Kenan-Flagler Business School
The University of North Carolina

The Customer Lifecycle

As businesses shift from a product-centric focus to a customer-centric focus, the customer lifecycle has emerged as a framework to describe the stages – over time – of the relationship between a customer and a business. It starts before a customer becomes a customer – when they are a prospect, and extends through their lifetime as a customer and ends when they become a former customer.

Exhibit 1 shows the major stages:

- Prospects
- Responders
- New Customers
- Retained or Repeat Customers
- Former Customers

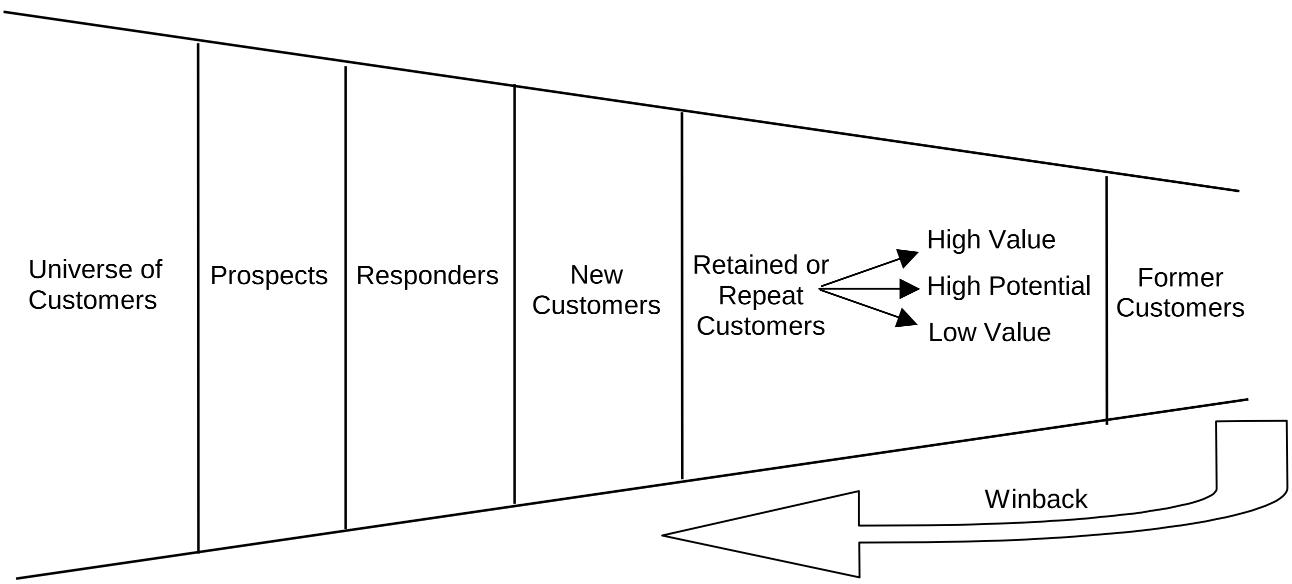

Exhibit 1 Customers progress through lifecycle stages

Professor Charlotte Mason prepared this note to provide material for class discussion rather than to illustrate either effective or ineffective handling of a business situation.

Customer Lifecycle Stages

Prospects are people who are in the target market, but are not yet customers. Likely prospects for car insurance are car owners or those about to purchase a car. Prospects for digital cameras may be defined by a combination of demographics (such as income exceeding $35,000 and college educated), known interests (such as photography), or product ownership (such as personal computer).

Responders are those who have made some contact with the business, but are not yet customers. Examples include a couple who calls a toll-free number to request information on life insurance, a person who registers at a website, or an individual who sends in the reply card requesting additional information from a direct mailing about vacation packages.

New Customers are those who have made an initial purchase of a product or service. Often, the early behavior of customers is predictive of future behavior. Regardless, once acquired, the focus shifts towards encouraging repeat purchases and customer loyalty.

Retained or Repeat Customers are customers who have made more than the initial purchase. Over time, customers can be characterized according to their value to the firm. Typically a small proportion of customers account for the majority of profits – these are high value customers that the business wants to retain. There is also a group of low value customers – often these are unprofitable for the firm as it costs more to service them than they yield in revenues. For these customers, the goal is to convert them to profitable customers or perhaps encourage them to take their business elsewhere. In between are customers of varying profitability. Of particular interest are those that can be identified as high potential customers. These customers are not yet in the high value category, but appear to have the potential to be in that group if the firm is able to develop the customer relationship.

Former Customers are those that are no longer active customers. Some customers voluntarily attrite by taking their business elsewhere. High levels of voluntary attrition (often called *churn*) are prevalent in long-distance and wireless phone service, internet access, and some financial services as customers are lured away by enticing offers from competitors. In other instances, customers may attrite because they no longer need the product or service. A family may outgrow the need for children's products or a retired couple may move to an apartment and no longer need a lawn service. In many instances it is difficult to determine when a customer becomes a former customer. Consider the regular catalog customer who doesn't make a purchase for several years or the credit card customer who stops using the card, but doesn't close the account. Are they still customers – or former customers? Finally, some customers are forced to churn if they fail to make payments.

Customer Profitability and the Customer Lifecycle

The value of the customer relationship varies across the stages of the lifecycle. Specifically, the value of the customer relationship depends on the revenues received and the costs to service. To initiate the customer revenue stream, the firm must first acquire the customer. The acquisition cost reflects the average per customer investment in advertising, marketing and selling expenses aimed at attracting new customers. Once acquired a business will typically incur additional expenses to develop and retain a customer. These may include spending on programs to increase the value of existing relationships, the costs of loyalty or frequent buyer programs, costs of campaigns to 'winback' former customers, or costs of servicing customer accounts.

The net cash flow received from a customer depends on the frequency and volume of purchases, the margin on those purchases and the duration of the customer relationship. This will vary across customers and customer groups but will follow the general shape shown in Exhibit 2.

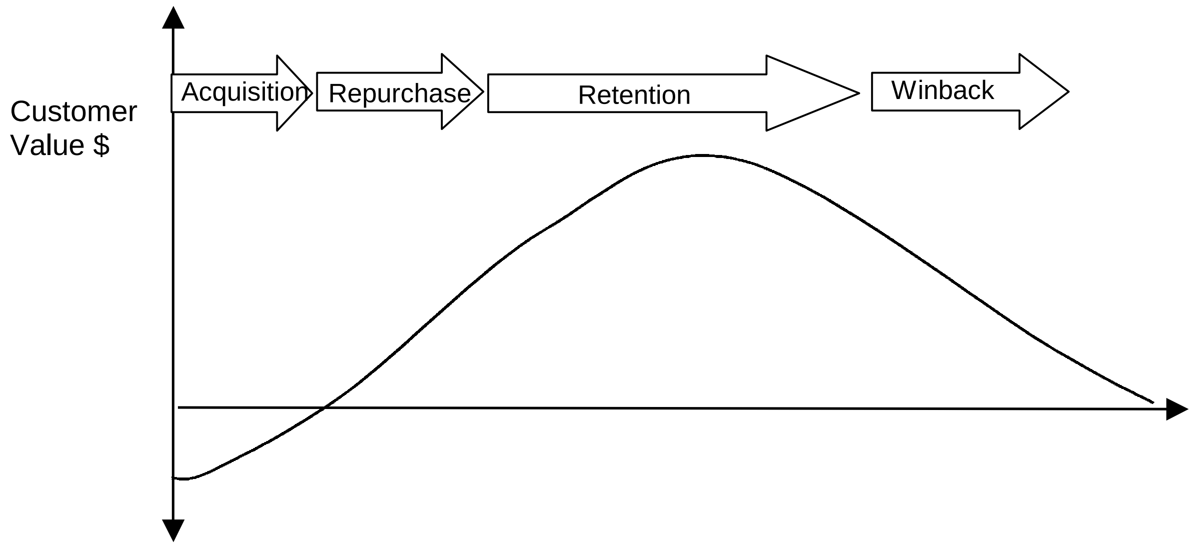

Exhibit 2 Customer Value and the Customer Lifecycle

More specifically, the lifetime value of a customer can be estimated using the following formula:

$$\mathrm{LTV} = \sum_{t=1}^{n} \frac{\mathrm{P_t}(\mathrm{Q}_t \pi_t)}{\mathrm{d^t}} - \sum_{t=1}^{n} \frac{(\mathrm{D_t} + \mathrm{R_t})}{\mathrm{d^t}} - \mathrm{A}$$

where P_t = the probability of purchase in period t
Q_t = the quantity purchased in period t
π_t = the margin on purchases in period t
d^t = the discount rate where d = [1+(interest rate$\times$risk factor)]
D_t = costs to develop the relationship in period t
R_t = costs to retain the customer in period t
A = initial acquisition cost
n = the number of periods

The first term in the LTV equation captures the net revenues received from a customer – discounted over time. The second term captures the ongoing costs to develop and retain the relationship – discounted over time. The final term reflects the initial cost to acquire the customer. Later we will examine how to compute customer lifetime value in more detail.

Customer Data and the Customer Lifecycle

Early in the customer lifecycle there is very limited data available on individuals, but gradually the amount of customer data accumulates as the lifecycle progresses. A summary of some of the data typically acquired in different lifecycle stages is shown in Exhibit 3. Some of the customer information is routinely captured by transactional systems needed to run the business. For example, a bank automatically captures a record of deposits and withdrawals. An airline knows how often, to which destinations and under which fare structure its customers travel. Phone companies can determine how many calls a customer makes, to which countries, states or numbers, and how long the calls last.

The customer may volunteer other pieces of data. This potentially valuable information may be lost unless an effort is made to capture it. The Four Seasons hotels are known for conscientiously recording customer requests and preferences in their database. If a customer requests a foam, rather than feather, pillow – that will be noted in the database and will be available the next time that customer makes a reservation at a Four Seasons property.

Other valuable information about customers is often buried in the data – and requires some analysis to uncover. Consider what your favorite supermarket potentially knows about your habits and preferences. Do you regularly purchase dog food or supplies? You must have a dog. Purchases of diapers and baby food indicate very young children. Perhaps you frequent the deli counter for prepared take-out items. Or do you prefer to stockpile frozen entrees?

Customer Lifecycle Stage	**Customer Data**
Prospects	Purchased data: Demographics (age, income, marital status, household size) Geodemographic data (e.g. PRIZM cluster profiles) Campaign History data (e.g., the number of times and means of contacting prospects)
Responders	Varies but often includes name, address, phone number, and product category interests. May also include financial or credit information, household size, education, employment status, product ownership or other relevant information.
New Customers	Amount of purchase Goods or services purchased Payment type (cash, check, credit card) Source of customer (direct mail, saw ad, referral)
Retained or Repeat Customers	Product Usage History Payment History Responses to marketing campaigns Channel preferences
Former Customers	Reason for termination

Exhibit 3 Customer data builds over the customer lifecycle

All too often these potentially valuable insights are never uncovered – simply because businesses have not made the effort. Recently this has started to change – as the competitive environment has become more intense, as consumers are more demanding, and as the technology is increasingly available – businesses are starting to 'mine' their databases to reveal insights and relationships that can be used for a competitive advantage. However, this is no small task. Consider the thousands, hundred of thousands, or millions of customers that a bank, a grocery store, a website, a catalog, or an airline has – coupled with potentially thousands of pieces of data for each customer accumulated over the years – and it is clear that the management and analysis of customer data is a formidable task!

Customer-Centric Marketing Initiatives and the Customer Lifecycle

Customer relationship management programs and initiatives aim to increase the customer value over the lifecycle. While the different programs and initiatives are as varied as the marketplace, once again the customer lifecycle provides a useful framework. Some typical customer-centric initiatives for key stages in the customer lifecycle are shown in Exhibit 4.

Stage	**Marketing Initiatives**
Customer Acquisition	• Reduce acquisition costs through more targeted acquisition campaigns • Profile valuable (and not-so-valuable) customers to try to increase the acquisition of high LTV customers
Customer Development	• Increase the usage of current products or services • Sell additional (cross-sell) products or services • Sell higher margin (up-sell) products or services • 'Personalize' communications and offers for the specific customer • 'Market-basket' analysis to identify opportunities for cross-promotion or store layout
Customer Retention	• Extend the duration of the relationship by reducing voluntary attrition of valued customers • Make unprofitable customers profitable by increasing fees or reducing service – perhaps encouraging some to attrite

Exhibit 4 Customer Initiatives during the customer lifecycle

Customer Metrics and the Customer Lifecycle

It has been said that you cannot manage what you do not measure. The key traditional measures or metrics that marketers have relied on include brand or category sales and market share. Sales personnel are often rewarded for bringing in new accounts or customers – and not always with any regard for their long-term profitability. An orientation around customer-centric marketing requires customer-centric metrics. An emerging set of metrics by which to assess the effectiveness of customer-centric marketing includes the following:

- Acquisition cost – the marketing cost to attract and acquire a new customer
- Retention rate – the percent of customers retained from one period to the next
- Churn – the percent of customers who attrite per period
- Share of customer (or share of wallet, share of garage – if you are General Motors, share of stomach – if you are in the food business, etc.) – a measure of how much of a customer's business you have
- LTV – the lifetime value of a customer
- Duration – time a customer remains a customer
- Gross income (equal to revenues-COGS and operating costs) per customer – both for new and repeat customers
- Repeat customer maintenance cost

In the e-commerce arena, there are numerous more metrics including hits, visits, conversion rates, yields, and more. These customer-centric metrics are becoming increasingly important as they are directly related to a business's financial well-being and profitability.