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CUSTOMERS

What Most Companies Miss About Customer Lifetime Value

by Michael Schrage

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Steven Moore for HBR

For managers and marketers alike, the power to calculate what customers might be worth is alluring. That's what makes customer lifetime value (CLV) so popular in so many industries. CLV brings both quantitative rigor and long-term perspective to customer acquisition and relationships.

"Rather than thinking about how you can acquire a lot of customers and how cheaply you can do so," one marketing guide observes, "CLV helps you think about how to optimize your acquisition spending for maximum value rather than minimum cost." By imposing economic discipline, ruthlessly prioritizing segmentation, retention, and monetization, the metric assures future customer profitability is top of mind.

For all its impressive strengths, however, CLV suffers from a crippling flaw that blurs its declared focus. The problem is far more insidious than those articulated in venture capitalist Bill Gurley's thoughtful CLV vivisection. In fact, it subverts how customers truly become more valuable over time.

When my book *Who Do You Want Your Customer To Become?* was published, five years ago, its insight was that making customers better makes better customers. While delighting customers and meeting their needs remain important, they're not enough for a lifetime. Innovation must be seen as an investment in the human capital and capabilities of customers.

Consequently, serious customer lifetime value metrics should measure how effectively *innovation investment* increases customer health and wealth. Successful innovations make customers more valuable. That's as true for Amazon, Alibaba, and Apple as for Facebook, Google, and Netflix. No one would dare argue that these innovators don't understand, appreciate, or practice a CLV sensibility.

Pushing organizations to rethink how they add value to their customers stimulates enormously productive discussion. A fast, cheap, and easy exercise for clarifying the innovation investment approach emerged when I operationalized my book's principles. The simple but provocative tool generates actionable insights. Having facilitated scores of workshops around it worldwide, I know it gets results.

Ask people to complete this sentence: "Our customers become much more valuable when…"

The immediate answers tend to be predictable and obvious. For example, customers become much more valuable when "they buy more of our stuff" or "they pay more" or "they reliably come back to us" or "they're loyal to our brand."

There are no prizes for recognizing that these initial responses reflect the variables that go into computing traditional CLVs. While everyone agrees these things are important, participants in the exercise quickly recognize how limited, and limiting, those instant answers are.

It doesn't take long before the answers start to incorporate an investment ethos that sees customers more as value-creating partners than as value-extraction targets. For example:

Our customers become much more valuable when...

- they give us good ideas
- they evangelize for us on social media
- they reduce our costs
- they collaborate with us
- they try our new products
- they introduce us to their customers
- they share their data with us

Almost without exception, these follow-on answers are disconnected from how the firm calculates customer lifetime value. But, almost without exception, these responses push people to revisit and rethink how customer value should be measured. At one company the immediate response was to look for correlations between CLV and net promoter score. At another, the conversation led to discovering a core group of top-quintile CLV clients, who served as essential references for closing deals with firms identified as top-decile CLV clients. Those reference firms instantly won renewed attention and special treatment.

The more diverse and detailed the answers, the more innovative and insightful the customer investment. The most-productive conversations came from cross-functional, collaborative interaction — not just from marketing, R&D, or business unit leaderships.

For example, for a global industrial equipment provider, customers became more valuable when they performed more self-service diagnostics and shared that information with the firm. That led directly to the firm's technical services teams offering cloud-connecting APIs and SDKs that let customers customize remote diagnostic gateways for their equipment. Customers embracing self-diagnostics inherently boosted their CLV. Not incidentally, information access swiftly redefined how the company qualified prospects and computed lifetime customer value.

By investing in and enabling new customer capabilities, firms create new ways for customers to increase their lifetime value. Making customers better truly does make for better customers.

But in keeping with the segmentation spirit of CLV, the question can easily be edited and modified to produce targeted insights. For example, at one workshop we used two versions of the sentence: “Our *best* customers become much more valuable when…” and “Our *typical* customers become much more valuable when…”

The innovation investment insights for one’s best customers proved qualitatively and quantitatively different from those for one’s typical customers. Forcing people to rigorously define the distinctions between *typical* and *best* frequently leads to even greater creativity around customer value.

My favorite CLV vignette emerged from a session at a global financial services giant in London. As the responses grew longer, richer, and more detailed, one of the participants called attention to an interesting fact. Some of the answers, he observed, began with “we,” as in, “Our customers become much more valuable when *we* do something.” The others, however, began with “they,” as in, “Our customers become much more valuable when *they* do something.”

“What is the difference between the potential customer lifetime value when we do something versus when they do it?” he asked. After a few moments of silence, the conversation went to a whole other level of engagement, around how the firm wanted to engage with and invest in its customers.

The best investment you can make in measuring customer lifetime value is to make sure you’re investing in your customers’ lifetime value.

Michael Schrage, a research fellow at MIT Sloan School’s Center for Digital Business, is the author of the books *Serious Play* (HBR Press), *Who Do You Want Your Customers to Become?* (HBR Press) and *The Innovator’s Hypothesis* (MIT Press)

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Really helpful reminder that value creation for customers is the precondition for value capture by the business. This article is a timely reminder to focus on creating value rather than just extracting it.
Your exercises sound like they force companies to think about the outcomes that customers are trying to achieve, encouraging them to see them as partners rather than just "value-extraction targets"

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