Customer Acquisition Cost (CAC): A guide for 2024

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The "growth at all costs" mantra is starting to fall flat. This mentality seemed to grow out of the startup age, when we would see freshly founded companies rapidly reach unicorn status – their valuations stretching into the billions.

But in the last few years, we've seen the emphasis on growth start to steer companies wrong – if they weren't also focusing on scalable, cost-effective operations. The VC firm, Fuel Venture Capital, [warned as much back in 2020](), in the early stages of the Covid-19 pandemic. They noted how businesses wrongly saw growth as a synonym for profitability, and that, *"if you really want to succeed, efficiency is the name of the game."*

The same is true for more established businesses and enterprises. At the moment, everyone is grappling with the threat of a recession, a bottlenecked supply chain, and trimmed-down budgets. Companies are scrambling to operate in a more efficient way, which means one of their top priorities should be looking at how they can acquire high value customers – and knowing how much it should cost them.

In this guide, you'll learn what a customer acquisition cost (CAC) is and how to calculate it. You'll read about what makes a good CAC, and what an LTV:CAC ratio is. Lastly, you'll find out how to reduce customer acquisition costs and improve your LTV:CAC ratio.

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What is Customer Acquisition Cost (CAC)?

How much money do you spend to win a new customer? That’s the question that Customer Acquisition Cost (CAC) answers. CAC is a measure of all the money you spend on sales and marketing to acquire each new customer.

Businesses track CAC to help identify their most profitable customer segments, determine which acquisition channels yield the most return on investment (ROI), project marketing budgets, and assess the viability of their business models. You answer these questions by comparing CAC to other business metrics like customer lifetime value (more on that later).

The CAC formula + how to calculate it

To know your CAC, add your sales and marketing expenses, then divide the sum by the total number of customers you acquired. Businesses typically calculate CAC on a quarterly or yearly basis.

$$\text{CAC (Customer Acquisition Cost)} = \frac{\text{(Sales costs + marketing costs)}}{\text{Number of Customers Acquired}}$$

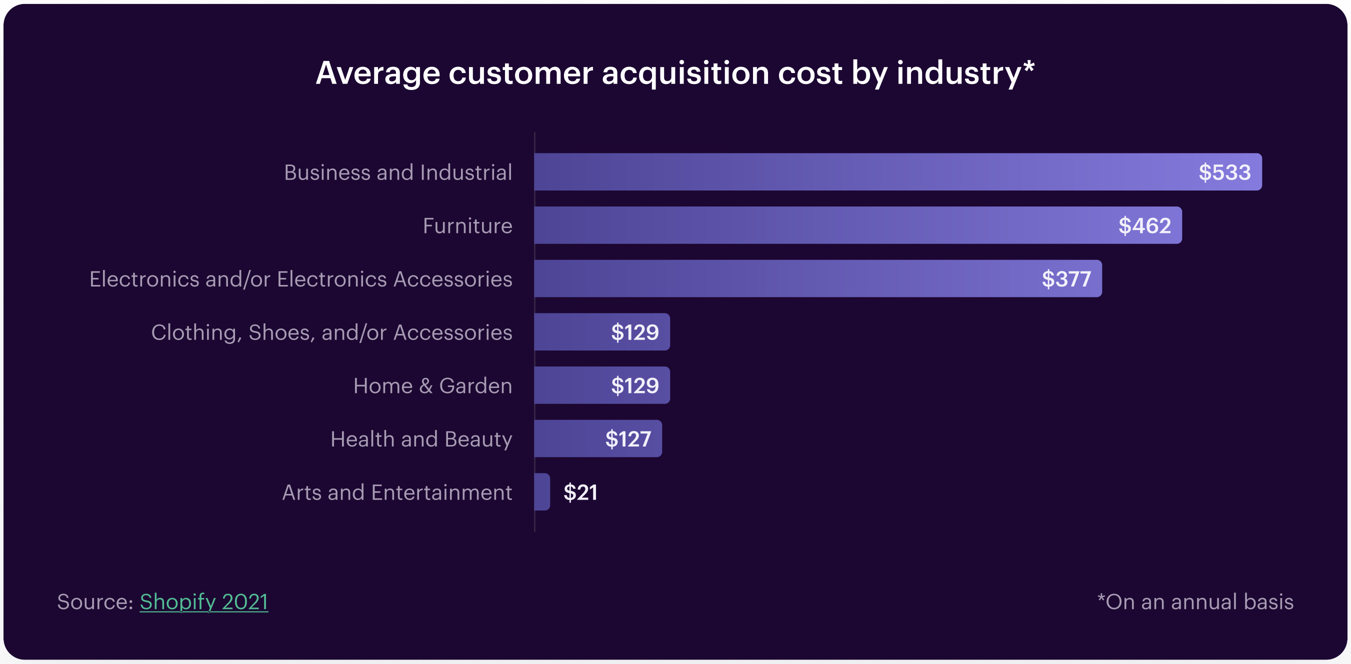
Sales and marketing costs include:

- Employee salaries
- Production costs (e.g., cost of producing articles, videos, email campaigns, and events)
- Software costs (e.g., marketing automation software, analytics tools, customer data platforms)
- Paid media and publishing costs (e.g., Google Ads, sponsored content in a magazine, influencer promotion)

Say you spent $11,000 on sales and $13,000 on marketing from May to July – that’s a total expense of $24,000. In that same quarter, you acquired 1,000 customers. Divide $24,000 by 1,000, and you have an average CAC of $24 per customer.

What makes a “good” CAC?

To know if your CAC is a “good” number, compare it with industry benchmarks. In 2021, Shopify surveyed 270 e-commerce business owners across various verticals to find out their average CAC. Here’s what they found:



Consider other business factors, too. If you’re a startup, you’ll have a high acquisition cost as you’re still setting up operations and establishing your brand. As you grow, you may gain more customer referrals or start to see the impact of previous campaigns (e.g., SEO, gated content, and so forth) which can all help lower acquisition costs.

Also, consider the price of your products, your sales cycle, and business model. For instance, a CAC of $1,000 sounds high, but not if you expect a customer to take an annual subscription worth $800 a year for the next four years. In contrast, a single-digit CAC isn’t great if your marketing strategies only yield customers who quickly churn. That’s why you don’t stop at simply knowing your cost of acquisition – you go a step further by calculating your LTV:CAC ratio.

What is an LTV:CAC ratio?

An LTV:CAC ratio is an important metric that compares how much you spend to win a customer compared to how much they're expected to spend with your business in their lifetime (i.e., customer lifetime value or LTV). An oft-cited rule of thumb – particularly for growing SaaS companies – is for the LTV to be 3x your CAC, which means an LTV:CAC ratio of 3:1.

LTV – also known as CLV (or customer lifetime value) – is the product of three factors multiplied together:

$$\text{LTV} = \text{Average value of purchases} \times \text{Average number of purchases per year} \times \text{Average customer lifespan in years}$$

You get your LTV:CAC ratio by dividing lifetime value by acquisition cost.

$$\text{LTV:CAC Ratio} = \frac{\text{Customer Lifetime Value}}{\text{Customer Acquisition Cost}}$$

Let's say your customers spend $20 on average, twice a year, for two years. That's an LTV of $80 ($20 x 2 x 2).

Divide $80 by your CAC of $24 from our previous example, and you get 3.33, or an LTV:CAC ratio of 3.33:1. That is, for every dollar you spend to acquire a customer, that customer spends $3.33 on your business.

What your LTV:CAC ratio tells you:

An LTV:CAC ratio of less than 3:1 means you're spending too much to acquire customers who don't spend enough on you. Your sales and marketing ROI is low, and you need to examine your strategies to find what should be fixed. Problems that lead to a low LTV:CAC ratio include:

- Overuse of expensive acquisition channels
- Failure to identify and attract a high-value customer segment
- Unconvincing messaging
- Wrong pricing strategy
- Too-high overhead costs

In contrast, if your LTV:CAC ratio is too high – say, more than 5:1 – you may be spending too little on sales and marketing and missing out on an opportunity to capture a larger market share.

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"[Customer Acquisition Cost] needs to be measured in relation to customer lifetime value. This has become a top priority for CFOs as the digitization of business has forced businesses to build direct relationships with their customers."

Khozema Shipchandler
COO, Twilio

Source

How to reduce CAC and improve your LTV:CAC ratio

Many marketers in 2022 have found that it's getting more expensive to acquire customers. In a survey conducted by CommerceNext in December 2021 and January 2022, 57% of retailers identified rising customer acquisition costs as a threat to their sales goals for the year. Another research study, conducted by social commerce platform SimplicityDX, revealed that eCommerce brands are losing $29 on average for every customer they acquire. Even direct-to-consumer brands that have attained cult status or gone public have crumbled beneath the weight of a CAC that keeps costing more dollars.

Tougher competition and privacy safeguards – including the phaseout of third-party cookies – are driving CAC up, especially for digital advertising. To balance out these costs, focus on the factors you can control.

Focus on lower-cost channels

While you can't control what channels your customers prefer, you can decide how much you spend on each channel. Use the most effective, low-cost channel for your product to reduce CAC and get more ROI for every marketing dollar you spend. The matrix below shows variables to consider alongside cost when choosing a customer acquisition channel:

Startup Inc Channel Matrix

	Cost	Targeting	Control	Input Time	Output Time	Scale
Perfect World	Low	High	High	Low	Low	High
Email	Low	High	High	Low	Low	High
SMS	Low	High	High	Low	Low	High
SEM	Medium	High	High	Low	Low	High
SEO	Low	Medium	Low	Medium	High	High
Viral	Low	Low	Medium	High	Medium	High
Sales	Very High	High	High	High	High	High

Channel value depends on business. For example, SEO input time could be high for one business and low for another depending on how competitive the terms are.

Channel matrix overview adapted from Brian Balfour's 5 Steps To Choose Your Customer Acquisition Channel

This advice comes with a caveat: Divert more marketing campaigns to lower-cost channels *only if it makes sense to do so*. One way to determine the most suitable channels to use is to figure out product-channel fit, a concept introduced by marketer Brian Balfour.

For example, a product made for B2B companies that comes with a high learning curve wouldn't be a great fit for viral marketing because it takes a lot of time to explain and probably serves niche segments. It will require lots of educational articles and videos, so you'll want to engage potential customers through SEO, email, and webinars.

Compared to B2B campaigns, an ad for a B2C product has a bigger chance of going viral. Think of Dollar Shave Club's tongue-in-cheek launch video, which spread so fast that the company's server crashed within an hour, and the company got 12,000 orders within two days. (Here's where to watch the video. Imagine their LTV:CAC ratio in those first few days!)

Paid vs. organic acquisition channels

You can categorize customer acquisition channels into two types: organic and paid. Organic methods, like content marketing, sending email newsletters, or running SMS loyalty campaigns are free (more on that below). Paid channels cost money, such as running ads on Facebook or having a sponsored placement in someone else's newsletter.

Of course, using organic channels is not entirely free because, like paid ones, they have operational costs. You'll often have to pay people to execute your acquisition strategy and equip them with the right tools to get their jobs done.

Paid vs. organic lead quality

Organic acquisition channels slowly drive a lower volume of higher quality leads. In contrast, paid acquisition channels quickly drive a higher volume of lower-quality leads. As a result, paid strategies are better for short-term growth spurts, while investing in organic approaches pays off long-term.

Should you go broad or deep?

Marketers have two choices for spending money on their acquisition channels: going broad by investing a little in many channels or going deep, focusing most resources on just one or two. Ideally, you'd do both, but that's not always an option. So, you'll need to choose.

Going broad allows you to reach more prospects and control your brand's messaging across many channels. But it also limits your team's attention and resources as you scatter them across many initiatives.

Going deep lets you become well-known on one or two channels, leaving a lasting impact on followers there. However, you may end up reaching fewer prospects and can lose ownership of your brand's presence on other channels. Most growth experts recommend going deep.

Optimize your funnel to improve conversion

Find out which parts of your marketing funnel are effective at converting leads and which parts you need to improve. Begin by mapping out the steps your prospects take in their journey to becoming customers. You do this by interviewing customers, getting Google Analytics data on how people navigate your website, gathering email and social media marketing data, or trying out the prospect's experience for yourself – for example, browsing your site and pretending to be a customer.

Next, gather data using your analytics platform on how many people get to each step – and identify the steps that have the largest drop off. Heatmaps, surveys, testing for bugs, and segmenting customers by referring channel can all help provide insight into why people leave. Once you know what's wrong, A/B test a solution and implement the one that's most effective in reducing drop-offs.

The process described above can be complicated, but if you're keen to try it out, you can consult this step-by-step guide on removing the funnel bottlenecks that are killing your conversion rate.

Target leads who are likely your best customers

Figure out which customer segments are your best customers – the ones who will potentially meet your minimum LTV requirements based on your target LTV:CAC ratio and the ones who will like your product so much that they will recommend it to others.

To find these people, dig into your customer data. Find traits common to customers who fit your criteria – for instance, customers who purchase from you at least 3x a year, spend at least $100 a year, or share referral codes with their friends. Next, set up a lookalike audience on an ad platform like Facebook to find and target prospects who exhibit the traits that you've identified. That way, you have a higher chance of acquiring a high-value customer and offsetting your ad spend.

Discovering your best customers' common traits is easier when you use a customer data platform (CDP) like Segment. A CDP is a centralized database for all your customer data, which may come from multiple sources. A CDP can identify the same customer across many channels and create a unified profile for that customer. It then identifies shared attributes to help you define your customer segments.

There are additional benefits to adopting a CDP. Businesses using CDPs report almost 2x higher customer satisfaction levels than those without a CDP, according to The Growth Report 2022. And 1 in 3 organizations say they've seen faster revenue growth as a result.

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The Growth Report 2022

Harness automation to target more leads

As your business grows, you'll find it more challenging to scale manual sales and marketing tasks like creating lead scores, sending personalized emails, and determining marketing attribution. Use marketing automation tools to scale routine tasks and repetitive workflows so that manual tasks will take up less of your marketing efforts and costs. You'll get a larger number of leads faster, too, by automating ad retargeting, email campaigns, landing page optimization, lead scoring, and other tasks.

For a deeper, more nuanced understanding of CAC and how to improve it, read our ebook, The Fundamentals of Customer Acquisition.

How Twilio Segment can help

Twilio Segment helps businesses identify their best customers and discover that customer segment's shared traits. Marketers can then use those traits to refine their ad targeting criteria by creating lookalike audiences. Learn how Twilio Segment helped **Vervoe** decrease its customer acquisition costs by 25% using more personalized ads.

With Twilio Engage's growth platform, marketers are empowered with real-time customer data to build and optimize hyper-personalized marketing campaigns on every channel for customer acquisition, conversion, and retention. Find out how retailer **Veronica Beard** built omnichannel experiences and decreased customer acquisition costs by 20%.

What's more, Twilio Segment allows businesses to make data-driven decisions faster by gaining visibility into data insights without relying on other teams so they can make smarter decisions and invest their budget more wisely. Learn how **Domino's** used first-party data powered by Twilio Segment to decrease cost per acquisition by 65%.

Schedule a demo to learn how to get the most out of your customer data with Twilio Segment

Want to learn more?

The Ultimate Guide to Customer Retention

This guide shows how to avoid rising acquisition costs by focusing on customer retention and strategies to increase customer engagement.

Download the ebook >

The Fundamentals of Customer Engagement

This guide breaks down the three types of customer engagement, and discusses key strategies and best practices to build lasting relationships.

Download the ebook >

The Customer Data Platform Report 2022

This report provides an in-depth look into how customer data is powering our daily lives, noting major consumer and business trends over the past year.

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