Vol. 3, 1, June. 2014

KASU Journal of Accounting Research and Practice

Published by: Department of Accounting
Kaduna State University (KASU)

Vol. 3, 1, June. 2014

KNOWLEDGE FOR DEVELOPMENT AND UNITY

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Articles

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EFFECT OF PRICING DECISIONS ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN KWARA STATE

Abstract: The strategic nature of price determination has been trivialized by the SMEs in Nigeria as they jumped at any opportunity of temporary raw material scarcity or associated price hike to increase their product prices leaving the consumers with paying higher for products that remain the same in quality and quantity. This share lack of pricing and marketing strategies had led to constant strike actions and increase in prices by bakeries in Kwara State and thus propelled the need to evaluate the effect of pricing decisions on turnover of these bakeries which forms the fundamental objectives of this paper. The primary data used in this study were obtained through questionnaire administration on 100 purposively selected respondents from 20 registered bakeries in Kwara State while the secondary data were obtained from the records of these bakeries. The primary data were anlysed descriptively while the secondary data were analysed using student t-distribution test of two mean and price elasticity of demand was conducted while Pearson Moment Correlation Coefficient was carried out to establish the degree of relationship between turnover and changes in pricing decision. The result reveals an insignificant increase in turnover/ profitability as price of bread increases while no form of conventional pricing methods or marketing strategies is followed in pricing policy of the bakeries but they depend on the rule of thumb as well as their desired profit margin in fixing product prices(X_1-X_2=65.06, $t=0.67$ and $R^2=84\%$). More so, the demand for bread is inelastic as it has no close substitute. The study recommends that training of the bakery operators on conventional pricing and marketing strategies, while the services of experts should be engaged in price determination with a view to keep cost of production under control and evolves appropriate prices that will increase their turnover and bring value to the consumers.

Introduction

Pricing decision is a crucial decision every organization has to make irrespective of industry, location or scale of operation as it ultimately affects their corporate objectives either directly or indirectly. Thus, any business, big or small, simple or complex, private or public, is established to provide competitive prices but setting prices for an organization's product or service is one of the most challenging decisions a manager faces as such decisions are influenced by myriad of factors both internal and external. Such factors include demand, competitors, costs, political and environmental factors, legal as well as image-related issues.

The objective of business enterprises vary from profit maximization, wealth maximization to market penetration, establishing market share and becoming a market leader. However, except for non-profit oriented organization which is not set up to make profit, all business organizations seek to maximize profits and minimize costs while pursuing the achievement of their corporate objectives. This gave rise to the need to adopt an appropriate pricing strategy. According to Lovelock and Wirtz (2004), the principal approach to an effective pricing strategy is to manage revenues in ways that support the profitability objectives.

Little emphasis is however placed on the effect that the costing techniques adopted by business organizations has on its sales and ultimately its profitability. Each costing technique give rise to different cost of production depending on the costs that were absorbed which ultimately affects its price. Since the law of demand and supply invariably relate price with the turnover of a product, the profitability of a product may be said to be indirectly influenced by the costing technique adopted by the organization. This study therefore examines the effect of pricing decisions on profitability of small and medium scale enterprises in Kwara State.

Decision is a choice between alternatives as well as having all necessary information about the various alternatives available. Pricing decision needs to be taken carefully using all available relevant information to make an informed decision. It goes without saying that a product cannot be sold at a price lesser than its cost of production as there is a need to recover cost in order to be able to continue operation and remain in business thereby satisfying the accounting going concern concept. Also, all things been equal, a product of similar quality and usefulness cannot be indefinitely priced higher than those of the competitors as this will lead to loss of market share and reduction in sales. This creates the problem of finding equilibrium between these two extremes that will achieve the objectives of profit maximization.

Pricing decision is handled by mere guesswork by most SMEs in Nigeria with little consideration for determinant factors. Adequate costing information is not available to make an informed decision as proper accounting records are usually not kept. More often than not, SMEs adopt costing and pricing strategies that are inimical to the achievement of their corporate objectives due to lack of requisite knowledge of cost and management accounting. This makes it difficult, if not impossible for them to compete favourably with their foreign counterparts or the large scale industries that have specialized department for this purpose. This leads to the incessant failure of SMEs in Nigeria. Because majority of Nigeria populace depend on SMEs, it portends an unfavourable trend for the economic development of Nigeria and the achievement of the millennium development goals if majority of them failed due to lack of proper pricing decisions.

The above scenario led to the following research questions:

i. What is the effect of product price changes on the profitability of SMEs in Kwara State?
ii. What impact does change in relevant costs have on product pricing of SMEs in Kwara State?
iii. What are the factors responsible for product price changes of SMEs in Kwara State?

In line with the research questions, the major objective of this study is to examine the impact of product pricing on the performance of Small and Medium Scale Enterprises in Kwara State. Other specific objectives are to:

i. assess the effect of changes in pricing decision on the profitability of SMEs in Kwara State
ii. examine the impact of change in relevant costs have on product pricing of SMEs in Kwara State
iii. evaluate the use any conventional costing techniques in making pricing decisions by SMEs in Kwara State

In view of the above objectives the following hypotheses have been formulated in null form:

H_{01}: Changes in pricing decision do not have any significant impact on the profitability of SMEs in Kwara State

H_{02}: Changes in relevant costs do not have any significant impact on the pricing decision of SMEs in Kwara State

H_{03}: SMEs do not use any conventional costing techniques in making pricing decisions by SMEs in Kwara State

The operations of small and medium scale enterprises have been found to be the springboard for accelerating the economic development of a developing nation like Nigeria. The success of these enterprises however depends on their ability to attain a sustained profitability in their operating and market environment which is highly contingent on the efficient handling of their costing and competitive pricing of their products. A

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The operations of small and medium scale enterprises have been found to be the springboard for accelerating the economic development of a developing nation like Nigeria. The success of these enterprises however depends on their ability to attain a sustained profitability in their operating and market environment which is highly contingent on the efficient handling of their costing and competitive pricing of their products. A research work conducted on the impact of various costing techniques and pricing strategy on the profitability and corporate goals of these selected enterprises will serve as an eye opener to the cause of continual failure and lack of competitiveness of the majority of these enterprises in the market place. In addition, the outcome of this type of research work should open up a wide area in accounting, finance and business fields for seeking a veritable solution to common problems of costing and product pricing encountered by similar and other enterprises in Nigeria.

This study was conducted on enterprises located and operating in Ilorin where the influence of major accounting firms is considered insignificant and the influence of business practices are fully embraced may be inconsequential. The result of the study should be able to motivate Accounting, Finance and Business Departments of Nigerian Universities to see opportunities in developing accounting/business packages having local initiatives which can be adopted by these enterprises for their operations instead of depending on the rule of thumb in price adjustments. Such practices are common things in United States of America where universities have developed accounting/business programmes and packages for local peasant farmers and other cottage and small scale enterprises.

Furthermore, as observed, the price of bread in Kwara State has being a subject of concern as bakeries went on production strike from time to time because of the need to increase prices thereby sending consumers on compulsory hunger strike. The sufferings and yearnings of the populace propelled the need to evaluate the input into bakeries pricing decisions as well as its impact on their turnover/ profitability. Therefore, this study examines the effect of pricing decisions on performance of small and medium enterprises in Kwara State.

Literature Review and Theoretical Framework

Central Bank of Nigeria (CBN) provides the classification of <50 and <100 respectively for employees in small and medium enterprises while their asset base should be <-₦1 million and <-₦ 150 million respectively. Findings by economists over the years show that small firms and entrepreneurships play a much more important role in economic growth and development. According to (Beyene, 2002), the private sector which in the past played a modest role in development is now being recognized as an engine of growth as manifested in employment generation, rural development, economic growth and industrialization and better utilization of Indigenous Resources

The price of a unit of goods or services is the monetary worth of it a producer is willing and ready to exchange it with any customer. Economists define price as the amount of money paid per unit of good or service (Black, Hashimzade and Myles, 2012). The pricing of goods and service is important for the success of an enterprise and for the efficient operation of the system as a whole (Nubbemeyer, 2010). Smith (2011) laid the foundation of the neoclassical concepts of price elasticity and market behaviour of firms in setting profit maximizing price at appoint in which the marginal cost coincides with marginal price of their products or services. A firm's pricing policy is a strategic decision that has significant effect on its entire operation scale and performance.

The pricing strategies adopted by companies differ and are influenced by some of the factors stated earlier in this study. Some of the pricing strategies that may be adopted when pricing decision is made according to Kotler, (1998) include Market penetration strategy, Market skimming and Loss leader pricing. Market penetration strategy he said is the process of setting a considerable price, which will be affordable for the customer, thus there may be need for price reduction in order to gain acceptance and thus create speed for the product in the market while **Market skimming**: involves setting a product price high initially and later reducing the price to improve sales. It is used mostly for newly introduced products so that consumers will not react negatively to an increased price to meet cost or make profit. However, **Loss leader pricing** occurs where a product is sold at a lower price probably at a loss in order to attract customers who might then buy other items at normal price. It is used when consumers resist prices charged by sellers and thus encourage sales of other products by the producer.

For an organization to compete favorably with its peer in the same industry, it must be able to meet the demand of the people, as well as set the right price for the right product. Low cost and high quality infrastructure service tends to improve price competitiveness (Beyene 2002). Thus, in any organization, profit making, nonprofit making, private enterprise, public enterprise, manufacturing or service rendering, before the price of a product or service is set, the cost of putting it into saleable condition must be considered. Contrarily, Monroe (2003) pointed out that cost is probably the least important factor to consider when setting product or services prices. Looking at it from the accountants' point of view, it is noted that there is no direct relationship between selling price and product costs, because of competition and elasticity of consumer demand (ICAN 2006, Lucey 1997). Cardinaels *et al* (2004) observed that the more accurate cost data is, the more likely to detect and filter competitors' prices when these prices are a poor reflection of actual costs than would participants with biased cost data. Consequently, prices under activity based costing are likely to be based on more accurate cost data (Ashton 1976; Briers *et al* 1997) rather than on less relevant market feedback.

Dockner *et al* (2004) stated that when firms are engaged in strategic competition, a higher speed of diffusion causes the individual firm to decrease the price, thus competition either directly or indirectly has an influence on the price of products, but vary from company to company, depending on the nature of the product and the industry in which the company operates. Thus, in (oligopolistic) competition, the speed of diffusion has an important influence on the optimal pricing policy in a monopolistic market, when essentials are sold, competition is not considered when setting price.

Fabiani *et al* (2005) investigated the behavioural mechanisms underlying price setting on the basis of new survey evidence covering 11,000 firms in the euro area. Two pieces of evidence from the survey suggest that the model of perfect competition with the law of one price does not seem to be the blue print for most of the goods and service markets in the euro area. First, mark-up pricing is the dominant price setting practice adopted by firms in the euro area. Second, price discrimination is a common practice.

Brierley, Cowton, Christopher and Drury (2008) conducted a research study on the British manufacturing industry. They employed the use of questionnaire to identify which types of product cost used in pricing decisions, and interviews to assess how product costs are used in pricing decisions. The results indicate that operating units using cost-plus pricing, to assist in determining selling prices, but consider market-based factors by adjusting the cost-plus price for these factors.

With respect to pricing and SMEs turnover/ profitability (performance), the related theories are the neoclassical theory and prospect theory. According to the neoclassical theory of the firm, businesses exist and make decisions in order to maximize profits. However, the modern view of the theory sometimes distinguishes between the long-run motivations (sustainability) and short-run motivation (profit maximization). The theory states that in making pricing decisions, firms are not only interested in profit maximization but also in goals based on sales maximization, public relations and market share. On the other hand prospect theory says that in decision making, managers differ in their attitude towards a risk of gain and a risk of incurring loss. This explains why a manager will be willing to sell a particular product at a lower price with certainty than taking the risk of charging a higher price and having excess stock on hand as long as the price leaves a margin of profit. Thus, in setting product prices, manager tend to err on the side of certainty as much as possible and will rather set a lower price and a make marginal profit than risk setting a higher one that may lead to losses.

Methodology and Data

To measure the relationship between the change in product prices and the sales/ turnover, primary data was used and was obtained through administration of structured hybrid questionnaire on respondents to determine their involvements in pricing while the secondary data relating to pricing were obtained from the financial records of the sampled bakeries. Check for the validity and reliability of the instrument was provided by ensuring that items that most related to independent and dependent variables are built into the instrument. A sample size of 100 respondents was randomly selected (5 each) from the population of the 20 registered and recognized Small and Medium size Bakeries in Ilorin, Kwara State was used. Our target was on bakeries that have engaged in price changes previously. A total number of 96 questionnaires were returned but only 92 questionnaires were found useful for the study.

The study variables include cost of sales, demand, sales turnover and profitability. These were modeled into student t-distribution test of two means in comparing whether significant difference exists between the old and new prices. Also, a price elasticity of demand was carried out to determine the susceptibility of bread demand to change in prices while a Pearson's moment correlation coefficient was computed to establish the degree of relationship between turnover and changes in pricing decision

The student t test is given as:

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$$t = \frac{\bar{X}_1 - \bar{X}_2}{S.E}$$

$$\text{Wher e } S.E = \sqrt{\frac{\sigma_1^2}{N_1} - \frac{\sigma_2^2}{N_2}}$$

σ_1^2 = variance at old prices
σ_2^2 = variance at new prices
N_1 = number of observation at old prices
N_2 = number of observation at new prices
X_1 = mean of old prices
X_2 = mean at new prices

Result and Findings.

Analysis carried out includes demographic characteristics of managers, sales volume and quantity as well as other variables related to the research questions.

Table 1: Data from Sample Firms (Sales Reaction to Change in Price)

Products	November 2012		December 2012		February 2013		March 2013	
	Price ₦	Sales ₦'000	Price	Sales ₦'000	Price ₦	Sales ₦'000	Price ₦	Sales ₦'000
Big loaf	200	4,700	200	4,750	250	5,000	250	5,125
Medium loaf	150	3,375	150	3,750	200	4,250	200	4,000
Mini loaf	100	1,350	100	1,725	120	1,500	120	1,950
Small loaf	50	537	50	625	60	600	60	675

Source: Data collected by Researcher (2014)

Evidence from table 1 reveals an alarming 25%, 33%, 20%, 20% increase in prices of big, medium, mini and small loaves of bread respectively. These prices changes were considered unorthodox and not in line with any theoretical proof (does not follow any pricing strategy) as the price jumps took place within a period of 5 months. Also, increase in prices of mini and small loaves had brought about more than a proportionate increase in sales revenue to the bread makers but untold hardship on the ordinary people that usually patronizes this class of bread.

Table 2: Data from sample Firms (Effect of Change in Cost of sales on price)

Month	Cost of sales ₦'000	Price	
November	6912.50	Big loaf	200
		Medium loaf	150
		Mini loaf	100
		Small loaf	50
December	7547.50	Big loaf	200
		Medium loaf	150
		Mini loaf	100
		Small loaf	50
February	8185.00	Big loaf	250
		Medium loaf	200
		Mini loaf	120
		Small loaf	60
March	8422.25	Big loaf	250
		Medium loaf	200
		Mini loaf	120
		Small loaf	60

Source: Research Findings, (2014).

Table 2 shows the relationship between cost of (production and sales) and selling price which indicates that as the cost of sales increases by 21%, selling prices of bread jumped up by 38%. This comparism shows that although cost of sales increases over the period but had resulted to a more than proportionate increase (almost double) in the selling prices of burden of which goes to the final consumer.

Table 3: Effect of Changes in Price on Net Profit

Month	Sales ₦'000	Cost of Sales ₦'000	Gross profit ₦'000	Other expenses ₦'000	Net profit ₦'000	Average profit ₦'000
November	9962	6912.5	3010.75	391.98	2618.77	2743.09
December	10850	7547.5	3302.50	435.10	2867.40	
February	11350	8185	3165	543.87	2621.13	2678.03
March	11750	8422.25	3327.75	592.82	2734.93	

Source: Author's Computation, (2014).

Table 4: Price Elasticity of Demand.

Product	Old price ₦	New price ₦	Change ₦	% change	Old qty	New qty	Change	% change	$E_{(R)}$
Big loaf	200	250	50	20	945	810	135	-14.3	-0.572
Medium loaf	150	200	50	33	950	825	125	-13.2	-0.40
Mini loaf	100	120	20	20	615	575	40	-6.5	-0.325
Small loaf	50	60	10	20	465	425	40	-8.6	-0.43

Source: Author's Computation, (2014).

Table 3 and 4 show the result of price elasticity of demand and the effect of changes in price on profitability. From table 3, it can be deduced that an increase in price led to an overall increase in gross profit of bakeries while the total revenue had declined as a result of other expenses not cost of sales. This is characteristic of relatively inelastic products and this is consistent with the result of the price elasticity of demand as presented in table 4 where all the products have a negative $E_{(R)}$ value that is lesser than 1. Such products are only minimally affected by changes in prices as long as they are not substantially overpriced or priced over those of substitutes. Unfortunately, bread has no close substitute and that accounts for the inelastic responses of demand to the incommensurate changes in cost of sales. More so, bread is a staple readymade diet and enjoys fairly constant demand irrespective of prices. No wonder why the increase in price has been successful without any repercussions on the part of the sellers.

Test of Hypotheses

Hypothesis I

H_0: changes in pricing decision do not have any significant impact on the profitability of SMEs

Table 4.5: Result of Student t-distribution Test and Correlation Analysis

X_1-X_2	S.E	$t_{0.95}$	$t_{0.99}$	t_{cal}	R	r^2
65.057	96.675	1.96	2.58	0.67	0.92	0.84

Source: Authors Computation, (2014).

From the results presented in table 4.5, the calculated *t* value is less than the tabulated *t* value *i.e.* 0.67<1.96(2.58). Thus, the null hypothesis is accepted at both 95% and 99% level of significances, indicating that, there is no significant impact of changes in pricing decision on turnover/profitability. This is because other expenses exercise a huge impact on profitability than prices of bread in Kwara State. However, in light of the price elasticity of demand test carried out, it can be concluded that the relative inelasticity of the demand for bread is responsible for the t-test result.

Hypothesis II

H_0: changes in relevant costs do not have any significant relationship with the pricing decisions of SMEs

From the results presented in table 4.6, the correlation coefficient "*r*" shows that there is a strong positive (92%) relationship between changes in cost of sales and pricing decision. Furthermore, the coefficient of determination "r^2" shows that 84% of the observed changes in price is explained by changes in costs of sales. Thus, it can be concluded that increase in cost of sales will result in an increase in prices of product indicating the rejection of the null hypothesis.

Hypothesis III

H_0: SMEs do not use any conventional costing techniques in making pricing decisions.

Table 4.7: Result of Z-Test

Responses		μ	S.E	Z0.99	Z0.95	Zcal	Decision
yes	no	46	17.68	1.96	2.58	1.414	Accept H_0
71	21						

Table 4.8 Primary Data Analysis

Items	Options	Frq.	%
For how many years have you being into bread making?	Less than 3 years	18	20
	3-5 years	21	22
	5-10 years	27	28
	Above 10 years	28	30
What type of production did you engage in?	Manual/ local	82	89
	Electric oven/bakery	6	7
	Both	4	4
What type of method did you adopt in your pricing decision in placing prices on your bread?	Target based pricing	2	2
	Value based pricing	3	3
	None	87	95
What type of market strategy did you adopt in your prici ng decisions?	Market skimming	1	1
	Market penetration	2	2
	Loss leader approach	Nil	-
	None	89	97
What happens to your sales/ bread selling when you increase your price	Bread demand increases	30	32
	Bread demand decreases	9	10
	Demand remain the same	53	58

Table 4.8 reveals that 30% of the selected bakeries have been in the business for more than 10 years while 28% have had between 5-10 years experience in baking. This indicates that those selected had been involved in costing and pricing decisions and as such are appropriate to give reliable responses to the research questionnaire. However, majority of the bakeries have been undertaken manual/ local production system, precisely 82% while 6% have electric oven and 4% use both methods.

Summarily, it can be seen from the table that the bakeries did not embrace any form of conventional method in placing prices on their products. Anytime they feel like, they just decide to increase the price of their products especially when a little temporary short supply/ price hike is experienced in their raw materials. Worse still, no form of marketing strategy is adopted in pricing decisions of the selected bakeries but decide to follow their desired profit margin. This result indicates the share lack of pricing and marketing methodology in price determinations and this rule of thumb make the generality of consumers suffer the pain of paying higher prices for unchanged quality and quantity.

Conclusion and Recommendations.

It can be concluded that the prices set by an organization affects its profitability either positively or negatively depending on the inherent characteristics/ price elasticity of the product as well as outside factors including the proficiency of managers in conducting strength, weakness, opportunity and threat analysis and making apt decisions there from. While the cost of sales has the ability to affect the prices of product, it cannot be considered in isolation in setting prices. This is because other factors including method of costing adopted by a firm, availability of adequate information and the aptness of pricing decisions that impact on the profitability of the small and medium scale enterprises in Nigeria.

Based on these findings, the study recommends that government should provide expert advisory services to SMEs on strategies for boosting performance instead of constant price changes. Small and Medium enterprises in Nigeria should take time out to conduct market research, because this is a toll that can be used for effective pricing, The organizational objective should be visited when making pricing policy while management of small and medium enterprises should always have adequate information about the cost of production before changing price, and customers reaction should be considered when fixing and after any significant change in product prices. Other methods of changing price, like reduction in quantity and introduction of new products can be looked at by the managers of small and medium enterprises in Nigeria. Better still; SMEs should employ the services of price experts when making pricing decisions.

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