

Chapter 27: Worksheet mark scheme (12 marks, HL 12 + 26)

- 1 List **four** factors that may be taken into consideration when deciding the selling price of a product or service. (4)
- cost of production
 - competitive market conditions
 - competitor prices
 - marketing objectives
 - price elasticity of demand
 - whether it is a new or existing product
 - stage of life cycle
- 2 The cost of making a product is \$10. Cost plus 40% pricing is used. Calculate the selling price. (2)
- Selling price = \$10 × 1.40
= \$14
- 3 a How would you calculate the selling price of a product using absorption cost pricing? (2)
- Selling price = (variable cost of 1 unit + allocated unit fixed costs) × 1.XX*
- * XX = percentage profit mark-up
- b What is the biggest problem with using the above calculation in reality? (2)
- Allocation of fixed costs can be done in diverse ways, none of which is ideal.
- 4 When may penetration pricing be used? (1)
- To enter an already established market.
- 5 Under which **two** circumstances would a business use price skimming? (1)
- To cover development costs for a product:
- that has a short life cycle
 - that may be quickly copied by competitors.
- 6 (HL) What does ‘marginal cost’ mean? (2)
- This is the cost of making one more additional unit of output.
- 7 (HL) Construct an equation to represent contribution. (2)
- Contribution = sales income – variable costs

8 (HL) What does the 'contribution' contribute towards? (1)
It contributes towards paying fixed costs.

9 (HL) If a business with spare capacity has a profit after paying fixed costs, why might it decide to sell additional items at a lower sales price? (2)
Spare capacity may otherwise go unexploited. After covering fixed costs using contribution, any additional income from items sold would be a profit.

10 (HL) What is the difference between competition (going rate) pricing and destroyer pricing? (2)
Competition pricing sets prices according to the prices of competitor products, whereas destroyer pricing deliberately undercuts competitor pricing in order to force them out of the market.

11 (HL) Under what circumstances might a business use price discrimination? (2)
When different groups of consumers have different elasticities of demand and there is no resale between the various groups.

12 (HL) Explain an example of a loss leader product in a supermarket. (2)

Accept any example which recognises that one product is sold at a price below the cost price in order to attract customers, who will probably buy other products too.

13 (HL) Give **two** reasons why a business may use promotional pricing. (2)

- to gain market share
- to sell off excess stock

14 (HL) Give an example of psychological pricing. (1)

Accept any answer with appropriate use of nines (e.g. 99p, £1.99, £9999, etc).

15 (HL) In a supply and demand graph, what does demand mean? (2)
This is the quantity of items customers are willing and able to buy at the existing market price.

16 (HL) Give the equation for price elasticity of demand (PED). (2)
$$\text{PED} = \frac{\% \Delta \text{ quantity}}{\% \Delta \text{ price}}$$

- 17 a** **(HL)** How would the PED equation given in your previous answer be adapted to calculate cross elasticity of demand (XED)? **(2)**
The percentage change in quantity would relate to one product and the percentage change in price would relate to another product.
- b** **(HL)** For what type of products would a XED be calculated? **(1)**
Substitutes
- 18** **(HL)** How would the PED equation be changed in order to calculate income elasticity of demand (IED) or advertising elasticity of demand (AED)? **(1)**
The denominator is changed to be either average income or advertising spend respectively.
- 19** **(HL)** PED is calculated to be 1.4. What does this mean? **(2)**
This means that if price is dropped 1%, demand increases 1.4%.