Switching Costs: 6 Ways To Lock Customers Into Your Ecosystem

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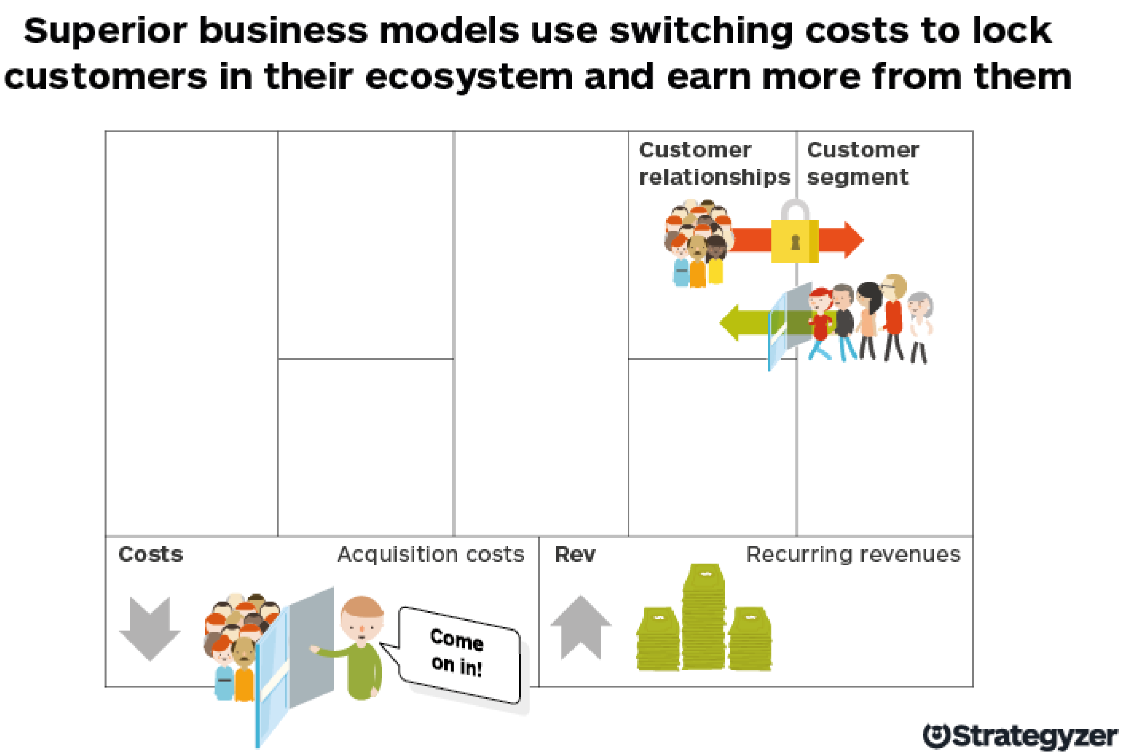
A great product isn't enough to bring a flock of customers to your door. You must design a superior business model to attract and retain customers into your ecosystem. Switching costs have enabled industry leaders such as Adobe, Salesforce, Microsoft or Rolls Royce to lock customers in and outcompete other players. In this post, I explain 6 switching cost strategies to lock customers into your ecosystem.

Switching costs are [one of the seven business model mechanics you can use to design superior business models]. Switching costs help lower customer acquisition costs and thrive on recurring revenues from customers. They can also protect you from your competition. There are plenty of ways to embed them in your business model. If you look closely at companies like Adobe, Salesforce, Google, or Rolls Royce, you'll see that their dominance is no mere coincidence. Customers stay because they are locked into their ecosystems through high switching costs. Let's take a look at 6 different 'traps' that companies have used to lock customers in through switching costs:



1. 'Base Product & Consumable trap': Nespresso, Gillette, HP, Kodak

For this trap, companies lure customers into their ecosystem with a base product and then milk profits from 'consumables' that customers are forced to buy. Nespresso coffee machines (base product) are sold at cost and available at major retailers so anyone can buy them. But the highly-profitable coffee pods are only sold through Nespresso’s owned sales channels, allowing them to absorb juicy margins. There was no way to buy pods from another manufacturer until 2011 because Nespresso owned exclusive rights to produce them. That's how consumers got locked in. Companies that have used the ‘base product & consumable trap’ include Gillette (razors & blades), Kodak (cameras and film), Hewlett-Packard (printers and cartridges).

2. ‘Data trap’: Apple, Google Android, Spotify

The ‘Data trap’ consists encourages customers to create or purchase content and apps that are exclusively hosted on a platform. These platforms can be websites, software or devices. But, leaving one platform for another forces customers to let go of data or activity that can't be migrated to another app. For example, smartphone marketplaces like the AppStore or the Google PlayStore host content & apps that can’t be transferred elsewhere. Android or Apple users will have to give up their purchased music tracks, apps or movies if they want to switch to a competitor. Spotify, a music software company, threatened Apple and Google’s music revenues and switching costs by offering a vast catalogue of songs on an app that can be downloaded from major smartphone marketplaces. But if you switch from Spotify to another music app, you’ll lose your playlists. Another example of 'data trap'!

3. ‘Learning Curve Trap’: Adobe, Salesforce, Box

Customers can be discouraged when they have to start over and learn how to use a new product. The ‘learning curve’ trap is centered around offering a great value proposition that’s only accessible to those willing to train to know how to use it. Salesforce and Adobe use the ‘learning curve trap’ to get customers hooked to their products--some users get so good at using their software that they become certified experts. They don’t feel like switching to something else unless they experience a very strong pain with their existing product. A similar example would be the file synchronisation app ‘Box’ for companies. It becomes so hard to rebuild an infrastructure for file sharing and synchronisation from scratch that companies prefer to stay with Box. It gets hard to switch to a different solution because it would mean losing a skill that you acquired in order to use the tool.

4. ‘Industry standards trap’: Microsoft, Adobe

Sometimes, you are forced to do things because everyone else does it a certain way. That's another way companies lock customers in. They position themselves as leaders by public acceptance. Their product, or one of their product features, has become the standard in an industry, which makes it very difficult to use something else. Microsoft Office’s Word software is one of them. The .doc format, distinctive to Word documents, has been the industry standard since Microsoft’s early entrance on the word processing software market. Switching costs are high because it is nearly impossible to work with a word processing software that doesn’t create or accept .doc files today. The .pdf format is another widely accepted file format around the world and has enabled Adobe to create switching costs the same way.

5. ‘Servitization Trap’: Rolls Royce, Hilti

If your competitor uses the ‘servitization trap’, you’re not just competing against their product, but against an entire experience they offer. In this approach, a company can bundle their products with complementary services provided only to their customers. Rolls Royce creates such switching costs in their ‘power by the hour’ offer. In essence, ‘power by the hour’ consists of leasing jet engines, maintenance and repair services for a flat fee. The real game-changer is that Rolls Royce only charges airlines for the time they use the engine. This experience is outstanding for airlines because it relieves them from the huge pain of losing money when defective engines block planes from flying. By bundling its highly profitable services with its first-class engines into one integrated offer, Rolls Royce make it harder for airlines to switch to a competitor. Another great example is Hilti who uses the 'servitization trap' to provide the best and latest constructions tools to its clients, which in turn can fend off competition from low-cost manufacturers.

6. ‘Exit trap’: Verizon, AT&T

The ‘exit trap’ forces customers to use a product for a certain period of time specified in a contract. If the customer wants to exit the contract, he/she has to pay early termination fees. This strategy is commonly used to dissuade customers from switching to a competitor before their contract ends. Telecom operators such as AT&T or Verizon can charge up to $350 in early termination fees. Companies like T-Mobile are trying to threaten this business model by offering to cover early termination fees if customers switch to their offers.