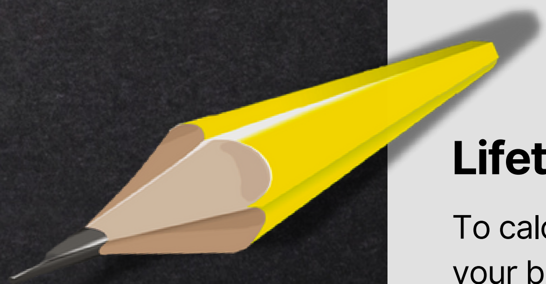
Lifetime value of a client (LTV)

Lifetime value of a client (LTV) =

$$\text{gross margin \%} \times \left(\frac{1}{\text{churn rate}}\right) \times \text{ARPC}$$



$$60\% \times \left(\frac{1}{10\%}\right) \times \$2{,}500 = \$15{,}000$$

What is it?

Lifetime value of a client (LTV) shows the **total financial benefit you can expect from a client** over the course of your business' entire relationship with them.

Why measure it?

On its own, LTV is a useful estimate of what a client is worth to your firm over the course of their relationship with you.

You can segment your clients and assess the LTV of various client types, which will help you to identify your more profitable groups and find out who the clients you should be aiming to gain more of.

Your findings will become even more useful when you compare your LTV to your cost of client acquisition (CAC).

Lifetime value of a client (LTV) in practice

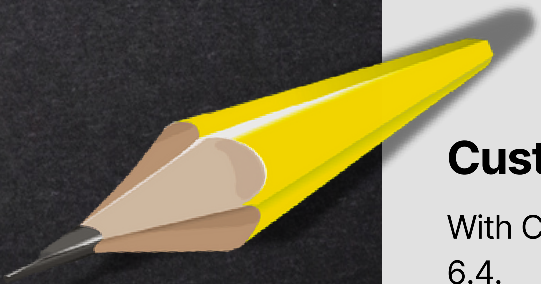
To calculate your LTV you first need to know how long your clients are staying with your business. Start with your churn rate and invert that value (1 / churn rate) to calculate how many years on average your clients stay with you. A 10% churn rate works out at 10 years.

You will also need to know your gross margin percentage (the percentage of profit that remains after your direct costs have been paid), and your average revenue per client (ARPC).

So, with a gross margin of 60%, churn rate of 10% and ARPC of $2,500, your calculation would look like this, giving you a LTV of $15,000.

Customer payback period

$$\text{Customer payback period} = \frac{\text{cost of client acquisition (CAC)}}{\text{average revenue per client (ARPC)}} \times 12$$



$$\frac{\$1{,}333}{\$2{,}500} \times 12 = 6.4$$

What is it?

Customer payback period is the time, usually in months, that it takes for **your business to break even on your cost of client acquisition (CAC)**, from revenue.

Why measure it?

This metric tells you whether you are spending too much acquiring clients, or if you are not attracting the right kind of clients.

If your customer payback period is longer than you thought it would be then you need to think carefully about reducing your sales and marketing costs, or targeting larger prospects who will have greater funds to spend with your business.

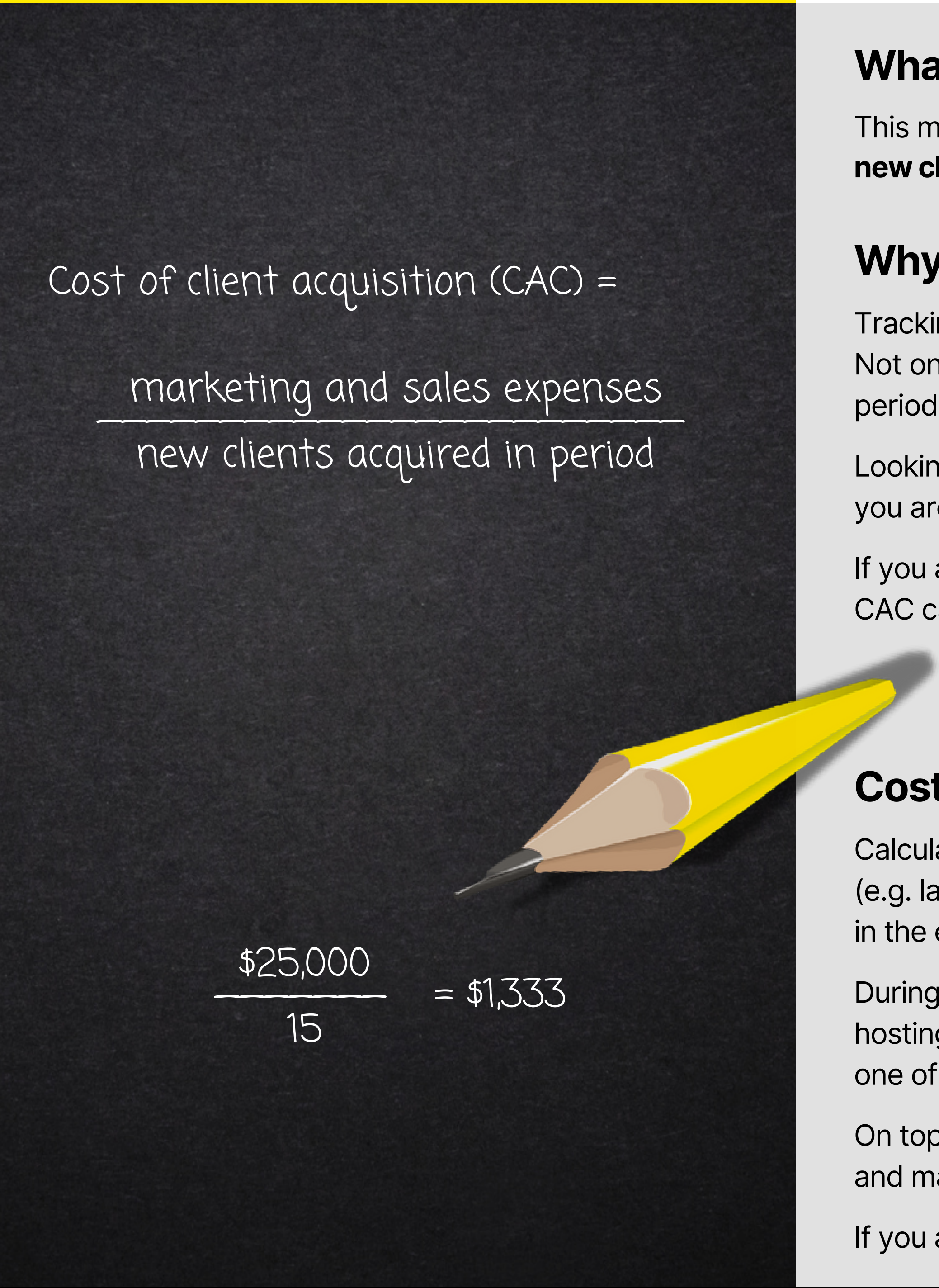
Customer payback period in practice

With CAC of $1,333 and ARPC of $2,500, your business' customer payback period is 6.4.

This would mean that on average, it takes you 6.4 months with a new client to break even on what you spent acquiring them.

Generally, a customer payback period of 6.4 months shows you are doing well in this area, but it does indicate that you can afford to invest slightly more in sales and marketing to acquire great new clients, and should explore this option.

Cost of client acquisition (CAC)



What is it?

This metric tells you the **average amount your business is spending to acquire a new client**. This spend usually refers to any sales and marketing expenses.

Why measure it?

Tracking your CAC measures the profitability of your sales and marketing efforts. Not only is CAC useful on its own, when it is used in conjunction with your payback period and LTV, it becomes even more powerful.

Looking at CAC with these other metrics enables you to calculate how much profit you are making from your clients relative to the amount you spend acquiring them.

If you acquire clients through multiple channels (e.g. referrals, social media, events), CAC can be used to assess which channels are the most profitable.

Cost of client acquisition (CAC) in practice

Calculate CAC by combining all of your sales and marketing expenses for a period (e.g. last quarter, for example) and dividing that by the number of new clients added in the equivalent current period (e.g. this quarter).

During the previous quarter, your business may have spent a total of $5,000 on hosting your website, an external copywriter for your blog, a social media course for one of your staff members and advertising using Google AdWords.

On top of this, $20,000 of staff wages from that quarter can be attributed to sales and marketing activities. In total, your sales and marketing expenses were $25,000.

If you acquire 15 new clients in the current quarter, your CAC would be $1,333.

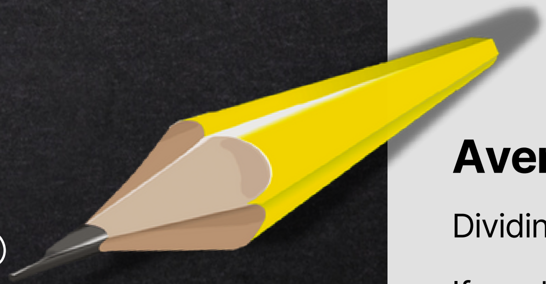
KEY PERFORMANCE INDICATOR

Average revenue per client (ARPC)

Average revenue per client (ARPC) =

$$\frac{\text{total revenue}}{\text{number of clients}}$$

$$\frac{\$500{,}000}{200} = \$2{,}500$$



What is it?

Average revenue per client (ARPC) tells you how much on average, **each client is contributing to your top line revenue**.

Why measure it?

ARPC is an extremely handy metric to know because it indicates if your practice is growing or not, and why.

Are you aiming your business at higher paying customers - and probably less of them? Or are you aiming for volume - lots of lower paying clients that you can service very efficiently?

When you have an understanding of your ideal client and have tailored your services and sales and marketing activities to reach them, your ARPC will tell you how well you are achieving that.

This metric also allows you to segment your clients to determine the effectiveness and combined revenue of your different client types and service offerings.

Average revenue per client (ARPC) in practice

Dividing your total revenue by your total number of clients gives you your ARPC.

If you have 200 clients and total revenue of $500,000, your ARPC would be $2,500.

This is interesting to know, but knowing your ARPC becomes even more meaningful when you can monitor its change over time, with a detailed understanding of who your ideal client is.

Client churn rate

$$\text{Client churn rate} = \frac{\text{lost clients}}{\text{total clients}}$$

$$\frac{1}{36} = 2.8\%$$

What is it?

Also known as attrition rate, your client churn rate **counts your percentage of clients lost**. Usually it makes more sense to factor in only consistent monthly clients, not one-off clients.

Why measure it?

Knowing your client churn rate highlights areas where revenue is lost. To grow, the number of new clients you acquire must exceed your churn rate. When your churn rate steadily grows, you know you have a problem.

Understanding your client churn rate requires you to look at your sources of churn to properly understand whether you have an issue that needs addressing.

If you know your target client or customer, it makes more sense to calculate your churn rate using the number of target clients in total or lost as opposed to all clients. It may be that losing a non target client is not a loss as all, especially if it frees your business up to focus on the target clients.

Client churn rate in practice

Dividing your total revenue by your total number of clients gives you your Average revenue per client (ARPC).

If you have 200 clients and total revenue of $500,000, your ARPC would be $2,500.

This is interesting to know, but knowing your ARPC becomes even more meaningful when you can monitor its change over time, with a detailed understanding of who your ideal client is.