Innovation Measures #3 - R&D Growth Effectiveness

by Bill Poston

There are several methods that can be used to measure the effectiveness of spending on research and development. I will cover a couple of them in this series. The one that is the easiest to measure and the least subject to manipulation is the R&D Growth Effectiveness Ratio.

This metric compares the percentage of revenue over the past year with the rate of revenue growth over the same time period. If you spend 6% of revenue on R&D and post a revenue growth rate of 3%, then you have a growth effectiveness ratio of 0.5. If those numbers are reversed, then you have a ratio of 2.0. This ratio can be calculated for any public company that breaks out spending on R&D.

This is a rough metric that should be interpreted carefully. It is best viewed as a comparative measure that can be tracked for trends over time and benchmarked against your competition. The measure asks a simple question, shouldn’t a point of revenue invested in R&D produce at least a point of revenue growth? There are many industries where it does not. In some circumstances, R&D spending simply retards the rate at which revenue shrinks. That is why this is best used as a comparative measure.

The second challenge with this measure relates to timing. The metric compares current investment in a period with growth in that same period. By right, the investment in R&D will not produce growth until some period in the future. That is why this measure is best used as a yardstick to see how the ratio moves over time. Organizations that innovate consistently and spend R&D money effectively will see their ratios improve and stabilize.

Since this is one of the few measures that can be calculated using publically available information, it has value for the Chief Innovation Officer as a useful competitive benchmark.

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For the past 30 years, Bill has helped executives in technology-driven industries transform their competencies to deliver results. He is a highly regarded consultant, speaker, and writer on the topics of innovation strategy, product development, portfolio management, technology commercialization, and the software systems that enable innovation. Keep up with Bill's latest research and thoughts on innovation and the rising role of the Chief Innovation Officer at www.TheChiefInnovationOfficer.com.
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