

1903/203
1906/203
BUSINESS FINANCE
November 2017
Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL

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

BUSINESS FINANCE

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of TWO sections; A and B.
Answers ALL questions in both sections in the answer booklet provided.
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.

Answer ALL questions in this section.

1. List **four** methods that the Central Bank of Kenya may use to lower the cost of credit in the economy. (4 marks)
2. Outline the importance of business finance to an organization. (3 marks)
3. Highlight **three** benefits of the use of credit cards as a source of finance. (3 marks)
4. Pemba Limited has 100,000 ordinary shares of Ksh 10 each. The company earned a profit of Ksh 100,000 and paid out the whole amount as dividends to the ordinary shareholders in a certain year. The current market price of an ordinary share is Ksh 15. Calculate the cost of equity. (3 marks)
5. List **three** motives of holding cash in an organisation. (3 marks)
6. The following are the expected cash inflows of two projects, Y and Z.

Year	Cash inflows	
	Project Y (Ksh)	Project Z (Ksh)
1	100,000	240,000
2	200,000	190,000
3	250,000	300,000
4	400,000	350,000

The discounting factor is 10%. Calculate the difference in the present values of the projects. (4 marks)

7. List **two** advantages of Accounting Rate of Return (ARR) as a method of investment appraisal. (2 marks)
8. The following information was extracted from the books of Melon Limited.

Income Statement
For the year ended 31 December

	2014 (Ksh)	2015 (Ksh)
Sales	1,000,000	1,200,000
Cost of Sales	500,000	600,000
Gross profit	500,000	600,000
Less: Expenses	150,000	200,000
Net profit before interest and tax	<u>350,000</u>	<u>400,000</u>

The company's initial capital was Ksh 2,000,000.

Calculate the return on capital employed for each year.

9. Outline **four** differences between debt financing and equity financing. (4 marks)
10. State **three** services rendered by finance houses. (3 marks)

SECTION B (68 marks)

Answer **ALL** questions in this section.

11. (a) Explain **four** advantages of using equity shares as a source of business finance. (8 marks)
- (b) The following is the summarised financial statements of Mavuno Limited for the year ended 31 December, 2015:

Mavuno Limited
Income Statement
For the year ended 31 December 2015

	Ksh' 000
Sales	4,320
Cost of Sales	<u>2,340</u>
Gross profit	1,980
Operating expenses	<u>846</u>
	1,134
Debenture interest	<u>45</u>
	1,089
Corporation tax	<u>326</u>
Net profit after tax	<u>763</u>

Mavuno Limited
Statement of Financial Position
As at 31 December 2015

	Ksh' 000	Ksh' 000
Ordinary share capital		900
Profit and loss		648
10% Debentures		<u>450</u>
Capital employed		<u>1,998</u>
Fixed Assets		
Plant and machinery	1,000	
Motor vehicles	400	
Furniture & fittings	<u>220</u>	1,620

Current Assets

Inventory	792
Accounts receivable	450
Cash in hand	171
	1,413

Less:

Current Liabilities

Accounts payable	261
Dividends due	270
Taxation due	504
	1,035

Net Current Assets	378
	<u>1,998</u>

(i) Calculate each of the following ratios:

- I. Current ratio; (2 marks)
- II. Stock turnover ratio; (2 marks)
- III. Gross profit margin; - $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$ (2 marks)
- IV. Average debt collection period. (2 marks)

(ii) Based on the value of current ratio ascertained in (i)I above, comment on the liquidity position of the firm. (1 mark)

12. (a) Paradise Limited had the following capital structure as at 31 December 2014:

	Ksh
39,000 Ordinary shares of Ksh 25 each	975,000
8.5% Preference share capital	450,000
Retained earnings	285,000
12% Debentures	280,000

The market value of each ordinary share was sh.30. The company expects to pay dividends of Ksh 1.50 per share on ordinary shares in the year 2014.

The corporation tax rate is 30%.

Calculate the:

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

(b) Explain the meaning of each of the following terms as used in inventory management:

- (i) Re-order level;
- (ii) Periodic review;
- (iii) Hybrid;
- (iv) Economic order quantity. (8 marks)

13. (a) Explain **four** factors that should be taken into account when selecting a source of business finance. (8 marks)

(b) Manyasi Limited intends to invest Ksh 1,000,000 in a project. The money was borrowed from Express Bank at an interest rate of 16% per annum. The following are the expected cash inflows from the project.

Year	Cash Inflows (Ksh)
1	60,000
2	250,000
3	300,000
4	700,000
5	850,000

- (i) Calculate the profitability index (PI) of the project.
- (ii) Using the results of (i) above, advise the management whether to invest in the project or not. (9 marks)

14. (a) Outline **six** challenges faced by commercial banks in their effort to provide credit to their customers. (9 marks)

(b) Individuals prefer a shilling today compared to a shilling in future. Explain **four** reasons for the preference. (8 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	.8065	.7813	.7576	.7353
2	.9803	.9612	.9426	.9248	.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	.4788	.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	.3986	.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	.8369	.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	.0318	.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	.4584	.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	.0666	.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

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