

# Evaluating channel performance in multi-channel environments

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## Abstract

Evaluating channel performance is crucial for actively managing multiple sales channels, and requires understanding the customers' channel preferences. Two key components of channel performance are (i) the existing customers' intrinsic loyalty to a particular channel and (ii) the channel's ability to attract switching customers. We apply the Colombo and Morrison (Colombo, R., Morrison, D., 1989. A brand switching model with implications for marketing strategies. *Marketing Science* 8, 89–99) model to assess channel performance along these dimensions. Using data from a large home-shopping company, we analyze the evolution in the performance of its main channels over time, and test for differences in channel performance among different product categories offered by the company, as well as between different customer segments. Based on the results, we derive implications for managers to operate a company's multiple sales channels more effectively.

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## 1. Introduction

More and more companies become multi-channel operators (Ganesh, 2004; Coelho et al., 2003). Therefore, managers need metrics that help them assess the performance of each individual sales channel, as well as the inter-relationships among the different sales channels in their portfolio. Preferably, these metrics should be grounded in marketing theory and should be objective, based on readily available data, easy to quantify, intuitively appealing, and should have diagnostic value (Ailawadi et al., 2003). Furthermore, these metrics should be based on customers' channel preferences (Reardon and McCorkle, 2002). A key component of customers' channel preference is their behavioral loyalty to each sales channel. Even though it was initially argued that customer loyalty would disappear in near-perfect Internet markets (Kuttner, 1998), recent research has convincingly argued that customer loyalty

remains central to long-run profitability.<sup>1</sup> However, channel loyalty is only one component of sales channel performance, because some customers may not have a strong intrinsic preference for any specific channel, and occasionally (or even regularly) switch among different channels. Therefore, a second key characteristic for sales channel performance is the ability to attract these switching customers (Reichheld and Schefter, 2000).

Insights into these issues can be obtained through the analysis of aggregate switching matrices (see, e.g. Lilien et al. (1992, pp. 41–42) for an in-depth discussion on the construction and interpretation of such matrices). Repeat purchases with the same sales channel then appear in the diagonal elements of the matrix, while switching between the various channels, or defection to competing companies, is reflected in its off-diagonal elements. However, not all observed consecutive purchases through the same sales

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<sup>1</sup>For an extensive review on the brand-loyalty literature, we refer to Mellens et al. (1996) and Oliver (1999). Papers on the relevance of the loyalty concept in an Internet environment are, among others, Danaher et al. (2003), Flavián et al. (2006), Harris and Goode (2004), and Srinivasan et al. (2002).

channel reflect the same level of channel loyalty. Indeed, some repeat purchases could come from customers who buy repeatedly with probability one, and hence do not consider the use of other sales channels or companies. But a repeat purchase could also come from customers who have considered other sales channels or companies, but have not yet switched. Terech et al. (2003) refer to the former as hard-core loyals, and to the latter as soft-loyal customers. Obviously, the former are the more attractive customers for a given sales channel.

Various stochastic models allow for a further decomposition of the aggregate switching matrix beyond the simple diagonal/off-diagonal dichotomy (e.g. Bayus, 1992; McCarthy et al., 1992; Colombo and Morrison, 1989; Grover and Srinivasan, 1987). A well-established model is the one developed by Colombo and Morrison (1989). Its empirically determined parameter estimates have clear managerial interpretation and diagnostic value. Furthermore, its data requirements are low and its implementation and interpretation are straightforward, thereby satisfying the various criteria advocated in Ailawadi et al. (2003).

In this paper, we apply the Colombo and Morrison model to assess multi-channel performance. We illustrate that it allows for more detailed insights into customers' channel preferences by decomposing the observed switching behavior among a company's sales channels into (i) customers' intrinsic loyalty to a particular sales channel and (ii) each sales channel's ability to attract potential switchers, referred to as its conquering power. In doing so, we also distinguish between hard-core loyal and soft-loyal customers to account for different levels of loyalty (Terech et al., 2003). In addition, we not only investigate the overall channel performance, but also evaluate whether there are (i) changes in a channel's loyalty and conquering power over time, (ii) specific product categories that are better suited to be sold over a particular channel (Inman et al., 2002; Morrison and Roberts, 1998), and (iii) differences between specific customer segments. To that extent, we distinguish between heavy and light users. Lim et al. (2005) argue that light users are more likely to attribute their channel choice to external causes than to an internal cause—such as their intrinsic preference for that sales channel.

Those more detailed analyses provide multi-channel managers with additional insights into the performance of a company's sales channels. Thus, analyzing changes over time enables managers to evaluate whether customers start to migrate from one sales channel to another. Moreover, knowing the product-channel association helps to better tailor the assortment to the different sales channels, and additional insights into different customer segments allow managers to better target their multi-channel marketing activities.

The remainder of the paper is organized as follows: Section 2 outlines the research methodology. Section 3 describes the data set. Empirical results are given in Section 4, and Section 5 provides conclusions and implications of our results.

## 2. Method

We use the model developed by Colombo and Morrison (1989) to examine customers' behavioral channel loyalty and inter-channel switching behavior. The model is based on the assumption that there are two groups of customers:

- customers who are intrinsically loyal and stay with the same sales channel, called *hard-core loyals*, and
- customers who potentially switch from one sales channel to another on every purchase occasion. They choose between the available sales channels according to a zero-order process. We refer to those customers as *potential switchers*.

Potential switchers who use the same channel on two consecutive purchases are called 'soft-loyal' customers, whereas those who switch are labeled as 'switchers'. All potential switchers are assumed to have the same probability to use a specific channel, but this probability may differ across channels. The fraction of loyal customers (hard core as well as soft-loyal customers) and the switchers' choice probabilities are linked to the elements of the observed switching matrix through:

$$p_{ii} = \alpha_i + (1 - \alpha_i)\pi_i, \quad i = 0, 1, \dots, I, \quad (1)$$

$$p_{ij} = (1 - \alpha_i)\pi_j, \quad i, j = 0, 1, \dots, I \text{ and } i \neq j, \quad (2)$$

where  $p_{ii}$  ( $p_{ij}$ ) is the conditional probability that a customer who last used channel  $i$  will next use channel  $i(j)$ ;  $\alpha_i$  the fraction of channel  $i$ 's current customers who are completely loyal to that channel (hard-core loyals);  $\pi_i$  ( $\pi_j$ ) the fraction of potential switchers who will next use channel  $i(j)$ , with  $\sum_{i=0}^I \pi_i = 1$ .

The diagonal elements of the switching matrix ( $p_{ii}$ ) might be considered as an intuitive metric for channel loyalty, since those elements express the repeated use of a particular sales channel. However, the diagonal elements of the aggregate switching matrix can be decomposed into repeat purchases from hard-core loyal ( $\alpha_i$ ) and soft-loyal customers ( $(1 - \alpha_i)\pi_i$ , since also a zero-order buyer may end up making two or more consecutive purchases from the same sales channel. To accommodate customers who did not use any sales channel within a considered time interval, a 'no purchase' option is introduced (see Chiang, 1991 for a similar practice). The corresponding  $\alpha_0$  denotes what fraction of all current non-users can be considered hard-core non-users, while  $\pi_0$  measures the probability that a potential switcher opts to not use any of the company's sales channels in a given period. To take left-censoring of the data into account, we use a certain time interval of the observed time span for initialization purposes. Specifically, to determine whether the first purchase in a given time interval was a 'repeat use of a particular channel' or a 'channel switch', the sales channel currently used is compared to the sales channel used for the last purchase

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