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# THE STRATEGIC POWER OF CUSTOMER RELATIONSHIPS LEVERAGING LOYALTY TO CREATE VALUE

In an increasingly complex economic and market scenario, building quality customer relationships is a necessary condition for business success. Given all the resources required to retain customers, there is a need to demonstrate how customer loyalty affects the consistency and durability of revenue streams and, consequently, the value of the company.

In particular, greater customer loyalty leads to longer-term relationships, which in turn generate higher profits, shore up the firm's competitive position, and reduce future cash flow risk.

MARKETING//LOYALTY//CUSTOMER LOYALTY//CUSTOMER LIFETIME VALUE//COLLABORATIVE INNOVATION



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Companies need to manage their customer base according to loyalty-based logic, focused on building and maintaining loyal relationships that stand the test of time. This reality has long been underscored by the shift from transactional to relationship marketing. The digital revolution has fueled and accelerated this transition, redefining the structure and competitive mechanisms of many industries and creating new ones, breaking down geographic barriers and activating processes of cross-sector convergence. On the one hand, the exponential increase in available information (on individual preferences, interests, attitudes, choices, and behaviors) the sharing of consumer experiences, and the progressive reduction of information asymmetries have all contributed to consumer empowerment. On the other,

these trends have also highlighted the strategic importance of quality customer relationships. Only genuine loyalty, i.e. loyalty rooted in a solid perception of value by the customer, can mitigate the threat posed by the proliferation of forms of competition, some of which are indirect and difficult to detect *ex ante*.

The value of customer loyalty is compounded by escalating integration across channels, platforms, and devices. As the customer repeatedly interacts with multiple touchpoints during a single customer journey, companies need to collect and process data on consumer attitudes and behaviors in an integrated manner across all touchpoints: from physical ones to the website, from smartphones to social networks, and across the various interactive platforms offered by the company (for instance via chat, email, chatbots, and virtual assistants). To facilitate data collection to build loyalty indicators consistent with the omnichannel logic (Cai and Choi, 2023) that drives purchase and consumption behavior, in-store technologies are unquestionably useful for retailers: QR codes, sensors (such as beacons, NFC-near, RFID), interactive storefronts, smart mirrors, kiosks, mobile POS, and so on. Appropriate investments in these technologies can streamline integration of online and off-line data on customer behavior, providing a comprehensive view of loyalty levels throughout the customer journey.

In an increasingly complex environment, the quality of relationships is critical to a company's economic and competitive success. Not only does customer loyalty directly affect the size, duration, and risk profile of revenues and cash flows, it also stimulates the collaborative innovation processes (Fernandes and Remelhe, 2015) that underpin growth and value creation. Yet, despite widespread awareness of the link between customer loyalty and economic value creation (a link which is essential for determining the return on the cognitive and financial resources devoted to studying, measuring, and developing trust) translating this knowledge into concrete, measurable parameters remains a challenge. In summary, given the sizeable resources required to build customer loyalty, it is crucial

to demonstrate the link between loyalty, the consistency and duration of revenue streams (current and potential), and the magnitude of discount rates, highlighting the main benefits that customer loyalty brings to the firm (Busacca and Bertoli, 2024).

## THE BENEFITS OF LOYALTY

Numerous studies have shown that the longer the customer-firm relationship, the greater the profitability generated by the customer. For example, Reichheld and Sasser (1990) analyzed the average revenue per customer in certain service industries as a function of the number of years that the relationship lasts with the firm in question and found that the profitability generated by the customer systematically increases with the length of the relationship. These authors compiled similar findings in a later study (Reichheld and Schefter, 2000) on online sales: customer acquisition costs take more than a year to recoup on average, but once this threshold is crossed, profitability rises in direct proportion to the length of the relationship between the customer and the firm.

There are several factors behind the growth in corporate profitability. First, by maintaining a portfolio of customers, companies can amortize the cost of acquiring them (such as marketing and sales force commissions) over a longer time horizon, thereby reducing the cost per customer. When acquisition costs are carefully calculated to link the total costs incurred to the number of customers actually acquired (rather than the total number of people contacted), it becomes clear that the actual cost per customer acquired is much higher than many companies generally assume. Hence the observation that the higher the cost of acquisition, the higher the value of loyalty.

Familiarity with a trusted supplier also leads customers to allocate more (if not all) of their purchases in a given product category to the same supplier (*upselling*), or to choose product versions of higher quality or complexity that generate higher margins for the company (*trading up*). Loyal

customers also often tend to make a mix of higher-value purchases, adding new products to the ones they originally purchased (*cross-selling*). Greater cross-selling potential is therefore directly linked to higher levels of customer loyalty.

The role of positive interpersonal communication should also be considered. In many industries, good referrals and spontaneous testimonials from satisfied customers are key to attracting new customers, especially for products or services that are complex, difficult to evaluate, and involve some risk in the purchase decision. Satisfied customers who have established a rewarding relationship with the company tend to generate positive word-of-mouth about the company. Research on this topic has shown that the level of word-of-mouth is higher among both extremely satisfied and dissatisfied customers, albeit with opposite valences, while WOM is lower among those who express indifference. This form of communication, which is now even more pervasive thanks to social media (Kozinets et al., 2021), can prove to be more effective than other kinds of advertising and has the added advantage of cutting the cost of acquiring new customers.

In fact, various studies have shown that word-of-mouth generated by loyal customers is a vital communication channel for attracting new customers, especially in the tourism, leisure, banking, insurance, real estate and professional services sectors in general. As has been noted, “Connectivity allows customers to express opinions and listen to those of others. It produces a mindset shift, leading customers to believe that advice from strangers may be more credible than a recommendation from a famous endorser” (Kotler et al., 2017). So connectivity creates an ideal context for customer advocacy, turning a portfolio of satisfied and loyal customers into an effective and less costly driver of business growth. Some research also suggests that loyal customers tend to attract similar people to the company, who are themselves potentially loyal and attractive (Reichheld, 1997, p. 48). In contrast, it’s not uncommon for customers won over through promotions or other short-term means of influence to show little loyalty; they

also have a tendency to leave the moment a more competitive offer comes up.

Another benefit of customer loyalty is it allows companies to charge a premium price. While new customers often benefit from discounted introductory rates, long-term customers tend to pay full price. (Think of the different economic terms many banks apply to checking accounts, for example.) Sometimes, a customer’s interest in maintaining a relationship of trust with the provider over time (as is the case with many professional services or in B2B relationships) makes it possible to charge a premium price. In other words, the cost of “starting from scratch” with a new provider may indeed justify paying extra (Homburg et al., 2005). In addition, customers who trust their supplier are often more willing to accept higher prices in special situations, such as during peak periods or for urgent work.

Mindful observers have noted another essential element to establishing recursive relationships with customers: the willingness to engage in knowledge sharing. This refers to the activation of co-evolutionary processes between supply and demand based on the exchange and integration of knowledge developed in specific contexts. This interaction promotes mutual learning (creating a *learning relationship*) and allows the company to collect ideas, suggestions, and critical observations that can be used to develop new products or improve existing ones. As a real-world example, anyone familiar with the reality of Italian industrial districts knows how many products and processes in machine tools and mechanical engineering have been created thanks to similar co-evolutionary approaches, which new information and communication technologies have helped to extend. For example, through virtual customer relationship management environments, companies can engage in systematic dialogue with existing and potential customers to keep them actively involved in innovation activities (Prandelli and Verona, 2006). By creating virtual consumer communities, the Web allows companies to access the social dimension of consumer knowledge shared by groups of users with common interests.

Finally, research in the service sector shows that customer loyalty is associated with higher retention rates for front-line employees. The explanation for this phenomenon is basically that having satisfied customers makes it easier for the firm to retain its employees. As Zeithaml and Bitner (2002, p. 133) state, “People like to work for firms whose customers are loyal and happy. Their work becomes more satisfying, and they can spend more time nurturing relationships than damning their souls to find new customers. Customers, in turn, are more satisfied and become even more interesting and profitable for the company – a positive ascending pyramid. Because employees stay with the company longer, service quality improves, and turnover-related costs decrease, benefiting profits.”

## THE VALUE OF CUSTOMER LOYALTY

The impact of loyalty on the value creation process has long attracted the attention of business scholars and practitioners. This interest has led to an impressive accumulation of interpretive models and empirical evidence, clarifying the areas of influence of this resource on a firm’s economic capital (and in turn shareholder value) and highlighting the results that can be achieved through a systematic approach to loyalty development.

A useful concept for understanding how much a customer is worth for a company over time is *customer lifetime value* (CLV), which takes into account both the size of the purchases that a customer makes periodically and the overall stability and duration of the trust-based relationship that leads to those purchases. In summary, CLV measures the economic value, in terms of margins, that an individual customer brings to the company over the time horizon of the relationship established with that customer. This value is expressed by the following formula (Gupta and Zeithaml, 2006, p. 724):

$$CLV = \sum_{t=0}^{T^*} \frac{(p_t - c_t)r^t}{(1 + i)^t} - AC$$

Where:

- $p_t$  is the price paid by the customer at time  $t$ .
- $c_t$  is the direct cost of serving the customer at time  $t$ .
- $(p_t - c_t)$  is the customer’s contribution margin at time  $t$ .
- $i$  is the discount rate or the cost of capital.
- $T^*$  is the expected life of the customer relationship.
- $AC$  is the customer acquisition cost.

By adding the probability that the customer will remain loyal for a given time horizon, the formula is modified as follows:

$$CLV = \sum_{t=0}^{T^*} \frac{(p_t - c_t)r^t}{(1 + i)^t} - AC$$

where  $r$  is the probability that the customer will repeat the purchase or will still be “alive” at time  $t$ , given the already known variables.

Customer loyalty impacts all components of customer relationship value, augmenting contribution margins and the longevity of customer relationships, and reducing capitalization rates (and often the cost of acquiring new customers through positive word-of-mouth).

## CUSTOMER LOYALTY AND CONTRIBUTION MARGINS

The benefits of customer loyalty analyzed in the previous sections represent growth opportunities that contribute to incrementing the company’s contribution margin achieved at the level of the individual customer, gradually extending the reach of the relationship. Essentially, these opportunities arise from the high transferability that characterizes customer loyalty, like all invisible assets based on the consumer’s cognitive system. This is due to the generalization of the positive values that the customer attributes to the purchase and use experience. This transferability is embodied in the so-called *halo effect*, which induces customers to extend the loyalty they’ve developed towards a certain asset (tangible or intangible) to other products or services marketed under the same brand.

A loyal customer base also shrinks operating costs thanks to familiarity with the supplier's business system and its integration into logistics, product development, and communication processes. In contrast, acquiring new customers inevitably involves adaptation costs, as well as commercial and collection risks, which are lower and more predictable with loyal customers. The ability to rely on a solid base of loyal customers also facilitates sales forecasting, which simplifies all business planning processes: from purchasing to production scheduling, from staffing to financial forecasting, and so on.

Another factor to consider is the greater bargaining power that a company with high customer loyalty can enjoy. For example, customer loyalty at the point of sale (*store loyalty*) means fewer constraints on the composition of the product range; higher profitability margins, directing consumer choice towards own brands or more profitable (typically unbranded) references; and, in a non-confrontational logic, strengthening relations with industrial companies.

#### *Customer loyalty and relationship longevity*

As a first approximation, the influence of customer loyalty on the expected life of the customer relationship can be clarified by making explicit the link between the concepts of customer retention rate (CRR) and average prospective longevity (APL) of the relationship. In practice, the first indicator is used as an expressive measure of the loyalty coefficient of the customer base, constructed by comparing the number of customers at the beginning of a certain time interval (usually, but not necessarily, the year) and the number who remain in the portfolio at the end of that same interval, net of newly acquired customers. The second indicator (again assuming the year as the time interval) is defined by the ratio  $1/(1-CRR)$ . The relationship between these two indicators is expressed by an exponential curve: as the retention rate increases, the duration of the relationship (and therefore the profitability generated by the customers) progressively rises.

These synthetically described indicators are based on certain simplifying assumptions (Busacca and Bertoli, 2024) that can be eliminated by focusing not on the total customer base in a given time interval, but on the various cohorts that make up the portfolio, i.e., on sets of customers that were all acquired in the same year. Another suggestion is that we think not in terms of the average time that customers remain in the company's portfolio, but in terms of the expected duration of current relationships, making an estimate of the time interval in which each cohort resets to zero, i.e., the time it takes for all customers in a given cohort to cease being active.

#### *Customer loyalty and discount rate*

A final but no less relevant way in which CLV is affected by customer loyalty is how it impacts the discount rate of future economic flows generated by market relationships. As an initial estimate, this rate can be calculated as the sum of the interest rate on risk-free assets and a factor that accounts for risk at the country, industry, company, and, in this specific case, individual relationship levels. As anticipated in our discussion of the customer contribution margin, as customer loyalty augments, the competitive position of the company is strengthened. That means the risk profile of the relative economic flows is reduced. This leads to lower discount rates and in turn higher customer lifetime value.

Similar considerations can be made using more sophisticated methods of calculating rates, such as the weighted average cost of capital adjusted for the risk associated with the customer (or group of customers) in question. Similar to the beta coefficient used in financial valuations, the adjustment value can be determined by jointly analyzing the time volatility of a customer's purchases with respect to the average volatility of the purchases of all customers (of the company or of another reference portfolio) (Costabile, 2005).

At a conceptual level, the positive correlation between customer loyalty and the solidity of the competitive position is justified by the lower

sensitivity of loyal buyers to the actions of competitors and the greater attention they pay to the firm's initiatives. These elements translate into lower competitive vulnerability. In essence, customer loyalty reinforces the company's isolation mechanisms (Rumelt, 1984, pp. 566-569), that is, the barriers that prevent competitors from imitating company resources, which form the foundations of the competitive position it can attain.

## CONCLUSIONS

The need for sustainable growth has highlighted the increasingly central role of customer loyalty and the marketing skills that support it. The ability to anticipate market changes, integrate the customer into business processes through continuous innovation, and develop a balanced value proposition depends on customer loyalty. This applies not only to profitability and finance,



but also from the perspective of corporate social responsibility and fair market behavior.

In an ever-changing environment where companies face ever more complex challenges in building long-term, high-quality relationships, developments in knowledge and technology are opening up fascinating new areas to explore: from interacting with customer who are more and more connected and proactive, to the potential offered by the data-driven economy and artificial intelligence (Chen et al., 2023; Blut et al., 2024), from

crafting memorable experiences to managing these experiences by following an omnichannel approach, to creating value through collaborative innovation (Franklin and Marshall, 2019), the impact of which is further amplified by the new platforms and logic of our *sharing society*. In this sense, it is crucial to understand and manage the links between customer loyalty and economic value creation, measuring their impact on customer contribution margins, their durability over time, and the level of risk involved.



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