

1903/203  
1906/203  
1926/203  
BUSINESS FINANCE  
November 2021  
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 TWO sections: A and B.  
Answer ALL the questions 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 5 printed pages.**

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

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**Turn over**

## SECTION A (32 marks)

*Answer ALL questions in this section.*

1. State **three** limitations of using ratios in evaluating the performance of a business. (3 marks)
2. Outline **four** services offered by merchant banks to their customers. (4 marks)
3. State **two** ways in which business finance may be important to an organisation. (2 marks)
4. State **three** limitations of credit cards as a source of business finance. (3 marks)
5. Biwendi Ventures Limited paid dividends at the rate of Ksh 3 per ordinary share at the end of the last financial year. The current market price of each share is Ksh 35. The company expects the dividends to grow at the rate of 5% per annum.  
Calculate the cost of equity to the firm.  $= \frac{D_1}{P_0 - g} = \frac{3 \times 1.05}{0.35 - 0.05} = 13.57$  (3 marks)

6. Radak Limited intends to invest Ksh. 4,000,000 in a project. The following are the expected net cash inflows from the project:

Year	Net Cash Inflows (Ksh)
1	1,600,000
2	1,400,000
3	2,400,000
4	2,800,000

The firm's cost of capital is 14%.

- (i) Calculate the discounted pay back period of the project.
  - (ii) The policy of the management is not to invest in any project with a discounted pay back period of more than 3 years. Based on the results in (i) above, advise the management on whether to invest in the project or not. (4 marks)
7. State **three** uses of the cost of capital to a business organization. (3 marks)
  8. Bakal Enterprises requires 25,000 units of a certain raw material per year. The ordering cost is Ksh. 7,500 per order. The purchase cost of each unit is Ksh. 100. The carrying cost is 15% of the purchase cost. Calculate the Economic Order Quantity. (EOQ).  $\sqrt{\frac{D \times C_o}{C_c}}$  (3 marks)
  9. Runa has deposited Ksh 200,000 in a fixed deposit account at Focus Bank. The bank pays interest at the rate of 7% per annum, compounded quarterly. Calculate the compound interest earned at the end of 5 years. (4 marks)

10. State three types of credit policies that may be adopted by an organization.

2.0  
clerical  
loose

(3 marks)

**SECTION B (68 marks)**

Answer ALL questions in this section.

11. (a) Explain four methods that the central bank of a country may use to control the amount of money in circulation in the economy. (8 marks)
- (b) Mlongo Limited intends to invest Ksh. 2,000,000 in a machine. The following are the expected net cash inflows from the machine:

Year	Net Cash Inflows (Ksh)
1	800,000
2	600,000
3	900,000
4	1,200,000
5	1,300,000

6,555,700

The company's cost of capital is 14%.

- (i) Determine the Net Present Value (NPV) of the machine;
- (ii) Advise Mlongo Limited on whether to invest in the machine or not.

1,156,700  
1156 700

(9 marks)

12. (a) Outline four types of costs associated with holding of stock in a firm. (8 marks)

insurance  
brokerage  
obsolescence

(b) The following is the capital structure of Vantage Limited:

	Ksh
160,000 ordinary shares at Ksh 10 each	1,600,000
80,000 8% preference shares at Ksh 10 each	800,000
Retained earnings	1,000,000
10% debentures at Ksh 100 each	600,000
Capital employed	<u>4,000,000</u>

The company's expected ordinary dividend is Ksh 3 per share. The ordinary shares are currently selling at Ksh 20 each. The preference shares are selling at Ksh 16 each. The corporation tax rate is 30%.

Calculate the Weighted Average Cost of Capital (WACC) of the company. (9 marks)

18.3

13. (a) Explain four differences between ordinary shares and preference shares. (8 marks)
- (b) The following information was extracted from the books of accounts of Tayari Limited on 31 December 2020.

	Ksh
Sales	2,000,000
Cost of sales	200,000
Net profit before tax	1,800,000
Cash	900,000
Debtors	100,000
Capital employed	4,000,000
10% debentures	1,000,000
Current liabilities	200,000
Inventories: on 1 January 2020	50,000
on 31 December 2020	150,000

- (i) Using the information above, calculate each of the following ratios:

- (I) Return on capital employed;  $\frac{\text{Net Profit} \times 100}{\text{Net Asset} \rightarrow \text{CA} - \text{CL}}$
- (II) Acid test ratio;  $\frac{\text{Cash} + \text{Debtors}}{\text{Total Assets}}$
- (III) Debt collection period;  $\frac{365}{\text{Debtors} / \text{Sales}}$
- (IV) Stock turnover ratio;  $\frac{\text{Cost of Sales}}{\text{Average Stock}}$

- (ii) Comment on the liquidity position of the company. (9 marks)

14. (a) Explain four advantages of Leasing, as a source of business finance. (8 marks)

- (b) Nancy plans to buy an embroidery machine in 3 years' time, at a cost of Ksh 1,400,000. To achieve this, she deposited Ksh. 400,000 in a fixed deposit bank account in the first year. The bank pays interest at the rate of 9% per annum. In the second year, she deposited Ksh 450,000 in the same account at the same rate of interest. Calculate the amount that she should deposit at the beginning of the third year to enable her buy the machine. (9 marks)

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