



Revenue Forecasting

Principles and procedures for more reliable revenue forecasts and better budgets

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There is a time-honored way to develop a household budget. First, determine the income you are virtually certain to have. Then, develop a realistic plan to live within your means.

Far too often, nonprofit groups do just the reverse. First, we determine what it will cost to do everything we want. Then we project as much revenue as necessary to match projected expenses.

Of course, this can easily lead to fundraising goals that are based on nothing more than wishful thinking. That is a recipe for disaster.

Rosy nonprofit revenue scenarios are often generated by intelligent people who are otherwise rational and responsible in their personal and professional lives. It's easy to see why. Passion for mission, commitment to programs, pride in work and care for staff are frequent causes.

Another is the inherent difficulty of projecting a budget revenue figure for a future full of uncertainties. Most households budget to a known salary figure. Most agencies budget to appropriations that are known in advance. Even businesses can usually project revenue with more accuracy and confidence than most nonprofits, which depend on major gifts, contracts and grants that are never certain until they are received.

There is one more major cause of rosy nonprofit scenarios: they allow hard decisions to be postponed. Need to avoid trimming programs, cutting salaries and benefits, or laying off staff? It's all too easy. Simply assume more revenue.

This ever-present temptation is one of the reasons that turnover of development staff in small- to medium-size nonprofits is extraordinarily high. That high turnover rate is the number one reason many nonprofits are not raising more money today. It's also one of the major reasons that turnover of executive directors is high.

Nonprofit budgets *must* be based on realistic revenue forecasts. Here are some principles and procedures for developing them.

Principles:

1. ***Begin early.*** It takes time to develop a good budget. When the process gets rushed, rigor always suffers. The detailed work needed to develop a good revenue forecast is the most common casualty. Make sure you *budget the time necessary to build your budget* properly.
2. ***Start the budget process with your initial revenue forecast.*** Complete the first draft of your revenue forecast before you even *begin* developing the expense side of your budget. Try not even to *think* yet about what expenses are likely to be. There will be plenty of time for that later.
3. ***Break your revenue projections into major categories.*** Different revenue streams (such as Individuals, Foundations and Businesses) behave differently. Projecting revenues from them often requires different methods. Documenting your projection and underlying rationale for each category makes your overall revenue projection more reliable, transparent and defensible. It also makes later review and revision much easier.
4. ***Be conservative with your assumptions.*** Err on the side of caution with each of your assumptions, such as those about renewal rates, new donor acquisition and the amount of work you can get done with the people you have. If you feel later that being cautious with every single assumption has led to a revenue projection that is unreasonably low, you can adjust it.
5. ***Run your revenue projections at least three different ways.*** Many forecasting methods have merit. Several are described below. But no one method is perfect – and all can lead to bad results if they are based on bad assumptions. If three methods produce results in the same ballpark, you may proceed with confidence. If they produce widely varying results, go back and take a hard look at each. When in doubt, err on the safe (low) side with your revenue projection. In any case, don't base a budget revenue recommendation on a high-side outlier that hasn't been intensely scrutinized.
6. ***Generate and consider alternate scenarios.*** “Worst-case” and “best-case” scenarios have limited utility. There is always an outside possibility that something catastrophic will occur to limit fundraising – or that there will be some windfall, such as a large bequest. Instead of dreaming about best- and worst-case scenarios, think in terms of scenarios that are 80%, 50% and 20% likely. Given the results of your projection methods, what is the figure that you think you have an 80% chance of exceeding this year? 50%? 20%? Most organizations seem to peg their budgets on figures in the 50%-likely range. But that simply ensures that even if their projection methods are good, they will fall short half the time – perhaps by a great deal some of the time. That is no way to build a steadily stronger organization. I encourage groups to peg their budget revenue figures at levels they are 80% confident they will exceed and that they are virtually certain they will not fall short of by much.
7. ***Make a clear distinction between a budget recommendation and a fundraising goal.*** While budget revenue recommendations should be cautious, fundraising goals should be ambitious. I like to see fundraising goals that are significantly higher than budget figures. That builds in

reasonable margin for error in the budget if the ambitious fundraising goals are not met. As a way to express *how* ambitious your goals are, you might say what chance you think you have of reaching them. It's fine if that's only 50%, or even 20% -- provided your budget recommendation is a figure you are much more confident about, something in the 80% realm described above.

8. ***Support ambitious fundraising goals with solid fundraising plans.*** Ambitious does not mean pie-in-the-sky. Your ambitious fundraising goals should be supported by well thought-out action plans you can implement with the people, time and resources you have. If they aren't, they are just meaningless figures on paper.

Exceeding budget figures most of the time and meeting ambitious fundraising goals some of the time results in happy development staff, program staff, executive directors, boards and funders. Most of all, it means a strong, nimble, resilient organization capable of fulfilling its mission over time.

Methods

As stated above, there are many methods for forecasting revenue. None is perfect. Each is only as good as the assumptions behind it – and the care with which its results are interpreted.

With those caveats, here are a few revenue projection methods worth consideration. All can be used to project overall revenues, revenues for major categories (foundations, individuals, businesses, etc.) or both.

Back of the envelope

Don't be fooled by the name I've given this method; it's not pejorative. A simple, macro-level analysis at the beginning of your revenue projection process is useful. It may overestimate or underestimate next year's results, but so may other, more elaborate methods. It can be as simple as this:

<u>Step</u>	<u>Example</u>
Consider results for the last three years.	We raised \$400K overall two years ago, \$550K last year and \$500K this year.
Identify special considerations.	Last year we received a one-time \$100K gift. Excluding it, the adjusted figures for the three years are \$400K, \$450K and \$500K.
<i>Project next year's results.</i>	<i>If recent trends continue, we should be able to raise \$550K next year.</i>

Renewals plus new gifts

This method requires a little more time and thought than the first, but it is still fairly simple. I find it is usually a good second step.

<u>Step</u>	<u>Example</u>	<u>Result</u>
Identify renewable gifts. Multiply by a reasonable assumed renewal rate.	<ul style="list-style-type: none"> • This year 50 donors made gifts totaling \$500K. • Of those, 10 totaling \$80K were one-time gifts. • The other 40 totaling \$420K were gifts to our annual fund that we have a good chance of renewing. • Our renewal rate for these types of gifts in recent years has been 80%. • To be safe for budget purposes we will assume a renewal rate of 70% next year. 	\$420K x 70% = \$294K.
Determine reasonable expectation for new gifts.	<ul style="list-style-type: none"> • Our results for new donors for the last three years have been \$70K, \$85K and \$100K. • We expect the pace of growth to increase this year due to a major new campaign beginning now. • We believe we can raise \$125K next year but will assume only \$115K in our budget calculations to be on the safe side. 	\$115K
TOTAL		\$409K

In our hypothetical example, this method returned a projection nearly 20% lower than the first. A discrepancy this large should give some serious pause. It certainly suggests a need for more thought and work before making a budget recommendation.

Donor-by-donor projections

This method is widely used. It is sometimes the *only* method used. Like the rest, it has its strengths and weaknesses.

Typically, all larger donors and prospects are listed, along with expected ask amounts and estimated likelihood of success. Smaller donors (say, all individuals giving between \$1 and \$99) can be clumped into a single group.

<u>Donor</u>	<u>Ask amount</u>	<u>Likelihood</u>	<u>Projection</u>
Jane Doe	\$100,000	60%	\$60,000
John Hancock	\$60,000	50%	\$30,000
Mary Green	\$50,000	70%	\$35,000
Bill White	\$25,000	90%	\$22,500
<i>Etc... (All other major donors/prospects, listed separately)</i>	<i>\$1,100,000</i>	<i>various</i>	<i>\$531,000</i>
\$100-\$249 donors	\$60,000	80%	\$48,000
\$1-\$99 donors	\$40,000	90%	\$36,000

TOTAL	\$1,210,000	\$762,500
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One of the benefits of this method is that it produces an actual list of asks to be made. It can be turned into a real workplan by adding a few more columns, such as Date of Ask, Date of Expected Response, Lead Staffer, and so forth. There is great value to this.

However, because this somewhat detailed projection method seems highly rational, it tends to inspire excessive confidence in its results. It can actually lead to projections that are quite unrealistic. The reason? There are several.

- It's easy to make a list of prospects that is longer than you can work effectively enough early enough in the year to get gifts in the door by the end of the year.
- It's easy to come up with unrealistic ask amounts that you must reduce later when you do more research or when you get more information from the donor.
- It's very easy to be a little too optimistic in the likelihood column, which is after all a guess. It may be a fairly educated guess for some prospects on the list, but even then, it's a guess.
- Jane Doe may have a projection of \$100K. But what does a 60% likelihood of a Yes to a \$100,000 ask really mean? There are many possible outcomes, but the two most likely are \$100,000 and zero. Still, it's often said in a case like this that Jane is "in the budget" for \$60,000. If a few of the top prospects on the list give little or nothing, the results can be very far short of the projection this method generates.

Perhaps the biggest danger of this method is the ease with which it can be used to justify *any number you want*. Do you need to find another \$100K to balance the budget? Just add a few more prospects and jiggle a few assumptions about Ask and Likelihood here and there, and it's done! This is systematic self-delusion – and it's practiced in thousands of nonprofit groups every year.

Excessive optimism in the use of this method allows an organization to believe in a rosy scenario. That just puts off necessary hard decisions and allows financial holes to be dug deeper. Conversely, undue pessimism or timidity in the use of this method can return unreasonably low revenue forecasts that cause unnecessary budget cuts that pain and weaken an organization.

In short, while this method may appear on the surface to be the most reliable, I believe it may actually be the least reliable overall. I believe it has its merits and its place, but I never like to see a group use it *exclusively*.

Projections by subcategory

One of the best ways to ground-truth the above method is to take it one more step. Simply group your donors in a given category such as Individual Giving by gift size (\$25K & up, \$10K-\$25K, \$1K-\$10K etc.). Then ask yourself some questions about each group, such as

- How much did you get from that group as a whole last year?
- How confident are you that you will actually make the assumed asks of everyone in the group in the coming year?
- Do you expect to identify additional prospects in this gift range?

- If things go about as well as you hope, how much do you think you will raise from the group?
- What’s the most likely scenario (the one you have a 50-50 chance of realizing)?
- If a few of your top donors don’t come through, how much less will you see?
- And so forth...

After thinking the questions through, assign a projection for each subcategory. Then add them up.

<u>Category (number this year)</u>	<u>This year (projected year-end)</u>	<u>Next year’s projection</u>
\$100K and up (1)	\$ 100K	\$ 0
\$25K-\$99K (5)	\$ 175K	\$ 225K
\$10K-\$24K (12)	\$ 150K	\$ 180K
\$1K-\$9K	\$ 35K	\$ 70K
\$250-\$999	\$ 25K	\$ 35K
\$1-\$249	\$ 15K	\$ 20K
TOTAL	\$ 500K	\$ 530K

This method is somewhat subjective, of course. But so are the others, in different ways. Over the years I have found this method to be as reliable as any – particularly when it is used to cross-check projections made in other ways.

Final thoughts

There are other methods you might employ. You might invent some of your own. The important things are to:

- Run the numbers at least two different ways.
- Don’t assume that more complex methods are always more accurate.
- Be skeptical of outliers – and throw out any results that don’t pass the laugh test.
- Make your budget recommendations conservative. Make your fundraising goals ambitious.
- Develop a solid fundraising plan to give the organization a good chance of exceeding the fundraising goals by a little, and the budget figures by a lot. (It’s infinitely better to adjust the budget upward by a lot at mid-year than to have to do the opposite.)
- Boil down the rationale for your final budget recommendations in a brief memo so that others in the organization understand it – and so that you can easily revisit it at mid-year and revise your projections as appropriate.