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3 Ways to Use the Magic Formula to

DOUBLE YOUR PROFITS

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Introduction

Almost everyone in business is familiar with the magic formula, but few are aware of its power or consciously use it to consistently grow their businesses.

Today I want to share 3 ways that I have used the magic formula to make billions of dollars for my clients and employers.

What is the Magic Formula?

It is represented simply as $LTV / COCA$.

That is customer lifetime value (LTV) divided by the cost of acquiring a new customer (COCA).

It represents the underlying economics of a business and is predictive of how profitably a business will scale. Its other powerful use is in business design, as a guide to optimising the factors that influence LTV and COCA.

How do we Calculate it?

LTV is determined by dividing the gross profit per customer by the annual percentage customer churn. For example, if a customer spends \$200 per year, your gross margin is 50% (i.e. \$100 gross profit per customer) and you lose 20% of your customers every year (20% churn). Then the LTV would be \$500 ($\$100/0.2$).

COCA is determined by dividing the total spend on new customer acquisition by the number of new customers that you acquire.

Imagine that you spent \$10,000 on brand development, lead generation and sales conversion and the result was 100 new customers, then your COCA would be \$100 ($\$10,000 / 100$).

LTV/COCA is not the full story

Yes, LTV/COCA does not incorporate all the important metrics in your business. It does not incorporate the total addressable market (TAM), which is another factor in your scaling decision, nor does it address COCA recovery time (how long it takes to recover the cost of acquiring the customer), or the overhead (which LTV – COCA contributes to). These and other elements are covered in our training programs and blogs. However, it remains a powerful tool to help you consistently double your revenues and profits.

How to use LTV / COCA to double your gross profit?

1. Use it to optimise your marketing spend

The first step is to make the effort to measure and track it. It is predictive of how profitable your growth will be. Unfortunately, most businesses don't take the trouble to measure or track it.

If your LTV is at least 3 times greater than the COCA, then you have a campaign that you should invest more in. If you can get it to 5 times, then you likely have a great business.

If you had an LTV of \$500 and a COCA of \$100, then $LTV - COCA$ would be \$400, meaning that you make \$400 net contribution (to overheads and profits) for every \$100 you spend on marketing. Few investments will provide that level of return.

What you do is double your marketing spend (of course you need to ensure that your lead conversion process is scalable and can cope with the increased number of leads). And if your LTV / COCA remains high you can double it again and again. This is how businesses can grow very rapidly.

2. Use it as a guide to increase LTV and reduce COCA to a point where you can invest ten times more in your marketing and get the increased spend back in 3 to 6 months.

- Optimise your LTV

Increasing your LTV delivers two things. Firstly, it improves your underlying business economics and profitability. Secondly, it improves the LTV / COCA ratio, enabling you to invest more aggressively in marketing, leading to faster growth.

Here are three ways to improve LTV

i) Find a cross selling opportunity. Shoe sellers sell shoehorns, shoe polish, insoles, etc. and at the end of the sale suggest that the customer buy one of these accessories to prolong the life of their shoes. Hairdressers sell hair products. McDonald's, Walmart and other businesses make sure that you leave with a basket or even a trolley full of stuff.

There are no doubt complimentary products and services in your business that you are not offering in a systematic way. Brainstorm a list of 20 cross sell opportunities, then pick and implement the one that resonates best with you.

ii) Find upselling opportunities. McDonalds regularly ask, would you like it as a meal (cross sell), or would you like it large (upsell). These are simple and effective questions, even if only 40% of customers say yes.

Take 10 minutes now to brainstorm a list of 20 upsell ideas that could be applied to your business. Pick one of them and try it out.

- iii) Increase loyalty (i.e., reduce churn). A reduction in churn from 20% to 10% would double your LTV, even small changes in churn have a big impact on LTV and the profitability of your business! Here are three ways to increase loyalty.
 - a. Put in place a contact calendar and make meaningful contact with your customers on a regular basis, for most businesses this could be every quarter. There are many excuses for contact, birthdays, anniversaries, joining anniversaries, Christmas, valentines, Easter, etc. Pick a few that make sense to your business and make a meaningful upsell or cross sell special offer, it doesn't matter if you only break even on the offer, the purpose is to offer meaningful and undeniable value in exchange for loyalty. For a birthday offer, a coffee shop could offer a free latte, a clothier could offer 65% off one garment. In one life I offered customers £10 of free telephone calls on their birthdays, it reduced churn by 30% vs the control group.
 - b. Events. Try to get your customers to an event every quarter or twice a year. Depending on your business it could be a live or online seminar with some top speaker (B2B businesses), a fashion show or product demo, a training seminar, etc.
 - c. Change of behaviour. Generally, customers leave for one of three reasons, a change in circumstances, a break in pattern, a bad experience or being poached by a

competitor. There are normally tell-tale signs either just ahead of them leaving or exactly when they leave. Your job is to have in place a system to monitor. No doubt this is easier for service businesses and businesses that have a direct relationship with the customer.

If you have a hair salon and your customer normally comes in every 2 weeks, if they have shown up for 3 weeks you need to contact them to find out why. If you operate a telecoms business and the customers normal spend in £30 per month and it drops to £15, you need to contact them. In my experience over 50% of leaving customers can be rescued. This can be a major boost to LTV.

- Optimise COCA.

Reducing COCA is the other obvious implication of the magic formula. There are three ways to do this. Reduce the cost per lead, increase the lead conversion rate and improve your referral program (that is if you are one of the minority of business that have a systematic referral program).

- i) Reduce the Cost per Lead.

Here are three of the best ways to do this

- a. Create a stronger offer. Your offer is one of the most important levers in your business. If you don't have an irresistible offer, then you've been leaving your business on the table. Here are three ways to strengthen your offer.

- i. Add more bonuses. Find bonuses that cost you little but add a lot of value to your customer. They could be information products (e.g a gym membership can

come with the ultimate diet guide, exercise manual, eating out guide, etc.), discounts or free trials arranged with complimentary merchants (e.g. a hair salon can negotiate vouchers for the local restaurant, shoe shop, etc.), or stuff you can make yourself (e.g. a book seller can offer a second book for free).

b. Create better headlines

- i. Your headline represents 80% of the cost of your advertising. If people don't read it, then the rest of the ad is lost. You should spend as much as you can on copy writers to give you great headline ideas and as much time as you have testing new headlines.

c. Different channels to reach your target market

- i. Are you hitting your customers where they congregate? Do you know the websites your customers visit and are you making direct deals with them, or are you just buying FB and Google Ads? Are you testing the magazines they read? Are you in their FB groups?

ii) Increase the lead conversion rate

Here are three ways to do this.

- a. Create a stronger guarantee or risk reversal. The risk of doing business with you is the biggest reason people don't convert. Anything you do to take that risk away from the customer increases conversion. Typically, a strong guarantee can double your conversion vs. having no guarantee (i.e. halve your COCA). If you even modestly deliver on your promise, your refunds will be very small

compared to the increased gross profit from your increased conversion.

- b. More powerful bonuses. I spoke about this in the last section. In a live sale situation, you would introduce the bonuses when the customer is raising their objections. And if you didn't use the bonuses in the close, then you bring them up after the close almost as a reward to the customer.
- c. Introduce an element of urgency and/or scarcity. People prefer to procrastinate or leave their options open. Creating a deadline or feeling that it might not be available later will help many get over the edge. If you can build a natural deadline into your product this is great. When the shoe salesperson comes back from the stock room to say that this is the only one left in my size, I always know suspect that its not true, but it spurs me to a decision anyway.

Even if your product or service is not naturally open to urgency or scarcity, you can create it artificially through a seasonal offer or creating a scarce or urgent bonus. For instance, 'if you buy today, I can give you 2 free tickets to our masters seminar next week.'

- iii) Put in place a systematic referral system. Leads you get through referrals are usually easier to close, faster to close and spend more money than leads from other sources. And though most business get referrals; few businesses have a systematic process to maximise the number of referrals they get.

The simplest referral program is to ensure that you ask the customer, either at the end of the onboarding process

and/or twice a year, if he/she can think of two or more friends who are in a similar situation to them who they think would benefit from having you solve this problem.

Of course, you can also develop more elaborate referral programs which include payments or discounts to the referring and referral customer.

Conclusion

These are a few tips on how you can use the magic formula to consistently double your gross profit. Collect the metrics for your business, optimise the key elements until LTV / COCA is at least 3 times, then test your way into spending as much as you can on customer acquisition.

About Afam

Afam helps businesses achieve and sustain double digit growth. As a consultant, investor, business owner and manager, he has helped over a dozen businesses achieve exponential growth, including taking three from under \$1 million to over \$50 million and one to over \$1 billion.

He started his business career over 30 years ago at Procter & Gamble, where he learnt all they could teach him about marketing, later managing the Fairy Liquid and other brands. From this experience he developed the High-growth Transformation Program a step-by-step process that he has used with dozens of businesses and in the process created over \$10 billion of market value.

Afam remains passionate about helping businesses grow and continues to serve as Chair of Courteville Business Solutions PLC and on the boards of various telecoms, saas and other technology firms.