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THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC ADMINISTRATION PROGRAMME
FINAL EXAMINATION – 2018 JULY
MCP2605/ MSP 9305 – MANAGERIAL ECONOMICS
DURATION: THREE (03) HOURS

DATE: 22.07.2018 **TIME: 01.30 PM – 4.30 PM**

Answer Question No.01 from Part – A (40 Marks) and any three (03) questions from Part - B (20 each). Use of non-programmable calculator is allowed.

PART - A

Question No. 01.

A) a, How relevant and practicable for firms that operate in modern day dynamic environment under various constrains to pursue the goal of profit maximization? Using examples and also highlighting limitations of the theory of profit maximization, explain you answer. **(07 Marks)**

b, What assurance is there that the managers carry out actions necessary to create maximum team performance and to ensure that the owners will earn the most residual income? Explain taking Principal – Agent theory into account. What solutions are available to overcome Principal – agent problem? Explain. **(07 Marks)**

B) a, Coefficient of Price Elasticity of Demand for pharmaceutical drugs given as **– 0.42** and personal computers given as **-1.24.** If the technological advancement has considerably increased the supply of both, what could be the final market outcome? How would it affect the consumer spending on both products? Explain using illustrations. **(06 Marks)**

b, "Industries selling products that have high Income Elasticity of Demand coefficients are particularly hard hit by recessions than products with low or negative Income Elasticity of Demand." Do you agree? Explain with examples. **(07 Marks)**

c, How useful are the concepts of Cross Price Elasticity and Cross Advertising Elasticity of demand in making effective business decisions? Explain with examples. **(07 Marks)**

d, Agronomists discover a new hybrid variety of rice that is more productive than existing varieties, would this make farmers better off or worse off? If farmers are made worse off by the discovery would they still adopt it? Using illustrations explain your answer. **(06 Marks)**

(Total – 40 Marks)

PART – B

Question No. 02.

A) a, How would a production function of a firm change under neutral, capital saving and labour saving technological progress? Use illustrations to explain your answer. **(07 Marks)** b, Explain the concept of "Returns to Scale", with the help of Cobb-Douglas production function. Provide illustrations. **(07 Marks)**

B) The production function of a firm is given as;

$$Q = 100K^{0.5}L^{0.5}$$

K –Capital L –Labour

a, Determine the equation for expansion path assuming that the price of a unit of capital as Rs.64/=, and unit of labour as Rs. 36/=.

b, Find the efficient combination of inputs to produce 2400 units of the given good.

c, If the unit price of labour also increases to Rs.64/=, same as capital, find the new efficient combination of inputs needed to produce 2400 units. **(06 Marks)**

Question No.03.

A) a, " Compared to Perfect Competition, Monopoly creates an efficiency loss."Using illustrations compare and contrast the said two markets with respect to price, output, profit and allocation of resources. **(06 Marks)**

b, Demand equation of a Monopolist given as;

Q = 32 – 0.2P Q- output (Units) P – Price (Rs.)

If the Marginal Cost is constant and equal at Rs. 10/=;

i. Find the revenue maximizing price and output.

ii. Find the profit maximizing price and output.

iii. What is the dead weight loss resulting from Monopoly?

iv. Compared to pricing at Marginal Cost, how much income is redistributed from consumers to the owners of Monopoly?

(Use illustrations to explain your answer) **(08 Marks)**

B) "Compared with single pricing by a Monopolist, perfect price discrimination results it greater Profit and greater output" Do you agree? Explain using illustrations. **(06 Marks)**

Question No o4.

A) According to three main models of oligopoly, kinked- Demand theory, Collusive pricing and Price Leadership, how would the firms in Oligopoly market determine price and output? Explain providing illustrations where necessary. **(08 Marks)**

B) The short run demand and cost equations of a Monopolistically Competitive firm are given as;

$Q_d = 800 - 20P$ (Demand) $TC = 500 + 10Q$ (Total Cost)

Q – Output P – Price

i. Calculate the economic profit/loss.

ii. Based on the answer to above 'I', using illustrations explain the long run behavior of the firm. **(05 Marks)**

C) a, Why would the Monopolistically Competitive firms fail to achieve allocative efficiency? Explain.

b, "The efficiency loss associated with Monopolistic Competition can considerably be reduced by the benefits consumers receive from product variety." Do you agree? Explain with examples.

(07 Marks)

Question No. o5.

A) a, What is meant by "Cost-Plus" pricing? Explain.

b, When a firm sets a price of a product on cost plus basis, can it possibly ignore the Price Elasticity of Demand of that product? Explain.

c, Price Elasticity of Demand for good 'A' is given as '1' and it costs the firm Rs.150/= to produce it. If the good is to be priced using Cost –Plus method, out of the two prices, Rs.250/= and Rs.350/=, which price is optimal? Explain with necessary calculations.

(10 Marks)

B) a, What is meant by Transfer Pricing? Explain.

b, A company has two divisions one that manufacture components (Division A) and one that assembles them into the final product (Division B). Using illustrations explain how the transfer price is determined;

- If there is no external market for both divisions A & B.
- External market exists, and it is possible for divisions A to sell and division B to buy the the component in competitive markets externally **(10 Marks)**