A three-page excerpt from our 13-page Best Practice Guidebook:

Implementing a Customer Lifetime Value Approach to Sales and Marketing Strategies
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GUIDEBOOK SUMMARY

**Firm:** Farmers Group, Inc.
**Industry:** Multi-line, multi-company insurer and financial services provider
**Headquarters:** Los Angeles, California, USA
**Geographic Footprint:** United States
**Ownership:** Wholly owned subsidiary of Zurich Financial Services
**Revenue (2011):** ~$10 billion USD

**Problem:**
Farmers’ traditional business metric, policies in force, lacked customer focus and resulted in sales and marketing strategies focused on the quantity, rather than the quality, of customer relationships.

**Solution:**
The Market Analytics team creates a customer lifetime value (CLTV) model to predict the dollar revenue a customer will generate over his/her lifetime with the company. This allows Farmers to:

- Identify the CLTV of each individual customer
- Measure the effectiveness of their marketing spend
- Attract and retain higher CLTV customers
- Embed CLTV-based strategies within the sales function

**Business Results:**

- 20% improvement in overall marketing ROI
- Incremental increase in Farmers average customer profitability through an improvement in their market share of higher-value customers
- 100% improvement in direct mail ROI

**Resources Required:**

- Building and testing the CLTV model took six to eight months
- The CLTV initiative involved a ten-member team composed of analysts and managers within Market Analytics, as outlined below:
  - Analysts: SAS programmers to perform statistical modeling
  - Analysts: Staff familiar with the firm’s internal data infrastructure
  - Managers: MBAs with a strong technical and business background
- Building, testing, and rolling out the CLTV model cost approximately $1 million
- Senior Leadership Executive—a champion for CLTV initiatives within leadership ranks, e.g., Chief Marketing Officer, Chief Operating Officer

**Applicability of Best Practice to Executive Functions:**

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<th>Function</th>
<th>Applicability</th>
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<td>Corporate Strategy</td>
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**KEY TAKEAWAY:** Create a model to calculate customer lifetime value (CLTV)—the monetary revenue each customer generates over their lifetime with the firm—and establish the foundation for a data-driven marketing strategy.

*Farmers’ model calculates CLTV using three variables: total relationship revenue, predicted customer tenure, and predicted future purchase revenue.*

<table>
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<tr>
<th>Variables</th>
<th>Description</th>
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<td><strong>1. Total Relationship Revenue</strong></td>
<td>This is the total revenue an individual customer generates from the total number of relationships they have with the company. This can be calculated daily, weekly, monthly or annually. Farmers looks at the total number of policies and the monthly premium revenues associated with each.</td>
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<td><strong>2. Predicted Customer Tenure</strong></td>
<td>This is defined as the entire time period an individual customer has a relationship with the company. Farmers uses survival analysis because it allows them to predict how long a customer will remain a policyholder and differentiate between customer groups.</td>
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<td><strong>3. Predicted Future Purchase Revenue</strong></td>
<td>This is the expected future purchases customers will make based on their current relationship with the company, historical data, and demographic profiles. Farmers uses logistic regression to calculate the probability that a customer will make additional purchases.</td>
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**CLTV Example**

Jane Doe is 44 years old, married, living in Nevada and needs full-coverage automobile insurance for her new domestic sedan and liability-only insurance for her 10-year old family car. The monthly premium for the full-coverage policy is $50. The monthly premium for liability policy is $25.

The full-coverage automobile insurance policy is estimated to last 48 months. The liability-only automobile insurance policy is estimated to last 30 months.

Based on the customer’s data, Farmers’ future cross-sell model predicts a 60% probability that Jane will purchase a homeowner’s insurance policy. The average home policy’s life span is 120 months and premiums are $100 per month.

Future cross-sell models are built on five years of data from a sample of 100,000 customers and validated on the balance of the customer base over the same five years. Market Analytics develops product-specific future cross-sell models to calculate the probability of adding a home policy, an automobile policy, etc.

| New Sedan Policy: $50 | × | 48 months |
| Family Car Policy: $25 | × | 30 months |

\[
\text{CLTV} = (50 \times 48 + 25 \times 30 + (0.60 \times 100 \times 120)) = 10,350 \text{ CLTV}
\]

**CRITICAL DATA INPUTS FOR THE CLTV MODEL**

1. Four to five years of historical customer data to analyze the initial and subsequent purchase relationship with the company;
2. Transaction-based data that is aggregated at the customer (household) level;
3. Customer information such as age, marital status, credit history, and number and type of policies held.

Note: Of the six to eight months it took to build and test the model, 80% of the time was spent cleaning and understanding the data and 20% was spent modeling and determining the strategic implications of its output.

*Source: Farmers Group, Inc.; Growth Team Membership™ research.*
KEY TAKEAWAY: Analyze existing customers through CLTV and leverage results to secure buy-in for a CLTV-based segmentation study

Market Analytics segments existing customers into three lifetime value segments and evaluates their profitability...

...and utilizes the results to demonstrate CLTV’s impact and secure sponsorship for additional segmentation work

Profitability calculations for each segment requires allocating the elements of cost of goods sold (cost of coverage, i.e., losses, claims support, etc.) to each customer.

STAKEHOLDER ENGAGEMENT STRATEGY

1. Highlight sense of urgency through CLTV’s financial implications:
   - Emphasize the major differences between revenues from different customer types—the best customers bring in 25 times more revenue than lower value customers.
   - Stress that current sales and marketing expenditures do not differentiate between high- and low-value customers—acquiring customers whose acquisition costs exceed their revenue.

2. Establish trust in accuracy of the CLTV model:
   - Demonstrate model’s strength by applying it to historical customer data—2000 customers from three years prior—and showing the high correlation between its predictions and actual customer loyalty.

3. Issue call to action on new segmentation:
   - Establish that current segmentation scheme has resulted in over one third of current customers generating losses.
   - Emphasize the need to develop a new CLTV-based segmentation model to enable targeted customer acquisition strategies.

Source: Farmers Group, Inc.; Growth Team Membership™ research.
View GTM's webinar with Shiv Gupta (Farmers)

Register for the Webinar

Implementing a Customer Lifetime Value Approach to Sales and Marketing

GTM and Shiv Gupta, Director of Insight and Innovations at Farmers, will present this best practice where Shiv shared his key lessons learned and participated in a Q&A.