Innovation Measures #4 - R&D Effectiveness Index

by Bill Poston

A few days ago I wrote about the R&D Growth Effectiveness Ratio. This is a simple comparison of rates of R&D spending with rates of revenue growth. It is simple and easy to calculate with public information.

Today, we will discuss another measure of innovation effectiveness, the R&D Effectiveness Index. This metric compares the profit generated from new products to the dollars invested in research and development. It is a more sophisticated metric, but is also subject to manipulation and measurement error.

The index divides the gross margin generated by new products over the past year by the absolute dollar amount spent on research and development activities during the same time period. An index value above one indicates effective investment in innovation. This index is best used as a way to track trends in the measure over time.

There are many difficulties in accurately measuring this index. The first is the decision to consider a product “new.” Over time, I have seen organizations seek to manipulate this metric by classifying everything they launch as a new product. This often includes things like simple packaging or labeling changes or minor tweaks to a product specification. These items should clearly be eliminated.

The second challenge is the question of how long to count gross margin. Should it be one year from the first launch or should it be one year post launch in each market. If it is the latter, then you have a real mess trying to gather information from multiple global systems and normalizing it to feed the formula.

This is a good metric with value to the Chief Innovation Officer if she can remain diligent in ensuring the validity of the inputs and accuracy of the information.

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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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