SI 646 - Information Economics, Winter 2007

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Bundling as competitive strategy

Jeff MacKie-Mason
SI 646
Do you want to see...

Gone With the Wind?
...well, then you also gotta pay for...

Getting Gertie’s Garter?
Loew's “block booked” its movie backlist for licensing to TV.

Why?
Suppose GWTW worth $10K, GGG worth $0K.

Can’t get any more from block-booking than from separate booking.
<table>
<thead>
<tr>
<th>Network</th>
<th>GWTW</th>
<th>GGG</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABC</td>
<td>$12,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>NBC</td>
<td>$10,000</td>
<td>$4,000</td>
</tr>
</tbody>
</table>

- **max separate prices?**
  - $10,000 for GWTW
  - $3,000 for GGG
  - Revenue = $26,000

- **Bundle price?**
  - $14,000
  - Revenue = $28,000
Consider selling two goods to many consumers with different valuations. So, best strategy depends on number of customers in each region.
When is bundling effective?

Perfectly positively correlated valuations

No gains from bundling

(P_1 = P_2, P_B = P_1 + P_2)

Perfectly negatively correlated valuations

Complete surplus extraction from bundling

(P'_1 = P'_2, P_B = P'_1 + P'_2)
Bakos & Brynjolfsson on bundling information goods
Bundling paperback books

\[ p_b = 2 \times \pi \times b = 3 \]

\[ p_l = 1 \times \pi \times l = 5 \]

Sources:
Image on left: CC BY-NC-SA Yochai Benkler (Wealth of Networks) http://creativecommons.org/licenses/by-nc-sa/2.5/
Image on right: http://www.gutenberg.org/etext/14304
Prop 2: If MC large enough, bundling will be unprofitable.

Bundle will include some goods with $v > MC$, some goods with $v < MC$.

If MC high enough, paying so much for unwanted goods that it outweighs benefit of demand averaging.
Economies of scale in distribution favor bundling.

The Internet reduces distribution economies, can induce unbundling.
Why consider only bundling monopolists? Info products usually face some competition.

Fay & MacKie-Mason: With some imperfect competition, most demand aggregation profit competed away. Consumers keep surplus.
Bundling is alternative to price discrimination when demand heterogeneous.

Bundling: average across goods
“Even information commodities can be successfully differentiated if you exploit the unique features of the Internet.”

(S&V p. 26)