EXECUTIVE INSIGHTS

10 Tactics To Drive LTV in DTC Businesses

In L.E.K. Consulting's two-part series focused on direct-to-consumer (DTC) businesses, we first discussed[1] how the changes in privacy laws have resulted in spiraling customer acquisition costs (CACs) and offered a number of strategies businesses can employ to mitigate both the rising cost of social media that underlies those CACs and the poor visibility of data impacting precision consumer targeting.

But that's just one side of the equation — and the side where DTC businesses arguably have the least control. Indeed, we believe CACs will continue to rise, and while that rise can be mitigated, the focus of DTC businesses needs to be on driving value within their existing customer base.

The days of simply buying new customers and expecting profitability are largely behind us. Instead, once DTC businesses are successful in bringing expensively acquired customers through the door, they need to retain them and get them to spend as much as possible over the course of that relationship. Sustainable growth will come from increasing their lifetime value (LTV) — and by extension, their LTV:CAC ratio — by improving retention (i.e., getting a customer to buy again and again over a long-time horizon), order volume (i.e., increasing the number of items purchased) and average order value (i.e., increasing the average price per item).

Which metrics to track

Customer LTV metrics should sit at the top of reporting dashboards used by all DTC businesses. But since the metrics can be open to interpretation, they should also be clearly defined.

Customer LTV is the value of a customer based on number of orders multiplied by order value, less costs, over that customer's lifetime with the brand. It's also another way of representing a customer's gross margin over that lifetime. Tracking the LTV:CAC ratio is key. In growth modes, the ratio might be low but ideally above one (i.e., breakeven), whereas for more stable, cash cow businesses, it might rise to the high single digits.

LTV metrics should always specify the customer set included and the time frame (e.g., among the 2020 cohort, the first 12-month LTV is $40). The time frame is rarely the customer's actual lifetime with a brand, as many DTC businesses do not have that data. They should instead choose the time frame for tracking LTV that makes the most sense depending on factors such as how frequently consumers purchase the product — be it every three months, six months, 12 months or longer.

For one-off, higher average order value (AOV) purchases (e.g., mattresses, cookware), first-order profitability can be a better metric, assuming the LTV has an order frequency equal to one. In such cases, the first-order value needs to offset the CAC — the assumption being that a repeat purchase cannot be relied upon in the short term. Product mix and upsell rates are critical to driving growth in first-order value.

Those are the levers that can be tracked and influenced by the use of 10 core tactics.

10 tactics for improving the revenue component of LTV

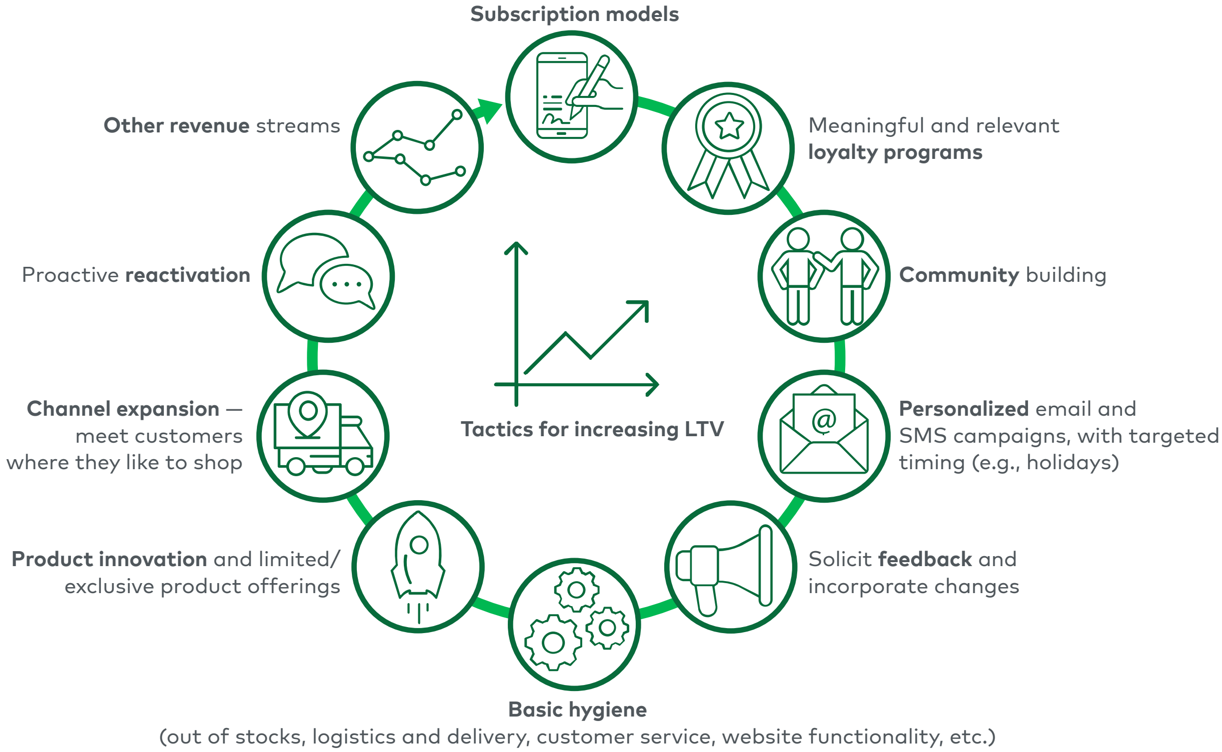
In a world increasingly full of "me too" brands, thriving instead of just surviving requires each DTC business to have a differentiated proposition — to offer a fantastic product at the right price and target the right audience in a way that is distinct from the competition. As credit markets continue to tighten and venture capital funding starts to contract, we expect many DTC businesses will fail, or will need to bootstrap growth. Meanwhile, rising inflation and worries about a possible recession are causing consumers to be more mindful of discretionary spending; consumers will only buy where they see value. As such, only DTC businesses with a genuinely distinctive value proposition will thrive.

For DTC brands that have a distinctive, winning proposition, there are many tactical measures they can implement to drive LTV by improving retention, order volume and AOV. Below we look at 10 of these tactics that can drive up the revenue components of LTV (see Figure 1), and then provide an overview of each.

1. Subscription models: Customer retention and AOVs are typically higher with subscription models than they are with a la carte purchasing, and more businesses are adopting this model. U.S. sales growth for subscription ecommerce sales is forecast to exceed $40 billion

Figure 1

10 examples of tactics to increase the revenue components of LTV

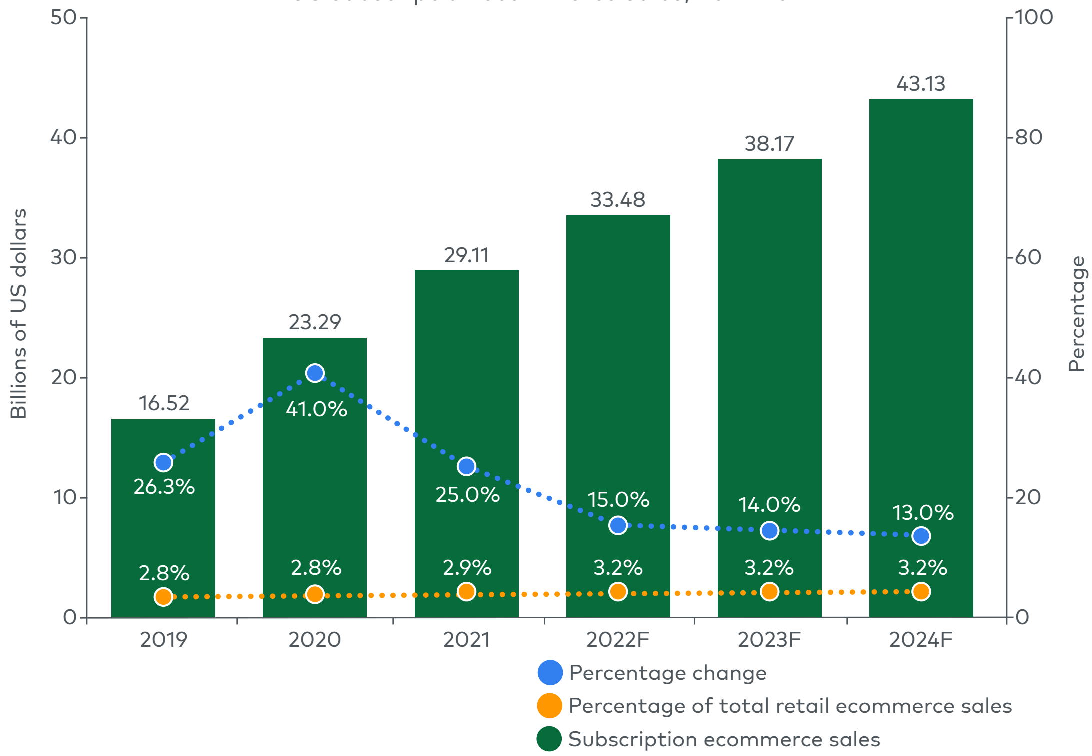


Note: LTV=lifetime value; SMS=short message/messaging service
Source: L.E.K. research and analysis

by 2024 (see Figure 2). It's why personalized protein powder and supplement business Gainful decided to go the subscription route. As a brand that targets consumers looking for a healthy lifestyle instead of just immediate weight loss, offering a subscription service with a wide range of products that can be used every day makes it a longer-term lifestyle choice. And such a model allows Gainful to share some of the economic benefits of its high customer retention level through favorable subscriber rates.

Subscriptions can also be positioned as a club/community (think Dollar Shave Club); offering perks and discounts (e.g., "subscribe and save") makes them more compelling than buy-as-you-go models. That said, one-time purchases can have their role. Some subscription businesses such as Prose, Function of Beauty (both personalized hair care brands) and Rent the Runway (rentable apparel), for example, also offer one-off purchases. Be it through flash sales or exclusive opportunities to buy, onetime purchases allow a brand to trial new products or even support partners with exclusive cross-sell opportunities. But generally speaking, the preference is to get subscribers.

Figure 2
US subscription ecommerce sales, 2019-2024F



Source: eMarketer; L.E.K. research and analysis

2. Loyalty programs: As inflation and a potential recession cause consumers to cut back on spending — a recent Brand Keys study of 39 brand and restaurant categories[2] found that 38% of them were seeing "declining" loyalty — retailers and brands are doubling down on loyalty programs. Rewards programs can be a core driver of loyalty; 79% of consumers in a recent Cheetah Digital survey[3] said they'd prefer brands invested in such programs over social media marketing. So, while brick-and-mortar retailers and restaurants such as J.Crew, Starbucks and Burger King are overhauling their loyalty offerings, DTC brands are also starting to lean in.

Brands such as hair care company Prose (Prose Perks), fashion brand Rebecca Minkoff (RM Rewards) and menswear brand Mizzen + Main (Main Man Rewards) are among those offering loyalty programs that reward consumers with points for actions such as liking pages, filling out quizzes and simply making purchases — in the case of Prose, customers receive a free product after every 10 they buy as part of its program. While gamification can spur interaction, points that can be redeemed for offers/free gifts are attractive to consumers. However, to be successful, loyalty programs need to be easy to understand and have some degree of personalization. As a recent Salesforce survey[4] found, 61% of consumers would use loyalty programs more often if rewards were automatically applied, 55% if rewards were personalized and 51% if tracking were easier.

3. Community building: Brand loyalty and stickiness are often the result of community building. Sharing product reviews, providing active chat sites for discussion and offering brand responses on social media or other platforms like Discord are common in industries such as beauty and fashion, as are consumers sharing product photos. Such community building not only engenders brand awareness, trust and a sense of belonging among consumers, it boosts customer engagement, loyalty and retention. User-generated content, surveys, polls, contests, reshares and live events also serve to build community around brands while generating active conversations between brands and consumers. Glossier and Sephora are two examples of brands that have successfully built community in the beauty space, while other brands have built community around social missions or consumer pain points (e.g., gluten-free).

Meanwhile, interesting new forays into community building can be found in the metaverse. American Eagle launched a "Members Always club" in Roblox for consumers to hang out in, for example, and lets them virtually try on jeans in its online stores. Meanwhile, Old Navy[5] launched an incredible consumer-generated ad campaign based on crowdsourced ideas.

4. Personalized content delivery: The availability of consumer data now makes it possible — and advisable — to tailor content to individuals. Based on prior purchases, brands such as Ritual (personalized vitamins, minerals and supplements) suggest products that consumers "might also like" during browsing and at checkout to drive AOV. Using personalized emails and Short Message/Messaging Service (SMS) to prompt the next purchase is also critical. And in addition to knowing what a consumer might like, leveraging the details of when they last made a purchase and when — based on their history — they are likely to buy next can also encourage the purchase of personalized "it's time to stock up" content. Even Sichuan food brand Fly by Jing, which uses puns and animations in its emails to make them feisty and fun, customizes them based on metrics such as what's in a consumer's shopping cart, how long they've been on the website, etc.

Some product categories — namely consumables that consumers run out of but are not always top of mind, such as deodorants or other hygiene products — naturally lend themselves to sending purchase reminders. Oh My Cream, a concept store that launched its own skincare brand, sends reminders to its customer relationship management (CRM) customers via email when it estimates they are nearly out of their product, an excellent opportunity to reengage and increase purchase frequency. Importantly, unlike with batch and blast models, emails and SMS should be used to surprise and delight, and to make a consumer feel part of the brand.

5. Soliciting and incorporating feedback: Understanding why customers return items and why they don't is crucial. To find out, many brands simply ask them. Brands are increasingly doing exit surveys to understand why consumers are switching off subscriptions; for example, Lola (which makes women's period and sexual health products) and Ritual (which makes DTC vitamins and supplements) both do so regularly. But asking isn't enough; brands need to take that feedback and act on it.

Other good sources of actionable customer feedback include online reviews and customer service reports. Surveying existing customers (obviously not too frequently) is another great way brands can show genuine interest in their customers, build relationships with them and figure out what they need to do more of to keep them — from running additional customer satisfaction and product feedback surveys to conducting simple net promoter score check-ins. Brands such as meal kit provider Home Chef do this regularly. Others conduct user tests. Doing so allowed Daily Harvest (meal kits) to change the price/shape of its delivery boxes and related options to stimulate retention, for example.

Taking this concept a step further, some brands are actively encouraging customer input to help design their next product, be that by responding to initial feedback provided through surveys and comments or running campaigns to actively seek new product design ideas. This isn't unique to DTC. LEGO turned around its business when it launched its ideas crowdsourcing platform in 2004, which received more than a million ideas and resulted in the launch of 23 new product sets that consumers helped design (those whose ideas were selected even got a cut of the profits).[6] Brands such as DeWalt, Heineken, Coca-Cola and Unilever have made similar moves.

Another example, Asphalte, a digitally native vertical fashion brand based in France, launched in 2016 with an innovative business model that removes the need for inventory by selling pre-ordered clothes, online, that are co-designed with its customers; it manufactures product based on groups of orders, limiting waste and supporting local production. Each time a new prototype is launched, an email is sent to its customer base and promoted on social media to test consumers' expectations, asking questions such as "Why do you have a sweater in your closet that you no longer wear?"

6. Getting the basics right: Some of the most common reasons customers cite for not reordering could be taught in a Retailing 101 class: a poor/slow delivery experience, product that is no longer in stock, a glitchy/slow website experience and/or purchasing process, unclear subscription terms — or those that don't allow for any flexibility (e.g., pausing during vacations). In the tough environment we are currently in, mitigating some of that is tricky — think supply chain snarls impacting availability. But DTC businesses have to get the basics right. That extends to customer service that, when done poorly, can be a core reason for churn (a single error can be annoying, but generally poor response times can be fatal for retention). They must be careful not to focus on cost cutting at the expense of customer service.

Nor should DTC businesses underestimate consumer expectations on social media. They need to remember that it's not just about delivering content to their community; it's about answering questions from customers and prospects alike. The personalization of feedback, the tone and response times are all key here. Customers are looking for answers in hours, not days, which reinforces the need for internal teams to work together, not in silos, so as to be present at every stage of the customer journey. A good example of this is Daily Harvest, which has seen a positive impact on LTV after investing heavily in its "care team," whose members are trained to treat every customer as an individual.

7. Product innovation/limited releases: By giving consumers more reasons to return to buy, product innovation can drive LTV through increased order values and greater stickiness. Expanding product range not only creates excitement through fresh new offerings but can also help build out a complementary system of goods as customers are shopping to solve a need, not just buy a product (see Figure 3). For example, Curology went from selling personalized acne-fighting products to selling an entire acne-fighting regimen (by adding face wash, moisturizer, etc.) that could be bundled but also drove more reasons for a consumer to get hooked on the brand. Another example is Brightland, which added vinegars and honey to its core oil offering in response to customer requests. Meal kit providers, realizing that customers don't always have time to cook, have also made inroads here recently. For example, Blue Apron and others have added pre-prepared microwaveable meals to give the option of quicker prep times, removing a core reason that customers give up their subscriptions.

Figure 3
Examples of product innovation

Source: L.E.K. research and analysis

Exclusive product drops keep things exciting and fresh for existing customers. This is a tactic employed by brands such as Dr. Squatch with its limited-release soaps, which include Star Wars-themed soaps and soaps with fragrances such as "Bow Chicka Wow," "Frosty Peppermint" and "Irish Cream and Whiskey." It is also the basis of Last Crumb's entire business model. Similar in some ways to Supreme in the apparel space, Last Crumb's limited availability/drops and constantly evolving flavors mean consumers have to join a wait list to buy its cookie boxes, which retail for around $150 for a dozen cookies.

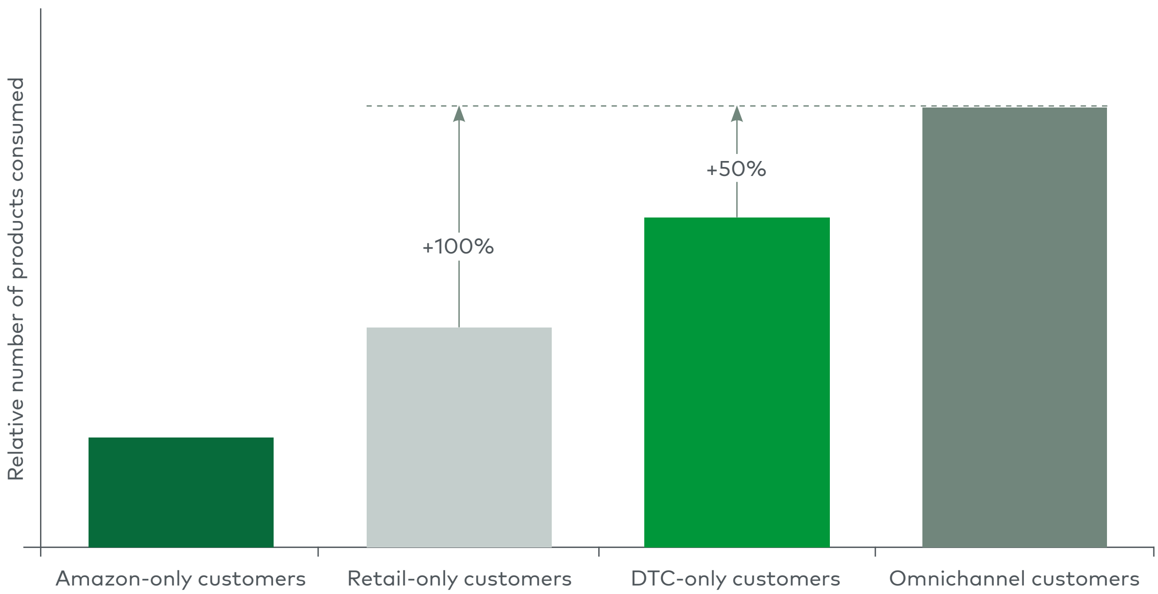
8. Channel expansion: Meeting consumers where they want to shop is vital not only to acquiring new customers but also to keeping them. And with the rise in CACs, omnichannel expansion is how DTC businesses can raise their brand profile and increase sales without having to pay for new customers. But omnichannel expansion also drives LTV, in particular by capturing diverse and complementary consumption occasions.

Consider how an online customer might stumble upon their favorite brand in a store; doing so could trigger an impulsive purchase spurred by familiarity with said brand. Conversely, a customer who when buying one product discovers another brand may then be inspired to visit that brand's website if the product's packaging invites them to do so (via QR code, visuals, etc.). The brand will then have to convert them by offering them an incentive — not simply a price promotion, but a special edition or other unique option. To that end, digitally native vertical brands have increasingly been moving toward the physical channel, either by opening their own store network (e.g., Glossier, Avril, Sézane, Warby Parker) or by retreating from their

Recent research conducted by L.E.K. for one of its clients looked at the impact of omnichannel on the LTV of customers. It showed that the omnichannel model enabled a net improvement of the LTV:CAC ratio of up to 2x. This positive impact is the result of two main parameters: LTV improvement due to an increase in the average spend per customer (see Figure 4) and higher loyalty, and CAC reduction via the dilutive effect of the investments made through increased customer acquisition.

This research was the result of a collaboration with the client's digital marketing department, using both internal data such as web analytics and customer transaction data and external data on customer behavior via a survey conducted by L.E.K., which captured differences in behavior by channel. Reconciling the different data sources is always a meticulous but very insightful task. Different scenarios were also run using attribution models to deduce the impact on the LTV:CAC ratio.

Figure 4
Declared number of products consumed per period



Note: DTC=direct-to-consumer
Source: L.E.K. research and analysis

direct-to-consumer DNA (e.g., Fenty Beauty, Huda Beauty, Ilia) so they can instead be found only through selective distribution or other channels. This move reinforces the idea that there is incremental value to be found for DTC businesses in expanding channels.

When it comes to understanding the impact of channels on customer behavior and monitoring the business, data is essential. Every marketer knows the limitations and related headaches of attribution models when the customer journey contains different digital touchpoints. They also know all too well the near impossibility of tracking an omnichannel customer journey, which is why we are increasingly seeing the emergence of customer journey orchestration tools.

9. Reactivation: Shifting the mindset from capturing new customers to retaining existing customers is critical given the cost of customer acquisition and that extending the life of a customer is vital for LTV. Reactivating lapsed customers through well-placed email or SMS reminders and exclusive reactivation promotions can be a key lever in increasing retention. The benefit of this group is they have bought before, so they understand the proposition and are likely to have a higher return on investment (ROI) compared to new customers. And DTC businesses already have data on them. So, segmenting the lapsed customer group and treating them differently is important. Customers who have historically been more active/valuable should receive better promotions and more bespoke communications than lower-use customers. Likewise, those who have churned for the first time (versus those who "zigzag" in and out) should receive stronger incentives.

10. Other revenue streams: DTC businesses should consider ways they can leverage the first-party data they hold to stimulate other revenue streams. A great example of this is through advertising. Advertisers are increasingly struggling to access their target customers, so spots on DTC businesses' websites can be viewed as prime real estate by brands looking to target the same set of customers. Some companies will help DTC businesses monetize those placements in ways that do not disrupt the site's consumer experience (e.g., through advertisements on the order confirmation page).

Why analytics are critical to DTC LTV success

All these tactics can have a meaningful impact on LTV. And they are measurable — in real time. Indeed, without good analytics in place, it is not possible to proactively track the success, react to any changes and test, learn and improve. Data analytics should be seen as something akin to a heart monitor: If the metrics start to slow and DTC businesses don't react by changing their proposition, it could signal imminent failure. Without such data, DTC businesses may see their top line struggling but not understand why or how to stem the loss. For too long, DTC businesses have been run on instinct alone. Now that they have data, they must be sure to use it.

For more information, please contact strategy@lek.com.

Endnotes

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