# **Customer Lifetime Value**

### What is Customer Lifetime Value (CLV)

- Present value of customer relationship
- Pay upfront vs after service
- Discounted cash flows (net)
- How much to spend to retain/acquire
- Valuation of company
- To segment customers

# What are the components of CLV?

- Retention spending
- Retention Rate
- Margin
- Discount rate

# A Simple Metric - Netflix

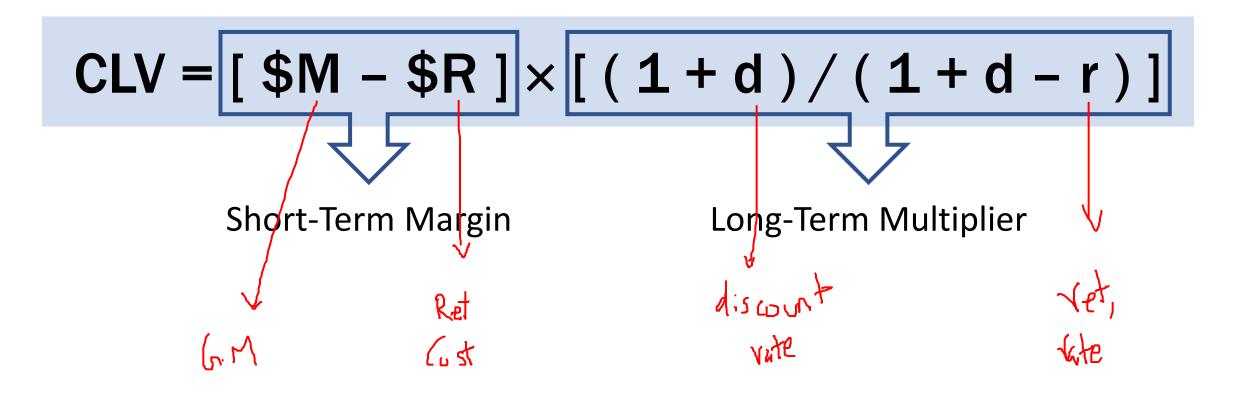
| Expected Customer Lifetime in Months           | 20    |
|--|-------|
| Average Gross Margin per Month per Customer    | \$50  |
| Average Marketing Costs per Month per Customer | \$10  |
| Average Net Margin per Month per Customer      | \$40  |
| Customer Lifetime Value                        | \$800 |

### Lifetime Value of a Customer (CLV)

- Just like we use Net Present Value (NPV) to evaluate investments and companies, we use CLV to evaluate customer relationships
- CLV is the expected NPV of the cash flows from a customer relationship

CLV is defined as the discounted sum of all future customer revenue streams minus product and servicing costs and remarketing costs.

#### The Base CLV Model



### Example 1 - Netflix

Netflix charges \$19.95 per month. Variable costs are about \$1.50 per account per month. With marketing spending of \$6 per year, their attrition is only 0.5% per month. At a monthly discount rate of 1%, what is the CLV of a customer?

If Netflix cuts retention spending from \$6 to \$3 per year, they expect attrition will go up to 1% per month

Should they do it?

# Challenges / Tips?

- Same units of measure
- Retention vs Attrition rate

- Net worth of the customer
- Company's worth (based on customer valuation)
- Optimize / simulate yield. Tweak variables to calculate churn
- How much to spend on acquiring a new customer?
- Or retain an existing customer

#### CLV-Initial Margin

- Customer pays before using the service
  - e.g., apartment rentals, Netflix,
    Hulu

- Customer pays after using the service
  - e.g., credit cards

$$CLV = [\$M-\$R]^*[(1+d)/(1+d-r)]$$

$$CLV = [$M-$R]*[r/(1+d-r)]$$



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$$CLV = [$M-$R]*[r/(1+d-r)]$$

### Market Cap & CLV

- Differences?
  - Variance in Mcap
  - External (sentiment) vs CLV Internal
  - Normalized adjustment
- Similarities?
  - Lag in trend

- What increases CLV the most?
  - Retention
  - COGS (Margin)

#### What Is CLV Used For?

- To determine how much to spend to acquire a customer.
- To determine how aggressively to spend to retain a particular customer or group of customers
- To value a company

#### Conclusion

• Customer Lifetime Value can provide a forward looking measure of the customer relationship.

It can connect marketing strategies to financial consequences.

 Strategic marketing alternatives, (e.g., targeting, and promotion campaigns) can be evaluated based on whether they improve customer retention, and lifetime value