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RETURN ON CUSTOMER

Creating Maximum Value From Your Scarcest Resource

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The Web site for this book is at www.returnoncustomer.com.

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MAIN IDEA

Most people are familiar with the concept of return on investment – how well a firm creates added value from a given investment. There is, however, no equivalent metric which measures how well a company creates value from its most scarce and therefore most valuable asset – its customers. Return on customer (ROC) is a new business metric which is designed to measure the amount of value a business creates by acquiring, retaining and then growing its customer base. It is calculated in this way:

$$\text{Return on Customer} = \frac{\text{Current period cash flow} + \text{Change in customer equity}}{\text{Total customer equity at the beginning of this period}}$$

where:

- Current period cash flow is the revenue the company will generate in this period through the sale of products and services.
- Customer equity is the net present value of all cashflows the company expects to generate from customers over their lifetimes.
- Change in customer equity is the increase or decrease generated in this period by the actions of the company.

When ROC is positive, your firm is creating value from your customer base, either by increasing sales in the current period or by enhancing the likelihood the customer will do more business with your firm in the future. This lifetime value of future business is captured by changes in customer equity, which in essence is the current discounted-cash-flow value of a customer's future business. Conversely, when ROC is negative, your firm is destroying customer equity or customer lifetime value, making it less likely you will be able to generate profits from your customer base in the future.

Return on customer represents the costs and trade-offs which are inherent in business. For example, if a firm carries out an aggressive telemarketing campaign, it might increase current period sales but also erode the likelihood customers will buy again in the future. That harm to the customer lifetime value won't be captured by any other established business metric, and yet it might even exceed the boost in current sales which was achieved. Conversely, if a firm always focuses on customer equity, it may not generate enough profit on a current basis to stay in business. To maximize return on customer, companies need to optimize their mix of short-term profit and long-term customer equity created.

The arguments in favor of return on capital as a management metric are:

The seven key arguments for using return on customer (ROC) as a management metric

#	Argument	Summary
1	Scarcity	Customers are any company's scarcest resource.
2	Wall Street	Most firms focus on short-term results, not long-term value.
3	Balance	ROC helps firms optimize trade-offs and make good decisions.
4	Perspective	To increase ROC, firms must take the customer's perspective.
5	Personalization	To maximize ROC, treat different customers differently.
6	Leverage	ROC creates great leverage for your competitive strategy.
7	Education	Your shareholders have to buy-in to ROC for it to work.

Argument #1 – Scarcity – Customers are any company's scarcest resource. . . . . Page 2
Argument #2 – Wall Street – Most firms focus on short-term results, not long-term value. . . . . Page 3
Argument #3 – Balance – ROC helps firms optimize trade-offs and make good decisions. . . . . Page 4
Argument #4 – Perspective – To increase ROC, firms must take the customer's perspective. . . . . Page 5
Argument #5 – Personalization – To maximize ROC, treat different customers differently. . . . . Page 6
Argument #6 – Leverage – ROC creates great leverage for your competitive strategy. . . . . Page 7
Argument #7 – Education – Your shareholders have to buy-in to ROC for it to work. . . . . Page 8

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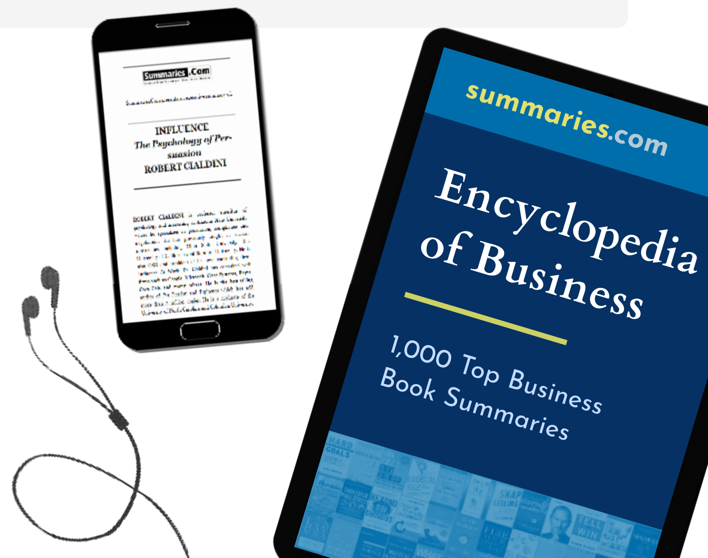

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