WHAT IS CUSTOMER LIFETIME VALUE?

By: **Laura Bassett,** *Director of Marketing, Customer Experience and Emerging Technologies, Avaya*

Customer lifetime value (CLV) is both a concept and a measure. At its core, CLV is about optimizing each interaction and conversation in order to create an engaged customer relationship which drives customer retention, repeat purchases, customer referrals, reduced support costs, and possibly even price premiums.

The value of a customer over the lifetime of a business relationship can be measured using a simple formula. (See Figure 2.1.)

As with all mathematical equations, changing a value in the equation changes the result. Thus, increasing customer revenue or the length of the relationship would increase CLV. Likewise, reducing acquisition and support costs would also increase CLV.

Why Customer Lifetime Value Matters

Improving the customer experience is good for business in terms of increasing CLV and wallet share and for internal operations. According to Forrester in

Figure 2.1: How to Calculate Customer Lifetime Value

| customer revenue | − | support costs | X | average length of relationship | − | support costs | = | customer lifetime value |
| 1 | | 2 | | 3 | | 4 | | 5 |
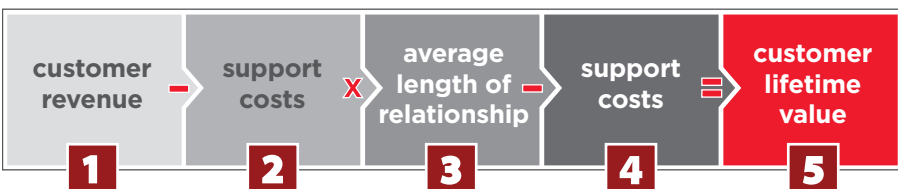
Source: Avaya internal research.

its 2012 white paper, *Delivering a Superior Customer Experience,* companies that have invested in delivering better customer experiences report a greater ability to collaborate internally, reduced operational costs, greater productivity of front-line personnel, and greater business agility.

The key levers of customer lifetime value are efficiency, growth, and revenue, which align with the different perspectives of customers and businesses. (See Figure 2.2.) Improving efficiency requires a focus on internal processes, systems, and resources and is influenced through customer acquisition and support costs. Improving growth and revenue, on the other hand, requires a focus on customers and is influenced through customer retention, loyalty, and advocacy.

It is essential to understand how to influence the levers of CLV as customers move through their journey with the organization.

- **Acquisition.** The acquisition stage incorporates the **research**, **select**, and **buy** steps in the customer journey. Acquiring customers incurs costs such as sales and marketing expenses, free samples or trials, sales collateral, and promotions. Not only must the organization understand what the acquisition costs are, but it must also measure the ROI of these costs. In other words, the organization must guide prospects to a buying decision. This could mean incorporating Web or video chat into a website, answering questions about a product, or even conducting an interactive demonstration online.

Figure 2.2: Customer Lifetime Value and the Customer Journey
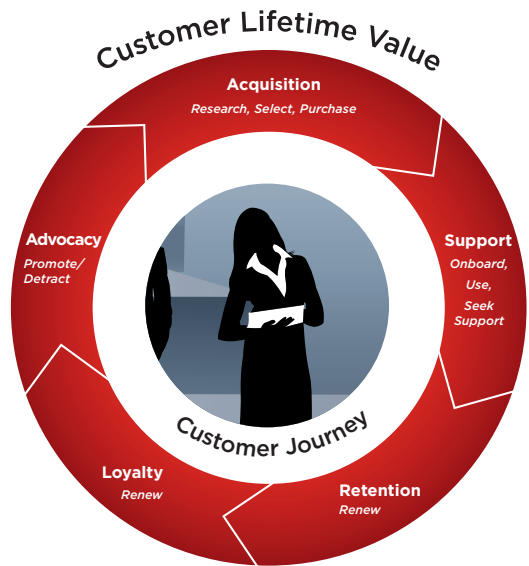
Source: Avaya internal research.

Products and services should arrive as expected to ensure that customer expectations are met; to this end, businesses can offer shipment tracking options or proactive messages notifying customers that a package or service is en route. In other words, the organization must become very efficient at acquiring new customers successfully.

- **Acquisition leads to support.** The support stage incorporates the onboarding, use, and support steps of the customer journey. Customers need help with their purchases—initially for general setup or technical assistance, and later as they use and maintain their purchases. This requires support resources. In addition, organizations may initiate promotions or outreach activities to nurture relationships. All of these activities incur costs to the business. ➲

The stock price of companies ranked in the top 10 of Forrester Research's Customer Experience Index gained 22.5 percent between 2006 and 2010. The S&P 500 lost 1.3 percent over that time.

This critical phase of the customer journey has a huge impact on the ultimate value of the customer to the organization, as it sets the potential for growth based on upon how well the company performs. Specifically, the onboarding of a customer within the support stage represents many potential opportunities and pitfalls for the company:

1. **Businesses** have up to seven times the number of interactions with customers during onboarding than in any other step in the support stage.
2. **Customers** are five times more likely to accept complementary products and offers during onboarding than in any other step in the support stage.
3. **Businesses** have a 30 to 50 percent higher probability of retaining the customer in the onboarding step.
4. **Customers** have a 5 to 10 percent defection rate during the onboarding process.

• **Support drives retention.** The retention stage refers to a customer's spending over some period of time. For example, fitness center members typically sign up for one-year memberships. The more members the fitness center keeps from one year to the next, the higher its retention. Whether the member uses the facility regularly or not isn't typically factored in. However, when a member cancels or fails to renew a contract, it becomes clear that the member has not been retained. High retention results in a longer relationship and a higher CLV. So it's essential that organizations become very effective in delivering products and services that customers view as valuable and want to continue to use.

• **Retention drives loyalty.** The loyalty stage refers to a customer's continued interaction with a company. Though similar

to retention, loyalty is not about the length of the relationship. Rather, it refers to a customer's purchasing patterns and activities that take place during the relationship. For example, while one customer may renew a contract without question each year, another may shop around and insist on a discount. The more loyal customer may purchase additional value-added services, while a less loyal one may go elsewhere for these same services. Higher CLV is impacted by the organization's ability to build valuable, sustainable relationships with its customers.

- **Loyalty drives advocacy.**
  The advocacy stage involves a customer speaking well about a company to others, which in turn influences others either to do business or not to do business with the company. Word of mouth is a classic form of advocacy; customers regularly share their experiences about brands and companies with their friends, neighbors, co-workers, family members, and even complete strangers. These stories are often told in person but are increasingly found in online media such as consumer forums and social media sites. Advocacy directly impacts an organization's Net Promoter Score®: While positive advocacy could influence someone to become a customer, negative advocacy could have the opposite effect.

The steps in the customer journey that align with retention, loyalty, and advocacy are **promote/detract and renew**. After acquiring and supporting a new customer, the focus shifts to fostering customer retention, loyalty, and advocacy. While the other stages of the customer journey are related to efficiency, these stages are related to growth and revenue. Increasing conversion rates, average order ➲

> Customer lifetime value is a cycle that doesn't just rely on customer satisfaction; as customers become advocates, their advocacy can bring in new customers at a lower cost—which restarts the cycle.

value, cross-selling, and up-selling are common tactics employed during these stages.

CLV is about much more than maximizing profitability. It's about maximizing customer profitability over the longest possible period; in other words, keeping customers longer and reducing overall churn in the base. Improving efficiencies and reducing costs during the acquisition and support stages while driving revenue and growth during the retention, loyalty, and advocacy stages can increase the lifetime value of the customer relationship. It's a cycle that doesn't just rely on customer satisfaction; as customers become

advocates, their advocacy can bring in new customers at a lower cost—which restarts the cycle.

In 2011, Forrester Research conducted a study comparing companies ranked in the top 10 of its Customer Experience Index against the S&P 500 for a period of five years. The results were impressive: While the S&P 500 lost 1.3 percent during that period, the top 10 Customer Experience Index companies returned 22.5 percent.

Though the formula for CLV relies on numbers, the most important factor of all is less tangible: Ultimately it's the customer experience, which, when prioritized and managed effectively, positively impacts CLV. [A]

Laura Bassett has over 20 years' experience in applications consulting, development, and delivery. Laura is responsible for all aspects of customer experience management marketing, including business planning and strategy, market awareness, product marketing, sales enablement and engagement. She also established Avaya's Market Driven Innovation Model and Early Adopter Program to support Avaya's efforts to accelerate the commercialization of innovation.