Smith Insights
Whitepaper

Customer lifetime value.
The metric to rule them all.

Optimizing and streamlining the selling process to help increase your sales.

The most important metric to ensure your business not only prospers, but also thrives, is Customer Lifetime Value (CLV). If you're not tracking it now, we recommend adding it to your to do list.

CLV is the best measure of profitability of a customer to your business over that relationship's lifespan. Profitability can be impacted by many factors, such as Customer Acquisition Costs (CAC), ongoing cost-to-serve, gross margins and service lengths. CLV helps you clearly understand a customer's value and lets you find balance in managing the many factors that can quickly affect profitability.

Another benefit of CLV is that it can be calculated by customer segment rather than in aggregate, giving you a clear picture of how value can differ across your business.

Calculating Customer Lifetime Value

CLV is an extension of metrics that calculate Recency, Frequency and Monetary value (RFM). It's a more advanced metric than basic measurements like Average Order Value (AOV) or Customer Value (CV), but it is a natural outgrowth of these other datapoints.

At its core, CLV is the measure of how profitable a customer is to your business over the lifespan of the relationship. Profitability depends on many factors, including the costs to acquire and serve the customer, the cost of goods and services sold, plus the length of the relationship. CLV helps show that even if your early costs in acquiring a customer outweigh the profit from their first purchase, you could still make a profit from them in the long run.

Using CLV will help you see your customers more clearly, use your budget wisely and lead your company to be more customer-centric. CLV makes it easier to know how much you should spend to acquire, serve and retain customers. It's also a metric used to build better digital commerce results across the entire lead-to-loyalty customer journey.

Calculating a basic CLV is actually very simple. It uses information that nearly every business is tracking already and combines that data in a new way.

To find a customer's CLV, start by calculating their CV:

1. Find a customer's AOV—divide their total sales revenue by their total number of orders to date.
2. Multiply their AOV x their purchase frequency (PF).
3. Now, take that result—their CV—and multiply it by your company's Customer Average Lifespan (CAL).

That's it: AOV x PF x CAL—you've got your customer's basic CLV. One datapoint that contains all the information you need to calculate customers' true worth to your business. Of course, there's much more complexity to a complete, real-world calculation, including cost of goods, marketing costs, churn rate, profit margin, etc., but right now we're keeping it simple.

CLV is Vital For Digital Commerce Profitability

If you want to grow, consider making CLV a central pillar of your strategy and performing this calculation by customer segment. Once you've identified which segments have the highest CLV, you can pinpoint your most valuable customers, and know where to target your efforts to convert lower-value customers into high-value ones.

CLV accounts for all the most important variables when measuring customer value and isn't skewed by data points such as large one-time purchases.

But CLV is more than just a great tool for measurement. CLV calculations can also be fine-tuned by changing the variables that impact its underlying metrics—for instance, by using purchase frequency to find and highlight a cohort of more regular customers.

Here's a simple example that shows how handy it is to know your CLV:

$20 x 10

Customer A makes **ten $20 purchases** from your company over the course of one year.

$200 x 1

Customer B makes **one $200 purchase** in that same time frame.

Which customer is more valuable?
We'll start with a basic metric like AOV—add all purchases to find total value, divide by number of purchases:

Customer A: 20 x 10 / 10 = $20

Customer B: 200 / 1 = $200

Customer B seems to have 10x the value of Customer A. Without a deeper analysis, this company may decide to spend considerably more resources on engagement and retention of Customer B. But what if we calculate each customer's CLV?

(Remember: AOV x PF x CAL. Let's assume a CAL of 2 years.)

Customer A: AOV $20 x 10 x 2 = $400

Customer B: AOV $200 x 1 x 2 = $400

In reality, both customers accounted for the same amount of business over the same amount of time. In fact, Customer A shows equal value to Customer B as a repeat customer—despite Customer A's individual purchases all being of a much lower cost than Customer B. But if this business relied only on a metric like AOV to calculate customer value, they would have failed to recognize this, and potentially missed out on a worthy engagement.

Understanding CLV Is Step One—Learning To Apply It Comes Next

Once you're properly tracking customer value by CLV, you can easily use that data to create customized campaigns that will drive customer experience for all segments of your business.

For high-value customers, you can create targeted methods to build and maintain loyalty—VIP programs, account-based marketing efforts, personal attention from your sales team, or exclusive or early product access—whatever makes sense for your business and for how these customers behave.

For lower-value customers, you can use similar methods to encourage them to do more business with you and increase their value. That might mean using the same tactics as with high-value customers as an enticement to join the VIP ranks. Or it may mean a different approach, such as a subscription service or product bundling.

CLV can improve customer experience in a variety of ways. You could target efforts to improve AOV or PF through automated targeted emails. Or you could use your segmented CLV data to identify which channels bring in your highest-value customers and use them to acquire new ones.

Creating a more personalized experience through CLV segmentation lets you offer the most appealing enticements to different cohorts of customers through data-driven methods. Customers get the experience they want without the enormous manual workload of intensive research and marketing. Both sides win.

Strengthen Your Efforts For Greater Results

Acquiring, engaging and retaining customers should no longer be separate tasks—CLV provides a single, universal metric to collapse your company's silos and unite sales, marketing, engagement and retention efforts. Businesses can apply CLV to all customer cohorts, accounting for every means (or cost) of acquisition, customer age, purchase frequency, retention rate, monetary value, cost-to-serve, customer satisfaction and beyond. Each of these elements factor into a full, detailed calculation of CLV and can be prioritized as needed.

Once you know the true value of your customers through CLV, you can intelligently build marketing strategies to maintain and increase value across your entire business. With a clear picture of CLV, efforts to model new tactics to increase sales and improve CLV can be easily implemented, tracked and even A/B tested to see exactly what works, and what doesn't, on precise segments of your customer base. When integrated into the digital commerce process, a customer engagement platform like Emarsys allows you to easily segment your customers and use pre-built tactics to grow sales through multiple channels.

Next Time: Optimize CAC

Now that you've got the basics, what are your next steps in applying CLV across your digital commerce business? Our next post will focus on customer acquisition strategies and tactics to help improve your company's CLV, because we all know not all new customers are created equal. (Hint: some cost much more than others.) Be the first to get that info by signing up for our newsletter.

Contact Smith today and learn how we can help.
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