

USING CUSTOMER EQUITY TO DETERMINE OPTIMAL MULTICHANNEL STRATEGIES

Michael Paul, Bauhaus-University Weimar, Germany
Thorsten Hennig-Thurau, Bauhaus-University Weimar, Germany
Thomas Rudolph, University of St. Gallen, Switzerland

SUMMARY

During the last decade, the practice of multichannel management has become a widely used strategy in multiple retailing industries. Today, about 40 percent of retailers employ three or more channels, while another 42 percent sell their merchandise through two channels (DMA 2005). In this research, we address a key question for multichannel management: What is the optimal channel mix for distributing products to existing customers? In practice, no common answer to this question seems to exist, as Amazon exclusively distributes through the Internet, whereas Barnes & Noble uses both physical stores and the Internet, and several local book stores focus on their bricks-and-mortar business, neglecting the online channel. Research-wise, the question which channels a company should employ has received only limited research attention. Some studies have been concerned with the optimal mix of communication channels to acquire new customers, while our focus is on distribution channels to retain existing customers (Verhoef and Donkers 2005; Villanueva, Yoo, and Hanssens 2008).

We use customer equity (CE) to determine optimal multichannel strategies. Specifically, our modeling framework is structured as follows: As part of their channel strategy, a company decides which channels to employ. When making a buying decision, customers progress through the stages of search, purchase, and after sales. In each decision stage, customers choose among the available channels. We distinguish between single channel and multichannel shoppers, with the latter being defined as customers that purchase from a particular company in more than one channel, and allow shopper segments' behavior to differ in each decision stage. Customers' channel choices affect CE via their influence on customer retention (and, subsequently, channel revenues) as well as costs. Research has shown that channels affect customer retention, but results are mixed: While some studies report that loyalty toward a company is higher when products or services are chosen online than offline (e.g., Shankar, Smith, and Rangaswamy 2003), other studies suggest that increased Internet usage may erode loyalty (e.g., Ansari, Mela, and Neslin 2008). Moreover, positive (Wallace, Giese, and Johnson 2004) and negative (Gensler, Dekimpe, and Skiera 2007) effects of multichannel availability on loyalty have been found.

We apply our model to a leading European travel company that distributes through physical stores and the Internet. We first measure the effect channel strategies have on customer retention by conducting a role-playing experiment that simulates the internet and store channels as offered by the company. The experimental design was a two (channel: internet or store) by three (decision stage: search, purchase, or after sales) between-subjects design (i.e., six different conditions). Each of the six conditions relates to a hypothetical role-playing exercise that asks participants to envision themselves as long-term customers of the company. We assign respondents randomly to the six scenarios. Our sample includes 895 consumers and corresponding group sample sizes between 138 and 154. The experimental results are used to determine customer retention rates and shopper segments. Information on channel revenues and costs was obtained from the travel company's internal databases. Based on this data, we calculate customer lifetime values (CLV) for each shopper segment and each channel setting. In the final step, we determine CE of optimal and probable channel choices for shopper segments of varying size. Whereas the optimal channel setting corresponds to the CLV maximizing setting for each shopper segment, each segment's most probable channel setting is given where the retention rate is highest.

Results show that, for online shoppers, customer retention is maximized when customers use the Internet across all three decision stages. For both store and multichannel shoppers, customer retention is highest when they use the Internet for search and then make purchases in the store. In the after sales stage, store shoppers' retention increases when they visit the store, whereas multichannel shoppers' prefer using the Internet. For online shoppers, the CLV maximizing channel setting is also the most probable, that is, online shoppers use the Internet in all three decision stages. The same channel setting maximizes CLV for the multichannel shoppers. Store shoppers' CLV is highest when they search online, purchase in the store, and use after sales services in the Internet. In the probable channel setting online shoppers are 36 percent more valuable than multichannel shoppers and 220 percent more valuable than store shoppers. Accordingly, CE increases with the size of the online shopper segment and the worst case scenario is a customer base with 100 percent store shoppers. The travel company can

improve CE for both multichannel and store shoppers when customers are steered to the optimal channel setting.

We have shown how companies can determine optimal multichannel strategies that maximize CE of existing customers, while accounting for different decision stages and customer heterogeneity. Our approach can be used by other companies that want to identify a CE maximizing multichannel strategy. Travel companies planning to implement our approach have to gather data on channel revenues and costs, while companies from other industries also have to collect information on channel choices and

customer retention rates. If possible, such data should be longitudinal and on the level of the individual customer. This study also adds to our understanding of multiple channels' impact on customer retention. No study has yet considered the impact of multiple channels on customer retention across all three customer decision stages and for different segments. Moreover, we contribute to the literature by using an experimental design that controls for possible self-selection biases and allows for an understanding of the cause-and-effect relationship between channel choices and customer retention. References are available upon request.

For further information contact:
Michael Paul
Department of Marketing and Media Research
College of Media
Bauhaus-University Weimar
Helmholtzstr. 15
99425 Weimar
Germany
Phone: +49.3643.58.3793
Fax: +49.3643.58.37 91
E-Mail: michael.paul@medien.uni-weimar.de
