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EPP 1387 No. of Pages 7

ARTICLE IN PRESS

Evaluation and Program Planning xxx (2016) xxx–xxx

Contents lists available at ScienceDirect

Evaluation and Program Planning

journal homepage: www.elsevier.com/locate/evalprogplan

Using cost-benefit analysis and social return on investment to evaluate the impact of social enterprise: Promises, implementation, and limitations

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ARTICLE INFO

Article history:
Received 15 October 2016
Accepted 20 November 2016
Available online xxx

Keywords:
Cost Benefit Analysis
Social Rate of Return
Social Impact

ABSTRACT

Since the early 2000's there has been growing interest in using the Social Return on Investment (SROI) as a measure for assessing the performance of social enterprises. By analogy with its business counterpart, the Return on Investment (ROI), the SROI is a metric that compares the monetized social costs of a program with the monetized social benefits of achieving an outcome (or set of outcomes). For example, calculating the SROI of a nonprofit half-way house for drug addicts might involve estimating the reduced social costs attributable to successful rehabilitation of addicts, and comparing this to the social costs of operating the half-way house. Alternatively, the total return of a for-profit social enterprise providing affordable housing might consist both of the traditional private return on investment along with the economic value of meeting the housing needs of lower income households.

Early descriptions of the methodology for calculating the SROI suggest that the approach initially evolved from standard methodologies found in the business finance literature for evaluating investments, with the important twist that nonprofit sector returns/payoffs are defined in broader social terms (Thornley, Anderson, & Dixon, 2016). Yet, someone who is familiar with the economic literature on cost benefit analysis (CBA) as it is applied to the evaluation of public programs cannot help but be struck by the similarity between the outcomes that CBA is intended to measure, and those that are the object of efforts to calculate the SROI. One implication is that the literature on the theory and practice of cost benefit analysis offers useful lessons about how to measure the social return on investment, as well as about potential caveats and limitations that need to be confronted when attempting to undertake an analysis of the SROI.

The paper discusses the potential uses and limitations of CBA and SROI as tools that governments, private donor/investors, and foundations can use to help set funding priorities, and evaluate performance. It summarizes: (1) the conceptual foundations of CBA and its application to SROI analysis, (2) issues raised in the implementation of CBA and SROI in practice, and (3) discusses when CBA and/or SROI approaches are a useful lens for setting priorities and/or evaluating performance, as well as important limitations of such methods.

1. Introduction

Since the early 2000's there has been growing interest in using the Social Return on Investment as a measure for assessing the performance of social enterprises. By analogy with its business counterpart, the Return on Investment (ROI), the SROI is a metric that compares the monetized social costs of a program with the monetized social benefits of achieving an outcome (or set of outcomes). For example, calculating the SROI of a nonprofit half-way house for drug addicts might involve estimating the reduced social costs attributable to successful rehabilitation of addicts, and comparing this to the social costs of operating the half-way house. Alternatively, the total return of a for-profit social enterprise providing affordable housing might consist both of the traditional private return on investment along with the economic value of meeting the housing needs of lower income households.

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http://dx.doi.org/10.1016/j.evalprogplan.2016.11.008
0149-7189/

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2. Cost-benefit analysis and public program evaluation[1]

CBA has become an increasingly important element in the design, implementation, and evaluation of a wide range of public programs in areas such as education, the environment, health, and human resources. The potential use of CBA as a means of evaluating the performance of nonprofit organizations was recognized by Young and Steinberg (1995) prior to development of the approach for estimating the SROI.

Those advocating the use of CBA as an evaluation method argues that it provides a useful aid to public decision-making because it provides a coherent and comprehensive social accounting framework. The framework is coherent because it draws on a consistent set of economic principles for defining social benefits and costs. It is comprehensive because its objective is to arrive at a "bottom-line" based on the concept of *social* benefit and cost that is broader than *private* revenue and cost normally be used to assess the performance of profit-making enterprises.[2]

The broad character of the social accounting framework in CBA makes it a potentially valuable evaluation method in the nonprofit/social enterprise sectors. Because nonprofit organizations and social enterprises both have an expressly social mission, and many often provide goods and/or services that either substitute for or are complements to public outputs, it seems natural to use CBA as an aid in choosing how to spend scarce financial resources, and to evaluate the performance of nonprofits/social enterprises.

The objective of undertaking a CBA is to gauge the effect of a particular public policy or program on what economists describe as *social surplus*. Does the policy or program being evaluated produce outcomes with social benefits that equal or exceed what it costs society to achieve the outcomes? As Sunstein (2002) notes, the advantage of evaluating public programs through the CBA lens is not only, or even primarily that these approaches result in "bottom line" metrics of net social surplus. Rather it is that the accepted economic framework for arriving at this bottom-line measure involves systematically applying a social accounting framework for identifying, classifying, and measuring the effects of public programs that is both coherent and comprehensive.

The framework is coherent because it draws on a consistent set of economic principles for defining social benefits and social costs. It is comprehensive because its objective is to arrive at a "bottom-line" based on concepts of social benefit and cost that are considerably broader than private revenue and cost normally used to assess the performance of profit-making enterprises.

As a result, it is not only the estimated bottom line that is reached by applying CBA to a particular activity that is a useful input into the decision process. In addition, the process of arriving at that bottom line is at least, if not more valuable than the bottom line itself, chiefly because careful application of the social accounting framework that is the methodological underpinning of CBA requires the analyst to clearly specify essential features of the policy being analyzed, and to account fully for its effects on all stakeholders. This process provides both measures of program effects and valuable insights about ways in which to improve the program by reducing the costs of attaining particular objectives, increasing the potential benefits (positive outcomes) that can be attained for a given outlay of scarce resources, or both.

2.1. Cost-benefit analysis and assessing social efficiency

The general approach taken by CBA to evaluating public programs, as well the potentially applicability of the framework to measuring outcomes in the nonprofit sector can be illustrated by summarizing the steps that would be involved in undertaking a CBA of a program that took homeless families off the street and placed them in housing in residential neighborhoods, while also providing them with a range of counseling services.

2.1.1. Identifying program impacts

A key first step in undertaking a CBA of such a program would be to identify and classify program impacts. One distinctive feature of CBA as a *social accounting framework* is the attempt to account for three broad types of program outcome: (1) features of a program that add to social value, which define the *social benefits* of a program; (2) features of program that take from social value which define a program's *social costs*; and (3) any program outcomes which neither take from nor add to aggregate social value, but instead shift existing social value from one segment of society (e.g. taxpayers) to others (e.g. transfer recipients), referred to as *transfers*. In the case of the illustrative program for the homeless, focusing on these three types of effects would require measuring the program's impact along several dimensions including: (1) how many homeless persons or families received housing and counseling services as a result of the program; (2) the program's impacts on the ability of the homeless to function in society; (3) the main benefits accruing both to homeless persons and to society at large from providing housing and counseling services; and (4) the resources needed to provide the housing and services.

2.2. Monetizing social benefits and social costs

Careful identification and measurement of program outcomes are not unique to CBA, but are also goals of other formal approaches for assessing outcomes. What distinguishes CBA from these approaches, however, is the attempt to translate both outcomes and inputs into monetary values to permit a "bottom-line" comparison between what the program adds to and takes from social value.

As is discussed more fully below, an important but also controversial advantage of pushing the analysis toward monetization is that different programs can be compared against a common benchmark. The main criticism of monetizing inputs and outcomes of social programs is that doing so inappropriately applies "business-like" thinking to evaluating public programs. On the one hand, it is true that attempting to estimate the social surplus garnered by a public program bears at least a surface similarity to

[1] Section 2 draws extensively on Cordes and Coventry (2011).

[2] See Boardman et al. (2011), Chs. 1 and 2. Sunstein (2002) makes a compelling argument that because of its broad scope, when properly used, CBA ensures that the interests of all relevant stakeholders are represented in the analysis.