SWITCHING COSTS

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Reference this article

Abstract / Definition
Switching costs are defined as the costs that consumers face in order to change between substitute products. Switching costs arise from all impacts that a substitute can have on the buyer's value chain, including any linkages with the supplier's value chain. They can be the result of investment by the buyer in high-cost specialized equipment, investment in learning how to operate such equipment, or even the result of product specifications, which tie the buyer to particular inputs.

Typical switching costs include the costs of identifying, evaluating, and testing the substitute, the costs of product or process redesign, the costs of purchasing additional equipment, employee retraining costs, and the costs of the technical help needed to affect the changeover.

Switching costs typically change and fall over time. Early adopters of a new substitute have to develop their own technologies, procedures, and standards, and so in effect they subsidize subsequent adopters, who may find it easy to copy the early work.

As switching costs can lock in buyers, they constitute effective barriers to entry. Incumbent firms pursue switching costs and new entrants try to challenge them. Establishing high switching costs, however, may foster inflexibility.

Keywords
Switching costs, lock in, standards, substitute products

Link to publication