THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES DEGREE (BMS) - LEVEL 5
FINAL EXAMINATION 2013
PROJECT APPRAISAL - MCU 3204

DURATION: THREE (03) HOURS

DATE : 21st July, 2013	**TIME : 1.30 pm – 4.30 pm**

Instructions:

- Answer **Question 1 (compulsory) and any THREE (03)** from others.
- Use of a non-programmable calculators is allowed.
- A PV table is attached herewith.

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(1) ABC is a medium-size educational institution located in Colombo. ABC offers diploma programs for IT skills and English language. ABC's most recent annual net income statement is as follows (all values are in Rs. `000).

Revenue from operations		Rs.5800
Total costs		
Cost of operations	Rs. 2260	
Wages and salaries	Rs. 200	
Rent	Rs. 320	
Depreciation	Rs. 160	
Utilities	Rs. 180	
Miscellaneous	Rs. 30	

ABC's revenue and expenses have remained relatively constant over the past few years and are expected to continue unchanged in the near future. To increase revenue, ABC is considering using some floor space to introduce a new Advance Diploma programme for Marketing of one year duration. ABC intends to operate the Advance Diploma programme

for a three-year period, initially, and then would re-evaluate its profitability. Commencement of the new programme would require an incremental investment of Rs 2 million for initial planning, finalizing course structures, preparing study materials and purchasing furniture and equipment. This is the only capital investment required during the initial three-year period. At the end of that period, an additional capital would be required to continue the degree programme and capital would not be recovered if the project is terminated. The new programme is expected to have 50 enrolments each at a fee of Rs 100,000. Operating expenses are estimated to be Rs 800,000 per year. With the new programme, wage and salary expenses are expected to increase by 8% and utility expenses by 5%. The commencement of the new programme will reduce the floor space available for other programmes and, as a result, ABC will have to reduce the number of enrolments of other programmes. Hence, the revenue from the existing programmes is expected to decline by 10%.

i. Calculate net incremental cash flows for the new programme. (05 Marks)

ii. Assume that ABC has the capital needed to commence the new programme and that they place a 12% opportunity cost on those funds. Should ABC commence the new Advance Diploma programme for Marketing? Why or why not? (05 Marks)

iii. Calculate;

a. Internal Rate of Return (IRR)of the project (08 Marks)

b. Accounting Rate of Return (ARR) of the project (07 Marks)

c. Net Benefit Investment Ratio (NBIR) of the project (07 Marks)

iv. Evaluate the new project concentrating on different aspects of financial analysis. (08 Marks)

(Total 40 Marks)

(2) 'The decision to start a new project and go ahead with that project can be thought of as a project appraisal decision. You only go ahead if projected returns look attractive on a personal and financial basis.' Discuss this statement. (20 Marks)

(3) i. Define a project elaborating its finite characteristics. (10 Marks)

ii. Is a programme totally different from a Project? Elaborate. (10 Marks)

(total 20 Marks)

(4) "Managing each stage of a project is equally important." Discuss. (20 Marks)

(5) i. Is project financing an important decision? Elaborate your answer with suitable examples. (10 Marks)

ii. The total capital requirement of a project is 450 Mn, of which two third is financed by ordinary shares. 60% of the rest is financed with 16% debentures and the balance is finance by 22% bank loan. Owners expect 24% return on their investment. Calculate the total cost of capital. (05 marks)

iii. Explain why working Capital management is important in project management. (05 Marks)

(6) Write short notes on the followings. (5 Marks each)

i. Independent project and mutually beneficial projects

ii. Externalities and subsidies offered to projects

iii. Technical feasibility of a project

iv. Application of ratio analysis

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Table of Present Values

PVIF = 1/(1+i)

Period (n)	Discount rates														
	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	22%	24%
1	0.9259	0.9174	0.9091	0.9009	0.8929	0.8850	0.8772	0.8696	0.8621	0.8547	0.8475	0.8403	0.8333	0.8197	0.8065
2	0.8573	0.8417	0.8264	0.8116	0.7972	0.7831	0.7695	0.7561	0.7432	0.7305	0.7182	0.7062	0.6944	0.6719	0.6504
3	0.7938	0.7722	0.7513	0.7312	0.7118	0.6931	0.6750	0.6575	0.6407	0.6244	0.6086	0.5934	0.5787	0.5507	0.5245
4	0.7350	0.7084	0.6830	0.6587	0.6355	0.6133	0.5921	0.5718	0.5523	0.5337	0.5158	0.4987	0.4823	0.4514	0.4230
5	0.6806	0.6499	0.6209	0.5935	0.5674	0.5428	0.5194	0.4972	0.4761	0.4561	0.4371	0.4190	0.4019	0.3700	0.3411
6	0.6302	0.5963	0.5645	0.5346	0.5066	0.4803	0.4556	0.4323	0.4104	0.3898	0.3704	0.3521	0.3349	0.3033	0.2751
7	0.5835	0.5470	0.5132	0.4817	0.4523	0.4251	0.3996	0.3759	0.3538	0.3332	0.3139	0.2959	0.2791	0.2486	0.2218
8	0.5403	0.5019	0.4665	0.4339	0.4039	0.3762	0.3506	0.3269	0.3050	0.2848	0.2660	0.2487	0.2326	0.2038	0.1789
9	0.5002	0.4604	0.4241	0.3909	0.3606	0.3329	0.3075	0.2843	0.2630	0.2434	0.2255	0.2090	0.1938	0.1670	0.1443
10	0.4632	0.4224	0.3855	0.3522	0.3220	0.2946	0.2697	0.2472	0.2267	0.2080	0.1911	0.1756	0.1615	0.1369	0.1164

Period (n)	Discount rates														
	25%	26%	27%	28%	30%	32%	34%	36%	38%	40%	42%	44%	46%	48%	50%
1	0.8000	0.7937	0.7874	0.7813	0.7692	0.7576	0.7463	0.7353	0.7246	0.7143	0.7042	0.6944	0.6849	0.6757	0.6667
2	0.6400	0.6299	0.6200	0.6104	0.5917	0.5739	0.5569	0.5407	0.5251	0.5102	0.4959	0.4823	0.4691	0.4565	0.4444
3	0.5120	0.4999	0.4882	0.4768	0.4552	0.4348	0.4156	0.3975	0.3805	0.3644	0.3492	0.3349	0.3213	0.3085	0.2963
4	0.4096	0.3968	0.3844	0.3725	0.3501	0.3294	0.3102	0.2923	0.2757	0.2603	0.2459	0.2326	0.2201	0.2084	0.1975
5	0.3277	0.3149	0.3027	0.2910	0.2693	0.2495	0.2315	0.2149	0.1998	0.1859	0.1732	0.1615	0.1507	0.1408	0.1317
6	0.2621	0.2499	0.2383	0.2274	0.2072	0.1890	0.1727	0.1580	0.1448	0.1328	0.1220	0.1122	0.1032	0.0952	0.0878
7	0.2097	0.1983	0.1877	0.1776	0.1594	0.1432	0.1289	0.1162	0.1049	0.0949	0.0859	0.0779	0.0707	0.0643	0.0585
8	0.1678	0.1574	0.1478	0.1388	0.1226	0.1085	0.0962	0.0854	0.0760	0.0678	0.0605	0.0541	0.0484	0.0434	0.0390
9	0.1342	0.1249	0.1164	0.1084	0.0943	0.0822	0.0718	0.0628	0.0551	0.0484	0.0426	0.0376	0.0332	0.0294	0.0260
10	0.1074	0.0992	0.0916	0.0847	0.0725	0.0623	0.0536	0.0462	0.0399	0.0346	0.0300	0.0261	0.0227	0.0198	0.0173