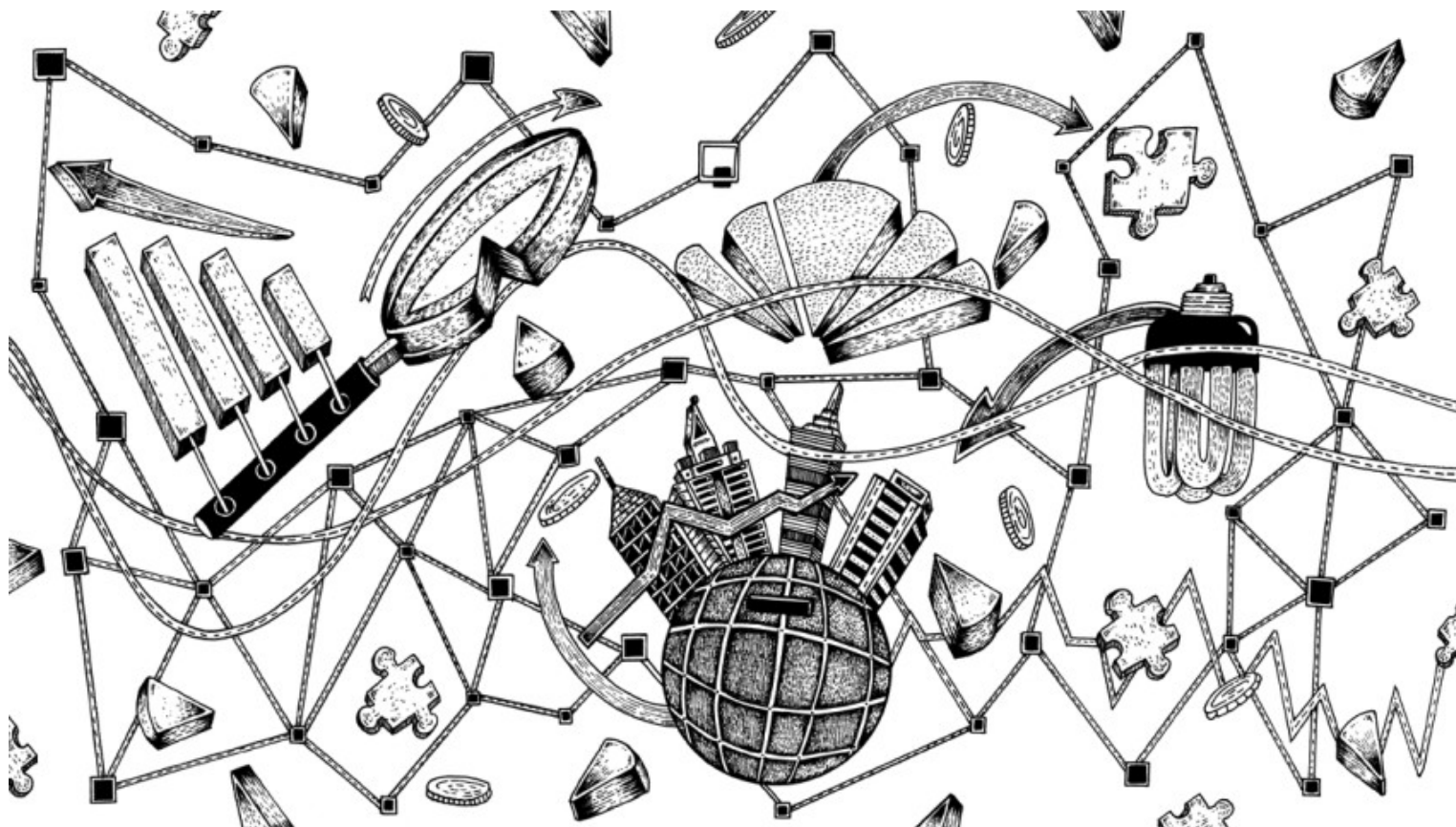


Tesla Shows How Traditional Business Metrics Are Outdated

by Eddie Yoon

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Laura Schneider for HBR

Elon Musk is having a moment. Tesla just delivered its first Model 3, the affordable model that he envisioned in his “secret” strategy some 11 years ago. He wanted to build a sports car, then build a more affordable car with zero emissions. He’s basically already there. The Model 3 has mostly rave reviews and a multiyear waiting list, which is quite a feat, even for an industry leader like Musk.

And yet confusion still abounds regarding Tesla. There are roughly the same number of buy, hold, and sell ratings on the company, which means Wall Street has no idea what's going on. Tesla's recent announcement to raise \$1.5 billion in debt was largely met with a yawn by stockholders, as shares moved down a slight 0.5%. Tesla's ability to surprise has analysts wondering if it is wise to ever bet against Elon Musk.

At the core of the confusion over a company like Tesla is that traditional business metrics are outdated and can create overconfidence or underestimation. Classic metrics like market penetration and market share, which many leaders are measured on, are the very things causing us to miss market opportunities and threats. I consider someone like Musk to be a category creator – someone who doesn't rely on incremental innovation but instead changes the rules of the road entirely by creating a new category. In that landscape, our established modes of measurement just don't work.

We don't need to throw out all classic business metrics. But we should recognize their fundamental flaws and complement them with a new set of metrics. Essentially, we need bifocals for business metrics. Here are some of the areas I see as most ripe for change:

Market share is one of the most widely used, and wildly misused, business metrics. In May Forbes tried to dampen the Tesla enthusiasm with the fact that Renault-Nissan was the global electric vehicle market leader in Q1 of 2017, with 1.5X more units than Tesla. However, Tesla recently said that its gross margins on the Model 3 could hit 25% in 2018, which is comparable to the Model S and X and nearly twice as high as gross margins from Ford and GM. Share of profit is far more useful than share of units in this scenario.

But even share of profit has two fundamental problems: It focuses your attention backward, to "what happened," instead of forward, to "what will happen." And it focuses your attention on your own performance or your competition, rather than on where market is headed. It's a metric that's better but still part of the problem.

The biggest problem is the very definition of "market." Some define Tesla's market as electric vehicles. But others say that Tesla is killing it in the large luxury car market, where the Model S is outselling Mercedes, BMW, and Porsche combined. Tesla's ludicrous mode (where it goes from zero to 60 miles per hour in 2.5 seconds) has gotten a lot of attention, but what about Tesla's

“camper mode?” This isn’t an actual mode but rather a novel use case that a set of Tesla superconsumers have figured out, creating a whole subculture of camping in Teslas. That’s because the seats fold back to fit a person up to 6’ 9” tall, it has a glass canopy overhead, and the Model 3 can maintain a comfortable temperature all night with just 7% of the battery. When category creators blur the lines we’re used to around a given market, your old measures don’t work as well and it’s much easier to get blindsided or surprised. The solution to this, which I’ve written about previously, is to enhance share-of-market metrics with share of growth.

Market penetration (what percent of people in the market buy your product) is another widely used and wildly misleading metric. If you have low market penetration, the assumption is that you can expect more people in the market to buy your product, whereas businesses with high market penetrations are at risk of being written off as tapped out. The core problem with market penetration is that it is often underestimated. This creates complacency, and leaders wind up overlooking opportunities.

For category creators, the underestimation issue is clearer. Tesla’s market penetration of electric cars is one thing, but if you add in luxury cars, the glamping/camping market, and others, then the addressable market becomes bigger, especially with the introduction of the more affordable Model 3. Are people who use budget hotels folks we can add to the addressable market? How about families who participate in travel sports leagues for their kids? How about consumers in the “staycation” market? What the Model 3 brings to market echoes what I suggested the Apple Car should be: your favorite parts of your home, on wheels. The upside for Tesla is much bigger than people realize.

Even for non-category-creating situations, we should realize that market penetration estimations are likely incorrect. Most penetration is calculated from data providers gathering transaction-level data. This is fine data to use on a longitudinal basis or on a relative basis. But it is not good for estimating the addressable market or market growth potential. Why? First, just because you bought something once in the past year doesn’t mean you use it, like it, and want it again. It’s about as elementary as kindergarten logic, where if two kids held hands once during recess, they were “married.” Transaction data tells you what people bought, not what they want – and sales are not the same as demand.

Second, market penetration is measured at the household level, not at the individual level. Just because my household bought kimchi doesn't mean we all eat it and like it (sadly). The reason why Netflix allows multiple users per household and asks for separate logins is that data about the individual is valuable. Brands with greater than 50% household/transaction penetration may find their actual individual/usage (and liking) penetration to be much lower, which means those brands may still have upside to uncover.

My suggestion here is to flip market penetration into something I call *problem penetration*. What percentage of your customers or potential customers who have a problem (or unmet need) related to your product have addressed it with a viable solution and higher commitment? This flips the focus off of what we make and shifts it to the core problem that consumers and potential consumers want to solve. Too many companies I know don't have a good grasp of what problem their product or category is trying to solve. Next, we need to measure how many are actually satisfied with their solution or workaround for the problem. This is the truest measure of the addressable market and how it can grow. For example, you might say 90 million households have a coffeemaker, so there isn't much upside. And then Starbucks, Keurig, and Nespresso come along and show us that the core problem isn't getting a cup of coffee but getting my *ideal* cup of coffee, when I want it, how I want it, wherever I want it.

Category creators are changing the world – and our metrics need to keep up.

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