EBOOK · CUSTOMER YIELD

Retention is *smart business*.

An ebook on the economics of customer retention — why the customers you already have are the most undervalued growth asset in most businesses, and how to think about CAC, CLV, and share of customer.

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8 CHAPTERS · ~14 MIN READ · BY TERRY SULLIVAN

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6 TO FIX SERIES
VOLUME 2 OF 6

THE FRAMEWORK

Six strategy areas. Six value drivers.

WHERE THIS FITS

Customer is one of *six* strategy areas marketing owns.

*The 6 To Fix framework maps the six strategy areas marketing owns to the six value drivers buyers pay for at exit. Customer maps directly to **Customer Yield** — the recurring economic value each customer relationship generates over time.*

STRATEGY AREA	VALUE DRIVER	VALUATION EFFECT
Brand	→ **Brand Worth**	→ *EBITDA numerator + Goodwill*
Customer	→ **Customer Yield**	→ *EBITDA numerator + Goodwill*
Offering	→ **Category Claim**	→ *EBITDA numerator + Goodwill*
Communications	→ **Demand Engine**	→ *Multiple expansion + Goodwill*
Sales	→ **Revenue Quality**	→ *Multiple expansion + Goodwill*
Management	→ **Transferable System**	→ *Multiple expansion + Goodwill*

Retention marketing: making the case for marketing to *existing customers*.

Most business owners and managers are focused on two major things: growth and profitability. However, the battle for business growth is largely focused on customer acquisition versus retaining and growing existing customers. Why is that?

> *"We showed that in industry after industry, the high cost of acquiring customers renders many customer relationships unprofitable during their early years. Only in later years, when the cost of serving loyal customers falls and the volume of their purchases rises, do relationships generate big returns.* ***Increasing customer retention rates by 5% increases profits by 25% to 95%.****"*

FREDERICK F. REICHHELD · AUTHOR, "LOYALTY RULES!" AND CREATOR OF THE NET PROMOTER SYSTEM

Customer retention is *smart business*.

The proverbial "shiny new object."

Are new customers the proverbial "shiny new object"? Is customer acquisition perceived to be "better" because more new customers equate to a better or growing business? Or is it simply because customer retention is hard to define, and somewhat of an ambiguous black hole?

Customer retention is not a panacea, or a simple thing to address, but it is one thing: **necessary**.

Unless your business involves a one-time sale to a one-time customer, chances are good that your business needs to retain its customers.

> BOTTOM LINE
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> *Existing customers are the most undervalued growth asset in most businesses.*

> *"It costs 6 to 7 times more to acquire a new customer than to retain an existing one."*
>
> BAIN & COMPANY

Less expensive than *new customers*.

New customers are an important part of growing a business. But what about the customers we already have? Are we doing everything we can to help them help us grow our business?

Do you know your CAC?

Customer Acquisition Cost (CAC) is a commonly overlooked metric in many businesses. In fact, a sale to a new customer is usually considered such a "win" that the costs of getting that sale are often ignored.

Let's say it costs your business $300 to acquire a new customer with sales and marketing costs, and related expenses. Depending on industry, gross margins, etc., that might be an acceptable acquisition cost — but it may not be. The point is that we *need to know*.

Otherwise, it is hard to determine how long we need to make our investment back, how much business we need from each customer, how much we should spend on sales and marketing. The list goes on.

BOTTOM LINE

Know your customer acquisition cost.

"Customer profitability increases over the life of a retained customer."

EMMET MURPHY & MARK MURPHY · LEADING ON THE EDGE OF CHAOS

The long-term value of *current customers*.

Customer Acquisition Cost (CAC) is only half of the equation. The other side of the coin is **Customer Lifetime Value (CLV)**.

Business smarts.

Simply put, CLV is the value of a customer over a specific period of time — or their "lifetime" as a customer. For example, if a customer spends $50 per month for one year, their "One-Year CLV" is $600.

An existing customer was a *new customer* at one time. But the important thing to consider is how much that customer will contribute to the business over time.

CAC and CLV work together and help determine what you *should* spend on a new customer. Spending $300 to acquire a new customer makes sense if that customer spends $30 per month for two or three years. But it would take well beyond one year to earn back the CAC plus a profit — which may not make sense at all.

BOTTOM LINE

Know both sides of the customer value coin.

"Customer loyalty can be worth 10 times as much as a single purchase."

WHITE HOUSE OFFICE OF CONSUMER AFFAIRS, WASHINGTON, DC

Selling to current *vs. new* customers.

Sales to existing customers can be significantly more profitable than new customer sales, because there is a cost reduction in each additional sale.

Hello, bottom line.

Using the example from earlier, let's compare sales to a *new* vs. *existing* customer:

$300 = Customer Acquisition Cost for a new customer.
$300 sale to an *existing* customer = $150 gross profit + $0 CAC = **$450 gross profit**.

Current customer sales are more profitable because the *acquisition cost savings* goes to the bottom line on **each additional sale**.

Sure, other costs exist — it's not "free" to sell to existing customers, but it is typically much cheaper.

BOTTOM LINE

Profitable sales add up to a valuable business.

"There is a 5%–20% probability of converting a prospect into a new customer, but a ***60%–70% probability*** *of selling an existing customer."*

MARKETING METRICS

Existing customers are *easier to sell*.

Most companies default to customer acquisition versus selling more to existing customers. Why?

Go where the crowd isn't.

Maybe companies simply don't know what to do. Maybe it's assumed current customers won't purchase more. Maybe new sales might be larger or more profitable. Maybe it's an "ego thing" — to say we have *a lot* of customers versus a few who are really profitable.

Most businesses have additional products and services they could sell to existing customers. What better way to reinforce a customer's initial purchase decision — or demonstrate you are "new" again? What better path to growth and profitability?

> BOTTOM LINE
>
> *Your best customer is the one you already have.*

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*"A 5% reduction in the customer defection rate can **increase profits up to 95%**."*

BAIN & COMPANY

Repeat customers are *essential for growth*.

Whether you plan to grow your company well into the future, or have an exit strategy to sell your business, growth equates to customers.

The proverbial bucket.

Repeat purchases are essential, because growth from new business alone is expensive, time-consuming, labor-intensive, and probably unsustainable.

Let's assume our customer churn rate is 20%; we lose 200 customers per year; and customers spend $300 each year with a $150 gross profit on each sale.

Reducing the churn rate by even 10% = **$6,000 in revenue** (20 × $300) and **$3,000 gross profit** (20 × $150).

Acquiring 20 new customers at $300 spend and $150 gross margin = $6,000 CAC and $3,000 gross profit respectively, but we actually *lose money* — because the $6,000 CAC is an *expense*: $3,000 − $6,000 = **−$3,000 loss**.

> BOTTOM LINE
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> *Plug the hole and keep more customers.*

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*"80% of your company's future revenue will come from **20% of your existing customers**."*

GARTNER RESEARCH

Add significant value to *your company*.

The 80/20 rule dictates that 80% of business comes from 20% of your customer base.

Staying even isn't profitable.

Perry Marshall, noted author and marketer, reveals in *"80/20 Sales and Marketing"* that the 80/20 concept can be magnified even further. Just a *few* customers are actually worth *exponentially more* than ALL other customers combined. These are the customers who can really help grow business value.

Let's say in five years, you want to sell your business. A company with *active* and *profitable* customers makes a business valuable.

If you gain a *new* customer for each *lost* customer, you are not "staying even" — you are actually **losing money**, because of lower margins due to the expense of acquiring new customers versus selling to existing customers.

> BOTTOM LINE
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> *Customer retention isn't about more sales. It's about profitability.*

> *"About 4% of dissatisfied customers complain.* ***96% just go away.***"
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> HARRIS INTERACTIVE · CUSTOMER EXPERIENCE IMPROVEMENT STUDY

Customer experience is *more than a sale*.

Without a positive Customer Experience, it is difficult to successfully retain and grow profitable customers.

Retention requires intention. Experience requires effort.

While there are many benefits to customer retention — notably profitability, growth, and loyalty — it isn't free. We make substantial investments in acquiring new customers, so why don't we invest in keeping and growing customers we already have?

Investing in existing customers means *leveraging the acquisition investment already made* to build a more profitable and valuable business.

Invest in the Customer Experience. If we educate, motivate, and inspire existing customers, they will become even *better* and more *profitable* customers.

> BOTTOM LINE
>
> *Customer Experience begets Customer Retention.*

WHAT'S NEXT

See where you *score*.

Customer is one of six strategy areas in the 6 To Fix framework — and it maps directly to **Customer Yield**, one of the six value drivers marketing owns. The next step is to see how your business scores across all six.

2-MINUTE SELF-SCORECARD

Score your business across the *6 To Fix*.

Free score in two minutes. Get your headline band immediately, with the detailed per-area breakdown sent to your inbox. No call required.

Score Your Business →

scorecard.**strategicglue.com**

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This is one chapter from *6 To Fix* — Terry Sullivan's fourth marketing textbook, serialized chapter by chapter. Other chapters cover Brand, Offering, Communications, Sales, and Management.

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