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Maximizing customer lifetime value

Challenges and strategies for the new economy

With power shifting from the seller to the customer, it is essential for every business to re-examine its approach to customer relationships. This paper explores the issues involved and suggests possible strategies to adopt.

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Overview

One of the biggest impacts of the Internet is the shifting of power from sellers to buyers, who now dictate what, how and when they want to buy. This new breed of "e-customer" has forced businesses to rework their Customer Relationship Management (CRM) plans and find new ways to maximize customer lifetime value. This document explores this phenomenon and discusses ways to measure and maximize customer lifetime value.

Customer solutions

The mission of Andersen is to provide an innovative solution set that leverages strategy, e-business, organizational and process design and technology. This helps clients understand, manage and ultimately maximize the value of their customer relationships. Before we discuss customer lifetime value, we will examine the forces changing the buyer-seller relationship.

New customer relationship paradigm

A number of key parameters are changing the way customers are viewed by business. As shown below, the Internet is a key enabler of these parameters.

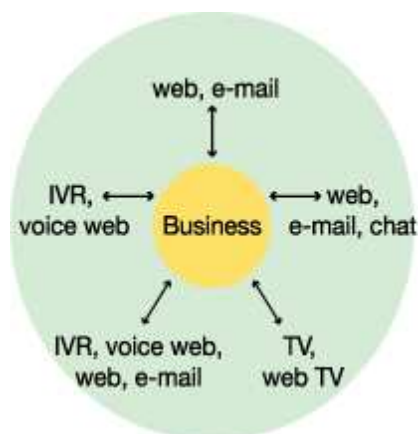


The change has occurred through the following focus areas:

- *Market globalization.* Internet technology now enables a business to target customers all around the world. While this opens up new markets, it also creates issues of language, cultural differences and local regulations new issues that the business has to resolve.
- *Growing customer sophistication.* The Internet has empowered consumers by serving as a tool to research prices, compare and understand features offered by different vendors, and review customer feedback on these products/vendors.
- *Growing customer expectations.* The Internet has led the customer to expect higher levels of service. Consumers are now accustomed to the speed and ease of online transactions, the self-service approach offered by web sites and the 24x7 access the Internet provides.
- *Mass customization.* Internet technology enables businesses to personalize and customize the user's online experience. Businesses have the tools to market to a customer segment of one individual or business.

Customer touch-points

Customer touch-points have shifted from traditional telephone, direct, IVR and Kiosk access. With new technological developments and the general availability of products, the web and e-mail have become additional touch-points. The new advances in customer touch-points are shown in the diagram below:



Customer communication

While the means of interactions between the customer and the business have changed, the types of communication between them remains the same. These can be grouped under three main areas: marketing, sales and service.

Marketing

Customer acquisition is an important activity of any business. The main objective of this communication is to create awareness, educate people about the product features and motivate them to try the product. These communications include direct marketing campaigns, promotions and content delivery.

Sales

Once the person decides to try the product or service, a series of communications ensures that the customer gets information about the status of the sale. These communications are usually order fulfillment notifications, receipts and other forms.

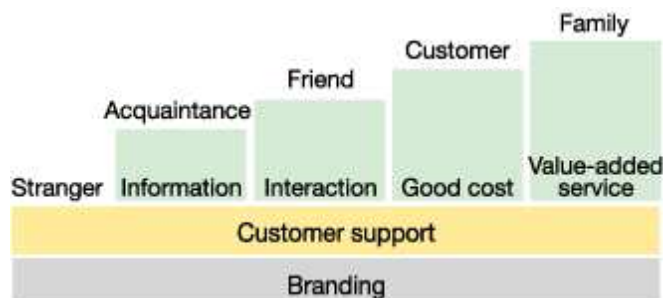
Service

A customer needs to be served at different stages of the sell cycle from answering presale questions to helping the customer troubleshoot problems after the sale. These communications are associated with case management, presale inquiries, feedback and support fulfillment.

Business must now take into consideration the new modes of communication and ensure that the customer obtains information through all or most of these modes.

Staircase of customer relationship

It is imperative for every business to understand customer dynamics and make sure business strategies are aligned with their customers' demands. During the course of their interactions with the business, e-customers pass through definite stages before becoming truly valuable to the business. The customer relationship can be graphically represented as a staircase:



Thus, the objective of every business must be to move the customer quickly between the stages until the final stage is reached. The characteristics of these stages and their requirements are detailed below:

Stage	What the user needs	What the business needs to do
Stranger	Awareness of the site's existence.	Create site awareness through ad campaigns in the online and offline medium.
Acquaintance	Information about site, company and its products and services.	Provide detailed marketing information in a user-friendly and intuitive format.
Friend	Ability to share preferences and demographic information.	Make it worthwhile to provide the information (customized content, better deals) and build customer trust.
Customer	Ability to purchase products and services.	Provide clean user interface and good value for money.
Family	Desire to promote the site among friends and invest in the business.	Provide value-added service to existing customers and make it worthwhile to spread the word.

Other important factors are:

- Branding and customer support is required for every stage of the relationship.
- The customer is in a state of inertia in each stage and the business must motivate the customer to move to the next stage.
- The business can identify problems and manage communication better by measuring the conversion ratios for each of these stages.

What is customer lifetime value?

During the course of the customer-business relationship, the customer uses products and services and generates revenue for the business. The business spends money to acquire and retain the customer. The difference between these two values over the lifetime of the customers relationship is defined as the customer lifetime value. The following points need to be kept in mind:

- Customer lifetime value is measured over a long period of four years or more. Hence, this requires a large amount of historical data.
- The business must be spending only a fraction of this value to acquire a customer. Usually businesses are willing to invest 40 percent of the calculated lifetime value to acquire a new customer.
- Different types of customers have different values.
- This is different from the value of a sale or a one-off profit.

Measuring customer lifetime value

The basic equation for measuring customer value is:

Customer lifetime value	=	(Customer acquisition and retaining costs)		(Customer benefit/revenue)
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Let us look at these parameters in more detail:

Customer acquisition cost

The customer acquisition cost is the total cost a company spends on advertising and marketing promotions divided by the total number of new customers obtained through that spending. Recent metrics published in The Industry Standard (March 2000) indicate that companies spend an average of US\$250 on marketing and advertising to acquire a single customer.

Customer retaining cost

Once the customer makes an initial purchase, the business has to spend money to retain that customer. The same report in The Industry Standard states that for each repeat buyer, a company spends an average of \$1,931 to keep their site up and running.

Customer benefit/revenue

The benefits to the business from its interactions with the customer can be both tangible and intangible. The tangible benefit is the revenue generated by the sale of the product or service to the customer. This is the dollar value of the actual sale.

The intangible benefits include those caused by other interactions with the customer outside the actual transaction. These range from feedback received from the customer regarding the product or service (which the business can use to improve its offering) to the customer recommending the product and services to friends and relatives. These are much more difficult to quantify directly.

The above discussion raises the following important points:

- It is better for businesses to retain customers than to attract new ones because the conversion rate from visitors to buyers is in the low 5 percent range.
- The business must also focus on cross-selling and up-selling to increase the purchase made by the customer.
- The business must be focused on reducing the operating costs involved in retaining a customer. This will help the company move to a positive cash flow.
- Intangible benefits are overlooked in most cases. The business must set up a process that not only enables the customer to perform these interactions easily, but also allows the business to effectively analyze and respond to the information received.

Provide the market differentiator

Once the customer life cycle is understood, it is very important for the business to add value to the customer relationship and differentiate its offerings from other sources on the market. Here are some approaches to achieving this objective:

Convert investors to customers

According to a study done by Bain & Company, the lifetime value of an investor who is also a customer is 150 to 200 percent greater than the value of a non-stockholding customer. They are also more likely to recommend the business site to their friends, visit the site more often and spend more. Businesses need to harness the power of these stockholders to enhance their revenues.

Enhance the customer experience

As Richard Owen, vice president of Dell Online Worldwide said, the customer experience is the sum total of the interactions that a customer has with a company's products, people and processes." In the e-business world, the web site is the company. It not only creates your identity but could also set the tone for future customer relationships. Here are some points to consider:

- Develop an extraverted web site. The site should be organized around customer needs and not be a representation of the organizational structure or the product lines of the company. A customer interested in purchasing a computer should be able to reach information about all the necessary accessories from the page describing the computer itself. This is as opposed to finding out about the computer in the computer section, then visiting the printer section for a printer and finally visiting the accessories section for the other accessories.
- Provide means for the customer to interact and add content (discussion forums, product reviews, etc.). A self-help paradigm not only empowers the customer but also saves the company expense in maintaining an elaborate customer support desk.
- Develop communities or neighborhoods where your customers can interact with people of similar requirements/profiles. The rationale behind this model is that the user will be more willing to accept a review or recommendation from a fellow user as compared to the most detailed arguments and fancy artwork the company may produce.

Personalized products

One of the areas in which companies can differentiate themselves is in the personalization of products or the purchasing experience. Imagine that you own a computer and like to purchase computer products and accessories online. It would be extremely advantageous for a business to find and store your current product inventory and recommend new products that are compatible with your existing one. A typical scenario would be an established PC customer who would, on each visit, be presented with a customized list of compatible software and hardware, not simply a general list of all available products.

This has two implications:

- You have customer lock-in, since you already have the customer's details and preferences. The positive

experience of purchasing from you would be better than purchasing from 5 different stores.

- Cross-selling and up-selling becomes very feasible and a value-added service which you can provide to the customer.

Pricing models

As recent studies have indicated, a good price ranks among the top reasons why customers prefer to shop online. New business models have been developed and companies have experienced successful IPOs based on the perceived strength of these models. A list of some of the more common models is given below:

Company	Model	Focus area
Priceline.com	Name your own price.	Starting with airline tickets, this model has now been applied to hotel rooms, car rentals, home financing, long distance and new car purchases.
	Demand aggregation.	Harnessing the power of group buying to ensure better prices.
eBay Yahoo Auctions	Online digital auctions.	Enabling many transactions in an auction format.
Covisint	Exchanges: Two-way simultaneous auctions in which both buyer and seller prices float.	Identifies and eliminates the inefficiencies of the market.

Each of these models and initiatives have their own merits, and each threatens the traditional companies who have not adopted similar models.

One of the proposed methods is the concept of personalized pricing. You sell the product to each customer group at precisely the highest price they are willing to pay. The key is to identify dimensions of your product that are highly valued by some customers, but of little importance to other customers. Then, offer versions that differ in ways designed to appeal specifically to each type of customer.

Understand and use technological advances

In today's market, the move to capture the e-customer has become a war. Companies are using high-end technology to ensure their product positioning in relation to their competitors. From earlier days of passive measures like targeted banner ads, strategies have now moved to actively monitoring customer activity and hijacking them away from competitor sites.

These are some of the companies supplying weapons in this escalating war for web customers:

Company	Product
iChoose.com	Pop-up window guides consumers to better deals elsewhere.
Liaison.com	Automatic agent grabs prices and other data from thousands of web sites.
Auctionwatch.com	Agent compiles price and product data from auction sites.
Clickthebutton.com	Comparable price data for consumers in real time.
IQorder.com	In-store price comparisons via cellular phone.

It has become a matter of survival for businesses to understand and use these new marketing weapons. So what countermeasures can be adopted?

- If you cannot fight them, join them. Make sure that your prices are readily available to these automated agents. Contract with the major players to ensure that you get the desired edge.

- Use litigation and counter-technology measures (IP blocking for instance) to slow down or stop these companies.

Conclusion

The CRM world is experiencing the effects of the new paradigm. To be successful, businesses need to understand the dynamics involved and deploy systems to effectively exploit the new model.

About the authors

Anthony S. Treccapelli is an Andersen Business Consulting partner with more than 14 years' consulting experience. He has helped clients successfully develop strategy and architecture, and implement information technology. Tony takes a leading role in the development of Integrated Customer Solutions.

Raghavan Rajendran is an Andersen manager working in the Advanced Technology Group. Raj has over 13 years of experience in providing client technology solutions.