

Pricing & revenue architecture

What is packaging strategy?

Packaging strategy decides what a firm sells together, what it sells alone, how a bundle's price relates to its parts, and why that structure fits.

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Management summary Packaging strategy, in pricing rather than product design, is the decision about which products, features and services a firm sells together, which it sells alone, and how the price of a bundle relates to the prices of its parts. This concept guide uses the classification of Stremersch and Tellis: price bundling versus product bundling, and unbundling, pure and mixed bundling. It reports the conditions under which they argue each form pays, explains why large bundles of digital goods behave differently (Bakos and Brynjolfsson), separates packaging from tiered pricing and pricing architecture, and gives a one-page record for writing a packaging decision down with the test that will show whether it works.

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What is packaging strategy?

§ 1 of 8

Packaging strategy, in pricing rather than in product design, is the decision about which products, features and services a firm sells together, which it sells alone, and how the price of a bundle relates to the prices of its parts. Its core term is bundling, which this guide uses as Stremersch and Tellis (2002) define it: “Bundling is the sale of two or more separate products in one package.” Separate has a precise meaning in their account: “We define separate products as products for which separate markets exist, because at least some buyers buy or want to buy the products separately.”

In this guide the decision covers the whole set of offers: what is in each, what is also sold on its own, how the prices of the wholes relate to the prices of the parts, and the reason for that structure. A price list records the outcome; the strategy is the decision and its reason.

What is the difference between price bundling and product bundling?

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Price bundling discounts separate products sold together; product bundling integrates them. Stremersch and Tellis (2002) define the first as “the sale of two or more separate products in a package at a discount, without any integration of the products”, and the second as “the integration and sale of two or more separate products or services at any price.” Because a price bundle changes nothing about the products, they note that “bundling itself does not create added value to consumers, and thus a discount must be offered to motivate at least some consumers to buy the bundle”.

The two differ in what they ask of a firm. “Whereas price bundling is a pricing and promotional tool, product bundling is more strategic in that it creates added value.” And: “Managers can therefore use price bundling easily, at short notice, and for a short duration, whereas product bundling is more of a long-term differentiation strategy.” A product bundle needs design, development and delivery work; a price bundle needs a discount and a reason. Integration also has to be real: “Merely bolting products together does not constitute genuine integration”.

What are pure bundling, mixed bundling and unbundling?

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They are the three forms a bundling decision can take. Stremersch and Tellis (2002)² define them: “Unbundling is a strategy in which a firm sells only the products separately, but not the bundle.” “Pure bundling is a strategy in which a firm sells only the bundle and not (all) the products separately.” “Mixed bundling is a strategy in which a firm sells both the bundle and all the separate products in the bundle separately.” Their classification crosses form with focus: “(1) the focus of bundling, whether on price or product, and (2) the form of bundling, whether pure or mixed”. It sorts bundles, not whole offer sets: the two focuses are strategies “which firms can mix and match to best meet consumer demand”, so one offer set can hold a product bundle, a price bundle and parts sold alone.

² Stremersch, S., & Tellis, G. J. (2002). Strategic bundling of products and prices: A new synthesis for marketing. *Journal of Marketing*, 66(1), 55-72.

Figure 1 Five positions for a packaging choice

Each bundle sits in one cell, and one offer set can fill several: is each bundle a discount or an integration, and are its parts also sold alone?

Form	Price bundling (discount, no integration)	Product bundling (integration, any price)
Unbundling (parts only)	Each module priced alone; no package of any kind	Each module priced alone; no package of any kind
Pure bundling (whole only, or not every part alone)	Several modules sold only as a discounted set	An integrated suite whose parts are not sold alone
Mixed bundling (whole and parts)	A discounted set beside the modules sold alone	An integrated suite beside its modules sold alone

Unbundling is one position across both columns, since nothing is combined. The other four cells are different decisions with different conditions. In the product column the integration has to add value: Stremersch and Tellis count a software suite sold without integration as a price bundle.

Source Classification after Stremersch and Tellis (2002), p. 57, Table 1, and p. 58, Figure 1: focus (price or product bundling) crossed with form (unbundling, pure, mixed), giving five cells because unbundling is one cell across both columns. The source figure also marks the two pure-bundling cells with legal notes for firms with market power under US law as of 2002; they are left out here. The software examples in the cells are the author's illustrations, not cases from the source.

When does bundling pay?

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It depends on five things, according to the propositions Stremersch and Tellis (2002)² advance: how buyers value the parts, what the firm is trying to achieve, competition, costs, and how buyers perceive bundle prices. They ground the propositions in the marketing and economics literature, but say that “most have never been discussed” before. On valuations: “A price bundling strategy (either pure or mixed) yields higher revenues than unbundling if conditional reservation prices are asymmetric”, and “Mixed price bundling yields higher revenues than pure price bundling only when reservation prices for the bundle vary across consumers.”

Three terms carry these propositions. A reservation price is “the maximum price a consumer is willing to pay for the product”; the conditional reservation price is that price “conditional on the consumer

buying another product”; and variation “refers to the difference among consumers’ reservation prices for the bundle of products”. Both propositions compare revenue, not profit; costs enter with the next group. The mechanism is price discrimination: by pricing a bundle well, a supplier can “capture different segments with substantially different valuations for the individual products in the bundle”.

On margins, costs and competition: “The profitability of price bundling is likely to be higher than that of unbundling (a) the higher the relative contribution margin and (b) the stronger the economies of scale or scope”; “If costs of product bundling are subadditive, a product bundling strategy is always superior to an unbundling strategy”; and “In competitive markets, a mixed price bundling strategy dominates a pure price bundling strategy.”

The product-bundling column has its own propositions. Because integration adds value, “A product bundling strategy (either pure or mixed) yields higher revenues than unbundling for both symmetric and asymmetric conditional reservation prices”; mixed product bundling “can yield higher revenues than pure product bundling only when reservation prices for the bundle vary”; in competitive markets “mixed product bundling strategies dominate unbundling and pure product bundling strategies”; and “Combining a product with a price bundling strategy is superior to mere product bundling” if two conditions hold: conditional reservation prices for the separate products are asymmetric, and so are those for the price bundle and the product bundle, as when “one segment values the price bundle but not the integrated product bundle” and another segment the reverse. As for what matters most, the authors guess that for price bundling “the distribution of conditional reservation prices is probably the predominant condition”, and that “For product bundling, costs seem to be the important condition for optimality.”

On presentation, P12, one of the three propositions with partial support in earlier work, holds that it is optimal to “integrate all price information in a single bundle price” and to “separate the bundle discount in multiple savings rather than present it as a single saving”. The authors add that “there may be exceptions to this general guideline”, such as a price split into product and shipping charges.

They also turn around the common view that mixed bundling is always at least as good as pure bundling: “we propose that mixed bundling is superior to pure bundling only in highly competitive environments or when consumer reservation prices vary a fair amount”. Their new-product argument carries a condition. It concerns bundling a new

product with an existing one when the goal is “to maximize market penetration first and profits second”, and in that setting “we argue that for new products, pure bundling strategies tend to outperform mixed bundling strategies”.

Two cautions come with these propositions. The authors write that “limitations of time and space prevented a formal mathematical proof or empirical validation for each of the propositions”, and they count partial support in earlier work for only three of their twelve: P1, P8 and P12. And they add a legal one: “firms with dominant market power that consider implementing pure bundling strategies should scrutinize the legality of their bundling strategy”. Their legal discussion concerns US law as of 2002; this page does not assess legality.

Why do large digital bundles behave differently? § 5 of 8

Because, in the model of Bakos and Brynjolfsson (1999)¹, a buyer’s valuation of a very large bundle varies less per good than the valuations of single goods, and so is much easier to predict. They find that “bundling very large numbers of unrelated information goods can be surprisingly profitable”, because “the law of large numbers makes it much easier to predict consumers’ valuations for a bundle of goods than their valuations for the individual goods when sold separately”.

¹ Bakos, Y., & Brynjolfsson, E. (1999). Bundling information goods: Pricing, profits, and efficiency. *Management Science*, 45(12), 1613-1630.

The result has a boundary in cost. “Our main results do not extend to most physical goods, as the marginal costs of production for goods not used by the buyer typically negate any benefits from the predictive value of large-scale bundling.” Their own illustration: cable television, where marginal cost is near zero, sells a few standard bundles “in an attempt to achieve some degree of price discrimination”, but “When similar video entertainment is packaged in the form of videocassettes, the marginal costs rise dramatically and bundling vanishes as a pricing strategy.”

And it has a boundary in segments: “when different market segments of consumers differ systematically in their valuations for goods, simple bundling will no longer be optimal”, and their answer is a menu: “by offering a menu of different bundles aimed at each market segment, bundling makes traditional price discrimination strategies more powerful”. The model is of “a multiproduct monopolist”, and its predictions “appear to be consistent with empirical observations”, which is weaker than a test.

For software the marginal-cost condition often holds, and Stremersch and Tellis (2002)² count software, “with low variable costs relative to price”, among products with a high contribution margin. But the result concerns large bundles of unrelated goods, and Bakos and Brynjolfsson¹ give the reasons a few related modules are a different case: in their example with independent valuations, a seller who could already capture 80% of the value through separate sales “might require over one hundred such goods to make an equally profitable bundle”, and complementarities “can lead to the bundling of goods for reasons that have nothing to do with the reshaping of demand that is modeled in this article”. This page does not claim the model’s profits for such a package.

How is packaging strategy different from tiered pricing? § 6 of 8

Tiered pricing is one packaging pattern, not the whole decision. In this guide’s reading, which neither source states, a tier ladder works like the menu of bundles aimed at segments that Bakos and Brynjolfsson (1999) describe: an “economy” bundle that is a subset of a “premium” bundle, priced so that buyers “signal their valuations by their choice of bundles”. Their model concerns very large bundles of information goods, so the reading borrows the logic, not the profit result. The two sources also label a ladder differently. Bakos and Brynjolfsson¹ call such a menu mixed bundling. In Stremersch and Tellis’s² (2002) terms each tier is a mixed bundle only if every module in it is also sold alone, and a pure bundle otherwise, so one ladder can hold both forms; and a tier is a bundle in their sense only for modules that some buyers buy or want to buy separately. The tiered-pricing guide treats how tiers are fenced and priced.

Two other pages border the package. The value-metric guide decides the unit each offer is priced in. The essay on pricing architecture treats the system of terms, access, authority and review in which an offer is sold, and its bundle worksheet decides what a combined offer promises and who carries its delivery burden. Packaging decides what each offer contains and why it has that form.

The architecture essay draws the tier line elsewhere: there a tier moves a customer between levels, and a bundle composes modules into one offer. The pages agree if each rung is read as one offer and the ladder as the menu. The essay’s point that a bundle is more than a discount concerns the promise and its delivery: combining components changes what the customer believes it bought, what the provider must coordinate and which component absorbs an exception.

Stremersch and Tellis² draw their line by value instead: a price bundle adds nothing for the buyer and so needs a discount, while a product bundle has to add value. The essay's worksheet records the first question, and Figure 2 below records the second. The tiered-pricing guide also calls its tiers product bundles in the everyday sense of feature packages; here, product bundling means integration.

How do you write a packaging decision down? § 7 of 8

As one record per offer set that states the contents, the form, the focus, the reasoning about who values what, the cost and competition conditions, and the check that will show whether the structure works. The fields follow the conditions in the propositions above, which is also why each needs its own check: most of the propositions are argued, not tested.

Figure 2 A packaging decision record

Write the offers and contents, the form and focus, who values what, the cost and competition conditions, and the check in separate fields.

Offers and contents	Form and focus	Who values what	Cost and competition	Check
Which packages exist, what is in each, and which parts are also sold alone?	Pure, mixed or unbundled? A price bundle or a product bundle?	Which segments value which parts, how unevenly, and do bundle values vary?	Margins, marginal costs, savings from combining; and how close are rivals?	Which take rates, upgrades or losses will show it works, and when to look?

A package without a stated reason cannot be reviewed. Write the reason before the price.

One row per offer set. If the valuation field is a guess, the check field is where the guess gets tested.

Source Author's decision worksheet. The form and focus fields follow Stremersch and Tellis (2002), pp. 56-57; the valuation, cost and competition fields follow their propositions on pp. 62, 67-68; the segment question in the valuation field follows Bakos and Brynjolfsson (1999), pp. 1613 and 1625. The fields are reader inputs; no company data is supplied.

A worked illustration, with no company data: a firm sells two add-on modules to the same base product. One group of buyers values the

first module highly and the second little; another group the reverse. That is what Stremersch and Tellis (2002)² mean by asymmetry: “When there is asymmetry, different consumer segments highly value different products in the bundle.” Under it, the propositions favour a price bundle over selling the modules only alone, on revenue. Offering the modules alone beside the bundle can do better only if buyers’ valuations of the pair also vary, and only once they vary enough. If the two modules are worth more to buyers integrated with each other than side by side, the product-bundling column applies instead, and the record should say what the integration adds. The check field then names the take rate of each offer and the share of buyers who would have bought the parts alone.

Where does the evidence on packaging strategy stop? § 8 of 8

At a synthesis whose propositions are mostly new, and a model. Stremersch and Tellis (2002)² review the marketing, economics and law literature; by their own count earlier work partly supports three of their twelve propositions, and the other nine rest on their argument and on examples, some of them numerical, without formal proof or empirical test. They take the end user’s view: “This article focuses on bundling from an end user’s perspective and does not deal with bundling in a channel context.” Their end user includes firms (“either consumers or businesses”), though most of their examples are consumer goods, and both works are more than twenty years old. Bakos and Brynjolfsson (1999)¹ model a monopolist selling very many information goods, and their predictions “appear to be consistent” with observed markets. Neither tests a packaging change in a firm, so a packaging decision still needs its own test.

 End of essay

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