Profitable Customer Management
A Study in Retail Banking

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Profitable Customer Management: A Study in Retail Banking

Key words: Customer Profitability, Customer Equity, Customer Assets, Customer Relationship Management, Customer Lifetime Value, Retail Banking, Marketing Accountability, Heuristics, Cost to Serve, Profitable Customer Management

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This at times seemingly never-ending story apparently has a happy ending, manifested as the book you are now holding in your hands. Nevertheless, this outcome of my doctoral process could never have been generated without the help and support of a number of individuals. First and foremost, I would like to extend my deepest gratitude to my thesis supervisor, Professor Lynette Ryals of Cranfield School of Management, who has played the most instrumental role in my doctoral research. Ever since I first visited Cranfield and met with her, my thesis has been on track and she has provided me with invaluable advice, detailed feedback, and uplifting encouragement.

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Uppsala, 25th of April, 2011

Andreas Persson
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PART 2

THE PAPERS
PART 1
1 INTRODUCTION

...a company’s most precious asset is its relationships with its customers. (Levitt, 1983, p. 91)

A consensus seems to be emerging within the marketing community around the notion that a key task of marketing is to enable the creation of value for various stakeholders. The official American Marketing Association (AMA) definition, which was last updated in 2007, states:

Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large. (American Marketing Association, 2007)

An alternative definition offered by Grönroos (2006) reflects a similar focus on value creation:

Marketing is a customer focus that permeates organizational functions and processes and is geared towards making promises through value proposition, enabling the fulfilment of individual expectations created by such promises and fulfilling such expectations through support to customers’ value-generating processes, thereby supporting value creation in the firm’s as well as its customers’ and other stakeholders’ processes. (Grönroos, 2006, p. 407)

Both of these definitions focus on value creation. The measurement of this value creation, however, is an elusive issue that has long been plaguing marketers. Despite the advances in information technology, John Wanamaker’s classic statement, “Half the money I spend on advertising is wasted; the trouble is I don’t know which half,” is still relevant for many organizations.

One of the research areas that has sought to quantify the value created by marketing through the management of customer relationships could be termed “profitable customer management” (PCM) (cf. Kumar and Rajan, 2009). Several streams of research have developed, focusing on customer profitability, customer lifetime value (CLV), customer equity (CE), and related concepts. The common theme of this research is the concentration on the importance of measuring customers’ value to the company, and managing customer relationships in order to maximize the long term value of the customer base, and by extension enhancing shareholder value. Therefore, this type of research also potentially improves the possibilities for marketing to demonstrate its importance for the creation of value to the firm, thereby allowing marketers to take a step toward achieving greater clout at the boardroom and top management level (cf. McGovern, Court, Quelch, and Crawford, 2004).

The concept of CLV, however, is certainly not new (see Kotler, 1974), receiving a breakthrough in the arena of direct marketing already in the late 1980s (Dwyer, 1989). Nevertheless, in spite of the heavy theoretical development concerning CLV and CE since then, the uptake of these metrics among marketing practitioners remains limited. Several marketing academics have taken the route of aiming to connect marketing investments in customer relationships to CLV and shareholder value (Berger, Echambadi, George, Lehmann, Rizley, and Venkatesan, 2006; Hogan, Lehmann, Merino, Srivastava, Thomas, and Verhoef, 2002a; Kumar and Shah, 2009; Rust, Ambler, Carpenter, Kumar, and Srivastava, 2004a; Ryals and Knox, 2005; Stahl, Matzler, and Hinterhuber, 2003). However, in practice marketers still seem to lack influence within companies. For example, Nath and Mahajan (2008) find that the
presence of chief marketing officers (CMOs) in top management teams has nearly no impact on firm performance. Hence, there is a need for marketing to continue assessing how it can contribute to demonstrable improvements in customers' long term value to the firm, and by extension shareholder value.

1.1. Research problem

The concepts of relationship marketing (RM) and customer relationship management (CRM) have received much attention in marketing literature since the 1990s. It has been argued that a paradigm shift has occurred, from the marketing mix to relationship marketing (Grönroos, 1997a). Meanwhile, the profitability of relationships has been identified as one of the key goals of marketing (Grönroos, 1990; Storbacka, 1994). The increasing focus of RM and CRM studies on issues of customer profitability has led to the emergence of an area of research on PCM, which has also been termed customer asset management (Berger, Bolton, Bowman, Briggs, Kumar, Parasuraman, and Terry, 2002; Bolton, Lemon, and Verhoef, 2004; Hogan et al., 2002a; Storbacka, 2006) or customer equity management (Bell, Deighton, Reinartz, Rust, and Swartz, 2002; Blattberg, Getz, and Thomas, 2001; Hogan, Lemon, and Rust, 2002b; Berger, Bolton, Bowman, Briggs, Kumar, Parasuraman, Ramani, and Varadarajan, 2006; Dibb and Meadows, 2004; Ryals, 2005). A core feature of this research area is the identification of methods to maximize the CLVs of a firm’s customers, thereby increasing the long term value of the customer base, which is referred to as the firm’s customer equity. Various approaches have been suggested, most of them incorporating aspects of efficient use of customer databases, segmentation, forecasting of customer purchase behavior, and effective resource allocation towards optimal customer acquisition and retention. The view of the customer base as a portfolio of customer assets has also gained greater acceptance as a number of researchers have highlighted the importance of taking the risk and expected return of different customers and customer segments into account (Dhar and Glazer, 2003; Ryals, 2003; Tarasi, Bolton, Hutt, and Walker, 2011), during different stages in their relationships (Johnson and Selnes, 2004).

PCM is a research area currently in a state of rapid expansion. A number of empirical studies have examined companies’ CRM efforts (e.g., Bohling, Bowman, LaValle, Mittal, Narayandas, Ramani, and Varadarajan, 2006; Dibb and Meadows, 2004; Ryals and Payne, 2001). Customer profitability and CLV have also been analyzed in several case studies within single companies (e.g., Narayanan and Brem, 2002; Ryals, 2005; van Raaij, Vernooij, and van Triest, 2003). However, with the exception of Ryals’ (2006) study of how ten best-practice global suppliers manage the profitability of their key customer relationships, there is a notable lack of empirical research examining the current practices of firms specifically with regard to the profitable management of customer relationships according to the approaches suggested in the PCM-related literature. Consequently, although Bell et al. (2002) conceptually suggest possible barriers to the adoption of their customer asset management approach, practical obstacles that firms encounter in efforts to implement such an approach have not earlier been studied empirically. This thesis fills this research gap by exploring PCM in the retail banking sector.

The retail banking sector is a particularly suitable context for research on PCM due to the prevalence of sophisticated CRM systems (Krasnikov, Jayachandran, and Kumar, 2009), the frequency of customer contact (Storbacka, 1994), the comparatively long duration of many relationships (Leverin and Liljander, 2006), and the fact that due to customer acquisition costs, it can take several years for customers to break even and
become profitable (Reichheld, 1996), highlighting the importance of CLV measurement. Indeed, retail banking has already proven to be a useful setting in which to investigate various aspects of CRM (e.g., Dibb and Meadows, 2004; Narayanan and Brem, 2002; Ryals, 2005; Ryals and Payne, 2001; Storbacka, 1994, 1997). One would imagine that with the ever increasing data collection, storage, and analysis capabilities (see *The Economist*, 2010a, b), companies should be able to mine customer data more and more effectively, leading to more precise and reliable CLV calculations that in turn could be used to allocate marketing resources in such a way that CE is maximized. However, the connection between marketing theory and practice in this area has not yet been thoroughly investigated, giving rise to two pertinent questions:

- What types of metrics could be useful in measuring the value of customer relationships and in aiding decision making related to PCM?
- Do banks manage customer relationships for profit in the systematic ways suggested by the marketing literature?

This thesis will address these questions conceptually and empirically by covering several topics, including marketing metrics and accountability; challenges in the implementation of PCM approaches in practice; analytic versus heuristic decision making with regard to PCM; and the modification of costly customer behavior in order to increase customer profitability, CLVs, and CE.

### 1.2. Purpose of the thesis

Based on the research gap and research questions identified above, the overall purpose of the thesis is twofold: first, to critically review the concept of customer equity; second, to explore the practical implementation of various aspects of PCM approaches in a retail banking setting. The thesis thereby aims to provide an increased understanding of the potential disconnect between marketing theory and practice in the area of PCM. The findings offer a foundation for further meaningful theoretical development on PCM and for more effective application of PCM-related theories in practice.

The thesis comprises four papers, which together contribute to fulfilling the overall purpose of the thesis. The first paper fulfills the first part of the overall purpose, i.e. to critically review the concept of customer equity. The remaining papers fulfill the second part, i.e. to explore the practical implementation of various aspects of PCM approaches in a retail banking setting. The specific purposes of the individual papers are as follows:

- **Paper 1, “Customer Assets and Customer Equity: Management and Measurement Issues”**: First, based on a review of the customer equity-related literature, to argue the case for a clear distinction between, on the one hand, customer assets; and on the other hand, customer equity. Second, to demonstrate the advantages for external stakeholders of including the actual drivers of customer equity in management commentaries to financial reporting, rather than simply reporting customer equity and its components, and show how this could be done, using a Customer Equity Scorecard.

- **Paper 2, “The Management of Customer Relationships as Assets in the Retail Banking Sector”**: To explore the extent to which retail banks in the Nordic region are currently implementing key aspects of PCM / customer asset management that have been identified in the literature. Based on the
findings, obstacles to the successful implementation of a PCM / customer asset management approach are identified and discussed.

- **Paper 3, “Marketing Decision Making – Fact Versus Rule of Thumb”:** To analyze how marketing decisions related to customer relationship management are actually made, in a retail banking context. Particular focus is placed on the role of customer lifetime value calculations vis-à-vis managerial heuristics with regard to PCM decisions.

- **Paper 4, “Profitable Customer Management: Reducing Costs by Influencing Customer Behavior”:** To investigate how firms attempt to increase the profitability of specific groups of extant customers by achieving adjustments in customer behavior that consequently lead to decreased costs associated with serving these customers. Three methods used in order to change customer behavior will be described, and their success will be assessed based on their impact on customer-related costs and thereby customer profitability, CLVs, and CE.

### 1.3. Delimitations

In spite of the heavy concentration on the financial value of customers in PCM-related research, it is clear that customers are actually worth more (or less) than the “money” they generate for the firm (see Kumar, Aksoy, Donkers, Venkatesan, Wiesel, and Tillmanns, 2010a; Ryals, 2002). Much research has been conducted on word-of-mouth behavior, and Kumar, Petersen, and Leone (2007, 2010b) demonstrate that certain customers’ referral value (CRV) can even be higher than their CLV. In a similar vein, Ryals (2008a) emphasizes the importance of taking the indirect value of customers into account, which includes referrals and reference effects as well as learning and innovation effects. Nevertheless, this thesis constrains itself to empirically investigating those aspects of PCM that are directly related to the financial value of customers to the firm. Indirect value, although relevant, is not explored, for several reasons. The causes, extent, and effects of genuine/spontaneous word-of-mouth are notoriously difficult to measure, and to a great degree outside the control of the firm. Positive word-of-mouth is typically a consequence of favorable customer perceptions and experiences with the provider, which in turn are a result of sustained efforts to maintain a high level of service quality and customer satisfaction in general, rather than being a result of explicitly focusing on achieving positive word-of-mouth in order to for example reduce acquisition costs. Referral programs, on the other hand, do specifically seek to achieve such induced word-of-mouth behavior, and the success of these in reducing acquisition costs and attracting new profitable customers can more easily be measured (see Kumar et al., 2007, 2010b; Schmitt, Skiera, and Van den Bulte, 2011). However, such programs were not implemented by any of the banks studied in this thesis. Finally, with regard to learning and innovation effects, these are more likely to occur in business-to-business settings (see Ryals, 2008a) and could be expected to be a rare phenomenon in a retail banking context.

The field of relationship marketing is extremely broad and multi-faceted. Much research has focused on the customer’s perception of relationships with firms, arguing for example that relationships “should be defined from the customers’ point of view” (Liljander and Strandvik, 1995, p. 163). However, since the focus of this thesis is not on the relationships themselves, but on their management and profitability, the thesis adopts a company (service provider) view of the relationships with customers. The
retail banks studied themselves define when a relationship exists, based on contracts and customer behavior. Consequently, the emotional states of customers and their perceptions regarding the possible existence of a bank relationship are not taken into account. The customer’s view of value creation has been explored extensively in prior research (e.g., Bitner, 1995; Grönroos, 1997b; Khalifa, 2004; Ravald and Grönroos, 1996; Woodruff, 1997; Zeithaml, 1998). This thesis, however, focuses on value from the firm’s point of view, emphasizing the responsibility of marketing to consider the financial value of the customer to the firm (see e.g., Gupta, Lehmann, and Stuart, 2004; Hogan et al., 2002a; Kumar, Dalla Pozza, Petersen, and Shah, 2009; Rust et al., 2004a; Srinivasan and Hanssens, 2009; Wiesel, Skiera, and Villaneuva, 2008).

Finally, the empirical parts of this thesis are limited to a European retail banking context. The study of PCM is further limited to the banks’ relationships with household/personal customers and sole proprietors (in one case). The banks’ management of relationships with larger companies is not explored, as it is beyond the scope of this thesis. Business-to-business relationships, also in banking, are different in nature compared to business-to-consumer relationships, due to for example the size of customers and the types of products and services offered.

1.4. Definitions

Several terms and concepts used in this thesis are the source of some confusion in the marketing literature, as they often are used differently by different authors. The following definitions clarify how a number of concepts are understood in the context of this thesis.

**Customer relationship:** A series of interactions transpiring between a provider and a customer. A relationship does not exist unless more than one interaction transpires between the provider and the customer (see Storbacka, 1994, p. 73).

**Customer management** comprises all of the firm’s (i.e. the provider’s) activities dealing with the entire relationship with a customer (or group of customers), from pre-acquisition contacts until all interaction and communication between the firm and the customer ends. In contractual settings, relationships can be terminated, and following possible attempts by the firm to re-acquire the customer, communication will typically end. In non-contractual settings (and certain contractual settings, such as retail banking), firms may always have a share of the customer, as customers patronize several competing providers, but after a certain period of customer inactivity and failed reactivation by the firm, communication will typically end.

**Customer relationship management** (CRM): Synonymous with customer management. According to the definition of customer management above, customer management is concerned with the management of customer relationships. If only one interaction transpires between the provider and the customer, no relationship exists and no customer management occurs. Hence, since the firm has relationships with all of the customers who are managed by the firm, customer management is considered synonymous to customer relationship management. The question of whether the firm manages the customer or the customer relationship is semantic. In essence, a customer per se cannot be managed; only a part of the relationship with the customer can be managed. That is, the provider can attempt to influence the nature and outcome of the series of interactions with the customer.
Profitable customer management (PCM): The management of customer relationships with an explicit focus on increasing and/or maintaining the profits generated by these relationships over time. Hence, the financial valuation of customers is often a central aspect of such customer management approaches, as firms seek to increase the financial value of its customer base.

Customer assets: The relationships that a firm has with its customers.

Customer equity (CE): The value of a firm’s customer assets.

Customer lifetime value (CLV): The sum of the discounted cash flows the firm expects to receive from the customer over the projected lifetime of the customer's relationship with the firm (see e.g., Dwyer, 1989; Berger and Nasr, 1998). CLV is a measure of the value of an individual customer whereas CE is an aggregate measure of the value of a group of customers or all of the firm’s customers; prospective customers can also be included when calculating CE.

Customer asset management: Synonymous with PCM.

Customer equity management: Synonymous with PCM.

Customer equity-related research: Research on PCM.

1.5. Positioning of the thesis

This thesis deals with different aspects concerning the profitable management of customer relationships. Hence it is clear that the present research falls under the broad umbrella of relationship marketing in general and customer relationship management in particular. In addition, the research on different facets of marketing performance/accountability, including customer profitability, has to a large extent arisen at what has become known as the marketing/finance interface. The following two sections will discuss the positioning of this thesis within these two complementary and partly overlapping research streams (see Figure 1).
1.5.1. *Positioning within relationship marketing*

Grönroos (2004) defines marketing based on a relational perspective as:

> the process of managing the firm’s market relationships, or more explicitly … the process of identifying and establishing, maintaining, enhancing, and when necessary terminating relationships with customers and other stakeholders, at a profit, so that the objectives of all parties involved are met, where this is done by a mutual giving and fulfillment of promises (Grönroos, 2004, p. 101)

This definition thus clarifies the broad scope of relationship marketing, covering relationships between different stakeholders. Much research on business-to-business relationships between different stakeholders in networks has been conducted by scholars associated with the Industrial Marketing and Purchasing (IMP) Group (e.g., Håkansson, Ford, Gadde, Snehota, and Waluszewski, 2009; Holmlund and Törnroos, 1997; Ulaga and Eggert, 2005). Nevertheless, the focus of relationship marketing research has been on customer relationships. Consequently, a large area of research within relationship marketing has become known as customer relationship management (CRM). The development of this research area coincided with rapid developments in database technology and as a result, CRM became heavily associated with the technological aspects of managing customer relationships, especially so-called CRM-systems covering diverse aspects such as the sales process, marketing campaigns, customer service, and analytics. Nevertheless, early failures of many CRM implementations were attributed to the fact that companies tended to implement CRM software solutions before restructuring customer-related strategies and processes within the firm (see Kumar and Reinartz, 2006; Rigby, Reichheld, and Schefter, 2002). Hence, it is worthwhile to reiterate that CRM comprises all of the firm’s activities dealing with the entire relationship with a customer. Technology is only one aspect of
the management of customer relationships, although it increasingly plays an important part.

Grönroos (2004) also points out that the firm should manage its relationships at a profit. In much of the early research on relationship marketing this profitability was assumed to arise as a consequence of high service quality, customer satisfaction, and customer loyalty (e.g., Heskett, Jones, Loveman, Sasser, and Schlesinger, 1994; Reichheld, 1996; Storbacka, Strandvik, and Grönroos, 1994). Subsequently, the strength of these connections has been questioned by a number of researchers, most notably Reinartz and Kumar (2000, 2002), who demonstrated that loyal customers are not necessarily profitable. At the same time, research on CLV and CE flourished. A plethora of CLV models have been developed for the purpose of more accurately measuring the (primarily financial) value of different customers to a firm (see e.g., Berger and Nasr, 1998; Gupta, Hanssens, Hardie, Kahn, Kumar, Lin, Ravishanker, and Sriram, 2006; Jain and Singh, 2002), in order to be able to more optimally allocate resources in order to manage the entire customer base to maximize its CE (see Petersen, McAlister, Reibstein, Winer, Kumar, and Atkinson, 2009). It is within this area of CRM, which focuses on managing customer relationships profitably, that this thesis is positioned. Paper 2, Paper 3, and Paper 4 focus on how retail banks have implemented different aspects of PCM approaches in practice.

1.5.2. Positioning within the marketing/finance interface

The marketing/finance interface is a rather loose research domain, covering a variety of issues concerning the relationship between marketing activities and the firm’s financial performance (Hyman and Mathur, 2005; Srivastava, Shervani, and Fahey, 1998; Zinkhan and Verbrugge, 2000), as well as for example the role of marketing insights in the design of financial products (Pennings, Wetzels, and Meulenberg, 1999) and in understanding and predicting investor behavior (Aspara, Nyman, and Tikkanen, 2009; Hoffman and Broekhuizen, 2009). Nevertheless, in response to the growing concern regarding marketing’s relative lack of influence within the firm at top management and board level (e.g., McGovern et al., 2004), research on marketing accountability has received increasing attention. This is also in line with the Marketing Science Institute's (MSI) research priorities for 2008-2010, where “accountability and ROI of marketing expenditures” tops the list.

In order to demonstrate marketing accountability, it has been suggested that marketers attempt to quantify the value they create in financial terms. Hence, marketing actions should not be seen as costs, but rather as investments in intangible assets such as brands and customer relationships; these investments are expected to have a positive impact on customers, leading to higher brand equity and customer equity, thereby paying off in the long term in the form of improvements in market position and financial position, and ultimately an increase in the value of the firm (Rust et al., 2004a). Key marketing metrics that potentially could be used as a measure of the value created by marketing activities are thus brand equity and customer equity, where it has been suggested that customer equity has replaced brand equity in firms that have shifted from a product focus to a customer focus (Hogan et al., 2002b; Rust, Zeithaml, and Lemon, 2004c). Other researchers, meanwhile, point out that customer equity and brand equity are complementary, albeit to some extent overlapping concepts (Ambler, Bhattacharya, Edell, Keller, Lemon, and Mittal, 2002; Leone, Rao, Keller, Luo, McAlister, and Srivastava, 2006). Nevertheless, with regard to quantitatively reporting the value created by marketing to external audiences, such as investors, customer
equity is the metric that has received the most high-profile recognition in the marketing literature (Wiesel et al., 2008). It is within this area of marketing accountability that this thesis is positioned. Paper 1 focuses on the distinction between customer assets and customer equity, and the importance of understanding not only the components of customer equity, but also its drivers. Paper 3, meanwhile, discusses how the use of managerial heuristics in marketing decision making may undermine the case for marketing accountability. Finally, Paper 4 suggests that a greater marketing focus on the management of customer-related costs may provide marketers with a more responsible and credible voice within the organization, with regard to demonstrating marketing accountability.

1.6. Structure of the thesis

This thesis is structured as follows. In Part 1, this introductory chapter has identified the research problem, stated the purpose of the thesis and its component papers, and discussed the delimitations, key definitions, and positioning of the research. Chapter 2 provides the theoretical background of the thesis, based on PCM. The third chapter discusses the methodology, as well as the ontology and epistemology. Chapter 4 provides a summary and describes the contribution of each of the four papers. The final fifth chapter of Part 1 discusses the overall contribution of the thesis. Part 2, meanwhile, consists of the four papers that form the foundation of this thesis.
2 PROFITABLE CUSTOMER MANAGEMENT

The idea that customers or customer relationships are valuable firm assets is by no means new. Bursk (1966, pp. 92-93) states that “... the fact is that customers do represent assets built up over time; and, from this point on, costs incurred to improve these assets are like capital expenditures...”. Levitt (1983, p. 91) claims that “... a company’s most precious asset is its relationships with its customers”. Wayland and Cole (1994) describe an approach referred to as customer franchise management, which is based on the notion that “a company can out-perform its industry’s average by better managing its portfolio of customer assets”. Cravens et al. (1997, p. 497), meanwhile, declare that “… satisfied customers are assets who represent long term value to an organization”. Anderson, Fornell, and Lehmann (1994) also state that customers can be considered to be assets to the firm, and present an equation for the measurement of current customers’ net present value. Furthermore, in the framework proposed by Srivastava et al. (1998), customer relationships are included as one type of market-based asset that should be developed and managed to increase shareholder value. Buyer-seller relationships have also been identified as an example of a firm’s strategic assets (Amit and Schoemaker, 1993). Recently, research in marketing has, in addition to recognizing the value of customer relationships, increasingly focused on developing frameworks to quantify the returns generated by customer relationships as a result of marketing actions (Kumar and Petersen, 2005; Rust et al., 2004a, b; Sheth and Sisodia, 2002). The concept of customer equity (Blattberg and Deighton, 1996; Rust, Zeithaml, and Lemon, 2000) has thus emerged alongside brand equity (Aaker, 1992; Keller, 1993), in line with a similar conceptual development suggested by Liljander and Strandvik in a service context (1995, p. 164), who proposed that “… relationship equity should be defined as the differential economic value of the customer’s response to the service firm. From a managerial point of view, relationship equity thus represents an interesting factor to measure and monitor.”

Several researchers have developed models or frameworks for the attraction and retention of valuable customers (e.g., Berger et al., 2002; Berger and Nasr, 1998; Blattberg and Deighton, 1996; Reinartz, Thomas, and Kumar, 2005). Blattberg and Deighton (1996) propose CE as a criterion for determining the optimum balance between a company’s customer acquisition and retention spending. They measure CE by first measuring the expected profit from each customer over the customer’s expected lifetime. The expected profit is then discounted by the required rate of return to a net present value, resulting in a basic form of the CLV. The total CE is subsequently calculated by adding together the discounted, expected profits from all of the firm’s current customers. Blattberg and Deighton (1996) also put forward several guidelines with regard to how CE should be maximized. They mention investment in the highest-value customers first, add-on sales and cross-selling, reduction of acquisition costs, tracking of changes in equity against marketing programs, relation of branding to CE, monitoring of customers’ intrinsic retainability, and separation of acquisition and retention activities. These aspects are also discussed in subsequent research where the common theme is the view of customers as assets or equity of the firm.

The field of CRM thus incorporated concepts such as customer asset management (e.g., Berger et al., 2002; Bolton et al., 2004) and customer equity management (e.g., Bell et al., 2002; Hogan et al., 2002b). Various approaches have been taken in the conceptual development of these concepts. Rust et al. (2000) describe value equity, brand equity, and relationship (or retention) equity as three components that constitute CE. Blattberg et al. (2001), meanwhile, integrate aspects of customer relationship
management, database marketing, and customer satisfaction within a customer equity framework. They advocate a number of key changes to marketing strategy, such as managing customer lifecycles; organizing around customer acquisition, retention, and add-on selling; and balancing marketing costs against financial returns. Berger et al. (2002) present a framework for customer asset management that incorporates four components: creation of a comprehensive customer database, segmentation of the customer base, forecasting of CLV, and resource allocation. These aspects are indeed vital, and appear in some form in most of the literature dealing with PCM. Although no industry-specific PCM framework has yet been proposed, a framework for service organizations has been developed, which relates the length, depth, and breadth of customer relationships to the value of customer assets (Bolton et al., 2004).

In recent years, the concepts “customer asset management” and “customer equity management” have virtually ceased to appear in the marketing literature, where researchers instead use a variety of concepts, such as “the customer equity paradigm” (Villanueva and Hanssens, 2006), “CRM strategies based on the CLV metric” (Kumar et al., 2009), and “a customer equity (CE)-based framework” (Kumar and Shah, 2009). The common theme is thus reliance on CLV and/or CE as a basis for the CRM strategy. Various models and frameworks based on CE have been proposed, taking different aspects into account, such as brand switching (Rust et al., 2004b), the customer acquisition process (Villanueva, Yoo, and Hanssens, 2008), or using only publicly available data (Gupta et al., 2004). A number of studies have applied Rust et al.’s (2004b) CE models in different contexts such as retailing (Vogel, Evanschitzky, and Ramaseshan, 2008) and the cell phone operator market (Sublaban and Aranha, 2009). Kumar and George (2007) discuss different distinguishing features with regards to the measurement and maximization of CE using various aggregate- and disaggregate-level approaches. They also propose a hybrid approach, which allows firms to select an appropriate approach or different combinations, based on the objectives of customer valuation and the consequent data requirements.

One of the key differences between PCM approaches based on CLV/CE and traditional CRM is identified by Kumar et al. (2009), who present a framework that “reverses the logic of the conventional path to profitability”. They claim that established assumptions regarding the links between customer satisfaction, loyalty, retention, and profitability (e.g., Anderson and Mittal, 2000; Heskett et al., 1994; Reichheld, 1996) will lead firms to allocate unnecessary resources to unprofitable customers. Instead, firms that take CLV as the point of departure when making CRM decisions will achieve differential loyalty and satisfaction based on a more efficient allocation of resources. Rather than rewarding all customer purchases equally in the hope of achieving loyalty and profitability across the customer base, customers are rewarded based on their profitability, thereby satisfying different customers to different extents in order to increase the retention rate of the most profitable customers. Several studies have also suggested that the customer base should be viewed as a portfolio of customer assets, and that this entire portfolio must be managed properly, taking into account the risk and expected return of different customers and customer segments (e.g., Dhar and Glazer, 2003; Ryals, 2003; Tarasi et al., 2011).

2.1. Customer portfolios

Marketing literature advocating the notion of customer portfolios has developed as a sidetrack to research on CE, but clearly falls within the scope of PCM. Classic portfolio theory demonstrates that by considering financial securities in relation to each other as
parts of a portfolio, optimum portfolios matching a desired level of risk and expected return can be constructed (Markowitz, 1952; Sharpe, 1963). Within a marketing context, the idea of portfolios has mostly been used in a metaphorical sense, for example to emphasize the need to maintain a diverse network of customer and supplier relationships (e.g., Cunningham and Homse, 1982; Fiocca, 1982; Homburg, Steiner, and Totzek, 2009; Nenonen, 2009; Terho and Halinen, 2007; Zolkiewski and Turnbull, 2002). Johnson and Selnes (2004), meanwhile, describe a firm’s portfolio of customers by focusing on the stage of a customer’s relationship with the firm. They argue that although customers that have close relationships with a firm in some cases may be the most profitable, customers with weak relationships to the firm often dominate the customer base and contribute to profit by allowing economies of scale. Therefore, individually unprofitable relationships may create value on a portfolio level.

However, in addition to these metaphorical applications of the concept of portfolios, research on business portfolio analysis (Larréché and Srinivasan, 1981, 1982), product portfolios (Cardozo and Smith, 1983; Cardozo and Wind, 1985; Leong and Lim, 1991), retail format portfolios (Brown, 2010), and market segment portfolios (Ryals, Dias, and Berger, 2007) has attempted to more closely apply the notion of risk and return as advocated by financial portfolio theory. Furthermore, in spite of certain objections toward the use of portfolio theory in marketing decisions (Devinney, Stewart, and Shocker, 1985), this possibility has recently been afforded increasing attention in relation to CLV (Buhl and Heinrich, 2008; Dhar and Glazer, 2003). Dhar and Glazer (2003) assert that if the customer base is viewed as a portfolio of assets, it is not sufficient for firms to consistently allocate resources towards acquiring customers with lifetime values that are expected to exceed acquisition costs. The rationale behind this statement is that a customer base comprised of too many high lifetime value customers may burden the company with an unacceptable degree of risk. From a company standpoint, large cash flows from customer relationships are naturally attractive, but if they are highly volatile, it makes sense to balance them with less volatile cash flows. The aim, as when an investment portfolio is constructed of for example stocks and bonds, is to reach a point on the so-called efficient frontier, where the greatest possible return on investments in customer relationships is achieved, corresponding to a given level of risk. From a portfolio perspective, the risk of a customer relationship can be expressed in the form of a customer beta, reflecting the correlation of a customer’s returns to that of the overall customer portfolio (Dhar and Glazer, 2003; Hopkinson and Yu Lum, 2002; Tarasi et al., 2011).

As the concept of portfolios has been brought into the literature on PCM, we must understand that the analogy of the customer relationship as an asset not only remains on the balance sheet as an investment decision, but also moves into the arena of capital markets and the management of portfolios of securities. The risk and return of investments in customer relationships thus receives another dimension as the contribution of a customer relationship to the volatility of the entire portfolio of customer relationships is considered (see Dhar and Glazer, 2003; Hopkinson and Yu Lum, 2002; Ryals, 2003; Tarasi et al., 2011).

The general area of research on PCM, however, is still at an early stage of development. This is demonstrated by the rapid growth in the number of studies on PCM over the past few years, which has been accompanied by the emergence of certain problems concerning the usage of terms and definitions of concepts. The following section will detail a number of the issues that have given rise to a measure of confusion.
2.2. Differential usage of key terms in research on profitable customer management

A review of the literature on PCM reveals that the usage of the following terms is inconsistent, thereby potentially causing for example arguments and metaphors to falter: managing *customers* and *customer relationships* (as assets); *profit* and *profitability*; and customer *asset* management and customer *equity* management. Each of these terms will be addressed in turn.

Although the term “customer management” is increasingly used (e.g., Grönroos, 2007; Kumar and Shah, 2009), it can be assumed that “management” actually refers to the management of interactions with customers, i.e. the management of customer relationships (see section 1.4). Frow and Payne (2009), meanwhile, choose to distinguish between “customer relationship management” and “customer management”, stating that customer relationship management is the “strategic management of relationships with customers, involving appropriate use of technology”, whereas customer management is the “implementation and tactical management of customer interactions”. Nevertheless, according to the definition of a customer relationship presented in section 1.4 of this thesis, Frow and Payne’s tactical customer management also involves the management of customer relationships. In the present research, customer management refers to both strategic and tactical aspects of the management of customer relationships.

Concerning the concept of customers / customer relationships as assets, with regard to the unit of analysis, sometimes customers are described as assets (Berger et al., 2002; Bolton et al., 2004; Gupta and Lehmann, 2003, 2005), sometimes customer relationships are described as assets (Srivastava et al., 1998), and often, as in the present research, these two entities are used interchangeably (Blattberg et al., 2001; Hogan et al., 2002a, b; Ryals, 2002). Referring to customers as assets is feasible for the sake of simplicity, but based on the definition of a customer relationship in the present research (see section 1.3), it is clear that actually the *customer relationships* are assets, not the *customers* themselves. There are a number of reasons for noting this distinction. First, the notion of a customer as an asset becomes dubious, because although ownership of a tangible asset can be claimed by a company, this cannot be done with respect to a customer (Rust et al. 2004a; Ryals, 2002). A customer can most often defect at any time, unless there is a contract in place, but even contracts can be renegotiated or terminated. On the other hand, based on this thesis’ understanding of what a relationship constitutes, it is quite reasonable for a firm to claim ownership of at least part of a customer relationship. That is, since a relationship necessarily consists of two-way interactions, both parties in the relationship are partial “owners” of the relationship. Both parties also expect present and future value to be generated as a result of investments they make in the relationship. Firms expect to for example increase the lifetime values of customers by achieving greater loyalty and more profitable behavior through various measures. Customers, meanwhile, may expect a diverse set of tangible and intangible benefits as a reward for their loyalty and purchasing behavior.

Alternatively, on the issue of relationship ownership, Hunt (1997) argues that entities must not necessarily be owned by a firm in order to be considered resources. According to resource-based and resource-advantage theory, entities may be described as firm resources if they are simply *available* to the firm. However, Hunt (1997) still maintains that it is the customer relationship that is the resource which is available to the firm, and not the customer him/her/itself. In support of this standpoint, Srivastava et al.
describe how a relational asset fulfills the four resource-based tests for competitive success, namely that it is: (1) convertible; (2) rare; (3) imperfectly imitable; and (4) does not have perfect substitutes. Emphasizing the relationship as the unit of analysis appears to be reasonable also by serving as a reminder to both marketing practitioners and academics that customers are not solely “cash-flow generators”. If customers themselves are considered to be assets, this creates an illusion that customers are static and inactive parties that can simply be managed by placing them in different segments and exposing them to different strategies. However, customers are clearly an active part of the relationship with a firm, especially in service industries, although the balance of power is certainly a factor with regards to who is in a position to maintain and reap more benefits from this relationship. From a company (provider) perspective, the fact remains that a customer (or possibly the provider) can choose to terminate a relationship at any time, but pieces of it may remain in the form of customer information or “memories” (see Storbacka and Lehtinen, 2001). These relationship memories can also be seen as assets, as they can provide insights as to how the customer relationship can be re-established, or how to avoid this type of customer defection in the future.

The term “relationship marketing” was coined by Berry (1983) and relationships have naturally been a fundamental part of business and “marketing” since ancient times (see Grönroos, 1997a). However, a more recent development is the usage of terms in marketing that originate from the fields of accounting and finance, and which appears to have created a degree of confusion at times. The crucial distinction between customer profitability and customer lifetime value is thoroughly addressed by Pfeifer, Haskins, and Conroy (2005), who state that profit stems from accounting, and is an arithmetic calculation of revenues minus costs for a specific time period, whereas value originates in finance, where the value of an asset is determined by the present value of its future cash flows. Furthermore, Thomas (2004) succinctly articulates, from an accounting point of view, how profit and profitability differ:

Profit is a figure in absolute terms... It is calculated by taking the income earned and deducting the expenses incurred in deriving that income. Profitability on the other hand is a measure of the profit compared to a number of relevant factors. (Thomas, 2004, p. 35)

Thus profitability is a relative figure which is expressed as a percentage relating profit to for example sales revenue. The distinction between economic profit and accounting profit, meanwhile, is explained clearly by Doyle (2000):

Economic profit differs from accounting profit in that it does not deduct just the interest on debt, but instead deducts a charge for all the capital employed in the business. (Doyle, 2000, p. 45)

Thus, the return on the capital invested in customer relationships must exceed the firm’s cost of capital in order for value creation (for the firm) to occur. Furthermore, the inherent risk of various customer relationships, including for example credit or attrition risk, should be taken into account if the value generated by these relationships is to be accurately measured (Ryals and Knox, 2005).

Finally, the theoretical basis of the management of customer relationships as assets or equity of a firm may seem straightforward, but the two concepts “customer asset management” and “customer equity management” sometimes appear interchangeably in the literature. To be sure, they refer to the same underlying ideas, but the field of finance may offer some clarity. Assets here traditionally appear on the left hand side of the balance sheet and are related to the investment decision, i.e. how funds should be allocated over time in order to increase shareholder wealth. Equity, alongside
liabilities, appears on the right hand side of the balance sheet and is related to the financing decision, i.e. how to generate funds. Using the analogy of customer relationships as assets, it can be said that firms invest in these relationships in order to create value for the shareholders, i.e. equity. Hence, it seems more appropriate to refer to the management of customer (relationship) assets [in order to maximize customer (relationship) equity] rather than to refer to the management of customer equity itself. In other words, customer relationships themselves are the assets and customer (relationship) equity is simply a measure of their value. Maintenance of such a position enables avoidance of the confusion that may occur when the term “customer equity” is used to refer both to the customer (relationship) asset and to the value of that asset (see Brodie, Glynn, and Little, 2006, p. 367; Rust et al. 2004a, p. 78)

2.3. Investments in customer relationships

Traditional definitions of relationship marketing (e.g., Grönroos, 2004) emphasize the importance of meeting the objectives not only of the firm, but also of the customers and other stakeholders, thereby creating value for all involved parties. Clearly, sustainable firm (and shareholder) value cannot be created if customers, employees, and other stakeholders do not receive acceptable value from their relationships with the firm. Without satisfied customers and employees, and a society at large that approves of a firm’s general practices, a firm might soon find it difficult to attract and retain customers, employees, and investors, meaning that profitability and shareholder value will consequently suffer.

However, although the importance of the stakeholders already mentioned, as well as numerous others, is acknowledged, the focus of this thesis is on the firm itself (including its owners, i.e. shareholders for publicly listed firms) and its customers. Thus, it is beyond the scope of this thesis to examine the creation of value for employees and other stakeholders. As this thesis deals with the management of customer relationships, however, the intricate topic of customer value must at least be touched upon. In a business-to-business context, Grönroos (2009a) states:

> Although the supplier’s role is to support their customers’ value creation, the reason for doing this is to be able to capture value from these business engagements for themselves. (Grönroos, 2009a, p. 5)

This thesis focuses on the management of customer relationships in the business-to-consumer context of retail banking but takes a corresponding view, namely that creation of customer value is not an aim in itself, but rather a method of increasing the value of selected customer relationships to the firm, thereby also increasing shareholder value.

Since it is recognized that customers provide essential cash flows to the firm over time, a customer orientation appears to be crucial for the profitable management of firms, especially within service industries. In addition, survival of a firm is contingent on sustainable competitive advantage, i.e. consistently being able to create value for and satisfy the needs of target customers more effectively and efficiently than the competition. Thus, marketing strategies aiming to achieve sustainable advantage through satisfied customers and long term relationships fit well with an approach based on maximizing long-run shareholder value (Day and Fahey, 1988). These ideas are in line with value-based marketing as described by Doyle (2000) and captured in his clarification of the fundamental principle of capitalism, namely that customer value creates shareholder value (p. 70).
The very notion of customer relationships as assets (on a balance sheet) implies that investments are made in customer relationships. However, investments are never made for their own sake, but only if the return on these investments is expected to exceed a pre-specified acceptable rate of return, which at a minimum must cover the cost of capital. Hence, we see that the rationale for investing in customer relationships is the expectation of returns in the form of increased future profit streams from the customer relationships, either through higher relationship revenues, lower relationship costs, longer-lasting customer relationships (see Storbacka, 1994), or lower risk (see Ryals and Knox, 2005, 2007). On the other hand, investments in customer relationships also imply that the customers themselves should experience that their relationship with the firm increases in value; indeed this would appear to be a prerequisite if lifetime value aggregated across the customer base (i.e. CE) is to be maximized. Certain relationship investments made by firms may in reality not be perceived by customers as creating value. However, investments in customer relationships should ideally create value not only for the firm, but also for its customers, if not in the short run, at least in the long run. For example, retail bank customers may view attempts by the bank to shift customers’ usage of expensive channels (such as branch offices) to cheaper channels (such as the internet) as poor service, especially if service fees are used to achieve such a shift. However, rather than pressuring customers to adopt another channel, the bank could strive to provide such efficient and effective internet services that customers perceive usage of this channel to provide enhanced value through for example time savings, simplicity, and even a lower (or zero) fee. In essence, there are two sides of customer value: the value provided by the firm to its customers, which is the investment in customer relationships; and the value provided by customers to the firm, which is the return on the investment (see Gupta and Lehmann, 2005).

Thus, firms need to identify investment opportunities for particular customer relationships (or groups of customer relationships) that are expected to improve customer value in such a way that the customers respond in a profitable manner. Furthermore, this change in customer behavior as a result of the investment should be profitable enough to generate expected returns on the investment that exceed the required rate of return. Consequently, certain customers (or groups of customers) will at different points in time receive greater investments than others.

Firms are continuously faced with making decisions regarding how large investments should be made in different types of customer relationships. Firms are naturally constrained since they operate in markets where resources (e.g., capital) are scarce, but a fundamental point of business operations is to invest these resources so that they deliver an acceptable rate of return. Morgan and Hunt (1999) point out that resources only result in a truly comparative advantage if the cost of acquiring them is lower than the gains they generate. In essence, firms seek to maximize returns on their investments in order to maximize shareholder value (subject to certain limitations), thereby attracting future capital and securing the firm's survival (Rappaport, 1986).

Investments in customer relationships are usually seen as expenditures, regardless if they pertain to marketing activities, personnel training, product/service development or other areas. However, as Selden and Colvin (2003) point out, any capital spent today that is expected to pay off in the future in the form of profit streams from customers, should be viewed as an investment. In the same vein, Anderson (1981) states that a long run investment perspective is inherent in the marketing concept. Lukas, Whitwell, and Doyle (2005, p. 418) mention the lagged effects of most marketing investments and suggest that “treating these expenditures as accounting costs is a dead end for marketers”. Similarly, Rust et al. (2004a) consider marketing expenditures as
investments and claim that “... marketing assets represent a reservoir of cash flow that has accumulated from marketing activities but has not yet translated into revenue” (p. 78). In effect, firms invest their limited resources in marketing as well as other activities to establish, maintain, and enhance relationships with customers, in order to maximize the return on these investments in the form of maximized CLVs and CE.

Since the firm is subject to resource constraints, the path to value maximization is through an optimization of resource allocation to different customer relationships, such that maximum return on the invested resources is generated (Rust, Zahorik, and Keiningham, 1995; Streukens, van Hoesel, and de Ruyter, 2010). Thus, although value for the customer and value for the firm are inextricably linked, they obviously do not correlate perfectly. In fact, in many cases, in order to increase the profits generated by a customer relationship (or convert a negatively profitable relationship into a positively profitable one), a firm may have to re-allocate resources in such a manner that the customer actually perceives a decline in value. Nevertheless, as discussed in the banking example above, long term strategies typically strive to increase value to the firm by increasing value to the customer. Additionally, in certain cases (especially in business-to-business relationships), the customer could be made aware of the problems that are driving the negative or low profitability, and the firm and the customer could subsequently jointly invest in the development of a mutually beneficial plan that improves value for both parties. This is in line with the view of the customer as a co-producer (Prahalad and Ramaswamy, 2000; Vargo and Lusch, 2004) or co-creator (Grönroos, 2008, 2009b; Vargo and Lusch, 2008) of value.

In summary, a PCM approach seeks to maximize CE by optimizing the allocation of investments in customer relationships. The aim is thus to maximize firm (and shareholder) value through an optimization of customer-perceived value, given the limitation of scarce resources. Hence, in accordance with contemporary financial theory (e.g., Brealey, Myers, and Allen, 2006), the goal of a firm is the maximization of shareholder wealth through the utilization of scarce resources to optimize value for customers and other stakeholders. The optimal value for customers is achieved by allocating resources to different customer relationships in such a way that long term shareholder value is maximized.

2.4. Marketing accountability and customer equity

“Marketing needs to be accountable now. Marketing accountability is long overdue. The time is now to go forward and take action.” (Stewart, 2009, p. 642) This plea for marketing accountability is taken from David W. Stewart’s plenary address to the Society for Marketing Advances, but similar calls for action have been appearing more and more frequently over the past decade, both from marketing academia (e.g., Doyle, 2000; McGovern et al., 2004; Rust et al., 2004a) and from companies (McDonald and Mouncey, 2009; Dunn and Halsall, 2009).

From an academic perspective, an increasing number of marketing researchers have recognized the need for marketing to become financially accountable, in order to at least defend its position within companies, but optimally to gain greater influence and acknowledgement of its strategic importance. Much of the research on the effectiveness of marketing has emerged within a research stream labeled the marketing/finance interface, which has been the topic of two notable special issues in the Journal of Business Research, 2000 and the Journal of the Academy of Marketing Science, 2005. Other recent special issues relating to this topic include linking marketing to financial
performance and firm value (Journal of Marketing, 2004); return on marketing investment (Journal of Strategic Marketing, 2007); the marketing/accounting interface (Journal of Marketing Management, 2008); and “Marketing Strategy Meets Wall Street” (Journal of Marketing, 2009). In addition, the accounting discipline appears to be showing a renewed interest in marketing-related intangible assets, as evidenced in a special issue on intangibles (Accounting and Business Research, 2008).

From a practitioner perspective, meanwhile, CEOs seem to lament marketers’ lack of fluency in the language of finance (McDonald and Mouncey, 2009, p. 2). At the same time, marketing executives reportedly admit this shortcoming while conceding the importance of being accountable. According to one survey of senior marketers, 67% of CMOs (Chief Marketing Officers) considered calculating marketing ROI (Return on Investment) important, but 60% were dissatisfied with their ability to measure these returns (Dunn and Halsall, 2009, p. 8). Thus, there is an apparent risk that marketing executives will be outmaneuvered by finance executives, who can apply their financial skills to make decisions on PCM. Indeed, an article in CFO Magazine has already suggested that CFOs (Chief Financial Officers) should adopt the role of Customer Profitability Managers as well: “By pinpointing your profitable customers and looking for more ways to serve them, you may be able to coax new life into the bottom line.” (Hyatt, 2009, p. 50)

The following two sections will provide a review of the topic of marketing accountability and its relation to CE, from the marketing and finance perspectives, respectively.

### 2.4.1. The marketing perspective

From a marketing perspective, the drivers of firm value are market-based assets, marketing capabilities, and marketing actions that leverage these assets and capabilities (Hanssens, Rust, and Srivastava, 2009). In research on marketing accountability, marketing academics have focused on aiming to connect marketing investments in customer relationships, brands, and other off-balance sheet intangible assets to the generation of shareholder value (Grönroos, 2003; Kumar and Shah, 2009; Lukas et al., 2005; Rese and Wulfhorst, 2009; Rust et al., 2004a; Ryals, 2008a; Stahl et al., 2003). In particular, there has been a rapid growth in the number of studies on PCM over the past few years (see Kumar, Lemon, and Parasuraman, 2006), tackling the issues of measuring the value of customer relationships and of managing these relationships in order to maximize their value.

Most of the research on CE has been concerned with measuring CE for internal management purposes (e.g. Berger et al., 2002; Blattberg and Deighton, 1996; Bolton et al., 2004; Reinartz et al., 2005; Rust et al., 2004b; Ryals, 2005; Venkatesan and Kumar, 2004). The focus of CE calculations in this context is to facilitate decision-making with regard to optimal resource allocation in the management of different customer relationships. However, CE is increasingly suggested as one of the key metrics, alongside brand equity, in the quest for demonstrating marketing accountability. For example, Berger et al. (2006) note that CE would be of interest to the financial market and investors for firm valuation purposes. In line with this, Wiesel et al. (2008) make a case for including CE statements in the management commentaries of firms’ financial reports. They propose that the CE statements should include the value of the customer base, including the components of CE and changes in value over time (see also Blattberg et al., 2001). The reported aim of including these statements is not only to demonstrate marketing accountability to top management,
but also to answer the calls from the finance community (e.g., Cañibano, García-Ayuso, and Sanchez, 2000; IASB, 2005; Lev, 2001; Whitwell, Lukas, and Hill, 2007) for more transparency in financial reporting of intangible assets in order to assist investors’ decision making.

Nevertheless, a number of marketing scholars have voiced concerns regarding the accuracy and practical usability of discounted cash flow (DCF)-based marketing metrics, such as CLV and CE (Malthouse, 2009; Malthouse and Blattberg, 2005). Ambler (2006, p. 27) objects to the use of such measures as “silver metrics” on five grounds:

1. DCF calculations, at different points in time, confuse variances in performance with variances outside management control.

2. Variances vs. forecast might be due to performance and/or poor forecasting, and the two cannot be distinguished.

3. Using DCF takes credit today for marketing activities in the future, which (obviously) have not yet happened and certainly should not be included in the evaluation of past performance. For example: poor short-term performance (which is what we’re evaluating) might bring about changes for which no short-term credit should be taken.

4. We can estimate the future in various ways, but we cannot measure it.

5. If forecasts are used for performance assessment, then those being assessed—and the assessors—might have difficulty judging the forecasts’ reliability, given the moral hazard associated with their generation. (Ambler, 2006, p. 27)

Ambler’s observations in addition to recent findings indicating that the winning model of a high-profile CLV competition was “typically off by a multiplicative factor of 5.4” (Malthouse, 2009, p. 275) undoubtedly raise question marks regarding the appropriateness of measuring marketing effectiveness using CLV and CE. Nevertheless, Ambler and Roberts (2008) concede that these measures might be useful for planning and could be included in a set of multiple performance metrics forming a dashboard. However, if CLV cannot be used as a basis for efficient marketing resource allocation, there is a risk that marketers will continue to base customer management decisions on heuristics, or rules-of-thumb, and will only use CLV for post hoc rationalization of decisions. The merits of managerial heuristics were recently highlighted by Wübben and von Wangenheim (2008), who found that relatively simple heuristics work as well or better than complex stochastic models for prediction of active/inactive customers, most valuable future customers, and future purchases at the overall customer base level. These findings potentially undermine the case for marketing accountability, reiterating that marketing is an imprecise discipline.

2.4.2. The finance perspective

From a finance perspective, the academic research touching on issues related to marketing accountability is primarily concerned with measuring the value of intangible assets, which is value that to a large extent is associated with the effects of marketing activities. There have been numerous calls for more transparency in financial reporting of intangible assets in order to assist investors’ decision making (e.g., Cañibano et al., 2000; IASB, 2005; Lev, 2001; Whitwell et al., 2007). Issues concerning the valuation of intangible assets were once again brought into the limelight with the International Accounting Standards Board’s (IASB) 2004 publication of the IFRS 3 statement on business combinations. IFRS 3 requires that, in the case of corporate acquisitions, both
tangible and intangible assets be restated at their market values when accounting for the acquisition. However, although customer-related intangibles are one of the five categories of intangible assets recognized by IFRS 3, the well-established marketing metrics, CE (Blattberg and Deighton, 1996) and CLV (Dwyer, 1989; Kotler, 1974, p. 24), have not sparked any noticeable attention within the finance community (Gleaves, Burton, Kitshoff, Bates, and Whittington, 2008).

One reason for the finance community’s apparent lack of interest in marketing metrics such as CE and CLV may be the evident fragmentation in the marketing literature. Jain and Singh (2002) point out that customer profitability (CP), CLV, and CE are often not recognized as distinct concepts. Pfeifer et al. (2005, p. 13) argue that “many people use these terms interchangeably and loosely. ‘Customer value’ becomes ‘profit’, which becomes ‘company’s profit’”. Gleaves et al. (2008, p. 836) concur, stating that:

the actual usage of the term CP varies considerably and, especially in the marketing literature, there are additional terms, which can become blurred with CP including the terms CLV and CE which should have very specific meanings. There is also some vague use of costing terms in the marketing literature where collaboration with management accounting (MA) specialists should lead to greater clarity.

Thus, terminological confusion in the marketing field, which was also mentioned previously in section 2.1.2., has hindered the acceptability of key customer-related marketing metrics as far as finance academics and practitioners are concerned (Gleaves et al., 2008). With regard to the terms CP, CLV, and CE, and their calculation, Gleaves et al. (2008, p. 839) claim that “the marketing literature suggests, from an accountant’s perspective, a lack of understanding and clear use of such terms”.

Although the concept of customer profitability has received some attention in the management accounting literature (Bellis-Jones, 1989; Foster and Gupta, 1994; Foster, Gupta, and Sjoblom, 1996; Guilding and McManus, 2002), the lack of finance interest in CLV and CE appears to be due to reservations regarding the reliability of these measures. For example, Weir (2008, p. 805) states that “what can readily be seen from this is that it becomes increasingly complicated to determine a CLV figure, and that the metric itself becomes ‘messier’ as it becomes more steeped in financial calculus”. Thus, the called-for collaboration between marketing and the accounting and finance disciplines (Gleaves et al., 2008; Weir, 2008) appears to be a prerequisite to the development of customer valuation measures that will be accepted as reliable enough for financial reporting purposes.

Nevertheless, the finance community is not necessarily primarily craving CLV-type metrics. For example, Wyatt (2008, p. 244) calls for more background information on the processes leading up to the effects of marketing: “understanding how customer loyalty is generated and destroyed in different industries is a pre-requisite for identifying value-relevant information on customer loyalty”. Similarly, Sidhu and Roberts (2008, p. 682) emphasize the need for disclosure of more meaningful customer-related information: “from a financial analyst perspective, intermediate constructs must be related to value downstream and marketing activity upstream”. The inclusion of such intermediate constructs in the management commentaries of firms’ financial reports is also mentioned in the IASB discussion paper on management commentaries, published in 2005. Examples of customer-related measures are:

- customer satisfaction levels (§§ 121, 130 and 135);
- risks related to customers (§ 128);
• customer loyalty (§ 138);
• penetration (number of products purchased per customer) (§ 138);
• customer churn rates (§ 146);
• acquisition costs (§ 146);
• average revenue per user (§ 146).

Furthermore, the appendix to the discussion paper (IASB, 2005, § A42) states that

management should include information about key relationships the business has in place, how they are likely to affect the performance and value of the business and how they are managed.

Thus, the finance community is calling for the inclusion of a diverse set of customer metrics in management commentaries on financial reports. Some parts of the finance community even appear to prefer qualitative customer information rather than quantitative customer metrics. For example, in a response to IASB 2005, the Austrian Financial Reporting and Auditing Committee (AFRAC) state that

companies should not be obliged to present quantitative forecasts or give projections, but they should present information about those aspects and events for the year under review that could be relevant in assessing future prospects. Forward-looking information should focus on qualitative information. (AFRAC, 2006, p. 3)

In summary, this chapter has reviewed the literature on PCM that serves as a background to the conceptual and empirical research of this study, which is documented in the following chapters and in the four papers comprising Part 2 of this thesis. The following two research questions will be addressed:

• What types of metrics could be useful in measuring the value of customer relationships and in aiding decision making related to PCM?

• Do banks manage customer relationships for profit in the systematic ways suggested by the marketing literature?
3 RESEARCH METHODOLOGY

This chapter will first outline the ontological, epistemological, and methodological assumptions of this thesis. Next, the methods used to collect and analyze the empirical material will be reported. Finally, the reliability and validity of the research will be discussed.

3.1. Ontological assumptions

The ontological approach of this thesis fits most closely into the realm of realism. Ontological realism considers reality to exist independently of any of our thoughts about it or perceptions of it (Potter, 2000). In the present research on the activities retail banks engage in to profitably manage their customer relationships, reality is considered to exist independently of the minds of the people involved in the customer management process, i.e. managers, various other employees within the organization, and customers themselves. This reality is manifested through objectively verifiable actions, such as deposits, withdrawals, investments etcetera. In essence, PCM must consider the predictable and rational (i.e. objective) behavior of all parties involved in the customer management process separately from their emotional (i.e. subjective) attitudes; both of these aspects affect the relationships between customers and the bank, and how they should be managed.

3.2. Epistemological assumptions

The epistemological approach of this thesis is also based on realism. Scientific realism can be seen as an overarching theory, stating that scientific practices are successful in producing relative knowledge about the nature of reality, and that the attempt to produce such knowledge is the only way to make scientific practices comprehensible (Potter, 2000). According to Hunt (1990), scientific realism comprises four tenets:

  ...(1) the world exists independently of its being perceived (classical realism), (2) the job of science is to develop genuine knowledge about that world, even though such knowledge will never be known with certainty (fallibilistic realism), and (3) all knowledge claims must be critically evaluated and tested to determine the extent to which they do, or do not, truly represent or correspond to that world (critical realism) (Hunt, 1990, p. 9).

Hunt (1990) labels the fourth tenet “inductive realism”, which proposes that

  the basic claim made by scientific realism [...] is that the long term success of a scientific theory gives reason to believe that something like the entities and structure postulated by the theory actually exists (McMullin, 1984, p. 26).

By conducting interviews with relevant personnel at a number of retail banks, I aim to develop genuine knowledge about the reality of customer management in retail banking. At the same time, the analyses of my findings aim to provide insights that can be used in marketing practice within banks and potentially other organizations. The practical real-world applicability of the implications generated by this thesis should be tested in future research, in order to determine the long term success of the developed theories.
In summary, the ontological and epistemological assumptions of this research are based on scientific realism, adopting a correspondence perspective (Patton, 2002, p. 91), meaning that:

...there is a real world with verifiable patterns that can be observed and predicted – that reality exists and truth is worth striving for. Reality can be elusive and truth can be difficult to determine, but describing reality and determining truth are the appropriate goals of scientific inquiry. Working from this perspective, researchers and evaluators seek methods that yield correspondence with the “real world”. (Patton, 2002, p. 91)

3.3. Methodological assumptions

The nature of this research project is exploratory and theory-building, rather than theory-testing. The thesis empirically explores, in a retail banking context, three underresearched areas of PCM:

- Current practices of firms specifically with regard to PCM, and practical obstacles that firms encounter in efforts to implement a PCM approach (Paper 2);

- Customer management decision making in practice; in particular the prevalence of CLV calculations vis-à-vis managerial heuristics (Paper 3);

- Company activities aimed at reducing customer-related costs by achieving changes in customer behavior (Paper 4).

Due to the lack of previous empirical research describing the current PCM-related practices of firms, a qualitative approach was deemed to be the most suitable in order to successfully gain sufficient insight into various aspects of retail banks’ PCM. In-depth interviews with relevant personnel were conducted, allowing for lengthy explanations concerning the nature of customer management strategies. Due to expected differences between the banks regarding various aspects of PCM, a semi-structured interview format was used, in order to allow the necessary flexibility to shift tracks of questioning based on the responses of the interviewee.

In Paper 4, the choice of conducting case studies of three retail bank initiatives was borne out of the goal to gain deep insight into specific strategies for PCM in order to generate ideas for further theoretical development. Theory building based on case studies also offers great possibilities for the generation of novel theory and testability of the theory as it emerges, which should ensure the empirical validity of the theory that is established. On the other hand, case study based theory building may have a tendency to lead to theories that are highly complex, narrow, and/or idiosyncratic (Eisenhardt, 1989). The qualitative approach with in-depth interviews and the possibility for follow-up interviews should reduce the propensity for narrowness and idiosyncrasies. Furthermore, care was taken to encourage the interview subjects to clearly state what they considered to be the most important aspects, and which aspects were less relevant, in order to limit the risk of obtaining overly complex results.

Case study research appears to most often take an inductive or abductive approach, rather than a deductive one. In studies based on an abductive approach, the original framework is modified successively, taking unanticipated empirical findings into account, as well as theoretical insights that develop during the research process (Dubois and Gadde, 2002). The methods used in the present research are best
described as following an abductive approach of systematic combining (Dubois and Gadde, 2002). With regard to Papers 2 and 4, the projects’ initial phases consisted of the integration of existing theories in order to develop theoretical frameworks, serving as a basis for the interview guides (Appendices 2 and 3). During the course of the interviews that were then conducted, these frameworks continually evolved, taking into account the realities of the empirical world. Dubois and Gadde (2002) use the term systematic combining to describe such a process, where theory is confronted with the empirical world more or less continuously throughout the research process. One key characteristic of systematic combining is termed matching, and entails going back and forth between the theoretical framework, the data sources, and analysis (Dubois and Gadde, 2002). In the present research, the interviews for the different papers were conducted over periods of several months (four months for Paper 2 and nine months for Paper 4), which allowed me to continuously gain theoretical insights from literature and empirical insights from analysis of the interviews. This gradual increased understanding was used during the course of the research process to successively revise the theoretical frameworks and to identify successful lines of follow-up questioning for different parts of the interviews. Finally, although Paper 3 is based on the same empirical material as Paper 2, theory development took place after all the interviews had been conducted and after Paper 2 had already been completed. The theory developed in Paper 3 was the result of going back and forth between further analysis of the interview results and reading of literature on decision making, which had not been included in the research process for Paper 2.

3.4. Methods

The following sections will describe the methods used to collect and analyze the empirical material for Papers 2, 3, and 4. Paper 1 is conceptual and thus a discussion of methods is not applicable.

3.4.1. Paper 2

To gain an understanding of retail banks’ practices for the profitable management of personal/household customer relationships, in-depth interviews were conducted with marketing personnel at nine of the largest retail banks in the Nordic region. All of the banks included in the study have deposits from the public of at least 2.5 billion euros and loans to the public of no less than 3.7 billion euros. The nine banks together have a total of about 18 million private customers compared with a total population in the Nordic region of slightly less than 25 million.

The objective was to interview one senior individual at each bank, although in one case two bank representatives were interviewed simultaneously. The positions held by the interview subjects included vice president / segment manager, director of marketing communications, head of marketing/CRM, head of business development, and data warehouse manager. In several cases clarifying follow-up questions were asked during a second meeting or by e-mail. Focusing attention on only one key decision maker at each bank was considered reasonable, as the interview questions pertained to purely factual matters regarding the banks’ PCM practices. Thus, interviews with employees occupying various other positions within the banks were not expected to provide contradictory, supplementary, or more accurate information. Kumar, Stern, and Anderson (1993, p. 1634) explain how key informants – such as the ones interviewed for this thesis – differ from representative survey respondents in the following way:
"Researchers do not select informants to be representative of the members of a studied organization in any statistical sense. Rather, they are chosen because they are supposedly knowledgeable about the issues being researched and able and willing to communicate about them." When only one key informant per organization is questioned, Huber and Power (1985) emphasize the importance of attempting to identify the person most knowledgeable about the issue of interest, and suggest several approaches to accomplish this. For example, if the informant is chosen by somebody other than the researcher, Huber and Power (1985) propose that the importance of selecting an informant based on knowledge, rather than convenience, should be emphasized to the selector. If the researcher him/herself selects the informant, Huber and Power suggest that one option is to gather information about the knowledge of potential informants, for example through telephone interviews or from third parties. If the informant is chosen based on organizational title (Seidler, 1974), the researcher should ascertain that the informant carries out the presumed duties and if applicable, that this person held the position in question during the time period which is being researched (Huber and Power, 1985). The ten informants from the nine banks included in the study for Paper 2 were selected by an expert sample approach (cf. Ryals and Humphries, 2007) in the following ways:

- Four informants were identified by the banks themselves based on the stated area of inquiry. These informants were selected following contacts between the author and managers at the banks through e-mail correspondence, telephone conversations, and in one case a face-to-face meeting. These managers in turn had in three cases been identified by the author through an information search of banking industry articles and conference/seminar presentations related to PCM, and in one case through information provided by another researcher. The managers who were initially contacted were no longer in a position at their respective banks, where they had enough insight to provide sufficient information on the specified aspects of PCM, and therefore each of these managers recommended another informant within the bank deemed to be the most knowledgeable about the issues at hand. The author emphasized the importance of interviewing a person at the bank with specific knowledge of the collection and analysis of customer information; segmentation; customer profitability measurement; strategies to increase profitability, etcetera.

- Three informants were identified by the author himself, based on information gathering about the knowledge of potential informants. One of these informants was selected based on information provided by another researcher, who had collaborated with the person in question on PCM-related issues. Another informant was chosen based on the author’s prior knowledge of this person’s expertise on PCM-related issues, after having previously interviewed him in connection with another research project. The final informant was selected after his name appeared as the speaker at two banking industry conferences, where his presentations covered PCM-related topics.

- Finally, three informants were chosen based on organizational title. In each of these cases, the author ascertained that the informant was knowledgeable of and carried out duties related to the stated area of inquiry, i.e. PCM.

The interviews typically lasted between 1.5 and 2.5 hours, resulting in a total of 16 hours and 45 minutes of interview time. The aim was to investigate the extent to which the banks applied different aspects of PCM that have been proposed in the literature.
Furthermore, based on the banks’ current practices, insights were sought concerning potential obstacles to the implementation of various aspects of PCM. A semi-structured interview guide (Appendix 2) was designed to allow the author to ask general questions, and then probe as necessary from case to case. The interviews covered six main interview themes, derived from a review of the literature on PCM: customer database management, including collection and analysis of customer information; segmentation; organizational structure for the management of customer relationships (e.g. segment managers, product managers etc.); calculations of the profit generated by customer relationships; forecasting of the lifetime values of customer relationships; allocation of resources to activities that aim to maximize the risk-adjusted value of the entire customer base.

Based on the author’s pre-understanding from conducting previous research in the retail banking sector, customer profitability was considered to be a sensitive topic. Therefore, in order to encourage the interviewees to speak freely, the interviews were not tape-recorded. Instead, detailed notes were taken by hand and were immediately transcribed after each interview. The author then analyzed the transcripts from the interviews manually, using color-coding to classify the text within the six themes mentioned above. Inter-coder reliability was achieved through independent coding of notes from one interview by a peer. The observed agreement was 72%, resulting in a Cohen’s kappa (Cohen, 1960) of 0.65, which is considered substantial agreement (Landis and Koch, 1977). Nevertheless, the independent coder identified a new theme, namely competitors. However, since competitive action was beyond the scope of Paper 2’s aim, the identification of this new theme was not seen as a problem. Finally, the reported instances among the nine banks of 29 aspects/activities within the six themes of PCM were tabulated (see Table 3).

3.4.2. Paper 3

Paper 3 is based on the same empirical material as Paper 2, although Paper 3 focuses on customer management decision making. As it was not an explicit purpose of the interviews to investigate this topic, it is important to note that the responses related to decision making emerged during the analysis of the empirical material, forming an interesting pattern that indicated the use of managerial heuristics within different aspects of PCM. Thus the interview subjects were not directly asked to specifically describe their decision making methods. Instead, the bases for various PCM decisions were elicited through a range of questions on the management of customer relationships. This form of interviewing can be expected to minimize response biases such as post-hoc rationalization, which may occur if respondents are directly asked to explain how various types of decisions are reached. In the present research, interview subjects freely and spontaneously revealed information on their decision making, without being specifically prompted by the interviewer.

The author analyzed the transcripts from the interviews manually. Responses related to decision making methods were identified and classified as being based on analytic or heuristic criteria. The heuristic methods were further categorized through color-coding, according to the type of heuristic used. The following heuristics were identified: the affect heuristic; the representativeness heuristic; the availability heuristic; and other simple/fast and frugal heuristics. The coding was validated by peer review.
3.4.3. Paper 4

Paper 4 takes the form of multiple case studies in the retail banking sector, using case study methodology based on Yin (2003). Three specific initiatives launched by European retail banks for the stated (partial) purpose of modifying customer behavior in order to reduce customer-related costs were assessed. Multiple case studies were conducted in order to demonstrate the feasibility of reducing customer-related costs in three different banking contexts.

A major concern for the author was gaining access to a minimum of three different cases related to the stated area of inquiry, i.e. modifying customer behavior to reduce customer-related costs. The proposed case studies require the participating banks to invest resources, primarily in the form of time to participate in interviews and provide supplementary information. The topic of customer profitability is also sensitive for companies from a public image perspective, as firms seek to be viewed as customer-friendly, treating all customers equally and striving for customer satisfaction rather than profitability. This is currently particularly true in the banking industry, whose public image has suffered significantly in the wake of the recent financial crisis and associated scandals with regard to bonuses and mismanagement. The banking industry is also more closed than many other industries due to regulations with regard to customer confidentiality. Furthermore, in the case of the current research, the payback for the participating banks could only be articulated in vague terms, promising the banks that they would receive the results of my research, which hopefully would be both interesting and useful for them. Consequently, the author did not expect to gain sufficient access to any random bank, and decided to approach persons within his international contact network who held positions or maintained close business connections at European banks. Based on these contacts, the author initially selected ten banks to pursue with inquiries regarding whether they had implemented any initiatives to modify customer behavior in order to reduce customer-related costs. After engaging in e-mail correspondence and telephone conversations with knowledgeable representatives at each of the ten banks, the author concluded that only three of the banks had carried out initiatives whose (partial) purpose was to modify customer behavior in order to reduce customer-related costs. After engaging in e-mail correspondence and telephone conversations with knowledgeable representatives at each of the ten banks, the author concluded that only three of the banks had carried out initiatives whose (partial) purpose was to modify customer behavior in order to reduce customer-related costs.

The methodology was qualitative, using semi-structured interviews. These in-depth interviews were carried out with four to six persons per bank in order to receive an understanding of the nature of the banks' initiatives (an interview guide is provided in Appendix 3). Furthermore, information regarding the costs of each campaign and the results in the form of changes in customer behavior was requested in order to evaluate the effect of each initiative on customer profitability and the return on investment (ROI). Table 1 details the types of positions held by the interviewees at the respective banks.

The initial interview subjects, all of whom occupied senior positions within their respective banks, were selected by an expert sample approach, where the banks themselves were asked to identify persons who would be knowledgeable about the area of inquiry. Most of the other informants were recommended by the initial interviewee, and in the case of Banks A and C, the branch managers were selected by the second person interviewed at each respective bank. In e-mail correspondence, telephone conversations, and/or face-to-face meetings with the selectors of interview subjects at each bank, the author emphasized the importance of interviewing persons with specific knowledge of the case initiative.
Table 1  Positions held by interview subjects at the three case banks

<table>
<thead>
<tr>
<th>Bank A</th>
<th>Bank B</th>
<th>Bank C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business development manager</td>
<td>Head of business development and sales</td>
<td>Head of telephone banking</td>
</tr>
<tr>
<td>Concept manager*</td>
<td>Business development manager</td>
<td>Regional chief operating officer / Senior Vice-President</td>
</tr>
<tr>
<td>Assistant regional manager</td>
<td>Head of SME</td>
<td>Branch manager*</td>
</tr>
<tr>
<td>Customer service manager</td>
<td>Customer advisor</td>
<td></td>
</tr>
<tr>
<td>Branch manager</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Note. *Two different persons with this position were interviewed.*

The interviews typically lasted between 45 minutes and 1.5 hours, resulting in a total of 13.5 hours of interview time. They were semi-structured and conducted with the aid of an interview guide (Appendix 3) that comprised questions under the following headings:

- Identifying the issue/problem and the group of customers to target;
- The logic behind the anticipated cost reduction and methods used;
- The initiative’s effect on the targeted customers;
- The customers’ reaction to the initiative;
- The initiative’s impact on service quality, satisfaction, and retention;
- The initiative’s payoff.

Since the author guaranteed the banks’ anonymity by promising to refer to them only as European banks without even mentioning the country of their headquarters, tape-recording of the interviews was not considered to negatively affect the quality of responses. Hence, having received permission from the interviewees, all of the interviews were tape-recorded. They were then transcribed verbatim by the author directly after each interview. The author analyzed the transcripts from the interviews manually, using color-coding to classify the text within ten themes, derived from the interview guide and several readings of the transcripts. The coding was validated by peer review. Responses covering issues pertaining to the purpose of the paper were then identified and triangulated through a comparison with responses by other interview subjects, as well as material provided by the banks themselves in the form of internal presentations as well as customer brochures, and information provided on their websites.
3.5. Reliability and validity of the research

Four different criteria are generally acknowledged for judging the quality of any forms of empirical research in social science, including case studies: reliability; construct validity; internal validity; and external validity (Yin 2003).

Reliability is concerned with ensuring that if another researcher followed the same procedures and carried out the same case study as a previous researcher, the second researcher would arrive at the same findings and reach the same conclusions. In order to enhance the reliability of the research included in this thesis, the procedures for data collection were carefully documented (Yin 2003) through a detailed description of the methods that were used for data collection (section 3.4) and inclusion of the interview guides (Appendices 2 and 3). Furthermore, all of the empirical material that was collected was gathered in a database and is available for independent inspection.

Construct validity refers to the establishment of correct measures for the concepts being studied. In the data collection phase, construct validity can be enhanced by using multiple sources of evidence; in the composition phase, meanwhile, key informants can be asked to review a draft of the case study report (Yin 2003). The research conducted for this thesis aimed to achieve construct validity through triangulation (Patton 2002). Data triangulation was achieved for each empirical paper in this thesis through a comparison of the data collected through a certain method (e.g. an interview) with all other data collected through that method (i.e. all other interviews). Methods triangulation was achieved through the collection of data through both interviews and documentation / archival data in the form of material provided by the banks themselves, such as internal presentations, customer brochures, and information provided on their websites. Analyst triangulation was achieved by systematically coding the data, which was then peer-reviewed. Finally, all of the informants were requested to review a draft of the case study report, and were permitted to make amendments and additions, which were incorporated in subsequent versions of the empirical papers.

Internal validity is only considered to be a concern for causal (or explanatory) case studies, but is related to the problem of making inferences based on interviews and other material that is collected (Yin 2003). In order to enhance the internal validity of the present research, findings were supported by quotations, tabulated summaries were provided, and cross-case analyses were carried out.

External validity is concerned with the establishment of the domain to which a study's findings can be generalized. With regard to Papers 2 and 3, the findings can be considered to be generalizable to the Nordic retail banking sector, since nine large Nordic banks were included in the studies; these banks together have a total of about 18 million private customers compared with a total population in the Nordic region of slightly less than 25 million. Nevertheless, case studies rely on analytical generalization, where findings are generalized to theory, not to a larger population of cases, as in statistical generalization.
4 SUMMARY AND CONTRIBUTION OF EACH PAPER

The four papers that form the foundation of this thesis are included in their entirety in Part 2. The following sections will provide summaries of the papers, including descriptions of each paper's contribution.

4.1. Paper 1

A much-needed narrowing of the gap between marketing and finance and accounting is currently under way, as evidenced by the publication of several special issues on topics such as the marketing/finance interface (Journal of Business Research, 2000; Journal of the Academy of Marketing Science, 2005); linking marketing to financial performance and firm value (Journal of Marketing, 2004); return on marketing investment (Journal of Strategic Marketing, 2007); the marketing/accounting interface (Journal of Marketing Management, 2008); intangibles (Accounting and Business Research, 2008); and “Marketing Strategy Meets Wall Street” (Journal of Marketing, 2009). Worryingly, however, we find evidence that marketing academics and finance academics are taking divergent perspectives on the appropriate metrics for marketing accountability.

This paper takes the form of a literature review and makes two contributions to the field of marketing accountability. First, based on a review of the customer equity-related literature, we argue the case for a clear distinction between, on the one hand, customer assets; and on the other hand, customer equity. The second contribution is that we demonstrate the advantages for external stakeholders of including the actual drivers of customer equity in management commentaries to financial reporting, rather than simply reporting customer equity and its components, and show how this could be done, using a Customer Equity Scorecard.

We propose the following definitions:

**Customer assets** are the relationships that a firm has with its customers.

**Customer equity** is the value of those customer assets.

Therefore, the function of marketing and of customer relationship management as a process is to manage the customer assets so as to maximize their value (customer equity).

Using the distinction between customer assets and customer equity allows us to clarify the drivers and components of customer equity. These drivers and components fit into a customer equity framework, as illustrated in Figure 1. Customer relationships - the assets - are on the left hand side of the diagram. These customer assets are managed by the firm by engaging in marketing activities that affect customer perceptions and behavior, which are the drivers of customer equity. Customer equity – the measure of value - is on the right hand side of the diagram. The components of customer equity and CLV are affected by the firm’s management of its customer assets and the subsequent changes in the drivers of customer equity. In order to increase its customer equity, a firm naturally needs to continuously measure its customer equity.
Based on our literature review, it appears that the inclusion of a section in financial reports where customer relationships and their management are discussed would be useful for investors. A range of customer metrics related to customer equity should be reported for the sake of objectivity and maximum provision of useful information. Based on the drivers and components of customer equity (Figure 2), we propose a Customer Equity Scorecard (Table 2). For each item on the scorecard, we have listed the data source and identified how it is related to the future earnings potential of the firm. Depending on the market situation, industry characteristics, and the current position of the firm, different metrics will be of varying importance.

Naturally, management can provide guidance in the commentary regarding its view of the currently-crucial measures, but financial analysts and investors should be capable of determining which weights they assign to the different metrics when undertaking their assessment of the value of the firm’s customer base. If the firm provides all the necessary information, the external audiences can, if they wish, even make their own customer equity calculations of the firm. Once a standardized system of measures is in place, it would also be possible to report the various customer equity drivers and components over several time periods, including future projections.
Table 2  Customer equity scorecard for financial reporting purposes. Source: Persson and Ryals (2010, pp. 429-430)

<table>
<thead>
<tr>
<th>Customer equity (CE) driver/component</th>
<th>Data source</th>
<th>Implications for future earnings potential of the firm</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer perceptions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value equity</td>
<td>Survey</td>
<td>Positively correlated with behavioral loyalty, retention and acquisition of new customers (Danaher and Rust, 1996; Rust et al., 2004b)</td>
</tr>
<tr>
<td>Brand equity</td>
<td></td>
<td>Negatively correlated with risk (Anderson, Fornell, and Mazvancheryl, 2004; Srivastava et al., 1998) and discount rate (Harrison-Walker and Perdue, 2007)</td>
</tr>
<tr>
<td>Relationship equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Customer satisfaction</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>Survey</td>
<td>Positively correlated with behavioral loyalty, patronage concentration, cross-buying, retention (Loveman, 1998) and referral behavior (Verhoef, Franses, and Hockstra, 2002)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Negatively correlated with risk (Anderson et al., 2004; Srivastava et al., 1998) and discount rate (Harrison-Walker and Perdue, 2007)</td>
</tr>
<tr>
<td><strong>Attitudinal loyalty</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Attitudinal loyalty</td>
<td>Survey</td>
<td>Positively correlated with behavioral loyalty, purchase frequency, patronage concentration, retention (Kamakura, Mittal, de Rosa, and Mazzon, 2002) and referral behavior (Reinartz and Kumar, 2002)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Negatively correlated with risk (Anderson et al., 2004; Srivastava et al., 1998) and discount rate (Harrison-Walker and Perdue, 2007)</td>
</tr>
<tr>
<td><strong>Customer behavior</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Behavioral loyalty</td>
<td>Database</td>
<td>Positively correlated with retention (by definition)</td>
</tr>
<tr>
<td>(average length of customer relationships)</td>
<td></td>
<td>Negatively correlated with risk (Anderson et al., 2004; Srivastava et al., 1998) and discount rate (Harrison-Walker and Perdue, 2007)</td>
</tr>
<tr>
<td>Average number of purchases</td>
<td>Database</td>
<td>Positively correlated with customer revenues (by definition)</td>
</tr>
<tr>
<td>Average patronage concentration / share-of-spending</td>
<td>Survey/ database</td>
<td>Positively correlated with customer revenues (by definition) and retention (Perkins-Munn, Aksoy, Keiningham, and Estrin, 2005)</td>
</tr>
<tr>
<td>Average number of different products/services bought/held</td>
<td>Database</td>
<td>Positively correlated with customer revenues and retention (Reinartz and Kumar, 2003; Venkatesan and Kumar, 2004)</td>
</tr>
<tr>
<td>Average customer risk score</td>
<td>Database</td>
<td>Positively correlated with discount rate (by definition)</td>
</tr>
<tr>
<td>Number of customers acquired by referral</td>
<td>Survey/ database</td>
<td>Positively correlated with acquisition rate (Stahl et al., 2003), customer revenues and future referral behavior (Villanueva et al., 2008)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Negatively correlated with acquisition expenditures (Stahl et al., 2003)</td>
</tr>
<tr>
<td><strong>CE components</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acquisition rate</td>
<td>Database</td>
<td>Positively correlated with customer equity (by definition).</td>
</tr>
<tr>
<td>Acquisition expenditures per customer</td>
<td>Database</td>
<td>Negatively correlated with CLV and customer equity (by definition).</td>
</tr>
<tr>
<td>Retention rate</td>
<td>Database</td>
<td>Positively correlated with CLV and customer equity (by definition)</td>
</tr>
<tr>
<td>Retention expenditures per customer</td>
<td>Database</td>
<td>Negatively correlated with CLV and customer equity (by definition)</td>
</tr>
<tr>
<td>Churn rate</td>
<td>Database</td>
<td>Inverse of retention rate (by definition)</td>
</tr>
<tr>
<td>Average customer revenues</td>
<td>Database</td>
<td>Positively correlated with CLV and customer equity (by definition)</td>
</tr>
<tr>
<td>Average customer costs</td>
<td>Database</td>
<td>Negatively correlated with CLV and customer equity (by definition)</td>
</tr>
<tr>
<td>Discount rate (e.g. WACC)</td>
<td>Estimated or determined by borrowing costs</td>
<td>Negatively correlated with CLV and customer equity (by definition)</td>
</tr>
<tr>
<td><strong>Customer base profitability distribution</strong></td>
<td>Database</td>
<td>Higher dependence on profits from a smaller number of customers (= higher risk) positively correlated with discount rate (by definition; cf. Storbacka, 1994)</td>
</tr>
<tr>
<td><strong>Customer portfolio diversification</strong></td>
<td>Database</td>
<td>Negatively correlated with customer equity (by definition)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Optimization of investments across the customer base (= higher risk-adjusted return) positively correlated with customer equity (by definition; cf. Dhar and Glazer, 2003)</td>
</tr>
</tbody>
</table>
Hence, rather than continuing on the quantitative path and attempting to value customer assets and include customer equity in a firm’s financial reporting as suggested by Wiesel et al. (2008), a more fruitful exercise would be to seek to determine how and to what extent various aspects of customer relationships and their management can be reported, in order to provide information that can be used by investors and other external audiences to predict the future earnings potential of the firm. To this end, we have argued the case for a clear distinction between, on the one hand, the management of customer assets and the drivers of customer equity; and, on the other hand, the measurement of customer equity and its components. Identification of the drivers and components of customer equity not only serves marketing managers in their efforts to manage customer relationships profitably. The provision of these metrics in the management commentaries of financial reports would also more directly answer the call from the finance community for more transparency in financial reporting of intangible assets in order to assist investors’ decision making. The potential positive implications of including customer equity drivers and components in financial reporting are not only limited to more well-informed firm valuations by an external audience. The concretization of the intermediate and financial outcomes of customer relationship management efforts in financial reports will also enable marketing to demonstrate accountability, thereby preventing any further erosion of its influence within the firm.

Many CEOs feel that their future potential, based particularly on their ability to leverage various types of intangible assets, is not fairly reflected in their share prices. Such firms could attempt to provide greater transparency to the investor community by including more detailed information on the performance of the firm’s intangible assets in their financial reports. However, a few issues should be considered here. First, there is a clear risk that companies abuse this possibility by using creative methods of measuring the performance of its customer relationships and other intangible assets. This risk could be neutralized by the introduction of standardized, industry-wide measures (see Stewart, 2009). Second, rather than attempting to include customer relationships and other intangible assets on the balance sheet, the management commentary on financial reports appears to be a more useful place in which to describe the underlying reasons for the gap between book value and market value and/or the firm’s own assessment of what its market value should be, based on its potential to utilize its capabilities to leverage its various tangible and intangible assets. Such supplemental reporting should include both qualitative and quantitative data and could take the form of a scorecard. We have in this paper suggested a set of customer metrics that could be included on a customer dimension of such a scorecard. Further research could investigate the feasibility and usefulness of including this and various other dimensions on a scorecard, in order to provide financial analysts and investors with sufficient information to make decisions while at the same time allowing firms to be held accountable for the management of their customer relationships.

4.2. Paper 2

PCM is a research area currently in a state of rapid expansion. A number of empirical studies have examined firms’ CRM efforts (e.g., Bohling et al., 2006; Dibb and Meadows, 2004; Ryals and Payne, 2001). Customer profitability and CLV have also been analyzed in several case studies within single companies (e.g., Narayanan and Brem, 2002; Ryals, 2005; van Raaij et al., 2003). However, with the exception of Ryals’ (2006) study of how ten best-practice global suppliers manage the profitability of their key customer relationships, there is a notable lack of empirical research examining the
current practices of firms specifically with regard to PCM. Consequently, although Bell et al. (2002) propose possible barriers to the adoption of their customer asset management approach in theory, practical obstacles that firms encounter in efforts to implement such an approach have not earlier been studied empirically, to my knowledge. This article fills this gap by exploring PCM among nine Nordic retail banks. The financial services industry indeed seems to be a fruitful setting in which to conduct such an investigation, as it appears to be one of the industries most interested in establishing customer relationships through the implementation of relationship marketing efforts (Barnes and Howlett, 1998, p. 15). In particular, the retail banking sector is especially well-suited for research on the development of PCM since the existence of comparatively lengthy relationships (Leverin and Liljander, 2006) and access to historical customer data (Storbacka, 1994, 1997) potentially enables retail banks to base strategies on both current and expected future profit streams from customers.

The purpose of this study is to explore the extent to which retail banks in the Nordic region are currently implementing key aspects of PCM that have been identified in the literature. Based on the findings, obstacles to the successful implementation of a PCM approach are identified and discussed.

In-depth interviews with personnel at nine retail banks in the Nordic region of Europe were conducted in order to gain an understanding of the banks' practices for the profitable management of personal/household customer relationships. The banks were selected by size, in order to reflect the practices of major Nordic retail banks. As a point of reference, all of the banks included in the study have deposits from the public of at least 2.5 billion euros and loans to the public of no less than 3.7 billion euros, as of the fiscal year 2006. Nine banks were considered to be a sufficiently large sample in a region with a population of slightly less than 25 million.

Based on the results of the interviews, the banks' stages of development with respect to the core features of PCM were assessed. Summaries of the key findings within the six explored areas are presented in Table 3. In order to ensure preservation of the banks' anonymity, the attributes are not reported per bank, but instead in the form of how many banks that implement each of the activities.

Based on the results of the interviews, a model (Figure 3) is constructed to summarily describe the current practices that appear to be prevalent within Nordic retail banks, regarding PCM. The existence of a database with relevant customer information can be considered a prerequisite to PCM in the retail banking sector. Segmentation and various statistical analyses were also widely used, in particular as a basis for decisions on customer contact channels and in order to identify customers that potentially could be in need of certain products/services. Calculations of the profits generated by customer relationships, albeit to varying degrees of accuracy, were calculated by all but one of the banks in the study. Based on the results of these calculations, in combination with insights gained from segmentation and statistical analyses, most of the banks considered the following to be the key activities to increase the CRP of extant customer relationships: personal advisory sessions, cross-selling, up-selling, and encouragement of more profitable customer behavior concerning both the channels and the frequency of interaction. With regard to customer acquisition, there was consensus among the banks that new relationships were primarily sought with high net worth customers and customers with a presumed potential for high future profitability. Finally, all of the banks at least to a certain extent followed up the results of their investments in the establishment and maintenance of customer relationships.
Table 3  Aspects/activities of profitable customer management. Source: Persson (2011, pp. 109-111)

<table>
<thead>
<tr>
<th>Aspect/activity</th>
<th>Number of banks (out of 9)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer database management</strong></td>
<td></td>
</tr>
<tr>
<td>Active customer database management</td>
<td>6</td>
</tr>
<tr>
<td><strong>Segmentation</strong></td>
<td></td>
</tr>
<tr>
<td>Customer contact decisions based on segmentation</td>
<td>8</td>
</tr>
<tr>
<td><strong>Organizational structure</strong></td>
<td></td>
</tr>
<tr>
<td>Information systems based on customers rather than products</td>
<td>0</td>
</tr>
<tr>
<td>Possibility to coordinate product and customer information through CRM-marts</td>
<td>3</td>
</tr>
<tr>
<td>Ongoing organizational shift from product to customer orientation</td>
<td>3</td>
</tr>
<tr>
<td>Segment managers responsible for customer relationship profitability</td>
<td>3</td>
</tr>
<tr>
<td><strong>Calculations of customer relationship profit (CRP)</strong></td>
<td></td>
</tr>
<tr>
<td>CRP calculated</td>
<td></td>
</tr>
<tr>
<td>Relationship revenue on a customer relationship level</td>
<td>7</td>
</tr>
<tr>
<td>Relationship costs on a customer relationship level</td>
<td>7</td>
</tr>
<tr>
<td>All customer visits to branch offices registered</td>
<td>3</td>
</tr>
<tr>
<td>Allocation of administrative costs according to an internal system</td>
<td>7</td>
</tr>
<tr>
<td>Even allocation of mass marketing costs</td>
<td>7</td>
</tr>
<tr>
<td>Specific allocation of targeted marketing costs</td>
<td>7</td>
</tr>
<tr>
<td>CRP estimated on a continuous basis</td>
<td>1</td>
</tr>
<tr>
<td>CRP calculated on a monthly basis</td>
<td>6</td>
</tr>
<tr>
<td>CRP calculated on an annual basis</td>
<td>1</td>
</tr>
<tr>
<td>Access to historical CRP data</td>
<td>8</td>
</tr>
<tr>
<td>Economic profit of customer relationships identified as an issue</td>
<td>4</td>
</tr>
<tr>
<td>Economic profit of customer relationships measured</td>
<td>0</td>
</tr>
<tr>
<td><strong>Forecasting of customers’ lifetime value (CLV)</strong></td>
<td></td>
</tr>
<tr>
<td>Experimentation with CLV calculations</td>
<td>7</td>
</tr>
<tr>
<td>CLV calculations used for active decision-making</td>
<td>0</td>
</tr>
<tr>
<td>CLV actively measured for certain products</td>
<td>1</td>
</tr>
<tr>
<td>Assumptions regarding positive/negative CLV based on intuitive reasoning</td>
<td>9</td>
</tr>
<tr>
<td><strong>Allocation of resources to activities that maximize the risk-adjusted value of the entire customer base</strong></td>
<td></td>
</tr>
<tr>
<td>Explicit analysis of reasons for low/negative CRP</td>
<td>5</td>
</tr>
<tr>
<td>Active measures to change unprofitable customer behavior</td>
<td>3</td>
</tr>
<tr>
<td>Analysis of current and potential CRP levels as basis for decisions on resource allocation and activities to pursue</td>
<td>1</td>
</tr>
<tr>
<td>Attempts to estimate bank’s share of customers’ wallets</td>
<td>9</td>
</tr>
<tr>
<td>Measurement of relationship risk</td>
<td>0</td>
</tr>
<tr>
<td>Portfolio theory used to manage customer relationships or to form acquisition/retention strategies</td>
<td>0</td>
</tr>
</tbody>
</table>

Based on this summary of the present situation, it is clear that important aspects of PCM that are mentioned in the literature are not currently being implemented by Nordic banks. These include the calculation of the economic profit of customer relationships, allocation of resources based on CLV, evaluation of the optimal diversification of the customer relationship portfolio, and the appointment of segment managers responsible for the development of profitable customer relationships.

The apparent lack of interest in calculating the economic profits of customer relationships stems from an uncertainty concerning the added value of such calculations. Nevertheless, the capital that needs to be reserved to cover risk will definitely vary depending on the products held by the customer as well as the risk profile of the individual customer relationship. Therefore, it is conceivable that retail banks could in fact measure a limited form of economic profit at the customer relationship level by allocating a capital charge based on the risk associated with the entire relationship.
An explicitly stated obstacle to the successful use of CLV measurements in several banks was the difficulty to achieve results that corresponded to intuitive reasoning in the industry. In addition, skepticism was voiced concerning the inability of CLV equations to accurately account for future occurrences. However, the critical issue to keep in mind concerning resource allocation is that the absolute value of customer relationships is of much lesser consequence than the relative value. Therefore, regardless of the precision of CLV calculations, if they are able to provide a more accurate view, than any available alternative, of the relative future profitability of different types of customer relationships, significant progress will have been made in the direction of achieving optimal resource allocation in order to maximize CE.

The usefulness of considering the risk/return ratio of the customer relationship portfolio when establishing new relationships was questioned by the banks in this study. Nonetheless, over time, especially for smaller banks, an over-reliance on cash flows from certain types of customer relationships may create an unnecessary risk burden. Therefore, the adoption of a portfolio perspective of the customer base could lead to a greater potential for maximization of the long-term risk-adjusted value of the customer base, viewed as a customer relationship portfolio.

Several of the banks in the study claimed to have segment managers but these were in fact “customer tier managers”. When the customer base is divided into only three tiers, and one manager is in charge of one or even two tiers, it is rather difficult to hold this person accountable for improvements in profits generated by customers, or to create any meaningful incentive systems with the aim of promoting activities that maximize the value of the customer base. However, in a majority of the banks, there were indications of organizational restructurings in progress, which when complete, would
potentially allow the appointment of segment managers with accountability for improving the profit levels of customers within their segments.

This study contributes to bridging the evident gap in research on how firms are currently implementing actions related to PCM, taking into account potential obstacles to implementation. In a Nordic retail banking context, it appears that more traditional areas of CRM, such as customer database management and segmentation, are well-developed, whereas emerging issues, such as economic profit, CLV, customer portfolio management, and customer segment managers, although under consideration, are not being used effectively to profitably manage customer relationships. The importance of exploring the current practices and challenges with regard to PCM in firms should not be underestimated. Although the theoretical development of many issues related to CLV and CE has blossomed over the past few years, empirical evidence demonstrating successful implementation of a comprehensive PCM approach is scant. Consequently, in order to allow further meaningful theoretical development and the effective application of theories in practice, there is clearly a prerequisite need for greater assessment of the practical possibilities and challenges perceived by firms in connection to the different aspects of such an approach. This paper provides a significant step in this direction, by examining current practices related to PCM in a retail banking context, and discussing obstacles to implementation of a range of activities, as well as potential ways of overcoming these perceived barriers. Managers, particularly in banking and other financial services, could use this research to assess the current management of customer relationships within their organizations, and to determine the potential benefits and challenges offered by the adoption of various aspects of a PCM approach.

4.3. Paper 3

Since Kahneman and Tversky’s groundbreaking work on human judgment under uncertainty, carried out in their heuristics and biases program in the late 1960s and early 1970s (Kahneman, Slovic, and Tversky, 1982), the use of heuristics has received much attention across a variety of disciplines, ranging from psychology and medicine to economics and law. However, within the field of marketing, research on heuristics has for the most part focused on consumer decision making and choice behavior (Merlo, Lukas, and Whitwell, 2008), rather than managerial decision making. One reason for this apparent lack of interest might be that managerial decision making (such as CRM decisions and marketing resource allocation) is assumed to be a logical analytical process. Certainly, many of the papers in the CRM field assume that maximizing CLV and profit is a key driver for CRM (e.g., Bruhn, Georgi, and Hadwich, 2008; Dong, Swain, and Berger, 2007; Ryals and Payne, 2001; Sublaban and Aranha, 2009).

Marketing is currently striving to gain increased attention from top management and to place customers on the boardroom agenda (see e.g., McGovern et al., 2004). Consequently, a number of academics within the discipline have called for marketing to demonstrate its accountability (e.g., Rust et al., 2004a). In line with this development, research on CLV, CE, and other marketing metrics has flourished. However, there is no reason to believe that marketing managers are any more logical/rational than other individuals, and Kahneman and Tversky’s work certainly suggests that the majority of decision makers use heuristics, even where those heuristics cause them to make suboptimal decisions. If marketing managers are tending to use heuristics rather than analytics to make their customer management decisions, this would go some way to explain why marketing struggles with problems of accountability. The idea of basing
marketing decisions on heuristics rather than some type of CLV and/or ROI calculation is consequently not in line with the current aspirations of marketing. This paper analyzes how marketing decisions related to PCM are actually made, in a retail banking context. Retail banking is an important context for research on PCM because the prevalence of sophisticated CRM systems (Krasnikov et al., 2009), the frequency of customer contact (Storbacka, 1994) and the comparatively long duration of many relationships (Leverin and Liljander, 2006) should make this industry a prime candidate for highly analytically-driven PCM decisions (see Ryals, 2005). The paper focuses on the use of CLV calculations vis-à-vis managerial heuristics when managers make customer management decisions.

To gain an understanding of banks’ practices for the profitable management of personal/household customer relationships, in-depth interviews are conducted with marketing personnel at nine of the largest retail banks in the Nordic region. All of the banks included in the study have deposits from the public of at least 2.5 billion euros and loans to the public of approximately 3.7 billion euros. The nine banks together have a total of about 18 million private customers compared with a total population in the Nordic region of slightly less than 25 million. The interview subjects are not directly asked to specifically describe their decision making methods. Instead, the bases for various PCM decisions are elicited through a range of questions on the management of customer relationships.

The results indicate that the use of CLV as a basis for active decision making is viewed with some skepticism within the retail banking sector. The banks do engage in data mining of customer information and they do conduct customer profitability analyses, but the ultimate assessments of customers’ value tend to be influenced by heuristic elements. Furthermore, relatively simple heuristics are used by the banks in the determination of active/inactive customers and as a basis for marketing resource allocation decisions related to important customer management activities, such as customer acquisition and selection of customers for marketing campaigns.

This study provides evidence of the use of heuristics and the lack of a reliance on CLV measurements within decision making related to PCM in retail banking. Hence, a clear gap between marketing theory and practice is identified. The results indicate the existence of certain perceived obstacles preventing the successful use of CLV in practice. The preference for using simple heuristics implies that future research in marketing should further investigate how widespread and how successful various types of heuristics are in managerial decision making. In addition, future studies should examine whether the perceived obstacles to the use of CLV in practice can be overcome, and whether CLV calculations in that case can perform better than simple heuristics and lead to more optimal decision making with regard to increasing CE.

4.4. Paper 4

Most of the research on PCM has focused on increasing CLV and/or CE by increasing loyalty/retention and/or revenues from customers over time (e.g., Bolton et al., 2004; Kumar and Shah, 2004; Rust et al., 2004b). Nevertheless, concentrating on customer loyalty primarily makes sense for customers with a positive CLV, and revenue increases need to outstrip associated costs in order to increase the lifetime value of customers (cf. Cumby and Barnes, 1995; Reinartz and Kumar, 2000). In spite of this, marketing researchers have paid scant attention to cost issues, and CLV-related studies typically make ad-hoc assumptions about costs or simply use part of the direct costs when
calculating CLV (Gupta, 2009). Empirical research on PCM has also largely ignored several crucial areas of customer-related costs, such as marketing and interaction costs, choosing instead to focus on acquisition costs (e.g., Blattberg and Deighton, 1996; Reinartz et al., 2005) or general cost reductions (e.g., Krasnikov et al., 2009; Mittal, Anderson, Sayrak, and Tadikamalla, 2005; Rust, Moorman, and Dickson, 2002) to improve overall internal efficiency.

One possible reason for this research gap is a simple continuation of a general focus amongst marketing scholars and practitioners on the demand side, measuring success in terms of for example sales and revenues, without a thorough understanding of the related costs (Gupta, 2009). Certainly, as Gupta (2009) points out, there are a number of difficulties involved in accurately measuring and allocating different types of customer-related costs. Customer-related revenues, on the other hand, are in most cases quite straightforward to measure (the sum of the prices paid for the products purchased). Furthermore, revenue expansion is seen as a more lucrative and long-term strategy than cost reduction (Rust et al., 2002). Nevertheless, the potential for increases in customer profitability by decreasing the costs of serving the customer should not be overlooked. Indeed, in the wake of the financial crisis, a majority of global business leaders are planning further cost-reduction initiatives (see PricewaterhouseCoopers, 2010). In spite of this cost concern among businesses, only a few studies in the marketing literature have examined the success of company activities aimed at reducing customer-related costs (Campbell and Frei, 2010; Madichie, 2009; Ryals, 2005).

This paper investigates how retail banks attempt to increase the profitability of specific groups of extant customers by achieving adjustments in customer behavior that consequently lead to decreased costs associated with serving these customers. Various methods used in order to change customer behavior are described, and their success is assessed based on their impact on customer-related costs and thereby customer-related profits, CLV, and CE.

The aim of an initiative to reduce customer-related costs is to improve the overall profitability of the customer base. Therefore, a certain amount of decreased customer retention as a result of such an initiative may be acceptable, as long as the resulting decreased revenues are more than outweighed by cost savings. Nevertheless, an initiative striving to reduce customer-related costs does not necessarily have to lead to a reduction in service quality, customer satisfaction, customer retention, or customer-related revenues. Optimally, such an initiative would aim at changing customer behavior in a way that reduces costs for the firm without leading to any negative effects (or even achieving positive effects) with regards to the customers’ perceptions of and interactions with the firm; Grönroos and Ojasalo (2004) refer to such a development as an improvement in service productivity (see also Parasuraman, 2002). The model in Figure 4 summarizes the chain of effects that a firm would seek to achieve as a result of changing customer behavior in order to reduce customer-related costs within a target group.

This paper takes the form of multiple case studies in the retail banking sector, using case study methodology based on Yin (2003). Three specific initiatives launched by European retail banks for the stated (partial) purpose of modifying customer behavior in order to reduce customer-related costs were evaluated. In-depth interviews with 4-6 persons per bank were carried out in order to receive an understanding of the nature of the banks’ initiatives (an interview guide is provided in Appendix 3).
The case study findings provide evidence of how customer-related costs can be reduced without incurring the often assumed inevitable decrease in customer retention and customer-related revenues. In summary, the three cases demonstrate a positive chain of effects that firms can achieve as a result of changing customer behavior in order to reduce customer-related costs within certain target groups. The aim is to change customer behavior in a sustainable way, such that the ongoing costs of serving them (not only acquisition and marketing / service quality / retention costs) are reduced, while at the same time maintaining (or improving) customer-related revenues and customer relationship duration. Such a development leads to increases in the lifetime values of customers, which in turn has a positive impact on the firm’s CE.

The customer management implications of the findings from the case studies are substantive. The findings bring the issue of costs into CRM in a constructive manner, abandoning the view of cost reductions as a necessary evil or drastic measure to handle problematic customers. Clearly, customer revenue expansion and loyalty enhancement are crucial marketing goals (Bolton et al., 2004; Rust et al., 2004b), but customer-related cost reduction is also critical for firms that seriously aim to maximize CE (Campbell and Frei, 2010; Ryals, 2005). This paper reclaims the management of costs as a key customer management activity, thereby answering Gupta’s (2009) call for more attention to cost issues in marketing. The findings show that customer behavior can be altered in a cost-reducing manner without negatively affecting customer retention or customer-related revenues. Consequently, marketing and customer relationship managers who consider strategies to change customer behavior in a cost-reducing way as a complement to traditional revenue and loyalty enhancement strategies will expand their opportunities to achieve increases in CLVs and CE. From a broader perspective, the management of customer-related costs may also provide marketers with a more responsible and credible voice within the organization, with regard to demonstrating marketing accountability.

Figure 4  The cost-profit chain
5 CONTRIBUTION

This final chapter of Part 1 discusses the overall contribution of this thesis. Following a summarizing discussion of the main findings, the contribution to theory and the managerial implications are elaborated upon. Finally, the limitations of the thesis and suggestions for further research are discussed.

5.1. Discussion

The overall purpose of this thesis was twofold: first, to critically review the concept of customer equity; second, to explore the practical implementation of various aspects of PCM approaches in a retail banking setting. The thesis thereby aimed to provide an increased understanding of the potential disconnect between marketing theory and practice in the area of PCM.

The concept of customer equity was critically reviewed in Paper 1. A measure of confusion with regard to concepts borrowed from finance and applied in marketing was identified, and clear definitions distinguishing between customer assets and customer equity were proposed. Furthermore, it was suggested that marketing, in its quest for accountability and increased clout at the strategic level, may be off track in its attempts to promulgate financially-inspired marketing metrics to the finance community. The importance of the components of customer equity, and how they are affected by the drivers of customer equity should not be underestimated. In fact, finance is not nearly such a precise and quantitative discipline as the marketing community appears to believe. Marketing does need to become more aware of the financial implications of marketing, but development of appropriate metrics to measure marketing outcomes cannot be achieved by marketers in isolation; a constructive dialog with finance and accounting is necessary if such metrics are to be taken seriously outside marketing academia. The Customer Equity Scorecard proposed in paper 1 could provide a starting point for such a discussion. There is no reason for marketing to constantly be on the defensive; without successful marketing and CRM, it is clear that profits and shareholder value will suffer. Nevertheless, unless marketing seriously considers engaging finance in an open and positive manner, there is a clear risk that finance will take greater control over the measurement of the value of customers and decisions on how customers should be managed. However, since customer management and measurement issues go hand in hand, PCM is contingent on both marketing management skills and financial measurement skills.

The practical implementation of various aspects of PCM approaches was explored in a retail banking setting in Papers 2, 3, and 4. A clear gap between marketing theory and practice was identified in Papers 2 and 3. PCM practices in the retail banking sector were found to be quite conventional, based on established activities such as segmentation, cross-selling, up-selling, and loyalty enhancement. Key customer management aspects that have been proposed within the literature on PCM for many years, however, were not being actively applied by the banks included in the present research. Skepticism was voiced by the banks regarding the usefulness and added value of calculating the economic profit of customer relationships, allocating resources based on CLV, evaluating optimal diversification of the customer relationship portfolio, and appointing segment managers responsible for the development of profitable customer relationships. Instead, several areas of customer management decision making were found to be influenced by heuristics. The banks used relatively simple heuristics for the
A possible answer to this question is found by returning to the issue of the components and drivers of CLV and CE. CLV is an aggregate metric composed of a number of components. This means that although two customers may have the same CLV, the revenues, costs, risk, and projected lifetime associated with these customers could be significantly different. Furthermore, the drivers of each customer’s CLV could also be entirely different; that is, the customers’ actual behavioral patterns could be quite dissimilar, and the customer perceptions influencing their behavior could also diverge. Hence, marketing needs to emphasize that although CLV and CE may provide certain indications regarding the relative value of customers and the approximate value of the customer base (or groups of customers), respectively, the value created by marketing manifests itself in the effect of marketing actions on customer perceptions, behavior, and ultimately the components of CLV, namely revenues, costs, risk, and retention, as well as additional components of CE, such as customer acquisition. Nevertheless, certain customers will be more profitable to focus on, but the optimality of marketing resource allocation will depend upon the relative potential improvement in different components of an extant customer’s CLV that can be achieved, in addition to the ROI with regard to acquiring certain types of new customers.

Marketing in general, and CRM in particular, has traditionally focused on improving customer profitability by increasing revenues and by improving customer satisfaction in order to enhance customer loyalty and reduce customer risk. However, one crucial component of CLV that has largely been neglected is costs. Cost-cutting has often been viewed negatively in customer-focused marketing literature on service quality and customer profitability. For example, several researchers describe a downward spiral where costs are cut, customer service deteriorates, customer satisfaction suffers a blow, customer defection increases and customer acquisition decreases, profits decrease, additional costs are cut, and so on, until the company goes bankrupt (Grönroos, 1984; Normann, 2000; Rust et al., 2000). However, the case studies in Paper 4 of this thesis demonstrate that reduced costs do not necessarily have to lead to lower service quality, customer retention, and customer-related revenues. Furthermore, cost-cutting is not restricted to improvements in the efficiency of internal processes or reductions in acquisition costs or expenditures related to service quality. By implementing initiatives to change customer behavior, it is demonstrably possible to decrease costs while simultaneously increasing revenues as well as customer retention and acquisition.

Consequently, this thesis provides an expanded foundation upon which marketers can stake their claim for accountability. By focusing on the range of drivers and all of the components of CLV and CE, marketing has the potential to provide specific evidence concerning how various activities have affected the drivers and components of CLV within different groups of customers, and the implications for CE on a customer base level. Such a transparent analysis of the impact of customer management decisions can also provide the basis for a fruitful discussion with finance regarding how the value of
customers should be measured, how marketing performance should be evaluated, and what implications this has for continuous PCM that drives long term shareholder value. In addition, if marketers can show that they are aware of cost issues and that they are capable of developing innovative initiatives to reduce customer-related costs in a sustainable manner, the dreaded threat of cuts in the marketing budget may be alleviated.

5.2. Contribution to theory

This thesis contributes to marketing theory by bringing added clarity to the literature on customer assets and customer equity; by identifying gaps between customer management theory and practice, and discussing how these gaps could be closed; and by providing empirical evidence of how customer-related costs can be reduced without incurring the often assumed inevitable decrease in customer retention and customer-related revenues. The main theoretical contributions of the thesis are summarized in Table 4. The research findings offer a foundation for further meaningful theoretical development on PCM and for more effective application of PCM theories in practice.

Table 4 Summary of the main theoretical contributions of the thesis

<table>
<thead>
<tr>
<th>Contribution to theory</th>
<th>Paper in which contribution was made</th>
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<tbody>
<tr>
<td>• In order to profitably manage customers in the long term, firms need to acknowledge the importance of maximizing CLVs and CE, while at the same time understanding that the path to profitability requires a focus on the drivers of CE (customer perceptions and customer behavior) and how these affect each of the different components of CLV and CE.</td>
<td>1</td>
</tr>
<tr>
<td>• The Customer Equity Scorecard details the various drivers and components of CE and how they are related to each other. The scorecard also serves to bridge the gap between marketing theory and financial theory with regard to customer equity-related issues.</td>
<td>1</td>
</tr>
<tr>
<td>• The existence of certain obstacles hinders the implementation of a number of aspects of PCM in the Nordic retail banking sector, viz.: calculation of customers' economic profit and CLV; customer portfolio management; and appointment of segment managers.</td>
<td>2</td>
</tr>
<tr>
<td>• There is a gap between PCM theory advocating the use of the CLV metric, and managerial practice in Nordic retail banks, where simple heuristics are used to make different types of PCM decisions.</td>
<td>3</td>
</tr>
<tr>
<td>• Evidence from three case studies demonstrates that customer management efforts can be used to change customer behavior in such ways that customer-related costs are reduced without an adverse impact on revenues and retention</td>
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To date, much of the research on PCM has focused on the CLV and CE metrics, examining issues such as how CLV should be measured (Berger and Nasr, 1998; Jain and Singh, 2002; Gupta et al., 2006; how customers can be managed to maximize their CLVs and the firm’s CE (Berger et al., 2002; Blattberg et al., 2001; Bolton et al., 2004); how resources should be allocated based on CLV (Kumar and Petersen, 2005; Ryals,
2005; Venkatesan and Kumar, 2004); and how firms can report CLV and CE to external stakeholders (Wiesel et al., 2008). However, Papers 2 and 3 of this thesis clearly indicate, from a Nordic retail banking perspective, that the CLV metric is viewed with skepticism by marketing practitioners. In line with this, managers make many types of customer management decisions based on simple heuristics rather than using CLV calculations; a gap between PCM theory and managerial practice is thus identified. The key theoretical contribution of this thesis emerges in Paper 1, namely the argument that in order to profitably manage customers in the long term, firms need to acknowledge the importance of maximizing CLVs and CE, while at the same time understanding that the path to profitability requires a focus on the drivers of CE (customer perceptions and customer behavior) and how these affect each of the different components of CLV and CE. Most of the previous research on PCM has focused on customer revenue and loyalty/retention enhancements in order increase CLV and CE. Customer related costs, meanwhile, have largely been neglected (Gupta, 2009), and Paper 4 thus provides evidence from three case studies, demonstrating that customer management efforts can be used to change customer behavior in such ways that customer-related costs are reduced without an adverse impact on revenues and retention. Finally, Paper 1 presents a Customer Equity Scorecard, detailing the various drivers and components of CE and how they are related to each other. By suggesting that this scorecard can be used to demonstrate the (potential) value of a firm’s customer assets to external stakeholders, this thesis also contributes to a bridging of the gap between marketing theory and financial theory with regard to customer equity-related issues.

5.3. Managerial implications

Many CEOs feel that the future potential of their firms, based particularly on their ability to leverage various types of intangible assets, is not fairly reflected in their share prices. Such firms could attempt to provide greater transparency to the investor community by including more detailed information on the performance of the firm’s intangible assets in their financial reports. The inclusion of a section in financial reports where customer relationships and their management are discussed could thus be useful for investors, as described in Paper 1. The proposed Customer Equity Scorecard comprises a range of metrics based on customer perceptions, customer behavior, and outcomes in the form of the components of CLV and CE.

The provision of these metrics in the management commentaries of financial reports would also more directly answer the call from the finance community for more transparency in financial reporting of intangible assets in order to assist investors’ decision making. The potential positive implications of including CE drivers and components in financial reporting are not only limited to more well-informed firm valuations by an external audience. The concretization of the intermediate and financial outcomes of PCM efforts in financial reports will also enable marketing to demonstrate accountability, thereby preventing any further erosion of its influence within the firm.

The identification of the drivers and components of CE is not only useful for marketing accountability purposes; it also serves marketing managers in their efforts to manage customer relationships more profitably. Figure 5 illustrates how the connections between the various drivers and components of CE can be operationalized to support the planning of marketing strategies and activities. The long term goal of marketing, and in particular, CRM, is to maximize the firm’s CE. Figure 5 shows the various, often
Figure 5: The connections between marketing/customer relationship management strategies and activities and customer equity (based on Persson and Ryals 2010, pp. 429-430).
complementary, paths that a firm’s customer management efforts can take towards this goal. Marketing strategies and activities can be developed to affect four key facets, for the purpose of maximizing CE.

(1) First, firms can engage in marketing activities to directly influence different aspects of customer behavior that drive CE, such as the length, depth, and breadth of customer relationships (Bolton et al., 2004); patronage concentration (Storbacka, 1994, 1997; Storbacka et al., 1994) or share-of-spending (Keiningham, Perkins-Munn, Aksoy, and Estrin, 2005); intensity and channels of interaction (Storbacka, 1994); risk (Ryals and Knox, 2005, 2007); and contribution to learning and innovation (Ryals, 2008a). Changes in these various aspects of customer behavior in turn affect different components of CE, namely projected customer lifetime (e.g. retention rate); revenues; costs; the discount rate (e.g. WACC); additional potential obtained through changes in specific customer segments, or through the way they are managed (Ryals, 2008b); the balance between customer acquisition and retention (Blattberg and Deighton, 1996; Reinartz et al., 2005); the profitability distribution across the customer base (Ryals and Knox, 2007; Storbacka, 1994, 1997; van Raaij, 2005); and customer portfolio diversification, driven by the volatility and vulnerability of cash flows from customers (Dhar and Glazer, 2003; Kumar and Shah, 2009; Ryals et al., 2007; Stahl et al., 2003; Tarasi et al., 2011).

(2) Second, firms can implement marketing activities that seek to influence customer behavior indirectly, by improving customer perceptions. With regard to extant customers, firms can aim to improve customer satisfaction (e.g. Fornell, Mithas, Morgeson, and Krishnan, 2006) and attitudinal loyalty (Reinartz and Kumar, 2002), as well as different facets of value, brand, and relationship equity (Rust et al., 2000, 2004b). Initiatives to improve the firm’s value, brand, and relationship equity can also be targeted at prospective customers, thereby striving to achieve higher levels of customer acquisition. Importantly, the improvement of customer perceptions – both among extant and prospective customers – may lead to positive word-of-mouth and customer references, which drive customer acquisition and imply lower acquisition expenditures. In contrast, deteriorations in customer perceptions of the firm may cause negative word-of-mouth, potentially leading to a decrease in customer acquisition rates and an increase in customer defections, in turn leading to higher acquisition costs, lower retention rates, and declining revenues.

(3) Third, firms can seek to directly enhance the level of new customer acquisition.

(4) Finally, firms can develop initiatives to directly affect the components of CE, which are not part of individual customers’ CLVs, namely additional potential; the balance between customer acquisition and retention; customer profitability distribution; and customer portfolio diversification.

The paths displayed in Figure 5 indicate general connections that are also shown in the Customer Equity Scorecard (Table 2). Paper 2 examines more specifically how Nordic retail banks are currently implementing actions that are considered necessary for the successful adoption of a PCM approach in line with Figure 5. The paper also discusses obstacles to implementation of a range of activities, as well as potential ways of overcoming these perceived barriers. Managers, particularly in banking and other financial services, could use this research to assess the current management of customer relationships within their organizations, and to determine the potential benefits and challenges offered by the adoption of various aspects of a PCM approach.
Figure 3 described the main current practices of Nordic retail banks with regards to key aspects deemed necessary for the adoption of a PCM approach, indicating that only certain key actions are currently being implemented. Hence, based on Paper 2, Figure 6 displays an alternative model that offers managers in the retail banking sector a more comprehensive framework that can be used to develop existing practices in a direction which to a greater extent supports PCM.

Figure 6  Model of aspects forming a basis for adoption of a PCM approach in retail banking

The key differences that form the basis of a PCM approach, as displayed in Figure 6, are the calculations of CLV and CE; the analysis of the underlying drivers of current levels of CLV and CE in different customer groups (i.e. components and drivers of CLV and CE, including customer behavior and perceptions); allocation of marketing resources towards influencing the drivers of CE based on the relative increases in CE that can
potentially be achieved among different customer groups; long term planning with regard to the profitable development of customer relationships; customer acquisition activities primarily directed toward customers exhibiting high CLVs, while at the same time ensuring that the customer portfolio remains diversified in terms of profitability and the volatility and vulnerability of cash flows from customers; and finally measuring ROI of customer management activities based on the achieved increases in customer equity among different customer groups, and structuring the organization in such a way that responsibility for increasing CE rests with marketing and segment managers.

Meanwhile, in spite of knowledge of and experimentation with CLV calculations, retail bank managers tend to base customer management decisions on simple heuristics, as demonstrated in Paper 3. This gap between theory and practice reinforces my proposition that managers need to go beyond the CLV and CE metrics and understand how CE is connected to the management of customer assets, i.e. the management of the firm’s customer relationships, as illustrated in Figure 5.

Case evidence of three retail banking initiatives that specifically sought to follow one of the paths in Figure 5 is provided in Paper 4. The banks engaged in customer management activities to change customer behavior (intensity and channels of interaction), in turn leading to a reduction of customer-related costs and higher CLVs and CE among the targeted customer groups. Importantly, one of the key components of CLV and CE, i.e. customer-related costs, was improved, while other key components, in particular customer acquisition, retention, and revenues were maintained at previous levels or in some cases even improved. Managers should thus be aware of how customer management activities affect the different drivers and components of CE, in order to determine the net effect of various activities on CE. In addition, with regard to the often neglected issue of costs in research on PCM, it is vital that managers recognize that CE is not only affected by marketing costs [as in Bolton et al.’s (2004) customer asset management framework]. The ongoing costs of managing customer relationships are a crucial component of CLV and CE, and Paper 4 demonstrates that these costs can be reduced in a sustainable manner in order to increase CLVs and CE. Consequently, marketing and customer relationship managers who consider strategies to change customer behavior in a cost-reducing way as a complement to traditional revenue and loyalty enhancement strategies will expand their opportunities to achieve increases in CLVs and CE. From a broader perspective, the management of customer-related costs may also provide marketers with a more responsible and credible voice within the organization, with regard to demonstrating marketing accountability.

5.4. Limitations

This thesis is subject to a number of limitations, which need to be addressed.

The Customer Equity Scorecard, which was proposed in Paper 1, has not been tested empirically, but I encourage further research to do so, taking several issues into account. First, collecting survey data on customer perceptions entails the challenge of non-response bias, which researchers are still attempting to develop ways of tackling (Kreuter, Olson, Wagner, Yan, Ezzati-Rice, Casas-Cordero, Lemay, Peytchev, Groves, and Raghunathan, 2010). Nonetheless, there are existing methods to account for biases, such as non-response weighting, which is widely used in order to correct for variations in probability of selection (cf. Rust et al., 2004b). Furthermore, companies with long sales cycles or a small customer base might not be able to measure some of the drivers and components of CE annually. Nevertheless, even in typical industries
with long sales cycles for goods, such as heavy machinery or automobiles, firms often maintain continuous relationships with customers through the provision of services. Hence, interactions and cash flows are likely to occur in between the sales of the core product, allowing firms to complete the Customer Equity Scorecard at regular intervals. It is also important to recognize that the Customer Equity Scorecard by its very nature is multi-faceted, meaning that the data which is included does not necessarily offer a “ready-made” analysis of the health of the company’s customer base. Different stakeholders could draw different conclusions, and due to lagged effects, it may often be necessary to compare scorecards over time to gain meaningful insights regarding the company’s present and potential future performance. Management is therefore recommended to provide qualitative descriptions that complement the data in the scorecard, in order to enhance the meaningfulness of the reported measures. However, external audiences must also be aware of the fact that the company would have a clear incentive to frame the information provided on the Customer Equity Scorecard in the direction of its own interests. Therefore, the value of the information provided on the scorecard would be enhanced if stakeholders could verify the accuracy of the information, or if its objectivity could be ascertained. A possible solution would be to introduce standardized, industry-wide measures (cf. Stewart, 2009), and to outsource the gathering of data and the reporting of the customer equity drivers and components to external objective organizations. Alternatively, a system of customer equity auditing by certified firms could be developed. Finally, the question of providing transparency to competitors must be taken into account. There are clearly trade-offs between the benefits of providing information about the customer base to investors and the disadvantages of giving competitors access to potentially sensitive information. Nevertheless, by reporting customer metrics at an aggregate level, the risk related to disclosing critical information that could be used by competitors is reduced (cf. Wiesel et al., 2008).

Papers 2 and 3, meanwhile, are primarily limited by their reliance on empirical material from only the Nordic region. Nevertheless, there are six Nordic banks among the 35 largest European banks by assets, and two Nordic banks among the 35 largest banks in the world by assets (Forbes, 2010). The Nordic region can thus be seen as representative of a wider banking industry. Furthermore, although the sample is limited to nine retail banks, they together have a total of about 18 million private customers compared with a total population in the Nordic region of slightly less than 25 million. Hence, the findings with regard to PCM can be considered representative of the Nordic region. A larger sample could, however, have been achieved by including banks from other geographical regions, and/or by using structured surveys to obtain the viewpoints of various managers and other employees at a greater number of banks. Nevertheless, in-depth interviews were considered to offer the possibility of gaining deeper insight into PCM within the retail banking sector, than what could have been achieved through the use of structured surveys. Thus, constraints with regard to time, resources, and access led to the decision to constrain the studies in Papers 2 and 3 to a sample of nine Nordic banks. Another key limitation of Papers 2 and 3 is the reliance on one key informant at each bank. If there existed other knowledgeable informants at each or any of the banks, and access could have been gained to them, this would have been beneficial for reasons of validity. However, a number of steps were taken to ensure that the key informant at each bank indeed was the person most knowledgeable about the issues of interest (cf. Huber and Power 1985), as detailed in section 3.4.1.

Paper 4 includes three case studies and the findings are thereby based on the implementation of three specific initiatives carried out by three European retail banks, limiting the generalizability of the findings. Furthermore, the findings are based on a
relatively short time frame, with the effects of the banks initiatives being assessed approximately one to two years after implementation; however, this follows standard practice within the case banks. Nonetheless, although the changes in customer behavior and customer-related costs are likely to be enduring, long-term effects on customer-related revenues and retention rates are associated with greater uncertainty. For example, the maintenance of customer relationships through self-service channels may be more challenging than through face-to-face interactions at brick-and-mortar branches. Furthermore, mixed findings have previously been reported concerning the profitability effects of customer adoption of self-service channels. For example, Xue, Hitt, and Harker (2007) demonstrate that “efficient” retail banking customers, who use self-service channels more extensively, are more profitable than customers who utilize these channels less efficiently. Campbell and Frei (2010), meanwhile, find multiple effects related to customer adoption of online banking: a shift away from more costly self-service channels of interaction (e.g. automated teller machines and voice response units); an expansion of interactions in more costly service channels (e.g. branches and call centers); a significant increase in total transaction volume; an increase in average cost to serve as a result of the three previous points; a reduction in short-term customer profitability; higher customer retention rates over one-, two-, and three-year time horizons; and higher market share. Thus, there is a need for longitudinal studies that measure the long-term effects of customer behavior-changing initiatives on each of the components of CLV and CE. Finally, Paper 4 is based on qualitative data in the form of interviews with bank representatives. Hence, the findings reflect the perceptions of these individuals within the case companies; customer perceptions are not directly taken into account. Further research could incorporate interviews with customers and periodic customer surveys to specifically determine the effects of customer behavior-changing initiatives on customer perceptions, such as customer satisfaction, attitudinal loyalty, and/or value, brand, and relationship equity. In addition, future studies could analyze customer databases and use activity-based costing (ABC) to quantitatively assess the impact of customer behavior-changing initiatives on customer-related costs and lifetime values.

5.5. Suggestions for further research

Paper 1 proposed a Customer Equity Scorecard comprising a set of customer metrics that could be included on a customer dimension of a more comprehensive scorecard reporting on a wider range of intangible assets and firm capabilities. For example, brands and networks are other dimensions that could be included on such a scorecard, in line with arguments for the integration of the concepts of customer equity, brand equity, and network equity into a theory of marketplace equity (see Brodie et al., 2006; Brodie, Glynn, and Van Durme, 2002). Further research could investigate the feasibility and usefulness of including these and various other dimensions on a scorecard, in order to provide financial analysts and investors with sufficient information to make decisions while at the same time allowing firms to be held accountable for the management of their customer relationships. An issue that still needs to be addressed is the potential existence of interaction effects between different customer equity drivers. Another interesting avenue for future research is to investigate whether marketing is viewed as being more accountable in companies that make use of CLV and CE calculations in customer management than in organizations that do not make use of such measures.

Paper 2 contributed to bridging the gap in research on how firms currently implement actions that are considered necessary for the successful adoption of a PCM approach,
taking into account potential obstacles to implementation. Future research could investigate these barriers further. For example, organizational challenges faced by firms shifting from a product focus to a customer (segment) focus could be examined in order to develop guidelines for how such a transition may be smoothly undertaken. Furthermore, as a substantial amount of variation in future customer profitability has been shown to be left unexplained by current profitability (Campbell and Frei, 2004), it appears crucial that research on CLV continues in order to allow the development of more reliable calculations that are able to take into account the uncertain conditions within various markets, industries, and firms.

Paper 3 provided evidence of the use of heuristics and the lack of a reliance on CLV calculations within decision making related to PCM in retail banking, indicating the existence of certain perceived obstacles preventing the successful use of CLV in practice. Future research could further investigate how widespread and how successful various types of heuristics are in managerial decision making. In addition, further research could examine whether the perceived obstacles to the use of CLV in practice can be overcome, and whether CLV calculations in that case can perform better than simple heuristics and lead to more optimal decision making with regard to increasing CLVs and CE.

The findings presented in Paper 4 showed that customer behavior can be altered in a cost-reducing manner without negatively affecting customer-related revenues and retention. Nevertheless, the paper was based on three specific case initiatives implemented by three European retail banks. Further research could use structured surveys to investigate on a broader scale the success of company initiatives to sustainably reduce customer-related costs through behavioral changes.

Finally, all the empirical material included in this thesis is from a retail banking setting. For purposes of generalizability, further empirical research is encouraged within other industries on the various topics covered in this thesis, such as managerial heuristics, customer behavior-changing initiatives, customer-related costs, as well as the Customer Equity Scorecard and PCM in general.
REFERENCES


*The Economist* (2010a): A Different Game: Information is Transforming Traditional Businesses [online] Available from:


APPENDIX 1 LIST OF PAPERS INCLUDED IN THE THESIS


3) Persson, Andreas and Ryals, Lynette, "Marketing Decision-Making – Fact Versus Rule of Thumb." Submitted to the *Journal of Business Research* Special Issue on Decision Making: Fast, Frugal, Effective. A previous version of the paper was presented at the AMA’s 9th International Conference of Relationship Marketing, 2009

4) Persson, Andreas, "Profitable Customer Management: Reducing Costs by Influencing Customer Behaviour.” A similar version of the paper is in the 2nd round of review for the *European Journal of Marketing*. A previous version of the paper was also presented at the 18th International Colloquium in Relationship Marketing, 2010
APPENDIX 2  INTERVIEW GUIDE FOR PAPER 2 AND PAPER 3

What types of information about customers do you collect and store?

Do you monitor and register customer behavior in any way? How and how is this data used? (Do you have an “early warning system” to detect customers who might be at risk of defecting?)

Do you monitor and register customer dialogue (feedback and opinions provided by customers through various channels) in any way? How and how is this data used?

What types of techniques do you use to analyze customer data?

[Do you use data warehousing and data mining techniques to synthesize and analyze customer data? For example, is customer feedback integrated with other customer information (e.g. based on customer behavior and/or market research)? Would this be possible?]

How comprehensive of an understanding of your customers’ life situations are you able to create based on the information you possess?

(What types of information do you make use of and how?)

What types of criteria do you use when segmenting customers?

Do different parts of the organization use different segmentation methods? (e.g. RISC for marketing communications, profit for relationship management...). 

How is segmentation used by different functions?

Are you able to use information on customers in order to make relevant offerings at the right time?

Do you distinguish between ‘active’ and ‘passive’ customers?

Do you define a customer ‘relationship’ in a certain way? (e.g. is a relationship considered to exist only if your bank is the customer’s main bank, or is it based on the existence of a salary account, mortgage etc.)

How do you deal with the issue that the effective management of customer relationships hinges on the realization that many customers are part of a household, although permission must be asked to register households? Do you regularly ask for such permission?

Do you have any way of predicting and using information on the customer’s (or the household’s) share of business with other financial institutions?

Do you measure the risk of each customer relationship? How? (credit risk vs. relationship risk)

Do you measure risk on some other level, e.g. segment or customer group levels?

Do measure the profitability of each customer relationship? How and how often?
How is this information used? How do you allocate costs to specific customer relationships?

Do you register all meetings with customers (e.g. advisory sessions, sales meetings)? Are these costs allocated to specific customers?

Do you analyze the reasons for lower than optimal (potential) profit?

If so, do you develop strategies based on these analyses?

Do you measure the lifetime value of customer relationships? How?

When measuring customer profitability/lifetime value, do you take the cost of capital into account? (economic profit)

Are resources allocated to certain types of relationships based on CLV/risk or other calculations?

Do you make any effort to connect customer satisfaction and/or loyalty measures to customer profitability? If so, how? If not, what are these measures used for?

Do you attempt to measure the financial returns on investments in customer relationships / marketing investments? How?

How large of a proportion of your private retail customer base consists of unprofitable customers? Have you conducted a specific study on this or do you automatically receive such information?

Do you believe that all customers have the potential to become profitable?

Do you base strategies on current customer profitability, potential customer profitability, or primarily on other criteria? Do you use predictive modeling techniques?

When managing customer relationships and forming strategies for acquisition and retention of customers, do you consider the volatility (risk/return ratio) of the entire customer base? How?

Who is responsible for customer retention?

Are your information systems based on products (rather than customers)?

Are your product/sales managers and their subordinates given incentives to sell as much as possible of their products/services?

Do you have segment managers in addition to product managers? If so, what incentives are they provided with?

Who is responsible for acquiring new customers? Are they given directives regarding which types of customers to acquire? If so, what types of analyses are such directives based on and who makes such decisions?

Overall, is your current strategy based on increasing revenue or reducing costs? Has the strategic emphasis changed over the past years? Do you have different strategies for different segments? Please elaborate.
How do you aim to create value for customers?

Is value creation for customers (and improvement of satisfaction) considered a strategic objective? If so, is creating value for customers (and improving their satisfaction) seen as a goal in itself or only as a way of increasing profit for the bank?

Do you attempt to mobilize customers to create value for themselves? (do you attempt to influence customer behavior?)

Have changes in the competitive environment led to changes in strategy with regards to marketing and management of customer relationships? How?
APPENDIX 3  INTERVIEW GUIDE FOR PAPER 4

Brief background: The purpose of this interview is to gain insight into the initiative we discussed earlier, that your bank has undertaken in order to improve the profitability of a certain group of customers, by reducing the costs associated with serving them.

Identifying the issue/problem and the group of customers to target

What made you realize that there was a problem with a certain group of customers? (i.e. a problem with their interaction / transaction / product/service usage behavior and/or a problem with their level of profitability)

Why did you believe that cost reduction was the right strategy to address this problem?

How did you identify the area in which customer-related costs could be reduced?

How was the target group of customers identified? What factors were used to profile these customers? For what reasons was this particular group of customers a problem?

The logic behind the anticipated cost reduction and methods used

In what ways did you hope to be able to reduce costs?

In what ways did you want customers to change their behavior?

How did you arrive at the final decision regarding what actions should be taken in attempts to reduce the costs? What different options were considered?

What actions were finally taken? What was actually communicated to customers (how, when, how often)? Please describe the details of the initiative.

The initiative’s effect on the targeted customers

Did the cost-reduction initiative lead to any changes in service levels? If so, how did the customers react to these changes?

What parts of the initiative were visible to your customers? Were there any changes that were not noticeable to your customers?

The customers’ reaction to the initiative

In general how did you expect the targeted customers to react to the initiative (positive, negative, neutral)?

In what ways did you expect the customers to change their behavior?
How many customers did you expect to react in the intended way and how many did you expect to remain neutral or react in other ways, respectively?

Did customers react to the initiative in the anticipated/intended ways? How many (%)?

Can you give any examples of specific customer reactions and behavior?

How many customers changed their behavior in the expected way?

How many customers changed their behavior in an unexpected way? Please elaborate. Were these unexpected reactions positive or negative?

How many customers did not change their behavior in any way?

Do you think that the changes in customer behaviors are lasting changes or only temporary?

The initiative’s impact on service quality, satisfaction, and retention

What impact did the initiative have on service quality (in the targeted group)?

What impact did the initiative have on customer satisfaction (in the targeted group)?

What impact did the initiative have on customer retention/churn (in the targeted group)?

If you witnessed a change in the churn rate, what was the time span of this change? (Has the churn rate returned to and stabilized at the level that existed prior to implementation of the initiative? If so, how long did it take for this to occur?)

How did the outcomes of this initiative compare with what you had predicted?

If there were changes in revenue as a result of these initiatives, how did these changes compare with what you had predicted?

The initiative’s payoff

How did you measure the success of the initiative?

Were costs reduced as a result of the actions taken as part of the initiative? By how much?

How did the level of achieved cost reductions compare to the level you had aspired for?

How did you cost the change that was made (total cost of the initiative)?

Did the initiative, during or after implementation, bring with it any unanticipated costs? Were these monetary or other costs (e.g. negative press coverage, negative word-of-mouth etc.)? How much did the initiative really cost you (hard costs and soft costs)?
What was the impact of the initiative on the total profit of the targeted customer group (i.e. not only costs, also revenues)? Is this change in profits from the customer group only temporary or will it last?

What was the total payoff (return on investment) of the initiative?

Did the total change in customer profits from the targeted group and the total payoff (return on investment) of the initiative correspond to what you had predicted beforehand (including reduction in costs, possible increase in churn, other consequences)? In hindsight, was the initiative worth implementing? Was the increase in customer profitability and the total payoff of the project significant enough?

Do you have data on the target customer group’s behavior, revenue, costs, profit, retention rate etc. before and after the initiative was carried out? Do you have this data also on an individual customer level?