BUS.MK4 Pricing strategies

AQA 8132 · Calculator allowed · about 65 minutes

Total Marks

Name: ______________________________ Date: ____ / ____ / ______

Answer ALL questions in the spaces provided. Show your working for every calculation: method marks are available even if your final answer is wrong. Vantage Audio, used throughout this pack, is a fictional business.

1 Which one of the following best describes 'penetration pricing'?

- ☐ A) Setting a low price when a product is launched, to build sales volume quickly
- ☐ B) Setting a high price when a product is launched, to maximise profit from early adopters
- ☐ C) Setting a price by adding a fixed markup to the unit cost
- ☐ D) Setting a price to exactly match a competitor's price

(Total for Question 1 is 1 mark)

---

2 For each definition below, state which pricing strategy is being described: penetration pricing, price skimming, competitive pricing or psychological pricing.

(a) Setting a high initial price for a new product, then gradually lowering it over time as competitors enter the market. **(1)**

(b) Setting a price just below a rival business's price for a very similar product. **(1)**

(c) Pricing a product at 19.99 pounds rather than 20.00 pounds, so it appears cheaper to customers. **(1)**

(d) Setting a low price on a brand-new bluetooth earbud to quickly build a large customer base. **(1)**

(Total for Question 2 is 4 marks)

3 Vantage Audio, a fictional audio equipment company, is launching a genuinely new type of wireless earbud with no direct competitor on the market yet.
State why price skimming would be an appropriate strategy for this launch.

(Total for Question 3 is 2 marks)

---

4 State why penetration pricing might instead be more appropriate if a rival company launches a similar wireless earbud at the same time as Vantage Audio.

(Total for Question 4 is 2 marks)

---

5 Vantage Buds cost 18.00 pounds per unit to manufacture. Vantage Audio adds a markup of 40% to set its selling price.
Calculate the selling price using cost-plus pricing. Show your working.

(Total for Question 5 is 2 marks)

---

6 Explain one advantage and one disadvantage of Vantage Audio using cost-plus pricing.

(Total for Question 6 is 3 marks)

---

7 Vantage Audio raises the price of Vantage Buds from 40.00 pounds to 44.00 pounds.
Calculate the percentage change in price. Show your working.

(Total for Question 7 is 2 marks)

8 Following the price rise in question 7, monthly demand for Vantage Buds falls from 2,000 units to 1,600 units.
Calculate the percentage change in quantity demanded. Show your working.

(Total for Question 8 is 2 marks)

---

9 Price elasticity of demand (PED) = percentage change in quantity demanded divided by percentage change in price.
Using your answers to questions 7 and 8, calculate the PED for Vantage Buds. Show your working.

(Total for Question 9 is 3 marks)

---

10 Explain what the PED value of -2 calculated in question 9 tells Vantage Audio about demand for Vantage Buds.

(Total for Question 10 is 3 marks)

---

11 Suppose instead that demand had only fallen to 1,900 units after the same 10% price rise (from 2,000 to 1,900 units).
Calculate the PED for this scenario. Show your working.

(Total for Question 11 is 3 marks)

12 Explain the difference in pricing implications for Vantage Audio between the elastic result in question 9 (PED = -2) and the inelastic result in question 11 (PED = -0.5).

(Total for Question 12 is 3 marks)

---

13 Explain psychological pricing, giving an example of how Vantage Audio could apply it to Vantage Buds.

(Total for Question 13 is 2 marks)

---

14 State two factors, other than production cost, that Vantage Audio should consider when setting the price of Vantage Buds.

(Total for Question 14 is 2 marks)

---

15 Vantage Audio is deciding whether to go ahead with raising Vantage Buds' price from 40.00 pounds to 44.00 pounds. Its own market research (like the earlier PED calculations in this pack) is uncertain about whether demand will behave elastically (PED = -2, question 9) or inelastically (PED = -0.5, question 11).

Recommend whether Vantage Audio should raise the price. Justify your answer using the figures calculated in this pack.

(Total for Question 15 is 9 marks)

Mark scheme · BUS.MK4 Pricing strategies

Question 1

- **B1** A cao
- **Answer: A**

Question 2

- (a) **B1** price skimming
- **(a) Answer: Price skimming.**
- (b) **B1** competitive pricing
- **(b) Answer: Competitive pricing.**
- (c) **B1** psychological pricing
- **(c) Answer: Psychological pricing.**
- (d) **B1** penetration pricing
- **(d) Answer: Penetration pricing.**

Question 3

- **B1** identifies there is no direct competitor, so Vantage Audio can charge a high price without customers switching elsewhere
- **B1** identifies that early adopters are often willing to pay more for a genuinely new product
- **Answer: With no direct competitor, Vantage Audio can charge a high price without customers switching elsewhere, and early adopters are often willing to pay more for a genuinely new product.**

Question 4

- **B1** identifies that with a competitor launching at the same time, customers have a choice
- **B1** identifies that a low price helps Vantage Audio win customers and build market share quickly before the rival becomes established
- **Answer: With a rival launching at the same time, customers have a choice, so a low price helps Vantage Audio win customers and build market share quickly before the rival becomes established.**

Question 5

- **M1** 18.00 x 1.40 seen, or 18.00 + (18.00 x 40%) seen
- **A1** 25.20 pounds cao
- **Answer: 25.20 pounds.**

Question 6

- **B1** identifies an advantage, e.g. it is simple to calculate and guarantees a profit margin is built into every unit sold
- **B1** identifies a disadvantage, e.g. it ignores what competitors charge and what customers are actually willing to pay
- **B1** develops the disadvantage, e.g. so the price set could be too high (losing sales to cheaper rivals) or too low (leaving profit on the table)
- **Answer: Advantage: it is simple and guarantees a margin on every unit. Disadvantage: it ignores competitors and customer willingness to pay, so the price could end up too high or too low.**

Question 7

- **M1** ((44.00 - 40.00) / 40.00) x 100 seen
- **A1** 10% increase cao
- **Answer: A 10% increase.**

Question 8

- **M1** ((1,600 - 2,000) / 2,000) x 100 seen
- **A1** 20% decrease (-20%) cao
- **Answer: A 20% decrease.**

Question 9

- **M1** -20% and 10% correctly identified from questions 7 and 8
- **M1** -20 / 10 seen
- **A1** -2 (PED = -2) cao
- **Answer: PED = -2.**

Question 10

- **B1** identifies that a PED with a magnitude greater than 1 means demand is price elastic
- **B1** explains what this means, e.g. quantity demanded changes proportionally more than price does
- **B1** links to the business consequence, e.g. raising price further would cause revenue to fall, since the percentage drop in units sold outweighs the percentage price rise
- **Answer: A PED magnitude greater than 1 means demand is elastic: quantity demanded changes proportionally more than price. This means raising price further would reduce revenue, since the fall in units sold outweighs the price rise.**

Question 11

- **M1** ((1,900 - 2,000) / 2,000) x 100 = -5% seen
- **M1** -5 / 10 seen
- **A1** -0.5 (PED = -0.5) cao
- **Answer: PED = -0.5.**

Question 12

- **B1** identifies that with elastic demand (PED = -2), raising price further would reduce total revenue, since customers are highly sensitive to price
- **B1** identifies that with inelastic demand (PED = -0.5), a price rise would increase total revenue, since quantity demanded falls proportionally less than price rises
- **B1** concludes that Vantage Audio should only continue raising price if demand behaves like the inelastic (question 11) scenario, not the elastic (question 9) one
- **Answer: With elastic demand (PED = -2), a further price rise would cut revenue, since customers are highly price sensitive; with inelastic demand (PED = -0.5), a price rise would raise revenue instead. Vantage Audio should only keep raising price if demand actually behaves inelastically.**

Question 13

- **B1** identifies psychological pricing as setting a price just below a round number so it appears cheaper
- **B1** applies it, e.g. pricing Vantage Buds at 39.99 pounds instead of 40.00 pounds
- **Answer: Setting a price just below a round number so it appears cheaper, e.g. pricing Vantage Buds at 39.99 pounds instead of 40.00 pounds.**

Question 14

- **B1** any one factor, e.g. competitors' prices
- **B1** any second distinct factor, e.g. what customers are willing to pay, the product's positioning/brand image, or the stage of the product life cycle
- **Answer: Any two, e.g. competitors' prices and what customers are willing to pay.**

Question 15

- **Level 1** (1-3): Makes simple, undeveloped comments about raising or not raising the price, with little or no use of the pack's figures and no clear recommendation.
- **Level 2** (4-6): Gives a developed argument for or against the price rise, using some of the pack's figures, but does not fully weigh both PED scenarios or reach a clearly justified recommendation.
- **Level 3** (7-9): Weighs the evidence for and against the price rise under both the elastic and inelastic PED scenarios from this pack, and reaches a justified recommendation supported by that analysis.
- **Indicative content:**
  - If demand behaves as in question 9 (PED = -2, elastic), raising the price would cut total revenue: units sold would fall by 20% while price only rises 10%, so revenue falls overall.
  - If demand instead behaves as in question 11 (PED = -0.5, inelastic), raising the price would raise total revenue: units sold would fall by only 5% while price rises 10%, so revenue increases overall.
  - Vantage Buds is a genuinely differentiated new product (question 3) with no direct competitor at launch, which suggests demand may be closer to the inelastic case, since customers have fewer substitutes to switch to.
  - However, if a rival launches a similar product (question 4), demand would likely become far more elastic, since customers would then have an alternative, making the price rise riskier.
  - Judgement: given that Vantage Buds currently has no direct rival, the inelastic scenario is more plausible in the short term, so raising the price to 44.00 pounds is likely to increase revenue; however, Vantage Audio should monitor competitor launches closely and be ready to reverse the rise if a rival product appears and demand starts to behave more elastically.