

Lifetime Value Of A Loyal Client

By Stephen A. Saenz, October 2000

If you have been paying attention to what's happening in the world of e-commerce, you have probably heard of a term called "lifetime value" (of a customer). This is a very powerful concept that has extraordinary implications. If you want to maximize the value of your business, you must grasp this concept and apply it in your business as soon as possible!

The first thing you need to do is calculate the LTV of a loyal client in your business. Consider the following example:

- \$1 million fee-based account
- Average annual fee = 2% (all-inclusive)
- Account value grows at 7% per year (net of fees)
- Client "life" = 10 years

To make the calculation easy, let's assume that the account grows in value at exactly 7% each year and that the fee is charged annually, rather than quarterly (I think that the actual fee paid by the client would be higher). In any event, here's what the LTV of this client looks like. In Year 1, the client pays \$20,000; in Year 2, he/she pays \$21,400, etc. If you add up all ten year's worth of fees, you come up with a total of **\$276,330**. It gets even more interesting when you consider the impact that referrals have on the LTV of this client. Let's take this scenario one step further. Let's assume that your original client refers you one new client (of equal size) each year, beginning in Year 2. Let's see what happens to the LTV...

As you can see from the table below, the total LTV of this client (including referrals) is over **\$1.3 million!** While the number itself is impressive, the implications of this on your business are even more profound. Consider the following points:

- ✓ The profitability of this relationship (the amount of time required to service the relationship versus the annual revenue received) goes up significantly over time. In other words, the real upside in a fee-based relationship comes in the later years. This is true for most fee-based relationships.
- ✓ Given this reality, your current business model may not allow you to capitalize on this increasing profitability. For example, if you allocate most of your resources to asset gathering (as opposed to client service) you may not have the clients in the later years.
- ✓ One could argue that under the fee-based business model the people who are responsible for servicing and retaining client relationships are contributing more to the bottom line (and thus should be paid more) than the people who are responsible for bringing in new assets. How's that for challenging the conventional wisdom?

Remember that in a commoditized world, where the cost of switching to another provider is virtually zero, you must spend more time building client loyalty. You cannot do this for 400, 500 or even 200 relationships. It is extremely important that you build your business around LARGER but FEWER clients.

The best way to convince yourself of this is to analyze the profitability of every relationship you have. To do this, just divide the annual revenue you receive from a client by the number of hours you spend servicing that client each year. This will tell you how much you are making per hour. If you want to see something that will really open your eyes, compare the profitability of a \$1 million account to that of a \$250,000 account. The difference is impressive!

Make sure you take some time to internalize what LTV is all about and what it means to your business. Most importantly, make sure you have a business model in place that enables you to compete effectively in the Digital Age.

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Year	Client's Annual Fee	Referral 1	Referral 2	Referral 3	Referral 4	Referral 5	Referral 6	Referral 7	Referral 8	Referral 9	Annual Totals
1	\$20,000										\$20,000
2	\$21,400	\$20,000									\$41,400
3	\$22,898	\$21,400	\$20,000								\$64,298
4	\$24,501	\$22,898	\$21,400	\$20,000							\$88,799
5	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000						\$115,015
6	\$28,051	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000					\$143,066
7	\$30,015	\$28,051	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000				\$173,081
8	\$32,116	\$30,015	\$28,051	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000			\$205,197
9	\$34,364	\$32,116	\$30,015	\$28,051	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000		\$239,561
10	\$36,769	\$34,364	\$32,116	\$30,015	\$28,051	\$26,216	\$24,501	\$22,898	\$21,400	\$20,000	\$276,330
	\$276,330										\$1,366,747