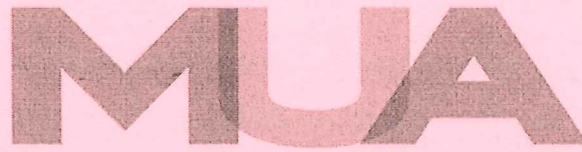


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**UNDERGRADUATE UNIVERSITY EXAMINATIONS**  
**SCHOOL OF MANAGEMENT AND LEADERSHIP**  
**DEGREE OF BACHELOR OF DEVELOPMENT STUDIES**

**PMT 404: PROJECT FINANCING**

**DATE: 4<sup>TH</sup> APRIL 2025**

**DURATION: 2 HOURS**

**MAXIMUM MARKS: 70**

**INSTRUCTIONS:**

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

**QUESTION ONE**

Matibabu Pharmacia Ltd. recently carried out clinical trials on a new drug which was developed to reduce the effects of diabetes. The research and development costs incurred on the drug amount to Sh.160 million. In order to evaluate the market potential of the drug, an independent research firm conducted market research at a cost of Sh.15 million. The independent researchers submitted a report indicating that the drug is likely to have a useful life of 4 years (before new advanced drugs are introduced into the market). It is projected that in the year the drug is launched it could be sold to authorized drug stores (chemists and hospitals) at Sh.20 per 500mg capsule. After the first year, the price is expected to increase by 20% per annum. For each of the four years of the drug's life, the sales have been estimated stochastically as shown below:

<b>Number of Capsules sold</b>	<b>Probability</b>
11 million	0.3
14 million	0.6
16 million	0.1

If the company decides to launch the new drug, it is possible for production to commence immediately. The equipment required to produce the drug is already owned by the company and originally cost Sh.150 million. At the end of the drug life, the equipment could be sold for Sh.35 million. If the company decides against the launch of the new drug, the equipment will be sold immediately for Sh.85 million as it will be of no further use to the company.

The new drug requires two hours of direct labour for each 500 mg capsule produced. The cost of labour for the new drug is Sh.4 per hour. New workers will have to be recruited to produce the new drug. At the end of the life, the workers are unlikely to be offered further employment with the company and redundancy costs of Sh.10 million are expected. The cost of ingredients for the new drug is Sh.6 per 500mg capsule. Additional overheads arising from the production of the drug are expected to be Sh.15

million per annum. Additional work capital of Sh.2 million will be required during the drug's 4-year life.

The drug has attracted interest of the company's main competitors and if the company decides not to produce the drug, it could sell the patent right to Welo Kam (K) Ltd., its competitor, at Sh.125 million. The cost of capital is estimated to be 12%.

**Required:**

- a) The expected Net Present Value of the new drug. **(15 Marks)**
- b) State with reasons whether the company should launch the new drug. **(2 Marks)**
- c) Discuss two strengths and two weaknesses of the expected Net Present Value approach for making investment decisions. **(8 Marks)**

**QUESTION TWO**

- a) Examine three roles of management accounting in project finance. **(6 Marks)**
- b) "Total Risk Management (TRM) will become a common term in project finance just like Total Quality Management (TQM) has in production and marketing."  
(Professor Andrew W. Lo. 1999).

**Required:**

- (i) Define risk management as used in project finance. **(1 Mark)**
- (ii) Discuss four reasons why risk management might contribute to project success. **(8 Marks)**

**QUESTION THREE**

- a) Discuss three applications of marginal costing in project costing. (9 Marks)
- b) Jamii Company Ltd manufactures and sells a single product. The following information regarding the company's operations for the year ended 30 September 2001 was presented to you.

Profit and loss account for the year ended 30 September 2001

	<b>Sh''000</b>	<b>Sh''000</b>
<b>Sales</b>		30,000
<b>Less</b>		
Production costs		
Direct material	6,500	
Direct labour	5,400	
Production overhead variable	<u>7,000</u>	
Prime costs		<u>18,900</u>
		<b>11,100</b>
<b>Other expenses:</b>		
Selling		
Variable	2,600	
Cost	1,997	
Administration	<u>2,100</u>	<u>6,697</u>
<b>Net profit</b>		<b><u>4,403</u></b>

The following changes are expected to occur during the year ending 30 September 2002:

1. Selling price will be adjusted downward by 3% in order to attract more customers.
2. Material prices will rise by 2% due to inflation.
3. There will be a reduction in labour cost by 4%.
4. Production overheads will increase by 3%.
5. Increase in the efficiency of sales persons will reduce direct selling costs by 5%.

All other factors are expected to remain constant.

Required:

- i) Break-even point in sales value. (4 Marks)
- ii) The margin of safety in sales value. (2 Marks)

**QUESTION FOUR**

- a) Explore the relevance of Zero-Based Budgeting (ZBB) in project financial planning.  
(5 Marks)
- b) Discuss five challenges facing project financing in developing countries.  
(10 Marks)

**QUESTION FIVE**

- a) Evaluate five risks associated with Public-Private Partnerships (PPP) in financing projects.  
(10 Marks)
- b) Discuss the significance of the project financing course to managers.  
(5 Marks)

**QUESTION SIX**

- a) Gome Drug Products Ltd. (GDPL) is faced with several possible investment projects. For each, the total cash outflows required will occur in the initial period. The cash outflows, expected net present values and standard deviations are as follows:

Project	Cost Sh.'000'	Net present value	Standard deviations
A	10,000	1,000	2,000
B	5,000	1,000	3,000
C	20,000	2,500	1,000
D	1,000	500	1,000
E	50,000	7,500	7,500

All projects have been discounted at a risk-free rate of 8% and it is assumed that the distribution of their possible net present values are normal.

**Required:**

- i) Construct a risk profile for each of these projects in terms of the profitability index. **(5 Marks)**
- ii) Ignoring size problems, do you find some projects clearly dominated by others? Should size problem be ignored? **(5 Marks)**
- b) Discuss five benefits of Build-Operate-Transfer (BOT) model in stakeholder management for project financing. **(5 Marks)**