

Switching Costs: The hidden gem of the subscription economy

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The COVID-19 pandemic has shocked the global economy, leading to changes in consumer behaviour and putting much of day-to-day life on hold.

Subscription-based businesses in EMEA have outperformed their product-based counterparts, with revenue growth of 8%, in stark contrast to the 10% decline in counterpart models¹.

WHY HAS THE SUBSCRIPTION MODEL DONE SO WELL?

One-time payment models require consumers to actively and repeatedly make purchasing decisions. For subscription models, consumers must make an active decision to stop purchasing products or services.

The success of this model could be explained by the “switching cost” concept: the cost that the consumer pays if they decide to switch brands or products. These switching costs can be monetary, psychological effort or time-based.

By choosing to move away from your current subscription offering, whether it is Netflix, a wine club or gym membership, you incur a switching cost.



And if you later decide to subscribe again, you incur a re-subscription switching cost.

Take my parents’ subscription to BT Sport, for example, they could have paused their £10 monthly subscription as the sports games were postponed during the lockdown. However, the cost of the time spent to contact customer support or fill in a lengthy form appears to be greater than the £10 per month that they would have saved. Seemingly as the disruption was going to be temporary.

Of course, these costs differ from person to person. However, in the case of BT Sport subscription, £10 per month for 2 months (a total of £20 worth of credits) seemed to be less than the time and effort required to pause the subscription.

If the price is lower than the total switching cost, consumers are likely to stay subscribed to products or services.

KEY TAKEAWAYS

Different commercial models exert different burdens upon consumers. Whilst the subscription model puts a burden upon consumers **to stop consuming** products or services, the

¹The Subscription Economy Index, September 2020



traditional model puts a burden upon them **to consume**.

Choosing the right commercial model is important as the differences can have a significant impact on businesses. This includes market positioning, incentive strategies towards consumers, and the development of products or services.

In times like these, when you expect changes to revert to normal in the future, consumers of subscription models will often choose to 'sit it out' and that is what we have seen to date. Subscription companies have benefited from our initial under-estimate on the length of this crisis.

ABOUT PEARSON HAM

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