Making the case for investment in fundraising

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ABSTRACT

Fundraisers frequently find that trustees are reluctant to commit funds to investment in fundraising initiatives, whether this is developing existing fundraising work or investment in new areas. On the other hand, trustees often report that the plans put forward by fundraisers are too vague and do not present the case well enough. Commonly, there is more work to be done on both sides. First, this paper focuses on some of the financial plans that should be developed as part of the case for investment, as this is often the weakest area. The paper then demonstrates how this assists in appraising the risk profile of new initiatives and finally looks at the policy framework needed for decisions to be made.

MEASURING PERFORMANCE

Fundraising performance is often measured by cost/income ratios. So typically, a reader of charity accounts will look at the fundraising costs and compare these to income. This is unlikely to provide a true picture of performance for a number of reasons, including:

— costs may not be matched to the right type of income
— costs may be incurred in one accounting period and income raised in a later accounting period.

The emphasis on cost/income ratios leads to short-term target setting — charities may be satisfied if fundraisers have achieved an absolute target for raising funds and kept the charity within an overall cost/income ratio for the financial statements. It may also lead the charity to cut investment-type spending on fundraising in order to keep the amount spent down in the short term. Thus the emphasis on cost/income ratios distorts the way decisions are made about investment in fundraising.

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Table 1: Calculating the return

Incremental income (as above)	£207,500
Incremental costs (as above)	£116,000
Net income	£91,500
Average annual net income (£91,500 over five years)	**£18,300**

Table 2: Profile of the investment over the five-year period

Year 1	£6.000
Year 2	£48,000
Year 3	£22,000
Year 4	£20,000
Year 5	£20,000

Table 3: Return on investment percentage

	£	*Multiplier*	£
Year 1	6,000	5	30,000
Year 2	48,000	4	192,000
Year 3	22,000	3	66,000
Year 4	20,000	2	40,000
Year 5	20,000	1	20,000
Total	116,000		348,000

The average is calculated by dividing £348,000 by 5 years = £69,600

So the return on investment is $\frac{£18,300}{£69,000}$ = 26%

RETURN ON INVESTMENT

These problems would be avoided if charities measured the performance of fundraising by examining the return on investment.

Example of return on investment for an initiative

A charity has a regular giving scheme, currently with 2,400 regular givers who donate, on average, £100 per year. The plan is to increase both the number of regular givers and the average amount they give. The costs of the campaign to achieve this will be £116,000 over a five-year period. The additional income they anticipate is approximately £207,500 over the same period. The *return* is the average annual net income (incremental income less incremental costs). The *investment* should be the average amounts invested over the period, in this case the additional costs annualised (see Table 1).

The nature of this scheme is that the investment will be incurred over several years, so it was necessary to calculate the average annual amount invested (see Table 2). The £6,000 invested in year one counts as part of the annual investment for each of the five years. £48,000 invested in year two counts only for year two onwards, and so on. (See Table 3.)

The return on investment percentage can be compared validly to other options and activities that the charity might undertake. For example, how does a return of 26 per cent on a fundraising activity compare to investment in equities? Trustees should be able to set a range for expected return on investment for fundraising initiatives as a policy. As part of making the case for investment in fundraising, it would first be necessary to demonstrate what the return on investment is likely to be.

PAYBACK PERIOD

Another element of the necessary financial forecasting is to consider the time period over which the investment should be made, and when the return will start to be achieved. The turning point when the initiative turns into profit from a cash point of view is known as the payback period.

Example of the payback for an initiative

The initiative pays back mid-way through year 4. The maximum amount of cash invested is in year 2 at £54,000. (See Table 4.) Demonstrating the cashflow impact of the proposal through a payback period analysis will show the extent of the investment needed for the initiative to deliver the benefits.

Table 4: Payback period

	Costs	*Income*	*Cumulative cash position*
Year 1	6,000		–6,000
Year 2	48,000		–54,000
Year 3	22,000	43,700	–32,300
Year 4	20,000	76,000	24,100
Year 5	20,000	87,400	91,000

RISK ANALYSIS

In making the case for investment, obvious areas of risk should be addressed. Frequently these will fall into the following categories:

— Forecasts of income may be over-optimistic
— Unforeseen costs may arise
— The timing of both income and costs may change.

A section on risk analysis should therefore address these issues. It should ask questions such as 'what if income is less than forecast by 10 per cent?' to generate new versions of the plan, showing the impact on the return on investment and the payback period. In the presented case for investment, there is no need to show all the detailed calculations for such assessment, but all the foreseeable financial risks should be covered to demonstrate that the planned investment is still worthwhile. Similarly, all the assumptions underlying the calculations should be documented, but these can be included as an appendix, so as not to distract from the key points of the case.

RESEARCH

Risk can be significantly reduced by undertaking good quality research before reaching the stage of putting a proposal forward. Even for small proposals, a basic amount of market research needs to be done and a basis established for making financial forecasts. For large new investments, research is ongoing and it is likely that a new activity will be piloted before the major investment decisions are made. The implementation plan will include the stages where future decisions will be needed on whether to continue the investment and can be linked to monitoring performance, thus creating milestones.

MAKING THE CASE

In putting together the case for investment, the case should be built with the following sections:

— Background: Short introduction to the proposal with information about the reasons for the proposal
— Proposal: Brief summary of the proposal, highlighting key benefits and

the level of investment required. Include the return on investment and compare to the charity's policy, as well as the overall level of cash investment required, where this is likely to be sourced, and the payback period. Also consider comparing this proposal to other options examined and provide an explanation for the choice
- Implementation plan: The plan should show the various stages of the proposal, demonstrating how it will be checked that key milestones are being achieved as the proposal unfolds
- Risk analysis: Examine in further depth the key risks affecting the proposal and the possible financial consequences of these. These can be linked to milestones in the implementation plan so that it is clear what action would be taken if an adverse risk materialised.

This does not have to be a large document; it should be proportionate to the level of investment.

MAKING THE INVESTMENT DECISION

Trustees should have the right information to make the decision and putting a case together as described above should provide them with an appropriate level of information. Trustees may still struggle to make a decision, however, if they do not have an appropriate policy framework for decisions of this type. If investment decisions are made in an *ad hoc* manner simply responding to proposals put forward in a random way by the fundraising teams, then it will be difficult to see how this helps the organisation to achieve its strategic objectives. A lack of a framework may cause trustees to put off decisions, so they need to ensure that such a framework is in place. This should address the following issues:

- What is the funding strategy for the organisation?
- In order to implement the strategy, does the organisation need new initiatives and change?
- How much cash is available for investment in new initiatives?
- Are trustees prepared to borrow cash for investment in fundraising?
- What return do trustees expect from investments in fundraising?
- What is the portfolio of investments, both in stocks and shares and in fundraising? Does the fundraising strategy require a diversification in the fundraising undertaken?

CHOOSING BETWEEN INVESTMENT OPTIONS

In fundraising, every organisation wants to maximise the return for the minimum risk. There is usually a trade-off between risk and return, so this is a careful balance that needs to be struck. A major drawback to *ad hoc* decisions to invest is that they may not optimise the return the organisation could make and minimise the risk.

Trustees should be comparing different investment options. They can assess the return on investment in order to maximise the return, and evaluate the payback period as one means of comparing risk, together with the risk analysis.

CONCLUSION

Good ideas are not enough. Fundraisers need to be able to research their idea thoroughly and calculate the potential return and cashflow implications of a plan. Presenting the case then becomes a lot easier, but trustees will also really only be able to make good decisions if they have a policy framework and other options against which they can compare their investment choice.