



Robert Ciccone

Customer lifetime value opens financial options

Too few understand simple concept

The other day at a business luncheon, I overheard a discussion where one person was telling another how his son recently joined a "buy five movies for under a dollar" DVD club. The conversation revolved around the implementation of the club's marketing strategy, with the two wondering how these clubs can ever make money when they are "practically giving the stuff away."

So, with this eavesdropped conversation as inspiration, let's look at how that DVD club can afford their strategy and how the underlying concept applies to all businesses, big or small.

Besides the lessons of back-end selling, packaging, up-selling and constant contact, the DVD club also illustrates the important underlying concept of Customer Lifetime Value.

Every business has a customer base, and each customer represents a quantifiable value to the business that goes beyond the initial sale. The "lifetime" value of the customer refers to the measure of worth (value) over the lifetime of your business relationship with that customer.

Small businesses in particular often fail to understand the impact of lifetime value, and it causes them to think short-term instead of long-term when it comes to making key business decisions. Until you identify exactly how much profit a customer represents for the life of that relationship, you can't begin to know how much time and expense you can afford to invest in your lead acquisition and customer retention activities.

Can you afford that direct mail campaign or that newspaper ad? Should you hire another customer-service rep? If your typical instinctive answer is "No" or "I don't know," you probably haven't looked past the initial first-time revenue generated by a customer. This oversight is what causes worried business owners to claim: "There's no budget for that!" But once you know the Lifetime Value of a customer, you take the guesswork out of the equation, and budget for business activities with complete peace of mind.

The formula is simple: Average Dollar Sale Per Customer times Average Number of Times a Customer Buys per Year times Average Number of Years

Customer Continues to Purchase equals Lifetime Value.

There are a number of advantages for any business that fully understands and leverages Lifetime Value. Here are a few:

- You'll realize you have more marketing dollars than you thought, and you'll make better decisions on how and where to invest them.
- You'll know how to deal with customer service issues: when to bend over backwards, and when to let the customer walk.
- You'll know what sales commission and referral incentives you can offer while remaining profitable.
- You'll know how to measure profitability in your activities and put a better focus on repeat, add-on and retention strategies.

When you know the Lifetime Value of your customer, you've got more leverage and creativity, not only in your marketing efforts, but elsewhere in your business. I know one company that gives its salespeople 100 percent of the revenues from the first sale they make. This kind of commission is unheard of. Because they know the lifetime value of their customer, they've determined that it's worth it to give the 100 percent commission. This not only attracts the best salespeople, it also keeps them motivated.

This is precisely why that DVD club can "afford" to justify their front-end spending to acquire each new customer. They know that historically, enough customers will join the program and repeat-purchase enough times to more than make up their costs to acquire the customer in the first place.

The company that leverages Lifetime Value will out-market, out-sell, out-service, out-convert and get more referrals than its competition every time. When you understand the Lifetime Value of your customer, you'll know that you can afford to invest in marketing. You simply need to do the calculation; then use that knowledge to the fullest.

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