Is Table Wine a Good Product for Loss-Leader Pricing?
Evidence from Mendoza State

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Abstract

In previous papers, it was shown that the “sales” (temporary deductions on the price of a product in relation to its normal price when the reason of this behaviour can not be a reduction of costs) are an important economic phenomenon of the food’s retail competition in the state of Mendoza. In this paper, the empirical evidence is completed, focusing on the table wine’s prices and their position in the ranking of products that multiproduct retailers use in “loss-leader pricing” practice.

Retailers use a variety of marketing tools to gain short-term competitive advantages. These includes services at the store, advertising, temporary price reductions on selected products, among others. “Loss-leader pricing” will be the principal subject to analyze during this research.

The theory shows how multiproduct retailers compete for the demand of an assortment of goods. In this model, rational consumers are uninformed about prices and they must decide where to buy each product. Firms are located at either end of a Hotelling line, with consumers uniformly distributed along the line. In equilibrium, competition between retailers results in prices which yield consumer surplus to all consumers. The equilibrium level of surplus reflects consumer’s costs of traveling between retailers. The theory considers the question of how that surplus is obtained; i.e., whether prices are set so that consumers obtain roughly equal amounts of surplus on all of products they buy, or whether some prices are set “low”, so that the surplus is primarily derived from relatively few products. Advertising conveys price information to consumers, and consumers, correctly, believe that any product whose price is not explicitly advertised will yield zero surplus. In equilibrium, firms advertise prices below marginal cost to attract consumers into the store and profit of others goods which consumers plans buy at the store.

To sum up, retailers have reasons to compete strongly for the demand of the loss-leader product, giving the fact that this is the tool that will allow them to extract the consumer’s surplus of the rest of the basket goods.

The higher the price, the more intensive the competition will be. The rationality of the consumers is the reason that justify this behaviour, giving the fact that they already know the strategies of the sellers.

To realize this paper, there where used non-public data set that where obtained from the Bureau of Consumer Protection. Background information on this data source was provided, giving the fact that it has not being used in previous academic studies.

The data consist of individual price series for specific products. For example, each price series in the wines category contains observations on the price of a specific brand and container size of wine at a specific retail store, each week between March 2002 to December 2003.

Most product categories have multiple price series in each multiproduct store. The price series provided contain information that identifies the product and package size sampled within each category. According to this, it is possible to know that all of the prices within a price series correspond to prices for a specific product, specific brand and specific package at a specific store within a category. I know, for example,
whether that specific cola product is a 1-liter bottle or a 2-liter bottle. All the products are collected during dias habiles and correspond to non perishable goods.

The data from the Bureau of Consumer Protecion contains all of the price series the Bureau collected on 20 categories of food goods from five local stores of multiproduct retailers from Mendoza. In total, there are 514 series that contain 24,886 observations. The data distribution for store, month and category of the product turned out to be reazonably balanced.

This paper identifies and provides an explanation for some empirical regularities in retail price variation. Results suggest that a number of pricing regularities exists for these goods.

First of all, for 78% of the series, retailers put product on sale at least once in a period.

Secondly, there is considerable heterogeneity in sale behavior between different category of goods. Third, items are more likely to go on sale when demand is highest. There is an explanation for this phenomenon: A retailer attracts a consumer by offering more consumer surplus than its rival does. In order to inform consumers of the surplus that can be obtained, retailers invest resources in advertising sale prices.

Fourth, it is also examined the extent to which retail price changes represent changes in retail margins, rather than in wholesale prices. Price changes across retailers on any particular item are not highly correlated, suggesting that sales are not simply the result of short term changes in wholesale prices. This evidence confirms that most retail price changes reflect changes in retail margins, rather than changes in wholesale prices.

Fifth, it is analized the wine product in relationship with the rest of the basket goods. The results confirm that wines are a good product to be used as a loss-leader product in the strategy of the “loss leader pricing”.

Finally, the evidence presented in this paper combined with previous works suggests that retail sales are an important component of retail price variation in Mendoza, and that many of the observed instances of sales are consistent with intertemporal price discrimination.