EXECUTIVE INSIGHTS

Tiers and Bundles: The Pricing Strategies Taking Hold in Streaming Services

In a bid to provide consumers with more options — and earn more of their business — the streaming industry is trying bundling on for size.

Streaming has become an essential outlet for all traditional content businesses. While this evolution has allowed many households to "cut the cord" on traditional multichannel linear television, it has also left many consumers juggling multiple subscriptions. Some may find themselves spending as much on streaming services as they once did on cable TV, leading to churn as consumers rebalance their monthly budgets.

One solution the industry has turned to is bundling. This familiar concept from the world of television subscriptions now allows consumers to purchase a family of different streaming services for one monthly payment, sometimes with the services collapsed into the same app (such as Disney+ and Hulu, or Paramount+ and Showtime). But do these bundling strategies drive incremental revenue for streamers or merely cannibalize revenue from existing subscribers? So far, that's an open question.

Tiering and price increases

In recent years, as subscriber growth has slowed and content production costs have skyrocketed, streaming services have had to find ways to increase revenue. This has often been achieved through price increases and the implementation of tiered pricing structures to maintain affordable entry points for new subscribers while raising premium-tier pricing ever higher.

Tiered pricing makes a lot of sense here as not every customer has the same willingness or ability to pay, nor do they value the same features. By introducing some complexity, different products can be tailored to different users along the willingness-to-pay curve. In subscription video services, tiering primarily reflects differences in picture quality, number of permitted users and advertising, rather than content.

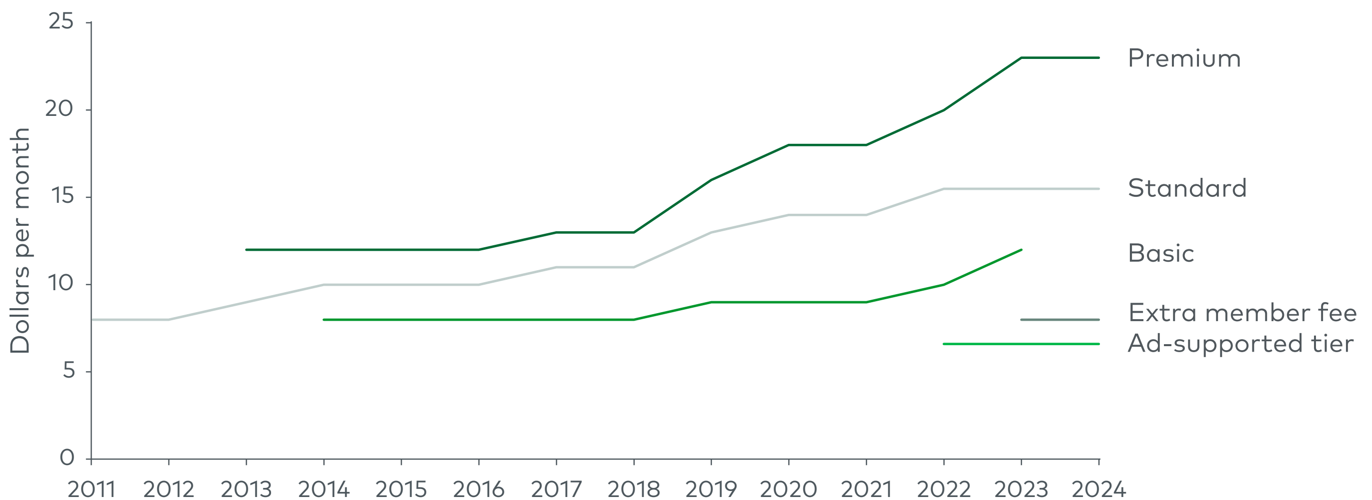
Netflix, for example, launched its stand-alone streaming service in 2011 for $7.99 a month. Two years later, the company introduced a premium tier at $11.99 a month, which included access to four simultaneous streams and 4K resolution. By late 2022, Netflix had four tiers of service, including a new ad-supported plan that cost $6.99 a month for almost all the same content.

Other services, such as Hulu, had already demonstrated the value of streaming services with ads. Ad-supported tiers often have higher combined average revenue per user than ad-free ones. At the same time, ad options expand the audience base with an accessible price point.

In Netflix's case, the basic standard-definition plan has now gone away, replaced by an ad-supported high-definition plan. Netflix is also leading streamers in tackling password sharing by offering a discounted tier for related accounts (see Figure 1).

Figure 1

Netflix streaming prices over time, from launch



Source: L.E.K. research and analysis

A less common alternative to tiering is creating parallel packages for different segments, where the content varies. This model is more common with cable TV. It will be interesting to see if streaming services adopt this approach (think separate packages for kids or superfans).

The drive to bundle

In the old multichannel world, super bundles were priced according to the number of channels they included. Consumers traded up partly to get more content and to access niche networks. Super bundles are less valuable in streaming services because each service already has tens of thousands of hours of content and consumers can access specific content a la carte via services like Apple TV.

However, most generalist streaming services are exploring bundling with each other or with other subscription services, such as cellular phone plans, to drive new subscriptions. Similarly, smaller niche services have either merged into a generalist one (e.g., WWE Network with Peacock) or are being sold as upsells through larger platforms like Prime Video and Hulu.

Bundling is driving trials, adding to subscriber counts and possibly helping with retention. But it isn't clear how much incremental margin bundling can drive. Average revenue per user is typically much lower with bundling, depending on the negotiations with partners that pay wholesale rates. The streaming market also has to adjust to its new status as a material expense for consumers and the scrutiny that comes with that.

There's also litigation risk. In August 2024, a federal judge blocked the launch of Venu Sports, a proposed streaming service bringing together sports rights from Disney, Fox and Warner Bros. Discovery. The injunction highlights potential challenges with trying to create bundles across media families.

Tools for price setting and package development

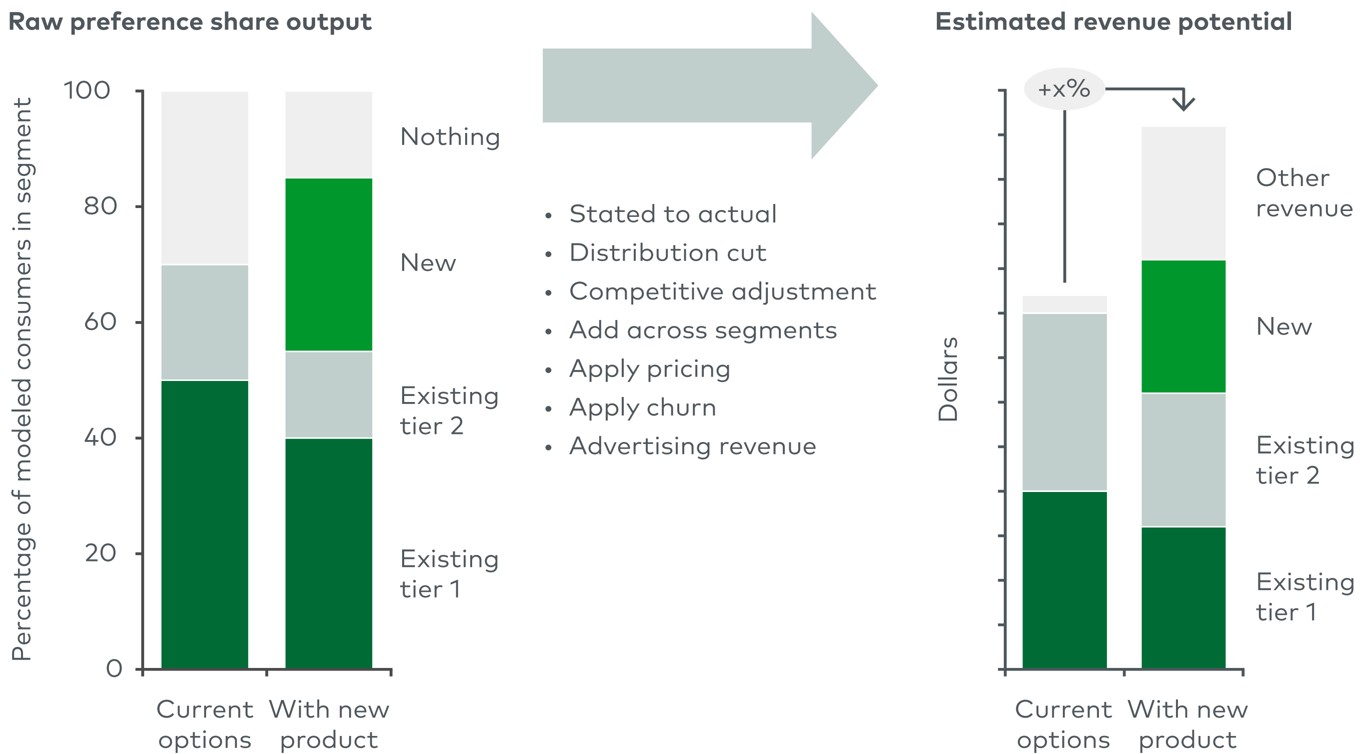
The decision to bundle or tier a streaming offering should focus on long-term value creation. Since content costs are fixed, the low marginal cost of each incremental subscriber makes incremental subscriptions feel like "found revenue." However, some of that additional revenue might have occurred anyway or could cause churn elsewhere.

So an effective pricing and bundling strategy requires a sophisticated understanding of consumer preferences, perceptions of value and likely buying choices by segment. A segment can be defined by demographics, content avidity or current behavior.

One place to start is with conjoint analysis, a statistical technique for gauging price elasticity or the value consumers place on different package components. Although it can help with tiering and bundling decisions by mimicking the purchase process, conjoint analysis lacks the real-world frictions of discovery, money exchange and household decision-making. That makes it essential to stress-test new services against existing and comparable services while correcting for discrepancies between what consumers say they will do and what they actually will do.

At L.E.K. Consulting, we typically supplement conjoint analysis with other methods such as Van Westendorp, Gabor-Granger or TURF analysis. We also like to run real-world pilot tests to help refine price-setting, although these aren't always feasible for high-profile services.

Figure 2
Forecasting demand of a new service using conjoint analysis



Source: L.E.K. research and analysis

Economics of bundling

Another consideration is the impact of tiering or bundling on profitability and value creation. The classic approach to subscription economics involves comparing customer acquisition cost (CAC) to the lifetime value of the subscription. Some CAC elements are directly trackable to new accounts (like free trials and performance marketing spend). Other, less direct expenditures such as mass marketing are also typically allocated to new accounts, even though they also support churn reduction. This is one area where bundle math can sometimes muddy the economic picture.

Bundling is fundamentally a way to reduce friction around product discovery, purchase and retention. The idea is to make it easier for somewhat interested consumers to sign up and harder for them to leave. However, bundling can get complicated when combined with tiering. For example, if the ad-supported version comes in the bundle but a subscriber is willing to pay for the ad-free version, the user experience can be clunky if not altogether impossible.

An appealing strategy for a maturing industry

Overall, we believe that most bundling deals are positive for the streamer and help drive growth and certainty. However, streaming companies must be realistic about the costs to serve and downsides like cannibalization. Don’t forget to mitigate complexity, be thoughtful about the impacts on share of subscriber time and wallet, and avoid giving away too much of the economic value. A thoughtful, analytical approach — paired with the flexibility to make course corrections — can result in a quality offering that attracts subscribers and keeps them coming back for more.

For more information, please contact us.

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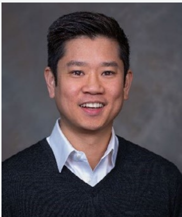

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