



Contents lists available at ScienceDirect

## Intern. J. of Research in Marketing

journal homepage: [www.elsevier.com/locate/ijresmar](http://www.elsevier.com/locate/ijresmar)

## Replication

# “Are multichannel customers really more valuable? An analysis of banking services”<sup>☆</sup>



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## ARTICLE INFO

## Article history:

First received on August 5, 2015 and was under review for 3 months  
Available online 21 January 2016

Replication Editor: Donald R. Lehmann

## Keywords:

Multichannel customer management  
Customer profitability  
Banking services  
Time series

## ABSTRACT

Conventional wisdom suggests that multichannel customers are more profitable. With a focus on goods, Kushwaha and Shankar (2013) demonstrate that it depends on the type of product purchased. Our study looks at the profit implications of multichannel customers in services (banking). Our research shows that fully multichannel customers (using all channels available) are not the most profitable for service firms. We find that concentrating the interactions through high-margin channels as well as using specific dual-channel combinations produce improvements in profitability.

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## 1. Introduction

Whether multichannel customers are really more profitable has become a central research question in marketing (Neslin et al., 2006). The study by Kushwaha and Shankar (2013) (K&S) intends to provide an answer to this question in a product context. They begin with the notion that “across all product categories, multichannel customers have a higher monetary value of purchases than single-channel customers”. This thesis is based on three main reasons: a) additional channels provide greater convenience value for customers, increasing their purchase frequency and accelerating purchases across multiple items and categories; b) multichannel providers may offer a wider assortment of products and therefore customers have multiple opportunities to buy and increase their spending; c) customers can combine the benefits that different channels provide to derive a higher value from them and, thus, increase spending. Based on an analysis of single (catalog-only or Internet-only) vs. multichannel preferences and their impact on sales across multiple catalog/online retailers and product categories, K&S conclude that multichannel customers are not always more profitable: multichannel customers are more profitable for hedonic products, while (traditional) single-channel customers have a higher monetary value for low-risk products.

<sup>☆</sup> The names of the authors appear in alphabetical order. Jesús Cambra-Fierro, Iguacel Melero-Polo, and F. Javier Sese are members of the research group Generes (<http://generes.unizar.es/en/>), and they appreciate the financial support received from the projects ECO2014-54760 (MICINN, FEDER), and S09-PM062 (Gobierno de Aragón and Fondo Social Europeo) as well as from the program “Ayudas a la Investigación en Ciencias Sociales, Fundación Ramón Areces”. They want to show their gratitude to the collaborating bank for providing the data for the analyses. The authors want to show their gratitude to Prof. Goldenberg, Prof. Lehmann, and the anonymous reviewer for the guidance, encouragement, comments and suggestions received during the review process.

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This study replicates K&S's research in a services context (banking). Compared with goods, we expect the nature of services (e.g., intangibility, simultaneity of production and consumption) to influence the way in which customer preferences for channels affect profitability: while an increase in the number of channels used in goods enhances profits by leading customers to purchase more frequently and spend more (Kumar and Venkatesan, 2005; Venkatesan, Kumar, and Ravishanker, 2007), using multiple channels in services may increase the cost to serve the customer, with negative implications for profitability. We expect the extent to which customers are more or less profitable using various channel combinations in services to depend on the nature of the specific channels used (high vs. low-margin channels) and on whether they promote more vs. less efficient interactions (substitution effect vs. augmentation effect, Campbell and Frei, 2010).

**2. Study**

**2.1. Design**

The data used in our empirical tests were provided by a European bank that offers financial services (e.g. certificates of deposit, savings accounts, mortgages) to individual customers (B2C) and has a volume of activity of 100,000 million euros, with 3.3 million customers, 6300 employees and 1400 offices. We obtained a random sample of 1000 customers from which we had complete transaction and balance data for multiple services and channels for a period of 24 months (from August 2009 to July 2011). This bank operates on four main channels: Point-of-Sale (POS) machines at retail shops and service providers, automatic teller machines (ATM), its own branches (BRANCH) and via internet (ONLINE). We categorized the bank's services into three main groups: ASSETS (savings, interest-bearing checking, investments, etc.), CREDIT (credit card, installment loan, mortgage, line of credit, etc), and SERVICES (debit card, insurance, etc).

The empirical problem we face is distinct from the one faced by K&S, who had access to aggregate measures gathered for multiple products across a large sample of consumers, and relied on cross-sectional analyses, accounting for cross-sectional endogeneity with demographics as instrumental variables. In contrast, we rely on a panel of customers from one bank, which we track over 24 months. Therefore, we are able to account for endogeneity biases due to selection and other effects associated with unobservable heterogeneity more directly, by incorporating fixed effects into our model. Given that we have enough information to account for individual differences, our main preoccupation is with endogenous effects that might affect our results over time.

To test for the impact of channel use on profitability, we estimate the following cross-sectional time-series model:

$$\begin{aligned}
 \text{MARGIN}_{it} = & \mu_i^P + \mu_t^P + \alpha^C \text{BAL}_{it}^C + \alpha^A \text{BAL}_{it}^A + \sum_k \beta_k \text{CHANNEL}_{ikt} + \sum_k \gamma_k^C \text{BAL}_{it}^C * \text{CHANNEL}_{ikt} + \sum_k \gamma_k^A \text{BAL}_{it}^A * \text{CHANNEL}_{ikt} \\
 & + \sum_k \sum_{k'} \beta_{kk'} \text{CHANNEL}_{ikt} * \text{CHANNEL}_{ik't} + \sum_k \sum_{k'} \sum_{k''} \beta_{kk'k''} \text{CHANNEL}_{ikt} * \text{CHANNEL}_{ik't} * \text{CHANNEL}_{ik''t}
 \end{aligned} \tag{1}$$

where,

MARGIN<sub>it</sub> sum of gross margin for financial and non-financial products plus fees for customer i during month t.

μ<sub>i</sub><sup>P</sup> fixed profitability (margin) effect for each customer i, accounting for endogenous cross-sectional effects.

μ<sub>t</sub><sup>P</sup> fixed profitability (margin) effect for each month t, accounting for seasonal and trend effects.

BAL<sub>it</sub><sup>C</sup> balance held by customer i on credit services during month t.

BAL<sub>it</sub><sup>A</sup> assets held by customer i on deposit and investment services during month t. Balances are not relevant for the third category (SERVICES).

CHANNEL<sub>ikt</sub> number of times customer i used channel k during month t, with k = 1,4 capturing the use of Point-of-Sales, ATM, BRANCH and ONLINE channels.

Eq. (1) parses out the effect of (single and multiple) channel use on customer profitability, after accounting for individual differences, time trend and volume of funds. While this equation accounts for endogenous effects across customers, it does not take into consideration changes in channel use induced by managers' marketing effort. This marketing effort can be endogenous, as managers usually base their targeting on what they observe in their customer database. Thus, to correct for these endogenous effects, we estimated two additional equations measuring how the customers' channel use is affected by their exposure to marketing communications (Eq. (A1)), and how this marketing effort is affected by the customer information managers observe (Eq. (A2)). We provide details on these two equations and their results in the Appendix A. Appendix B provides information on the correlation matrix and descriptive statistics for the studied variables. Based on this information, we conclude collinearity is not an issue in our empirical application.

We estimated our three-equation model using a 3-stage process. In the first stage, we estimated Eq. (A2) as a fixed-effects multi-level Poisson regression, with months nested under individual customers. These estimates were the basis for replacing MKTG<sub>it</sub> in Eq. (A1) with a measure of marketing effort adjusted for the bank managers' targeting decisions. This adjusted marketing effort is combined with other indicators in a multivariate generalized linear model, to adjust the observed use of the four channels (POS, ATM, BRANCH and ONLINE) by each customer in the 24-month period. In the final stage, we combine the adjusted (for marketing effort) channel use with other factors believed to affect customer profitability, in a fixed-effects linear model explaining

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