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Donor Acquisition Series #2 – Lifetime Value: The Key Metric

Posted By *Roger Craver* On January 20, 2016 @ 1:00 am In Direct mail,Donor acquisition,Donor retention / loyalty / commitment,Fundraising analytics / data,Nonprofit management | 2 Comments

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A drunk loses the keys to his house and is looking for them under a lamppost. A cop comes over and asks what he's doing.

"I'm looking for my keys," he says. "I lost them over there."

The policeman looks puzzled. "Then why are you looking for them all the way over here?"

"Because the light here is so much better."

It's human nature. We all look for things where the light is better, rather than where we're more likely to find them. We don't see things as they are. We see things as we are or as we've been told to see them.

That's why so many fundraisers and their consultants persist in using the strategically meaningless measures of 'cost of fundraising' and 'ROI' rather than develop strategies and steer their programs based on the key metric of Lifetime Value.

The result, as Australian fundraiser Sean Triner makes clear in this piece [1], is that this obsession with cost of fundraising and ROI in the end damages our ability to make the world a better place.

So, rather than stagger around in the dark, let's focus on Lifetime Value and why it's such an essential tool in the fundraiser's kit.

Simply stated, Lifetime Value is the net revenue an organization will receive from each donor during his or her lifetime with that cause.

Using historical data, we can compute this for every donor. How you choose to do the calculation is up to you. What is important is to begin by benchmarking your file so you will know in the future whether you're winning or losing the battle to constantly improve Lifetime Value (LTV).

HOW TO CALCULATE LTV.

You can do the calculation on the back of an envelope …

[Gross income from donor over whatever period of years you choose MINUS the cost of Acquisition + the per donor costs of file maintenance, overhead, cultivation, appeals and renewal = Lifetime Value]

Or you can go online and use the free spreadsheet from the Database Marketing Institute [2]. Or you can get our sister company DonorTrends to do it for you [3].

HOW TO USE LTV. Once you've computed a base Lifetime Value then dream up a new strategy to improve it. Estimate the benefits and costs. Determine whether your new lifetime value goes up or goes down. And for heaven's sake don't jump into any new strategy until you can at least see that it might be successful in lifting LTV. If it will, then go ahead and test it.

USING LTV AS YOUR FUNDRAISING GPS. Let's work through a few examples of how you can use LTV to develop effective strategies to improve the bottom line. Here is a table I'll be referring to in the examples.

Non Profit Lifetime Value	Acquisition Year	Year 2	Year 3
Donors	200,000	70,000	31,500
Retention Rate	35%	45%	55%
Acq. Resp Rate	5.0%		
Gifts per year	1.10	1.30	1.50
Average Gift	$10.00	$11.00	$12.00
Total Revenue	$2,200,000	$1,001,000	$567,000
Overhead	20%	20%	20%
Overhead Cost	$440,000	$200,200	$113,400
Acquisition Mail	4,000,000		
Appeal Mail	50,000	400,000	400,000
Cost Each	$0.42	$0.42	$0.42
Mail Costs	$1,701,000	$168,000	$168,000
Total Costs	$2,141,000	$368,200	$281,400
Net Profit	$59,000	$632,800	$285,600
Discount Rate	1.00	1.14	1.30
Net Present Value	$59,000	$555,088	$219,692.31
Cum. NPV	$59,000	$614,088	$833,780.03
Lifetime Value	$0.30	$3.07	$4.17

[4]

Example: Premium Acquisition Program. Premium-driven acquisition programs are notorious for their low average gifts and lousy retention rates. But they're mighty attractive for boosting acquisition response rates — and that pleases boards and CEOs who don't know any better. [Note the 5% acquisition response rate in Year 1 in the table above. Note also the low average gift and the low retention rate.]

Several possible strategies suggest themselves in a case like this. We could work on improving average gift size, the number of gifts per year or retention rates. Let's concentrate on retention and decide to add an online component with more personal emails, a more personal website and also a little postal mail in the form of cultivation to boost retention.

Notice that nowhere in these figures is 'Cost of Fundraising' or 'ROI' indicated. That's because they're largely meaningless numbers. Of course our costs would go up, but so would our retention rates and also our net income. So we draw up a plan and a set of assumptions based using a retention hypothesis.

Hypothesis: By Improving Retention Rates by 10 points LTV will dramatically improve.

Our plan might look like this.

Non Profit Lifetime Value	Acquisition Year	Year 2	Year 3
Donors	200,000	90,000	49,500
Retention Rate	45%	55%	54%
Acq. Resp Rate	5.0%		
Gifts per year	1.30	1.50	1.60
Average Gift	$11.00	$12.00	$13.00
Web Average	$16.00	$20.00	$24.00
Web Gifts /Yr	1.30	1.40	1.50
Web Givers	8%	12%	14%
Web Gifts	$332,800	$302,400	$249,480
Total Revenue	$3,192,800	$1,922,400	$1,279,080
Overhead	20%	20%	20%
Overhead Cost	$638,560	$384,480	$255,816
Email & Website	$150,000	$150,000	$150,000
Acquisition Mail	4,000,000		
Retention Mail		200,000	200,000
Appeal Mail	50,000	400,000	400,000
Cost Each	$0.42	$0.42	$0.42
Mail Costs	$1,701,000	$252,000	$252,000
Total Costs	$2,489,560	$786,480	$657,816
Net Profit	$703,240	$1,135,920	$621,264
Discount Rate	1.00	1.14	1.30
Net Present Value	$703,240	$996,421	$477,895.38
Cum. NPV	$703,240	$1,699,661	$2,177,556.44
Lifetime Value	$3.52	$8.50	$10.89

[5]

Then comparing this 'retention' plan with the original LTV calculation we can see what the difference is. And clearly this strategy indicates a difference worth testing.

Example: First Gift/Welcome/Second Gift Strategy

Whether you're spending $1 or $125 to acquire a new donor, chances are you probably aren't spending or investing enough. That's because almost no one calculates acquisition costs with Lifetime Value in mind.

Acquisition costs should be calculated NOT on the front-end costs of postage, printing, mailing lists, creative, etc, but also on the steps you should be taking immediately after a prospect responds.

Let me explain.

Most respondents to an acquisition effort are not yet 'donors', they're simply qualified leads to become a donor. It's what you do to transform their status from 'lead' to 'donor' that's the key to both Lifetime Value and your organization's future.

Thus, for example, if you're spending $800 per thousand pieces of mail and getting a 1% response with a $20 average gift, that part of the acquisition process has so far cost $60 per new 'donor/lead' [$800 minus $200 in income = $600 divided by 10 donors/leads = -$60 each]

Whether and how fast this investment is recovered and then begins producing net income depends on what you do next. If you do nothing but send out an acknowledgement and, say, four appeals a year, you might be able to recover an additional $20 per each lead in Year One.

That still leaves you with at least a negative -$40 in Year One. Worse yet, given today's poor retention rates (averaging 30% or less) those original 10 donors you got from that 1% Year One acquisition response will dwindle to 3 or 4 in Year 2.

And even though they'll retain at a higher rate in Years 2, 3 and 4 there's not much value dropping to the bottom line.

It's in this situation that Phase 2 of a great acquisition program must kick-in. And by this I mean the expenditure of additional funds in those first days/weeks after the 'lead's' initial response to ensure that as many as possible are bonded to the organization.

How? Well, I'd certainly recommend spending at least an additional $5 to $8 on telemarketing to welcome each new 'lead' and convert him/her to donor status right then and there.

All the testing I've done and all the results I've seen from others indicates that retention rates are likely to go up an average of between 15% and 25% and subsequent average gifts usually rise also.

Of course, if you're hounded by the ghost of 'Fundraising Costs' this bonding process may scare you off, because it will add another 15% or 20% to the cost of acquiring a donor. But, it's the best investment you can make in boosting Lifetime Value because it dramatically boosts retention rates. You'll go into the second and subsequent years with far more donors giving higher average gifts.

Please take a moment and do the math as it affects your organization, **then argue internally that a 'Retention Tax' or 'Retention Investment' should be planned in as part of any acquisition program.**

Why? Because, if you don't have a plan — and the money set aside — for taking those critical steps that convert a 'lead' to a loyal and more permanent donor, you're really wasting money.

Does your budget reflect plans and investment to increase Lifetime Value?

Roger

P.S. In the upcoming Part 3 of this Donor Acquisition series I'll take a look at some of the conventional mindsets that stand as barriers to effective acquisition.

And, in case you're just tuning in you may want to read Donor Acquisition Series #1 – The Investment Mindset [6].

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URLs in this post:

[1] this piece: **http://seantriner.blogspot.nl/2008/10/cost-effectiveness-could-be-end-of-your.html**
[2] Database Marketing Institute: **http://www.dbmarketing.com/special_ltv.htm**
[3] DonorTrends to do it for you: **http://donortrends.com/performance-reporting/maap-report/**
[4] Image: **http://www.theagitator.net/wp-content/uploads/ACQ-Chart-1.JPG.png**
[5] Image: **http://www.theagitator.net/wp-content/uploads/Acqu-Chart-2.JPG1.png**
[6] Donor Acquisition Series #1 – The Investment Mindset: **http://www.theagitator.net/nonprofit-management/donor-acquisition-series-1-wanted-an-investment-mindset/**