

Cost/Benefit Analysis

Evaluating Whether to Follow a Course of Action

You may have been intensely creative in generating solutions to a problem, and rigorous in your selection of the best one available. This solution may still not be worth implementing, as you may invest a lot of time and money in solving a problem that is not worthy of this effort.

Cost/Benefit Analysis is a relatively simple and widely used technique for deciding whether to make a change. As its name suggests, to use the technique simply add up the value of the benefits of a course of action, and subtract the costs associated with it.

Costs are either one-time, or may be ongoing. Benefits are most often received over time. We build this effect of time into our analysis by calculating a payback period. This is the time it takes for the benefits of a change to repay its costs. Many companies look for payback over a specified period of time – e.g. three years. In its simple form, cost/benefit analysis is carried out using only financial costs and financial benefits. A more sophisticated approach to cost/benefit analysis is to try to put a financial value on intangible costs and benefits.

Cost/Benefit Analysis is a powerful, widely used and relatively easy tool for deciding whether to make a change.

To use the tool, first work out how much the change will cost to make. Then calculate the benefit you will receive from it.

Where costs or benefits are paid or received over time, work out the time it will take for the benefits to repay the costs.

Cost/Benefit Analysis can be carried out using only financial costs and financial benefits. You may, however, decide to include intangible items within the analysis. As you must estimate a value for these, this inevitably brings an element of subjectivity into the process.

For more information on Problem Solving and Decision Making see:
Mind tools – Essential Skills for an Excellent Career www.mindtools.com.