

Chapter 4

Buffet or à la Carte: Pricing Digital Goods

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ABSTRACT

Pricing strategy plays a key role in most organizations. The pricing decision of bundling or à la carte in the case of cable television industry is a long debated one. While consumers seem to favor the à la carte option, operators are persistent in continuing with the bundling options. In this chapter, we explore both sides of the argument. We then discuss several factors affecting the players in the eco-system of cable television industry; these include the subscriber-operator relationship, operator-distributor relationship, and the role of government policies affecting their decisions. In concluding we use these factors to conceptualize a framework that seeks to assist the players in the cable television industry in choosing an adequate pricing model.

INTRODUCTION

Pricing takes a key role in most of the organizations as it determines the turnover and achieved returns (Lehmann & Buxmann, 2009). The concept of network effects (Shy, 2001) and the lowered costs of reproduction play a dominant role in digital media industry that makes the pricing strategies different from other industry types. With the

increase in choices, consumers today can decide what to opt for. Instead of purchasing an entire music album, a consumer is able to pick his favorite song through i-Tunes. Similarly, customers might want to view movies at home based on their preferences rather than the ones offered by the distributor. On the other hand an office executive might prefer a bundled Microsoft Office suite for all his document needs. Likewise a consumer of a new PC might not mind adding a little price to buy a package consisting of a mouse, mouse pad

DOI: 10.4018/978-1-61350-147-4.ch004

and a maintenance kit. Hence it becomes critical for organizations to understand when to bundle the products in a package and when to offer an à la carte option for the consumers.

The cable television rates have increased tremendously over the years on the assumption of improvements in the quality and the increase in the number of channels offered (Buckley, 2008). Crawford et al. (Crawford, Kwerel, & Levy, 2008) report that the unadjusted cable prices increased by 84.1% over the period from 1997-2005, quality improvements by 50.5% in comparison while the consumer price index by 18.8%. However several consumer groups feel that the fact that subscribers generally do not watch all the added channels is ignored (Prices, 2004). They argue that bundling practiced by the cable TV operators has led to a steep increase in the prices (Chen, 2009). The report states that the cable television operators abuse their market power by claiming that despite the massive cost production increase, the consumers are getting a greater value for their dollar. The operators on the other hand believe that bundling helps them lower the transaction costs, realize economies of scale and simplify the decision process for the consumer. A la carte option would simply increase the prices for the consumer (Crawford & Yurukoglu, 2009). The situation is further worsened by the ambiguous stand of US Government's Federation Communication Commission (Rennhoff & Serfes, 2008). The November 2004 report by the Commission states that using an à la carte option would increase the prices and thereby limit the benefits to the consumers while their February 2006 report take a completely opposite stand (Chen, 2009). This leaves both the operators and the consumers confused.

There is hence a need to understand the basis of arguments in each case that will help understand what is suitable. Although there have been research done on this case of the cable television, it is still not clear how the option of à la carte would benefit customers. In this chapter, we use the case

of cable television to compare the pros and cons of à la carte or bundling or otherwise known as a buffet system as strategies for pricing. We first explore both sides of the coin by researching the recent trends and then consider several factors that impact the pricing options. At the end of it, we propose a conceptual framework that seeks to help the concerned people in the eco-system of cable television industry understand the suitability of each pricing option.

BACKGROUND

The stand on whether the cable television operators should offer channels on an individual (or à la carte) basis as opposed to the bundled options that are offered presently, has been a long debated one. While customers seem to prefer the individual options, there must be a reason why operators favor the bundled option. In this section, we see both the sides of the coin and then use the research materials to compare the two.

Literature Review

Emergence and growth of the Internet has not only created new opportunities for pricing the digital goods but also made the firms re-consider their pricing models and strategies (Bakos & Brynjolfsson, 1997). The ability to create and distribute electronic goods at minimal cost has brought a change in the old pricing model of price being equal to marginal costings. However, the pricing in organizations is often plagued by rationality deficits in the form of ad hoc or arbitrary decisions (Florissen, 2008). Internet has made possible, the monitoring and micro payment, making it more feasible to sell small units of information, which may be used for limited time, by limited people and in limited situations; which has given rise to the concept of on-demand (Bakos & Brynjolfsson, 1997) consumption.

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