How To Calculate the Lifetime Value of A Client

By Lisa Nirell

How To Calculate the Lifetime Value of A Client

Lisa Nirell
info@nirell.com

Nirell & Associates http://www.nirell.com

How To Calculate the Lifetime Value of A Client
By Lisa Nirell

First, some food for thought.

• Jeffrey Pfeffer, best-selling author and Stanford University Graduate School of Business Professor, reported in the December 2002 issue of Business 2.0 a major disconnect between technology investments and customer satisfaction. He found that although one research firm reports that 34% of technology managers continue to invest in customer relationship management (CRM) software (to the estimated tune of $38B through 2005), customer service in several industries is deteriorating rapidly.

• A November 2002 issue of CBI Industrial Trends predicts that at least half of the traditional sales jobs that currently exist will be gone in the next five years.

Beyond "What Have You Done For Me Lately?"

Client value is the total benefit (tangible and intangible) that you, your business partners, and your coalition provide to a company throughout the life of the relationship. (Personally, I believe client value is NOT created or sustained by cutting costs to increase efficiencies, or by propping up share price through buybacks, spinoffs, or mergers/acquisitions.)

The concept of client value requires a bit of guessing and new thinking. Especially for people who are running a new business, working in a financially-driven (versus a sales-driven) culture, or haven't been keeping close track of customers, estimating the lifetime value of a client may require a bit of groundwork.

But there's no better way to gain perspective on each and every client relationship, or to predict the impact of every management decision on long-term revenue goals.

Why does this concept matter?

There are several reasons that companies perform this calculation.

1. To ensure their long-term survival through recessionary times.

Author Michael Gerber (The eMyth Revisited) uses a cautionary statistic: He asserts that 80% of all new businesses fail within the first 5 years due to a lack of a balanced, systematic philosophy towards growing their business. This "client value calculation system" may be one the best insurance policies against a young, struggling business becoming part of that casualty list.

2. To know how much to pay to acquire a customer.
Most growth-oriented companies have a client acquisition/marketing budget. Do you? How is it constructed? Is it currently built as a fraction of one transaction, or many?

3. To know how much time/effort to put into retaining a customer.
Most banks, for example, have customers who cost more to serve than they generate in positive revenue. These banks would often really like to drop the customer, but can't. Banks manage the discrepancies by raising fees to such "problem" clients, or putting them on endless loops of touch-tone voice-mail support.

4. To keep them focused on increasing the lifetime consumption of products and services.

The first sale takes most of the time, energy, and investment and costs four times as much as selling to an existing client. Cross-selling and upselling drive innovation and open the door to deeper, collaborative client relationships, which are a good thing.

I've personally witnessed two polarized viewpoints when it comes to lifetime client value. The first is the "field of dreams" perspective. People with this perspective think, "If you do good work, your clients will buy more from you and send you referrals." This is a great model for lifestyle companies and for small business owners who want to work part-time.
The second perspective is what I call the "seasoned business builders" view. This point of view assumes that investing in marketing, branding, web sites, and professional development will design client relationship and business growth that can be franchised, replicated, and sold.

Which best describes your approach?

If you want to be a business builder, the secret is to figure out exactly what you're willing to pay to find/acquire a new client.

Typically, a realistic acquisition cost ranges from 5% to 25% of your fees for the lifetime of that client. This may seem expensive, but it's simply a good business decision to budget a part of your revenue to building your business.

Ten Steps to Living According To Lifetime Client Value in 2003

1. Identify and document your ideal customer. Get very specific. What are their job functions, key frustrations, buying behavior, lifestyle, age, willingness to advise you on new offerings, and typical spending habits with your firm? Do they value expertise and are they willing to pay a premium for good service, or are they transactional buyers who only care about price (a la WalMart?) Write down the percentage of firms in your portfolio fit each description.

2. Keep a journal for one week detailing how much time you're spending with your ideal customer. The next week, track how much time you are spending with your "less than ideal" customer. The third week, list three ways you can streamline the way you work with your "less than ideal" customer--beginning one month from the day you make the list. This may include everything from referring them to another firm, to delegating them to a more junior associate, to asking them to pay you in a more efficient way (paypal.com), etc.

3. Guesstimate how much your ideal customer will buy from you during the entire buyer/seller relationship. For example, if you are a consultant, and a typical client stays with you for 2 years, and they are paying you $10,000 a month, then the current lifetime direct transaction value of a client is $10,000 x 24 months = $240,000. But wait--there's more.

4. Guesstimate how much business each client will refer to you over the next 2 years. Let's say the typical client sends you 1 new client every 2 years at $10,000 a month. That's $240,000 in referral value.

5. If you have an advisory team of customers helping you design or launch new products or services, estimate the value of 1 successful sale for that new offering based on your customer's input. (For this illustration only, assume that 1 new sales equals $20,000.)

6. Add all 3 figures. The true lifetime customer value, including referrals and advisory support, is $500,000.

7. Provide your ideal clients with one free service, trial offer, or referral, just to show them how much you value the relationship. No expectations, period. Make 2003 your season for giving unconditionally.

8. Create and regularly administer a low-cost survey to find out how your ideal clients define, receive, and measure value. Ask several representative current clients to tell you new ways they would be willing to extend their relationship with your company.

9. Create a Tandem Flying (MasterMind) group of professionals dedicated exclusively to defining, attracting, and creating lifelong clients.

10. Create a referral network of companies, clients, and individuals. Share this with your clients and update often.

Lisa Nirell, President of Nirell & Associates, is a business mentor who works with high-tech entrepreneurs and executives who want to accelerate growth. With more than 20 years in software, consulting, and sales, Lisa has served on 3 Boards of Directors and has published in ComputerWorld and Software Strategies. For more information, visit www.nirell.com .

Get-Articles.com : 1000's of reprintable business and internet marketing-related articles.

Submit your article for reprint.