Retailitix
Retail Analytics at Work

CUSTOMER LIFETIME VALUE

CALCULATING YOUR BEST CUSTOMERS

CONTENTS

A DEFINITION OF

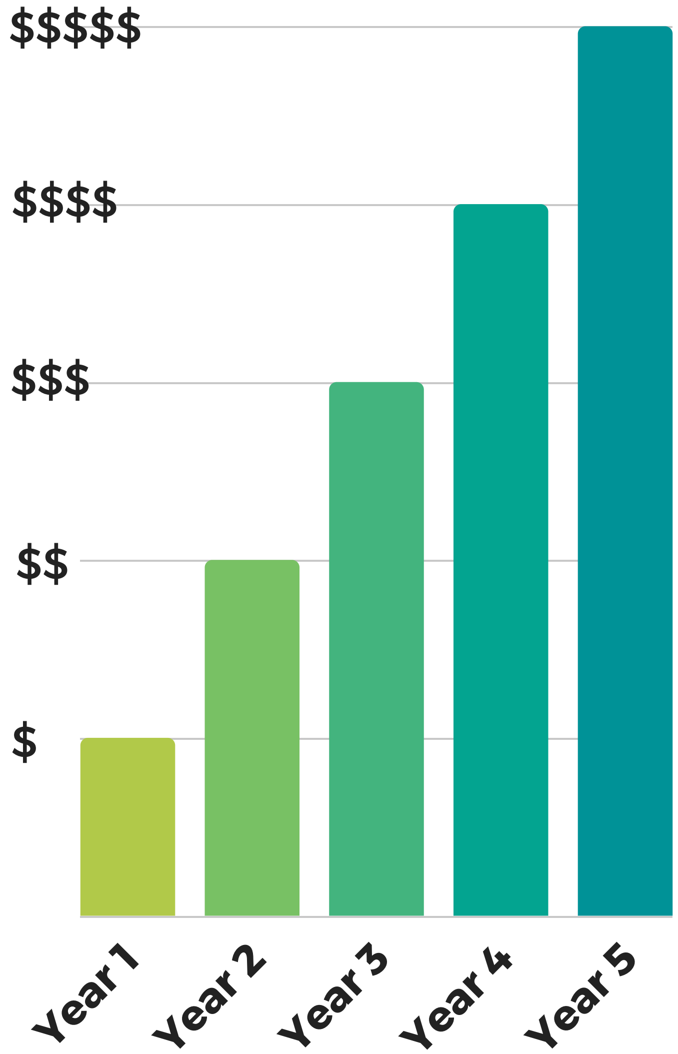
CUSTOMER LIFETIME VALUE

Customer Lifetime Value (CLTV) is one of the most valuable metrics in your retail analytics toolbox. CLTV calculates what your customer is worth over the lifetime of their relationship with your company, and it provides you with vital business intelligence.

AN ESSENTIAL METRIC FOR AN

OMNICHANNEL WORLD

The CLTV concept has been around for a long time, but it is now more relevant than ever with the evolution of retail into omnichannel. Retailers want their customers to have the best shopping experience possible across all channels, so they will return to purchase again and again.



THE VALUE OF
REPEAT BUSINESS

- It costs less to retain an existing customer than to acquire a new one
- Existing customers are more likely than prospective customers to shop with your company
- Loyal customers often become brand advocates by promoting your company and recruiting new customers for you
- Longtime customers provide predictable cash flows

CALCULATING YOUR

FUTURE RELATIONSHIPS

Customer Lifetime Value is often defined as the revenue a customer generates over a period of time, less the cost it took to acquire them. This is true, but to understand what your customer relationship is truly worth over time, you must also predict the **value of their future margin today**, as well as **the probability that they will return**, to get a complete picture of their potential financial impact on your business. Here is a simplified version of how CLTV is calculated taking present value into consideration.

PRESENT VALUE OF YOUR FUTURE MARGIN X **PROBABILITY OF RETAINING YOUR CUSTOMER** − **ACQUISITION COSTS** = **CLTV**

PART 3: UNDERSTANDING THE CLTV CALCULATION

WHAT YOUR FUTURE IS WORTH

TODAY

Taking it a step further, CLTV involves a common equation in finance known as **net present value**. NPV calculates your future cash flows in today's dollars, giving you a more accurate portrayal of your customer's worth.

VISIT THE RETAILITIX BLOG TO UNDERSTAND HOW WACC (THE WEIGHTED AVERAGE COST OF CAPITAL) IS CALCULATED.

$$CLTV = \sum_{(n=1)}^{N} \left(\frac{(GM_n * p^n) - RC_n}{(1+r)^n} \right) - AC_0$$

AC = INITIAL ACQUISITION COSTS
RC = ONGOING RETENTION COSTS
GM = GROSS MARGIN
N = NUMBER OF POTENTIAL YEARS (USUALLY 3 TO 5)
n = CURRENT YEAR
p = PROBABILITY THE PERSON WILL REMAIN A CUSTOMER
r = WEIGHTED AVERAGE COST OF CAPITAL

PART 3: UNDERSTANDING THE CLTV CALCULATION

Let's see how this works. You invest $100 to attract a new customer and plan to track their profitability over three years. You have an 85% probability that they will return to purchase each year, and your company's weighted cost of capital is 9%. When will they become profitable?

r = .09	p = .85	Year 0	Year 1	Year 2	Year 3
Sales		$0	$150	$200	$250
Gross Margin		$0	$117	$156	$195
Ongoing Retention Costs		$0	$25	$40	$35
Present Value		$0	$68.30	$61.20	$65.45
Acquisition Costs		-$100	$0	$0	$0
CLTV		-$100	-$31.70	$29.50	$94.95

Sales are increasing, indicating your customer was a good target

Gross Margin equals your Sales minus the Cost of Goods Sold

Retention costs vary annually depending on your marketing strategy

NPV is calculated using Gross Margin (GM), Probability (p), WACC (r) and Retention Costs (RC)

Your company must earn back the initial acquisition costs to become profitable

Your customer incurs a loss for the company in Year 1, but becomes profitable in Years 2 and 3

PUTTING CLTV INSIGHTS INTO MOTION

Once you've set your company's profitability goals and measured which customers have the most value, you'll be armed with powerful information to inform your business strategy, optimize your resources, and boost your customer lifetime value.

What is your customer worth?

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