

Project Appraisal

Project Appraisal is the analysis of costs and benefits of a proposed project with a goal of assuring a rational allocation of limited financial resources amongst alternate Investment opportunities with the objective of achieving specific goals.

Project Appraisal is mainly the process of transmitting information accumulated through feasibility studies into a comprehensive form in order to enable the decision maker undertake a comprehensive appraisal of various projects and embark on a specific project or projects by allocating resources.

Objectives & Scope: -

- To extract relevant information for determining the success or failure of a project.
- To apply standard yardsticks for determining the rate of success or failure of a project.
- To determine the expected costs and benefits of the project.
- To arrive at specific conclusions regarding the project.

Significance: -

- It helps in arriving at specific and predicted results.
- It evaluates the desirability of the project.
- It provides information to determine the success or failure of a project.
- It employs existing norms to predict the rate of success or failure of the project.
- It verifies the hypothesis framed for the project.

Various Aspects of Appraisal

Technical Analysis

The analysis for determining the technical viability of the development project is based on the technical data and information given in the PC-I form as well as the earlier experience of carrying out similar projects. The technical tests and yard-sticks to be used to determine the technical viability differ from project to project and from sector to sector. In cases where high level technology is involved and the country has little or no experience, foreign consultants are also employed to prepare the feasibility studies. The technical analysis concerns the project's input (supplies) and output (production) of real goods and services. For example, in an agricultural project, technical analysis will determine the potential yields in the project area, the co-efficients of production, potential cropping patterns, and the possibilities for multiple cropping. The technical analysis will also examine the marketing and storage facilities required for the successful operation of the project. The aspects like soil/ground water or collection of hydrological data may also be examined. Knowledge about farmers in the project area, their current farming practices, and their social values to ensure realistic choices about technology is also examined.

Social Analysis

Social analysis is undertaken to examine the aspects like employment opportunities and income distribution. The project analyst would also examine the effects of a project on particular groups/regions.

Commercial Analysis

The commercial aspects of a project include the arrangements for marketing the output produced by the project and the arrangement for the supply of inputs needed to build and operate the project. On the output side, careful analysis of the proposed market for the project's production is essential to ensure that there will be an effective demand at a remunerative price. It needs to be ensured that adequate input supplies are available for the efficient operation of the project.

Financial Analysis

Financial analysis involves assessment of financial impact, judgement of efficient resource use, assessment of incentives, provision of a sound financing plan, coordination of financial contribution and assessment of financial management competence. The main objective of financial analysis is to determine the requirements of funds/timing and the expected returns on investment from the points of view of the various parties involved in the financing of the project. Under this analysis, judgement is framed about the project's financial efficiency, incentives, credit-worthiness and liquidity. In financial analysis, cost and benefits are calculated using current market prices. Interest payments on borrowed capital and repayment of loans are not included. Taxes in the form of excise duties, customs duties, sales taxes are considered cost, while subsidies and loan receipts are considered benefits and are fully accounted for in the analysis.

Economic Analysis

Analysis from the economic aspect assesses the desirability of an investment proposal in terms of its effect on the economy. The question to be addressed here is whether the investment proposal contributes to the developmental objective of the country and whether this contribution is likely to be large enough to justify the use of scarce resources such as capital, skilled labour, managerial talents etc., that would be needed to implement and operate the project. In economic analysis, input and output prices are adjusted to reflect true social or economic values. These adjusted prices are often termed as shadow or accounting prices. The taxes and duties are treated as transfer payments and are excluded from the capital and operating cost.

The two main steps in economic analysis are:

- (a) the "pricing of project inputs and outputs" and
- (b) the "identification of project costs and benefits".

These steps are discussed below:

(a) Pricing of Project Inputs and Outputs

In economic analysis, the valuation of inputs and outputs can be made keeping in view the following three rules:

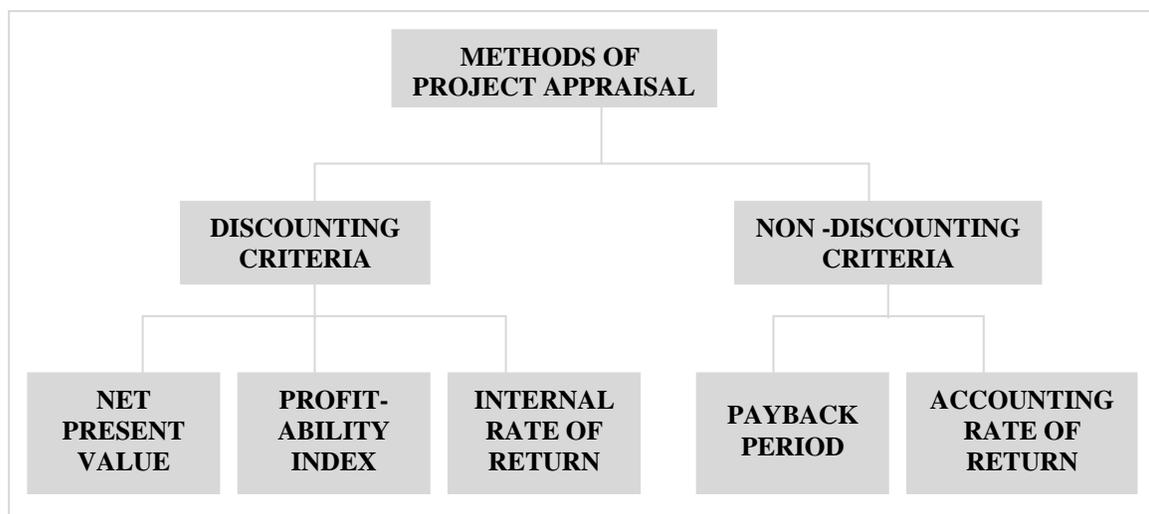
- i) Most of the inputs in economic analysis are valued at opportunity cost or on the principle of willingness to pay. Actually it is assumed that all inputs to the project are diverted away from alternative uses. Each input has generally value in alternative use. But this use may be sacrificed so that the input can be used by the project. This sacrifice is a cost to the nation; it is an opportunity foregone because of the project. Every input to the project is valued at this opportunity cost-the value of the input in its best alternative use;
- ii) For some final goods and services, usually non-traded ones, the concept of opportunity cost is not applicable because it is consumption value that sets the economic value. This criterion is called "willingness to pay" or "value in use".
- iii) The third rule of pricing inputs and outputs is that the analysis is done at present, i.e. constant prices. This is because current price analysis entails the prediction of inflation rate which is difficult and unreliable.

(b) Identifying Project Costs and Benefits

Proper identification of project costs and benefits is an important step. An improper identification of costs and benefits would lead to under - estimation of costs or over-estimation of benefits or vice versa. The identification of secondary costs and benefits is a difficult task. For example, most of the benefits from an expanded irrigation project may be offset by a fall in fish production and reduce income for thousands of fishermen. Increased benefits due to the construction of a new highway may be equally matched by a reduction in the income of the railways due to decrease in passengers/goods. An important technique which is followed for correct quantification of costs and benefits is "with and without project" comparison of costs and benefits. Project analysis tries to identify and value costs and benefits that arise with the proposed project and to compare them with the situation as it would be without the project. The difference is the incremental net benefits arising from the project investment. This approach is not the same as comparing the situation "before" and "after" the project. The

"before" and "after" comparison fails to account for changes in production over the life of the project that would occur without the project and thus leads to an erroneous statement of benefits attributable to the project investment. A change in output can also occur without the project if production would actually fall in the absence of new investment. In some cases, an investment to avoid a loss might also lead to an increase in production so that the total benefits would arise partly from the loss avoided and partly from increased production.

Methods of Project Appraisal



Reading Assignment:

Study all the above methods/techniques of Project Appraisal.