EXPONEA

The Formula for E-Commerce Success

$$E = mc^2$$

The Formula for E-Commerce Success

CAC & CLV

At its simplest, the formula for e-commerce success is to keep your Customer Acquisition Cost (CAC) below your Customer Lifetime Value (CLV):

$$CAC < CLV$$

The formula itself isn't the key: what matters is how well you can calculate your numbers, and what you do with the information.

There are four KPIs successful e-commerce companies look at to determine CAC and CLV:

- Cost Per Visit (CPV)
- Average Order Value (AOV)
- Average Purchase Frequency (F)
- Gross Margin (GM)

Why perform these calculations? First off, **you need to figure out if you're spending more on acquiring your customers than you're getting back from them.** Second, the process of solving this formula will show you which areas of your company need

the most improvement. **What's your weakest metric? How do you plan to address it?**

In this e-book, I'll discuss the importance of Customer Lifetime Value, along with actionable methods to effectively apply this underutilized metric. I'll also go over conversion optimization tactics you can use to increase your average CLV; technological approaches, communication-based approaches, and the methodology to measure your results.

Ready? Let's go.

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The Importance of Customer Lifetime Value

The importance of Customer Lifetime Value (also called CLV, CLTV, LCV, or LTV marketing) has been understated for a long time.

CLV is the most important metric that companies tend to ignore. Marketers have been writing about how important knowing CLV is for years, and it's still being ignored or underutilized: [UK study](#) found that **only 34% of the marketers they surveyed were "completely aware of the term and its connotations."** And only 24% of respondents felt their company was monitoring CLV effectively.

What is Customer Lifetime Value?

The definition of Customer Lifetime Value is simple: Customer Lifetime Value represents a customer's value to a company over a period of time. You can calculate a simple Customer Lifetime Value model for your company with this formula:

There are other methods of calculating CLV that get much deeper and can focus on the individual customer. In this section I'm going to move straight into the importance of Customer Lifetime Value, and the actionable ways you can use it to improve your business. If you'd like more background on the metric or ways to calculate it, I recommend this write-up from the Harvard Business Review.

Why is Customer Lifetime Value Important in 2019?

CLV Informs You of How Much You Should Spend on Customer Acquisition

Your customer acquisition costs may very well equal more than you make from a first purchase, but are you still making money from that customer in the long run? Figuring out the lifetime value of a customer to your company will give you the answer.

CLV Allows You to Segment Your Customers Based on Value

"Using CLV, you can better understand the different personas among your customers; the first step to effective targeting or personalization." - Daniar Rusnak
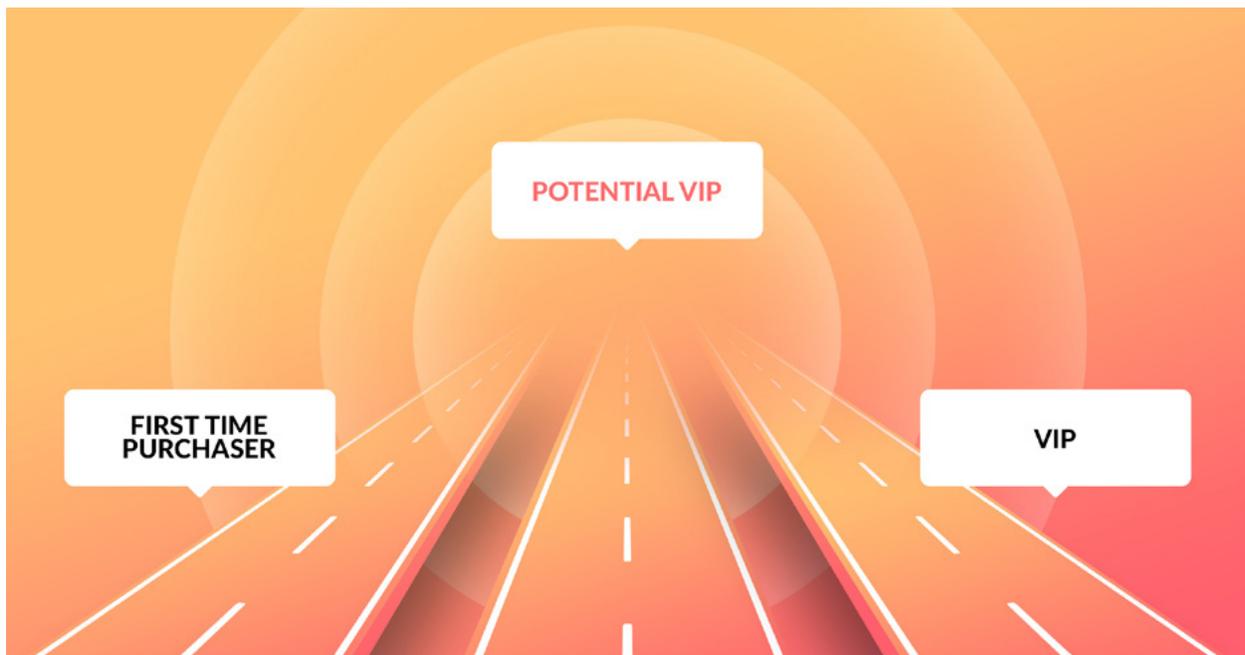
You can narrow your focus: send a special offer or gift to your "VIP" customers to make sure you retain them, or focus on acquiring new customers with similar backgrounds using [look-alike modeling.](#) You can start slowly upselling customers that bring less value to increase their CLV. This segmentation allows for a personalized experience; something many customers now expect.

Focusing on CLV is the Key
For Long-Term Company-Wide Growth

It's a competitive market for e-commerce companies in 2019, and price isn't the only determining factor in a customer's decisions. **CLV is a customer-centric metric, and a powerful base to build upon** to retain valuable customers, increase revenue from customers that bring less value, and improve the customer experience overall.

The Process of Finding Your CLV is Valuable

"The advantage of determining customer lifetime value is not just the final number itself, but also the thinking and calculation behind the metric." - Lukas Sitar

It's about Customer Lifetime Value meaning more than any one statistic. Finding your Customer Lifetime Value will make you think, not just about the sale, but about the full customer journey: when, where, why, for how much, and how often do your customers make a purchase. Answering these questions will bring valuable insights, and help you spot issues you may not have noticed before.

Why Don't More Companies Use Customer Lifetime Value Effectively?

Many Established Companies Keep Their Data in Different Silos
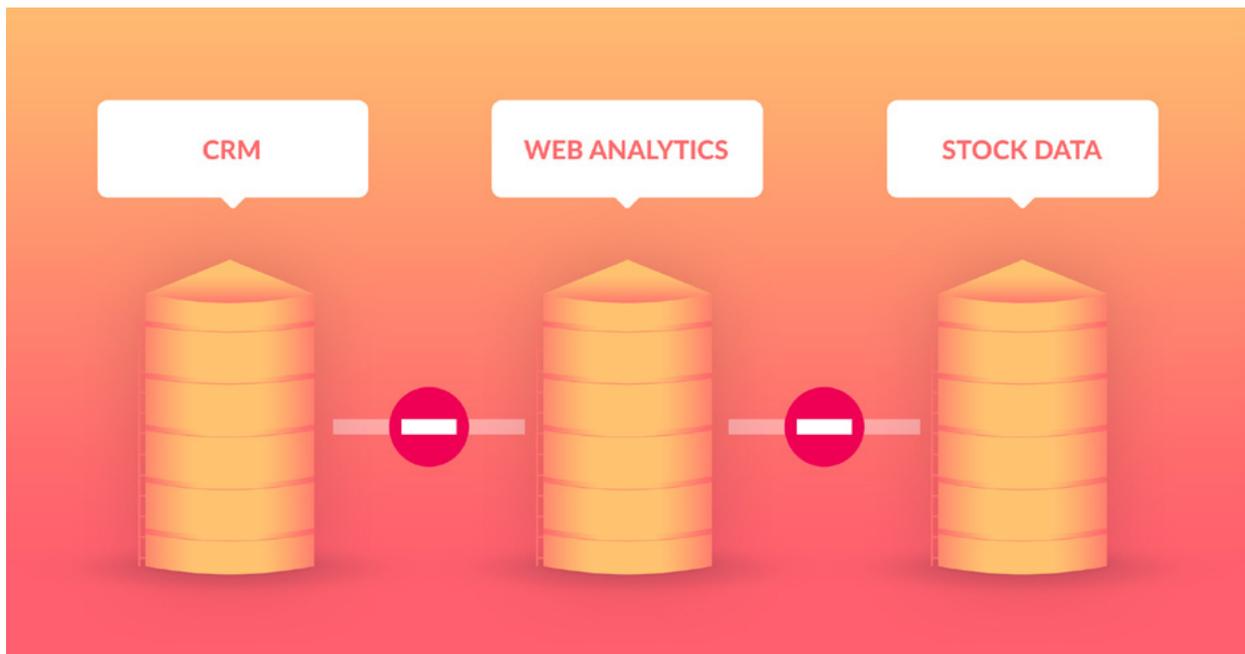
As companies grow, it's common for their data to become fractured; different pieces kept in separate places (often using different software) as each department pursues its own goals. This makes collaboration more difficult, and can result in less trustworthy data if the same information is stored in two places without an effective time-stamp to show which is more current.

The old model for finding one's most valuable customers was

through RFM analysis: examining the **Recency** of a customer's last purchase, the **Frequency** with which that customer makes a purchase, and the **Monetary** value of their purchases. RFM analysis is still what's used by most companies looking into this metric; even with the data separated into silos, an RFM analysis is still possible.

But we know a lot more about our customers in 2019.

"One major disadvantage of the RFM Models is that they're very rigid, mostly unable to utilize the rich data that companies today have on users' behaviour and engagement." - Samuel Sucik

Siloed data also gives reason as to why only 24% of respondents in the previously mentioned study believed their company was monitoring CLV effectively: without unified customer profile data, it's nearly impossible to get the sort of actionable results you want. In order to make use of the wealth of data that's been collected, you need a CLV model that utilizes Machine Learning methods to make predictions. And that's just not possible with siloed data.

Customers Now Make Purchases From Multiple Devices

With the same customer making purchases from their computer,

phone, and tablet, many companies have difficulty combining all the data streams into one measurable whole. **Attempting to extract meaningful insight from these separate streams can be both expensive and inefficient.** Companies without a main dashboard synthesizing all customer data in one place are finding themselves increasingly left behind.

Companies Lack In-House Skills

Many companies who have not yet begun tracking CLV are dealing with a lack of qualified personnel to follow the data and produce actionable plans based on it. This, coupled with the need for an in-house dashboard for qualified personnel to use, creates a strong barrier to entry.

How to Use Customer Lifetime Value

In order to get the most out of CLV, some of the specifics discussed in this article are a must.
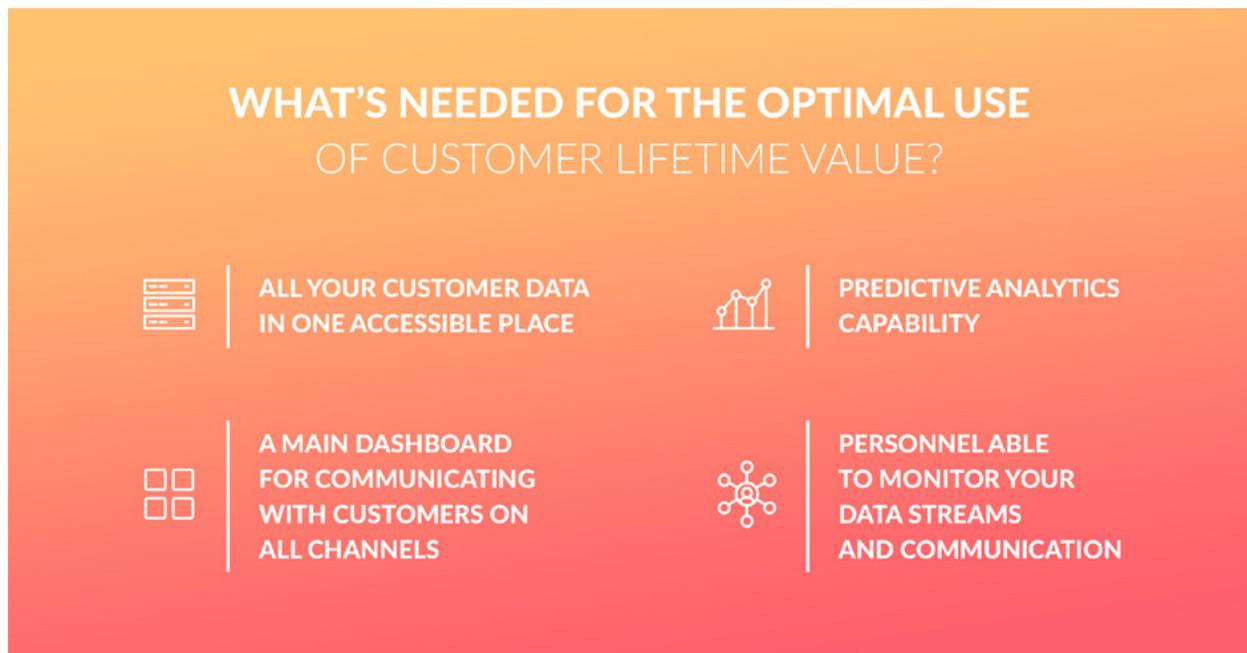
Once that's in place, there are numerous actionable uses for the metric. Using CLV effectively can improve customer acquisition and customer retention, prevent churn, help you plan your marketing budget, measure the performance of your ads in more detail, and much more. Here are a few of our favorite ways to use CLV:

Acquire Higher Value Customers

Once you've performed a CLV analysis on all your current customers, **you'll know how much to spend on acquisition.** You'll also know which acquisition channels produce the highest value customers, and can repeat the strategies you used to find them.

Secure Future VIPs

Once you have a solid data profile of what characteristics your VIPs have, you can **use predictive analytics to get a better idea of which new customers will likely be future VIPs,** and focus on these customers with personalized messaging and offers. You can also make use of a look-alike model, as was mentioned in the first section, to target similar profiles.

Practice Value-Tier Segmentation

We touched on this in the first section. CLV makes it possible to identify which customers are VIPs and which are lower value. Once you separate your customers into different value tiers, you can see where your money is really coming from. Look at your VIPs, the top 5%: **how much of your total revenue is provided by just this 5% of your customer base?**

With defined levels of customer value, you can then focus on converting customers from their current tier to a higher one.

Prevent Churn

Now that you now know the Average Order Value and Purchase Frequency of your customers, the door is open for personalized messaging to **send the right offer to the right person at the right time.**

Find Your Weak Point - Then Strengthen it

The insights gained from calculating your CLV will lead you to where problems can be found in your company: **you'll be able to see which area you most need to invest your time and money into.**

Plan Your Yearly Advertising Budget

If you know your CLV, you can figure out how much you can spend on acquisition while remaining profitable. This, in turn, allows you to **determine how much you'll need to spend on advertising much more precisely.**

Measure Your Ad Performance

Without CLV, you're relying on the profit from the first purchase to tell you which customer is more valuable.

Take this Customer Lifetime Value example:

Jim spent $6 and Billy spent $15 so Billy is the kind of customer we care about. But after measuring for CLV, you may find that Jim makes multiple purchases a month, while Billy is never seen again.

Now you know that the ads you invested in to acquire Jim can actually create more value than the ones that acquired Billy. Scale that with the data of all your customers, and **you get the full picture of which ads are most effective for your business.**

E-Commerce Conversion Optimization Guide

We've gone over the importance of CLV, and tactics for using it. But how do you increase a customer's CLV? How do you make sure those customers stick around?

There are numerous ways to optimize your e-commerce conversions. The problem is, many companies today (including major ones) are putting their efforts into the wrong tactics. This section focuses on **tactics you can use to thrive in the constantly-evolving world of e-commerce, in the stage that is beginning to be recognized as the most important: customer retention.**

According to [figures gathered by Invesp,](#) 44% of companies focus more on customer acquisition, while only 18% focus on retention, **but retaining a customer is five times cheaper than acquiring a new one.** Further, an older but oft-cited [study from Bain & Co.](#) found that **increasing customer retention by just 5% led to an increase in profits of 25% - 95%.**

It's not just about selling anymore; it's about building a place for your customers to return to, again and again. Convert your 1st time purchasers into repeat shoppers, and move them along the path to VIP.

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Technology for E-Commerce Conversions

A [Retail Trends report](#) predicts that within the next two years, **85% of all transactions will be AI-based.** The report continues by stating that 2018 was the year when retailers really started to understand the value behind AI. **No major e-commerce company can afford to fall behind in this sector.** As AI becomes more rooted in e-commerce, the gap between the capabilities of retailers utilizing AI vs those without it will grow too wide for a company without AI to stay competitive, **as their Customer Acquisition Cost moves past their Customer Lifetime Value.**

Tactic #1: Personalized Customer Experiences

How do you know what a customer wants to see? You can never be certain, but sophisticated predictive analytics systems can come up with a pretty good idea. **When a customer returns to your site, the site can separate them into a predefined customer segment,** based on their data profile. The Gold Standard of personalization is the Single Customer View: a consolidation of customer data from across all channels, expressed as continuously updated one page profiles for each individual customer. This level of personalization allows for better understanding of patterns in customer behavior, and far more targeted segmentation.

For example:

Customer A is a young man living on a budget. The last purchase he made was a t-shirt. **The site determines what is most likely to convert Visitor A, and shows him a selection of t-shirts on sale,** including a special offer on a shirt similar to the one he bought last, just for him.

Customer B is an older woman in a high-income bracket who usually purchases several items of clothing in one order. **The site takes a look at her profile and history and displays a special deal just for her:** a bundle that includes a purse, a dress, and a hat; three items she viewed during her last visit to the

site.

With the insights gained through a Single Customer View, you can create automated campaigns that **email customers with a recommendation for a product they'll like, with a discount they'll be interested in, sent at the optimal time for them to be checking their inbox.**

Tactic #2: Automated Email Campaigns

Email is still a great way to communicate with your customers, and another area where you can use personalization to your advantage. Whether you're sending a regular weekly newsletter, an abandoned cart scenario, or a special weekend promotion, personalization is key.

Create customer segments to talk to customers with a message that relates to their interests. [Set up automatic sends that target customers] based on their personal interests. **Every time a customer abandons their shopping cart, they can be sent an automatic, staggered series of emails reminding them about items in their cart, and/or offering them a special discount on the specific product they were interested in.**

If you have all of your customer information and automation tools in one main dashboard, it's easy to create detailed

automations for whatever scenario you can think of: **email, SMS, and push notifications with precise timing for every send.**

Tactic #3: Value Segmentation

Customer Lifetime Value (CLV) estimates how much customers will spend throughout their time as your customer. With this data, **you can segment your customers based on the long-term value they represent.**

You'll likely find that the 4% of your customers **with the highest CLV account for the majority of your revenue.** These are your VIPs. With your most valuable customers identified, you can start to treat them accordingly with special deals. Once you have your segments (EX: bottom tier; mid-tier; VIP), you'll know the average order value and order frequency for each tier, and you can **focus on converting customers in the bottom tier up to the middle tier, and customers in the middle tier up to VIP status.**

Tactic #4: Converting Customers into VIPs

It's not enough to focus on your existing VIPs; you should always be searching for customers who fit the profile to become VIPs in the future. What do these look like? It's different for

every company, but **predictive analytics can measure the purchase and churn patterns of your current VIPs, and find new customers** that will likely fit the bill - even after just one purchase! That's one more important group to nurture.

Communication for E-Commerce Conversions

The customer's desire for authenticity has been brewing for

years: a 2014 study of 12,000 consumers across 12 markets found that **87% said it was important for companies to act with integrity at all times.** Compare that to the only 72% that factored innovation into their buying decisions, and the

71% that cared about unique new products, and you see how important authenticity really is.

Consumers are more informed than ever before. If they don't trust your message, they'll move on to somewhere else.

Tactic #1: Create Value in Your Product Descriptions

Yes, you want copy that sells, but you don't want copy that looks like it's selling. Instead of a pitch, use your product descriptions to create value for the customer. **What can you tell them about this product to help them make an informed decision?** How can you give them this information in the simplest, most digestible way?

Write openly and conversationally; address your customers like living, breathing people, and you'll keep them coming back.

WHAT TO DO: Ugmonk

Ugmonk is a fashion e-commerce retailer with unique (and often pricy) products. It would be easy to just write: "T-shirt with text: 'Do a lot with a little'" and call it a day. But Ugmonk does more to justify the price, writing conversationally about the thought process behind the shirt and what it represents for the buyer.

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They even have a link to the backstory and design process for the buyer interested in detail.
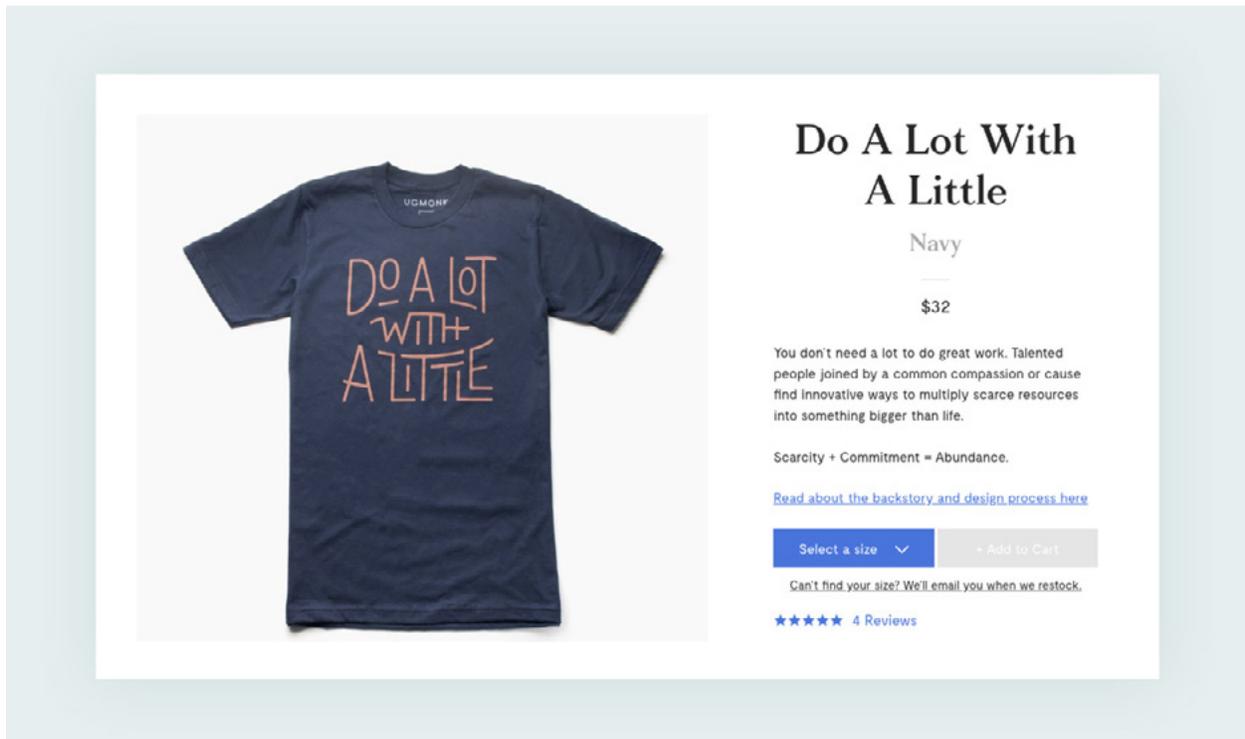
WHAT NOT TO DO: Zara

Zara is a well-known clothing brand, yet their product copy is lacking. **It gives a basic description of the product, but nothing that indicates what makes it special, what makes it worth buying.** Beyond that, the page placement of the copy makes it difficult to read it while getting a full view of the shirt, something that could cost them that extra conversion.
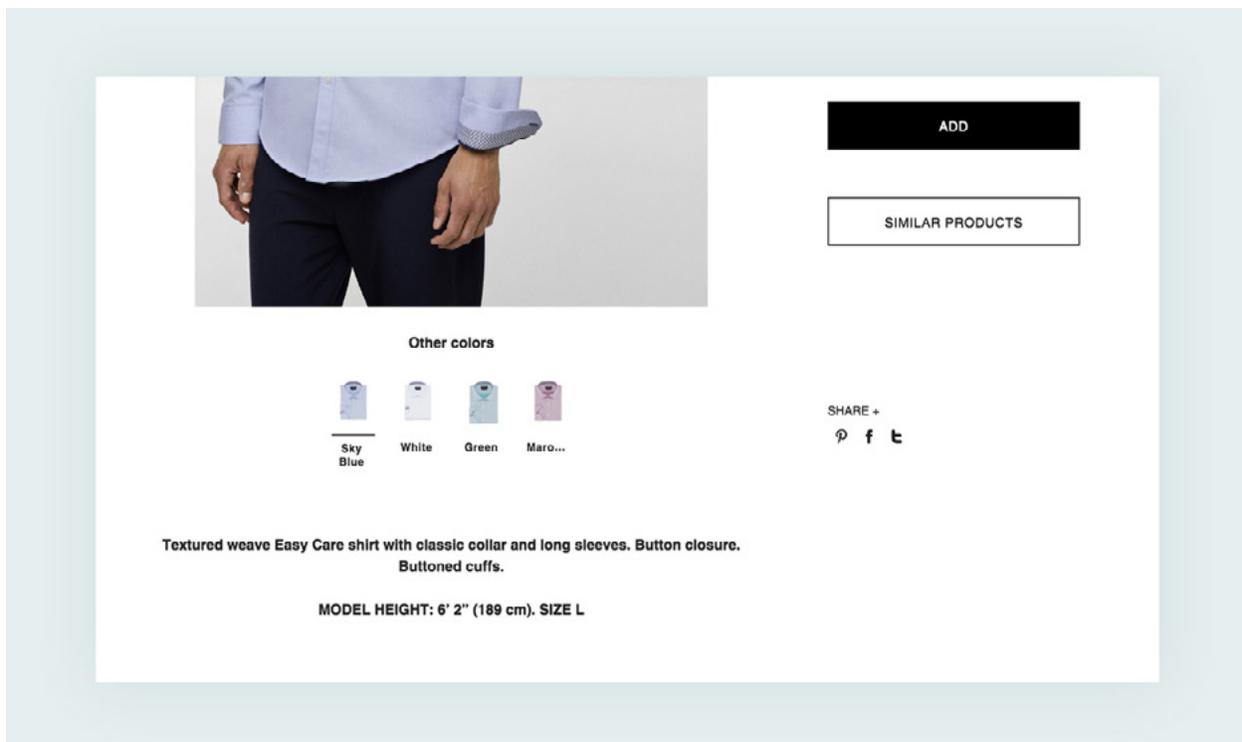
Tactic #2: Apply Proactive Communication

Communication is key in any relationship, including the one you have with your customers. Are you changing your return policy? Make sure your customers hear about the details before you make the change. **In general, just keep your customers informed; they always should feel like they are in-the-loop.**

Tactic #3: Construct a Self Service Portal

Steven Van Belleghem's 2013 study, The Self Service Economy, found that **all over the world, customers are becoming more demanding.** They don't just want friendliness, transparency,

and their problem solved in one interaction: they want that all to happen **now.** 55% of consumers who contact a company through Twitter or FB now **expect an answer within four hours.** And 86% of consumers who call the company directly expect the same.

Rather than attempting to scale that level of customer service, **many companies have supplemented their customer interactions with a Self Service Portal:** a section of the site's visitors can use to solve their problems quickly and easily, without outside help. This section may have a FAQ page, discussion forums, and a form to submit issues.

Data is also a driving force behind Self Service:
"62% [of consumer respondents] ask companies to use their data to make the buying process faster & easier. 81% ask companies to use client data to shorten waiting times when they have a complaint."
- Steven Van Bellegham

Finally, **a Self Service Application is something that 70% of consumers now expect.** Don't let your company find itself lacking.

Methodology for E-Commerce Conversions
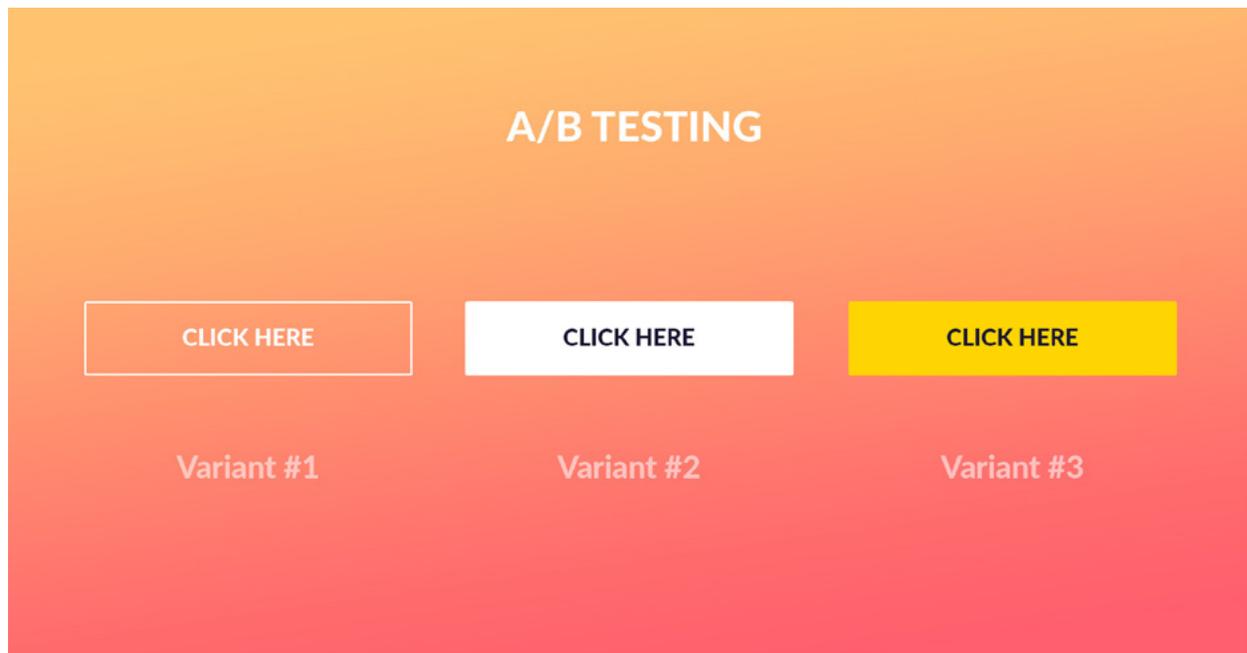
"Find the drive to A/B test and experiment with simple ideas. Starting small is better than not starting at all." - Daniel Viglas

Every business is different, and the only way to know if you're doing the right thing is to test it, and continue to test it. **Don't just rely on industry best practices; you need to make sure your optimizations are working for you.** Should that Add to Cart button be green or should it stay red? Would my free shipping banner work better on the homepage or the product page? Test it.

[A/B testing](#) is a popular way to use segments of similar

customers in order to find the most positive response. You **set one segment as the Control Group, which keeps the original design, and then try as many variations as you want with additional segments.**

You can use A/B testing to optimize photos, email formats, recommended items, button shapes, anything you can think of. With that in mind, here are two real-world examples of great testing done by major companies.

Netflix - Viewing Destination for TV and Film

When [Anna Blaylock](#) joined the Product Design department at Netflix, she pitched her big idea: show potential customers the full range of available content before they sign up. She wasn't the first to suggest it. In fact, **Netflix had surveyed non-members and asked them what one thing they would want to know before signing up. The most popular answer, by an overwhelming margin, was to know what movies and TV shows were available.** Netflix decided to A/B test the idea.

Netflix ran a series of A/B tests to see which version would convert the best, pitting the control (their standard page with no selection info and one simple "Start Your Free Month" CTA) against different variations that detailed the content available on the site. **The control group performed best.**

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They tested it again against different variants, and **again, the control group won.** They tried it another time with new variants. Then they tried it a fourth time. A fifth. **But each time the control still won.**

Conclusion: Challenge your assumptions. Even your customers don't necessarily know what they want. The only way to find something out for sure is to test it.

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Adore Me - E-Commerce Lingerie Retailer

While A/B testing is common practice for fashion e-commerce companies, Adore Me takes it a step further. **Adore Me A/B tests all the images on their site every month,** and they test everything you could think of: should the model's hand be on her hip or on her head? **(Apparently hand on head can double sales).** Do blonde models lead to more lingerie sales? (Nope).

Through rigorous testing, Adore Me found that, for their business, **using the right model for a product matters even more than price.** These seemingly minor tests have helped Adore Me grow their brand and maximize their sales. They now also have a huge subset of data they can continue to work from.

Conclusion: Keep testing. Something that works today may not work next month. Try new variations. **Don't ignore the little changes that can maximize the sale.** (These things are easier to put together if you're working with one main dashboard with all your data, tests, and results together).

The more specific you can get to the individual customer, the more powerful your message will be, and the more likely the conversion. Solutions exist for companies ready to improve their personalization capabilities, their automated email campaigns, their predictive analytics, and their A/B testing. Many businesses have begun partnering with SaaS companies, whose tech is ready to be implemented.

If you'd like to hear how Exponea can help,
be sure to contact us.

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