CLV - Customer Lifetime Value - What does it Really Mean?

Customer Lifetime Value (CLV) can get a little tricky, but I?ll try to make it simple. By now you?ve probably heard the term yet may not fully understand how to use it effectively, if at all. That?s because every ?Tom, Dick and Mary Marketer? have done their best to make it more complicated than necessary.

The hardest part of calculating CLV is figuring out exactly what your customers? ?lifetime? really is?. and the only accurate way to arrive at that number is by getting, storing and analyzing your customers? data. Period. If you?ve been in business for a while, this should be easy to get, but if you?re a start-up you?re going to have to estimate this based on industry standards.

Although there are several ways to arrive at CLV, the easiest is to calculate:

1. The average length of time a customer stays your customer

2. The number of transactions that an average customer will have with you during that time and

3. The average dollar amount per transaction

Multiply these together and you?ll arrive at a usable number. But remember, junk in, junk out? so make sure your original numbers are accurate!

Once established, you can use your CLV as a benchmark for developing a realistic customer acquisition (or retention for that matter) budget. For example, let?s say you find out that your average customer:

1. Stays with you for 5 months

2. Purchases something from you 3 times per month

3. Spends an average of $2 per transaction

In this case your average CLV would be $30. Based on this, it would be foolish to spend even $20 to gain one customer? you?d be left with little, or no, profit (unless of course, your margins are outrageously high). On the other hand, your customers may hang in there for 22 months, spend $20 per transaction and purchase from you a greater number of times. Since your CLV would be much higher, you could afford to pay more to gain a customer. Again, the specifics differ widely and there are many factors to consider, Also note that this does not include any costs associated with preserving this customer relationship. In the real world these must be included.

It is crucial that you understand your CLV and use it to guide your communication decisions! (A good book on this subject is Donald Lehmann and Sunil Gupta?s, ?Managing Customers as Investments?? visit our website, www.StrategicMarketingAdvisors.com for a review and ordering information.)

3. Your specific goals, such as: * Acquiring ?x? numbers of new customers * Increasing the number of current customer transactions * Increasing the length of time your customers remain your customers

4. Proposed media costs and actual/forecast response and sale rates (you can find these out online or from any reputable advertiser)

Once armed with this information, you?ll be in a good position to choose. Here?s an example of how this might work. Let?s assume the following:

* I am a widget retailer

* My goal is to get 1,000 new customers this year

* I will get 200 customers whether I do ?anything? or not? (for example word-of-mouth, walk- ins, etc.)

* That means, I need to acquire the remaining 800 using some form(s) of advertising

* I can spend $40,000 to ?buy? these 800 new customers

* My CLV is $40

* After careful consideration, I decide to conduct a direct mail campaign

* Based on my careful research and experience, I know that I can sensibly assume that 1% of my audience will respond by calling (called a ?response rate?) and that 80% of the responders will become new customers.

* Given this forecast and my goal of 800 new customers, I know that I?m going to have to mail out 100,000 sales letters.

* As luck would have it, the cost to create, print and mail one letter is 37 cents (using 3rd class postal rates) which comes to $37,000? leaving me with a $3,000 ?fudge factor?

So, let?s see where I stand?

1. The campaign cost is well within my budgeted amount of $40,000, my forecasts are reasonable based on industry standards and experience, and can realistically accomplish my goals. So everything is perfect, right? Wrong.

2. 800 customers with a CLV of $40 will result in revenues (over time no less) of only $32,000! That?s called a losing proposition!

What should I do?

1. In the short term, find out if there are less expensive advertising vehicles that may bring you similar results.

2. Find ways to reduce the direct mail costs without sacrificing response and sale rates (e.g. one color vs. four; lighter paper stock).

3. Identify ways of increasing the sales rates (for example beef up the offer; send to more people ? you?ll get economies of scale this way so the per piece price will drop dramatically and you?ll acquire more customers)

4. Offer added products to increase your customer?s average transaction amount

5. Institute robust retention programs aimed at increasing the longevity of your average customer

Although this is a very simple example of how CLV works, it clearly demonstrates how important understanding it is to your business. Without considering CLV, you'll be shooting in the dark - potentially wasting thousands of dollars and commiting serious, or even devastating, blunders.

Short note about the author

Mary Eule specializes in helping small and medium-sized businesses get and keep profitable customers. Formerly a Fortune 500 marketing executive; founder of two successful small businesses and award-winning speaker, Ms. Eule is President of Strategic Marketing Advisors, LLC. and co-author of a new book, "Mandatory Marketing: Small Business Edition".

She has a BA in Journalism/English from the University of Maryland and earned her a master?s degree in marketing from Johns Hopkins University. Log onto her website: http://www.StrategicMarketingAdvisors.com for free articles, newsletter and helpful marketing tools, tips and templates? and/or to purchase the book.
