Training Resources *for* *the* Environmental Community

TREC

Revenue Forecasting

Principles and procedures for more reliable revenue forecasts and better budgets

There is a time-honored way to develop a household budget. First, determine the income you are virtually certain to have. Then, create 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 and then some. Then we project as much revenue as necessary to match projected expenses.

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

Rosy nonprofit revenue scenarios are often generated by smart 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 important causes.

Another barrier 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 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 significant 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 your organization is going to take in more revenue and delay the hard decisions.

This ever-present temptation is one reason why the turnover of development staff in small- to medium-size nonprofits is notably higher. That high turnover rate is the number one reason many nonprofits are not raising more money today.

Nonprofits must base their budgets 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 to develop the expense side of your budget. Try not to think about what your 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 require 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 an unreasonably low revenue projection, you can adjust it.

5. **Run your revenue projections at least three different ways.** Many forecasting methods have merit. Several are described below. 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 conservative (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 a 75% 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 75% 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 revenue goals.** While budget revenue recommendations should be cautious, revenue goals should be ambitious. I like to see goals that are significantly higher than budget figures. That builds in a reasonable margin for error in the budget if the ambitious income goals are not met. 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 75% realm described above.

8. **Support ambitious fundraising goals with solid fundraising plans.** Ambitious does not mean pie-in-the-sky. You should support ambitious fundraising goals with 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. Fundraising Goals may also be, at times, less than your projections. Make sure your goals are ambitious yet realistic.

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 a variety of methods you can utilize for forecasting revenue. None is perfect. Each is only as good as the assumptions behind it—and the care taken interpreting the results.

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 Napkin

Don't be fooled by the name given to 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:

Step	Example
Consider results for the last three years in a specific category—for example, all income, major donors, foundation grants, or earned income.	Looking at all income over the last 3 years, we raised $525k this year, $550k last year, and $400K overall two years ago.
Identify special considerations.	This year we cancelled a gala that brings in $7500, which will resume next year. Last year we received a one-time $35K gift. Excluding it, the adjusted figures for the three years are $525K, $515K, and $400K.
Project next year's results.	If recent trends continue, we should be able to raise $557,500 next year.

...Income over last 3 Years	Total Raised	Annual Increase	Special Considerations	$ Changes Due Special Considerations	Adjusted Figures	Annual Increases
Current Year	$525,000	-$25,000	Canceled gala, will resume next year	-$7,500.00	$532,500	$17,500
Prior Year	$550,000	$150,000	Received additional one time $35k donation	$35,000	$515,000	$115,000
2-years ago	$400,000	$400,000			$400,000	
TOTAL 3 year Income	$1,475,000	$525,000	Total Special $	$27,500		
					Your Projected Growth	$25,000
				Next Year's Projection	**$557,500**	

Next Steps: Run multiple income sets of your “Back of the Napkin” income amounts. For example, take a close look at your grant funding current year, prior year, and two years ago. If you have major donor program, run those 3-year totals using this method. The more income sets you run; the more data you will have available when making decisions.

Likelihood

This method is widely used. It is sometimes the only method used by time-crunched nonprofit leaders. Like the rest, it has its strengths and weaknesses. **It is important NOT to make this the only way you run your income projections.**

Typically, all larger donors and prospects are listed, along with expected ask amounts and the estimated likelihood of success. You may also lump smaller donors (say, all individuals giving between $1 and $99, $100 to $249, or all online donations) into a single group.

Example Revenue Category: Major Donors	Ask	Likelihood/ Confidence Level
Kisha Johnson	$100,000	75%
Allison Tamaki	$60,000	80%
Bryan Greene	$50,000	30%
Rashid Chan	$25,000	90%
TOTAL	***$235,000***	

Major Donors: Lump Sums	Ask	Likelihood/ Confidence Level
$5,000 donors	$10,000	70%
$1,000 donors	$15,000	90%
$500-$1,000 donors	$5,000	95%
TOTAL	***$30,000***	

One of the benefits of this method is that it produces an actual list of asks to be made, which can then 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.

However, because this somewhat detailed projection method seems highly rational, **donor-by-donor projections tend to inspire excessive confidence in its results**. It can lead to projections that are unrealistic and have potentially catastrophic impacts on your bottom line.

So how can you offset potentially damaging wrong projections? By projecting conservatively. This means counting every projection with a likelihood of 75% or above as 100% likely and every projection with a likelihood of less than 75% as a zero. For example, Kisha Johnson may have a gift projection of $100K. But since we gave her gift a likelihood or our confidence level of 60%, her gift projection would remain zero. However, your goal may be a different amount.

Example Revenue Category: Major Donors	Ask	Likelihood/ Confidence Level	Projection	Your Fundraising Goals
Kisha Johnson	$100,000	75%	**$100,000**	$60,000
Allison Tamaki	$60,000	80%	**$60,000**	$55,000
Bryan Greene	$50,000	30%	**$0**	$25,000
Rashid Chan	$25,000	90%	**$25,000**	$25,000
TOTAL	***$235,000***		***$185,000***	***$165,000***

Let's take a closer look at Foundations and Grants using this 75% likelihood method. You have identified five grants totaling $240,000 with a confidence level ranging from 60% to 100%. The first four grants have a 75% or higher likelihood or confidence level, and therefore your projections should equal the total amount. However, your fifth grant has a 60% likelihood or confidence level. Therefore, that projection would equal $0.

All Grants (Foundation & Gov't)	Ask	Likelihood/ Confidence Level	Projection	Your Fundraising Goals
ABC Family Foundation	$50,000	75%	**$50,000**	$35,000
XYZ Family Foundation	$150,000	80%	**$150,000**	$130,000
In-Between Memorial Trust	$25,000	90%	**$25,000**	$22,000
Giving for Betterment Foundation	$10,000	100%	**$10,000**	$10,000
Why Don't We Ask Foundation	$5,000	60%	**$0**	$1,000
TOTAL	***$240,000***	-	***$235,000***	***$198,000***

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 using the donor-by-donor projections method allows an organization to believe in a rosy scenario. That just puts off necessary hard decisions by organizations and enables them to dig deeper financial holes. Conversely, undue pessimism or timidity in using this method can return unreasonably low revenue forecasts that cause unnecessary budget cuts that pain and weaken an organization.

This method has its merits and its place and will provide relatively conservative numbers. However, don't make this the only method which you use to run your income projections.

Projections by Subcategory

One of the best ways to ground truth surrounding the Likelihood method is to take it one more step. 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 as well as you hope, how much do you think you will raise from the group?
- What's the most likely scenario?
- 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.

Example Revenue Category: All Donors	This year (projected year-end)	Projection for next year	GOAL	Variance from Goal
$100K & up (1)	$100,000	$50,000	$100,000	-$50,000
$25K-$99K (5)	$175,000	$225,000	$175,000	$50,000
$10K-$24K (12)	$150,000	$180,000	$200,000	$-20,000
$1K-$9K (25)	$35,000	$70,000	$70,000	$0
$250-$999 (75)	$25,000	$35,000	$40,000	$-5,000
$1-$249 (600)	$15,000	$15,000	$15,000	$0
TOTAL	***$500,000***	***$575,000***	***$600,000***	***$25,000***

This method is somewhat subjective, of course. But so are the others, in different ways. This method has proven to be as reliable as any — particularly when using it to cross-check projections made in other ways.

Renewals and New Gifts

There is another method you might use. The renewal and new gifts method requires a little more time and thought than the first, but it is still simple and helps you drive deeper into your renewal projections.

Step	Example	Result
Identify renewable gifts. **Multiply by a reasonable assumed renewal rate.**	This year 50 donors made gifts totaling $500K. • Of those, 10 gifts 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.	$420K x 70% = $294K
	The renewal rate for our annual fund gifts in recent years has been 80%. To be safe for budget purposes, we will assume a renewal rate of 70% next year.	
Determine reasonable expectations for new gifts.	Our results for new donors for the last three years have been $70K, $85K, and $100K.	$115K
	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.	
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.

Final thoughts

Of course, there are other methods you might employ. You might invent some of your own. Regardless of which methods you choose to use there are some important things to remember:

- Run your income numbers in at least two different ways. Three is even better.
- 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.