1903/203
1906/203
BUSINESS FINANCE
July 2018
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 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 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

SECTION A (32 marks)

Answer ALL questions in this section.

1. Highlight **three** ways in which Business Finance is important to an organisation. (3 marks)

2. Bingwa Limited uses material Tx in its production process. The annual demand of the material is 160,000 units. The annual holding cost is ksh 250 per unit per annum and the cost of placing an order is ksh 500.

   Calculate the Economic Order Quantity. (3 marks)

3. Outline **four** advantages of ordinary shares as a source of business finance. (4 marks)

4. Differentiate between leverage ratios and turnover ratios. (4 marks)

5. John intends to save ksh 50,000 at the end of each year for 6 years, in a bank account which pays compound interest at the rate of 10% per annum.

   Calculate the amount in the account at the end of the 6 years. (3 marks)

6. Outline **four** ways in which cost of capital is important in business decision making. (4 marks)

7. The current ratio of a company is given as 2.33:1.

   Interpret the ratio. (2 marks)

8. Highlight **three** ways in which non-banking financial institutions are important in an economy. (3 marks)

9. Outline **three** limitations of the Pay Back Period as a method of investment appraisal. (3 marks)

10. Peter expects to receive ksh 1,600,000 as retirement benefits at the end of 4 years. Calculate the present value of the amount, at a discount rate of 14% per annum. (3 marks)

$$\frac{4}{8}$$

$$\frac{1,600,000}{14} \times 100 \qquad 400,000$$

$$1,600,000$$

SECTION B (68 marks)

Answer ALL questions in this section.

11. (a) Explain **five** factors that a firm should consider when selecting a source of finance.

(10 marks)

(b) The annual cash requirement of a firm is ksh 2,500,000. The amount is available in the form of marketable securities which can be converted into cash at a cost of ksh 100 per transaction. The yield on the marketable securities is 20% per annum.

Using Baumol's model, calculate the:

(i) optimal cash balance;

(ii) number of conversions per year;

(iii) annual cost of the optimal cash balance. (7 marks)

12. (a) Explain **five** functions of commercial banks in an economy. (10 marks)

(b) The following is a profit and loss account for Kotu Limited for the year ended 31 31 December 2016.

	Ksh	Ksh
Sales		1,300,000
Less cost of sales:		
Opening stock	610,000	
Purchases	1,060,000	
	1,670,000	
Less closing stock	(550,000)	(1,120,000)
Gross profit		180,000
Less expenses:		
Depreciation	30,100	
General expenses	22,000	
Interest on loan	5,000	(57,100)
Net profit before tax		122,900
Less corporation tax (30%)		(36,870)
Net profit after tax		86,030
Less appropriations:		
Ordinary dividends		(15,000)
Profit and Loss account		71,030

Calculate the:

(i)   gross profit margin;

(ii)   net profit margin;

(iii)   operating ratio.   (7 marks)

13.   (a)   Explain **five** factors that may affect the efficiency of savings and credit co-operative societies in Kenya.   (10 marks)

    (b)   The management of Mabato Limited intends to invest Ksh 5,500,000 in either machine A or machine B. The expected cash inflows of the machines are given as follows:

<center>Cash inflows (Ksh)</center>

Year	Machine A	Machine B
1	200,000	450,000
2	720,000	800,000
3	1,200,000	1,550,000
4	900,000	700,000
5	600,000	400,000

The firm's cost of capital is 10% per annum.

(i)   Calculate the Net Present Value (NPV) of each machine;

(ii)   Using the results in (i) above, advise the management on the machine to invest in.   (7 marks)

14.   (a)   Explain the use of each of the following financial ratios in business decision making:

(i)   Current ratio; _helps in giving of idea's of company to have an ability to pay back liabilities_

(ii)   Gearing ratio; _measures the proportion of companies funds borrowed._

(iii)   Gross profit ratio;

(iv)   Dividend pay out ratio;

(v)   Price earnings ratio.   (10 marks)

    (b)   Pata Limited intends to raise capital from the following sources:

- 200,000 ordinary shares of ksh 10 at ksh 18 each;
- 150,000 10% preference shares of ksh 10 at ksh 15 each;

-Helps in inserting & pressit that has been made
-Dividend Pay out ratio - Helps to know what has been payed out & by how much

- 50,000 15% debentures of ksh 100 at ksh 120 each;
- Bank loan of ksh 6,000,000 at an interest rate of 14% per annum.

The company will pay ordinary dividend at 12% and the corporation tax rate is 30%.

Calculate the:

(i)   total amount of capital to be raised by the company;

(ii)   component cost of capital;

(iii) weighted average cost of capital.   (7 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	.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	*	*	*
50	.6080	.3715	.2281	.1407	.0872	.0543	.0339	.0213	.0134	.0085	.0035	.0014	.0009	.0006	.0003	.0002	*	*	*	*
60	.5504	.3048	.1697	.0951	.0535	.0303	.0173	.0099	.0057	.0033	.0011	.0004	.0002	.0001	*	*	*	*	*	*

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