopted" strategy by many manufacturers. Since this strategy risks a majority of profits, while they hopelessly feel "insecure" and "beyond estimation" about the real benefit it can bring. Either reward promotion and rebate promotion, the higher the promotion intensity is, the more loss the company suffers; the threat promotion is utilized to promote sales volume after all, the three types of promotion strategies are used alternatively. As a result, judged from the marketing practices, enterprises are urged to make appropriate price promotion strategies cautiously according to real situations in market, enterprises and Distributors. This thesis unveils customer behavioral changes when different promotion strategies are carried out by observing varied distributor behaviors on ordering intention, and provides reference for enterprises to take up different promotion strategies in front of different Distributors and different goals. For example, when an enterprise launches a new product and anticipates a wider distribution of product occupation with more orders, it is better to adopt reward promotion strategy, which makes Distributors more likely to determine to order; when an enterprise has occupied enough Distributors and badly desires frequent ordering making, the threat promotion strategy defeats. Moreover, the enterprise can adjust the promotion intensity to play a greater incentive, in order to meet the growing business goal willing and enhance promotion. As to rebate promotion, it is known that it has remarkably positive effect on Distributors' determining to order and intention of frequent ordering, which enlightens the managers to set as many rebate strategies as they can catering for Distributors of varied abilities in different areas, in order to expand the range of benefits this strategy brings.

4.3. Limitations and Further Research

Although this research is theoretically novel and practical in certain sectors, it still has some drawbacks for further study. This research only targets at different promotions strategies on Distributors' decision of order making and number of order made, while other customer behaviors are also required to be studied. Besides, this research applies the western theories to B2B marketing in Chinese market. It is doubted from the special marketing rela-

tion and relation marketing situations in China that other factors still exist influencing Distributors' intention of ordering, apart from price promotion strategies.

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