International Journal of Business and Management Invention
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org Volume 2 Issue 9‖ September. 2013‖ PP.101-111

Switching Costs and Sustained Competitive Advantage

Abhi Bhattacharya
(Kelley School of Business, Indiana University, United States)

ABSTRACT: *Research increasingly points to the importance of switching costs as a strategy for customer retention and to achieve sustained competitive advantage. However, the conceptual tools and theoretical models developed to understand this important phenomenon cannot explain some key micro and macro phenomena. In this article, the author delineates the foundations of a new theory and contrasts it with the mainstream economic theory of competition in the presence of switching costs, and shows how the new theory is better able to explain real-world occurrences. Finally, the author studies the downstream effects of the various types of switching costs with respect to their role in contributing to sustained competitive advantage.*

KEYWORDS: *Strategy, Sustained Competitive Advantage,Switching Cost* "It is wrong to have an ideal view of the world. That's where the mischief starts. That's where everything starts unraveling..." V.S.Naipaul

I. INTRODUCTION

Although the cumulative body of literature in marketing has grown considerably over the years, marketing scholars voice concerns regarding the health of the field and the general decline of conceptual articles in the field [1].In this context, Reibstein, Day, and Wind find that research on strategic marketing issues is steadily declining,leading to an identity crisis in strategic marketing andas early as 1992, Day had pointed out that marketing is being marginalized by competing principles in management and economics [2] [3].It therefore seems pertinent to reanalyze some of these principles froma 'marketing point of view' [4]. There has since been a call for articles that review past research and integrate that research to provide new concepts and theories, germane to strategic marketing [5].This article is in response to the calls, where I reanalyze an important concept in economics from a marketing perspective.The role of switching costs as an important tool for customer retention has received a great deal of attention from academics in economics over the last decade, cementing its position as one of the most important constructs in the field [6]. The strategic importance of switching costs to influence both profitability and market share has been aptly demonstrated by Sharpe among others [7].In spite of this, research into switching costs, in strategic marketing literature, is fewer and its importance has often been eclipsed by econometric studies [8], probably both due to marketing's preoccupation with the 'satisfaction trap'---a myopic belief that consumer satisfaction and quality of service or products are the only key ways to achieve customer retention and loyalty [9], and the difficulty in studying the phenomenon of switching costs empirically [10], resulting in an almost'informal' agreement by academics to focus on other issues. However, customer satisfaction cannot explain all the variation in repurchase intentions or attitudinal loyalty, since customers are never completely free to choose suppliers whether due to real or perceived barriers---switching costs [11].Studies have also shown how switching costs affect satisfaction, repurchase intentions and attitudinal loyalty, competition and consumer behaviorand thatswitching costs can modify and influence the cognition and behaviors of consumers in ways that are conducive to the consumption of product or service offerings of a particular firm [12]. Thus a discourse on switching costs seems well suited to core marketing strategy research [13].

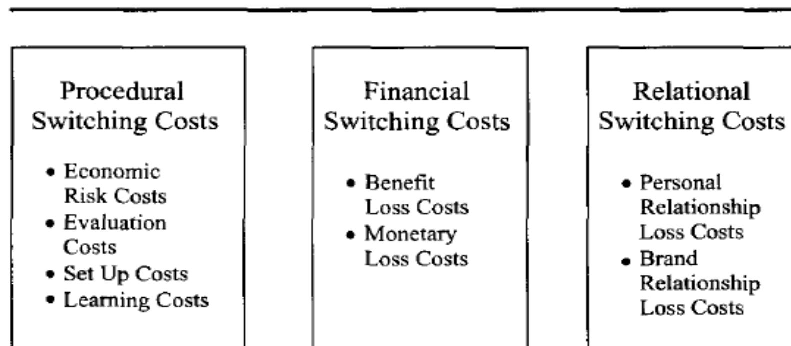
Notwithstanding the dominant status of economic rationales in explaining business strategies employed by oligopolistic firms in markets with switching costs, there have been a number of critiques of these explanations within economics and marketing literature.For instance, Biglaiser, Cremer, and Dobosquestion whether a stationary equilibrium exists as assumed in static models or whether even dynamic models provide proper explanations under conditions of consumer learning [14];Jones, Mothersbaugh, and Beattypoint out that the parsimonious inclusions of customer heterogeneity in most econometric models on switching costs makes it difficult to make the conclusions generalizable and accurate [15].Even in some of the practitioner literature it is pointed out that discrepancies exist between the proffered economic reasoning and real world differences [16].In this article, following the approach by Hunt and Morgan, I do not overview all the critiques but acknowledge them and thereinafter develop the foundations for a rival model [17]. Darden stresses the role of theoretical frameworks in advancing the frontiers of knowledge within a discipline [18].

The absence of such a framework within the strategic marketing literature dealing with switching costs might be the reason why economic explanations for the effects of switching costs retain their dominant status despite their weaknesses. The fact that the strategy literature in marketing,in many instances, shows different effects of switching costs with respect to its econometric counterpartbears testimony to the importance of developing a separate model based on strategic marketing principles.An illustrative example might be the work byDube, Hitsch, and Rossiwhere they show that equilibrium prices fall as switching costs increase, which differs from the conventional wisdom of econometric studies that switching costs soften price competition [19]. In this article, over the next few paragraphs, I identify what a theory on switching costs should aim to explain, and how econometric studies explain these phenomena. Thereafter, I delineate the foundations of my theory, developed from a marketing perspective, and explore its explanatory power. Lastly, I argue how different types of switching costs may be perceived differently by customers, and how firms may achieve sustainable competitive advantage.

II. DEFINITION OF SWITCHING COSTS

In many markets consumers undergo switching costs when they move from one product to another in the same category, or when they change their suppliers. Thus, ex-ante homogeneous products become ex-post heterogeneous [20]. While early literature classified switching costs as being either pecuniary (for e.g. termination fees charged for breaking a contract) or psychological (for e.g. the disutility faced by a consumer for buying a brand he/ she is not familiar with), recent work suggests that switching costs are multi-dimensional [21]. Burnham,Frels, and Mahajanbuild a comprehensive typology of switching costs and identify three major types of switching cost, each with various sub categories: procedural costs (involving mainly expenditures of time and effort and consisting of economic risk, learning and setup costs), financial costs (involving the loss of financially quantifiable resources), and, relational costs (psychological and emotional discomfort due to personal and brand relationship breakages and identity loss)[8].

Figure 1:



Adapted from Burnham, Frels, and Mahajan (2003)

III. THE MAINSTREAM ECONOMIC EXPLANATION

Table 1 shows the foundational premises of mainstream economic explanations of the effects of switching costs[22].

The firm's objective, according to mainstream economic theory as applied to switching costs, is inherently competitive andthe market process is one in which sellers are continually attempting to inch ahead of rivals by offering more attractive prices and opportunities to potential buyers. There is a singular aim of profitmaximization which helps a firm maintain a superior position in the market [23]. Consumers are assumed to have perfect information about the existence and quality of the firms' offerings before purchase [22]. Further, consumers themselves are stratified into old and new; old customers have already tried out the product or service and have developed an attachment for it while new customers,have not yet tried the product or service and ceteris paribus not yet developed an attachment to the particular product or service [24].In this context, when new consumers buy goods or services which are different (in quality or type) from that bought by old consumers, the firm can differentiate between old and new consumers and can charge different prices, in part because old consumers are less price sensitive and may be buying more follow-on goods.

However, when old and new consumers buy the same goods, it may be harder for firms to differentiate between them [25]. In a classical setting with homogenous consumers and products, the firms view old and new consumers as simply two separate markets and only compete for the new consumers. In a more realistic and sophisticated setting consumers do have heterogeneous tasteswhich results in horizontal product differentiation, yet there is no heterogeneity between the two groups of old and new customers,i.e. all old customers are exactly the same, as are all new customers [26]. Economists also implicitly assume that there are no effectual differences between types of switching costs, except that the costs may be stemming from different origins, which in itself is hard to evaluate [27].

IV. EXPLAINING FIRM STRATEGIES

Competition in markets with switching costs, according to mainstream economic theory, is characterized by contrasting incentives for firms. A customer would not be willing to change his or her supplier unless the competing product was priced below the price charged by his/ her current supplier plus the switching cost the customer will incur due to changing suppliers. Thus the firm has an incentive to charge its current customer higher prices. However, firms also face an opposing incentive to price low to attract and build a new customer base which would promise future profits. Thus firms face what is known as a harvest or invest dilemma: firms wish to set high prices and harvest loyal consumers in the short term but have to balance it with the need to invest in attracting newer customers for future harvesting. The main pricing pattern seen is thus termed “bargain then rip-off pricing”. Firms may price low initially to attract customers but overcharge them once they are locked in [28].In such a market,the strength of competition becomes a function of the ratio of existing and new customers (or how old or new the market is). Firms may price their products aggressively when the product (or the firm) is new to the market and raise its price once it has a stable stream of customers [29]. Klemperer argues that, under these conditions, theoretically all rents gained ex-post due to switching costs could be competed away (in unproductive ways such as through ‘socially inefficient’ marketing) ex ante owing to competition in creating a customer base [30]. However, in reality, ex ante competition usually fails to compete away ex post rents. Extant literature in mainstream economics has also typically found that switching costs create a “fat cat” effect. Firms with large existing customer bases should rationally set higher prices, having more to gain from harvesting current customers than winning new ones, since obtaining new customers is inherently costly to the firm. However, smaller firms with fewer “locked” customers price more aggressively to attract new customers and end up attracting a disproportionate share of new entrants. The overall effect results in the shrinkage of large shares and growth of small shares; hence firms’ shares become similar and they return to a stable steady state in the long run after any shock[31].

Though mainstream economic theory seemingly provides an elegant explanation for the pricing strategies firms may use in markets with switching costs, it unfortunately cannot provide for the innovative orientation of certain firms or the incentives for innovation for large firms. Economists propose that consumers will have developed skills with respect to one product and will be unwilling to learn the functionalities of a new product leading to demand inertia. Also,in models with consumer switching costs, small firms may be forced to introduce products new to the market at low prices to first obtain people who might then develop a habit for it but large firms, who already have a ‘locked-in’ customer base have no real incentive to do so. Thus, consumer switching costs have been projected as an impediment to technological progress and innovation [32]. However, it goes against common knowledge that innovation happens even in markets with switching costs andis a successful firm strategy as exemplified by Baumol, who identifies it as a primary weapon wherein a firm comes out with a superior product that consumers love much more [33].Mainstream economic literature also cannot account for the sustained competitive advantage enjoyed by certain firms in markets with switching costs. It rather points to an alternating leadership model. The aforementioned fat cat effect, where the incumbent loses market share and then rents, leads first to a convergence of market shares and then, in some cases, alternating leadership.The only way a larger firm can enjoy a sustained advantage is if the smaller firm gives up the fight, does not price aggressively and accepts a smaller market share [34]. However, in marketing it is widely accepted that a firm can enjoy sustainableadvantage if it has the ability to learn and anticipate market trendsfaster than the competition [35]. Also a large body of management literature states that firms draw on different resources, which make them differentially effective,and that there exists dynamic processes through which firms establish the preconditions for capturing persistent returns [36][37].Explaining the diverse reward structure (and at times lower prices) for loyal customers, even when they are locked in,also poses problems for mainstream economists. According to mainstream econometric theory, it makes little sense to continually reward locked-in customers since these customers will avoid switching providers anyway and a continual reward system will mean that the ex-ante rents which are lost due to competition for building the customer base will never be recovered [38]. The general Customer Relationship

Management literature and conventional marketing logic points in a separate direction (Boulding et al. does an excellent review)[39].CRM scholars show that rewarding a loyal customer not only helps to ensure his/ her future loyalty but may also bring in higher future income to the firm since the customer has a lifetime value usually greater than his/ her current spending.While mainstream economic theory posits the exploitation (by charging higher prices) of loyal customers, in the real world, the phrase ‘Building Relationships’ seems to be epitomizing where many companies are headed.How well then does mainstream economic theory explain the business strategies followed by firms in markets with switching costs and the market outcome of those strategies? As we have seen, mainstream economic theory does a good job in explaining some of the pricing strategies of firms but cannot explain the superior innovativeness of certain mature or larger firms. As to the sustained competitive advantage that some firms enjoy, mainstream economic theory predicts the opposite--- a convergence of market shares in the long term. Also, it might be true that the effect of switching costs is counterbalanced by other endogenous and exogenous factors; however, a theory which explains more phenomena or the same phenomena more accurately is a better theory and thus in the subsequent section I delineate the premises of the proposed theory[40].

Table 1:*Foundations of Mainstream Economic Theory alongside Competitive Advantage Theory for Competition in Markets with Switching Costs*

	Mainstream Economic Theory	**Competitive Advantage Theory of Switching Costs**
Firm Objective	Profit maximization	Value maximization
Consumer Categories	Old and New	High inertia and Low inertia
Consumer Choice	Rational	Irrational, initial attachment and biases exist
Competition	Pure, non-cooperative	Cooperation alongside competition
Switching Costs	Neutral to consumers	Positive or Negative

V. THE COMPETITIVE ADVANTAGE THEORY OF SWITCHING COSTS

In Table 1, the foundational premises of the new proposed theory are displayed. I follow the epistemology of scientific realism; thus all the premises may be suitably subjected to empirical tests and are falsifiable.I also agree with Bacharach, where he states that a vision loses accuracy when it is converted into propositions [41]. Hence, I present herein a gestalt which might be disassembled by future scholars into linear propositions.

Consistent with Jensen and Meckling’s theory of the firm, I propose that the firm’s primary objective is value maximization and the objective function of the firm is to maximize total long term firm market value [42]. Firm value can obviously not be maximized if any one constituency, be it employees, managers, shareholders or customers, is ignored or treated unfairly. Here, the term firm value means much more than just profits or market share andas a financial metric, firm value is simply the total economic value of a company, reflecting the value to be allocated to the company’s shareholders and debt holders.In the real world, profit and cost flows are asynchronous and many managerial decisions require time to pay off which brings a long-term element to the value maximization objective. If a firm is solely obsessed with profits or immediate market share, ignoring or exploiting one or more constituencies in the process, it might lead to the firm’s loss in terms of long-term profits and competitive position in the market[43]. For example, if the firm pays lower wages to employees in an effort to maximize profits, efficiency and ultimately quality of service or products may deteriorate. Similarly, if loyal consumers are squeezed to generate higher rents for the firm, they may change loyalties or may retaliate against the firm through means such as negative word of mouth behavior or vindictive complaining even to third party arbitrators [44]. In fact, it is to the firms’ advantage as well as a socially beneficial outcome if firms aim for value maximization. If a firm rewards employees more, it is rewarded with productive employees and ultimately superior service. Similarly, a firm which values loyal consumers and rewards them may expect higher returns from them (and maybe a higher share of wallet) over the lifetime. This should ultimately lead to greater rents and market share[45].

A firm which prioritizes maximizing value for all players across the vertical chain will realize the importance of its customers. Further, a joint value maximization perspective (with other firms) may enable the creation of new market toeholds, technology transfer, and the creation and exploitation of production synergies. There might of course be tensions characterizing efforts to establish cooperation for joint value creation, but with a value maximization perspective,cooperating firms can create value that could be more than what each firm would have created independently[46].Note the departure from a purely competitive model where each firm 'selfishly' pursues a singular objective of profit maximization to one where firms can cooperate and strive towards maximizing value for all players. This is not to preclude competition (or indicate a utopian ideal of full inter-firm cooperation) but rather to emphasize the importance of merging cooperation and competition together to form a different kind of strategic interdependence between firms, giving rise to a coopetitive system of value creation [47]. The categorization of customers simply into old and new buyers is also inherently problematic.Old customers are constrained from making a choice due to switching costs while new customers have a host of choices available before them. However, old customers may experience fatigue after they have attained a high level of familiarity with a product, and may actively seek to explore new products or they may choose to be passive and intentionally not consider switching [48].Unless switching costs are infinitely high, old customers should be able to switch and have different propensities to switch depending on their level of inertia.

Low inertia customers may want to switch providers but may be deterred to do so by switching costs, especially if they outweigh the benefits. This gives rise to a low relative attitude towards the firm and its offerings, though customers may begrudgingly remain with the firm [49]. For high inertia customers, a favorable disposition may be causing the inertia. This may be caused by high customer satisfaction levels and essentially reflects a stable relationship based on trust and commitment [50]. A customer, who wants to stay with the firm, rather than being forced to stay, is beneficial to the firm. These customers may be more willing to try new products introduced by the firm, buy more often or in larger quantities and recommend the firms' product to others. However, customers may also be highly inertial if they are indifferent towards competing products or providers and may stay with the incumbent either out of habit or to avoid change [51].Irrespective of whether this level of inertia is stemming from liking the product or indifference towards the product, the net effect is that high inertia customers are not actively contemplating switching, and are willingly staying in a relationship with the firm [52][53].Firms may thus wish to invest more in creating positive staying reasons such as increasing customer satisfaction or increasing the quality of products, making the customer wanting to stay in the relationship. Under this classification, while old customers may be classified according to their levels of inertia, a new customer may simply be treated as having no inertia; and in line with mainstream economic literature, firms should employ strategies to encourage new customers to try its products or services. Thus I reject the classification of the firm's customer as simply 'old' and 'new', and a blanket harvest and invest stratagem towards these 'old' and 'new' customers. In consonance with my previous arguments, firms should instead strategize to maximize value for all its customers and should not clump all 'old' customers as one; instead it should investigate (through surveys and feedback) whether its 'old' customers are willingly loyal and decide its strategies accordingly. The economist also assumes that new consumers evaluate products rationally and have no initial attachment towards a firm's offerings. However, there are a large number of studies in consumer behavior which show that customers may form an initial predisposition towards a firm's offerings even before they try it,owing to the positioning of the product or service in the marketplace [54]. This may be because of customers being familiar with the product due to marketing activities by the firm (such as advertising) or through the experiences of other buyers or through their own search. Therefore a new consumer is never truly neutral to the offerings of competing firms but may already have formed (emotional) biases favoring a certain brand of product or service.

VI. EXPLAINING FIRM STRATEGIES

The first question which arises is what pricing strategy should be employed by the firm, in markets with switching costs, to help maximize its long term market value? The mainstream economic literature points to the use of either tiered pricing---higher for old customers and lower for new customers, or flat pricing when the firm cannot distinguish between the two cohorts. A tiered pricing is characteristic of customer favoritism, where ironically the old customers are exploited in spite of their continued loyalty. Anderson and Yap investigate how seemingly good relationships may go bad and how these relationships, which seem stable, are also vulnerable to decline [55]. Customers are not static entities and both old and new customers may be actively scouting for better deals and prices. It would not be wise for a firm to neglect any category of consumers and take them for granted. In fact, old customers may find that they are differentiated against, which might provide the potential for dissent.

Here, a tiered or a flat pricing strategy assumes that the value which a consumer gets from using a service or a product remains constant. However customer value drivers (which are the emotional bonds that summarize customer beliefs about the product and firm, and create positiveattitudes towards the firm's offerings) are dynamic and it is important that firms understand how important these value drivers are to each segment of customer and how important each is in their decision to stay [56]. Finally, switching costs may naturally arise in a relationship as parties know each other and invest in the relationship, but they are not necessarily "dark side" costs which gives firms an opportunity to exploit its built customer base [57]. Rather they should be regarded as representing relationship-specific assets that have value to both parties involved. I would thus argue that a tiered pricing strategy is not beneficial to either the firm or the customer;and a flat pricing strategy is just flat. A firm would not be optimally pricing its products or be reaping rewards if it simply employs a flat price. In accordance with my previous arguments, I would reason that firms which have a value maximization objective and not a profit maximization objective wouldopt for a value based pricing strategy. A firm which employs such a pricing strategy gives importance to the value the customer perceives for the product or service and the price the customer is willing to pay for it and would not artificially assume that loyal customers always attribute higher value to the product or service. In reality, the whole pricing picture may be much more complicated than the simplistic argument presented above but a comprehensive examination of the advantages of such a strategy is beyond the scope of this article (the interested reader may refer to Tellisfor more details [58]); however, the crux of the argument presented is that the rationale behind firms setting a particular price should not simply be dependent on the level of perceived switching costs faced by its consumers but on the perceived value consumers attribute to the product or service during a period. Thecommonly observed strategy used by firms, of rewarding old customers, also fits in with the above arguments. Thus a firm which seeks to provide increased value to its consumers would look to intermittently reward its loyal consumers rather than simply treating them like cash cows.

How then does the proposed theory explain the innovative ventures of large and mature firms in markets with switching costs, who according to mainstream economic theory have no incentive to innovate?First, a joint value maximization perspective enables firms to jointly innovate, and thus reduce individual risks. In a market characterized by high switching costs and adoption inertia, cooperative innovation strategies by large players may signal a truly remarkable product which a consumer may try. Second, even without inter-firm cooperation, firms would still have an incentive to innovate. Firms with an installed customer base would still be looking to create more value for its consumers since it may not only enjoy more support and loyalty from existent customers, but also portraying a 'lean and hungry look' signals to future customers and competitors that it is not resting on its laurels but is always trying to provide the optimum product or service catering to customer needs [59]. An innovative firm projects a positive image to future buyers and can cause a favorable predisposition. Third, an innovating firm may provide further staying reasons for loyal customers. A firm which continually innovates (and betters) its service or product offerings might address some of the deficiencies which might have caused old active customers to be looking for other alternatives; or increase the attitudinal loyalty of truly loyal customers [60].

VII. COMPETITIVE ADVANTAGE THROUGH SWITCHING COSTS

Till now, the proposed theory has been used to explain some important market phenomena such as why some firms, in markets with switching costs, have an incentive to continually innovate. However, the question remains as to what enables a firm to enjoy a sustained competitive advantage in markets with switching costs. The previous arguments mightsimplyshow that firms which pursue an objective of value maximization would profit whether or not the market has switching costs andthat the presence of switching costs only help firms simply reap the benefits of customer retention.Barney iterates the importance of valuable, rare, inimitable and non-substitutable resources as key to a firm's competitive advantage [36]. Switching costs do not help a firm acquire those resources. However, as we move onto a post-industrial economy, importance has shifted from the supply side to the demand side, and herein switching costs help a firm sustain one of its key assets---customers. A firm may pursue accepted strategies for achieving competitive advantage like low cost or differentiation strategies, but switching costs help a firm sustain the advantage. Consider the case of a cost leader vis-à-vis a competitor who comes up with a viable differentiated product or a similar product matching the price. In the absence of switching costs, the incumbent firm's customers would soon switch brands. What I wish to illustrate is that if a firm loses its leadership position in a market for a period of time, it would not lose its customer base immediately since the presence of switching costs make it a sticky asset. Thus a firm can get some time to recover and reassess what went wrong and suitably implement strategies to recover its lost position. Therefore, switching costs, I would argue, provides the sustainability part to the competitive advantage.

Many economists have traditionally modeled switching costs as exogenous to the firm and simply a characteristic of the marketplace and as long as we stick to that view, it would be hard to explain why certain firms enjoy sustained competitive advantage and why other firms do not [22]. In reality, the conduct of a firm is not simply reflective of its external environment and firms seek to influence and control the external environment in which it participates. Therefore, instead of conceptualizing switching costs as factors outside firm control, we should realize that firms can actively influence the perceived switching costs faced by the consumer through a variety of means such as contractsand decisions to make incompatible products, or through increasing relational benefits such as improving service or product quality and so on. Thus switching costs may be erected by the firm or simply be reflective of the purchase process and maybe categorized as exogenous or endogenous.In view of attribution theory, we may assume that a firm's consumers will likely attribute the endogenous switching costs to firm actions [61]. Thus, if a firm invests heavily in building a personal relation with the buyer, the buyer should be able to recognize it as an effort from the firm's side. Exogenous switching costs (such as the set up costs which a consumer might have to undergo when setting up a bank account) are costs over which a firm may have little influence and is likely to be perceived as a 'natural' costand probably not be attributed to the firm by the consumer [62].As indicated earlier, consumers perceive a difference between having to be and wanting to be in a relationship where having to be in a relationship with a supplier is seen as more of a constraint by the consumer and a negative reason to stay in a relationship [63]. In this context, in the next section, I examine how switching costs might engender negative or positive reasons for a customer to stay in a relationship.

VIII. POSITIVE AND NEGATIVE SWITCHING COSTS

In any relationship, and even in a buyer- seller relationship, perceived inequity on either side creates tension and the created tension motivates the individual to reduce it [64]. Here the focus is on fairness towards the buyer, as it is seldom the case that an individual buyer can influence the relationship (or firm behavior). A customer will willingly stay in the relationship provided he or she perceives that he/ she is being treated fairly and has value to gain from the exchange. In light of the proposed theory, switching costs which are reflective of increased value to customers should be viewed as positive to customers. Let us also revisit the typology of switching costs provided by Burnham, Frels, and Mahajan [8]. They categorize switching costs as procedural, financial and relational.The first category i.e. procedural costs are usually exogenous to the firm though the firm may have some influence over them. Customers should perceive these costs neutrally, accepting them as a natural part of the purchase process[65].

The second category of costs i.e. financial costs should be viewed negatively by the consumer. A consumer may incur monetary losses if a contract is broken or lose benefits such as reward points (linked to monetary rewards) thatmay have been painstakingly acquired. Thus, even thougha consumer may have found a better supplier or product,he/ she is forced to remain because of financial repercussions---the freedom of choice which was previously enjoyed is now constrained by factors outside the consumer's control [66]. As such, these costs may be perceived as coercive or punitive to the buyer and viewed negatively. Since losses loom higher than gains, the consumer may still be participating in the relationship, but as hostages [67]. Relationships with high levels of constraint are characterized by calculative commitment, negative emotions and spurious loyalty, and consumers would wish to exit such relationshipsas soon as they can; or if they can't they might retaliate against the firm [12][68]. The third category of switching costs is relational switching costs and should be viewed as positive by consumers. If customers believe they are handled with care and attention and are familiar with the brand, store or employees of the store, they would not wish to leave the relationship. Similarly, if customers perceive a brand as having a strong, unique and desirable image, they would likely be attached to the brand even on an emotional level and would not like to leave the relationship [69]. In this case customers have positive reasons to stay in a relationship. Such a relationship is characterized by customers who are willingly staying, giving rise to positive emotions, affective commitment and true loyalty[12].

True loyalty is more sustainable and results in a consistent pattern of purchase of a specific brand over time and a favorable attitude towards a brand [49]. If a firm wishes to build a sustained competitive advantage, it needs a loyal set of customers who are truly loyal. Thus a firm may wish to invest more in erecting switching costs which belong to the third type in the Burnham, Frels, and Mahajanclassification [8].High switching costs of the second type may lead to a higher short term profitability and return rates, but since spuriously loyal customers lack true motivations to purchase a product and may easily switch to another brand because of situational circumstances such as a competing brand on sale, the profitability enjoyed not be sustainable [70]. The proposition is summarized in Table 2.

Table 2:*Types and Effects of Switching Costs*

Type of Switching Cost (Adapted from Burnhams et al. 2003)	Exogenous or Endogenous	Perception of Consumer
Procedural	Exogenous	Neutral
Financial	Endogenous	Negative
Relational	Endogenous	Positive

IX. CONCLUSION

Historically, marketing was supposed to be responsible for the efficient distribution of economic goods and services across places and marketing activities were primarily a subsystem in the provision of this economic function. Over time though, the role of marketing has been integrated in the thinking of the firm and marketing managers now are responsible for vital strategic decisions of the firm [71]. Dialogue on strategy and competitive advantage, once an exclusive domain for economists, have since been infiltrated by marketing academia who have come up with their own novel ideas to explain these phenomena andin the same essence, this article provides an alternate theory for explaining how firms may adjust their business strategies in the presence of different types of switching costs and the impact of those strategies on market outcomes. Further research may investigate whether additional premises should be included in the theory or empirically test any of its implicit propositions. One interestingfuture research direction, which may further the realms of the proposed theory,is mentioned.Marketing adds value to the customer through building trust and closer relations with the customers and information to the customer as to the distinctive advantages of the firm's product over its rivals. In light of this article then, can the marketing function be said to be an endogenous switching cost, erected by firm actions, and seen positively by consumers?Developing a comprehensive understanding of how firms should operate and strategize in real-life markets with switching costs is critical to both managers and marketing academics. Shugan, the then editor of *Marketing Science*, had observed that it is more common to find articles narrower, more specialized, less accessible and perhaps more dogmatic [72]. The observation probably holds true today and even for other journals andthis article hopes to provide a broader and more accessible perspective to analyze the complex phenomenon of switching costs.

APPENDIX1

I have used the term mainstream economics and mainstream economic theory a number of times throughout this article. I use the term as described by Dequech, who defines mainstream economics as "that which is taught in the most prestigious universities and colleges, gets published in the most prestigious journals, receives funds from the most important research foundations, and wins the most prestigious awards" [73].

APPENDIX 2

Appendix 2shows the proposed competitive advantage theory of switching costs has allowed me to create a framework for the existence of positive and negative switching costs and an insight into how firms might enjoy sustained competitive advantage. I have rejected the profit maximization objective and have instead opted for a value maximization objective for the firm. With such an objective, firms have a longer term vision and would view customers as important stakeholders. Thus firms have an incentive to provide superior value to them as well and not regard them simply as sources of income. I have also rejected the dichotomous categorization of customers into old and new, rather opting for categorization based on levels of inertia. Thus demand not only comes from new customers who do not face any switching costs, an implicit assumption in economics literature on switching costs, but also from old customers who do not need to remain with their products until product deaths but actually have a choice of whether or not to switch [74]. Also, following the competitive advantage theory of switching costs, existing consumers do not face infinite switching costs, again an implicit assumption in most economics literature, but may switch away from the firm [22]. Further, new customers may form predispositions towards a firm's offerings even before trial and that existing customers may view different types of switching costs differently. Finally, I have reasoned that a firm would be well served if it caters to its customer's needs at all times and should not relax on its laurels (in this case a steady base of customers) since seemingly 'locked-in' customers may also be able to switch. Hence the principal argument presented may be summarized as follows---a firm's old customers may switch and their reason for staying or leaving the relationship will depend on firm actions (in this case endogenous switching costs).Therefore a firm will be able to achieve 'sustained' competitive advantage through its own actions.

APPENDIX 3

	Position			1	2	3	4	5	6	7	8
	Exogenous	1.	Procedural	L	L	L	L	H	H	H	H
Type Of Switching Cost	Endogenous	2.	Financial	L	H	L	H	H	L	L	H
	Endogenous	3.	Relational	L	L	H	H	L	H	L	H
			Sustainable Competitive Advantage?	No	No	Yes	?	No	Yes	?	N/A

H: High levels of switching cost

L: Low levels of switching cost

Appendix 1 shows and explains the possible positions a firm may belong to in a market characterized by switching costs, and which of those positions a firm would prefer to achieve sustainable competitive advantage and should be of particular use to managers. The matrix is constructed as follows: exogenous switching costs are assigned a score of 0 (being neutrally viewed by consumers), positive endogenous switching costs a score of 1 (being positively viewed by consumers) and negative endogenous switching costs a score of -1 (being negatively viewed by consumers). Firms which end up in positions having a negative score would not be able to enjoy sustained competitive advantage while firms in positions having a positive score would be. Firms which belong in positions with a score of zero might be hard to classify and may or may not enjoy sustained competitive advantage. Let us further explore the concept.Firms in position 1 are operating in markets with low exogenous and endogenous switching costs. A sustainable advantage would be hard to achieve in this position, simply because it would not be able to retain a customer base for long (customers may easily switch if they find a better priced product). Firms in position 2 have erected a large amount of Type 2 switching costs which are viewed negatively by the consumer. The competitive advantage enjoyed, if at all, by firms in this position, would be short-lived. Firms in position 3 are in markets with low exogenous switching costs but have erected high levels of Type 3 endogenous switching costs (perceived positively by consumers) and would be able to enjoy a sustained competitive advantage. Firms in position 4 may or may not be able to enjoy a sustained competitive advantage depending on whether the effects of Type 3 switching costs outweigh the effects of Type 2 switching costs. Positions 5 and 6 may also be explained in the same vein. Thus position 6 will allow a firm to enjoy sustained competitive advantage while position 5 will not. Firms in positions 7 may be able to hold on to their competitive advantage but might be particularly susceptible to new competition. Position 8 is rather unique. In here, markets are characterized by high levels of all switching costs and customers face a high level of lock-in, makingfirms in this position almost monopoly-like.

Let us explore the matrix in detail through concrete examples. While analyzing the examples, clues as to whether or not a market has high exogenous switching costs have been obtained from the detailed examples given in the Office of Fair Trade report [75]. The automobile market is characterized by high Type 1 switching costs---the economic risks of purchase are high, evaluation and set up costs are also high. In India, the absence of a post purchase contract, and the ready availability of compatible aftermarket parts and servicing from a variety of suppliers (for the firms being analyzed in this case) mean that post purchase, the customer has low financial (Type 2) switching costs. The customer does not lose benefits or money even if he/ she does not use original manufacturer parts or servicing. Here,Maruti, an auto manufacturer in India, has stationed itself in Position 6 by building a strong brand image and a personal relationship with its customers through its varied CRM measures. It enjoys a whopping 45% of the market share in India and a sustained competitive advantage over its rivals. Compare it to Fiat, which has also been an auto manufacturer in India for a long period of time. The Fiat brand was not strong enough and did not appeal to Indian buyers. Neither did Fiat invest in building strong networks with customers. Thus Fiat might be said to belong to Position 7, and while Fiat enjoyed a period of success when there were not too many alternatives in the Indian market, it was soon overtaken by other players. Thus Maruti and not Fiat, enjoys a competitive advantage even though the number of auto manufacturers (and thus alternatives and competition) has increased manifold [76].Let us now shift our attention to the cell-phone service providers and consider the case of O2-Mobile vis-à-vis 3-Mobile, both major operators in the UK. Mobile service providers rely on two primary business-models: ‘

pay as you go' and contracts and the mobile phone service market is essentially characterized by low Type 1 switching costs since evaluation, set up and learning costs are low. Further due to the availability of multiple carriers and the ease of purchase, transaction costs are also low. 3 mobile, which is relatively new to the UK market, provided price discounts and schemes in its contract model to attract new customers and essentially built up its customer base by 'locking in' its customers. It however cut costs on customer service (which was inferior with respect to competitors) and also did not make its 'pay as you go' line very attractive. 3 mobile may hence be said to belong to Position 2 of the matrix. Under restrictive contracts, 3 mobile had taken away from customers, the choice of walking away if the service is unsatisfactory and ended up with .19 out of every 1000 (the highest in the market) pay monthly customers (under a contract) complaining because they could not exit even when service quality was sub-par. 3 could not sustain its initial growth rate as its brand image weakened. Thus, while 3 rapidly grew its customer base initially due to its attractive pricing, its competitive advantage was short lived. Compare it to O2-Mobile who built their customer service as the unique selling proposition and also allowed the option of converting a post-paid contract plan to pre-pay for a small fee. Thus O2-Mobile provided value for its customers, and at the same time did not create a 'hard lock-in' to allow customers more freedom. O2 may be said to belong to Position 3 in the matrix and (unsurprisingly) has been able to maintain a sustained competitive advantage [77][78].

REFERENCES

[1]. M.S. Yadav, The decline of conceptual articles and implications for knowledge development, *Journal of Marketing*, *74*, 2010, 1-19.

[2]. D. J. Reibstein, G. Day, and J. Wind, Is marketing academia losing its way?,*Journal of Marketing, 73(4)*, 2004, 1-3.

[3]. G. Day, Marketing's contribution to the strategy dialogue, *Journal of the Academy of Marketing Science*, *20*, 1992, 323-30.

[4]. A. Goldman, A publishing activity in marketing as an indicator of its structure and disciplinary boundaries, *Journal of Marketing Research*, *16*, 1979, 485-494.

[5]. D. MacInnis, Where have all the papers gone?,*Association for Consumer Research Newsletter*, 2004, 1–3.

[6]. C. M.Wilson, Market frictions: a unified model of search Costs and switching costs, *European Economic Review*, *56*, 2012, 1070–1086.

[7]. S. A. Sharpe, The effect of consumer switching costs on prices: a theory and its application to the bank deposit market, *Review of Industrial Organization*, *12*, 1997, 79–94.

[8]. T. A. Burnham, J. K. Frels, and V. Mahajan, Consumer switching costs: a typology, antecedents, and consequences, *Journal of the Academy of Marketing Science*, *31(2)*, 2003, 109-126.

[9]. F. F. Reichheld, *The loyalty effect* (Boston: Harvard Business School Press, 1996).

[10]. H. Schlesinger and J. M. Graf von der Schulenburg, Consumer information and decisions to switch insurers, *The Journal of Risk and Insurance*, *60*, 1993, 591–615.

[11]. S. M. Keaveney, Customer switching behavior in service industries: an exploratory study, *Journal of Marketing*, *59*, 1995, 71-82.

[12]. N. Bendapudi and L. L. Berry, Customers' motivations for maintaining relationships with service providers, *Journal of Retailing*, *73 (1)*, 1997, 15-37.

[13]. G. S. Carpenter, R. Glazer, and K. Nakamoto, Toward a new concept of competitive advantage, in *Readings on Market-Driving Strategies: Towards a New Theory of Competitive,* (New York: Addison-Wesley, 1996).

[14]. G. Biglaiser, J. Cremer, and G. Dobos, The Value of Switching Costs, *Journal of Economic Theory*, forthcoming.

[15]. M. A. Jones, D. L. Mothersbaugh, and S. E. Beatty, Why customers stay: measuring the underlying dimensions of service switching costs and managing their differential strategic outcomes, *Journal of Business Research*, *55*, 2002, 441–450.

[16]. C. Shapiro and H. R. Varian, *Information rules – a strategic guide to the network economy* (Boston: Harvard Business School Press, 1998).

[17]. S. D. Hunt and R. M. Morgan, The comparative advantage theory of competition, *Journal of Marketing*, *59*, 1995, 1-15.

[18]. L. Darden, *Theory change in science: strategies from Mendelian genetics* (New York: Oxford University Press, 1991).

[19]. J. P. Dube, G. J. Hitsch, and P. E. Rossi, Do switching costs make markets less competitive?, *Journal of Marketing Research*, *46(4)*, 2009, 446-452.

[20]. P. Klemperer, Markets with consumer switching costs, *Quarterly Journal of Economics, 102*, 1987, 375–394.

[21]. R. W. Rosenthal, A dynamic model of duopoly with customer loyalties, *Journal of Economic Theory*, *27*, 1982, 69-76.

[22]. J. Farrell and P. Klemperer, Coordination and lock-in: competition with switching costs and network effects, in M. Armstrong and R. Porter (Eds.), *Handbook of Industrial Organization Vol. 3,* (Amsterdam: North Holland Publishing, 2007).

[23]. L. M. Spadaro, *New directions in Austrian economics* (Kansas: Universal Press Syndicate, 1978).

[24]. K. A. Froot and P. D. Klemperer, Exchange rate pass-through when market share matters, *American Economic Review*, *79*, 1989, 637–654.

[25]. A. Beggs and P. D. Klemperer, Multiperiod competition with switching costs, *Econometrica*, *60*, 1992, 651– 666.

[26]. T. To, Multiperiod competition with switching costs: an overlapping generations formulation, *Journal of Industrial Economics*, *44*, 1995, 81–87.

[27]. A. J. Padilla, Revisiting dynamic duopoly with consumer switching costs, *Journal of Economic Theory,67*, 1995, 520–530.

[28]. J. I. Bulow and P. D. Klemperer, The tobacco deal, in *Brookings papers on economic activity: microeconomics*, 1998, 323–394.

[29]. European Commission, Commission Notice: Guidelines on vertical restraints. (2000/C 290/1), *Official Journal*, 13 October 2000.

[30]. P. D. Klemperer, Competition when consumers have switching costs, *Review of Economic Studies*, *62*, 1995, 515–539.

[31]. J. A. Chevalier and D. S. Scharfstein, Capital-market imperfections and countercyclical markups: theory and evidence, *American Economic Review*, *86*, 1996, 703–725.

[32]. D. C. Mueller, First-mover advantages and path dependence, *International Journal of Industrial Organization*, *15*, 1997, 827-850.

[33]. W. J. Baumol, *The free-market innovation machine: analyzing the growth miracle of capitalism* (Princeton: Princeton University Press, 2002).

[34]. J. Farrell and C. Shapiro, Dynamic competition with switching costs, *RAND Journal of Economics*, *19*, 1988, 123–137.

[35]. A. de Geus, Planning as learning, *Harvard Business Review*, *66*, 1988, 70-74.

[36]. J. B. Barney, Strategic factor markets: expectations, luck, and business strategy, *Management Science*, *86*, 1986, 1231-1242.

[37]. I. Dierickx and K. Cool, Asset stock accumulation and sustainability of competitive advantage, *Management Science*, *35*, 1989, 1504-1511.

[38]. R. Caminal and C. Matutes, Endogenous switching costs in a duopoly model, *International Journal of Industrial Organization*, *8(3)*, 1990, 353-73.
[39]. W. Boulding, A. Kalra, R. Staelin, and V. A. Zeithaml, A dynamic process model of service quality: from expectations to behavioral intentions, *Journal of Marketing Research*, *30(1)*, 1993, 7–27.
[40]. K. E. Weick, What theory is not, theorizing is, *Administrative Science Quarterly*, *40*, 1995, 385-390.
[41]. S. B. Bacharach, Organizational theories: some criteria for evaluation, *Academy of Management Review, 14(4)*, 1989, 496-515.
[42]. M. C. Jensen and W. H. Meckling, Theory of the firm: managerial behavior, agency costs, and ownership structure, *Journal of Financial Economics, 3(4)*, 1976, 305-360.
[43]. M. C. Jensen and W. H. Meckling, Knowledge, control and organizational structure, in L. Werin and H. Wijkander (Eds.), *Current economics* (Oxford: Blackwell, 1992).
[44]. Y. Gregoire and R. J. Fischer, Customer betrayal and retaliation: when your best customers become your worst enemies, *Academy of Marketing Science*, *36*, 2008, 247-251.
[45]. P. G. Klein, J. T. Mahoney, A. M. McGahan, C. N. Pitelis, Who is in charge? A property rights perspective on stakeholder governance, *Strategic Organization*, *10(3)*, 2012, 304-315.
[46]. E. J. Zajac and C. P. Olsen, From transaction cost to transactional value analysis: implications for the study of interorganizational strategies, *Journal of Management Studies*, *30(1)*, 1993, 131–45.
[47]. A. M. Brandenburger and B. J. Nalebuff, *Co-opetition*(New York: Doubleday, 1996).
[48]. M. Colgate and B. Lang, Switching barriers in consumer markets: an investigation of the financial services industry*, Journal of Consumer Marketing*, *18(4)*, 2001, 323–347.
[49]. A. S. Dick and K. Basu, Customer loyalty: toward an integrated conceptual framework, *Journal of Academy of Marketing Science*, *22*, 1994, 99–113.
[50]. T. Hennig-Thurau and A. Klee, The impact of customer satisfaction and relationship quality on customer retention: A critical reassessment and model development, *Psychology & Marketing*, *14(8)*, 1997, 737–764.
[51]. M. Givon, Variety seeking through brand switching, *Marketing Science*, *3(1)*, 1984, 1-22.
[52]. V. Yanamandram and L. White, Switching barriers in B2B services: a qualitative study," *International Journal of Service Industry Management*, *17(2)*, 2002, 158-192.
[53]. R. Lee and L. Neale, Interactions and consequences of inertia and switching costs, *Journal of Services Marketing*, *26(5)*, 2012, 365-374.
[54]. J. W. Schouten and J. H. McAlexander, Subcultures of consumption: an ethnography of the new bikers, *Journal of Consumer Research*, *22*, 1995, 43-61.
[55]. E. Anderson and S. D. Yap, The dark side of close relationships, *Sloan Management Review*, *46(3)*, 2005, 75-82.
[56]. J. N. Sheth, B. I. Newman, and B. L. Gross, *Consumption values and market choices: theory and applications* (Cincinnati: South-Western, 1991).
[57]. P. Frow, A. Payne, I. F. Wilkinson, and L. Young, Customer management and CRM: addressing the dark side, *Journal of Services Marketing*, *25(2)*, 2007, 79-89.
[58]. G. J. Tellis, Beyond the many faces of price: an integration of pricing strategies, *Journal of Marketing*, *50*, 1986, 146-160.
[59]. D. Fudenberg and J. Tirole, The fat-cat effect, the puppy-dog ploy, and the lean and hungry look, *American Economics Review*, *74*, 1984, 361-368.
[60]. P. N. Golder and G. J. Tellis, Will it ever fly? Modeling the takeoff of really new consumer durables, *Marketing Science, 16(3)*, 1997, 256–270.
[61]. J. W. Thibaut and H. W. Riecken, Some determinants and consequences of the perception of social causality, *Journal of Personality, 24*, 1955, 113-133.
[62]. [62] J. Egan, *Relationship marketing: exploring relational strategies in marketing* (New Jersey: Prentice Hall, 2001).
[63]. A. O. Hirschman, *Exit, voice, and loyalty: responses to decline in firms, organizations, and states* (Cambridge: Harvard University Press, 1970).
[64]. J. S. Adams, Inequity in social exchange, *Advanced Experimental Social Psychology, 62*, 1965, 335-343.
[65]. R. Vasquez-Carrasco and G. Foxall, Influence of personality traits on satisfaction, perception of relational benefits, and loyalty in a personal service context, *Journal of Retailing and Consumer Services*, *13*, 2006, 205-219.
[66]. D. J. Ringold, Consumer response to product withdrawal: the reformulation of Coca-Cola, *Psychology & Marketing*, *5(3)*, 1988, 189-210.
[67]. N. Sharma and P. G. Patterson, Switching costs, alternative attractiveness and experience as moderators of relationship commitment in professional consumer services, *International Journal of Service Industry Management*, *11(5)*, 2000, 470-490.
[68]. G. T. Gundlach, R. S. Achrol, and J. T. Mentzer, The structure of commitment in exchange, *Journal of Marketing, 59*, 1995, 78-92.
[69]. R. T. Rust, V. A. Zeithaml, and K. N. Lemon, *Driving customer equity: how customer lifetime value is reshaping corporate strategy* (New York: The Free Press, 2000).
[70]. J. M. Jensen, Consumer loyalty on the grocery product market: an empirical application of Dick and Basu's framework, *Journal of Consumer Marketing*, *28(5)*, 2011, 333–343.
[71]. G. R. Laczniak and D. A. Michie, The social disorder of the broadened concept of marketing, *Journal of the Academy of Marketing Science, 7(3)*, 2009, 214–32.
[72]. S. M. Shugan, Fifty years of marketing science, *Marketing Science, 25(6)*, 2006, 551–555.
[73]. D. Dequech, Neoclassical, mainstream, orthodox, and heterodox economics, *Journal of Post Keynesian Economics*, *30(2)*, 2007, 279-302.
[74]. L. Cabral, Dynamic price competition with network effects, *Review of Economic Studies*, *78*, 2011, 83-111.
[75]. Office of Fair Trading, Switching costs: annex C, in *Economic discussion paper #5* (London: OFT, 2003).
[76]. A. Nigam and R. Kaushik, Impact of brand equity on customer purchase decisions: an empirical investigation with special reference to hatchback car owners in Central Haryana, *International Journal of Computational Engineering & Management*, *12*, 2011, 121-28.
[77]. Ofcom, *The communications market* (London: Office of Communications, 2008).
[78]. Ofcom, *The communications market* (London: Office of Communications, 2012).