Product Manager's Desk Reference (3e)
Abstract – Chapter 6

Finance for the Product Manager: Keeping Score

Executive Summary

1. Product managers should have a solid understanding of the "numbers" in order to plan and manage products.
2. Product managers who understand the mechanics of financial statement construction can readily evaluate the performance of their products, their own companies, their competitors, and even the industries in which they compete.
3. Financial data should be graphically represented to form a product life cycle curve to illustrate the product's overall progress and performance, shared with stakeholders, and used as a tool to make strategic decisions.

Product managers should be able to review and analyze financial statements, the functional instruments used to manage a business, make decisions, and communicate results to various interested parties. The Income Statement, also known as the Profit and Loss Statement (P&L), tracks product or business performance over a given time period, such as a month, quarter, or year. The P&L helps to determine whether the product has contributed a profit or loss over the specified time period. It compares revenue (sales of products or services), the specific costs to create that revenue (cost of goods sold [COGS]), and expenses (such as marketing, sales, research and development, and general and administrative expenses).

Revenue = Unit Selling Price × Units Sold
Material + Labor + Overhead = COGS
Revenue – COGS = Gross Margin
Gross Profit / Revenue = Gross Margin %

After operating expenses are accounted for, the next level of product profitability must be calculated: the earnings before interest, taxes, depreciation, and amortization (EBITDA). This allows for the separation of interest and taxes from the actual operating P&L for the product. *[Gross Margin – Operating Expenses = EBITDA]*

The true profit of a business, as well as a product's "bottom line," or net income (or net profit), can be calculated by subtracting all expenses, interest, and taxes from EBITDA.

(EBITDA) – (Interest, Taxes, Depreciation, and Amortization) = Net Income
Net Income / Revenue = Net Income %

The Balance Sheet takes a snapshot of the assets and liabilities of the company at a specific point in time and depicts the overall net worth or equity of the company at that particular point in time. It depicts the assets owned by the business and how those assets are financed with money from creditors or the capital of its owners or shareholders, or both. *[Assets – Liabilities = Owner's Equity]*

Product managers must be able to create Business Cases for product investments, assemble forecasts, test planning assumptions (sensitivity analysis), derive product cost models, establish pricing models, and prepare product budgets. They must also make sure that the product is achieving its stated business goals as budgeted, or in relating the product's performance against the original Business Case, and be able to determine where the product is situated on the life cycle curve. In financial analysis, ratios are especially useful in comparing results between time periods for the same product, between different products in a portfolio, and even in comparing competitors' products' financial performance with the company's own.

Gross Margin / Total Revenue = Gross Margin %
Net Profit / Total Revenue = Net Profit %