

1903/203
1906/203
BUSINESS FINANCE
July 2020
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 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.**

SECTION A (32 marks)

Answer *ALL* the questions in this section.

1. State **three** reasons why money has time value. (3 marks)
2. The current market price of an equity share of Malaba Limited is Ksh 40. The current dividend per share is Ksh 2. The dividends are expected to grow at the rate of 5%. Calculate the cost of the equity capital. (4 marks)
3. Outline **two** objectives of Business Finance to an organization. (4 marks)
4. State **three** functions of insurance companies in Kenya. (3 marks)
5. Highlight **two** limitations of using working capital in estimating the liquidity position of a business. (2 marks)
6. March Limited intends to invest Ksh 5,000,000 in either Project X or Project Y. Project X has net cash inflows of Ksh 2,000,000, Ksh 3,000,000 and Ksh 3,500,000 in the first, second and third years, respectively.
Project Y has a positive net present value of Ksh 500,000 over the three years.
 - (i) Calculate the Net Present Value (NPV) of project X, if the cost of capital is 12% per annum.
 - (ii) Advise the management on the project to invest in. (4 marks)
7. On 1 January, 2018, Nabok Limited obtained a bank loan of Ksh 2,000,000 which was invested in the business. The interest rate was 14% per annum. The net profit before tax and interest for the year 2018 was Ksh 400,000.
Calculate the;
 - (i) return on capital employed;
 - (ii) interest coverage ratio. (4 marks)
8. Highlight **three** advantages of leasing as a source of finance. (3 marks)
9. State **three** tools that may be used by the Central Bank of Kenya to control credit in the economy. (3 marks)
10. State **two** disadvantages of using Pay-Back Period as a method of evaluating long term projects. (2 marks)

SECTION B (68 marks)

Answer ALL the questions in this section.

11. (a) Explain **four** factors that may be considered by a firm when developing its credit policy. (8 marks)

- (b) Marema Limited intends to raise funds in the forthcoming year as follows:

	Ksh
500,000 fully paid up ordinary shares	5,000,000
Retained earnings	2,000,000
100,000, 8% preference shares	2,000,000

Additional information:

- The market value of ordinary shares is Ksh 26 per share;
- The expected dividend on ordinary shares is Ksh 2 per share;
- The growth rate in ordinary dividend is 6%.

Calculate the Weighted Average Cost of Capital (WACC).

(9 marks)

12. (a) Explain **four** measures which may be taken by a government to protect financial institutions from collapsing. (8 marks)

- (b) Mambo Limited intends to borrow Ksh 4,000,000 to finance either project A or project B. The following are the expected net cash inflows for four years.

	Project A	Project B
Year	Ksh	Ksh
1	1,800,000	1,600,000
2	1,500,000	1,200,000
3	1,300,000	1,400,000
4	1,700,000	1,200,000

The cost of capital is 12% per annum.

- (i) For each project, determine the:
- (I) present value;
 - (II) profitability index.
- (ii) Advise the management on the project to invest in.

(9 marks)

13. (a) Jeko Enterprises is a fast growing business with a high demand for its products. The firm intends to issue shares for public subscription. Explain four requirements that should be fulfilled by the firm in order to be quoted at the Nairobi Securities Exchange. (8 marks)

- (b) The following information relates to the Wema Limited for the years ended 31 December.

	2017	2018
	Ksh	Ksh
Sales	240,000,000	280,000,000
Gross profit	180,000,000	200,000,000
Expenses	20,000,000	80,000,000
Current assets	40,000,000	480,000,000
Current liabilities	240,000,000	280,000,000

The average inventory was Ksh 60,000,000 for the year 2017, and Ksh 80,000,000 for the year 2018.

- (i) For each of the years, 2017 and 2018, calculate the following ratios:
- (I) Gross profit margin;
 - (II) Net profit margin;
 - (III) Stock turnover ratio;
 - (IV) Current ratio.
- (ii) State two measures which the management may take to increase the profitability of the firm. (9 marks)

14. (a) Differentiate between each of the following sources of finance:

- (i) Bank credit and trade credit;
- (ii) Factoring and invoice discounting;
- (iii) Hire-purchase and leasing;
- (iv) Promissory note and bills of exchange.

(8 marks)

- (b) Lara plans to buy a machine after 3 years. The machine will cost Ksh 2,000,000. She intends to deposit Ksh 300,000 in the bank at the beginning of the first year and Ksh 400,000 at the beginning of the second year. The bank pays a compound interest at the rate of 10% per annum. Calculate the amount Lara should deposit at the beginning of the third year to enable her acquire the machine. (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	.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	.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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