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Department of Business & Economics

EXAMINATION (AUGUST, 2014)

ABA 306 -Managerial Economics

Date:

Time:

(2 hrs)

Instructions

1. The paper contains Five (5) Questions
2. Answer three Questions
3. Question ONE is compulsory with 30 Marks
4. Answer ANY OTHER TWO Questions of 20 Marks each

SECTION A: (Compulsory)

QUESTION ONE

- (a) Why is the understanding of the principles of Managerial Economics necessary for a business manager? **(10 Marks)**
- (b) Assuming the unit price of a commodity is defined by: $P = 90 - 2q$, and the cost function is given as: $C = 10 + 0.5 q^2$,
- (i) Determine the profit-maximising level of output and the unit price. **(5 Marks)**
- (ii) Determine the cost-minimising level of output **(5 Marks)**
- (c) Economic Theory of the firm puts profit as the main objective of the firm. This notion has been disputed by various economists who believe that businesses pursue a multiplicity of objectives.

Required

State and explain four other objectives of the firm **(10 marks)**

SECTION B: Answer ANY TWO Questions

QUESTION TWO

- (a) Define Capital Budgeting **(3 Marks)**
- (b) Investment appraisal techniques are the methods used by managers to evaluate the viability of projects for decision-making

Required:

Enumerate four features of good investment appraisal techniques **(4 Marks)**

- (c) A company is considering two mutually exclusive projects requiring an initial cash outlay of Sh 10,000 each and with a useful life of 5 years. The company required rate of return is 10% and the appropriate corporate tax rate is 50%. The projects will be depreciated on a straight line basis. The before depreciation and taxes cashflows expected to be generated by the projects are as follows.

YEAR	1	2	3	4	5
Project A	Shs 4,000	4,000	4,000	4,000	4,000
Project B	Shs 6,000	3,000	2,000	5,000	5,000

Required:

Calculate for each project

- i. The payback period **(2 Marks)**
- ii. The average rate of return **(2 Marks)**
- iii. The net present value **(2 Marks)**
- iv. Profitability index **(2 Marks)**

- v. The internal rate of return **(2 Marks)**
Which project should be accepted? Why? **(3 Mark)**

QUESTION THREE

The table below shows the relationships between quantity (Q), Total Cost (TC), Average Cost (AC) and Marginal Costs (MC) of XYZ company.

Output (Q)	Total Cost (TC)	Average Cost (AC)	Marginal Cost(MC)
	Kshs	Kshs	Kshs
1	60		
2	80		
3	90		
4	96		
5	100		
6	144		
7	210		
8	320		
9	540		
10	900		

Required:

- Compute AC and MC in the table **(5 Marks)**
- Derive a graph of TC, AC and MC **(10 Marks)**
- Comment on the shapes of the graphs **(5 Marks)**

QUESTION FOUR

- Define production function and describe the assumptions. **(6 Marks)**
- What are fixed and variable inputs? Illustrate with one example in each case **(4 Marks)**
- Distinguish between laws of return to variables proportion and laws of returns to scale
- In a free market system, prices of goods and services are determined by the forces of demand and supply. In order to promote good practises and protect her citizens, the government is sometimes forced to impose regulations which are seen as interfering with free market forces.

Required:

Giving examples, explain Four (4) ways in which government interferes with free market mechanisms **(10 Marks)**

QUESTION FIVE

- i.** Discuss the objectives of a business firm **(4 Marks)**
- ii.** What is profit maximisation? **(2 Marks)**
- iii.** Differentiate between value maximisation and size maximisation **(4 Marks)**
- iv.** A monopolistic firm is one which fixes its price without necessarily using the demand and supply. In Kenya today, the emergence and survival of such firms have been attributed to the factors that prevent the entry of other firms into the market through barriers to entry.

Required

- (a)** Give two examples of monopolistic companies in Kenya **(2 Marks)**
- (b)** Enumerate four main barriers to entry **(8 Marks)**

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END

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