

1903/203
1906/203
1926/204
BUSINESS FINANCE
July 2019
Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

CRAFT CERTIFICATE IN SUPPLY CHAIN MANAGEMENT
CRAFT CERTIFICATE IN BUSINESS MANAGEMENT
CRAFT CERTIFICATE IN HUMAN RESOURCE 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.
Show **ALL** your workings clearly.
Maximum marks for each part of a question are as shown.
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 the questions in this section.

- Outline **two** differences between debentures and retained earnings, as sources of business finance. (4 marks)
- Highlight **two** services rendered by commercial banks to their customers. (4 marks)
- The following information relates to Waka Limited for the last quarter of the year 2017.

| | |
|---------------------------------|-------------------------|
| Ordinary share capital | 200,000 at Kshs. 1 each |
| Net profit after tax | Kshs. 1,000,000 |
| Ordinary share dividend paid | Kshs. 400,000 |
| Market price per ordinary share | Kshs. 20 |

Using the information above, calculate each of the following ratios:

- Dividend per share;
- Earnings per share;
- Dividend yield;
- Earnings yield.

(4 marks)

- State **two** types of policies that may be used in the management of credit in an organization. (2 marks)
- The following information shows the net cash inflows of Tambako Limited.

| Year | Net Cash Inflows (Kshs.) |
|------|-----------------------------|
| 1 | 400,000 |
| 2 | 450,000 |
| 3 | 600,000 |
| 4 | 480,000 |

| | |
|--------------------|----------------|
| Initial investment | Ksh. 2,000,000 |
| Target return | 30% |

- Calculate the Accounting Rate of Return (ARR) of Tambako Limited.
- Using the result in (i) above, comment on the performance of the company.

(4 marks)

1903/203

1906/203

1926/204

July 2019

6. John intends to buy a car in three years' time, at a cost of Ksh. 1,000,000. At the beginning of the first year, he deposited Ksh. 300,000 in a bank, which pays compound interest at the rate of 10% per annum. At the beginning of the second year, he deposited Ksh. 400,000 in the same bank.

Calculate the amount John should deposit in the bank at the beginning of the third year to enable him buy the car.

(3 marks)

7. Outline the relationship between business finance and each of the following disciplines:

- (a) Financial Accounting;
(b) Economics.

(4 marks)

8. Sigo Limited has ordinary share capital of Ksh. 1,000,000 with a par value of Ksh. 20 per share. The ordinary shares are currently selling at Ksh. 35 each. The company paid ordinary share dividends totalling Ksh. 100,000 during a particular year.

Calculate the cost of equity of the company.

(3 marks)

9. The following balances were extracted from the books of account of Viewpoint Limited:

| | Ksh. |
|---------------------|-----------|
| Fixed Assets | 2,000,000 |
| Current Assets | 500,000 |
| Current liabilities | 150,000 |
| Capital | 2,350,000 |

- (a) Calculate the company's current ratio.
(b) Compare the ratio in (i) above with the industry's ratio of 2:1.

(2 marks)

10. Highlight **two** advantages of internal financing to an organization.

(2 marks)

Answer **ALL** the questions in this section.

11. (a) Explain **four** measures that an organization may take to shorten its cash operating cycle. (8 marks)
- (b) The following information was extracted from the books of account of Nyakari Limited and Gabo Limited.

| | Nyakari Limited | Gabo Limited |
|------------------------------|------------------|------------------|
| | Ksh. | Ksh. |
| Ordinary share capital | 1,400,000 | 1,000,000 |
| 13% preference share capital | 50,000 | 400,000 |
| 15% debentures | 60,000 | 100,000 |
| Bank loan (5 years) | <u>90,000</u> | <u>100,000</u> |
| Total | <u>1,600,000</u> | <u>1,600,000</u> |

- (i) Calculate the gearing ratio for each of the companies.
- (ii) Based on the results in (i) above, determine the company that has a higher risk, with regard to lending. (9 marks)
12. (a) Explain **four** functions of merchant banks. (8 marks)
- (b) Kesta Limited intends to borrow Ksh. 4,000,000 to finance either project X or project Y. The following are the expected net cash inflows for each project:

| Year | NET CASH INFLOWS | |
|------|---------------------|---------------------|
| | Project X (Ksh.) | Project Y (Ksh.) |
| 1 | 1,500,000 | 2,000,000 |
| 2 | 1,000,000 | 1,100,000 |
| 3 | 2,400,000 | 9,000,000 |
| 4 | 1,200,000 | 1,500,000 |

- (i) Calculate the payback period for each project.
- (ii) Based on the results in (i) above, advise the management on the project to invest in. (9 marks)

13. (a) Outline **four** factors which influence the choice of finance for a business. (8 marks)
- (b) The following is the capital structure of Nakum Ventures Limited.

| | Ksh. |
|---|-------------|
| 100,000 ordinary shares of Ksh. 20 each | 2,000,000 |
| Retained earnings | 800,000 |
| 12% preference shares of Ksh. 10 each | 1,000,000 |
| 13% debentures | 900,000 |

The company paid ordinary dividend of Ksh. 3 per share. The ordinary shares are currently selling at Ksh. 25 per share. The preference shares are selling at Ksh. 16 per share. The corporation tax rate is 30%.

- (i) Calculate the cost of each component of capital.
- (ii) Calculate the Weighted Average Cost of Capital (WACC). (9 marks)

14. (a) Explain **four** differences between ordinary shares and preference shares. (8 marks)
- (b) The following information relates to material B24 of a firm.

| | |
|-------------------------------|-------------|
| Maximum consumption | 7,500 units |
| Minimum consumption | 3,400 units |
| Lead time | 2 - 4 weeks |
| Economic Order Quantity (EOQ) | 10,500 |

Calculate each of the following:

- (i) Re-order level;
- (ii) Minimum stock level;
- (iii) Maximum stock level;
- (iv) Average stock level. (9 marks)

Present Value of 1 Received at the End of *n* Periods

$$PVIF_{r,n} = 1/(1+r)^n = (1+r)^{-n}$$

| Period | 1% | 2% | 3% | 4% | 5% | 6% | 7% | 8% | 9% | 10% | 12% | 14% | 15% | 16% | 18% | 20% | 24% | 28% | 32% | 35% |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1 | .9901 | .9804 | .9709 | .9615 | .9524 | .9434 | .9346 | .9259 | .9174 | .9091 | .8929 | .8772 | .8696 | .8621 | .8475 | .8333 | .8065 | .7813 | .7576 | .7353 |
| 2 | .9803 | .9612 | .9426 | .9246 | .9070 | .8900 | .8734 | .8573 | .8417 | .8264 | .7972 | .7695 | .7561 | .7432 | .7182 | .6944 | .6504 | .6104 | .5739 | .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 | .8548 | .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 | .6499 | .6209 | .5674 | .5194 | .4972 | .4761 | .4371 | .4019 | .3411 | .2910 | .2495 | .2149 |
| 6 | .9420 | .8880 | .8375 | .7903 | .7462 | .7050 | .6663 | .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 | .3996 | .3759 | .3538 | .3139 | .2791 | .2218 | .1776 | .1432 | .1162 |
| 8 | .9235 | .8535 | .7894 | .7307 | .6768 | .6274 | .5820 | .5403 | .5019 | .4665 | .4039 | .3506 | .3269 | .3050 | .2660 | .2326 | .1789 | .1388 | .1085 | .0854 |
| 9 | .9143 | .8368 | .7664 | .7026 | .6446 | .5919 | .5439 | .5002 | .4604 | .4241 | .3606 | .3075 | .2843 | .2630 | .2255 | .1938 | .1443 | .1084 | .0822 | .0628 |
| 10 | .9053 | .8203 | .7441 | .6756 | .6139 | .5584 | .5083 | .4632 | .4224 | .3855 | .3220 | .2697 | .2472 | .2267 | .1911 | .1615 | .1164 | .0847 | .0623 | .0462 |
| 11 | .8963 | .8043 | .7224 | .6496 | .5847 | .5268 | .4751 | .4289 | .3875 | .3505 | .2875 | .2366 | .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 | .3262 | .2897 | .2292 | .1821 | .1625 | .1452 | .1163 | .0935 | .0610 | .0404 | .0271 | .0184 |
| 14 | .8700 | .7579 | .6611 | .5775 | .5051 | .4423 | .3878 | .3405 | .2992 | .2633 | .2046 | .1597 | .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 | .3387 | .2919 | .2519 | .2176 | .1631 | .1229 | .1069 | .0930 | .0708 | .0541 | .0320 | .0193 | .0118 | .0073 |
| 17 | .8444 | .7142 | .6050 | .5134 | .4363 | .3714 | .3166 | .2703 | .2311 | .1978 | .1456 | .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 | .0376 | .0208 | .0118 | .0068 | .0039 |
| 19 | .8277 | .6864 | .5703 | .4746 | .3957 | .3305 | .2765 | .2317 | .1945 | .1635 | .1161 | .0829 | .0703 | .0596 | .0431 | .0313 | .0168 | .0092 | .0051 | .0029 |
| 20 | .8195 | .6730 | .5537 | .4564 | .3769 | .3118 | .2584 | .2145 | .1784 | .1486 | .1037 | .0728 | .0611 | .0514 | .0365 | .0261 | .0135 | .0072 | .0039 | .0021 |
| 25 | .7798 | .6095 | .4776 | .3751 | .2953 | .2330 | .1842 | .1460 | .1160 | .0923 | .0589 | .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 | .0318 | .0221 | .0107 | .0053 | .0037 | .0026 | .0013 | .0007 | .0002 | .0001 | | |
| 50 | .6080 | .3715 | .2281 | .1407 | .0872 | .0543 | .0339 | .0213 | .0134 | .0085 | .0035 | .0014 | .0009 | .0006 | .0003 | .0001 | | | | |
| 60 | .5504 | .3048 | .1897 | .0951 | .0535 | .0303 | .0173 | .0099 | .0057 | .0033 | .0011 | .0004 | .0002 | .0001 | | | | | | |

* The factor is zero to four decimal places

THIS IS THE LAST PRINTED PAGE.

1903/203
1906/203
1926/204
July 2019