

# The Agitator

## GUIDE TO CALCULATING INVESTMENT COMPARISONS

There are two figures you need to draw the comparison between your organization's 'conventional' returns on its investment portfolio and the returns on your 'fundraising investment':

- 1) The average annual rate of return for the reserve/endowment fund over a five year period.
- 2) And the average annual rate of return on your fundraising investment.

You can probably get item 1) from the annual report or from your CFO.

To calculate the return on the fundraising investment you'll have to first determine the average five year Life Time Value of your Donors.

### **IMPORTANCE OF LIFETIME VALUE AND HOW TO CALCULATE IT.**

The Lifetime Value calculation will tell you how much income you can expect from a particular donor or group of donors. Knowing this will help you decide how much you're willing to spend to "acquire" those donors for your organization in the first place.

#### **The Simplest Way to Estimate Lifetime Value.**

There are a variety of ways, some simple, some more complex, to calculate Lifetime Value. For now let's keep it simple. Put the actual or estimated numbers into the following equation:

**(Average Value of a Contribution) X (Number of Repeat Contributions) X (Average Retention Time in Months or**

**Years for a typical donor) = Gross Lifetime Value. (You can arrive at the Net Lifetime Value by deducting the costs of soliciting and servicing the donor over the period of time you're measuring.)**

If you would prefer to do the calculation online there are several free calculators available. We recommend the one from Harvard Business School which you can find at this link:

<https://cb.hbsp.harvard.edu/cbmp/resources/marketing/multimedia/flashtools/cltv/index.html>

An easy to understand, non-fundraising example of the Lifetime Value concept is that of a gym member who spends \$20 every month for 3 years. The value of that customer would be:  $\$20 \times 12 \text{ months} \times 3 \text{ years} = \$720$  in total revenue (or \$240 per year). You can see even from this example why many gyms offer a free starter membership to help drive traffic. Gym owners know that as long as they spend less than \$240 to acquire a new member, the customer will prove profitable in a relatively short amount of time.

To put it in fundraising terms assume a hypothetical organization has a 200% "cost of fundraising" in its acquisition campaign. Let's also assume the organization enjoys a 5 year Gross Donor Lifetime Value of \$300.

(To arrive at the Net Lifetime Value you'll have to subtract the costs of donor care—sending appeals, communications, and database maintenance) from the \$270 gross revenue.)

When you look at the acquisition investment using Lifetime Value you'll see that instead of 'losing' \$30 per donor the acquisition effort actually produced a valuable asset worth \$270 per donor in income over the next 5 years. That's a 55% compound annual growth rate on that acquisition investment. Far better than the organization is probably getting from the 1.5% Certificates of Deposit in its endowment. Happy CFO. Happy CEO. Happy Board.

### **Calculating Compound Annual Growth Rate**

Compound Annual Growth Rate is what is generally used to measure return on stocks and bonds and that's what we're recommending you use for your comparative analysis.

Make it easy on yourself just use the calculator found at this link:

[http://www.moneychimp.com/calculator/discount\\_rate\\_calculator.htm](http://www.moneychimp.com/calculator/discount_rate_calculator.htm)

The calculator will ask you to enter "Present Value". Type in the amount you've invested to acquire that new donor. For example the \$30 we used in the illustration above.

Next it will ask you to enter the "Future Value". That's where you use the five year Lifetime Value. For example the \$270 in the illustration above.

Next the calculator requests the number of years. Using the illustration above you'd enter "5".

Finally, click on "Calculate". In our illustration you'll see it's a 55.1% Compound Annual Growth Rate.

NOW...start thinking of the raise you should ask for when you show the CFO the paltry 1.4% the Investment Committee is getting compared to your 55.1% !

### **Using This Information to Deal with "High Cost of Fundraising" Arguments**

There's no question in our minds that a great deal of the furor over the 'high cost of fundraising' on the part of the watchdog groups, the press, regulators and many nonprofits themselves stems from absolute ignorance about what "acquisition" is, how it should be measured, and when or whether its costs should be considered acceptable.

Because the acquisition of new donors is essential to maintaining and growing virtually every organization we all need to get much better at both understanding and explaining this essential process.

The alternative is continued ignorance on the part of some watchdogs, implied scandal on the part of the press, panic and finger pointing in the boardroom, and angry, turned-off donors.

Roger and Tom

P.S. Send us your questions about this Agitator Guide or your suggestions for improving it to [editors@theagitator.net](mailto:editors@theagitator.net)

