Cost-Benefit Analysis

The Cost-Benefit Analysis Process

A cost-benefit analysis (CBA) should begin with compiling a comprehensive list of all the costs and benefits associated with the project or decision.

The costs involved in a CBA might include the following:

- Direct costs would be direct labor involved in manufacturing, inventory, raw materials, manufacturing expenses.
- Indirect costs might include electricity, overhead costs from management, rent, utilities.
- Intangible costs of a decision, such as the impact on customers, employees, or delivery times.
- Opportunity costs such as alternative investments, or buying a plant versus building one.
- Cost of potential risks such as regulatory risks, competition, and environmental impacts.

Benefits might include the following:

- Revenue and sales increases from increased production or new product.
- Intangible benefits, such as improved employee safety and morale, as well as customer satisfaction due to enhanced product offerings or faster delivery.
- Competitive advantage or market share gained as a result of the decision.

An analyst or project manager should apply a monetary measurement to all of the items on the cost-benefit list, taking special care not to underestimate costs or overestimate benefits. A conservative approach with a conscious effort to avoid any subjective tendencies when calculating estimates is best suited when assigning a value to both costs and benefits for a cost-benefit analysis.

Finally, the results of the aggregate costs and benefits should be compared quantitatively to determine if the benefits outweigh the costs. If so, then the rational decision is to go forward with the project. If not, the business should review the project to see if it can make adjustments to either increase benefits or decrease costs to make the project viable.

Otherwise, the company should likely avoid the project.

Important:-

With cost-benefit analysis, there are a number of forecasts built into the process, and if any of the forecasts are inaccurate, the results may be called into question.