

# What's a Customer Really Worth to You?



Calculate their lifetime value to your business, and you'll work harder to never let them go.

BY RYAN CONDON, DAVID SEMB, AND JEFF LEFEBVRE

**A study conducted several** years ago found that the lifetime value of a Taco Bell customer amounts to approximately \$11,000. For Taco Bell, the profit from a single \$5 exchange for a taco, soda, and cinnamon crisps is less important than the long-term benefits of fostering enduring customer relationships. Many companies fall into the trap of thinking of customers as purely short-term individual transactions, but a closer look at customer lifetime value, or LTV, reveals that spending the time and effort to develop long-lasting customer relationships often yields greater profits over the long term.

Employing a transactional view of

customers can create a tunnel-vision perspective that sees each transaction as an opportunity to garner the most profit possible at any cost. Transactions that offer more benefits to the customer might be less profitable in the short-term but create win-win situations that keep customers invested in your company over time. Shifting to a long-term perspective that considers the value of all transactional moments in a customer's relationship allows you to develop relationships with staying power that often increase in value over time. LTV is a tool used to calculate the long-term worth of your customers. Each customer has a different LTV, and the higher the

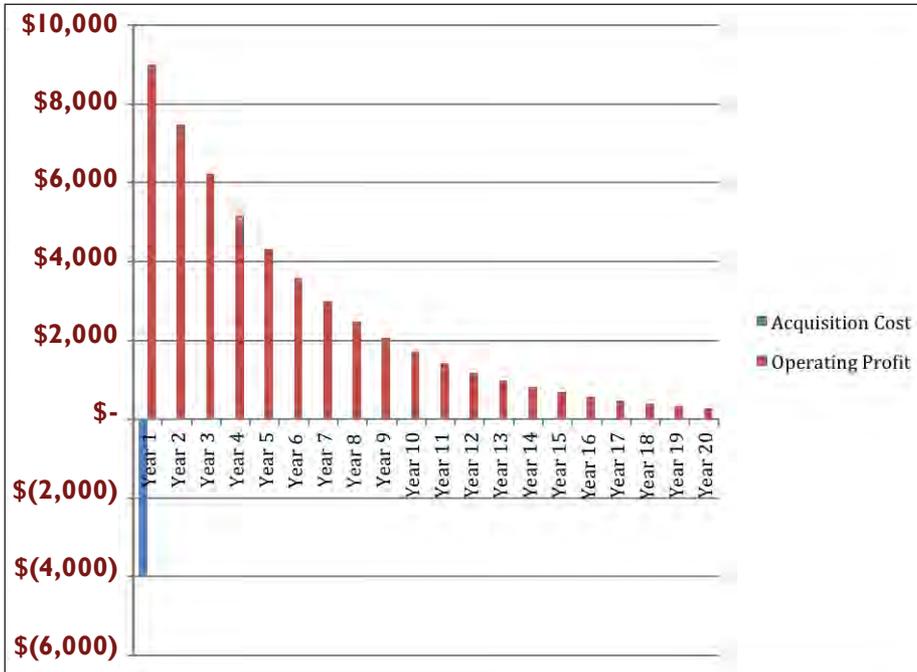
potential LTV, the more time and effort should be invested in fostering a relationship.

### **Calculating LTV**

Knowing the LTV for your customers will allow you to:

- (1.)** Rank customers to determine who is the most valuable.
  - (2.)** Create a system for increasing the value of high LTV customers.
  - (3.)** Educate your company so all employees understand and are able to aid in effective customer relations.
- LTV calculations take into account

Figure 1



revenue, expense, and the duration of customer relationships. By analyzing different customers' LTVs, you can develop strategies for maximizing interactions with your highest value customers.

Figure 1 depicts simplified cash flows associated with a single customer. The red bars represent the positive operating profit associated with the customer over time (eg. customer revenues less Cost of Goods Sold and other operating expenses). The blue bar represents the initial customer acquisition cost. Adding up all the positive operating profits and subtracting the negative acquisition cost determines the Net Cash Flow, which is equal to the LTV. An ideal model takes into account the time value of money in which \$1 today is worth more than \$1 in the future, but for the sake of simplicity assume that cash flows have already been adjusted. The duration of a customer's relationship is factored into the equation by assuming that few customers, if any, remain with a company forever. This "defection" is taken into account by reducing cash flows by a retention percentage such that the hypothetical customer no

longer interacts with the company at some point in the future (as seen by the decreased amounts of the red bars representing "Operating Profit" over time). You can download a simple LTV calculator at [prisim.com/News/Reference.htm](http://prisim.com/News/Reference.htm).

### Creating Positive Customer Interactions and Ranking Customers

After using LTV calculations to determine your most valuable customers, a system can be developed to make these relationships last and grow. Increasing LTV to enhance profits requires positive customer interactions, a system for evaluating and ranking customers, and tools for measuring customer satisfaction. The following steps will help you create a system that will keep profitable customers tied into your business for the long term and eliminate customers that are not generating profit.

The equipment industry offers an ideal example of the importance of creating positive customer relationships. Equipment companies cater to a limited, and in some cases shrinking, customer base. Being a

## Revenue-Oriented vs. Profit-Oriented LTV Calculations

**At times, LTV is calculated as a lifetime revenue stream rather than a lifetime profit stream. Beware!** Revenue-based LTV calculations tell only half the story. For the best management insights, expenses associated with customer acquisition and relationship management must be considered when measuring LTV. If the goal is simply to understand total income, then determining LTV by measuring lifetime revenues can be effective; however, this approach might not provide the best information for allocating resources and targeting customers.

For example, assume Customer A brings in an average of \$2MM of revenue per year for two years at a 1 percent contribution margin for \$40,000 in profit. Customer B brings in an average of \$1MM of revenue per year for two years at a 2.5 percent contribution margin for \$50,000 in profit. Customer A has brought in more revenue and would have a higher LTV based on revenue, but Customer B is actually more profitable.

A real-world example of why revenue-based analysis might be dangerous can be found in the mortgage industry. Many mortgage bankers and brokers in the boom years had a revenue-based view of customer value. This ended poorly when high-revenue customers – who were also low-profit – started dominating the books and ultimately drove down profits.

dependable business partner can result in a profitable long-term relationship, but one sour transaction can drive the customer to a different provider, requiring 10 times the effort and resources to bring them back. When customer relationships

*(continued on next page)*

## Easy Dealer Program Lets You Reward Best Customers with Service Credits

As Condon, Semb and Lefebvre discuss in the main story, rewarding your most profitable and “Elite” customers is an important dimension in the long-term relationship-building process toward which you should be striving. Advantage Dealer Insurance (ADI), an AED member firm, offers equipment dealers an innovative loyalty program that offers a convenient, hassle-free way to reward a dealership’s best customers. Called Dealer Rewards, the program is based on giving service department credits to customers, and on average, customers enrolled in the program spend 27 to 32 percent more in the dealer’s service department than customers not enrolled.

“Loyal customers spend more,” said Raj Julka, managing partner of ADI. “This program is designed to reward your most loyal customers – to keep them coming back to you.”

Capturing high-margin service revenue is how this program pays off for dealers. Typically those who purchase new machines will take their machine to a dealership while under warranty; however, historically, only about 50 percent of those who purchase new or used machines will use a dealership’s service department. Instead, that potential revenue is lost when equipment owners use other dealers or perform the work themselves.

An increase in potential service spending of just 10 percent can translate into a huge increase in total revenue and profit. Also, each time a customer comes in to the dealership, there is a greater opportunity to sell new machines, parts or service.

Unlike some other loyalty programs, dealers don’t need to purchase any special equipment. According to Julka, monthly fees are such that it takes a minimal increase in service revenues to cover the cost of the program. For the fee, dealers get a fully automated loyalty marketing platform, including dealer-branded reward cards and key tags, dealer branded brochures and posters, access to the rewards centralized control system, the ability to e-mail marketing messages to reward members, as well as a multitude of reporting and data management services. ADI also creates a customized web page for the loyalty program that is fully optimized for search engines, which improves the online visibility of the dealer.



Dealer-branded key tags for customers are included with the Dealer Rewards program.

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require such a high level of maintenance, it is necessary to rank customers by their LTV in order to determine if the payback is worth the effort.

Using the LTV calculation method provided in Figure 1, complete the following exercise:

- (1.)** Create a list of your top 200 active customers. You may find that some customers are very similar in terms of acquisition cost and operating profitability. If this is the case, create a grouping or segmentation of the customers (e.g., “High-Touch, Big-Spenders” or “High-Touch, Low-Spenders”), and note which customers belong to this grouping or customer segment.
- (2.)** Calculate the likely LTV for each customer or customer segment.
- (3.)** Categorize the top customers or segments as “Elite,” the next as “Premier,” and the last as “Something.” (Download a pre-made online Excel template to facilitate this process at [www.satisfyd.com/resources](http://www.satisfyd.com/resources).)

The objective of this exercise is to keep the highest “Elite” customers in their long-term high LTV-generating rank. A typical sales approach focuses on prospecting new customers, but maintaining high LTV customers should be the highest priority. The airline industry treats their preferred customers to such benefits as early boarding, free upgrades, and even free flights. Giving away a free piece of equipment is rarely an option, but something as simple as an oil change or free maintenance service can go a long way toward retaining an elite customer. Don’t assume that you have to differentiate by providing a discount or price break – consider priority service scheduling or a 24-hour guarantee for parts delivery.

Keep in mind that offering Elite customers special treatment does not mean ignoring the rest of your customers. Attempt to convert lower-ranking customers to a higher LTV but “fire” customers who don’t add meaningful LTV after additional effort has been made.

### Measuring Customer Satisfaction That Drives LTV

Rather than simply hoping Elite customers are having a positive experience with your company, develop a system of open communication that



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will provide a better gauge of customer satisfaction. An effective system allows you to address the constant business changes your customers experience, consistently provides current feedback from the customer, maintains positive relationships through exchange and review, and alerts you of potential problems that might have slipped past other warning systems.

Two important aspects of a successful customer feedback system are consistency and uniformity. Periodic approaches tend to break down and eventually fall to the wayside, while an ongoing commitment will reveal undiscovered gems and create an open path for communication. Having a consistent system will allow you to avoid potential problems created when employees use discretionary approaches while listening to the customer or when inconsistent information is reported up through the organization. Surveys are one effective approach and can alert you to changing customer needs as well as indicate if you have a problem. Integrate this feedback process into sales as tightly as possible to create an internal focus that takes sales and existing customer satisfaction into account on a daily basis.

Implementing a customer satisfaction process today will allow you to begin evaluating trends in just a few months. After the third month, take a snapshot of your scores, write down your average, and set a goal that you hope to achieve by the next evaluation. Bring your entire dealership together and openly discuss and solicit feedback about what your team thinks would be required to raise the score 1-2 percent. The actual amount is less critical than the opportunity to create a shared understanding of the feedback. In the future, complete the same exercise on a quarterly basis. Make sure the entire dealership understands that this process is just as important as sales reviews and planning. By completing these activities,

you can ensure customer satisfaction and a higher LTV from your most profitable customers.

### The Bottom Line on Satisfaction

Satisfied customers work for your companies in two ways: They buy more products and services from your dealership, and they promote your brand. Take action today by determining the current value of your customers and categorizing them by their LTVs. Use the new

rankings to create a plan for promoting up-and-coming customers to the more profitable Elite status. Create an ongoing customer feedback process that ensures you are changing with your customers' needs as well as identifying any problems that might not have been uncovered. Finally, tightly integrate this process into your sales management effort. If you do not think of a customer "for life," we can guarantee another dealer will. ■



Ryan Condon



David Semb



Jeff Lefebvre

**RYAN CONDON** is president and CEO of SatisfYd, a customer experience management company serving the equipment industry. He can be reached at 630-276-7934, [rcondon@satisfyd.com](mailto:rcondon@satisfyd.com).

**DAVID SEMB** and **JEFF LEFEBVRE**

are partners and co-founders of PriSim Business War Games, which conducts AED's "Test Drive" program again this fall, Oct. 2-3 in Oak Brook, Ill. They can be reached at (847) 548-7888, [dsemb@prisim.com](mailto:dsemb@prisim.com) and [jlefebvre@prisim.com](mailto:jlefebvre@prisim.com).

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