THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES PROGRAMME
LEVEL 05 – 2005/2006
FINAL EXAMINATION 2006
MANAGERIAL ECONOMICS – MCU 3207

DATE : 05.03.2006	**TIME : 01.30 a.m – 04.30 p.m**

INSTRUCTIONS
Duration: Three Hours
ANSWER ANY FIVE (05) QUESTIONS.
All questions carry equal marks.

This question paper has eight questions.
Non-programmable calculators are allowed.

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(1) (a) How will the knowledge about the co-efficient of price elasticity of demand help a manager in making decisions ?

(10 marks)

(b) How will the price elasticity of supply affect,
(i) Garment
(ii) Tea industries, in responding
to the changing price in the market ?

(10 marks)

(2) (a) Explain (i) Substitution effect
(ii) Income effect

(05 marks)

(b) Briefly comment on Income and Substitution effect in relation to Normal, Inferior and Giffen goods.

(06 marks)

(c) Suppose, when the price of good X is Rs. 10/=, 2000 units are demanded and when price increases to 12/= demand drops by 200 units (assume that the demand function is liner)

(i) Derive the demand function of the good X.

(ii) If the supply function is given as, $Q_S = 300 + 50p$ find the equilibrium price and the quantity.

(iii) What is the price elasticity of demand at price Rs. 10/= ? Comment on the value of the coefficient. (3 marks x 3)

(3) (a) What is break even analysis ? (05 marks)

(b) Prove that the break even output of a firm is given by; $\dfrac{TFC}{P - AVC}$

TFC – Total fixed cost, AVC – Average Variable Cost, P-Unit price.

(05 marks)

(c) Explain the relationship between a firm's fixed cost and the break even level of output.

(05 marks)

(d) How would the operating leverage technique assist manager in decision making ?

(05 marks)

(4) Cost structure of a firm is given below.

Output	T.F.C.	T.V.C.	T.C.	A.F.C.	A.V.C.	A.T.C.	M.C.
0	400	0	-				
1	-	60	-	-	-	-	-
2	-	100	-	-	-	-	-
3	-	130	-	-	-	-	-
4	-	180	-	-	-	-	-
5	-	-	650	-	-	-	-
6	-	-	-	-	-	-	90

(a) Complete the table. (08 marks)

(b) What is Envelop curve ? (04 marks)

(c) Give reasons for the 'U' – shape of long run average cost curve.

(08 marks)

(5) (a) Explain the market out-come when a perfectly competitive firm is taken over by a monopoly. (12 marks)

(b) Suppose demand function of a monopolist is , Q = 100 – 0.5P, and the total cost function is, TC = 100 + 20Q.

(i) Find the profit maximizing output and price. (04 marks)

(ii) Calculate the amount of profit. (04 marks)

(6) (a) Explain how a loss making perfectly competitive firm determine whether to continue with the production or shut down in the short run.

(10 marks)

(b) "Perfectly competitive markets are extremely rare in the real world" Do you agree ? Explain. (10 marks)

(7) Write brief notes on the following

(a) Optimum expansion path.

(b) Business and Economic profit.

(c) Cartel.

(d) Exceptions to Law of demand. (5 marks x 4)

(8) (a) Briefly explain the relationship among Total Product, Marginal Product and Average Product in the short run. Using the above, explain which stage the rational producer should operate.

(08 marks)

(b) "Short and Long run in the production process vary from industry to industry" Do you agree ? Briefly explain with examples.

(06 marks)

(c) Prove that the firm achieves optimum level of output in the long run, when ; $\frac{MP_L}{MP_K} = \frac{P_L}{P_K}$

(06 marks)