FINDING "TRUE NORTH" ON YOUR MARKETING COMPASS:

A Practical Guide to Using Customer Cost and Lifetime Value Metrics

Introduction: Seeking "True North" in Your Marketing Measurement

Modern B2B marketers have learned to coexist with chaos. They watch hot new tactics come and go constantly, each promising in its turn to fix something the others can't. They're inundated with marketing metrics that offer countless ways to dissect their campaigns. They can't turn around without another upstart technology vendor joining the hundreds that compete for their attention.

The challenge is that many of the new ideas in this mix have value; some are genuine game-changers. Very few of them, however, help marketers to rise above the chaos and get a sense of their big-picture performance. In fact, some of the most talked-about B2B marketing concepts, such as inbound and demand generation, exacerbate the problem: They dominate the conversation so much that marketers tend to overestimate their benefits and overlook their limitations.

Even the sharpest marketers can lose their way in a landscape where change is a constant and tunnel vision is an ever-present risk. There's immense value in having a proven, reliable way to regain your bearings and know where you really stand.

Tunnel vision is a real occupational hazard for modern B2B marketers: One study found that marketers who claim "inbound alone drives our business" still report 25% of revenue from outbound. Those who claim to rely entirely on outbound report 36% of revenue from inbound.[1]

CLV/CAC: The Formula to Find "True North" on Your Marketing Map

Fortunately, there's a metric that can lead B2B marketers out of the woods and serve as a pocket compass that helps them find "true north."

CLV / CAC

The metric itself is deceptively simple to calculate: It's the number you get after dividing the lifetime value a customer brings to your business (CLV) by the cost of acquiring that customer (CAC).

CLV/CAC: The Formula to Find "True North" on Your Marketing Map *(continued)*

Those two metrics are powerful on their own, but combining them answers one of the most important questions anyone can ask about a business: Did it (the business) make more money from a customer than it spent to acquire that customer?

"The expected lifetime value of a customer represents the maximum allowable acquisition cost of that customer," stated Ruth Stevens, President of eMarketing Strategy. "Then using those numbers, you can craft a marketing budget that is related to firm profitability versus some fussier method of budgeting for marketing expenses."

It's useful to ask if you are making money, of course, but this formula also addresses practical questions every B2B marketer should be able to answer:

- Are you finding your most valuable customers?
- Are you targeting them effectively?
- Are you making the most of the relationship once you win their business?

These questions aren't always essential for B2C marketers who work in transactional, mass-market environments. In the B2B world, however, a company's future often depends upon the answers. "In B2B, we don't often have the luxury of locking customers in to contracts," said Megan Heuer, VP of Research at SiriusDecisions. "So we have to make sure our marketing investments . . . have a smart balance of pre- and post-sale support to ensure that the customer stays for the longest lifetime possible."

We'll come back to these and other questions. We'll also explain how to use CLV/CAC to assess marketing effectiveness, diagnose common problems, and make smarter decisions. First, however, let's take a step back and ensure that both elements of this formula – customer lifetime value and customer acquisition cost – are doing their jobs and giving you a clear view of the things they're supposed to measure.

Customer Cost & Value: Powerful Metrics for Marketing Decisions

Stepping back to look at CLV and CAC on their own terms isn't just a formality. Each metric covers a lot of ground – and some of that ground can be slippery if you're not used to traversing it.

First, be prepared to read, see and hear a lot of advice on the finer points of calculating CLV and CAC. Here's some good news: The more detailed the advice gets, the less likely it is to make a real difference to your results.

Here is one of (at least) three ways to calculate CLV: [2]

$$CLV(\delta|r, \alpha, s, \beta, p, q, y, x, t_x, T) = \frac{\alpha^r \beta^s \delta^{s-1} \Gamma(r + x - 1)\Psi(s, s; \delta(\beta + T))}{\Gamma(r)(\alpha + T)^{r+x+1} L(r, \alpha, s, \beta|x, t_x, T)} \times \frac{(\gamma + m_x x)p}{px + q - 1}$$

Fortunately, much simpler approaches can also be effective.

Customer Cost & Value: Powerful Metrics for Marketing Decisions *(continued)*

In fact, two straightforward rules will get you 90% of the way to generating marketing metrics that do their jobs (and help you do yours!).

Rule 1. **These are common-sense marketing metrics. It's important to keep them that way.**

Rule 2. **Consistency is key. Pick the right metrics for your business and use them consistently.**

Always keep in mind why it's so important to take a consistent and sensible approach to CLV and CAC: Your marketing decisions are only as good as the information that goes into making them.

These two metrics, however, are more important than most; marketers routinely use them to make strategic decisions about program goals, priorities, target audiences and resource investments. Some of these decisions are difficult to walk back – and some can even determine whether a business succeeds or fails.

As a result, CLV and CAC, like most powerful tools, can be extremely helpful, but they can also cause problems if marketers don't set them up and use them properly. Here's a primer on how to accomplish this, before we apply these metrics to create an even more powerful core marketing metric.

The Case of the Missing Market Metrics

CLV and CAC may be important, but that doesn't mean they're ubiquitous. According to a 2014 Econsultancy study, just 42% of companies can measure CLV.[3] According to Ruth Stevens, President of eMarketing Strategy, many firms may simply lack access to the data they need to calculate this and other metrics.

"The reason that … it's not really operational for many firms is because this data may not be available," said Stevens. "For example, if the customer relationship is managed by a third party or an agent, then you're not going to have this visibility into the expected revenues and cost at the account level."

As more marketing organizations adapt more data-centric decision-making, these accessibility issues will get worse. For marketers on the outside looking in, getting access to the data they need, or finding ways to acquire it, will become top-of-mind issues.

Customer Lifetime Value By the Numbers

What is CLV? The word “lifetime” is the one that really matters when looking at what the term really means to marketers. Most B2B firms spend a lot of time and effort avoiding “one and done” customers – ensuring that the money they spend to acquire customers today also generates returns for years to come. CLV rounds up all of that value and expresses it as a single per-customer dollar figure.

How do you calculate CLV? Start with three questions that every B2B marketing organization should be able to answer (or at least know where to find the answer):

1. What is the average sales value of your first transaction with a customer?
2. How much do you typically make per year from a customer after the first purchase – including cross-sell and upsell revenue (if relevant)?
3. How long does a typical customer continue to do business with you? (The answer, ideally, will be in years – not months or weeks.)

For example, a typical first sale of $20,000, a typical ongoing annual value of $5,000 and a typical customer lifespan of five years (or 5 * $5,000), yields a CLV of $45,000.

Customer Lifetime Value By the Numbers *(continued)*

Is that all there is to lifetime value? No. This formula can get much more complicated. Marketers can and do use net profit instead of simple revenue; apply a rate of discount to capture today's value of future customer purchases; and/or inject all sorts of other nuances.

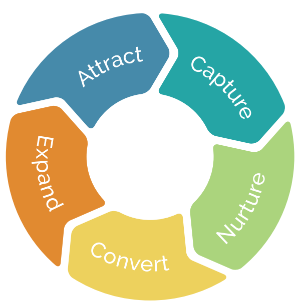
Before you go that route, remember Rule #2: Consistency beats perfection. If you know what went into your CLV formula, and those numbers are reliable, and you apply them consistently, then the changes you notice over time are far more valuable than the pinpoint accuracy of each point on the line.

How do you know whether your CLV is good or bad? That depends on a few things:

1. How much you spent to acquire a customer. (This leads back to CLV/CAC, so let's set it aside for a moment.)
2. Whether businesses like yours typically generate significant revenue from return/repeat customers.
3. How much you typically spend to maintain these ongoing customer relationships.

What's the most important mistake to avoid when calculating CLV? The biggest mistake, by far, comes back to the word lifetime – marketers who calculate customer value based only upon the value of the first sale are underestimating the total value of the customer.

The real problem, however, isn't the amount of revenue you lose with a first-sale focus. Much of the value marketers get from CLV comes from tracking the impact of ongoing marketing campaigns, customer service interactions, upsell / cross-sell programs, and many other tactics designed to increase that ongoing revenue. When you base CLV entirely on the first sale, you lose the ability to measure the success of these activities – effectively blacking out your visibility into an entire category of marketing, customer service, and sales investments.



Pro Tip:

Getting a true reading on lifetime value requires access to reliable metrics at every point in the customer lifecycle. Ensure that you understand and document what that customer journey looks like in your world; then decide where and how to collect that information with consistency and reasonable accuracy.

Customer Lifetime Value By the Numbers *(continued)*

How can I use CLV to improve marketing effectiveness?
First, of course, a complete view of CLV allows you to track the impact of your customer onboarding, retention, upsell / cross-sell efforts, and loyalty programs. You can pull each of those levers, assess the results, and decide where to focus future efforts – and, of course, future investments.

"Customer lifetime value has long been used to determine not just campaign effectiveness, but also to determine how much should be spent on marketing, on media buys, and other marketing investments," said Rebecca Lieb, strategic advisor, analyst and author of *Content Marketing: How To Use Content To Market Online And In Social Media.* "Because obviously, you want a customer to be profitable."

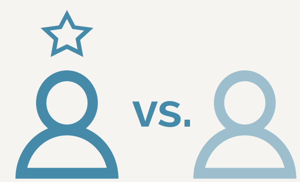
Marketers also work very hard to increase the value of a customer's initial purchase. You don't need CLV to do that; average revenue per customer tells the story. Changes in initial deal value, however, often interact in interesting ways with changes in long-term customer value – and this is a story that CLV often helps to tell.

A third application of lifetime value involves using it to determine how much to invest in your best customers:

1

Identifying and segmenting your "**best**" customers (based on whatever standard makes sense for your business).

2



Comparing this group's typical lifetime value against average CLV for your customer base as a whole.

3

When you know how much more those "best" customers are truly worth, you can decide how much to invest in acquiring them and keeping their business.

Customer Lifetime Value By the Numbers *(continued)*

Any meaningful use of CLV requires a commitment to track and report it regularly – ensuring that marketers will spot trends in the data as quickly as possible. "It's important to know that customer lifetime value is not a static figure," Lieb explained. "Customer lifetime value changes just as products and services and offering and pricing changes."

Finally, a clear view of lifetime value allows marketers to spot and fight back against "sloppy growth." This is often a problem when marketers choose high-volume lead-gen tactics without considering where and how to protect lead quality. Sloppy-growth customers are the inverse image of a company's "best customer" segment: They buy less initially, spend little or nothing after the first purchase, and vanish faster from a company's books. Falling lifetime value can alert you to the presence of these unwelcome guests; you can then adjust your lead-gen programs to deflect them and minimize their impact on your customer service and support costs.

Happy Customers: Your Secret Weapon to Boost Lifetime Value

There are lots of ways to improve CLV, but one method consistently shines. According to a seminal study published in Harvard Business Review, increasing customer retention by 5% can increase profits by 25% to 95%.[4]

Customer Acquisition Cost By the Numbers

What is CAC? The key to defining CAC is the word “acquisition.” A marketing organization typically performs a wide range of tasks; only some of these play a part in converting prospects to first-time paying customers.

How do you calculate CAC? This is another straightforward formula: divide the amount your marketing organization spends on customer acquisition during a specific period by the number of customers acquired during the same period. A $500,000 customer acquisition spend, for example, divided by 1,000 new customers, gives you a CAC of $500.

Is that all there is to CAC? That depends on how strict you want to be about zeroing in on acquisition costs. The simplest way to calculate this figure is to determine your marketing budget after subtracting headcount and overhead costs. This might yield a very rough picture of acquisition costs (if a marketing organization also targets the post-purchase phases of the customer lifecycle), but it's easy to get these numbers and get the job done.

Customer Acquisition Cost By the Numbers *(continued)*

A more refined approach to CAC, however, could look specifically at the budget devoted to the customer acquisition process, and an organization's finance department might come up with an even more specific (and complicated) formula. Choose the approach that best suits your needs – as long as it satisfies our cardinal rules regarding common sense and consistency.

How do you know whether CAC is good or bad? A single CAC calculation won't answer this question, and a savvy B2B marketer won't ask it. Before you assess CAC, you need to know what you get for your money – when you spend a dollar to acquire a customer, how many dollars in revenue does that customer generate?

What's the best way to uncover this cost-to-value ratio? This is where CLV/CAC once again enters the picture, so let's hold this thought for a moment (we promise we'll get there!).

Keep in mind that you can get useful insights from looking at how CAC changes over time. As with any cost metric, sudden unexplained spikes are a red flag and potentially a cause for alarm; stop calculating and start investigating.

Pro Tip:

The most common "mistake" marketers make with CAC may be the fact that so few of them track it. In fact, according to one 2015 study, CAC is the least commonly reported major marketing metric. Perhaps this is a case where ignorance feels like bliss – but that feeling won't last as more businesses insist their marketing teams show accountability for their efforts.

Customer Acquisition Cost By the Numbers *(continued)*

What are the most important mistakes to avoid when calculating CAC? Some of the biggest (and easiest to make) mistakes are variants on our rule #1: a lack of context when you calculate CAC and using this metric to make decisions and assess marketing effectiveness. Consider two examples:

1. **New businesses almost always incur much higher CAC than established firms.** This is simply a fact of life; the available options to acquire customers at this stage of the game are more limited and often much more expensive. As a business matures and less expensive acquisition tactics (such as referral programs) come in to play, CAC typically decreases.
2. **Aggregate CAC can mask the impact of specific, high-cost programs.** Targeting a new market segment or breaking in to a new geographic region can drive up the cost of related customer acquisition programs, and those, in turn, will spike overall CAC. These aren't (we hope) unexpected CAC spikes, but they may not be apparent to everyone who will look at CAC and draw conclusions from what they see.

How can I use CAC to improve marketing effectiveness?
Looking at how CAC changes over time allows you to target improvements to the other variable in the CAC equation: the number of customers acquired. How you do this depends on your business; some common areas to focus on include:

Fine-tuning your email, landing pages, forms and other touch-points where some leads continue on a path to purchase and others tend to drop out.

Improving on-site e-Commerce conversion metrics is a broad, but very important, set of concerns that includes issues such as mobile optimization, website responsiveness and user experience.

Experimenting with tactics such as retargeting, and inbound and referral programs that can simultaneously drive down marketing spend and increase conversion rates by packing your funnel with higher-quality leads.

Customer Acquisition Cost By the Numbers *(continued)*

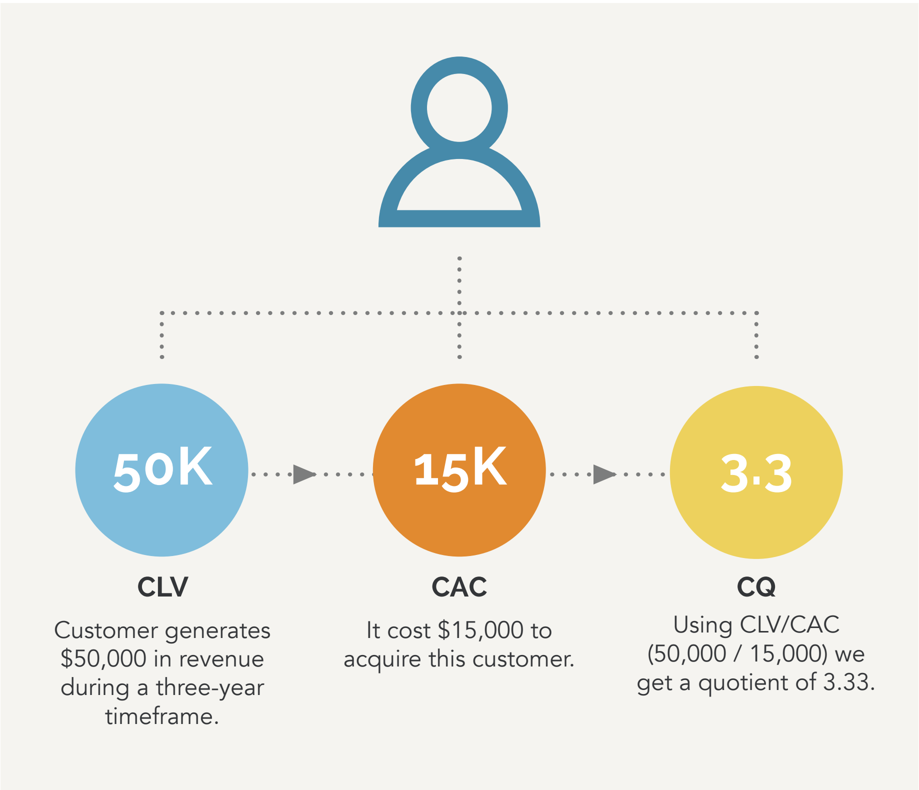
In addition, analyzing your CAC trends can drive home some harsh realities about the true cost of many popular and widely adopted acquisition tactics. SEO, SEM, and social marketing, for instance, often cost more than marketers realize or expect, given typical conversion rates for such tactics.

The real eye-opener usually happens with marketing tactics that involve any sort of human touch. A conversion process that involves a handful of manual email follow-ups can push CAC from tens to hundreds of dollars; add a field salesperson to the mix, and that figure routinely runs into many thousands of dollars. Understanding the impact of these costs, as well as the comparative benefits of lower-cost marketing tactics, can be an educational (but not always pleasant!) experience.

Mapping a Path to Profit: A Closer Look at the Marketing "Compass" Metric

Let's assume you've buttoned up your customer cost and value metrics: You understand how CLV and CAC work, what they can do, and how to make them tell a reasonable and consistent story. Accomplishing these things sets you up for success with CLV/CAC – our "compass" for navigating even the most dynamic and changeable marketing environments. Let's take a closer look at how to analyze and apply these insights.

Mapping a Path to Profit: A Closer Look at the Marketing "Compass" Metric *(continued)*



One Number to Rule Them All

Here's an example of what we can put to work in this discussion. *For the sake of brevity, we'll refer to the quotient* ***of CLV/CAC from here on as our "compass quotient" or CQ.***

- For CLV, let's assume a customer generates $50,000 in revenue during a three-year timeframe.
- For CAC, let's assume it cost $15,000 to acquire this customer.
- **Using CLV/CAC (50,000 / 15,000) we get a quotient of 3.33.**

Let's review what this number tells us: *For every $1 that we invested to acquire this customer, we generate well over $3 in revenue.* If this looks like a healthy number, you're right: Many experts consider a CQ over 3 to indicate a business with very strong fundamentals.

Working with Your Compass Quotient (CQ)

Our humble CQ number tells quite a story if you ask it the right questions – although even a metric this powerful has its limits. Here are seven keys to getting your bearings when you analyze and apply a CQ calculation:

1. **The CQ is (within reason) a self-contained marketing metric.** In other words, a CQ of 3 or any other value on its own can tell you something meaningful about a business.
2. **The CQ is a historical metric, rather than a predictive metric.** In other words, it tells you how things were and makes no claims to predict the future. (There are ways to do "predictive CQ." All of them require computers and people who aren't afraid of math.)
3. **The CQ offers a clear "redline" for identifying urgent and fundamental business problems.** If a CQ equals 1, then a business spends as much to acquire a customer as it earns from that customer. Unless there's a good reason why a CQ is at or below this level, this is your cue to ask hard questions about the viability of this business.
4. **The CQ can't tell you whether a business is (or will be) profitable.** A business could, after all, have an excellent CQ, but still run itself out of business if it spends that surplus unwisely. And there will always be trends and market factors that are out of your control.
5. **The CQ can include customer retention costs...** and, in fact, this is one of the first upgrades many marketers make to get a more accurate view of customer value.
6. **...but including retention costs is not always important or even helpful.** Acquisition costs are usually far more important to the big picture than retention costs – and the best way to track how CAC impacts CQ is to keep it isolated as a single variable instead of throwing it in to a customer-cost stewpot.
7. **The CQ offers powerful insights to assess marketing performance and support a marketer's decision-making process.** As a marketer, this is what you care most about – so let's put this capability into specific terms.

Working with Your Compass Quotient (CQ) *(continued)*

Insight to Impact: Using CQ in Day-to-Day Marketing Decisions

There are definitely more than five ways to put CQ to work in your marketing organization. But these examples (we'll look at three of them in detail and summarize a couple more) offer a sense of what's possible.

1. Build a more valuable customer base. We already touched on the value of using CLV to decide how much you can invest to acquire more valuable customers. Using CQ to guide this process gives you a more complete view of what you're currently spending to acquire high-value customers, and how much you can invest to acquire more customers with the same defining traits.

"Just like marketers work with different personas, different demographics, or different psychographic segments, it's important to look at long-term customer value not as a one-size-fits-all number, but as different templates for different types of customers," said Lieb. "That's a relatively easy thing to apply to specific types of marketing because different types of marketing should be aimed at different segments."

You can segment customers in any number of ways to uncover those high-value chunks of your target market: demographics, industry, location, and other variables might play a role. You'll also want to look at how different marketing tactics (content marketing, referrals, SEO) shift the balance between cost and lifetime value that the CQ represents.

The key to making the most of CQ in conjunction with segmentation is to calculate CLV and CAC for that segment. This ensures that you're looking at changes to CQ that are relevant to your spending on a target segment, rather than viewing the impact of many other variables. This doesn't necessarily make CQ more complicated, but it does require the ability to apply the same metrics to different specific segments of your customer base – and that generally requires investing in marketing technology that delivers this capability.

Working with Your Compass Quotient (CQ) *(continued)*

2. Minimize risk due to customer churn. This is a high priority for most businesses for a couple of reasons. First, research shows that it's cheaper to retain customers than to acquire new ones, and those existing customers are far more likely to generate superior value (see callout).

In addition, look at the CQ in our example (3.33) and consider that it covers a three-year stretch of the customer lifecycle. It's logical to ask how long it takes, on average, for our business to recover enough revenue to break even (a CQ equal to 1) and eliminate the risk that a customer will leave before she covers the cost of acquiring her. (We didn't break down our numbers far enough to calculate this break-even point, but it's enough to know that it exists, and it's important.)

The High Cost of Customer Churn

70% of companies say it's cheaper to retain a customer than to acquire one, and businesses that get better ROI from relationship marketing outnumber by 4:1 those that benefit more from acquisition marketing.[5]

Working with Your Compass Quotient (CQ) *(continued)*

These questions get complicated very quickly; customer retention depends on the types of customers you acquire in the first place, as well as your ability to keep those customers around and spending freely. This is exactly the time to lean on your CQ to show whether you're balancing both sides of this process effectively, and to move quickly when cost or retention issues surface.

"If there are retention issues or high post-sale cost-to-serve issues that impact how long a customer stays, marketing may not be focused enough on post-sale engagement to get to that profitable point," Heuer stated. "All the work and expense that went in to acquiring the customer won't matter if they defect and never live up to their potential value."

Finally, while you don't have to bring customer retention costs in to the picture to get useful insights, this is obviously an area where adding these costs to your CQ model can help.

3. Other places to apply CLV/CAC. Any marketing activity that shifts the critical balance between acquisition cost and customer value can probably benefit from a CQ-focused analysis. Whether you're assessing the value of new market opportunities, prioritizing target audiences, planning content marketing programs, or simply deciding where to focus your analytics investments, the CQ can play a role – cutting through noise and complexity to give you a clear view of the marketing landscape, and offering simplicity without being simplistic.

CQ & Account-Based Marketing: A New World of Possibilities

Unless your marketing team works in a cave, you've heard something – or a lot of things – about account-based marketing (ABM). This is a tried and true B2B marketing tactic that got a new lease on life as more organizations have rediscovered its potential – especially when combined with modern technology and analytics tools.

ABM is not a fast or easy path to marketing ROI. First, it requires access to the right data and analytical insights to identify high-value target accounts and to understand how these buyers think, feel, and behave. ABM also requires carefully targeted content and the ability to conduct seamlessly coordinated, integrated campaigns that engage multiple buyers inside the same account across multiple channels, and hand off individual buyers at precisely the right time.

Since ABM puts more of a company's marketing eggs in a smaller collection of baskets, it's very important to know whether your efforts are on target or falling short. CLV is a critical metric here; ABM customers are most commonly large enterprises that enter business relationships for the long haul, and looking at these accounts as first-purchase snapshots can drastically underestimate the lifetime value they bring to a business.

Ultimately, CQ is the "killer metric" for assessing ABM investments. It gives you a single view of how your ABM costs stack up against the total value of the accounts you land. By most accounts, a CQ of 3 or greater is very likely to reflect a sustainable and profitable ABM strategy; programs that slip below 3 can prioritize changes designed to cut acquisition costs, increase deal size or continuing revenue, improve retention rates, or move other levers that can improve program effectiveness.

To learn more about ABM, take a look at this eBook: How to Profit From Account-Based Marketing

Conclusion: The Right Insights for Firms of Every Size

We'll close by pointing out that one of the most useful aspects of the CQ is its flexibility. Getting started requires nothing more than some fundamental marketing data, a common-sense approach to calculating cost and value metrics, and a commitment to apply these tools as consistently as possible. Marketers can and do turn their CLV and CAC calculations into comprehensive, highly complex math workouts, but a "stay with the basics" approach, when it's applied consistently, will capture most of the detail required to use CQ effectively.

This is very good news for smaller firms and their marketing organizations. Whether a smaller firm starts simple with these metrics and then builds the knowledge required to advance them, or sticks with basic, tried-and-true models, they can use CLV, CAC, and the Compass Quotient to make decisions that reflect enterprise class consistency and data-driven consideration.

Resources

[1] Demand Metric Research: https://www.act-on.com/blog/2016/06/is-inbound-marketing-holding-your-business-back/

[2] http://customersthatstick.com/wp-content/uploads/2011/11/if_post_2011-11_CLV.jpg

[3] https://econsultancy.com/blog/64659-just-42-of-companies-are-able-to-measure-customer-lifetime-value/

[4] http://hbswk.hbs.edu/archive/1590.html

[5] https://econsultancy.com/blog/63303-almost-a-quarter-of-businesses-don-t-carry-out-any-relationship-marketing-report

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