



**UNIVERSITY OF RUHUNA**  
**FACULTY OF GRADUATE STUDIES**  
**Master of Business Administration Degree Programme Semester I**  
**Examination (January 2020)**  
**Academic Year 2019**

**MBA 101: Business Economics**

**Duration: Three hours**

**Calculators are allowed.**

**The Question Paper contains 08 questions.**

**Answer only Five (06) Questions.**

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1. You are given the following cost function:

$$TC = 100 + 60q - 3Q^2 + 0.1Q^3$$

- a. Derive the average variable cost, average cost, and marginal cost functions. (03 Marks)
  - b. Find the point at which diminishing returns occur. (02 Marks)
  - c. Discuss the relationship between marginal cost and average variable cost and between marginal cost and average cost. (05 Marks)
2. Assume firms in the short run are earning above-normal profits. Explain what will happen to these profits in the long run for the following markets:
- a. Pure monopoly (2.5 Marks)
  - b. Oligopoly (2.5 Marks)
  - c. Monopolistic competition (2.5 Marks)
  - d. Perfect competition (2.5 Marks)

3. Your firm has an opportunity to make an investment of Rs.50,000. Its cost of capital is 12 percent. It expects after-tax cash flows for the next 5 years to be as follows:

Year 1	Rs. 10,000
Year 2	20,000
Year 3	30,000
Year 4	20,000
Year 5	5,000

- Calculate the Net Present Value. (02 Marks)
- Calculate the Internal Rate of Return (to the nearest percent). (02 Marks)
- Calculate the Profitability Index. (02 Marks)
- Would you accept this project? Explain. (02 Marks)
- Under which circumstances can the NPV and IRR calculations lead to conflicting results? Which of the two methods is preferable? Why? (02 Marks)

4. Consider the situation of job market where job seekers and job providers interact. 6.

- Which side (the job seeker or the potential employer) has the informational advantage that is the key to the *lemons* model? Explain how the *lemons problems* occur. (04 Marks)
- Explain how adverse selection and moral hazard work in the employment related agreements. (04 Marks)
- Is the *lemons* model an example of the adverse selection problem? (02 Marks)

5. Consider an economy described by the following equations: 7.

$$Y = C + I + G + X \text{ (Income Identity)}$$

$$C = 300 + 0.8Y_d \text{ (Consumption)}$$

$$I = 200 - 1,500r \text{ (Investment)}$$

$$X = 100 - 0.4Y - 500r \text{ (Net export)}$$

$$M = 0.5y - 2,000r \text{ (Money demand)}$$

With government spending  $G = \text{Rs. } 200 \text{ Million}$ , the tax rate  $t = 0.2$ , the nominal money supply  $M = \text{Rs. } 550 \text{ Million}$  and assume the predetermined price level is fixed.

I. What is the IS curve? (03 Marks)

II. What is the LM curve? (03 Marks)

III. Compute the interest rate and the level of income when both goods market and money market are simultaneously in equilibrium.

(02 Marks)

iv. A change in which of the following would cause the IS curve to shift or affect slope of the IS curve?

(a) Increased planned government expenditure

(b) Decrease of net exports

(c) Increase in Interest rate

(d) Increase of Business confidence

(02 Marks)

6. I. Describe the functions of money.

(03 Marks)

II. Explain how the banking system creates money

(03 Marks)

III. What causes money supply to rise?

(04 Marks)

7. I. What is meant by economic globalization? (02 Marks)

II. What are the driving forces of globalization? (04 Marks)

III. Briefly explain the advantages and disadvantages of globalization. (04 Marks)

8. Provide **three** descriptive notes out of the following **four**.

I. Business cycle

II. Nominal and real exchange rates

IV. Causes of inflation

iv. Economic liberalization in Sri Lanka

(10 Marks)