Estimated Commercial Value

The 'estimated commercial value' method is a technique to evaluate innovation projects in a stepwise manner. It considers risks and their probabilities in order to inform mitigation strategies and fairly value projects. Instead of a go or no-go decision being made in the early stages of the project, the approach focuses instead upon whether a relatively small investment ought to be committed to further investigation of the project's potential. In this way, decisions during the idea-to-launch process can be comprehended as 'buying a series of options'.

Using 'Estimated Commercial Value'

Step 1: At various predetermined stages of the project's development, scenarios are defined that represent possible outcomes. Generally, these are simplified to assist understanding.

Step 2: Each scenario is assigned a probability value that represents its likelihood of occurring. Next the project value is estimated. The combination of the estimated project value and probability are represented, often on a decision tree.

Step 3: A formula is applied to determine the expected commercial value of the project. It is ECV = $[(PV*P_{cs} - C)*P_{ts}]-D$. The items contained in this formula are detailed below. Those contained in the regular parentheses are dealt with first, followed by the multiplication within the squared brackets, and finally the subtraction.

ECV = Estimated commercial value.

PV = Present value of future earnings. This is determined by dividing the cash flow for a period by the value of 1 plus the rate of return multiplied by the number of periods.

P_{cs} = The probability that the project will be commercially successful.

P_{ts} = The probability of the project being technically successful.

C = The cost of commercially launching the project.

D = Development cost.