



# THE CATHOLIC UNIVERSITY OF EASTERN AFRICA

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**MAIN EXAMINATION**

**JANUARY - APRIL 2015 TRIMESTER**

**FACULTY OF COMMERCE**

**DEPARTMENT OF ACCOUNTING AND FINANCE**

**CEC 411: MANAGERIAL ECONOMICS**

**Date: APRIL 2015**

**Duration: 2 Hours**

**INSTRUCTIONS: Answer ONE and ANY other TWO Questions**

- Q1. a) Explain briefly the following terms
- i Zero-sum game ( 2 marks)
  - ii Equilibrium outcome ( 2 marks)
  - iii Free-rider problem ( 2 marks)
  - iv Hidden preferences problem ( 2 marks)
  - v Certainty equivalent adjustment factor ( 2 marks)
  - vi Possible risk attitudes ( 2 marks)
  - vii Degree of operating leverage ( 2 marks)
  - viii Least squares method ( 2 marks)
  - ix Income elasticity of demand ( 2 marks)
  - x Long run primary goal of the firm ( 2 marks)
- b) State the basic assumptions of utility theory (3 marks)
- c) State two key importance of the expected value maximization model of the firm. (3 marks)

- d) Suppose an investor faces the following choices
- i To invest Ksh. 8 million and receive: Kshs 80 million from a successful project. Nothing if project fails. The probability of success is 50 percent.
  - ii The Thustor does not make the investment, so keeps the Ksh. 8 million.

Required to:

- i Show the certainty equivalent sum **( 1 mark)**
  - ii Calculate the expected pay off from the investment **( 1 mark)**
  - iii Calculate the level of risk **( 1 mark)**
  - iv Interpret the result in (iii) above. **(1 mark)**
- Q2. a) Explain briefly three models used in trend analysis forecasting methods **( 6 marks)**
- b) Explain briefly the following terms as applied in the theory of the firm
- 1. Revenue analysis **(2 marks)**
  - 2. Cost analysis **(2 marks)**
  - 3. Interest/discount rate analysis **(2 marks)**
- c) Given the following table of cost-output relations

Quantity '000s (per month)	Fixed Cost 640 (Kshs)	Variable Cost (Kshs)	Total Cost (Kshs)	Marginal Cost (Kshs)	Average Cost (Kshs)
0		0.00			
1		360			
2		800			
3		1,320			
4		1,920			
5		2,600			
6		3,360			
7		4,200			
8		5,170			
9		6,120			
10		7,200			

Required to:

- i Complete the table. **(4 marks)**
  - ii Present graphical presentation of the total cost, marginal cost, average cost and quantity relations. **(4 marks)**
- Q3.
- a) Using suitable illustration explain briefly. **(6 marks)**
  - b) Explain briefly the market and non-market solutions to economic problems posed by externalities. **(4 marks)**
  - c) Using suitable illustration explain briefly term 'movement of price elasticity along a linear demand curve' **(5 marks)**
  - d) Using suitable illustrations, explain briefly the relationship between
    - i Income and quantity consumed of a normal good. **(2<sup>1</sup>/<sub>2</sub> marks)**
    - ii Income and quantity of an inferior good **(2<sup>1</sup>/<sub>2</sub> marks)**
- Q4.
- a) Using suitable illustration, explain briefly the term 'income – consumption curve'. **( 4 marks)**
  - b) In economic optimization state conditions/rules for
    - i Revenue maximization **(2 marks)**
    - ii Cost minimization **(2 marks)**
    - iii Profit maximization **(2 marks)**
    - iv Given the following equations

$$\Pi = -\$8 + \$20Q - \$2Q^2$$

$$MR = \$24 - \$3Q$$

$$MC = \$4 + \$Q$$

Where

$\Pi$  = total profit

MR = Marginal revenue

MC = Marginal cost

Q = output sold

Required to:

- i Calculate the profit – maximizing output level. **(3 marks)**
- ii Calculate the maximized profit **(2 marks)**
- c) Explain briefly the term 'risk of measurement' as applied in risk analysis. **(5 marks)**

**\*END\***

