

4 Initial Ways for Finance to Approach R&D

- 1 — Calculate R&D as a % of Sales
- 2 — Isolate Product Development within R&D
- 3 — Bucket R&D Spend into Categories
- 4 — Start to Measure R&D Effectiveness



1. Calculate R&D as a % of Sales

Questions to ask:

1. Is R&D as % of sales increasing or decreasing year-over-year? Why?
2. How does R&D as a percentage of sales compare with competitors? Can you articulate why your company is higher or lower?
3. Does the narrative around the trend make sense?

2. Isolate True Product Development Spend

Potentially remove these costs from R&D:

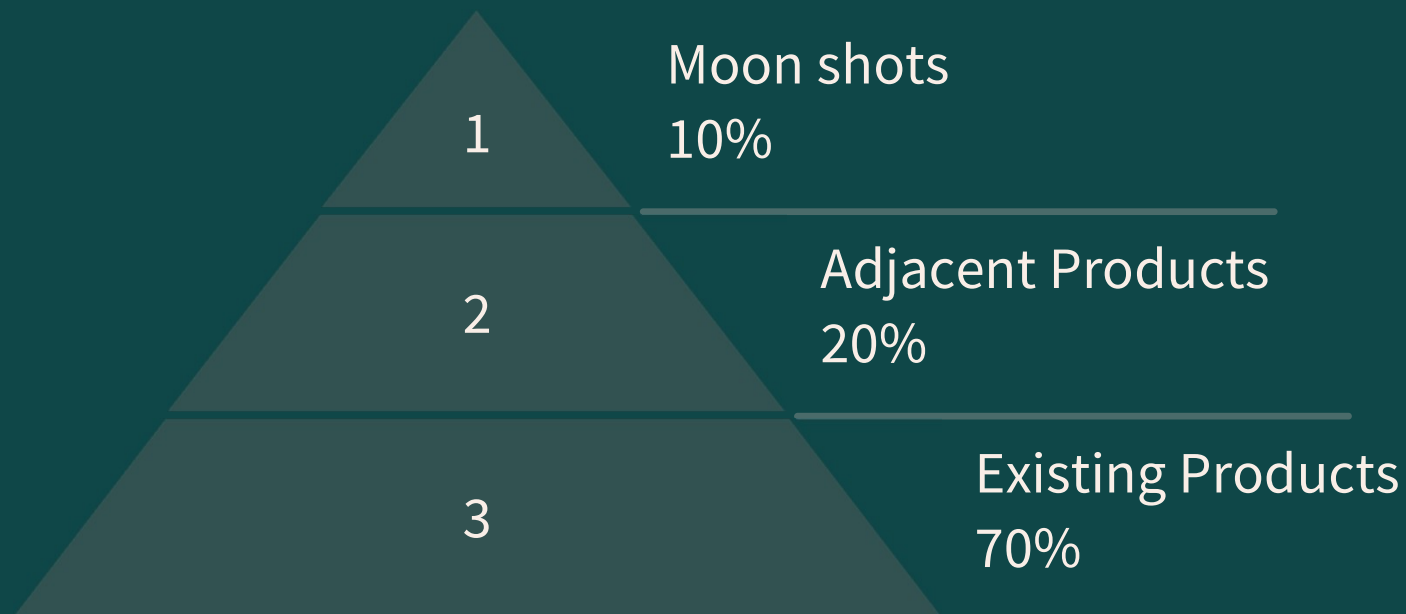
- Product managers pitching new business (S&M)
- Engineers working on internal tools (COGS or G&A)
- Analytics supporting employees with reporting (various)
- IT supporting employees with hardware/software (G&A)

The goal is to understand how much is spent on product development, so that you can start to think about the return on that investment.

However, it's useful to ask about the ROI on the non-product spend as well or analyze as part of another function.



3. Bucket R&D Spend into Categories



Comments:

- Google has used this as a guiding framework historically
- Buckets and allocations will be different for every company
- The goal is to clarify investments, seek alignment and potentially reduce lower value spend.

4. Start to Measure R&D Effectiveness

New Product Vitality Index (NPVI)

Revenue from products launched in the past 2-5 years

Total revenue

Comments:

- Introduced by 3M which historically reported ~30%
- Highlights recent innovation over the durability of existing products

R&D ROI

Revenue from new products over a specific period

Total R&D spend

Comments:

- Simple but crude measure; Does not take profit into account
- Difficult to match rev with R&D spend
- Full DCF would be more complete picture

Research and Development Index (RDI)

Y/Y organic growth

R&D spending, as % of revenue from last year

Comments:

- Introduced by Boston Consulting Group (BCG)
- Top quartile > 1.3
- Simplified metric but may not work as well across industries

