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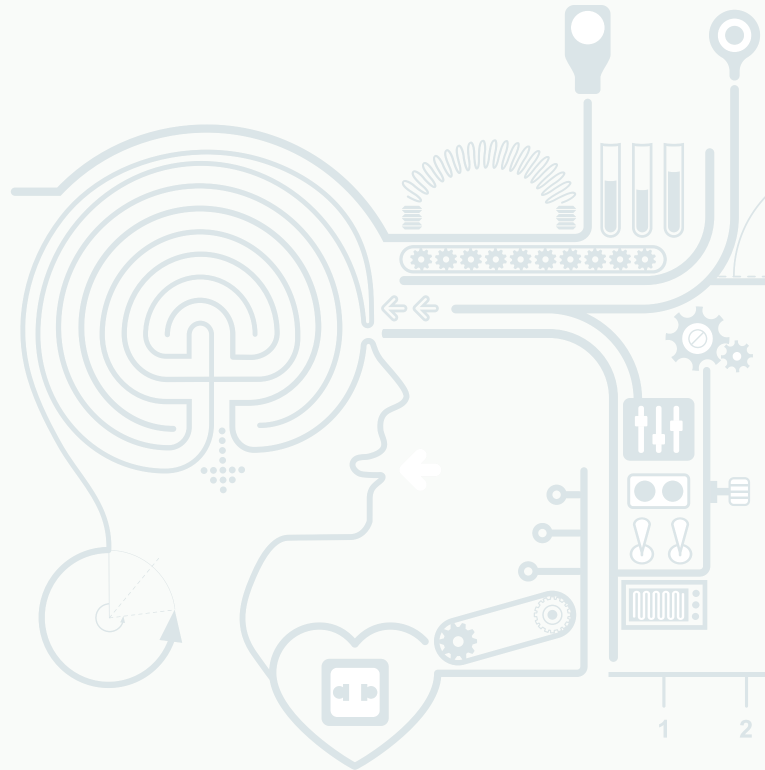

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How Much Are Your Sales Leads Really Worth?

By David Dodd

Every day, distributors make significant investments to acquire and develop sales leads. The ultimate objective is to grow revenues and profits by winning new customers. Unfortunately, these investment decisions are often made without a clear and accurate understanding of how valuable leads actually are.

When salespeople, whether owners of the company or part of a larger sales force, don't know the true value of their sales leads, they can invest too little and miss out on profitable new revenues, or they can invest too much and acquire customers who are unprofitable.

Knowing the true value of sales leads is particularly important when you are involved in long and complex demand generation cycles, such as one-to-one (personalized printing), web-to-print or multichannel marketing. In these situations, the purchase decision is the end result of a buying process that contains multiple steps and often extends over a period of months. Demand generation investments must be made to acquire new leads, and additional investments are required to move those leads through the revenue pipeline. To manage demand generation spending effectively, you need to know the value of leads at various stages of the process.

Determining the value of sales leads is a four-step process. Let's look at each of those four steps.

Step #1: Estimate Customer Lifetime Value

The first step in determining the value of sales leads is to estimate the value of a new customer or prospect. Customer value establishes the ceiling for how much you should invest to acquire that customer because new customers will contribute to *profitable* growth only if the value they create exceeds the costs you incur to acquire them. For this purpose, value means *customer lifetime value*, which can be defined as the present value of the total profits that a company expects to earn from a customer throughout the full duration of the customer relationship.

There are several methods for calculating customer lifetime value. One of the more simple formulas is: $CLV = m(r/(1+i-r))$

where CLV = customer lifetime value
m = annual gross profit
r = customer retention rate
i = discount rate

We can use a simple example to illustrate how the formula works. Suppose that your distributorship sells web-to-print (W2P) solutions to corporate customers. The average new W2P customer produces annual gross revenues of $100,000 and an annual gross profit of $30,000. Your customer retention rate for new W2P customers is 90 percent and your discount rate is 10 percent. If we insert these values into the formula, the calculation would be:

CLV = $30,000(.9/(1+.1-.9))
CLV = $30,000(.9/.2)
CLV = $30,000(4.5)
CLV = $135,000

On these facts, therefore, each new W2P customer you acquire is worth $135,000 to your company.

Step #2: Calculate the Maximum Allowable Investment

As noted earlier, the value of a new customer sets the ceiling for how much you can spend to acquire that customer without diluting company profits. However, when customer acquisition costs are equal to customer lifetime value, you will not earn a return on your acquisition investment. Therefore, it's important to determine how much you can spend to acquire a new customer *and* earn an acceptable return on your acquisition investment. We can call this the *maximum allowable investment*.

The formula for calculating the maximum allowable investment is:
Maximum allowable investment = CLV/(1+ROI Threshold)

In this formula, CLV is the customer lifetime value, and ROI threshold is your minimum acceptable ROI on demand generation investments. If we assume that your ROI threshold is 15 percent, the maximum allowable investment would be calculated as follows:

Maximum allowable investment = $135,000/(1+.15)
Maximum allowable investment = $135,000/1.15
Maximum allowable investment = $117,391.30

So, in this example, the most you should spend to acquire a new W2P customer is approximately $117,000.

Step #3: Identify Lead Stages and Conversion Rates

The next step in the process is to decide what lead stages you want to use in your lead value model and identify the rates at which leads convert from one stage to the next. To be clear, the "lead value" we are calculating is equal to the maximum amount that a distributor should spend to acquire or develop a sales lead at a given lead stage. With this approach, the value of a lead is a function of two factors: the maximum amount you should spend to acquire a new customer and the rate at which leads at a given stage convert to become customers.

To illustrate this process, let's add some facts to the previous example. Distributors define lead stages in a variety of ways, but one of the most widely used frameworks is the demand waterfall developed by marketing and sales research firm SiriusDecisions. We'll assume that our hypothetical distributor uses this framework to describe its lead stages. The table below shows the major stages that are included in the SiriusDecisions framework.

This table also shows the rates at which leads "convert" from one lead stage to the next. These conversion rates were developed by SiriusDecisions, and they describe the conversion rates of an average performing B2B company. The table shows that 4.4 percent of inquires will become marketing qualified leads, 66 percent of marketing qualified leads will become sales accepted leads, 49 percent of sales accepted leads will become sales qualified leads, and 20 percent of sales qualified leads will become new customers. Your conversion rates will differ those shown in the table, and it's critical to use your rates for calculating the value of your sales leads.

Step #4: Calculate Lead Value

The final step is to calculate lead value. To do this, you first need to determine how many leads are required at each of your lead stages to produce one new customer. These amounts will depend on your lead conversion rates.

Lead Stage	Conversion Rate	Required for One New Customer	Lead Value
Inquiries	04.4%	351.4	$333
Marketing Qualified Leads	66.0%	15.5	$7,588
Sales Accepted Leads	49.0%	10.2	$11,466
Sales Qualified Leads	20.0%	5.0	$23,400
New Customers		1.0	$117,000

For example, the above table shows that the conversion rate for sales qualified leads to new customers is 20 percent. Therefore, it takes five sales qualified leads to result in the acquisition of one new customer (1/0.20). Likewise, the table shows that the conversion rate for sales accepted leads to sales qualified leads is 49 percent. So, it takes 10.2 sales accepted leads to produce five sales qualified leads (5/0.49). This also means that it takes 10.2 sales accepted leads to produce one new customer.

Once you've determined now many leads are required at each lead stage to produce one new customer, calculating the lead value is easy. You simply divide your maximum allowable investment for one new customer by the number of leads required to produce one new customer. As the above table shows, the value of sales leads for our example distributor are as follows:

Sales Qualified Leads = $23,400 ($117,000/5)

Sales Accepted Leads = $11,466 ($117,000/10.2)

Marketing Qualified Leads = $7,568 ($117,000/15.5)

Inquiries = $333 ($117,000/351.4)

This model clearly demonstrates that leads increase significantly in value as they move through the demand generation pipeline. In our example, a late-stage sales qualified lead is about 70 times more valuable than an early-stage inquiry. This dramatic increase in value provides strong justification for investing in effective lead nurturing programs that will move prospects through the pipeline.

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