Better by the Bundle?

Video game companies do it, fast-food restaurants, too. Why don't more companies bundle products and services together in one package at a bargain price? Research by Assistant Professor Vineet Kumar.

by Dina Gerdeman

Sales can soar when companies bundle products together into one cheaper package—Happy Meal, anyone? Yet a buyer's affinity for such deals comes with a big caveat, according to new research: These groupings are often successful only if the consumer is given the option of buying the same products separately.

“Bundling is pervasive in several markets, and it works in many cases,” says Vineet Kumar, an assistant professor in the Marketing Unit at Harvard Business School. People appreciate bundles even at places like McDonald's, where they can purchase burgers, fries, and drinks cheaper in a bundle—known as an Extra Value Meal—for cheaper than the products would cost if purchased individually.

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But those same customers might not value being given only the option of a bundle without the ability to buy a burger alone, he says.

All kinds of products are sold in bundles. Microsoft Office is sold as a bundle of computer software, including Word, Excel, and PowerPoint. Cable companies offer their channels in bundle packages. Even a music CD is essentially a bundle of songs.

And yet research on how consumers view bundles has been thin. Do shoppers prefer them? Do sales increase when companies bundle their offerings? Or, would a bundle cannibalize sales from its existing products leading to lower overall revenues?

To help answer these questions, Kumar teamed with Timothy Derdenger of Carnegie Mellon University on research that culminated in their paper The Dynamic Effects of Bundling as a Product Strategy.

Kumar and Derdenger studied the handheld video game market between 2001 and 2005, specifically Nintendo's Game Boy Advance and Game Boy Advance SP consoles and the games for both devices. During that time Nintendo essentially enjoyed a monopoly because Sony's PlayStation Portable had not yet entered the market.

The researchers found that consumers might actually value the bundle less than they would value the individual component products, that is there was a “negative synergy” associated with the bundle. Despite this, they found that Nintendo sold the most products when it offered a bundle option—a video game console and a game sold together as one package-—*coupled with an option to buy each piece individually*.

Sales from this “mixed bundling” offering were estimated to be much stronger than a scenario where such a bundle was not offered. Total hardware sales were higher by approximately 100,000 units when bundles were offered. Much more surprising, the sales of software video games jumped by over a million units. The company would see an increase in revenue from bundling due to better sales for both hardware and software.

However, when a bundle was the consumer's *only* option—a “pure bundling” scenario—Nintendo would fare much worse, when compared with both offers that lacked any bundle as well as those with the mixed bundling option. Revenues decreased by over 20 percent compared with the mixed bundling scenario; the total hardware units sold declined by millions of units; and software units fell by over 10 million as well.

Wait and see

The pure bundling findings may run counter to some executives' expectations.

“If consumers really want a product and they only have the option of buying the bundle, you would think the company could potentially take in more revenue since the consumer has no choice but to get the bundle,” Kumar says. “But it turns out that's not the case.”

Consumers like bundles, but they like options even more.

The reason: Consumers know they can put off buying and wait for a better deal because, after all, prices for video games and other electronics drop significantly over time. Nintendo's Game Boy console, for example, started out at $100 but within a year had decreased to $70.

“If consumers don't like the offering you put out, they can postpone their purchases. In a sense, you're competing with yourself over time, especially if you're a monopolist.”

And in fact, there may be other factors that tempt consumers to hold off on purchasing a new product.

For example, people who bought video game machines when they were first released may not have had many game choices, whereas if they deferred their purchases until later, they would likely have had many more options. Besides, those who waited could have ended up with better, faster, more advanced products, as was the case for those who held out for the latest versions of the iPhones and iPads, which improved with each update.

“If no bundle is offered at all, people might wait until much later, perhaps even a year, to make purchases,” Kumar says. “Nintendo doesn't want that. The more consumers purchase its products, the sooner Nintendo can make more video games.”

So bundles can entice some consumers to buy consoles earlier, especially when they are offered the choice of buying either the bundle or the console.

“Those who are more price-sensitive choose the bundle, and those consumers are separated from the people who are willing to pay more for just the hardware alone,” Kumar says. “Since the games are copied at close to zero cost to Nintendo, this gives the company a way to separate out segments of consumers—we call this dynamic customer segmentation.”

Some consumers don't care much about the specific game and will go for the bundle, even if the game isn't great, because it is cheaper than buying them separately. Meanwhile, high-end consumers may buy the console alone and separately purchase games not included in the bundle.

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"It's crucial to allow that flexibility to the consumer," Kumar says. In fact, more sales might result if a company like Nintendo gave consumers even greater choices, perhaps by allowing them to choose among a variety of games to bundle with the console.

"Nintendo puts out only certain bundles with certain games," he says. "If the company allowed consumers to purchase consoles with any game they wanted—create the bundle themselves—it might do even better."

The BMW bundle

Although it's difficult to determine without additional research, Kumar says a bundling strategy is likely to find success with a variety of products—especially where one piece of the bundle is produced at very low cost. Digital products, which have low marginal cost, are especially suitable for bundling. It also helps if the bundled products work well together, he says.

For example, luxury cars such as BMW are often coupled with packages of options that work well together, essentially a mixed bundle. The consumer has the option to purchase just the base model or a model equipped with a convenience package or technology package.

"Ideally you should be bundling products that have a positive synergy together," Kumar says, "but what we have shown here is that even when synergy is negative, bundling can be profitable. Bundling might fail because you have chosen the wrong product, but that wouldn't be my biggest worry," he says.

"Bundling is a rather easy way of putting new product offerings together to complement the product line. There's more potential to get it right than to get it wrong." WK

About the author

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