Social Cost Benefit Analysis

The foremost aim of the entire individual firm or a company is to earn maximum possible return from the investment on their project. In this aspect project promoters are interested in wealth maximization. Hence the project promoters tend to evaluate only the commercial profitability of a project**.** There are some projects that may not offer attractive returns as for as commercial profitability is concerned but still such projects are undertaken since they have social implications. Such projects are public projects like road, railway, bridge and other transport projects, irrigation projects, power projects etc. for which socio-economic considerations play a significant part rather than mere commercial profitability. Such projects are analyzed for their net socio economic benefits and the profitability analysis which is nothing but the socio-economic cost benefit analysis done at the national level.

The social cost benefit analysis is a tool for evaluating the value of money, particularly of public investments in many economies. It aids in decision making with respect to the various aspects of a project and the design programs of closely interrelated project. Social cost benefit analysis has become important among economists and consultants in recent years.

SCBA is used primarily for evaluating public investments and has received increased emphasis in recent years due to the growing importance of public investments especially in developing countries where government play significant role in economic development. SCBA is also relevant in major private investments, which require governmental approval since these investments have bearing on national considerations.

Factors that will be considered in accept or reject decisions of a project

1. Employment Potential:

The employment potential of a project is looked into. A project with high employment potential is considered highly desirable.

2. Foreign Exchange:

A project with potential to earn foreign exchange to the country or an import substitution project which saves the country's foreign exchange reserves is highly desirable.

3. Social Cost-Benefit Analysis:

A project with net benefits to the society over the costs to the society is preferred.

4. Capital-Output Ratio:

If the value of expected output in relation to the capital employed is high, the project is given priority over the others.

5. Value Added Per Unit of Capital:

The amount invested in the project should generate the value addition to the capital employed by earning surplus profits which can be used for further capital investments to contribute development of the national economy.

Features of Social Cost Benefit Analysis

1. Assessing the desirability of projects in the public as opposed to the private sector
2. Identification of costs and benefits
3. Measurement of costs and benefits
4. The effect of (risk and uncertainty) time in investment appraisal
5. Presentation of results – the investment criterion.

Stages of Social Cost Benefit Analysis of a Project-

1. Determine the financial profitability of the project based on the market prices.
2. Using shadow prices for the resources to arrive at the net benefit of the project at economic process.
3. Adjustment of the net benefit for the projects impact on savings and investment.

4. Adjustment of the net benefit for the projects impact on income distribution.

5. Adjustment of the net benefit for the goods produced whose social values differ from their economic values.

Limitations of Social Cost Benefit Analysis

Social cost benefit analysis suffers from the following limitations:

1. The problems of qualification and measurement of social costs and benefits are frightening. This is because many of these costs and benefits are intangible and their evaluation in terms of money is bound to be subjective.

2. Evaluation of social costs and benefits has been completed for one project, it may be difficult to judge whether any other project would yield better results from the social point of view.

3. The nature of inputs and outputs of projects involving very large investment and their impact on the ecology and people of the particular region and the country as a whole are bound to be differing from case to case.

What Is the Relevance of Cost-Benefit Analysis for Business?

When you're in love with an idea, it's easy to let your imagination run away with you. Many businesses have suffered badly because they invested in a project that sounded good in the boardroom, but ultimately didn't generate any returns. A cost-benefit analysis can bring your ideas into the real world, effectively asking the question "Is it worth it?"

In terms of business decision-making, you can use the methodology to analyze a wide variety of situations:

- To evaluate whether a capital investment is worth it.
- To decide whether to hire new employees.
- To determine whether a project or operating change is feasible.

- To develop a benchmark for comparing projects.
- To weigh up one marketing initiative against another.
- To appraise the desirability of a proposed policy.
- To prioritize investments, so you're focusing on the actions that return the most value first.
- To quantify the effects that a change initiative would have on stakeholders.
- To establish goals for the project itself, for example, to set time, productivity or cost restraints on a project you've analyzed and approved.

In many ways, the cost-benefit equation is what business is all about. Spending money (costs) to creating value (benefits) is what businesses do, so customers will buy from you and you can turn a profit. Introducing a formal process for assessing the cost and benefit of making the proposed changes simply adds rigor to something your business is already doing each day.

How Do You Perform a Cost-Benefit Analysis?

While there's no right or wrong way to perform a cost-benefit analysis, most methodologies will contain the following steps:

What is the problem? An important part of a cost-benefit analysis is identifying what the problem is you're trying to solve. A cost-benefit analysis is most effective when you articulate the problem in its simplest terms – "should we hire a new customer services associate?" is a better problem to evaluate than "how should we resolve the gaps in our customer service offering?"

What are the costs? The next steps is to brainstorm all the costs associated with the problem and make a list of these. For example, for the costs associated with hiring a new team member, you might write:

- Annual salary $40,000.
- Cost of benefits package $2,000.

- Recruiting costs $4,500.
- Training costs $1,500.
- Value of HR manager's time in hiring $3,000.

And so on. Costs include the direct cost of the resources - raw materials - needed and indirect costs – overhead, administration – as well as the value of the human effort involved in the implementation of the project. Think laterally and include all the possible expenses that may be incurred both during the project and after it is finished. Will you need to train staff? Will there be a decrease in output while the team gets used to the new system?

What are the benefits? This step is the trickiest because it is very difficult to predict future revenues accurately, especially if you've never undertaken a project like this one before. Also, there may be intangible benefits that are tough to allocate a dollar value to. Things like employee satisfaction or the impact of your action on the environment fall into this category.

In this step, you've got to come up with a numerical value for all the possible benefits associated with your action. It's important to consult with stakeholders so you can properly evaluate the benefits that may arise over the long term.

Compare the costs and benefits and make an informed decision. The final step is to compare the total costs against the total benefits and make your decision. Do the benefits outweigh the costs? Do they do so significantly? If so, you should green light the project.

At this stage, most businesses will consider the payback period. This represents just how long it will take for the business to reach the break even point, which is the point at which the benefits have repaid the costs. The shorter the payback period, the less time you'll have to wait before your project starts making money.

For simple analyses, the following calculation will give you a rough idea of your payback period:

Total cost / total revenue = length of payback period