Winning in high-turnover markets

When managers evaluate potential new businesses, the first question they often ask is: How fast is the market growing? By focusing only on growth, however, they often overlook another critical measure of market potential — high turnover of the customer base. High turnover can make a market dynamic, even when the overall growth rate is low.

Consider the US market for smoking-cessation aids. In the past 10 years, this market has hardly grown. Yet, during that period, the market shares of the leading brands, Nicorette and Nicoderm, were cut almost in half by the brands of Walgreens, CVS, WalMart and others. Compare this to the market for cigarettes. Although growth was equally flat during the same time period, the market share of leaders Marlboro and Camel hardly changed and no new brands gained a foothold.

Why the difference? Customers of smoking-cessation aids turn over quickly — either they quit smoking or they take up the habit again. In the cigarette market, by contrast, customers stay put, and this low turnover protects incumbents.

The same concept applies to fast-growing industries. Case in point: Nintendo's position in the video-game industry seemed unassailable in the mid-1990s. But Sony saw an opportunity as teenage players transitioned into adulthood. By 1999, Sony’s PlayStation 1 had transformed the industry and dethroned Nintendo. The tables turned again when Nintendo’s Wii overtook Sony’s franchise through a combination of innovative game play and low pricing.

The bottom line: In high-turnover markets, customer loyalty is less meaningful, and that can put market leaders at risk.

Capitalising on customer turnover

Our research shows that growth alone doesn’t predict the percentage of new customers a market will gain in any given year. In fact, low-growth markets may have a higher share of new customers than high-growth markets, and mature industries can be very dynamic indeed — if they have a high turnover rate.

Three factors drive customer turnover: infrequency of use, product durability and age specificity. Anything that is rarely used, such as funeral services or pregnancy tests, will have a constantly changing pool of customers. The same is true for durable products such as cars or refrigerators, which customers tend to buy and hold on to. Finally, products that target a specific age group or life stage will have customers who turn over regularly. Baby products and teen magazines are good examples.
Winning strategies for new entrants

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High-turnover markets offer exceptional opportunities to new entrants because few customers have established loyalties. But winning these customers can be challenging as they may be risk-averse or reluctant to try something new. New entrants may break through with the following strategies:

Cut customers' trial costs. The goal is to overcome customers' inertia or reluctance to try something new. When Sony entered the video console market, the Nintendo and Sega systems were well entrenched. Sony was unknown and untested. To gain share, Sony equipped its Playstations with a CD drive, essentially creating the cheapest CD player in the market. Customers got two uses out of one system, which increased its perceived value and offset their concerns that the new system wouldn't be a hit. Sony used the same strategy when it launched the PlayStation 2 (with a DVD player) and the PlayStation 3 (with a Blu-Ray player).

Use bundles to drive adoption. Bundles give customers more value than existing products offer. To compete in the browser market that was dominated by Netscape, Microsoft seamlessly bundled Explorer with its highly valued Windows operating system. Apple took a different but equally successful approach, shrewdly extending its powerful "i" brand — from iPod to iPhone to iPad — to enter markets dominated by Sony, Nokia and Amazon.

Form alliances with reputable partners from low-turnover markets. Unknown new entrants can increase the comfort level of potential customers by forming alliances with established, reputable partners that can provide referrals. For instance, real estate agents gain credibility by associating themselves with banks and insurance companies, stable players in low-turnover industries. And textbook publishers build long-term relationships with professors to get their books on the reading list in the high-turnover college market.

Defensive strategies for incumbents

Once a successful position has been established, the next task is to consolidate and grow at the same time as turnover undermines the share gains. The following strategies achieve this:

Provide a migration path. When customers see ways to extend the value of an existing product or service — and that it can meet current and future needs — they have fewer incentives to leave. Loyalty programmes such as the "frequent flier" membership clubs that airlines offer help retain customers by offering progressive rewards at different levels, such as silver, gold and platinum. Similarly, Lego gets toddlers started with Duplo and offers increasingly diverse and sophisticated Lego products for young adults that may even keep them from playing video games.

Increase total platform value. Customers like products that provide additional, often unrelated value. Airline or bank loyalty points that become a currency for buying other highly valued products and services such as hotel rooms, golf clubs, electronic devices and even once-in-a-lifetime experiences can help to retain current customers and attract new ones. Similarly, "family and friend" packages for mobile phones increase customer loyalty.

Build alumni networks. High-turnover markets have many more "alumni" than current customers. These former users can become powerful allies, effective spokespeople and an excellent source of referrals. Universities use alumni reunions, conferences and sporting events to build the loyalty, support and recommendations of past students. Similarly, consulting firms seek referrals from the executives they've worked with — many of whom are "graduates" of the firm and an ongoing source of new business.

Fast turnover of a market's customer base can present major growth opportunities for newcomers and incumbents alike — if they have the right strategy for gaining, growing and keeping share.

But turnover can change as markets age, creating new openings and risks that come and go. It is critical, therefore, that companies monitor the turnover rates of their different products and revise their strategies as needed, making informed decisions about when to decelerate turnover to defend their position or accelerate turnover to gain more share.

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