



# How Much Can You Afford to Spend Acquiring a Customer – and Eight Tricks to Determine If What You Are Spending Is Making You Any Money

By Don Kent ■ *eCablevision Consulting*

*"I know that half my marketing programs do a great job at driving sales and providing me an acceptable return for my investment – the problem is that I don't know which half."*

*An anonymous and perplexed executive*

When you pay for a router, you know exactly what you're getting and how much you are spending. And the same is true when a company purchases a server, furniture, or a laptop. But in the opaque and illusive babble that is called customer acquisition campaigns – just what are you getting for the money that you spend to acquire customers? And can you afford that price?

Here's a methodology to determine the maximum to spend acquiring each new customer, followed by eight "tricks" to help you ensure that these marketing expenditures are making you money. To begin this discussion, let's figure out how much you can afford to spend acquiring each customer.

To determine how much money a company can afford to spend acquiring a new customer, first we must determine how much a customer is worth. During extraordinary times if the company is being prepared for sale and management knows how much the shareholders will receive per incremental customer available to be sold, deriving the maximum amount is straight forward. As a hypothetical, if each incremental customer increases the value of the company by \$2,000, then the company can't afford to spend any more than \$2,000 in marketing and other costs per customer and make any money. During the bubble era of the late 1990's, some companies not for sale would spend excessively acquiring cus-

tomers because this increased the theoretical value of their company, and sometimes the value of managements' stock options. When companies spend amounts in excess of the total incremental cash flow that is generated by a customer, it has the effect of increasing the leverage of the company. When some companies followed this strategy during the bubble era, it was a recipe for insolvency.

Companies should spend less than the lifetime value of each customer – or the value that a new customer generates – to acquire that customer. A simple way of calculating the approximate lifetime value of a customer is to subtract a customer's installation related costs from its flow of EBIDA earnings. Here's how you can approximate the amount you can afford to spend to acquire a customer:

a. Review the company's financial statements to calculate the monthly EBIDA earnings generated by one "average" customer .

b. Next, multiply the EBIDA generated over the number of months that the average customer is retained. If the incremental customer is entering into a one-year contract – then multiply EBIDA times twelve months. Next, add this number to the percent of customers that renew their contract for a subsequent one-year term. If 50% of customers renew their agreements, then to conservatively calculate the value of a cus-

tomers over the next three years, calculate the flow of EBIDA by adding 100% of the first year's EBIDA, 50% of the second year's EBIDA, and 25% of the third year's EBIDA.

c. Here's an example: a customer is billed \$50 per month for service and generates \$15 in EBIDA earnings per month. As calculated above, the average customer's lifespan over a three-year term is 21 months, or twelve months plus six months plus three months. A 21-month customer lifespan times \$15 in EBIDA generates \$315. Next let's assume that it costs a net of \$200 in equipment and installation related expenses to activate the customer. So the lifetime value of a customer is \$15/month times 21 months or \$315 less \$200 – or \$115, in this example. To make things simple, we'll assume disconnect expenses equal the residual value of salvaged equipment.

d. In the example above, a company should spend less than \$115 to acquire an average customer, to ensure that sufficient earnings exists to justify the company's infrastructure costs and generate a profit. And if your customer acquisition costs begin to approach \$115 per customer, you know that you are spending too much – it's time to gather the management team together and strategize how best to add customers more effectively.

This is a quick and rough methodology to show how to approximate the most you can prudently pay to acquire a new customer. The approach described above would tend to over-count marketing expenses, but its purpose is to serve as the beginning of a discussion for you to have with your CFO.

Now that we've discussed a maximum acquisition cost for which a company should

never exceed, the next question is to determine how to ensure the money is being spent wisely. The key to ensuring that your customer acquisition campaign costs are spent wisely is tracking the sales and costs associated with each tactic in each acquisition campaign. While tracking costs per tactic is fairly straight forward, it's sometime difficult to determine where the sales are coming from. Here are several tricks of the trade to help you determine the effectiveness of tactics that are driving your sales – and understand which marketing campaigns are making you money.

1. Unique telephone numbers. If you advertise in newspapers and magazines to promote your service, list a unique telephone number in each publication to help track which media is generating the leads or sales. Using this approach, you can utilize your telephone management reporting system to track the leads or sales for each campaign. You then will be able to measure which media is the most effective investment for a specific promotion by tracking the sales generated by each publication and dividing it by the cost to advertise in that publication.

2. Special discount codes. In print and online advertising, use a special discount code and encourage prospective customers to specify the code when they order to take advantage of the special price. This way and no matter how the sale originates – if coupons are redeemed, website forms are submitted, or inbound calls are received – the source of the advertisement can be tracked and the cost per sale calculated.

3. Track both sales and installations. Is a campaign that generates the most sales at the lowest cost the most effective marketing campaign? The answer is..."maybe." Sales that aren't converted into installations are as useless as leads that aren't converted into sales. So knowing the cost per sale is important, but it's not the most accurate indicator to measure the successfulness of a campaign. If a campaign results in a cost per sale of \$50 and only 50% of the sales are ultimately installed, then the customer acquisition costs should most accurately be reported as \$100 per installation – or twice the cost per sale. Knowing this information allows management to determine if they

have an installation conversion problem, and the true cost of acquiring a customer.

4. Churn counts. Are two campaigns that result in a cost per installation of \$100 per customer of equal value to the company? The answer is..."maybe." A more aggressive call-to-action may help meet the month's customer acquisition target, but if the offer is so aggressive that it results in the installation of a customer that hasn't been fully qualified, then the customers won't be as committed and will generate a higher rate of churn. Tracking the cost per sale and cost per installation assume that the customers that are acquired will have an equal customer life. If a customer acquisition campaign results in customers that churn at a rate even 10% higher than the average customers' rate of churn, the profitability of the customer may be significantly reduced.

5. Which email list works the best? Use the software that provides you the email address, date, and list source of each contact that receives an email and then clicks on a link to learn more. From here, these prospects can be tracked and sent follow up emails if they don't immediately make a decision to purchase. Also, this type of software can track the conversion rate of leads into sales by list.

6. Using a freebie offer to drive traffic on the Net. Web advertising is often paid on the basis of the number of click-throughs that are generated, but the click-through rates does not always mean increased business. A freebie offer will drive click-throughs, but those that take you up on such offers are not necessarily the individuals that will result in qualified prospects, sales, or installations.

7. Conversion software. Conversion software can help quantify the source of sales and leads, the effectiveness of your advertising placement, the cost per sale, and the relative effectiveness of each advertising tactic. This software goes beyond tracking by log files and landing pages. Here are a couple of the many alternative software programs available, just to get you started.

• Adminder ([www.adminder.com](http://www.adminder.com)) allows the option to enter cost so that cost per click, cost per sale, and ROI can be calculated on a by-campaign basis. Adminder exports to Excel, has an intuitive interface,

and simultaneously tracks multiple campaigns.

• PromotionsStat ([www.promotionstat.com](http://www.promotionstat.com)) reports visitors from different advertising sources and tracks their behavior once they visit your site. Consequently, this package measures the click-through rates on a by-campaign and by-advertising vehicle basis.

• NetAuditNow ([www.Netauditnow.com](http://www.Netauditnow.com)) analyzes a website's log files and generates detailed reports, including ROI and advertising quality reports. This software reports on search engine performance to unique visitors, and track the effectiveness of banners and links.

8. Focus your marketing dollars on valued media that reaches your targeted audience. Deals that seem "too good to be true" often are. If you're in the business of – as an example – renting luxury apartments in Chicago metropolitan area, don't be seduced by a media sales rep that offers to cut its advertising prices by 75% for you to advertise to lower middle class demos in New Mexico. If a media's audience isn't a good match with your targeted prospects, then even that 75% off deal will likely prove to be a very bad deal. And advertise in the publications that you - yourself - read and value. If you don't read a publication that focuses on your industry, it's a safe bet that many others don't either. And if you usually find yourself picking up a publication and finding value in its articles, it's likely that your prospects are also reading both the articles and the advertising.

Good management practices require that management knows how much they can afford to spend when acquiring each new customer. Additionally, management also has a responsibility to ensure the marketing dollars are spent wisely. Quantitative analysis is the basis for accomplishing both – and will help ensure your company's success. ■

## About the Author

*Don Kent is CEO of eCablevision, a broadband consulting company. He has spent over 26 years working with early stage companies specializing in the delivery of broadband and digital content services. Please address questions or topics that you'd like to see discussed in subsequent columns to [Dkent@eCablevision.com](mailto:Dkent@eCablevision.com).*