Customer Profitability Analysis and Customer Lifetime Value:

comparing and contrasting two key metrics in Customer Accounting

Ashok Sridhar and Michael Corbey

ABSTRACT The main objective of this paper is to compare two key approaches in the field of Customer Accounting (CA), namely Customer Profitability Analysis (CPA) and Customer Lifetime Value (CLV). While CPA is a retrospective analysis of past accruals that represent the results of doing business with a customer over a certain, mostly single-period of time, CLV is a predictive measure of future customer-related cash flows over a certain (multi-)period of time. This paper draws on the state-of-the-art knowledge in the Customer Accounting (CA) literature to identify the impacts of CPA and CLV on managerial decision-making. It also offers recommendations as to the scenarios in which these metrics should be deployed in order to arrive at meaningful managerial decisions, and highlights their collective limitations.

PRACTICAL RELEVANCE Organizations may be confronted with the need to extend their cost system design from a product-based orientation towards a customer-focused orientation, which is also known as Customer Accounting (CA). This paper is valuable for practitioners that want to learn more about the most important approaches in CA: Customer Profitability Analysis (CPA) and Customer Lifetime Value (CLV). After a brief introduction into CPA and CLV, it is shown that both approaches differ considerably when it comes to issues like complexity, impact on managerial decision making, and implementation. The analysis may serve as a support for practitioners who are in the process of assessing which approach is best, given their typical organizational contingencies.

1 Introduction

Managing customer relationships is the essence and crux of any business. A satisfied customer is probably the best form of publicity a company can get. This is valid for business-to-business (B2B) as well as business-to-consumer (B2C) scenarios. According to Ryals (2008), the true value of a customer comprises not just the *cash* that a person, or a business entity, generates for the company, but also the *relational value* (which also includes the willingness to recommend the company to a third party, i.e., advocacy) brought in by that very customer. It is generally considered more efficient for a business to keep its existing customers satisfied, than to focus on customer acquisition with little regard to customer churn (Stone, Woodcock & Machtynger, 2000, p. 102). It is, nevertheless, important for a company to distinguish between customer satisfaction and customer retention, and handle these as separate, albeit related, aspects. For it is likely that a company can retain a satisfied customer, this is, however, not a given. On the other hand, it is also possible that an unsatisfied customer can still be retained. There are a host of other factors besides customer satisfaction that play a role in customer retention, see, e.g., Hong and Lee (2014, p. 43-44) and Kumar, Batista and Maull (2011). An important facet of company-customer relationship is the notion that a satisfied customer need not necessarily be retained by all means. In fact, satisfied customers may well turn out to be unprofitable! In other words, the company has to be aware of the costs and the revenues of keeping a customer satisfied - this is where Customer Accounting (CA) comes into the picture.

CA plays an increasingly important role as companies shift from a product-centric approach to a customer-centric approach (in which customers are treated as assets). It is an essential approach that helps companies to identify and to distinguish between the most profitable customers and the less profitable or loss-generating ones, so that they can find the right balance between customer retention and customer acquisition. According to Kotler (CIMA, 2009, p. 3), a profitable customer is "a person, household or company that, over time, yields a revenue stream that exceeds by an acceptable amount the company's cost stream of attracting, selling and servicing that customer."