



# **R&D Productivity: How to target it.. How to measure it. Why it matters..**

*Gerald P Dundon*

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# R&D Productivity: How to target it,. How to measure it. Why it matters..

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## **R&D Productivity: How to target it,. How to measure it. Why it matters..** Gerald P Dundon

Based on work from the frontline of high-tech business, this book describes a new approach to targeting and measuring research and development (R&D) productivity. Using logic and basic math, lifecycle revenue and profit targets for R&D project spending can be calculated that are intrinsically allied with corporate goals for revenue growth and profitability. It describes how to measure and track R&D productivity performance versus target and how to interpret and report on variance. CRRM, or the Cumulative Required Revenue Multiple, is the value of cumulative revenue an R&D investment must return by the end of its lifecycle (expressed as a multiple of the cost of the R&D investment) in order to support the declared business goals. The business goals are generally articulated as a desire to grow corporate (or divisional) revenue at a given CAGR in the medium to long term and a willingness to commit a fixed percent of annual revenue to R&D spending, to fuel the revenue growth ambition. Once the desired revenue CAGR and annual R&D spend are known, and the lifecycle of the investment is estimated, it becomes possible to calculate the CRRM. The book develops the logic and math to calculate CRRMs. The book contrasts the utility of the CRRM metric to the more traditional methods of assessing project ROI using discounted cash flow-Net Present Value (NPV) and Internal rate of Return (IRR). By comparison, NPV is a very blunt instrument. For a given cost of capital, a positive NPV says it's a good investment, zero means it's neutral or breakeven, and negative says it's a bad investment. Even if an investment shows a positive NPV, it still doesn't tell the user if the predicted returns are sufficient to support the stated business goals. If the cost of capital is adjusted until the NPV = 0, this yields the internal rate of return (IRR). But knowing that the IRR is higher, or even substantially higher than the assumed cost of capital, still fails to answer the question "Is the investment return sufficient to support the stated business goals?" CRRM does provide an answer to that question, and thus it is a far superior ex ante measure of the required R&D return on investment because it ties that required return to the business goals. It tells the user what the cumulative revenue return for any R&D project or portfolio of projects needs to be, as a multiple of the project(s) cost, to support the stated business goals. It answers the question, is the projected return enough. If the proposed project or portfolio of projects is judged as unlikely to reach the required multiple, then either more-productive projects need to be considered and selected, or the business goals need to be changed. CRRM can also be used very effectively as an ex post measure of R&D productivity, when used in conjunction with a "model" curve of cumulative revenue that is also discussed/developed in the book. The book also explores

- Why discounted cash flow metrics (NPV and IRR) are inadequate for R&D project valuation and selection ?
- Why one of the most popular current measures of R&D performance- percent of revenue coming from new products- is a poor R&D performance metric ?
- Why annual R&D spending must be included in return rate calculations ?
- How product lifecycles influence required target return rates ?
- How R&D overhead costs should be treated when targeting return rates for R&D projects ?
- Why correctly targeting, measuring, and reporting R&D productivity performance is a critical management competency?

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