



White Paper

How much is a customer worth?

Measuring lifetime net value

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1. Introduction

It goes without saying that the ultimate goal of all marketing activity is to increase revenue, but at what cost? How much is it worth investing in capturing a new customer?

This white paper sets out a practical approach businesses can take when assessing their investment in sales and marketing.

2. How much is a customer worth?

Sometimes we can get diverted into discussions about customer base, market share or competitive positioning, yet they are all subsets of the same objective of driving more sales for the business. Generally there are three parameters for growing revenue, all of which will be crucial for success:

- Increasing the number of customers or clients
- Increasing the value of the average transaction
- Increasing the frequency of re-purchases

It is worth taking some time to reflect on what we believe to be the key levers for the organisation and how the marketing strategy addresses them. This concept of business optimisation will enable us to target scarce marketing funds much more precisely. A simplistic example can illustrate this. Let's say that right now we bring in 500 new customers per year, each of whom makes one purchase of roughly \$100:

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<u>New Customers</u>	X	<u>Average Sale</u>	X	<u>Repurchase Frequency</u>	=	<u>Total New Sales</u>
500		\$100		1		\$50,000

We might run a major marketing initiative to bring in an extra 50 customers this year meaning:

<u>New Customers</u>	X	<u>Average Sale</u>	X	<u>Repurchase Frequency</u>	=	<u>Total New Sales</u>
550 (+10%)		\$100		1		\$55,000 (+10%)

Now what would happen if we didn't focus only on getting new customers, but also on increasing the average sale value per customer and their number of repurchases that year, also by 10%?

<u>New Customers</u>	X	<u>Average Sale</u>	X	<u>Repurchase Frequency</u>	=	<u>Total New Sales</u>
550 (+10%)		\$110 (+10%)		1.1 (+10%)		\$66,550 (+33%)

Although it may seem obvious, the overall business impact of a modest improvement in all three parameters is significant and the marketing strategy needs to take account of this. The true value of a

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customer lies not merely in what they spend on an initial purchase but rather their worth throughout the lifetime of the business. This, incidentally, goes beyond their own repeat purchases since they should also be a source of referrals and word-of-mouth advertising. When setting a target for the cost of customer acquisition this concept of net value is crucial since the target may well not be achieved on the first sale. Investment needs to be made in all three areas to allow a customer to achieve their full worth.

To increase the number of new customers, it is tempting to focus a lot of attention on stimulating curiosity in the market which will either drive prospects to the website, cause them to phone in or condition them for a direct sales approach. Yet, without a fierce focus on conversion this effort could be wasted. With very little extra effort it should be possible to increase the chances of an interested prospect turning into a confirmed sale. In another white paper (*'Does the sales team get it'*) we discussed the power of building Potential Use Scenarios to enable prospects to "see" how they would benefit from using this product. However, underpinning this it is important to recognise that all organisations need to invest in Education-Based Marketing to some degree in order to condition their potential market.

It is unsafe to assume that because the internet is full of information this will enable customers to make wise buying decisions. That is because it does not address consumer fear. Fear of: overpaying; looking foolish; buying a "lemon"; not buying the best; buying something they don't really need; that the promised benefits won't appear; that the company will not stand behind the product; that they won't get a refund if they make the wrong choice. Information overload can be a turn-off but the prospect needs as much relevant information as we can get to them to help them make what they believe to be the best decision. If they regard our company as the honest and trustworthy teacher who gave them a good education then they are much more likely to buy from us. Highly educated consumers have the ability to differentiate the benefits of products and services which in turn gives them a sense of comfort and security. The amount of education we need to give prospects varies but is based on the value of our product or service and their awareness of it – and it is always more than we think!

Our second key parameter is average sale value – encouraging customers to spend more money each time they shop. All organisations are engaged with customers at a certain level of revenue and ongoing, consistent efforts must be employed which help them do business at a higher level of revenue. Most companies limit their contact with customers to the area of service or products in which the customer originally expressed interest. But once the relationship has been established it makes sense to utilise it to the fullest extent. Again our role is to help the customer understand what other purchase opportunities there are through merchandising actions. There are many possible routes but the ones we should pay the most attention to include:

- **Cross-sales:** related products or services to a prospect viewing or buying from the website, by phone or face-to-face
- **Up-sales:** a more advanced or expensive product than the one being considered

- **Volume discounts:** a powerful incentive for the customer to bulk buy up front
- **New in stock:** new items that have "just arrived". This can be great for early adopters who always want to be on the leading edge of whatever is new
- **Package deals:** combine a number of items into a package with a special discount, which might also help shift slow items
- **Free delivery with orders over a certain number or value:** encourages customers to top up their order to save money
- **Free gift with orders over a certain number or value:** again encourages the customer to top up their order

All of these are pretty much "business as usual" actions, but how often are they costed into the complete equation of the true value of a customer's lifetime worth to the company? This also leads into our third parameter of repurchase frequency. If customers perceive that in some way they are getting a good deal then they will be minded to turn to our company first for their future purchases.

Loyal customers are by far the most cost-effective source of revenue.

Loyal customers are by far the most cost-effective source of revenue. On top of providing excellent service, there are at least seven "magic moments" when we can reinforce the bond by just going that extra mile at the right time:

1. **Pre-planned moments:** It is important to take time out to thank solid, steady reliable customers who never complain but keep buying. These "non-squeaky wheels" are often the most neglected but equally the richest source of revenue. Even a plain thank-you letter can reinforce loyalty and should be in plan quarterly or every six months.
2. **When a customer complains:** Odd though it may seem, this is a really magical moment when the customer does us a favour by saying what they think! Most dissatisfied people just disappear into the night until they turn up at a competitor's door. Complaining customers give us a chance to regain their loyalty and help spot problem areas in our operation. A recent survey showed that, on average, 96% of unhappy customers never complain, especially about little things. So for each complaint received there are probably 26 silent voters. But a disgruntled customer, like an elephant, never forgets. We know the power of both good and bad stories related by customers so we should regard each complaint as "hitting the jackpot" and treat it accordingly. The most vociferously loyal customers are those that have been through hell with the company but have come out the other side totally impressed by how their situation was personally resolved.
3. **When a new customer comes back to place a second order:** However big or small the order the customer has made a positive choice. A small token of appreciation for their vote of confidence can work wonders.
4. **When a customer has thanked us:** If somebody has gone out of their way to express gratitude for something we have done then it presents a tremendous opportunity to deepen and strengthen the bond with a small token that says "We appreciate you too".
5. **When a customer has had a bad experience:** It may be our fault or theirs but if we have worked together to resolve the issue, let's just do a little extra.

... we must anticipate and plan for these magic moments...

6. **When a customer needs a favour:** If we can help them through an issue by bending a procedure then we should, but also ensure they realise we have made them special.
7. **When the customer brings in a referral:** This is a great position because we have just acquired a new customer with a full lifetime's worth at no cost. A reward, however small, is appropriate, even if there is no published "recommend a friend" scheme.

None of these activities needs to be very expensive. It is the thought that counts, but we must anticipate and plan for these magic moments so that we are ready when they arise or else we will miss a golden opportunity.

So, when setting out the marketing strategy, the concept of customer lifetime net value should be at the forefront of our minds. Most organisations would claim they do this but typically their focus and detailed planning slides down from being heavy on the customer acquisition actions to moderate on the average sale to low or ad hoc loyalty initiatives on the repurchase front. A robust and comprehensive strategy to drive revenue growth demands attention on all three parameters.

3. About the author

Rhys Torrington leads Wright Associates Sales Performance focus area. Rhys has over thirty years executive management and consulting experience in the technology sector gained with major organisations such as IBM, Groupe Bull, SAIC and Gartner Consulting.

His focus is on helping companies take their propositions to market, particularly in an international context. For most organisations this means enhancing their direct and indirect sales capability and Rhys is a leading sales management mentor, coach and trainer.

As an example, he has most recently worked with an international mobile telecommunications company in creating and launching a full function pay-TV service across sub-Saharan Africa. Previously he led several major European Go To Market engagements with leading technology companies on behalf of Gartner Consulting.

4. About Wright Associates

Founded in 1994 Wright Associates is a management consultancy firm offering support to senior executives lacking the time or resource to deal with critical issues as fast as they would like. Our clients range from corporates to SMEs and start-ups. We work across business sectors with a particularly strong track record in technology, media and services. Our services are grouped into focus areas:

- Go to market
- Decision support and planning
- Sales performance
- Africa solutions
- Organisational support

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