MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

THIRD YEAR SPECIAL /SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

EAE 303: MANAGERIAL ECONOMICS

DATE: 23/7/2019 **TIME: 11:00 – 1:00 PM**

INSTRUCTIONS:

- **i) Answer question one (Compulsory) and any other two questions**
- **ii) Do not write on the question paper**
- **iii) Show your working clearly**

QUESTION ONE (COMPULSORY) (30 MARKS)

a) Project A has the following cashflows over its useful life of 3 years. The market value (Abandonment value) has also been given.

Year	***Cash flow Sh`000'***	***Abandonment value Sh`000'***
0	(4,800)	4,800
1	2,000	3,000
2	1,875	1,900
3	1,750	0

Required:
Determine when to abandon the project assuming a discount rate of 10%. (10 marks)

b) Assume a project costs Sh 30,000 and yields the following uncertain cashflows:

Year	*Cashflow*
1	12,000
2	14,000
3	10,000
4	6,000

Assume also that the certainty equivalent coefficients have been estimated as follow $\alpha_0 = 1.00$

$\alpha_1 = 0.90$

$\alpha_2 = 0.70$

$\alpha_3 = 0.50$

$\alpha_4 = 0.30$

The risk-free discount rate is given as 10%

Required

Compute the NPV of the project (10 marks)

c) Differentiate between the monopolistic and oligopolistic market structures. (10 marks)

QUESTION TWO (20 MARKS)

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	**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

ii) The average rate of return

iii) The net present value

iv) Profitability index

v) The internal rate of return

Which project should be accepted? Why?

QUESTION THREE (20 MARKS)

a) Using a diagram explain the product life cycle pricing strategy (10 marks)

b) A company is considering manufacturing 2 mutually exclusive products A and B. Product A is a watch band specifically designed to fit on watches manufactured by the firm only. Product B is a watch band that is designed to be adapted to a variety of watches including those produced by competitors. Expected investment is $100,000 for each of the products. Expected cash flows are $20,000 per year for product A. The expected value for B is $23,000 for 8 years also.

The coefficient of variation (CV) for A is 1.0 and for B is 1.5. Because of high risk attached to B the risk adjustment to B is k=15% and for product A, k=10%. Which project would you recommend to the company for investment? (10 marks)

QUESTION FOUR (20 MARKS)

a) Briefly explain the assumptions of oligopoly market structure. (8 marks)

b) With the aid of a diagram explain the equilibrium of a monopoly market structure in the short run. (12 marks)

QUESTION FIVE (20 MARKS)

a) Explain the limitations of direct interview method (8 marks)

b) Briefly explain the various steps involved in estimating demand by regression analysis. (8 marks)

c) Clearly distinguish between consumer clinic and market experiments. (4 marks)