Bundling in banking: a powerful strategy to re-establish customers’ trust and increase profits

By cleverly combining different items to create a “bundle”, or package, companies have one of the most powerful levers available to reposition themselves and increase customer lock-ins.

The most renowned examples are the McDonald’s value meals and MS Office packages. These market leaders are the “best-in-class” example for creating attractive and profitable bundles through a systematic, multi-stage approach to customer segmentation, targeting and product positioning, as well as sales across product areas. If this strategy is implemented correctly, it promises various advantages for financial institutions as well (more cross-selling, cost synergies and profit increases).

Now more than ever, banks should take advantage of bundling strategies to reduce customers’ uncertainty and to increase their awareness of the bank’s services. However, if applied incorrectly, bundling can also be a damaging concept. Therefore, the key is to develop structured and systematic bundling strategies.

Creating successful bundles: a four step process

Achieving the advantages of bundling is not always easy. In order for banks to use bundling as a profitable growth strategy, they must follow four key steps:

Step # 1: Combination of products and services

The most important success factor in bundling is correctly designing the structure of the package. Bundles must satisfy both the bank’s and the customers’ interests – from the bank’s perspective, it is a good idea to combine attractive “must have” products with less attractive elements, in order to increase the sales of the latter. However, if the bundle contains too many unattractive products, customers will opt to buy the attractive products separately. To achieve the optimal mix, banks should clearly define target segments and develop specific bundles to fit their needs.

Beyond core bank products, bundles should be supplemented with additional services or non-banking products. As core products are very similar (and viewed as commodities), the added value of supplementary services allows the bank to further differentiate itself from its competitors. In order for the package to be successful, it is crucial to offer benefits that are both attractive to the customer and not already offered by competitors. In practice, we rarely find unique auxiliary services in bundles (most packages include hotel discounts, travel insurance, etc.), making differentiation almost impossible. It is therefore vital to pay careful attention to the selection of these services and not offer only those services which are already included in direct competitors’ packages.
Step # 2: Multi-stage evaluation process through customer research

Product managers should first brainstorm to select the appropriate products to bundle from the entire product portfolio. It is important to strike a balance in the combination of lead products, less popular products and customer needs. A focus group follow-up analysis can be very helpful in assessing the market appeal of the designed packages.

After the appropriate products have been selected, one of the most important aspects of bundling is the extraction of customers’ willingness to pay for the bundle, as well as for its individual components. Several methods can be used to measure these ‘unknowns’, each having advantages and disadvantages:

The simplest method is the direct method: asking customers what their willingness to pay is. However, the reliability and validity may be questionable due to the customers’ attention being purely focused on price. This may create a higher price consciousness and result in an artificially lower willingness to pay. In reality, however, customers weigh the price of the product/service against other features they value and make subsequent trade-offs.

Therefore, a more systematic approach is conjoint analysis, in which respondents evaluate several scenarios or available bundles. In doing so, conjoint can measure the importance and the value of the individual bundle components from the customers’ perspective. The respondent chooses between two unique but similar combinations of product features, establishing his or her individual preferences among the alternatives and capturing the value they place on each feature. A utility function, which indicates the perceived value of each feature and how sensitive consumer preferences are to changes in product features, is calculated for each product feature. The utility values are then input to a simulation model to find the overall profit optimal price and product bundle combinations. Conjoint leads to reliable and actionable results but is a significantly more complex and expensive methodology.

Unlike conjoint analysis, expert judgment is a simple and low-cost method. This procedure systematically uses the knowledge of internal experts to estimate market reactions to different price scenarios. Typically, ten experts from different departments of the bank (i.e. sales, product management, control) follow a structured, multi-step exercise where they individually estimate the customers’ willingness to pay for different bundle options. This method can lead to pragmatic and sound results.

Step # 3: Pricing of the packages – structure and level

Optimal pricing is crucial for the success of bundling. Not only do you need to decide on the price level, you must also decide on the best pricing structure. There are two main options for a bundled price structure: a single price covering all components, or an “a la carte” structure, where the price depends on the type and number of the chosen services. Which option is better for an individual bank depends on a number of factors, such as the bank’s objectives and its customers’ preferences, among many others. The optimal price level is established using the results from the willingness to pay research. To incent purchase, the bundle is generally discounted between 5 to 20 per cent, often depending on the number of components purchased. Alternatively, it is possible to offer extra services (more value) rather than discounting prices. In either case, it is vital to pay careful attention to price thresholds. Empirical studies have shown that mixed bundling, where both a bundle and individual products are offered, makes more sense when it comes to profit optimization than pure bundling, where only the bundle is offered. Pure bundling alienates customers who are not interested in some of the bundling components, and, as a result, don’t buy any products.

Step # 4: Create internal preconditions

Bundles often consist of products that belong to different profit centres or divisions within a company such as the insurance company and the bank entity. As the bundle price is usually lower than the sum of the individual prices, this difference has to be allocated to different profit centres, often leading to conflicts over revenue share. It is imperative to
manage internal processes and company structures that are affected by bundling. Moreover, in order to ensure that customers receive appropriate consultation, it is essential to thoroughly train employees in all services included in the package and to offer an appropriate incentive system for sales employees. These incentives are extremely important if the bundles consist of products from separate business units, so that the sales representatives do not focus on only one of the product groups.

**Mismanaging bundling: price promotions**

Despite the fact that bundling can be a powerful tool to re-establish customers’ trust and increase profits, it can also hurt banks if not applied correctly as described above. The most common mistake we observed is the combination of bundling and price promotions. Particularly in times like the financial crisis, banks tend to give a discount on the bundle and price-promote the individual bundle items as well; a very dangerous strategy.

This holds true not only for financial services, but is a common mistake across most industries. The fast food industry frequently promotes value meals and individual items at the same time. In the airline industry, individual companies will offer huge rebates on travel packages, while launching price promoted tickets at deep discounts. The computer industry is also no exception. Companies will discount computers and printers individually and meanwhile, make them available in a bundle or package at a special price.

Simon-Kucher studies have shown that the combination of bundling and price promotions can diminish the effectiveness of bundling strategies considerably. In one study, a promotional activity increased on the individual banking products, buyers perceived less savings on the bundle, appeared less inclined to purchase the bundle, and were less willing to pay for the bundle. The consequence was a rapid decrease in the bundle’s overall profitability.

Overall, profits can drop up to 20 per cent if the strategy is not correctly implemented. The following are some guidelines.

- Financial institutions should not promote individual products that are also available in a bundle as frequently and cheaply as the bundle. Otherwise, the consumer will not perceive the attractiveness of the bundle. The bundle price should be much lower than the sum of individual products.

- Should financial services companies nevertheless want to promote individual products, the focus should be limited to a single product in the mix. An alternative is to alternate promotions (one after another), which avoid a conflict of two promotions. This will also slow the purchases of individual products at lower prices than the mix.

- Should the provider decide to offer large rebates on individual products, it must be an absolute exception. Otherwise the consumer will use the price of individual products as an external reference for the bundle, which then loses value. Frequent rebates of individual products suggest to the consumer that the bundle is no longer attractive nor is the offer credible.

**Summary**

Bundling promises multiple advantages for financial institutions, profit increase and customer lock-ins are among the most important ones. Bundling products into attractive packages is a challenging task though and requires a sophisticated strategy to create interesting packages and proper pricing structures. Experience has shown that many banks lack the knowledge to control the complex bundling process.

Price bundling requires a great deal of information on individual customers and customer segments, and each case has to be carefully investigated in order to determine the appropriate form of bundling. Bundling can also be a dangerous strategy in the current financial crisis if it is combined with promotional activity on the individual items. If
implemented correctly though, bundling is a powerful strategy to not only increase banks’ profits, but more importantly, re-establish customer’s trust. In current times, there are very few strategies and approaches left that can accomplish those two key objectives.

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