



Using Customer Lifetime Value to Make More Money

Customer Lifetime Value (LTV)

The amount of money a person spends with your company, minus all associated costs, is the lifetime value of that customer.

LTV should be used as a planning and assessment tool because it gives you a sense of what you can afford to spend to acquire a new customer. Plus, knowing the potential value of a new customer will help you make better decisions, identify profitable opportunities, and proceed with greater confidence—knowing how much you can (or should) spend, given what you gain from a single sale.

Medicare HMOs, for example, receive a fixed amount of money from the U.S. Government per month for each of their members. With this information in hand, along with a sense of their monthly costs (claims, administration, new member acquisition, etc.) and average customer retention rates, a Medicare HMO can determine how much they can spend to acquire a new member without compromising its profit margin.

A simplistic way of determining LTV, if you sell widget, for example, is to multiply the profit of an average order times the number of widgets an average customer buys per year. Then, multiply the resulting figure by the number of years an average customer stays with your company.

Here's an example: You sell widgets for . Your average profit on each widget is . An average order is 10 widgets or profit. An average customer places an order 10 times a year and stays with your company for 10 years. Thus, the LTV of a widget customer is ,000 or average order X 10 annual purchases X average retention of 10 years.

If you offer a service on the other hand, a simplistic way of determining LTV is to start with the average revenue stream per customer per month and multiply that figure by the average length of retention (in months). Now, follow the same steps with costs and, then, deduct costs from revenue. The resulting figure is your lifetime value.

As an aside, you may not know the length of retention for an average customer off the top of your head. To find out, query your customer database and use spreadsheet functions to calculate average retention. If you don't have the benefit of a customer database with this information, developing this average might be a matter of asking your salespeople what their "sense" of the average is, or what their own sales records show. In any event, start with some means of estimating so that you can refine this estimate as you move forward and keep records of customer purchases.

Once you have an average lifetime value figure for services, you can use it to determine what you're willing to pay for a sale, appointment and response, also known as your "allowables". Through testing and experimentation, you'll be able to adjust your allowables for greater accuracy and profitability.

Here is a sample LTV formula for you to study:

LTV formula for an insurance plan

Average per member per month premium revenue: \$1,000

(-) Average per member per month claims cost: \$500

(-) Average administrative costs per member per month: \$100 optional

(x) Average retention in months: 36

(=) Cash flow before acquisition costs: \$14,400

(-) Sales acquisition costs: \$3,000

(=) LTV before marketing costs: \$11,400

(-) Marketing cost per sale: \$3,000

(=) Net LTV: \$8,400

It's all about getting a response

Simply being aware of the average lifetime value of your customers will make you a more confident businessperson. Knowing how to calculate the lifetime value of a potential customer and how to use that information will enable you to take a giant step toward making more money.

In the next installment, I'll present a short course on knowing when to use direct mail, email, print ads and other direct marketing media. Until then, feel free to call or email me with your questions or remarks.

What We Do

Postcard Marketing Group (www.easymailmaker.com) is a leading direct mail and web portal solution provider that provides businesses and marketing departments a platform for creating, managing, delivering, and measuring the return on cross media marketing campaigns and business communications. It helps clients understand where their valuable marketing money is going, increases campaigns effectiveness, reduces marketing expense, and differentiates themselves from their competition.

We develop, design and implement custom Web Portals, Customer relationship Management(CRM), personalized URL's(PURL, cross media campaign creation and management, personalization of communications, asset management, and a Web to Print Engine, reports and data analytics.

Our solutions focus on driving ROI, reducing marketing costs, increasing brand awareness, and helping the client increase awareness on their clients buying habits.