

1903/203
1906/203
BUSINESS FINANCE
November 2016
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.
Write your answers in the answer booklet provided.
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.**

Answer ALL the questions in this section.

1. Highlight **two** disadvantages of using retained earnings as a source of finance to a company. (2 marks)
2. Highlight **three** reasons why it may be necessary for the Central Bank of Kenya to control money supply in the economy. (3 marks)
3. The annual demand of a material is 10,000 units. The cost per unit of the material is Ksh 20. The ordering costs are Ksh, 1,600 per order. The carrying cost per unit is Ksh 2 per annum.
Calculate the Economic Order Quantity. (3 marks)
4. Bakari intends to buy a motor vehicle in two years' time, which will cost Ksh. 605,000. The compound interest rate is 10% per annum.
Determine the money to be saved at the beginning of the period. (3 marks)
5. List **four** cost components of the weighted average cost of capital. (4 marks)
6. Outline **two** types of ratios which may be used to evaluate the liquidity position of a business. (4 marks)
7. A project requires an initial cash outlay of Ksh. 500,000. The expected inflows for 5 years are: Ksh. 100,000, Ksh. 160,000, Ksh. 200,000, Ksh. 240,000 and Ksh. 300,000. Determine the payback period. (4 marks)
8. Outline the importance of business finance to an organisation. (2 marks)
9. In the recent past, the number of financial institutions which have collapsed in country Q has increased. Advise the governor of the central bank of county Q on **two** measures which may be taken to avert the trend. (4 marks)
10. Outline **three** advantages of preference shares, as a source of finance to a company. (3 marks)

SECTION B (68 marks)

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

11. (a) Explain **four** disadvantages of using working capital cycle in ascertaining a company's liquidity position. (8 marks)
- (b) Mega Limited intends to invest in a project. The following are the expected cash flows of the project:

| Year | Outflows (Ksh) | Inflows (Ksh) |
|------|----------------|---------------|
| 0 | 1,700,000 | |
| 1 | 550,000 | 350,000 |
| 2 | | 600,000 |
| 3 | | 840,000 |
| 4 | | 790,000 |
| 5 | | 920,000 |

The cost of the capital is 12% per annum.

- (i) Determine the present value of the project.
- (ii) Using the profitability index method, advise the management on whether to invest in the project or not. (9 marks)
12. (a) Explain **four** methods which may be used by the Central Bank of Kenya to control the supply of money in the economy. (8 marks)
- (b) Beka Limited had the following capital structure as at 31 December 2015:

| | Ksh |
|--|------------------|
| 165,000 ordinary shares of Ksh. 20 each | 3,300,000 |
| 55,000 10% preference shares of Ksh. 10 each | 550,000 |
| 10% long-term loan | 1,100,000 |
| 12% debentures of Ksh. 100 each | 550,000 |
| Capital employed | <u>5,500,000</u> |

The company paid dividends on ordinary shares at the rate of Ksh. 1.50 per share. The ordinary shares, preference shares and debentures are currently selling at Ksh. 40, Ksh. 15 and Ksh. 100, respectively. The tax rate is 30%.

Calculate:

- (i) the cost of each component of capital;
- (ii) the weighted average cost of capital. (9 marks)

13. (a) Explain **four** disadvantages of using debt finance, as a source of finance to a business. (8 marks)
- (b) The following are the income statements of X Limited and Y Limited for the year ended 31 December 2015:

| | X Limited | Y Limited |
|--------------------------|-------------------------|--------------------------|
| | Ksh | Ksh |
| Sales | 48,000,000 | 76,000,000 |
| Less: Cost of sales | <u>26,000,000</u> | <u>44,000,000</u> |
| Gross profit | 22,000,000 | 32,000,000 |
| Less: Operating expenses | <u>9,600,000</u> | <u>15,200,000</u> |
| Net profit before tax | 12,400,000 | 16,800,000 |
| Corporation tax | <u>(3,720,000)</u> | <u>(5,040,000)</u> |
| Net profit after tax | <u><u>8,680,000</u></u> | <u><u>11,760,000</u></u> |

The capital employed by companies X and Y are Ksh. 120,000,000 and Ksh. 114,300,000, respectively.

- (i) For each of the companies, calculate the following ratios:
- Net profit margin;
 - Operating ratio;
 - Return on capital employed;
 - Gross profit margin.
- (ii) Using the results in (i) above, determine the company that has a better control of operational costs. (9 marks)
14. (a) Explain **four** functions performed by commercial banks as agents of the customers. (8 marks)
- (b) Explain **six** factors which may influence the credit policy of a firm. (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% | 36% |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 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 | .2384 | .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 | .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 | .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 | .1697 | .0951 | .0535 | .0303 | .0173 | .0099 | .0057 | .0033 | .0011 | .0004 | .0002 | .0001 | | | | | | |

The factor is zero to four decimal places

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