## <u>Customer Lifetime Value Calculation (a step-by-step guide)</u>

For this exercise, you will work through a complete calculation of customer lifetime value, which is provided over a ten-year period with all information clearly provided.

Your task is to essentially explain the mechanics of the calculation.

The following diagram can be enlarged by clicking, and it provides a ten-year view of customer lifetime value, with the final key CLV number listed in the bottom in yellow.

| EXAMPLE CUSTOMER LIFETIME VALUE<br>CALCULATION                         | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Initial Acquisition Cost per Customer                                  | -250   |        |        |        |        |        |        |        |        |        |         |
| Average Customer <b>Revenue</b> (of those customers who are retained)  |        | 500    | 550    | 600    | 650    | 700    | 750    | 800    | 850    | 900    | 950     |
| Average Customer <b>Cost</b>   |        | 250    | 275    | 300    | 325    | 350    | 375    | 400    | 425    | 450    | 475     |
| Average <b>Profit</b> Contribution                                     |        | 250    | 275    | 300    | 325    | 350    | 375    | 400    | 425    | 450    | 475     |
| % of Customers Retained each year at a 75% retention rate              |        | 100%   | 75%    | 56%    | 42%    | 32%    | 24%    | 18%    | 13%    | 10%    | 8%      |
| Average Profit Contribution of RETAINED<br>CUSTOMERS ONLY              |        | 250    | 206    | 169    | 137    | 111    | 89     | 71     | 57     | 45     | 36      |
| Discount Rate Applied Each Year at a 10%<br>Discount Rate              | 1.00   | 1.10   | 1.21   | 1.33   | 1.46   | 1.61   | 1.77   | 1.95   | 2.14   | 2.36   | 2.59    |
| DISCOUNTED Average <b>Profit</b> Contribution<br>PER RETAINED CUSTOMER |        | 227    | 170    | 127    | 94     | 69     | 50     | 37     | 26     | 19     | 14      |
| Running TOTAL of Average Profit<br>Contribution, with Year 10 = CLV    | -250   | -23    | 148    | 275    | 368    | 437    | 487    | 524    | 550    | 569    | 583     |

## **Student Discussion Questions**

- 1. Work through each line of the calculation and take turns in your group to explain what is happening in each row.
- 2. Once this is completed, work through the mechanics of the calculation and discuss why each row is necessary.
- 3. What options with this particular situation have in order to improve final customer lifetime value (that is, what numbers could increase or decrease) to increase the final value?