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The Lifetime Value of a Customer

Understanding the Value of Your Customer Base

By Robert Ciccone - Success Unlimited Sales & Marketing Group Inc.

It's a common occurrence for business owners to be uncertain about creating a budget for marketing because they don't know how to estimate what they should be spending, and where or how they should be spending it. Should they spend money on customer acquisition or customer service? What about sales training? What percentage of the budget goes to one area over another? Some are even concerned that they can't afford to spend money on marketing. The solution to these issues is to understand and apply the concept of "The Lifetime Value of a Customer".

Anyone who has ever heard me speak about marketing knows that I like to talk about "hidden marketing assets" (i.e., overlooked marketing opportunities), and Lifetime Value is an *asset* that is underutilized and misunderstood by many business owners. You can get more out of your marketing strategy by understanding and leveraging this asset in your business.

What is Lifetime Value? And why should I care?

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

Until you identify exactly how much combined profit a customer represents for the *life* of that relationship, you can't begin to know how much time, effort and expense you can afford to invest in your marketing activities and business operations. Do we need to buy a new machine? Should we hire another customer service rep? We don't know because we don't know how many customers it will take to pay for that machine or that new employee. The "not knowing" is what causes worried business owners to claim, "There's no budget for that!" Once you know the Lifetime Value of a customer in your business, you take the guess-work out of the equation, and you no longer have to

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worry and wonder about what you're spending on marketing: you can budget with complete peace of mind.

The Formula for determining Lifetime Value of a Customer

Lifetime value is a quantifiable concept, and the formula is simple:

> Total profit of an average client over the relationship's lifetime
> (including all residual sales)
> LESS advertising, marketing and incremental product or service fulfillment expenses.
> EQUALS *Lifetime Value of the Customer*

Let's work with a real-life example to better help you see how to apply this formula.

I work with a security alarm company that installs alarm systems in both commercial and residential buildings. For residential customers, they charge an average installation fee of $650. They then charge $35 per month for the security monitoring service. The industry average says that people will stay with the same security company for 5 years.

$35/month X 60 months (5 years) + $650 installation fee = $2,750, which represents the gross revenue per the lifetime of each customer. Now, to get the Lifetime Value, we would subtract the alarm company's overhead expenses for marketing, advertising and fulfillment over the same 5 year period (averaged out per customer, of course). The result is the Lifetime Value for each customer. The company can now see whether or not the revenue they receive from each customer is enough to cover marketing and fulfillment expenses at a profit, and they can determine a marketing budget.

By knowing the Lifetime Value, this company can now make informed marketing decisions. For instance, others in the security alarm industry are offering free installation. Armed with the knowledge of what their average client is worth in terms of Lifetime Value, they now know that they can compete with a free installation offer and match it, if they so choose. Or, they might get really creative and come up with any number of other special offers or programs to compete. With Lifetime

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Value clearly defined, the company knows what it can afford in terms of sales incentives, commissions or other marketing/advertising expenses.

The advantages of understanding Lifetime Value

By now you can deduce that there are a number of real advantages available to any business that fully understands and leverages the Lifetime Value of its customers. Here are just a few:

- You'll realize you have more funds for marketing than you thought you would ever have, and it will free you to be more creative in your marketing efforts.
- You now know how to deal with customer service issues – when to back off and when to give in. If the value is high, you'll go that extra mile without resenting the customer; if the value isn't as high, you can make the decision that it's okay to let the customer go. You'll know where that critical balance lies.
- You'll know how much to spend on holiday or "thank you" client gifts.
- You now know how to measure profitability in your activities.
- You can make better decisions on how and where to spend your money, on marketing and elsewhere in your business.
- You now know how to compensate your sales force. You can calculate how much commission, bonuses and incentives you can offer and still be profitable.

When you know the Lifetime Value of your customer, you've got leverage and more opportunities to be creative, not only in your marketing strategies but elsewhere in your business. There is one company that gives their sales people 100% of the revenues from the first sale they make, because they know the lifetime value and they've decided it's worth it to give that 100% commission to motivate the sales force. This kind of commission is unheard of! How's that for creative leverage?

What happens when a company that understands Lifetime Value goes up against one that doesn't? It's no contest. The company who "gets it" will out-market, out-sell, out-service, out-convert, and get more referrals than its competition, every time.

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When you understand the Lifetime Value of your customer, you'll know that you *can* afford marketing; not only that, you can't afford NOT to invest in a creative marketing strategy. Your business cannot grow or survive without an investment in attracting new customers and keeping your current ones happy. You simply need to take the time to determine the Lifetime Value of your customers; then use that knowledge to the fullest to get the competitive edge on all those other businesses out there that don't "get it".

About the Author

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