

How to determine your saas business' cost of acquisition

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Without customers, it's impossible to build a successful SaaS business. And, when you're first getting your business up and running, you might be inclined to get new customers by any means possible. In the long run, however, this can make your acquisition costs unpredictable and, more often than not, overinflated.

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If you measure the cost of acquisition against customer lifetime value, you will likely discover that the revenue earned from each customer is less than you originally thought -- or worse.

Wouldn't you rather know exactly how to budget for sales and marketing, than to just fly by the seat of your pants? Let's take a look at how to determine your SaaS business' cost of acquisition.

What is customer-acquisition cost?

Very simply, customer-acquisition cost takes into account the sales and marketing costs involved in acquiring one new customer for your SaaS business.

In general, the less you have to spend on getting an additional customer, the better. However, this isn't to suggest that there is a magic number to aim for. Acquisition costs can vary significantly from one business to another, depending on the niche and the target audience.

Customer-acquisition cost is also an important metric to help you determine whether or not you have a viable business model that can be scaled over the long haul. The higher the profits you see after expenses, the better.
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If you don't match up your acquisition cost against your customer lifetime value, it will be hard to determine whether your costs are high, low or somewhere in between. We need to take a closer look at customer lifetime value.

What Is customer lifetime value?

How much revenue do you earn from a single customer while he or she is paying for your services? When you average out that figure across your customer database, the result will be your customer lifetime value.

In this case, it's better to have a higher number. The longer a customer stays and pays for your services, the more valuable that person is to your business.

There isn't necessarily a target to hit, because customer lifetime value can vary a lot from one SaaS business to another. In general, though, your customer acquisition costs should be at or less than 33 percent of your customer lifetime value. If you aren't there yet, don't buckle, because the scale can be tilted in your favor.

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Customer-lifetime value and customer-acquisition cost ratio

When you're looking to better understand your business' cost of acquisition, there are many important to understand. But comparing customer lifetime value and customer acquisition cost gives us a much better idea of your revenue per customer.

It should be apparent that it's better to spend less and earn more, as opposed to the other way around. This can also help you determine your ROI -- the overall efficacy of your marketing strategy.

Ideally, your customer lifetime value and customer-acquisition cost ratio should be three or higher. Fortunately, neither value is fixed. Think of it as a seesaw. You can reduce costs and generate more revenue, but those efforts will require ongoing optimization.

This ratio alone can give you a better idea of your business' cost of acquisition, but there are some other important factors to keep in mind, such as churn.

What is churn?

In practically every business, customers come and go. This is called churn. Even a 5 percent difference in annual churn between two businesses could be significant, especially over the course of five, 10 or 15 years.

If you're able to keep customers for longer, you can consistently increase revenues without having to generate more business. Churn drives up customer acquisition cost and takes a toll on customer lifetime value. A high churn rate is a likely indicator that your service is mismatched to your customer's needs, and may require further development. Adding features or tweaking the software could further drive up the costs.

Most small SaaS businesses tend to have a monthly churn rate between 1 and 11 percent. As with other metrics already mentioned, the exact nature

of the business and the customers you're targeting are factors here. There is no perfect score.

The lower the churn rate, the better, but smaller businesses typically have a higher churn rate, so don't be put off by that. It can be improved upon.

Calculating your SaaS business cost of acquisition

A simple way to calculate your customer acquisition cost is by dividing the total cost of sales and marketing by the number of customers you acquired. Let's say, for example, that you spent \$10,000 to acquire 350 customers. That would make the cost of acquisition roughly \$28.57 per customer.

Customer-lifetime value is also easy to calculate -- you would simply add up the revenue earned from each inactive customer and divide it by the total number of customers.

As previously mentioned, if your customer-lifetime value and customer acquisition cost ratio are higher than or equal to three, you know that you have a viable business model on your hands.

You would still need to account for churn, because, as we already determined, a higher churn rate would be indicative of a problem with the product. It might be a mismatch with your target audience members; it might not offer the right features or benefits they want; or the solution itself might not be what they were looking for, and there are better options on the market.

Don't forget: Cost of acquisition is like a seesaw, and can be optimized.

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Final thoughts

In developing your online and offline presence, you need to realize that is key. You have to take your leads and prospects from completely unaware to most aware for your marketing and sales to be effective.

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The added benefit to reducing customer-acquisition cost and increasing customer lifetime value is that it can help your valuation. If you're interested in selling your business at some point, you will need to take a close look at acquisition cost and lifetime value. You don't need to optimize it to the nth degree to pique the interest of investors, but going through the process will be beneficial for you as well.