BOOSTING YOUR GIVING PROGRAMS THROUGH PROSPECT RESEARCH

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Through Prospect Research

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Introduction

With competition for donor dollars at an all-time high, nonprofit organizations are increasingly turning to prospect research to help them identify their best prospects, as well as to strengthen their donor relationships and fundraising programs. To achieve the best results, they must develop and follow a strategy based on information about each prospect's likelihood and capacity to give to their organization. But how and what effect can a strong prospect research strategy have on helping an organization grow its giving programs?

Armed with results from predictive modeling — or better yet, custom statistical modeling — an organization can find its best prospects, target appeals properly, and raise more money. Turning propensity and wealth data into actionable information empowers a nonprofit to grow its annual giving programs, build donor loyalty, and move givers up the donor pyramid to reach their ultimate giving potentials. Further, implementing an effective marketing approach that leverages prospect research results enhances an organization's overall financial health. Done well, and in accordance with privacy standards, prospect research becomes an integral tool for successfully acquiring and upgrading prospects at each stage of the donor life cycle — and ultimately increasing fundraising results.

Regardless of its size, your organization can benefit from a well-developed and implemented prospect research strategy. If you wonder if you are doing everything possible to advance how well you know your prospects and donors, this book is for you. Through expert insight, practical examples, and real-world success stories, it is designed to help get everyone in your organization thinking on the same page about giving your fundraising efforts a major boost.

CHAPTER 1

The Nitty Gritty of Predictive Statistical Modeling

by Lawrence Henze

Nonprofits increasingly rely on statistical modeling to help them target their best prospects and strengthen their fundraising programs.

statistical modeling works

A well-designed predictive statistical model can help you to analyze every person in your database — not just those whose wealth profiles or giving histories suggest they are good prospects. This will enable your nonprofit to get a more complete picture of who is most likely to give, their ultimate gift potential, and what kind of appeal you should use. With this information in hand, you can save valuable time and money by focusing appeals on those most likely to contribute to your organization.

Almost any nonprofit can use predictive statistical modeling to optimally target fundraising efforts. In fact, nonprofits are generally in a good position to use this tool because most already have electronic databases of potential prospects. Whether you are preparing for a capital campaign, looking for planned gifts, or seeking contributions to an annual fund, you can use a model to identify your best prospects and build a broad base of support.

Use statistical modeling to increase donations — success begins with choosing the right model for your organization!

three types of models

There are three principal types of predictive statistical models: generic, prescriptive, and custom. Each offers a different approach to presenting information on individuals in your database, yet all are designed to help you better understand which potential donors are your best prospects. The usefulness of information gleaned depends on which approach you use.

To illustrate, let's select three sample organizations — a local hospital, a private college, and a small museum — and compare how two sample donors with different interests and lifestyles would be scored on propensity to give using different methodologies.

Sarah is a 56-year-old New Yorker who donates generously to a number of charities each year. She is a cancer survivor who was treated at the local hospital and attends their annual Survivor's Gala. She goes to sporting events at the local private college but did not donate when the school was raising funds to build a new stadium.

Andrew is a 23-year-old graduate of the private college where Sarah attends sporting events and is enjoying his first job at a boutique Wall Street research firm. He is a strong believer in limited government regulation and generally votes against publicly-funded healthcare reform. During his college years, he volunteered at several nonprofits, and he has been a member of the Metropolitan Museum of Art for six years.

> *"You don't have to be a Fortune 500 nonprofit to do statistical modeling. You can do it very effectively on a small budget."*
>
> *— Nancy Baglietto, Development Officer, Regional Parks Foundation*

generic modeling

With a generic model, you can build a profile to describe charitable giving in the United States. This model tends to use aggregate data, often based on the past giving history of a number of organizations, plus some demographic data about age, income, and family status. Although it never hurts to understand the characteristics of a typical donor, a generic model will not provide information about who is more likely to donate to a specific type of nonprofit, let alone your organization.

How would Sarah and Andrew score using a generic model? Given their New York City ZIP Codes, education levels, median incomes, and quality of life indices, both would be rated as good prospects for all three charities.

	Generic Modeling Likelihood to Give	
	Andrew	Sarah
Local Hospital	Good	Good
Private College	Good	Good
Small Museum	Good	Good

prescriptive modeling

Prescriptive modeling incorporates both industry data and variables about your own donors to better quantify your most likely prospects. However, because of its heavy reliance on industry data, in most cases a prescriptive model will only predict who is likely to give to an organization like yours.

Unlike generic models, most prescriptive models incorporate an important personal variable — affinity to the organization — which helps to characterize a prospect's tendency to support your nonprofit's mission based on his or her past giving history. Turning to Sarah and Andrew, a prescriptive model would suggest that although it is likely that Sarah would give to a hospital, it is not clear that Andrew would. Likewise, Andrew is far more likely than Sarah to give to both a college and a museum — and his score reflects this. In other words, although the prescriptive model is not comprehensive, it does provide a better snapshot of Sarah and Andrew's likelihood to give to each organization.

	Generic Modeling Likelihood to Give		**Prescriptive Modeling** Likelihood to Give	
	Andrew	Sarah	Andrew	Sarah
Local Hospital	Good	Good	Fair	Excellent
Private College	Good	Good	Excellent	Fair
Small Museum	Good	Good	Excellent	Poor

Prescriptive modeling is often used when a nonprofit does not have enough unique data about the activity it is trying to predict. Say, for example, your organization wants to generate more planned gifts. You have only secured a few planned gifts over the past two years and do not have enough data to build a custom model. A well-designed prescriptive model for planned giving will incorporate industry data about the typical profile of a planned giver and specific lifestyle variables — such as age, income, and giving history — to supplement the information in your database and help identify your best planned giving prospects.

custom modeling

A custom model is similar to a prescriptive model, but it constructs a profile of giving behavior unique to your organization. A custom model examines the people in your database who have done what you are trying to predict, such as contributing to your capital campaign or making a planned gift, as well as the people who have not donated to your organization but who have been solicited.

> *"The results of custom modeling have helped us to communicate more with the right people, saving us time and money as we secure new planned gifts."*
>
> *— Glenn Pittsford, Director of Planned Giving, Texas A&M Foundation*

Using your own data, a custom model will factor in the age, income, giving history, and other lifestyle variables of your prospects. The custom model will also factor in the strength of each individual's relationship with your organization, such as whether he or she volunteers regularly, purchases season tickets every year, or sits on your board of directors. A custom model will identify and rank the best prospects in your database, whether or not they have already given to your organization. This will enable you to better understand your donors' and non-donors' relationships with your organization — and then turn that knowledge into fundraising results.

The custom model built for each of our three sample nonprofits would incorporate the variables that are unique to that organization. The custom model for the hospital might weigh several factors, including whether a prospect attends events and is a consistent donor, as well as estimated income and other lifestyle variables. The model for the college probably weighs different factors, perhaps including gender, the person's alumnus status, and median rent.

The key factors in scoring individual prospects under the museum's custom model might include volunteerism, the size of the donor's largest gift, and the type of museum membership he or she holds.

What does this mean for Sarah and Andrew? A look at the table reveals that their scores — representing their propensities to give — are better aligned with what we know about them. Although both are excellent prospects for the small museum's fundraising campaign, the custom models reveal that Sarah is no more likely to give to the college than Andrew is to give to the hospital.

	Generic Modeling Likelihood to Give		**Prescriptive Modeling** Likelihood to Give		**Custom Modeling** Likelihood to Give	
	Andrew	Sarah	Andrew	Sarah	Andrew	Sarah
Local Hospital	Good	Good	Fair	Excellent	Poor	Excellent
Private College	Good	Good	Excellent	Fair	Excellent	Poor
Small Museum	Good	Good	Excellent	Poor	Excellent	Poor

One note about custom modeling: it can be undermined by something statisticians call endogeneity. Simply put, misleading or endogenous variables can dramatically dilute the effectiveness of your custom model.

For example, you may have collected email addresses from many of your donors, but simply having an individual's email address is not predictive of whether he or she will donate to your organization. Therefore, that variable should be stripped from your custom model. Other examples of endogenous variables include a business address or a middle initial. (When you are looking to work with a company that provides modeling services, ensure that they are fully equipped to address this key issue.) This type of modeling is frequently labeled as "descriptive", and although it may offer insights into the composition of your donor pool, it adds little in predicting future behavior and may ultimately be misleading if used for that purpose.

success stories

A number of nonprofits, both large and small, have used predictive statistical modeling to improve their fundraising results:

- Jacksonville University used custom statistical modeling to identify its best donor prospects before launching a capital campaign. The model identified about 50 previously-untapped prospects with a high propensity to make major gifts, paving the way for a special appeal.

- The Regional Parks Foundation applied the results of its custom model to effectively triple both the response rate from, and total contributions to, its holiday appeal — while reducing its mailing by one-third. By custom-tailoring its appeal based on individual prospect criteria, the organization boosted its annual contribution rate from approximately $20,000 to $62,000 by mid-year.

- The Texas A&M Foundation used a combination of prescriptive and custom statistical modeling to better target its charitable gift annuities appeal. It screened 62,000 prospects, identified one-third as good candidates, sent a targeted appeal, and closed a new seven-figure gift.

tips to getting started

If you are interested in using statistical modeling to grow donations at your organization, here are some tips to help you get started.

1. Pick the right model.

Custom modeling is a powerful tool to help you identify and rank the best prospects in your organization's database. Whenever possible, you should choose to develop a custom model. If you do not have enough giving history to build a custom model, then you can apply a prescriptive model to segment your database and better understand who is likely to give to an organization like yours. You should never waste time and money on a generic model; it will not tell you anything useful about whether the people in your database are inclined to give to your organization.

2. Select the right vendor.

The ideal vendor will understand modeling, fundraising, and the nonprofit community. At a minimum, he or she will need to understand the fundamentals of fundraising in order to create a solid model to predict the charitable giving behavior of your potential donors. In selecting a vendor, you must make sure that the company you choose understands — and actually can build you — a custom model.

- Will your vendor explain the contents of the model? With a custom model, your vendor should be willing to share detailed information about what is in your model. If not, it is likely the vendor incorporated proprietary information that he or she does not want to give away — and the model is not a custom one.
- There are a number of tests you can perform on custom models to see if they work. Has your vendor tested the model? If a vendor is not willing to show you what he or she has done to test the effectiveness of the model, it is probably because he or she has used a prescriptive or generic model instead.

It is also very useful if your vendor has former practitioners on staff who can assist in the delivery of results once your custom model has been built and tested. This means that the person should be familiar with both fundraising and nonprofits and can discuss with you his or her findings and recommendations for using the data to maximize your fundraising success.

Finally, the right vendor will provide follow-up support. Custom modeling works only if nonprofits apply the results. How does your vendor follow up? A good vendor will check back with you to make sure your organization understands how to use the results and is, in fact, applying them.

3. Prepare your data.

Getting started is easy. Because most nonprofits have their data stored in some form of electronic database, it is just a matter of pulling together three to six years of historical data. A good vendor should be able to accept most electronic database formats. The vendor will then go through the files and clean them, perhaps appending other data if required, such as prospects' ages or the values of their homes. Then the vendor will start to build your custom model. Once the model is complete, the vendor should place the results into a software format that you can use.

conclusion

Nonprofits that use modeling have discovered that applying statistical methodology to help identify their best giving prospects is an effective way to jumpstart a new fundraising campaign or to strengthen existing programs. Although there are different types of models — generic, prescriptive, and custom — that offer differing levels of specificity and usefulness, custom modeling alone uses your own data to identify the unique characteristics of your best donors and help you raise more money.

CHAPTER 2

Getting to Know Your Annual Fund

by Lawrence Henze

New donors traditionally start out by giving to an organization's annual fund. As a result, annual funds offer a unique opportunity to begin the process of building donor loyalty. But dozens of repeat solicitations each year will not do the trick; rather, nonprofits need to measure their efforts and target their appeals with the right message and the right approach. Done poorly, each lost opportunity can cost a charity thousands of dollars over a person's lifetime. Done correctly, you can improve your annual fundraising results, create loyal donors, and identify those people who are most likely to become your best planned giving and major gift prospects. Simply put, your annual fund is the cornerstone of a successful fundraising program.

Your annual fund is the first step to securing donor loyalty — take control of your annual fund today!

the five aims of annual giving

Almost every nonprofit has an annual gift fund — the building block for major and planned giving success. Annual giving is the name given to solicitation efforts that are designed to achieve five aims:

- To promote introductory giving
- To reach large groups of individuals
- To promote loyal giving
- To be efficient and cost effective
- To minimize the intrusion into a donor's life

Although organizations generally incorporate the first three aims into their equation, they often forget about the final two goals.

Many charities rely on direct mail campaigns to solicit small donations from a large pool, and they hope in the process to reel in people who will become loyal donors. The problem, however, is that the bar is generally set too low and the solicitation strategy is scattershot at best.

To explore the problem, I randomly selected 50 national and regional charities and gave each an unsolicited $10 donation in 2001 in order to find out how the nonprofits would treat me going forward. In the first year, 21 of the nonprofits each sent me 18 or more mailings to try to get me to repeat that $10 gift. And the problem has only gotten worse over time. During 2002-2007, I added an additional 300 charities to my test group. Once again, I gave each an introductory $10 donation. Now the 350 organizations are sending me an average of 12 to 14 mailings each — or more than 4000 direct marketing pieces per year.

Anyone who has felt hounded by a direct mail campaign knows that exasperated people do not make good sales prospects. And yet nonprofits too often alienate the very donors they are trying to reach. As donors are increasingly demanding to see good business practices from their charities, nonprofits can no longer afford to ignore the importance of efficiency and cost effectiveness in their operations. A successful annual giving campaign must not just ask for a donation — the ask must be done strategically.

a stepping stone to big money

Research has shown that annual fund donors represent a nonprofit's future major contributors. Many of those individuals you count on for donations year after year are, in fact, your best major gift and planned giving prospects. A donor can be defined as reaching the loyal donor threshold when he or she has given to your organization in a minimum of three of the past five years, or 60 percent of the time. Once people achieve this threshold, they are much more likely either to advance to a higher level of annual giving or to make a planned or major gift.

There are, of course, exceptions to this rule. As people get closer to the end of life, they are statistically more likely to make a major gift in support of their religious beliefs — whether or not they have ever given before. Similarly, a grateful patient may give a major donation to the hospital that treated her. In addition, a gift to an annual fund will not necessarily help you predict who is likely to give to a capital campaign. A sports fanatic, for example, may decide to support construction of a new basketball arena at his college even if he has never — and is never likely to — provide a dime for academic programs.

My research indicates that after six solicitations in one year, the likelihood for long-term loyalty diminishes significantly. As a result, it is important for charities to focus on building long-term relationships rather than on squeezing an extra $20 from donors in any given year. It is time to realize that the seventh fundraising letter sent in a year is likely to alienate the same small donor who might otherwise be a good prospect for a large gift a few years down the road.

Beloit Memorial Hospital Foundation *realized a 17% increase in donations over the previous year the first time models were used to target annual fund donors. In addition, the results showed that Beloit Memorial Hospital Foundation was attracting a different profile of giver than most healthcare organizations — more of its donors were younger men than older women. With this information in hand, the foundation was better able to target both its message and approach to suit those prospects most likely to support the hospital.*

the role of data modeling

As we discussed in the prior chapter, there are three different types of models available — generic, prescriptive, and custom. Generic modeling allows you to build a profile to describe charitable giving in the United States. Prescriptive modeling, which relies heavily on industry data, can help you predict who is likely to give to an organization like yours. Custom modeling, meanwhile, allows you to build a profile of giving behavior that is unique to your organization.

Custom modeling is the only one of the three models that will predict which of your annual gift donors are likely to make a larger gift. This is because annual gift characteristics vary significantly from one charity to another and even vary within multiple chapters of the same organization. Someone giving to the United Way in Miami may be concerned about people displaced by the latest hurricane, while those giving in Los Angeles may be interested in bridging the gap between the city's rich and poor.

Using your own data, a custom model will factor in the demographic, relational, and financial variables applicable to your donors. The custom model will also factor in the strength of each individual's relationship with your organization and help you to identify and rank the best prospects in your annual fund database. This will enable you to better understand your donors' relationships with your organization — and then turn that knowledge into fundraising results.

Equally important, you want to avoid modeling based on one-time donors. Whether they gave in response to a natural disaster, in honor of a deceased relative, or in support of an aspiring marathoner, the fact that they never repeated the gift suggests that pursuing them is a waste of both time and money. Because your aim is to identify and encourage repeat giving, build your model based on donor loyalty.

A target gift range custom model can be a valuable tool in figuring out how much your annual gift prospects can give in a 12-month period. This is instrumental in understanding your annual gift donors and building the appropriate relationship with each. Because while some of your $10 donors will stay at that level, others may be more than willing to give $250 or even $1,000 annually if they are just asked — and asked the right way. In fact, one of the top three reasons people do not give is that they are asked to give too little. The other two reasons: they are not asked at all and they do not support the nonprofit's mission.

using data for targeted marketing

Once you have your custom model, it is easy to begin applying the results. The model will assign a score to each prospect, indicating his or her likelihood to give and suggesting a gift size. You can then use this information to segment your database. For those with high scores (and large assets), for example, you might want to consider personalizing your fundraising efforts; for those with low scores, it may be time to either cut back on mailings or even pull the person from your database.

It is becoming more and more common for donors to make small, initial contributions in order to see how a charity will respond. While too many organizations blow their opportunity to build loyalty by sending 20-25 follow-up solicitations in hopes of securing another small donation, savvy charities are investing in target gift range models and customizing approaches that work. For example, if you know a museum donor's taste runs to post-modernism, wouldn't it be more effective to talk about the 20th century collection than to send a one-size-fits-all letter about the museum's general collection? And if a person receives a high score and appears to have significant assets, wouldn't it make more sense to cut out the direct mail entirely in favor of one-on-one cultivation?

***Covenant House Vancouver** applied the results of its custom model to significantly improve the results from its annual fund appeal. Equipped with a list of top prospects and reliable data on each, the charity was able to target lapsed donors with a new annual fund mailing. Whereas the charity had achieved a one-percent response rate from past direct mail campaigns, the new campaign brought the response rate up to 5.5 percent. In addition, the average gift climbed to $67 — almost double the previous average of $35.*

In addition to crafting different messages for different donors, it is equally important to offer donors information about how their gifts will be used. Maybe a $250 donation to a relief organization will feed 1,000 refugees for a day or a $500 gift to a healthcare charity will allow 5,000 children to be vaccinated against tuberculosis. The more donors recognize the impact of their gifts, the more likely they are to bond with your nonprofit's mission and become loyal donors.

Even if your organization is not yet ready to invest in a custom model, here is a strategy you can test to enhance donor loyalty. First, identify those annual fund donors who give consistently to your organization (at least three times in the last five years) in the same month or same quarter. Once you know who they are, solicit them during that time. And let them know what you are doing.

Say, for example, that someone always seems to give in April. Mention in your fundraising letter that you noticed that they like to give in April and that, if they respond with a gift, you will not send them requests the rest of the year. And point out that this allows your nonprofit to reduce costs and make their gift more valuable. This will make you an efficient and cost-effective organization, which is always important in building donor loyalty.

Great Lakes Science Center *used custom modeling results to narrow down its mailing list of 40,000 to a more reasonable 15,000. By better targeting the messaging and investing some savings in a higher quality solicitation piece, the organization surpassed the previous year's donations in the first seven months. It also reports that trustees are more willing to participate in fundraising since the adoption of this more targeted approach.*

A custom annual fund model is easy to implement. Once you understand the target gift range capacity of the people in your donor database, you can develop different messages for different categories of annual gift donors. While you might continue to ask one group for small donations, you can now craft a completely new appeal for those with the potential to make a larger annual gift. Applying a more strategic approach to fundraising will result in more donations.

annual fund best practices

If you are interested in improving your annual gift fundraising results, here are some best practices in the industry.

1. Implement anniversary data solicitations.

Soliciting donors when they like to give builds loyalty and proves your nonprofit is paying attention. Identify those people in your database who have consistently given to you in the same month or same quarter, and appeal to them at that time. Use the other two or three mailings you send them each year to provide news, give a project update, or just say thank you.

2. Build gift clubs based on loyalty.

Most gift clubs are based on donation size. Organizations from universities to operas have gift clubs based on $10,000, $1,000, or even $100 donors. Missing from this approach, however, is recognition of donor loyalty. Since consistent low-end annual-gift donors are your best planned gift prospects, it is important to reward that loyalty early and often. Consider creating a gift club for loyal donors — regardless of whether they give $250 or $25 a year.

3. Test your appeal.

The best way to learn what works and what does not is to test your messages. Take a subsection of your list, and try out a more targeted appeal. If it works, then expand the experiment and watch your annual fund grow.

4. Do not always ask for money.

The best donor is a loyal donor, and people like to be courted. Sometimes it pays not to ask for anything. Build a strong relationship over time by sending thank-you notes, items of interest, and other news. The bottom line: Make your donors feel special.

In addition to crafting different messages for different donors, it is equally important to offer donors information about how their gifts will be used.

conclusion

A nonprofit's annual fund is a building block to fundraising success. Annual funds offer charities a great opportunity to make a good first impression and to start the process of promoting lifelong donor loyalty. Savvy appeals can help you efficiently and cost-effectively raise money while minimizing the intrusion into your donors' lives. Custom modeling can help you identify who is likely to give more and which of your loyal donors are your best prospects for planned or major gifts. All of these factors are critical elements to sustaining your mission over the long haul.

CHAPTER 3
Planned Giving Up Close and Personal
by Lawrence Henze

Developing a successful planned giving program can be a complex undertaking. But it is one that is well worth the trouble. Extensive research has shown that planned giving is about lifestyles and loyalty, not wealth. Many organizations still think they have to find the millionaires in their database to secure planned gifts. The truth: everyone in your annual fund program has the potential to be a planned giver. This means you have more control over the process than you think. Equipped with solid information and the right marketing strategy, your organization can build a successful planned giving program.

"golden age of philanthropy"

Americans will transfer at least $41 trillion between 1998-2052, according to a study[1] by the Social Welfare Research Institute at Boston College. At least $6 trillion of that funding will be bequests to charity, according to authors Paul Schervish and John Havens, who wrote that "a golden age of philanthropy is dawning."

[1] *Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy*, by Paul G. Schervish and John J. Havens. Social Welfare Research Institute, Boston College, Boston, MA, October 1999.

With so many philanthropic dollars up for grabs, nonprofits need to position themselves to capture a share of the wealth. Research from the National Committee on Planned Giving[2] shows that although 42 percent of Americans have wills, only about nine percent have included charities. But once charities are included, they stay: 97 percent said they had not revoked a charitable provision. An additional 14 percent of those surveyed said they had considered including a charitable bequest in their wills — even though no nonprofit has asked them to do so. This leaves a largely untapped market.

about planned giving

Planned giving, once called deferred giving, refers to any charitable gift that requires more thought and planning to execute than the average donation. Planned giving has traditionally been defined as the gift that an individual makes near the end of his or her lifetime. There are many kinds of planned gifts, from simple bequests in a will or an estate plan, to annuities, charitable remainder trusts, charitable lead trusts, pooled income, life insurance, and life estates.

Nonprofits often have trouble securing planned gifts. Why? The answer generally boils down to four basic factors: targeting the wrong prospects, sending the wrong appeal, asking too late, and soliciting planned gift prospects for major gifts instead, so the organization can get the money more quickly.

Many charities assume that their major gift donors will be their best prospects for planned gifts. When these solicitations fail, organizations are left with the impression that planned giving is just not right for them. Other organizations send broad-based planned giving mailings to older donors, telling them about a multitude of planned giving vehicles and asking them to contact the organization for more information. In my experience, returns

[2] *Planned Giving in the United States 2000: A Survey of Donors*. National Committee on Planned Giving.

on such requests for information often average less than one percent. Moreover, little — if any — personal follow up is done with the prospects who do not respond.

The historical lack of meaningful research on planned giving has done little to help nonprofits rethink their strategies. It is often difficult to get reliable, accurate information on planned giving donors, as between 70-90 percent of all bequests are unknown to the charity until after the donor's death. Add to this the fact that, for many groups, their small cadre of planned gift donors are trustees, board members, and others with unusually close relationships to the charity, and much of what researchers thought they knew about planned giving prospects has proved to be wrong.

Faced with poor responses to their planned giving solicitations, many organizations have focused on soliciting annual funds rather than expending resources to seek out future dollars. If you are doing this, however, you could be missing a major opportunity to strengthen the long-term viability of your charity.

what makes a planned gift donor?

A recent National Committee on Planned Giving survey offers some insight into why people make charitable bequests:

- 97 percent say they care about the charity
- 82 percent want to do something special
- 35 percent use planned giving as an income or estate tax planning strategy
- 21 percent say they know someone at the organization

Our research, as well as work done by the National Committee on Planned Giving, has also provided a better understanding in recent years of who makes the best planned giving prospects. The answer: **annual gift donors**. Major gift donors are already on your radar, and it is wise to ask them to consider a planned gift as well. Most annual donors, however, have not distinguished their giving with large amounts and often escape your notice as planned giving prospects. It is important for charities to focus attention on building long-term relationships with those donors who are counted on for donations year after year.

Not every annual gift donor is alike; and different types of people are likely to gravitate to different planned giving vehicles. The good news is that there are some income and lifestyle factors that can help you to distinguish your best bequest prospects from your charitable gift annuity or charitable remainder trust prospects:

- Older retirees on fixed incomes who still give to the charity, although the size of their annual donation may have plateaued or gone down, are more likely to make a charitable gift annuity to support an organization they care about the most as well as to provide a guaranteed income stream to meet their own needs.
- Younger married couples in their forties and fifties may be charitable bequest prospects. They typically still have children at home, tend to have moderate to upper-moderate incomes, and are active consumers who use credit and get credit much more aggressively than older retirees.
- Single females over age 65, many of whom have outlived spouses, are excellent prospects for charitable gift annuities. They tend to be living on fixed incomes and are worried about their future income stream. Annuities appeal to them because they guarantee an income stream for the rest of their lives.
- Wealthier people between their mid-50s and age 70 are good charitable remainder trust prospects. They are typically fiscally aggressive, and their credit histories and lifestyles indicate that they are upscale and generous. Some may in fact have made a major gift prior to establishing a trust.

Armed with these donor profiles, there are steps you can take to identify and target the planned giving prospects in your database.

Make planned giving work for you: implement these planned giving strategy tips at your organization.

using research to identify your best prospects

According to research on fundraising and philanthropy, each person in your database has an ultimate gift potential for your organization. For many, the ultimate gift potential may be $0. Perhaps they are not charitably inclined — or an alumnus only gives to his graduate school, or a former patient paid a large bill and does not think of your hospital as a charitable entity. Other people in your database, however, may be loyal donors, giving pretty much the same amount year after year.

According to the concept of ultimate giving potential, there is a third category of people in your database: those who are likely to make a large donation. These are the people you should analyze most closely and with whom your organization should build relationships. They include three types of donors:

- those who will make a major gift (however defined by the organization);
- those who will make some form of planned gift; and
- those who will do both.

My experience shows that this last category is typically comprised of the 15 percent of prospects at the top end of your donor list who know your charity the best.

As you look at your donors, their lifestyles and their giving histories in order to identify your best planned giving prospects, it is important to avoid using misleading data. Most generic models used to identify individuals to approach, for example, will steer you toward people who have reached a certain age and income level. While you might find some good major gift prospects, this does nothing to identify who is likely to make a planned gift. Similarly, an intuitive model will look at those people in your database who have already made a planned gift — mostly trustees with a close affinity to your organization and other top donors — and assume that all your planned giving prospects will share similar characteristics. Yet the research on planned giving makes clear they do not.

As you look at your donors, their lifestyles and their giving histories in order to identify your best planned giving prospects, it is important to avoid using misleading data.

The good news is that individuals who make planned gifts, whether to a university, a hospital, a human rights group, or an art museum, tend to look very similar from organization to organization. This is where predictive modeling can help. Statistical models that incorporate planned giving behavior around the country can apply historical giving patterns to analyze your database and create profiles of your annual donors by type of planned gift.

Although it is important to understand who your best bequest prospects are, or your best "trust" prospects, this knowledge does not instantly translate into fundraising success. You still need to solicit planned gifts for your organization. Here again, your profiles can help you to devise the best marketing approach for these different potential donors.

using marketing to reach out to your best prospects

Understanding how to ask for a donation is always critical, and research on planned giving offers useful guidance to steer the right message to the right person. Here are some tips to help you get started:

1. Keep your message simple.

When soliciting for a planned gift, simplicity is key. The most successful solicitations are clear, concise, and focus on only one type of planned gift at a time. Because we know that bequest prospects are different from annuities prospects, for example, there is no reason to send anyone information about both giving vehicles. And do not talk about a CRAT3 or a CRUT4 — eliminate the acronyms, technical language, and insider jargon in favor of plain English.

2. Make anniversary date solicitations.

The best time to ask someone for a donation is when he or she is most likely to make one. You should analyze your database to learn which donors faithfully give in a particular month or quarter. If you know when someone gives each year, then you can gear your solicitation to that time of year (and eliminate mailings they will never respond to and telephone calls that might annoy them). This will save you money even as you build a more meaningful relationship with your donors. In addition, research shows that anniversary date donors tend to be good planned giving prospects.

3. Adopt a segmented solicitation strategy.

No solicitation strategy will be effective if you do not ask the right way. Segmenting your database based on who responds to what type of solicitation (e.g., direct mail as opposed to telemarketing) will improve your response rates and save your organization money. Understanding who gives — and what solicitation different individuals will respond to — also offers you another way to target potential donors. Research shows, for example, that people who respond to direct mail solicitations have historically been more likely than telemarketing-responsive people to be good planned giving prospects.

4. Cultivate relationships with annual donors.

Once you understand that your best planned giving prospects will come from the ranks of your annual givers, the next step is to build an ongoing relationship with these individuals. Ideally, officers and other top representatives of your nonprofit should reach out to consistent givers once they reach age 40 to cement their relationships with the organization. While the personal touch is time consuming, the long-term payoff can be substantial.

5. Encourage your annual fund staff to collaborate with your planned giving team.

Successfully securing planned gifts is all about building relationships with donors. Make sure the staff managing your annual fund understands both the importance of promoting long-term relationships and how their work can help result in larger gifts to the organization over time. If a spot opens up on either team, make sure you place emphasis on hiring a good communicator. Technical expertise is abundantly available from financial planners and attorneys.

conclusion

Nonprofits are discovering that the right planned giving program can bring in significant donations and provide a future income stream for their organizations. A successful program depends on solid research, savvy marketing and — most importantly — understanding the characteristics of a typical planned gift donor. Once your planned giving strategy is in place, your nonprofit will be poised to capture a share of the estimated $6 trillion in philanthropic donations up for grabs over the next half-century.

CHAPTER 4

Why Privacy Matters

by David F. Lamb

Faced with ever-increasing competition for the donor dollar and the never-ending need to "do more with less," nearly every nonprofit professional would agree that identifying and appealing to the best potential donors requires more information about those individuals than just their names and addresses. However, disagreement abounds regarding how much personal information is really necessary; which techniques (if any) used to secure such information are not only legal, but also ethical; how far one can delve into a potential donor's nonpublic life before crossing the line into privacy invasion, and whether prospect research is ultimately "worth it." I separate fact from fiction and highlight the right way for you to reel in major gifts, plus I'll discuss legal and ethical boundaries, working with outside vendors, and the importance of a well-crafted and highly conspicuous privacy policy.

privacy and the prospect researcher

Most of us present a version of ourselves to the public that we hope is attractive, or at least, inoffensive. But in our own houses with the doors closed, all our defenses are down, and our imperfections are unprotected. We are safe from exposure. To find that this sanctuary can be violated without our consent, however, challenges some deeply rooted cultural assumptions about privacy.

Those we allow into our private space are there because (we hope) they understand the context of our lives. They are less likely to judge us unfairly because they know us as complex people with both attractive and unattractive qualities. If you know the whole context of a person's life, an isolated example of an unseemly quality will probably seem less offensive. That's the theory anyway.

If someone who does not know us observes us in our private space, it feels like a terrible invasion of privacy. It is not just a physical intrusion that triggers this sense of violation. Finding out that we have been observed without our knowledge, either directly or by access to private information about us, may be enough to cause a sense of injury. We fear that facts about us may be taken out of context and used to harm us.

This brings us to the crux of the problem of privacy and the prospect researcher. The role of the prospect researcher is to gather information about potential donors. Prospect researchers are quick to point out that they limit themselves to public information sources and do their work with a presumption of respect for the prospective donors they research. Nevertheless, if you tell someone that your job is to collect facts about donor prospects, the chances are good that they'll look at you as if you'd just confessed to voyeurism. But, the fact is, prospect researchers as a group tend to be strong privacy advocates. Knowing that privacy lines can sometimes be crossed with relative ease, prospect researchers are vigilant not to cross them.

trouble at the ACLU

The problem came into focus a few years ago when the American

Civil Liberties Union (ACLU) received some unwelcome publicity over plans to engage a vendor to conduct research on its donors and other constituents. On December 18, 2004, **The New York Times** broke a story entitled "ACLU's Search for Data on Donors Stirs Privacy Fears," which detailed how the ACLU's executive director hired a firm to screen its database for prospects capable of contributing to an upcoming fundraising campaign. An officer of the ACLU learned about the project and alerted the board of directors because the organization's privacy policy explicitly states that the ACLU will not gather personal information on members and donors without their permission. After the board expressed concerns, the policy was changed to use more general language.

Although the ACLU has been the focus of much recent attention, the situation *does not* bring into question the ethics of doing prospect research. It does point out that if your policy states that you don't do research, or don't do certain kinds of research, you had jolly well better not do it. If you decide to change your policy on what you'll do with donor data, you should do so publicly so that the donors are duly warned.

If you decide to change your policy on what you'll do with donor data, you should do so publicly so that the donors are duly warned.

legal and ethical boundaries

The 4th Amendment notwithstanding[1], there is no Constitutional right to privacy. Over the last 100 years, however, the courts have upheld "the right to be left alone." With this as a starting point,

[1] The Fourth Amendment says: "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

legally recognized invasions of privacy can be boiled down into four distinct categories[2]:

1. Unreasonable intrusion upon the seclusion of another
2. Appropriation of another's name or likeness
3. Unreasonable publicity given to another's private life
4. Publicity that unreasonably places another in a false light before the public

While all of these should be avoided while doing donor research, it is the first invasion that is most likely to tempt prospect researchers. A healthy ethical orientation is the best safeguard against "intrusion on the seclusion" of our prospects.

The Association of Professional Researchers for Advancement (APRA) is the international organization that promotes and supports the activities of prospect researchers. APRA has taken a strong stand on the privacy issue and offers good guidance in its Statement of Ethics[3], which includes these lines:

- "Advancement researchers should be experts on the reliability of sources (print, electronic, and otherwise), as well as the sources utilized by third parties to gather information on their behalf."
- "Advancement researchers shall present information in an objective and factual manner, note attribution, and clearly identify information that is conjecture or analysis. Where there is conflicting information, advancement researchers should objectively present the multiple versions and state any reason for preferring one version over another."

These two points can't be emphasized enough. It is not enough to limit yourself to public information. The quality of the information

[2] www.ffhsj.com/21stbook/chapters/ch12intr.htm
[3] www.aprahome.org/advancement/index.html

in the public domain ranges from rock solid truth to outright lies. Researchers must do their best to discern the quality of the information found and report only that which is truthful. Whenever possible, the researcher should find two or more reliable sources that agree with each other.

Before leaving the topic of ethical and legal boundaries, it must be noted that prospect researchers at certain types of nonprofits must pay attention to industry-specific laws. I speak here primarily of hospitals that are governed by the Health Insurance Portability and Accountability Act (HIPAA) regulations. It behooves researchers employed by healthcare institutions to read the law and know the parts that are relevant to their work.

working with vendors

In the world of prospect research, a "vendor" is a business that aggregates and sells data useful to prospect researchers. Example companies are Dun & Bradstreet®, Hoover's®, 10K Wizard®, DIALOG®, and LexisNexis®. These companies collect, organize, and index news, business, and asset information. The researcher usually accesses all this information through a Web page with simple search commands, retrieving large amounts of data in a short time. Collectively, these vendors are known as "commercial data brokers."

The power of the search capability provided by data brokers is impressive, but it is *not unlimited*. Much of the data they collect is information that legally *must* be disclosed by certain individuals and companies. Everyone has a right to see it. The data brokers just make it easier to access.

For example, a public company insider (defined as a top officer, director, or 10% shareholder of a public company) has enormous potential to make decisions that affect the profits of the company.

The government recognizes that the shareholders of that company and the public at large (who for the most part are *not* insiders), have a legitimate interest in knowing if the insiders bought or sold shares in the company and how much of the company each insider owns. This openness is designed to reduce the ability of a company's leaders to surreptitiously take actions that are harmful to the stockholders and to the economy. However, a person could own stock worth billions of dollars and not meet the criteria for an insider. A non-insider's stock is invisible to the prospect researcher. Because most people are not insiders, their stock is safe from examination by strangers. On the other hand, insiders know and expect strangers to be interested in their stock holdings.

The collection of insider stock data is just one example of a growing number of data streams funneled to commercial data brokers. It is important for researchers to understand the provenance of the information provided to them by their vendors. Only information that is legally and ethically collected can be used for the purposes of prospect research. But the question remains, how do you know when there's a problem?

The power of the search capability provided by data brokers is impressive, but it is not unlimited. Much of the data they collect is information that legally must be disclosed by certain individuals and companies.

Let's consider the kind of information that might be purchased from a commercial data broker:

Insider stock holdings: The government collects and publishes this information for the good and protection of the public. It is easily accessed from the government's own Web site, though data brokers improve the ease of search and retrieval.

Real estate values and descriptions: The government records property values for the purpose of levying taxes. It is made available to the public to ensure that taxation is evenly and fairly administered. Data brokers obtain the information from county assessor offices and index it for ease of searching.

Private company directories: Much like phone directories, these sources allow customers and suppliers to find and evaluate companies with which they might do business. Some vendors, Dun & Bradstreet® for example, also deliver a credit reporting function to further analyze a company. For most researchers, the credit report is too expensive and too detailed to bother with. Basic descriptive information, however, such as sales, top officers, number of employees, etc., is less expensive to buy from a data broker. All of this information is self-reported by the companies.

Biographical directories: Most of the information in biographical directories, such as *Who's Who*®, is self-reported. A small number of celebrities are researched by *Who's Who*® because of the general public interest in these people.

Foundation affiliations: The only tax returns that are open to public scrutiny are filed on forms 990 or 990PF, and they are filed by charities and private foundations. You don't need to go through a commercial data broker to read these, but the data brokers index these tax returns for more efficient searching. Other vendors do additional research about the foundations and publish profiles of them in directory form.

Direct marketing databases: Direct marketers collect data from many different sources and perform statistical analyses to answer the question of who is likely to buy which product. If you are statistically similar to someone who buys golf clubs, you'll probably receive advertisements for golf clubs. This helps the companies that sell golf clubs because they don't waste money advertising their products to people who don't know a fairway from a runway. And it helps the golf aficionado, who learns about the latest new golf gadgets.

Regarding direct marketing databases, the obvious application to fundraising is that you could use this same technique to answer a different question: "who is likely to make which kind of gift to my organization?". The data that might be used to answer that question might come from many sources, including the census, surveys, polls, behavioral research, consumer supplied data (for example, when you register the new software you just bought), magazine subscriptions, and credit.

The bomb in that sentence is "credit." One could imagine prospect researchers checking the credit rating of prospects to see if they "qualify" to make major gifts. **Nothing could be further from the truth.** It is, in fact, inappropriate for a researcher to have direct access to any credit information. There is, however, a way for researchers to use credit information appropriately without violating privacy.

In the last two decades, a number of vendors have created screening tools that apply the lessons of direct marketing to fundraising. By including aggregated credit information, along with all the other typical data sources used in direct marketing, these vendors create a statistical profile of someone likely to make a gift to a particular organization. All of the people in the nonprofit's database can then be scored against this model. The credit data for any one person is not revealed, it simply becomes part of a composite "likelihood" score.

Companies that provide this modeling service are collectively known as "screening vendors." There can be much more to the services they offer, but that is a subject for another paper. There are two points to keep in mind with respect to credit data when using a screening vendor. First, even the vendor shouldn't see the detail in a person's credit record. The company only sees aggregated data that groups people with similar credit profiles together. Second, you should request assurance that any credit reporting agency used by the vendor complies with all applicable laws, such as the Fair Credit Reporting Act (FCRA), designed to protect the privacy of the public.

is it even worth it?

There are some who might say that ethical and legal guidelines for researchers and vendors are not restrictive enough. Information that is relevant and truthful may still be too personal to be recorded. They argue that collection of *any* information, even if it is publicly available, requires too great an intrusion on the prospect's "seclusion" to be tolerated. With social fears about infringements on privacy and the potential for bad publicity for nonprofits, why would a respectable nonprofit want to do prospect research at all? Don't you risk offending major donors by doing research on them? My answer is no.

At a recent fundraising conference, there was a panel of wealthy donors who responded to questions about what it was like to be on the other side of the tin cup. The moderator asked, "What is something that you find annoying as a donor?" Without hesitation, one of the panelists responded, "It's the volume of requests for money from organizations I care nothing about." There was general agreement on the panel about this complaint. Wealthy people are often besieged by solicitations from organizations that need their support. Usually, the only ones they fund are those whose missions involve them personally. The others appeal to them as much as a swarm of annoying flies.

If you don't want your organization to be perceived as an annoying fly, your best bet is to do some research to find out what plucks the heartstrings of your most capable prospects. That way, you can present your project in the light that your prospect will find most appealing.

Another panelist noted that he could tell when a fundraiser had not done his or her homework. "They'll ask for too much or too little." It's almost a cliché in development that if you ask for too little, the prospect will get out her checkbook and write you a check for the amount you requested. It's usually less of a problem to ask for too much, but this still usually results in a smaller gift. The prospect may be flattered, but will probably counter with an amount that is less than his capability.

The ideal ask will be a gift that the prospect must stretch to make but is well within his or her capacity. This will make the prospect think long and hard about his or her depth of commitment to your cause, and when the gift is made, the prospect's joy in giving it will be all the greater.

This is the noble role of the fundraiser: to help generous people do the good things they want to do with their money. It is the noble role of the prospect researcher to ascertain the right project and the right amount for the right donor. When that happens, everyone wins. But let's be clear. Doing your homework does not extend to gathering every scrap of data and gossip that may be available on a prospect. When collecting prospect information, a researcher should be able to answer "yes" to all of these questions:

- Is it truthful?
- Is it relevant to the mission of the organization and the fundraising process?
- Is it respectful of the prospect?

make a statement

Thanks to legislation like the Fair Credit Reporting Act and Health Insurance Portability and Accountability Act, privacy statements abound on documents relating to our health care and finances. Most commercial Web sites have links to the corporate privacy statement. Legislation about what nonprofit organizations must guarantee in terms of privacy is less well formed.

Charity Navigator® (www.charitynavigator.org) evaluates nonprofits to help donors make informed decisions about which organizations should receive their charitable dollars. One of the things that Charity Navigator® looks for is whether the nonprofit provides a privacy statement to donors. This statement must "have a donor privacy policy in writing, guaranteeing that they will not sell or trade their donors' personal or contact information with anyone else. Furthermore, the policy must be prominently displayed on the charity's Web site or in its marketing and solicitation materials."[4]

In December of 2004, Charity Navigator® reported on a study of how 3,282 of the nation's largest charities and nonprofits were implementing their privacy policies, or if they had one at all. The results of the survey became a part of the company's rating of these organizations. Here's what they found, as reported on their Web site:

- 18% have donor privacy policies that the company's analysts were able to verify (depicted on their ratings page as a latched padlock)
- 7% told us that they either didn't have a policy or that they hadn't taken the time to put their policy in writing (depicted on their ratings page as an unlatched padlock)
- 75% choose not to respond to our inquiry (identified on their ratings page with the term 'no response')[5]

[4] www.charitynavigator.org/index.cfm/bay/glossary.list/word/DONOR%20PRIVACY%20POLICY/print/1.htm
[5] www.charitynavigator.org/index.cfm/bay/content.view/catid/68/cpid/238.htm

As concerns about identity theft and erosions in privacy continue to rise, nonprofits can ill afford to be among those whose privacy policy is ambiguous or nonexistent. While the prospect researcher can lead the initiative to publish clear privacy policies, he or she cannot do it alone. Donor privacy must be safeguarded at every level of the nonprofit organization. The purpose of a privacy policy is to let donors know that you abide by strong ethical standards and you insist that the vendors you hire do the same. It should answer the following questions:

- What information is collected?
- How will the personal information be used?
- How will the personal information be saved? How is it protected? Who will see it?
- Will the personal information ever be disclosed? Shared? Sold?
- Should donors expect to be contacted only when permission is granted? Without permission? By third parties?
- When personal information is submitted, is there an implied consent granted?
- If so, what is implied?
- What other information (for example, demographic information) may be kept, used, and shared?[6]

conclusion

Regardless of your answers to these questions, it is essential that your organization's position on privacy is clearly stated. A rare donor may disagree with your policy and elect to give his support elsewhere. Some may never inquire about it at all and donate generously anyway. But an ever-growing number of discerning donors are choosing to put their confidence in organizations with a transparent stance on privacy. By declaring and maintaining the privacy of your donors, you will be on your way to earning the ultimate prize — a lifetime of passionate support.

[6] www.washington.edu/webguides/guidelines/forms/privacy.html

resources

TRUSTe® model privacy policy:
(www.truste.org/docs/Model_Privacy_Policy_Disclosures.doc)

TRUSTe® guide to writing an online privacy policy:
(www.truste.org/pdf/WriteAGreatPrivacyPolicy.pdf)

A great example from The Nature Conservancy®:
(http://nature.org/aboutus/misc/)

Online Privacy for Nonprofits: How to Protect Members' Privacy and Personal Information: (www.privacyrights.org/fs/fs28-nonprofits.htm)

This link to advancement research standards on the Web site of the Association of Professional Researchers for Advancement (APRA) has several items of interest, including the APRA statement of ethics and a position paper on privacy:
(www.aprahome.org/advancement/index.html)

The following sample language is taken from a handout provided by Lona Farr, partner in the Farr Healey Consulting firm[7], at the 2004 AFP International Conference in a session on donor privacy:

- "Prospect research enables ABC Charity to obtain highly confidential background and wealth information on prospects and donors. This policy is intended to protect these individual's privacy, to control the gathering of that information and to control the costs of purchased internet prospect research.
- Prospect research will only be used to gather information about potential ABC Charity prospects and donors and will not be utilized by any other person for any other purpose.
- All requests for prospect research on individuals must be cleared by the chief development officer. It is suggested that

[7] www.farrhealey.com/

the gift potential triggering these requests is anticipated to be in excess of $25,000.

- Prospect research will only be conducted by a designated advancement officer or the chief development officer. All requests for prospect research will be logged in by this person.
- Only a designated advancement officer of the chief development officer will have the password for any search services purchased for the purpose of prospect research.
- A designated advancement officer or the chief development officer will compile the research information in a composite form to be viewed only by those personnel involved in preparing briefings for meetings and solicitations. This information will be maintained in highly confidential manner.
- This information will not be included in the computerized data available about the donor or prospect. It will be filed alphabetically in hard copy in a filing cabinet which is accessible only to those individuals approved by the chief development officer.
- A code or note in the donor/prospect's computer file will indicate that additional information is available in hard copy."

Note — Not every organization will adopt a research policy exactly like this, but these points bear discussion. A point on which some may disagree would be the method of profile storage. Some would argue that if the proper security measures are taken on a nonprofit enterprise database, keeping the donor information in an electronic format is every bit as secure as putting hard-copy documents under lock and key.

BONUS CHAPTER

Private Company Valuation — Why and How

by David F. Lamb

What is a private company worth? And why would anybody want to know? Valuing a company could have a major impact on whom a development officer decides to solicit for a gift. A prospect's ownership of a company is a strong indication of wealth, and, in extension, his or her capacity to give. But the prospect of valuing a private company makes even the most experienced development officers and prospect researchers quake. However, with the right techniques and resources, it can *and should* be done.

private company valuation and the prospect researcher

Private company owners are hard to research. Give researchers a choice between profiling a private company owner or a public company insider, and they'll take the insider almost every time.

But those researchers are making a couple of big mistakes by favoring the insiders. First, most nonprofit donor databases contain very few, if any, public company insiders. Second, in any nonprofit constituency, there is often more company wealth held by private company owners than by public company insiders.

The researcher's problem lies in the fact that private company wealth is hidden, while stock owned by public company insiders is out in the open for anyone to see. Thus, the common preferences among researchers when selecting individuals to review are top officers, directors, or major shareholders of public companies because they're easier to research.

Prospect researchers want to know about company ownership — public or private — because it can be a major component of a family's wealth. If you demonstrate that a prospect has lots of company ownership, you've got a strong indication of significant wealth in other categories as well, and by extension, the prospect's philanthropic capacity.

It may be difficult to research private companies, but it's not impossible. There are tools and guides that are available to help you make some reasonable estimates of a company's value. With that in hand and a good guess at what percentage of the company your prospect owns, you can arrive at a reasonable estimate of the value of that asset in your prospect's financial portfolio.

motivation matters

I've already explained the reason why prospect researchers try to determine a company's value. But most people trying to estimate a company's value have other motivations. Surprisingly, the value assigned to a private company is heavily influenced by the reason you're asking the question. So why would someone ask? A person might need to value his or her company…

- To sell it
- To raise capital from investors

- As part of a divorce settlement
- For a management buyout
- For estate planning
- For an employee stock ownership plan
- For taxation

Change the question, and you change the value of the company. If the data allows for any interpretation (and it almost always does), the owner will certainly interpret a lower value if the purpose is to determine the company's taxable value or if the company itself is part of a divorce settlement. On the other hand, the owner will interpret a higher value if he or she is going to sell the company or is trying to raise additional capital from investors. The key issue is that a private company's value is not entirely objective. The value is at least partly subjective.

The value of a private company is influenced by many things that have nothing to do with the cost of the buildings, equipment, furnishings, or inventory. Ultimately, if the owners of a company want to know what it is worth, they will have to sell it. Since you, as a development officer or prospect researcher, are not in a position to do that, you'll need to resort to some indirect measures of value. To understand what we're doing, we need to go back to Business 101.

business 101

When a company files incorporation papers with the proper government office, it issues a certain number of shares. These are known as outstanding stock or outstanding shares. The value of the company is evenly divided among these shares. If the company issued 1,000 shares, and the whole company is worth $1000, then each share is worth one dollar. Specify any value for the company and do the math. That's what a share is worth. At the point of the company's founding, however, you could truthfully say that the value of the company or a share is irrelevant.

Shares of a company are not so much an item of value as a claim of ownership and control. The more shares you own, the more control you exercise over the company. This is true of both public and private companies, though in the case of a public company, a share does have a specific value. You can look it up on any number of print or electronic resources. You multiply the value of one share times the number of outstanding shares, and that's what the public company is worth — more or less. The product of this calculation is known as the "market capitalization" or, simply, "market cap." We call public companies "public" because any member of the public with enough money is free to buy stock in them. Since most private companies have just a few owners whose shares are not offered to the public, their stock is called "closely held."

There isn't a page in the *Wall Street Journal* — nor is there any Web site — where you can go to look up the value of a share of a private company's stock. Yet, from time to time, the owners of private companies decide to determine the value of their investment. It is a difficult and complex task. Private company owners pay accounting firms big money to determine that value. The chances are low that a prospect researcher could make an accurate assessment of a company's value without access to inside information from the company. But it's not always necessary to be precise about value. Sometimes it's enough just to have a general idea.

methods of valuation

Professionals who practice company valuation have several methods for estimating the value of a particular company. These include calculating the book value of all assets and adding them up, using the price/earnings ratio, and using the discounted cash flow model. For a researcher who does not have access to detailed financial information from inside the company, none of these are an option. A more feasible approach is to find comparable companies whose values are known.

When looking for comparable companies, there are two options: (1) find one or more similar public companies, or (2) find similar private companies with known values. Although there are many metrics we might use to compare your target company [I'll use the phrase "target company" when referring to the company being valued] to these others, you are most likely to find comparable data on sales, industry, and region. Let's first deal with the use of comparable public companies.

comparison to a public company

Immediately we are faced with the fact that, because of certain accounting realities, a public company will almost always be valued higher than a private company having the same characteristics. Still, it is usually worth the effort to try this method, if only to get a feel for the industry.

To compare your target company to a similar public company, follow these steps:

1. First you need some basic information about your target company. If you don't have data from any other source, you should be able to get a basic report from Dun & Bradstreet®, which will provide some key indications such as sales, number of employees, and line of business or a Standard Industrial Classification (SIC) code. Dun & Bradstreet® sells these reports in varying formats and prices. The one called the "Duns Market Identifiers" would be a good compromise of cost and data completeness.

2. Go to the Yahoo!® Stock Screener at http://screen.yahoo.com/stocks.html.

3. Among the various metrics available for searching at the Yahoo!® Stock Screener, the only ones usable in comparison to

a private company are "sales" and "industry category," which is based on SIC codes. Enter the relevant information in the form and click "find stocks."

4. Read through the profiles of the public companies returned. With luck, you'll find a public company in the same region as your target company.

Here are some things to consider when using this method:

- Public companies tend to be much larger than their private counterparts, so you'll probably have to use a sales range that is greater than your target's in order to find some examples.
- Your target's industry will not always match those offered by Yahoo!® perfectly. Don't get stuck on this. Try to find something that is close.
- Read the profile to see if the comparison company is similar enough to the target's business.
- The market capitalization (share price x outstanding shares) is one of the simplest ways of stating the value of the company. If your target company is similar to the public company, it might have a similar, though probably somewhat lower, market cap.
- Even if a public company has flat or negative earnings, it may still have value. The same may be true of your target private company.

comparison to a private company

If you wanted to buy a used car, you'd probably start by opening the daily paper to the classifieds section and reviewing the cars for sale. This would give you a good sense for the market price for the kind of car you want to buy. There may be a few businesses for sale in the daily paper as well. But if you wanted to buy a business, you'd probably do better consulting some specialized resources that are designed specifically for business buyers and sellers. One of the best is www.bizbuysell.com. On the home page, you'll see a search form that allows you to select a business category (which you could also describe as "line of business" and is roughly equivalent to SIC) and a location. Location includes all the states in the U.S., as well as other countries and continents. After selecting the appropriate line of business and the correct state, click the search button and a list of businesses will be presented. As you click on each one, you'll see a description of the business and some financial data, such as asking price, gross sales, and cash flow.

If you're very lucky, you'll find a business that closely resembles your target company in description and sales figure. However, even if the companies you found have different sales figures and don't have quite the same description as yours, reading through these profiles will give you a feel for the buying and selling market in your target's industry. You may also notice a relatively consistent ratio between the sales figures reported for these businesses and their asking prices. This can be a helpful metric for you. If, for instance, most of the businesses you found are selling for about half of their annual sales, that ratio between annual sales and company value may apply to your target company.

It should be clear by now that there is no generalized rule of thumb for the ratio of sales to company value that can be applied across the board. Each industry will have specific conditions not shared by other industries that affect value. You could say the same for different parts of the country as well. Using business classifieds like this can help you to establish your own rule for valuing one kind of business in your part of the country.

On the subject of rules of thumb, you'll find some handy guidelines for valuing businesses in different industries at www.bizstats.com/rulesofthumb.htm. It certainly doesn't contain an exhaustive list of industries, but if your target's industry is among them, you'll have a useful guide for estimating value. If you back up to www.bizstats.com, you'll find some other useful information for valuing businesses.

A company called Business Valuation Resources, or BV Resources (www.bvresources.com), has created some useful tools for estimating the value of a company. This is a resource that is designed for professional business appraisers. However, a researcher with a general understanding of valuation concepts can use several of these tools effectively. In particular, there are two databases at BV Resources that are useful to prospect researchers attempting to value private companies: Pratt's Stats and BizComps.

The idea behind both of these databases is similar to using business classifieds to create a ratio for valuing companies in a specific industry. Except, instead of looking at businesses that are for sale, these tools contain data for companies that have been sold. This eliminates the uncertainty about what the company is actually worth. With BizBuySell, you only know what the asking price is. With BV Resources data, however, you know the actual value of the company. Unarguably, it is worth what someone — or some other company — paid for it.

After the sale of the company, Pratt's Stats and BizComps collect various metrics about the company including those ever-important values: annual sales and selling price. Once they've collected enough examples of companies that sold within a specific industry, they can establish an overall ratio between annual sales and company value. An individual using either Pratt's Stats or BizComps (you can search them separately or together) picks an industry and a sales figure and gets an approximate value for the company based on the appropriate ratios.

Naturally, such powerful tools come at a price, unlike all the other resources I've mentioned thus far. Pratt's Stats, which contains data for companies having a median selling price of $1.5 million, costs $595 for an annual subscription. BizComps, which covers companies with a median selling price of $132,000, costs $395 per year.

conclusion

What *is* your target company worth? It's a simple question with a complex answer. As you've probably gathered from this white paper, you almost certainly won't be able to answer that question with precision unless you have inside information and advanced knowledge of how to interpret all the variables. Most development professionals have neither.

Fortunately, a general idea of the value is almost as good to the development officer as a precise figure. Since you won't be tendering an offer to buy the company, you don't need to know all the details. Instead, you want to know how ownership of the company affects a prospect's philanthropic capacity. It may be sufficient enough to know that the company's value is in a range of $10-20 million vs. $1-2 million. This information, then, becomes one factor among many in your ultimate estimate of philanthropic capacity for the private company owner.

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Lawrence Henze has extensive experience in fundraising, market research, and applying predictive modeling services to the nonprofit marketplace. The founder of Core Data Services, which Blackbaud acquired in 2001, he has also served as vice president of predictive modeling services at USA Group Noel-Levitz and president of The Philanthropic Division of Econometrics, Inc. Mr. Henze has 15 years of experience in development, raising more than $125 million primarily for higher education institutions. He holds a bachelor's degree in political science from Carroll College in Wisconsin, a master's degree in public policy and administration, and a law degree from the University of Wisconsin at Madison.

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David Lamb helps nonprofits identify their best prospects for annual, major, and planned giving and uncover comprehensive wealth asset information to determine appropriate ask amounts. Widely recognized for his Web resource entitled "David Lamb's Prospect Research Page," an essential resource for prospect researchers around the world, he has played a significant role in the development of prospect research best practices throughout his 15-year career. Mr. Lamb joined Blackbaud following three years as an independent consultant. Previously, he served as the director of prospect research and tracking at the University of Washington, where he helped private support more than double during his tenure. He holds a bachelor's degree in sociology from Sterling College in Sterling, Kansas and a master's degree in sociology from Wichita State University, as well as a master's of divinity from San Francisco Theological Seminary.

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