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FINANCIAL MANAGEMENT

November 2022

Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

**DIPLOMA IN BUSINESS MANAGEMENT
DIPLOMA IN INVESTMENT MANAGEMENT
DIPLOMA IN HUMAN RESOURCE MANAGEMENT**

FINANCIAL MANAGEMENT

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of SEVEN questions.
Answer any FIVE questions in the answer booklet provided.
All questions carry equal marks.
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.**

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Turn over

1. ✓ (a) Highlight **five** roles played by a finance manager in a business organization. (10 marks)
- (b) Highlight **five** factors that should be considered when choosing a source of business finance. (10 marks)
2. ✓ (a) Highlight **four** ways in which cash disbursements in a business may be delayed. (8 marks)
- (b) Munube Traders borrowed Kshs 2,00,000 from a bank at an interest rate of 12% per annum. The loan is to be repaid in 3 equal annual instalments.
- (i) Determine the annual instalment.
- (ii) Prepare a loan amortization schedule. (12 marks)
3. (a) Explain **five** roles played by the Nairobi Securities Exchange. (10 marks)
- (b) Nandes Limited intends to invest Ksh 4,000,000 in a project. The project is expected to generate the following net cash inflows:

Year	Net cash inflows Ksh
1	1,500,000
2	2,000,000
3	2,800,000
4	1,000,000

- The company's cost of capital is 10%.
- The company's policy is to accept a project with a maximum payback period of 2 years.

- (i) Calculate the discounted payback period.
- (ii) Advise the management on whether to invest in the project or not. (10 marks)

4. ✓ (a) Highlight **four** characteristics of retained earnings as a source of business finance. (8 marks)
- (b) Jenga Limited intends to invest Ksh 5,000,000 in a project whose expected useful life is 4 years.

The expected net cash inflows and the corresponding certainty equivalent coefficients are as follows:

Year	Net cash inflows (Ksh)	Certainty equivalent coefficient
1	1,000,000	0.95
2	1,500,000	0.80
3	2,000,000	0.70
4	2,500,000	0.60

The risk free rate is 5%.

- (i) Determine the Net Present Value (NPV) of the project.
- (ii) Advise the management on whether to invest in the project or not. (12 marks)

5. ✓ (a) Explain **four** economic factors that should be considered when forecasting foreign exchange rates. (8 marks)
- (b) The following is the capital structure of Manuu Limited as at 31 December 2021.

	Ksh '000'
2,00,000 ordinary shares @ Ksh 20 each	40,000
8%, 1,000,000 preference shares @ Ksh 10 each	10,000
10%, Debentures @ Ksh 100 each	<u>10,000</u>
	<u>60,000</u>

Additional information:

- (I) The ordinary shareholders have just been paid a dividend of 10%. The dividends are expected to grow at 10% per annum.
- (II) The market price of an ordinary share and a preference share is Ksh 40 and Ksh 20 respectively.
- (III) The corporation tax rate is 30%.

Determine the:

- (i) component cost of each source of capital.
- (ii) weighted average cost of capital (WACC).

(12 marks)

6. (a) Highlight **four** limitations of using ratios to analyse the financial performance of a business. (8 marks)
- (b) The ordinary shares of AK Brothers Limited are currently selling at Ksh 60 per share. The company expects to pay a dividend of Ksh 6 per share at the end of the current year.

The ordinary dividends for the past five years are as follows:

Year	Dividend per share
	Ksh
2021	5.50
2020	4.90
2019	4.68
2018	4.50
2017	4.40

The company intends to issue new ordinary shares at a price of Ksh 58.20 per share after floatation costs.

Determine the:

- (i) growth rate in dividends
- (ii) floatation cost i percentage.
- (iii) cost of retained earning;
- (iv) cost of new shares.

(12 marks)

7. (a) Explain **four** components of working capital. (8 marks)

(b) Lenga Limited is considering investing in either Project A or Project B. The following information relates to the projects.

Probability	Net cash inflows	
	Project A Ksh	Project B Ksh
0.10	3,000,000	3,000,000
0.25	3,500,000	4,000,000
0.40	4,000,000	5,000,000
0.10	4,500,000	6,000,000
0.15	5,000,000	7,000,000

(i) Calculate the:

- (I) expected net cash inflows for each project;
- (II) standard deviation;
- (III) co-efficient of variation.

(ii) Using the result in III above, advise the management on the project to invest in.

(12 marks)

Table A Present Value of Sh 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%	36%
1	.9901	.9804	.9709	.9615	.9524	.9434	.9346	.9259	.9174	.9091	.8929	.8772	.8696	.8621	.8475	.8333	.8085	.7813	.7578	.7353
2	.9803	.9612	.9426	.9246	.9070	.8900	.8734	.8573	.8417	.8264	.7972	.7895	.7561	.7432	.7182	.6944	.6504	.6104	.5739	.5407
3	.9706	.9423	.9161	.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	.4558	.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	.3508	.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	.1184	.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	.1458	.1078	.0929	.0802	.0600	.0451	.0258	.0150	.0089	.0054
18	.8360	.7002	.5874	.4936	.4155	.3503	.2959	.2502	.2120	.1799	.1300	.0948	.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	.0588	.0378	.0304	.0245	.0160	.0105	.0048	.0021	.0010	.0005
30	.7419	.5521	.4120	.3083	.2314	.1741	.1314	.0994	.0754	.0573	.0334	.0196	.0151	.0118	.0070	.0042	.0018	.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	.0005	.0003	.0001
60	.5504	.3048	.1897	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001

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