The “Lock-In” Effect of Multiple Payments on Defection Decisions Over Time

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In three experiments and a field survey we show that when customers of an on-going service are engaged in multiple-payments program for a supplementary product, they perceive these payments as switching costs, which fade over time, and increase defection intentions. This psychological lock-in experience is demonstrated beyond actual financial constraints.

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EXTENDED ABSTRACT

Many service providers offer their customers supplementary-products that are related to their core services (e.g., an Internet service provider (ISP) that offers a router). In many of these cases, customers choose to pay for supplementary product in multiple-payments. In this study, we show that the payment method for the supplementary, product has a substantial effect on customers’ likelihood of defecting from the service provider. Specifically, we show that when customers pay for a supplementary product (e.g., a handset) in multiple-payments rather than in a single payment, defection rates from the core service provider (e.g., cellular provider) increase over time.

From a pure economic perspective, once the decision to purchase a product has been made, consumers should consider its cost as a sunk-cost, regardless of the payment mechanism chosen. Thus, the payment method for the product should not influence consumers’ decision to leave the service provider. We propose that multiple-payments create a psychological lock-in experience, which dissolves over time, as the payments are made. Thus, the magnitude of these switching costs diminishes over time. Hence, we refer to these costs as temporal switching costs. This decrease in perceived switching costs results in an increase in the customer’s tendency to defect from the core service provider over time.

We find that the counter-intuitive effect of multiple-payments on customers’ defection decisions holds even when the supplementary-product is universal and can be used under a new service provider, thus ruling out the alternative explanation that customers refrain from switching to a new provider due to their concern of incurring additional expenses. Finally, we show that customers’ increasing likelihood of defection over time in the presence of multiple-payments occurs above and beyond customers’ fundamental satisfaction with the incumbent provider.

In Study 1 we compare defection intentions over time between customers paying for a service-related supplementary product in multiple-payments versus customers who pay for the same product in a single lump sum. Student participants (n=202, M=30.9) read a scenario in which they had joined a cellular provider’s service program and purchased a handset. Participants were each randomly assigned to one of five time-duration manipulations, indicating the assumed number of months that have passed. Half the participants were told that the handset was to be paid for in equal monthly payments, the other half were told the “shape meter” is paid in equal monthly payments. Participants reported their defection intentions and the extent to which they felt tied and bound to their current provider.

This research links customers’ chosen payment method to their decision to defect from a service provider. We demonstrate how multiple payments for a supplementary, service-related-product affect customers’ decisions to defect from the core service provider, resulting in an increase in customers’ defection rates over time. This underexplored phenomenon provides a more complex perspective on the findings of past studies, according to which a customer’s likelihood of defection typically decreases over time (e.g., Gupta and Lehmann 2005; Schweidel, Bradlow and Fader 2011). These studies generally took place in settings that did not involve switching-costs, assuming that customers were free to defect from their providers at any time. Our results have important implications for service providers’ managers as well as for regulators, who aim to reduce switching costs in markets.

REFERENCES

