Cluster III in 2006
Customer Management in a Multi-Channel Environment

1   Motivation

For decades, financial institutions have pursued strategies which are product and transaction oriented. Hence, they focused on the profitability of an individual transaction with a customer, rather than the profitability of a long lasting customer relationship. But financial institutions are becoming aware of the value of a customer relationship. This paradigm shift was primarily triggered by the research conducted by Reichheld and Sasser. They have shown that a customer relationship orientation can tremendously improve the overall profitability.

Financial institutions are now trying to derive clear benefits from operationalizing this customer orientation. Customer management has emerged as the marketing practice which aims to implement and to profit from a customer orientation philosophy. Customer management deals therefore with the acquisition and retention of customers with the aim to increase the customer lifetime value and customer equity, an aggregate measure of the life time value of current and potential customers.

As sales channels represent the link to the customer, their management is one crucial factor of the customer management approach. But many financial institutions are currently faced with a confusing array of choices and operational challenges in managing their multiple sales channels. Hence, the mission of Cluster III is to optimize Customer Equity by standardizing and automating customer management in a multi-channel environment.

Figure 1 represents the vision of our cluster "Customer Management in a Multi-Channel Environment".

Figure 1: Vision of Cluster III "Customer Management in a Multi-Channel Environment"
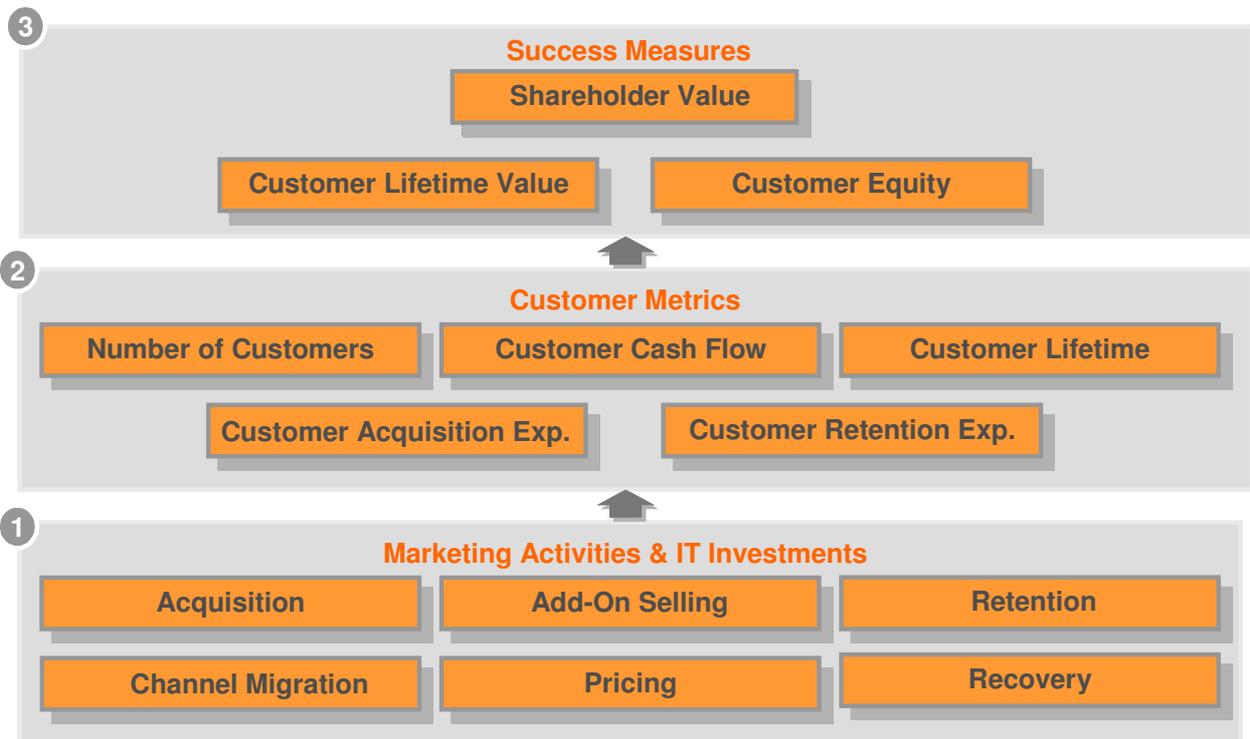
Our cluster is structured in three modules which all aim to optimize the Customer Equity of a financial institution. The modules are as follows:

Marketing Activities & IT Investments (1): This module studies the impact of marketing activities and IT investments on the 5 key customer metrics. For example, we will analyze the impact of customer channel migration activities on customer cash flow and on customer value and the ROI of IT investments. Further-

more, interdependencies between product categories will be investigated to evaluate the advantageousness of add-on selling activities with respect to customer profitability.

Customer Metrics: This module pursues two objectives. Firstly, it analyzes the interdependencies between the different customer metrics. The second objective of this module is to evaluate the impact of the different customer metrics on the success measures.

Success Measures: This module also has two objectives. Firstly, this module meets the challenge how to calculate the success measures. Second, the relationship between the different success measures will be investigated and implications for managers will be derived.

The insights from the three modules will be used to develop marketing decision support systems that guide the customer management strategy in a multi-channel environment for financial institutions. Based on these results, financial institutions can employ this decision support tool to increase their Customer Equity and to predict the impact of different strategies on enterprise value.

2 Customer Management Projects

In 2006 the Cluster III will focus on the following work packages.

2.1 Market Analysis: German Retailbanking Market

"Typologie der Wünsche Intermedia" (TdWI) is published by Burda Advertising Center and under license by 19 partners in the advertising media. This survey provides data on a regular basis on German consumer behavior and covers the financial service industry. It is based on the German-speaking population from the age of 14 belonging to private households in Germany. The participants are sampled by their addresses selected at random. The sampling scope is about 20.000 households. The survey is based on personal interviews and a written questionnaire. Interviews are carried out using a structured questionnaire; the written part of the survey is based on instructions provided by the interviewer. The survey is conducted once a year and we have got the data for a time period of 3 years.

Based on these data it is possible to conduct several analyses. For example, market shares for different product categories can be determined as well as the cross-selling rates of different financial institutions can be evaluated and compared. It is the aim of this project to provide several analyses of the German Retailbanking market to provide the partners of the E-Finance Lab with additional information.

This project has already started in 2004. An yearly analysis will be done to provide the partners of the E-Finance Lab with new trends and developments in the financial services industry.

2.2 Customer Management Benchmarker

The 5 key metrics for customer management in the financial services industry will be analyzed. The key players in the market will be surveyed. Therefore, a survey with the German Top 500 financial services institutions will supply the data needed. This will allow to derive implications for managers and to benchmark several institutions.

2.3 ROI of Multi-Channeling Investments

This work package will identify a structured process to improve multi-channel integration within a banking environment.

2.3.1 This work package's first objective is to visualize the procedure for the measurement of a certain bank's status quo concerning their multi-channel integration, for the evaluation of possible improvements, and for the implementation.

2.3.2 The second objective would be the application of the results with a banking partner.

Partner: Microsoft, BearingPoint

2.4 Beraterarbeitsplatz

This work package will analyze the decision for certain CRM software (IBM´s "Integrierter Beraterarbeitsplatz") and its impact on the customer lifetime value and underlying marketing metrics.

2.4.1 This work package's first objective is to identify the improvements of the certain CRM software and its linkage to the underlying marketing metrics. This will be done in close cooperation with the partner (IBM).

2.4.2 The second objective is to build a ROI measurement tool and utilize this tool with key customers of the partner. This will lead to further improvements of the tool as well as its application.

Partner: IBM

2.5 Success Factors of Multi-Channel Management

This work package is designed to determine the success factors of Multi-Channel Management in the financial services industry. The results of this work package will therefore provide guidance on how to transform a financial institution into a multi-channel organization.

2.5.1 The first objective of this work package is to define and to conceptualize the construct of Multi-Channel Management. This will be achieved by reviewing the relevant literature not only from the field of Multi-Channel Management (MCM) but as well from the field of Customer Relationship Management (CRM). The conceptualization of Multi-Channel Management will furthermore allow to derive preliminary hypotheses about the critical success factors of Multi-Channel Management and the implementation of Multi-Channel Management.

2.5.2 The second objective of this work package will be to either verify or to reject the critical success factors identified by the literature review by conducting an empirical study among European financial institutions. The aim of this empirical study will be to link the hypothesized success factors to the financial and market performance of financial institutions. By using the statistical method of Structural Equation Modelling it will be possible to determine the impact of each success factor on the performance of a financial institution. This study will therefore not only provide information about whether a hypothesized success factor is relevant for the performance of a financial institution, but will determine as well which success factors have the highest impact on performance. In addition, this study will provide an overview of the state of Multi-Channel Management in the financial services industry on an European level. This offers the opportunity to identify best practices in Multi-Channel Management and to benchmark specific financial institutions against the industry average.

Partner: Accenture

2.6 Metrics for Customer Management (CE Dashboard)

This work package will develop a so called "Customer Equity Dashboard" to monitor the financial impact of marketing spending suitable for senior management needs. So far, no translation of marketing outcomes to financial measures has been done and this kind of important information is not handed over to senior management to assist managing the firm based on its values. A connecting link between the concepts has to be drawn because it is imperative to set appropriate measurement metrics to track and monitor the effectiveness of marketing (e.g., customer management) activities.

2.6.1 The first objective of this work package is to use the customer equity and customer lifetime value concept to propose the "Customer Equity Dashboard" that should inform senior managers about the current value of their customer base as well as monitor changes over time. Software will be developed to implement the CE dashboard.

2.6.2 The second objective of this work package is to apply the developed approach with a partner.

Partner: to be determined

2.7   Development of Customer Metrics over Time

Among the most important metrics in marketing, customer profitability is traditionally regarded as a measure with broad applications in the operative management of the customer base in financial services. Therefore a sound understanding of the development is required to ensure decision quality, especially if there is need for a decision on deepening or ending a customer relationship.

This work package will analyze the development of profitability of a certain retail banking customer over time.

2.7.1   The first objective is to determine whether there are major shifts in the calculated profitability from one year to another. Objects of the analysis will be profitability measures as used for the calculation of the customer lifetime value. The data set should reflect the retail customer base of a financial service provider in Germany and allow the comparison of at least two years forecasting.

2.7.2   The second objective of this work package is the analysis of the customer retention development with respect to the previous year's measurement results.

2.7.3   The third objective is the analysis of the Customer Lifetime Value development as a result from underlying customer metrics like profitability and retention.

Partner: Postbank

2.8   Analysis of Customer's Product Portfolios

Managing customer relationships turns out to be very complex, because of interdependencies between the different products offered by a company. In the case of positive interdependencies customer management activities that intend to broaden customer relationships by selling additional products will unambiguously improve the value of a customer relationship. However, in the event of negative interdependencies it is not clear whether a company should encourage its customers to broaden or deepen their relationship with the company. To decide whether cross-selling or up-selling activities are more appropriate, a company needs to understand the effects of selling additional products on customer profitability. Therefore, managing customer relationships requires examining the interdependencies between different products of a company and, furthermore, it is crucial to take the monetary consequences of those interdependencies into account. Hence, decomposing the effect of selling an additional product is crucial.

2.8.1   The first objective of this work package is to closely investigate the interdependencies between the different products that are offered by a company.

2.8.2   The second objective of this work package is to evaluate the monetary consequences of pushing individual products by decomposing customer profitability into its several components.

Partner: Postbank

2.9   Risk Adjustment in Customer Lifetime Valuation

This work package will analyze how and when to incorporate risk into the customer lifetime valuation formula. Currently, a risk adjustment in customer lifetime valuation is done rather hands on. Future customer cash flows streams are discounted at the same discount rate, assuming that all customers are equally risky.

2.9.1   The first objective of this work package is to identify possible applications for risk-adjusted customer lifetime valuation. In other words, this work package tries to review marketing applications in terms of the usefulness of risk-adjusted customer lifetime valuation and identify associated customer risk factors.

2.9.2   The second objective of this work package is to develop a way of how to incorporate the customer risk factors into the current customer lifetime value models and apply it to a dataset of a German bank. Stated differently, this work package aims to determine the discount factor in customer lifetime value models. The developed approach will be applied to a real world setting.

Partner: to be determined

2.10 Customer Channel Choice and its Impact on CLV

This work package will analyze the lifetime implications of the channel choice behavior of banking customers. It will therefore extend the research that has started in 2004 and was continued in 2005 on customer channel migration.

2.10.1 The first objective of this work package is to determine the impact of the sales channel usage on the lifetime of banking customers. In other words, this work package tries to evaluate whether customers who interact with the bank through a certain channel mix are more loyal than banking customers who use a different channel mix to interact with a bank. This work package will therefore build and complement the work that has been done on the monetary implications of channel usage in 2005. The combination of the research findings on monetary and lifetime implications will allow to estimate the entire impact of channel usage on the Customer Lifetime Value. The project will be conducted by using a data set of one or two large German retail banks.

2.10.2 The second objective of this work package is to extend the existing decision support system on customer channel migration which has been developed in 2005. The enhanced decision support system will incorporate a model describing the channel choice behavior and all the implications of the channel usage for the Customer Lifetime Value.

This project is linked to the projects "Entwicklung eines Modells zur Messung von Kundenpräferenzen" "Vertriebskanal-Mix" and "Vertriebssteuerung/Kundensteuerung" mentioned in the IBM proposal.

Partner: Deutsche Bank, Postbank

2.11 Impact of Multi-Channel Usage on Customer Profitability

This work package will determine profitability differences between multi-channel customers and single-channel customers of a bank. As a consequence, it will be possible to determine the effects of using multiple sales channels as opposed to using only one sales channel of a bank on the profitability of banking customers.

2.11.1 The objective of this work package is to compare the profitability of multi-channel and single-channel customers. In order to receive unbiased estimates, it will be necessary to account for so called self-selection effects. This can be achieved by decomposing the profitability differences between multi-channel and single-channel customers in customer specific and channel specific effects. One method to statistically decompose the profitability impact of using multiple sales channels is called matching. The matching approach compares actual behavior of an individual with the assessment about how this individual would have behaved, had she or he not used multiple sales channels. This comparison will allow to define the impact of using multiple sales channels on the profitability of the individual customer. If the profitability difference is not completely explained by the channel effect, the remaining difference can then be attributed to the self-selection effect.

Partner: Postbank