Profitability, Impact and Risk Analysis of an Investment Project

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Abstract: Creating local zoning regulations is a complicated procedure, involving considerable conflict due to the large circle of interested parties. Therefore, feasibility studies in these instances cannot focus only on profitability analysis; rather, in addition, the needs of all stakeholders must be considered, and cost-benefit analysis and risk analysis must be done.

In this paper with stakeholder analysis we try to consider the parties involved in the zoning and planning of a local region who take risks when they create the local regulations and when pursuing individual development projects. The circle of those who share the risk of a particular project changes through the life of a development project. Diagrams in the paper show the relationships between these interested parties.

Looking at risk analysis, we show the four ways of differentiating a risk according to how the benefits of a risk are shared, and consider different cases of risk analysis depending on the amount of information available to the parties bearing the risk. The paper outlines the concepts of equitable and inequitable risk as developed by Kindler. The conclusion of the paper points to the necessity of thorough stakeholder analysis and risk analysis in order that development projects minimise conflict and bring the greatest utility to both investors and society.

Introduction

Creating local zoning regulations is a complicated procedure, involving considerable conflict due to the large circle of interested parties. This procedure is even more complicated when a formerly protected area has become privately owned but due to its former status as a public property it must now serve public functions as well as the interests of the private owners.

Despite the fact that the development of a property is to be realised with private capital and is intended to bring a return on investment to the owners, the development must serve societal interests as well. Therefore, feasibility studies in these instances cannot focus only on profitability analysis; rather, in addition, the needs of all stakeholders must be considered (Kerekes [1997]), and cost-benefit analysis (Mishan [1982]) and risk analysis must be done. These cases hold true to
the common understanding that what benefits or harms one part of the economy – one or more parties – does not necessarily harm or benefit the overall economy or that of the particular region.

While the cost-benefit analysis can concern the whole economy, the realisation of project is necessarily local. Consequently, it is necessary to analyse the impact particular to the local area as well as the general societal impact. It is clear that using these multiple analyses to show a clearer picture of reality is better than using simply a profit-loss analysis, which is concerned only with the maximising the investors’ profit and does not consider all the people whose interests must be taken into account. Therefore, for the above reasons, local projects require more complete analysis.

Furthermore, there are development projects which must concern themselves with regulations for the protection of the environment and the development of green areas. In these instances, the picture is further complicated through potential conflict between the investors, the local government and environmental activists, and the relevant increased cost.

1 Stakeholder Analysis

The parties involved in the zoning and planning of a local region take risks when they create the local regulations and when pursuing individual development projects. Risk here means the description and probability of the potential negative consequences of a given project (or alternative projects).

The circle of those who share the risk of a particular project changes through the life of a development project. However, the development project can be separated into three distinct phases, and the circle of risk-sharers can be clearly defined at each phase. For example, during the first phase – the creation of the zoning regulations – the risk holder is the local government, who must take responsibility for future projects’ usefulness to society as well as their profitability. If the government makes local zoning and development regulations too strict, there will be no profitability, as there will be no investors for development projects. However, if the regulations are too permissive, then the local governments will allow the developers to satisfy their hunger for profits to the detriment of the welfare of society. The laws governing the creation of zoning regulations are so strict that no information is held back; all the interested parties can judge the level of risk. Information is only held back due to loopholes in the laws.

The following is a list of the complete circle of interested parties from all three phases (the preparing of the zoning plan, the development project, and the use).

The circle of the interested parties:
The relationships among these interested parties is shown in the following diagrams (1, 2, 3)
Diagram 2
The investment project: Interested Parties

Diagram 3
The property use and operation: Interested Parties
The negotiating positions are similar in all the three phases. Therefore, below is shown simply the positions for the interested parties in phase one.

<table>
<thead>
<tr>
<th>LOCAL GOVERNMENT</th>
<th>INVESTOR</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Willing to Negotiate</td>
<td>Compromise acceptable to both parties (3,3)</td>
<td>Investors win; local government loses (4,1)</td>
<td></td>
</tr>
<tr>
<td>Play hard-ball</td>
<td>Local government wins; investors lose (1,4)</td>
<td>External actors/circumstances force a solution (2,2)</td>
<td></td>
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1 = the best outcome
4 = the worst outcome

Diagram 4
Negotiating Positions Under the Stakeholder Dilemma

2 Risk Analysis

There are four different cases of risk analysis, depending on the amount of available information. *(Kindler [1997])*

a) All information related to the risk is known by the risk-taker.
b) Information is kept from the risk-taker. The risk-taker is not informed of this information.
c) The information about the risk is accessible, but the risk-taker neglects to gather this information.
d) There is no accessible information about the risk. The risk is unknown.

There are two ways of differentiating a risk according to how the benefits of a risk are shared:

a) If the risk-taker shares in the benefits coming from the risk, it is considered an equitable risk.
b) If the risk-taker does not share in the benefits coming from the risk, it is considered an inequitable risk.

The equitable and inequitable risk are outlined in the following table, as outlined by Kindler. *(Kindler [1997])*
Known risk (open)  Informed equitable risk  Informed inequitable risk
Unknown risk - hidden (closed)  Deceptive equitable risk  Utilized inequitable risk
Unknown risk – accessible (open)  Negligent equitable risk  Negligent inequitable risk
Unknown risk – not accessible to anybody (unsure)  Unknown equitable risk  Unknown inequitable risk

Informed equitable risk: The risk-taker accepts the risk consciously in order to get a direct benefit.

Informed inequitable risk: The risk-taker knows the risk but does not take part in the direct benefit.

Deceptive equitable risk: The risk-taker may get some benefits, but the primary beneficiary is the person or organisation who held back information.

Utilized inequitable risk: The risk-taker does not get any benefit, and the information of the nature and degree of the risk is held back from the risk-taker.

Negligent equitable risk: The risk-taker gets some benefit, but the risk-taker ignores the risk and the degree of risk because the risk-taker is negligent or does not make the effort to get the information, despite the accessibility of the information.

Negligent inequitable risk: The risk-taker is ignorant of the fact of taking a risk, and does not get any benefit. The information is not held back. The risk-taker can decide whether or not to get the information about the risk. There are some people who would rather put their heads in the sand because they believe it is better not to know the risk they take.

Unknown equitable risk: In spite of the visible benefits, the risk can be unsure (i.e. there is no sure knowledge that there is or is not a risk, and what degree of risk).

Unknown inequitable risk: The risk-taker does not get any direct benefit, and the risk is unsure too.

‘In summary, we can establish that the equitable risk includes the liberty of choice whether the risk-taker accepts or rejects the risk alternatives after weighing the risks and benefits.

If the risk-taker does not get any direct benefit from a risk alternative, or if it is impossible to weigh the risks and benefits of an alternative because information is held back, then the risk is inequitable and the risk-taker can only decide to minimise the inequitable risk borne by him – but of course at a cost to the risk-taker. But the decision and action to avoid the risk does not give any benefits to
the risk-taker. So in the even of inequitable risk, there is no choice of accepting or rejecting the conditions causing risk. There is only a choice to minimise the cost relating to the risk.’ (Kindler [1997])

However, the investor as a profit-orientated entrepreneur tends to prefer the profit over utility to society. It is know that in a changing economic system, corruption surrounds large investment projects. In these cases, the investor sells the developed property, and only after time during the use of the property are the problematic impacts on the environment the faulty plans for environmental protection finally known.

Conclusion

As was explained at the beginning of this paper, the development of zoning plans and regulations involves considerable complication and potential conflict between interested parties. That is not to say, however, that the interests of all parties affected by the regulations and plans are taken into consideration. The same holds true for the development project phase and the use and operation phase as well. The stakeholder analysis and risk analysis dealt with in this paper are not always fully performed. In many instances, it could be argued that the stakeholders are not even fully identified, nor the risks they bear analysed and described. It is in the interests of local governments and groups influential in the development of zoning and planning regulations and undertaking development projects and the use and operation of properties to pursue more thorough stakeholder analysis and risk analysis, in order that to the greatest degree possible all the stakeholders bear an ‘Informed Equitable Risk’. The alternative is frequently that greater conflict erupts later as the costs are at long last fully realised to previously ignorant, uninformed stakeholders. With proper stakeholder identification and analysis and informed risk analysis, development projects can at the same time bring profit to the investors and utility to society.

References
