

# Contextual Bundling: A New Angle when Strategizing for Higher Market Penetration

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## Abstract

Bundling has emerged as a key issue in current marketing and business thinking. By extending contemporary conceptualizations, this article proposes a new approach to bundling for both marketing of products and services. It reviews the literature on both bundling and consumer product evaluations and puts forward a new theoretical approach. The research uses case method as a means of defending the argument and justifies its use. It demonstrates that contextual bundling can constitute the strategic core of a company; at least if the firm's primary goal is to maximize the opportunities of attracting valuable customers towards its products within highly competitive markets. This research carries forward some results from previous studies, while it finds other prior results to be questionable. Shows that strategic implications of bundling are only partially explained in terms of a price or product focus, which is where most of the previous research has concentrated on. A context specific price or product bundling focus can have more strategic implications than a simple price or product focus on consumer product evaluations. A company must define bundling through an in-depth appraisal of the actual contextual experience of the customers, rather than focusing solely on reservation prices, which is where previous literature has put maximum emphasis.

## Keywords

bundling (marketing), strategy, consumer perceptions, contextual experience, psychology, price discount

## Introduction

The emergence of bundling in business such as travel and tourism (airlines routinely bundle vacation packages, combining air travel with car rentals and lodging), banking and financial services (banks offer special programs in which customers with large deposits can obtain home loans, credit cards for lesser rates) and retailing (services for 1 years are better priced than month to month), has created an interesting challenge for consumer evaluation.

Bundles might offer added value through the integration of products in the bundle ("product bundling"), and/or through bundle discounts ("price bundling"). Price bundling is a price promotional tool, while product bundling is a marketing strategy for packaging complementary or related products.

Stremersch and Tellis (2002) define price bundling as the sale of two or more separate products in a package at a discount, without any integration of the products. Because the products are not integrated, the reservation price for the price bundle is, by definition, equal to the sum of the conditional reservation prices of the separate products. In other words,

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. Example: a software suite, a six-pack of beer, a combo meal, or a season ticket for the opera.

Guiltinan (1987), suggested that, “managers attempting to select bundles to achieve a customer acquisition objective must rely more heavily on price discount element of bundling than they would if cross selling were the objective”. That is, the role of price bundling in this case is to create a consumer surplus where none is present or to provide a consumer surplus that rivals the surplus obtainable from competing providers.

A product bundle can be thought of as having an integral architecture (Ulrich & Eppinger 1995). Stremersch and Tellis (2002) define product bundling as the integration and sale of two or more separate products or services at any price. This integration generally provides at least some consumers with added value, such as compactness (integrated stereo systems), seamless interaction (PC systems), reduced risk (mutual fund), interconnectivity (telecom systems) or convenience from an integrated bill (telecom calling plans). The greater value raises consumers' reservation prices for the product bundle compared with the sum of the conditional reservation prices of the separate products.

Mulhern and Leone (1991, 66) introduce the concept of implicit price bundling as “the pricing strategy whereby the price of a product is based on the multitude of price effects that are present across products without providing consumers with an explicit joint price”. By this term, the authors imply that retailers that decrease price in one category must consider potential sales increases or decreases in other categories.

Price bundling obviously benefits consumers by providing monetary savings (Yadav & Monroe 1993; Estelami 1999). On the other hand, product bundling benefits consumers by reducing the time and cognitive effort required to make purchase decisions, a benefit that is particularly relevant when purchasing an unfamiliar high-tech product (Moriarty & Kosnik 1989). Product bundles can replace several confusing options with simpler ones (Ovans 1997). For example, AT&T offers to bundle local phone service, long-distance phone service, cellular phone service and Internet access in a single package with a single monthly bill (Blumenstein 1999).

Bundling strategies have been used extensively because of benefits to both sellers and consumers. Sellers use bundling as a competitive strategy to increase demand for an entire product line (Monroe 1990), to build new markets (Ovans 1997), to enhance a market position (Lawless 1991), and to differentiate themselves from competitors (Porter 1980). In addition, product bundling can reduce production, carrying and shipping costs (Monroe 1990; Eppen et al. 1991). Price bundling can function as a price discrimination device (Stigler 1968), allowing sellers to segment the market based on consumers' reservation prices (i.e., the price a consumer is willing to pay; Adams & Yellen 1976; Nagle 1984).

The focus of bundling literature till now has been on price discount. The literature on consumers' perceptions of price discounts is grounded in prospect theory (Kahneman & Tversky 1979) and mental accounting (Thaler 1985). This literature suggests that in risky situations, consumers are more sensitive to possible losses than to possible gains, and that they are likely to accept more risk when potential losses are aggregated. Losses are

aggregated when several losses are summed and presented as a single unit. For example, if an investor sees losses in a portfolio only once after three months (e.g., in a quarterly financial statement), he/she will be more willing to take risks than if he/she saw the same losses with greater frequency (e.g., by reviewing the portfolio daily or weekly). The principle of aggregated losses suggests that bundling several otherwise risky products together might reduce perceived risk, as the bundle would offer several distinct benefits (gains) for one price (loss).

Central to prospect theory is the value function. Munger and Grewal (2001) explain the three critical features inherent within the value function (see Figure 1). First, it is defined on deviations from a reference point, incorporating the notion that the value of a particular outcome is evaluated on the basis of gains and losses. Second, the value function is concave for gains and convex for losses. This reflects the general tendency for people to be risk-averse in the face of gains and risk-taking when facing losses. Third, the value function is steeper for losses than for gains relative to deviations from the reference point.

Recent research has found that consumers who buy a bundle of products at a bundled price consume less of the bundle than do consumers who are presented with separate product prices (Prelec & Loewenstein 1998; Soman & Gourville 2001).

Consumers who buy a bundle of products at a bundled price perceive far greater ambiguity on the cost of their purchase than do consumers presented with separate product prices. This greater ambiguity "decouples" the cost of the purchase from the extra benefit of consuming the entire bundle. In other words, consumers who are presented with a bundled price will account less for the costs of their purchase than will consumers who are presented with separate prices (Stremersch & Tellis 2002).

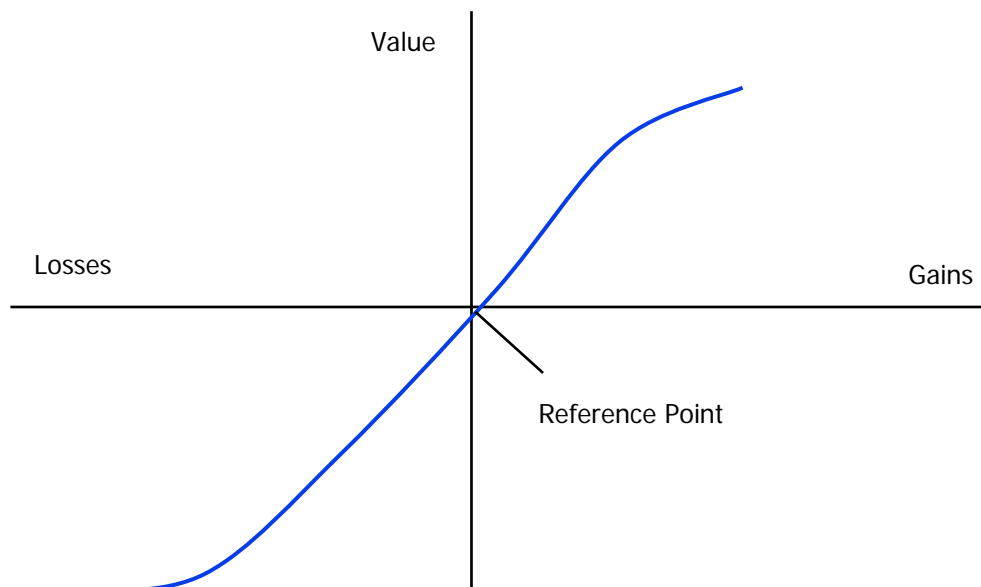


Figure 1. Value function; source Munger and Grewal (2001)

In case the valuations of all goods are correlated to one or more underlying variables then the valuation of bundle will also be high. For instance, if business users have higher valuations than home users for both a stock quotation and a financial news story, they will also have a higher valuation for a bundle of both these goods. Hence, in this case, the distribution of consumer valuations for the bundle does not converge to a Gaussian distribution as more goods are added. In general, when valuations are correlated with underlying variables, bundling may not reduce deadweight loss even for very large bundles, and a simple bundling strategy may not be the profit-maximizing strategy for sellers of information goods.

This approach questions, among other things, the role of price and product bundling as the primary and only goal of a business organization. The importance of product bundling is not questioned as such, but it is rather seen as a measure of overall value offering to the consumer. More room and insight is required to listen to the consumer voice and taking his views, needs and opinion into account in strategic decision-making.

The aim of this article is to extend the contemporary conceptualizations about bundling and propose a new approach to bundling for both marketing of services and products. The article has the following structure: First, the conceptual framework for contextual bundling is presented. Secondly, an empirical case is presented to provide an example how the contextual bundling can be used when strategizing for higher market penetration. Finally, practical and theoretical issues are discussed.

## **Contextual bundling**

Contextual bundling is all about bundling to optimize the end user experience in a specific context. An illustration of this phenomenon of offering product bundles is the automobile industry's adoption of telematics (Hamilton & Kovalski 2000), an onboard service for automobile drivers and passengers. The telematics devices include hardware components such as sensors and microprocessors that work in conjunction with software features, such as automotive information systems, the global positioning system (GPS), and wireless communications. Consider how telematics development has been conducted and integrated with the automobile's design and development.

A holistic concept of purchase intention is related to "determination or act to purchase", which also deal with the potential to experience, consume and satisfy. The consumer purchase research looks at things *from the payment perspective* of the consumer. In a complex, socially constructed consumer thinking, it is logical to assume that a bundling of a superior experience inevitably results in higher consumption and better satisfaction. With this logic, this study *challenges the unintentional assumption that price discount is a value as such*, inevitable and equal to better consumer experience.

A high-tech wireless device manufacturer, for example, is able to offer (alone or by matchmaking or through partnership) a variety of different offerings to a consumer. These offerings, for example, can be wireless data connection, SMS (Short Message Service), MMS (Multimedia Message Service), listening to Music service, a Music player and songs (content) to listen. The manufacturer, in an effort to favourably affect the purchase decision may combine and optimize a-set of these offerings, in a particular context, to make the

product work optimally for one or few particular service(s). As an example, a product-package with integrated Music player device, ready songs (content) on the move and listening to Music service. This can be defined as *contextual bundling i.e. bundling of offering in a particular context*. The manufacturer in this case does not offer (n multiply n) offerings to the consumer. The manufacturer offering is focused in a particular context and experience for the consumer. In its most simple and basic form, contextual bundling can be considered as product bundling.

Traditionally economists and consumer researchers have studied consumer behaviour, especially under imperfect information, without paying a great deal of attention to one another. Consumer researchers have concentrated on the individual choice while economists have focused on market outcomes (Wilde 1980).

There is a clear pattern of the inter-working among today's high-tech devices, consumers do experience risk about their purchase. And that takes time and energy on part of consumers making the decision more difficult. Consumer today is often very busy and confused between the products and thus clear positioning and fit of product in consumers mind is very necessary, more support should be provided to consumers to better understand the clear benefits of the resulting product. Contextual bundling is an effective tool to make product benefits clearer to the consumers. By bundling around a particular context, manufacturers can present various faces of the product and thus enable consumers to understand the product in complete sense.

Bakos and Brynjolfsson (1999), find that when different market segments of consumers differ systematically in their valuations for goods, simple bundling will no longer be optimal. However, by offering a menu of different bundles aimed at each market segment, bundling makes traditional price discrimination strategies more powerful by reducing the role of unpredictable idiosyncratic components of valuations. Their findings appear to be consistent with the markets for Internet and online content, and copyrighted music.

The purpose of bundling is also to make the technology clearer to customer segment - "clear benefits" and effectively connect customers of products with services. The gain is in terms of better, clearer understanding of the benefits of the product, improved positioning of product in consumer's mind and its fit in user's mind. In cases of innovative, disruptive technologies bundling acts to reassure the consumer about viability of the product concept giving them complete and ready to products.

Previous research in social science suggest that direct product experience, experience with similar or related product and external stimuli are sources of consumer expectation formation. Many psychologists have provided such a perspective concerning consumer expectations. Consumers get frustrated with the technology complexity and want bundled products that are simple and easy to use, compatibility and inter-working between product, and they want products that offer them capability of differentiation.

Thus, companies can deepen value for the customer by individualizing market offers to match the individual customer's contextual experience.

## Empirical evidence

The research approach of this study is best described as action analytical, with clear orientation towards understanding the effect of bundling on consumer purchase intentions. The “action” in this study is represented by intentions and experiences related to on-line bundling, which provide a new point of analysis and understanding consumer purchase intentions.

The action analytical analysis in this study is a methodological combination of interpretative study of concepts, theme analysis (Eskola & Suoranta 2000) and Alasuutari’s (1995) factist perspective. Research method is defined as consisting of those practices and operations, through which the researcher produces *observations* and those rules according to which those observations can be further *interpreted* as possible leads in solving the problem (Alasuutari 1995). The phases, producing observations and interpretation, are partly integrated, describing the process through which the mystery is solved (Alasuutari 1995).

According to Alasuutari, there are two significant aspects in the purification of observations. The first is related to selecting the theoretical and methodological viewpoint that fits for solving the problem and to the observations available. In this study, the selected viewpoint is the *factist perspective*.

The factist perspective assumes that there is a reality that can be studied by collecting claims about it. Those claims can be categorized into two types, testimony or indicators. Interviews typically represent a testimony approach for a certain question as the interview is considered as a more or less honest, objective and accurate description of the aspect of reality the researcher is studying (Alasuutari 1995, p.51). A survey is another example of an indicator, since the respondents do not know how the responses will be used. In this study, it is likely that the respondent had an idea of the survey’s purpose, thus it has also a testimonial nature. In indicator approach, the important quality criterion is related to avoiding reactivity of measurement. This means that measuring should not be allowed to influence the answers. The essential question for fact approach is its reliability, whether the testimony or indicator is truthful and whether announcements give facts correctly (Alasuutari 1995).

The second aspect in purification of observations is combining the various observations in a way that the common denominator can be seen (Alasuutari 1995, p.40). The principal is that different observations are only examples of one general phenomenon. In the analytical phase of the research process, the material is referred to as observations, rather than data. This is based on an idea that the data is observed according to researcher’s subjective sight, and does not represent all possible information available in the raw data.

As a part of research, the author conducted a survey of the consumers utilizing digital technology products like a mobile phone, digital camera, Internet services etc as a part of their day-to-day life. The aim of the survey was to study the consumer evaluations for different forms of bundling, giving practical real-life examples.

The target group was selected at random and no specific prior condition is laid down to pre-select the survey respondents. At the same time, to ensure wider geographical coverage respondents from North America, Europe and Asia, who could understand and communicate

in English, were approached to fill the survey. The survey was conducted both in electronic and paper form. The preference at all times was to have the survey conducted in electronic form and participants were encouraged to send the reply of survey in electronic form.

The main topics of the survey are identified based on the preliminary theoretical framework, but the language and variable scales were justified with a pilot round done with few respondents. Once satisfied that the respondents are able to understand the questions and complete within 10-12 minutes, the survey was sent with a possible deadline of 3 weeks. Within the deadline of 3 weeks, 104 filled-in forms were received.

The survey responses were partly analysed with the SPSS® 13.0 program and in an exploratory manner. According to Olkkonen (1994), this kind of approach is often used for new problem areas, in order to find out what the problem is actually all about. Typically, the empirical material in this approach is collected and analysed according to the researcher's personal understanding of the problem area. The explorative method usually, and also in this study, serves well as a basis for future research in the area.

### **Summary of empirical results**

The respondents were vastly impacted by the "Availability of Right mix of features" when making a purchase decision. It is a significant finding that more than half (56%) of the respondents feel that availability of right mix of features as the most important characteristic that has an impact on their purchase decision involving a bundled product. Here, the availability of right-mix of features can be understood in terms of what consumer feels is the right mix, meaning providing the experience to the consumers in their own specific context. The consumers value the product most in their own specific context and the consumer valuation comprises of experience from the product, positioning of product, reassurance to the viability of concept, relative advantage of the product as perceived by the consumers. Figure 2 shows the consumer responses during the survey.

The second important characteristic that has an impact on consumers purchase decision involving a product bundle is availability of price discount. Thirty-five (32%) of the survey respondents feel that availability of price discount as the second most important characteristic that affects their purchase decision involving a bundled product. This can be understood in terms of price promotions, product consumption and number of (loss) transaction involved in the purchase. The literature shows that consumer perceive each transaction as a loss transaction (Kahneman & Tversky 1979; Thaler 1985). Price discount, higher consumption and reduced transaction costs are typical elements in price bundling.

The third important characteristic that has an impact on consumers purchase decision involving a product bundle is availability of wider features. Survey results point that thirty-five (27%) of the respondents feel that availability of wider features as the third most important characteristic that affects their purchase decision involving a bundled product. This can be understood in the light of product bundling. Typical elements that define a product bundle are risk mitigation, innovation, brand and a higher user base when involving new, technology, such as Internet, product bundles.

Should a manufacturer of new-technology products package two or more products together to offer as a single product, which of the following would impact your purchase decision favourably? (Mark 1-4 in the order of importance with 1 as highest)

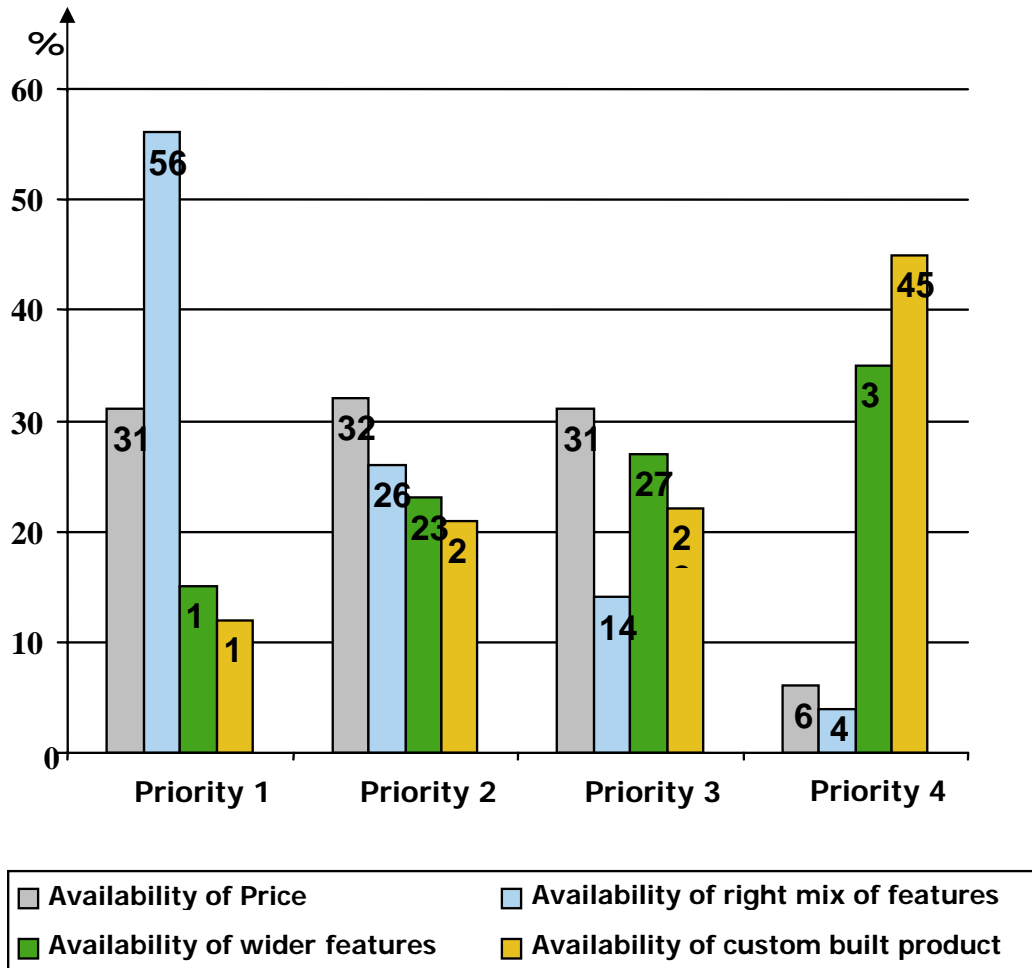


Figure 2. Consumer preference indicated in the survey.

The least important of the four characteristics that has an impact on consumers purchase decision involving a product bundle is availability of custom build product. It is a significant that about half (45%) of the respondents feel that availability of custom build product as the least of four important characteristics that affects their purchase decision involving a bundled product. This can be understood in the light of information needs of the consumer, information search efficiency, complexity of the decision-making environment. Such bundles are effective when the product is fast becoming a commodity and the capability of differentiation is minimal.

In the survey, the respondent had a possibility to give open feedback at the end. A large amount of the feedback was targeted at getting the right mix of bundling and the problems of over-bundling. The comments indicated that when the right (related) elements are put together

in the bundle then it creates a value and benefit for consumers, at the same time it is unconnected bundles that reduce the consumer interest.

## Discussion and conclusion

Marketers typically rely on price promotions to induce trial among nonusers for new products, to increase purchase volume, and/or to retain current consumers who might otherwise switch brands. Price bundling has been suggested as a critical strategy for achieving market penetration (Stremersch and Tellis 2002). *A bundle discount is one form of price promotion.*

Adoption of new products can be influenced by economic constraints. Consumers may delay adopting a new product because they feel its price is too high (Robinson & LaKhani 1975), or they expect its price to fall (Holak et al. 1987; Narasimhan 1989). Under such conditions, consumers prefer to wait and see results from others who can afford to take economic risk (Sheth 1968). Previous research suggests a relationship between price and perceived risk in two directions. Roselius (1971) suggests that consumers may buy a more expensive product because they perceive less risk based on price-quality association. Alternatively, others argue that price acts as a constraint to purchase and represents a financial risk (Kaplan et al. 1974).

Some consumers may question product quality when a high discount is offered. However, in the context of a new product introduction, consumers may interpret a bundling discount as a promotion for a trial period rather than an indicator of poor quality. Moreover, a bundle discount offers a greater risk-return trade-off to the customers and lowers their financial risk (Sarin et al. 2003).

Despite the broader implications of bundling, previous research has examined bundling primarily as a promotional vehicle that marketers use to sell two or more products together at a discounted price. The mention of consumer experience is totally absent in bundling strategies. It is clear from the consumer experience and valuation will drive the consumer to higher satisfaction and hence also higher purchase and consumption. We need to extend the meaning of *bundling* and decrease the ambiguity about the concept by understanding the core concepts of consumer valuation and purchase process.

Consumers often feel that the add-on products either are not needed by them or are unimportant because they do not understand their benefits but when the bundle is carefully planned and the secondary products are closely linked to the primary product offering then consumers does show an inclination to try the secondary products offered in the bundle. One of the purposes of bundling is to make consumer understand the product and its benefits more clearly.

Several findings point to the use of specific strategies by the consumer to diminish pre-purchase uncertainty. As total risk of the purchase situation increases, an individual's direct observation and experience become a preferred information source (Lutz & Reilly 1973) and thus clear positioning and fit of product in consumers mind is often necessary. Businesses can effectively connect consumers with services, giving them possibility of recurring revenues by providing them a superior overall experience. Bundling in a specific context, contextual bundling does exactly that; it educates the consumer about the various faces of the product

related to different situation giving them a holistic experience and hence improved positioning of product in consumer's mind driving higher consumption and repeat purchases.

Research by Hoover et al. (1978) clarifies that when making a purchase decision, consumers use various amounts and types of information sources to reduce perceived risk, depending on the amount and type of risk. Increase in feeling of subjective certainty of a consumer to purchase is accomplished by seeking additional information about a purchase decision.

Bundling also affects complexity of decision environment and consumers indicate that often bundling has made the decision-making easier for them. One of the purposes of bundling is also to offer one-stop-shopping experience. Consumer gets more/different functionality and easier inter-working of devices and hence they need to bother less first searching for the product and then how to use the product. This should lead to reduced time and cost to search information about the product since now the consumer does not need to shop around the town to find the compatible devices or lower prices.

The study proposes a new approach to bundling in the relation to contextual marketing. It also shows that strategic implications of bundling are only partially explained by price or product focus, whereas previous research has focused mainly on this aspect. A specific price bundle can have more strategic implications than a different specific product bundle, due to associative power of bundling and its interactive capacity. The study demonstrates that the distinction between transactional and contextual is key to understanding the strategic relevance of bundling and the consequences to companies. Whereas transaction bundling is a promotional tool, contextual bundling is more strategic in that it greatly facilitates the consumer experience.

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