LIFETIME VALUE OF A CUSTOMER BY DAVID BANCROFT AVRICK

It would be wonderful if every time you advertised, you generated enough new business to pay for the advertising cost. But in the real world that hardly ever happens.

What happens instead is that you hope to generate new customers who will create substantial profits to your business over the years.

A great example of this is a credit card solicitation. When you receive a solicitation and sign up for a free credit card, it's obvious that the bank has lost money on that transaction. They paid to create, print, and mail you the solicitation, and then when you responded, they paid to process your application, check your credit, and issue you a free card.

The bank makes money by charging you interest and fees. They estimated your lifetime value as a customer based on knowing what their average customer pays in interest and fees over the period of time they hold the credit card. Once they know that amount, they determine how much they can afford to get a new customer.

This is true whether the business is selling pizza or insurance, pet grooming or chiropractic services. Once you determine the lifetime value of a customer, you can realistically assess the responses generated from your advertising.

Of course you need to take costs into consideration. The bank which receives $30 in interest and fees during your first year does not make $30 in profit. They have costs of the money they lend, as well as overhead. The pizza that sells for $10 does not represent $10 in profit, it must also cover the cost of ingredients and overhead.

It's not very difficult to come up with a good estimate of the lifetime value. You must consider:

- What is your average sale? You probably know this already.
- What is your gross profit? If it's 50%, then a $14.00 sale generates a $7.00 profit.
- How often does your typical customer use your service? If you sell pizza it may be 25 times a year, if you're selling chiropractic services it may be 3 times a year.
- How many years does your typical customer stay an active customer? One, two, five, more?

Once you've answered these questions the math is pretty easy. For example:

- Your average sale is $30.00.
- Your gross profit is 50% or $15.00 per order.
- Your average customer buys 5 times a year, 5 x $15.00 = $75.00 per year.
- Your average customer stays active for 3 years, 3 x $75.00 = $225.00.

You have determined that the value of a customer is $225 in profit to you over the lifetime of that customer. Now you know that it's reasonable to spend $50 or $75 to bring in that customer.

This is one reason why you should make the most compelling offer possible. If you offer "buy one, get one free" you'll get a small response. When you offer; "get one free, no strings attached" you'll get a huge response. And you want a huge response. You want as many new customers as possible. Another reason to make a compelling offer is to entice a prospect to try your business before trying a competitor. If you can get a prospect in the door, and provide a good experience, you have a good chance of keeping that person as a customer.

In most media you can not afford to make a completely free offer. After all you don't want to offer free merchandise or services to your existing customers. You often see advertising saying; "new customers only". That does nothing but upset your current customers.

When mailing to new movers you're reaching people who are not already your customers. That allows you to make a powerful offer and generate lots of new customers.