MACHAKOS UNIVERSITY COLLEGE

(A Constituent College of Kenyatta University)
University Examinations for 2015/2016 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BUSINESS ENTREPRENEURSHIP AND MANAGEMENT SCIENCES

FIRST SEMESTER EXAMINATION FOR DEGREE IN DOCTOR OF PHILOSOPHY IN BUSINESS ADMINISTRATION

BBA 920: ECONOMICS ANALYSIS FOR BUSINESS DECISIONS

Date: 9/8/2016 **Time: 11:00 – 1:00 PM**

INSTRUCTIONS:

Answer All Questions In Section A And Any Other Two Questions In Section B.

SECTION A: ANSWER ALL QUESTIONS

QUESTION ONE

An economy has a high rate of open unemployment and very low levels of investment. The planning commission of this economy has sought the services of a consultant who has superior knowledge on the application of the Hicksian IS-LM framework of a macro economy. Using the model, the consultant has recommended expansionary monetary and fiscal policies for the economy. Would your recommendations be any different from those of the consultant? Explain your answer in detail using well-labelled diagrams. (15 marks)

QUESTION TWO

(a) Yogesh Carpets, a carpet manufacturing and exporting firm, has to supply an order for 500 pieces of woolen carpets of two varieties X and Y to K.I.C.C. for its conference rooms. The joint cost function for the two varieties of the carpets is given as:

$$C = 100X^2 + 150Y^2$$

The quantity of X and Y are not specified and so the firm is forced to supply any combination. The firm wishes to minimize the cost of producing the carpets but meet the demand by K.I.C.C. Determine how many of each type of carpet the firm will produce to minimize costs. What will be the minimum cost of production? (10 marks)

(b) The Dean of the School of Business and Economics at MUC is considering introducing a new area of Specialization in Production Management. The planning subcommittee has estimated that it will cost Kshs 50,000 per year to maintain classrooms, furniture and equipment. The Lecturer's salaries plus supplies will cost Kshs 20 per student per year. If the University charges Kshs 120 in tuition fees per student per year:

(i) How many students should the School enroll so as to break even? (4 marks)

(ii) Determine the total revenue, total cost and total profit or loss at this level of output (6 marks)

(iii) Suppose the University College Management sets a profit target of Kshs. 600,000 from the programme per year, how many students should the school enroll to achieve the profit target? (5 marks)

SECTION B: ANSWER ANY TWO QUESTIONS

QUESTION THREE

Gina Picareto is a production manager at the Rich Manufacturing Company. Each year her unit buys up to 100,000 machine parts from Bhagat incorporated. The contract specifies that Rich will pay Bhagat its production cost plus Kshs 5 markup (cost-plus pricing). Currently, Bhagat's costs per part are Kshs 10 for labour and Kshs 10 for other costs. Thus the current price is Kshs 25 per part. The contract provides an option to Rich to buy up to 100,000 parts at this price. It must however, purchase a minimum volume of 50,000 parts.

Bhagat's workforce is heavily unionized. During recent contract negotiations, Bhagat agreed to a 30% pay raise for the workers. In this labour contract, wages and benefits are speficied. However, Bhagat is free to choose the quantity of labour it employs.

Bhagat has announced a Kshs 3 price increase for its machine parts. This mount represents the projected Kshs 3 increase in labour costs due to its new union contract. It is Gina's responsibility to evaluate this announcement.

(a) Explain the process of price fixation under cost-plus pricing strategy. (2 marks)

(b) Why do many firms use cost-plus pricing for supply contracts? (2 marks)

(c) What potential problems do you envision with cost-plus pricing? (2 marks)

(d) Should Gina contest the price increase? Explain. (2 marks)

(e) How will a Kshs 3 increase in the price of machine parts affect Gina's own production decisions? (2 marks)

QUESTION FOUR

(a) Explain the meaning of macroeconomic models and discuss the major types of macroeconomic models (2 marks)

(b) Suppose aggregate demand and potential output are respectively given as:

Aggregate demand: Y=4000+2000/P where Y= Actual Output and P=Price level

Potential Output : Y*=5000.

i. Assuming prices are sticky at P=1, what is the level of actual output? Is there pressure on prices to move upwards or downwards? (2 marks)

ii. What is the level of prices P if prices are flexible? (2 marks)

iii. Suppose prices are sticky at P=3, what is the level of actual output? Is it above or below potential output? What pressure is on the prices? (2 marks)

(c) Carefully distinguish between the consumer price index (CPI) and the GDP deflator. (2 marks)

QUESTION FIVE

Fully discuss the FOUR pillars of classical macroeconomics and present the Keynesian critique for each of the pillars. (20 marks)