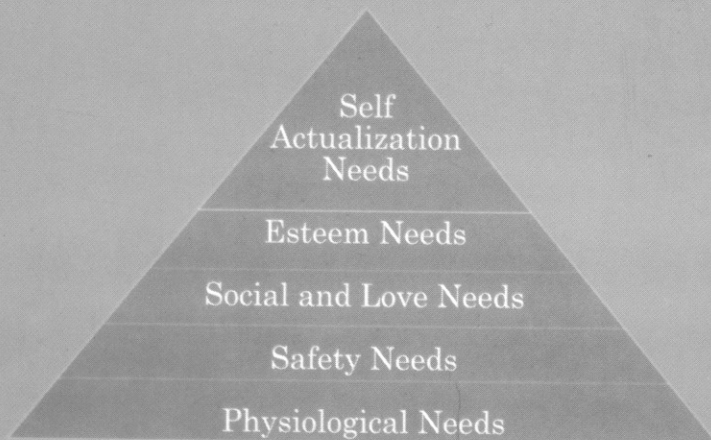
A black and white photograph of a city skyline at night, with numerous skyscrapers illuminated against a dark sky. The lights from the buildings reflect on a body of water in the foreground.

# Light of Management

EDITORS  
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## Project Finance

— F. O. Bello, S. O. Ashamu & D. A. Awotundun —

### Introduction

A project is any series of activities arranged in a logical order, having well-defined objectives and achieving a specific end result (Pete Spinner, 2007). It can be conceived as a scheme or any part of a scheme for investing resources which can easily be analyzed and evaluated as an independent unit (Akarakiri, 2007). A project is considered to be successful when it is delivered on time, within budget, and meets the customer's requirements (PMBOK, 2004). The World Bank defines a project as a proposal for capital investment to develop facilities to provide goods and services. It is a technically coherent production which can be carried out independently of other projects by a private or public agency. It is the smallest unit of investment activity for producing goods and services. The United Nations (1958) defines a project as the compilation of data which enable an appraisal to be made of the economic advantages and disadvantages attendant upon the allocation of a country's resources to the production of specific goods and services. Projects may be conceived and prepared for all types of activities contained in the International Standard Industrial Classification, and may vary from a simple car-wash undertaking or crop farm to produce maize or beans, through a more complex manufacturing outfit such as aluminium cooking pots, to a more generalized investment involving many facilities and activities such as automobile production, the Kainji Dam, iron and steel complex, petroleum refinery, and construction of railways. A project may be an investment to build something entirely new – for example, the BRT road construction by the Lagos State Government or for the expansion, improvement, rehabilitation, replacement or modernization of an existing facility.

A project may be distinguished from a programme. A programme is defined by Odufalu (2000) as a coordinated set of projects within the same country, state, local government area or city. For example, a rice project may require, for its success, road and transportation facilities for the evacuation of the products, and water supply for parboiling rice to prevent the germination of the harvested rice. The road and transportation facilities, the water supply and the rice project may be regarded as a programme if they have to be simultaneously implemented to ensure the success of the project.

Odufalu (2000), citing the World Bank, regards a project as a continuous and self-sustaining cycle of activity which runs through four principal stages, viz: the identification of the project, its preparation, its appraisal, and supervision of its construction and operating stages to make sure that it achieves its objectives.

Project finance is finance for a particular project, such as a mine, toll road, railway, pipeline, power station, ship, hospital or prison, which is repaid from the cash-flow of that project. It is a long-term financing of infrastructure and industrial projects based upon the projected cash flows of the project rather than the balance sheets of the project sponsors.

Project financing discipline includes understanding the rationale for project financing, how to prepare the financial plan, assess the risk, design the financing mix, and raise the funds.

Denzil and Anthony (2001) assert that project finance involves provision of resources (where funds are raised from), the allocation of resources (where funds are deployed to) and finally the control of resources (whether funds are being used effectively or not). Project financing is concerned with the efficient and effective management of finance of an organization in order to achieve the objectives of that organization.

Thus, project financing is an innovation and timely financing technique that has been used on many high-profile corporate projects. Employing a carefully engineered financing mix has long been used to fund large-scale natural resource projects, from pipelines and refineries to electric-generating facilities and hydro-electric projects. Increasingly, project financing is emerging as the preferred alternative to conventional methods of financing infrastructure and other large-scale projects worldwide. A project financing structure usually involves a number of equity investors, known as sponsors, as well as a syndicate of banks that provides loans to the operation.

Research has shown that innovative financing is often at the core of long-term projects to transform a company's operations irrespective of the decisions of the organization. Project finance can be defined as financing of an industrial (or infrastructure) project with myriad capital needs, usually based on non-recourse or limited recourse structure, where project debt and equity (and, potentially, leases) used to finance the project are paid back from the cash flow generated by the project, with the project's assets, rights and interests held as collateral. In other words, it is an incredibly flexible and comprehensive financing solution that demands a long-term lending approach not typical in today's marketplace.

Finery (1996) defines project finance as the raising of funds to finance an economically separable capital investment project in which the provider of the funds looks primarily to the cash flow from the project as the source of funds to service their loans and provide the return on their equity invested in the project. In the view of Nevitt and Fabozzi (2000), project financing is financing of a particular economic unit, in which a lender is satisfied to look initially to the cash flow and earning of that economic unit, as the source of funds from which a loan

will be repaid and to the assets of the economic unit as collateral for the loan. Herring (2006) conceives project financing as a specialized form of financing that may offer some cost advantages when very large amounts of capital are involved. He opines that project financing can be tricky to structure and is usually limited to projects where a good cash flow is anticipated. The International Project Finance Association (IPFA) 2009 defines project finance as the financing of long-term infrastructure, industrial projects and public services, based upon a non-recourse or limited recourse financial structure, where project debt and equity used to finance the project are paid back from the cash flow generated by the project. Once a project has been selected by an organization, financing and sources of financing are imperative. In capital budgeting, project financing is intertwined with project planning, analysis and selection.

### Sources of Project Finance

Financial instability and cash flow volatility in many developing economies have been attributed to a wide range of microeconomic instability issues, institutional failure and project failings (Ojo 2006). The flow of financial resources within the economy is determined primarily by the way the financial system is organized (Somoye, Awotundun, Bakare and Subair, 2008). Similarly, Chandra (2009) classifies project financing into two broad sources: shareholder fund and loan funds. Shareholder fund appears mainly in the form of equity capital and retained earnings and secondarily in the form of preference capital. Loans fund on the other hand come in a variety of ways such as term loans, differed credit, fixed deposit, and working capital advance. Ojo (2010) identifies four types of market where funds can be obtained to finance a project. These markets are the capital market, money market, security market and the foreign exchange market.

The capital market is to serve primarily as a medium for raising long-term project finance; it allocates the nation's financial resources efficiently among alternatives – competing and sometime conflicting projects. It also provides liquidity for projects from the standpoint of individuals in the economy; and through its pricing mechanism, it provides management with some current idea about the cost of capital necessary for successful project execution. While the money market is the short-term end of the financial market providing instruments for working capital support for the project activities that could not be delayed pending the availability of long-term funds. The foreign exchange market covers all transactions involving the sales and purchase of foreign currencies or conversion of naira to foreign currencies and vice-versa. Ojo (ibid) adds that the development of the financial market is crucial based on the belief that the market would serve as a source of industrial/project finance to foster economic growth and development. Generally, the sources of project finance could be divided into two: the capital market and the money market (Nwankowo, 1980).

Financial markets are the meeting points for individuals, governments, firms, institutions and project managers/promoters that either need money or have money to lend or invest. In a broad context the financial market exists as a

vast global network of individuals and financial institutions that may be lenders, borrowers or owners of public companies worldwide. Generally, the financial market is made up of the money and capital market.

### Capital Market

The capital market is a market that which deals with long-term funds. The market facilitates the transfer of funds from a surplus unit to the deficit unit. Just as it was in the money market, the capital market could be broadly divided into the primary market where new capital could be raised and the secondary market which provides arrangements for existing securities to be traded. The instruments that are available in the market are:

(1) *Equity*: This represents the ownership interest in a company. Equity, or company share, is sold as either new issue in initial public offer or as a secondary offer. It is the most important instrument in the capital market. Basically, we have three types of shares and stocks.

(i) *Ordinary Shares*: The holders of ordinary shares are usually called shareholders. Stockholders are the legal owner of the firm; they bear the main risk of the business and are entitled to dividends which are decided by the board of directors.

(ii) *Preference Shares*: These are shares that have a fixed percentage of dividends which are paid before any payment is made to ordinary shareholders. Preference dividends are usually paid if the company makes profits. In the event of liquidation preference shareholders are given preference before ordinary shareholders. Different types of preference shares exist:

(a) Cumulative preference shares, where the arrears of dividends are carried forward each year until they are paid. Any non-cumulative preference shares dividends not paid in one year are lost.

(b) Redeemable preference shares are shares which a company can buy back as contained in the terms of agreement. Irredeemable preference shares are treated like permanent capital.

(c) Participating preference shares are allowed to participate in further dividends after the ordinary shareholders have been paid a certain amount in a good year when high dividends are paid. Non-participatory preference shares are limited to the rate attached to the share.

(iii) *Deferred Shares*: These are founder shares usually issued to the promoters of the business. These shareholders share the remaining profits after the ordinary and preference shares have been paid.

(2) *Debentures*: In addition to the issue of shares, project managers/promoters



raise long-term capital by issuing loan stocks, usually called debentures. A debenture is a long-term fixed income security. Debenture holders are creditors of the firm, irrespective of whatever happens to the business. They are entitled to receive interest which is legally binding on the firm and are tax deductible for computing the company's corporate taxes. These debt instruments are issued either through public underwriting or private placement. Debentures are of various types:

- (a) *Redeemable Debentures*: These are issued for a specific period and the company returns the per-value to the holders and terminates the contract. Irredeemable debentures are treated as permanent capital in perpetuity.
- (b) *Full Convertible Debentures*: These are debentures that are convertible into shares as per the agreement at the time of issue, usually quoted at a lower rate of interest. Non-convertible debentures are not convertible but repayable at maturity and the holders are entitled to interest and repayment of principal. Partly convertible debentures share the features of convertible and non-convertible debentures.
- (3) *Government raises long-term fund through the issuance of development stocks*: Such money is used to finance long-term projects such as roads and power supply facilities. Development stocks are redeemable at maturity date by the government and bear a fixed rate of interest.

### **Money Market**

The money market is the market in which short-term, highly liquid debt securities are obtained. It comprises of a financial institution and other dealers in short-term money who either want to lend or borrow funds. The period of borrowing and lending in the money market is usually one year or less. The market can be classified into primary and secondary markets. The primary market makes short-term funds available to the borrowers, whereas the secondary market provides liquidity to various instruments available in the money market.

#### **Instrument of the Money Market**

The money market operates through a number of instruments. These are short-term securities that are converted into cash at short notice. Short-term debt claims traded at the money market include:

*Treasury Bills*: These are one of the common instruments in the money market, usually issued on an auction basis by the Central Bank of Nigeria for 91 days to borrow on behalf of the government pending the collection of revenue by government. The instrument has zero credit risk, low interest rate and is mostly liquid. The instrument was first issued in 1960 and has since become a monetary policy instrument in the money market to regulate money supply when the need arises.

*Treasury Certificate*: This is a security issued by the Central Bank on behalf of the Federal Government of Nigeria with a maturity of one year. It was

introduced in 1968 to boost the larger volume of securities in the money market and is similar to treasury bills in all respects except the tenure.

*Certificate of Deposits:* These are deposits accepted by banks in exchange for certificates. They are forms of interbank instruments which maturity date varies from 3 months to 36 months and may be negotiable or resold in the market, provided the holder needs funds. If otherwise, they are non-negotiable.

*Bank Deposit:* These are commercial bank interest-bearing deposits of various forms such as savings account and fixed deposit accounts.

*Banker Unit Funds:* These are instruments that provide opportunities for banks and other financial institutions to invest part of their surplus funds in government securities at money market rates through the Central Bank which provides a window for the pool of funds to invest in government stocks. They are withdrawable on demand.

*Eligible Development Stocks:* These are eligible stocks included in the liquidity requirement of commercial banks. Banks were encouraged to invest in development stocks, which have less than three years to mature.

*Bank Acceptance:* These are bills of exchange that are drawn by companies on banks and accepted by the banks. In effect, the banks guarantee to pay the value of the bills to the holder at maturity. These securities are sold at discount and vital to the operations of trading and manufacturing firms.

*Commercial Paper:* These are unsecured promissory notes usually issued by blue-chip companies. The papers are subscribed by banks and funds realized are used by the issuing house to finance the working capital requirement. The paper is very popular with investors and only strong companies can successfully issue the security on favourable terms.

### **Medium-Term Finance**

In between the long-term and the short-term instruments, there exists a market for medium-term finance that is repayable within three to five years. It is frequently used by companies to finance projects with a corresponding medium-term life, such as plants and equipment, and to fund core liabilities inherent in a restructuring of facilities arrangement. Repayment may either be en-block at an agreed date or instalments over a period. Financial institutions normally tailor the pattern of repayment to the earning strength of the acquired assets or cash flows of the business before granting the loan. The main sources of medium-term funds are discussed below.

*Bank Term Loan:* This is similar to a bank overdraft except that the degree of control is higher. Term loans are available for a longer period and the collateral security required is often higher than for bank overdraft and the bank would evaluate the company's project for which the fund is required. This kind of finance is usually provided by deposit-mobilised institutions.



**Venture Capital:** This type of finance is suitable for young enterprises seeking to grow rapidly. It is a form of private limited partnership between the entrepreneurs and the institutional investors such as banks and finance companies. The venture capital may take the form of equity investment or debentures. Apart from providing the necessary financial support, the venture capitalist would participate in the management of the entrepreneur's business and would not hold its investment for too long. As soon as the business is able to find its feet, the venture capitalist would dispose off their investment. Small-scale projects require this type of fund to survive.

**Lease:** This method of finance is one of the easiest ways of acquiring assets such as land, buildings and equipment. A lease agreement exists between a lessor, usually the owner of the assets, and the lessee the user of the assets, for an agreed period of time subject to payment of a consideration called 'Lease Rental'. The user of the assets (lessee) pays the rent to the owner (lessor) over a period of time. At the end of the contract, the assets revert to the lessor, who is the legal owner of the assets and is entitled to claim depreciation over the leased assets except where the lessee has the option to buy the asset at the expiration of the contract under a long-term lease contract. Two types of lease agreement exist, namely operating and finance leases.

(a) **Operating Lease:** These are short term cancellable lease agreements which cover a period that is shorter than the useful life of the asset. Under this agreement, the lessor has the responsibility of maintaining, insuring and providing necessary services to facilitate the use of the assets. An operating lessee is common for car rentage, computers, office equipment and hotel room.

(b) **Finance Lease:** This involves lease contracts that are not cancellable. The cost of the lease assets are amortized over the lease period tailored to recover the principal cost of the asset. The lessor is not charged with maintenance insurance and providing necessary services that would facilitate the use of the assets. This kind of agreement is often used for land, building, ships and aircraft.

**Hire Purchase:** This is an instalmental credit agreement between the hiree, usually the finance company, and the hirer, the user of the assets, in exchange for payment to be made over a specified period of time called hire purchase instalment. In the hire purchase contract, the hiree gives possession of the assets to the hirer while ownership of the assets would transfer to the hirer on full payment of all instalments but the hirer has the option to terminate the agreement anytime before the transfer of ownership.

### **The Risk of Project Finance**

Project finance is different from the traditional form of finance because the financier principally looks to the asset and revenue of the project in order to secure and service the loan. In contrast to an ordinary borrowing situation, in a project financing deal, the financier usually has little or no recourse to the non-

project assets of the borrower or the sponsors of the project. In this situation, the credit risk associated with the borrower is not as important as in an ordinary loan transaction; of great importance are the identification, analysis, allocation and management of every risk associated with the project.

In a no recourse or limited recourse project financing, the risk for a financier is great since the loan can only be repaid when the project is operational. If a major part of the project fails, the financiers are likely to lose a substantial amount of money. The assets that remain are usually highly specialized and possibly in a remote location. If saleable, they may have little value outside the project. Therefore, it is not surprising that financiers and their advisers make substantial efforts to ensure that the risks associated with the project are reduced or eliminated as far as possible. It is also not surprising that because of the risks involved, the cost of such finance is generally higher and it is more time-consuming for such finance to be provided.

### **Risk Minimization Process**

Financiers are concerned with minimizing the dangers of any events that could have a negative impact on the financial performance of the project; in particular events which could result in the following are avoided as much as possible:

- (a) The project not being completed on time, on budget, or at all.
- (b) The project not operating as its full capacity.
- (c) The project failing to generate sufficient revenue to service the debt.
- (d) The project prematurely coming to an end.

The minimization of such risks involves a three-step process. The first step requires the identification and analysis of all risks that may bear upon the project. The second step is the allocation of those risks among the parties. The last step involves the creation of mechanisms to manage the risks. If a risk cannot be minimized, the financiers will need to build it into the interest rate margin for the loan.

### **STEP 1 – Risk Identification and Analysis**

The project sponsors will usually prepare a feasibility study, e.g., as to construction and operation of a mine or pipeline. The financiers will carefully review the study and may engage independent expert consultants to supplement it. The matter of particular focus will be whether the costs of the project have been properly assessed and whether the cash-flow streams from the project are properly calculated. Some risks are analyzed using a financial model to determine the project's cash-flow and hence the ability of the project to meet repayment schedules. Different scenarios will be examined by adjusting economic variables such as inflation, interest rates, exchange rate and price for the input and output of the project. Various classes of risk that may be identified in a project financing will be discussed below.

## **STEP 2 – Risk Allocation**

Once the risks are identified and analyzed, they are allocated by the parties through negotiation of the contractual framework. Ideally, a risk should be allocated to the party who is the most appropriate to bear it (i.e., who is in the best position to manage, control and insure against it) and who has the financial capacity to bear it. It has been observed that financiers attempt to allocate uncontrollable risk wisely and to ensure that each party has an interest in fixing such risks. Generally, commercial risks are allocated to the private sector while political ones are allocated to the state.

## **STEP 3 – Risk Management**

Risk must be also managed in order to minimize the possibility of the risk event occurring and to minimize its consequences if it does occur. Financiers need to ensure that the greater the risks that they bear, the more informed they are and the greater their control over the project. This is because they take security over the entire project and must be prepared to step in and take it over if the borrowing defaults. This requires financiers to be involved in and monitor the borrower and control project accounts. Such measures may lead to tension between the flexibility desired by borrowers and the risk management mechanism required by the financier.

### **Type of Risks**

Of course, every project is different and it is not possible to compile an exhaustive list of risks or to rank them in order of priority. What is a major risk for one project may be quite minor for another. In a vacuum, one can discuss the risks that are common to most projects and possible avenues for minimizing them. However, it is helpful to categorize the risks according to the phases of the project within which they may arise:

(1) the design and construction phases, (2) the operation phase, or (3) either phase. It is useful to divide the project in this way when looking at risks because the nature and the allocation of risks usually change between the construction phase and the operation phase.

### **(1) Construction Phase Risk – Completion Risk**

Completion risk allocation is a vital part of the risk allocation of any project. This phase carries the greatest risk for the financier. Construction carries the danger that the project will not be completed on time, on budget or not at all because of technical, labour, or other construction difficulties. Such delays or cost increase may delay loan repayment and cause interest and debt to accumulate. They may also jeopardize contract for the sale of the project's output and supply contract for raw material.

Commonly employed mechanisms for minimizing completion risk before lending takes place include: (a) obtaining completion guarantees requiring the

sponsors to pay all debt and liquidated damages if completion does not occur by the required date, (b) ensuring the sponsors have a significant financial interest in the success of the project so that they remain committed to it by insisting that sponsors inject equity into the project, (c) requiring the project to be developed under a fixed price, fixed-time turnkey contracts by reputable and financially sound contractors whose performance is secured by performance bonds or guaranteed by third parties, and (d) obtaining independent experts report on the design and construction of the project.

Completion risk is managed during the loan period by methods such as: making per-completion phase, draw downs of further funds, and conditional certificate being issued by an independent expert to confirm that the construction is progressing as planned.

## **(2) Operation Phase Risk – Resource/Reserve Risk**

This is the risk for a mining project, rail project, power or station or toll road where there may be inadequate inputs that can be processed or serviced to produce adequate returns. For example, this is the risk that there are insufficient reserves for a mine, passengers for a railway, fuel for a power station or vehicle for a toll road. Such resource risks are usually minimized by: (a) expert's report as to the existence of the inputs (e.g. detailed reservoir and engineering reports which classify and quantify the reserve for a mining project) or estimates of public users of the project based on surveys and other empirical evidence (e.g. the number of passengers who will use a railway), (b) requiring a long-term supply contract for inputs to be entered into as protection against shortages or price fluctuations (e.g. fuel supply agreements for a power station), (c) obtaining guarantees that there will be a minimum level of inputs (e.g. from a government that a certain number of vehicles will use a toll road), and (d) "take or pay" off-take contract which requires the purchaser to make minimum payment even if the product cannot be delivered.

### **Operating Risk**

These are general risks that may affect the cash-flow of the project by increasing the operating costs or affecting the project's capacity to continue to generate the quantity and quality of the planned output over the life of the project. Operating risks include, for example, the level of experience and resources of the operator, inefficiencies in operations or shortages in the supply of skilled labour. The usual way for minimizing operating risks before lending takes place is to require the project to be operated by a reputable and financially sound operator whose performance is secured by performance bonds. Operating risks are managed during the loan period by requiring the provision of detailed reports on the operations of the project, and controlling cash-flow by requiring the proceeds of the sale of product to be paid into a tightly regulated proceed account, to ensure that funds are used for approved operating costs only.

### *Market/Off-Take Risk*

Obviously, the loan can only be repaid if the product that is generated can be turned into cash. Market risk has to do with the idea that buyers may not be found for the product at a price sufficient to provide adequate cash-flow to service the debt. The best mechanism for minimizing market risk before lending takes place is an acceptable forward sales contract entered into with financially sound purchasers.

### **(3) Risks Common to Construction and Operational Phases** **Participant/Credit Risk**

These are risks associated with the sponsors or the borrowers themselves. The question is whether they have sufficient resources to manage the construction and operation of the project and to efficiently resolve any problems which may arise. Of course, credit risk is also important for the sponsor's completion guarantees. To minimize these risks, the financiers need to satisfy themselves that the participants in the project have the necessary human resources, experience in past projects of this nature and that they are financially strong (e.g. so that they can inject funds into an ailing project to save it).

### **Technical Risk**

This is the risk of technical difficulties in the construction and operation of the project's plant and equipment, including latent defects. Financiers usually minimize this risk by preferring tried and tested technologies to new unproven technologies. Technical risk is also minimized before lending takes place by obtaining expert reports as to the proposed technology. Technical risks are managed during the loan period by requiring a maintenance retention account to maintain and to receive a proportion of cash-flows to cover future maintenance expenditure.

### **Currency Risk**

Currency risks include the risk that: (a) a depreciation in loan currencies may increase the cost of construction where significant construction items are sourced offshore, or (b) a depreciation in the revenue currencies may cause a cash-flow problem in the operating phase. Mechanisms for minimizing resources include: (i) matching the currencies of the sales contract with the currencies of supply contracts as far as possible, (ii) denominating the loan in the most relevant foreign currency, and (iii) requiring suitable foreign currency hedging contracts to be entered into.

### **Regulatory / Approvals Risk**

These are risks that government licenses and approvals required to construct or operate the project will not be issued (or will only be issued subject to onerous conditions), or that the project will be subject to excessive taxation, royalty



payments, or rigid requirements as to local supply or distribution. Such risks may be reduced by obtaining legal opinions confirming compliance with applicable laws and ensuring that any necessary approval is a condition precedent to the drawdown of funds.

### **Political Risk**

This is the danger of political or financial instability in the host country caused by events such as: insurrections, strikes, suspension of foreign exchange, creeping expropriation and outright nationalization. It also includes the risk that a government may be able to avoid its contractual obligations through sovereign immunity doctrines. Common mechanisms for minimizing political risk include: (a) requiring host country agreements and assurances that the project will not be interfered with, (b) obtaining legal opinions as to the applicable laws and the enforceability of contract with government entities, (c) requiring political risk insurance to be obtained from bodies which provide such insurance (traditionally government agencies), (d) involving financiers from a number of different countries, national export credit agencies and multilateral lending institutions such as development banks, and (e) establishing accounts in stable countries for the receipt of sale proceeds from purchasers.

### **Force Majeure Risk**

This is the risk of events which renders the construction or operation of the project impossible, either temporarily (e.g. minor floors) or permanently (e.g. complete destruction by fire). Mechanisms for minimizing such risks include: (a) conducting due diligence as to the possibility of the relevant risk, (b) allocating such risks to other parties as far as possible (e.g. to the builder under the construction contract), and (c) requiring adequate insurance which note the financiers' interests to be put in place.

### **Multiple Choice Questions**

- (1) A \_\_\_\_\_ is any series of activities arranged in a logical order, to achieve well defined objectives and specific end results.  
(a) project (b) programme (c) unit (d) goals
- (2) A coordinated set of projects within the same country, state, local government areas or city is otherwise known as \_\_\_\_\_.  
(a) project (b) programme (c) unit (d) objective
- (3) A project is usually financed from the following except \_\_\_\_\_.  
(a) shareholder and loans funds (b) working capital funds (c) retention funds (d) none of the above
- (4) Project finance requires the following except  
(a) allocation of financial resources (b) deployment of financial resources (c) distribution of earning (d) employing a carefully engineered financing mix

- (5) Shareholder fund is made up of the following except \_\_\_\_\_  
(a) equity (b) retained earnings (c) overdraft (d) preference capital .  
Term loans, differed credit, fixed deposit, and working capital advance is known as \_\_\_\_\_ (a) debt (b) equity (c) internal fund (d) all of the above
- (6) the financial market is usually classified into \_\_\_\_\_  
(a) money and capital market (b) product and money market  
(c) real and intermediate market (d) physical and money market
- (7) The structure of project finance requires \_\_\_\_\_  
(a) equity investors (b) syndicate bank (c) long term debt (d) all of the above
- (9) Which of the following is applicable to project risk minimization?  
(a) identification and analysis of all risks that may bear upon the project  
(b) the allocation of those risks among the parties  
(c) the creation of mechanisms to manage the risks.  
(d) all of above.
- (10) Project risks can be categorized using \_\_\_\_\_ (a) design and construction phase  
(b) operation phase (d) none of the above (d) a and b only
- (11) A report containing details of the execution as well as economic and financial viability of a project is otherwise known as \_\_\_\_\_ (a) implementation report  
(b) examination report (c) feasibility report (d) progress report
- (12) The risk associated with the nature of business as well as the capacity of the project to generate continuous cash flows is known as \_\_\_\_\_  
(a) operating risk (b) financial risk (c) interest rate risk (d) currency risk
- (13) The risk applicable to the manner of financing a project is \_\_\_\_\_  
(a) operating risk (b) financial risk (c) interest rate risk (d) currency risk
- (14) The risk common to fluctuation of foreign exchange is \_\_\_\_\_  
(a) operating risk (b) financial risk (c) interest rate risk (d) currency risk
- (15) The common mechanisms for minimizing political risks include.  
(a) requesting host country agreements and assurances that project will not be interfered with.  
(b) obtaining legal opinions as to the applicable laws and the enforceability of contract with government entities.  
(c) requiring political risk insurance to be obtained from bodies which provide such insurance and involving financiers from a number of different countries, national export credit agencies and multilateral lending institutions  
(d) all of the above
- (16) Information available to estimate the pattern of cash flows associated with a particular project is a typical example of decision under \_\_\_\_\_  
(a) certainty (b) uncertainty (c) risk (d) all of the above-
- (17) Where information is not available to determine the pattern of cash flows associated with a particular project this is a typical example of decision under \_\_\_\_\_  
(a) certainty (b) uncertainty (c) risk (d) all of the above-

- (18) The following are necessary for risk minimization.
- timely completion of a project
  - full capacity operation
  - capacity to generate sufficient revenue to service the debt
  - all of the above
- (19) Four types of market where funds can be obtained to finance a project are
- capital market, money market, security market and foreign exchange market.
  - money market, intermediate market, security market and foreign exchange market.
  - capital market, money market, security market, and product market
  - capital market, money market, foreign exchange market and product market
- (20) The following are to be considered before project execution
- cost of the project and cash benefit
  - the cash benefit accrued to the project in the future and discount rate
  - the initial outlay, future cash flows and discount factor
  - none of the above

### Theory Questions

- Discuss the components of internal and external finance and show which of these is appropriate for project finance.
- Discuss the concept of financial market and show its applicability to project finance.
- Outline and discuss the various risks that are common to project in your own country and how you would mitigate the effect of these risks.
- What is political risk? How would the political risk associated with project execution and implementation be controlled?
- Discuss the concept of risk minimisation and show the various mechanisms available for sponsors of a project to minimize the effects of risk on project execution.

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