LIFETIME VALUE OF THE CUSTOMER

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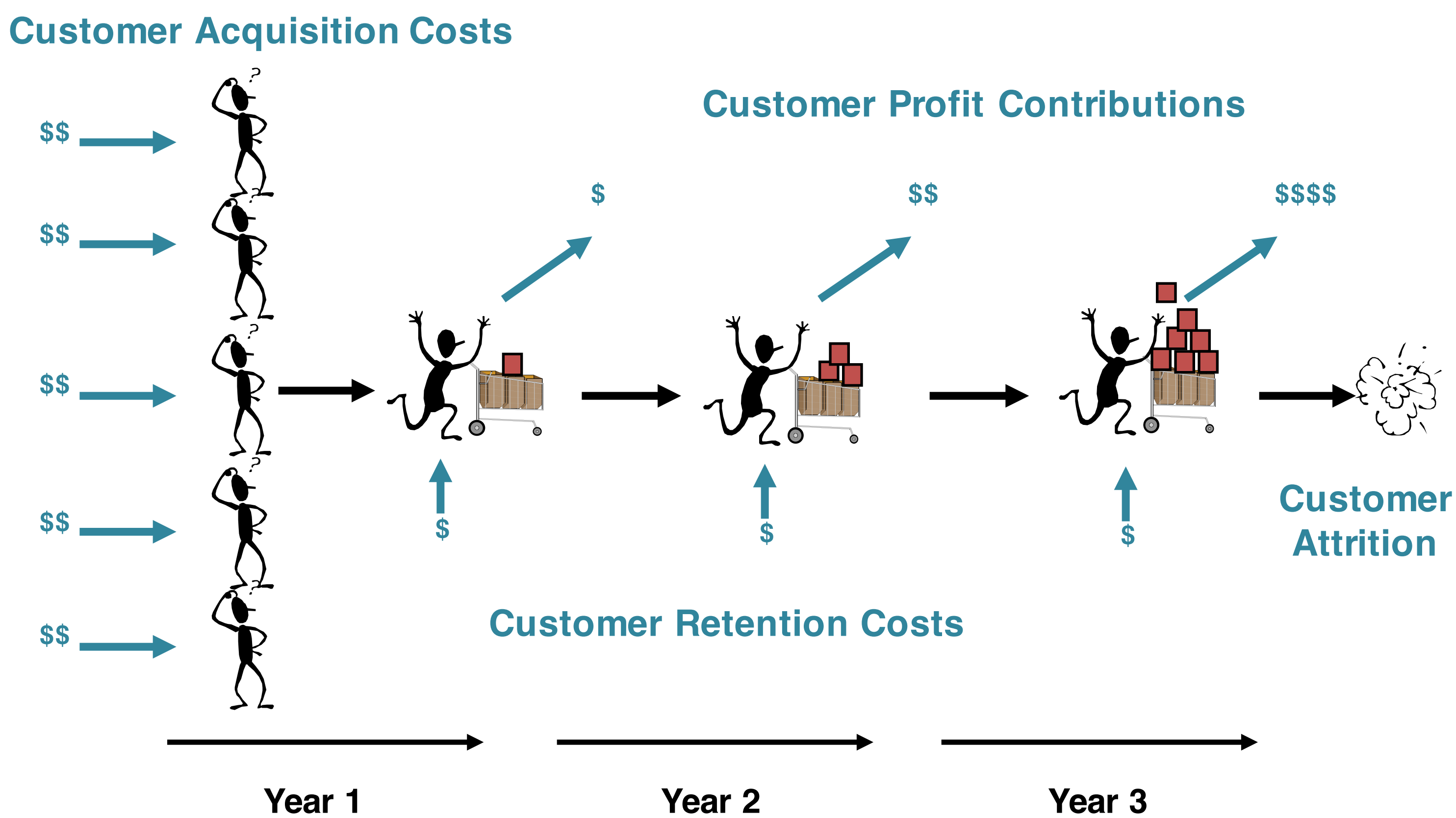
Lifetime Value of the Customer: Overview

- The CLV process
  - Visualization
  - Individual components
  - Implications of the CLV perspective

- CLV calculations
  - Without attrition and discounting
  - With attrition
  - With attrition and time value of money


Customer Acquisition Costs
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Customer Profit Contributions
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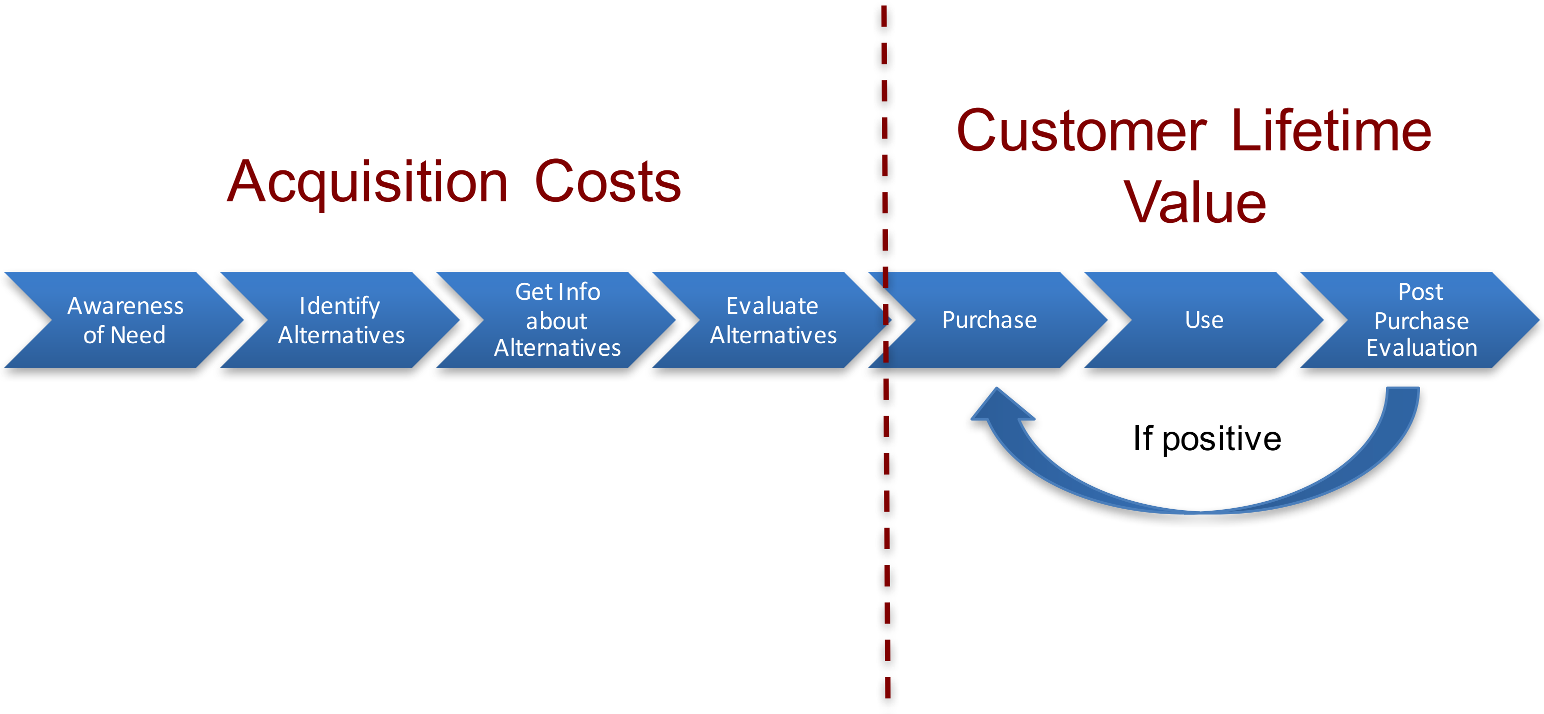
Customer Attrition
Customer Retention Costs
Year 1
Year 2
Year 3


Acquisition Costs
Customer Lifetime Value
Awareness of Need
Identify Alternatives
Get Info about Alternatives
Evaluate Alternatives
Purchase
Use
Post Purchase Evaluation
If positive

Customer Status

Customer Value		Inactive	Active
	Low	Minimize Effort	Increase Transactions
	High	Targeted Promotion	Foster Loyalty

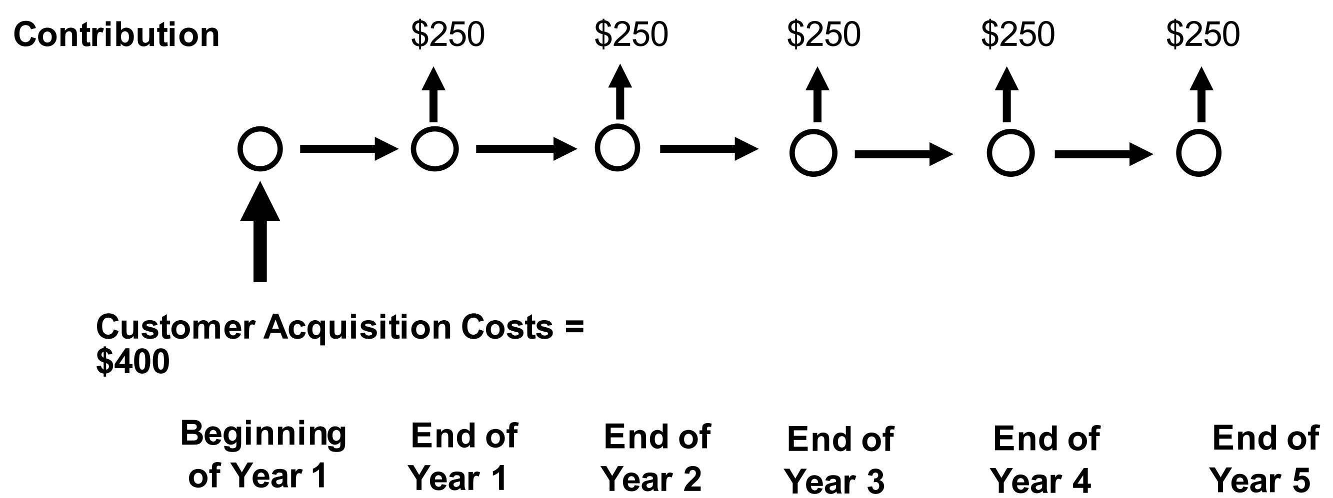
Practical Uses for CLV

- Acquire an individual customer
  - Is it worth the effort and at what price?
- Retain an individual customer
- Fire an individual customer
- Acquire an entire customer base (or firm)
  - How much should one pay?

Customer Lifetime in Action

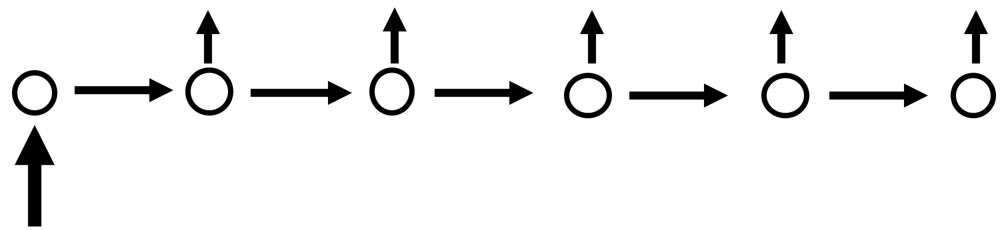
- **In order to complete the calculations we will need to know**
- ***m*** = margin = ***(p – c)***
- ***r*** = retention per period
  - Estimated as the percentage of customers returning **when they have the option to leave**
- ***d*** = discount rate (or, ***i*** = interest rate) for "time value of money"
- ***t*** = index for time periods

- Assume no customer attrition
- Assume value of money does not change with time (no discounting)
- CLV = 5 x $250 = $1,250
- CLV net of Acquisition Costs = $1,250 - $400 = $850



- Assume probability of losing a customer is .2 each year (retention rate = 80%)
- CLV = $250 + $200 + $160 + $128 + $102 = $840
- CLV net of Acquisition Costs = 840 - 400 = $440

Expected Contribution EC	$250	$250 x .8	$250 x .64	$250 x .51	$250 x .41
Retention Factor	1.0	.8	$.8^2$	$.8^3$	$.8^4$
Contribution	$250	$250	$250	$250	$250

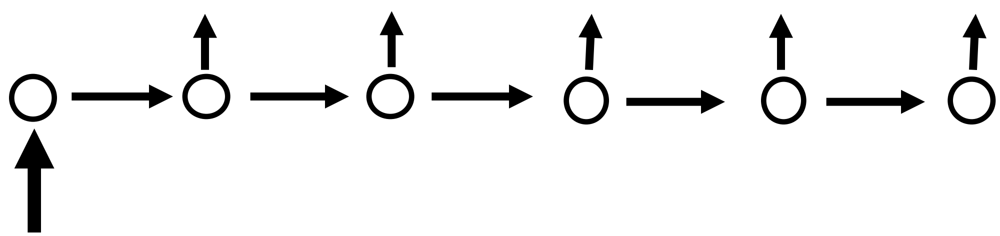


Customer Acquisition Costs = $400

Beginning of Year 1 | **End of Year 1** | **End of Year 2** | **End of Year 3** | **End of Year 4** | **End of Year 5**

- Assume probability of losing a customer is 0.2 each year (retention rate = 80%)
- Assume value of money decreases with time (discounting included); first year contribution comes at end of the year
- CLV = $227 + $165 + $120 + $87 + $64 = $664
- CLV net of Acquisition Costs = $664 - $400 = $264

EC x DF	$250/1.1	$200/(1.1)^2	$160/(1.1)^3	$128/(1.1)^4	$102/(1.1)^5
Discount Factor	1/(1+0.1)	1/(1+0.1)^2	1/(1+0.1)^3	1/(1+0.1)^4	1/(1+0.1)^5
Expected Contribution EC	$250	$200	$160	$128	$102
Retention Factor	1.0	.8	.8^2	.8^3	0.8^4
Contribution	$250	$250	$250	$250	$250



Customer Acquisition Costs = $400

Beginning of Year 1 | **End of Year 1** | **End of Year 2** | **End of Year 3** | **End of Year 4** | **End of Year 5**

CLV $\approx$ Return/Churn

= \$250 / (1 - .8) = \$1,250

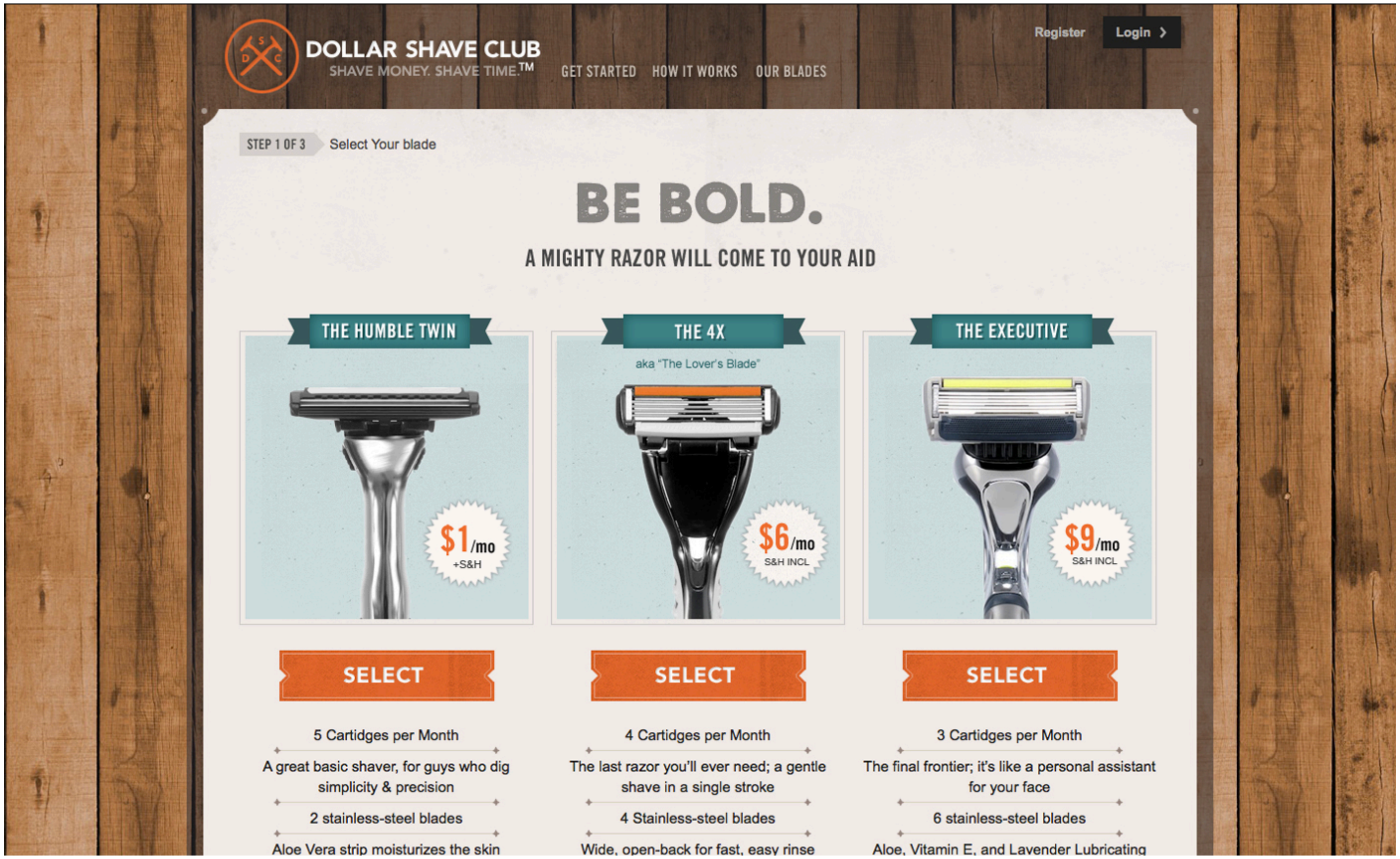
CLV $\approx$ Return/(Churn + Discount Rate)

= \$250 / (.2 + .1) = \$833

Acquisition Targeting

- Be **selective** (initially) and acquire so long as CLV is positive!
- Be **prepared** to see acquisition efforts get harder!
- Be **aware** that the more leverage you get from **retention** the more you should be prepared to pay to acquire
- Be **informed** that investors like to see as much recovery as possible from **fewer** transactions
- Be **reminded** that customers are heterogeneous on
  - Retention profit potential
  - Acquisition recovery time

CLV in Action



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