Research in Transportation Economics 49 (2015) 22–35

Contents lists available at ScienceDirect

Research in Transportation Economics

journal homepage: www.elsevier.com/locate/retrec

How service bundling can increase the competitiveness of low market share transportation services

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ARTICLE INFO

Article history:
Available online 7 May 2015

JEL classification:
L91
L92
M15
M31
M13

Keywords:
Service bundling
Price bundling
Bundling strategy
Business model
Value added services
Value of time
Transportation competition

ABSTRACT

While transportation service providers continuously seek for new linkages to create value and to offset the risk of competition, they are compelled to restructure their business models and processes to become more integrable. A consequence of this has been a shift from the traditional focus on individual service strategies to a focus on bundle strategies. Building on bundle value is gradually becoming a key ingredient for the long-term viability of services as it fosters better allocation of resources and investment choices. This entails the assessment of the value that customers assign to bundles and the alignment of business models to match this value. To address this issue, this paper investigates the conditions under which a low share transportation service, bundled together with a ferry service and a tie-in recreational package, can compete with a faster transportation connection. By merging the conceptually rich business model research with the more rigorous bundling literature, the current paper proposes a mixed service bundling strategy as an effective way to increase market share and create customer value over time. This bundling strategy is applied in the case of an illustrative example of the connection between Patras, Kalamata and Crete and the results are reported.

1. Introduction

Modern enterprises in the transportation industry face strong pressures to increase competitiveness by engaging in alliances of several kinds. With a rapidly increasing pace, traditional organizational structures evolve towards value networks which tie together the competencies of different specialized service providers. As a result, new forms of network interaction and business strategies have emerged as important facilitators of such networks. These strategies, along with increasing customer demand for sophisticated and customized services, have encouraged new forms of service organization which Stremersch & Tellis (2002) define as service bundling.

Service bundling is a form of flexible multi-service delivery which requires coordinated value chains in order to satisfy complex customer needs, which cannot be satisfied simply by one service. This form of value creation is not new in the transportation industry; it has its origins in the latter half of the last century and has been instrumental in turning travel into a consumer item. Nowadays service bundling is growing in popularity in the cruise market while price bundling is found to be significant in the airline and travel wholesaling industry (Hooper, 2006, p.32). One key characteristic of service bundles is their agility to provide added value by packaging together service components offered by either the same or different enterprises. Considering the complementarity of these components and depending on the importance of information and transaction costs, and the utility of joint consumption, significant economies may be achieved in purchasing them together. Moreover, the practice of bundling has been gaining greater significance generally in the marketing of services. While service providers continuously seek for new linkages to create value, they are compelled to restructure their business models and processes to become more open and integrable. The reason for this is the need to leverage disparate assets to become more efficient, and to mitigate the risk of losing customers to competitors that offer similar services and better overall customer experiences. A consequence of this has been a shift from the traditional focus on individual services strategies to a focus on bundle strategies.

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http://dx.doi.org/10.1016/j.retrec.2015.04.003
0739-8859/

Building on bundle value is gradually becoming a key ingredient for the long-term viability of services as it fosters better allocation of resources and investment choices. This entails the assessment of the value that customers assign to bundles and the alignment of business models to match this value. It also highlights the need for new assessment capabilities and business models to enable greater capture of customer value. A challenge therefore arises about what can be done to keep the bundling strategies and value assessment models aligned and turn a service bundle into real profit.

Given the above considerations, the literature is surprisingly sparse in describing how this integration could be realized in the transportation industry, or in detailing the challenges inherent in the transition. Even at the strategic level, it is not clear what are the key aspects of transportation bundling decisions, or what factors to consider when deciding on a bundling strategy, mix and pricing. The sparseness of the literature in this field has prompted our research. The objective of this paper is to provide high-level insight in the mechanisms underlying bundling strategy decisions and to identify a business model that will help coordinate the business dependencies of individual services in order to enable greater value capture over time. This paper also suggests a fast screening method for the assessment of the value of service bundles, and explores the conditions that enable that possibility. Unlike other service bundling research, we investigate the interaction between business decisions and assessment of the value of bundling in an attempt to increase the market potential of the delivered services.

In order to better understand the suggested approach this paper uses an illustrative example of the extension of the Adriatic-Ionian corridor from Patras to Crete. Today, transportation between Patras and Crete is mainly via the port of Piraeus. The feasibility of a new service following the alternative route via kalamata would lie, firstly, in the need to reduce travel time and road congestion on the Patras—Piraeus axis—also helping to reduce environmental and other externalities—and, secondly, in the prospects and opportunities that arise for the development of the western Peloponnese, in particular, for the tourism industry. Given that the infrastructure (road connections, ports terminals, etc.) is already there, the challenge lies with the development of reliable and quality services able to compete with existing transportation options, thereby claiming a viable market share. This requires combined action of different, often disparate, service providers which, due to the particularities of the Greek transportation industry, is not a trivial task. To meet this challenge, the current paper investigates whether a mixed service bundling strategy can provide effective means to increase passengers and service revenue over time.

The work is organized as follows. First the main concepts are defined (Section 2) and the recent developments in the service bundling research field are discussed (Section 3). Next, a conceptual framework that shows how service bundling strategies fit in the transportation context and what are their key drivers is presented (Section 4). This is followed by the application of the suggested framework on the case of the connection between Patras, Kalamata and Crete (Sections 5 And 6). The paper is ended with concluding remarks (Section 7).

2. Definition of concepts

Typically, bundling refers to the sale of two or more separate products in one package (Collet & Kuhnimhof, 2008). The economic literature defines separate products as products for which separate markets exist, but in the service sector and particularly in the transportation sector the term needs more precise definition. That is because transportation services can be separate at one level while being parts of another service at a different level. Classic example is the case of an airline and a luggage service which are mere parts of the same service if seen from the user perspective, but they are considered separate services by the airport operator. This paper focuses on service bundling from an operator's perspective and does not deal with bundling in the end user's context.

Furthermore, the economic literature uses the term service bundling and price bundling interchangeably without clearly distinguishing between the two strategies. This paper adopts the definition of Stremersch and Tellis (2002) according to which:

1. Price bundling, refers to "the sale of two or more separate services in a package at a discount, without any integration of the services". Because the services are not integrated, the reservation price (i.e. the maximum price a user is willing to pay for the bundle) is, by definition, equal to the sum of the conditional reservation prices (i.e. the reservation price conditional on the user buying another service) of the separate services. Put simply, price bundling itself does not create value added to users, and thus a discount must be offered to give an incentive to some of them to buy the bundle.
2. Service bundling, is defined as "the integration and sale of two or more separate services at a price". Such integration provides users with value added like, for example, interconnectivity, enhanced performance, reduced transaction costs or convenience from single interaction (one-stop-shop). The greater the value the more users' reservation prices for the service bundle soar, compared to the sum of the conditional reservation prices of the separate services.

Clearly, the decision between price and service bundling is important for transportation operators and other partnering companies because it entails different strategic choices with different consequences for their businesses. Whereas price bundling is a pricing and promotional tool, service bundling is more strategic in that it creates added value. Transportation operators and third-party service integrators such as, for example, tour operators can use price bundling as a short term marketing option. Nevertheless, service bundling is more of a long-term differentiation strategy in which the constituting services require redefinition, optimization of the interfaces among them, or redesign of the delivery processes.

A service bundling may take one of the following forms: pure, mixed, or unbundling (Stremersch & Tellis, 2002).

1. Unbundling is a strategy in which a company sells only the individual services separately, but not the bundle. Typically, this is a base strategy for most transportation companies, but is called unbundling only when it is contrasted with a bundling strategy.
2. Pure bundling is a strategy in which a company offers only the bundle and not the individual services.
3. Mixed bundling is a strategy in which a company offers both the bundle and all the separate services in the bundle separately.

3. Literature review

Generally speaking, bundling is a prevalent practice in most, if not all, service and product industries. However, the academic literature is very limited in terms of research in the field of transportation service bundling. For this reason this section will present findings from complementary research areas and applications from other industries, trying to infer the distinctive traits of service bundlings in the transportation industry.

Lancaster (1966), in one of his contributions to consumer theory, suggested that every single product could be viewed as a bundle with characteristics affecting consumer utilities in various ways.