Customer Lifetime Value

CUSTOMER LIFETIME VALUE

Most of my initial meetings with new clients follow the same general format. They come to me and want to use a very specific marketing channel to grow their business. Then we sit down and have a discussion on why they want to use that certain form of marketing with their business, and through a series of questions and answers, I get back to the real purpose of the meeting: what they want to change about their current business. This is almost always to grow revenue and customers in a specific way. Once I get the prospect to this point is where the real work starts.

That is my starting point to work on a marketing strategy for the client.

- ☑ The first and most important thing that I am looking for in new discussions with clients is what they are trying to achieve.
- ☑ The second is always budget. How much money do I have to achieve the goals that we are looking at.

The objective tells me what I am going to do, but the budget lets me really figure out how.

When looking at budget, which usually comes at the very end of the meeting, I usually get a stumped look on my client's face because they have no idea.

Dealing with small businesses, I work with budgets from $200 and up. $200is ashoestring budget that we can't really achieve a whole lot with, but I am going to try anyway. The higher we are the easier it gets, but the budget that we are working with is one of the most important parts of what I do, and it shouldn't be left to a gut feeling or guess work.

Customer Lifetime Value

When I work on a marketing budget for my own company, I want to look and see where my profits are.

To find that information, I need to know what my Customer Lifetime Value (CLV) is.This is one of the most important metrics that you should know.

Customer Lifetime Value

Bigger and more complicated businesses may have a number of CLV metrics and calculations that they use, depending on the customer. For Coca-Cola, it would be much harder to calculate. There are customers who are forced to buy Coke products because the restaurant/corner store/hotel where they are at only has that brand.

Then there are the grocery store buyers, some of whom are very brand loyal and some who only buy what is on sale that week. I don't envy the analyst team that has to make those calculations. We don't need to get that complicated, but it is a good frame of mind to start with. Luckily, for most small businesses, this is a much easier calculation to make.

For example...

Let's take a local martial arts academy. They offer one service, $79 for unlimited martial arts per month. As more students come, the profit rises because the fixed costs of the space to rent, instructors, etc., remain the same. One way to increase that profit is do local marketing to increase the number of students attending. The simplest CLV calculation is pretty easy to use in this situation.

Annual revenue per customer x number of years of retention– customer acquisition cost = CLV

I think most of us should be able to do this math pretty easily. Many times, we may not have the exact numbers historically, and that is okay. In the future, try to look at this once a year to keep a mark on your marketing efforts. In the meantime, we will use the closest estimation we can get.

In our example, let's say that the average student will stay at the martial arts school for 7 years. That means we can expect to generate $6,636 in revenue from each student that we have. Now we can work backwards into a marketing budget based upon what we already know.

What are you willing to pay to acquire that student?

Customer Lifetime Value

Let's do the math!

Breaking down a marketing campaign, I can say that we spent $3,750 on a direct mail campaign to 5,000 local residents. A conservative response rate for a direct mail campaign is 2%. Then the close rate, or number of students who tried a class and signed up, is much higher at 70%.

Time to pull out our calculators again...

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The simplest CLV calculation is pretty easy to use in this situation.

2% x 5 000 = 100 responses ❯ **70% x 100 = 70 new Students**

Okay, I know that the math is never this simple in real life, but a girl can dream, can't she?

So now we go back to our CLV calculation. Each of those new students is worth, on average, $6,636 during their time at the school. Then we spend $3,750 on a campaign to bring in 70 new students for a lifetime value of $464,520. WOW! Let me say that again, I spent only $3,750 and in return I got $464,520 over the next 7 years?

That seems like it is worth it to me.

PANTHER CITY Marketing

Customer Lifetime Value

This is why I believe in marketing. It works when you look at it from a numbers-based evaluation.

What is my ROI? I understand that marketing is never this simple, and that there are a lot of moving parts, but this is a key calculation that every business owner should run through. When looking at the monthly fee, it might not make sense to spend $3,750 to earn $5,530 the next month, but when you look at the CLV as we have, then the marketing efforts make a lot of sense.

This is why you have seen a lot about customer retention and why it is so important. That is a completely different blog post all together, but that doesn't matter. The point is to look at the entire picture, and not what is happening a month or even a year from now.