Lifetime Customer Value

What are your customers really worth?

Far too many business owners are locked into a short-term view. It's a natural tendency to think something like: "I place an ad that costs £1,000. That ad brings in 230 responses, and of those, 21 turn into actual sales. At £90 per sale, I have a gross income of £1,890. When I subtract the cost of the ad I end up with £890. Next I subtract my other expenses associated with producing or buying my product wholesale, fulfilment, salaries and other factors, and I end up with about £230 in net profit."

Results like these can seem discouraging. After all that money spent and effort, you end up with a tiny £230. To get another £230, you have to do it all over again -- buy another £1,000 ad, and all the rest. This is where a lot of business people drop out and try something else that seems more profitable.

But wait -- this view of things is too short sighted. The initial ad brought in 21 new, paying customers. What if that same business person had read my earlier item on back-end marketing and had a second-tier product ready to sell after each of those 21 customer paid £90 for the first? What if his second-tier product sold for £65 and 13 of the 21 also bought it in addition to the first product? That's an additional £845, which you add to the first £230 for £1,075! Suddenly things are looking a lot more profitable - but this is still not the end.

Repeat customers are the backbone of any business

If the seller does what he must to keep the customer satisfied and coming back for the next three to five years, each of those customers may end up spending another £400 or £500. If each of those original 21 customers is converted into a long-term customer spending £500 each, that's £10,500! Now, we're talking.

It's reasonable and perhaps even conservative to expect another £500 in sales over the next five years from each customer you capture with your initial ad, for which you paid £1,000 - which had actually generated more than 10 times that cost - £10,500. Furthermore, each of those initial customers will often refer a friend, (or you can be even more proactive by asking for a referral) and sometimes more than one friend to also make a purchase. You pay nothing for a word-of-mouth referral - and the result is even more profit that can be tied to your original ad expenditure.

Remember who your customers are – they are another word for sales

So what you should do is calculate the lifetime value of each customer. Doing so helps you realise that you can spend a lot more on ads and other marketing tools to go out and get them simply because the long-term payoff is literally... fantastic. When you know that the lifetime value of each customer may be £500 to £900 each, for example, then a £1,000 ad that gets you 21 of them is a real bargain.

Another benefit of knowing the lifetime value of your customers is that because you know that a £1,000 ad – as per the above example - will generate £10,500, it provides you with the ability to plan and estimate your future cash flow with a degree of certainty.

Furthermore, should you ever want to sell the business, demonstrating this knowledge could have a tremendous impact on the capital value and therefore the sale price.

All of this requires a long-term view and planning, however, to happen. You have to be prepared with back-end products to sell, you have to sell quality and make the customer want to come back, you have to develop a healthy relationship with your customers, and more. But when you plan and take a long-term point of view, you set yourself up for long-term success. You also gain the confidence of spending what you need to spend to get new customers, knowing that it will pay off.