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Practice exam questions

Drip pricing: an underhand practice?

Mark Hage

Check your answer to the question on pp. 8–11 of the magazine. This question relates to the AQA specification.

Sample answer

As Natural Weigh (NW) appears to sell items that are comparatively price inelastic, due to their unique selling point of being less wasteful, it may be able to increase prices with little drop in demand. For example, having put the price of muesli up by approximately 33% in 2024, to £4 per 500g, demand dropped by a comparatively small amount of 5%. If the other ethically sourced products sold by NW, e.g. bamboo toothbrushes, have the same level of PED then Chloe and Robin Mansfield may be confident that NW's profit margins will increase by around 33%, with only a small reduction in demand. As PED is calculated to be 0.15, demand may be said to be inelastic to changes in price, leading to greater overall profits. Such premium pricing will help to maximise profits, leading to greater funds available to finance growth of the business without a significant increases in fixed costs, such as having to increase the size of the premises.

However, it may be that other products sold by NW, e.g. nuts, are more price elastic than muesli. Increases in the price of these products could cause a large decrease in demand. The majority of other products sold by NW may have a PED greater than 1, meaning that a 5% increase in the price of nuts, for example, may actually result in a 30% drop in demand – a highly elastic product. As a consequence, profit margins across all products may reduce significantly and may even result in fixed and variable costs not being covered by sales revenue, causing an inability to break even – a loss. This may mean that not only would price increases fail to finance any further growth for NW, but also none of the £40,000 initial set-up costs could be recouped as the business may fail to make any profit.

The market for ethical household goods has grown by £951 between 2017 and 2019 (£1,238 a year in 2017). It is clear from NW's PED for muesli that increasing the price of its products to fund business growth is likely to allow them to have greater levels of profits for this objective. As it is unlikely that NW has any current competitors in the 'small Welsh town' it operates in, its product range may have first-mover advantage, increasing profit margins and allowing for reinvestment to grow their business.

Sample examiner comment

Mark: 12/12 (level 3 – an excellent response, fully focused on the question)

The answer demonstrates a depth and range of knowledge and understanding of issues regarding increasing product prices to fund growth of the business.

Application is shown through the use of appropriate context applied to the question.

The answer demonstrates well-developed analysis, giving cause and effect of the range of issues impacting Natural Weigh's decision to raise product prices in order to create increased profits and fund growth.

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