FE-rapport 1999-367

Price Bundling Theory Applied to Retail Banking

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Abstract: The current report presents a theoretical and empirical investigation of a pricing method called price bundling and its application in retail banking in Sweden and Finland.

Price bundling was found to be an appropriate model for banks since by price bundling it was possible to reduce selling, marketing and production/delivery costs and therefore to utilise the banks' fixed capacity more efficiently. The greatest potential in price bundling is, however, the way it stimulates demand for additional services. Banks can take advantage of this by introducing new complementary services to the customers since it is likely to reduce customers' uncertainty and to increase their awareness of the bank's services. Price bundling also creates switching costs for the customer which means that their loyalty may increase. From a competetive point of view price bundling was found out to be beneficial since it diminishes competition between the banks and therefore will lead to higher profit potentials in the market.

Retail banks in Sweden and Finland use price bundling extensively. Bundles seemed to be more like a reward system for customers' existing demand rather than introducing new demand. Thereby price bundling would in the first place affect customers' loyalty, and sales only indirectly. Another base model was a bundle around a current account and most cost efficient transaction services to minimise banks' costs.

The author wants to thank Jan Wallanders och Tom Hedelius stiftelse för samhällsvetenskaplig forskning for financing this project.

Key-words: Price bundling, retail banking, pricing strategy.

JEL-code: M20, M30, L11.

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Appendix 1

1. Background to the research project

This research project started as a part of a larger research programme for pricing studies in three different areas: banking, electricity and health care. All of these areas are characterised by large fixed costs for the production capacity in relation to marginal costs for the operations. If in such cases theoretically correct marginal cost prices are set fixed costs will not be covered and the linear pricing model becomes inappropriate in practice. Therefore the main purpose of this program is to find an alternative pricing method that would lead to efficient use of resources as well as financing the fixed costs.

All of these study objects are important areas in the public economy and authorities have a great interest to govern or have other control in the businesses. Health care is for example almost solely provided by the state (Landsting) and not by private suppliers. Banking and electricity markets on the other hand have been highly regulated but the recent pressure from abroad for deregulation has led these branches to become more market driven businesses. Increased competition is now expected to lead to better efficiency in these areas.

This project concerns the banking industry and there the retail banking area. The starting point chosen for the pricing investigation in this project is, despite of the importance of the public concern, business concern for banks in their pricing decisions in order to survive in the increased competition. The increased competition is in turn forcing banks to get more customer-oriented whereby the public interest will be indirectly taken into account.

The overall questions for the research programme were twofold:

1. Pricing method: There is a need to improve pricing in order to obtain greater efficiency. This pricing method must lead to revenue levels that are sufficient to finance the fixed costs on each accounting period making it possible for the bank to stay in business in the long run.
2. Cost accounting: What kinds of accounting principles are needed to support the pricing decision?

The banking project is limited to investigate a pricing method called price bundling according to which several products are sold together to a common price. The current report that will be

presented here is concentrated on the theoretical aspects of price bundling. These theoretical aspects will be analysed against the price bundles applied in several Swedish and Finnish retail banks. Conclusions will then be made about both the overall research questions for the programme and the study done in this report.

This report is disposed in the following way:

1. Introduction. Summary of the background and problem for the dissertation project.
2. Price bundling in theory. Price bundling will be studied from economic and strategic point of view. Managerial aspects of applying price bundling theory will also be examined.
3. Price bundling in practice. Several Swedish and Finnish banks' price bundling models are studied.
4. Conclusions.

There is one major limitation in this study. The customer perspective is nearly totally omitted. It is however one of the main determinant factors in the price bundling context and therefore it will be dedicated a separate report at a later stage.

2. Introduction

In this section further insights of the research problem beyond the overall research problem for the programme of financing the fixed costs will be presented. Since the discussion is done from a bank point of view efficiency equals maximum profits / profitability for a bank.

2.1. Changes in the banking market

Financial deregulation has lead to a restructuring of the financial markets around the world. It has meant that new actors have entered the banking market and the competition of customers has become more and more intensive. When the existing large banks have tried to protect and improve their market shares and profitability they have mainly used the following strategies[1]:

- **Merge and consolidate**: Examples of bank mergers in Sweden are Nordbanken and Gotabanken in 1993 and Sparbanken and Föreningsbanken 1997. Handelsbanken in turn merged together with mortgage finance institute Stadshypotek in 1997 while S-E-Banken merged with insurance company Trygg Hansa also in 1997. The latest merger was made between Nordbanken and Finnish Merita bank in 1997.

- **Cut costs to improve productivity and efficiency:** Banks have shut down branches and diminished personnel in order to shift to cheaper delivery channels such as telephone bank and Internet.

- **Increase service quality and customer retention:** In order to improve service quality banks have forced to become more service minded and they have increased the types of services they offer, such as mutual funds and insurance products.

- **Seek customer and wallet share:** Banks have started to segment its customer base: Wealthy customers, students. These segments are then cross-sold different banking services in order to increase the bank's wallet share of the customers' total demand.

- **Improve risk management:** The credit loss years have forced banks to make several improvements in their credit analysis and evaluation processes.

- **Shift from net interest income to fees:** Since net interest income fluctuates and more so after the deregulation and at the same time business costs remain on the same level, new income sources need to be found. For example payment services have started to be priced on transaction and service fee basis.

All of these strategies have improved banks' profitability. For example Swedish banks' profits have increased considerably during the past years. In 1993 banks made losses –15.395

[1] Furash (1997).

millions SEK while already in 1994 the result was +16.225 millions SEK[2]. Profits have in fact increased each year until the 1997. The diminishing of the profits was now caused by the big merger activity in banking that burdened 1997-year's results. It appears clearly that the cost side is dominating how efficiency develops in the banking industry. Revenue side in turn seems to come in second regarding the improvement of efficiency.

But, banks cannot just improve efficiency entirely through cutting costs since costs cannot be cut eternally. Customers' relationships and the long-term efficiency of banks need to be managed at least with the same concern as minimising costs. However, banks have failed to consider the demand side[3]. For example the enormous amount customer information that banks have is not efficiently utilised in order to segment customers and to cross-sell new services to these segments. Also many mergers have more been motivated by the cost saving argument than increased cross-selling opportunities and a larger customer base.

However, banks do not ignore the demand side. For example, in FöreningsSparbanken it is noted that most of the earlier Föreningsbanken's customers did not have completing savings products why these customers now show a high potential for cross selling.[4] MeritaNordbanken on the other hand sees potential in cross-selling through different customer concepts and pricing[5]. The demand side management has got increasingly more attention during the 1990's and the challenge appears to be to develop suitable strategies in order to improve banks' profitability.

2.2. Customer relationship profitability

Profitability of different kinds of customer relationships has been a problem for banks generally: it is said that around 20% of customers bring 100% of a bank's profits and with 80% of customers a bank just looses money.[6] This means that cross subsidisation between customers and between different services is present in banking. That is illustrated in Figure 1. That picture illustrates at the same time the underlying research problem: how should the large overhead costs be financed – by which customers and by which services?

[2] Kreditmarknadsstatistik, (1998)
[3] Furash, (1997)
[4] FöreningsSparbanken, Annual Report (1997)
[5] MeritaNordbanken, Lägesrapport (1998)
[6] Channon (1986), Storbacka (1993), Meltzer (1996)

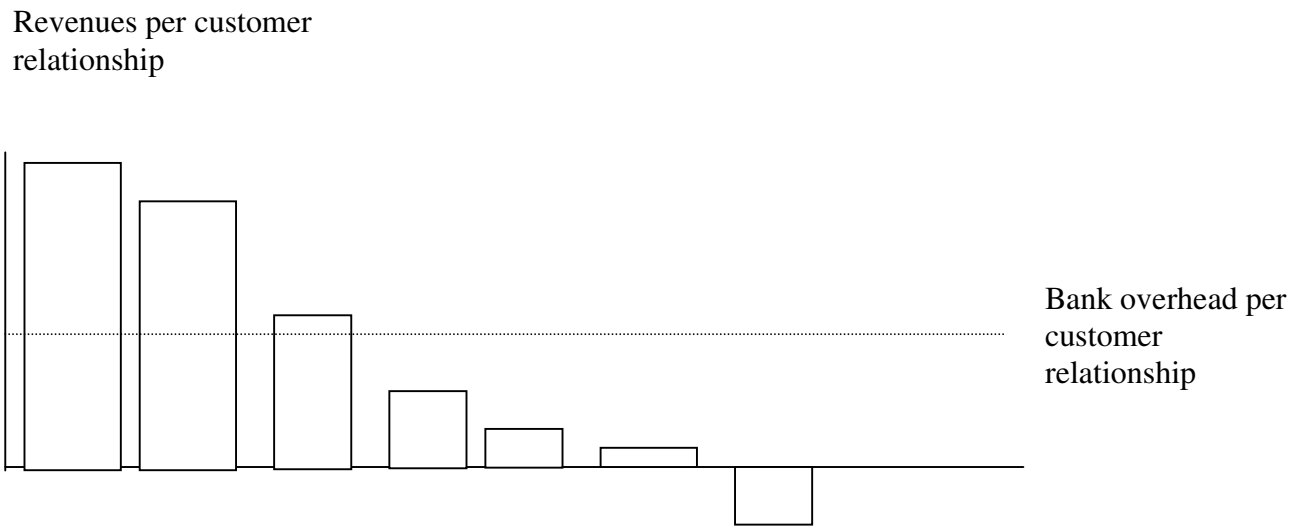

Figure 1: Different customer segment revenues against bank overhead.[7]

There is a further complication to the bank's profitability problem: banking products are not consumed at a single point in time. There is a continuing basis for serving customers and therefore the relationship profitability issues must be thought in a long run perspective. Since a customer's demand varies through time, an unprofitable customer for the time being may turn out to be highly profitable in the long run. In this respect a customer can be said to cross-subsidise himself through time. But, that in turn requires that the customer also stay in a bank for a long time to be able to compensate the eventual deficit years. This is naturally problematic for banks for two reasons: firstly there is a risk that a customer buys nothing more in the future and secondly that a customer can always switch to another bank. How should a bank then price its services so that all the relationships become profitable, or cover at the minimum the costs for maintaining them?

The model in Figure 2 shows the determinants of the profitability of a customer relationship. The starting point of the profitability is customers' *perceived value* with the banking services. It determines whether the service is experienced as worthwhile and whether it will be bought when it is compared with the *perceived sacrifices* that the customer experiences in buying it. Such sacrifices stem from price that must be paid, time that is used in the aquiring the servce and other purchasing efforts. Also the *service quality* affects the perceived value. The higher the perceived value is compared to the sacrifice in buying and the higher the perceived quality

[7] Adapted from Kimbal (1997) pp. 32

compared to expectations the more satisfied the customer becomes. This satisfaction will lead to a development of different kinds of *bonds* with the bank and to *comittment* or loyalty to the bank. All of these three factors then facilitate the customer's *relationship strength* with the bank. By this relationship strength is simply meant the amount services that the customer buys from the bank. The more satisfied and committed he/she feels, and the more bonds he/she has created with the bank the more services will be bought from that particular bank.

The relationship strength is also affected by *perceived alternatives.* A customer, even if satisfied, will probably not accept just any offers if there are competitor banks that offer considerably better contracts. Customers want to naturally be aware of the alternatives too. During the 1990's both of these factors have hardened the competition in the banking market. New niche banks have entered the market and customers are more informed because of all the marketing activities of the banks. A customer may also limit the relationship strength if he/she is not satisfied with the service of the bank. The *critical episodes*, i.e. personal contacts with bank tellers and other bankers', if unsuccessful, may also cause that the relationship strength will not develop as expected. The current changes in the bank market in this respect have meant that all the personnel must become increasingly service minded and skilful in order to meet the increased requirements from the customers.

Relationship length is the next factor affecting the customer relationship profitability. On the revenue side the *patronage concentration* refers to the bank's share of the customer's total demand of financial services. The larger the share that one single bank has succeeded in obtaining of the customer's total demand the higher will the relationship revenue be. In this respect customers have noticed being to an increasing extent shopping around and even changing banks altogether[8]. The *episode configuration* in turn illustrates the customer's consumption pattern of different services and how this consumption creates relationship costs through time. Banks have recognised that customers for example have continued to use branch network for simple payments instead of using solely the payment orders, or customers use cash, when they could also use bank card. From the bank's profitability point of view these consumption choices of are not irrelevant. The above mentioned factors then sum up to the customer's profitability.

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[8] Furlong, (1993), Burton, (1994), Morral, (1995), Milligan (1995)

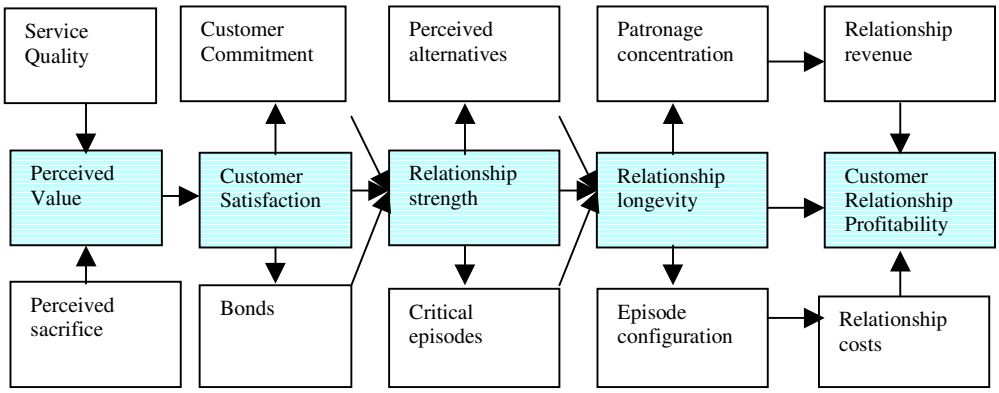

Figure 2: A relationship profitability model.[9]

Since profitability is harvested by appropriate pricing decision we will turn into the main problem in this report: What would be a suitable pricing model taking the identified profitability factors into account? In another words, how should a retail bank price its services? Obviously the method should aim at to increase customers' perceived value and customer satisfaction thereby reinforcing the relationship strength and relationship longevity.

[9] Adapted from Storbacka, Strandvik and Grönroos (1994), pp. 23

3. Research problem

Price bundling is a strategy where two or more products are sold together in a package. Some common examples of price bundling could be:

- Computers are often sold together with screen, software packages and other equipment such as mouse, printer etc.
- Mobile telephones are often sold together with the subscription
- Hotels announce weekend packages including accommodation, meals and other facilities.

Retail banks' different total customer packages are one type of examples of price bundling too. In these packages a customer needs to fulfil certain requirements before he qualifies to, or can buy the bundle. These requirements function as a 'price' for the bundle giving then an opportunity to buy other banking services to reduced prices. Since profitability of a customer relationship is dependent on the relationship strength as well as the relationship length, price bundling needs to improve these factors. One of the questions dealt with in this report is to enlighten the theoretical as well as practical knowledge about price bundling in the context of retail banking. To be more specific, the overall problem dealt with in this report concern examining whether price bundling is in principal an appropriate pricing model to lead to improved efficiency in retail banking and in which way it might work.

In price bundling either price or availability is made conditional on the offer. In the literature there appears concepts like commodity bundling, package selling etc all describing price bundling, but do these concepts mean the same as price bundling? How is price bundling actually defined? The next question that emerges in price bundling concerns the economic and strategic justifications for price bundling. Under which conditions is price bundling more efficient than individual selling practice? What factors in retail banking speak in favour of using price bundling? And how should a manager use the economic and strategic principles in the practical price bundling decisions? Results from the economic literature need to be transferred into managerial issues in order to be useful in practice.

The following research questions concerning the theoretical aspects of price bundling will be investigated:

1. How is price bundling defined in the literature?
2. What are the economic and strategic justifications for price bundling?
3. When is price bundling a good strategy?
4. What are the managerial issues in price bundling?
5. How does price bundling apply to retail banking and how should it be applied?

Price bundling is currently applied by different retail banks in Sweden and Finland. It is likely that price bundling is also applied in other retail banks all over the world. The differences between Sweden and Finland are apparent and differences exist also between the national actors. How does the practical price bundling correspond to the theoretical findings how price bundling ought to be applied? The economic theory starts from the short-term profit maximisation goal, but what are the pricing goals for retail banks? How do retail banks motivate their price bundling decisions? And how do they then apply price bundling? As a final research question in this study some empirical findings of price bundling are examined:

6. How is price bundling applied in Swedish and Finnish retail banks?

4. Aim and scope of the study

The aim of the this study to find out on which theoretical grounds price bundling is a suitable strategy for retail banking and how the practical price bundling appears in the light of the theoretical findings.

The current study is limited to examine the price bundling phenomenon on a *principal* level. The literature review summarises the prevailing knowledge about price bundling. The empirical findings also are reported with an objective to give a description and an analysis of the models used in practice. The profitability of the retail banks' price bundling models is not examined nor is any profitable price bundling models developed within the scope of this study. Furthermore, all the considerations concerning profitability of customers' point of view are omitted from this report.

5. Methodology

This research project can be divided into two parts. The research questions 1-5 identified in Chapter 3 concern theoretical aspects of price bundling whereas the research question 6 demands empirical information gathering in order to be answered. Both of the parts demand a descriptive survey method rather than an analytical data processing method.

The theoretical questions about price bundling can only be answered through a thorough literature review. Since price bundling is called in many different ways by other concepts as well it was necessary to use several key words in searching relevant sources. Naturally several databases were also used in the search (Gunda, ABI/Inform Global, General Business File International & Helecon International). It is quite certain that the most important literature in this field has been covered.

The empirical part of the study requires an appropriate data gathering method. Three alternatives were possible: collect secondary information about product offers and prices, make a survey or to do personal interviews. In a way collecting secondary information could have been enough for the research question 6: how is price bundling applied in Swedish and Finnish retail banks. By examining the banks' price lists and product offers such a question is possible to answer. Since the research project has been going on nearly two years the secondary information collection was done in two phases, the first time in 1996 and the second time in 1998 in order to see whether bank offers and prices change as rapidly as the market structure does.

Although the secondary information is very important in this study it was judged not to be complete. The way of looking at the problem could be done more interesting if the banks were directly contacted. That is why the results were planned to be analysed partly against the normative theory of price bundling and partly against the problems and goals identified by the banks. For that contact an open interview guide was constructed. Pricing questions are naturally sensitive and complicated matters for banks why the open ended questioning was chosen instead of closed end questioning. The postal survey method was omitted for the same

reasons. The questions dealt with general aspects of pricing financial services and price bundling[10]. The interviews were tape-recorded and they lasted around one and half-hours.

Interviews were done only in 1996. Banks that were contacted were Nordbanken, S-E-Banken and Sparbanken in Sweden. In Finland Merita bank, Osuuspankki and Postipankki were interviewed. In Sweden there would have been interesting to contact Handelsbanken and Föreningsbanken too. However, Handelsbanken was left out since it does not apply price bundling other than to a very limited scale and Föreningsbanken was the last one of the Swedish banks to start applying price bundling. Therefore, interviewing these two banks was not judged to increase knowledge considerably since the questions were so general. Concerning Finland all the main actors were interviewed. Persons that were contacted worked as directors for retail markets and had key positions in regard to product and pricing decisions. It can be concluded that for the purpose of this study the amount banks interviewed gave a sufficient picture of the pricing challenges in retail banking. Similarities in answers were considerable.

While the secondary information gathering was done in two phases, interviews were only done just once. The reason for this is the sensitive nature of the problem. Answers during the interviews implied that deeper information would be difficult to obtain. It can also be suspected that the overall strategies in pricing do not change but the banks' actions do. These can be observed through the price lists while getting answers why different changes have been done would have been more difficult to obtain. A new interview in other words was judged to be unnecessary because of the information would have been too sensitive and no real answers would have been able to gather.

[10] See appendix 1.

6. Price bundling in theory

The theory of price bundling has been developed since 1960's. There are quite a few concepts of price bundling that are now going to be reviewed in order to end up with a definition what is meant with price bundling in this work. Subsequently several other pricing concepts that are closely related to price bundling will be exemplified to clarify the difference between price bundling and these.

Thereafter the literature concerning price bundling is reviewed. This literature can actually be divided into three main categories. There are economic explanations for price bundling, managerial implications for price bundling and customer perceptions of price bundling. Firstly the economic and strategic reasons for price bundling will be presented whereafter the literature regarding the managerial implications of price bundling is reviewed. As it was said in the beginning, the customer perspective will be studied in another report. Finally it is turned back to the research field and the appropriateness of price bundling is discussed regarding retail banking.

6.1. Definition of price bundling

A tie-in sale is the oldest concept of price bundling where two or more products are sold together. In tie-in sales a durable product (tying good) is combined with different complementary products (tied goods) to be used with it and the buyer must accept the whole offer in order to get access to the tying good.[11] The most famous example of tie-in sales is IBM's renting of its tabulating equipment together with an obligation for a buyer to buy also all the punch cards used with it from IBM.

Block booking is another classical price bundling example. The concept was used in connection with a selling arrangement where a film producer only sold its films together with other films thereby using the popularity of one of the films to increase sales of the unsuccessful film.[12] This term is only used in this context.

[11] Burnstein (1960)
[12] Stigler (1968)

The above examples can also be called *commodity bundling* that in turn may be separated depending on the form how products are made available to customers. In p*ure bundling* products are sold only in a packaged form. Therefore individual sales do not occur when a firm is applying pure bundling. When individual selling is offered at the same time with bundled alternatives it is called *mixed bundling*[13]. In order to be a distinctive strategy from individual selling, mixed bundle price must be less than sum of the individual prices. Were the price higher, customers would naturally self-bundle and buy the products separately.

Mixed bundling can in turn be divided into two different types of bundling depending on the way the discount is presented to customers.

- *Mixed leader bundling* is an offer where "the price of one of the two products is discounted when the other product is purchased at the regular price" and
- *Mixed joint bundling* on the other hand is applied when "a single price for the bundle is set when the two products are purchased jointly".[14]

Still another type of price bundling is add-on bundling where "an add-on service is one that will not be purchased unless the lead service is purchased"[15]. Add-on bundling in turn is a special case of mixed bundling where the add-on service does not have any utility if consumed alone.

Usually the price for the bundle is set lower than the sum of the individual prices in order to facilitate the demand. Therefore most of the price bundling involves planning different discount strategies that in the best way would increase demand. *Premium bundling* in turn means that the charged bundle price is set higher than the sum of individual prices for the products[16]. In certain specific circumstances, for example when the purchase involves great search costs for the customer or there is high uncertainty in the buying process, this becomes possible.

[13] Adams & Yellen (1976).
[14] Guiltinan (1989) pp. 377
[15] Guiltinan (1987) pp. 389
[16] Cready (1991)

Price bundling can also be renamed depending on its motive[17]. *Aggregate bundling* is a selling arrangement where a bundle is targeted to a wide customer segment. *Trade-up bundling* on the other hand means that a customer is offered additional services after the main service is bought. By *loyalty bundling* is meant a price bundle which should tie the customer to the firm. These different motives naturally affect the price bundle construction and the chosen price bundle form.

Price bundling is a strategy for a multiproduct firm. In all the examples presented earlier price bundling was used to combine two or more products in the selling offer. Therefore, the products that are combined in the bundle are different from each other and the selling offer means an explicit connection with these products. We saw that there are also different forms of price bundling as well as different price structures but these factors just characterise price bundling. We can define price bundling in the following way:

> Price bundling is a selling arrangement where *several different products* are *explicitly marketed together* to a price that is dependent on the offer.

6.1.1. Related concepts to price bundling

There are some related issues concerning pricing of a product line more generally for a multiproduct firm. For example, *implicit bundling* is defined as "… a 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".[18] It is used in a retail context where price promotions are to be implicitly related to other products. This definition of implicit bundling is very close to another pricing method called *complementary pricing* or *loss-leader pricing* according to which a product in the product line is sold at loss in order to increase demand for the other products that in turn are sold with higher margins[19]. But, in these examples products are not explicitly bundled together why this kind of 'making use of interdependencies among different products' is not called price bundling.

[17] Eppen, Hanson & Martin (1991)
[18] Mulhern & Leone (1991) pp. 66
[19] Gijsbrechts (1993).

Quantity discounts is another borderline case of price bundling. Quantity discounts are, as the name suggests, given for packages of different amounts of the same product. Since price bundling was defined as a strategy for a multiproduct firm where several different products were offered together quantity discounts are not price bundling as it is defined here.

Disneyland pricing is a practice to set one single price for several services[20]. The most well known example of this is the pricing practice in Disneyland, hence the name. Since admission and rides are all bundled together it makes this a pure bundle. Related to this way of pricing is a use of *two-part tariffs*. It would suggest setting two different prices for the amusement park: an admission fee and separate fees for rides[21]. Customers can then choose between to only enter the park if they are not interested in the rides or also to use the rides for additional prices. It is obvious that customers do not earn anything by only buying tickets for rides without paying the admission fee first. This makes two-part tariffs to resemble add-on bundling. If two-part tariffs are set in a way that the offer form explicit packages such as different combinations of admission fee + certain rides, it clearly is price bundling. But if two-part tariffs are set as fixed fee + variable fee for the same service, for example telephone, it is not price bundling. Therefore, a combination of two (or several) prices does not necessarily mean that it is question of price bundling.

Coupons in turn are explicit offers. Usually they are targeted price discounts to some specific product but they can also be used to tie two different products together thereby forming a price bundle that demands a coupon to give access to the bundle. Since a coupon is an additional element in the price bundle offer the total offer becomes a new bundle containing the coupon and the ordinary offer. The coupon reminds of admission fee in the two-part tariff case and the situation add-on bundling even though the coupon is not usually bought and it is not giving any utility by itself as for example admission to amusement park is doing. These last features propose that coupons are not price bundling as it is defined here since a coupon is not a product but a marketing gimmick whereas all the elements in price bundles are real products.

[20] Llewellyn & Drake (1993)
[21] Llwellyn & Drake (1993)

6.2. Economic and strategic reasons for price bundling

6.2.1. Economic reasons

The most fundamental reasons for price bundling concern the cost or demand factors: whether price bundling reduces costs in some way or increases revenues compared to individual selling.

Cost factors

Cost savings from price bundling may come from three different sources:

1. Economies of scope
2. Economies of information and transacting
3. Economies of time

Economies of scope advantages refer to cost savings that originate from production or delivering several products in a single entity rather than separately[22]. One example of economies of scope is subscription television market where many television channels are distributed to households in different packages through the same cables[23]. The cost of distributing one single channel to separate households is quite high but if several channels are bundled together and sold to each of the households, the price can be set higher whithout corresponding cost additions and the profits would increase. In this way the existing capacity is utilised better.

Economies of information and transacting refer to cost advantages for a producer when they are searching trading partners[24] and when several services are sold at one selling effort[25]. Since price bundling means selling several products together, such economies are achieved when a customer that is already located, i.e. existing customer, is sold many services simultaneously. Economies of information and transaction refer therefore to marketing and selling activities that can be reduced by price bundling. Price bundling may also make the selling easier and faster since there are prepared product combinations to be sold together.

[22] Baumol, Panzar & Willig (1988)
[23] Chae (1992)
[24] Stigler, (1968)

Economies of time is a related cost concept to the economies of information and transacting. By economies of time it is meant long-term cost savings in location of buyers[26]. It is more economical to retain existing customers instead of having to replace them by new customers in successive time periods. Also costs to serve an existing customer are assumed not to increase proportionally through time. If price bundling can be used in order to lengthen the relationship with a customer it will reduce the need of resources to be put on acquiring new customers.

Demand factors

It could be seen that there are many cost factors that favour price bundling instead of individual selling. Usually, however, motives for price bundling are stated to come from demand side factors whereby a producer is assumed to be able to exploit consumer surplus and increase his net returns. In fact the whole price bundling literature is focused on the demand side motivations for price bundling. These explanations suggest the following reasons for price bundling:

1. Complementary products
2. Negatively correlated reservation prices for the bundle products
3. Reduction in heterogeneity of buyer evaluations of the bundle products
4. Price discrimination between customers
5. Leveraging monopoly power to another market

When two products are complementary, it means that they increase the value of the other when they are sold together. This impact can be either mutual or one-directional but the main effect is that price bundling increases the reservation price of the combined offer compared to the reservation prices for the individual products. Making price bundles of complementary products expand customers' willingness to pay and a producer has space to increase his price or alternatively to sell more to a given bundle prices.

Another explanation why price bundling works occurs when the reservation prices for the bundle products are negatively correlated. An example of this is the block booking case where

[25] Demsetz (1976)
[26] Bergendahl & Lindblom (1996)

two films are sold only in the package form. While both cinemas (A and B) would prefer the successful film, the relative valuation of these films between the two cinemas vary[27]:

A would pay $8.000 for film X and $2.500 for film Y
B would pay $7.000 for film X and $3.000 for film Y

The most the producer could take for individual films would be $7.000 for film X and $2.500 for film Y in order to sell both films and then he would earn $19.000. But if films were sold together for $10.000 the producer's profits would increase by $1.000 compared to individual selling. The explanation is that the consumer surplus experienced on one product is transferred to the other one. When reservation prices are negatively correlated a firm has the greatest possibility to capture most of the consumer surplus.

Still one argument for price bundling is the reduction in buyers' heterogeneity[28]. It is to be observed here that the negative correlation of reservation prices is not necessary for bundling to become profitable. Already less that perfect positive correlation gives incitements for bundling. In pure bundling case this occurs because when buyers' reservation prices are not perfectly correlated, the standard deviation for the bundle price becomes lower than the sum of the individual standard deviations. Therefore, the bundle price will capture more buyers than would be possible with individual pricing. In the mixed bundling case the buyer heterogeneity is reduced within the group that value both products relatively high while still offering individual products for those customers that value only one of the products high but care little for the another. In this way price bundling offers 'double' advantage for the seller in order to capture more of the consumer surplus.

An alternative explanation for price bundling is given by a *price discrimination* motive[29]. Price discrimination occurs when different customers are charged different prices for the same product. In the case of tie-in sales type price bundling the durable product is tied with a non-durable, like the earlier mentioned IBM example of tabulating machines and punch cards. Those who are heavy users of tabulating machines are assumed to have higher reservation prices for the equipment than the light users. By metering the intensity of the demand through tying the punch cards to the tabulating machine such discrimination of prices becomes

[27] Example adapted from Stigler (1968) pp. 165.
[28] Schmalensee (1984).

possible. Customers are now doing the discrimination by themselves since the effective price they are paying varies according to their use of punch cards. If IBM had not done its pricing in this way, it would not have been able to identify differences in customers' valuations for the tabulating machine. In this case the reservation prices for the different products are assumed to be positively correlated as opposed to the earlier presented motive for price bundling that demanded negatively correlated reservation prices –or at least less than perfectly positively correlated reservation prices.

Another example of price discrimination motive for price bundling is the mixed bundling strategy. When mixed bundling is practised customers can be divided into different groups by their self-selection. In the two-product example there are buyers of product 1 only, product 2 only, bundle buyers and non-buyers. The advantages from both individual and bundle pricing can be utilised simultaneously when customers with high valuation for one product can be charged the high price and customers with less extreme but negatively correlated values can be charged a common 'high' bundle price. This is again just another interpretation of the explanation provided earlier where the motive for mixed bundling was to reduce buyer heterogeneity among bundle buyers but still to price the individual products with high margins.

The last motive for price bundling comes from leveraging monopoly power to a product that is sold under competition. Once again the IBM case can serve as an example. Punch cards were also sold by competitors but when IBM 'forced' customers to buy either the whole offer or nothing. Therefore, market power from the copying machine was moved on to punch cards that were sold under competition.

6.2.2. Strategic reasons

In the previous section it was assumed that the company had monopoly power over the products that were bundled together alternatively the company was able to leverage monopoly power on other markets through bundling. Competitors' actions could then be ignored. However, when the monopoly assumption is relaxed to imperfect markets (ranging in between perfect competition and monopoly), the appearance of price bundling obtains new motives.

[29] Adams & Yellen (1976),

Strategic motives given in the present literature to use price bundling concern reduction of competition by

1. Exclusion of rivals
2. Product differentiation

Exclusion of rivals from the market is one way to diminish competition[30]. It is possible to do by a monopolist that bundles the monopoly product with a product that is sold in the competitive market. If the competitive product is sold to a price that will make the sales for the other firms to decline to levels that are unprofitable, the competitor will exit the market by leaving the monopolist with a higher market power on the second market as well. The difference of this analysis to the earlier mentioned motive for price bundling by leveraging market power is the longer-term consequences for price bundling. The motive in case of imperfect markets with non-constant returns to scale seems to be to maximise longer-term profits instead of short-term profits.

Price bundling may cause less aggressive competition also in other ways in imperfect markets. If a firm applies price bundling it differentiates its products compared to rivals on the same market where the products are sold individually or in another kinds of bundles[31]. This product differentiation means that prices can be maintained in a higher level than otherwise would be the case. Price bundling is therefore applied in order to affect the competitor to behave less aggressively. "Sometimes the favourable response takes the form of the rival charging a higher price. Other times the rival may cut price, but nevertheless the bundling firm achieves an increase in market share large enough to more than offset the decreased margin".[32]

The same motivation is sound even if a company is competing in the primary market (tying good market) too. Price bundling can then be shown to provide a useful way for firms to differentiate their primary products and thus gain market power in their primary market[33].

[30] Whinston (1990)
[31] Carbajo, de Meza & Seidmann (1990), Chen (1997)
[32] Carbajo, de Meza & Seidmann (1990), pp. 296

6.2.3. Summary of conditions for profitable bundling

The previous section offered several motivations for bundling, but what are the conditions when price bundling becomes a preferable strategy compared to individual selling? In this section any general conditions for profitable price bundling are not presented. The theoretical motivations for price bundling has been derived by using several assumptions. Most often only two products have been considered. Both economies in the bundling process and compelmentarity of consumption have been disregarded. And only one product is bought by each of the customers whose distribution of the reservation prices is known. Based on such simplifications but when costs are considered to be a part of the bundling process, there are two main results offered in the literature:

1. Bundling is most profitable when demands are negatively correlated and when component costs are low [34] (and bundling is not assumed to affect costs[35]).
2. If demands for the products are positively correlated, price bundling tends to be more profitable than individual selling when price bundling reduces costs and when component costs are high[36].

In the former case the common bundle price is possible to reduce considerably because the costs are low. Therefore the bundle becomes attractive to most of the customers and the more negatively correlated the reservation prices are the more of the consumer surplus is possible to exploit. In the latter case the positively correlated reservation prices would mean that the same customer is willing to pay a high price for both of the products therefore leading to conclusion that revenue from bundling would be the same as from individual selling. In that case a firm is induced to use price bundling only if it causes costs to decrease and when it does price bundling is more profitable strategy than individual selling.

These above-mentioned results ignore the interdependencies between different demands and it has appeared that price bundling is profitable even without any complementary relationship between demands. But the complementary relationship surely facilitates the profitability of

[33] Chen (1997)
[34] Adams & Yellen (1976), Schmalensee (1984)
[35] Salinger (1995)
[36] Salinger (1995)

bundling. In fact, a bundling effect (BE) can be identified when diversity in consumers' valuation of the bundle relative to their valuation of its parts are allowed[37]:

$$BE = P[a(x) + b(y)] - [a(x) + b(y)]$$

Where

P[a(x) + b(y)] is the reservation price for the price bundle of products A and B
a(x) is reservation price for the product A
b(y) is the reservation price for the product B

The bundling effect is then the difference between the reservation price for the bundle reduced by the sum of the individual reservation prices. If the bundling effect is positive then the bundle offers an extra utility of its own and it should be used. On the other hand if the bundling effect is negative, the bundle contains an element that a customer does not want and then the products should be sold separately. Therefore, the profitability of bundling is also dependent on the degree of additivity of reservation prices as well as the distribution of them and cost effects.

The choice of price bundling form –pure bundling or mixed bundling, depends also on the distribution of reservation prices and costs. If the reservation prices are negatively correlated the mixed bundling strategy is recommended to be applied[38]. This strategy dominates the strategy of pure bundling and both dominate individual selling when the bundling firm is assumed to have monopoly power over of one of the products. Even if the mixed bundling strategy dominates pure bundling strategy, a company should still apply pure bundling if some of these three reasons are valid[39]:

1. The set-up cost associated with offering additional products is high
2. The firm wants to maintain more complex pricing arrangements
3. Resale of the products cannot be prevented

[37] Dansby & Conrad (1984)
[38] Adams & Yellen (1976), McAfee, McMillan, Whinston (1989)
[39] Schmalensee (1984)

In the case of imperfect competition pure bundling is the preferred strategy to mixed bundling[40]. Moreover, pure bundling emerges as an equilibrium strategy in presence of competing firms because of its strategic effect to reduce competition through product differentiation.

6.3. Managerial principles for price bundling

The reviewed economic and strategic reasons relied very much on the knowledge of the reservation price distribution but in the real life that is one of the least known factors. Also costs were important as well as the relationship between the products. How should price bundling then be applied in practice by using the knowledge from the previous sections? In this part we will go through the managerial literature of price bundling to view how the economic principles have been translated into practical use.

Managerial motives and guidelines

The main motive for price bundling is that it creates more profits compared to individual selling practice either in the short or in the long run. This overall 'profit maximisation motive' can be divided into more concrete goals on how it may be achieved in the practice[41]:

(a) Reduce costs
(b) Increase demand
(c) Lock in customers
(d) Improve product performance
(e) Differentiate the product offer

Costs can be reduced when products or components that have high set-up costs are bundled together. This is an example of using economies of scope in production. Another way of to cut costs occurs when low cost products or components are bundled together and more expensive parts are priced separately. If bundling increases demand and more of these low cost products are now sold, it will lead to cost savings.

[40] Chen (1997)
[41] Eppen, Hanson & Martin (1991)

Price bundles are usually aimed at to increase short-term demand. This can be done principally in two ways. Firstly through so-called a*ggregation bundling* that is a term to describe the situation when a company tries to please all the customers with one single offer. Customers' total valuation of the bundle is similar albeit they buy the bundle for different reasons. The second main way of bundling is *trade-up bundling* that in turn means a bundling strategy where a consumer is sold one basic product that successively is tried to be completed with additional, preferably higher priced, products at a later stage. If the bundle price should be discounted or premium depends. Instead of offering a price discount for the bundle price a premium price is recommended if the bundle offers the buyer savings in information and transaction costs[42]. The price premium set for the bundle should be approximately equal to search and transaction cost savings realised by buyers.

To lock in customers is one further form of increasing demand but then the focus is in long term. The basic idea in such *loyalty bundling* is to form bundles that create switching costs for customers that will make them to stay with the original supplier. Such switching costs occur where information is difficult to obtain, uncertainty is high, and contracting costs are high. Also, buyers' familiarity with a firm can function as a type of switching cost. It is also noted that a bundle consisting of complementary products can help locking in customers in the future, if at least some of the products are proprietary[43].

Price bundling can also be motivated by the performance of the products. If products are performing better as a whole than individually, there are strong incentives for selling them together. Then pure bundling should be used. One other possibility is to define a bundle as a 'new' product. The product consists of several parts but it is only sold as if it was a single entity. This latter way of bundling can be risky in the long run if competitors start selling the different parts separately and customers become more aware of the different functions.

By price bundling a firm is differentiating its product offer from competitors. There are then opportunities for increased profits. Even though competitors would follow the first mover, it is not simple for them to be equally successful since as long as the companies are not equal in every sense the demand and cost factors are likely to vary between the firms. The more

[42] Lawless (1991)
[43] Lawless (1991)

products there are in a firm's price bundle, the more difficult it is for competitors to duplicate the bundling firm's offer, in terms of competencies and co-ordination[44].

Price bundling decision

When the manager has analysed the branch in which his business is involved and the factors that might motivate the bundling decision, the next step becomes to create concrete price bundles. In order to do that the manager must decide the customer segment and which products are to be sold together and through which kind of offer.

1. Customers and the strategic objective

The first step in price bundling decision is to select the customer segment the bundle is targeted to and to choose a strategic objective[45]. If there are two products (A and B) that are considered to be bundled together the comprehensive strategic objectives for the different customer segments are the following:

- Cross-selling to customers that only buy one of the products
- Retaining customers that already buy both of the products
- Acquiring new customers when they buy neither product for the time being.

This can be illustrated as in Figure 3. There are then different strategies depending on the current sales to customers. Both cross selling as well as acquiring new customers are clear methods of increasing demand. Customer retention in turn merely maintains demand in a certain level for a longer time period.

[44] Lawless (1991)
[45] Guiltinan (1987)

Product A

Yes	No
Retain customers	Cross-sell to existing customers
Cross-sell to existing customers	Acquire new customers

Yes

Product B

No

Figure 3: Strategic objectives for price bundling in order to enhance demand.

2. Price bundling form

Price bundling could be applied as a pure form and as a mixed form. It was concluded that mixed bundling almost always worked better than pure bundling did. Mixed bundling was said to combine the advantages of individual selling and pure bundling. Mixed bundling was also possible to divide into two different forms:[46]

1. Mixed leader bundling
2. Mixed joint bundling

Add on bundling may be regarded as a special case of mixed bundling where the tied product do not have any utility if consumed alone. In Table 1 the bundling form and consumer choices are shown.

Table 1: Consumer choice in different bundling forms.

BUNDLING FORM	CONSUMER CHOICE
Pure bundling	A and B together
Mixed leader bundling	A to a reduced price if B is bought, or A only or B only
Mixed joint bundling	A and B to a common reduced price, or A only or B only
Add on bundling	A only or A and B together

The problem then is to choose an appropriate bundling form. The chosen strategic objective for different customer groups needs to be combined with demand and cost prerequisites in order to bundle successfully. Since the manager does not know the distribution of reservation prices he needs to base his judgement on other factors. The managerial information needed in order to decide the bundling form consists of *sales quantities* for the products, the *relative profitability of the products, degree of complementarity between* products and *price elasticities*.[47] With this information it is possible to count the effects on future sales and profitability for the different strategic objectives. Instead of the reservation price distribution a manager uses sales quantities to choose the mixed bundling form. When there is one product that has very strong demand it is appropriate to choose it as a leader product since there is a greater chance that its popularity and the corresponding consumer surplus is transferred to other products than the opposite. How well the products complete each other is another fact that facilitates the selling of the bundle. From profitability point of view it is better if the leader product has a lower margin than the tied product. Then, if the selling of tied product increases along the bundle offer, the addition to profits will be higher than if that product had had a lower profit margin. Concerning the profitability, a firm needs to observe any possible cannibalisation effects of the price bundle too. By that is meant any reduced profits from the three customer segments –retention and both cross-selling segments, because existing customers that already buy bundled products to normal prices now get discounts. General conditions for profitable price bundling are presented in Table 2.

[46] Guiltinan (1987)

Table 2: Conditions leading to success of bundling programs.[48]

Cross-Selling/Mixed Leader
Quantity of A > Quantity of B
Profit margin for A < Profit margin for B
Large consumer surplus on A
B enhances value of A and/or search economies reduce the real cost of B
Cross-Selling/Mixed Joint
Quantity of A = Quantity of B
Profit margin for A = Profit margin for B
Each customer has large consumer surplus on A or on B
Bi-directional complementarity between A and B due either to enhanced image of seller or to join search economies
Customer Acquisition/Mixed Leader
If A is leader, demand for A elastic
B and A complements because of search economies or enhanced value
A value much more highly than B
Customer Acquisition/Mixed Joint
Demand for A + B elastic (both A and B composed primarily of search attributes)
Strong bi-directional complementarity (or it can be established between A and B.

6.4. Price bundling and retail banking

Retail banking is often mentioned as an appropriate field for using price bundling. In this section the findings about price bundling from the previous chapter are stated against a retail banking business reality: cost structure, services offered and competition to see in why price bundling could be a suitable strategy for a retail bank.

Cost structure

A bank's costs can be divided into financial intermediation costs and business costs[49]. Financial intermediation costs are the cost of deposits and shareholders' provided equity capital. Financial costs are depended on the level of interest rates that causes movements in the deposit balances and changes the required return on equity. Business costs in turn involve to a large extent staff and management costs. Other main costs are overhead and infrastructure costs for branch network, costs for the payment system and costs in the provision of services.

[47] Guiltinan (1987)
[48] Source: Guiltinan (1987), pp. 389.
[49] Llwellyn & Drake (1993)

Most of the business costs are fixed in nature while costs in provision of services are variable and depend on a customers' use of services, for example how many checks a customer writes or how many withdrawals he makes. Activities that demand fixed resources are for example opening an account and managing accounts. Most of the business costs can be allocated according to customer driven activities. In Figure 4 this situation is presented.

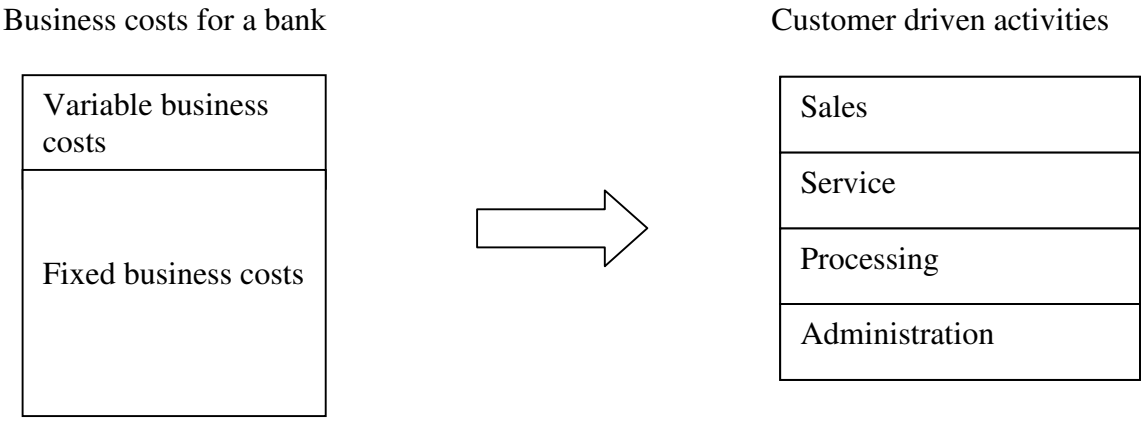

Figure 4: The business cost structure of a bank and customer driven activities.

The business costs can naturally also be allocated to different services that the bank offers by using volume or time used for different activities as an allocation base. One of the conclusions from the previous chapter was that price bundling improves efficiency if it lowers costs compared to individual selling. In the short run the question concerns how the fixed capacity is best utilised. Therefore the question becomes here in which way price bundling can make use of economies of scope, economies of information and transaction and economies of time to reduce the business costs and/or the financial intermediation costs for a retail bank to free resources for other uses.

A customer relationship with a bank is usually longstanding. In Figure 5 a principal development of a customer relationship with the bank and the associated revenues and costs is illustrated. On the revenue side it can be seen that in the beginning of the relationship the customer perhaps starts with a single service, for example a current account is opened. When the relationship develops new demands usually appear, such as different loans and savings and the customer relationship revenue then comes from different sources. On the cost side the most noticeable cost concerns the origination of the relationship. The bank needs to put a lot of resources in order to acquire a new customer: these costs involve heavy advertising costs,

price incentives, set up costs for accounts, information and service costs etc. When the customer has been caught up the costs in the following period mainly involve processing costs for, as in the example above, the current account. In proceeding periods when the bank sells additional services to the customer it can be seen that such selling costs are considerably less for this existing customer compared to selling the same service for a totally new customer. It is also possible that when the customer becomes familiar with the bank's routines, the serving costs for the existing customer are lower than for a new customer.

On the other hand, banks cannot solely manage their existing customers but they need also secure staying in the business in the long run. Since origination of a relationship demands a lot of resources it can be asked whether price bundling can be a better strategy to acquire new customers than individual 'loss leader' offers would be. From the cost point of view price bundling is motivated by possibility to take advantage of economies of transaction. But in this respect the answer is, however, better given by demand conditions whether price bundles appeal to new customers more than individual 'pang' offers.

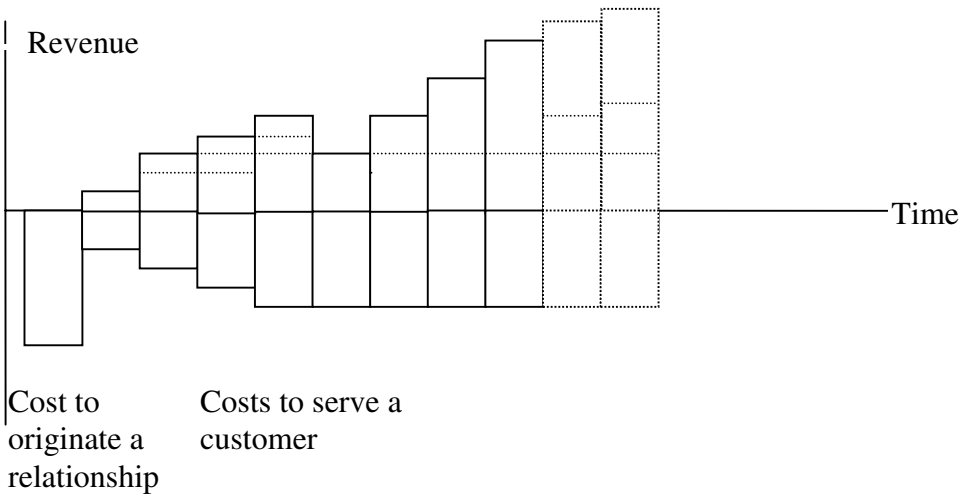

Figure 5: A representative customer's relationship cost and revenue development.[50]

A retail bank uses several parallel distribution systems for its services. There are traditional branch offices, telephone service and Internet banking. Not all the services can be delivered through all the channels but the supply through telephone and Internet is increasing as the systems improve. The producing and the delivery costs for the services are much less for the

[50] Adapted from Carroll & Rose (1993), pp. 8.

automated distribution channels telephone and Internet than for the labour intensive branch network why it lies in the retail bank's interest to get its customers to use these channels. As it were said earlier it was customers' use of services that causes many of the costs for the bank and especially the customer choice between the different distribution channels makes a big difference from the cost standpoint.

Based on the above reality in retail banking: large fixed capacity costs, customer driven costs, high relationship origination costs and considerable cost differences serving the customers through the different distribution channels, three conclusions can be made of usefulness of price bundling. The fourth notice concerns financial costs.

1. If price bundling means increased sales compared to individual selling, the customers will be more tied to the bank that in turn might increase or at least secure the relationship length. Therefore, if price bundling can be used to retain customers it will lead to cost savings for a bank due to *economies of time.* By it was meant the cost savings that are made because a bank does not have to replace an existing customer by acquiring a new one. These cost savings stem also from serving an existing customer that has become familiar with the bank's systems and routines than would be the case with a totally new customer.

2. If price bundling can be used to sell more services to customers, it is naturally more economic to market and sell many services together at a same time compared to selling them individually. In addition, the efforts should be put on improvements of existing customers' relationships rather than attracting new customers. Still, to the extent that new customers will be attracted price bundling can be advantageous compared to individual selling. This kind of cost advantage was called *economies of information and transacting.*

3. As it was said earlier banks distribute services through branch network, telephone and Internet where the use of these channels give rise to totally different cost levels. For example making a payment in a branch office demands a lot more resources than using self-service function via telephone or Internet. If price bundles are combined to cost efficient distribution systems a retail bank can make use of *economies of scope*. Also, if price bundling originate inclusion of a new service in the existing product line, the bank would be achieving economies of scope in production too.

4. If a retail bank by using price bundling can tie the customer closer to the bank and the bundle products and terms of contract mean, for example, a steadier level of deposits, the financial intermediation costs may be reduced because of the less liquidity risk. Also credit risk can be diminished if the customer has concentrated all his affairs to the bank thereby offering more information about his economic conditions.

Services and demand

Full service retail banks have several hundred services in their product lines. Services can be divided into different classes and here they have been classified according to core service, facilitating service and supporting service[51].

1. The core service is the reason for being on the market.
2. Facilitating services (and goods) are needed so that the core service can be used; and
3. Supporting services (and goods) are not required for the use of the core service but which helps distinguish the service package from those of the competitors.

In Table 3 there is example how banking services could be divided according to the classification above. However, examples are not a complete list of all the banking services.

Table 3. Classification of some bank services.

CORE SERVICE	FACILITATING SERVICE	SUPPORTING SERVICE
Payment services	• Cash • Foreign currency • Giro payments • Cheques • [Current account (often)]	• Telephone bank • Internet
Current account	• ATM card • Payment orders • Account statement	• Master card/Visa card • Credit limits • Cheques • Telephone bank • Internet
Savings account 1. Ordinary 2. Time deposit	• Availability of money	• Interest rate ladders • Better interest rates for family's children
Mutual funds 1. Securities 2. Interest bearing assets 3. Mixture of both		• Buying and selling information and fee structures
Insurance services 1. Life insurance 2. Pension insurance		• Additional insurance for family members • Additional insurance in case of death for pension insurance
Securities brokerage		• Selling and buying securities via telephone bank and Internet
Loans 1. Consumption credit 2. Car loan 3. House loan	• Current account (often)	• Promise of a loan • Interest rate assurance • Interest rate ceilings • Loan protection
Other such as: Safety box, counselling etc.		

The fact that a retail bank offers many services gives it huge possibilities to combine different services in different kinds of bundles. Since in many cases demand for one service affects the demand for another service, for example demand for a current account and payment services are clearly related, price bundling could be a better alternative than individual selling. However, the question is how much more the demand for either or both of the services is increased compared to individual sales, and how much the price must be reduced in the bundle in order to the get more than compensating effect in increased sales quantities. Demand levels for current account and payment services can assumed to be nearly equal and in that case individual pricing could in fact be more profitable compared to a reduced common bundle price. But, for example, a combination of current account and savings account could in turn lead to increased savings when they are sold together. Price bundling concerns, however, many considerations before the application can clearly be assessed as more efficient, or more profitable, than individual pricing. The choice of customer segment, bundle products, bundling form and pricing method after analysing the underlying demand

[51] Grönroos, (1998) The three definitions are quoted from Grönroos, pp. 13.

conditions are some variables to be analysed. In any case, there is forum for price bundling in retail banking that is based on interrelated services it offers.

To continue the above theme price bundling was assessed to be favourable when services are complements. In case of banking that is the situation with most of the services. Some of the services can also be treated as substitutes like different savings accounts, mutual funds and securities brokerage. These services are however not perfect substitutes but they have distinctive risk and return characteristics and they may therefore be complementary services for some persons. This incident stresses the importance of segmentation of customers in order to use price bundling most appropriately.

Financial services are characterised by intangibility, inseparability of production and consumption, heterogeneity, fiduciary responsibility and long-term nature.[52] Heterogeneity results from the interaction between the sales staff in the bank and the customer. Fiduciary responsibility in turn refers to the promises a retail bank may make in advertising campaigns or otherwise, but is unwilling to fulfil these promises later on. For example, a person can be denied a loan when he has made the decision to take one if the bank considers the customer being unable to meet the repayment obligations. This can be true even when the customer has other relations with the bank making the relationship delicate to manage. Financial services and the relationships altogether are complex for consumers to evaluate because of the above mentioned characteristics and the number of features they have. There are for example different risk-return characteristics; different ways of charging the price and it is also difficult to assess whether an occurrence was because of the skilful manager or favourable economic conditions. All these facts make a claim for trust and confidence to be of vital importance for customers in their relationship with the bank.

Financial services lack of intrinsic appeal.[53] This means that financial services are not bought because a person wants to buy a loan, or savings account, but because these services help the consumer to buy for example a house now, or a house in five years. Moreover, in some cases, such as insurance products or supporting services for loan products, consumers may not understand the meaning of the service and therefore they have no need for such a service. This make information and marketing to be in focus for retail banks in order to facilitate demand.

[52] Ennew & McKechnie (1998)
[53] Ennew & McKechnie (1998)

To connect these findings with price bundling, there are several consequences or motivations for enhancing the demand by price bundling. Since a retail bank wants to sell more services to its customers, the price bundling should be applied in a way that they

1. Reduce uncertainty.
2. Are easy to understand and the benefits of buying the bundle are shown clearly.
3. Introduce new services / demand for the customers.
4. Segment customers after their specific needs

A bundle that reduces uncertainty in the customers buying process may for example include a counselling service, or a promise of a loan. The price bundle should also be easy to understand that perhaps would mean not to include very many services in the same bundle. This must be weighted against the desire to sell as much as possible to each customer and therefore to include just about everything in the bundle. The demand for a price bundle is not likely to be affected if the benefits of buying such a bundle are not clearly visible. Since it is already difficult to evaluate performance and value of one financial service, a bundle of services may be even more difficult from this standpoint. On the other hand, a consumer usually demands several services at one time and a price bundle may in fact be a preferred alternative. This is true especially if the benefits of the bundle are shown to be evident compared to buying services individually. It was also mentioned that customers do not always recognise all the needs they might have concerning financial services. In this respect price bundling could be a effective way of introducing new services and thereby increasing the demand compared to an attempt to sell these services alone. The last motivation deals with more efficient marketing of specific service packages to targeted customer groups. It should be possible to divide even the private market into different segments, although it often is assumed that the needs in the private market are homogeneous.

Competition

Financial services market is a mature market. In mature markets many firms unbundle since then buyers are more informed and familiar with the services and competition has been intensified by new entrants[54]. Many of the new competitors choose to enter only some part of the market and sell services individually. This is also something that has happened in the financial markets during 1990's but despite of the increased information and competition price bundling has increased in retail banking at the same time –at least in Sweden and Finland.

The theoretical argument for price bundling in imperfectly competitive markets was to find a way to differentiate the product offer from competitors. In banking this could be true too since bank services are nearly identical between the actors and new services are easy and fast to copy. Still, there are transaction costs, information costs and psychological factors that imply inertia for the market and customers tend not to change banks very easily, although this phenomenon has been increasing[55]. Thus, being distinctive in this market seems not to be the most relevant factor when customers decide where they consume their financial services.

The concern for retail banks for the time being is to lose the profitable affairs with customers to smaller niche banks. Another threat is that customers are totally lost to competitors because the customer satisfaction and trust for banks has diminished during 1990's. Therefore, price bundling from the competitive point of view is motivated if it leads to maintaining and increasing existing customers' total demand. If all the retail banks were having the same strategy to concentrate on existing customers with full service bundle concept the aggressive competition between banks would probably diminish after the market would have reached some equilibrium leading banks to have higher profit opportunities. There will still always be competition between the banks about new customers in order to keep the banks in the business in the long run. Price bundling in that respect could also be a conceivable strategy. When making an attractive total solution for a customer the price perhaps loses its importance compared to attracting customers by strongly reduced prices for individual services. That in turn would mean better opportunities to maintain a higher price level on services although the competition would be harder in that segment.

[54] Lawless (1991)
[55] Burton (1994)

7. Price bundling in practice

In the previous section the theory of price bundling and its applicability for retail banking was studied. On theoretical grounds there are several motivations why there are great potentials for using it in retail banking. In this section the interview results of the six Swedish and Finnish banks' identification of the problem with pricing of financial services and their opinion about where they see the potential of price bundling is going to be presented[56]. After that the practice of price bundling in some of the interviewed Swedish and Finnish banks will be investigated. The models detected in this section will be analysed against the theoretical aspects identified earlier. The factors that will get most attention will concern the price bundling effects on demand enhancement, cost reduction and locking in customers. Some reflection is also made based on the interviews and the goals that banks have had with their price bundles and future consequences.

7.1. Interviews with Swedish and Finnish retail banks

General views about pricing and cost accounting

The main aim for each bank was quite awaited: a long-term surviving in the increased competition. Another important goal was to lead customers' demand to services that are cost efficient from banks' point of view.

The biggest concern for banks was the negative attitude of customers. Banks have had difficulties to recover the trust that customers earlier had for banks. The interviewed banks claimed that customers were very sensitive regarding service prices applied by the banks. While customers may accept high profit margins on other products, for example clothes, they tend to complain heavily banks' interest rate margin to be too wide and service fees absurd. At the same time customers seem not to understand that for example payment services are expensive for a bank to offer and they have no willingness to pay for such services that have traditionally been free of (explicit) charge. On the other hand, customers have claimed that banks should actually pay them for using the self-services, after all it is the customer who

[56] Banks interviewed in Sweden were Nordbanken, Sparbanken and S-E-Banken. Finnish banks interviewed were Merita, Osuuspankki and Postipankki. Interviews were done in 1996.

does all the work. One big challenge for a bank is therefore to increase customers' valuation of financial services.

Another major area that concerned banks was the long-term profitability of a customer relationship. Banks stated that it is difficult to create relationships so that a customer would be profitable during the whole relationship time. If a customer suddenly left the bank while still being unprofitable or right the point of time is unprofitable, the bank would just have lost money on that customer. The profitability in many cases is created through time and that fact necessitates that the customer also stays in a bank for a long time. Banks try actively to direct customers' demand by customer concepts. But some banks also mentioned that their own defined regular customers are not necessarily the profitable ones. Therefore there seems to be a need to improve the regular customer concepts and the accompanied reward systems.

One possible starting point to the above problems could be to improve cost accounting principles. Banks asserted that cost accounting in general and the allocation of the high overhead costs to different services or customers in particular was not a serious problem anymore. Several cost accounting methods were used although the ABC-method dominated the internal accounting. The interviewed banks claimed that the problem is instead how these overhead costs are financed. Traditionally different services and different customers cross subsidise each other. For example, the payment system is financed only 20% by the fees for these services. And it is also said that around 20% of customers are profitable at a given time period. The situation is further complicated by the fact that cost and revenue flows do not occur at the same time. As it was mentioned earlier, customers' willingness to pay is low for the financial services and the hardened competition cause even more worries to banks. Moreover, even if the pricing in the financial markets is deregulated, authorities are keeping a close eye on banks. Banks concluded that there is a demand for efficient pricing principles in order to overcome the mentioned problems of negative attitude of customers, long-term profitability of customer relationships and financing the fixed costs!

Considerations about price bundling

Price bundling has started to be applied approximately at the same time in most of the interviewed banks: in the beginning of the 1990's. One of the most prevalent reasons for that

was the bank crisis when revenue generation became an acute problem to counteract some of the credit losses.

Price bundling was introduced in order to charge higher prices from customers that would not have been possible with individual pricing. As banks noted earlier one of the biggest problems was the low willingness to pay for financial services and through a larger offer, i.e. price bundle, higher prices for multiple services were expected to be accepted easier than higher prices for individually sold services. Before 1990's there were hardly any transaction fees and the opinion against the introduced individual pricing was devastating.

Another motive for price bundling of the interviewed banks was to tie the customer closer to themselves and to increase customer loyalty. Banks wanted to reward the loyal customers (meaning customers with a certain amount business with them) and to accomplish fairer prices: a maximum reward to a customer who causes the least costs for the bank. This argument was though more apparent for Swedish banks. In Finland the banks wanted to emphasise simplicity and usefulness for the customer when they contact the bank. Price bundles were constructed so that they meant an easy way for a bank to get income as well as they were an easy way for a customer to know how much his consumption of everyday financial services costs per month. Pricing services individually would have mean that a customer did not know how much his consumption would turn up to be at the end of the month or a year. Banks in Finland claimed therefore that easiness and clearness were more important arguments in price bundling than to diminish cross subsidisation between the customers.

Differences in the emphasis of the banks in Sweden and Finland have naturally lead to different types of price bundles in these markets. The price bundles in Sweden were comprehensive including current account, payment services, savings and loans whereas in Finland the price bundles were smaller payment packages combined with the current account. To some extent the size of a customer's engagement affected the price paid for the bundle in Finland too.

Common for all the banks were that their goal was to get 'total customers', i.e. customers that concentrated all their affairs to a one supplier. Price bundles in Sweden are certainly more constructed in collecting a customer's affairs than the comparable practice is in Finland.

Banks divided the customer base into different segments in order to target the price bundles more efficiently to right customers. Customers have different needs and therefore segmentation is more or less necessary. The roughest distinction is between private customers and corporate customers. The private customer market is also regarded as a mass market but despite of that customers are further divided into different segments depending on the level of engagement with the bank or the service level preferred. In some banks there were special student packages.

Corporate market was in some banks also divided into different segments: small firms, medium size firms, associations and these were offered special packages. Price bundling was thought to suit private market by all the banks whereas corporate market was more dubious. In some banks corporate bundles worked very well but in some other banks applications of price bundling had been a catastrophe.

Banks had an opinion that customers did not necessarily think positively about the price bundles. Therefore, in Sweden banks wanted to call price bundles as different agreements or concepts. In Finland banks had experienced that customers reactions about the bundles were very negative in the beginning since banks did not give customers any alternative but they were forced to buy the bundles, but later on customers have understood the benefits compared to individual pricing and now they are accepted.

Concerning the future of price bundling, banks claimed that the choice of services would be determined by the technical development. The changes that future will imply to the existing price bundles were not assumed to cause any difficulties regarding the customer reactions. Banks were convinced that customers' needs are compatible with banks' interests so that customers will see the benefits of the new services in the bundle compared to the old ones.

7.2. Price bundling in Swedish banks

General market overview

There are four major retail banks in Sweden: Handelsbanken, FöreningsSparbanken, Nordbanken and S-E-Banken. In Figures 6 and 7 market shares for loans and savings to public are presented. According to these figures Handelsbanken and FöreningsSparbanken have the largest market share concerning both loans and savings in the private market.

If the amount customers measure the size of the bank Table 4 shows the current market situation.

Table 4: Bank size by number of customers[57].

Bank	Number of customers
Handelsbanken	3 000 000
FöreningsSparbanken	4 500 000
Nordbanken	3 500 000
S-E-Banken	2 500 000

It can clearly be seen that the sum of amount customers in different banks exceeds the Swedish population. The reason is that the definition of a customer varies between banks when it on one bank is defined as a person that has either current account or loan in the bank, while another bank defines a customer as a person that buys any service from a bank[58]. Still, it is also evident that same individuals are customers to several banks at the same time.

[57] Source: Different banks own information.
[58] Knutsson (1998)

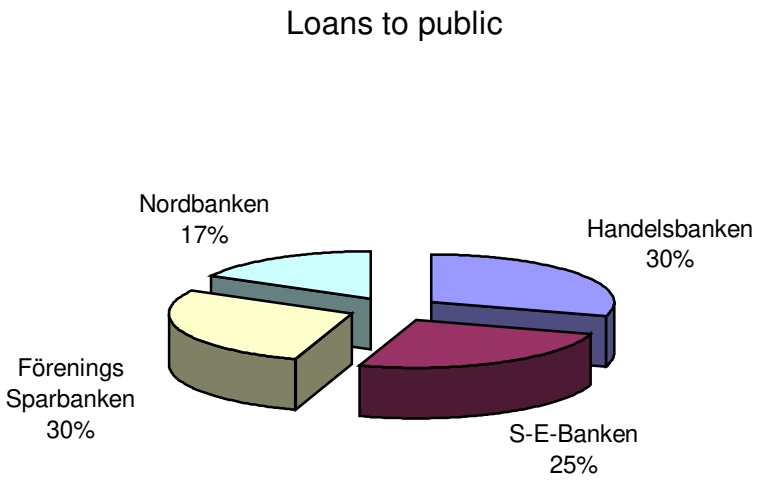

Figure 6: Market share of loans to public[59].

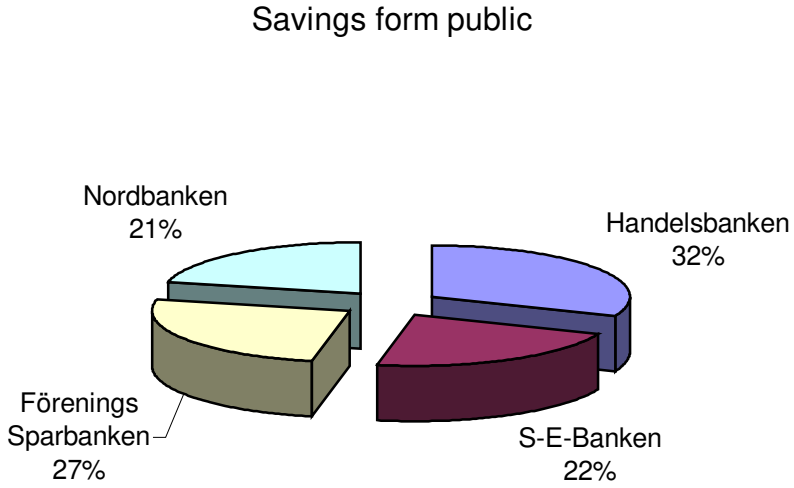

Figure 7. Market share of savings from public[60].

[59] Kreditmarknadsstatistik (1997). Observe that there is a rounding error in the numbers.

7.2.1. Nordbanken

The first price bundle was introduced by Gotabanken in 1984 and it was targeted to the affluent customers in the bank. Nordbanken in turn introduced its Plus-concept in 1989 having the same basic idea. When these two banks merged in 1994 both bundles were maintained in the new bank. Gotabanken's Förmåns-Customer-bundle was still aimed at the affluent customers while Plus-package was targeted to 'middle wealthy' bank customers. In 1996 there were 750.000 Plus-Customers and 350.000 Förmåns-Customers. The figures were in 1997 reduced to 499.000 Plus-Customers but increased to 499.000 Förmåns-Customers[61]. The total amount of customers in Nordbanken, around 3.500.000, has been fairly constant during the past years. The reduction in Plus-Customers is due to harder requirements to qualify to a package while some earlier Plus-customers have also achieved the Förmåns-Customer segment[62].

Price bundling in Nordbanken means that a customer is offered certain discounts on a large number services if the customer fulfils the requirements for either Plus- or Förmåns-Customer bundle. The requirements include current account, savings and loans. In Table 5 these requirements are specified for both the years 1996 and 1998. The profitability of the 1996 bundles has perhaps not been on the expected level why the requirements have been hardened later on. In 1998 the loan amounts required are specified as well as savings amounts have been set to higher levels 15.000 SEK => 25.000 SEK for Plus-Customers and from 80.000 SEK =>125.000 SEK for Förmåns-Customers.

Table 5: Requirements for Plus- and Förmåns-Bundles 1996 and 1998.

REQUIREMENTS FOR PLUS-CUSTOMER 1996	**REQUIREMENTS FOR FÖRMÅNS-CUSTOMER 1996**
A customer has three of the five following: 1. Current account with debit card and automatic telephone service 2. Saves 300 SEK/month to a savings account 3. Savings > 15 000 SEK 4. Savings > 50 000 SEK 5. Loans	A customer or his/her family has either 1. Savings > 80 000 SEK 2. Loans > 250 000 SEK
REQUIREMENTS FOR PLUS-CUSTOMER 1998	**REQUIREMENTS FOR FÖRMÅNS-CUSTOMER 1998**
A customer has three of the following 1. Current account with ATM card and/or automatic telephone service/Direct service 2. Saves at least 200 SEK/month to a long term savings account 3. Savings or loans > 25.000 SEK 4. Savings or loans > 50.000 SEK	A customer or his/her family has either 1. Savings > 125.000 SEK 2. Loans > 125.000 SEK

[60] Kreditmarknadsstatistik (1997)
[61] Nordbanken's annual report (1997)
[62] Nordbanken's annual report (1997)

When the customer 'can buy'= qualifies to the bundle, he is able to buy certain other services to reduced prices. These price bundles can then be interpreted as mixed leader bundling. The leader service, in this case all the requirements, are 'bought' whereafter several other services can be bought to discounted prices. Some of the services do not have any utility of their own but need to be combined with for example current account (giro payment service, bank card) why these bundles include even add-on bundles. Services that are combined to the bundles are presented in Tables 6 and 7 for 1996 and 1998 respectively. As it can be seen these bundles include very many services!

Table 6: Plus- and Förmåns-Customer discounts (1996)

Discounted services	Plus-Customer	Förmåns-Customer	Ordinary price
Interest rate benefits:			
➢ current account	> 30 000: 1,50% < 30 000: 0,75%	➢ 30 000: 1,50% < 30 000: 0,75%	> 30 000: 0,75 % < 30 000: 0,50 %
➢ savings account 1	> 50 000: 4,25 % < 50 000: 3,75 %	➢ 50 000: 4,25 % < 50 000: 3,75 %	> 50 000: 3,25 % < 50 000: 2,75 %
➢ savings account 2	1,50 %	1,50 %	0,75 %
➢ account credit	-2,0 % cheaper	-2,0 % cheaper	
➢ consumption loan	-0,5 % cheaper	-0,5 % cheaper	
➢ auto loan	-0,5 % cheaper	-0,5 % cheaper	
Other benefits:			
1. free counselling service once a year	Yes	Personal banker	
2. cheaper information package for household economy	100 SEK	100 SEK	150 SEK
3. retirement accounts yearly fee	75 SEK	75 SEK	125 SEK
4. payment orders	0 SEK	0 SEK	12 SEK/order
5. fees for cheques (depends on the amount, and the fee is per cheque)	> 300 SEK=> 0 SEK < 300 SEK=> 3 SEK	> 300 SEK=> 0 SEK < 300 SEK=> 3 SEK	6 SEK / cheque
6. transactions via telephone automate and ATMs	0 SEK	0 SEK	3 SEK
7. service fees for account credit, other loans, auto loan	0 SEK -50%	0 SEK -50%	400 SEK 600-2500 SEK
8. currency exchange	0 SEK	0 SEK	35 SEK
9. identity card	0 SEK	0 SEK	150 SEK
10. Reduced price for 'Emergency Service' in connection with international credit card.	150 SEK	150 SEK	300 SEK

Additional and discounted services	Förmåns-Customer	Ordinary price, Plus-Customer
Personal banker	Included	Not available
Economic information 4-5 times a year	Included	Not available
Customer's whole bank engagement information 3 times a year	Included	Not available
Bank card Visa Bank card Master card Bank card Electron Bank card Classic Visa	135 SEK 135 SEK 75 SEK 235 SEK	270 SEK 270 SEK 150 SEK 470 SEK
Telephone service NB direct	120 SEK	240 SEK

Table 7: Plus- and Förmåns-Customer bundle discounts (1998)

Discounted services	Plus-Customer	Förmåns-Customer	Ordinary price
Interest rate benefits			
➢ Current account	> 30 000: 0,60% < 30 000: 0,25%[63]	> 30 000: 0,60% < 30 000: 0,25%	> 30 000: 0,25% < 30 000: 0,25%
➢ Savings account 1	0-100 000: 1,75 % 100 001-250 000: 2,25 % > 250 000: 3,25 %	0-100 000: 1,75 % 100 001-250 000: 2,25 % > 250 000: 3,25 %	0-100 000: 0,75 % 100 001-250 000: 1,25 % > 250 000: 2,25 %
➢ Savings account 2	0,60 %[64]	0,60%	0,25 %
➢ Account credit	9,25 %	9,25 %	11,25 %
➢ Consumption loan	-0,50%	-0,50%	-
➢ Auto loan	8,45 %	8,45 %	8,95 %
Other benefits			
	Free household economic counselling once a year	Personal banker	
Price per cheque	5 SEK	3 SEK	10 SEK
Giro payment service per payment order[65]	6 SEK	3 SEK	12 SEK
Bank card ▪ Visa/Master Card ▪ Classic Visa ▪ Electron	 190 SEK 470 SEK 120 SEK[66]	 135 SEK 235 SEK 96 SEK	 270 SEK 470 SEK 180 SEK
Telephone bank NB Direct (yearly fee)	240 SEK	180 SEK	300 SEK
Automatic telephone bank (transaction fee)	0	0	3 SEK
Loan writing fees	-30%	-50%	
Promise of a loan	200 SEK	100 SEK	400 SEK
Currency exchange	0	0	35 SEK
Monthly account statement (each)	10 SEK	0 SEK	10 SEK
Customer's whole bank engagement information 3 times a year	Not available	Yes	Not available

[63] Information is valid for money that is held in an account for the whole month. Otherwise the interest rate is 0,25% if transactions are less than seven and 0% if transactions are more than seven.
[64] See the footnote 35 above.
[65] There are three different service level choices of giro payment orders. Prices in table 7 refer to the self-service option.
[66] The price is actually a monthly payment of 10 SEK.

Mixed leader bundling is successful when the demand level for the leader service are higher than the demand levels for the bundled services. When the leader service in Nordbanken's case is in fact three services and the discounted services are of several different kinds such differences in demand are not at one glance obvious. Current account is the most common service and should be a good leader. Add on services like giro payment, bankcard etc are adequate to combine with such a leader. However, the services and other benefits that are tied to these price bundles do not necessarily lead to additional sales compared to that the services were sold separately. Since the requirements already mean that a customer has to have considerable amount saved or borrowed and continuous savings, it is questionable whether for example interest rate benefits increase customers' demand for these products. Moreover, savings accounts to which the interest rate benefits are targeted are traditional savings accounts. These are however not so popular anymore. In absolute terms they still are most in number but in relative terms there are other savings forms that are more popular. Demand for savings products today is very much directed to mutual funds and retirement savings. Therefore, if the price discounts are not pointed to services that are valuable for customers, they naturally lose their effect.

On the other hand, the interest rate benefits for example may just be one way to reduce the price of the leader service in order to give higher consumer surplus for the tied services and increase the selling of them. This price effect is perhaps stronger for Plus-Customers that could be assumed to be a more price sensitive group than Förmåns-Customers. However it is the Förmåns-customers that get the most discounts. The bundles consist also of diverse payment services. A customer may want to buy telephone or Internet services because of the reduced prices for these in the bundles. However, the effect how these price bundles enhance demands for the different services is still not totally straightforward, especially when the situation is to be compared with individual selling.

The other feature that has to do with profitability of price bundling concerns the margins for the leader service and the additional services. The leader service profit margin should be less than the tied products' profit margin in order to be a maximally successful bundle. In the case of these bundles the tied products often do not have as high profit margins as the three requirements to qualify to these bundles. Therefore, it seems to be more important for a bank to get as many customers' bank relationship as possible up to requirement level in order to

improve profitability rather than to trust the price bundles cross selling effect on the demand for different services and thereby improved profitability.

The success of mixed leader bundling is also dependent on the value enhancement effect and achieved search economies of the bundled products on the leader service that customers experience. There is a clear difference between 1996 and 1998 years discounted services in these bundles. In 1996 many of the services included in the bundle were not directly related to the lead services (Emergency service, identity card, a reduced yearly fee for pension account, book "Råd med mera"). In 1998 on the other hand most of the services were directly related either to current account (cheques, giro payment service, bankcard, telephone bank) or loans (promise of a loan, discounted loan drawing up fees). Therefore, the bundle construction in 1998 is more motivated by the theoretical findings. The related services should both increase the utility of either current account, savings or loans or to reduce search economies when they are bundled together with other services in order to enhance the demand.

It seems though that the motivation of Nordbanken's bundles is not to increase new sales for existing customers. It is surely desired that non-bundle customers (ordinary customers) would trade up to the requirements level but more important seems to be to assure that the customers' whole demand is collected to the bank. By requiring that a customer must both have current account, loans and savings under the same roof, around half of Nordbanken's customers that currently have affairs with other banks might want to concentrate all their affairs to Nordbanken because of the bundle. In that case Nordbanken's price bundles would have a great demand enhancement effect.

With the extensive pricing schedule, Nordbanken tries to allocate most of the costs to specific services. The bundle consists of a jungle of different transaction fees, monthly fees, yearly fees, interest rate benefits etc. One of the reasons for price bundling in Nordbanken is therefore also that in this way the cross-subsidisation between customers is possible to diminish. The motive of that is correct according to the efficient pricing principle: every customer should pay for the use of his services. Förmåns-Customers pay least direct fees since they are giving profitability for the bank through interest bearing assets, Plus-customers pay more fees than Förmåns-Customers since their savings and loans are not as profitable as Förmåns-Customers and ordinary customers pay 'only' directly since their demand is not profitable otherwise. Transaction fees were originally introduced in retail banking to direct

customers' demand to use transaction services through cost efficient distribution channels. In the case of Nordbanken's price bundles this aspect is not apparent in every respect. Telephone bank as well as Internet is charged a yearly fee that may affect the demand for these services negatively. Price bundling through Plus- and Förmåns-Customer bundles is therefore not obviously leading customers' demand to least cost delivery channels so that the overall costs for the bank would be automatically minimised.

Both types of Nordbanken's price bundles include a personal relationship function. Plus-Customers are invited to the bank once a year to get counselling for their private economy. Förmåns-Customers in turn are divided to different 'Personal bankers' who contact them or can be contacted more frequently. This personal element is aimed at to lock the customers to the bank by increasing their loyalty by a personal commitment. Also, as was noted earlier, this personal function is very important in selling new services to the customers that otherwise might not have even recognised their needs for such services. Nordbanken's strategy seems therefore to be to retain profitable customers, assuming that Plus- and Förmåns-Customers already are profitable by bundle construction. But, the bank does not pay too much attention to ordinary customers. These are offered neither price bundles nor personal relationships. Perhaps they cover their costs with high transaction and yearly fees but by ignoring that segment means implicitly that the bank does not see any future potential of these customers either.

How do Plus- and Förmåns-Customer bundles function in the dynamic perspective? Now the bank has changed the requirements and benefits for Plus- and Förmåns-Customers. It has meant that several earlier Plus-Customers have been dropped out and become ordinary customers. It may naturally influence these customers to increase their savings (if possible) in order to qualify as Plus-Customers again but it may also be a good reason for these customers to look around for competitor banks. After all it seems as it is the bank that dictates the rules and the customer's role is just to obey. One peculiar feature of these price bundles is just that a customer is not really allowed to choose which bundle he wants to buy but the bank segments the customers to these two different types according to bank's preferences how customers' relationship should look like. On the other hand the changed rules show now clearer the importance of the Förmåns-Customer segment. But since the bundles are very complicated it is also questionable if a customer can see and is able to count all the benefits of being an Plus- or Förmåns-Customer. Another concern is whether the benefits are of so a

great importance that they would have any effect on the demand. That is especially important factor when Nordbanken wants to collect customers' demand for themselves from competitors.

Nordbanken has also created a new bundle in 1998: A price bundle for students. Detailed information about the bundle is presented in Table 8. This bundle is a kind of mixed joint bundle where the whole package is bought to a common reduced price. The price reduction is considerable in this case, nearly 600 SEK compared to ordinary customers prices. The bundle offers cost efficient services used by telephone bank and Internet. The bundle offers also savings incentives by promising higher interest rates for money that is held on the current account the whole month and for savings in telephone bank's savings account in which the interest rate is higher than the bank's normal savings account's interest rate.

Table 8: Student bundle (1998).

REQUIREMENTS FOR STUDENT PACKAGE	SERVICES IN THE PACKAGE	PRICE OF THE PACKAGE
1. Age 18-28 2. Study at a university or a college 3. Be entitled a student loan	• NB Direct telephone service • High interest rate on current account for money that is held there the whole month • Bank card Visa • Internet bank • Payment service • High interest rate on savings account (NB Direct account) • Information brochure	(300) 2,25 % (470) (320) (144) > 50 000: 3,35% < 50 000: 2,25% Price of the package: 220 SEK

Requirements to buy the bundle concern age and proof that the person actually is a student. As was stated earlier in section 6.5. mixed joint bundling is profitable when the demand levels for bundle products are about the same as well as the profit margin for the products are about equal. These requirements seem to be quite well satisfied in this construction. Mixed joint bundling is further reinforced when the products give bi-directional benefits. That the case with the services included in this bundle. Therefore, the construction of the student package appears sound according to the theoretical findings.

The price reduction in this bundle is very high compared to the normal prices. The motivation to set a low price for the student bundle is that this is a way to acquire new customers. Since student group is likely to be a price sensitive group the demand conditions are met of the elastic demand and the low price should tempt many new customers. S-E-Bank is offering a

similar kind of student bundle at the price of 250 SEK and therefore the price is set near the competitive level. However, the contents in the bundles are not identical why some higher difference in the bundle prises could be motivated. But the difference between the normal Nordbanken customer's price 800 SEK and 250 SEK is probably too high. When the student finishes his education and becomes a normal customer –without very high savings and but with massive student loans that are however not bank loans, he then suddenly has to pay 800 SEK (or the comparable future amount) for the same services that earlier cost him 220 SEK. If that student does not get a job in the same wave, qualify to Plus-Customer and wants to keep the same service level, the price increase may be difficult to accept. In that situation it is possible that he starts looking around for another banks' offers. Consequently the longer-term effects of this bundle may become quite the opposite what the bank is planning.

7.2.2. FöreningsSparbanken

FöreningsSparbanken is a result of a merger between Föreningsbanken and Sparbanken in 1997. Since the research period is the years 1996-1998 both of the bank's price bundles and the development in the new bank will be discussed here.

Price bundling in Sparbanken started in 1993. The concept was called Eken-Customer and it was a vehicle to introduce comprehensive changes in pricing. Sparbanken was actually the first bank in Sweden to take the step of making radical changes in pricing of payment services. Zero interest rate for a current account as the payment for the related services was replaced by explicit pricing: higher interest rate for the current account and separate fees for the related services for all the customers. If the customer became Eken-Customer according the requirements presented in Table 9, the payment services were then given price discounts compared to ordinary customers.

Föreningsbanken's price bundle was called 'Privatbonus' and it was introduced in 1995. It had a similar structure concerning requirements and tied services as the bundles presented so far. In Table 10 the price bundle is shown in details.

The new FöreningsSparbanken has expressed that its goal is to collect all the existing customers' affairs through diverse approaches such as price bundling[67]. FöreningsSparbanken does not have almost any balance restrictions although the structure has been maintained concerning requirements about current account, loans and savings. This feature addresses the Nära-bundle bundle to most of the customers as opposed to Nordbanken's bundles that were directed to wealthier customer classes. FöreningsSparbanken has actually two different kinds of bundles that are presented in Table 11. Sparbanken's earlier Eken-Customer bundle has been modified a little separating relationship aspects and personal service from everyday banking transactions. When Eken-Customer earlier got reward for collecting his affairs to Sparbanken, he got price discounts for various payment services. Now there are two totally unconnected price bundles: 'Nära[68]' and 'Enkelt[69]'. In the Nära-bundle three main services are combined with personal advice service and information to customers. The Enkelt-bundle in turn is the payment service bundle in which a customer is demanded to have certain self-service products and then they will be rewarded by higher interest rates and reduced transaction fees. The changes in the bundles from the Sparbanken's Eken bundle and Föreningsbanken's Privatbonus-bundle can be assumed to be well accepted by the customers since the merger is a natural source for changes. On the other hand, customers may during this period have become more aware of the alternatives too.

Table 9. Eken-bundle discounts 1996.

REQUIREMENTS FOR 'EKEN-CUSTOMER' (1996)	REQUIREMENTS FOR 'PAYMENT BUNDLE'
A customer has to meet two of three following requirements: 1. A current account 2. Savings > 50 000 SEK 3. Loans	A customer that has 1. Debit or credit card 2. Payment service 3. Telephone service will get higher interest rate than other customers on current account.

Discounted services	Eken-Customer	Ordinary price
Telephone service Sparbanken Direct	140 SEK / year	200 SEK / year
Payment orders	105 SEK / year	150 SEK / year
Bank card ATM	105 SEK / year	150 SEK / year
Maestro debit card	105 SEK / year	150 SEK / year
Visa	175 SEK / year	250 SEK / year

[67] Annual report for FöreningsSparbanken (1997).
[68] Nära = Close.
[69] Enkelt = Easy.

Table 10: Föreningsbank's Privatbonus bundle 1996.

REQUIREMENTS FOR 'PRIVATBONUS' 1996
A customer has to meet three of four of the following requirements: 1. A current account 2. Saves 300 SEK/month to a long term savings account 3. Savings > 50 000 SEK 4. Loans > 50 000 SEK

Discounted services	Privatbonus-Customer	Ordinary price
Cheques	25 cheques for free, then 15 SEK each	15 SEK
Payment orders	150 SEK / year	240 SEK for 12 orders (then 20 SEK each)
Bank card MasterCard	240 SEK / year	290 SEK / year
Visa Electron	150 SEK / year	190 SEK / year
Automatic telephone service including faxservice	0	400 SEK / year
Identity card	100 SEK	180 SEK
Loan service fees	-50% of the normal price	
Savings account	Ordinary interest rate +2,75% for maturity least 2 years	Not available

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Table 11: FöreningSparbank's Enkelt and Nära bundles 1998.

REQUIREMENTS FOR 'NÄRA'	REQUIREMENTS FOR 'ENKELT'
Two of three 1. Income on current account 2. Loans 3. Continuous saving or saved > 50 000 SEK	All the three 1. Income on current account 2. Bank card 3. Giro / Internet payment service

Discounted services	Nära / Enkelt	Ordinary price
Nära: • Invitation to a yearly counselling • Economic overview four times a year • Economic news letters • Special offers		Not available
Enkelt: • Current account	Interest rate: < 15 000: 3,5 % 15 000: 2 %	0,35 %
• Bank card Maestro Visa MasterCard	120 SEK 180 SEK 280 SEK	170 SEK 270 SEK 395 SEK
• Giro payment service / Internet	140 SEK 105 SEK	200 SEK 150 SEK

How successful then are these bundles? The direct increase in demand in the old Eken-Customer bundle as well as the new 'Enkelt' and Nära' bundles can be assumed to be quite modest. The Privatbonus bundle in turn had a bit same tendencies as Nordbanken's price

bundles. It contained more services (but not even near as many as Nordbanken), and the similarities were cheques, payment orders, bank cards, telephone service, identity card, loan drawing-up fee and interest rate benefits. This bundle in a way stimulated the use of cheques although it was clearly marked that it is an expensive service for the bank and more than 25 cheques per year would cost 15 SEK each. Customers were also directed to use self-service products. However, it is not totally clear whether any of the Privatbonus-customers would buy additional services or to increase their 'consumption' of loans and savings in order to qualify. FöreningsSparbanken has now decided to work with smaller packages with no balance requirements for the main services in order to achieve the total customer relationship with all of its customers.

Other change in the new Enkelt-bundle compared to Sparbanken's Eken-bundle is that the telephone service is missing. This is because it is made free of charge for every customer whether or not having a bundle in FöreningsSparbanken, and therefore it would not give any extra value if included in the bundle. Now it is the Internet bank as well as bankcard that are desired to be cross-sold to customers. But, the Enkelt-bundle is still perhaps better motivated by the cost reduction than demand enhancing motive. The product choice is concentrated on cost efficient payment services and customers are rewarded for using them. This is a plausible strategy and since the benefit for using these services is an attractive interest rate for the current account FöreningsSparbanken's customers do not have to switch to niche banks when these are marketing their high interest rate current accounts.

Regarding the Nära-bundle, the increased demand would mean continuous savings in order to qualify to the bundle. The Nära-bundle gives invitation to a yearly counselling and also economic information by post several times a year. As it was stated earlier it is easy to qualify to this bundle. The reason becomes obvious too: there are not many concrete services included in this bundle but the customers are shown care and offered information in order to introduce bank's services and thereby to increase their demand for financial services. It is also desirable that the relationships between the bank and its customers are reinforced so that the customers would use FöreningsSparbanken as the main bank. For the bank this kind of bundling offers great potential if the information is studied and accepted by the customers. In any case the intention of this strategy seems sound since most of the customers will be Nära-Customers and therefore also to get personal counselling and information. The effect on demand is however indirect through this kind of price bundling. Counselling and information

are complementing all banking services that could enhance the total image of the bank and would decrease customers search costs for additional services. Therefore the willingness to pay for additional services may be increased and price sensitivity decreased. But since no other services are explicitly targeted in the bundle it is difficult to assess how effective this kind of bundling in practice is. A bank should in any case be interested in contacting its customers and making them aware of the services.

The Nära-bundle is also constructed in order to lock in customers in the long run by the continuous saving or savings at least 50.000 SEK requirement. The long run profitability becomes dependent on to which extent customers then will use FöreningsSparbanken. That is not, however, secured in the bundle construction. What can be said though is that the contents of FöreningsSparbanken's bundles are easy to understand and the benefits too. The question is how beneficial the once a year counselling and the information are for customers.

The customer segment that FöreningsSparbanken seems to work on concerns existing customers and nearly all of them. There are not any student bundles or wealthy customer bundles but the bundles circulate round relationships and easiness. FöreningsSparbanken said that its goal was to increase its share of their customers' demand for financial services but as have been indicated earlier that seems not to be done by persuasive selling efforts through price bundling.

7.2.3. S-E-Banken

S-E-Banken introduced its Förmåns-Customer bundle in 1996. It was the last of the Swedish banks to start applying price bundling (excluding Handelsbanken that does not use nearly any bundling). Today, in 1998, there are around 400.000 Förmåns-Customers meaning that around 16% of S-E-Banken's customers fulfil the requirements for the bundle. The bundle is created according to the same basic model as has been identified earlier: requirements concerning current account, savings and loans in order to get price discounts in payment services and some other fees.

Requirements for Förmåns-Customer bundle remind the earlier bundles. However, what is surprising is that a customer needs to fulfil only one of the requirements. This would lead to a conclusion that nearly every customer should qualify since it is enough either to have 1) a

current account and monthly saving, or 2) current account and a loan of at least 100.000 SEK, or 3) savings alone (100.000 SEK or customer in the Treasury Department) in order to be a Förmåns-Customer. At least the first requirement should be relatively easy to fulfil by most of the customers. But, S-E-Banken had only 400.000 Förmåns-Customers of its 2.500.000 private customers. This should mean that neither the discounted services nor the requirements in the bundle are stimulating customers. Moreover, when all the different kinds of Förmåns-Customers get the same benefits, it should mean that they pay different effective prices for the benefits. In Tables 12 and 13 further details of S-E-banken's bundles are presented for 1996 and 1998 respectively.

Table 12: S-E-Banken's Förmåns-Customer bundle 1996.

REQUIREMENTS FOR 'FÖRMÅNS-CUSTOMER' 1996		
A customer has to meet one of three requirements: 1. Current account and saves at least 300 SEK each month to a long term savings account 2. Savings > 100 000 SEK 3. Is a customer in Trading		
Discounted service	**Förmåns-Customer**	**Ordinary price**
International bank card	190 SEK / year	250 SEK / year
Giro payment service	120 SEK / year	180 SEK / year
Current account credit drawing up fee	0	500 SEK
'Simple loan' drawing up fee	0	350 SEK

Table 13: S-E-Banken's Förmåns-Customer bundle 1998.

REQUIREMENTS FOR 'FÖRMÅNS-CUSTOMER' 1998		
A customer has to meet one of the four requirements: 1. Current account and saving at least 300 SEK on a long term account 2. Current account and loan at least 100.000 SEK 3. Savings at least 100.000 SEK 4. Customer at Treasury Department		
Discounted servce	**Förmåns-Customer**	**Ordinary price**
International bankcard	190 SEK	250 SEK
Giro payment service	200 SEK	300 SEK
Current account credit drawing up fee	0	500 SEK
Simple loan drawing up fee	0	350 SEK

The possible reason why demand is probably not enhanced by this bundle construction is that the additional services are not always related to the customer's demand or they are already utilised. For example, if a customer has only savings in S-E-Banken and qualifies as a Förmåns-Customer the discounted services would not matter for that customer since they concern only payment services or loan fees that this customer does not have. Naturally, a customer could in that case be affected to buy the tied services and thereby to move his demand for a current account to S-E-Banken. But it is not likely to be the most obvious way to stimulate concentration of this customer's businesses. Moreover, Förmåns-Customers' discounted prices do not deviate from the general price level on the market and therefore they perhaps do not appear very tempting as such. The customer would need stronger reasons for switching banks. It is perhaps a rare situation that a customer uses S-E-Banken only for savings and in that case would get advantages of the current bundle by being a Förmåns-Customer. But when a bundle is constructed, it is unnecessary to offer something that has potentially a little value for the customer.

The reduced simple loan and account credit drawing up fees are aimed at to increase demand for smaller consumer loans of Förmåns-Customers. How much the zero fees in fact affect the demand is questionable but it is more likely that this advantage will keep the existing customers business in S-E-Banken. Consequently, it can be argued that the demand enhancement effect of this price bundling is not very effective for the different kinds of Förmåns-Customers. Customers are not trading up to fulfil requirements, other than the monthly savings perhaps, and the discounted services are such services that would even otherwise be bought in most of the cases. The benefits function therefore more as rewards for the current demand directed to the bank.

The changes in requirements of the 1996 and 1998 bundles meant that even loans were set up as qualifications to Förmåns-Customers in the new bundle. The only change in the choice of services concerned the price of giro payment service that increased. This should imply that S-E-Banken is satisfied with this bundle model and that it is profitable.

However, this price bundle seems to suffer from lack of focus. Which customers should be offered what? Now very many different customer types are all getting the same benefits for payment services and an invitation to borrow for consumption. It is unlikely that every customer group has the same needs or should be rewarded in the same way. Furthermore,

there are no elements that would introduce a personal relationship with the bank and neither there are clear cost saving arguments for customers to use for example Internet bank or telephone bank. The Förmåns-Customer bundle would not be very special for the purpose to acquire new customers either: the whole offer and prices are not very low compared to competitors. It is also questionable if the bundle works too well even as locking existing customers to the bank. When customers only need to have one or two services to become Förmåns-Customers, it should be relatively easy to terminate such relationship. Since S-E-Banken was the last bank to introduce this type of bundle for its customers, it appears as if it has copied the concept from competitors without thinking about the full potential or own goals with price bundling.

While being the last to introduce a total customer bundle, S-E-Banken has been the first to canvass new customers from the student segment by introducing a special price bundle for these. The details are presented in Table 14. Requirements for this bundle demand only a guarantee that a person is a student. In 1998 the time period for being able to buy the beneficial bundle has been restricted to maximum five years. The other change that has appeared concerns the choice of services. Since savings accounts have been removed from the bundle they must have been a service that students do not demand. Or they rather invest their money on other savings products. In the latter case price bundling would not be utilised for increasing that demand. It is interesting that Nordbanken had quite a few incentives for just saving products in its student bundle. Internet has also come to replace the telephone service. S-E-Banken has maintained the grant for a loan for buying a computer. There is a clear concept and idea what kinds of services a student needs in order to get through the studying time. The promise of the loan for a computer should give a higher value for the bundle. Students are not otherwise the most attractive loan customers for banks.

Table 14: S-E-Banken's student bundles 1996 & 1998.

REQUIREMENTS FOR STUDENT PACKAGE 1996	**REQUIREMENTS FOR STUDENT PACKAGE 1998**
Is a student and gets student grant	A student at the University or College and get students grant. Package is valid at the most five years.
Discounted service 1996	**Discounted service 1998**
1. Current account with payment services 2. Entitled to get a student credit 25.000 SEK 3. Savings account 4. International bank card 5. Telephone bank	1. Current account with payment services 2. Entitled to get a student credit 25.000 SEK 3. International bank card 4. Internet bank
Price for the package	**Price for the package**
175 SEK	250 SEK

Even if the student bundle is beneficial the price for the bundle is not that deviating from normal customers' (550 SEK) or from Förmåns-Customers' (390 SEK) prices for an identical 'self-bundle'. It is reasonable to have half off the price offering for the students without annoying any other customer group. Therefore, when the student time is over the normal prices would not come as a chock for the customer as the case can be with Nordbanken's student bundle. In this respect the Förmåns-Customer concept may work well since it is easy to qualify to and prices for many of the same services do not increase over the acceptable range.

If the bank can retain most of the customers from this segment they will also be used to use the most cost efficient services too therefore leading cost minimising for the bank. And what is even more important, the bundles are targeted to university and college students who will earn 'high' salaries in the future and may have large needs for financial services.

7.3. Price bundling in Finnish banks

General market overview

In Finland there are three main retail banks: Merita, Osuuspankki and Postipankki[70]. Merita is the biggest bank in Finland comprising around 40% market share both in savings and lending. Together these three banks comprise around 88% of the total market. Foreign banks' market share is around 2% of loans and 0,6 % of savings and the rest is the market share of smaller domestic banks.

Osuuspankki has the largest market of private customers; around 2.000.000 Finns treat it as the main bank[71]. Merita has nearly as many customers. Postipankki's (Leonia's) customers amounts to 1.000.000. There are 5.000.000 inhabitants in Finland so the customers seem to be quite clearly divided between the banks. This does not mean that customers were only using one bank and the challenge for the banks seem to be to increase bank loyalty in the same way as the Swedish banks.

[70] Postipankki is now called Leonia. The new name was introduced when Postipankki and Finnish Export Credit merged together in April 1998.
[71] Figures have been obtained from the different banks.

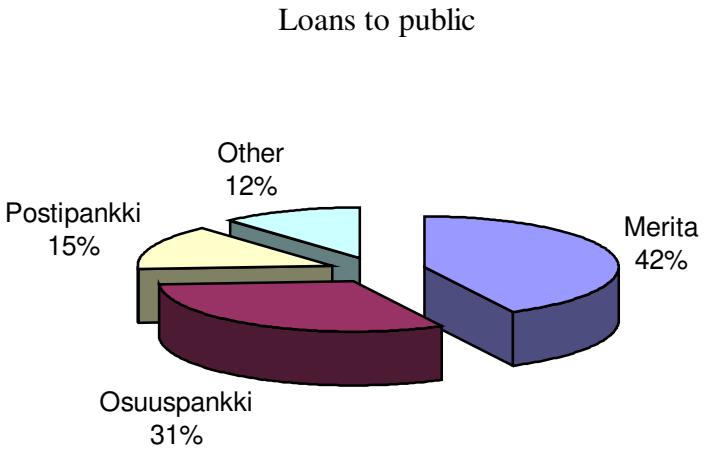
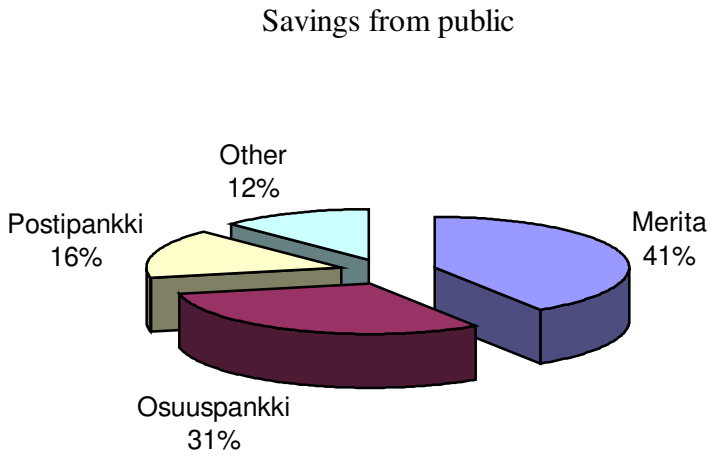


Figure 8: Market share of loans to public 1997[72].

Figure 9. Market share of savings from public 1997[73].



[72] Source: Pankit 31.12.1997
[73] Source: Pankit 31.12.1997

7.3.1. Merita bank

Merita bank was established in 1995 when then the two biggest banks in Finland, Kansallisosakepankki and Yhdyspankki, merged. In Yhdyspankki price bundling was started in 1990 whereas Kansallisosakepankki introduced its bundle in 1993. In both of these banks price bundling was applied in a very similar way and it was natural that in the new bank the old practice was continued.

Merita bank's bundles are presented in Table 15. Price bundling involves only payment services and it is nearly unaffected by the customer's other relations with the bank. The difference between the two 'payment service' bundles is that the higher service bundle include a payment service that means that a customer leaves his bills in an envelope to the bank and the bank makes the payments manually. If a customer chooses self-service bundle, he must pay the bills himself either through Solo ATM's, Telephone bank, Microbank (Internet) or Homebank (direct connection to the bank's service systems). Otherwise the services that are included in the bundle are identical in both of the bundles. The second difference is that the self-service bundle costs 10 FIM per month whereas the payment service bundle costs 20 FIM per month.

	Solo-bundle (self-service package)	**Payment service bundle**	**Normal prices**
Current account	√	√	0 FIM
Account statement			
▪ Posted home	√	√	7 FIM
▪ Additional			7 FIM
▪ ATM	√	√	0 FIM
Bankcard alternatives			
▪ ATM	√	√	0 FIM
▪ Debit card/Visa	√	√	10 FIM/month
▪ Electron			40 FIM/year
▪ GoCard (teenage)			40 FIM/year
ATM services	√	√	0 FIM
Payment services			
▪ Solo ATMs	√	√	2 FIM each
▪ Autogiro	√	√	0 FIM
▪ Telephonebank	√	√	10 FIM/month
▪ Microbank	√	√	10 FIM/month
▪ Homebank	√	√	10 FIM/month
▪ Payment service (bank makes the payment manually)		√	4 FIM each
▪ At the cashier			8 FIM each
Price of the bundle	10 FIM / month	20 FIM / month	

Table 15: Merita bank's price bundles 1996.

The Table 15 illustrates the price bundle in 1996. The only difference to 1998 is that Merita has added one service to the bundle: a customer can get account information through his GSM-telephone as a text note. The prices for the bundles have not changed.

As a price bundle the above packages only sell additional facilitating and supporting services to current account in a mixed joint bundle form. Most of the services are also type add-on services that also should be bundled in this to be sold most. But other type of cross selling is totally absent. The main motive seems actually to be to encourage customers' self-service so that the bank can allocate its resources to other more profitable functions. Since price bundles offer a high variety of distribution channels to customers it is surely making business with the bank flexible.

The price reductions for the bundles are quite significant compared to the individual prices that should mean that all the customers want to have either kind of bundle. Only perhaps the oldest customers would prefer single transaction fees. It is still questionable if the price for the bundle is too low in comparison with all the services that are included in the bundle and the costs the bank has for offering these services.

In addition, Merita bank offers the bundles free of charge in three cases:

1. A customer is over 55 years and gets his pension to current account.
2. A customer is under 26 years old.
3. A customer has at the minimum 10.000 FIM on the current account during the whole month.

The possible reason to give persons over 55 years the bundle without a cost is that if they can be introduced to use self-services it would still be more profitable for the bank than having them in the branch office even when they would pay the transaction fee. Why young customers pay nothing for the bundles can be regarded to be a kind of student rebate. The third class of customers are clearly rewarded for being 'good' customers –and the balance requirement mean that the payment services will be paid in another way. While the rebates of course are welcome to the customers it can be questioned whether they are very effective as means of tying a customer if he really was considering switching banks. Savings are after all only 120 FIM/240 FIM per year.

Apparently the price bundling strategy of Merita is to a large extent motivated by the cost reduction purpose. Customers are directed to use self-service services and if they prefer higher service it is clearly marked that it is more costly for the bank and such customers should pay for it. The bundle services are complementary that enhance the value of the other when they are put together. The bank can also easily be contacted through all the channels possible. But, the prices for the bundles are so low that any probable bundling effect in form of higher profit possibilities through this enhanced value for customers is by-passed. All the other benefits such as increasing demand for other banking products, locking in customers for longer time or any strategic advantages seem to be omitted too.

7.3.2. Postipankki/Leonia

Postipankki applies a similar kind of payment services bundling as Merita. However, in 1996 Postipankki started to apply it in pure bundling form. Postipankki had had even earlier an identical payment service bundle but then a customer could choose to pay a transaction fee too. Now, however, only bundle alternatives were offered to all customers.

The bundling alternatives were four in 1996. A customer could choose between different accounts where the difference concerned whether the account was taxable or tax-exempt and whether the interest rate was fixed or variable. One bundle was also offered for free of charge but then transactions were restricted to at the most five per month. The services included in the bundles were the same in all the different bundles (accounts) and they are presented in Table 16.

Table 16. Postipankki's price bundle 1996.

Current account	Price of the bundle	Contents of the package
Variable interest rate + tax-exempt	10 FIM / month	▪ Account statement once a month ▪ ATM (withdrawals, account information) ▪ Bank card or debit card ▪ Payment services in ATMs and micro bank Rahalinja. ▪ Telephone bank
Fixed tax-exempt interest rate	20 FIM / month	
Variable interest rate + taxable	20 FIM / month	
Variable interest rate + tax-exempt	0 FIM, no monthly fee, but the price is dependent on the amount transactions. The first five transactions are free. Then they cost 4 FIM each.	

It is interesting that Postipankki has dared to challenge the market with pure bundle making everyone to accept the offer or change banks. Since customers have stayed in Postipankki, the price sensitivity of the transaction services is not at least that high. Customers may complain about the prices but who actually think that the prices would be unacceptable are rare. Besides, the alternatives were not so many. Similarities with the other banks may have dampened the price sensitivity as well as there still were four bundles to choose among and the contents of the bundle were all more or less necessary services. Also, according to Postipankki's customer surveys, customers preferred a fixed monthly payment to variable transaction fees and therefore only the bundling alternatives were offered.

In addition to that Postipankki offered for 'good savings or loan customers' discounts for any types of these bundles if a customer had either

1. loans at least for 100 000 FIM or
2. savings at least for 50 000 FIM

Such a relationship would give 10 FIM reduction in the payment bundle price leading some of the bundles become free of charge. Postipankki counted in 1995 that there were around 200.000 customers that got discounts[74]. The discount of the bundle was though quite loosely related to the overall customer's relationship with the bank. The connection came as in a second place. The reward that a customer then gets for the whole relationship is something he is not really taking into account. On the other hand the current account is the most common service and it should be a good leader service to tie other products to. However, saving 10 FIM or 20 FIM is probably not stimulating taking loans or starting saving. The reward might increase that customer's loyalty towards the bank, but the actual effect in that seems not to be easily controllable.

In 1998 price bundles were changed again in Postipankki. Now it was due to the merger with the Finnish Export Credit and the new bank was called for Leonia. The contents of the bundle includes now above the earlier mentioned services also a manual payment service so that a customer is able to send his payments to the bank that in turn makes sure that they will be executed. Otherwise the same services like bankcard, ATM, microbank and telephone bank

[74] Postipankki's news letter 28.5.1995.

are included. Now there are only three types of accounts offered for customers. They are as in Table 16 but the taxable account is not offered anymore. In addition, customers are also offered discounts for the chosen price bundle to a larger extent than earlier. Three kinds of advantages were possible to obtain: regular customer advantage, balance advantage and youth advantage. In Table 17 details for these advantages are presented. The third account or price bundle is the self-service package with limited withdrawals. It is actually a savings account package and details of it are seen in Table 16 where it is the last alternative.

Table 17. Leonia's price bundles (1.4.1998)

Account	Benefit	Price of the payment bundle
Variable interest rate + tax exempt		
❖ regular customer	10 FIM	0 FIM
❖ balance advantage (>15.000 FIM)	5 FIM	5 FIM
❖ youth advantage (under 21 years)	10 FIM	0 FIM
Fixed interest rate + tax Exempt		
❖ Regular customer	10 FIM	10 FIM
❖ Balance advantage (>15.000 FIM)	5 FIM	15 FIM
❖ Youth advantage (under 18 years)	20 FIM	0 FIM

The requirements for the above mentioned regular customer are presented in Table 18. This kind of practice resembles the kind of price bundling Swedish banks apply.

Table 18: Requirements for Leonia Regular-customer (1.4.1998).

RE QUIREMENTS FOR LEONIA REGULAR CUSTOMER
A customer must fulfil both: 1. A customer gets his salary, pension or other at least 2.000 FIM to a current account each month and 2. A customer buys other services from the bank for at least 75.000 FIM. As other services are counted all the bank savings, private bonds, shares, mutual funds, pension insurance and all the loans.
DISCOUNTED OR ADDITIONAL SERVICES
10 FIM price discount for the payment package (as earlier)
Leonia regular customer information four times a year
Leonia regular customer special offers four times a year

Later in 1998 the price bundling was changed again. Now the customers are directed to have one type of current account, so called Leonia account, even though other possibilities still are available. The interest rate for the Leonia account is dependent on the customer class a person belongs to. There are 'Benefit-customers', 'Regular-customers and 'Ordinary customers'. Ordinary customers are not paid any interest rate for the Leonia account whereas Regular-customers get 1% and Benefit-customers get 2%. One more segment is youngsters under 26 years but they get benefits only on the self-service payment package. In Table 19

requirements for the different customer classes are shown and Table 20 presents the benefits. There are both interest rate benefits and large discounts on payment services packages as well as information magazines and other newsletters are offered for customers.

Table 19. Requirements for Leonia'c customer classes

Benefit-Customers	Regular-Customers
1. Customers total relationship strength is > 75.000 FIM 2. Regular income > 2.000 FIM 3. Age over 18 years old	1. Regular income is > 4000 FIM or Relationship strength is > 15.000 FIM 2. A customer has Leonia's debit card or Visa bank card 3. Age over 18 years

Table 20: Benefits for the Leonia's customer classes.

Benefit-Customers	Regular-Customers
❖ Current account interest rate: 2% ❖ 75 % discount of the payment bundles ❖ Leonia magazine for Benefit-customers four times a year ❖ Special offers and other benefits	❖ Current account interest rate: 1% ❖ 75 % discount of the payment bundles ❖ Regular-customer newsletter four times a year ❖ Special offers and other benefits

In addition to these price bundles there are two payment packages:

1. On-line package and
2. Payment service package

The difference between these packages is that the On-line package does not allow payment of bills through sending them to bank or payment of bills in ATMs. On-line package does not include account statements either but the customer has to keep the record of his transactions himself. The On-line package costs 15 FIM whereas the Payment service package costs 30 FIM. Young people under 26 years old get the On-line bundle for free but no discount on the Payment service package. They are therefore clearly directed to self-service services. Otherwise the contents of these packages are the same as in Table 16. And for these packages both the Benefit-customers and the Regular-customers get 75% discount off the normal price.

There is no question that price bundling is in transition in Leonia bank. It is clearly seen that segmentation has increased. In 1996 segmentation was based on the preference on tax-empt or taxable account with fixed or variable interest rate. Otherwise the contents of the bundle were the same for all these segments. Thereafter the account structure has been marginally simplified leading to three customer groups and the manual envelope payment service was added in the package. Then customers were also classified according to their total relationship with the bank, balances on the current account and age. Later in 1998 customers were even more clearly segmented and the payment bundles were also differentiated according to low service (self-service) and high service (manual payment service). Moreover, only one type of current account wants now to be sold to customers where the differentiation is due to interest rate paid for the different types of customers. Therefore, it can be said that segmentation has increased, cross-subsidisation has been diminished between the customers and the offerings are better adapted to their purpose. The customers that are more beneficial for the bank are also to be rewarded. Young people in turn are educated to use self-services and they are rewarded for this behaviour by offering the bundle for free. It has also been recognised that a bank needs actively inform its customers and market its products in order to affect the demand.

However, this bundling likewise the most of the other banks' bundling is not directly cross selling new products. The special offers that are sent to customers with the information magazine will mean that price bundling becomes a short-term strategy in Leonia changing in every three months. How such a strategy succeeds depends naturally on which way and which kind of offers are introduced. If heavy price incentives are needed to affect demand it might become a costly strategy. On the other hand, if only Regular and Benefit customers can buy these specially offered services the stimulation would be directed to those customers that are already profitable. Naturally it is possible that these segments are the only ones with any potential. But, the ordinary customer segment would neither increase their demand nor get any information of the bank's services.

One potential difficulty in Leonia's bundles is that the customers still are very heterogeneous groups despite the fact that they have now been segmented in three classes. There are many different bases to qualify to the bundle: some customers have loans, other customers have savings and it was only the relationship strength measured in FIM that counted. Such a point is not making any future price bundling easy for the whole group.

The last 1998 bundling makes an attempt to increase the customers incentives to stay in the bank. When customers are rewarded for the more business they have in the bank the more likely it is that happens. In the Finnish market this advanced 'customer orientation' is quite exceptional. If the problem is in the Finnish market as in the Swedish that customers are shopping around in different banks it can though be doubted if the incentives for a customer to concentrate all the affairs would be affected by Leonia's bundle offers. How valuable an information magazine is for a customer is also a bit uncertain. If customers do no read the magazines, they will lose their function. Furthermore, there is no direct attempt to introduce personal relationships with customers by price bundling.

The bundles have originally been constructed around the transaction services offered by bank. The bank has strived for to minimise its costs by including all the self-services in the bundle. Experience proved probably that the manual payment service was something that many customers wanted since it was again included in the bundle in 1998. Since it is quite a resource demanding service the common payment bundle was then further divided into two types. The customers that wanted higher service from the bank should also pay more for the service. In this way and also combining the customers whole relationship together there is an attempt to minimise cross-subsidisation between the customers and rationalise the use of the parallel payment functions.

8. Conclusions

Now it is time to draw some conclusions about the research questions that were studied in this project. The main questions dealt with the theoretical reasons for price bundling to be applied in retail banking and the practical use of it in retail banks in Sweden and Finland. Originally the project was directed by two overall research questions that concerned the pricing method and cost accounting to support the use of the method. This starting point has been the theoretical part of the project and a discussion of these findings will be presented first. The second part of this section deals with conclusions concerning the actual price bundles used by Swedish and Finnish retail banks and a comparison of the different banks' models.

8.1. Why and how should price bundling be applied in retail banking?

Reasons for price bundling

Price bundling is a method for a multiproduct firm and it has often been exemplified in the context of banking. It can be concluded that price bundling has many possible advantages compared to individual selling and pricing of services in retail banking and therefore price bundling may help to finance the fixed costs in a better way. The three explanations result from the following fundamentals: cost structure, demand conditions and competition.

Cost side advantages

A large part of the costs in a bank are dependent on customers' use of services and customer driven activities. To the extent that price bundling can diminish such costs or to lead to better use of the capacity compared to individual selling the efficiency will be improved. Three types of cost advantages concerning the business costs with price bundling were identified:

1. Initiating a customer relationship is a very resource demanding activity. If customers can be retained in a bank for a long time through price bundling, fewer resources need to be put on acquiring new customers.
2. There is another cost advantage in selling several services together. If a customer with one contact with the bank can be sold many services instead of only one, some resources are again released for other activities.

3. The third cost reduction possibility is due to technology. There are several delivery systems for bank services and if the services are tied to the most cost efficient way of delivery, it will reduce processing and servicing costs.

Demand side advantages

There are several hundred banking services. Demand for different services is interrelated therefore bringing up very many opportunities to create different bundles. If price bundling is more efficient than individual selling it will increase income for the bank. There are several points why this should happen:

1. Products that are complements increase the value of the bundle compared to selling them individually since the complementary relationship makes the total offering worth more to the customer than having the services individually.
2. Search economies for the customer makes it more economic to buy everything in the same place and customers demand often concern several services rather than only one. Price bundling is likely to facilitate such demand.
3. Through price bundling it is possible to reduce customers' uncertainty of a new or unfamiliar product when it is sold together with a well-known product in a price bundle.
4. The more services are sold to customers the more difficult it is for them to change banks. Price bundling is likely to increase switching costs for the customer and thereby to increase his loyalty towards the bank. The bank will then get more and securer income for successive time periods.

Competitive advantages

Banking services are very similar between the different banks and they are also very easy to copy. At the same time there are high transaction costs, information costs and psychological factors that hinder the market to function efficiently. Since that is the case in the retail bank market, price bundling will be best used to concentrate on the profitability improvement of banks' own customers. The following reason is offered in favour of price bundling concerning the competition in the banking market.

1. Since the service range is similar between the universal retail banks, price bundling is an advantageous strategy if it reduces competition and allows charging higher prices. This is

likely to happen if all the banks concentrate on existing customers rather than compete aggressively of new customers through extensive price reductions on a couple of services. Price bundles are also more difficult to copy than individual services and that can also diminish competition between banks since it is difficult for customers to compare different banks' alternatives.

Principles for price bundling

What should a bank do in practice when applying price bundling?

Information, goals and segmentation

In the theoretical overview we identified a couple of factors in order to support the decision making for price bundling. According to the economic theory customers' reservation price distribution together with marginal costs for the services are the main decision factors. From the managerial point of view information of the customers' reservation price is very hard to obtain even through an extensive marketing research. Cost accounting information likewise offers bad estimates for the real marginal costs. Guiltinan (1987) suggested following factors to be taken into consideration[75]:

- Individual sales quantities
- Profit margins
- Price elasticities both for the individual products and the bundle
- The extent and nature of complementarity between the products

On the whole this kind of 'product calculation' is making distance from the traditional cost plus- or incremental cost analysis for pricing decision. The clear difference is that customers and demand are more relevant decision variables than a company's costs. Theoretically there is nothing new, demand should always lead the pricing decision. The 'novelty' is that the whole price bundle decision should be started from the customers even in *practice*. In a Cost Accounting conference in Örebro (1998) 'revenue accounting' was presented as a new way of practising and making pricing decisions. It was suggested that different 'potential measures' of the future development of the demand should be used in order to improve the pricing

[75] Guiltinan, (1987), pp. 386-387.

procedures. In that model future sales potentials should be based on the customer's relationship today.

How customers can be divided into different segments according to the future potential is presented in Figure 10. This model is basically the same as Guiltinan's model (Figure 3) even though this model applies a wider perspective both in selling and time horizon that is to be considered.

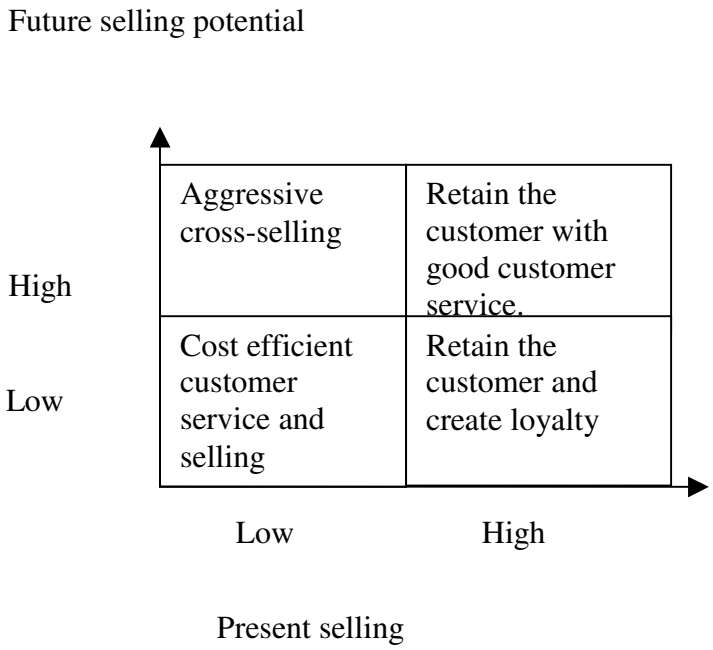


Figure 10. A model of potential selling.[76]

Customer segment that is low in present selling and the potential is low too should be served with the minimum resources. This kind of segment could include persons with low education and therefore low probability to earn a lot in the future. Such customers should perhaps be introduced to self-service bundles in order to minimise costs for the bank. If the current sales are low but there can be deemed a high future potential, for example a group of university students, the bank should cross-sell aggressively as many services as possible to this segment in order to tie them to the bank. Profitable customers for the time being but having less potential in the future should be rewarded by being loyal to the bank. Such customer segment might contain older people for example. The last segment could mean customers with high

incomes, relatively young and with high selling potential in the future. The relationships of such customers need to be cherished and retained in order to realise the potential.

The price should be higher for the segment the more uncertain and the less potential the revenue generation in that segment is. If the length of the relationship with the customer gets longliving or a longliving relationship can be affected by the bank pricing should reflect it by discounts. In the case there is high potential for further cross selling the discounts or other incentives should be higher than for the segments where the potential is lower. The segment that already is buying a lot of financial services may be less price sensitive than the segment currently buying a few services. If that is the case prices should be higher for the segment with lower price elasticity. The customer segment in which the future potential is low but that currently has bought many services should be rewarded for being loyal.

Banks have extensive databases of their customers with a lot of information why there should be good possibilities to make this kind of segmentation and identification of different customer types. The problem is of course the identification and reliability of such key factors based on the historical data analysis that would make a good prognosis about the future profitability. The internal information about customers should also be completed by external information about different macrovariables that are likely to affect customer behaviour. Such variables could for example be GNP, interest rates, inflation, unemployment, house prices etc. These types of information could then be combined with appropriate price bundle offers for each of the segments. It is clear that one common offer for every type of segment will not be successful but the offer needs to be more tailor-made for each group.

When the long-term customer account perspective is applied it will even be possible to decide which customers are wanted to retain and which not. In such potential models costs for serving the customers and how the costs will develop in the future are naturally also to be considered. Otherwise it is not possible to assess profitability. But the cost perspective has an inferior importance compared to thinking of revenue potential. The temptation to do the opposite is that costs are better manageable than customers' demand.

[76] Adapted from Örebro Kalkylsymposium, Weidenman: Effektivare kundbearbetning med nya modeller, 1998.

Price bundling demands therefore accounting principles that start with customers and not with products. It is important to know the current relationship demand level as well as be able to assess the future potential in sales and profitability. For that some dynamic measures showing change could perhaps be more appropriate to show the potential than absolute measures. There is also need for information about the interrelationships within products and the product costs as well as the appropriate time horizon for the accounting model is to be decided. The principles should attach relevant probabilities for customer actions and naturally the expected cash flows are to be discounted to the decision-making year in order to see whether the price bundle will improve customer relationship profitability.

Several findings have been made also concerning the actual price bundling construction. Price bundles can be formed between core services and for example current account and payment services as well as loans and current account are more or less formally already combined together. But there are larger possibilities to sell additional services beyond these two main services. One of the ways of increasing demand discussed in the previous section was to create a large bundle when the demand for the services is strong and multiple smaller bundles when the demand is weaker. The relation with different core services is probably quite varying. It is questionable if a large price bundle containing most of the core services should be used. The demand is strong when it concerns the current account but it is a lot less concerning for example insurance services that are relatively recently included in the service line. If insurance services are included in the bundle it might perhaps be better to create multiple smaller bundles between it and another core service and to sell it in mixed bundling form. The bundle between two or more high demand services would in turn be more appropriate to sell together the mixed joint form. The advantage with mixed bundling is the offered greater availability of services to customers. It is questionable that forcing a customer to accept a price bundle consisting of two or more core services and not offering a possibility to buy these individually could cause more leaving customers than new sales.

Another type of price bundling would be between the core service and facilitating/supporting services. Since facilitating services are needed for the core service it is reasonable to assume that an appropriate price bundle could be one single offer, i.e. a pure bundle, alternatively a mixed joint bundle. On the theoretical grounds pure bundling is recommended when components perform better together than separately. In retail banking there are also supporting services that are not necessary to use with core service but that mean a higher

service level in some way or another. To bundle such services with core services might be most appropriate to do by some of the mixed bundling forms.

Some examples are given about different price bundling service choices connected with the earlier discussion about reasons for price bundling:

- Current account should be used, as basis for price bundling since it is a service that most of the customers have.

- One important motive for price bundling is to tie the customer to the supplier by reducing a customer's trial, i.e. selling as many related services as possible to each of the customers or creating other incentives to stay, i.e. increasing switching costs for a customer. An example of the latter would be to tie a long living service with another that could be switched away with a couple days notice. An example of a service with a long contract is housing loan or pension fund.

- It would mean cost savings if the consumption of price bundle services were combined with most efficient distribution channels such as telephone and Internet.

- To reduce customers' uncertainty about the overall evaluation of the bank and its services and to counteract any switching possibility, a personal contact could be included as a part of the bundle.

- New services should be included in the bundle with complementary well-known services in order to introduce a new demand for customers while at the same time reducing customers' insecurity of buying it. An example of such services could for example be new supporting services (interest rate ceilings, interest rate assurance, and loan protection) for different types of loans.

- Price bundles should be constructed in a way that consumers are able to evaluate them and see the benefits of buying it. A retail bank wants most likely of the competitive reasons to offer bundles that are not comparable with competitors. For that reason, there is a risk that bundles become too complex leaving customers uncertain about the real benefits of them.

8.2. How is price bundling applied in Swedish and Finnish retail banks?

There were basically two different kinds of models that the banks applied. One model was constructed as a mixed-leader bundle. The leader service was a set of requirements that when fulfilled offered a customer certain price discounts or other services to reduced prices. The requirements as well as the included services varied between the banks but the basic idea was the same. The other model was a mixed-joint bundle that consisted of current account and different supporting and facilitating services to be used in everyday transactions. The first model was used extensively in Sweden but it is a new phenomenon in Finland. According to the interviews in 1996 the Swedish banks stressed more the importance of getting the whole customer relationship to themselves and to reduce cross subsidisation between customers whereas in Finland the focus was on cost reduction. That is why Swedish banks seem to have concentrated on customers' total relationship and how it should affect pricing. In Finland banks in turn have made cost efficient payment packages. The relationship aspect has been in a secondary place and it has only meant that certain customer classes have got the packages for free.

Problems that banks have been facing when they try to price their services were according to the interviews following:

1. Negative attitude of customers
2. Profitability of a customer relationship (i.e. customers are shopping around – competition)
3. Financing the business costs for payment services and transactions

Price bundling has been introduced in order to counteract the above problems. Bundling was thought to help to gain acceptance for different service fees and transactions fees through a larger service offer. Price bundling was also thought to be a way to get the whole customer's demand to one single bank thereby tying the customer closer to the bank for a longer time. Therefore, by price bundling a bank aimed at to get more fee income, sell more services per a customer relationship and make the length of the relationship longer. Cost savings have also been one of the main arguments for the presented price bundles.

Increased fee income

The first motive to gain acceptance for service fees and transaction fees by price bundling has probably been reached. Customers have accepted the fact that payment services cost and they have not started a massive switching movement for that reason. In Sweden there were for example big reactions after Sparbanken introduced its new fees in 1993 but at the same time they offered a higher interest rate for the current account to compensate for that. And since the other banks followed Sparbanken's example to introduce transaction fees, customers were not really given any choice. Only Handelsbanken in Sweden has kept the old way of pricing through the interest rate margin. In Finland the same was true, banks started charging explicit fees and customers were not offered a choice other than to accept the prices. The bundles were introduced and they were made advantageous compared to the individual prices. The only bank that does not apply price bundling in Finland, Osuuspankki, is charging individual transaction fees for its services. Since it is the largest private customer bank, price bundling is not the only alternative for improving the acceptance for different fees –nor the only way to make customers to stay in a bank.

In any case, price bundling has probably helped customers to accept the new prices since bundles appear as more advantageous than individual prices. Especially in Sweden the bundle customer is clearly rewarded.

Cross-selling to get total customers

The another threat for banks was the increased competition, customers shopping around in different bank, eventual diminished loyalty and therefore a threatened profitability of customer relationships.

Banks in Sweden are all trying to make total customer relationships by price bundling and to sell more to their customers. The bundle requirements mean that the customer has to concentrate his affairs to the particular bank and for this behaviour he is rewarded. Nordbanken has the most extensive bundle by having hardest requirements for qualifying to them as well as by tying most services in their bundles. FöreningSparbanken has divided the offering into two parts, an everyday transactions bundle and a long-term relationship bundle. S-E-Banken does not demand a very large relationship to qualify and the bundle only includes a few payment services and some reduction in fees for consumption loans.

The likely cross-selling effects of new services in these bundles are however not very obvious. Nordbanken's bundles make an explicit connection with many different services. It is possible that customers start using cheques, giro payment service, some of the bankcards, telephone bank or increases loan demand because of the price reductions in certain fees and interest rates on these services. On the other hand, these services would perhaps have been bought in any case. Moreover, the requirements already mean that a large part of the customer's demand for banking services is satisfied. So, the cross-selling effect would be considerable if customers wanted to trade up to the requirements level in order to become Plus-Customers or Förmåns-Customers. Since around 50% of the Nordbanken's existing customers do not qualify to these bundles there should be a lot potential if these customers in fact moved their business to Nordbanken. It is in turn depending on this segment of customers' evaluation of the benefits and a comparison of the competitor banks' offerings.

When Nordbanken's benefits list is studied it appears that the reality is not always that beneficial. For example, price bundles in Nordbanken may seem beneficial compared to Nordbanken's normal customers but if they are compared to competitors' bundles the conclusions become quite different. Nordbanken seems actually to be the most expensive bank when some yearly fees and transaction fees are studied -even for the Plus- and Förmåns-Customers[77]. When all the interest rate benefits are counted for that may change the picture, but nevertheless even those discounts are not too rewarding in all the cases. Plus-Customer and Förmåns-Customer for example get 0,6% interest rate if they have over 30.000 SEK on the current account and for lower balances they get 0,25% interest rate. Ordinary Nordbanken customers' price is 0,25%. If that is compared for example to FöreningsSparbanken where a customer gets 3,5% up to 15.000 SEK and thereafter 2% for higher balances, Nordbanken's benefits do not look like benefits at all. The effect of these price bundles on collecting customer affairs can therefore be suspected to be quite humble on the bundle benefits basis.

FöreningsSparbanken's bundle seems to be directed to existing customers but with not many incentives to increase consumption of new banking services. The Enkelt-bundle concentrates on selling three services to all customers by giving both interest rate benefits and price discounts compared to ordinary customers. This bundle is easy for customers to evaluate and

[77] This conclusion is based on comparison between three services Visa bankcard, Telephone bank and Giro payment service. This does not cover all the services that Nordbanken includes in the bundle why it is a bit misleading. Moreover, S-E-Banken does not offer personal telephone service as Nordbanken and

should be cross-selling these services quite efficiently since the services are more or less necessary. The relationship bundle Nära in turn is not likely to increase cross-selling of different services since there are no trading up goals for the customers and the benefits are not very comprehensive. Only personal counselling and information is offered for these 'good' customers that have most of their affairs in FöreningsSparbanken. S-E-Banken's price bundle is not introducing much new demand either. A customer might start saving 300 SEK continuously in order to qualify as a Förmåns-Customer but other addition to selling is difficult to see. Bankcard and giro payment services are likely to be bought in any case.

In Finland the price bundles cross-sell only related services to current account. Leonia bank has now, however, changed its bundling to involve the total relationship with the bank to affect prices. Otherwise the bundling has been concentrated on introducing cost efficient services to customers in order to minimise bank's costs. In that respect cross selling has surely worked well but it is questionable whether the charged prices cover the bank's costs for the advanced services. Bundles have been sold for a monthly fee (10 and 20 FIM) that means more income than without bundling, but the monthly fee is low compared to what the customers are offered and the individual prices. It seems that the banks have failed to communicate the value of the services to their customers. Also compared to Swedish prices the Finnish monthly payments seem low. However, Leonia has now made some changes and increased the price of higher service bundle.

The main finding concerning the cross-selling aim of price bundling is that it is not used in order to sell new services but more to reward customers for the demand they are already directing to the bank. Price bundling functions therefore as a means of increasing existing customer satisfaction and loyalty to the bank. Therefore, even the success of the aim to get customers to concentrate their affairs to one bank is questionable since the benefits offered by any of the banks might not be large enough to make customers to take such a big step. It seems though that Nordbanken has constructed the bundle with the clearest attempt to that direction.

Mutual funds, insurance services and new loan services are all absent from these bundles even though the demand especially for mutual funds has been increasing strongly during the late

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FöreningsSparbanken do.

1990's. Banks have also started to offer different insurance services that are relatively new for them. Price bundling could be used in order to get customers for example to switch their insurance affairs to them and to introduce other new products. The price bundles in Sweden contained a personal counselling contact once a year. This is an appropriate action since customers need to be better informed about what the bank offers in order to affect the sales. The personal relationship with the bank is also good for improving the bank's image and for increasing customer's commitment for the bank. It is though arguable whether customers see that as a real advantage or if the personal contact and advice is something he expects to get in any case. In the latter case, such a service is not increasing the customer's perceived value of the bundle offer. However, the relationship function is important in selling new services.

The studied banks seem not to have paid enough attention to segmentation of their customers and making directed price bundles for these. For example, when a customer qualifies to the bundle and becomes a 'preferred customer' he often can do it by many different ways. It depends on the requirements how homogeneous the segments become. It seems as it is the total relationship measured in SEK and FIM that matters for the banks and not the different types of services a customer has. If future sales are going to be increased the more appropriate ground should be to start from the services that a customer has and the probable demand that kind of customer might have in the future. Then price bundling could affect consumer trial for new services more directly. For the existing services that the customer already has it would be appropriate to set goals in order to increase the profitability of these services.

One final point concerns the fact that customers do not actively buy the price bundles but they usually qualify to the bundles. In some cases a customer is not perhaps even aware of being a preferred customer and getting several advantages. In such cases the demand is not affected at all and the price reductions would be unnecessary. This would mean that in order to affect the customers' future demand the bundles should give right incitements for the desired behaviour.

Building long term relationships

One of the motives for price bundling is to lock in customers for a longer time period. It can be done by increasing a customer's switching costs and by reducing a customer's trial needs. One important such element is a personal relationship with the bank and therefore a personal commitment. It is harder for a customer to switch banks when there is some real person in

mind when the bank is thought about rather than just a faceless bank. Other type of increasing switching costs is to have many hooks in the customer, i.e. to sell many services, and that was the earlier discussed cross-selling motive's long-term effect.

Swedish banks are trying to affect the personal commitment by including counselling in the packages. Of Nordbanken's customers three are really only Förmåns-Customers, Plus-Customers and students that are desired to retain. Normal customers are not treated in any way: they are not offered any price bundle or counselling. In FöreningsSparbanken almost all of the customers can qualify to the Nära-bundle and will get access to one free counselling per year. In S-E-Banken's price bundle the personal contact effect is depended on the customers' willingness to take the current account credit or other consumption credit. In Finland price bundles do not include any personal contact other than Leonia's information brochure. Since personal relationships are important to customers in order to reduce their uncertainty and to increase their loyalty, banks should pay a lot attention how this is achieved.

Other barriers for customers to exit could be that their demand is tied to one bank by long-term contracts that are included in the price bundles. If a longer-term service is combined with another kind of service, for example pension insurance and current account, that would diminish a customer's willingness to change banks since for example a pension insurance matures when the person is 55-65 years old. The set of requirements in the current bundles often included current account, savings and loans. Loans are usually longstanding that will lock the customers to the date they mature or in the case fixed interest rate loan to the date they can be bound again. Still, the same customers perhaps do not demand loans during the whole relationship why other long-term services should be found to the bundles. Moreover, such customers perhaps would not qualify to the bundle after repayment of the loan that would not be a good policy of the bank to reward a loyal customer. Other possibility to affect the relationship length would be to set some kind of goals for a customer to achieve or make an offering that would be based on the relationship length.

Price bundling and cost reduction

The price bundling used in order to diminish operating costs is quite well utilised in all the banks. Consumption of transaction and payment services is directed to cost efficient delivery channels. In Finland all the ways of payment are included in the bundle. In Sweden banks are

either charging for telephone banking or Internet or both. Nevertheless, they are in most cased included in the bundle and then the reduced prices should increase demand for these. If the use of Internet or telephone bank were equally intensive (and the costs were same) in both countries, Swedish banks would save costs as much as the Finnish banks but they would earn a lot more for the services since their prices are higher. On the other hand, if the prices would restrict customers' use of the cheapest possible services, the cost saving benefits would not be that great.

The other cost advantages concerned savings in marketing and selling costs. Such costs are diminished for example by the counselling service that has been included in the packages. Bundling is, when it is concentrated mostly on existing customers, utilising economies of time. The long- term effect however must be measured in an alternative way. It is not totally obvious how to measure the costs to lose an existing customer and having to replace him by a new one. To the extent that cross selling can improve relationship strength and/or a customer's relationship length, price bundling will be further motivated from the cost point of view and give room for price discounts in order to enhance demand.

Future of price bundling

During this short time period all the banks had made some modifications to the bundles and it is likely that there are more to come. The increased competition will further accentuate the importance of fee income and secured income by steady customer relationships when the interest rate margins shrink.

8.3. Concluding remarks

What have we learned about banks' price bundling practice compared to the theory? The economic principles gave three motivations for price bundling: 1) cost factors, 2) demand factors and 3) strategic reasons.

Banks are currently mostly making use of cost economies with their price bundling. More specifically, of the cost economies the advantages that economies of scope offer are reasonably well utilised. The other cost advantages offered by price bundling concern marketing and selling activities and they are on the other hand not working equally well since

these functions have to do with the demand enhancing affect of price bundling. And the demand enhancement possibilities of price bundling seem not to have been taken advantage of in the current price bundles. The third cost factor has to do with retaining existing customers. Banks' price bundles are in a way creating incentives for customers to concentrate their affairs to one bank. In some cases it is clearly defined when a customer is a 'wanted' customer and in some cases banks try to initiate a personal contact with a customer through its price bundles. It can still be argued that the current price bundles are not directly constructed in a way that would lock the customer to the bank. There are not any explicit benefits of being a long-term customer or there are not, for example, any further selling offers for the changed future demand.

Of the demand factors banks are using the fact that most of its services are complementary and therefore appropriate to combine together –that is why it is natural to make price bundles of the different financial services. Although price bundles in some way are extensive, there would be further opportunities to create not necessarily larger price bundles, but different kinds of price bundles. The current price bundles are not directly constructed in a way that would facilitate demand for most of the services offered by banks. Furthermore, such bundles should be directed to specific homogeneous customer groups.

It seems also that the price bundling considerations have not been done directly from the customers' reservation price distributions. Price bundling for example is most advantageous when reservation prices are negatively correlated, meaning that one customer values one product high and the other low when the opposite is true for some other customer. When the price bundles are looked at most of them are not bought by the customers but a customer qualifies to them and the bundled discounted services are just a reward for being a kind of customer that a bank wants. The planning and construction of these bundles seems to have started from the bank point of view –what kind of customer a bank wants to have. But price bundling should be started from the customers and the factors that determine their demand. Banks surely do extensive customer research too but the message to customers has a bit negative tone: a customer must fulfil certain requirements before he is given rewards. That is a more static way of treating the customer than dynamically directing customers' demand. It seems to be important to have good customers for the time being than to make good or better customers in the future.

The third theoretical aspect dealt with strategic advantages through price bundling. The reasons given in the existing theory seemed not to suit the banking market. Therefore, it both banks strategic behaviour and the theory about the strategic price bundling should be developed. Strategic issues mean also that price bundling should have a long term perspective. The models and motivations that the theory offers are all short-term models.

Concerning the managerial principles based on theory there seems to be a gap between motivations for bundling and practical accounting principles for different bundling decisions. What are the conditions for profitable price bundling in the long run? What is the relevant factors and how are they going to be measured in order to measure the profitability of the different bundling strategies? What kind of marketing research needs to be done in order to obtain relevant information about the customers' preferences? There were several questions that initiated this report and it seems that this report is finished with further questions. The findings in this report need to be analysed in a more detailed level in order to make conclusions about the profitability of the different strategies and to improve price bundling models.

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Appendix 1: Interview guide

General questions about accounting and pricing:

- What is the goal for your pricing?
- What are the challenges in pricing financial services?
- Are there differences between different customer groups?
- What accounting principles do you use for pricing decisions?

Price bundling

- When have you started to apply price bundling in your bank?
- Why did you chose that pricing method (alternatively why not?)
- What principles have directed the price bundling decision?
- What kind of profitability calculations do you use?
- How do you decide the prices for the bundles?
- Is there any need to develop price bundling?