PROCUREMENT
FOR
PROJECTS

Cost-Benefit Analysis

01

COST BENEFIT ANALYSIS

The cost-benefit analysis compares the costs and benefits of a project and then makes a decision on whether or not to proceed with the project.

How to do Cost Benefit Analysis?

#1 – Net Present Value Model:

The NPV of a project refers to the difference between the present value of the benefits and the present value of the costs. If NPV > 0, then it follows that the project has economic justification for going ahead.

#2 - Benefit-Cost Ratio:

The Benefit-Cost provides value by calculating the ratio of the sum of the present value of the benefits associated with a project against the sum of the present value of the costs associated with a project.

NET PRESENT VALUE(NPV) FORMULA

NPV = ∑ Present Value of Total Future Benefits - ∑ Present Value of Total Future Costs

BENEFIT-COST RATIO (BCR) FORMULA

BCR = ∑ Present Value of Total Future Benefits / ∑ Present Value of Total Future Costs

EXAMPLE

Project Alternative 1	Project Alternative 2
•Present value of Costs = $80 million •Benefits = $150 million •NPV = $150 million – $80m = $70m •BCR = 100 Mn. /70 Mn. = 1.88	•Present value of Costs = $9 million •Present value of Benefits = $20 million •NPV =$20 million – $9 million = $11 million •BCR = 20 Mn /9 Mn = 2.22

- From this cost-benefit analysis, it can be seen that while both investment proposal provides a net positive outcome.
- However, the NPV and BCR methods of obtaining results provide slightly varied outcomes.
- Using NPV suggests investment option 1 provides a better outcome as the NPV of $70 million is greater than the NPV of option 2 ($ 5 million).
- On the other hand, applying the BCR method, option two would be preferred as a BCR of 2.22 is greater than the BCR of 1.88.

STEPS FOR COST BENEFIT ANALYSIS

1. Define the framework for analysis
2. Identify Costs and Benefits
3. Drawing a Timeline for expected costs and revenues
4. Moentize Costs and Benefits
5. Discount Costs and Benefits to obtain Present Values
6. Calculate Net Present Values

SUMMARY

How to Make a

Cost Benefit Analysis

Study shows that many businesses suffered financial failure because they invested on a project that sounded good but can't generate any returns.

Define Your Goals & Objectives

The first step is to define your goals and objectives in making a cost and benefit analysis.

Identify Your Outcome Costs and Benefits

After conducting your data analysis and calculate your cost and benefits.

Review Your Previous Cost Benefit Analysis

Before you begin your analysis, review your previous cost benefit analysis reports.

Conclude Your Findings

Consider your opportunity cost and potential risk in your conclusion as well.

Gather Your Data

The next thing to do is to gather data for your analysis. Ask yourself, what is my current problem?

Review Analysis

Finally, review and proofread your cost benefit analysis report for any errors.

Did I help?

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