Customer lifetime value calculator, CLV calculation in business marketing and why customer lifetime value is important…

This article is about a **customer lifetime value and includes a customer lifetime calculator** or what is often abbreviated to CLV calculator. I'm also going to explore **CLV calculation** and how to calculate the lifetime value of a customer.

Customer lifetime value is one of the most important metrics or Key Performance Indicators (KPI's) for businesses to track and manage. However, not many businesses track it. If you're new to the term or not quite sure what it means it is known for a variety of other names too, which include CLV, lifetime value or total customer value.

Essentially, customer lifetime value refers to what each of your customers or clients are worth to your business over a long period of time. That's assuming your customers stay with you for a long time. If not, then you need to look at what you are doing in terms of customer retention strategies.

Customer lifetime value; lifetime value calculator and CLV calculation

The cost of acquiring new customers vs retaining and servicing existing customers is much higher. Also, it's much easier and cheaper to sell to existing customers, assuming they're happy customers, than to sell to new customers.

Also, by understanding the impact customer lifetime value can have on your business; this will help you to understand how to grow your business too.

But before I look at the calculation of **lifetime value**, it's worth understanding the meaning of customer lifetime value.

Customer lifetime value definition or customer lifetime value meaning…

Customer lifetime value (CLV) is defined as the total amount of revenue derived from a customer over the entire relationship with that customer. For example, if a customer has a net spend of on average of £500 per year (net means net of cost of sales) with you and they remain as a customer of five years, the **customer lifetime value** (CLV) is £2,500 (i.e. £500 x 5 years).

This is better explained further with a **customer lifetime value example**…

Customer lifetime value example…

Mr Smith became a customer of *CLV Calculation Ltd* on 20 September 2014. On that day he purchased £65.00 of products from the business.
In the following month the same client spent £159.00. The next time Mr Smith bought from *CLV Calculation Ltd* was in January 2015, when he spent a further £360.00. There was then a gap of nearly 12 months before he next spent £450 in December 2015.

In 2016, Mr Smith spent £115 in March, April and September and £255 in November. His last purchase from the company was £45 in August 2017, at which point he explained that this was his last purchase.

He didn't provide any reasons for his decision to leave, and the employee of *CLV Calculation Ltd* didn't think to ask why…more on this later in the article and why it's important to hold an exit interview with your 'leaving-customers.'

Customer lifetime value calculation for CLV Calculation Ltd and Mr Smith…

The **lifetime value calculation** for Mr Smith is done by taking his total spend over the lifetime of him being a customer.

The total gross lifetime value of the customer Mr Smith in the period from 20 September 2014 through to August 2017 is £1,679 (i.e. £65+£159+£360+£450+£115+£115+£115+£255+£45).

However, this is the gross lifetime value of the customer Mr Smith. But this is not the true value, as we haven't taken into account the costs associated with these sales to Mr Smith.

True customer lifetime value calculation…

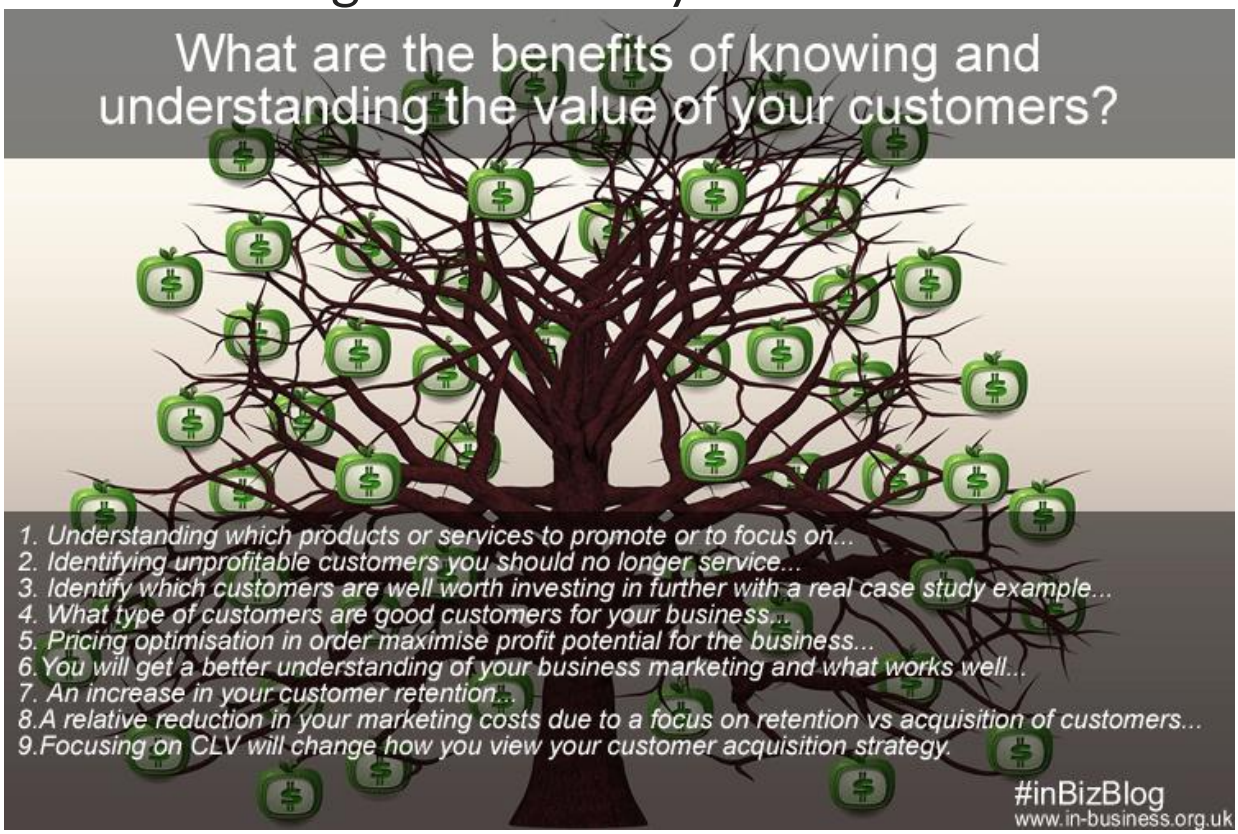
To get a true lifetime value of Mr Smith we need to look at the gross profit he contributes to the business. So let's assume that the cost of goods sold to Mr Smith for the products he buys is 40%. This would result in a true customer lifetime value of £1,007 (i.e. £1,679 – £672 = £1,007).

How to determine the value of a customer…

When you determine the value of a customer, there a few key principles to consider, which include:

- **How much a customer spends with you each year:** The amount a customer spends with you each year will help towards determining how profitable they are to your business. This will include the frequency of visits and the amount they spend at each visit. See the section on customer lifetime value formula below.
- **How often a customer refers new customers to your business**: A customer that refers new customers to your business should be regarded as an advocate. This is especially true if they recommend new customers, despite not having a customer referral program or some form of reward scheme in place to encourage this form of growth. Customers that recommend without reward are highly valuable customers to have and to retain.
- **The customer difficulty scale**: How difficult a customer is to deal with? The more difficult the customer, the less valuable they become. But conversely, the easier they are to work with, the more valuable they should become. Difficult customers that take up excessive time are less valuable than those customers that are not time hungry at all. These types of customers that take up loads of time and energy and cause problems for your employees need to be managed properly. In some cases they should be sacked or encourage to leave to go elsewhere.
- **Length of time they remain as a customer**: The longer a customer stays with you, the more valuable they become. This is especially true of your advocates who are customer referrers. It is therefore essential to recognise your '**hero customers**' and introduce special rules to thank them for their loyalty.

What are the benefits of knowing and understanding the value of your customers?



Through knowing and understanding the value of your customers, there are a number of business growth benefits, which include:

Understanding which products or services to promote or to focus on…

CLV takes into account the products or services that are more profitable for the business. Identifying key profit metrics in this way will help you to focus on business growth.

This works in two ways; firstly, by helping you to identify those products or services that are most profitable and should therefore lead to more promotions of these products or services.

Secondly, it highlights those products or services that are not so profitable. The non-profitable products should be discontinued, unless they act as a loss-leader for your business.

Identifying unprofitable customers you should no longer service…

As with the need to identify products or services that are not profitable, it is also important to identify non-profitable customers too. I would encourage you to find ways to convert these non-profitable customers into profitable ones, instead of getting rid of them. However, if after working hard to improve their profitability without success, then you should consider sacking them as a client.

This may sound harsh, but you are a business after all and not a charity.

However, there are a number of considerations to take into account when deciding on customer profitability; one such consideration is customer referrals. If a customer doesn't spend much themselves with your business, but instead are an active referrer, then I'd regard this customer as valuable. And so long as the referred clients are profitable clients in themselves, then this behaviour should be encourage.

Identify which customers are well worth investing in further with a real case study example…

The law of 80:20 comes into play or the **Pareto principle**. I remember once learning about the Pareto principle for the first time. It was when I had my own accounting practice.
I decided to put the principle to the test and prepared an Excel spreadsheet of all my clients. The list included the name of the client and the total annual value they brought to my business.

I was astounded to find that 20% of my clients produced almost exactly 80% of my revenues. Whereas 80% of my clients were responsible for only 20% of my revenues. This meant that in theory my business was spending 80% of its resources on only 20% of revenues. I was stunned at how the 80:20 rule applied in such a clear way. Had I not done the exercise, I would have been blind to this key underlying data about my business.

The magic and power of management data and metrics for business growth…

So what did I do with this interesting discovery? I decided to increase the price of my fees to the 80% of clients on the basis that even if I lost 100% of these clients my

business wouldn't be too badly affected. Moreover, we'd have more time to provide an even better service to the 20% of clients. Plus it would allow us to look for more of the 20% type of clients.

In actual fact what happened was I lost a small percentage of these smaller clients, but my business became more profitable as a result.

In this exercise I reviewed my customer value in terms of a fixed period of 12 months, rather than over a 'lifetime.'

Using the **12-month customer value** instead of the lifetime value worked for this exercise. It helped me to grow my business and to become more profitable. This small *case study* in using customer value provides an idea of how powerful a metric customer value is for your business.

What type of customers are good customers for your business…

This point leads on from the previous point. From understanding my customer value, I was able to grasp the true value of my '*spread of clients*'. I looked at a short term customer value in this example, instead of a long-term lifetime value, but nevertheless it was hugely valuable for my business growth.

As a result of carrying out this exercise, I was able to better identify the types of clients that added the best value to my business. This enabled me to then focus my marketing efforts on finding more of this type of customer.

Pricing optimisation in order maximise profit potential for the business….

In the Pareto principle exercise above I was able to identify two broad client groups. The 20% of clients that contributed 80% of my business revenues vs the 80% that contributed just 20% of revenues. As a result of having this information (i.e. the power of information) I was better able to make pricing decisions for my business.

I was able to confidently increase the prices for one group of clients, without the added fear of client loss, as the revenues affected were clearly identified and measurable. Many entrepreneurs and business owners fear the loss of customers when they increase their prices, which is why I created a useful tool to measure the effect of potential client losses on the business.

This product can be found over on my other site Bowraven.com. The tool is the Price increase calculator tool. Please feel free to take a look.

You will get a better understanding of your business marketing and what works well…

Through focusing on CLV and customer retention, you will begin to focus on marketing in a more targeted way. Whereas too many businesses are driven to market and advertise to more and more new customers, CLV has the effect of turning your focus towards your current customers.

So instead, the marketing budget is focused inwards and not all outward. Of course to grow your business you need more new clients, but your focus should be looking for more long-term customers.

By having a customer lifetime value focus, you will look for ways to keep your customers for longer. You will be more creative in how to sell more to each of your existing customers. The focus is on happy customers and great customer service, rather than *client churn*.
Customers who stay longer and buy more, equals higher customer lifetime value. This in turn leads to an improved long-term business value.

An increase in your customer retention…

When a business focuses on CLV, it goes hand in hand with the focus on customer retention. Customer retention directly affects customer lifetime value. You cannot fail to see the importance of improving customer retention if you have CLV as one of your key performance indicators (KPIs) as a management metric to manage and improve. It costs many times more to gain a new client than it does to retain a client. It's much easier to market and sell to an existing customer than to get a potential customer to

part with money. Potential customers have to go through a '*trust cycle*' before they'll buy from you, whereas existing customers already trust you.

Where CLV is a top metric you track, and where you implement strategies to improve or grow your CLV, customer retention will automatically improve. Although, as already noted, if you implement strategies to improve customer retention, your customer lifetime value will also increase.

A relative reduction in your marketing costs due to a focus on retention vs acquisition of customers…

I've already mentioned about the lower costs associated with retaining customers and selling to an existing customer vs acquiring new customers.

If you as a business decide to spend a good percentage of your marketing budget on customer retention, improving customer services and focusing on improved products or services, aligned with introducing new products, in the long run the cost of marketing as a percentage of overall revenues will reduce.

Focusing on CLV will change how you view your customer acquisition strategy…

Where you focus on your CLV it will change how you view your customer acquisition strategy. This is better explained by way of an example or another case study using Google Pay Per Click…

Customer acquisition strategy case study example…

For example, let's assume that you sell a product to customers for £50 and that product costs £10 to produce. This calculates at a gross profit of £40 per sale. However, through a careful series of promotions and up-sells over the lifetime for the average customer they spend a further £5,000, representing additional gross profit of £4,000. This means that the lifetime value for an average customer is therefore £4,040.

Assuming that the average cost of a click through Googles Pay Per Click for a website visitor is £1 and on average you sell to 1 in every 50 visitors to your website. This

represents a 2% website conversion rate, which in itself could be regarded as quite low, but ignoring that for this example, let's take a look at the marketing costs.

For each customer gained through pay per click it, costs £50 (£1 x 50 clicks). If you were to look at the initial sale of £50, or £40 gross profit, you'd think that spending £50 to get £40 of gross profit was misguided. If this was looked at in isolation, each sale would represent a loss of £10. However, this ignores the lifetime value of the customer.

Therefore, if instead you look at the cost of acquisition of £50 against the lifetime value of £4,040 (i.e. £40+£4,000), this suddenly makes sense.

Customer acquisition cost vs lifetime value…

The **customer acquisition cost** or CAC to **customer life time value** measures the relationship between the life time value of a customer and the cost of acquiring that customer, which has been demonstrated in the Google pay per click customer acquisition example above.

What is the customer acquisition cost formula?

The **customer acquisition cost formula** is the total cost of acquiring a number of customers over a given period, divided by the number of customers acquired in the same period. The customer acquisition cost formula looks like this:

$$\text{Customer Acquisition Cost Formula (CAC)} = \frac{\text{Total Marketing Costs in Period}}{\text{Number of Customers Acquired}}$$

Why is Customer Acquisition cost or CAC important?

Knowing your cost of customer acquisition is another key metric to manage. Knowing your CAC will encourage you to improve on both elements of the formula.

By improving or reducing what it costs to acquire each customer your CAC will reduce. Equally, by improving your acquisition conversion rates will improve your CAC.

This is why website design is crucial for businesses in today's world of commerce. A better converting website, which converts visitors into leads, will help you to reduce your CAC.

With off-line businesses, as compared to online shopping cart type businesses, there are additional metrics for you to work on, like lead conversions from website visitors that have turned into a prospect.

ROI on customer acquisition…

Taking the above pay per click example, when we see the result of the calculation, most business owners cannot fail than to then focus on improving their **return on investment of customer acquisition**.
Of course in the above example, the initial sale from the customer resulted in a short term loss, but in the long run the business profited.

However, through thinking in this way, you begin to look at other ways of obtaining customers. Some of these other ways may be even more expensive, but when you look at the long-term lifetime value, the cost of acquisition is put into perspective.

It might be that through using other marketing channels to obtain customers, which may even be more expensive initially, they may lead to an even higher lifetime value.

Focusing on customer lifetime value or CLV is the silent competitive edge for businesses…

Gaining a competitive edge in business is the dream for most successful entrepreneurs. Tracking metrics such as CLV in a business will not be obvious to the outside world. More importantly, it will not be obvious to your competitors.

Having a competitive advantage is always a great thing to have in business. I always remember a good saying for business; '*improve a thousand things by a small percentage instead of improving one thing by a big percentage.*'

One large improvement is more likely to be seen by everyone. This includes your competitors. This may result in copy-catting. It the improvement is seen as successful, it's likely to be copied. You may get an initial competitive advantage in the short term, but in the long-term this will not last.

However, if you are continually changing little things incrementally and in line with a focus on customer retention and CLV, this will be difficult for your competitors to spot and to keep up.

By working closely with your customers, perhaps though the vehicle of a customer advisory board (see below), you can keep making improvements week after week, month after month and year after year. With this continual improvement, through obtaining customer feedback by using for example customer exit interviews, you will keep a competitive advantage in silence.

Your competitors will be left behind and wonder what you did, when in fact you did plenty.

Group your customers into CLV groups or clusters to target marketing messages and products or services…

As a result of grouping your customers into CLV clusters you'll be able to better target your customers. Customers with a lower historic lifetime value may respond and react differently to customers with higher historic lifetime values.

You can also market differently to your customers at different points in their lifetime cycle with the business. It maybe that newer customers will not initially spend higher amounts with you, but over time they will increase their spend. Knowing the age (and when I say age, in this context I don't mean their personal age, but the time they've been a customer) of your customers, and by understanding where they are in their lifetime cycle with your business, this will allow you to better target them with relevant promotions and marketing materials.

This leads to customer lifetime value analysis…

Customer lifetime value analysis includes historic CLV and predictive CLV…
What is historic lifetime value or historic CLV?

Historic CLV is essentially working out what a customer has spent with your from when they first became a client to date, less the cost of sales relating to that spending. The historic value is the year to date gross profit of customers.

Historic CLV can be used to predict future or predictive CLV. Historic customer lifetime value can also be used to predict the potential lifetime value of new customers. This metric or 'value' can then be used to calculate what to invest in marketing for new customers. This was demonstrated in the case study using Google pay per click above.

In the example above with CLV Calculation LTD, the lifetime value calculated for Mr Smith was in fact the historic lifetime value for this customer. The fact that he had explained he was no longer going to use the services of the company is not important for this calculation. However, having said that there are many lessons to be learnt from this example. One of which is explained below in the importance of customer exit interviews.

What is future CLV or predictive CLV?

Predictive CLV is looking at potential customer lifetime values using past data, or in this case using historic CLV to predict the future or long-term lifetime value of a customer.
Predicting customer lifetime values is an essential part of business marketing. Without it, it's almost impossible to calculate how much a business can spend on marketing or advertising to attract new customers.

Customer lifetime value formula…

The **customer lifetime value formula** is represented as follows:

Customer Lifetime Value (CLV) = Average monthly transactions X Average Transaction Value X Average Gross Margin X Average Customer Lifespan in Months

By knowing the *customer lifetime value formula* and the constituent elements of the formula, it becomes easier to see how to affect the overall business value and profitability.
Taking each one of the above elements of the customer lifetime value formula, as follows:

Average monthly transactions…

The average monthly transaction is the number of times a customer returns to buy from your business in a month.

If you increase the number of times a customer returns to buy from you, your sales will increase and as a consequence your profits will too. There are many methods by which a business can encourage customers to return to buy.

Through having a '*CLV focus*' and by knowing the *customer lifetime value formula*, and having the necessary data to hand, you are more likely to look to improve the metric. The saying goes; '*what you can measure, you can manage.*' Whereas I prefer to say; '*what you measure, you will more likely to manage.*'

Average transaction value…

Knowing your average transaction value and focusing on ways to improve it, is probably one of the most powerful business growth tools I know. I have used this metric or key performance indicator to successfully grow businesses.

The average transaction value is the average amount a customer spends with you each time they visit your store or website. Essentially, the more they spend with you each time, the higher your revenues, but more importantly the higher your profits.

Most times, which is the absolute beauty of focusing on the average transaction value, the costs associated with increasing it are never huge.

Average transaction value case study example…

Let me demonstrate this by way of an example…and it goes like this; '*would you like to go large,*' or '*would you like fries with your burger.*'

If you've not heard either of these expressions then you've never been to a McDonald's restaurant before. I recommend you do, not necessarily for the food if that's not your 'cup of tea', but to experience this business growth technique at its best.

Firstly, how much does it cost McDonald's to ask these questions? The simple answer is zero, nada or nothing!

But how much does it add to their bottom line? Significantly, is the answer.

With regards to adding fries to the order, this is the cheapest element of the order. By adding a portion of fries to the order, the gross margin just increased. Similarly with going large, the only things that increase in size with '*going large*' are the fries (i.e. the higher margin item) and the drink, which again is a high margin item, or low cost product.

Average gross margin…

It is possible to affect your average gross margin in a number of ways. One example is to sell higher margin products over the lower margin products, which can be achieved though different marketing techniques.

The McDonald's technique above improves the overall gross profit margin. Both up-sells include higher margin items and therefore a higher average gross profit margin is obtained.

Average customer lifespan in months…

Improving the **average customer lifespan** is all about customer retention strategies. The longer a customer is with your business, the move valuable they become. They will spend more money with you and in the long term will recommend you to family and friends. Retaining customers is a key strategy and one that should be top of your customer service improvement list.
The value of customer loyalty and retention should never be under estimated. Customer loyalty means that customers not only spend more money with your business, but they become advocates of the business. This is why the introduction of customer loyalty programs is so important. It encourages yet more customer loyalty, which leads to even better customer retention.

Customer exit interview…

In the '**customer lifetime value example**' above, Mr Smith wasn't asked why he chose not to purchase from *CLV Calculation Ltd* again in the future.

This is a mistake on behalf of the company and it's something that is not necessarily the employee's fault who didn't ask the question.

It's all too often that businesses see clients come and go, but fail to ask them why they left. It's too easy to close the account and send the final invoice, without thinking about why the customer went elsewhere.

The reason may be as simple as they no longer require the product or services you provide. But equally, it could be about something more serious where you need to get to the bottom of the problem.

I suggest using a customer exit interview as a business strategy. There are many **customer exit interview questions** or questionnaires you can get for this.

The best way to carry out the customer exit interview would be face to face. Failing that, a personal phone call would be much better than an impersonal email.

However, if your business is so large that this makes carrying out one to one customer interviews difficult, you could send them a link to an **exit interview questionnaire**.

Business should focus on customer retention and not just on customer acquisition…

As already discussed in this article, too many businesses focus too much on customer acquisition. There's not enough that focus on customer retention too.

By focusing on customer retention, your overall marketing costs as a percentage of revenues and profits will reduce. Your customer lifetime value will increase as a result.

Invest in customer retention strategies will pay dividends in the long term…

Spending money on this area of your business will pay dividends. If you are doing things right already, and as you improve your customer services and '*CLV focus*' in your business, there shouldn't be too many customers leaving you in any case. So customer exit interviews shouldn't take up too much time, as you get less and less 'leavers'.

If however, there are so many customers leaving your business, which would make carrying out these interviews a struggle, this is not a reason not to do it. Finding out why so many customers are leaving is crucial. Over time the number of leavers will reduce, as you begin to get to the bottom of the problems they face and as you begin to fix the problems that are uncovered.

Money should be set aside for customer exit interviews, employ an external consults if necessary. I encourage you to carry these out in person wherever possible (subject to locality issues) or at worst over the telephone.

Using something like Skype would be even better, as you'll be able to see the customer and get better feedback that way.

Bear in mind with investing in customer exit interviews, and by keeping the focus on extending customer lifetime, adopting customer exit interviews will in turn will increase the customer lifetime value, but more importantly will make your company the better for it.

What are the best customer exit interview questions?

I've included what I feel are the best **customer exit interview questions**. Essentially there are a few pertinent questions to ask an '*exiting customer*', which include the following six questions:

"How did you find doing business with our company?"

This question is an open ended question. It may lead to both the good and the bad replies from their dealings with your business.

"What could we have done differently given the chance to change things?"

This question gives the customer the opportunity to open up about what the business could change. Use this as a positive. Take the attitude that all feedback is good feedback.

"How have you found our communications with you and what could we have done better?"

Communication and the way we communicate is extremely important. Sometimes this comes down to '*under promising and over delivering*'. Keeping customers informed at every stage is the best approach to adopt. The quickest way to upset anyone is by keeping them in the dark. By asking this question, you will either confirm things are good, or uncover any gaps in your customer communication system.

"What did you like about our services or products?"

It's always good to get feedback on what's good about what you do. By doing so, this gives you comfort about the things you are doing right. Also, by talking about the positives in your services or products, can provide the window of opportunity to explore the possibility of this customer continuing to work with you or to continue buying your products or services, and therefore extend the lifetime value.

"What didn't you like about our services or products and what could we do to improve them?"

By asking the client what they didn't like about your services or products will allow you to see what improvements you can make. It can also flush out ideas for new and/or better services or products to offer in the future. This will also provide another

opportunity to see if the customer would stay if the things they didn't like were changed. This could also be the case if you were to introduce the new or better services or products they've suggested.

"Were your expectations met by us?"

Everyone is different and each one of us has different levels of expectation. This may be a difficult question to ask and reciprocally a hard question for some to respond to. Human nature as it is makes it difficult sometimes to be tough with the answers we give. Emphasise when you ask this question about how important it is to get the customers honest opinions and feedback, no matter how difficult it would be to hear. Explain to the customer about how their answers will be used to improve things going forward.

Customer exit interviews can lead to improved customer retention…

One outcome of carrying out a **customer exit interview** is the customer may have second thoughts. The customer concerned may see that you care enough to ask these questions. They may be inclined to see the process as a positive; they may even change their mind and stay.
You never know, they may be annoyed at something very small. However, by reaching out to them in this way and by asking important questions, you will show them how important they are as a customer. If what they say is easy to address and by making this small change, may make all the difference to them.

Saving customers at the exit interview stage improves your marketing ROI…

Think of the cost of gaining a new client when you go through the customer exit interview process. Each customer saved, means that the marketing costs associated with that client was no longer wasted. The overall marketing investment and ROI on marketing will improve as a result.

So long as the relationship hasn't been soured too much for whatever reason, it's never too late to speak with someone. It's never too late to build bridges and it's never too late to make a positive change.

There's only one sure thing in life: "*We cannot change the past, but we can certainly influence what happens in the future.*"

Of course, once a customer has left, carrying out a customer exit interview is a bit like closing the stable door after the horse has bolted. However, it does provide valuable feedback for looking forward. The answers given can be used as a tool to improve things within your business.

In addition to carrying out *customer exit interviews* and questions, I recommend using a customer advisory board. A customer advisory board looks at these customer questions before they become a problem. Using customer advisory boards is a proactive approach to having happy customers and to extending and increasing client lifetime values.

Customer advisory boards…

Customer advisory boards are a great way to get a better understanding of your customers. They are also a fantastic way of improving customer services. Getting a few key customers together in a room and by asking them a set of well-constructed questions can prove to be highly valuable.

I'd recommend inviting between 10 and 12 customers to each advisory board. Make sure the customers you include are the advocates of your business. This is not necessarily always the ones who are always happy with your service. You also need to receive the negative feedback too, in order to improve things.

Keep the advisory board constructive. Where negative feedback is brought up, look to how it can be turned into a positive. Ask for feedback from the group on how the business could change so that this doesn't happen again.

Entrepreneurs and business owners worry about clients speaking with each other in a customer advisory board…

The most common worry among business owners about holding a customer or **client advisory board** is of other customers hearing what an unhappy customer might say. Embrace this and get the feedback from the other customers in the room.
If however, you do unfortunately find there's a particularly negative customer in the room and they become destructive instead of constructive, you have the option to ask them to leave, or don't invite them again. You may find the other customers, and in particular the advocates, will support your business and stick up for the good things.

Customers who attend an advisory board will feel extremely valued and will provide some essential feedback. Use the customer advisory board to ask about existing products or services. Get feedback on the introduction of new products or services. Look for what improvements can be made, changes in pricing and many more areas of the business should be explored.