1.12 Price Elasticity of Demand: Determinants and Business Applications: 30-minute Pack

AQA 7136 · Calculators not allowed · about 30 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Allocate most time to the final 15-mark essay. No calculator is allowed. Show working for all calculations.

1 Evaluate the view that firms should always raise prices for goods with inelastic demand. In your answer, consider the relationship between PED and total revenue, the role of costs and profit margins, firm objectives other than revenue maximisation, time period effects, and potential long-term changes in elasticity. Use diagrams where helpful; describe any diagram you would draw and the features to label.

(Total for Question 1 is 15 marks)

2 Short evaluation: should a supermarket always raise prices on inelastic basic goods during peak demand?

(Total for Question 2 is 5 marks)

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Mark scheme · 1.12 Price Elasticity of Demand: Determinants and Business Applications: 30-minute Pack

Question 1

Level 1 Basic statements about inelastic demand and price rises, with little development or application. Limited or no use of examples or diagrams. **1-3**

Level 2 Simple application of the revenue rule (increasing price raises total revenue when demand is inelastic). Some relevant examples or partial consideration of costs or objectives, but limited evaluation. **4-6**

Level 3 Clear explanation of why raising price can increase revenue and profit when demand is inelastic, with consideration of costs, margins and a labelled diagram described. Some evaluation of counterarguments such as competition, long-run elasticity changes and non-revenue objectives. **7-9**

Level 4 Developed analysis linking PED, revenue and profit, explicit discussion of the time path of elasticity, strategic reasons not to raise prices, and distributional or reputational effects. Uses examples and assesses likelihoods. **10-12**

Level 5 Comprehensive evaluation weighing both sides, showing that while price rises can increase revenue when demand is inelastic, firms should not always do so. Considers costs, competition, dynamic changes in elasticity, multi-product and long-term strategy, and gives a supported conclusion. Describes an appropriate diagram with labels: price, quantity, demand curve inelastic portion, revenue rectangles or TR curve. **13-15**

Indicative content:

- explain the revenue rule: when PED < 1, a percentage rise in price causes a smaller percentage fall in quantity, raising total revenue
- link to profit: if marginal cost is constant, higher revenue per unit raises profit, but must consider margin and fixed costs
- mention firm objectives: market share, growth, penetration pricing, or corporate social responsibility may make price rises undesirable
- time period: demand may be more inelastic in the short run but more elastic in the long run as substitutes appear or consumers adjust
- competition: in competitive markets or online with price comparison, raising price may lose customers to rivals, increasing elasticity faced by the firm
- dynamic responses: consumer backlash, reputational damage, and regulatory or political attention if price rises affect necessity goods
- multi-product firms: cross-price effects, complementary goods and joint pricing may change the optimal decision
- diagram guidance: draw demand curve and show a movement along an inelastic portion where TR rectangles increase, or show TR curve rising on inelastic segment; label axes and areas
- conclude that while raising price for goods with inelastic demand is often profitable short term, it is not always the correct strategy once wider factors are considered

Question 2

identifies argument for raising prices: in peak demand with inelastic demand supermarkets increase revenue and reduce shortages **M1**

identifies argument against: reputational damage, regulatory scrutiny, fairness concerns and long-run elasticity rising as customers switch stores **M1**

develops by weighing short-term revenue gain against long-term costs such as loss of customer loyalty and potential fines or boycotts **A1**

provides a qualified conclusion, e.g. temporary price rises for supply-constrained items may be justified, but permanent or excessive price rises risk harm to the business **A1**

good answer gives a clear supported judgement referencing both commercial and ethical/regulatory considerations **B1**

Answer: Temporary price rises may be justified to manage demand and raise revenue, but permanent or heavy price increases risk reputational damage and regulatory action, so supermarkets should not always raise prices on inelastic goods.

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