

1903/203
1906/203
BUSINESS FINANCE
November 2018
Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

**CRAFT CERTIFICATE IN SUPPLY CHAIN MANAGEMENT
, CRAFT CERTIFICATE IN BUSINESS MANAGEMENT**

BUSINESS FINANCE

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of **FOURTEEN** questions in **TWO** sections; **A** and **B**.
Answer **ALL** the questions in **BOTH** sections in the answer booklet provided.
All questions carry equal marks.
Maximum marks for each part of a question are as indicated.
Show all your working.
Candidates should answer the questions in English.*

This paper consists of 6 printed pages.

**Candidates should check the question paper to ascertain that
all the pages are printed as indicated and that no questions are missing.**

SECTION A (32 marks)

Answer ALL questions in this section.

1. Explain the relationship between Business Finance and Economics. (2 marks)
2. A company intends to issue 200,000 15% debentures of Ksh. 110 each at Ksh. 90 each. The corporation tax rate is 30%. Calculate the cost of the debt. (3 marks)
3. Outline **four** advantages of retained earnings as a source of business finance. (4 marks)
4. Jane deposited Ksh. 595,000 in a bank account paying interest rate at 15%, compounded half yearly, for a period of four years. Calculate the total amount in the account at the end of the four years. (3 marks)
5. Highlight **four** ways of reducing the level of debt in a company. (4 marks)
6. The internal rate of return for a project is 18%, whereas the firm's cost of capital is 7%. Advise the management on whether or not to invest in the project. (2 marks)
7. Outline **four** factors that may have led to the increase in the growth of commercial banks in Kenya in the recent past. (4 marks)
8. Highlight **three** limitations of using average industry ratios in decision making. (3 marks)
9. Outline **four** differences between ordinary share capital and preference share capital, as sources of business finance. (4 marks)
10. Outline **three** factors that may influence the level of debtors in a business. (3 marks)

SECTION B (68 marks)

Answer ALL questions in this section.

11. (a) Explain **four** challenges that a firm may face by holding inadequate working capital. (8 marks)
- (b) A company intends to invest Ksh. 3,500,000 in either project A or project B. The expected cash inflows from the projects are as follows:

Cash Inflows (Ksh)		
Year	Project A	Project B
1	200,000	300,000
2	300,000	475,000
3	700,000	900,000
4	850,000	770,000
5	1,800,000	620,000
6	700,000	500,000
7	400,000	200,000

- (i) Calculate the payback period of each project.
- (ii) Using the results in (i) above, advise the management on the project to invest in. (9 marks)
12. (a) Explain **five** differences between commercial banks and non-banking financial institutions. (10 marks)
- (b) Sarah received Ksh. 4,200,000 as insurance benefits. She intends to invest the money in any of the following options:
- (i) A project paying compound interest at the rate of 15% per annum for 4 years.
- (ii) An account paying interest of 7%, compounded half yearly for 5 years.
- (iii) A project that pays interest of 6.5%, compounded quarterly for 3 years.
- Advise Sarah on the option to select. (7 marks)
13. (a) Outline **five** advantages of trade credit as a source of business finance. (10 marks)

(b) Theta Limited intends to raise capital as follows:

- 500,000 ordinary shares of Ksh. 20 par value at Ksh. 25 each.
- 200,000 10% preference shares of Ksh. 15 par value at Ksh. 20 each.
- 100,000 20% debentures of Ksh. 150 par value at Ksh. 180 each.

The company intends to pay an annual dividend of 11%. The corporation tax rate is 30%. Calculate the component costs of capital for the company. (7 marks)

14. (a) Explain the importance of ratio analysis to each of the following stakeholders of a company:

- (i) Shareholders;
- (ii) Creditors;
- (iii) Management;
- (iv) Competitors;
- (v) Potential investors.

(10 marks)

(b) A company intends to borrow a loan of Ksh. 500,000 at an interest rate of 19% per annum. The loan will be repaid in six equal instalments at the end of each year for the next 6 years.

Prepare a loan amortization schedule.

(7 marks)

Table A Present Value of Sh 1 Received at the End of n Periods:

$$PV/F_{rn} = 1/(1 + r)^n = (1 + r)^{-n}$$

Period	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%	36%
1	.9901	.9804	.9708	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8055	.7813	.7576	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7695	.7561	.7432	.7182	.6944	.6504	.6104	.5729	.5407
3	.9706	.9423	.9151	.8890	.8638	.8396	.8163	.7938	.7722	.7513	.7118	.6750	.6575	.6407	.6086	.5787	.5245	.4768	.4348	.3975
4	.9610	.9238	.8885	.8546	.8227	.7921	.7629	.7350	.7084	.6830	.6355	.5921	.5718	.5523	.5158	.4823	.4230	.3725	.3294	.2923
5	.9515	.9057	.8626	.8219	.7835	.7473	.7130	.6806	.6498	.6209	.5674	.5194	.4972	.4761	.4371	.4019	.3411	.2910	.2495	.2149
6	.9420	.8880	.8375	.7903	.7462	.7050	.6653	.6302	.5963	.5645	.5066	.4556	.4323	.4104	.3704	.3349	.2751	.2274	.1890	.1580
7	.9327	.8706	.8131	.7599	.7107	.6651	.6227	.5835	.5470	.5132	.4523	.3995	.3759	.3538	.3139	.2791	.2218	.1776	.1432	.1162
8	.9235	.8535	.7894	.7307	.6768	.6274	.5820	.5403	.5019	.4655	.4039	.3506	.3269	.3050	.2660	.2326	.1769	.1388	.1085	.0854
9	.9143	.8369	.7664	.7025	.6446	.5919	.5439	.5002	.4624	.4241	.3626	.3075	.2843	.2630	.2255	.1936	.1443	.1084	.0822	.0628
10	.9053	.8203	.7441	.6755	.6139	.5584	.5083	.4632	.4224	.3855	.3220	.2697	.2472	.2267	.1911	.1615	.1154	.0847	.0623	.0462
11	.8963	.8043	.7224	.6496	.5847	.5268	.4751	.4289	.3875	.3505	.2875	.2368	.2149	.1954	.1619	.1346	.0938	.0662	.0472	.0340
12	.8874	.7885	.7014	.6246	.5568	.4970	.4440	.3971	.3555	.3186	.2567	.2076	.1869	.1685	.1372	.1122	.0757	.0517	.0357	.0250
13	.8787	.7730	.6810	.6006	.5303	.4688	.4150	.3677	.3252	.2897	.2292	.1821	.1625	.1452	.1163	.0935	.0610	.0404	.0271	.0194
14	.8700	.7579	.6611	.5775	.5051	.4423	.3878	.3405	.2992	.2633	.2046	.1587	.1413	.1252	.0985	.0779	.0492	.0316	.0205	.0135
15	.8613	.7430	.6419	.5553	.4810	.4173	.3624	.3152	.2745	.2394	.1827	.1401	.1229	.1079	.0835	.0649	.0397	.0247	.0155	.0099
16	.8528	.7284	.6232	.5339	.4581	.3936	.3367	.2919	.2519	.2176	.1631	.1229	.1069	.0930	.0708	.0541	.0320	.0193	.0118	.0073
17	.8444	.7142	.6050	.5134	.4363	.3714	.3166	.2703	.2311	.1978	.1459	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0946	.0808	.0691	.0508	.0375	.0208	.0119	.0068	.0039
19	.8277	.6864	.5703	.4746	.3957	.3305	.2765	.2317	.1945	.1635	.1161	.0829	.0703	.0598	.0431	.0313	.0168	.0092	.0051	.0029
20	.8195	.6730	.5537	.4554	.3769	.3118	.2584	.2145	.1784	.1496	.1037	.0728	.0611	.0514	.0365	.0261	.0135	.0072	.0039	.0021
25	.7798	.6095	.4776	.3751	.2953	.2330	.1842	.1460	.1160	.0923	.0588	.0378	.0304	.0245	.0160	.0105	.0046	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0116	.0070	.0042	.0016	.0006	.0002	.0001
40	.6717	.4529	.3066	.2083	.1420	.0972	.0668	.0460	.0316	.0221	.0107	.0053	.0037	.0028	.0013	.0007	.0002	.0001	.0001	.0001
50	.6060	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0001	.0001	.0001	.0001	.0001
60	.5504	.3048	.1997	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	.0001	.0001	.0001	.0001	.0001	.0001

Table B: Present Value of an Annuity of Sh. 1 Per Period for n Periods:

$$PVIFA_{i,n} = \sum_{t=1}^n \frac{1}{(1+i)^t} = \frac{1 - \frac{1}{(1+i)^n}}{i}$$

Number of payments	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	12%	14%	15%	16%	18%	20%	24%	28%	32%
1	0.9901	0.9804	0.9709	0.9615	0.9524	0.9434	0.9346	0.9259	0.9174	0.9091	0.8929	0.8772	0.8656	0.8521	0.8475	0.8333	0.8085	0.7813	0.7576
2	1.9704	1.9416	1.9125	1.8831	1.8534	1.8234	1.7931	1.7625	1.7316	1.7004	1.6689	1.6372	1.6052	1.5728	1.5400	1.5068	1.4568	1.3916	1.3215
3	2.9410	2.8839	2.8266	2.7691	2.7113	2.6532	2.5948	2.5361	2.4771	2.4178	2.3582	2.2983	2.2381	2.1776	2.1168	2.0557	1.9653	1.8684	1.7663
4	3.9020	3.8077	3.7131	3.6181	3.5228	3.4272	3.3313	3.2351	3.1387	3.0421	2.9452	2.8480	2.7506	2.6529	2.5549	2.4567	2.3240	2.1857	2.0457
5	4.8534	4.7135	4.5735	4.4334	4.2931	4.1526	4.0119	3.8710	3.7299	3.5886	3.4471	3.3054	3.1635	3.0214	2.8791	2.7366	2.4544	2.2470	2.0657
6	5.7955	5.6014	5.4172	5.2421	5.0757	4.9173	4.7668	4.6229	4.4858	4.3553	4.2241	4.0922	3.9595	3.8260	3.6917	3.5566	3.1342	2.8619	2.6542
7	6.7282	6.4720	6.2303	6.0021	5.7864	5.5824	5.3893	5.2064	5.0330	4.8694	4.7153	4.5607	4.4056	4.2500	4.0939	3.9374	3.4652	3.1479	2.8975
8	7.6517	7.3255	7.0197	6.7327	6.4632	6.2108	5.9754	5.7564	5.5534	5.3659	5.1834	5.0058	4.8331	4.6653	4.5024	4.3444	3.8222	3.4509	3.1555
9	8.5660	8.1822	7.8661	7.5683	7.2887	7.0261	6.7804	6.5509	6.3370	6.1382	5.9441	5.7547	5.5699	5.3897	5.2141	5.0431	4.4710	4.0457	3.7051
10	9.4713	8.9826	8.5302	8.1108	7.7217	7.3611	7.0288	6.7141	6.4167	6.1359	5.8602	5.5987	5.3514	5.1082	4.8691	4.6341	4.0120	3.6267	3.2404
11	10.3676	9.7968	9.2528	8.7905	8.3064	7.8983	7.4657	7.0076	6.5230	6.0014	5.4927	5.0069	4.5440	4.0941	3.6571	3.2321	2.5600	2.1167	1.7250
12	11.2551	10.5753	9.9540	9.3851	8.8833	8.4536	7.9947	7.5061	7.0877	6.6391	6.1704	5.7215	5.2924	4.8831	4.4836	4.0939	3.3718	2.8685	2.4250
13	12.1337	11.3484	10.6350	9.9858	9.5056	9.0917	8.6431	8.1601	7.7427	7.2909	6.8141	6.3731	5.9580	5.5587	5.1751	4.8064	4.0343	3.4710	3.0000
14	13.0037	12.1052	11.2961	10.5931	9.9986	9.5857	9.1431	8.6701	8.2677	7.8349	7.3711	6.9361	6.5200	6.1229	5.7447	5.3854	4.5633	3.9300	3.4100
15	13.8651	12.8493	11.9379	11.1164	10.3787	9.7122	9.1079	8.5659	8.0857	7.6671	7.2193	6.7924	6.3863	6.0001	5.6337	5.2864	4.4143	3.7210	3.2500
16	14.7178	13.5771	12.5611	11.6523	10.8378	10.1059	9.4466	8.8514	8.3126	7.8237	7.3940	6.9851	6.5972	6.2308	5.8845	5.5572	4.6351	3.8820	3.3500
17	15.5623	14.2919	13.1561	12.1857	11.2741	10.4773	9.7603	9.1216	8.5436	8.0210	7.5913	7.1824	6.7945	6.4281	6.0818	5.7545	4.7824	3.9693	3.3700
18	16.3983	14.9920	13.7535	12.6583	11.6988	10.8176	10.0591	9.3719	8.7556	8.2014	7.7497	7.3608	6.9849	6.6285	6.2912	5.9639	4.9318	4.0587	3.4000
19	17.2260	15.6765	14.3228	13.1328	12.0853	11.1581	10.3368	9.6036	8.9501	8.3649	7.8859	7.5070	7.1401	6.7937	6.4664	6.1491	5.0670	4.1339	3.4100
20	18.0458	16.3514	14.8775	13.5903	12.4622	11.4809	10.5940	9.8181	9.1285	8.5138	7.9940	7.6231	7.2662	6.9299	6.6126	6.3053	5.1632	4.1701	3.4100
25	22.0232	19.5225	17.4131	15.8221	14.0938	12.7624	11.6530	10.6748	9.8226	9.0770	8.4231	7.8421	7.3642	6.9895	6.6322	6.2925	5.0804	4.0073	3.2500
30	25.8377	22.3865	19.8304	17.2320	15.3725	13.7648	12.4090	11.2578	10.2737	9.4289	8.6552	7.9227	7.4448	7.0701	6.7128	6.3731	5.1000	4.0000	3.2500
40	32.8347	27.3555	23.1148	19.7928	17.1591	15.0463	13.3317	11.9248	10.7574	9.7791	8.2438	7.1050	6.4118	5.9666	5.6329	5.3000	4.0000	3.2500	3.2500
50	38.1961	31.4236	25.7296	21.4822	18.2545	15.7619	13.8007	12.2335	10.9617	9.9148	8.2045	7.1227	6.5005	6.2483	5.9954	5.7425	4.0000	3.2500	3.2500
60	44.9550	34.7608	27.6768	22.5225	18.9225	16.1814	14.0292	12.3258	11.0460	9.9672	8.2340	7.1401	6.5851	6.3322	6.0793	5.8264	4.0000	3.2500	3.2500

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