

A Fresh Approach to using Lifetime Value Analysis as a Donor Recruitment Tool

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Introduction

Charities in the UK and elsewhere spend large sums each year on the recruitment of new supporters to their cause. Expenditure on fundraising and publicity for the top 500 UK fundraising charitiesⁱ in 2002 was over £700 million. A very conservative estimate would be that at least one third of that expenditure was on recruiting new supporters, or over £200 million.

In recent years, UK charities have spent very large sums on recruiting new donors giving through monthly direct debits. In 2004, one technique alone, direct dialogue fundraising (asking individuals to sign monthly direct debit mandates on the street or door to door) recruited over 600,000 new donors to UK charities at a total cost of over £50 millionⁱⁱ.

Expenditure on donor recruitment thus represents a significant investment for many charities. In the majority of cases, these investments will not produce a positive return for many months, if not years. In the light of this, it is perhaps surprising that the tools used by the majority of fundraisers to measure the profitability of donor recruitment activities are so crude.

In the author's experience, many donor recruitment investment decisions in UK charities have been made using very simplistic tools, not infrequently provided by a marketing agency being used by the charity to carry out the recruitment campaign (who may have an interest in the campaign going ahead). These tools rarely provide more than a crude estimate of likely future income from donors recruited by the campaign and they very infrequently allow for all the costs involved in servicing and developing relationships with the recruited donors. Issues such as donor attrition, upgrade propensity, reactivation rates, inflation and discounting of future cash flows are often dealt with simplistically or ignored altogether.

The consequence is that many charities have found returns from donor recruitment activities to be significantly lower than they had originally anticipated with all kinds of repercussions for the charity and its future operations.

A minority of charities, mostly but not exclusively the very largest, use significantly more sophisticated investment models. The problem these organisations have is a different one, the investment models are much more soundly based but they are so complex that they require specialist data analyst

staff to operate them and interpret their results.

Charities need better tools than are currently available to them to inform investment decisions on donor recruitment. Such tools need to be able to predict future income streams from new donor recruitment and to calculate real terms return on investment. The tools need to be able to be utilized by fundraisers who are not statisticians or accountants but they need to be robust enough to withstand scrutiny from financial experts. As well as the tools, however, fundraisers need to understand the issues that have a significant bearing on the profitability of new donor acquisition activity and spend their times and money on improving the performance of those areas.

Current methods of evaluating investment on new donor recruitment

At the risk of oversimplification, there are essentially two major approaches to recruiting new individual donors used currently by UK charities. Each approach can be used in a wide variety of different media and it is common for charities to use both approaches at different times and in different places.

Recruiting donors through a recruitment channel that asks for a single gift. This is called “cash donor recruitment”.

Recruiting donors through a channel that asks for a regular gift (usually a monthly direct debit or standing order). This is called “regular giving recruitment”.

The two approaches are not exclusive. Typically, charities will have conversion programmes for cash donor recruitment campaigns to convert cash donors to regular giving. Equally, regular giving recruitment campaigns frequently also recruit cash donors.

Despite the overlap between the two recruitment approaches, most UK charities will use different tools to judge the effectiveness of each.

Cash donor recruitment

A typical cash donor recruitment campaign will be analyzed using something like the following combination of variables:

Initial return on investment. Simply immediate revenue from the recruitment campaign divided by initial cost of recruitment. Properly speaking this is a simple cost/ income ratio rather than a real return on investment calculation.

Cost of acquiring each donor. A net donor acquisition (NDA) cost is typically given to each donor recruited. This is, again, a simplistic calculation of immediate income from the activity divided by immediate cost. This can be viewed as a crude guideline at best.

Regular giving donor recruitment

For regular giver recruitment, it has become common to use a completely different method of evaluating investment in donor recruitment and predicting future income flows. This essentially takes the value of new donors recruited and spreads the payments out in a spreadsheet on a monthly (or more crudely an annual) basis. An overall figure can therefore be calculated for return on investment based on $(\text{total income over } X \text{ years})/(\text{recruitment cost})$.

Such an approach typically makes provision for donor attrition (although not necessarily to a high enough level). It rarely takes into account such factors as the cost of servicing the donor, upgrade rates, lapsed re-activation rates, inflation and the discount rate.

The use of two different approaches to evaluating donor recruitment performance for cash and regular giving campaigns makes producing a single overall analysis difficult. Campaigns that include a combination of cash and regular gift recruits are also difficult to analyse.

Lifetime value calculationⁱⁱⁱ.

In principle, donor lifetime value (LTV) analysis offers the best available approach to determining the profitability of different forms of new donor recruitment. LTV analysis is used by a number of, generally, larger UK charities.

Lifetime value is the total net contribution that a donor generates during her/his lifetime on the donor list.

Sargeant and Jay define donor lifetime value as follows^{iv}:

*LTV = the net contribution by each donor each year * the expected duration of the relationship in years * the discount rate.*

A number of charities carry out lifetime value analysis and use the result of such analysis to make decision on the relative profitability of donor recruitment sources.

There are a number of problems with using this analysis as the basis for investment decisions in donor recruitment.

Firstly, this analysis is most commonly carried out on a relatively infrequent basis. The calculation can be cumbersome to perform on a typical charity database, particularly when costs and income are recorded on separate systems. Income is often held on a fundraising database, while costs reside on a corporate finance system and links between the two systems may be rudimentary (it is surprising how inadequate the management information systems used to support the

fundraising activities of even some major UK charities can be). Where the information is available, specialist data analysis staff are often needed to run the necessary calculations.

These problems can result in LTV figures being used which are quite old and do not allow for changes in many of the factors that determine them in the intervening period.

There is also the issue of comparability. The author attempted to use lifetime value to determine acquisition allowances for different donor recruitment sources several years ago for Sight Savers International^v. The problem he faced was that a number of recruitment sources had been in use for less than two years so meaningful comparisons of lifetime value with other sources were very difficult. New donor recruitment can be a dynamic area with new methods being introduced and results from existing methods varying widely from year to year. Historic life time value calculations can be seriously misleading as a guide to future performance.

Towards a new approach

The complexity of currently available approaches to lifetime value analysis when combined with the relative paucity of fundraisers with strong statistical skills has meant that many charities are currently only using the crudest analytical methods to inform investment decisions in new donor recruitment.

Even where more sophisticated methods are in use, there is a lack of standardization in approaches. Two organisations are unlikely to include the same variables, calculated in a uniform way to determine donor profitability.

Fundraisers need tools that will help them apply lifetime value considerations to daily decisions about fundraising investment.

It would be beneficial to have a single approach to evaluating all new donor recruitment investment decisions. This would ensure that all investments were judged by a common set of criteria allowing charities to make properly informed judgments on where to spend their investment money.

The objective is to create a model for determining expected return on investment of a particular donor recruitment activity that will calculate a predicted return on investment over 5 years.

The model is intended to be dynamic with the ability to deal with changes in key variables over time. Effective use of the model will depend on variables being regularly updated with the most current values.

The model is intended to be relatively simple to use and to requires no special

skills to implement. This inevitably means that some compromises between precision and ease of use need to be made.

Determining key variables

Analysis of past and current donor recruitment campaigns allowed the author to identify a total of 37 separate variables that potentially can have a material impact on the return on investment of a donor recruitment activity.

The impact of each variable on the profitability of a donor recruitment campaign depends upon the value of each which will vary by organisation, by donor recruitment source, by campaign and over time.

The variables have been divided into six categories:

Table 1: Categories of variables used for return on investment model.

Category	Includes
Recruitment	The costs of the original donor recruitment campaign, immediate gift values, numbers and value of each type of donor recruited
Loyalty	The proportion of both cash and regular gift donors who don't give again or who stop giving and at what point.
Additional giving	Subsequent (non regular) gifts from donors including the costs of all communications including appeals and newsletters and donation processing costs.
Gift Aid	The proportion of donors who Gift Aid their donations
Telemarketing	The proportion of donors contacted by telephone and asked to convert, upgrade or reinstate their gifts. The cost of this activity and proportion and values of donors responding by type
Inflation & discount rate	What annual inflation rate and what discount rate will be used for future year cash flows

Recruitment

How much it costs to recruit a donor and the level and type of gift that are taken out at a point of recruitment are major determinants of donor profitability.

Analysis of donors recruited through face to face (direct dialogue) fundraising for a third world development charity revealed that 80% of the total costs incurred by the charity on these donors over a five year period was accounted for by initial donor recruitment costs (see table 1 below). 8% of costs were accounted for by donation processing expenditure and 4% each for mailing costs and telemarketing costs. Clearly, an increase or decrease in recruitment costs per donor will have a proportionately much greater impact on ROI than a variation in donor servicing or communication costs.

Table 2: Sample costs as a proportion of total for an individual regular giver over 5 years

Cost	% of total
Recruitment costs	80%
Mail communication costs	4%
Telemarketing costs	4%
Donation processing costs	8%

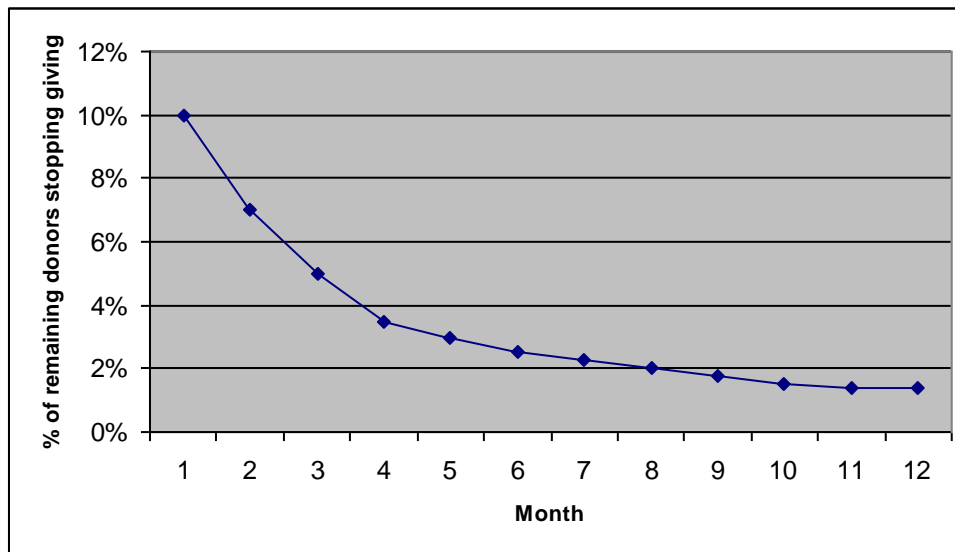
Gift values at the point of recruitment are also very significant. On a sample direct dialogue (face to face) campaign (which only recruits regular givers), a 10% increase in regular gift value at point of recruitment led to a 9% improvement in overall five year return on investment for the campaign. Likewise size of initial cash gift has a substantial impact on campaign profitability because even for one off gifts, initial gift value is a very good predictor of future giving levels.

Loyalty

The proportion of donors who do not give again (donor attrition) has a major impact on profitability. For regular givers this is the rate at which donors stop giving and when. What is important is not only how many donors stop giving but at what point they stop.

Chart 1 shows a typical attrition profile for regular givers recruited through a technique such as direct dialogue fundraising.

Chart 1: Attrition profile for a direct dialogue fundraising campaign (first year)



Donors stopping in month 1 or 2 are going to have a bigger impact on profitability than donors stopping in month 8 or 9. To determine profitability it is necessary to calculate not only an attrition rate (a percentage rate for the year) but an attrition profile (at what point in the year do donors stop giving).

For single gift donors, loyalty is as important but expressed somewhat differently. A significant number of responses to a donor recruitment campaign will not be available for adding to a database for future activity. These include anonymous responses and responses where the donor insists on no further contact. Some will be responses from people already on the supporter database. The efficiency of a donor recruitment method in producing new donors who are available for further contact will be a significant variable.

Many people who will respond to a donor recruitment campaign with a single gift will not give again, ever. The proportion of single gift donors giving again needs to be factored. Of those who do give again, a proportion will each year stop giving. This needs to be allowed for.

Additional giving

The responsiveness of both single gift donors and regular gift donors to subsequent appeals is important. Number of appeals, response rates and average gift values will be very significant for single gift donors, less so for regular givers who may receive fewer cash appeals and/or respond less well to them.

The costs of servicing a donor relationship including communications such as appeals and newsletters and donation handling costs also need to be allowed for. As discussed above, these are likely to have only a relatively small impact on overall profitability in most circumstances.

Gift Aid

Gift Aid in the UK allows charities to increase the value of a donation to them by 28%. The proportion of donors taking out Gift Aid declarations can thus have a significant impact on the profitability of donor recruitment campaigns.

Telemarketing

Telemarketing is widely used by charities to upgrade regular givers, to persuade cash givers to take out regular gifts and to reactivate lapsed donors. These activities can have a significant impact on overall profitability. These activities can also be undertaken by other media such as mail and email. Telemarketing is likely to have a higher response rate but also a much higher unit cost than the other techniques and thus its success or otherwise is likely to be a more significant determinant to overall profitability.

Inflation and the discount rate

It is important to transfer future income and expenditure streams in the model

into today's values to undertake a meaningful analysis. The model therefore allows for an inflation rate and a discount rate to be applied to all figures.

The full list of variables is as follows:

Table 3: Full variable list for the donor recruitment ROI model

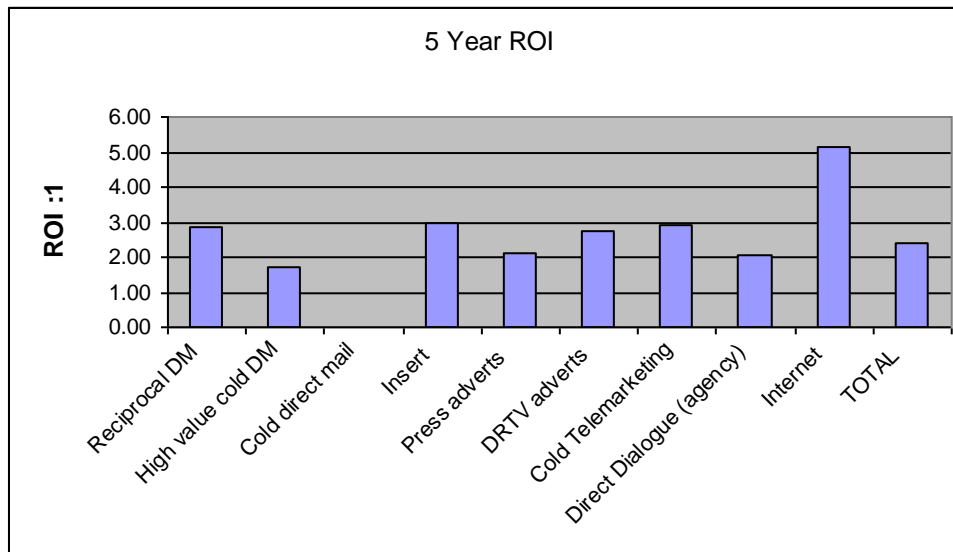
Variable number	Category	Variable	Description
1	Recruitment	No of cash	<i>How many cash donors will the campaign recruit</i>
2	Recruitment	No of RG	<i>How many regular gift donors will the campaign recruit</i>
3	Recruitment	Recruitment cost	<i>What is the total cost of the initial donor recruitment campaign</i>
4	Recruitment	Cash amount	<i>What is the value of cash gifts produced by the campaign</i>
5	Recruitment	RG amount	<i>What is the annual value of all the regular gifts produced by the campaign</i>
6	Recruitment	RGs/month	<i>How many regular givers will be recruited each month</i>
7	Recruitment	Cash/month	<i>How many cash givers will be recruited each month?</i>
8	Recruitment	Average RG	<i>What is the average value per annum of new regular gifts from the recruitment activity</i>
9	Loyalty	% new	<i>What proportion of ad hoc gift responses to donor recruitment campaigns are not mailable new donors</i>
10	Loyalty	Cash attrition	<i>Of those who give again what proportion each month stop giving</i>
11	Loyalty	RG attrition	<i>What proportion of monthly regular gifts fail to make each monthly payment</i>
12	Additional giving	Cash comms no	<i>What is the average number of mail communications a cash donor receives from you a year</i>
13	Additional giving	Cash RR	<i>What is the average response rate to all mail communications to cash donors</i>
14	Additional giving	Cash comms cost	<i>What is the average cost of communications to cash donors per person mailed</i>
15	Additional giving	Donation processing cash	<i>What is the average cost of processing a response to a cash donation including postage costs for receipts</i>
16	Additional giving	Donation processing RG	<i>What is the average cost of processing a regular donation including bureau costs and bank charges</i>
17	Additional giving	Av cash gift	<i>What is the average donation value for second and subsequent gifts from a new cash donor</i>
18	Additional giving	RG comms no	<i>What is the average number of mail communications a regular giver receives from you a year</i>
19	Additional giving	RG comms cost	<i>What is the average cost of communications to regular givers per person mailed</i>
20	Additional giving	RG RR	<i>What is the average response rate to all mail communications to regular givers</i>
21	Additional giving	Cash gift uplift	<i>What will be the increase in average cash gift per donor per year</i>
22	Gift Aid	Gift Aid % RG	<i>What proportion of all regular donors have valid Gift Aid declarations</i>
23	Gift Aid	Gift Aid % cash	<i>What proportion of all ad hoc donors have valid Gift Aid declarations</i>
23	Gift Aid	Gift aid rate	<i>What is the % amount of reclaimed tax per donor with a Gift Aid declaration</i>
24	Inflation & discount rate	Discount	<i>What discount rate will be used p.a</i>
25	Inflation & discount rate	Inflation	<i>What is the inflation rate</i>
26	Telemarketing	TM penetration cash	<i>What proportion of new cash donor recruits will be contacted by telephone for conversion to regular gift campaigns</i>
27	Telemarketing	Conversion pledge rate	<i>What is the proportion of donors contacted by telephone who take out a regular gift as a result</i>
28	Telemarketing	Cash gift rate	<i>What is the proportion of donors contacted by telephone who make a cash gift as a result</i>
29	Telemarketing	TM cost per contact conversion	<i>What is the total cost per contact of outbound telemarketing for cash to regular gift conversion campaigns</i>
30	Telemarketing	TM RG value	<i>What is the average value per annum of new regular gifts taken out from outbound telemarketing</i>

31	Telemarketing	Cash from committed value	What is the average value of cash gifts made by regular gift donors
32	Telemarketing	TM penetration RG	What proportion of new regular giver recruits will be contacted by telephone each year for upgrades or reactivations
33	Telemarketing	TM RG upgrade rate	What proportion of new regular giver recruits will increase the amount of their gift in an upgrade campaign
34	Telemarketing	TM cost per contact upgrade	What is the total cost per contact of outbound telemarketing for upgrade campaigns
35	Telemarketing	TM cost per contact lapsed	What is the total cost per contact of outbound telemarketing for lapsed regular gift re-activation campaigns
36	Telemarketing	TM upgrade value %	What is the average percentage increase in regular gifts by those agreeing to upgrade
37	Telemarketing	TM lapsed reactivation rate	What proportion of lapsed regular givers contacted by telephone who will resume their regular gift

Using the model

The Donor Recruitment Return on Investment model is designed to be simple to operate. Based on a simple spreadsheet, the model works by entering current figures for each variable and from these an overall 5 year return on investment figure will be calculated dynamically. It is a simple matter to link worksheets for multiple donor recruitment methods together to create comparative Return on Investment figures for each.

Chart 2: Sample 5 year Return on Investment (ROI) figures for a range of donor recruitment methods



For a copy of the Donor Recruitment Return on Investment model email aldrich_green@yahoo.co.uk.

Considerations

The Donor Recruitment Return on Investment model has a number of shortcomings. The model is relatively simplistic. The decision about which variables to include is to some extent an arbitrary one. The model excludes mail and email regular giving upgrade activity, for example, solely on the basis of the author's experience that the impact of such activity on profitability has been small. This is an assumption which could be challenged. However, adding additional variables to the model is relatively simple.

More important than the precise details of the particular model is the approach. Currently, UK fundraisers lack a shared basis for calculating the return on investment for new donor recruitment investment. Many discussions on the subject are hampered by an inconsistency of definition. Issues such as what comprises an acceptable return on investment cannot be sensibly discussed until we have a common understanding of how to calculate a return on investment and over what period.

The Donor Recruitment Return on Investment model is an effort to make a practical contribution to this debate. It is a tool that some fundraisers may find useful in itself. For others, it may help to clarify the methodology that is used to inform decisions on investment in new donor recruitment.

ⁱ Charity Trends 2004, Charities Aid Foundation

ⁱⁱ Direct dialogue sign up numbers are from the PFRA www.pfra.org.uk. The cost is an estimate based on average charges to charities including VAT per donor of around £85.

ⁱⁱⁱ For a good overview of donor lifetime value see "Fundraising Management" Sargeant and Jay 2004 pp 144-146.

^{iv} Sargeant and Jay 2004 pp 144

^v This is detailed in "How much are our donors worth?" T Aldrich. *Journal of Voluntary Sector and Non Profit Marketing* May 2000.