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In Brief—Bundled Products, Pricing, and Revenue

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Wind River Announces Pricing Change

On Friday, November 1, 2002, Wind River's released its new pricing strategy. Their new pricing scheme is reflects two strategic choices. First, Wind River has opted for an annual subscription pricing plan over a per-project plan. Second, Wind River has created new software combinations bundling what were individual software products. While both of these moves are noteworthy, this article explores the revenue and profit impact of bundling software.

Wind River is the largest maker of real time operating systems (RTOS) for embedded systems. Headquartered in Alameda, CA, their FY 2002 revenues were $351 million. Their customers are often design engineers making products for Consumer, Industrial, Aerospace, Network Equipment, and Server Appliances industries. Wind River's largest competition is Microsoft's CE among other industry participants.

Jerry Fiddler, Chairman & Cofounder, claims in a The Wall Street Journal (11/1/02 p. B7) that the new pricing strategy should stimulate wider use of overall technology and produce the same overall revenue. While this may be true, bundling individual software products into packages should produce more than a market share increase for Wind River. Importantly, bundling should produce higher revenues and profits as well. What follows is a numerical example to demonstrate the value of bundling and a brief list of major requirements to be met prior to successfully implementing a bundling strategy.

Numerical Example

Suppose there are two software products that have distinct but complimentary value add to the market. Also, suppose that the market can be characterized by having at least two segments. Lastly, suppose each of these software products are initially priced equally at $75/product.

One customer segment, I will name Mary, might perceive the value the first product at $90 and the second at $50. Because the first product is priced less than its perceived value to Mary, she will purchase the first product. (Mary's perceived value of $90 > Price of $75. Result: Sale.) In contrast, the second product is priced higher than its perceived value to Mary and she will not purchase the second product. (Mary's perceived value of $50 < Price of $75. Result: No Sale.)

A second customer segment, I will name David, might perceive the value the first product at $40 and the second product at $80. Using the same logic as before, we can predict that David will forego the first product and purchase the second.

Thus, using a price-per-module strategy of $75/product, the total revenue to the company is $150 while Mary & David purchase one product each.

Alternatively, let us change the last condition and suppose the two software products are bundled for a price of $115 for both.

Mary will analyze the bundled offer and realize that she perceives the value of the combined package higher

than the offered price. (Mary's perceived value of $90 + $50 = $140 > $110. Result: Sale.) Likewise, David will purchase the bundle of products using the same logic. (David's perceived value of $40 + $80 = $120 > $115. Result: Sale.)

Using the bundled pricing strategy of $115/bundle, the total revenue to the company is $230 while Mary & David purchase both products.

Bundling, as seen in the above example, produces a win for both the company and the customers. The customers get more product and benefits while still spending less than their perceived value for the total bundle. The company has a 53% increase in revenue with virtually zero increase in costs.

Theoretical Requirements

Two main requirements for successfully implementing a bundled pricing scheme are segment demand differences and low unit costs.

First, individual segments must value the constituent parts of the bundles differently so that their sum value is somewhat constant, while their constituent part values are greatly varying. This requirement can be stated as requiring individual segments to have different preference weightings but similar overall demand levels.

Second, the unit costs for the constituent parts of the bundle must be sufficiently low so that selling discounted bundles of products is more profitable than individual products at a lower overall volume.
There are further caveats and issues and each can be illustrated through analogies and examples. In an effort to keep this article simple, these aspects are left for private conversations.

Conclusion

While Wind River may have bundled their software products into five major platforms to increase market penetration and encourage higher use, they should also expect increased improved revenue and profits.
As demonstrated in the numerical example, bundling products into packages can provide a costless means to increase revenues and profits providing the marginal costs are low and individual market segments have different preferences. Software, intellectual property, and other value offerings created from large up-front costs and low marginal costs meet the second requirement. Likewise, software product "add-on" modules often meet the requirements and are appropriate for bundled pricing strategies.

One key issue not explored is that of setting the price of the bundle correctly in relation to the price of the individual constituent parts. This step requires market research into the specific preference profiles of customers.

Is bundling the right strategy? It was for Wind River as well as for Microsoft when they launched the Office Suite. It might be for you as well.