Inferred Transaction Value: a Key to Understanding the Effects of Price Bundling

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EXTENDED ABSTRACT - This paper examines a common marketing tactic called price bundling, defined as the practice of marketing multiple products and/or services at a bundle price (Johnson, Herrmann, and Bauer 1999). Examples include the purchase of a car where the basic model and options are bundled into a package or the purchase of a skiing pass good for multiple days. Behavioral research on price bundling has traditionally viewed the psychological impact of price bundling in separation from, and as violation of, its economic logic (Prelec and Loewenstein 1998; Soman and Gourville 2001). This frame overlooks the possibility that some of the psychological impact of price bundling may be driven by its economic logic.

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This paper examines a common marketing tactic called price bundling, defined as the practice of marketing multiple products and/or services at a bundle price (Johnson, Herrmann, and Bauer 1999). Examples include the purchase of a car where the basic model and options are bundled into a package; or the purchase of a skiing pass good for multiple days. Behavioral research on price bundling has traditionally viewed the psychological impact of price bundling in separation from, and as violation of, its economic logic (Prelec and Loewenstein 1998; Soman and Gourville 2001). This frame overlooks the possibility that some of the psychological impact of price bundling may be driven by its economic logic.

This paper proposes and tests a psychological impact of price bundling that is derived from its economic logic. We call it the inferred transaction value (hereafter, ITV) effect. It has become a popular belief that bundles typically involve a discount (Estelami 1999; Yadav and Monroe 1994). Since prior beliefs can drive perception and judgment (Abba, Broniarczyk, Shimp, and Urbany 1994), consumers may infer a bundle saving or transaction value (Thaler 1985) when being presented with a bundled offer even in the absence of explicit information about bundle savings. And because signal of a deal is sufficient to generate consumer reaction (Inman, McAllister, and Hoyer 1990), this ITV should enhance consumer evaluation, and hence purchase likelihood, of the bundle offer.

The ITV hypothesis offers new insights into the direction and mechanism of the psychological impact of price bundling. The dominant perspective in the literature relies on mental accounting’s loss aggregation principle (Thaler 1985) to explain pre purchased bundle effects, e.g., the impact of price bundling on consumer perceptions of an offer (Stremersch and Tellis 2002). Assuming that price information is coded as a relative loss, Johnson, Herrmann, and Bauer (1999) suggested that price bundling enhances consumers’ evaluations because consumers perceive a single loss as less punishing than multiple losses. We believe that this assumption is inconsistent with mental accounting theory. According to this theory, the cost of good is treated as losses or gains when being evaluated against a reference point, e.g., in cases of a price change (Mazumdar and Jun, 1993), but the price of a product in and by itself is unlikely to be coded as a loss. As Thaler (1985) suggested, “...the cost of the good is not treated as a loss. Given the steepness of the loss function near the reference point it is hedonically insufficient to code cost as loss” (p. 205). Therefore, we argue that it is the ITV, rather than the lost aggregation effect, that accounts for Johnson et al’s (1999) empirical findings about the positive impact of price bundling on consumer perception of the offer. This implies that, contrary to the convention, the positive impact of price bundling may not be universal, because price bundling may not always produce ITV.

The ITV hypothesis can also explain the impact of price bundling on post-purchased consumption behavior. Soman et al (2001) proposed the transaction-decoupling hypothesis, which holds that price bundling further decouples the sunk cost of the bundle from its benefits, thereby reducing the likelihood of consuming the entire bundle. The ITV effect provides another mechanism for this effect. Specifically, the inferred bundle saving may reduce the perceived sunk cost of the bundle itself. While the two hypotheses are complementary, the inferred transaction cost hypothesis has the advantage of being able to account for both pre and post purchased bundle effects, which to date have been too relatively unrelated areas of research on price bundling.

We conducted three lab studies to test the ITV hypothesis. In study one, respondents were presented with a bundled (unbundled) offer and then asked to indicate how much they think the total price of an equivalent unbundled (bundled) offer would have been. As a triangulation, respondents provided open-ended rationales for their response. As expected, respondents presented with the bundled (unbundled) offer believed that an equivalent unbundled (bundled) offer would have been 10.2% more expensive (6.9% cheaper) than the original offer. In study 2, three automobile offers were presented; the first two were identical to the bundled and unbundled offers in Johnson et al’s (1999), while the third was a bundle offer in which the ITV was excluded (by indicating that the price of an equivalent unbundled offer would have been the same). Consumer preference for the bundle versus unbundled offer was reversed as ITV was removed: Once ITV was removed respondents’ evaluation of the bundled offer drops significantly (from 5.08 to 4.48, p<.05), to a level even lower than that of the unbundled offer. Study 3 modified the skiing scenario employed in Soman et al’s (2001). Respondents imagined that they had bought separate individual one-day tickets (unbundled condition), and then indicated how much they think the total price would be for a/ single ski pass (bundled condition), and b/ a set of tickets (semibundled condition). As expected, respondents believed the bundled offer would have been 20.6% cheaper than the unbundled offer, and the semibundled purchase would have been 14.4% cheaper than the unbundled purchase.

Overall, these studies provided strong evidence that the ITV effect is robust in both product and service bundling contexts and can provide alternative explanations for the results found by Johnson et al (1999) and Soman et al (2001). Study 2 also provided some evidence that it is the ITV, rather than the loss aggregation effect, that accounts for the positive impact of price bundling on consumer perception of the bundle offer. This finding has important theoretical and practical implications. Because price bundling, or more generally, price integration, may not always produce ITV, this tactic may not always enhance consumer perception of the offer, and thus, contrary to the convention (Stremersch et al 2002), is not always an optimal tactic for firms. For example, because integrating base price and surcharge into one inclusive price does not involve any inferred discount, it may be better to partition price information to take advantage of the heuristic effect (Mortwitz, Green, and Johnson 1998).

Reference