

# **The Optimal Discount Strategy for Product Bundles from the Perspective of Prospect Theory**

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## **Abstract**

Nowadays, marketers introduce product bundles which include more than one single product more and more frequently. The most popular bundling strategies contain the pure bundling strategy and the mixed bundling strategy. The former means the company introduces product bundles only without any single products available where the latter allows consumers to choose either product bundles or single products separately. In the previous studies, many papers have addressed how to price product bundles properly. However, none of them has considered the impacts of reference price effects mentioned in prospect theory. In this research, we try to use the experimental design method to analyze the optimal discount strategy for product bundles from the perspective of prospect theory and attempt to answer the following questions: (i) The regular prices for single products or product bundles could be a source of reference price effects. Should marketers announce the regular prices of single products, the regular price of product bundle, or none of them to increase consumers' purchase intention? (ii) Suppose the discount prices of single products can arouse reference price effects, should marketers implement either the pure bundling strategy or the mixed bundling strategy? (iii) How does the complementary relationship among single products influence answers of the

above questions? What is the impact of promotion-focus and prevention-focus?  
(iv) Is the free gift design more favorable to consumers? We wish this research can both provide some applicable advices for marketers and shed the lights of the issue about the optimal discount strategy for product bundles.

**Keywords: product bundle, discount strategy, prospect theory, reference price effect, promotion-focus, prevention-focus.**

## **Introduction**

Nowadays both sales and promotion are the common used marketing strategies. For example, the companies will introduce several product bundles or implement other product promotion to appeal to consumers in specific timing. The product bundle means selling two or more products and/or services in one package with a specific price (Guiltinan 1987), or selling product in a package (Adams and Yellen 1976). General speaking, product bundle is a strategy in selling two or more single products in one package, and the price in bundle is usually lower than the sum of the single product price in bundle. The most popular bundling strategies contain pure bundling strategy and mixed bundling strategy (Adams and Yellen 1976). The former means that the company selling product bundles can not admit consumers buying products separately where the latter can admit consumers buying either product bundles or single products separately. Besides, given the product bundles with the complementary, will it increase or decrease the purchase intention? Telser (1979) found that the product bundles with the complementary goods get more profit than product bundle with the alternative goods. Harlam et al. (1995) indicate that products in a product bundle with complementary have a higher purchase intention. Previous studies showed how to price

product bundles merely, but we try to add the factor about reference price and test the final results. The modern markets use different marketing strategies for different customers in the specific period. We make some examples in Taiwan as follows.

1. Single Product Sale: Billionaire's summer series sandals priced at NT\$3650, now priced at NT\$1500; Pao-hsiang-chen's crystal necklace priced at NT\$1980, now priced at NT\$1280.
2. Pure bundling : The Chinese food (Chang-Chi) introduced food bundle (including pork ball and Sichuan dan-dan noodles) priced at NT\$210, now priced at NT\$150; the Thai food (Silver Fish) introducing food bundle ( including fried rice and the spicy chicken) priced at NT\$230, now priced at NT\$170.
3. Mixed Bundling: One pair of clothing priced at NT\$1680 and tie-in sales priced at NT\$2000; one pair of clothing priced at NT\$7280 and tie-in sales priced at NT\$10500 (by Guess).

In the convenience store Family Mart, the beverages have 21% discount which the bottles priced in NT\$20 and the chocolate have a 20% discount when buying in pairs. In the convenience store 7-Eleven, buying potato or any kinds of snack in 7-select, which is 7-Eleven's private label just costs NT\$17. Besides, drinks bundle: also has 8% to 12% discount and the coffee has the special discount that the second one has a 30% discount.

In this research, we try to use the experimental design method to analyze the optimal discount strategy for product bundles from the perspective of prospect theory and attempt to answer the following questions: (i) The regular prices for single products or product bundles

could be a source of reference price effects. Should marketers announce the regular prices of single products, the regular price of product bundle, or none of them to increase consumers' purchase intention? (ii) Suppose the discount prices of single products can arouse reference price effects, should marketers implement either the pure bundling strategy or the mixed bundling strategy? (iii) How does the complementary relationship among single products influence answers of the above questions? What is the impact of promotion-focus and prevention-focus? (iv) Is the free gift design more favorable to consumers? We wish this research can both provide some applicable advices for marketers and shed the lights of the issue about the optimal discount strategy for product bundles.

## **Literature Review**

### Product Bundle

Product bundle is one of the famous promotional strategy and is used in many industries widely, especially in the computer industry, tourism industry, direct selling industry, beauty and cosmetic industry. In order to maximize their profits, companies always introduce different product bundles on promotional strategies in the special period. Product bundle does not have a precise definition to accept broadly. The following researchers made some definitions for product bundle: Guiltinan (1987) said that it means to sell two or more products and/ or services in one package with a specific price. Adams and Yellen (1976) supposed that is means to sell product in a package. Yada and Monroe (1993) define it as selling two or more products and / or services in a specific price. Stremersch and Tellis (2002) proposed that it represents to sell two or more single product in one package. General speaking, product bundle is a strategy in selling two or more single products in one package,

and the price in bundle is usually lower than the sum of the single product prices in bundle.

According to previous studies, the product bundle with different types of strategy can be divided into sales methods and combination methods (Liang 2004). In the sales methods, Adams and Yellen (1976) summarize the following three strategies and will be used in this paper:

1. Pure Component Strategy: For the purpose of profit maximum, marketers price and sell two products separately.
2. Pure Bundling Strategy: When company sells product bundles, it can not admit consumers buying products separately.
3. Mixed Bundling Strategy: When company sells product bundles, it can admit consumers buying either product bundles or single products separately.

In the previous studies, many papers have addressed how to price product bundles properly. However, none of them has considered the impacts of reference price effects mentioned in prospect theory. In this research, we try to use reference price factor to analyze the optimal discount strategy for product bundles from the perspective of prospect theory to increase consumer's purchase intention.

### Reference Price Effect

When shopping in the markets or department stores you can easily notice that the posters show "The xxx's regular price: \$750; now sale in: \$399." The former price is the reference price. The reference price is the price information which is seen by consumers (Biswas and Blair 1991). The reference price can be the external reference price and internal reference

price. The external reference price can be provided through different channels such as the competitors (Delia Bitta et al. 1981; Federal Trade Commission 1986), retailing stores and manufactures. The internal reference price is stored in consumer's mind (Grewal et al. 1998), and is also the reference for consumers to compare for the / next purchase. Chou (1998) defined the internal reference price as a adaptation level price. According to Chang and Kao (1995) and Lichtenstein and Bearden (1989), the internal reference price standards can be combined with the normal price perception range, the highest price perception range, the latitude of the price acceptance, the internal reference price and the lowest price perception range. Based on the above theories on reference price, we make a graph below (Thaler 1985; Winer 1986; Urbany et al. 1988; Chang and Liang 1993; Chang and Chou 1999; Hsieh 2000).

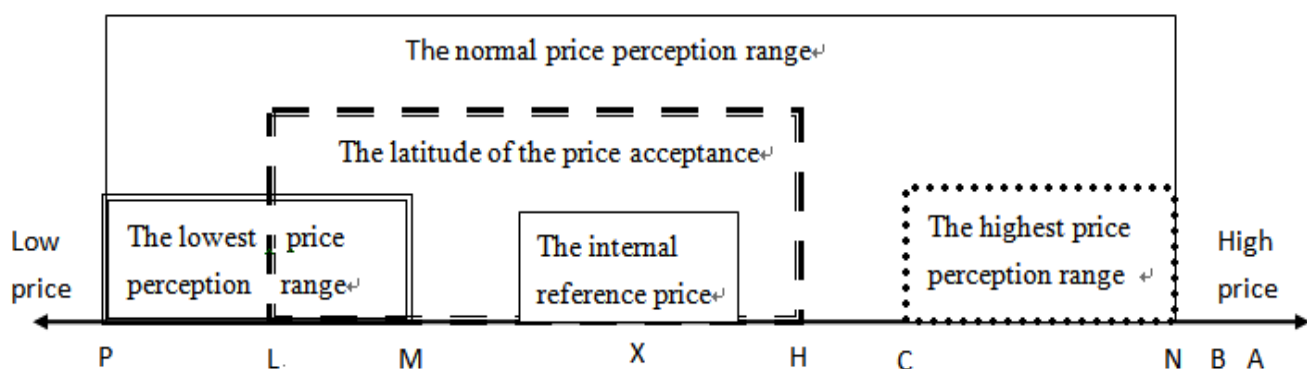


Figure 1 Internal Reference Price Standards

( Re-modified: Lichtenstein and Bearden 1989; Chang, Chou and Chang 2006)

### Prospect Theory

Thaler (1985) used prospect theory to explain when people face to the different combinations of gains and losses. In the multiple gains case, consumers feel more satisfied under the separated format than under the combined format. In the multiple losses case,

consumers feel more satisfied under the combined than under the separated. In the mixed gains case, consumers feel more satisfied under the combined than under the separated, because the slope in losses is steeper than that in gains. In the mixed losses case, we have two situations. First, when two outcomes are similar, the consumer feels more satisfied in separated than in combined. Second, when two outcomes differ much from each other, the consumer feels more satisfied in the combined context than in the separated context.

### Self-regulatory

Higgins (1997) developed the self-regulatory focus theory to identify the different kinds of results of the consumer's different motivational procedure in the different situations about the self-regulatory. The self-regulatory is divided into promotion-focus and prevention-focus. The former has the achievement, ambition, upgrade and aspiration behaviors where the latter has the obligation, safe-security, responsibility and avoidance in produce negative results (Chernev 2004; Molden and Finkel 2009). According to previous studies, the strategies are moderated by individuals to get their goal target. Thus, we can infer that the consumers with promotion-focus seek the maximal gains and the minimal losses. However, the consumers with prevention-focus consider the safety and how much they save. (Brockner and Hinnins 2001; Crowe and Higgins 1997; Freitas and Higgins 2002; Higgins, Shah, and Friedman 1997; Brockner, Paruchuri, Idson, and Higgins 2002; Higgins and Silberman 1998; Idson, Liberman, and Higgins 2000; Alexander Chernev 2004)

Avent and Higgins (2006) have done an empirical study from the perspective of self-regulatory. They found that consumers are willing to pay more money to get the product and make their self-regulatory intention fit under the different status. For example, compared with



consumers with promotion focus, consumers with prevention focus pursuit the “not boring” instead of “exciting” feature (Aaker and Lee 2001; Aaker and Lee 2006). Thus, we can infer the following hypotheses.

**H1: According to multiple gains, when consumers are promotion-focus, the mixed bundling strategy is better than the single components and the single components is better than the pure bundling strategy.**

**H2: According to multiple losses, when consumers are prevention-focus, the pure bundling strategy is better than the single component strategy and the single component strategy is better than the mixed bundling strategy.**

Price Information Disclosure

There are many price disclosure methods in the markets. The consumers use different purchase strategies when companies reveal to different price information disclosures.

According to the previous studies, these semantic cues have significant effects on the process when consumers buying the products (Kahneman and Tversky 1979). We summarize some price information disclosure methods which are found by the previous researchers in Table 1.

Table 1 Price information disclosure methods

Researcher	Time	Methods
Barnes	1981	1. sales \$ 2. 25% discount, \$_ 3. the regular price \$_ sales \$_

Das	1992	<ol style="list-style-type: none"> <li>1. save\$_</li> <li>2. bundle pricing: buy A and B total \$_</li> <li>3. X% discount</li> <li>4. buy two products \$_ (before bought one already)</li> </ol>
Yadav and Monroe	1993	<ol style="list-style-type: none"> <li>1. single pricing: buy these bundle, X for \$_ Y for \$_</li> <li>2. bundle pricing: buy product X and Y total cost \$_</li> <li>3. mixed bundle sales</li> </ol>
Mazumdar and Jun	1993	<ol style="list-style-type: none"> <li>1. single pricing: buy these bundle, X for \$_ Y for \$_</li> <li>2. common pricing (use single rice)</li> </ol>
Harlam et al.	1995	<ol style="list-style-type: none"> <li>1. bundle pricing: buy product X and Y total cost \$_</li> <li>2. single pricing: buy these bundle, X for \$_ Y for \$_</li> <li>3. the free gift: buy A \$_ get Y for free</li> </ol>

Re-modified: Chen 1998; Lian 2004

The Barnes (1975)'s price information disclosure method is very common in the real world. The price information disclosure of 'the regular price \$\_ sales \$\_' is most popular. Lain (2004) proved Barnes's results by empirical data. Das (1992) found that "save \$\_" is more suitable for high-priced products than for low-priced products where "buy A and B total \$\_" and "the second products \$\_ (before bought one already)" are the best price information disclosure methods in different price level. Harlam et al. (1995) confirmed that there is an

interaction between product bundle's price level and price information disclosure method. When the product bundles price is lower than the consumer's reservation price, companies should use "bundle pricing: buy product X and Y total cost \$\_" method. When the product bundles price is equal to the consumer's reservation price, companies should use "single pricing: buy these bundle, X for \$ \_Y for \$" method. Finally, there is no effect when the product bundles price is higher than consumer's reservation price. The following statements summarize the recent studies about price information disclosure methods. Huang (2002) said that "the free gift" method is more effective when the main product in a product bundle has a high-priced (ex: an experience travel) where the combination bundles is proper when the main product in a product bindle is lower price (ex: beverage). Gaeth et al. (1990), Drumwright (1992), Yadav and Monroe (1993), and Stremersch and Tellis (2002) found that the "bundle pricing: buy product X and Y total cost \$" is better than the " single pricing: buy these bundle, X for \$ \_Y for \$" from the losses side. On the other hand, from the gains side, the " single pricing: buy these bundle, X for \$ \_Y for \$" is better than the "bundle pricing: buy product X and Y total cost \$" (Johnson et al. 1999; Mazumdar and Jun 1993).

**H3a: When the consumers are promotion-focus, the consumers will choose the free gift design instead of the pure bundling strategy.**

**H3b: When the consumers are prevention-focus, the consumers will choose the pure bundling strategy instead of the free gift design.**

### Complementary Product

Based on the past studies, the product bundles with complementary products can arouse consumer's purchase intention. Telser (1979) found that the product bundles with the

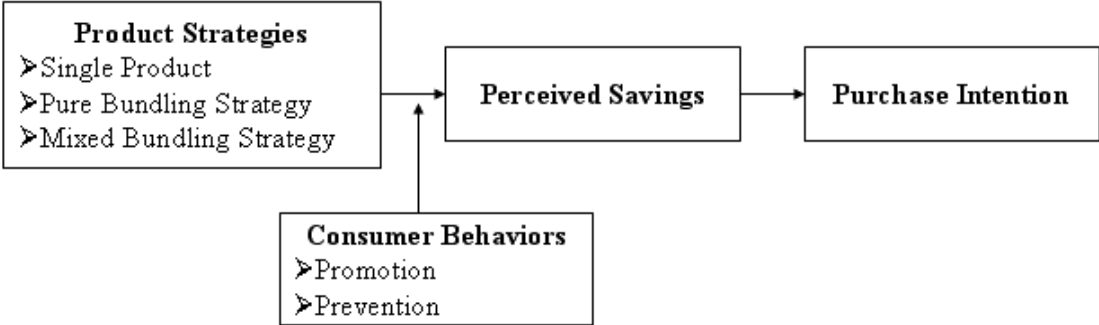
complementary goods get more profits than product bundle with the alternative goods. Guan (1999) found that complementary goods have a higher purchase intention. Gaeth et al. (1991) and Lewbwl (1985) found consumers pay a higher reservation price and spend more money to buy the product bundles with complementary. In contrast, Chou (1998) found that bundles with non-complementary feature have a higher cognitive value to get higher purchase intention. Liao (2009) proved that complementary bundles have less perceived value than non-complementary bundles. Harlam et al. (1995) indicated that products in a product bundle with low familiarity have a higher purchase intention when the bundle’s price is the same as the reservation price on consumer.

**H4a: For the complementary bundles, the consumer will choose the free gift design instead of the pure bundling strategy.**

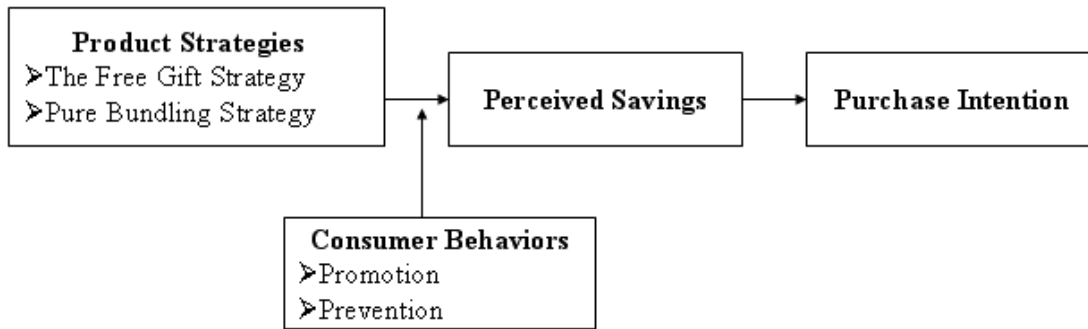
**H4b: For the non-complementary bundles, the consumer will choose the pure bundling strategy instead of the free gift design.**

The following graphs represent our research frameworks.

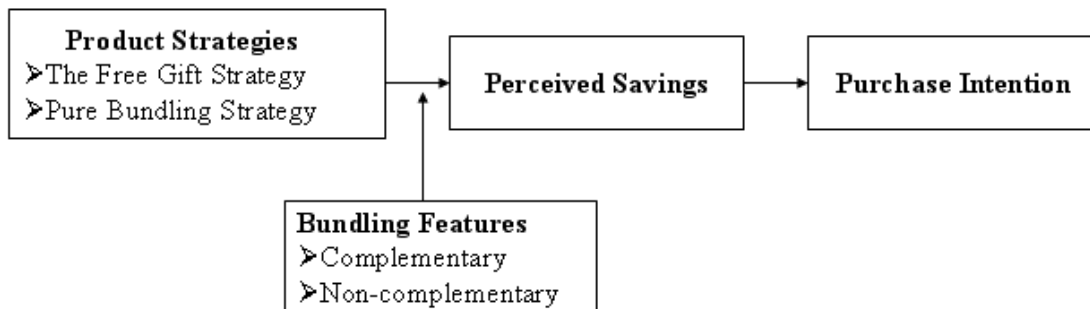
Study 1



Study 2



### Study 3



## Methodology

In study 1, we use a 3 (product strategies: single / pure / mixed) x 2 (consumer behaviors: promotion-focus / prevention-focus) experimental design method to test the hypotheses that we proposed. We use a between-subjects experimental design in which we manipulated three orthogonal factors: whether a product's strategy is single product, pure bundling strategy or mixed bundling strategy and whether a consumer behavior is promotion-focus or prevention-focus. 200 participants with equal proportion of male and female will be chosen from the undergraduate students in National Taiwan Normal University. We use the statistical method in SPSS to analyze the data we collected, and ANOVA to test our hypotheses.

In study 2, we use a 2 (product strategies: pure / free) x 2 (consumer behaviors: promotion-focus / prevention-focus) experimental design method to test the hypotheses that we proposed. We use a between-subjects experimental design. 200 participants are chosen from the undergraduate students in National Taiwan Normal University. We use the statistical method in SPSS to analyze the data we collected, and use ANOVA to test our hypotheses.

In study 3, we use a 2 (product strategies: pure / free) x 2 (product features: complementary / non-complementary) experimental design method to test the hypotheses that we proposed. We use a between-subjects experimental design. 150 participants are chosen from undergraduate students in National Taiwan Normal University. We use the statistical method in SPSS to analyze the data we collected, and use ANOVA to test our hypotheses.

## **Expected Result**

In study 1, we explore the relationship between the bundling strategies (the free gift design / pure bundling strategy / mixed bundling strategy) and the consumers behaviors (promotion-focus / prevention –focus), and we find that consumer with promotion-focus has a motivation about desired positive outcome and emphasis the gains in maximum. Besides, we also use the multiple gains concept to infer that the consumer will choose the mixed bundling strategy rather than the single component strategy and prefer the single component strategy to the pure bundling strategy. In contrast, when consumers are prevention-focus which means they have a motivation to avoid the losses and emphasis the safety, we use the multiple losses concept to infer that the consumers will choose the pure bundling strategy rather than the single component strategy and prefer the single component strategy to the mixed bundling strategy.

In study 2, we explore the relationship between the bundling strategies (the free gift design/

pure bundling strategy) and the consumers behaviors (promotion-focus/ prevention –focus), and we find the following results. According to Su’s research (2009), the consumers with promotion-focus like the promotion about quantity increasing and prefer the free gift design (Ramanathan and Dhar 2010). Thus, the consumers will choose the free gift design instead of pure bundling strategy. On the other hand, the consumers with prevention-focus prefer the price promotion, try to avoid losses and care about how much to save (Ramanathan and Dhar 2010). Thus the consumers will choose the pure bundling strategy than free gift design. In the last study, we explore the relationship between the bundling strategies (the free gift design/ pure bundling strategy) and the product features (complementary/ non-complementary). We find the following results. Based on the multiple gains, the consumer will get two gains when the bundle has a non-complementary feature. The free gift design can increase the consumers’ perceived value, so the consumers will choose the free gift design. With complementary feature, the consumers will regard them as the same type of products. Finally, we prove that the consumer will choose the pure bundling strategy when product bundle is complementary.

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