

UNDERSTANDING RETURN-ON-INVESTMENT

INTRODUCTION

Return-on-Investment (ROI) is a financial calculation that can be used to help determine whether your project is commercially viable. ROI measures the gain or loss from an investment in relation to the upfront expenditure. This calculation can also help you determine the period over which your initial investment will generate a financial return. Keep in mind, your ROI is only as good as the numbers you feed into the calculation. One of the most common mistakes is confusing cash flow and profit, this can result in a higher expected return. This worksheet is intended to help you calculate your project ROI.

EXAMPLE

You have designed and developed a new product, which has required an upfront investment of £150,000. Based on competitive products in the market, you have decided to set your unit price at £10.00. Your research leads you to believe that an annual sales volume of 25,000 units is achievable. The cost to manufacture your product is £6.00, which leaves £4.00 profit per unit.

Net Profit: $25,000 \times £4.00 = £100,000$ in Year1

Return-on-Investment: $£100,000 / £150,000 = 0.66 \times 100 = 66\%$ in Year1

From the equation above, you can see that your return-on-investment in Year1 is 66% of your upfront expenditure, which should enable you to break-even approximately halfway through Year2 providing your annual sales volumes continue at a consistent rate.

WHAT YOU NEED TO KNOW

1. How much your target market is willing to pay for your product (**unit price**)
2. Size of your market, i.e. how many units you are likely to sell her year (**volume**)
3. The cost of producing each product (**manufacturing cost**)
4. How much profit gained from each unit sold (**unit profit**)
5. Your total net profit (**unit profit x volume**)
6. Once you know your net profit, you can calculate return-on-investment.

CALCULATE YOUR RETURN-ON-INVESTMENT:

Unit Profit =

Annual Volume =

Net Profit (Unit Profit x Annual Volume) =

Net Profit =

Investment Cost =

_____ **×** 100 **=** _____ **(ROI) %**

HELPFUL TIP: It is important to consider the integrity of your financial data. For this reason, it is worth calculating a best- and worst-case ROI scenario.