EFFECTS OF CAPITAL BUDGETS ON CASH FLOWS: A CASE STUDY OF KENYA POWER AND LIGHTING COMPANY LIMITED

By

DAMARIS N. MOMANYI

A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE IN MASTERS OF BUSINESS ADMINISTRATION IN CORPORATE MANAGEMENT IN THE SCHOOL OF BUSINESS AND PUBLIC MANAGEMENT AT KCA UNIVERSITY.

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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

Damaris N. Momanyi **Reg. No. 12/00251**

Sign: …… Date……

I do hereby confirm that I have examined the master's dissertation of

Damaris N. Momanyi

And have certified that all revisions that the dissertation panel and examiners recommended have been adequately addressed.

Sign: …… Date……

Prof. Alfred Osiemo

Dissertation Supervisor

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ABSTRACT

Capital budgeting decisions have a long term effect on the performance of a firm and can determine its success or failure. These decisions are influenced by the changes in the business environment. Kenya Power and Lighting Company Limited is involved in capital intensive projects that have impacted on its performance and cash flows. The purpose of this study was to examine the effect of capital budgets and how they affect cash flows at the Kenya Power and Lighting Company Limited. The objectives were to evaluate the effects of cash flow mismatch, foreign exchange, inflation and government intervention on cash flows. The study used explanatory research design. Data was collected from existing records. The findings were presented using a linear regression equation. The research finally concludes that cash flow mismatch, foreign exchange rates, inflation and government interventions affect cash flows at The Kenya power and Lighting Company Limited. The researcher recommends that the Company should aspire to match the inflows to outflows, thorough education of budget holders on the need to be committed to budgets and the adoption of zero based budgets for non-key projects, evaluation of projects to determine cost versus benefits and monitor project implementation schedule to ensure no budget over-runs. To minimize the effects of foreign exchange risk, the study recommends the use forward contracts and swaps. The study finally recommends that the company should constructively engage the government to undertake projects after taking into consideration their benefits to the public and financial viability to the company.

Key words: Capital budgets, Capital budgeting, Cash flows.

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DEDICATION

I dedicate this work to my family for their undivided support and prayers during my studies. I hope the knowledge I have acquired will bear good returns to the family and the country at large. Thank you for investing the family time and resources in my education.

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ABBREVIATIONS AND ACRONYMS

KPLC - Kenya Power & lighting Company Ltd.

KenGen – Kenya Electricity Generating Company Ltd

KETRACO - Kenya Transmission Company Ltd

REA - Rural Electrification Authority.

MOE&P- Ministry of Energy and Petroleum

IPPs- Independent Power Producers

GDP - Gross Domestic Produce

GOK- Government of Kenya

ERC- Electricity Regulatory Commission

KIPPRA- The Kenya Institute for Public Policy Research and Analysis

MW- Megawatt

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Cash is an essential ingredient for the success and future survival of a firm. Firms invest in capital projects to regenerate themselves and remain relevant in the ever changing business world. They therefore invest in new products, open new branches, put up factories, and undertake major repairs and maintenance and develop business models that are cost effective.

The importance of capital budgeting to a firm cannot be underscored. The investments involve a large amount of the organizational resources, the effect on the future cash flows is felt by the organization for a long time, and the decisions are irreversible once the funds have been committed. A wrong decision therefore can affect the profitability and future operations of a firm (du Toit and Pienaar,2005).

Budgets are used as a management tool for planning and controlling organizational resources. The process involves setting of standards of performance and use of variance reports on the actual performance to give management the information required for control purposes (Horngren, Dartar and Foster, 2003). However, these decisions are more problematic due to changes in the international business environment, which is characterized by economic, social, political, and cultural diversity. The uncertainty arising from changes in exchange rates, inflation and uncertain future cash flows makes the process more complex. Organizations therefore must evaluate their projects to minimize the financial impact of making wrong decisions in the long-run.

Capital budgeting decisions require careful judgment in the allocation of organizational resources. During the budgetary process, decision makers are guided by institutional procedures, structures and the needs of the various interest groups among others. The questions often asked by the corporate planners include; how do we determine the total

amount of funds to be allocated? What activities should be considered for funding? Which criteria will be used to select the project? These decisions require careful deliberations before agreeing on the final decision model to be used. The ideal model that can meet the requirement of the decision is often mired by a poor economic measure of the costs and benefits of each project and their uncertainty (Azevedo & Mesut, 2005). The implementation of all projects according to the requests of all the interest groups is limited by the availability of resources. This calls for the priotization of projects in line with the company strategy.

Hall (2000) states that the most difficult part in capital budgeting is to define the project and estimate the future cash flows. To accurately estimate the future cash flows and efficiently allocate the financial and other resources among various alternatives is what determines the success or failure of a project.

It is believed that capital budgets positively impact the cash flows of a firm. It is therefore important to understand this relationship and provide a platform against which the impact of capital budgets on cash flow can be assessed.

1.1.1 Concept of capital budgets

A budget is a detailed plan that outlines how a firm acquires and uses the financial and other resources over some given time period. They give a guideline of the firm's plans for the future. To be successful, an Organization must use the resources available optimally and therefore, budgets must be in line with their goals and objectives. Budgets are used for planning and controlling of the organizational resources (Blansfield 2002). Premchand (2000) states that budget implementation is a company policy and determine the manner in which resources' are managed.

1.1.2 Cash flows

The statement of cash flow is a financial report depicting amount of money incoming and outgoing during a particular time period. According to Claessens, Stijn, Djankov, and Lang (2000) cash flow summarizes the actual or expected amount of money coming or leaving the firm over a period of time which can be a month, quarter or year. It is an analysis of the timing of cash receipts and cash disbursements over a specific time period.

The cash flows do not show whether the business will be profitable, but it shows the cash position of the business at any given point in time by measuring revenue against outlays. It also lists cash to and cash from operating, investing, and financing activities, and also the net increase or decrease in cash for a particular period. It therefore answers the questions about where the money came from and where it went to. According to Stowe et al, (2002), cash flow statement reflects a firm's liquidity.

1.1.3 The Electricity Sub-Sector in Kenya

The electricity sub-sector in Kenya consists of the Ministry of Energy and Petroleum that is in charge of formulating policies for the sub- sector and gives direction towards achieving the sub-sectoral goals , coordinates the activities undertaken within the sub- sector and gives incentives to investors looking for opportunities in the sector.; the Energy Regulatory Commission that is in charge of regulating the energy sector through setting of retail tariffs and the power purchase agreements; the Energy Tribunal which arbitrates disputes within the sub-sector; power generators comprising of Kengen and the Independent Power Producers(IPPs) that sell power in bulk to KPLC; the Geothermal Development Company (GDC) that undertakes preliminary assessment of geothermal resources in the country and drilling of the same; The Kenya Transmission Company (KETRACO) that constructs new transmission lines that are leased to the Power distributor; the Rural Electrification Authority (REA) that distributes electricity to rural households in Kenya and

to areas which are not economically viable; power importers and exporters in neighboring countries; and retail customers served by KPLC who are the end users of electricity.

Prior to 1990, the electricity sub-sector in Kenya faced numerous challenges. The sector was underdeveloped and the inefficiency level was high which made the investors to be cautious in putting their investment in the sector. This necessitated the government to initiate major policy and institutional reforms in the sector starting mid-1990s in order to overcome the imminent challenges that faced the sector. The initiatives involved the unbundling of the electricity sub-sector and the formation of the Electricity Regulatory Board (ERB) through the act of parliament, the Electric Power Act, 1997.

All the regional generation assets were consolidated under Kenya Energy Generating Company (KenGen) and the transmission and distribution assets were put under Kenya Power and Lighting Company (KPLC) making it a single buyer model. These reforms were a motivation to the investors who wanted to invest in the electricity sub-sector in Kenya and it led to the inflow of capital from private investors. Currently there are six Independent Power Producers (IPPs) which are owned and operated by private investors namely, Iberafrica, OrPower 4, Rabai Power, Imenti, Tsavo and Thika Power Company.

The power sector in Kenya is currently facing challenges which include unreliable power supply due to weak transmission and distribution networks, high cost of power, low consumption levels and low levels of access to electricity (KIPPRA, 2010).

1.1.4 Profile of the Kenya Power

Kenya Power (Formerly KPLC) formerly East African Power & Lighting Company (EAP&L) was incorporated as a limited liability company in 1922 to undertake the transmission, distribution and retail of electricity in Kenya. However, in 1997, the electricity sub-sector in Kenya was unbundled and the power generation part was split off from Kenya Power to become KenGen function, leaving Kenya Power with the responsibility of

transmission and distribution of power. The company owns and operates the national transmission and distribution grid, and retails to more than 2,000,000 customers throughout Kenya.

Vision 2030, Kenya's economic blue print strives to transform the country into a globally competitive and modern country with high quality of life for its citizens by the year 2030.

To achieve this, adequate and reliable supply of electricity is crucial for communication, commerce and everyday conveniences.

The mandate of purchasing, transmitting, distributing and retailing electricity in Kenya is vested with Kenya Power; therefore, the Company plays a central role in Kenya's social and economic development. The Company has been performing poorly despite the increment in capital budget position. There have been various projects that have been planned for implementation over the years. These include Replacement of plant and equipment in the substations, Reinforcement of existing distribution lines and Construction of new plants and distribution networks. However, despite the efforts made to the intended results this has not been realized. This could be attributed to among other factors the mismatch of cash flows between the budgeted and actual due to external financing whose effect is mainly felt on the cash flows of the companies within the electricity subsector. This study therefore aims at investigating the effects of capital budgets on cash at Kenya Power and Lighting Company limited.

1.2 Statement of the Problem

The energy sector though critical in boosting Kenya's development, has registered slow growth in the past due to the high initial capital outlay and inability to mobilize adequate financial resources to undertake massive investment (Calderon, C., 2008). Delays in disbursement of the foreign loans and at times partial disbursements have had serious ramifications for the implementation on the projects leading to prolonged delays in the

completion of the projects or complete stalling of the same (Eberhard and Gratwick, 2008). These delays have also exposed the company to the effects of inflation due to changes in prices of materials, labour and transport resulting to escalation of costs.

The external loans which are denominated in foreign currency and importation of materials for the projects have an impact on the company due the effects of changes in foreign currency (Clive Harris, Kumar V. Pratap, 2009).

The electricity sub- sector in Kenya falls under the ministry of energy and Petroleum (MOE&P), which facilitates regulation, monitoring and coordination of activities undertaken by the sector players. The MOE&P sometimes directs funds that are meant for a project to another. This causes some projects to be abandoned midway before they start realizing their projected returns while the government recommended projects are started before a proper evaluation is done to know their viability (Kagiri, 2008).

In recent years, Kenya Power has intensified its operations in order to support enhanced economic growth and the national development plans but it is experiencing severe scarcity for cash and its revenue growth is depressed compromising on the quality of power supply. It is now imperative that the organization accelerates its efforts to deliver on this commitment under the Vision 2030 to stimulate economic growth and launch the country into a trajectory of development that will place Kenya among the leading economies by the year 2030(The Kenya Vision 2030). These outturns emphasize the urgent need for a study to investigate the effects of capital budgets on cash flow at the Kenya Power. The purpose of this study was therefore to examine the effect of capital budgets and how they affect cash flows at the Kenya Power.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective was to evaluate the effects of capital budgets on cash flows at Kenya Power.

1.3.2 Specific Objectives

The specific objectives for the study are as follows:

i. To evaluate the effects of mismatch between budgeted cash flow and actual cash flow at Kenya Power.

ii. To determine the effects of foreign exchange on cash flows at the Kenya Power

iii. To assess the effects of inflation on cash flows of Kenya Power

iv. To identify the effects of government intervention on cash flows at Kenya Power.

1.4 Research Questions

The questions that the research sought to answer are as follows:

i. What are the effects of mismatch between budgeted cash flow and actual cash flow at the Kenya Power?

ii. To what extent does foreign exchange affect cash flows at the Kenya Power?

iii. What are the effects of inflation on cash flows at the Kenya Power?

iv. How do government interventions affect cash flows at the Kenya Power?

1.5 Significance of the Study

This study will benefit many people not only within Kenya Power and Lighting Company Limited, but also a number of other people and stakeholders within and outside the energy sub-sector. Some of the beneficiaries of this study include the following:

The study will be of help to other organizations and the government of Kenya because it will make them to understand the importance of capital budgeting and its implementation.

It will be useful to the government in identifying the challenges faced by institutions when preparing and implementing capital budgets and the effect on their cash flows. This would help the ministries concern to come up with possible approaches aimed at solving the problems.

The findings of this study will benefit Kenya power to improve its capital budgeting process and put in place measures that will improve its capital budgeting process and overcome the challenges faced during the process. Stakeholders within the sector would benefit from the issues raised in the study, which will help them to improve the existing capital budgeting framework. The study will be used by Kenya Power and other similar organizations in Kenya as a management reference point for application of capital budgeting knowledge and practices needed to put in place, both in the present and future.

The study would highlight other areas that require further research; this would be in the areas of capital budgeting and the strategies adopted to enhance its effective implementation. The results of this study would be useful to researchers, scholars, students and academics, who will use it as a basis for discussion on capital budgeting within the service sector and as a source of reference material on other related topics.

1.6 Scope of the Study

The conceptual scope of this study lay on the effects of capital budgets on cash flow at the Kenya Power and Lighting Company Ltd. The study focused more on the effects of mismatch between the actual and budgeted cash flow, foreign exchange, inflation and government interventions on cash flow. The study focused on the on the effects of capital budgets on cash flow at Kenya Power and Lighting Company Limited for a period of five years (2008-2012).

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. Specific emphasis has been put on the implementation of capital budget. The specific areas covered here are theoretical orientation, empirical review and the conceptual framework.

2.2 Importance of capital budgeting

A budget is a detailed plan outlining the acquisition and use of financial and other resources over some given time period. It determines the direction of the organization and its future success. Managers are required to indicate the future revenues and expenditure as a tool for planning and control in organizations.

Budgets are used to communicate top management's expectations to managers and employees. They also serve as a tool for planning and control (Horngren et al,2003). In large organization, budgets are used to communicate decisions and targets between top and lower managers. This participation makes the budgeters to own the process and work towards the achievement of the organizational goals (Harvey Arbel´aez, 2004). Budget implementation will not be achieved if there is a shortfall of revenue from the expected levels. When this happens some projects will stall while others will be delayed due to reduced expenditure (Pollit, 2004).

Capital budgeting is the rational allocation of financial resources among competing multi-period projects (Grinstein and Tolkowsky, 2004). It is a process of evaluating and selecting long term investments consistent with the firm's goal of maximizing shareholders wealth. Capital budgeting has been widely utilized as a management and strategic planning tool by corporations. Holme´n and Pramborg (2003) suggest that the budgeting process often has many behavioral outcomes in the organizational planning process, such as enhanced goal

congruence and more universal participation. Currently, a majority of major corporations make use of some type of capital budgeting technique in their strategic performance measurement process.

Capital budgeting plays a key role in the organization. It is a tool for determining the projects that a firm should undertake, the amount of money to allocate for capital projects and lastly the source of funds to finance the expenditure (Drury, 2004).Also a research done by Leon (2008) indicates that capital budgeting increases the firm's future cash flows, boost the company's current earnings and enhances growth in the market share and stock prices.

2.3 Theoretical Foundation of Budgeting

Lewis (1952) applied the principle of 'Marginal Utility'. He argued that, for any additional public expenditure to be undertaken, one has to take into account the returns expected from the project. The return from the project in this case should be at the margin. This is the point where the additional expenditure equals the returns. Therefore the decision makers must look at projects that have relative value. The relative value of a project must be assessed by comparing various alternatives before applications of public funds that will achieve the required goal. Budgeters should assist the decision markers by coming up with various proposals at different levels of budget requirements from which the best alternative will be selected.

However, his solution has a number of shortcomings. Firstly, he fails to identify on what basis 'relative effectiveness' may be assessed, though, by seeking an explicit link between programme costs and outputs, he points the way to a solution. Secondly, it is unlikely that government policy can be reduced to a 'common objective' rather the public sector may address diverse policy goals. Although attempts have been made to develop broad inter-sectoral applications of the principle of 'relative effectiveness', applications have been

more successful where they are restricted to the appraisal of alternative interventions in support of a single policy objective.

Theory of Risk-Adjusted Discount Rate by Crum and Derkinderen (1981) and Jones (1984) are still relevant today. They argue that the future is uncertain and therefore the Net Present Value should be adjusted with the Risk- Adjusted Discount Rate to compensate for future uncertainty. As a result the implementation of new techniques used in the analysis of capital investments such as the Discounted Cash Flows(DCF) methods have been developed which take into account the future uncertainty. Other researchers such as, Lumijarvi, (1991); Allison and Kaye (2005), (Azzone, Bertelè, 1991) have also focused on the relationship between investment decisions and financial theory, or on behavioral aspects of capital budgeting.

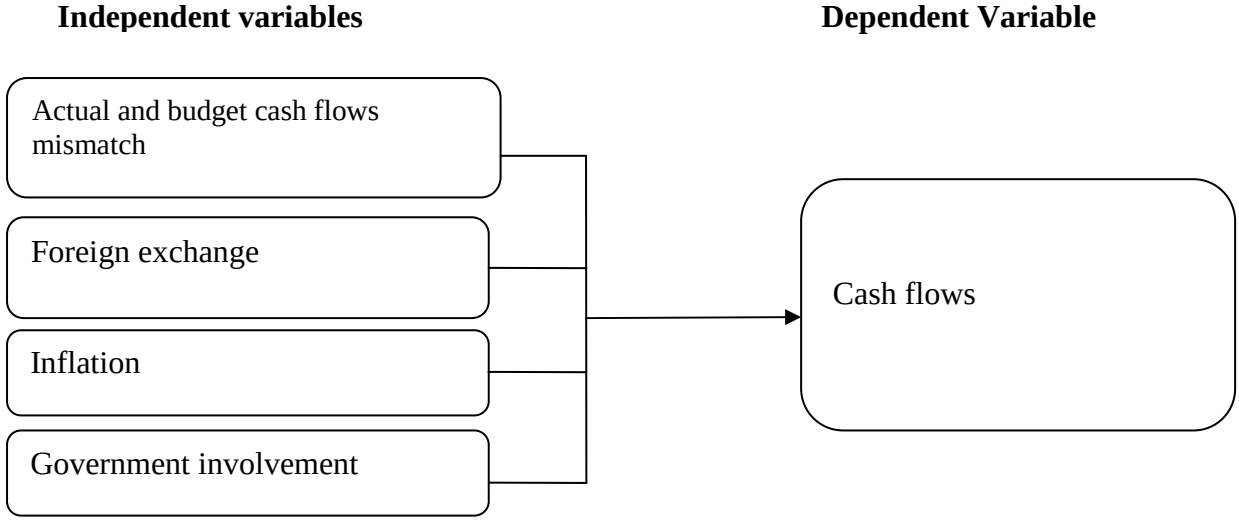
The budgeting process is political and requires strategic decisions to be made Wildavsky, (1974). Officials in charge of carrying out the government's functions are oriented toward needs. Interaction between spenders and guardians require compromise and both sides should justify and defend their position. The decision makers fall into two main categories, the ambitious advocates and the risk verse advocates. The ambitious advocates argue their cases and create confidence among their peers to gain support for their interests. The negotiations will differ from one person to another depending on their personality, negotiation skills and circumstances. Their aim is to avoid the risk of having their proposals being turned down. Crain and Crain (1998) argue that some advocates are risk averse who instead of arguing their case, they will opt to make small adjustment to their budgets with small increments to maintain their current expenditure levels. They will strive to maximize on their allocations and pursue their policies as long as their allocation is not reduced. These bargaining strategies do not reflect the position of the institutions they serve because their allocations are determined through the process of common amendment.

2.4 Conceptual Framework

The underlying causes of non-performance of capital budgets or poor implementation of capital budgets in organizations need to be studied carefully because their understanding has the potential of improving capital budgeting process and outcomes. Identifying the various ways in which capital budgets affect cash flows can have long-term implications for economic development of individual organizations and nations in general. From the literature review, the various effects of capital budgets on cash flow in Kenya Power form the conceptual framework in this study. A conceptual framework is a basic structure that consists of certain abstract blocks which represent the observational, the experiential and the analytical/ synthetical aspects of a process or system being conceived. The independent variables in this study are cash flow mismatch, foreign exchange, inflation and government interventions while the dependent variable is cash flows as the undernoted diagram elucidates.

FIGURE 1

Effects of Capital Budgets on Cash Flow at the Kenya Power



2.5 The effects of Mismatch between budgeted and actual cash flows

Selecting a project for implementation is a process which requires thorough and careful considerations. Projects are subjected to a financial appraisal process to confirm whether they are viable or not. Estimating the future cash flows, assessing the risk associated with those cash flows, carrying out sensitivity analysis on the possible changes in the cash flows and estimating the project's net present value (Dayanda et al., 2002).

The viability of the projects future cash flows is of more concern to the managers (Van Horne & Wachowicz, 2001). If the risk associated with the future cash flows is known, the same should be incorporated into the capital budgeting process by adjusting the discount rate with the anticipated risk to counter (Gibson, 2009).

A study carried out by kagiri (2003) on time and cost overruns in power projects in Kenya, found that delay in disbursement of funds by financiers was one of the many variables that contributed to time and cost overruns in the power projects implemented by KenGen on behalf of the Kenya Government. KenGen, failed to meet specific requirements by multilateral financiers, resulting to delays in disbursement of funds.

2.6 Effects of Foreign Exchange on Cash Flows

In the business world today, firms carry their businesses without taking into account where the buyers and sellers are located. In addition the financial markets have made it possible for firms to source for financing which are cheaper in the international financial institution. The effect of cross boarder businesses comes with challenges. One such challenge is the effect of foreign exchange fluctuations (Bradley and Moles,2002). When there are unexpected changes in the exchange rate compared to the home currency, the firm's earnings are affected and the resulting effect is a risk to business.

The foreign exchange fluctuations affect a firm's bottom line and the value of the net assets denominated in foreign currency. It also affects the firm's competitiveness in the

market (Allayannis and Ofek,2001). Therefore it is important for firms to be sensitive, understand their own level of foreign exchange risk and put in place strategies that will minimize the impact of the same on their operations.

Williamson (2001) found that between 1973-1995 firms in the U.S which traded with Japanese firms were affected by the exchange rate volatility of the Japanese Yen and that the effect had a negative impact. Chan et al. (2002) also did an investigation involving pharmaceutical firms in the US during the period 1990 to 1999. His findings indicated that the pharmaceutical firms were sensitive to exchange rate volatility between the year 1990-1994. However this reversed from negative to positive during 1995- 1999.

The effect of foreign exchange fluctuations differs from one country to another. This is demonstrated by the studies carried out by Choi and Kim (2003). They investigated the effect of exchange rate fluctuations on US firms with Asian Operations between January 1992 and December 1997. The study found that volatility in foreign exchange rates affected 29% of the US firms and the level of significance was 10%. Half of the firms that showed significant exposure had a positive exposure. However, this was not the case with US firms operating in the Asia-Pacific region as indicated by Chen and So (2002). Their study of 129 US multinationals from January 1996 to December 1998 indicated that study the relationship between the variability of exchange rates stock return for the multinational firms increased significantly with the exchange rate variability increase.

The effect of foreign exchange differs from one industry to another even when they operate in the same country. This was demonstrated by the study carried by Kiymaz (2003) 109 Turkish firms between 1991to 1998. He found that in as much as all firms were affected by the exchange rate exposure, textile, machinery, chemical and financial industries were more exposed.

Gachua (2011) examined the exposure of listed firms on the Nairobi Stock Exchange to exchange rate risk for the period January 2001 to December 2010. These findings revealed that there is an effect in the company‘s financial performance as a result of dealing with foreign exchange in the normal business operations. Most listed firms on the Nairobi Stock Exchange are significantly exposed to foreign exchange risk emanating from all the major hard currencies of international trade, namely, the US dollar, the Sterling pound, the Euro and the Japanese Yen. Foreign exchange risk management is thus crucial for companies frequently trading in the international market either as multinationals or simply involved in import and export trade

A study carried out by Abor (2005) in Ghana on how firms managed the foreign exchange risk, found that Ghanaian firms involved in international business had a low usage level of hedging instruments in the management of foreign exchange risk. The firms either adjusted the prices of products and services to reflect changes in import prices as a result of currency fluctuations or bought and saved currencies in advance. The problems that the firms faced were the frequent appreciation of foreign currencies against the local currency and retaining of local customers due to high prices of imported inputs which affect the prices of the final products sold locally. The study also showed that about 45 percent of those firms were naive about the risk posed by foreign exchange fluctuations. They had no departments or any one responsible for managing their foreign exchange.

The unrealized gains or losses are adjusted to the profits of a firm through the profit and loss of a firm. They therefore increase or reduce the profitability of a firm. They also carry information regarding the future cash flows (Campbell, 2010). This can compel them to pass price adjustments to customers.

Doukas John A. et al. (2003) examine the relation between Japanese stock returns and unanticipated exchange-rate changes for 1,079 firms traded on the Tokyo stock exchange

over the 1975–1995 period. Lagged-exchange rate changes on firm value are found to be statistically insignificant implying that investors are able to assess the impact of exchange-rate changes on firm value with no significant delay.

2.7 Effects of Inflation on Cash Flows

Micro economic instability due to changes in prices, changes in money supply and deficit in government expenditure are among the factors that contribute to inflation. Inflation affects financial decision making and planning especially making reliable forecasts (Awogbemi,2012).

Inflation in the past few years has not been a major macro-economic problem, but its specter is never for the agendas of financial decision makers. Macro- economic instability has necessitated that expectations about the future rate of inflation be taken into consideration in making decision(s) about which capital projects will be undertaken by a firm. Nominal cash flows determine its degree of profitability. However, in making the capital budgeting decision both real and nominal concepts must be considered (Coelho, et al., 2003). To be consistent, inflation in forecasting cash flows must also be reflected in a discount rate containing inflation; that is, a bias was introduced if nominal cash flows were discounted at the real and not nominal cost of capital.

In a world of no inflation, the interest rate charged on funds will be equal to nominal rate of interest. This is different from when inflation exists because it lowers the purchasing power. When budgeting for capital projects during the inflationary period, the budget must be adjusted upwards so at to cushion the firm from price increases. Failure to incorporate inflation in the budget will make the firms not to implement all the projects marked for implementation.

A firm does have a number of ways in which it can respond to the problems created by inflation. There are three major areas that could be addressed in an attempt to offset the

negative impact of rising price levels. One action would be to raise output prices above the level of inflation, but the ability of the firm to do so will be limited to the extent that the market will withstand the higher prices. Market structure will play an important role here, with the more oligopolistic firms enjoying greater success than the more competitive firms. However, in the long run, this will lead to high inflation and thus may be self-defeating. Unless other adjustments are made, the investment sector of the economy could under allocate resources to new investment projects.

2.8 Effects of Government Involvement on Cash Flows

The government of a country has the sole responsibility of ensuring that the citizens get sufficient supplies of what they need. The government therefore formulates laws, policies and regulations aimed at the provision of such services which can have significantly impact on the performance of the firms operating in that country and the future cash flows of the firm. The politics of the country can also affect the level of investments in a country. Dayanda et al (2002) recommends that when doing financial appraisals, firms should take into account the qualitative factors that will have on the project because they are cost.

The government plays a key role in providing goods and services for the common good of the citizens of that country. It can do this by subsidizing the price of goods and services of essential products or by subsidizing the cost of production of such goods. The value of this subsidy must be taken into account when preparing the capital budgets. This can be done by either adducting cost of capital or by including the value of the subsidy in the budget analysis. For a long time, there has been a concern that it is the donors who benefit from their aid at the expense of the intended beneficiaries in the developing world due to the common policy of tied-aid. Until recently these political dimensions to accounting and its associated function of auditing were given insufficient recognition, however well- known they were in practice. Instead of state audit legislation reflecting purely constitutional needs it

has been the result of a vortex of social and political forces which have masked their intent under the convenient banner of constitutional propriety.

The erratic electricity supply stems from other factors which include the absence of a real national sector policy and strategy; poor governance of the two State-owned electricity companies (non-functioning of the corporate organs, the lack of supervisory control, uncoordinated appointment of main managers, and political interference in their day-to-day management) which prevents rigorous management; the extremely weak financial situation of the two electricity sub-sector companies which are heavily dependent on State subsidies to stay operational and plagued by overstaffing, low billing and collection rates due to significant fraud, and inability to secure a regular supply of gasoil for the generator sets; lack of maintenance of equipment and obsolescence of the power grid that has led to major technical losses. On account of these weaknesses and situations, the two electricity sub-sector companies suffer enormous operational losses. Consequently, there is an urgent and crucial need for short-term and long-term reforms as well as priority investments in the sub-sector to improve its performance.

The unbundling of the energy sector into transmission and generation creates a problem to institutional investors in the energy sector. Investors are prevented from investing in the transmission capacity because of their engagement in the generation capacity. The provisions of the unbundling are seen as a regulatory risk but it is not clear how they limit the institutional investors' simultaneous involvement in transmission and power generation.

2.9 Study Gap

From the Literature review, various researchers found that cash flow mismatch has an effect on cash flows. Dayanda et al (2002), Van Horne & Wachowicz,(2001) and kagiri (2003) found that that cash flow mismatch negatively affects the implementation of capital

budgets and the project's level of risk associated with the cash flow mismatch should be incorporated in the budgeting process by adjusting discount rate upwards.

The results of studies on the effect of foreign exchange on cash flows are contradictory. Allayannis and Ofek (2001) and. Doukas et al. (2003) are neutral in their findings. They found that the exchange risk sensitivity of firms will depend on their operating, financial and hedging strategies and other firm-specific variables and are found to be statistically insignificant. Investors are able to assess the impact of exchange-rate changes on firm value with no significant delay. Kiymaz (2003) finds that firms are highly exposed to foreign exchange risks and the sign of foreign exchange exposure is negative, indicating an adverse impact of foreign exchange rate on firm value.

The study by (Coelho, et al., 2003) on the effects of inflation on cash flows indicates that inflation negatively affects cash flows. Firms must use a discount rate containing inflation when making capital budgeting decisions.

Dayananda (2002) found that Government regulations and policies have a negative impact on investment projects because they are viewed as a cost. He concludes that firms should consider qualitative factors for project proposals.

Most research on capital budgeting have focused on the selection of capital budgeting techniques and firm performance. Holme'n and Promborg (2003) surveyed the extent to which firms use pre –investment strategies to manage political risks. He found that firms used more stringent investment criteria and different decision criteria when investing in countries with higher political risk. They related each firm's capital budgeting methods to its actual Portfolio of Foreign Direct Investments. The survey provided evidence on firm's capital budgeting methods for foreign direct investments.

Locally, Kadondi (2002) carried out a study on capital budgeting techniques on firms listed at the NSE. In the study he sort to determine whether the techniques used conform to theory and practices of organizations in developed countries and to determine how firms and CEO characteristics influence the use of a particular technique. The issue of capital budgeting techniques being used as a strategic tool for benchmarking and gaining competitive edge was imminent in the study, findings which were also consistent with the survey done by Graham & Harvey (2002). Njiru (2008) looked at capital investment appraisal from point of view of shareholder wealth maximization and sought to identify the most commonly used capital investment appraisal technique by commercial Parastatals and determine the factors that influence the choice of capital investment appraisal technique used. The main factors that influence the choice of capital investment appraisal technique were found to be amount of funds regarded for investment, size of the organization, government policy and industrial practices.

kagiri (2003) sought to investigate on the factors that significantly contributed to time and cost overruns on power projects implemented by KenGen, evaluate their relative ranking, and to quantify their impacts. Improper project preparation, resource planning and government bureaucracy topped the list of the most significant factors affecting project implementation.

This study differs from other local studies in that it seeks to establish the correlation between capital budgeting decisions and the cash flows and if this is consistent with finance theory.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives an outlines of the methodology used in the study. It covers the following areas; the research design, population of the study, sample design, data collection instruments, data processing and analysis.

3.1 Research Design

The main objective of this study was to evaluate the effects of capital budgets on the cash flows at Kenya Power and lighting Company. The study adopted as explanatory design. This is because; the study involved describing the relationship between the different variables.

3.3 Population

The research was a case study of Kenya Power and Lighting. It was intended for development of detailed, intensive knowledge on the effect of capital budgets on cash flows of the Company.

3.4 Sample Design

The population served as the sample for this study

3.5 Data Collection Methods and Instruments

The study used secondary data from the desk top review of audited financial statements, management reports and financial /economic journals. The data on cash flow mismatch, foreign exchange, inflation and government interventions was for the five year period between July 2008 and June 2012.

3.6 Data Processing and Analysis

In this research project, the relationship between capital budgets and cash flows was tested. In the study, the variables to be measured were cash flows, cash flow mismatch, foreign exchange, and inflation and government interventions. Cash mismatch, foreign

exchange, inflation and government interventions are the independent variables and cash flows is the dependent variable.

The empirical analysis employed data for five year between July 2008 and June 2012 on cash flows, cash flow mismatch, foreign exchange, inflation and government interventions. The data was analyzed with the help of Statistical Package for Social Sciences (SPSS).

To test whether the relationship between capital budgets and cash flows holds at Kenya Power, a multiple regression model was conducted. The dependent variable was cash flows and the independent variables were, cash mismatch, foreign exchange, inflation and government interventions.

In the empirical analysis, the following model which shows the relationship between cash flows, cash mismatch, foreign exchange, inflation and government interventions was estimated.

The model specification was as follows:

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \ (i)}$$

Where:

Y = cash flows and cash flows

X_1 = cash flow mismatch

X_2 = foreign exchange

X_3 = inflation

X_4 = government involvement

$\beta 0$ = Y intercept

$\beta_1, \beta_2, \beta_3, \beta_4$ = Coefficients of determination

ε = Error term (To capture other variables)

CHAPTER FOUR
FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter presents the analysis of data obtained on the effects of capital budgets on cash flows at Kenya Power. Data was collected through desk top review of audited financial statements, management reports and financial /economic journals and books. This involved collecting the documented information with regard to cash flow mismatch, foreign exchange, inflation and government interventions. The data obtained was fed into SPSS version 21.0 and used to compute the ratios used as proxies to measure the effects of capital budgets on cash flows at Kenya Power.

The researcher conducted a multiple regression analysis so as to establish the relationship between various dimensions of capital budgets and cash flows at Kenya Power. The main purpose of multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent or criterion variable.

4.2 Capital Budgets and Cash Flow

The main purpose of this study was to evaluate the effects of capital budgets on cash flows at Kenya Power. This section therefore involves an analysis of the various aspects of capital budgets and cash flow in the Kenya Power. The power sector, just like other sectors of the economy, suffered from years of lack of new investments which resulted in the weakening and ageing of the electricity distribution infrastructure. However, the government has been very committed to energy in terms of creating an enabling environment for industries and improving the economic development of the country. Under Vision 2030 Kenya Power is expected to provide access to electricity to at least 50 percent of Kenya by 2030, which will reach 70 or 80 percent by that time.

Kenya does not have sufficient power for its citizens. There are plans to increase the generation capacity to 5000 megawatts by the year 2017. The government involvement in the

setting up of tariffs and subsidizing of some projects undertaken by Kenya power and lighting company limited has led to the reduction of the amount of capital available to Kenya Power to undertake the capital projects. The company has been recording low levels in the expansion of electricity network in the country due to financial constraints as a result of regulated electricity tariffs and failure or delay by the government to honor the payment of the subsidies. This has made project selection and implementation difficult at the Kenya Power.

4.4 Budget-Cash flow Mismatch

In order for the study to achieve its main objective the first specific objective of the study was to evaluate the effects of mismatch between budgeted cash flow and actual cash flow. The available data on budget-cash flow mismatch in the Kenya Power Company Limited is as presented in the table below.

TABLE 1
External Project Funding- Mismatch

Year	Project funds US Dollar	Exchange rate	Budgeted project funds KSH.	Disbursed funds US Dollar	Disbursed funds KSH.	Variance
2008	5,619,330	64.70	363,570,651	5,273,784	341,213,824	22,356,826
2009	14,123,661	86.49	1,221,555,439	11,734,421	1,014,910,072	206,645,367
2010	2,755,054	86.27	237,678,508	2,680,233	231,223,700	6,454,807
2011	29,126,298	89.44	2,605,056,093	26,764,280	2,393,797,203	211,258,889
2012	111,508,828	84.23	9,392,388,582	100,224,672	8,441,924,122	950,464,459
Total	**163,133,171**		**13,820,249,275**	**146,677,390**	**12,423,068,923**	**1,397,180,351**

Source: KPLC Audited Financial Statements 2008-2012

From the available data, there has been a major variance in the amount of money budgeted for the projects and the amount of funds provided for funding. For the five year period (2008-2012), the amounts budgeted for the projects were KShs. 13,820,249,275 of which, Ksh. 12,423,068,923 was disbursed. There was therefore a deficit leading to variance amounting to KShs. 1,397,180,351. It is an implication that there has been variances between

the amounts budgeted and the amounts disbursed for the implementation of projects in the company. This variance is believed to affect the timely completion of the planned projects and hence the failure to realize the forecasted cash flows.

The projects implemented by the Kenya Power Company Limited are usually funded through loans mainly obtained from the World Bank, Agence Francaise de Development (AFD) and European Investment Bank (EIB).These loans are mainly denominated in US dollar, Euro and Swiss Franc. It is therefore clear that the differences in the foreign exchange rates for these currencies are likely to have an effect on the project implementation budget especially when the loan repayments are done when the foreign exchange has changed.

4.5 Foreign Exchange

The second objective of the study was to determine the effects of foreign exchange on the actual cash flows at the Kenya Power. An exchange rate is the rate at which one currency may be converted into another. The real exchange rate (RER) is the rate at which goods, and services produced in one country can be exchanged for those produced in another country or group of countries abroad.

TABLE 2

USD Denominated Loans

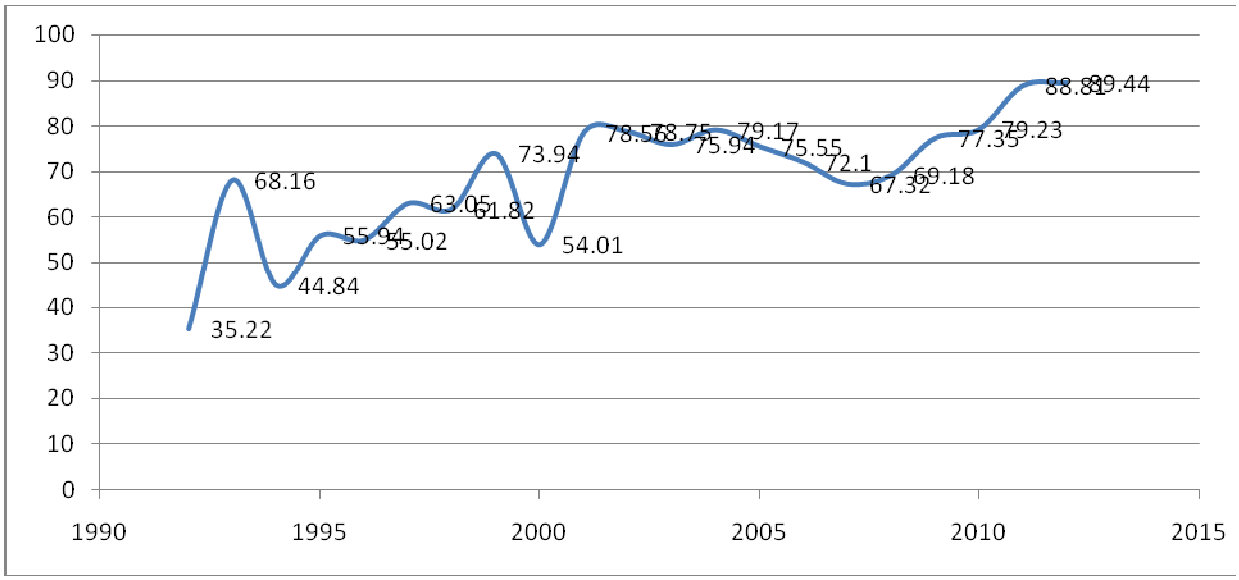
Year	Loan Currency	Mean Exchange Rate	Loan Balances in foreign currency A	Loan Balances at Beginning of Year Ksh. B=A*y0	Mean Exchange Rate At End Of Year Y1	Loan Balance at Year End Ksh. C=A*Y1	Revaluation Due to Exchange Rate Differences D=C-A
2008	USD	62.80	3,443,699	219,708,000	64.70	222,807,325	3,099,325
	EURO	72.40	32,067,810	2,321,709,444	101.92	3,268,351,195	946,641,751
	CHF	54.65	2,331,110	127,395,161	63.45	147,908,929	20,513,768
2009	USD	64.70	6,024,243	389,768,522	86.49	521,036,777	131,268,255
	EURO	101.92	40,604,422	4,138,402,690	111.39	4,522,926,566	384,523,876
	CHF	63.45	2,331,110	147,908,929	71.32	166,254,765	18,345,836
2010	USD	77	10,761,899	828,666,223	86.27	928,429,026	99,762,803
	EURO	108.80	58,607,094	6,376,451,827	98.09	5,748,769,850	(627,681,977)
	CHF	71.32	2,331,110	166,254,765	75.82	176,744,760	10,489,995
2011	USD	81.76	20,770,912	1,698,541,328	89.44	1,857,750,369	159,209,041
	EURO	100.20	74,929,385	7,507,924,277	130.42	9,772,290,391	2,264,366,113
	CHF	75.82	2,331,110	176,744,760	108.20	252,226,102	75,481,342
2012	USD	89.44	40,749,314	3,644,618,644	84.23	3,432,314,718	(212,303,926)
	EURO	130.42	76,359,656	9,958,826,355	105.96	8,091,069,149	(1,867,757,205)
	CHF	108.20	2,331,110	252,226,102	88.12	205,417,413	(46,808,689)
	Totals			**37,955,147,027**		**39,314,297,335**	**1,359,150,308**

Source: KPLC Audited Financial Statements 2008-2012

The results shown in table 4.2 above indicates the effect of exchange rate fluctuations on the cash flows based on the rates ruling at the beginning of the financial year and end of the financial year. The company borrowed Ksh. 37,955,147,027 in various currencies but due to fluctuations in the exchange rate, the repayment was KShs. 39,314,297,335, more by KShs. 1,359,150,308. This is a clear indication that exchange rate has an effect on the capital budgets and hence the cash flow at Kenya Power. The average exchange rate over the period was 78.555 and the standard deviation was 9.377. As Kenya has a floating exchange rate and an open capital account, doing nothing will allow the exchange rate to equilibrate reserves and determine the optimal flow of short-term capital.

FIGURE 2

Real Exchange Rate Trend between years 2008 and 2012



Source: Study Data, 2013

4.6 Inflation

In its third specific objective the study sought to assess the effects of inflation on cash flows of the Kenya Power. In this study the inflation rate data is expressed in terms of geometric calculation for inflation for the period between year 2008 and 2012.

TABLE 3

Descriptive Statistics for Inflation Rates

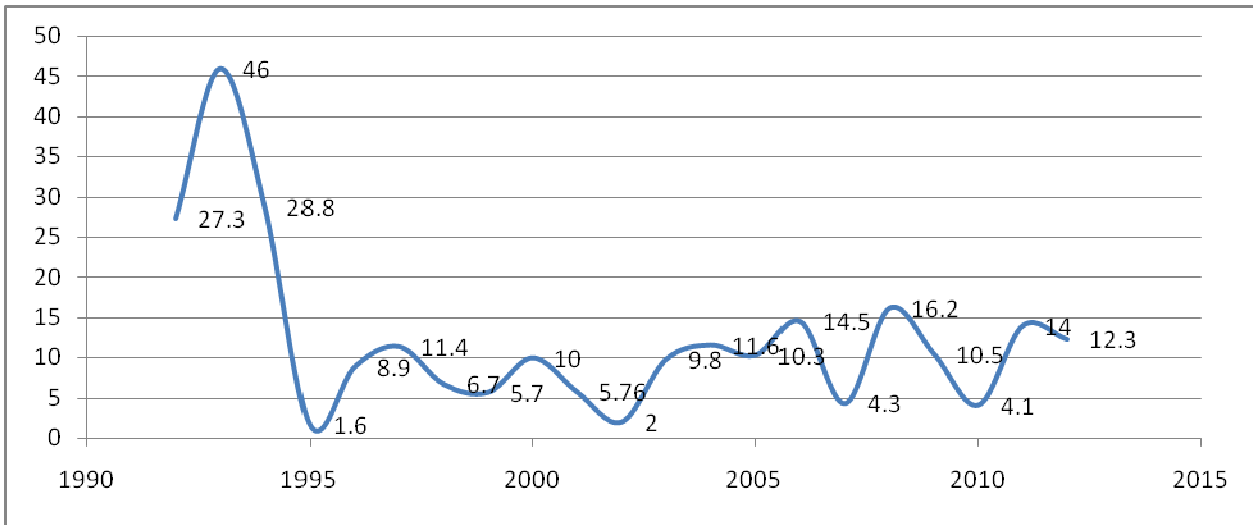
Year	2008	2009	2010	2011	2012	Mean	Std. Dev
Inflation Rates	16.2	10.5	4.1	14	12.3	10.233	5.03891

Source: Study Data, 2012

According to the results, year 2008 recorded the highest geometric inflation rates of 16.2%, followed by year 2011 with 14.0% and year 2012 with inflation rates at 12.3%. The lowest inflation rates were recorded in years 2009 with 10.5% ad year 2010 with 4.1%. The mean score for the period recorded was 10.233 and the standard deviation was 5.03891.

FIGURE 3

Inflation Rates Trend for Years 1992- 2012



Source: Study Data, 2012

The study also established that there has been a change in the inflation rates over the years. The highest inflation rate was recorded in year 2008 hitting a 26.2 mark, followed by year 2012 with 10.96, then 2009 with 9.2. Year 2011 recorded an inflation rate of 6.54 and year 2010 had the lowest in that period with inflation rate at 4.0.

TABLE 4
Inflation

Year	Rate	Contracted Price A	Actual price B	Price variation C=B-A
2008	26.2%	22,124,364	23,910,848	1,786,484
2009	9.2%	71,385,229	85,737,776	14,352,547
2010	4.0%	118,787,400	129,533,640	10,746,240
2011	6.54%	102,404,902	127,895,797	25,490,895
2012	10.96	793,143,163	858,634,058	65,490,895
Total		**1,107,845,058**	**1,225,712,119**	**117,867,061**

Source: KPLC Audited Financial Statements 2008-2012

The results indicate that there has been a change in the inflation rates. Generally an increase in inflation rates results in price increase for the materials required for the implementation of projects. Therefore, the implementation of projects at Kenya Power has been affected by the increase in inflation rates experienced in Kenya over the years. This in turn affects the cash flows of the Company.

4.7 Government Intervention

Government intervention is another factor that affects cash flows of institutions within its mandate. As such the fourth objective of the study was to identify the effects of government intervention on cash flows. Changes in a country's government can affect the attitude in that country towards infrastructural investments.

TABLE 5
Government Subsidized Projects

Year	Project budgeted expenditure KSH= A	Project actual expenditure KSH=B	Variance KSH.C =B-A
2008	165,947,985	579,726,841	413,778,856
2009	121,649,026	669,457,222	547,808,196
2010	126,621,276	566,847,902	440,226,626
2011	387,008,236	1,444,625,365	1,057,617,129
2012	318,687,457	1,547,610,269	1,228,922,810
Totals	**1,119,913,979**	**4,808,267,598**	**3,688,353,619**

Source: KPLC Financial Statements 2008-2012

The results depicted in table 4.5 shows that projects in the Kenya Power are jointly funded by the government and the other stakeholders. The dishonouring of government commitment in funding the projects is seen as the main aspect of government intervention that affects the capital budgets and hence the cash flows. In the period between 2008 and 2012, year 2012 recorded the highest variance where the projects' budgeted expenditure was KShs. 318,687,457.00 whereas the actual expenditure was KShs. European Investment Bank 1,547,610,269.00 leading to a variance of KShs. 1,228,922,810.00This is because the projects are quoted at subsidized costs while the actual expenditure is based on based on the cost of materials, labour and transport. When the government fails to honor their part of the commitment, this affects the cash flows. For the five year period (2008-2012), the deficit was KShs. 3,688,353,619.

From the data available, political directives to supply power to a public utility which is not planned for (national and country politics), payments of supply by government departments without providing for incidental costs e.g. taxes which have to go with the

projects, government policy on general connection to the national grid, guaranteeing loans advanced to Kenya Power and governments long term policies (vision 2030) affect the cash flows of the Kenya Power.

4.8 Regression Analysis

The researcher conducted a multiple regression analysis so as to establish the relationship between various dimensions of capital budgets and cash flows at Kenya Power for the five year period between 2008 and 2012. The main purpose of multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent or criterion variable. The researcher conducted a multiple regression analysis so as to establish the relationship between various dimensions of capital budgets and cash flows at Kenya Power. The main purpose of multiple regressions is to learn more about the relationship between several independent or predictor variables and a dependent or criterion variable.

Regression tests were done which included Model goodness of fit (Coefficient of determination). The coefficient of determination is a measure of how well a statistical model is likely to predict future outcomes. The coefficient of determination, r^2 explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (cash flows) that is explained by all the independent variables (cash flow mismatch, foreign exchange, inflation and government interventions).

TABLE 6
Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.981(a)	0.863	0.691	0.752

Source: Author, 2013

Figure 4.6 presents the regression model goodness of fit statistics to determine whether cash flow has a linear dependence on cash flow mismatch, foreign exchange, and

inflation and government interventions. The study established a correlation value of 0.981. This depicts a very good linear dependence between the cash flow and the four predictor variables.

An R-squared value of 0.863 was established in the model and adjusted to 0.691. The coefficient of determination depicts that the four independent variables contribute about 86.3% to the variation in cash flows while other factors not studied in this research contribute 13.7% of the cash flows. Therefore, further research should be conducted to investigate the other factors (13.7%) that affect cash flows.

TABLE 7

ANOVA

	Sum of squares	**Df**	**Mean Square**	**F**	**Sig or P-value**
Regression	46.294	4	11.574	11.815	000(a)
Residual	97.953	45	980		
Total	144.248	49			

Predictors: (Constant), cash flow mismatch, foreign exchange, inflation and government interventions.

ANOVA findings as explained by the P-value of 0.000 which is less than 0.05 (significance level of 5%) confirms the existence of correlation between the independent and dependent variables. The model shows the model fitness i.e. how well the variables fit the regression model. From the results, the F ratio of 11.815 and the significance of 0.000 shows that there was not much difference in means between dependent and independent variables. The sum of squares gives the model fit and hence the variables fit the regression model.

The researcher conducted a multiple regression analysis so as to establish the relationship between various dimensions of capital budgets and cash flows and the four independent variables.

TABLE 8
Multiple Regression Analysis

	Unstandardized Coefficients		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	3.374	.842		4.009	.000
Cash flow mismatch	-0.205	.105	-0.089	.849	.0067
Foreign exchange	-0.118	0.0847	-0.023	0.954	.046
Inflation	-0.853	.146	-0.330	2.276	.0015
Government interventions	-0.753	.088	-0.167	1.379	.0041

Source: Author, 2013

a. Predictors: (Constant), cash flow mismatch, foreign exchange, inflation and government interventions.

b. Dependent variable: Cash flow

The regression equation (**$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4$)** now becomes:

Y = 3.374 – 0.205X1 -0.118X2 - 0.853X3 – 0.753X4 (ii)

Whereby;

Y = cash flows

X1 = cash flow mismatch

X2 = foreign exchange

X3 = inflation

X4 = government involvement

β1, β2, β3, β4 = Coefficients of determination

ε = Error term

From the above regression model, taking all factors (cash flow mismatch, foreign exchange, inflation and government interventions) constant at zero, the cash flows at Kenya Power realized would be 3.374. The data findings analyzed also shows that cash flow mismatch, foreign exchange, inflation and government intervention negatively affect the cash flow. For every added unit in cash flow mismatch, foreign exchange, inflation and government intervention there will be a decrease in cash flow by 0.205, 0.118, 0.853 and

0.753 respectively. These results infer that inflation contributes more to cash flows at Kenya Power, followed by government interventions, cash flow mismatch and foreign exchange respectively.

Based on the results, all the explanatory variables are statistically significant (p=.0067, P=. 046, P= .0015, P= .0041). In statistics, a significant level of $p < 0.05$ is significant. This means that the four predictor variables are useful for predicting the cash flows at Kenya Power.

4.9 Discussion of Results

The results from this study show that capital budgets reduce cash flows at Kenya Power. This contradicts the findings by Leon (2008) that capital budgeting increases the firm's future cash flows.

The results of this study showed that budget- cash flow mismatch negatively affects the cash flows at Kenya Power and Lighting. This is findings are in agreement with the findings of Dayanda et al (2002), Van Horne & Wachowicz, (2001) and kagiri (2003) who found that that cash flow mismatch negatively affects the implementation of capital budgets.

The findings of this study showed that foreign exchange fluctuations negatively affect the cash flows at Kenya Power. Kiymaz (2003) also finds that firms are highly exposed to foreign exchange risks.

This study found out that inflation negatively affects cash flows at Kenya Power and Lighting. This is consistent with the findings of Coelho, et al., (2003). Firms must use a discount rate containing inflation when making capital budgeting decisions.

The study finally established that government interventions have a negative effect on the cash flows at the Kenya Power and Lighting Co. Ltd. This finding is consistent with literature. Dayananda (2002) found that Government regulations and policies have a negative impact on investment projects because they are viewed as a cost.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This is the final chapter in this study which gives the summary of the findings, the conclusions, discussions and recommendations of the study based on the objective of the study. This research was conducted to investigate the effects of capital budgets on cash flows at Kenya Power and Lighting Company Limited. From the discussions, conclusions and recommendations on the subject matter are made. The chapter finally presents the suggestions for further studies.

5.2 Summary of Findings

The objectives of this study were to evaluate the effects of mismatch between budgeted cash flow and actual cash flow; to determine the effects of foreign exchange on the actual cash flows at the Kenya Power; to assess the effects of inflation on cash flows of the Kenya Power and to identify the effects of government intervention on cash flows at the Kenya Power. The findings indicate that budget cash flow mismatch, foreign exchange, inflation and government interventions affect the cash flows at the Kenya Power and lighting Company Limited.

5.2.1 Budget-Cash flow mismatch

The study found that mismatch between budgeted cash flow and actual cash flow affect the cash flow at the Company. The effect of cash mismatch on cash flow was established to be negative. For every added unit in cash flow mismatch, there will be a decrease in cash flow by 0.205. Cash mismatch was also found to be significant in determining the cash flow with a significant level of p=0.0067

5.2.2 Foreign exchange

The study also found that fluctuations in foreign exchange rates affect the cash flow negatively at Kenya power. For every added unit in foreign exchange rates, there will be a decrease in cash flow by 0.118. Cash mismatch was also found to be significant in determining the cash flow with a significant level of p=0.046.

5.2.3 Inflation

According to the results, Kenya Power is affected by the inflation conditions that hinder it from achieving budget-cash flow objectives and goals. The relationship between inflation and cash flows was found to be negative. For every added unit in inflation, there was a decrease in cash flow by 0.853. Inflation was also found to be significant in determining the cash flow with a significant level of p=0.0015

5.2.4 Government Intervention

The study also found that fluctuations in foreign exchange rates affect the cash flow negatively at Kenya power. For every added unit in foreign exchange rates, there will be a decrease in cash flow by 0.753. Government intervention was also found to be significant in determining the cash flow with a significant level of p=0.0041

5.3 Conclusions

The study concludes that cash flow mismatch, foreign exchange fluctuations, inflation and government interventions have a negative effect on cash flows at Kenya Power.

5.4 Recommendations

The following recommendations are made based of the findings and conclusions of this study: the current installed generation capacity in the country is far below the requirements of the country with only 33 megawatts per million populations. This is not enough to meet the growing demand as a result of rising economic growth in the country. The

quality of power supply in the country is wanting due to frequent interruptions of the power supplies. It is estimated that the economic loss from the power interruption accounts to 2 percent of GDP. To deal with budget-cash flow mismatch the study recommends that the Company should aspire to match the inflows to outflows, educate budget holders on the need to stick to budgets and adoption zero budgets for non-key projects. The company should strive to use a cash flow forecasting model to minimize biased cash flow forecasts in capital budgeting. The study also recommends prompt and monitoring of implementation schedule and project evaluation to determine cost versus benefits.

In order for the Company to survive in the harsh economic conditions with foreign exchange risks, the study recommends for the use of hedging methods such as forward contracts and swaps to lock in the prices of goods and services and minimize the effects of foreign exchange fluctuations on the cash flows.

From the study, government interference is a major factor that affects cash flows at the Company. To minimize the delays associated with Government agencies, KPLC should formulate strategies for constructive engagement with the government through the ministry of energy and Finance. This will enable them to come up with an agreed strategy on Power projects. This will ensure that budget inflexibility does not pose a challenge in the budgeting process and future cash flows.

5.5 Limitations of the Study

There could be other variables, besides cash flow mismatch, foreign exchange, inflation and government interventions that affect cash flows or that would moderate the relationship between the variables. However, since these variables could not be statistically isolated, they would have affected the relationship. The study could be limited by the reliability of the data. However, since the information was obtained from the audited financial statements, it is assumed that the data is reliable.

5.6 Suggestions for Further Studies

The study has explored the effects of capital budgets on cash flows at Kenya Power and established that mismatch between budgeted cash flow and actual cash flow; foreign exchange, inflation and government intervention are the main aspects of capital budgeting affecting cash flows at the Kenya Power. The energy sector in Kenya however is comprised of various other institutions which differ in their way of management and have different settings all together. This warrants the need for another study which would ensure generalization of the study findings for all the energy sector institutions in Kenya and hence pave way for new policies. The study therefore recommends another study be done with an aim to investigate the effects of capital budgets on cash flows in the energy sector institutions in Kenya.

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