Finance for the Product Manager: Keeping Score

The Income Statement is sometimes called the Profit and Loss Statement, or just P&L. Since the P&L tracks product or business performance over a given time period such as a month, quarter, or year, it is referred to as a periodic statement. The P&L helps to determine whether the product has contributed a profit or loss over the specified time period. Each product should have its own P&L. The basic P&L format for a product is shown in below.

	BUDGET
SALES (REVENUE)	
Number of Units	10,000
Price per Unit	$6.25
Total Revenue	$62,500.00
COST OF GOODS SOLD (COGS)	
Materials	7,500
Labor	4,500
Overhead	$9,800.00
Total COGS	$21,800.00
Gross Margin	**$40,700.00**
Gross Margin %	**65.1%**
EXPENSES	
Marketing	5,400.00
Sales	3,300.00
R & D	3,235.00
General & Administrative	2,100.00
Total Expenses	**$14,035.00**
Earnings Before Interest & Taxes, Depreciation, and Amortization (EBITDA)	**$26,665.00**
Depreciation & Amortization	500.00
Interest Expense	350.00
Income Taxes	2,631.00
Net Income (Profit)	**$23,684.00**
Net Income %	**37.9%**

Finance for the Product Manager: Keeping Score

The Balance Sheet is a financial statement that 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 is different from the P&L, which shows results for a financial period.

Most product managers do not influence or control the balance sheet. However, if you manage tangible products, you may be interested in figures such as inventory and inventory turns, or the value of facilities that are used to produce or distribute your product. Inventory must be moved quickly so that company funds aren't tied up in idle resources. Facilities may be depreciated over time, and an annual depreciation charge may end up in your product P&L. See your CFO's office for information on the mechanics in your company.

	PAST YEAR	CURRENT YEAR	INCREASE/ DECREASE
ASSETS			
CURRENT ASSETS			
Cash	250,000	325,000	75,000
Marketable Securities	335,000	420,000	85,000
Accounts Receivable	650,000	700,000	50,000
Inventory	725,000	240,000	(485,000)
TOTAL CURRENT ASSETS	$1,960,000	$1,685,000	($275,000)
Property, Plant, & Equipment	$2,750,000	$2,850,000	$100,000
TOTAL ASSETS	**$4,710,000**	**$4,535,000**	**($175,000)**
LIABILITIES & OWNERS EQUITY			
CURRENT LIABILITIES			
Accounts Payable	635,000	720,000	85,000
Short-Term Loans	24,000	19,000	(5,000)
Taxes Payable	125,600	138,000	12,400
TOTAL CURRENT LIABILITIES	$784,600	$877,000	$92,400
LONG-TERM DEBT	$625,000	$550,000	($75,000)
TOTAL LIABILITIES	**$1,409,600**	**$1,427,000**	**$17,400**
OWNERS' EQUITY	**$3,300,400**	**$3,108,000**	**($192,400)**
TOTAL LIABILITIES & OWNERS' EQUITY	**$4,710,000**	**$4,535,000**	**($175,000)**

Finance for the Product Manager: Keeping Score

Throughout the year, many product teams ask management for investment money for their products. The CFO, working with the executive leadership team may take portion of the company's profits and invest it with product teams. If the product team wishes to "borrow" money from the CFO, it must be paid back with interest (providing a rate of return). This interest has another term in the corporate world: the discount rate. The discount rate is based on what is called the "cost of capital." (you can read about this in financial texts or speak to your CFO's office). Suffice it to say that the CFO charges you a discount rate that accounts for the fact that money expected to arrive further into the future is discounted back to the present. Hence we have the financial expression *discounted cash flow. The diagram below is from the book and depicts the mechanics of discounted cash flow.* However, it is recommended that you work with your CFO office to ensure that the calculations made for any product investment conform to corporate norms.

	Current Year	Current Year +1	Current Year +2	Current Year +3	Total
Cash Invested	**-$100,000**				
Revenue		$45,000	$60,000	$75,000	$180,000
Discounted Cash Flow		$39,600	$46,464	$51,110	$137,174
Cumulative Discounted Cash Flow		$39,600	$86,064	$137,174	

Finance for the Product Manager: Keeping Score

Given a basic understanding of financial statements and product budgets (plans), it's appropriate to expect that the product manager explain how actual outcomes compare with the established plans. One of the most important methods applied to analyzing the performance of the product and the business is variance analysis. Variance analysis looks at a financial plan or budget and compares that plan to the actual results as shown on the product's P&L. Variance information is a starting point for the product Manager to analyze what has taken place, why, and what kind of remedial action might be needed. The key in this kind of product-level financial analysis is to determine the relationships between unit volumes, costs, and product profitability. Every line item in the product P&L provides a glimpse into the business performance of the product. All variances, either positive or negative, must be explained. Each explanation should have some kind of action plan to remedy any deficiencies.

We started with the sample P&L budget from Figure 6.1; now we'll look at the figure on this page, which shows actual results that are now revealed, along with the associated variances. This is covered on the next page with Figure 6.5.

	BUDGET	ACTUAL	VARIANCE	VARIANCE %
SALES (REVENUE)				
Number of Units	10,000	10,450	450	4.5%
Price per Unit	$6.25	$5.88	-0.37	-5.9%
Total Revenue	$62,500.00	$61,446.00	-$1,054.00	-1.7%
COST OF GOODS SOLD (COGS)				
Materials	7,500.00	7,612.00	-112.00	-1.5%
Labor	4,500.00	4,250.00	250.00	5.6%
Overhead	9,800.00	10,412.00	-612.00	-6.2%
Total COGS	$21,800.00	$22,274.00	-$474.00	-2.2%
Gross Margin	**$40,700.00**	**$39,172.00**	**-$1,528.00**	**-3.8%**
Gross Margin %	**65.1%**	**63.8%**	**-1.4%**	**-2.1%**
EXPENSES				
Marketing	5,400.00	5,105.00	295.00	5.5%
Sales	3,300.00	3,410.00	-110.00	-3.3%
R & D	3,235.00	3,875.00	-640.00	-19.8%
General & Administrative	2,100.00	2,140.00	-40.00	-1.9%
Total Expenses	**$14,035.00**	**$14,350.00**	-$495.00	**-3.5%**
EARNINGS BEFORE INTEREST & TAXES, DEPRECIATION, AND AMORTIZATION (EBITDA)	**$26,665.00**	**$24,642.00**	**-$2,023.00**	**-7.6%**
Depreciation & Amortization	500.00	500.00	0.00	0.0%
Interest Expense	350.00	350.00	0.00	0.0%
Income Taxes	2,631.00	1,985.00	646.00	-24.6%
Net Income (Profit)	**$23,184.00**	**$21,807.00**	**-$1,377.00**	**-5.9%**
Net Income %	**37.1%**	**35.5%**	**-1.6%**	**-4.3%**

Finance for the Product Manager: Keeping Score

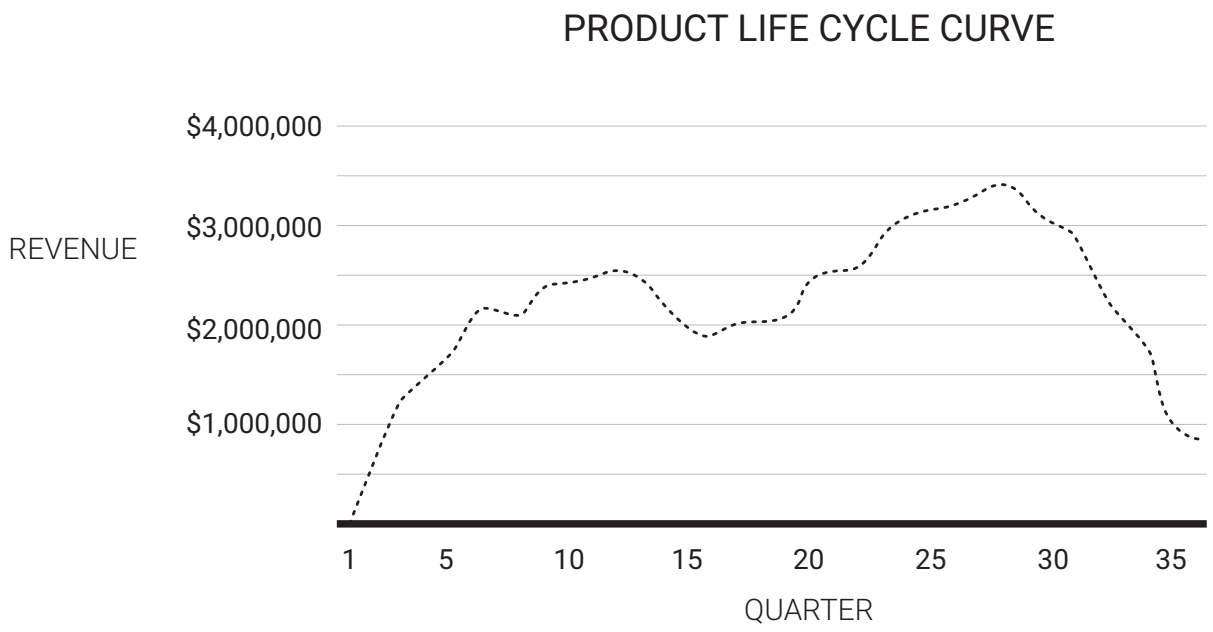
To properly evaluate the product's financial performance in an orderly fashion, three general questions have to be asked, and answered. 1. What is the variance? 2. What happened? 3. What is the action plan?

These questions can lead you to uncover possible problems to be addressed by the cross-functional team, the resolution of which may ultimately improve market performance and profitability of your products and services. The structure for carrying out the analysis and reporting to management during a product review session is demonstrated in the figure below.

WHAT IS THE VARIANCE?	WHAT HAPPENED?	WHAT IS THE ACTION PLAN/REMEDY?
Unit volume is 450 units (4.5%) greater than plan.	There was a sales contest in the last quarter.	Consider using this to boost sales in the future.
Unit prices were $0.37, or 5.9%, below plan.	Apparently, the sales team had to do intense discounting in the fourth quarter to promote sales. Sales volumes would have been lower than plan. Sales said that the competitors were also pushing deals in the fourth quarter.	Consider using this to boost sales in the future.
COGS are slightly above plan by an average of 2.2%. Material costs were greater than plan by 1.5%, and overheads were 6.2% higher than plan.	Upon further analysis, the supplier raised prices due to higher shipping costs and overhead was higher because electrical costs went up. Both material and overhead variances were due to fuel costs. (The utility said that oil prices went up 30%, and they raised some of their rates accordingly.) The higher costs for materials and overhead were offset by lower labor charges due to a productivity enhancement on the production line.	Purchasing is looking into local suppliers to minimize shipping costs, and Operations is exploring changing lights to energy-saving bulbs. It is also looking to change the hours of the plant from 9-5 to 7:30-3:30. Starting 1.5 hours earlier will reduce electric usage by 6% and, the production workers union agreed.
Gross margin is slightly below plan by 3.8%.	The problem with gross margin is the lower average selling price (even with higher volumes) as well as higher COGS, as explained earlier.	Remedial action is being taken with Sales, Purchasing, and Operations. Results will be provided at the next review session.
R&D expenses were 19.8% higher than plan.	R&D said that two of its top engineers left the company and went to work for a competitor. A major project deliverable necessitated the hiring of contract workers.	This is a temporary variance and was approved by the head of R&D and the CEO.

Finance for the Product Manager: Keeping Score

One of the ways product managers can use financial data is to organize the data so that the facts shown tell a story about the product's history. After the product is launched, it hopefully begins to earn a profit and contributes to the financial health of the company. Since there may be many products within the portfolio, each product's performance should be tracked against the original objectives as articulated in the Business Case. Financial data, particularly revenue, gross margin, and even cash flow (which could be difficult to track at the product level), can tell a story about the product's history. If the product remains viable for a long period of time, its history can be tracked beyond the monthly or quarterly numbers and back to its early years. By tracking the product's performance in a table or spreadsheet and graphing those numbers, even years back, you create the depiction of the product life cycle curve. That graphical portrait can be a very powerful tool when used by product managers to analyze the product's performance and to provide inputs to the strategic planning process for the product's business. Note the figure below. Consider how you might use this for your own product.



Return to the Online PMDR Community >>