Top Performing Companies Manage by LTV! Do you?

FlexPay

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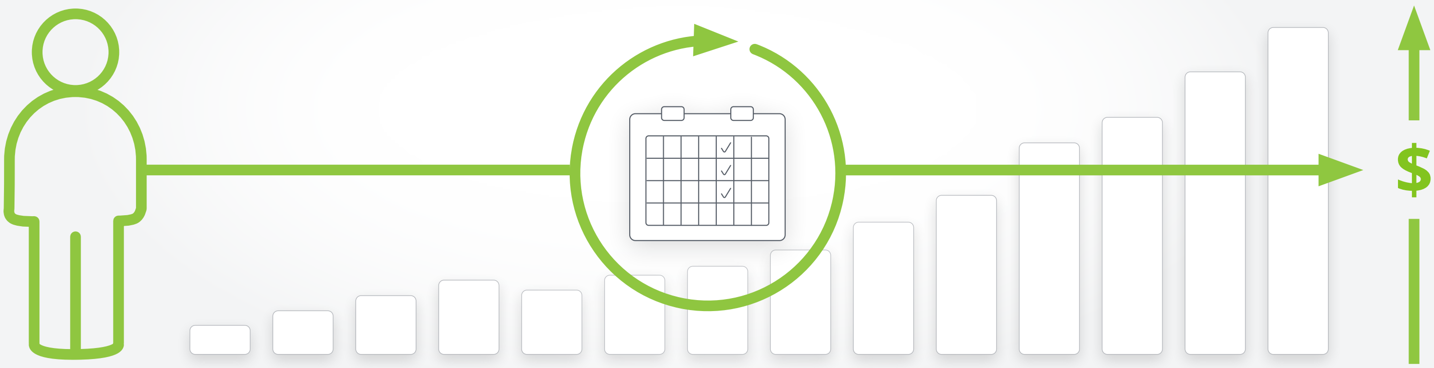

Introduction

Is your business missing out on its full potential? If you're running your subscription business the way most companies operate, then the answer is yes.

Which begs the question: How can you operate your business using a proven path to better results?

The State Of Subscription Business: Best Practices And Business Performance Drivers, a PYMNTS and FlexPay collaboration, identified that managing and optimizing customer LTV is one of the largest differentiators in subscription performance. The highest performing subscription companies measure and track LTV, and this information directly helps them achieve their success. However, the report also identified an apparent paradox — only a small fraction of subscription businesses measure customer LTV, much less manage their businesses by it.

The good news for those businesses who aren't currently measuring LTV is that they can improve their business performance with just one equation. This is not an empty claim — the relationship between LTV management and company performance is proven. Measuring LTV will help close the gap between average businesses and the top performers.

This report will dive into why LTV is such an important metric for subscription businesses to measure and optimize, and why so few businesses actually do so.

Key report insights about subscription LTV

Measuring customer LTV isn't a common practice. In fact, only 8.5% of all subscription companies reported tracking LTV. But measuring LTV is done at a much higher rate in the top performers with 33% of top performers tracking LTV, compared to only 6.9% of medium performers and a mere 3.8% of bottom performers.

Think about this: A company is 8.8 times more likely to be a top performer than a bottom performer if they measure customer LTV.

So why aren't more companies measuring LTV?

The most common reason why LTV isn't calculated is because there isn't an industry standard definition of LTV. It's obviously hard to measure something if you don't understand the parameters.

33% OF TOP PERFORMERS **TRACK LTV**, COMPARED TO ONLY **6.9%** OF MEDIUM PERFORMERS AND **3.8%** OF BOTTOM PERFORMERS.

How to calculate LTV

Here is the calculation FlexPay recommends using to measure LTV:

Standard LTV Equation

Billing Cycles x (Order Value – COGS) – Aquisition Cost

This equation factors in the number of billing cycles a customer is active (which equates to total revenue from each customer), multiplies this by the gross margin after removing the cost to deliver the product or service (order value – COGS), and subtracts the customer acquisition cost.

The value of this equation is that it allows powerful visibility into the most profitable customers. It also factors in varying costs of acquisition, and it can be used to manage the business. In other words, this equation is a gold mine of valuable information.

Of course, simply measuring LTV isn't enough. You must also share your LTV measurements widely across your entire organization, create internal initiatives to improve your variables in the equation — particularly your retention numbers — and assign accountability to appropriate teams to improve the input drivers that lead to higher LTV.

Why is LTV so important?

LTV is the most critical metric for subscription businesses to measure because it shows you the drivers that increase revenue, growth rates, and profitability.

Measuring LTV makes it obvious that increasing retention drives higher profitability. Measuring LTV also reveals the costly reality of subscription customer acquisition. For example, LTV measures exactly when a customer— or a customer source — becomes profitable by overcoming the cost of customer acquisition.

Typically, the longer a customer is active the more profitable they are. On average, acquiring a new subscription customer will cost you the amount of revenue earned over 3-6 successful billing cycles. A subscription customer who churns before you recoup their acquisition cost is immediately unprofitable.

On the other hand, customers who have stayed active long enough for you to recoup their cost of acquisition will deliver higher profit margins in each subsequent billing cycle compared to a new customer. This reinforces the importance of customer retention.

MEASURING LTV SHOWS YOU THE DRIVERS THAT INCREASE REVENUE, GROWTH RATES, AND PROFITABILITY

THE QUICKEST AND MOST EFFECTIVE WAY TO IMPROVE SUBSCRIPTION CUSTOMER RETENTION IS TO ACTIVELY MANAGE INVOLUNTARY CHURN.

How to improve retention

The quickest and most effective way to improve subscription customer retention is to actively manage involuntary churn, also known as passive churn. Involuntary churn is the percentage of customers who churn due to failed payments, rather than actively choosing to end their subscription. While this phrase may be new to you, it is a critical number to measure and manage.

FlexPay's data shows that up to 48% of all churn is caused by failed payments. Our research further shows that recovering failed payments increases customer retention and reduces involuntary churn. Top performing subscription companies are four times more likely to measure and manage failed payments than bottom performers. It is no surprise then to learn that the highest performing companies have been able to increase their LTV.

After you work through the equation we provided, you have a roadmap to help improve LTV. This roadmap gives you 3 options:

Option 1 - increase customer retention (i.e., more billing cycles)

Option 2 - decrease the cost of customer acquisition

Option 3 - increase margin (AOV – COGS)

While all these options are possible, the most impactful change to LTV will come from increasing customer retention and the overall number of customer billing cycles.

Putting customer LTV into practice

The highest performing companies apply LTV in innovative ways and measure the results of initiatives aimed at improving core metrics. For example, top performers are twelve times more likely than bottom performers to use third-party failed payment recovery software, AND six times more likely to calculate the LTV of customers who have been recovered from failed payments.

This makes perfect sense. These high performing companies understand that measuring the full LTV of a customer after they experience a failed payment unlocks the full value of this recovered customer, which quickly improves the financial performance of the business.

TOP PERFORMERS ARE **12X** MORE LIKELY TO USE THIRD-PARTY FAILED PAYMENT RECOVERY SOFTWARE.

Summary

It is imperative that all subscription businesses start to measure customer LTV because the LTV calculation unlocks visibility to the drivers of company revenue, growth and profitability. Top performing companies do three things: They measure LTV, use LTV to manage the results of initiatives aimed at improving business results, and create accountability across functions on the input drivers of LTV.

The good news for the 90%+ of companies that don't measure their customer LTV? Following these simple 3 steps will start them on the road to improved results, and help them reach top performer status.

- **LTV** Measurement
- **LTV** Management
- **LTV** Accountability