



MASENO UNIVERSITY
UNIVERSITY EXAMINATIONS 2015/2016

**FIRST YEAR FIRST SEMESTER EXAMINATION FOR THE DEGREE OF
BACHELOR OF BUSINESS ADMINISTRATION, ARTS, EDUCATION,
SCIENCE AND AGRIBUSINESS WITH INFORMATION TECHNOLOGY**

MAIN CAMPUS

AEC 101: INTRODUCTION TO MICROECONOMICS

Date: 20th January, 2016

Time: 11.00 - 1.00pm

INSTRUCTIONS:

- Answer Question ONE and any other TWO Questions.
- Question ONE carries 30 marks, the rest 20 marks each
- Marks will be awarded for being neat, clear and use of relevant illustrations.

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ISO 9001:2008 CERTIFIED 



QUESTION ONE (COMPULSORY) (25 MARKS)

- a) Discuss the agency conflict of financial management in detail (10marks)
- b) A company is thinking of replacing an old machine. The machine was bought 4years ago for Kshs.100,000. It is expected to last for 3years more and produce an annual net cash inflow of Kshs.60,000. The new alternative machine will cost shs.150,000 and will produce a net cash flow of Kshs.90,000, 90,000, 80,000, 80,000 and 70,000 from year 1 through year 5. There is no salvage value for the machines. The cost of capital is 12%.

Required:

Prepare computations to guide decision making in the above scenario. (15marks)

QUESTION TWO

- a) Discuss the factors that determine the choice of financing from financial markets. (5marks)
- b) For a levered firm, show that earnings per share are a linear function of earnings before interest and taxes. (10marks)

QUESTION THREE

- a) Discuss the typical complex investment decisions that face a firm (5 marks)
- b) The K 8 K company has two alternative investment projects A and B. A short lived project that will cost Kshs.150,000 and involve annual operating expense of Kshs. 40,000 for 4 years. B on the other hand will cost Kshs.200,000 and involve an operating expense of Kshs.25,000 for 7years. The project has no salvage value. The discount rate is 12%

Required:

Indicate which project should be selected and why? (10marks)

- (b) Using classical production function, explain the stages of production of a firm and advise on the best optimal stage of operation

(5marks)

QUESTION FIVE

- (a) Given a demand function of the form:

$$Q=1000-20P$$

Calculate the point elasticity of demand when

$$p=100 \text{ and } q=80$$

(6marks)

- (b) Explain the features of an oligopoly market

(8marks)

- (c) Explain the importance of price and income elasticity to a producer and government

(6marks)