A dynamic model of customer loyalty

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Abstract
Competitive and economic advantages stemming from the strengthening of customer relationships have been widely tested and discussed by practitioners and scholars in the relationship marketing and in the customer satisfaction and postconsumption research fields.

Many studies, early developed into the business to business marketing field, have focused on antecedents and consequences of market relationships, identifying cognitive, affective and behavioural constructs (satisfaction, trust, loyalty and co-operation) that qualify the relationship life cycle, from customer satisfaction up to customer loyalty and partnership.

Cognitive and behavioural constructs operating during the relationship life cycle have been widely analysed, and thanks to these studies it is possible to define a model of "customer buying process", as a preliminary step before submitting it to the canonical falsification process.

Starting from an overview of the literature, this paper proposes a dynamic model of customer loyalty, in the marketing relationship perspective. The paper aims to identify the antecedents and the consequences of the evolutionary links between the several relational constructs connected with customer satisfaction and loyalty.

The paper formulates research propositions on the loyalty development process, which will have to be empirically tested in order to theorise a model of customer buying behaviour, useful for loyalty management purposes, both in business to business and in business to consumer markets.

1. Introduction
Worldwide competitive conditions, which are taking the form of hypercompetition in a growing number of markets (D'Aveni, 1994), are enhancing the firms' attention towards their customer behaviour, in order to manage and reinforce market relationships.

The new forms of competition and the structural modifications of exchange processes, partly due to the emerging economy of the virtual network - *brand swithing is a click away* is becoming a popular way to describe the volatility of the customer bases in the so called "new economy" - are forcing firms to give top priority to customer relationship management.

Marketing scholars were showing an increasing attention to relationship management and customer buying behaviour from many years ago. A huge stream of research and models aimed to describe and interpret this behaviour has been developed.

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Referring to this context, the present paper proposes a model to analyse the customer behaviour, grounding on the *customer satisfaction* and *relationship marketing* literature. The model describes the process of customer loyalty development, considering *loyalty* the optimal stage of the relationship evolution, and identifying a *continuum* of perceptions, attitudes, beliefs and behaviours defining the several kind of relationship a firm is able to build with its customers. A dynamic model of customer loylaty is derived from the analysis of the different forms of 'link' that the firm can develop with its customers during the relationship life cycle.
The paper is divided into four parts. The first section reviews the main contributions to the study of constructs, antecedents, consequences and mediating variables defining the customer buying behaviour. The second part describes the development of *customer loyalty*, on the ground of the constructs emerging in the relationship consolidation over time. The third part tackles the problems of the variables influencing the process of *customer loyalty* development, to define some onditions that could limit the generalisation of the model described. The fourth part regards the managerial implications of the model, focusing on the opportunity to approach the customer marketing with a relationship portfolio perspective.

2. The literature on the customer buying behaviour and loyalty

The main contributions to understanding customer behaviour, and their buying habits after the initial preference towards a brand, a store or a given supplier, can be found in customer satisfaction and relationship marketing fields.

2.1 The customer satisfaction literature

Customer satisfaction theories are based on the social and experimental psychology studies, carried out by Hoppe (1930) and Lewin (1936) in the first half of the 20th Century. Investigating the construct 'self-esteem" (and selfconfidence), these scholars discovered the foundation of the 'confirmation/disconfirmation' paradigm useful to explain the "satisfaction" perception and the link between satisfaction and trust (or at least self-trust). What it is relevant in this 'return to the past' is not only about the nature of the satisfaction construct (in the expectations minus performances definition), but also the evidence of close connections between satisfaction over time and trust (Bitner, 1995; Costabile 1998). This connection allowed for the interpretation of the dynamic of market relationship, and thus the origin of trust and loyalty, both grounded on the experience of satisfaction accumulated over time.

The first conceptualisations of customer satisfaction in marketing studies (Cardozo, 1965; Hunt, 1977; Oliver, 1977 and 1980; Olson and Dover, 1979) came without explicit reference to the Lewin experiments. The research was concentrated into the determinants of satisfaction, attempting falsify the confirmation/disconfirmation paradigm. Many experiments produced interesting evidence about the antecedents and the mediating variables having a role in the customer satisfaction perception, but did not decrease the paradigm's explanatory capacity (Yi, 1990; Iacobucci, Grayson e Omstrom, 1992; Oliver, 1997; Costabile 1998; Fournier and Mick, 1999).

Recent developments in the study of *customer satisfaction* have investigated the emotional and affective components of satisfaction, and the dynamics of the construct over time (Westbrook, 1987; Oliver, 1997; Fournier and Mick, 1999). Many marketing scholars are also attempting to understand the variables that intervene between the perception of satisfaction and the choice of repurchase of a brand, or a set of brands (Oliver, 1999).

To sum up, it is possible to claim that three decades of research into customer satisfaction have demonstrated the causal connection between satisfaction - built up as a result of market transactions that confirm the performance expectations of the customer - and trust; as well as their influence on repurchase decisions, and thus on loyalty. Even if the 'satisfaction-trust-loyalty' linkage has not always been verified - apparent high levels of satisfaction may not result in a behaviour characterised by high loyalty, and viceversa (Jacoby and Chetsnut, 1978) - due to the many intervening variables of the exchange process over the time (Jones and Sasser Jr., 1995; Oliver, 1999).

2.2. The relationship marketing literature

As for customer satisfaction studies, a relevant amount of research has been designed to understand the social, rational, emotional, and behavioural dimensions that define 'market relation', and thus the paradigmatic essence of relationship marketing. These research started analysing business to business markets, and were then extended to channel marketing, service and consumer markets (Hakanson and Osteberg, 1975; Ford, 1980; Hakansson, 1982; Thurnbull, 1986; Anderson e Narus, 1984 e 1990; Dwyer et al., 1987; Anderson e Weitz, 1989; Morgan e Hunt, 1994; Gronroos, 1994b; Gurviez, 1996; Grayson e Ambler, 1999).

The determinants of long-term relationships have been studied under the influence of models and methodologies developed by the psichology of interpersonal relationhip (Thibaut and Kelley, 1959), as well as by economic sociology (Granovetter, 1985) and social networks theory (Boissevain and Mitchell, 1973; Burt and Minor, 1982; Burt, 1992).

From the 70's, relationship marketing scholars began investigating exchanges process that were repeated over time and that were based on diadic and network relations that, in a given social context, encourage co-operative partnerships between buyers and sellers (Hakansson e Osteberg, 1975; Ford, 1980; Hakansson, 1982; Turnbull e Valla, 1986). Many studies on the topic showed the central role of trust. A fundamental contribution of Dwyer, Shurr and Oh (1987) identified trust as the critical factor for the move from discrete market transactions towards continuous exchange relationships. Trust was viewed as one of the most relevant antecedents of stable and collaborative relationships. The centrality of trust in market relationships is made evident by the many research and some wide literature review are already available (Castaldo, 1995; Blois, 1999).

Different conceptualisations of trust as the glue in market relationships have been put forward, some of them uni-dimensional, and other multi-dimensional, with the only dimension about which there does not seem to be any doubt being the predictability of the counterpart's behaviours (Raimodno, 2000). Trust, in other words, is defined by the perception of reliability that, in a buyer's view, is based on experience, or rather on the sequence of transactions/interactions characterised by the confirmation of expectations regarding performance and satisfaction (Costabile, 1998).

Studies of market relations have identified other constructs, in addition to trust, that are a feature of the most stable and durable relationships. Among others, specific research has been carried out into the following: commitment, stability, interaction, power, influence, dependence, reciprocity and co-operation. Those which seem of greatest importance as far as the analysis of customer behaviour is concerned, are commitment, reciprocity and co-operation.

Commitment is defined as the 'durable desire to maintain an important relationship', and is considered an antecedent of loyalty. Morgan and Hunt (1994) have identified its determinants as: trust, the degree to which customers and firms share the same values (value congruence), the level of shared aims in the relationship (goal congruence), the value of the benefits deriving from the relationship, as well as the costs which interrupting the relationship would cause.

Trust and commitment then influence reciprocity and co-operation, also depending by the balancing of power and dependence (Stern and El Ansary, 1992; Bucklin and Sengupta, 1993).

Co-operation is considered a very relevant antecedents of long term relationship, comparable to trust. It has mainly been studied in the area of partnership and firm alliances, showing that co-operative attitudes depend on the levels of satisfaction experienced during transactions (Anderson and Narus, 1984 and 1990). It has been shown that co-operative attitude drive the adoption of non-opportunistic behaviours, or rather behaviours not designed to maximise short-term *self-interest*, on the basis of reciprocal future behaviour expected by the partner (Anderson and Weitz, 1989; Morh and Speckman, 1994; Ganesan, 1994; Kumar, 1996).

Gruen (1995) linked commitment to relationship, and to satisfaction deriving from the perceived equity in the exchange process, theorising that a high perception of equity and consolidated commitment to the relationship significantly reduce the risk of opportunism.
Within the area of relationship marketing, different models have been suggested to describe buying behaviour, in the perspective of a life cycle of the relation. Some authors have maintained that while the empirical evidence on relationship constructs and their determinants and consequences is founded on the state of the relationship at a specific moment, adopting a dynamic viewpoint makes it possible to better understand the buying behavior and the development of the relationship (Ford, 1980 and 1988; Dweyr, et al., 1987; Fontenot and Wilson, 1997; Iacobucci and Zerrillo, 1997;).

One of the best known models in support of this view is Ford's (1980) five stages (subsequently reduced to four) life cycle analysis of relationship development: i) the pre-relation, characterised by information gathering and the evaluation of the contents that the relationship could develop; *ii*) the exploration, during which the relationship requires tangible and intangible investment in experimentation with the exchange processes; *iii*) the development, characterised by high reciprocity both in learning processes and in investment, and thus in commitment; *iv*) the stability and *v*) the institutionalisation, the final stage, during which routines of exchange are adopted. The last stage in aimed to manage the interactions minimising uncertainty, and to eventually apply sanctions that discourage the interruption of the relationship.

Like Ford (1980), Dweyr, Schurr and Oh (1987) hypothesise a five-stage model of the relationship life cycle: *i)* awareness; *ii)* exploration; *iii)* expansion; *iv) commitment*, and *v)* dissolution. The main difference between the two models concerns the dissolution stage of the relationship, which the authors maintain is often characterised by unilateral decisions, unlike the other stages which require reciprocal attitudes and behaviours that tend to be synchronised.

A brief though interesting review of the authors who have suggested models of the relationship life cycle is contained in a work by Iacobucci and Zerrillo (1997). They offer further experimental evidence of the behaviours occuring in the development of the relationship, and specifically of the role of relational networks which the actors in a given dyad can set in motion. Among the various contributions they examine, the authors emphasise the originality of the model suggested by a social psychologist, Tuckman (1965), who studied the dynamics of interpersonal relationships and drew attention to the conditions for moving from one stage of the cycle to the next. Tuckman theorised the role of 'conflicts at the initial state'. His theory, validated by the experiments of Iacobucci and Zerrillo, shows the development course of dyadic relationships, defined by checking stages which take the form of potential conflicts – or real conflicts in the early state. It is from the positive resolution of these conflicts that relationships are reinforced, and move on to successive stages.

2.3 The equity theory literature

An important relational construct, considered both by customer satisfaction and by relationship marketing studies, is the 'equity' perception. Analysis of equity is based on social psychology studies (Homans, 1961; Austin, McGinn and Susmilch, 1980), showing that the construct is derived from the proportionality, as perceived by the customer, between the outputs (benefits) and the inputs (cost-sacrifices) of an exchange and the outputs and inputs that during the same exchange – or rather in a similar exchange (e.g. that of another customer with the same firm) – are generated for the partner (the firm)

The application of this definition of equity to customer satisfaction research (Swan and Mercer, 1981; Oliver and Swan 1989a and 1989b) has shown that this perception can negatively influence the satisfaction level – or influence it positively, where the proportion between inputs and outputs favours the customer or is fair. It has been suggested that low perceived equity – or in strictly dyadic terms or terms of discrimination of the sale conditions vis-à-vis other customers – generates a perception of partner opportunism in the customer which lowers the level of satisfaction. It has also been shown that, all things being equal, the absence of perceived equity in the exchange conditions is greater for 'long-term' customers than for occasional customers (Huppertz et al. 1978).

In relationship marketing studies, instead, the equity perception, regarding the fairness of the exchange, has been used to understand co-operative behaviours and long-term stability. Exchanges that lack partner equity are governed by the principles of reciprocity. This is guaranteed by the satisfaction that has accumulated in previous experiences, and thus by trust, by co-operative interactions, and by the goal congruence previously experienced. In this sense, the limited equity in a given exchange does not provoke dissatisfaction if it is sustained by the perception of reciprocity. Short term sacrifices are compensated for by the recovery of equity in the medium to long term (serial equity) (Ganesan 1994).

The brief literature review shows that customer satisfaction and relationship marketing scholars have focused on the same process: the customer behaviour and, with a the long term perspective, the evolution of the market relations. Analysing the consequences of customer satisfaction and the antecedents of long-term partnership relationships, both fields of study have developed original research into customer buyer behaviour. And specifically the link between satisfaction, trust and loyalty, in the field of customer satisfaction studies; the link between trust, loyalty and partnership between buyers and sellers, in the area of relationship marketing.

In both cases, it is clear that the customer, by repeating a purchase behaviour with the same firm, enters a dyadic relationship with the firm. Customer satisfaction studies have examined the early stages of the relationship; relationship marketing has started from the final stage, when the economic content of the exchange seemed secondary – sometimes even ancillary – compared to the social one (Granovetter, 1985; Dwyer, Schurr and Oh, 1987; Andaleeb, 1992; Morgan and Hunt, 1994; Ganesan, 1994).

2.4 The brand and customer loyalty literature

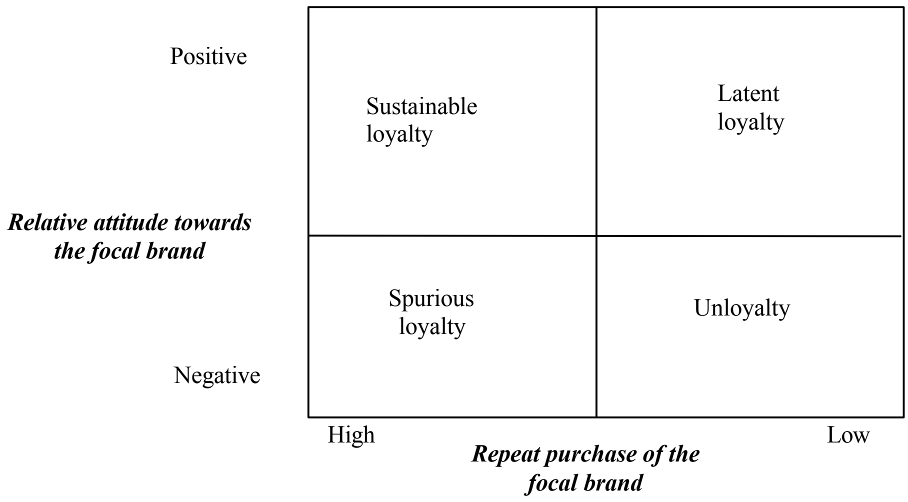
Many other contributions to the study of customer buying behaviour have been carried out in otherfields, and specifically in brand and customer loyalty studies. The seminal works of Day (1970), Jacoby (1971), Newman and Werbel (1973) and Jacoby and Kiner (1973), examined again in the famous book of Jacoby and Chestnut (1978), have shown the fundamental distinction between behavioural loyalty and cognitive loyalty (or, just to avoid confusion with the later distinction beetween cognitive and affective, mental loyalty), thus clarifying that repurchase behaviour is not a sufficient condition of brand loyalty.

These authors agree in maintaining that loyalty is the non-random repurchase behaviour (behavioural loyalty) of a brand, or group of brands, following a process of evaluation (mental loyalty). They identify different forms of loyalty, defining the repurchase behaviours that are not accompanied by a corresponding mental loyalty as ‘happenstance' purchase.

On the basis of these early works, studies of loyalty have concentrated on two principal phenomena. On the one hand there have been studies of the evidence of loyalty behaviours for more than one brand, characterised by variable levels of substitutability/complentarity (Wind, 1977; Jacoby and Chestnut, 1978; Wernerfelt, 1991; Keaveney, 1995), and thus the determinants of switching behaviour. On the other hand there have been studies of ‘mental loyalty’, and thus the perceptions, attitudes, and beliefs that can determine the different forms of loyalty. Regarding the second area of study, it is relevant the contribution of Dick and Basu (1994). They have suggested to classify the different forms of loyalty, analysing the relative attitude towards the focal brand and the repetition on purchase behaviour towards the same brand. The figure 1 show the alternative forms of loyalty.

While the different contributions on loyalty have deepened knowledge of its forms and determinants, they did fail to analyse the development of loyalty over the time, not explaining how and why these different forms of loyalty emerge. A dynamic approach, if it is properly considered, can explain the different configurations of customer loyalty in the various stages of the relationship life-cycle.

Figure 1 - A taxonomy of loyalty based on mental and behavioural dimensions



Source: Dick and Basu, 1994

One of the few attempts in this direction was that of Oliver (1997 and 1999), who suggested defining *customer loyalty* as a condition of strong involvement in the repurchase, or reuse, of a product or brand. This involvement is strong enough to overcome the 'situational' and 'competitive' influences which might drive a "variety seekers" or a switching behavior.

This condition of *customer loyalty* is reached through four sequential stages, in Oliver's view. In the first stage the customer is only *cognitively* loyal, in the sense of demonstrating direct or indirect knowledge about the brand and its benefits, and proceeds to the purchase on the basis of a belief in the superiority of the offer. It is only after repeated purchases that he develops a second form of loyalty: *affective* loyalty. This is a particularly favourable attitude to the brand which develops in the customer as a result of the repeated confirmations of his expectations, recorded during the stage of cognitive loyalty. It is only in the third stage, however, after the passage of time and repeated purchases, that - according to Oliver - the most intense levels of loyalty are reached. Loyalty, in fact, becomes *conative*, meaning that it is strongly intentional, and has a high involvement that is a motivating force, according to a model already suggested by Crosby and Taylor (1983) for voter behaviour analysis. Finally, referring to the 'action control' theory (Kuhl and Beckmann, 1985), Oliver identifies the most intense stage of loyalty as *action loyalty*. This means a loyalty that is sustained not just by strong motivations but one that results in actions undertaken by the 'desire to overcome' every possible obstacle that might come in the way of the decision to buy the brand to which the person is loyal.

With an implicit return to the classical 'cognition-affect/emotion-behaviour' seuqence, Oliver introduces a dynamic conceptualisation of customer loyalty.

3. From customer buying behavoiur analysis to a dynamic model of customer loyalty

The concept *loyalty* as used here is different to that more common one which too often obliges scholars to include additional specifications: mental, behavioural, cognitive, affective, conative, proactive, and so on. C*ustomer loyalty* is defined here as the strongest form of relation between a customer and a firm. It does not just have the features of 'true loyalty' already hypothesised by Jacoby and Chestnut (1978); it also identifies a customer and firm relationship that is enhanced by reciprocity, sustained by a high perception of equity and fairness, and thus connotated by co-operative attitudes and behaviours (with the only relationship stronger than loyalty - and widely overlapped - beeing the partnership one).

The model describing the development of customer loyalty interprets the customer-firm relationship life-cycle as a *continuum*, along which relational, cognitive and behavioural constructs overlap, to arrive - through successive sedimentation – at a multidimensional construct: *customer loyalty*.

This dynamic model is founded on empirical evidence and experiments ran in the different fields of study mentioned earlier. Specifically, it refers to:

- the studies on customer satisfaction, its determinants and consequences (Iacobucci, Grayson, and Omstrom 1992; Oliver, 1997; Costabile 1998;);

- the empirical evidence given on the trust construct, as well as the studies that have shown its connection with the propensity to repurchase and the consolidation of the relationship (Bitner, 1995; Blois, 1999);
- the studies of the relationship life-cycle and the different forms of loyalty, whose basic configuration is simple repurchase, but with an evolution path towards “true loyalty” on the base of the attitudinal constructs interacting with the behavioural one (Jacoby and Chestnut, 1973 and 1978; Ford, 1980 and 1998; Iacobucci and Zerrillo, 1997);
- the studies on equity perception and specifically those that have connected perceived equity with the readiness to co-operate (Ganesan, 1994);
- the empirical evidence of the growing sensitivity regarding the ‘fairness’ and the equity of the exchange, related to the longevity of the customer’s relationships with the firm (Huppertz et al., 1978).

The model identifies four stages of the relationship. Although these can be represented along a *continuum*, they are characterised by different evaluation processes that the customer carries out on the basis of the perceived value of the firm's offer. This value is compared with the known and the experienced market alternatives and, from the viewpoint of equity theory, it is also compared with the value that the customer believes the firm itself is obtaining from the relationship (dyadic value) – and or the equity “exchanged” with other customer (comparative equity). In substance, different configurations of the customer’s value perception are considered as the determinants of the relationship life-cycle:
- expected value in relative terms, given by the ratio between the expected benefits and costs which it is believed have to be sustained for the acquisition and enjoyment of the benefits, the perception of which is influenced by the comparison with the available alternatives;
- perceived value after purchase and use, generally related to expected value to derive the perception of satisfaction or dissatisfaction, and thus adopted as the dominant reference for evaluating the acquisition and consumption experience and thus the firm;
- perceived value in relative terms, that occurs after the first experiences of use, and it is compared with the competitors’ offer considered during the relationship life-cycle. This configuration might be defined ‘monadic value’ to emphasise the subjective component of the customer (monad) performing the evaluation, by comparing experiences, and expectations towards the evoked or evaluated set of alternatives. The perception of monadic value emerges from the comparison of the value experienced with the value expected by the firm’s competitors; and thisi is the main difference with the “expected value in relative terms” considered in the first stage of the relationship cycle;
- perceived equity value, as the ratio between the value that the customer has obtained (ratio between its perceived outputs and inputs) and the value that the firm has obtained during the ’history’ of the relationship. This configuration can be defined as ‘dyadic value’, to emphasise the essential nature of the comparison within the ‘customer-firm’ dyad, in the view of the equity over the course of a specific relationship.

The perception and significance of these different, although intuitively correlated, value configurations are supposed subject to variations along the relationship life-cycle. As a principle, the evaluation of certain specific configurations could occur simultaneously, or in sequence determined by the learning process of the customer (Rummelahrt e McClelland, 1986; Quinlan, 1991). In the model, however, an evaluative sequence is hypothesised, defining four main stages in the customer loyalty evolutionary process:
- The satisfaction and trust stage;
- The trust and buying repetition (behavioural loyalty) stage;

- The mental loyalty stage;
- The co-operative loyalty stage.

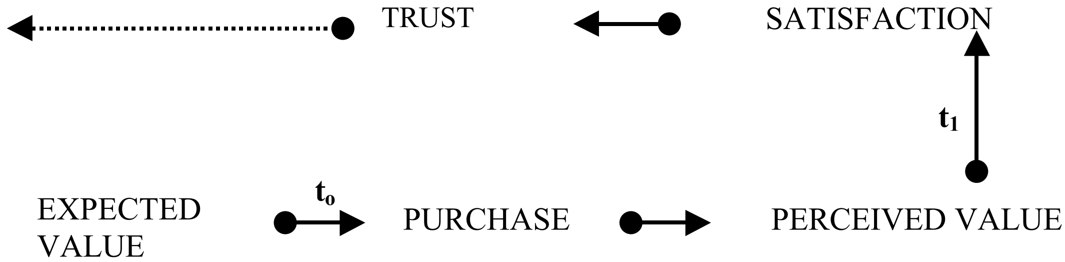
3.1 The satisfaction and trust stage

Customer and firm relationship in competitive markets has its origin in a choice, driven by a preference, and generally based on a perception of a differential value that the customer thinks can be obtained through the act of purchase and consumption. Consumer behaviour literature has widely analysed this topic, and in the recent years many authors have also studied the customer value concept and its main components, both rational and emotional ones (Zeithaml, 1988; Monroe, 1990; Costabile 1996; Holbrook, 1999). For the sake of brevity, what is offered here is a simplified description of customer value as the ratio between the benefits and costs that are perceived as part of the offer (good, service, brand or firm):
$V = B/C$

Customer value, then, is defined as the subjective perception of the ratio between the product's expected benefits and the different types of costs (sacrifices) that have to be undergone in order to buy and enjoy the benefits. The purchase choice is based on value expectations, or rather on the perception of the firm's ability to offer the benefits that are being sought in a better way than competitors and with more equity, between the benefits and the cost.

As the many customer satisfaction studies have shown, the perception of satisfaction has its origin in the congruence between expected and perceived value. With the satisfaction perception the post-purchase evaluative process starts, and also the relationship between the customer and the firm. Figure 2 describes the process which runs from the moment of choice, "t_o", to the moment of positive confirmation of value expectations, "t_1". As illustrated earlier, satisfaction with an object or individual is the perception that nourishes the formation process of a fundamental attitude: trust. The first purchase that produces satisfaction is followed by other purchases motivated by the satisfaction that has been experienced. In economic terms the perception of satisfaction is like a 'flow' that is produced by each interaction that the customer has with the firm, or with one of the firm's specific products (e.g. each time a personal computer or a mobile phone service is used). This 'flow', consciously or unconsciously, feeds a mental "stock", or what is better defined as an attitude. This kind of attitude works as a bias concerning the firm's capacity to meet the customer value expectations. It has also been defined as trust, or as the (high) probability of the firm (or the brand, or the store, etc.) offering a value that is congruent with expectations.

Figure 2 – the development of the relationship in the 'satisfaction-trust' stage



The purchase and consumption experiences, which result in customer satisfaction, feed the tendency to buying repetition (Boulding, Kalra, Staelin and Zeithmal, 1993). And, if satisfaction is further confirmed by all successive repurchases, this "accumulation" process gives rise to increasing levels of trust, in its reliability dimension, allowing the development of the relationship towards loyalty (Bolton and Drew, 1992; Chang and Wildt, 1994; Morgan and Hunt, 1994).

3.2 The trust and buying repetition (behavioural loyalty) stage

The growth in the stock of trust increases the probability of repurchase. This can be interpreted in the light of the trust placed in the subjectively perceived probability that the expected value will be effective and on the perception of the transaction costs, both in using the product - or the service - and in the hypothesis by which the customer also evaluates the option of terminating the relationship.

Regarding transaction costs, infact, is to be considered that the buying repetition becomes more and more economically convenient as the trust stock increases. The main categories of economies for the customer that are generated by an high level of trust are:

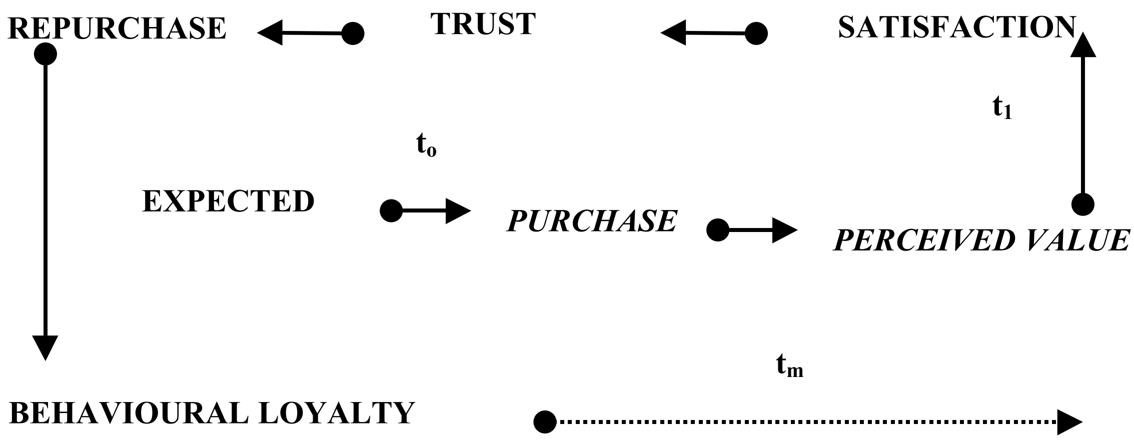
- *cognitive costs*, that would derive from the search and elaboration of data of any alternative good or service. This have to be sustained if the customer does not repurchase from the firm that has offered satisfactory performance;
- *emotional costs*, linked to the perception of risk and uncertainty that trust generally reduces. These costs are high as a result of the importance of the different components of perceived risk (physical, financial, social, psychological, functional or performance - Kaplan et al., 1974) that always accompany purchase and consumption, determining customer involvement;
- *operational costs,* therefore time and transfer costs, and all the other categories of costs that have to be sustained in the evaluation of offer alternatives and that instead are to be considered declining cost when a repurchase occurs;
- *structural costs* of the change, deriving from the technological features of the product in use (conversions, interfaces, accessories, and so on) and from the lock in policies (Shapiro and Varian, 1999) adopted by the firm.

Many of these are costs that the customer regards as sunk costs when a repurachase option is called (Oliva et al. 1992). And the perception of the economic advantage deriving from the repurchase is obviously much higher the greater the customer trust in the firm (*cost-based loyalty* - Wernerfelt, 1991).

In the light of these repurchase savings, it can be understood how the customer’s attitude of trust during the first stage of the relationship life-cycle leads to a serial repurchase from the same supplier (t_2, t_3, t_4…….). And the probability of repurchase grows until it reaches a level where, presumably becomes a "certainty event". It is thus probable that in conditions of highest trust, repurchase occurs without any consideration of the alternative offers in the market.

In this conditions, repurchase occure even when there are alternatives that could offer a greater "monadic value" than what is ‘guaranteed’ by trust in the firm towards which loyalty is shown (figure 3).

Figure 3 – The development of the relationship during the 'behavioural trust-loyalty' stage



From a dynamic viewpoint, the second stage of the relationship has a duration that is usually a function of the level of competitive pressure, the level of obsolescence in the technological solutions perceived by the customer, and the level of involvement. Where competition and technological obsolescence are limited, and there is low involvement with the product, behaviours are likely to become routine (Assael, 1995). More specifically, it can be argued that the duration of the second stage is a function of the type of good or service that is offered by the firm and the characteristics (individual, social, financial, and so on) of the actors involved in the relationship. It has an interval defined by the number of repurchase variables (t_1, t_2, t_3……, t_m), and it is usually terminated as a result of new internal or external stimuli (situational, and/or competitive, Oliver, 1997) to the customer's evaluative system. The evaluations expressed with reference to the level of satisfaction offered by the firm, and thus the trust that has been accumulated in the more or less lasting period of behavioural loyalty, have to be checked sooner or later.

The adoption of Tucker's (1965) 'conflict theory' that was experimented by Iacobucci and Zerrillo (1997) is useful for describing both the end of this stage and also how the relationship is reinforced.

According to this theory main concepts, the development of the relationship, from the trust and behavioural loyalty stages onwards, should follow a new process of comparison. This is the result of relational conflict between the value experienced in the period "t_1 ,………,t_m" and the value of the alternatives that are available on the market when the conflict begins.

As anticipated, 'relational conflict' and the activation of a new process of comparison increase with an increase in the customer perception of technological and competitive dynamism.

The comparison can conventionally be identified as "t_m" in the relationship life-cycle (figure 3). It usually takes place on the basis of monadic value, the ratio between the perceived (and experienced) benefits and costs of the offer of different alternatives on the market. The customer compares the value he has experienced during the first two stages of the relationship with the expected value of competing firms. This is discounted, however, by the trust that has been built up in the course of the relationship with the firm towards which behavioural loyalty has been shown.

The comparison that takes place at "t_m" generally produces three alternative output:

- the first is what Hirschman (1970) would have called "*exit*". The customer has discovered through the use of his individualistic viewpoint (monadic) that there are firms with offers of a greater value than the firm towards which he has shown behavioural loyalty, and he decides to terminate the relationship;
- the second kind of output does not lead to the termination of the relationship because of past experience and of 'economies of trust', developed during the first two stages. The relationship continues, and is configured as a form of 'spurious loyalty' (Day, 1970) or a generic "captive relation". Both the case could be explained by the "cost advantage" that a customer has in the short term, but this kind of relationship is often accompanied by awareness of the value of market alternatives, and by selective attention to competitor innovations. It may also be accompanied by an active search for firms whose *value proposition* could compensate the "diseconomies" of the option to exit from the relationship;
- the third result reinforces the relationship. When the comparative evaluation shows that the value offered by the firm is greater than that offered by competitors, the 'conflict' is resolved positively and the relationship is consolidated, thus entering the next stage .

3.3 The mental loyalty stage

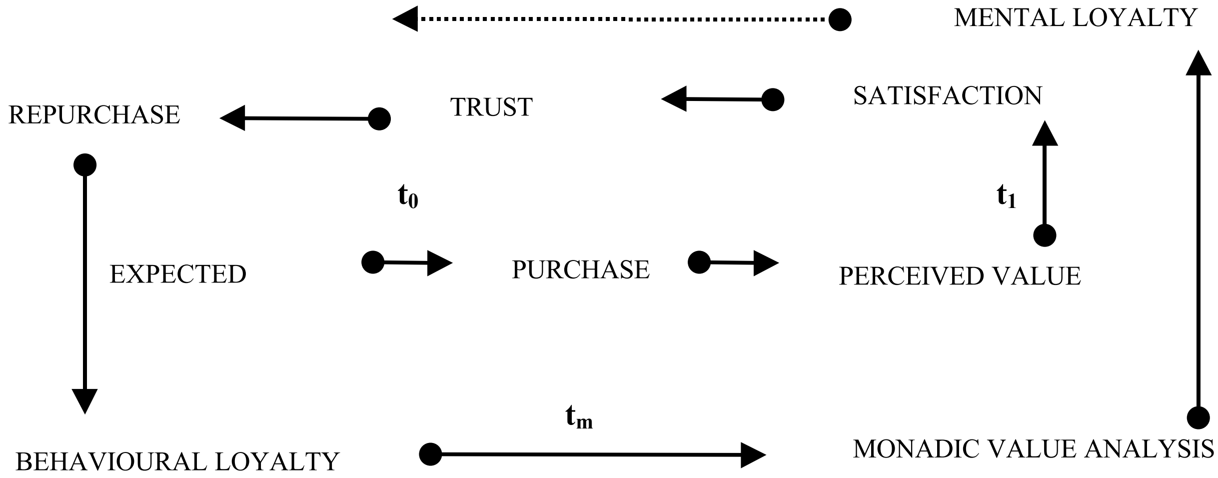
The positive resolution of the "conflict" imply that the customer considers the firm still able to offer a beter value proposition than competitors. And this perception might cause a customer belief about the capacity of the firm to maintain a constant value differential over time, or a positive value compared to competitors. This belief, which also reinforces the customer's self-effectiveness (regarding his capacity to choose the best market alternative) leads to mental loyalty.

Figure 4 summarises the relationship's development up to the stage of mental loyalty. This stage of the relationship is similar to the 'true loyalty' of Jacoby and Chestnut (1978) or to the 'sustainable loyalty' of Dick and Basu (1994). The stage is characterised by a high solidity and by the customer's readiness to widen the relationship scope. It is at this stage, for example, that the trust component of the brand allows its extension on new varieties in the same product line, on new product categories or on new business. Cross buying (and selling) phenomena are likely.

The repurchase behaviour of the mentally loyal customer is characterised by a "passive" search for alternatives, generally limited by a selective attention to competitors' offers. It is at this stage of the life cycle that the phenomena of proactive loyalty described by Oliver (1997) can be noted. This involves the repurchase even when there are negative situational or competitive influences (clear economic advantages deriving from changing brand or supplier.)

Other things being equal, the mentally loyal customer's purchases guarantee the duration of the relationship, and this, as noted, produces significant results under the financial heading (Busacca and Costabile, 1995; Reichheld, 1996; Srivastava et al., 1998).

Figure 4 – The development of mental loyalty



This form of loyalty is not, however, the "top level" of intensity a relatioship can reach. Mental loyalty, in fact, can assume two forms over time, as a result of a further evaluative process that is usually carried out by long-standing customers.

During the stages following the evaluation of monadic value (t_{m+1}, t_{m+2}, ……) customers generally have an established habit of links with the firm, acquiring solid knowledge about both the offer and the firm's organisational processes (Gummeson, 1987; Anderson e Weitz, 1989; Morgan e Hunt, 1994; Ganesan, 1994). It is this greater knowledge of the firm and its offer, as well as the increasing customer selftrust in his evaluative capabilities, that causes a further opportunity for 'conflict'.

In this case as well, conflict takes the form of a value comparison. The fundamental difference with respect to the evaluations carried out at "t_0", "t_1" e "t_m" lies in the preminent value configuration. After one or more stages of mental loyalty sustained by high perceptions of monadic value, the customer arrives at an awareness of having to consider dyadic value as well. So, the customer compares the 'historic' value obtained from the company with the value that has been generated for the company during the relationship life-cycle.

There are many possible reasons for the emerging of this comparison at this stage of the relationship life cycle. They may be found in the growing capabilities of the customer to evaluate the firm's offer with trasparence, as well as in increased awareness of the economic and organisational effort carried (absorbed) by the relationship. This evaluation is focused on the perception of the value that has been obtained by the customer, and that which has been generated by the firm. The customer's trust in his own evaluative capabilities is certainly higher than in the early stages of the relationship.

For various reasons, then, the increasing duration of the relationship and the awareness that repeated purchases generate a significant economic value for the firm, tends to make the customer form his own belief about the level of equity of the exchange. The dyadic value emerges from a comparison of the benefits (B) and sacrifices (S) of the purchase and consumption of the firm's goods and services (monadic value), with the costs (C) and revenue (R) that the customer believes the firm obtains (Oliver e Swan, 1989a and 1989b):

$B/S \cong R/C$

Obviously, the perception of equity could not be the result of the evaluation that takes place at "t_n". It is only when the exchange terms seem to have equity, and the value offered by the firm is thus held to be ‘fair’, that the relationship reaches the optimal stage: *customer loyalty*.

3.4 The co-operative loyalty stage

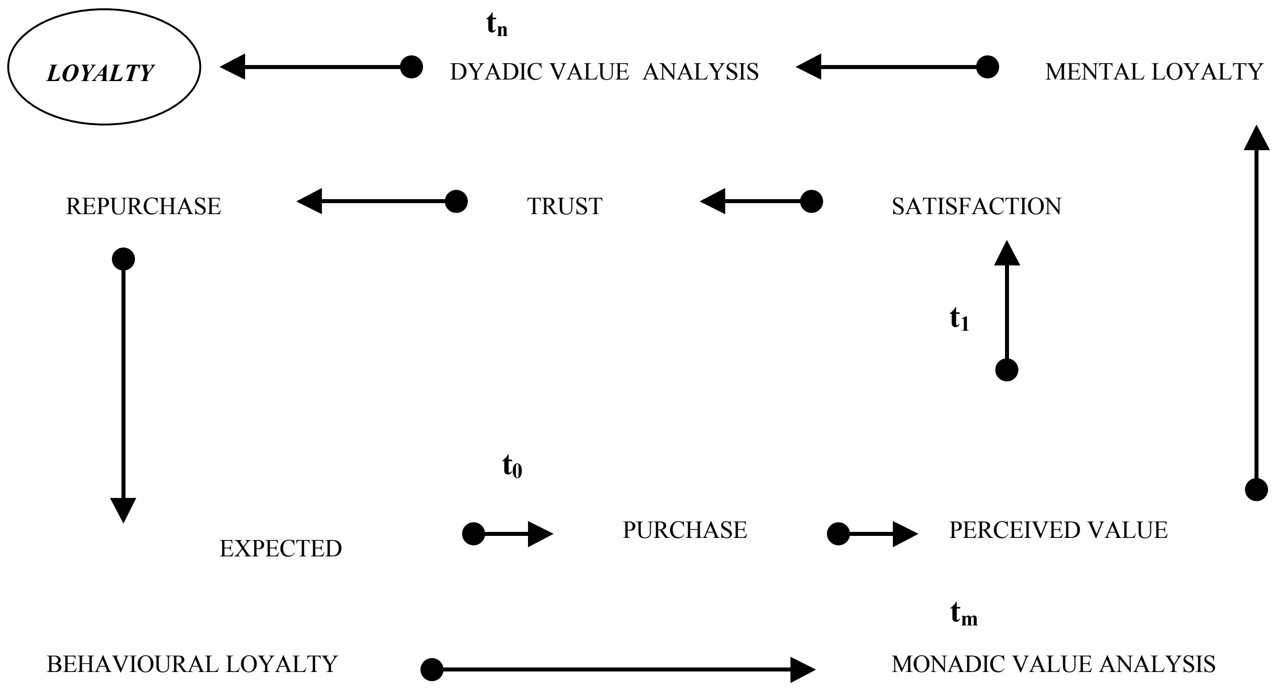
Customer loyalty is the stage towards which market relationship should ideally move. The loyal customer is tied to the firm by a relationship of mental and behavioural loyalty, and also by a belief in equity and fairness. Such a belief, based on the principle of reciprocity, leads to the adoption of fair and co-operative attitudes and behaviours.

In line with the definition suggested, *customer loyalty* is a multidimensional construct. It can be defined at the level of behaviour, such as repeat purchase. It can also be defined at the cognitive level considering satisfaction, trust, and the perception of the firm’s superior offer, measured by monadic value. Finally, it can be measured by dyadic value (the perceived equity in the terms of exchange).

Customer loyalty in this sense is a stage in the relationship life-cycle that was not previously distinct from the others, and may be similar to the forms of ‘real loyalty’ (Jacoby and Chestnut, 1978), to ‘sustainable loyalty’ (Dick and Basu, 1994), and to ‘proactive loyalty’(Oliver, 1997). Regarding these configurations, however, the customer loyalty of the model being described is very different. Its distinguishing feature is the customer’s co-operative attitude, and the behaviours belonging to this.

As shown earlier, the perception of equity in the terms of exchange is a fundamental component of the loyalty construct. This perception, although it is correlated to monadic value, is generated by an exclusively subjective evaluation of the congruence of the dyadic terms of exchange. It determines the belief in the fairness of the firm, and leads to the customer having co-operative attitudes and behaviours. The loyal customer, then, is willing to co-operate with the firm, both in a trade sense (by actively and spontaneously spreading the word about the firm), and in the technical and productive sense (by supplying suggestions about how the firm could improve products, processes, and forms of customer-firm interactions, trying out new organisational or commercial organisations, etc. etc.). Very briefly, the loyal customer forms an idea of the firm’s fairness on the basis of the perception of the equity of dyadic value, and this determines the reciprocity of attitudes and behaviours.
Figure 5 shows the *dynamic model of customer loyalty*. It starts from the purchase choice based on expected value, which is renewed over time (repurchase) on the basis of customer satisfaction and trust. This leads to the development of different forms of loyalty, and thus to loyalty.

Figure 5 – The dynamic model of customer loyalty



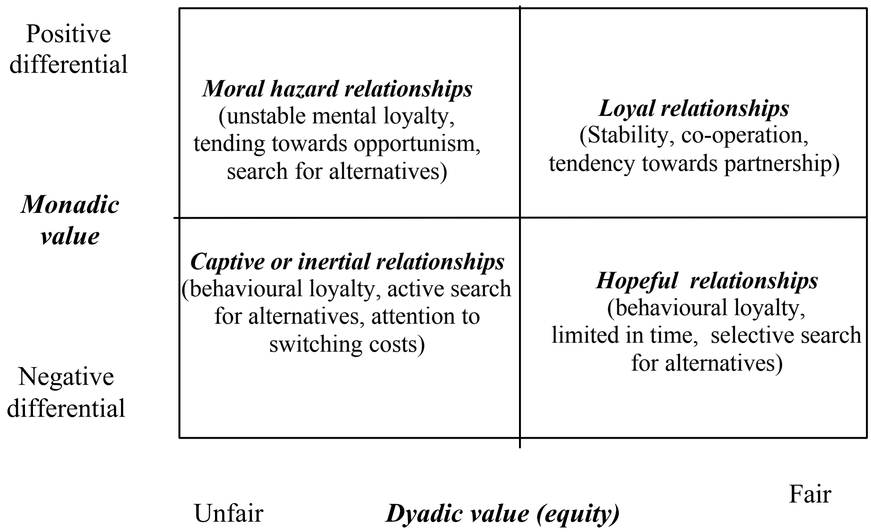
It should be borne in mind that the customer evaluation performed at "$\mathbf{t_n}$" can produce different results to those that have so far been outlined.

As well as the loyalty relationships, it is worthwhile also considering the other types of customer relationships.

Figure 6 shows a typology of customer relationships. After the early choices of purchase-repurchase characterised by the confirmation of expected value, these relationships can take different forms, and may be more or less stable and profitable, depending on the perceptions that have developed about monadic and dyadic value.

The first form of the relationship is characterised by the combination of perceptions of high monadic value and low equity referred to the term of exchange. In these conditions the customer does not form co-operative attitudes, and in the worst cases – after the firm's pursuit of an unclear price discrimination policy, for example – sees the partner (the firm) as opportunistic and this leads him to seek offer alternatives, and thus to terminate the relationship. This will be a selective search, however, as the monadic value is still perceived as high, and that exiting from the relationship would not lead to better alternatives in terms of the ratio between use value and the sacrifices involved in purchase.

Figure 6 – The state of customer relationships. A typology



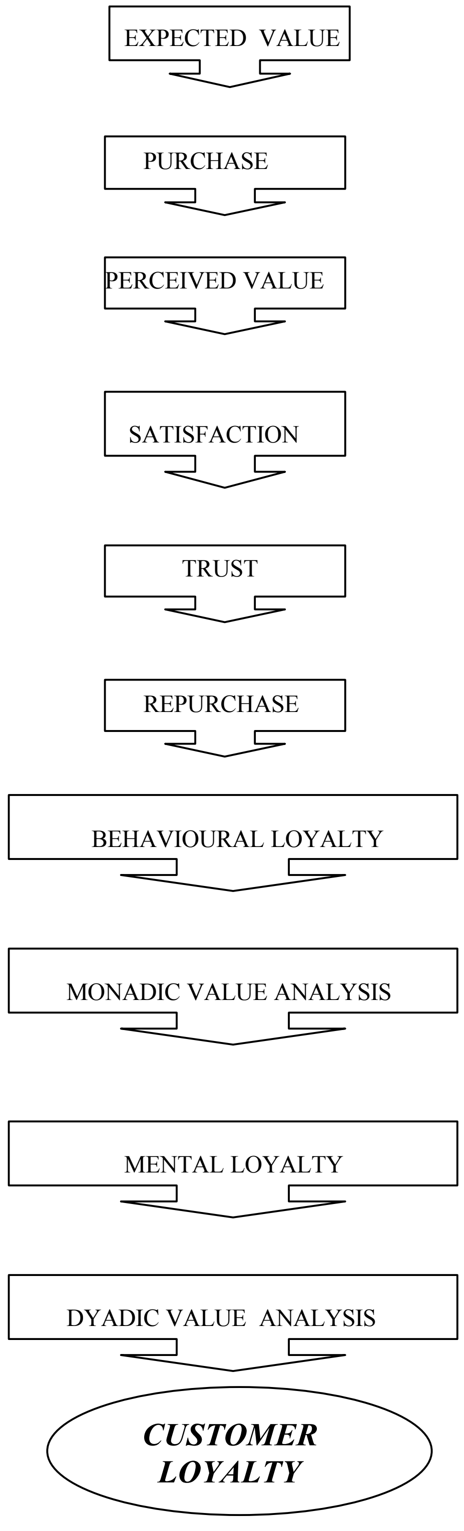
These are defined as 'moral hazard' relationships, because of the selective search for offer alternatives and thus the structural instability of the relationship which leads the customer to search for a way to 'balance' dyadic value in order to make it more fair, and thus more satisfying. The definition 'moral hazard' is motivated by the analogy with the forms of post-contractual opportunism theorized by some economists (Arrow, 1963; Pauly, 1968; Milgrom and Roberts, 1992). This means that the condition of the actor in a contractually concluded exchange process could appear unethical or even illegal because extra value is obtained at the expence of the partner. This is the risk (hazard) taken by a firm whose exchange system is perceived as unfair by a customer - the customer will maintain the relationship only because of the high monadic value perceived.

The second form of relationship is cused by low monadic value and low perceived equity. The resulting behaviour is usually the active search for alternatives, whose value has to allow for the compensation of trust economies that would follow from repurchase. In these cases the perception of 'economies' is a genuine 'exit barrier' in the relationship. These may be generated by the firm's *lock in* policies or by the structural conditions of the exchange process. The resulting relationships are temporary. They last because there are no alternatives which would allow for compensating the diseconomies (switching costs) that would follow the exit option. Loyalty in these cases is certainly 'spurious', in so far as the customer has a negative perception of the firm's offer. These are often forced or inertial relationships, that is they are often accompanied by the perception that the alternatives are not really differentiated as is their equity. Submission generally follows the perception of a kind of 'system monopoly' that can be met with in collusive oligopoly or highly regulated markets.

The final kind of relationship is the 'hopeful' one. It has this name because of its conceptual similarity to the typology suggested by Andaleeb (1992) about trust. This relationship occurs when the customer perceives the exchange relationship with the firm as fair, but not particularly advantageous from the monadic value perspective. In substance, the customer perceives the firm's offer as less competitive than other available offers. In such cases the relationship could last for a short period, or a few repurchases. It would be maintained by the high perceived fairness of the firm and by some kind of switching cost. This dynamic is relatively more probable in long-term relationships in which the customer has had the chance to experience the firm's reliability and its clear fairness. The 'hope' that drives the customer, then, is that the firm can enhance or innovate its offer system, thus making it competitive again. This is a frequent condition for customers who have previously developed loyalty relationships, and should be considered a further advantage of customer loyalty: a 'relational reserve' that consists for the firm to recover competitiveness. Behavioural loyalty in these cases presupposes a selective search for alternatives, in the expectation of verifying whether the firm has made the innovations to the offer system that would enhance the perceived monadic value.

In the light of the relationship life-cycle that has been described up to this point, it is possible to describe the customer buying behavior by following the stages illustrated in figure 7.

Figure 7 – A model of customer buying behaviour



For the purposes of empirical verification, it is worthwhile emphasising that customer loyalty as defined in this paper, consists of a search that can be stated in the following terms:

Customer loyalty is a multidimensional construct consisting of two behavioural dimensions (behavioural loyalty and co-operative behaviours) and three cognitive dimensions (trust, monadic value and dyadic value, with a latent dimension given by the co-operative attitude.

In a similar way to that proposed by certain authors (Morgan and Hunt, 1994), the two behavioural dimensions could be considered implicit, as the consequences of the three cognitive dimensions that define the construct. A future research will be designed to operationalise and measure the construct and its dimensionality.

4. The mediating variables in the dynamic of *customer loyalty* and the future research

The model described in the previous section has a number of stages that, in the majority of cases, follow a well defined temporal sequence.

In reality, however, the cognitive elaboration of the different value configurations may not follow a rigid sequence, but operate in parallel (Rumelhart and McClelland, 1986; Quinlan, 1991). As suggested earlier, the same customer could attribute different weightings to different perceptions of value at different stages of the relationship life-cycle. It is possible to hypothesise that the differentiation is a function of the physiological development of product and firm knowledge. It could also be argued that there are other context variables that may 'intervene' in the model, changing its general formulation both in terms of time and causation.

These variables can be identified:

a) in the dimensional and power asymmetry in the dyad;
b) in the informational asymmetry linked to the features of the object of exchange;
c) in the capacity to evaluate the technical-organisational processes of the firm;
d) in the level of commitment and complexity of the exchange process.

a) Dimensional asymmetry, and thus the power nearly always derived from it, may alter the sequence described in the model. A particularly large and important customer could perform an accurate dyadic value analysis at the same time as performing the monadic value analysis, or even while initiating the relationship. It often happens, particularly in *business to business* markets, that large customers 'impose' a pre-contractual examination on their suppliers of the supplier's productive, organisational and administrative-accountancy processes. This examination, which often determines the selection of supplier, and thus the initiation of the relationship, is also motivated by the great significance attributed to exchange equity. The examination of dyadic value, then, could sometimes precede, in terms of importance and timing, that related to satisfaction and reliability (trust).

b) Informational asymmetry, that is the information required to evaluate the offer, may cause the dyadic value to be given greater priority in terms of time and significance, than monadic value and the evaluation of reliability (deriving from the satisfaction accumulated over time). In the extreme case of "credence goods" (Darby and Karni, 1973) the customer cannot objectively evaluate performance until after the delivery or consumption of the good of service – and sometimes much later. In these cases an evaluative effort focused on individual elements of the dyadic value often takes place (for example idiosyncratic investment by the supplier). In this context transparency becomes the indicator of equity in the exchange process.

c) The capacity to evaluate technical-organisational process of the firm, however, may retard or accelerate significantly the arrival *customer loyalty*. In extreme cases it could compromise the consolidation of the relationship. When there is a gap of structural competence which acts against the customer, this could bring about a condition of 'judgement suspension' as a result of the absence of suitable elements for evaluating equity. When the customer has extraordinarily high competencies, however, this would result in the opposite asymmetry, leading to the situation described in a).

Other intervention variables such as the frequency of purchase and consumption, could compromise the stages, making the process of relationship development much more rapid, and thus the 'positioning' of the customer in one of the loyalty forms shown in figure 6.
More generally, taking the typology of purchase processes suggested by Assael (1995) it could be argued that the greater the customer's level of involvement, the more rapidly will the stages leading to *customer loyalty* be gone through. High perceived risk, which causes involvement, leads the customer to be more sensitive – other things being equal – to monadic and dyadic value analysis, pushing him to anticipate the learning process about the supplier organizational and economic structure. Where there is high involvement, in fact, *customer loyalty* reduces the risk of having to invest in a new process of choice (complex). This is the case even if high involvement does not allow the trust that has been accumulated in the early stages of the relationship to be regarded as sufficient for the adoption of habitual repurchasing behaviours. At the same time, however, a loyal relationship reduces the effects of possible cognitive dissonance which is common in conditions of high involvement but low perceived differentiation of the alternative offers.
d) The level of commitment and complexity of the exchange process. A high level of commitment and complexity of the exchange process might be very influential in the learning process of the customer. Its motivation as well as its capabilities in evaluating the several value configuration could be very intense and lead to an accurate information gathering and processing, well before the first buying choice. This could be quite common in business to business exchange processes, when some strategic product or component have to be bought, and so several and deep competences by company managers are deploited to build a "fair" relationship with the "right" supplier.

It is worthwhile, however, formulating a further research proposition for each of the variables that have been identified. Research can verify if these variable have a 'mediating' role on the causal connections of the model, and on the temporal sequence described.

5. Implications for the management of customer relationships

Most of the *customer loyalty* programmes that have currently been adopted by firms seem to be aimed at motivating repeat purchases (Hart et al. 1999). Many firms, then, invest a significant amount in *lock in* policies (Shapiro and Varian, 1999) in order to increase the costs of changes in supplier or brand. A new approach to *loyalty management* is suggested by the model that has been described. *Lock in* policies and 'loyalty' promotions do not allow for the development of customer relationships. It could be argued that they are not suitable promotional forms for increasing the business value deriving from stable and co-operative relationships (Prandelli and von Krogh, 1999).

The managerial implications of the dynamic model of *customer loyalty* concern both the policies and *operations* of customer relationships. The firm should, above all, examine the state of its own relationships and then define the 'relational' objectives and the most appropriate programmes for attaining them. It is clear that the *customer loyalty* goal should be principally aimed at the highest and most potential value customer segments, given also that not all relationships have to be managed in a evolutionary perspective. Potential value should not be defined solely in terms of the profit or income flows to be obtained, but above all in terms of the growth opportunities that the relationship offers the firm – commercial development of the trust and knowledge resources. The main categories of implications deriving from the analysis and application of the model are: *i)* the need to manage the different dimensions of *customer loyalty*, without limiting this to motivating repurchase based on short-term economies, but attempting also to use value perception and the positive evaluation of the firm's equity by the customer; *ii)* the need to adopt adequate measurement systems with suitable scales (batteries of items) for reflecting the state of the relationships and the course of their development from *customer satisfaction* to *customer loyalty*; *iii)* the use of segmentation policies of the customer portfolio to determine which relationships are suitable for value enhancement – not all customer relationships have value for the firm. The intangible dimensions of the exchange processes need to be considered as well, as the co-development of trust and knowledge resources; *iv) the opportunity* to manage the relationship portfolio which is characterised by different stages of the life-cycle, and thus by different expectations of the firm and its trade initiatives; *v)* the opportunity to segment customers as a function of the life-cycle, and thus to differentiate the investment needed for consolidation (barriers to *switching*, *customer satisfaction*, value increase, equity communication, *value sharing* programmes, and so on); *vi)* the need to increase the effectiveness of support tools for the management of customer relationships, starting with *customer profiling* systems and those for measuring *customer equity* (tangible and intangible, current and potential), in order to broad the *customer database* management approach, towards a customer relationship management system. All of this is aimed at making investment in *customer loyalty* consistent with the prospects for both financial and intangible returns, and at increasing the organisational commitment for integrating all the *customer focused* activities (customer care, call center, etc. etc.) in a wider customer marketing unit.

The management of a customer portfolio is undoubtedly complex and costly, above all from the organisational viewpoint. The recent developments of the exchange processes and the spread of the hypercompetition dynamics, however, do not offer alternatives. And the pervasive development of the economy in the form of digital networks makes customer relationships the only real source of value. Such a source can be enriched only if the customer relationships are, or will become, stable and suitable for the joint development and experimentation of products and firm processes. It is a value creation process that only the real *loyal* relationships can offer.

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