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Donor profitability measurement

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Received (in revised form): 3 April 2007

Abstract

Research in this paper examines, through analysis and a case study, the profitability of individual donors.

The purpose is to examine these questions:

- What can we learn about the range and distribution of donor profitability from case studies?
- Who counts the most, profit-wise?
- What are the implications for fundraising management?

The main conclusions are:

1. *Profitable and unprofitable donors*: About half of donors are profit making and half loss making in a year. Donors show a very wide range in their annual net profitability.
2. *It is down to a few*: A very few donors create the annual net surplus in a programme. In the case study shown, three quarters of net profit was generated by just one tenth of the donors.
3. *Strategy*: A strategic focus on the few profit generators seems obvious, and a new approach to fundraising management is strongly indicated.
4. *Changing fundraising practice*: Discussions with charities, agencies and consultancies suggest that cultural factors and a reluctance to change 'the way we do things' impede the take-up of a profit-based donor strategy.

Keywords: not for profit, charity direct marketing, donor profitability (use as a pair or singly), fundraising, ROI, case study, international

Journal of Direct, Data and Digital Marketing Practice (2007) **9**, 47–66.
doi:10.1057/palgrave.dddmp.4350075

This study

This is the first of a two-part research study of a relatively unexplored area of fundraising management: donor-level profitability. Part two of the research study will be published in a later issue of this volume.

In this study, and at its simplest level, we choose to define donor-level profitability as:

Annual gross revenue from each donor *minus* annual costs for each donor
Or:
(total given by a donor in one full year) – (total cost applied to donor in same period)

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The work is based entirely on case studies with contemporary data.

The work is divided into two parts for digestibility.

Part 1 deals with the calculation of net donor-level profitability calculated annually, discovering that donor-level profitability has a very wide range, and concludes with the deeper investigation into profit-making and loss-making donor groups.

Part 2 will examine some scenarios of what might happen *if* donor management is adjusted fully to take account of profitability. We will show that substantial improvements to profitability can be made with the application of simple techniques. The resultant changes to the philosophy of fundraising and the way donors are managed would, however, be profound.

Outline and summary (Part 1)

ROI

Return on investment (ROI) measurements are widely used and understood in fundraising. They are, however, generally focused on the performance of the fundraising activities surrounding donors, not on the donors themselves.

ROI is frequently summarised to show profitability at the level of 'the bottom line'. Bottom-line ROI statements do not generally include many mentions of donors, only money totals, percentages or ratios for a programme overall, and frequently the comforting, but highly misleading, 'average gift' amount.

Culture: Profitability is not generally calculated at the level of the individual donor. This is largely cultural: it is just not the way charities think, not the way they do things.

Measuring donor-level profitability needs two data sets:

(1) reliable base data on fundraising costs, which can then be apportioned and set against and (2) the gross annual revenues for individual donors.

Donor- level profitability is important

Why is donor-level profitability important? The author asserts that donor-level net profitability should be measured so that fundraising managers can understand clearly *who* generates the surpluses required to deliver their mission and, conversely, who is loss making. Knowing this, fundraising managers could adjust programmes in quite simple ways to make substantial improvements to performance.

Case studies show that, within a profitable annual giving programme,¹ individual donor giving levels range very widely, from extremely profitable to extremely unprofitable. The calculation of overall or summary profit margins obscures the fact that, within a programme, approximately half of annual donors are profit generators and half loss makers.²

A few profitable donors exert a huge effect: the amount of contribution to net profit by a relatively few high-profitability donors is exaggerated and extreme. In the case study for Part 1, *fully three quarters of the net profit for one year was provided by just 10 per cent of the donors.*

Because of the extreme profitability of a few donors, tests have been undertaken to establish if a few very high-value donors are the cause. They are not, and the finding that a relatively few donors provide the vast majority of profitability is valid.

Implications and impact on fundraising strategy and practice

These research findings cast doubt on the effectiveness of conventional fundraising management practices that tend, in many organisations, to treat all annual donors in largely one 'blanket' way.³ Some organisations have streamed donors into low-, middle- and high-value segments, but in our experience always at the level of gross revenue, but with no differentiation driven or directed by the level of donor profit.

The research findings suggest that new principles of fundraising are required.

**New principles
of fundraising are
required**

Changing fundraising thinking and culture

The implications for a change of approach that focuses on donor profitability, including 'what if?' simulations, will be discussed in Part 2.

The rewards for an organisation that builds in profitability management to its strategy are likely to be considerable. Very simple changes to fundraising can yield immediate and substantial effects on overall profitability. This concludes the outline and summary.

Introduction

Charities are described as 'not-for-profit organisations'. The term not for profit is used primarily to distinguish charitable organisations from commercial businesses.

Fifteen or 20 years ago the use of the word 'profit' in a public forum on charity fundraising might have raised objections, but not any more. Charities today (as we shall henceforward describe not-for-profit organisations) are recognised as businesses, albeit of a special type with profoundly different objectives to commercial ones, but businesses nevertheless, which are, in many cases, run in a businesslike manner.

Any charity that does not make a profit or surplus on its fundraising operations will eventually fail.

Measuring financial rates of return in the current year

ROI measures are an essential part of fundraising management and calculated routinely in all parts of a fundraising operation, for example:

- Budgeting for ROI: departmental revenue versus cost measures profitability at the highest level.
- Direct marketing campaign measurements use several variations of ROI, often to a level of fine detail.

- Events, legacies, retail, raffles and lotteries all have their own specialised ROI calculation methods and benchmarks.
- Communication channel ROIs compare the different effectiveness of ‘phone versus mail versus e-mail etc’.
- Product-level ROIs are sometimes measured (child sponsorship and monthly giving).
- Agencies and consultancies often find their fees and charges being measured against the added value they bring.

ROI calculations conclude (literally) with ‘the bottom line’: the final, summary deduction of all costs from all revenue in order to determine a net surplus figure and a rate of return.

Changing the focus of ROI measurements

Measurements of the operational surplus focus on the performance of *activities* in the fundraising operation under examination. It is the author’s experience that profitability *is rarely measured at the level of the individual donor*.

This paper examines, therefore, a relatively unexplored area of the ROI spectrum: donor-level profitability.

Simple calculations of donor profitability

At the simplest theoretical level, we might all agree that a £10 per year donor is of far less immediate impact on a charity, financially, than a £100 or a £1,000 donor.

We might also agree that the many £10 per year donors are likely to be loss making in a yearly accounting period. The far fewer £100 per year donors are much more likely to be profitable, and the very scarce £1,000 per year donor needs no assistance to convince us that he/she is ‘profitable’.

If we were able to calculate the net profit of these three classes of donors, we would be in a better position to judge their relative importance. For example, Table 1.

In the hypothetical example shown in the table below, the £10 donors are loss making in their acquisition year whereas the higher value donors yield a profit.

We might also agree that in subsequent years the repeat or ‘retained’ £10 donor will still be loss making because it costs more to keep them than they give. Higher value donors however go on to make steadily more profit.

Table 1: Hypothetical donor profit calculations

Gross annual donor value £	Acquisition cost (typical) £	Annual maintenance cost (typical) £	Net annual profit (in acquisition year) £
10	30	12	–32
100	50	20	30
1,000	90	24	886

Donor-level profitability is a relatively unexplored area of the ROI spectrum

Upgrading dreams

At this point, some fundraisers may be thinking: 'But surely, many low-value donors can be upgraded, moving them out of their unprofitable status into something profitable?'

We fully agree that a £10 donor who can be 'converted' to a £2 per month donor will likely transform into profit. Our focus, however, is on the great majority of single-gift, nonmonthly donors who are highly resistant to conversion to monthly giving.

It has been the author's experience, and over several years of intensive database enquiry, that a donor's initial giving level is, in effect, a 'floor value'. The floor value is a concept that has its origins in the USA. It is an empirical finding, from repeated observation, that there is a threshold or level of value given by a customer to a sale, above which the vast majority of customers will rarely if, ever, rise or rise in a sustained way (ie no 'step change').

This means that the vast majority of the £10 donors in our hypothetical example will *not* transform into £100 donors, not even into £50, £30 or even £20 donors.

The floor-value principle is itself a wide topic and outside the scope of this paper. For the purposes of this study, we shall, however, assume that the majority of donors gives roughly the same amounts each year, and that there is no order of magnitude or step change in their giving annually.

Where do fundraisers focus?

One might expect that, strategically, fundraisers would focus more attention and resources on profit-making donors.

In the author's experience, this too often is not the case. Fundraisers tend to focus on the profitability of *operations*, of fundraising at a *summary level*, at the *campaign level*, but not on the profitability of individual donors themselves.

Because there is no culture of donor-level profit measurement, charities do not know who is profitable or who is loss making.

It follows that they cannot build in to management systems the responsibilities for the relationships *with the donors who are the generators of the crucial annual surplus*.

The purpose of this Part 1 paper therefore is to examine these questions:

- What can we learn about the range and distribution of donor profitability from case studies?
- Who counts the most, profit-wise?
- What are the implications for fundraising management?

Scope of the study

Cash donors: We shall focus on cash donors giving to nonmonthly programmes. This is not to say that profitability studies are irrelevant to

'Floor value'

Key questions

monthly giving schemes — they are equally important and have their own special dynamics and characteristics. In many charities with older constituencies, however, the scope for extensive growth of monthly files is limited,⁴ and the mainstay of annual giving remains and will continue to be the annual cash donor.

Direct marketing: We shall focus on direct marketing programmes, because this has been the author's professional focus, and it is where the case study data are most easily available.

Direct giving by cash: We shall focus entirely on direct cash giving and not on the longer term potential for additional gifts such as legacies. This is not to ignore the importance of legacies and other channels of support, but rather to maintain a clear line of enquiry into donor profitability *from cash*, based on what can be measured reliably and with as little guesswork or wishful thinking as possible.

Accounting period: For simplicity, we shall examine and compare annual gross revenue value with the annual costs associated across one year. It is natural to measure annual donor value across a year and set costs against it. We are aware that charities all too often fall prey to short-term thinking, but we wish to explore donor profit and loss under typical annual cycles.

Fundraising costs

One of the practical constraints to measuring donor profitability is the ready availability of cost data. Some charities are better in this regard than others.

We divide costs into three logical layers that we term C1, C2 and C3:

Division of costs

C1: The direct costs of fundraising within direct marketing, made up of outbound and inbound components:

- Postal charges for appeals and newsletters, paper, print, list rental, creative and agency fees, database/data processing and lettershop.
- Fulfilment on receipt of gifts including data capture and database maintenance, opening and receipting, thanking, batching, banking and associated costs in the year such as newsletters, and tax receipts, which is normal practice in the USA and Europe but not in Great Britain.

C2: The salaries of staff directly assigned to the direct marketing role, taken as 'amounts paid as salaries before tax' with no allowance for additional costs for pensions, training or other HR costs.

C3: Overheads — the share borne by the direct marketing operations for buildings, heat and light, share of central management services, insurance and other overheads. Overheads are in general the most difficult costs to obtain and not all of our case studies include them.

Fundraising revenues

These are obtained from the gift files extracted from the charity's database. Any inappropriate gifts are removed, for example legacies, gifts from companies or Trusts, events revenue and major or capital appeal gifts.

Monthly giving revenue is also excluded.

Software

Gifts are processed by specialised software developed by the author (details in endnote⁵). From the marketing database produced by the software, it is simple to isolate the gross annual contribution of any donor for as many years as the database extends. We then introduce and apportion cost items so that net donor profitability can be calculated.

Principle of allocation of costs against revenue

We have chosen to apply costs only to donors who have given money during the year. We believe that this is the simplest and most practical way to measure annual donor profitability.

This means that if, for example, there were 100,000 active donors in a database at the year's beginning, that all of them were asked for support and that 25,000 responded, then the costs for the year would be allocated to the 25,000 gift-bearing donors and not apportioned to the entire 100,000.

This would mean, for example, that if the fundraising programme for the 100,000 donors cost £500,000 in a year, this cost would be applied to the 25,000 revenue-generating donors at an average annual cost per donor of £20.⁶

Costs are applied evenly/equally

Costs are applied equally to all donors who have given.

Certain costs are the same for the £10, £100 or £1000 donor: data processing, handling, tax/receipting and so on. Newsletters, for example, cost the same to produce and send whatever the donor's giving level.

In our case studies, we have made enquiries beforehand with the charity to establish if there is any *substantial* difference in costs applied to any segments or groups of donors. In the cases used in this paper, there were no special costs applied to the donors who gave, making even allocation of costs to donors a fair approach.

Separating out new-donor-acquisition costs

We do not make any distinction at this stage between the additional costs incurred in the process of acquiring new donors versus those applied to retained donors. The additional new-donor costs arise because (1) prospecting is, by its very nature, a more expensive operation than raising money from retained donors and (2) new donors are frequently inducted and welcomed, which costs money.

Simplest and most practical way to measure donor profitability

In some of the case studies we have used, *our clients have not been able to easily separate new-donor-acquisition costs from the costs to manage existing donors*. Therefore, we have decided to work with the costs data that we do have so that we can test profitability concepts and theories.

We are aware that the inability to break out new–donor-acquisition costs can influence the pattern of gross versus net revenue. We show however in Part 2 some profitability measures that have been adjusted to differentiate between new and retained donors.

How to calculate donor-level profitability

We group costs in three layers as above: C1 direct costs, C2 salaries and C3 overheads.

Calculation

By deducting C1, C2 and C3 costs from gross revenues, we obtain three measures of profitability:

- P1 profitability against direct costs,
- P2 profitability against direct costs plus salaries and
- P3 overall profitability with direct costs, salaries and overheads accounted for.

Case studies

We have developed case studies from organisations in North America and Europe with widely differing missions and causes. As a common characteristic, each has a well-established direct marketing operation although of different history and style. All have a strong direct mail element.

Currencies

Currencies for revenue and costs are applied in their local denominations with no attempt to convert to a common currency.

We believe that, if a case for profitability is to be built, then it should hold true in whatever country and against whatever costs and revenues are normal for that country.

No actual currency symbols will be displayed in the tables and charts.

Case 1

Charity characteristics: this case organisation, which started ten years ago, has a 72,000-name individual donor base⁷ that dates back to nine years from 2005. Donors who make gifts in the range 1 local currency unit (a handful of donors) to 900 (even fewer). Average gift is 39 and has been fairly steady at this level for the last five years.

Donors in general give modest amounts, with 90 per cent of all gifts under 75. The average gift is about 39 and the modal gift value (the most commonly occurring amount) is 25, representing around 20 per cent of all gifts.

The vast majority of donors give one gift per year (83 per cent) with 12 per cent giving two gifts per year and only 5 per cent giving more than two gifts per year.

The average gift level combined with the majority of donors making one gift per year marks this out as very typical of general charities⁸ in the country of origin.

In the last five years, gross revenue for the annual donor fund has climbed from 1.2m to close to 1.8m.

Summary of operational gross revenue, costs and net profit

This organisation obtained gifts from just over 33,000 donors in 2005 providing 1.77m in gross revenue. Direct costs (C1) were 1.003m, salaries (C2) 74k and no C3 overhead costs were available (Table 2).

As seen from the table below, Total C1 plus C2 costs were 1.077m leaving a P2 net revenue of 0.691m.

The average gross revenue per donor was 53.35, the average cost per donor was 32.5 leaving an average net revenue or 'net profit per donor' of 21 when rounded.

The profit margin P1 on direct costs was 43 per cent and P2, the margin including salaries, 39 per cent.

This is a respectable if unspectacular return on the year's operations: spend just over a million, make 1.77m and bank a net surplus close to seven hundred thousand.

Table 2: Profit calculations (case study)

Case 1	
Total database size	72,000
Donors who gave in 2005	33,133
Total gross revenue in year	1,767,720
Average annual gross contribution per donor	53.35
C1 direct costs	1,003,419
C2 salaries	73,546
C3 overheads	Unknown
Total costs in year (C1+C2)	1,076,965
Average annual cost per donor in 2005	32.50
Average C1 cost per donor 2005	30.28
Average C2 cost per donor 2005	2.22
Average C3 cost per donor 2005	Unknown
Overall cost per donor 2005 (C1+C2)	32.50
Net revenue against direct costs only (P1)	764,301
Net revenue against direct costs+salaries (P2)	690,755
Average net contribution per donor	20.85
P1 profitability on direct costs	43%
P2 profitability on direct costs+salaries	39%
P3 profitability on all costs inc. overheads	Unknown

Costs Case 1

The breakdown of major items is as shown in Table 3.

Comments

It is interesting to observe from Table 3 the relatively low impact of the cost of staff salaries, only 7 per cent (74,000 in local currency and 1.5 whole time equivalents). This is typical in the case studies we have worked on: most costs are on nonhuman items, and the human factor is modestly funded.

Non-labour-intensive fundraising operation

Internally, it seems that the charity in case 1 is not a labour-intensive fundraising operation, suggesting that most of the brainpower and the small amount of manpower inside the charity are directed to activities such as copy approval, art and data-processing requests followed by downstream production tasks.

The relatively high proportion of fulfilment and database costs (26 per cent) arises because the entire database and donor-processing operations are outsourced.

First evaluation of profitable and unprofitable donors

It cost 33 per donor in 2005 to acquire or retain, to process and to service a donor for the year.

Some of the donors in 2005 were profitable — by simple maths, those who gave more than 33 — whereas those who gave under 33 were unprofitable.

It would be useful at this stage if we knew, top down, how many profitable and unprofitable donors there were (Table 4).

Table 3: Breakdown of C1 & C2 costs

Costs: main items 1.076 million	
Print	42%
Fulfilment & database management (external)	26%
Postage	21%
Staff salaries	7%
Other items	4%
	100%

Table 4: Contributions to net profit by donors

	Profit or loss	Number of donors	Average profit or loss per donor
Total profitable donors	875,143	16,567	52.82
Total loss-making donors	– 184,616	16,566	– 11.14
Net profit	690,527		20.84

Explanation

From the table above, almost exactly half of the donors were profitable and half were loss making — a fluke, but ratios similar to this are found in other case studies.

The average net profit of the profitable donors was 52.85.

The average net loss of the unprofitable donors was –11.14.

The overall net profit, taking into account those who generated a surplus and those who made a loss, was 21.

Note that the maximum loss a donor can make is limited to the costs that the donor consumes. So, if a donor gave a very small gift, say 3, but consumed 33, the loss would be limited to 30.

Discussion

What is startling is that the profitable donors produced, on their own, 875k profit. By itself, this sum would have delivered a 50 per cent profit margin on the year, far higher than the 39 per cent actually achieved.

The maximum potential profit, however, has been pulled down from 875k to 690k by the –184,616 incurred by loss-making donors.

It follows that we should investigate more deeply and establish a detailed understanding of the mix of profitable and loss-making donors.

Ranking: Calculating the range of profit/loss per donor in deciles

To show the range of profitability, we rank all 33k donors in descending order of gross revenue value and divide them into ten groups of equal numbers of donors (deciles). We then deduct costs from each group. The results are shown in Table 5.

Table 5: Deciles of profit

1 Decile	2 # donors	3 2005 gross revenue	4 Average gross revenue per donor	5 Cost per decile	6 Profit or loss in decile	7 Cost per donor	8 Profit or loss per donor
1	3,314	628,882	190	107,719	521,163	33	157
2	3,313	299,397	90	107,719	191,678	33	58
3	3,313	183,060	55	107,719	75,341	33	23
4	3,314	165,700	50	107,719	57,981	33	17
5	3,313	136,700	41	107,719	28,980	33	9
6	3,313	100,930	30	107,719	–6,789	33	–2
7	3,314	82,850	25	107,719	–24,869	33	–8
8	3,313	74,778	23	107,719	–32,941	33	–10
9	3,313	61,497	19	107,719	–46,222	33	–14
10	3,313	33,925	10	107,719	–73,795	33	–22
Overall	33,133	1,767,720	53	1077193	690,527	33	21
75%							

Explanation: Column 1 decile positions 1 to 10, Column 2 number of donors in each decile, equal tenths, Column 3 total gross revenue in each decile, Column 4 average gross revenue per donor in each decile, Column 5 C1+C2 costs applied equally to each decile, Column 6 profit (or loss) in each decile, Column 7 cost per donor in each decile (the same for all donors), Column 8 net profit or loss per donor in each decile.

**Detailed
understanding
required**

Discussion

It is immediately clear from column 3 of Table 5 that some donors give far more than others and are much more important to performance. The decline in gross revenue with each subsequent decile is steep.

Column 4 shows that the average gross contribution across the deciles ranges from a high of 190 to a low of 10. This is a 19:1 ratio between the most and the least generous donor.

Column 6 shows that deciles 6 to 10 all make a loss with decile 10 over 73,000 ‘in the red’.

In this case study exactly 50 per cent of the donors are profitable, and the same proportion unprofitable.

Column 8 shows the net profit per donor in each decile. The range is wide, from a high of 157 to a low of minus 22.

We can safely conclude from this that, although all donors may be treated equally by the charity, financially at least, ‘some are more equal than others’ (George Orwell, *Animal Farm* 1945).

Who were the profit generators in 2005?

We can calculate what percentage of the 690k net profit is attributable to the donors in each decile (Table 6).

Discussion

Fully three quarters of the total 690k profit for the year was generated by the 10 per cent of the donors in the 1st decile as observed from the table below.

There is a strong fall in the 2nd decile, which produced 28 per cent of the profit, and further steep slides until, at the 50th percentile, we reached the lower limit of profitable donors.

Beyond the 50th percentile all donors are loss making.

These findings show the extreme imbalance of profitability in the donor base. Taking the top two deciles, 103 per cent of the net profit emanates from this special group (it is not a mistake that we can have figures that add up to more than 100 per cent profitability — we must

Table 6: Percentage profit by decile

Decile	Percentage profit in decile
1	75
2	28
3	11
4	8
5	4
6	–1
7	–4
8	–5
9	–7
10	–11
Overall	100

remember that the overall net profit total is made up of the sum of the positive *and* the negative amounts).

The combination of reward and *risk* surrounding these few donors is tantalising. Put simply:

If you are not focusing your attention on the small number of donors that generate the vast majority of profit, you are making a huge mistake.

Conclusions

It is clear from this breakdown of profit in deciles that:

- A very few donors delivered the vast majority of net profit in 2005.
- The unevenness and disproportion of the profit in the upper deciles compared to the lower deciles is extreme.
- The importance of relatively few donors to net revenue success is dramatic.

Unevenness and disproportion of profit is pronounced

Range of profit margins within the deciles

The overall margin of this programme is, as above, 39 per cent.

It is, however, insightful to calculate the profit margin per cent in each decile, where the differences are, of course, wide.

The range of profitability is dramatic in its contrasts (Figure 1).

Conclusions

Any view that we had before about the satisfactory nature of the 'bottom line' 39 per cent or 'average profit margin' is now shown to be misleading and hiding a more complex and disturbing truth.

The overall margin of 39 per cent is, in fact, a blend of five deciles of profitable donors mixed with five deciles of unprofitable donors.

The top 3,314 donor decile has a very substantial margin of 83 per cent. This means that every Dollar, Pound or Euro invested in these donors has yielded 1.83 in return.

At the lowest limit of profitability the margin in the 5th decile is still a respectable 21 per cent.

Figure 1: Variation in profitability by decile

In terms of profit, not all donors are equal

Below the 50th percentile everything goes badly. In deciles 6–10 everything is loss making. Donors in decile 6 are almost at break even, and the investment of one \$, £ or S has made a loss of 1.07.

Thereafter the fall into loss increases at a steep rate. In the 10th decile, the investment of one \$, £ or S has made a loss of 1.22.

Clearly not all donors are equal, profit-wise. The range of values is wide and the contributions of each decile are markedly different.

What of profitability patterns in previous years?

We now have a profitability picture for a single year, 2005. In order to establish if the 2005 pattern is representative and not merely a singular, or isolated occurrence, we back-calculated⁹ profitability for 2004 and 2003 (Table 7).

We see a three-year trend of rising revenue but with the profitability falling from 47 per cent in 2003 to 39 per cent in 2005 as shown in Table 7.

During this three-year period, we know that the charity in Case 1 was investing more in donor acquisition and development as part of the planned growth, so it is unsurprising to see the margin falling.

What is clear, however, is that the findings for the *distribution* of profit in 2005 are echoed strongly in the previous two years.

Detailed comparison 2003–2005

The bar chart Figure 2 shows the net profit in the ten deciles, side by side for three years.

It is clear that 2005 was no fluke with not a singular occurrence.

Looking for distorting ‘outliers’ in the top decile

The top decile of profitability is crucial to this study.

But, what if it contained a few very large or even spectacular gifts? This would throw things off somewhat, mathematically, and weaken the general argument.

It is usual for annual programmes to attract a few very large donors each year. We have therefore examined the top decile of profitability to how many such outlier donors there might be, and gauge their effect on the net profit figure:

‘Outliers’

Table 7: Three-year profitability comparison

	Gross	Net	Margin (%)	Total donors	Average profit/donor
2005	1,767,720	690,527	39	33,133	21
2004	1,637,029	692,482	42	30,777	22
2003	1,414,569	664,423	47	26,284	25

Figure 2: Net profit in the ten deciles

Descriptive statistics: net profit 2005: 33,133 donors

	N	Minimum	Maximum	Sum	Mean
Net_2005	33,133	-31.50	2,010.50	690,897.51	20.85

The figure 'maximum' shows that there is at least one very large giver at over 2,000.

It is the giving range in the top decile that concerns us. A focus on the top 3,313 donors is required:

Descriptive statistics: top 3,313 donors net profit 2005

	N	Minimum	Maximum	Sum	Mean
Net_2005	3,313	67.50	2,010.50	521,110	157.29

This small but potent group shows a wide range of giving. The mean net profit is 157, and the maximum value of 2,011 is nearly 13 times as large.

We employ a banding technique to group givers into ranges within the top 3,133 donors:

Observations

Inside the mean profit of 157, there is a wide range of net giving from this elite group: 68 to 2,011 (Table 8).

The contribution of the very high-value donors to the total of 521k is, however, modest: above 500, only 7 per cent+2 per cent=9 per cent of the revenue is accounted for by these big givers and there are only 64 donors in the upper bands (55+9).

Table 8: Distribution of value in top decile of profitability

Profit band ^a £	Sum	% of total sum	No. of donors	Mean £	Minimum £	Maximum £
Up to 100	102,187	20	1309	78	68	100
100–250	240,500	46	1559	154	103	248
250–500	129,657	25	381	340	253	493
500–1000	36,660	7	55	667	508	968
1000+	12,107	2	9	1,345	1,033	2,011
Total	521,110	100	3313	157	68	2,011

^aThe bands have no overlaps. Thus the up to 100 band closes at 100.00 and the next band, 100–250, begins at 100.01 and closes at 250.00

The main drivers of profit in this top 3,313 donors are the 100–250 and 250–500 donors, who between them bring 71 per cent of the profit.

The ‘up to 100’ donors also provide a respectable 20 per cent of profit.

We may conclude from this that:

- There are some outliers in the top decile, but their number and their value are not so extreme as to dominate or grossly distort the profitability picture.
- It is in fact the far more numerous ‘middle-range’ donors giving between 103 and 493 net, who drive the profitability of this group.

Conclusions

The chart and data table comparison 2003–2005 (Figure 2) illustrate clearly that the pattern for 2005 was very similar to that in the prior two years:

- The values in the top decile are all quite close, in the range 149–157.
- The fall into loss occurs around the 6th decile in all years.
- The extreme loss-making 10th decile shows values in the range –18 to –22.
- The top decile is not distorted by huge outlier values.

The profitability structure and dynamics of this organisation have been similar for three calendar years, and that findings from 2005 are indicative of a consistent and stable pattern.

This means that we can move now to a discussion of the implications for fundraising when profitability is factored in to strategy and operations.

Is there evidence contradicting these results?

As a one-time scientist, the author feels it is right that any contradictory evidence on this ‘donor profitability theory’ be shown.

Unfortunately (or fortunately) we cannot find any. Colleagues have sent us many published pieces that discuss *gross value* among donors,

Implications for fundraising

and we studied our own records of conference presentations for 15 years and asked agency, academic and charity people for their insights.

And of course we have Googled: 645,000 hits for 'donor+profitability', none of them about the topic of net profitability at the donor level as discussed in this paper. There are references to Guidestar and its approach to measuring charity performance, and occasional references to campaign profitability, nonprofit accounting and 'fiscal fitness', but nothing on donor-level profitability.

We must conclude that this is an unexamined area at the present time.

Overall conclusions — Part 1 study

Reality check:

Bottom-line profitability obscures essential — and surprising — truths about the real net value controlled by small segments of individual donors.

Hidden behind the overall — and broadly acceptable — bottom-line profit margin of 39 per cent, there is a wide range of donor profitability.

Campaign-by-campaign ROI and summary profitability do not go to the heart of the issue. We need a new focus *on the net value of our donors*.

The impact of a few donors on profit over the general mass of givers is strong. These few donors — as few as one-fifth of all givers — are the key to long-term success or failure, not the general mass of donors.

A case for *managing and stewarding* donors in a new way — according to their profitability — deserves serious exploration.

Conclusions

Knowing the minimum ask:

The charity in Case 1 now knows something that it has never known: that it has to obtain 33 before it can make any surplus at all.

The exercise into profitability has shown them what the minimum ask should be based on straightforward calculations.

It is a creative marketing challenge now to justify that 33 minimum ask.

Who is managing the very valuable top donors?

In Case 1, nobody is. There is not enough manpower. What manpower they have is devoted to the management, not of donors, but of tasks, operations and production.

Stewardship — something that many fundraisers, trained to *ask* for money, do quite badly — is not on this charity's radar.

But, are not people doing profit stuff like this already?

To be sure, most charities take some account of a donor's gross, before-profit gift value in marketing.

Some larger charities, blessed with good management and sufficient analytical resources, have developed robust lifetime gross value models. They can say with some certainty who is important to them financially. Such organisations are, however, in the minority.

In our experience, donor *gift level* considerations are applied mostly at the selection and targeting stage, prior to a campaign, and are used to drive 'gift prompts'.¹⁰

Net donor-level profitability is not, as far as we know, used strategically to manage the overall programme, though there are sporadic appearances at conferences by a few radical/boutique agencies who have clearly 'got it'. Being agencies, they are understandably cagey and unwilling to say exactly how they do it.

Research, anyone?

Do the most profitable donors show qualitative differences to their loss-making counterparts? If they do, we can differentiate our recruitment and seek out more like them.

What are the attitudes, beliefs, needs, wants, likes and dislikes of the most profitable donors? Knowing their needs will be crucial if we want to keep them.

Research needed

Wealth: some of the highest net value donors may be wealthy; anyone who can give 1000–2000 per year in whatever currency you use is most likely not poor. Some screening for 'HINWIs' (high net worth individuals) would be smart. Their potential for larger gifts should be investigated.

What we know already about the distribution of donor value:

Pareto's law about the uneven distribution of wealth,¹¹ usually popularised as 'the 80:20 rule', predicts that the distribution of economic values will be logarithmic,¹² that is, they will normally and *naturally* be dominated by extremes.

This being the case, we should not be surprised to see that a few highly profitable donors dominate the overall picture of annual giving.

What would the governing Board say if it saw these findings?

Some voluble expressions would be expected.

We might expect the Finance Director to have something to say. Alliances between fundraisers and finance people are not made

easily, but here is an opportunity to collaborate and for a common goal: a larger 'net return'.

The Board might justifiably ask the fundraiser: 'Mr. Smith — why are you *wasting* all this money on so many of the donors!?'

A Board might ask for immediate plans for cost control and cost reductions at the low profitability end. Cost control is, sadly, often a Board's first line of attack.

But, a discerning Board would want to see equal attention on the high-profit donors, their cultivation, stewardship and development.

The fundraising climate

It is a cliché, but 'it is getting harder and harder to attract new donors and raise money profitably'. In the UK, donors are now permitted a right of opt-out from any further communication at the point of acquisition. One charity reports that *as many as 40 per cent of new donors choose this*, making them unavailable to future solicitation, let alone development.

This being so, the discernment between profitable and unprofitable donors becomes an imperative, a 'must do'.

Discernment between profitable and unprofitable donors is imperative

Willingness to change: would you?

In researching this piece we have been struck by the comments from people in both the not for profit and for profit fields about the reluctance and inability to change in organisations.

The head of fundraising in one large, well-established nonprofit said: 'It is all very understandable and reasonable, but you are asking us to change the ways we've always done things'.

An agency head said: 'I've long suspected what you've now proved, but until this agency finds another form of remuneration from its clients that is not related to production volumes, I can't go your way'.

A commercial consultancy, well experienced in database issues in banking and insurance said: 'We've found such gradients of profitability commercially, as you have in charities. Sometimes as few as 5 per cent of the customers provide 200 per cent of the profit, and more than half of the customers bleed the company of profit. But, because overall profit meets targets, there is not enough pain to make anyone want to change the way they do things'.

The future: a change of climate in fundraising?

Another head of fundraising in a 'mega charity' predicted thus: 'The days of easy and cost-efficient mass recruitment to swell donorbases and revenue are coming to an end. We're going to have to turn our attention to donor retention much more actively than at present. With a focus on donor development the profitability view will become very important'.

Part 2

We will look at the range of management changes that can be applied using profitability considerations in Part 2.

Notes

1. Annual programmes are a North American term for general donor fundraising exclusive of major gifts or legacies. Outside that continent the term annual programme is not recognised, though the practice of raising modest sums from donors year on year is thoroughly ingrained into fundraising practice in Europe.
2. Individual charities vary. During extreme periods such as disasters or emergencies, revenues are inflated but costs are not. For a few distinct organisational types (hospital foundations, universities and child sponsorship-led charities) the general level of giving is elevated compared to 'general charities'.
3. Major donors always excepted.
4. Experience suggests that for charities with older constituencies, the monthly file rarely exceeds 10–15 per cent of the entire donorbase.
5. SPSS Base v. 11-15 (www.spss.com) was chosen from day one as an affordable and highly adaptable package from which to build a system base suitable for rigorous donor data analysis; the product called Clarity™, has been added to and developed over seven years. It takes un-aggregated donor transactions and restructures them to build a comprehensive data set suitable for life-cycle-based donor analysis, KPI determination and diagnostic tests. From summarised donor giving on an annualised basis, it is possible to apply fixed and variable costs of fundraising against classes of donors at various stages of the life cycle (a.k.a. 'the donor journey'). From annual gross values, costs appropriate to the class of donors are subtracted to produce a net profit figure at the donor level. From that point, it is a simple task to rank and report from whom the profit or loss is coming from, and to compare donors over several years of giving behaviour.
6. It has also been argued that the costs for the programme should be applied to all 100,000 donors, and that the 25,000 who respond should not be 'cost penalised' for the shortcomings of the nonresponders. This might be the most appropriate method if we were developing an overall database balance sheet (a worthy exercise but outside the scope of this paper) but we assert that our goal is to create an annual profitability calculation at the donor level.
7. 72,000 includes all active, inactive and lapsed donors.
8. By 'general charities' we mean those *other than* hospital foundations or universities, where the general level of giving is much larger.
9. The back calculation was done by reducing the 2005 budget by 7 per cent year on year.
10. For example, the gift matrix, which takes a recent gift value and subjects it to multiplications so that donors are 'encouraged' to upgrade. Focus groups confirm that donors generally hate this approach, will not or cannot change giving levels and come down hard on charities that ask constantly for more.
11. There are many online reference works available on Pareto esp. Wikipedia, and an excellent account of applying the 80:20 law in everyday life from Richard Koch.
12. Logarithmic scales are nonlinear and have value points of the 1, 10, 100, 1000, 10000 and 100,000 range. Log scales are applicable where whatever it is we are measuring has a very wide range of values.