CUSTOMER LIFETIME VALUE

CUSTOMER ACQUISITION COST

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CUSTOMER LIFETIME VALUE: CUSTOMER ACQUISITION COST

If you want to maximize your profitability over time, understanding which sales and marketing activities provide the most **profit dollars** is key.

The first step is to know the Customer Acquisition Cost ("CAC") for each activity. Without knowing how much it costs to acquire a new customer, it's impossible to prioritize investments in growth.

Let's take a simplified look at how to calculate CAC using internet leads as an example.

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The Scenario

Suppose you buy 100 leads for $500 and they play out like this:

- One full-time team member earning $14/hour spends 75% of the month working the leads.
- She wins 10 new P&C customers with an average premium of $1500.
- She earns average annualized commission of 4% on auto and fire (assuming auto commissions are based on 6-month premiums).

How much does each new customer cost?

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Step 1: Start with the cost of the leads.

This is the easy part. You already know that the cost of your leads was $500. We'll add other costs to this number to get the full cost of working with leads this month.

LEAD COST: $500

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Step 2: Calculate the related labor cost.

Remember your team member who makes $14 per hour and spend 75% of her time on this activity this month? How many hours did she spend?

(Note that a full-time employee works **173.3 hours** in an average month because there are slightly more than 4 weeks.)

173.3 hours * 75% = 130 hours

Also, you pay a 25% payroll burden on top of her $14/hour. So, her total cost for the month is:

$14 * 1.25 * 130 hours = $2275

LABOR COST: $2275

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Step 3: Calculate commissions due.

Your team member also gets a commission. It looks like this:

10 sales * $1500 premium * 4% commission = $600

COMMISSIONS COST: $600

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Step 3: Put it all together to get your CAC.

First, add up all your costs:

leads + labor + commission = total costs

$500 + $2275 + $600 = $3375

Next, divide the total cost by the number of customers you acquired:

$3375 / 10 customers = $337.50

CAC is $337.50

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The Conclusion

In this scenario, acquiring a new customer via internet leads costs you **$337.50**. You then have to ask three questions:

1. "How does this compare to my other business development activities and where should I prioritize my spend?"
2. "How long does it take me to break even (earn back my $337.50)?"
3. "Once I earn back my $337.50, How long do I keep this customer and how much CLV does that produce for my agency?"

NEXT STEPS CHECKLIST

- ❑ Try calculating your CAC for various activities: internet leads, customer appointments, referrals, digital marketing, etc.
- ❑ Review the document about "Contribution Margin and Payback Period" to see how long it takes you to break even and start earning profit on given sales and marketing activity.
- ❑ Dig in deep to figure out which levers you can pull to reduce CAC or increase return on CAC:
  - Experiment with leads of varying price/quality. Lead cost was only 15% of total costs in this example ($500 / $3375). There's room to play.
  - Call every lead at least 3-4 times to improve reach rate.
  - Discover and meet more of each customer's needs.
  - Close more often.

WANT TO LEARN MORE?

To schedule an in-depth conversation with your study group or large agency about Customer Lifetime Value and CAC, contact us at CLV@clientfocuscorp.com.

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