

# PRODUCT DEVELOPMENT

## BEST PRACTICES REPORT

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### METRICS STRATEGY: MANAGE THE REVENUE DRIVERS

Most companies manage their medium- to long-range revenue forecast using the black magic of sales and marketing forecasts. For short-term forecasting, there are many reliable techniques from which to choose. These include the order backlog, manufacturing production plans, and seasonality analysis, among others. The farther in the future the forecast, the less accurate the forecast.

Most companies have a compelling need to know with some level of certainty the revenue potential of their company in the two to four year horizon, longer than one year. By applying three metrics over a multiyear period it is possible to establish an improved ability to understand the revenue potential in the intermediate- and longer-range horizon.

- Product Releases
- Actively Supported Products [Products for which orders will be accepted]
- Current Year Sales Due To Products Released In The Prior "N" Years

The last of these three metrics, CYSDTPRITPNY, is widely used in industry. GGI's 1998 Product Development Metrics Survey, conducted with Management Roundtable, found that this metric was among the top ten commonly used product development metrics across 190 companies surveyed, many of whom are BPR readers. The question each company faces on this metric is the value of N. For the two case studies below, N equals three years. Across industry, N ranges from one to five for the most part.

The first two metrics may be more challenging to determine. Counting "Product Releases" is difficult. Not every released SKU counts in the calculation, only SKUs that required design/manufacturing engineering effort of some measurable amount count. Counting "Actively Supported Products" is equally difficult. Many companies have products not listed in their catalogs that they will ship if a customer places an order. You find them all over the factory and purchasing manager's desks. If a company will take an order for it, it is an Actively Supported Product.

Obsolescence management practices, compliance engineering, and sustaining engineering will also pose interesting decisions regarding active vs. new products. A good general guideline is to make rational decisions, and then to be consistent over a multiyear period in applying your logic. Consistency of measurement is quite important.

The good news is that these issues are manageable and that you do not have to wait for three to four years to accumulate data before the metric becomes useful. You only have to start now and baseline your historical performance for the past three-five years. In a few months, you should be able to see the relationship of your product development strategy to your medium-long term revenue projections.

Two companies provide contrasting examples of performance. Both companies are in generally rising markets that have little flat spots. Both companies are about the same size and provide custom-engineered and tailored-standard product to large dominant capital equipment manufacturers. Both companies have higher unit gross margins on new products, and then the product price and gross margin erode over time as the product ages and their customers/markets demand annual price discounts.

Company A's product releases go "up-down-up-down" fairly consistently. Company A has a small percentage of sales from products released in the last three years (see next page).

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## Company A

SENSING INSTRUMENT MANUFACTURER		NOT INCLUDED IN AVERAGE					AVG LAST THREE YEARS ACTUAL	%
METRIC	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5 <small>PROJECTED</small>			
PRODUCT RELEASES	8	5	12	7	12	8	100 %	
ACTIVELY SUPPORTED PRODUCTS	107	111	144	143	146	133	100 %	
\$ SALES <small>SALES DUE TO PRODUCTS RELEASED IN THE PRIOR THREE YEARS</small>	NA	NA	10 %	24 %	15 %	17 %		

ASSUME YEAR 5 IS THE ACTUAL RESULT FOR CALCULATION PURPOSES

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## Company B

INTEGRATED CIRCUIT MANUFACTURER		NOT INCLUDED IN AVERAGE					AVG LAST THREE YEARS ACTUAL	%
METRIC	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5 <small>PROJECTED</small>			
PRODUCT RELEASES	19	24	24	29	35	25.6	100 %	
ACTIVELY SUPPORTED PRODUCTS	196	133	153	161	?	149.0	100 %	
\$ SALES <small>SALES DUE TO PRODUCTS RELEASED IN THE PRIOR THREE YEARS</small>	41.3 %	43.8 %	65.0 %	43.6 %	?	50.7 %		

ASSUME YEAR 5 IS THE ACTUAL RESULT FOR CALCULATION PURPOSES

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Company B's product releases go "consistently up with a flat spot" and never down. Company B hovers around 50% of revenue from products released in the last three years.

The "metric in the middle" provides the driving ability. It is often hard as an executive management team to gauge exactly where the resources of the company are being deployed. Strategies can be rolled out, but unless resources are actively managed to achieve the strategy most employees become consumed with caretaking for operations. If one compares the Product

Releases against the Actively Supported Products for Company A for any three-year period, the total does not exceed 31. For Company B, the minimum is 67 and the range is 67 to 88. Yet both companies have roughly the same number of Actively Supported Products. Company A is consumed with caretaking for operations. Company B drives new product strategy to achieve revenue and profit goals.

A final calculation for the metrics aficionado would involve taking the total Product Releases for any three years, and dividing them into the Actively Supported Products in the following year. This is the same logic that is used to calculate the CYSDTPRITPNY metric. For Company A, Yrs 1-3 equals 25 which divided into 143 Actively Supported Products in Yr 4 equals 17%. For Company B, Yrs 1 to 3 equals 67 which divided into 161 Actively Supported Products in Yr 4 equals 42%.

Since the sales of Actively Supported Products equals company sales revenues by definition, one would expect that for a consistent product mix that there would be a high correlation between the percentage of new products in the "actively supported mix" and the percentage of new products in the "sales revenue mix." In fact there is, but most companies have not made the tie. Company A, caretaking for operations, has 17% "new of active" and 24% "new of revenues" in Yr 4. Company B, driving product strategy, has 42% "new of active" and 43.5% "new of revenues" in Yr 4.

Driving new product development and manufacturing strategy to achieve a high percentage of new products among the group of Actively Supported Products will, for most companies, lead to increased revenues and profits. As well, it will improve medium and long range revenue forecasting.<sup>P</sup><sub>D</sub>

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