Upturn

POINTING YOU IN THE RIGHT DIRECTION

How to Calculate the True Value of Long-term Relationships

Lifetime Customer Value

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Why Acquisition Marketing Will Put You Out of Business

When most people think about marketing, it is almost always focused on finding new customers. It is about meeting people they don't know and converting some of them into prospects and a few of them into customers. While this is an important component of marketing, it is difficult to sustain. Acquisition is the focus. Acquisition is the philosophy.

But this acquisition mentality is a huge problem for many organizations, because it tricks them into thinking that the faster they acquire, the faster you will grow. Everything is focused on finding the "next" customer—and not on exploiting the untapped value of the customers you already have. In time, you will just run out of business and wear yourself out.

Lifetime customer value is one of the hottest concepts in marketing today. This philosophy says that marketing should be focused on the entirety a customer could represent to your organization. Instead of the customer being worth only one sale, it suggests that the customer is very, very valuable when you consider all that they might spend with you. It includes concepts such as:

- The total amount of revenue the customer will spend over the life of your relationship.
- The total number of referrals (and their worth) to your organization.
- Advice, recommendations and other insights about new products and services.
- Assistance with articulating and defining your organization's brand image.
- Giving your business a fighting chance to succeed long-term and outlive your competition.

What I like best about this concept is that it elevates marketing efforts and makes them significant, especially when they are designed to build and maintain relationships. Instead of making a $5,000 sale, you have the opportunity to make a $50,000 over the next 3-5 years. Talk about dramatically improving your marketing ROI (return on investment).

Lifetime customer value also keeps you focused on high payoff activities—like selling to your existing customers which are easier to close. In the long run, your profits will increase because you are investing fewer resources in bringing in new business.

How to Calculate the Lifetime Value of a Customer

The simplest way to estimate the lifetime customer value is to: Determine how much a customer is likely to spend with you over a specific period of time (e.g., one month, one quarter or one year). Multiply that number by the total amount of time you anticipate that the customer will buy from you. Add the lifetime value of any referrals the customer may provide. Subtract out your estimated cost to acquire and maintain the customer.

A simple example could be:

- A customer who generates $10,000 a month to your business ($10,000 X 12 = $120,000 per year).
- On average, customers stay with you three years ($120,000 X 3 = $360,000).
- Most customers give you one referral a year to a customer who is also worth $10,000 per month ([$10,000 X 12 = $120,000] X 3 = $360,000).
- And this customer gives you a product idea which generates an additional $25,000.
- **Total lifetime customer value: $745,000.**

There's no doubt that you will treat a customer who you think is worth three quarters of a million dollars of business more importantly than one who is worth only one $10,000 sale. Yet, most of our customers—when we calculate a lifetime customer value—are worth a whole lot more than we first think.

Obviously, there are many more complicated formulas for determining a customer's lifetime value and beyond the purpose of this newsletter. However, as you think of what might go into your formula, consider including the following items:

- Average length of a customer relationship
- Average annual revenues per customer
- Average annual sales costs per customer
- Premium price charged for product or service
- Operational cost savings of servicing existing customers who already know how to buy from you
- Reduced acquisition costs (because customers made a referral)
- Discount rate(s)
- Retention rates (percentage of customers who stay with you year-to-year)
- Number of referrals per existing customer
- Percentage of customers with first product who buy other products and when they buy them
- Price sensitivity (number of customers you will win/lose if you lower/increase your price)
- Amount of money you might make if you outsourced all or part of your product or service production