Customer Lifetime Value

Kijpokin Kasemsap
Suan Sunandha Rajabhat University, Thailand

INTRODUCTION

Customer lifetime value (CLV) is the present value of all future profits obtained from customers over the life of their relationship with a company (Benoit & van den Poel, 2009). Companies have been increasing their focus on establishing and maintaining the good customer relations during the customers' life in the company (Haenlein, Kaplan, & Beeser, 2007), and thus, researchers and practitioners have realized the importance of the lifetime value of customers. CLV is the value of a customer's entire lifetime with the company, forecasts in the literature usually focus on a short-time period (Donkers, Verhoef, & de Jong, 2007).

CLV has been studied under the name of customer value, customer equity, and customer profitability (Kahreh, Tive, Babania, & Hesan, 2014). CLV, as an important metric in customer relationship management (CRM), has attracted the widespread attention over the last decade (Chen & Fan, 2013). In relationship marketing, CLV is the discounted profit streams of a customer across the entire customer life cycle (Ma, Li, & Chen, 2008). Companies can manage customers with different age groups, gender, and self-construal characteristics with different strategies to maximize benefits at different levels of customer loyalty to improve CLV (Qi, Qu, Zhou, & Li, 2015).

This article aims to bridge the gap in the literature on the thorough literature consolidation of CLV. The extensive literatures of CLV provide a contribution to practitioners and researchers by indicating the important perspectives on CLV in order to maximize the impact of CLV in global marketing.

BACKGROUND

Berger et al. (2006) indicated that companies need to consider revenues and costs based on cash flow of profits in measuring CLV. CLV is the sum of the revenues gained from company's customers over the lifetime of transactions after the deduction of the total cost of attracting, selling, and servicing customers, taking into account the time value of money (Hwang, Jung, & Suh, 2004). Companies can be more profitable if they identify the most profitable customers and invest disproportionate marketing resources in them (Malthouse & Blattberg, 2005). A profitable customer is one who can create profits, increase revenues, and assist in reducing losses (Kotler & Armstrong, 1996), and the difference between the revenues and costs generated by a customer is CLV (Dwyer, 1989).

CLV is presented to evaluate customers in terms of recency, frequency, and monetary (RFM) variables (Cao, Yu, & Zhang, 2015), toward to describe the value of a client through time in terms of profitability (Moro, Cortez, & Rita, 2015). Measuring RFM is an important method to evaluate CLV (Liu & Shih, 2005). Bult and Wansbeek (1995) explained the RFM terms (i.e., recency, frequency, and monetary perspectives). R (Recency) is the period since the last purchase, and a lower value corresponds to a higher probability of the customers making a repeat purchase. F (Frequency) is the number of purchases made within a certain period. Higher frequency indicates higher loyalty. M (Monetary) is the amount of money spent during a certain period. A higher value indicates that the company should focus more on that customer (Bult & Wansbeek, 1995).

DOI: 10.4018/978-1-5225-2255-3.ch137

IMPORTANT PERSPECTIVES ON CUSTOMER LIFETIME VALUE

This section emphasizes the prospect of CLV and the importance of CLV in global marketing.

Prospect of Customer Lifetime Value

Customer lifetime value (CLV) is viewed as the present value of the future cash flows associated with a customer (Pfeifer, Haskins, & Conroy, 2005). The main goal of CLV is to specify the importance level of each customer for a company (Hiziroglu & Sengul, 2012). CLV considers a customer's value to the company based on predicted future costs and transactions (Kumar, 2010). Glady et al. (2009) defined CLV as the discounted value of future marginal earnings, based on the customer's activity. Knowing the CLV of individual customers enables the decision maker to improve the customer segmentation and marketing resource allocation efforts (Kim & Lee, 2007) and this perspective will lead to the higher retention rates and profits for the company (Hawkes, 2000).

CLV models can estimate the value of a customer over the entire customer's lifetime (Kahreh et al., 2014). The application of CLV in marketing, used for segmenting customers or formulating strategies, has been found in literature (Cheng, Chiu, Cheng, & Wu, 2012). Kim et al. (2006) proposed a CLV computation model considering the past profit contribution, potential benefit, and defection probability of a customer. Kim et al. (2006) covered a framework for analyzing customer value, and segmenting customers based on their values, and applied their approach to formulating marketing strategies for a wireless communication service company. Shih and Liu (2008) proposed applying a collaborative filtering technique through CLV and customer demand to develop a product recommendation system.

Regarding CLV, a monetary value of a future relationship with a customer is a fundamental concept for the long-term management of the customer base and the planning of marketing activities (Karvanen, Rantanen, & Luoma, 2014). Kahreh et al. (2014) indicated that data inputs commonly used when making CLV calculations include seven major factors (i.e., acquisition cost, churn rate, discount rate, retention cost, time period, periodic revenue, and profit margin). Acquisition cost is the amount of money a marketing department has to spend, on average, to acquire a single new customer. Acquisition cost is positively associated with customer retention, future profits, and current market values (Livne, Simpson, & Talmor, 2011). Customer retention is a major driver of CLV and is a key performance metric in marketing management (Becker, Spann, & Schulze, 2015).

Churn rate is the percentage of customers who end their relationship with a company in a given time period (Kahreh et al., 2014). Customer churn (or customer attrition) is key for measuring success in the logistics industry (Chen, Hu, & Hsieh, 2015). CLV model considers the past contribution, potential value, and churn probability at the same time (Kim, Kim, & Sohn, 2009). Discount rate is the cost of capital utilized to discount future revenue from a customer. Retention cost is the amount of money a company has to spend in a given time period to retain an existing customer. Time period is the unit of time into which a customer relationship is divided for analysis. Periodic revenue is the amount of revenue collected from a customer in the time period. Profit margin is the profit as a percentage of revenue (Kahreh et al., 2014).

Customer loyalty is a driver of CLV (Qi, Zhou, Chen, & Qu, 2012). The aim of customer loyalty programs in modern organizations is to identify and encourage those customers exhibiting a high CLV (Steinhoff & Palmatier, 2016). Regarding CLV, the differential unit cost of marginal effects, ceiling rate, efficiency, and allocation of spending on acquisition and retention to achieve market share growth can maximize customer equity (Tsao, 2013). Value creation through customer-to-customer exchange occurs when the perceived

Related Content