An investigation into the pricing methods used by small and medium-sized enterprises

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ABSTRACT

This thesis investigates the pricing methods used by small and medium-sized enterprises (SMEs). Prices are a key determinant of demand which influences revenue and in turn the business' profits. A business may fail if products and services are priced incorrectly. Pricing decision is, therefore, one of the critical success factors of a business, including SMEs.

There is consensus widely disseminated in the textbook literature, that successful pricing can only be achieved when a multiplicity of factors are considered and managed and different pricing methods are applied. The shortcomings of limitations of theoretical concepts of supply and demand, market price and cost-based pricing make it necessary for managers to opt for alternative pricing methods that may address the gaps found in these determinants of price. Pricing objectives need to be stated explicitly and they should be in line with the overall company objectives.

One of the key factors that marketing managers need to remember is that price is one element of the marketing mix and should not be set in isolation. Since price is a major determinant of profitability, developing a coherent pricing strategy assumes major significance. There is both art and science in deciding the right price, but the basic principle must be to equate profitability with goodwill and repeat business.

It is not within the remit of this research to provide a detailed critique of small and medium-sized businesses, but clearly the population of SMEs ebbs and flows as businesses are started as businesses fail. The SME business sector is discussed briefly by giving an overview of the definition and discussing pricing as a critical success factor in SMEs.

The methodology applied is both quantitative and qualitative in nature. Secondary data has been collected and it was used as the point of departure for the study. The literature

review has given the background of pricing and price determination, followed by an empirical study through the questionnaire.

The overriding perception derived from the findings in this study is that no decisions are taken in an isolated or discrete circumstance. Price was consciously considered with different context such as considering costs, value, competition, demand, revenue, margins and markups, profits, survival and market share. However, in some cases setting price was based on a gut feeling of the managers. The company's pricing policy proves to be an important indicator of the company's overall image and the quality of its product.

Pricing will always be a challenging area. The researcher has therefore developed a model – called the integrated pricing model – which is recommended for SME managers.

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CHAPTER 1

INTRODUCTION TO THE STUDY

1.1 Background

During the last few decades there has been a renewed interest in the small and medium-sized enterprises (SMEs) in most countries, including South Africa. This interest can be attributed to the capability of SMEs to create jobs or employment opportunities, poverty alleviation, income distribution, economic growth and development, economic empowerment of previously disadvantaged population groups and democratisation of economic participation.

The importance of SMEs was brought to light first by David Birch, an American academic, over three decades ago. Prior to this, small enterprises have been a neglected part of most countries' economies for most of the World War II years. In the United Kingdom various studies, including the influential Bolton Committee Report, commissioned by the government to investigate the state of the small business sector, had identified that the sector was starved of equity capital and experienced management, but until Birch's paper no one accepted quite how important new and small enterprises were to a country's economic well-being (Barrow, 2002:1).

In South Africa, small enterprises, that may also be referred to as small, medium and micro enterprises (SMMEs), are defined according to the National Small Business Amendment Act (29/2004). According to the Act, small enterprise means a separate and distinct business entity, including cooperative enterprises, managed by one owner or more predominantly carried on in any sector or sub-sector of the economy in accordance with the Standard Industrial Classification (SIC), size of class, total paid employees, total turnover, and total gross asset value excluding fixed property. Although the Act refers to these enterprises as SMMEs, the universally used acronym is SMEs and this will be used throughout the study.

The assessment of the role of SMEs in the South African economy vary widely, but it is estimated that about 95% of the total business sector, formal or informal, is comprised of SMEs, accounting for about 46% of total South African economic activity. SMEs provide about 84% of all private sector employment. Formal sector SMEs, an estimated 80% of all formal sector activities, contribute more to the South African gross domestic product (GDP) than the cumulative amount of the corporate giants. Informal sector SMEs provide employment and income to more than 3,5 million people (Hamann *et al.*, 2005:13). It is thus apparent that SMEs play a crucial role in sustainable development in South Africa and this role can be enhanced considerably.

According to Griffin *et al.* (2005:127), the SME sector contributes up to 90% of the gross national product in Europe. The Confederation of British Industry estimates that there were 3.7 million SMEs in the United Kingdom (UK) at the start of 1999. The majority of these (98%) had less than 50 employees. It has been estimated that SMEs provide employment for over 74.5 million people and are responsible for around two thirds of total employment in the UK.

Dlabay and Scott (2001:225) cite that about 95% of all businesses in the United States of America (USA) have fewer than 50 employees. Of the 14 million businesses in the European Union, only 7% of them have more than 9 employees. Small businesses are commonly categorised according to number of employees. The US Small Business Administration defines a small business as one with fewer than 100 employees. Entrepreneurial efforts provide a nation with three main economic and social benefits. Small businesses are major creators of new products, sources of new jobs, and they often provide personal services.

According to Donegan (2002:2), of the 800 000 to 900 000 SMEs formed each year in the USA, over 80% will close their doors within five years of inception. Nearly 50% of these failures are due to management's lack of managerial and financial ability. An additional 16% of these failures are due to improper balance of operational and financial initiatives. There are many reasons for business failures, although it is clear that many are due to the inability of managers to balance administrative and back-office functions like finance with operations. By tying the finance to operations, SMEs that are inherently at risk may, at best, hold up themselves into profitability or, at least, extend their lives through challenging times.

Statistics on business failures are not always readily available in South Africa. However, Radipere and Van Scheers (2005:402) state that 40% of new business ventures fail in their first year, 60% in their second year, and 90% in their first 10 years. According to the Small Business Advisory Bureau (2005:13), many SMEs die in their infancy, thus within the first two years from start-up. More than 80% of new entrepreneurs almost always fail to recognise the importance of cash flow. This is critical, because most businesses grow from their cash flow. Bad pricing contributes to more than 70% of business failure.

One may ask why focus on SMEs. Perhaps the reason lies in the corporate mortality rate, the contribution these businesses could make to the economy of the country and the rate of unemployment in South Africa. In view of this, SMEs need to be developed to sustain operation and grow to their full potential. SME manager is compelled to wear many hats in carrying out his or her duties as leaders of business organisations. Often the finance hat is most critical. SMEs' survival depends on financial health. It is therefore important for managers to make sound decisions to optimise their companies' financial results and improve the financial position that may help to grow the business.

Gourville and Soman (2002:95) state that managers spend a lot of time thinking about how to get customers to buy their products. But that is just half the battle. Organisations that wish to build long-term relationship with customers should make sure that their customers actually use their products. Notwithstanding, the first step is pricing. Higher consumption means higher sales, costs drive consumption, and pricing drives perception of cost. This perception is influenced greatly by the manner in which the product is priced.

One of the critical success factors of a business, including SMEs, is pricing decision-making. Pricing is the key to revenue. Revenue is the price charged to customers multiplied by the number of units sold. Price is, therefore, half of the gross revenue equation. As a result, even a small change in price may drastically influence revenue, especially for SMEs. Revenue is what pays for every activity of an enterprise, which includes production, finance, sales, distribution and others; and what remains, is profit. Otherwise, one may experience either a breakeven, where total costs are equal to total revenue, or loss. Profit is important for the business's growth.

Pricing is the main revenue generator for SMEs. It may also determine their success or failure. Profit is important because it may allow an enterprise to grow to its full potential and solve its financial difficulties. Without profit, SMEs may not survive because they have limited financial resources to sustain operation as compared to large organisations that may have other sources of income. For example, large companies may get income from their subsidiaries and associate companies that may bolster their financial position. The total revenue of SMEs may be a direct reflection of the two components which are sales volume and price.

Avlonitis and Indounas (2005:1) have underlined the importance of pricing decisions for every company's profitability and long-term survival. They point out that if effective product development, promotion and distribution sow the seeds of business success, effective pricing is the harvest. Although effective pricing can never compensate for poor execution of the first three elements, ineffective pricing can surely prevent those efforts from resulting in financial success.

Prices are a key determinant of demand which influences revenue and in turn the enterprise's profits. Demand may be influenced by consumers' perception of value in the product and the ability and willingness to pay. Hence, for enterprises, the ability to integrate pricing and product decisions may result in significant gains. The price of a product may play two major roles in a business. It firstly influences how much of a product consumers or buyers may purchase. Secondly, it influences whether selling the product will be profitable for the marketer or seller. These two roles make setting the price of a product one of the most important decisions. If consumers are not able to buy at the price set, the seller may not sell his or her products. Product, marketing communication and distribution represent the marketer's attempt to create value, whilst pricing may be viewed as the attempt to capture some of the value in the profit to be earned. The key to effective pricing is to ensure that the price charged reflects the amount of value a customer is receiving and elicit the required demand to make targeted profits.

Price is the value that consumers put on the utility received from a product. Demand may fall to zero or close to zero when the prices are too high and they are not affordable to the consumers. This may also be the case if they do not perceive value in the price charged. The market-driven and value-creating approach to pricing is critical for SMEs. SME managers need to recognise that in the market-driven approach, price is a statement of value and not a statement of cost. Value is getting what one wants from a product. It roughly represents a buyer's overall evaluation of the utility of a product based on perceptions of the net benefits received and what should be given up. Phrases that are often heard from buyers include '*value for money, best value* and *you get what you pay for'*. Competition may also be important depending on the competitive environment. Competitors' prices and offers may be used as an orientation point for an organisation's prices.

One of the most important decisions managers may have to make is pricing. The manager may do everything else in the business correctly; however, a business may fail if products are priced incorrectly. Pricing decision-making is critical to the success of a business even though many small business managers make poor pricing decisions. The most frequent mistake made by new venture founders is to pitch prices too low. This mistake may be as a result of SME managers not understanding all the costs associated with manufacturing and marketing one's product. These costs are nearly always higher than first estimated and they also depend on the costing method or system used. Different costing methods may reflect different costs which may in turn show different prices and different profits for the same product. For example, standard costing, marginal costing and activity-based costing may reflect completely different unit and total costs. Managers should understand the implications of different costing methods. SMEs may also be caught through yielding to the temptation to undercut the competition at the outset without understanding pricing strategies and costs of the competitors. A further line of thought in the area of SMEs pricing is that the managers' intuition and experienced judgement may be the dominant factor. Prices may often be based on hunches.

According to Carson *et al.* (1998:74), the pricing practices of SMEs lead to less than optimal financial results. The apparent absence of a technical approach to pricing in SMEs has led some writers on the subject to contend that pricing be treated as more of a managerial art than a science. There is much evidence to suggest that SME managers do not manage their businesses in a textbook or functional way. They are more likely to take pricing decisions in a haphazard and apparently chaotic way as opposed to any orderly, sequential and structured fashion. Entrepreneurship dictates the pricing approaches employed by SMEs. However, there is a consensus widely disseminated in the textbook literature that successful pricing can only be achieved when a multiplicity of factors are considered and managed and different pricing methods are applied.

Many SME managers do not appear to be overly motivated to find the best price that may maximise profit. While in theory the SMEs should consider all the factors affecting pricing in their larger counterparts, in practice SME managers appear to be employing some form of cost-plus pricing probably due to its simplicity and easiness to use or because it carries an aura of financial prudence. Pricing products to yield a required return over all costs achieve financial prudence according to this view. While cost-plus pricing appears to be the most commonly used approach in the SME sector, it suffers from a number of weaknesses.

The problem with cost-driven pricing is fundamental. It assumes that enterprises actually know what their costs of production are at given levels of output. It may sometimes be impossible, in some enterprises, to determine a product's unit cost before determining its price because unit costs change with volume. This cost change occurs because a significant portion of costs is fixed and should somehow be allocated to determine the full unit cost. Since these allocations depend on volume, which changes with changes in price, unit cost is a moving target. Managers are forced to make the absurd assumption that they may set prices without affecting volume. The failure to account for the effects of price on volume and of volume on costs may lead managers directly into pricing decisions that undermine profits. It does not encourage efficient use of resources and it fails to consider consumer demand and competition appropriately. This pricing method may be detrimental to the success of the business. Cost should, therefore, be the last thing to be analysed in a pricing formula, not the first.

Microeconomics suggests a way of determining prices that assumes a profit maximisation objective. This technique attempts to derive correct equilibrium prices in the marketplace by comparing supply and demand. It also requires more complete analysis than actual business enterprises typically conduct. SME managers may understand price theory concepts but still encounter difficulty applying them in practice. There are practical limitations that interfere with price setting in this mechanism. First, many enterprises do not attempt to maximise profits. Economic analysis is subjected to the same limitations as the assumptions on which it is based; for example, the proposition that all enterprises attempt to maximise profits. Second, it is difficult to estimate demand curves. Modern accounting procedures provide managers with a clear understanding of cost structures, so managers can readily comprehend the supply side of the pricing equation. But they find it difficult to estimate demand at various price levels. Demand curves should be based on marketing research estimates that may be less exact than cost figures. Although the demand element can be identified, it is often difficult to measure in a real-world setting. The practical limitations inherent in price theory have forced practitioners to turn to other techniques or pricing approaches.

The seller and the consumer attach different meanings to the price concept. Sellers regard price as one of the marketing instruments used to achieve an enterprise's objectives. For the consumer, the price he or she pays for a product entails a sacrifice of disposable income. It is a salient attribute for nearly all consumers in virtually every product category. The final price usually represents a compromise between the seller who wants to receive as much as possible and the consumer who wants to pay as little as possible. This shows that prices cannot be set in a vacuum. There are factors like cost, demand, competition, revenue, profit and many others that need to be considered when pricing a product. The question now arises as to how the problem of setting an appropriate price in SMEs is going to be solved.

This empirical research attempts to establish the pricing methods used by SMEs and in need suggest possible solutions for the managers. The importance of price, pricing objectives, pricing policy, factors affecting pricing decisions, general pricing approaches, price setting in the business world, pricing as a critical success factor of small and medium-sized enterprises and pricing in small and medium-sized enterprises are discussed as the foundation for the empirical study.

It is imperative that SME managers understand the different pricing approaches that may enhance revenue and profits in their enterprises. Pricing approaches are critical for the achievement of company objectives as they are the execution of the strategy. They may in some instances be influenced by what a business would like to achieve either in the short or long-term. They have underlying objectives which may include survival, profitability, gaining market share, attracting customers, status or prestige and sustainability. There are also factors that may influence pricing and they should be taken into account when pricing products.

In summary, the pricing practices of SMEs lead to less than optimal financial results. A business may fail if products are priced incorrectly. Sellers may not be able to sell their products if there is no value perceived or if the prices are too high and they are not affordable to the consumers. Prices cannot be set in a vacuum as there are factors to be considered when pricing a product. Gut feel and thumb-sucking are not appropriate for pricing, especially in the world of stiff competition. A haphazard and chaotic approach of entrepreneurship that dictates the pricing approaches employed by SMEs may not be appropriate for businesses in the twenty-first century. The total revenue of SMEs may be a direct reflection of the two components which are sales volume and price. Effective pricing is the harvest of what has been sown. Appropriate pricing methods are important to price products effectively. Many SME managers make poor pricing decisions. They employ some form of cost-plus pricing which has serious shortcomings. Marketers may understand price theory concepts but still encounter difficulty applying them in practice because there are practical limitations that interfere with price setting. Managers may gain a lot by placing their emphasis on an integrated pricing approach and implement pricing methods that may achieve pricing objectives and in turn the enterprise's objectives.

In view of the factors above, it is evident that a problem exists in pricing for SMEs. This problem needs to be addressed by ensuring that appropriate pricing methods are applied. Price should be right to penetrate the market, to maintain market position and to make profit. Pricing should maintain the balance between keeping prices low enough to push sales up and keeping them high enough to make a profit. Pricing approaches or methods and the price setting process are discussed in the later chapters. A special attention will be given to pricing in the SME sector. It should be noted that the study is addressing both tangible and intangible products, namely, goods and services. The word product thus refers to both.

SMEs play a crucial role in sustainable development of a country. Their salient contribution to the GDP, job creation and employment opportunities, poverty alleviation, distribution of products to consumers and contribution to conglomerates cannot be ignored. However, the failure rate is a concern. SMEs need support from academics, government, conglomerates and the public at large in order to realise their financial objectives. This may allow them to grow further and create more jobs, especially in developing countries like South Africa where the rate of unemployment is very high. Extensive empirical research is necessary to give SME managers the base for learning more about pricing methods or approaches in their business sector.

Literature for pricing is enormous. Marketers have researched the subject intensively. However, the books relating pricing, specifically, to SMEs are very limited. SMEs' have also been researched very well but very few authors address pricing in this business sector. There are many books and some journals which address pricing and different pricing methods but they are general, as they do not specify the business sector to which the pricing approaches apply. Many marketing books address pricing under marketing mix although some may be very brief. The statement made by Avlonitis and Indounas (2005:1) '*there seems to be a lack of interest among marketing academics on pricing*' is difficult to justify. Pricing and pricing methods have ample research. The only concern may be the fact that they generalise as far as the business sector is concerned and the literature study for pricing appear to be limited with regard to SMEs, specifically.

The empirical research that has been conducted on the field of pricing for SMEs is very limited. However, pricing methods in the SME sector necessitate a closer look as pricing is a critical success factor of these businesses. Given this lack of empirical research, this research thesis attempts to contribute to the existing body of knowledge by investigating the pricing methods that the business sector adopts in order to set their prices. A review of the existing literature reveals that managers of SMEs have problems in using appropriate and effective pricing methods and they tend to use cost-plus pricing which has serious shortcomings. They need to understand that incorrect price may lead to business failure. It is also not easy for the seller to estimate the demand, which is critical in selling one's products, outrightly.

Nagle and Holden (2002:2) cite that the difference between successful and unsuccessful managers lies in how they approach the pricing process. Unfortunately, few managers have any idea how to facilitate a cross-functional blending of the two legitimate concerns that are internal financial constraints and external market conditions. From traditional cost accounting, they learn to take sales goals as given before allocating costs, thus precluding the ability to incorporate market forces into pricing decisions. From marketing, they are told that effective pricing should be entirely customer-driven, ignoring costs except as a minimum constraint below which the sale would become unprofitable. Perhaps along the way, these managers study economics and learn that, in theory, optimal pricing is a blending of cost and demand considerations. In practice, however, they find the economist's assumption of a known demand curve hopelessly unrealistic.

A comparative review of the relevant marketing and economics literature shows that there are important differences between the two disciplines in their treatment of pricing. Marketing demonstrates a richer and more empirically based treatment of the pricing issue from the buyer's perspective, while economics is unchallenged from the economy-wide perspective. The differences found between the marketing and economics approaches to pricing are mostly due to their different historical origins, primary concerns and doctrinal evolution. In contrast, interdisciplinary loans especially from behavioural science have made possible considerable advances in marketing, particularly in the understanding of the buyer's perspective. Previous reviews of the pricing literature do not attempt to provide a direct comparison and evaluation and offer no explanation for the observed differences among the economics and the marketing disciplines regarding their treatment of the pricing issue (Skouras *et al.,* 2005:366).

1.2 Problem statement

The current pricing practices of SMEs lead to less than optimal financial results despite the fact that pricing is the critical success factor in this business sector. SME managers are more likely to take pricing decisions in a haphazard and apparently chaotic way as opposed to any orderly, sequential and structured fashion. This pricing approach may be ineffective and prevent the managers' efforts from resulting in financial success. This prompts an investigation into the pricing methods used in this business sector in order to come up with possible solutions that may optimise the financial results of SMEs. To optimise financial results mean reaching the targeted profit. Pricing methods are the explicit steps or procedures by which enterprises arrive at pricing decisions. Traditional pricing methods like economic price theory, cost-plus and going-rate have limitations and they are not able to address the pricing problem SMEs are facing. The shortcomings or limitations of theoretical concepts of supply and demand, market price and cost-based pricing make it necessary for managers to opt for alternative pricing methods that may address the gaps found in these determinants of price. Margins in a stiff competitive environment are squeezed and SMEs are sometimes forced to close down because they are not able to make profit and sustain business in the current situation.

SME managers may fall into a trap of pricing at whatever buyers are willing to pay or what competition dictates rather than at what the product is really worth and this need to be avoided. They face a challenge of striking the balance between the cost of a product and the creation of value that may be perceived by consumers, bearing in mind the competitors' prices and their costs. Although the consumers may prefer to buy from the closer businesses they also would like to perceive the prices to be fair. This may pose a big challenge to SME managers to determine what is fair in consumers' mind. Price should be manipulated sensitively and creatively. Pricing should be viewed as a creative marketing challenge to be met with a new insight into buyers' motivations. The appropriate pricing methods that are in line with pricing objectives and the overall objectives of an enterprise should be effective and they should optimise the financial results, ultimately. The achievement of the financial objectives of an enterprise should be used as a yardstick to measure the effectiveness of the pricing method. Different pricing objectives may be set but it should be borne in mind that their ultimate end in a profit making and not-for-profit organisation is to optimise financial results. Pricing objectives provide directions for action. To have them is to know what is expected and how the efficiency of the operations is to be measured. Although some objectives may not directly be profit oriented, ultimately, they contribute towards optimising financial results.

The solution to the problem may be lying within the integrated approach of setting prices. The application of different pricing methods and consideration and management of multiplicity of factors affecting pricing may lead to successful pricing. It is necessary for SMEs to base prices on pricing objectives and to apply the pricing methods that relate to the objectives. The importance of pricing methods relevant to the pricing and overall business objective cannot be overemphasised. Pricing approaches are the execution of strategy to achieve pricing objectives in a business, and ultimately the overall objectives of an enterprise.

1.3 Objective of the study

The study has one primary objective and four secondary objectives. The primary objective is crucial for this study in order to meet its purpose whilst the secondary objectives give also some critical information that lead to specific actions and recommendations.

1.3.1 Primary objective

The primary objective of the study is to investigate the pricing methods used by small and medium-sized enterprises in order to suggest and recommend pricing approaches that may realise optimal financial results and contribute to the success of the business.

1.3.2 Secondary objectives

The secondary objectives include the following:

- To classify the small and medium-sized enterprises used in the sample.
- To establish the role of pricing to SMEs' financial results.
- To identify the pricing objectives, strategies and policies used in the SMEs.
- To examine pricing determination process in the SMEs.

1.4 Method of research

The study is part of a wider research on the pricing methods used by SMEs. Given the fact that the business sector includes a vast number of businesses, it is almost impossible to investigate all the existing enterprises. It was felt appropriate for the current research to focus on SMEs because they are considered to be significant for every national economy given their contribution to the country's gross domestic product and the number of employees that they employ. Consequently, the business sectors investigated include accommodation, business services, construction enterprises, exporters, financial institutions, importers, manufacturers, wholesalers and retailers.

An extensive review of the literature revealed the lack of intensive previous work aiming to investigate the pricing methods used by SMEs, in particular. The empirical research that has been conducted on the field of pricing for SMEs is also very limited. However, there is no evidence of empirical research for the pricing methods used by SMEs in South Africa. Thus, the value of the thesis lies in the fact that it may contribute to the limited research work done, if not presenting the first attempt, in the business sector with regard to exploring pricing methods, empirically. In order to achieve the research objectives, data was collected from SMEs around Johannesburg CBD. The questionnaire was completed by personally interviewing each respondent.

The number of business enterprises in the list given by the Bureau of Research at the University of South Africa was 1334 which is the population of the research in question. At this point, it was decided that the research should focus only on those businesses that satisfy the definition according to the National Small Business Amendment Act No.29 of 2004. The sample of 400 SMEs which makes 30% (400/1334) of the population, as indicated in table 1.1, was established. The questionnaire was distributed. An appointment was made with the managers who agreed to the personal interviews which were later conducted. The decision to use this method was based on its advantages compared to telephone or mail interviews. These advantages are related to the higher response rates associated with the method, the completion of every particular question and in the right order, the ability of the interviewer to explain ambiguous questions to the respondents along with the ability to ensuring the respondents' eligibility to the survey.

Table 1.1 - Total population, sample and sample as percentage of population

	Population	**Sample**	**Sample as a Percentage of Population**
Accommodation	6	6	100%
Construction firms	63	25	40%
Exporters	48	20	42%
Financial institutions	6	6	100%
Business services	184	50	27%
Importers	126	40	32%
Manufacturers	323	93	29%
Wholesalers and retailers	578	160	28%
Total	**1334**	**400**	**30%**

Source: Own work

A comprehensive review of the existing literature on pricing methods is presented along with the empirical study. The literature study provides a theoretical foundation for the research problem as well as the necessary background to guide the empirical part of the study. Moreover, the data analysis and the discussion of results are reported, while at the end of the thesis the conclusions and the implications of the main findings of the study are presented.

1.5 Scope of the study

Setting the price of a product is one of the most important areas of decision-making in any business. Yet, due to the multi-dimensional nature of pricing behaviour it is a highly complex process and can lead to either the success or failure of many enterprises. Essentially, the pricing decision does not rely on any discipline and encompasses many different theoretical aspects such as accounting, economics and marketing. Strategic pricing is actually the interface between marketing and finance. It involves finding a balance between the customers' desire to obtain good value and the enterprise's need to cover costs and earn profits. What is nearly always true, however, is that the price of a product has a floor determined by the cost and a ceiling determined by the market conditions. Financial managers allocate costs to determine how high prices should be to cover costs and achieve their profit objectives. Marketing analyses buyers to determine how low prices should be to achieve their sales objectives.

Effective marketing is never limited to pricing alone. However, if long-term profitability is the goal, then the pricing decision provides the unifying focus and rationale for the entire enterprise's other marketing decisions. Effective pricing requires proactive marketing strategy to enhance the enterprise's relative competitive position and improve its return on investment (Nagle & Holden, 2002:141).

The scope of the study involves a literature study and survey in 219 SMEs. Price is an element of the marketing mix and the study addresses it from this perspective. The study focused on the marketing discipline rather than from an economics or financial management viewpoint. For example, the economist may be interested in the equilibrium, where supply and demand curves meet to determine the price while the financial manager may emphasise the budget for the revenue generated through pricing. The marketer has to take into account factors like buyer behaviour, sales volumes and level of demand, competition, seasonality, costs, product quality, different pricing approaches, policies, objectives and customers' perception of value. Notwithstanding this, there are interrelations among marketing, economics, finance and other disciplines that should not be ignored in determining prices.

1.6 Limitations

The sample frame used in this study concentrated on the SMEs operating in South Africa. It is therefore important to note that any references made in this study regarding any part of the universe should be seen in the context of the sample frame that was used, which represents the population. The study addresses pricing methods from a marketing perspective. The study is conducted amongst SMEs within the Republic of South Africa under the laws of the country which are governing this business sector. The results pertain to this country's situation and should be interpreted as such. The study is limited to the pricing of products in the SME sector.

1.7 Outline of the chapters

The chapters have been engineered so as to follow a coherent and logical sequence to facilitate and achieve the stated objectives of the study.

Chapter 1 introduces and provides background about SMEs and the concepts of price and pricing. Problems facing pricing managers have been identified and were taken as the point of departure. The problems facing SMEs, the aim of the study, the method of research, the scope of the study and the limitations are explained.

Chapter 2 is a theoretical and literature review of pricing importance, definition of price and its meaning, pricing objectives, policies, and the factors influencing pricing decisions.

Chapter 3 analyses the different pricing approaches and tactics. Various pricing methods are identified and discussed to give an overview of how different organisations deal with pricing. Popular pricing approaches are highlighted in this chapter.

Chapter 4 reflects on determining the right price, factors to take into consideration when setting the price, selecting the final price, price determination process, repricing, pricing communication and pricing management. In this chapter, the discussions of the previous chapters are put into perspective and focused to address the specified research problem.

Chapter 5 provides an overview of SMEs. It details how pricing is viewed and dealt with in this business sector.

Chapter 6 elaborates on the broad outline of the empirical study. The findings are discussed by means of descriptive research, frequency analysis, the means procedure, reliability tests, means of the factor analysis and T-tests.

Chapter 7 discusses and interpretes the findings.

Chapter 8 details the conclusions and recommendations of the research study.

CHAPTER 2

PRICING STRATEGY

2.1 Introduction

Pricing should become an integral part of the strategy in order to achieve superior, sustainable profitability, not merely an afterthought. SME managers need to know what costs they may afford to incur, given the prices achievable in the market, and still earn a profit. They should know what their products are worth to the customers and how they may communicate that value better, thus justifying the price. The level of sales or market share that managers may most profitably achieve should also be known. Strategic pricing may require more than just a change in attitude. It may require a change in when, how and who makes pricing decisions. For example, strategic pricing requires anticipating price levels before beginning product development. Managers should ensure profitable pricing by understanding that adequate value may be captured to justify the cost. Strategic pricing requires that management takes responsibility for establishing a coherent process of pricing objective, strategies, policies and pricing methods consistent with the strategic goal of the organisation.

Pricing strategy and execution is an overlooked technique to increase revenue and profits. Managers should put pricing strategy on their agenda and consider the new concept of pricing execution. They should search for software tools that may give companies a new way of setting, optimising and enforcing pricing within the organisation. There has been an explosion of software applications in the pricing management space and an appropriate pricing execution may offer both growing and mature companies a lower-risk approach to revenue, margin, profit and capital growth for the owners. SMEs may generate revenue rapidly by using software that may improve pricing strategy and its execution (Davidson & Simonetto, 2005:25).

Strategic pricing is actually the interface between marketing and finance. It involves finding a balance between customers' desire to obtain good value and the enterprise's need to cover costs and earn profits. Pricing in many organisations is trapped between cost and customer driven procedures that are inherently incompatible. The purpose of this chapter is to suggest how managers may break this tactical pricing deadlock and infuse strategic balance into pricing decisions. Managers may achieve profitability through strategic pricing. They should discard the flawed thinking about pricing that leads them into conflict between product value and costs and that may drive them to make unprofitable decisions.

Pricing strategy is a process which encompasses its importance, objectives, strategies, policies, factors influencing it and different methods used to set prices. It should reflect all of the key elements. No one strategy or pricing method exists for every situation. It may be a strategic mistake to superimpose strategies or pricing methods that work in one business into another business with entirely different cost, customer or competitive conditions. The process of strategy formulation should begin with why is it important to price products, what the prices are intended to achieve, within what parameters prices should be set, and what may affect pricing and how to execute the strategy in order to formulate a pricing strategy that optimally balances them and optimise financial results.

In the ever-changing electronic environment of the twenty-first century, price is one of the key strategic elements that are often overlooked by enterprises (Yelkar & DaCosta, 2001:252). Despite decades of studies by economists and market researchers, price setting is still often determined by a best-guess decision that is quickly revised when the guess turns out to be wrong (Czinkota *et al.*, 2000:13).

Internal financial considerations and external market considerations are, at most companies, antagonistic forces in pricing decisions. Financial managers allocate costs to determine how highly prices should be to cover costs and achieve their profit objectives. Marketing and salespeople analyse buyers to determine how low prices should be to achieve their sales objectives. The pricing decisions that result are politically charged compromises, not thoughtful implementations of a coherent strategy. Although common, such pricing policies are neither necessary nor desirable. An effective pricing decision should involve an optimal blending of, not a compromise between, internal financial constraints and external market conditions (Nagle & Holden, 2002:36).

According to Macleod and Terblanche (2004:66), if one wants to stay in business, one has to have a deep understanding of what goes into determining the price of a product. An appropriate pricing mechanism is a key aspect of any business, new or established, and there is no place for thumb-sucked prices. Trial and error in pricing may be costly and disastrous. One needs to investigate all the factors that affect price. A purely cost-plus profit approach to pricing does not always work effectively. Price should be formulated to achieve clear objectives such as matching or beating competition, penetrating new markets and gaining short-term profits. This may be achieved provided there is value perceived by customers on the product concerned.

The price should be right from the onset because it may be difficult to adjust or to justify its adjustment to the buyers at a later stage. Price is an art and a science. It has quantitative and qualitative aspects that need to be understood by managers and these bring some sort of thinking before deciding on the appropriate pricing approach. Although SME managers may use experience to determine prices, this should be backed by some costing skills for numerical calculations and an intensive knowledge of the market, including possible market behaviour. The knowledge of different pricing methods is important for managers to determine appropriate prices based on the pricing objectives. Pricing strategy should, ultimately, address the issue of blending costs and market conditions.

2.2 Definition of price and its meaning

Cannon (1996:304) defines price as the amount for which a product or idea is exchanged, or offered for sale, regardless of its worth or value to the potential purchaser. Although a monetary equivalent or value may be imputed, prices may incorporate goods exchanged. George (2001:184) defines price as the amount of money consumers pay for the exchange of benefits of having or using an offering. Van der Westhuyzen and Van der Merwe (2001:92) also state that prices may incorporate goods exchanged. Ahmed and Rafiq

(2002:28) cite that it is appropriate to view the price dimension in the internal context as a balance between utility and value against cost to both the organisation and the individual.

It is evident from the definitions that although a monetary equivalent or value may be imputed, prices may incorporate goods exchanged. For example, cars may be traded in for similar deals. The price of a product is, therefore, what a seller expects to receive in exchange for a product which the buyer may use or derive value from.

Price has a wide meaning in different situations. Equivalent to a price of a product is the rent for an apartment, fee for a doctor, toll on a road, commission to a broker and taxes for the government (Marx *et al.,* 1998:539). Some organisations use terms such as fares, rates, charges and subscription (Palmer, 1998:235).

Price means something quite different to those on one side of the deal and those on the other. Price informs the suppliers, manufacturers, service providers or retailers whether their accounting methods are appropriate enough and how much profit they are going to make. It also tells the purchaser what the cost will be to them, though cost is not necessarily evaluated purely in terms of immediate cash payment (Wilmshurst & Mackay 2002:265).

The seller and the consumer attach different meanings to the price concept. Sellers regard price as one of the marketing instruments used to achieve an enterprise's objectives. For the consumer, the price he or she pays for a product entails a sacrifice of disposable income. It is, therefore, important to define price and explore its meaning to different parties and situations. Notwithstanding the concept of both the seller and the buyer regarding price, it should be understood within the concept of capturing adequate value to justify the price. It is the responsibility of the seller to create value in the product for the buyer to derive that value from the price to be paid. The three elements of the marketing mix which are product, promotion and distribution, are an enterprise's attempt to create value in the marketplace whilst pricing is an attempt to capture some of that value in the profits it earns.

2.3 Importance of price

Pricing is often regarded as being the most important decision variable in a company's marketing strategy. Pricing decisions draw from many sources and are vitally important to the competitive success of enterprises (Hornby & Macleod, 1996:34). Throughout most of history, price acted as the major influence on buyer choice, especially amongst the poorer nations and groups and with commodity products. Price, secondly, influences whether enough money will be raised to enable the organisation to carry out its task in the case of a non-profit organisation. These two roles make setting the price of a product one of the most important marketing decisions (Strydom *et al.,* 2002:427). Improper pricing of a product may nullify the effect of all other actions no matter how intelligently the product distribution and communication mix are conceived. Sound pricing decisions are essential for the long-run success of a company. Pricing is described as the moment of truth (Baker, 1995:182).

According to Cant *et al.* (1999:212), price is important because it is the only element in the marketing mix that generates revenue. It is also important because it affects the enterprise in a direct way, namely the profitability of the business. Jain (2001:323) states that pricing is an important decision in any business, be it domestic or international, because it directly affects revenue and thus profitability. In many cases, the price indicates a product's quality.

Niemand *et al.* (2004:359) cite that normal selling prices should be set high enough to cover total costs and to provide a reasonable profit otherwise the enterprise may not survive. Marx *et al.* (1998:425) cite that price is of critical importance to management because it represents a large portion of the revenue of an enterprise. Dempsey and Pieters (1999:78) mention that actual selling price and pricing of inventory play a role in determining the actual gross profit of an enterprise. According to Doyle (2002:218), pricing is the key to an enterprise's profitability in both the short and long-run. Suri *et al.* (2002:161) state that price has a direct impact on a company's profitability. Successful pricing is a key to the success of the business (Czinkota & Ronkainen, 2002a:563).

The role of pricing in generating revenue, determining breakeven point, profitability, success and failure of the business, show how critical it is to an enterprise. Price also helps management to achieve the overall company's objectives. It provides invaluable information to all parties involved in a transaction. The buyer may use price to assess his or her ability to pay. Customers may look at price as an indicator of value and they may also use it as a differentiator if they perceive the products to be the same. For example, banks offer the same kind of products and if the customers perceive the service to be the same, they will opt for cheaper prices. It is important to know these critical factors before choosing the pricing method that may suit one's situation. However, these should be understood in the context of what an enterprise would like to achieve with a particular price and pricing technique. SME managers should understand that the benefits of pricing may only be achieved if the right pricing methods are used for a specific reason or objective. It is imperative for the price to reflect the true value of the product in order to attract buyers and achieve the required demand and profit.

One of the intriguing aspects of pricing is that buyers are likely to use price as an indicator of both product costs and quality. Price may simultaneously be an attraction variable and a repellent. Customers' use of price as an indicator of quality depends on several factors, one of which is the information available to them. When quality is difficult to differentiate or when quality or price varies a great deal within a class of products, consumers may believe that price is the best indicator of quality. Because customers depend on price as a cue to quality and because price sets expectations to quality, product prices should be determined carefully (Zeithaml & Bitner, 2006:484). Demand is determined largely by the price of products. Prices largely determine which products will be bought and in what quantity (Smit *et al.*, 1996:105). Terpstra and Sarathy (2000:522) state that pricing affects realised demand and hence is an influential tool in gaining market share.

Established enterprises may create their own barriers to entry by applying strategies aimed at discouraging new enterprises from entering the market or forcing them out once they have entered. This may take many forms including pricing (Mohr & Fourie, 1995:359). According to Cronje *et al.* (2004:212), predatory prices are used to hurt competitors and to drive them out of business. This kind of pricing is used extensively by airlines to compete against newcomers in the market.

Price charged provides valuable information for the potential buyer to make a decision. Buyers may be able to determine whether they have the ability and willingness to pay for a product based on the perceived-value. Price may also stimulate demand and allow managers to estimate the possible demand at a particular price. The buyers' decision to buy, to a large extent, may be influenced by the pricing approach used, which captures the value that justifies the cost. Notwithstanding the importance of price, it should not be looked at in isolation but in conjunction with other elements of the marketing mix and value derived from the product. SME managers may use pricing methods to stop potential sellers from entering the industry. However, they should ensure that the potential competitors do not have any additional benefit that may differentiate their products from the existing ones or retaliate by lowering their prices. The buyers' perception of value may play an important role in such a situation. The underlying factor is that the organisation may improve its revenue and profitability or optimise its financial results provided it creates value in the marketplace. This may be achieved by blending costs with customer demand. Customer demand determines the revenue and profitability of a product.

Ancient philosophers recognised the importance of price in an economic system. Some early written accounts refer to attempts to determine fair or just prices. Price continues to serve as a means of regulating economic activity (Boone & Kurtz, 2001:569). Stiglitz and Driffill (2000:57) state that, when the forces of supply and demand operate freely, price measures scarcity. As such, prices convey critical economic information. When the price of a resource used by an enterprise is high, the company has a greater incentive to economise on its use. When the price of a product the enterprise produces is high, the company has a greater incentive to produce more of that good, and its customers have an incentive to economise on its use. In these ways and others, prices provide the economy with incentives to use scarce resources efficiently.

Varian (2003:562) states that prices have two roles in the market; namely, allocative and distributive roles. The allocative role of prices is to indicate relative scarcity whilst the distributive role is to determine how much of different products various agents may purchase. Gattorna (2003:447) cites that many problems in supply chains may be eliminated by recognising imbalances between supply and demand and using price to help correct the balance.

Inflation is measured as the rate of increase of the average price level during a specified period; normally, one year (Fourie, 2001:348). A decline in the rate of price increases helps make the country more competitive. The price changes reinforce the income mechanism by partially offsetting the payment imbalances caused by autonomous factors. It is relative behaviour of prices at home and abroad that determines a country's competitive standing, and the deficit country normally experiences a slowdown in the rate of price inflation (Kreinin, 2002:285). Mohr (2003:19) cites that by using the prices of products, national accountants could obtain the value of production.

Price is a comprehensive term in interpreting the economy. It conveys critical economic information. It helps the public to understand economic activities. Terms like inflation and GDP are expressed in terms of prices. Factors of production are expressed in terms of price. Rent is the price paid for using natural resources, interest for capital, wages for labour and profit for entrepreneurship. Increase in price reduces buying power while price decrease increases buying power. These are called inflation and deflation, respectively, in economic terms. Prices in the SME sector determine the sector's role to the economy of a country. Although the economic information does not specify the pricing approaches used, the contribution is a reflection of those approaches and also the value the customers attach to the products.

Pricing methods may go beyond business sector to affect national economic factors. Inflation, GDP and other economic activities may be affected by SME pricing approaches. A change in a pricing approach may affect income contributed by the SME factor to the economy of the country. The rate of inflation may also be altered due to different pricing approaches. The success of the pricing method should be reflected by the demand of the product and the profitability thereof. The pricing method that fails to optimise financial results may not be considered to be effective and need to be revised. The reflection of pricing in either economic or business activities is a reflection of value placed by consumers on the products. If customers are not able to see value in relation to price the product may not elicit the required demand, revenue and profit.

When one considers the importance of pricing to an enterprise's success, one wonders why pricing has not received more attention in marketing journals. Fewer than 3% of the articles that appeared in *Industrial Marketing Management* have dealt with pricing issues (Wilson, 1999:155). Avlonitis and Indounas (2005:1) state that despite the significance of pricing as an element of the company's marketing strategy, there seems to be a lack of interest among marketing academics on pricing, which has brought to suggest that pricing is the most neglected element of the marketing mix. Within this context, the empirical research that has been conducted on the field of pricing is very limited.

2.4 Pricing objectives

According to Bygrave (1997:102) many entrepreneurs fail to focus on pricing objectives. Pricing objectives are specific quantitative and qualitative operating targets that reflect the basic role of pricing in the marketing plan. New businesses usually have a set of objectives of which some are primary and others are collateral. Some are short-term whilst others are long-term. Pricing objectives may include a speedy exit of marginal competitors, discourage entrants, discourage price cutting and stabilise market prices. Strydom *et al.* (2002:444) state that the ultimate objective with pricing is to actualise the objectives of the enterprise, a predetermined profitability and certain social responsibilities. The choice of pricing objectives is influenced by the business objectives and the prevailing market conditions.

Avlonitis and Indounas (2004:344) state that while pricing policies and methods refer to the explicit steps that a company has to follow in order to set its everyday prices, the main purpose of pricing objectives is to guide these steps. As far as fundamental pricing objectives content is concerned, both quantitative and qualitative objectives may enter the objective functions of enterprises. The quantitative objectives include those objectives that are related to the enterprise's profits, sales, market share, cost coverage and production output and their main advantage relates to the observation that they may be measured easily and straightforwardly. However, an excessive emphasis solely on quantitative objectives may even risk the long-term position of an enterprise in the market. On the other hand, qualitative objectives are associated with less quantifiable goals such as the relationship with customers, competitors, distributors, the long-term survival of the enterprise, and the achievement of social goals.

SME managers need to understand that pricing objectives guide the pricing strategies, policies and approaches. Pricing objectives provide directions for action. They should flow from and fit in with the company and marketing objectives. Failure to address this may render the pricing approaches ineffective. Pricing objectives should be explicitly stated to allow pricing methods to achieve the intended pricing objectives and ultimately company objective, which is to optimise financial results. An adequate demand may be achieved if the pricing objectives and the price charged are realistic and could be achieved. The value-creating activities should be integrated with the pricing objectives and decisions.

According to Lamb *et al.* (2000:601), to survive in today's highly competitive marketplace, companies need pricing objectives that are specific, attainable and measurable. Realistic pricing goals require periodic monitoring to determine the effectiveness of a company's strategy. For convenience, pricing objectives may be divided into three categories which are profit-oriented, sales-oriented and *status quo*. Profit-oriented objectives include profit maximisation, satisfactory profits and target return on investment. Sales-oriented pricing objectives are based either on market share or on a monetary value or unit sales. *Status quo* pricing seeks to maintain existing prices or to meet competition's prices.

When a marketer gets involved in price setting, several principles guide decisions. These potential objectives include, maximising profits, recovering costs, maximising the number of target adopters, social equity and demarketing. Social equity is where reaching underprivileged or high risk segments are priorities and different prices might be charged according to ability to pay. Demarketing is where pricing strategies are used to discourage people from adopting a particular social product (Kotler *et al.*, 2002:229).

Worsam and Wright (1995:440) cite that pricing strategies could be selected with objectives such as survival, maximising revenue, maximising sale growth, market share acquisition and product quality leadership in mind. Paley (2000:274) mentions positioning product advantageously among competitive look-alike products as pricing objective. Van der Westhuyzen and Van der Merwe (2001:99) add maintaining price image to the list.

Doole and Lowe (1999:522) identify product differentiation, market skimming, market penetration, early cash recovery and prevention of new entry as the objectives of pricing. Pricing objectives vary according to the situational factors present and management's preferences. A high price may be set to recover investment in a new product. A low price may be intended to gain market position, discourage new competition or attract new buyers (Cravens, 1997:348).

Pricing objectives of not-for-profit organisations may include profit maximisation, cost recovery, market incentives and market suppression. Pricing, typically, is a key element of the marketing of not-for-profit organisations. Pricing strategy may help these groups to achieve a variety of organisational goals. While not-for-profit organisations by definition do not cite profitability as a primary goal, there are numerous instances in which they do try to maximise their returns on single events or a series of events. Some of these organisations attempt to recover only the actual cost of operating the unit. Others follow a lower-than-average pricing policy or offer a free service to encourage increased usage of the product. Price can also discourage consumption. High prices help to accomplish social objectives independent of the cost of providing products (Boone & Kurtz, 2005:385).

Table 2.1 – Pricing objectives

Objective	Purpose	Example
Profitability	Profit maximisation Target return	Low introductory interest rates on credit cards with high standard rates after 6 months
Volume	Sales maximisation Market share	Low prices to increase sales and market share
Meeting competition	Value pricing	Price wars among major competitors
Prestige	Lifestyle Image	High-priced luxury goods
Not-for-profit	Profit maximisation Cost recovery Market incentive Market suppression	High prices for tobacco and alcohol to reduce consumption

Source: Adapted from Boone and Kurtz (2005:386).

2.5 Generic pricing strategies

Pricing methods and policies are sometimes referred to as pricing strategies. However, the strategies referred to in this research are those that are used to skim or penetrate the market. New product pricing creates a unique opportunity to build a price umbrella and to skim price. Skimming pricing works when the new product is highly differentiated, not easily copied, and sold to a quality-sensitive market, and when competitor entry and intensity are not serious threats. When the opposite conditions exist, a penetration strategy may be needed in order to build a cost advantage. Both skimming and penetration pricing are cost and market-oriented. Their pricing approaches are cost-based, market-based and competition-based with the view to optimise profit. SME managers may use the strategies to take advantage of the new products before competitors enter the market and to attract customers through value and price.

Nagle and Holden (2002:152) state that, before setting a price, an enterprise should identify the role that price may play in the product's overall marketing strategy. The generic pricing strategies include skim, penetration and neutral pricing. Managers should decide on whether the price should serve to restrict the enterprise's market to an exclusive segment of buyers, whether it serves as the primary tool for attracting buyers or if it serves a neutral function, secondary to other aspects of marketing. Skim pricing involves setting price high relative to the economic value of most potential customers in order to profit from the relative price insensitivity of a small segment. Penetration pricing is where prices are set too low relative to economic value in order to gain from high market share or volume. Neutral pricing involves a strategic decision not to use price to gain market share, while not allowing price alone to restrict it. Sezen (2004:223) states that the success of a pricing strategy largely depends on the implementation of the right price at the right time.

2.5.1 Skimming and prestige pricing

Price skimming strategy tries to sell the top of a market at a high price before aiming at more sensitive customers. A skimming policy is more attractive if demand is quite inelastic, at least at the upper price ranges. Skimming may maximise profits in the market introduction stage for an innovation, especially if there is little competition. Some critics argue that enterprises should not try to maximise profits by using a skimming policy on a new product that has important social consequences (Perreault & McCarthy, 2002:493). Skim-the-cream pricing means setting a price in the acceptable range of prices, sometimes for a short period only, often for longer. It is largely, though not exclusively, associated with new products (Wilmshurst & Mackay, 2002:276).

Prestige pricing is setting a rather high price to suggest high quality or high status. Some target customers want the best, so they will buy at high price. But if the price seems cheap, they worry about quality and they do not buy. Prestige pricing is most common for luxury products such as furs, jewelry and perfume. It is also common in service industries where the customer cannot see the product in advance and relies on price to judge its quality (Perreault & McCarthy, 2002:537).

The skimming and prestige pricing are similar. They both operate at the top end of the market. One is designed to sell high quality at low financial risk. The other seeks to do the same but by using the price itself to promote the idea of status and prestige (Baker, 2003:308).

Skimming pricing may only be viable when the profit from selling to a price-insensitive segment exceeds that from selling to the larger market at a lower price. Buyers are often price insensitive if they belong to a market segment that places exceptionally high value on a product's differentiating attributes. Successful skimming pricing favours a cost environment where incremental unit costs represent a large share of a product's price, because even a small price premium may generate a large percentage increase in the contribution margin. An enterprise should have some source of competitive protection to ensure long-term profitability by precluding competitors from providing lower-priced alternatives. Patents or copyrights are one source of protection against competitive threats (Nagle & Holden, 2002:154).

SME managers should exercise care when skimming the cream. They should not ignore the perception of value and the required demand and profit. They should guard against the possibility of competitors selling the same product or substitute at a lower price. However, what is important is the communication of value of the product in relation to the price. The capturing of value is critical for pricing strategies, including skimming. The achievement of pricing objective should justify the effectiveness of the strategy.

2.5.2 Penetration pricing

Penetration pricing is where a relatively low price is set in order to gain maximum penetration of the market as quickly as possible. This has obvious advantages where large economies of scale can be gained from higher levels of production, and it also makes the market less attractive to competitors. A necessary condition of successfully applying this approach is, of course, that reducing the price will substantially increase the demand. Once a company has gained dominance of the market by penetration pricing, it can be very difficult for a competitor to enter successfully (Wilmshurst & Mackay, 2002:276). Penetration pricing strategy is even more attractive if selling larger quantities result in lower costs because of economies of scale. It may be wise if the enterprise expects strong competition very soon after introduction (Perreault & McCarthy, 2002:494).

Baker (2003:348) mentions that penetration pricing is where the market is undercut significantly and in such a way as to make it impossible for competitors to respond. As a result, there is a major increase in sales volume. It is an attractive idea in logic, but it is a route to disaster for most companies if they are forced into it. A penetration technique is dangerous, but it can be successful provided that managers know exactly what they are doing.

Penetration pricing strategy is designed to generate sales volume even at the expense of high margins and it may be favoured by a particular environment. Penetration prices are not necessarily cheap, but are low relative to value. Customers should perceive value in the product in relation to the price to achieve the objective of penetrating the market and increase market share. For penetration pricing to be successful, a large share of the market should be willing to change suppliers in response to a price differential. Competitors should allow a company to set a price that is attractive to a large segment of the market. Only when competitors lack the ability or incentive to undercut a penetration strategy by cutting their own prices is penetration pricing a practical strategy for gaining and holding market share. Costs are more favourable for penetration pricing when incremental costs represent a small share of the price so that each additional sale provides a large contribution to profit. Penetration pricing may succeed without a high contribution margin if the strategy creates sufficient variable cost economies, enabling the seller to offer penetration prices without suffering lower margins.

2.5.3 Neutral pricing strategy

Neutral pricing minimises the role of price as a marketing tool in favour of other tools that management believes are more powerful or cost-effective for a product's market. An enterprise generally adopts a neutral pricing strategy by default because the conditions are not sufficient to support either a skim or penetration strategy. For example, a marketer may be unable to adopt skimming pricing because the products in a particular market are so generally viewed as substitutable that no significant segment may pay premium. The same enterprise may be unable to adopt penetration pricing strategy because, as it is a newcomer to the market, customers would be unable to judge its quality before purchase and would infer low quality from low prices, or because competitors would respond vigorously to any price that undercut the established price structure. Neutral pricing is especially common in industries where customers are quite value-sensitive, precluding skimming, but competitors are quite volume-sensitive, precluding penetration. Another reason to adopt a neutral pricing strategy is to maintain a coherent product line strategy. Although neutral pricing is less proactive than skimming and penetration pricing, its proper execution is no less difficult or important. It is not necessarily set to equal those of competitors or set near the middle to the range. It may, in principle, be the highest or lowest price in the market and still be neutral (Nagle & Holden, 2002:158).

2.6 Pricing policy

Once the pricing objectives are known, the pricing policies may be put in place. This will guide management on the method or approaches to use to achieve pricing objectives. In structuring a pricing policy, managers should keep their actions within the requirements of the various laws that deal with price setting.

A strategy is a broad plan of action by which an organisation intends to reach its goal. A policy is more of a routine managerial guide to be implemented when a given situation arises. Giving certain price discounts when a certain amount of a product is ordered is an example of a policy (Lancaster & Reynolds, 2005:127). Pricing policy is the approach taken by a company with regard to setting prices for its products (Anon., 1998:1). Marketing managers should develop pricing policies guided by the corporate objectives. They should spell out what price situations the organisation may face and how this should be handled. The policies should explain how flexible prices may be, the levels of prices over product life cycle, to whom and when discounts and allowances should be given, and how costs should be handled (Quester *et al.*, 2004:391).

Cannon (1996:305) cites that in determining pricing policies the company needs to understand both the costs involved and alternatives open and the responses of the different groups and the values they place on the products. Ford *et al.* (2002:163) cite that pricing for the business marketer is an important but complex issue. If all other aspects of marketing strategy and implementation are sound, but pricing policy is flawed, then a company may fail.

Flynn *et al.* (2000:917) mention that a very sensitive decision which should be made by management relates to the pricing policy. It is accepted that the higher the price, the lower the likelihood of selling large quantities. However, a higher price offers a higher margin. A trade-off must therefore be made between margins and volumes which are reflected in the pricing policy. Erwee and Venter (2003:342) cite that international pricing strategy is a critical element of the enterprise's international marketing mix because many products competing on the basis of price and pricing policies affect the extent of an enterprise's income and profits. Anthony and Govindarajan (1995:690) state that many non-profit organisations give inadequate attention to pricing policies.

Dempsey and Pieters (1999:77) state that a trading enterprise usually has a price policy aimed at earning a fixed gross profit percentage. This price policy is executed by adding the gross profit percentage to the cost of merchandise.

Costs, demand and competition are the three pillars of price. None of the three pillars is more important than the others and sound pricing decisions have to be based on all three. Focusing exclusively on one pillar is not a sound strategy because price may be set to ignore those that are equally important. Whichever way one looks at it, cost, demand and competition must all come into play in the development of pricing policy (Baker, 1995:186). Drury (2005:194) cites that the final price that is selected will depend upon the pricing policy of the company.

Pricing policies may be seen as a guiding principle on:

- How flexible prices may be.
- At what stage of the product life cycle may prices be set.
- To whom and when discounts and allowances may be given.
- How transportation costs may be handled.

Enterprises may set specific pricing policies to reach objectives. Price policies may lead to administered and consciously set prices. In other words, instead of letting daily market forces decide their prices, enterprises may set their own prices. Companies may have hidden costs and the pricing policy may assist in how the organisation is going to recover them.

2.7 Factors influencing pricing decisions

Carson *et al.* (1998:74) state that as one of the variables of marketing, pricing has warranted considerable attention from marketing theorists. Opinions vary as to how a manager should implement a pricing policy. However, there is consensus, widely disseminated in the literature, that successful pricing may only be achieved when a multiplicity of factors are considered and managed. Katz and Katz (1997:19) state that successful pricing is a result of knowing what goes on at the place where products are sold. There are many interacting factors which include product quality, consumer interpretation of pricing as status or value, recovery of research and development costs, distribution channel margins and promotional costs.

Keegan (1999:408) states that in any country, three basic factors determine the boundaries within which market prices should be set. The first is product cost which establishes a floor price or minimum price. Second, competitive prices for comparable products create a price ceiling or upper boundary. Between the lower and upper boundary for every product there is an optimum price which is a function of the demand for the product as determined by the willingness and ability of customers to buy. Machado and Cassim (2002:14) have identified cost and competition as the bases of price determination.

According to Horngren *et al.* (2003:422), there are three major influences on pricing decisions and they include customers, competitors and costs. Managers should always examine pricing problems through the eyes of their customers. A price increase may cause customers to reject a company's product and choose a competing or substitute product. Competitors' reactions influence pricing decisions. Companies price products to exceed the costs of making them. The study of cost behaviour patterns gives insight into the income that results from different combinations of price and output quantities sold for a particular product.

According to Daly (2002:61), many strategic considerations come into play in determining price. These include substitutes for the product and legal and ethical constraints. Phillips and Sanders (1999:73) add political acceptability, buyers' willingness to pay and the price of perceived substitutes involving competitors' pricing actions to the list.

George (2001:184) identifies internal and external factors that impact on pricing. The internal factors include company objectives and marketing mix. The external factors that the marketer should consider when making pricing decisions include the nature of the demand for the offering and price elasticity and consumers' perceptions. The marketer has some degree of control over internal factors and little, if any, control over external factors that affect pricing. Palmer (1998:237) identifies the amount that consumers are prepared to pay for it, the price that suppliers are charging, and the constraints on pricing that are imposed by the outside agencies.

Groucutt *et al.* (2004:153) indicate that the key factors that influence price include government policy, economic worth, market conditions, geography, legal issues, consumer tastes, and preferences and price sensitivity. According to McNamee (1998:316), the influences that tend to predominate pricing include marketing objectives and product life cycle. Hodgetts and Kuratko (2001:487) cite that factors to be considered in pricing include the nature of the product, competition marketing strategy and general business conditions. The demand for some products seems to be little affected by a change in price.

Bradshaw and Brooks (1996:499) have identified price elasticity, relative power of buyers and sellers, and psychological factors as influencing pricing. Boone and Kurtz (2001:569) state that price affects and is affected by other elements of the marketing mix. Product decisions, promotional plans and distribution choices all bear an impact on the price of a product. Czinkota and Ronkainen (2002b:570) cite that pricing within individual markets in which the company operates is determined by corporate objectives, customer behaviour and market conditions, market structure and environmental factors.

Organisations are rarely free agents in setting prices. There are numerous factors that may force them to make certain pricing decisions and the use of particular methods. Some of the pricing methods will be based on factors like cost, demand, competition, government and many others. However, the underlying factor is that successful pricing is the result of understanding what is happening in your business and in the market. This will enable SME managers to price their products effectively.

Erwee and Venter (2003:343) state that the factors influencing global pricing decisions include environmental, market and company internal factors. Environmental factors include regulations, exchange rates, inflation rates and price controls. Competition, income levels and market structures are classified under market factors whilst company internal factors involve price objectives, production costs, distribution costs and profitability. According to McDonald (1999:369), factors influencing prices are marketing objectives, consumer attitudes, company and product image and economic situation. According to Nickels and Wood (1997:361), among the most important environmental influences on pricing are value-chain relationships and international competition.

Richardson (1998:64) states that traditional price theory delineates four basic market forms, namely, perfect competition, monopolistic competition, oligopoly and monopoly. Pure competition consists of many enterprises producing identical products in an environment of perfect knowledge and they are price-takers, as the market forces of demand and supply determine the price of their product. The other three market forms are, therefore, price makers, as they have the ability to adjust their prices up or down in line with their business objectives. Begg *et al.* (2003:125) state that in a perfectly competitive industry all enterprises should, essentially, be making the same product, for which they must all charge the same price. Kreps (2004:264) cites that the enterprise operating in a perfect competition is a price taker. Haydam (2004:212) agrees with Kreps (2004:264) that the enterprise operating under perfect competition is a price taker and it has no control over its price, but only over its output.

2.8 Summary

There are numerous factors that affect pricing decisions. However, the three main categories include cost, customer demand and competition. SME managers should, under no circumstances, overlook these factors and many others as they may determine the success or failure of the organisation. He or she needs to understand the costs and their implication for the survival and profitability of the company. The customer's perception of value and the market demand should not be ignored. Competition and competing products should be well understood to ensure that the marketer does not price his or products out of the market. Government legislations regulating prices are also important and they should also be adhered to. There may be government intervention in pricing which is sometimes referred to as price control or administered prices.

Businesses set prices in four types of market structures which are pure competition, monopolistic competition, oligopoly and monopoly. These market forms also have an influence on pricing. Despite this, all market structures have a degree of influence to pricing and the pricing methods used should take into account these market forms. SME managers should know that, even in these market structures, they are charged with the task of demonstrating enough value in the products to justify the prices to customers.

Once the SME managers have established pricing objectives, strategies, policy and identified factors that may affect the pricing decision, they may now start to identify the best approaches to achieve the objectives. The next chapter will identify and discuss different pricing methods which may be used by SME managers.

CHAPTER 3

GENERAL PRICING APPROACHES

3.1 Introduction

Pricing methods depend highly on the overall and pricing objectives of a company as discussed in the preceding chapter. Each pricing approach or method has a role to play. There are different reasons for choosing different approaches. However, the marketer should choose the approach based on the pricing objectives of an enterprise. There are many pricing approaches used by marketers which may be used for survival, profitability, gaining market share, attracting customers, status or prestige and sustainability.

Rust *et al.* (1996:30) mention that the standard economic solution to over or under-utilised products is to alter the price to change demand. Economic theory tells us that to maximise profits one must understand demand curves, the relationship between prices and the number of customers willing to pay those prices. It is obvious that for most non-status products, as price goes up, demand goes down. What marketers must know to maximise profits is, how many people will pay a particular price, and if the price is changed, will the loss (gain) of some customers be more than offset by the increased (decreased) revenue from each of the customers who buy at the new price. This information is essential, but getting it is extremely difficult.

Microeconomics suggests a way of determining prices that assumes a profit maximisation objective. This technique attempts to derive correct equilibrium prices in the marketplace by comparing supply and demand. It also requires more complete analysis than actual business enterprises typically conduct. However, there are practical limitations that interfere with price setting through this approach, which makes it inappropriate in certain situations. The practical limitations inherent in this price theory have forced practitioners to turn to other techniques (Boone & Kurtz, 2005:387).

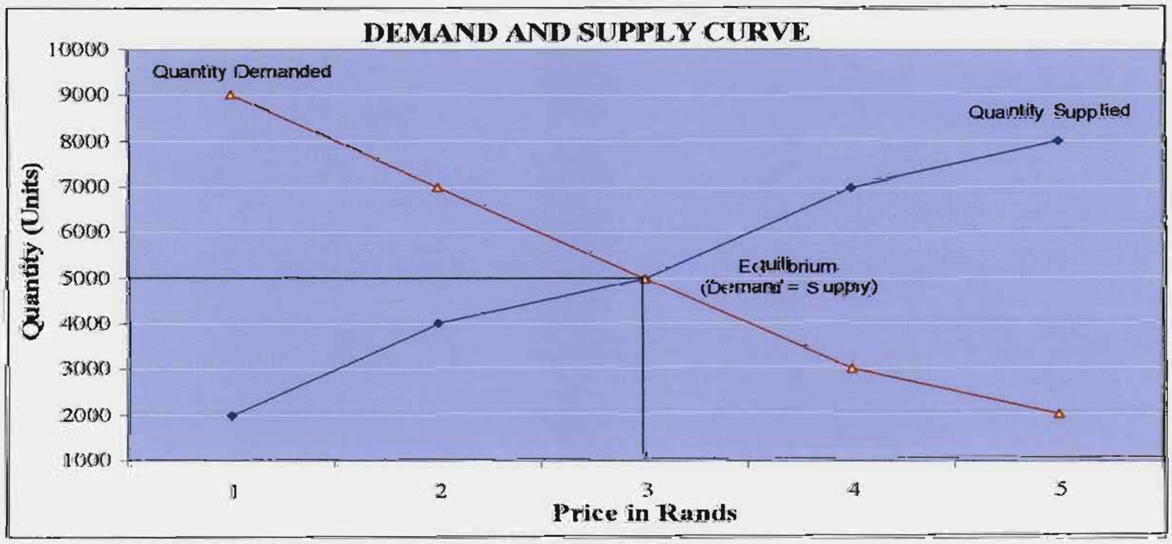
Table 3.1 and Figure 3.1 show how market forces may determine the price. Different prices reflect different quantities supplied and demanded. This is where buyers and sellers disagree about the value of a product. However, at R3 the quantity supplied and demanded is the same. This is the equilibrium price and theoretically the buyers and the sellers reached the agreement about the price of a product.

Table 3.1 – Demand and supply

Quantity Supplied	Price (R)	Quantity Demanded
2000	1	9000
4000	2	7000
5000	3	5000
7000	4	3000
8000	5	2000

Source: Own work.

Figure 3.1 - Equilibrium price



Source: Own work.

Avlonitis and Indounas (2005:1) state that a common finding of the few studies conducted is the dominance of the cost-plus methods mainly due to its simplicity and easiness to use. Boone and Kurtz (2005:392) agree with Avlonitis and Indounas (2005:1) and state that cost-plus pricing, the most popular method, uses a base cost figure per unit and adds a markup to cover unassigned costs and to provide profit.

Once the SME managers understand demand and costs, they are ready to select a price. He or she should remember that prices should be high enough to produce some profit, but not so high that the customers refuse to buy. The primary external constraints on your prices are the actions of competitors. Any pricing procedure that one selects should be in line with the prices set by competitors. The task is to find a method that balances demand, costs and competitive factors for an individual product. The six pricing approaches identified include markup, breakeven, target return, variable cost, peak load and new product pricing (Dalrymple & Parsons, 2000:541). Nieman and Bennett (2002:186) cite that when determining the basic price of a product, marketers could adopt any of the pricing approaches which include markup, target return, perceived-value, value and going-rate pricing.

The usual approach is that, most people, when asked how they arrive at a selling price for a product, answer that costs are calculated, provision is made for other operating expenses and then the desired profit is added. This is not surprising given the nature of South African business, where limited competition between a small number of suppliers and producers, state controlled prices, and a general lack of competition coupled with collusion, are the order of the day. In a competitive environment pure cost-plus pricing may lead to incorrect pricing. What is required is a combination of market driven pricing and accurate product costing prior to selling. This type of pricing presents challenges to managers (Bradshaw & Brooks, 1996:498).

Many managers do not sufficiently understand that pricing has the most significant impact on the performance of a business. More effective pricing is normally the single most important thing that new management may do to enhance profits quickly. Many companies are poor at pricing. One common mistake is to base prices upon mechanical cost-plus formulas. Managers fail to appreciate how seriously such methods may erode profits and detract from exploiting market opportunities (Doyle, 2002:218).

The emphasis in pricing a product is more on cost, customer demand and competition. Notwithstanding this, there are other pricing methods which are also important and may be used effectively by marketers. SME managers should therefore study different pricing approaches carefully and see which one will fit both the overall business and marketing strategies and objectives. They should guard against being dragged into concentrating in some few approaches and ignoring others. It should be to their benefit to explore other pricing methods so that they may have a broad knowledge and scope to choose from. The method should, however, be relevant and effective and blend cost and value to achieve pricing and overall enterprise's objectives.

3.2 Different pricing methods

Boone and Kurtz (2001:575) cite that marketers determine prices in two basic ways. It applies the theoretical concepts of supply and demand and by completing cost-oriented analysis. During the first part of the 20th century, most discussions for price determination emphasised the classical concepts of supply and demand. During the last half of the century, however, the emphasis shifted to a cost-oriented approach. Hindsight reveals certain flaws in both concepts.

According to Horngren *et al.* (1999:427), the starting point for pricing decisions may be market-based or cost-based, also called cost-plus. The market-based approach to pricing starts by asking: "*Given what our customers want and how our competitors will react to what we do, what price should we charge?*" Zeithaml and Bitner (2006:484) identify pricing methods such as cost-based approach, buyer-based approach, competitor-based approach and price bundling. George (2001:187) mentions premium, discriminatory, tactical and psychological pricing as pricing approaches. Weaver and Oppermann (2000:231) indicate that some of the main pricing techniques are profit-oriented and sales-oriented pricing.

Market-based pricing involves economic value, perceived-value, and segment pricing. Cost-based pricing includes commodity, cost leader and competitive bid pricing. Commodity pricing is where products are priced with normal industry markups and are adjusted on the basis of competitor price strategies. Cost leader pricing is when a business with a cost advantage prices are more aggressive in an attempt to build market share and volume. Other pricing strategies include product line, promotion, price promotion bundling, skimming and penetration pricing (Best, 2000:175). Ge (2002:174) has added value-based pricing to the list.

The concept of market forces would have been ideal if it was not because of its practical limitations. Demand and supply may determine the equilibrium price and balance the situation from time to time. Both sellers and buyers may play important roles in determining prices. Because of the shortcomings, this pricing method encouraged enterprises to look for alternative pricing methods that may address different challenges they are faced with. Although there are many pricing methods, the main ones are cost, buyer and competitor based pricing. Others will stem from these, with specific objectives to achieve. The reason may be to penetrate or skim the market, promote the product by reducing prices, convincing customers psychologically and many more tactics. The main reason for pricing is to make consumers to buy, based on their ability to pay and the perception of value. SME managers need to ensure that competitors are not taking away business from them and, where necessary, they should gain some customers with sales volume from competitors. Fixed and variable cost may also be considered, if necessary. All these may prompt for different pricing methods to be applied.

Worsam and Wright (1995:447) state that sealed-bid pricing is one of the more popular approaches. The tactics used are psychological, imitative and marginal cost pricing. Psychological pricing is the establishment of a price level which appeals psychologically. Thus prices are set around price points. A typical psychological price level is R199-99 which appears much lower than R200-00. Imitative pricing follows competition and so matches their tactics. Marginal cost pricing is based on the marginal cost of producing one more unit.

Morris *et al.* (2001:314) mention floor, parity or going-rate, price leadership, stay-out, and cross-benefit pricing. Floor-pricing means charging a price that just covers costs. Stay-out pricing refers to prices lower than demand conditions require in order to discourage market entry by new competitors. Cross-benefit pricing are prices set at or below costs for one product in a product line, but relatively high for another item in the line that serves as a direct complement.

Hodgetts and Kuratko (2001:489) mention that all pricing methods are based on a cost-plus profit markup. Only if this strategy proves unworkable will the manager reduce price and try to cut losses on a particular line. The factors to consider in setting price are the cost of products, competitive prices and market demand. Different strategies such as sliding, odd, price lining, geographical and discount have also been identified. A sliding price strategy is characterised by an enterprise that moves prices in relation to demand. Geographical pricing is a technique by which companies charge customers based on where the customer lives.

Paley (2000:274) cites that the pricing strategies include follow, slide down, segment, flexible, preemptive, phase out, and loss leader pricing. Pricing in relation to industry price leaders is termed follow pricing. The purpose of slide down pricing is to move prices down to tap successive layers of demand. Segment pricing involves pricing essentially the same products differently to various groups. Pricing to meet competitive or marketplace conditions is known as flexible pricing. Preemptive pricing is used to discourage competitive market entry. Phase out pricing means pricing high to remove a product from the line. Pricing a product low to attract buyers for other products is called loss leader pricing. The overriding purpose in all of the above strategies is to avoid or postpone price wars.

The price theory concepts and cost-plus pricing do not appear to be adequate enough to satisfy marketers. Due to their practical shortcomings, alternative pricing approaches, which may also benefit SMEs are therefore, identified. Because SME managers may experience the same difficulties with price theory concepts and cost-plus pricing method they need to identify pricing approaches which may be appropriate to their businesses and pricing objectives. Notwithstanding the fact the cost-plus pricing has shortcomings, Guilding *et al.* (2005:25), Avlonitis and Indounas (2005:1) and Boone and Kurtz (2005:392) indicate that it is widely used.

In order to afford SME managers opportunity to identify pricing methods that may be appropriate to their enterprises, different pricing approaches are discussed below. While the pricing objectives provide general directions for action, pricing methods are the explicit steps or procedures by which enterprises arrive at pricing decisions. A comprehensive review of the literature of pricing of products identified ten pricing methods which may fall into three large categories namely cost-based, demand-based and competition-based. Cost-based methods may include cost-plus, breakeven, marginal cost and time and material pricing. Perceived-value pricing and value-based pricing may fall under demand-based method. Competition-based methods may include going-rate, sealed-bid, price leader and market related pricing systems. Notwithstanding this, there is a pricing method that takes cost, demand, competition and other factors into account. This pricing method is called marketing-oriented pricing. Managers may also use different pricing tactics to attract buyers. These tactics are sometimes referred to as pricing methods and they are addressed as pricing tactics in this study as they do not necessarily need some kind of process but may be decided upon instantly and used for a short period of time. Although it is not conclusive that the pricing methods may be classified as indicated in table 3.2, a comprehensive review of the literature of pricing of products may lead one to look at them this way.

Table 3.2 - Pricing methods

Cost-based methods	**Demand-based methods**	**Competition-based methods**
Cost-plus method	Perceived-value pricing	Going-rate pricing
Breakeven pricing	Value-based pricing	Sealed-bid pricing
Marginal cost pricing		The price leader
Time and material pricing		Market related pricing systems

Source: Own work.

3.3 Cost-based pricing

Cost-plus profit approach should be a much healthier system because at least one may be guaranteed to stay in business. It is critical to sustain operation and this pricing method may be appropriate to achieve this. If the objective is to make profit, then cost is one of the components that determine profit. The marketer should know and understand the cost and cost implications of the enterprise in order to price appropriately and make the required return or profit. Different cost-based pricing methods are discussed in this section. Advantages and shortcomings are highlighted for the SME managers to use to benefit the enterprise or guard against them when using these methods.

According to Guilding *et al.* (2005:25), a relatively high degree of importance attached to cost-plus pricing is noted, although there appears to be a substantial number of companies that use cost-plus pricing for a relatively small sub-set of products. Companies confronted by high competition intensity attach relatively high degrees of importance to cost-plus pricing and manufacturing companies attach a relatively low degree of importance to cost-plus pricing. However, cost-plus pricing, often using full costs, is widely used.

The cost-based pricing approaches include full-cost and variable cost pricing (Cateora, 1996:555). Cost-plus formula is also based on absorption costs. Variable costs include variable manufacturing, selling and administration costs (Hilton, 1997:730). Niemand *et al.* (2004:360) added activity-based cost-plus markup.

The cost-based pricing approach has been criticised on a number of occasions. First, it may prove to be extremely difficult in practice to identify the true costs of a product. Second, such a cost-plus approach to pricing ignores the demand sensitivity of the marketplace. It may be that a price determined on a cost-plus basis is higher than the marketplace will accept, or perhaps it may be even lower than the price that the market will tolerate. The basic problem with any cost-based approach to pricing is that it implicitly assumes that the customer is interested in the company's costs, whereas in reality the customer is only concerned with their own costs (Christopher, 2000:150).

The widespread use of cost-plus pricing in the real world could be explained by several important advantages that it provides. First, cost-plus pricing generally requires less information and less precise data than the rule of setting price at the output level at which the marginal revenue equals marginal cost. Secondly, it seems easy and simple to use. Thirdly, it usually results in relatively stable prices when costs do not vary that much over time. This is an advantage because it is costly to change prices. Finally, cost-plus pricing may provide a clear justification for price increases when costs rise. Despite the above important advantages and widespread use, cost-plus pricing is criticised on several important grounds. One criticism is that it is based on accounting and historical costs rather than on replacement and opportunity costs. Finally, cost-plus pricing is criticised because it ignores conditions of demand (Salvatore, 1996:480).

Garrison *et al.* (2003:896) issued a cautious statement by indicating that although the cost-plus approach may be of great assistance to the manager in determining target selling prices, care must be taken not to apply the cost-plus rigidly. The reason is that they tend to ignore the relationship between price and volume, and if applied too rigidly might result in less profit, rather than more profits for the enterprise.

Although cost-based pricing is simple and straightforward, it ignores current demand and competition. The ignorance of these factors may be detrimental to the sales volume of the company. The price may not be affordable to the consumers and this may affect the demand and the profit of the organisation. SME managers should avoid pricing the product out of the market by failing to recognise the impact of competition and the market demand. The potential buyers' ability and willingness to pay are critical for a manager to reach the targeted demand and profit. There may be a perception by the consumers that the product is inferior to those of competitors because the price is lower than that of the rivals. SME managers need to understand these factors and exercise care when using cost-based pricing method and consider its *pros and cons*.

3.3.1 Average cost pricing

Average cost pricing means adding a reasonable markup to the average cost of a product. A manager usually finds the average cost per unit by studying past records. Dividing the total cost for the last year by all the units produced and sold in that period gives an estimate of the average cost per unit for the next year. To get the price, the producer decides how much profit per unit to add to the average cost per unit (Perreault & McCarthy, 2002:524).

3.3.2 Breakeven pricing

In breakeven pricing or target profit pricing the enterprise tries to determine the price at which it will breakeven or make the profit it requires. The prices are in most cases based on a return on specific item, for example investment (ROI). Target pricing uses the concept of a breakeven chart. A breakeven chart shows the total cost and total revenue expected per sales volume levels (Baker, 2003:342). Perreault and McCarthy (2002:524) state that target return has become popular in recent years. Target return pricing means adding a target return to the cost of a product. Some price setters use breakeven analysis in their pricing.

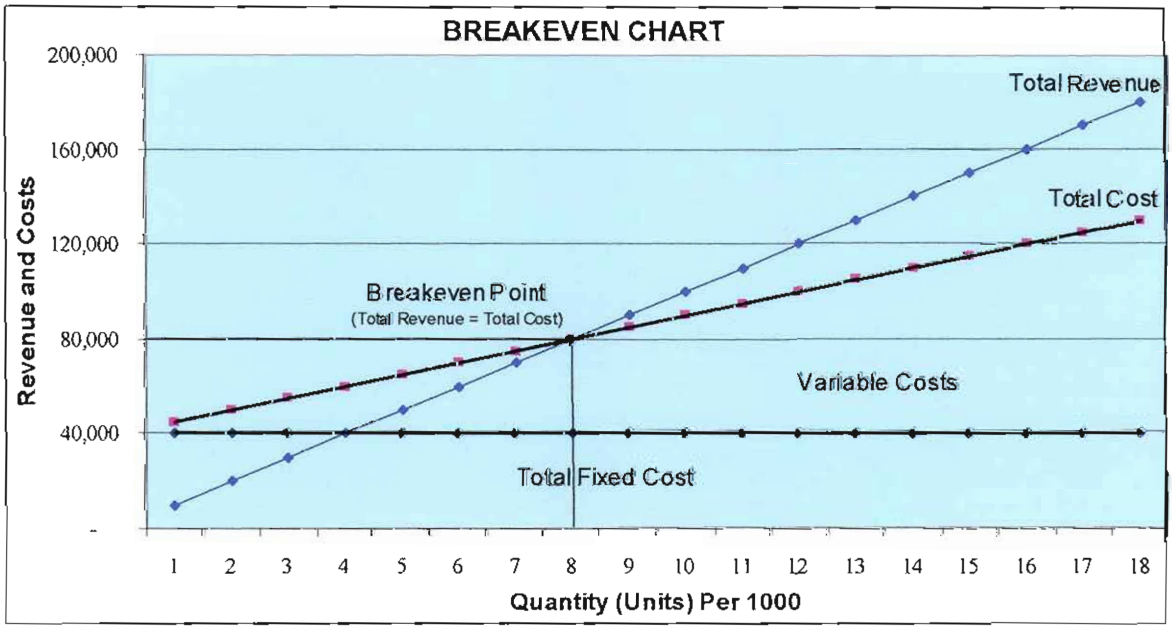
Table 3.3 and figure 3.2 show how an enterprise may determine a breakeven point which is at the cost and revenue of R80 000 and 8000 units. Fixed costs are R40 000 irrespective of the number of units whilst variable costs are R5 per unit. Selling price is R10 per unit. Breakeven analysis evaluates whether the enterprise will be able to cover all the costs with a particular price. This is important for an enterprise should to remain in business. Breakeven analysis is a useful tool for analysing costs and evaluating what might happen to profits in different market environments and at different prices. However, it is a cost-oriented approach and suffers the same limitation as the other cost-oriented approaches. Specifically, it does not consider the effect of price on the quantity that consumers will want, that is, the demand curve.

Table 3.3 – Cost versus revenue

Quantity	Total Fixed Cost	Total Costs	Total Revenue
1,000	40,000	45,000	10,000
2,000	40,000	50,000	20,000
3,000	40,000	55,000	30,000
4,000	40,000	60,000	40,000
5,000	40,000	65,000	50,000
6,000	40,000	70,000	60,000
7,000	40,000	75,000	70,000
8,000	40,000	80,000	80,000
9,000	40,000	85,000	90,000
10,000	40,000	90,000	100,000
11,000	40,000	95,000	110,000
12,000	40,000	100,000	120,000
13,000	40,000	105,000	130,000
14,000	40,000	110,000	140,000
15,000	40,000	115,000	150,000
16,000	40,000	120,000	160,000
17,000	40,000	125,000	170,000
18,000	40,000	130,000	180,000

Source: Own work.

Figure 3.2 – Breakeven analysis



Source: Own work.

3.3.3 Marginal cost pricing

According to Palmer (1998:241), a special kind of cost-based pricing occurs where enterprises choose to ignore their fixed costs. The charge to any individual customer is based not on the total unit cost of producing it, but only on the additional costs that will result directly from servicing that additional customer. Marginal cost pricing is widely used with low short-term supply elasticity and high fixed costs.

The best pricing tool marketers have, for looking at costs and revenue at the same time, is marginal analysis. Marginal analysis focuses on the changes in total revenue and total cost from selling one more unit to find the most profitable price and quantity. Marginal analysis shows how profit changes at different prices. Thus, it may help to find the price that maximises profit. You may also see the effect of other price levels. Even if you adjust to pursue objectives other than profit maximisation, you know how much profit you are giving up. Marginal analysis helps find the right price (Perreault & McCarthy, 2002:525).

The basic theory of marginal pricing is that price is set at a point where marginal cost equals marginal revenue. Marginal cost is the increase in total cost as a result of producing and selling one more unit of a product. Marginal revenue is the additional amount received as a result of selling one more unit of a product. Marginal revenue decreases as quantity increases. This is because of the supply and demand theory that people will buy greater quantities of a product at lower prices. However, marginal cost pricing is still based on cost.

3.3.4 Time and material pricing

According to Garrison *et al.* (2003:896), some companies use a variation on cost-plus pricing called time and material pricing. Under this method, two pricing rates are established in which one is based on direct labour time and the other based on the cost of direct material used. The rates include allowances for selling, general and administrative expenses, other direct costs and a desired profit. This pricing method is widely used in repair and printing shops. Many professionals such as accountants, attorneys, physicians and consultants also used it. Hilton (1997:733) cites that time and material pricing is cost-based.

3.3.5 Conclusion on cost-based pricing

There are cost-based approaches that are linked to demand oriented method of pricing. For example, flexible breakeven pricing requires estimates of consumer responses to prices. Marginal pricing requires the marketer to change price, up to the point where marginal revenue equals marginal cost. If demand is inelastic, prices will increase to reach this point and if it is elastic, prices will decrease.

It is critical for the SME manager to understand the cost of the product in order to price for profit. Different cost-plus methods are used by different organisations. The only real difference among these techniques is the relative sophistication of the costing procedures employed. It is, therefore, difficult to tell which cost-plus pricing method is the best. However, under the circumstances the activity-based cost pricing should be preferred. This will enable the organisation to recover its total costs. The problem of this method is that the costs calculations may be based on standard costing. It is important for the marketers to understand that the customers are not necessarily interested in their cost as they generally use cost as a justification to price increase. Customers are more interested in what it will cost them to buy the product and if they may afford. It may be a serious mistake to ignore what the competitors are charging for the same or substitute product.

Prices do not depend on costs alone, but on market forces that play an even greater role than costs in the setting of prices. Rather than using costs for pricing purposes, costs should be taken into account in the decision as to whether manufacturing and selling a product is going to produce profits for the business (Bradshaw & Brooks, 1996:503).

3.4 Demand-based pricing

The marketer should understand the customers' taste and the perception of value in order to capture their attention and persuade them to buy. The ability and willingness to pay become critical. The price charged should elicit the required demand which will in turn bring the required profit. Marginal pricing could be used. Enterprises use the non-price variables in the marketing mix to build up perceived-value in the buyers' minds. Price is set to capture the perceived-value. The company using perceived-value pricing should find out the value in the buyers' mind for different competitive offers, which may be very difficult. However, experience of the business and knowledge of buyers' behaviour may work to the SME managers' advantage. There is high degree of interaction with customers in SMEs and this may benefit managers as they may understand their customers better. The seller that charges more than the buyers' perceived-value may cause the company's sales to suffer. Care should be exercised in this regard because this may affect the financial position of the business negatively.

An important form of market-based price is the target price. A target price for a product is the estimated price for a product that potential customers will be willing to pay. This estimate is based on an understanding of customers' responses (Horngren *et al.*, 1999:428).

3.4.1 Perceived-value pricing

Nieman and Bennett (2002:186) cite that, in some instances, where consumers find it difficult to evaluate the quality of a product prior to purchase, consumers use price as an indicator of quality. Perceived-value pricing uses consumers' perceptions of value as the main input in the calculation of the basic price. Costs and competition are seen as less important, and in order to increase the price as much as possible, the organisation has to spend large amounts of money on advertising and personal selling to increase consumers' perceptions of value. Nowak and Newton (2006:157) state that product quality, positive emotions felt, preference for a product, customer commitment, and fair pricing are all significant predictors of repurchase intentions.

Perceived-value pricing may be very challenging. The SME manager needs to understand his or her clients very well. He or she should read their minds and understand their way of thinking. There are psychological effects in setting prices that will be acceptable to the customers. They need to have a perception of value to the price that they will pay. The ability to pay should also be considered when pricing the product. The features and benefits derived from the product play an important role in the decision by the customers to pay the price.

There is co-integration between the prices of two products. The prices of regular oranges and organic oranges were cited as an example, where many consumers are willing to pay more for organic oranges, perceiving them to be healthier. It might be expected that the price of these two products could be co-integrated since the difference in prices between the two cannot increase too much. That is, many people are willing to pay slightly more for organic products, but if the premium gets too large, they may switch to regular oranges (Koop, 2005:154).

Product quality and service availability come before price considerations, with quality and service levels determining the price. Quoting a price is generally the result of a complicated process. It employs many factors, often hidden from the salesperson who does not always make a persistent investigative effort to uncover them. Salespeople who investigate a variety of price related issues before making price quotations are basing their prices on the perceived-value of their respective products. They use the buyer's perception of value, not the seller's cost, as the key to pricing. They use the non-price variables to build up perceived-value in the buyers' minds. A price is then set to capture the perceived-value (Blem, 1998:277).

Market research should be used to support perceived-value pricing in order to determine the value which customers place upon the product. There is a very delicate balance to be struck between the dangers of overcharging, thus damaging sales, and undercharging, thus damaging the perception of value (Murphy, 1996:130).

Cutting high prices stimulates demand. However, cutting low prices probably does not. There may well be some short to medium-term high elasticity of demand for advanced new products. However, its effect probably is not sustainable in the long-term. Pricing based on demand elasticity is a short-term tool. If marketers want to create a business with sustainable advantage, they will need to do it on some other basis in which customers may perceive value (Weingarten & Stuck, 2001:34).

Buyer-based pricing is important to ensure that customers perceive value in the products that they may afford and be willing to pay for. If affordability and willingness to pay are not properly assessed the company may not be able to sell its products. The consumers' perception of the price in relation to the product is extremely important. If the price is below that of competitors' products, consumers may perceive the product to be of a low quality and the demand may not be as expected. The marketer will have to try to strike the balance between the value perceived and price.

3.4.2 Value pricing

According to Ge (2002:174), value pricing refers to a pricing principle that prices a product according to the value it brings to the customers or users. This principle is different in a number of aspects from other conventional pricing principles. First, different from all internal-oriented pricing principles such as cost markup, target return objective, value pricing is an external-oriented approach. It focuses on how much value one's product or service provides to the customer, rather than how much it costs to make the product or how much profit may be made from the product. Second, different from other external-oriented pricing approaches like competitive parity and sealed-bid pricing, the value pricing is driven by customer value evaluation rather than competitors' actual or expected pricing practices. Finally, value pricing is driven by measurable value provided to customers and not by customers' expressed willingness to pay. Aquila and Marcus (2004:226) state that value pricing is the maximum amount a given customer is willing to pay for a particular product before the work begins.

Value pricing is an old-fashioned price cutting, but with manufacturers redesigning the product to keep or enhance quality, lowering costs so as to still earn profit is offering more for a lot less (Salvatore, 1996:487). Christopher (2000:150) states that the underpinning idea is that customers will not pay for non-value adding activities or elements of a marketing offer.

According to Christopher and Peck (2003:56), the idea behind value pricing is to offer a guaranteed low price to the trade for a finite contractual period. This price is lower than the list price, but will not fluctuate during the contract period and neither will there be tactical price promotions. As a result both parties should benefit, as well as the final consumer.

Value pricing is not the same as perceived-value pricing. The latter is really a more-for-more pricing philosophy. It encourages a company to price at a level that the buyer thinks the product is worth. Value pricing, on the other hand, indicates that the price should represent an extraordinary bargaining for consumers. Value pricing is not a matter of simply setting lower prices on one's products compared to competitors. It is a matter of reengineering the company's operations to truly become the low-cost producer without sacrificing quality, and to lower one's prices significantly in order to attract a large number of value conscious customers.

The product demand may also increase due to low price and this may mean more profit. SME managers who are in a business of high quality products may use this method. However, they should know that there is a challenge that goes with it. They need to maintain the quality as they may have created a perception to potential buyers that they sell products of high quality. They should guard against possible stiff competition and they should strive for improvement of the quality of their products to keep ahead of competitors. Above all, the price charged should reflect the quality of the products at all times.

3.4.3 Conclusion on demand-based pricing

When you use a pricing method based on demand, you place more emphasis on the influence of customer needs and interests than on the influence of costs, profits or competitive forces. Among the demand-based pricing there are strategies and tactics such as price lining, skimming, penetration, prestige, odd-even, bundle and demand backward pricing. The demand backward pricing is where the price that will create a desired level of demand is determined first, and the product is then developed and marketed to fit that price (Nickels & Wood, 1997:348).

3.5 Competition-based pricing

Competition is one of the factors that influence pricing decision. It is, therefore, necessary for SME managers in a competitive market environment to know what competitors are doing and understand the different strategies they apply in pricing their products. SME managers who do environmental scanning and identify the strengths and weaknesses of competitors in pricing may have a competitive edge on pricing strategy as these may be used to either match or outclass competitors.

According to Uusitalo and Rökman (2007:121), new entrants in the industry may impact a previously stable market on the pricing behaviour. The pricing initiatives of the entrants and the reactions of the competitors may be analysed in terms of competition, geographical, assortment and time. This may result in competitors intensifying price competition by engaging in selective price changes. Both price cuts and price increases may be detected.

Competitors' actions cannot be ignored when setting prices. For example, a company with a small share of the market will probably find the general price level already set for him or her. This does not, of course, rule out the possibility of finding a differential advantage which enables a price well above the general level to be charged, especially if only a small segment of the market is being attacked. It may be wise to accept competitive prices as the starting point for any development of a marketing strategy. This does assume, however, and possibly wrong, that competitors have got their sums right. Against this, in an established market consumers will probably have come to accept this level as a going-rate and will need a lot of convincing if they are to accept something different (Wilmshurst & Mackay, 2002:275).

Most satisfied clients probably feel they could be similarly served by a number of each professional enterprise's competitors. If the products are perceived to be the same, then the only thing that will differentiate competing enterprises in the client's mind will be price. In essence, the enterprise is providing and selling a commodity. This description does not sit well with many professionals. However, if clients are choosing purely on the basis of price, the situation is in a commodity market the only differentiator is price (Walker *et al.*, 2000:32).

Perceived price may be defined as the customer's judgement about a product's average price in comparison to competitors. The notion of perceived price is based on the simplistic nature of competitive-oriented pricing approach. The guidance available to customers consists of information about whether they are charged more than or about the same as the competitors charge. Perceived price, therefore, does not eliminate objectivity rather it adds some subjectivity with the goal of achieving greater organised pricing structure (Chen *et al.*, 1994:25).

There are very few situations where an organisation may set its prices without taking into account the activities of its competitors. The competitors and the prices to be compared need to be carefully considered. Competition may be defined narrowly in terms of the similarity of the service offered, or more widely in terms of the needs which a product satisfies. Having established what market it is in and who the competition is, an organisation should establish what price position it seeks to adopt relative to its competitors (Palmer, 1998:245).

The competition-based pricing is closely related to buyer-based pricing. It is the buyers who are going to compare the product features and benefits of two or more enterprises in relation to their prices. They are the ones who are encouraging price competition through their perception of value to the price charged. In the circumstances, they may settle for the price where they perceive more value.

A market economy is characterised by, among other things, a competitive market environment. Thus every organisation that endeavours to market a product in the market environment is constantly up against competition. It is often competitors and not consumers who determine the actual quantity of a particular product to be marketed, including the price levels for the product (Smit *et al.*, 2007:70). Daniels and Radebaugh (2004:673) mention that a company may have many competitors and thus little discretion regarding its prices and it becomes a price taker.

The prices of standard materials and materials with a low monetary value are determined with the aid of price lists and telephonic, verbal or written quotations. Because standard materials are available everywhere, prices are in fact determined by competition (Cronje *et al.*, 2004:550).

Niemand *et al.* (2004:165) indicate that enterprises facing stiff competition use market-based pricing approaches. Target pricing is part of this approach. Competition-oriented pricing focuses on competitors rather than costs when setting prices. This may take two forms which are going-rate pricing and competitive bidding. Christopher and Peck (2003:4) cite that the more the organisations compete on price, the more they reinforce the customers' view that they are indeed commodity suppliers.

With competition-based pricing one may base his or her price on what others charge, setting a price that is equal to, higher than or lower than that of your rivals. At times you may set prices by bidding against competitors. Competition-based pricing covers a range of tactics including competitive bidding, customary, promotional, every day low and negotiated pricing (Nickels & Wood, 1997:387).

Competition in businesses is part of life and cannot be avoided. It is up to the SME manager to ensure that he or she remains in business despite the challenges in the business sector. Price may be used to sustain operation, make profit and gain market share in a competitive environment. Marketers should continuously scan the environment to keep up to date with the latest development regarding pricing and what makes competitors to lower prices, for how long and what is bolstering their profits to sustain business. Competition may also force the manager to price for survival. This may bring into account cost implication as one should at least breakeven to sustain operation and this may only be achieved if the number of customers, to buy the product, is adequate.

3.5.1 Going-rate pricing

In going-rate pricing the enterprise bases its price largely on competitors' prices, with less attention paid to its own costs or demand. The enterprise may charge the same, more or less than its major competitors. Going-rate pricing is quite popular. Marketers may also feel that holding to the going price may avoid harmful price wars.

Market-based pricing or going-rate pricing seems to duck the issue of cost allocation and therefore risks proving unprofitable. This approach to pricing also assumes that there are similar offerings in the market against which the going-rate may be determined. This rather undermines the claims of the product to competitive differentiation and unique selling points (Wilson, 1999:69).

According to Palmer (1998:246), in some markets which are characterised by a fairly homogeneous product offering, demand is so sensitive to price that an enterprise would risk losing most of its business if it charged just a small amount more than its competitors. On the other hand, charging any lower may result in immediate retaliation from competitors.

3.5.2 Sealed-bid pricing

Palmer (1998:246) cites that many businesses are provided by means of a sealed-bid tendering process where interested parties are invited to submit a bid for supplying services on the basis of a predetermined specification. In the case of many government contracts, the organisation inviting tenders is often legally obliged to accept the lowest priced tender, unless exceptional circumstances may be proved. Price therefore becomes a crucial concern for bidders, regardless of their efforts to build up long-term brand values which in other markets might have allowed them to charge a premium price.

According to Kerzner (2003:719), having the right intelligence information on customer cost budgets and competitive pricing would certainly help. However, the reality is that whatever information is available to one bidder is generally available to the others. Even more important, intelligence sources are often unreliable. The only thing, which is worse than missing information, is getting wrong or misleading information. When it comes to competitive pricing, the old saying still applies: "Those who talk don't know and those who know don't talk!"

3.5.3 Price leader

Leader pricing means setting some prices very low, real bargains, to get customers into retail stores. The idea is not only to sell large quantities of the leader items but also to get customers into the store to buy other products. In food stores, the leader prices are the specials that are advertised regularly to give an image of low prices. To avoid hurting profits, managers often select leader items that are not directly competitive with major lines (Perreault & McCarthy, 2002:535).

Price leadership is the pattern of pricing in which one enterprise regularly announces price changes that other enterprises then match. Sometimes a pattern is established whereby one enterprise regularly announces price changes and other enterprises in the industry follow suit. This pattern is called price leadership. One enterprise is implicitly recognised as the leader while the other enterprises, price followers, match its prices. This behaviour solves the problem of coordinating price. Everyone simply charges what the leader is charging (Pindyck & Rubinfeld, 2001:447). Mansfield and Yohe (2004:466) also state that price leadership is the behaviour where one or few enterprises set the price and the rest follow its lead.

Price leadership strategy prevails in oligopolistic situations. One member of an industry, because of its size or command over the market, emerges as the leader of an entire industry. The leading enterprise then makes pricing moves that are duly acknowledged by other members of the industry. The price leadership strategy is a static concept. In an environment where growth opportunities are adequate, companies would rather maintain stability rather than fight each other by means of price wars. Thus, the leadership concept works out well in this case (Jain, 2000:435).

3.5.4 Market related pricing systems

Market price is the price that the seller is prepared to ask for products which at the same time a buyer is prepared to pay. When a buyer and a seller agree on a price, equilibrium is reached (Badenhorst *et al.*, 2000:11). This pricing approach may work where sellers and buyers have constant interaction and they understand each other well. Otherwise it may be difficult to apply as the seller may have to take costs into account or elicit high demand to make profit.

3.5.5 Conclusion on competition-based pricing

A company that uses price leadership strategy as its principal technique should pick the price leader in its segment. Do not pick all the competitors, just pick the key company and go for it, on its weakness in product or service performance. In sealed-bid pricing the SME managers should calculate costs properly because there may be legal implications if the job is not finished and one has run out of funds because prices were incorrect. One needs to remember that contracts are signed in this situation. He or she may have to hire a professional to cost and price for him or her. Competition-based pricing, especially going-rate pricing may help to avoid price wars but may also ignore the recovery of costs and profitability of the business. SME managers should consider this when using this pricing approach.

3.6 Marketing-oriented pricing

Marketing-oriented pricing is more difficult than cost-oriented or competitor-oriented pricing because it takes a much wider range of factors into account. In all, ten factors need to be considered when adopting a marketing-oriented approach. These factors include marketing strategy, price quality relationships, value to customer, product line pricing, negotiating margins, political factors, costs, effect on distributors and retailers, competition and explicability (Jobber, 2004:332).

SME managers may learn more from this pricing approach. It encompasses several factors that may affect pricing decisions. It affords one the opportunity to take a much wider range of factors into consideration when pricing. It looks at a broader perspective. The factors mentioned in this approach may allow managers to use them as a checklist. Most of them may be found in other pricing approaches. This approach touches on all other pricing methods and it may be the most appropriate for SMEs. It enables managers to deal with costs, customers, competition and the relationship in the value chain.

3.7 Pricing tactics

Pricing tactics may be used to enhance pricing methods. They may give pricing methods another dimension of flexibility by looking at what may attract customers and use that as a tool to either capture value or create perception in the consumers' minds that there is additional value. They may include price bundling, unbundling, negotiation and discrimination and also two-part, promotional, discount relationship and dynamic pricing.

Lamb *et al.* (2005:509) state that there are tactics for fine-tuning the base price. Fine-tuning techniques are short-term approaches that do not change the general price level. They do, however, result in changes within a general price level. These pricing tactics allow the enterprise to adjust for competition in certain markets, meet ever-changing government regulations, take advantage of unique demand situations, and meet promotional and positioning goals. Fine-tuning pricing tactics include various sorts of discounts, geographical pricing and special pricing tactics. Special pricing tactics may include single-price tactic, variable pricing, leader pricing, bait pricing, odd-even pricing, price bundling and two-part pricing.

3.7.1 Price bundling

Bundling is a pricing strategy that takes a number of forms, but its principal characteristic is that it offers the buyer a package consisting of two or more products that is more attractive than the alternative of buying the products separately. Like many of the other tactics, it may enhance both revenue and profit (Truett & Truett, 2001:482).

Price bundling, also called iceberg pricing, refers to the inclusion of an extra margin, for support service, in the price over and above the price of the product as such. This type of pricing tactic has been popular with companies that lease rather than sell their products. Thus, the rental price, when using a bundling tactic, includes an extra charge to cover a variety of support functions and services needed to maintain the product throughout its useful life. In the bundling tactic, a charge for upkeep or iceberg services is included in the price (Jain, 2000:434).

Price bundling is effective in products that are related. The banks use price bundling in some instances to attract customers and to try to make their products look better than those of competitors. A typical example is one of current or cheque book accounts that may go with credit facility and credit card. Once one applies for the cheque book account he or she is already offered these other facilities as part of the package. Prices of bundled products may sometimes be lower than those that are not bundled. Bundled pricing may give SME managers an opportunity to sell those products that may not be in high demand by bundling them to those that may be in high demand. It may increase revenue and bolstered turnover with products that customers were not going to buy if they did not go together with what they need. SMEs in hospitals may put soap, washing wrack, skin lotion, toothpaste and toothbrush together for patients. The visitors who may wish to buy them for the patient or for themselves if they have forgotten to bring theirs may also appreciate the package.

3.7.2 Price unbundling

Price unbundling is another tactic that effectively raises prices. Many product offerings actually consist of a set of products to which an overall price is set, for example computers and software. Price unbundling allows each element in the offering to be separately priced in such a way that a total price is raised. A variant on this process is charging for services that previously were included in the product's price. For example, manufacturers of mainframe computers have the option of unbundling installation and training services and charging for them separately (Jobber, 2004:332).

Nowadays even the price of the computer monitor is separated from the hardware. Price unbundling may increase sales revenue substantially. The banks in South Africa have made more money when they started unbundling service fee and charging per product. A service fee was only charged on current account during the 1980's, but today other products like savings accounts and cash deposits and withdrawals are charged separately. It does not seem like the benefits were passed on to customers by reducing service fee of current accounts. The SME managers may use this method to make their businesses more profitable. One needs to think about which products should be charged separately to make more money. This should be done cautiously taking into account customers' perception of value and competition.

3.7.3 Price negotiation

Worsam and Wright (1995:451) indicate that, when negotiating prices at a tactical level, techniques such as bonuses, discount sales or return, special offers and wholesale prices may be used.

An alternative to either the cost-based or market-based approach is simply to haggle until you get the best deal possible on each occasion. There is a superficial logic to this in that it seems, by definition, to offer the highest price and anticipates a similar self-interested behaviour from customers. Aggressive negotiation over price and terms may result in reduced costs for customers or higher profits for suppliers in the short-term but the real world is not as simple as this (Wilson, 1999:69).

Price negotiations are always a challenge. The prospect or customer, having a reasonable desire for a product, will often ask for a modified price in the hope of arriving at a figure agreeable to all parties. Professional salespeople engaged in such a negotiation usually adopt the policy that they never drop a price, but may, if circumstances are suitable, reduce it to get an order. The implication in this is that the price should not change except in exchange for an order number (Blem, 1998:199).

SME managers are constantly interacting with their customers. Once they know their customers, price negotiations may be entertained. Price negotiations may be used as a tool to get the bulk of the business of a customer. The discount or special price afforded the customer may depend on the volume he or she purchases. This may increase sales revenue as one may be getting the bulk of the business and this may strengthen the relationship and promote loyalty.

3.7.4 Price cues

Anderson and Simester (2003:96) cite that there are several common pricing cues used by retailers. The most straightforward of the pricing cues that retailers use is the sale sign. It usually appears somewhere near the discounted item, trumpeting a bargain for customers. Tests with several mail-order catalogs reveal that using the word sale beside a price may increase demand by more than 50%. Another common pricing cue is using a nine at the end of a price to denote a bargain. In fact, this pricing tactic is so common that customers would ignore it, but the response to this pricing cue is remarkable. One explanation for this surprising outcome is that the nine at the end of the price acts the same way as the sale sign does, helping customers to evaluate whether they are getting a good deal. Signpost items are also used as pricing cues. Customers may use the prices of signpost items to form an overall impression of an enterprise's prices.

3.7.5 Price discrimination

According to Truett and Truett (2001:469), price discrimination involves either charging different prices for additional units of a product purchased by a consumer or separating groups of consumers into market segments and charging different prices to each segment.

Price discrimination is the situation where an enterprise sells the same product to different consumers at different prices. There are three major varieties of price discrimination, which include first degree, second degree and third degree price discrimination. First degree price discrimination is where the enterprise charges each customer the maximum price he or she is prepared to pay for each unit. Second degree price is where the enterprise charges customers different prices according to how much they purchase. It may charge a high price for the first so many units, a lower price for the next so many units, a lower price again for the next, and so on. Third degree price discrimination is where consumers are grouped into two or more independent markets and a separate price is charged in each market cost. An enterprise may use price discrimination to drive competitors out of the business. Price discrimination raises an enterprise's profit. Customers paying the higher price will probably feel that price discrimination is unfair to them (Sloman, 2003:188).

In a highly competitive market it may be necessary for SME managers to increase sales revenue by giving special prices to customers according to the quantity purchased. The high volume consumers should be charged lower prices as the high demand may offset profit that may be generated by high prices. This may encourage other buyers to buy most of the commodities from one's enterprise and this will bolster revenue as sales increase. Sales increase may in turn improve profitability. The company may also gain market share. Customers may be satisfied as they may influence prices through volumes purchased.

3.7.6 Two-part pricing

Two-part pricing is a strategy that divides the amount a consumer pays for a good or service into an access fee and a price per unit. Many enterprises use it. Examples are telephone or cellular services that impose a fixed monthly fee to have a phone plus an additional charge per time unit or phone use, golf course that charge a membership fee plus a green fee per unit of use, and amusement parks that charge an entry fee plus an additional fee for using each ride or attraction (Truett & Truett, 2001:478).

According to Lamb *et al.* (2004:403) two-part pricing means establishing two separate charges to consume a single product. For example, tennis clubs and health clubs charge a membership fee and a flat fee each time a person uses certain equipment or facilities such as playing a game of squash. In other cases they charge a base for a certain level of usage such as 10 games per month and surcharges for anything over that amount. Consumers sometimes prefer two-part pricing because they are certain about the number and the types of activities they might use. Also, the people who use the service most often pay a higher total price. Two-part pricing may increase a seller's revenue by attracting consumers who would not pay a high fee even for unlimited use.

SMEs may have a great opportunity to make more money with two-part pricing method. Managers should look at their products and see how they may charge two-part price. For example, a fee may be charged for entrance where snooker is played and participants should also pay for each game they play.

3.7.7 Promotional pricing

Companies use promotional pricing systems to fill up slack demand. For example, it is much cheaper to use the telephone for making calls at the weekend, or even in the afternoon, than it is to use the telephone at the peak hours of weekday mornings. You may get cheaper holidays in major hotels out of the main summer season. Retailers and manufacturers may use promotional pricing to force the market either to sell more, to hold their market position, or to make more profit for someone. Promotional pricing techniques are also used to clear special problems of excess stocks, and low selling lines (Baker, 2003:308).

Promotional price is a discounted price that is less than a conventional or regular price. Once the hallmark of discounters, promotional pricing has become an important element in the merchandising strategies of many department and specialty stores. Promotional pricing is often linked to one of the advertised events (Donnellan, 1996:307).

3.7.8 Discount pricing

Discounts are reductions from list price given by a seller to buyers who either give up some marketing function or provide the function themselves. Discounts may be useful in marketing strategy planning. Different categories of discounts are found in the businesses. They include quantity discounts, seasonal discounts, cash discounts, trade discount and sale price. Quantity discounts are discounts offered to encourage customers to buy in larger amounts. Seasonal discounts are discounts offered to encourage buyers to buy earlier than present demand requires. Cash discounts are reduction in price to encourage buyers to pay their bills quickly. Trade or functional discount is a list price reduction given to channel members for the job they are going to do. A sale price is a temporary discount from the list price. Sale price discounts encourage immediate buying (Perreault & McCarthy, 2002:497).

Baker (2003:348) cites that discount pricing is different from promotional pricing in that the discounts are used as a way of life. The technique is to set an artificially high price, and then to discount off it. Discount prices may be formally published as a series of offers for a given time or for a given quantity. Discounts might not be published, however. In which case, if the buyers do not ask, then they do not get.

Discount pricing may take different forms. There is trade, cash and quantity discounts. For example, trade discount may be applied when a customer pays within a certain period after purchase, usually, thirty days. Cash discount may be given to buyers who pay immediately and quantity discount will be based on the number of items bought. SME managers may use discount pricing to attract more customers and in turn increase sales volume. They may also use it to clear obsolete stock.

3.7.9 Relationship pricing

Price-centered relationships can be characterised as competitive. The customer is seen as an average statistic. The enterprise knows a great deal about such customer segments but very little about individual customers. Products and services for those in the patron group are created with very little dialogue or feedback. Patrons can be loyal to an enterprise that consistently offers them a good deal but that loyalty is conditional which is on getting the best price, perhaps not every time but most of the time. The enterprise that targets patrons should ensure that it focuses all of its energy around the idea that customers are aggressive, price-sensitive shoppers and these customers may insist on getting the best deal that the market could offer. The relationship is price-centered because it is focused on efficient operations in a free market where there is perfect information, perfect competition and standard products (McKenzie, 2001).

Relationship pricing needs transparency and quantification. The SME manager should be able to show the customer the calculations regarding costs, price and possible profit from the relationship. This may give him or her opportunity to justify the price charged to the client. The profits may not be high per product but the bulk purchase should make the difference even if the markup is low.

3.7.10 Dynamic pricing

Drummond and Ensor (2005:134) mention that the most commonly cited criticism of pricing is that it is too often cost-based. As such, it often fails to reflect market conditions, consumer behaviour and organisational goal. Therefore, increasing importance is being attached to more dynamic pricing models which, while based on cost, are responsive to current circumstances and strategic objectives.

According to Kotler and Armstrong (2006:307), dynamic pricing refers to charging different prices depending on individual customers and situations. For example, Internet has affected pricing as it seems now to be taking businesses back into a new age of fluid pricing, from the mostly fixed pricing practices of the past century. It could, potentially, push aside sticker prices and usher in an era of dynamic pricing in which a wide range of goods would be priced according to what the market may bear, instantly and constantly. Dynamic pricing may offer the following advantages for marketers:

- Internet sellers may mine their databases to gauge specific shoppers' desires, measure their means, instantaneously tailor products to fit those shoppers' behaviour, and price products accordingly.
- Catalog retailers may change prices on the fly according to changes in demand or costs, changing prices for specific items on day-to-day or even hour-to-hour basis.
- Online music retailers may allow consumers' demand to set the price for downloading songs, and increase prices as demand increases.
- Managers may monitor inventory, costs and demand at any given moment and adjust prices instantly.

- A wealth of Web sites, such as Yahoo! Shopping, Froogle.com, Bizrate.com, PriceGrabber.com and many others, give instant product and price comparisons from thousands of venders.
- Buyers may also negotiate prices at online auction sites and exchanges.

Blythe and Zimmerman (2005:186) state that, because the Internet has become pervasive, a marketing manager should assume that any facts placed on the Internet may quickly be obtained by buyers throughout the world. Because there are price-oriented search engines, many enterprises are wary about putting their prices on the Internet, because where prices are posted, the Internet makes comparisons quite easy and, therefore, would dictate a standardised pricing policy rather than a differentiated one. If differentiated prices should be used, the website should explain why there is a difference in a particular market based on additional cost.

3.8 Summary

Different pricing approaches have been identified and discussed. Several methods are classified under cost-based, buyer or demand-based and competition-based pricing. Cost-based is apparently the most popular approach. However, it has its shortcomings that have been stated. The demand needs to be taken into account when pricing products. One needs to know whether the consumers will buy the product at a set price. Competition cannot be ignored in a competitive environment. Competitors' prices are very important to use as the starting point although it denies one the opportunity to differentiate his or her products using prices. However, charging the same price as your competitors may avoid price wars whilst prejudicing the organisation from maximising its profit.

Other pricing methods are also important for specific reasons. They may assist in penetrating or skimming the market or differentiate one's product from those of the competitors. Marketing-oriented pricing seems to be covering almost all the approaches when looking at the factors it considers. It may be the most appropriate pricing method for

SMEs. However, the pricing approach to be used may depend on the pricing objective. Another pricing method worth of pursuing or exploring is dynamic pricing. Managers need to be familiar with Internet and the benefit they may derive from it with regard to pricing.

The pricing methods discussed in this chapter may give SME managers some options in pricing their products. They should exercise care in choosing the strategy to use. There are several factors to consider in pricing products successfully. There are overall company objectives and pricing objectives that should be achieved with the pricing method. There are pricing methods that use the same name as the pricing objectives and this make it easy for managers to identify the relevant method. Pricing methods are so important because they make sure that the objectives are achieved. Once the pricing method is identified, then price may be determined. The process of determining prices is discussed in Chapter 4.

CHAPTER 4

PRICE SETTING IN THE BUSINESS

4.1 Introduction

When one engages in a business venture, one of the challenges is what price is to be charged, whether it will be acceptable to potential buyers and what are the other companies are charging for a similar product or substitute product. SME managers are faced with a challenge of creating value that should be reflected in the price charged. Although the demand may not be accurately determined, the price may be used to estimate it and anticipate the breakeven point, and ultimately the profit. Managers should set prices with the value perceived by customers and optimisation of financial results in mind.

According to Hornby and Macleod (1996:32), setting the price of a product is one of the most important areas of decision-making in any business. Yet, due to the multi-dimensional nature of pricing behaviour it is a highly complex process and may lead to either the success or failure of many enterprises. Essentially, the pricing decision does not rely on any discipline and encompasses many different theoretical aspects such as accounting, economics and marketing. What is nearly always true, however, is that the price of a product will have a floor determined by the cost and a ceiling determined by the market conditions. George (2001:184) states that price is the most complicated of all the elements of the marketing mix. Hutt and Speh (2004:383) mention that the diverse nature of the business market presents unique problems and opportunities for the price setter.

Cannon (1996:305) cites that price formation for the practicing manager means hard work, carefully tested assumptions, expectations, research and judgement in what is probably the most difficult area of marketing decision-making. According to Cravens (1997:343), pricing decisions may have explosive and far-reaching consequences. Once implemented, it may be difficult to alter a price strategy, particularly if the change calls for a significant increase.

Le Roux *et al.* (1999:348) mention that the price will usually determine how much of a given product will be sold. Therefore, when you set a final price you will have to establish a price that is acceptable to the market. One needs to be careful not to make his or her selling price higher than that of the competitors for the same product. You may only be able to successfully charge a higher price if you have something special to offer your clients.

It may not be easy to arrive at a final stage of pricing. However, strategic marketing and pricing and proper planning may lead to successful pricing of products. Managers need to take factors discussed in the previous chapters into account and use them to their benefit. They may assist in keeping them focused until they identify the appropriate pricing methods. If the price is not effective in addressing the intended objective, the manager may revisit the process and check all the areas to find out where he or she might have gone wrong. Appropriate pricing methods should ultimately lead to the right price in which customers may find value and buy the required quantity of the product to achieve the targeted sales and profit.

4.2 Determining the right price

The right price may be interpreted as a price that is fair and reasonable to both the buyer and the seller. Unfortunately there is no magic formula for calculating precisely what constitutes a fair and reasonable price. The right price for one supplier may not necessarily the right price for the other supplier, either at the same time or different points in time. To determine the right price for any specific purchase, a number of constantly changing variables and relationships should be evaluated.

Dutta *et al.* (2002:61) mention that companies that know how to set the right prices for their products understand that pricing is not simply a matter of good tactics. By investing in specific areas of organisational capital, they have made it a strategic weapon that competitors can only envy. For many companies, pricing capabilities are increasingly critical to their ability to implement their strategies. Pricing is the essential capability for survival in the business. Pricing capability is not just a nice to have. It is often a matter of survival for companies of every shape, size and age. This is because the cost of not having a fully developed pricing capability goes beyond the losses associated with poor pricing decisions. After all, a bad decision or two can be rectified. The true cost should be reckoned by looking at the way an organisation's strategy is hampered, sometimes disastrously, by inability to price effectively. Companies with a pricing capability may also cluster around optimal prices and may rarely go so wrong that they end up outside the board

In many enterprises the struggle to find the correct price is not handled well. Too often organisations rely heavily on costs to set prices and ignore the effects of demand. Other enterprises fail to integrate pricing with their market positioning strategy (Dalrymple & Parsons, 2000:531). According to Donnellan (1996:286), what constitutes the correct price, in essence, is that, it should be high enough to cover organisational profit objectives, but low enough to stimulate customer purchase.

Bradshaw and Brooks (1996:498) mention that most pricing, especially of new products, is based on an instinctive method. Managers who intuitively weigh up estimated product costs and the market prices of similar products set prices. The fastest way for a business to realise its maximum profit is to get pricing right. The right price may boost profit faster than increasing volume. The wrong price may shrink it just as quickly. Managers do, however, tend to be wary of increasing prices because they fear that they may lose customers. However, the consequences of not managing prices are far more damaging.

Lamb *et al.* (2004:381) cite that to earn a profit, a manager should choose a price that is not too high or too low, a price that equals or exceeds perceived-value to target consumers. If a price is too high in consumers' minds, the perceived-value will be less than the cost, and sales opportunities may be lost. Lost sales mean lost revenue. Conversely, if a price is too low, it may be perceived as great value for the consumer but the enterprise loses revenue it could have earned. Setting prices too low may not even attract as many buyers as managers may think. Some buyers may intend to buy full-price items only. Managers who place too much emphasis on discounts may not be able to meet the expectations of these customers.

Perceptions on price directly influence satisfaction judgments as well as indirectly through perceptions of price fairness. Consumers' vulnerability, which is induced by a perceived demand and supply relationship and the urgency of need from the consumers' side, had a negative effect on perceived price offer fairness. The effect of consumer vulnerability implies that sellers should not only avoid exploiting their customers but should also anticipate consumers' potential feelings of being exploited. Being sensitive to the buyers' psychological state and assuring buyers of fair treatment will enhance perceptions of price fairness without changing the price offer. The influences of consumer vulnerability and price procedure fairness on satisfaction judgments are new and contribute to the dual-entitlement principle and our existing knowledge in price fairness (Herrmann *et al.*, 2007:49).

The right price is not necessarily the lowest price. A buyer should always strive to obtain the highest value from the product. The cost should be reasonable and should enable the business to make its own product competitive in the market. A reasonable price should be fair to ensure that an enterprise sells its product at a price that will ensure its profitability and survival. The price should therefore be in relation to the supplier's costs. Notwithstanding this, prices should also be perceived to be fair by consumers who may buy more in future.

Chaston (2000:81) states that price is one of the simpler facets of the marketing process to comprehend because there are a number of clearly identifiable rules and conventions that control the use of this variable in seeking to improve organisational performance. One of the most fundamental rules is that, with the possible exception of monopolistic scenarios, customers, not suppliers, determine at what price products may be sold in a marketplace. Strydom *et al.* (2002:427) cite that throughout history both buyers and sellers set prices by negotiating with each other. Through bargaining they would arrive at an acceptable price for both parties. In the modern economy the marketer mainly predetermines prices, although negotiations still play an important role in the marketing of industrial products and some durable consumer products.

According to Kotler and Armstrong (2006:307), fixed price policies, setting price for all buyers, is a relatively modern idea that arose at the end of the nineteenth century. Today, most prices are set this way. However, some companies are now reversing fixed pricing trend. They are using dynamic pricing.

Myers *et* al. (2002:162) state that price setting in international markets should be approached at two different levels. These levels include the external (customers, competition, government regulations) and the internal (cost reduction, ROI levels, and sales volume requirements) and both should be taken into account.

Price is critical for the success of a business. It may be complex and complicated. Pricing is a crucial decision to make. Critical thinking may be very important in price determination. It is critical for SME managers to choose the most appropriate pricing method to be able to determine the right price that may satisfy both the consumer and the seller. The right price should, ultimately, elicit the required demand and achieve the financial targets.

4.3 Factors to consider when setting price

Pricing may be a problem when an enterprise has to set a price for the first time. This may happen when the enterprise develops or acquires a new product. The enterprise should decide where to position its product on quality and price. This may make it difficult if the competitors react to any price set. The other challenge may be the recovery of cost and how customers may perceive the value of the new product. The factors to be considered should address the problem and the challenges faced by SMEs in order to stimulate demand and make profit.

McNamee (1998:320) cites that the pricing of existing products is generally a simpler task than the pricing of new products. Existing products have a pricing history and setting new prices is often merely an incremental adjustment to past price levels. However, when a new product that is unique is launched, setting its price tends to be more difficult. There are no competing peer products. The rules of the market in terms of growth rate, buyer behaviour and competitive reactions and strategies have not yet evolved. The only element known with certainty is cost.

Jobber (2004:326) cites that marketing managers need to remember that price should not be set in isolation. It should be blended with product, promotion and place to form a coherent mix that provides superior customer value. Understanding how to set prices is an important aspect of marketing decision-making. Since price is a major determinant of profitability, developing a coherent pricing strategy assumes major significance. Many people's introduction to the issue of pricing is a course in economics. Price is determined by the intersection of the marginal revenue and marginal cost curves. Unfortunately, in practice, economic theory is of little use in developing pricing strategy. Managers, therefore, turn to other methods of setting prices, which are cost-based, competition-oriented and marketing-oriented pricing.

4.3.1 Public policy and pricing

According to Kotler and Armstrong (2006:349), price competition is a core element of a free market economy. In setting prices, companies are not usually free to charge whatever prices they wish. There are laws that govern the rules of fair play in pricing. The major public policy issues include potentially damaging pricing practices within a given level of the channel and across levels of the channel. The four areas of pricing which are considered to be unethical and illegal include price fixing and predatory pricing, which are within the level of the channel and discriminatory pricing and deceptive pricing which are across the channel. Price fixing is an agreement among enterprises in an industry to set prices at certain levels. Kreitner and Kinicki (2004:368) cite that price collusion constitutes an unethical activity. Price collusion is suspected when seller talk to competitors about setting prices.

Deceptive pricing occurs when a seller states prices or price savings that mislead consumers or are not actually available to consumers. It is meant to deceive customers and to take unfair advantage of them. One type of deceptive pricing, bait-and-switch pricing, is a low price offer intended to lure customers into a store, where a salesperson tries to influence them to buy a higher priced item. Another deceptive practice is to offer a discount off an inflated price. Since the price is inflated, the consumer is not actually getting discount (Kotler & Armstrong, 2006:349).

Predatory pricing involves initially low prices to eliminate competition and ultimately increasing price levels as competitors withdraw from the market (Erwee & Venter, 2003:344). Pindyck and Rubinfield (2001:361) also state that predatory pricing is the practice of pricing to drive current competitors out of business and to discourage new entrants in a market so that an enterprise can enjoy higher future profits.

Varian (2003:439) cites that price discrimination is selling different units of output at different prices. Economists generally consider three kinds of price discrimination which include first degree, second degree and third degree price discrimination. Sloman (2003:188) agrees with Varian (2003:439) that price discrimination includes first degree, second degree and third degree. First degree price discrimination is where the enterprise charges each customer the maximum price he or she is prepared to pay for each unit. Second degree price is where the enterprise charges customers different prices according to how much they purchase. It may charge a high price for the first so many units, a lower price for the next so many units, a lower price again for the next, and so on. Third degree price discrimination is where consumers are grouped into two or more independent markets and a separate price is charged in each market cost. An enterprise may use price discrimination to drive competitors out of the business. Price discrimination raises an enterprise's profit. Customers paying the higher price will probably feel that price discrimination is unfair to them.

Underlying much discussion about price is the notion of the fair or just price, the price that could be called correct on the basis of social considerations. A great deal of government, pressure group and media action and discussion is geared towards achieving just prices, but it is seldom fully appreciated how sensitive this concept is to the point of view of those discussing it. For the seller a fair price is probably the amount he or she needs for their offering in order to make a reasonable profit. To the customer a fair price probably refers to some general idea of affordability allied to some sense of intrinsic value, with previous experience being a contributory factor (Cannon, 1996:305).

Ford (2003:175) states that customers in business markets are likely to have some perception of what is a fair price, reflecting the experience with similar offerings and in similar relationships, their experience with alternative ways of meeting their needs and competitive offerings. The availability of competing suppliers is a major moderator, as the price a competitor sets becomes part of a customer's evaluation of a fair price.

Nagle and Holden (2002:384) state that the price is ethical when it is paid voluntarily, based on equal information, not exploiting buyers' essential needs, and justified by costs. One should determine the losses and gains, for both individuals and societies, which may result from the restriction of these ethical constraints. Their effects on the material and social well-being of those who hold them as standards should be known. In assessing the standards that business associates and political representatives apply, managers should ask themselves if their personal standards are the same for their business as well as for their personal conduct. It may be important for individuals to make their own decisions and live with the personal and social consequences taking into account their business conditions.

Based on what the authors above have cited, one may conclude that the right price is the one that enables you to sell your goods, yielding an acceptable margin of profit, at the same time giving the customer the feeling of getting value for money and thereby retaining his or her goodwill. Unethical pricing practices may have bad publicity and may result in legislation by government control, ethical reforms within the company for survival, or the company going under. SME managers should guard against such a situation.

4.3.2 Price sensitivity

Cronje *et al.* (2004:302) cite that some consumers are price sensitive, and may be persuaded to purchase by means of small price decreases. These consumers like to bargain, and prefer to shop at discount stores. Most well-to-do consumers purchase what they need, paying very little attention to price. They are usually averse to shopping around for bargains, and they are also not much interested in sales. Consumers react negatively when a price is perceived to be too low. They immediately conclude that the cheap product lacks quality, and they therefore associate a high price with good quality and a low price with poor quality. If prices are lowered, these consumers buy less instead of more.

According to Hollensen (2003:497), price sensitivity is reduced when:

- The product is more distinctive.
- There is greater perceived quality of products.
- Consumers are less aware of substitutes in the market.
- There is difficulty in making comparisons in the quality of products.
- The price of a product represents a small portion of the buyer's total expenditure.
- The perceived benefit for the customer increases.
- The product is used in association with the product bought previously, so that, components and replacements are usually extremely highly priced.
- Costs are shared with other parties.
- The product or service cannot be stored.

Cant *et al.* (1999:212) state that marketers should carefully research and monitor the target market's sensitivity to its pricing strategy. Marlboro had to implement a significant price decrease a few years ago, when research revealed that it was losing market share because smokers were switching to lower priced or generic cigarettes in response to the price which they perceived to be high. The price decrease, although shocking in terms of traditional marketing strategy, did succeed in regaining lost market share for Marlboro.

Price sensitivity coefficient estimates are found in order from organic through ordinary to spray-free genetically modified products. When the genetically modified label is combined with a typical functional food benefit, genetically modified fruit may achieve significant market share amongst organic and ordinary fruit, even in a country where the genetically modified issue has been highly controversial. Genetically modified fruit may gain a sustainable competitive advantage from any price reduction associated with production cost savings and market shares of organic fruit are least sensitive to pricing and the introduction of genetically modified fruit (Mather *et al.*, 2005:387). It is essential for SME managers to look at the nature of the product and price accordingly. The degree of price sensitivity for a particular type of product may assist in determining the appropriate price for the product.

Different demand levels at different prices highlight the reactions of many individuals who are price sensitive. It is important to understand the reason for being price sensitive. When deciding on the final price SME managers need to consider the possible reaction of the customers. For example, consumers may also look at the nature of the product and show different degree of sensitivity on the prices of organic, ordinary and spray-free genetically modified products. This offers SME managers an opportunity to differentiate when pricing these products and take advantage of the buyers' perception of value.

4.3.3 Price wars

According to Worsam and Wright (1995:442), price wars start when one organisation lowers price, a competitor follows and the first cuts again. The second may cut again, and the first follows. In this way the prices may be slashed in a bid to gain supremacy, but the end result is that neither has secured a price advantage. They are still in the same price positions relative to each other. All that has happened is that both have cut into their profit margins, possibly wiped them out altogether. The buyers will have benefited substantially in the short-term and possibly long-term as well because the end may well be a new market price below the original level.

Marn *et al.* (2004:146) indicate that on rare occasions, a company may intentionally embark on a price war as part of a sound overall strategy. It may, for instance, invest in a new technology that slashes costs and then lower its prices to gain market share and block competitors from acquiring that technology. Only few price wars are started so deliberately and thoughtfully. Far more often, companies accidentally stumble into price wars. They are victims of misreads of competitor actions and market changes, or misjudgements of how competitors may react to their own pricing maneuvers. The price wars rarely have any real winners and few healthy survivors. The destruction such battle causes may be so severe and linger so long that the only reliable way to come out ahead is to avoid them altogether. The price war is real and universal. No company, however well run, is immune.

Once the company is aware of competitors' prices and offer, it may use them as an orienting point for its own pricing. If the enterprise's offer is similar to a major competitor's offer, then the enterprise will have to price close to the competitor, or otherwise it will lose sales. If an enterprise's offer is inferior, it may not be able to charge more than the competitor, but if the offer is superior the enterprise may charge more than the competitor as long as it is able to communicate what the product is really worth and capture the value in the earnings. Value- creating activities should be integrated with pricing decisions of an enterprise. However, the SME manager should be aware that the competitors may react to this kind of action. Price war may erupt. The best method to avoid price war is to go with going-rate pricing. However, it has several shortcomings which ignore how much the product is worth and may harm profits.

4.4 Selecting the final price

In selecting the final price SME managers should strive to blend cost and value. They should integrate their understanding of costs, customers and competition into effective pricing approaches. Financial analysis should be conducted for pricing decisions without letting costs driving those decisions. There should be coordination between pricing and other marketing activities. The interactions of the elements of the marketing mix should be used to improve pricing effectiveness. Ultimately, the managers should ensure that their final prices capture value.

4.5 Price determination

Hiebing and Cooper (1999:203) cite that the first major step in the development of a pricing plan is to establish pricing objective. Final pricing decision should take into consideration what one needs to accomplish in other areas of the business. Such goals, including sales and profitability objectives may be aided by appropriate pricing approach or derailed by an inappropriate one. Pricing contributes to the overall goals of the business and marketing plan.

According to Cronje *et al.* (2004:197), the price determination process consists of cost price, target price, market price and final price. Lamb *et al.* (2004:396) differ with Cronje *et al.* (2004:197) and cite that setting price on a product is a four-step process which include to establish pricing objectives, estimate demand, cost and profits, choosing a pricing strategy to help determine a base price and fine-tune the base price with pricing.

4.5.1 Price determination process

4.5.1.1 Determination of cost price

Cronje *et al.* (2004:197) cite that the first step in determining the price of a product is the responsibility of the cost accounting department, and not of the marketing management. The unit costs to produce and market the product are calculated. The product price cannot be lower than cost, because this will entail financial loss, which could ruin the enterprise.

4.5.1.2 Determination of market price

The market price is the price the consumer is prepared to pay or the current market price at which competing products are sold. It is marketing management's task to determine the market price. This may be done by launching a market research project, involving consumers or dealers. A survey of the prices of competitors' products may also be undertaken. If the cost price is much higher than the market price, it means a cost reduction adjustment has to be made, or else marketing management have to make a special attempt to convince consumers that the particular product warrants a higher price (Cronje *et al.*, 2004:197).

4.5.1.3 Determination of target price

Cronje *et al.* (2004:197) cite that the target price is the price that will realise the target rate of return, taking into consideration the cost structure, the enterprise's capital needs, and the potential sales volume of the product. One way of calculating the target price is the cost-plus method. Adding the profit margin to the unit costs of the product does this. The accepted rate of return determines how large the profit margin will be.

4.5.1.4 Determination of final price

According to Cronje *et al.* (2004:186), the final price is the price at which the product is offered to the consumers. The price is determined through the reconciliation of both the market price and target price. The final price therefore lies somewhere between the market price and the target price.

4.5.2 Alternative price determination process

4.5.2.1 Establish pricing objectives

Lamb *et al.* (2004: 396) state that the first step in setting the right price is to establish pricing objectives. Pricing objectives, which include profit oriented, sales oriented and *status quo* are derived from the enterprise's overall objectives. A good understanding of the market and of the consumer may sometimes tell a manager very quickly whether an objective is realistic. The market should be large enough to support the target return at given price. In other words the objective may be unrealistic. A thorough study of the environment may convince the marketing manager that the competition is too strong and that the market share objective cannot be met. Reaching the desired market share often means sacrificing short-term profit because without careful management long-term profit objectives may not be met. Meeting competition may be the easiest pricing objective to implement. However, the manager cannot afford to ignore demand, cost, product life stage, and other considerations. When creating pricing objectives, managers should consider these trade-offs in light of the target customer and the environment.

4.5.2.2 Estimate demand, cost and profits

Total revenue is a function of price and quantity demanded which depends on elasticity. After establishing pricing objectives, managers should estimate total revenue at a variety of prices. Next, they should determine corresponding costs for each price. They are then ready to estimate how much profit, if any, and how much market share can be earned at each possible price. This information will become the heart of the developing price policy. Managers may study the options in light of revenues, costs and profits. In turn, this information may help determine which price may best meet the enterprise's pricing objectives (Lamb *et al.*, 2004:397).

4.5.2.3 Choosing a price strategy

The basic long-term pricing framework for a product should be a logical extension of the pricing objectives. The marketing manager's chosen price strategy defines the initial price and gives direction for price movements over the length of the product life cycle. The price strategy thus sets a competitive price in a specific market segment based on a well-defined positioning strategy. The three basic strategies for setting a price are skimming, penetration pricing and *status quo* (Lamb *et al.*, 2004:397).

4.5.2.4 Fine-tune the base with pricing tactics

Once managers understand both the legal and the marketing consequences of price strategies they should set a base price, the general price level at which the enterprise expects to sell the product. The general price level should be in line with the pricing policy. Above the market means price skimming, at the market is *status quo* pricing and 'below the market' represents penetration pricing. The final step, then, is to fine-tune the base price. Fine-tuning techniques are short-run approaches that do not change the general price level. They do, however, result in changes within a general price level. These pricing tactics allow an enterprise to adjust for competition in certain markets, meet ever-changing government regulations, take advantage of unique demand situations and meet promotional and positioning goals. Fine-tuning pricing tactics include various sorts of discounts, geographical pricing and special pricing tactics (Lamb *et al.*, 2004:399).

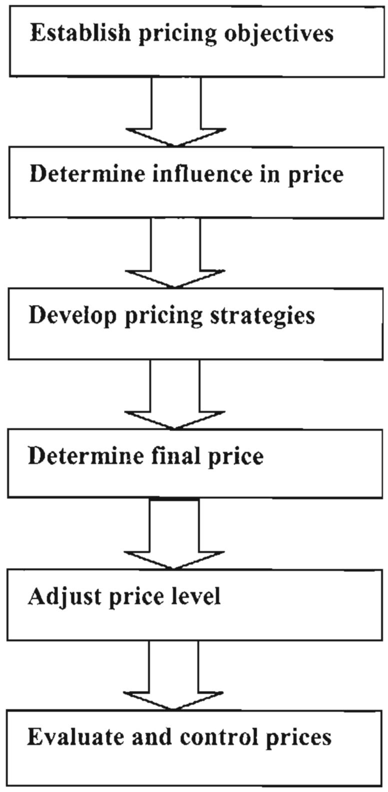
Table 4.1 – Comparison of price determination processes

Cronje *et al.*	Lamb *et al.*
1. Determination of the cost price	1. Establish pricing objectives
2. Determination of the market price	2. Estimate demand, cost and profits
3. Determination of target price	3. Choose a price strategy to help determine a base price
4. Determination of the final price	4. Fine tune the base price with pricing tactics
	5. The result is the "right" price

4.5.3 Conclusion on price determination process

The price determination process in table 4.2, developed by Assael (1993:654), differs with the processes in table 4.1 although it is closely related to the one developed by Lamb *et al.* (2004:396). Although it appears to be the oldest of the three it has two additional steps that the others do not have which may be important to SME managers. These steps are adjusting price level and evaluate and control prices. Managers should use the process that may suit their environment or in need modify it to suit their situations. They need not say one is wrong and the other is right but look at the circumstances and adjust the process accordingly. All the contents in all processes appear to be important but may be adjusted or amended as required by the manager. The processes are put together in the document to allow SME managers some flexibility. It is imperative that both cost and customers' perception of value are taken into account during the price determination process. It is the value of the product in relation to the price that may attract buyers.

Table 4.2 - Pricing process as developed by Assael



Source: Adapted from Assael (1993: 65)

4.6 Repricing

Pricing is one of the biggest decisions one's business has to make and it needs to be kept constantly under review. In many businesses the 80:20 rule applies; 80% of the profit is produced by 20% of the customers and this is often true of the product range as well. In mathematical terms, increasing one's prices is probably the easiest way to improve margins. But it is also nearly always difficult to convince the customers. One knows instinctively what to do when cutting prices to stimulate demand. He or she makes a lot of noise and publicity. Some people argue that increasing price should be the opposite, being silently passed through to suppliers and customers alike. In some markets this strategy seems to work. If one's business has been in existence for a number of years, one should know what the industry practice tends to be. A price increase with no added value is rarely the way to generate long-term loyalty. On the other hand, if the perceived added value is significantly greater, then customers will be prepared to spend considerably more (Barrow *et al.*, 2005:175).

SME managers may increase or decrease prices for existing products as part of their strategy. Companies may increase prices as a result of increase in raw material and labour costs or a change in the quality or features of the product. Other enterprises reduce price because they have been able to reduce costs and hope to gain a competitive advantage by passing the savings to the consumers. Price reduction may be a reactive strategy to a competitive move rather than a proactive strategy to gain competitive advantage. Prices may also be reduced in reaction to a change in the marketing environment, such as an economic downturn. Even when repricing products, managers should follow a price determination process.

It is not just 'across the board pricing' and discounting that affect profitability. Businesses may not be aware of other profit opportunities that they are missing. All customers are not necessarily created equal, certainly as far as margins are concerned. It is not many businesses that actually know who their most profitable customers are and which area of the business they should concentrate on. SME managers may also take advantage of cross-subsidisations and reprice the unprofitable customers based on the 80:20 principle.

4.7 Pricing communication

According to Marn *et al.* (2004:82), the method of communicating a price to customers may indicate the motive and commitment behind a price move. Companies should be careful to avoid misinterpretation. Every pricing move sends a message - the way it is done, when it is done, how it is announced, who announces it, the list goes on and on. Each component may increase or decrease the impact of the message. For example, a company may follow precedent and put a price change into effect on a specific date or it may send a stronger message by picking an effective date that breaks precedent. The announcement may be either buried in a press release or a key point in a speech by the chief operating officer. Many companies try to minimise communication around price increases, believing that sneaking an increase through may minimise resistance. However, price leaders and good followers understand how to communicate the message clearly and carefully to customers to maximise the outcome of their price increase initiative.

Price is used to provide consumers with very valuable information. One of the most basic roles of pricing is the informational role. Detailed knowledge of the company's pricing and discount policies and procedures is essential for successful selling (Bird *et al.*, 1998:7). Price is often used as the most convenient and visible marketing mix tool, since affordability constitutes an important pull factor in drawing buyers to particular destinations (Weaver & Oppermann, 2000:230). Suri *et al.* (2000:195) mention that price plays a dual role. Consumers may use price information to determine the quality of a product and also to determine the monetary sacrifice associated with its purchase.

The consumer should be led into the pricing issue if it is relevant. If the pricing issue is not relevant, the consumer should be led into the value issue. In some cases the pricing issue is essential. Pricing low in a price sensitive market means a trade-off. In this case, where low price is a virtue but a sacrifice is made to achieve it, it is good to state trade-off, minimising the importance of the minor change. If the price is higher, justify the importance of the additional features or value. Unless the only virtue of product is price, insert this issue separately in the respondent discussion process. To avoid rejection of new prices, SME managers should communicate price changes to regular customers every time there is a change. Their frequent interaction with customers may give them an advantage as they may establish quickly what the market reaction may be. This may also afford them the opportunity to communicate the additional value to the product.

4.8 Pricing management

According to Jain (2001:323), because of the crucial importance of pricing, management often plays a significant role in making pricing decisions. Management should decide the strategic significance of pricing in the marketing mix. Horngren *et al.* (2003:422) state that pricing decisions are management decisions about what to charge for the products that companies deliver. These decisions affect the quantity of product sold and hence product revenue.

McDonald (1999:369) cites that, traditionally, pricing has been the remit of accountants. Their concern was mainly about the impact of price on margin, and hence, revenue. The weaknesses of this approach are that the product may be overpriced because of arbitrary loading of production and other overheads, there is no room for strategic thinking, and products may be eliminated from the range, regardless of their synergy with others. In contrast, marketers look at price in terms of its influence in demand.

Campbell (1999:145) cites that setting and managing prices are critical elements of the marketing manager's job. Whereas the other areas of marketing such as product, promotion, and distribution involve the outlay of resources, price is the one element of the marketing mix that directly influences an inflow of resources.

Price management should be concerned with price segment structures and their specific price needs. Identical price segments can be identified across categories, whereas the individual segment membership depends on the nature and level of perceived risk in the category. Price segmentation could particularly benefit businesses in order to increase the effectiveness and efficiency of consumer targeting (Stamer & Diller, 2006:62).

Marketing managers should be responsible for pricing of products in their organisations. Most of the factors influencing pricing are marketing-related and price is an element of the marketing mix. Notwithstanding this, other functions or departments should give input to the determination of price. For example, the financial manager, in conjunction with the purchasing and production managers should do the costing; legal services should look at the legal aspect, salespeople should establish the target market's ability and willingness to pay. Strategic thinking is also important. A plan should be developed, with objectives, policies, strategies or approaches. These will give direction to what is to be achieved and how. SME managers can be the cornerstones of pricing in their enterprises. They should receive feedback regularly about pricing and the reaction of customers to their prices.

4.9 Summary

Making a decision of the final price to be charged may be extremely difficult. The price should be right to satisfy both the seller and the buyer. The level of demand should be acceptable to the SME manager to make sure that the targeted profit is achieved. When this is achieved, then the manager has done his or her job and the price may be considered to be effective. Some customers may be price sensitive and this may compel SME managers to be more cautious when deciding on the final price. Ethical issues may also be brought in to justify prices and profitability. This may be an area of conflict between the company and the community. What may be justifiable to the seller may not necessarily be the case with consumers. However, price needs to be set at the end of the day. SME managers may use price determination process as guidance. It should help them to check if they have gone through all the steps in the process. Marketing managers should take the leading role in pricing. Prices should be continuously monitored and adjusted if necessary. New prices should be communicated to customers to avoid many inquiries and misinformation.

The process of determining the final price is now complete. In the next chapter the literature on pricing in SMEs, in particular, will be discussed.

CHAPTER 5

SMALL AND MEDIUM-SIZED BUSINESSES

5.1 Introduction

The business sector that is being focused upon is the one of small and medium-sized enterprises (SMEs). It is against this background that SMEs are discussed. According to the problem statement, SMEs fall short in optimizing financial results through pricing. This indicates that there is an opportunity to investigate the pricing methods used in this sector and establish the possible weaknesses that prevent effective pricing that may bolster the financial position of the organisations. In this chapter, SMEs are defined and pricing aspects in this business sector are discussed. It is not within the remit of this document to provide a detailed critique of small and medium-sized businesses but to clearly highlight the pricing approaches used in this business sector.

Juul (2002:4) states that there are an estimated 45 million people in South Africa and nearly two million businesses. Over 95 per cent of all businesses are small businesses. Small, medium and micro-enterprises, or put simply, small businesses, contribute about 40 per cent to South Africa's gross domestic product, employ well over 50 per cent of those holding a job and constitute no less than 97 per cent of the total number of businesses in South Africa. Economists and governments agree that small business is an efficient vehicle. It is probably the most effective way through which to lower unemployment and improve the health of an economy. In reality, however, small business still requires substantial assistance and encouragement despite an abundance of task groups, forums and representative organisations.

Smit *et al.* (2007:21) cite that, in South Africa, large organisations still provide two-thirds of the GDP. In the economically successful countries of the world, SMEs provide as much as 85 per cent of the job opportunities and are therefore an important economic institution. In South Africa, SMEs need to play a greater role in the economy because their present contribution to the GDP is far less than that of similar organisations in Japan, Singapore, the USA and other countries. The survival rate of businesses in South Africa tends to be low. In Asia, Latin America and West Africa, the rate at which surviving enterprises graduate from micro-enterprises to become dynamic small and medium enterprises is, on average, 50 per cent. In East Africa and southern Africa it is only about 10 per cent.

The important role of SMEs in the South African economy and the high failure rate in this business sector prompted the identification of the critical success factors in this business sector. One of these factors is pricing decisions, which are responsible for generating revenue, payment of cost and profitability. The importance of pricing to the business sector then encouraged the investigation of pricing methods that may be used by SME managers to grow their businesses to their full potential.

5.2 Definition of small and medium-sized enterprises

Small businesses are, generally, defined according to the number of employees, annual turnover and annual balance sheet total. However, these differ from country to country. Each country decides on the number of employees and it uses its currency to determine the turnover and balance sheet figures in order to classify the business. The different currencies and their exchange rates may complicate the matter further. The situation would have been ideal if there was a common monetary value and consistency in the number of employees. In South Africa, small enterprises are defined according to the National Small Business Amendment Act No. 29 of 2004 and they are classified as indicated in table 5.1 below.

Table 5.1 – South African definition of SMMEs

Sector or sub-sector according to Standard Industrial Classification	Size of class	Total paid employees	Total Turnover	Total gross asset value (fixed property excluded)
Agriculture				
	Medium	100	R5m	R5m
	Small	50	R3m	R3m
	Very small	10	R0.50m	R0.50m
	Micro	5	R0.20m	R0.10m
Mining and quarrying				
	Medium	200	R39m	R23m
	Small	50	R10m	R6m
	Very small	20	R4m	R0.10m
	Micro	5	R0.20m	R0.20m
Manufacturing				
	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very small	20	R5m	R2m
	Micro	5	R0.20m	R0.10m
Electricity, gas and water				
	Medium	200	R51m	R19m
	Small	50	R13m	R5m
	Very small	20	R5.10m	R1.90m
	Micro	5	R0.20m	R0.10m
Construction				
	Medium	200	R26m	R5m
	Small	50	R6m	R1m
	Very small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Retail and motor trade and repair services				
	Medium	200	R39m	R6m
	Small	50	R19m	R3m
	Very small	20	R4m	R0.60m
	Micro	5	R0.20m	R0.10m
Wholesale trade, commercial agents and allied services				
	Medium	200	R64m	R10m
	Small	50	R32m	R5m
	Very small	20	R6m	R0.60m
	Micro	5	R0.20m	R0.10m
Catering, accommodation and other trade				
	Medium	200	R13m	R3m
	Small	50	R6m	R1m
	Very small	20	R5.1m	R0.90m
	Micro	5	R0.20m	R0.10m
Transport, storage and communications				
	Medium	200	R26m	R6m
	Small	50	R13m	R3m
	Very small	20	R3m	R0.60m
	Micro	5	R0.20m	R0.10m

Sector or sub-sector according to Standard Industrial Classification	Size of class	Total paid employees	Total Turnover	Total gross asset value (fixed property excluded)
Finance and business services				
	Medium	200	R26m	R5m
	Small	50	R13m	R3m
	Very small	20	R3m	R0.50m
	Micro	5	R0.20m	R0.10m
Community, social and personal services				
	Medium	200	R13m	R6m
	Small	50	R6m	R3m
	Very small	20	R1m	R0.60m
	Micro	5	R0.20m	R0.10m

Adapted from National Small Business Amendment Act (29/2004).

Most managers start small. Some have started in a basement or garage. Small companies are an important part of every economy. A small business is an independently owned and operated business that does not dominate an industry (Dlabay & Scott, 2001: 225). The SMMEs are further divided into five categories, ranging from survivalist to medium-sized as indicated in table 5.2 below.

Table 5.2 - Categories of small, micro and medium enterprises

Category of SMME	Description
Survivalist enterprises	Operates in the informal sector of the economy. Mainly undertaken by unemployed persons. Income generated below the poverty line, providing minimum means to keep the unemployed and their families alive. Little capital invested, not much assets. Not much training. Opportunities for growing the business very small.
Micro enterprises	Between one to five employees, usually the owner and family. Informal - no license, formal business premises, labour legislation Turnover below the VAT registration level of R300 000 per year. Basic business skills and training Potential to make the transition to a viable formal small business.
Very small enterprise	Part of the formal economy, use technology Less than 10 paid employees Include self-employed artisans (electricians, plumbers) and professionals.
Small enterprise	Less than 100 employees More established than very small enterprises, formal and registered, fixed business premises. Owner managed, but more complex management structure
Medium enterprise	Up to 200 employees Still mainly owner managed, but decentralised management structure with division of labour Operates from fixed premises with all formal requirements.

Adapted from Government policies (Small Business Development, 2004)

Bridge *et al.* (2003:182) state that to qualify as an SME both the number of employees, and the independence criteria must be met, and either of the turnover or the balance sheet total criteria. A small enterprise is one that has a relatively small share of its market. It is managed by the owners in a personalised way, and not through the medium of a formalized management structure. It is also independent in the sense that it does not form part of a larger enterprise and that the owner-managers should be free from outside control in taking their principal decisions. However, the weaknesses of a qualitative definition are acknowledged and the following quantification for different sectors is offered:

- Manufacturing with 200 employees or fewer.
- Retailing with turnover of 50 000 pounds per annum or less.
- Wholesale trades with turnover of 200 000 pounds per annum or less.
- Construction with 25 employees or fewer.
- Mining and quarrying with 25 employees or fewer.
- Motor trades with turnover of 100 000 pounds per annum or less.
- Miscellaneous services with turnover of 50 000 pounds per annum or less.
- Road transport with five vehicles or fewer.
- Catering means all excluding multiples and brewery-managed pubs.

In the UK for statistical purposes the Department for Trade and Industry and the Companies Act of 1985 usually uses the definitions in table 5.3.

Table 5.3 – United Kingdom's definition of small, micro and medium enterprises

Department for Trade and Industry		**Companies Act of 1985**			
Size of class	**Employees**	**Size of class**	**Employees**	**Total Turnover** (British Pounds Sterling)	**Balance sheet total** (British Pounds Sterling)
Micro	9	Small	50	2.8 million	1.4 million
Small	49	Medium	250	11.2 million	5.6million
Medium	50-249				
Large	250 and over				

Adapted from Bridge *et al.* (2003:185)

Bateman and Snell (1999:236) defined SMEs as businesses having fewer than 100 employees, independently owned and operated, not dominant in its field, and not characterised by many innovative practices. Day (2000:1033) states that a cursory review of the available statistics reveals that most enterprises, when defined by employee numbers, may be described as small. In the UK in 1998, 95% of all businesses employed fewer than 10 people, and this statistic is universal enough for it to be considered a common truth.

An empirical study confirms that small and medium-sized enterprises make a considerable contribution to national economies in terms of job and wealth creation. Despite their widely acknowledged importance and an extensive debate in the literature on SMEs' classification criteria, there appears to be little consensus on the most appropriate definition of an SME. However, the best definition so far has been an arbitrary classification propounded by the European Commission in 1996. This definition treats all enterprises employing less than 250 employees as a homogeneous grouping. It should be said that this consensus has largely been achieved in the absence of a more appropriate and acceptable definition (O' Regan & Ghobadian, 2004:64). The Small Business Service defines an SME as a business with less than 250 employees. The Confederation of British Industry estimates that there were 3.7 million SMEs in the UK at the start of 1999 of which the majority (98%) had less than 50 employees (Griffin *et al.*, 2005:127). Dlabay and Scott (2001:225) cite that about 95% of all businesses in the USA have fewer than 50 employees. Of the 14 million businesses in the European Union (EU), only 7% of them have more than 9 employees. Small businesses are commonly categorised according to number of employees. The US Small Business Administration defines a small business as one with fewer than 100 employees.

There is no single, distinct and uniformly acceptable definition of a small enterprise. However, the Small Business Service, UK, in 2004, defines businesses according to the number of employees, annual turnover and annual balance sheet total. The choice of measure is flexible and it does not matter much in practice which measure is adopted, for most measures are highly correlated with each other. It has also been stated that for practical reasons, it is advisable that only one measure of size is used or chosen at any one time (Egbu *et al.*, 2005:8). Generally, the definition in this paragraph, and as also specified by Bridge *et al.* (2003:182), is in line with South Africa's National Small Business Amendment Act No. 29 of 2004 because it also takes number of employees, annual turnover and annual balance sheet total into account.

There is no definition of a small enterprise that is suitable to all countries. Whilst South Africa's medium-sized businesses may only employ up to 200 people for all sectors, except for agricultural sector which has a maximum of 100 employees, other countries may go up to 249 employees. Although there are some similarities from South African and UK perspectives as reflected by Bridge *et al.* (2003:182) and also in tables 5.1 and 5.3, the currencies may complicate the matter. For example the equivalent of a Pound today is R14.19. Notwithstanding this, it is evident from the preceding paragraphs that the overwhelming majority of USA and EU businesses have less than 50 employees and this number is in line with the South African definition of small enterprises. In view of this, the literature used in the study may be considered to be relevant in South African context.

It is worth noting that, even in South Africa, the Department of Trade and Industry, organisations like Khula enterprises and different authors use different criteria regarding SMEs, despite the fact that there is a definition according to the Act. The literature also does not differentiate between the developing and developed countries. Generally, there is a lot of commonality in the SMEs irrespective of the countries and the level of development.

5.3 Pricing as a critical success factor in small and medium-sized enterprises

Under-pricing has certainly been a major factor in small business failures. It is always tempting for a small business to compete mainly on price. A small business may stimulate a purchase by offering a product at a lowest possible price. Low price may be an advantage over the competition for a small enterprise. In some instances, an enterprise with low overheads may compete on price for a longer term. There is evidence that many small enterprises compete on price when they are first set up, based on cheap labour of the owner. There is even concern that government subsidies, aiming at helping a new enterprise in its early days, may be used to gain short-term advantages by undercutting the competition. Unless a business has establishes economies not available to its competitors, it is unlikely to gain long-term competitive advantage through pricing policies alone. Other businesses are likely to react by lowering their prices and the only result of price competition is to reduce the profitability of the business (Stokes & Wilson, 2006:127). The business that initiates competition may sometimes be affected negatively on the long run. Economies of scale are usually not available to small businesses. Low prices are most likely to come from short-term savings. Once this is not sustainable, the business may be under tremendous pressure to increase its prices and it may not be easy. This may, ultimately, lead to failure. Katz and Green (2007:253) cite that, for most small businesses, the early years are survival years and the tendency is to sell products for whatever one can get. While it may be a fact of life at certain times, it should not be a firm's pricing objective. Maximising profits is a better option for the small firm. This does not mean that one has to have the most expensive product out there unless price is worth it, but it means that the price should be well above the average price. This simply adds to the profit.

According to Longenecker *et al.* (2006:300), for a business to be successful, its pricing should cover total cost plus some profit margin. Pricing should be based on an understanding of the basic behaviour of costs. Therefore, the pricing plan should include a schedule of both production and marketing costs. Hogan and Lucke (2006:55) state that pricing is a vital component to revenue and profit success and needs to be a functional lever for every company. Better revenue and profit margins can be accomplished by establishing a viable and value-based pricing strategy. Pricing strategy is an essential element for doing business successfully in the marketplace.

Pricing has tended to be the least considered element of marketing strategy, despite the fact that evidence from successful enterprises points strongly to the integral role of pricing in performance. Effective pricing has much to gain from an understanding of the entrepreneurial process, and its dimensions which are innovativeness, creativeness and risk-assumption. Because enterprises today operate in increasingly turbulent environments, a reluctance to be entrepreneurial in pricing could lead to stagnation or even demise. The entrepreneurial process provides a checklist for practicing managers to use to determine the extent of entrepreneurial pricing behaviour within their enterprises (Pitt *et al.*, 1997: 344).

Beaver (2007:11) states that the small enterprises that survive, prosper and grow, exhibited most or all of the following characteristics:

- They had an enterprise grip on their finances.
- They examined business forecasts carefully and returned to the original business plan to check principal assumptions made about sales volume and cash flow.
- They reduced the money that debtors owed by implementing an effective credit management system and/or used factoring.
- Many had a pricing plan and took a strategic view when setting price.

The strategy in the small enterprises that are referred to here is enacted in a highly personalised manner and is strongly influenced by the actions, abilities, personality and success criteria of the key role players. The successful enterprises are adopting a more imaginative and strategic approach to risk.

Kenning, *et al.* (2007:101) state that there are several studies on price knowledge but little is known about price knowledge in different business sectors. This is quite surprising since pricing strategy is a concept which is vitally important to all buyers and sellers. Schneider and Schneider (2006:451) mention that the price knowledge of consumers in an emerging economy turned out to be relatively poor, although the level of price differentiation is rather low in the market.

Maxwell (1998:336) states that in the affluent 1960s and 1970s, consumers tended to be price insensitive. Business consequently placed a low priority on pricing, and marketing educators in the USA responded by stressing the non-price elements of the marketing mix. As a result, when consumers became more price sensitive in the 1980s and 1990s, and business became more concerned about pricing, marketing was not involved. Now, however, marketing educators are beginning to respond to the renewed emphasis on price as a key component in consumers' perceived value. A new study shows an increase from 4 to 13 percent of US marketing education programs now including a course in pricing and another 22 percent are interested in adding one within two years.

Peterson (2001:334) cites that managers are able to identify the legal status of many activities, but lack knowledge on the legality of various important practices, especially those relating to pricing. Generally, managers employed by small enterprises were less informed than those employed by larger enterprises.

A study of critical success factors of small businesses in Australia examined the factors used to measure success across different industries including retail, manufacturing and services. Statistical analysis found success factors unique to each industry group. For example, in retail success is positively related to competitive pricing and quality, in manufacturing to competitive pricing and knowledge of competitors, and in services to employee relations issues such as training, staff involvement in decision-making, and job satisfaction. One common factor found in all three industries was that success is more likely when there are enough financial resources either contributed by the owner or gained through profits and cash flows (Simpson *et al.*, 2004:481). According to Fallon *et al.* (2000:171), pricing and positioning strategies are of increasing strategic importance and are crucial to the long-term competitiveness of SMEs.

Analoui and Karami (2003:93) state that, an unprofitable line in a big organisation may not lead to an immediate crisis, but in a small business it is a different matter. In small businesses, if the business is not profitable it simply cannot continue. More especially in the commodity-type businesses, competition tends to be based on price. If the enterprise cannot reduce the cost of production, the price will be raised.

Careless costing that leaves out some expenses, such as the costs of time, travel and packaging is fatal. If your costing is right, but the markup in your pricing is too thin, your business will struggle from one month to the next. It depends on the business you are running, but a low price strategy seldom works for a small business. High quality and personal service with middle-range pricing is usually the recipe for success (Macleod & Terblanche, 2004:237).

Urlacher (1999:186) cites that price is but one component and not necessarily the most important component in the buying-decision process. Yet there is a strong urge for many small business owners to attempt to increase sales by cutting prices.

Pricing is a critical success factor for SMEs. It generates revenue and profits for the businesses. The profits contribute to the financial resources of an enterprise and enough financial resources are responsible for the success of SMEs. The financial resources from owners when they start these businesses may be very limited and they may therefore need more money to grow these businesses to their potential. Pricing decisions are vital to SMEs because they directly affect both revenue and cash flow. They may also determine the success or failure of an enterprise. Although price may be perceived to be not the most important component in the buying-decision process by Urlacher (1999:186), it is critical for the success of the business. It is the price that customers use to assess the value of the product. The blending of cost and demand should maximise profits and improve the financial resources of the business.

5.4 Pricing in small and medium-sized enterprises

Literature studied in Chapters 2, 3 and 4 did not differentiate between business sectors when discussing pricing. Pricing in small and medium-sized enterprises should, therefore, not be that different from those of corporate organisations. The approaches should be practically the same. Notwithstanding this, it is necessary to peruse literature that specifically discusses pricing on SMEs and find out how products are priced in this business sector. This may also give the background of different pricing methods used by SME managers.

Hatten (1997:289) states that even though the pricing decision is critical to the success of a business, many small business owners and managers make poor pricing decisions. According to Barrow *et al.* (2005:65), the most frequent mistake made by new venture founders when they set a selling price for the first time is to pitch it too low. This mistake occurs either through failing to understand all the costs associated with making and marketing one's product and these are nearly always higher than first estimated, or through yielding to the temptation to undercut the competition at the outset.

A wider study of the small business literature will reveal an acknowledgement by most writers that, while in theory the SMEs should consider all the factors which affect pricing in their larger counterparts, in practice small business managers employ some form of cost-plus pricing while bearing in mind a number of secondary effects (Carson *et al.*, 1998:75).

Conventional wisdom argues that small enterprises tend to use relatively unsophisticated methods of pricing. It is, however, indicated that small enterprises may in fact be a good deal more sophisticated in their techniques of pricing than has previously been supposed. Reviews of the theory and empirical evidence to date noted a significant gap in the research into small business pricing. Using a case study method based on 12 detailed cases of the pricing policies of small companies, it was concluded that there is little evidence to support the findings of previous studies which indicate the predominance of full-cost pricing. It was found that small companies avoided "head-on" competition and sought to exploit their own market niche as a means of exercising more control over their prices (Cunningham & Hornby, 2003:1).

According to Longenecker *et al.* (2006:300), in setting a price, the entrepreneur decides on the most appropriate value for the product being offered for sale. This task might seem easy, but it is not. The first pricing lesson is to remember that total sales revenue depends on just two components which are sale volume and price, and even a small change in price may drastically influence revenue. For a business to be successful, its pricing should cover total cost plus some profit margin. Pricing, therefore, should be based on an understanding of the basic behaviour of costs.

One of the important functional marketing strategies in SMEs is the pricing strategy. Developing a proper pricing strategy, along with an advertising strategy during the different stages of the product life cycle, may help SMEs to satisfy their customers and increase their profit. The price is the monetary value of the products in the market which may affect buyer choice. Price is the weapon of choice for many companies in the competition for sales and market share. The main reason for that is the short process of pricing. In other words, no other marketing tool may be deployed as quickly or with such certain effect as a price discount. Small business managers should combine various criteria in setting prices rather than considering only product costs (Analoui & Karami, 2003:251).

Thompson and Coe (1997:73) mention that sustainable competitive advantage is recognised as a critical factor for survival in the turbulent environments of the 1990s. The limited use of pricing as a strategic tool to gain and hold competitive advantage has created an opportunity for companies willing to redesign their competitive portfolios and go with unorthodox strategy mixes. An approach to value pricing may be used to seize and drive competitive advantage, and yields a price that minimises the risk of buyers not perceiving value at least equivalent to that provided by a reference product. At the same time, the risk to sellers of not achieving minimum margins is controlled. This approach should enhance the ability of management to develop dynamic and proactive strategies for pricing.

According to Bontis and Chung (2000:247), there is no perfect generic pricing model. Sellers need to understand the value they provide to their customers and create a price structure that aligns pricing with value realisation, but more importantly facilitate their business objectives of the product.

Marsh (2000:203) states that specific country preferences require organisations to adapt to pricing. It is necessary to have a framework for analysing the micro environment and to identify ways in which organisations can use pricing to gain a competitive advantage. There is a need for a predetermined management mentality. Organisations may always under-perform until such time that pricing is given the attention it deserves, and is respected as an essential element of success.

It may be a serious mistake for SME managers to ignore the complexity of pricing by only concentrating on costs. Cost-based pricing has some shortcomings. It may not take into account factors that may influence the determination of price. This gap needs to be bridged by considering these factors so that an appropriate price may be determined through relevant pricing methods.

5.4.1 Pricing responsibility

In SMEs the manager or an entrepreneur should not be the only person who sets the price. More particularly in the high-tech SMEs, the technical entrepreneur or any technical staff who play a main role in developing the new product idea should not solely recommend the price of the developed product. It is much better to set the price through a team discussion. This team could consist of members from the technical as well as marketing and financial departments. In this regard, for any product pricing decision, it is a good idea to get three perspectives, which are the product-owner and creator perspective, financial and bottom-line perspective, and the marketing or objective customer and member perspective (Analoui & Karami, 2003:251).

Price setting may sometimes be subjective, especially if it is set by one person. He or she may use guard feel or thumb suck instead of being objective and use the available pricing methods. It is, therefore, necessary for the SME managers to engage other parties when determining prices. This may resolve the element of subjectivity and this may also give the marketer an opportunity to learn from others who are part of the price determination process. Notwithstanding, pricing decisions are the responsibility of the manager and he or she should be kept informed of what is happening in the organisation and also about the reaction of buyers to the prices.

5.4.2 Pricing strategies in small and medium-sized enterprises

Kuratko and Hodgetts (2004:308) cite that the price should be appropriate in order to penetrate the market, maintain a market position and produce profits. A number of pricing strategies should be examined and then one should be convincingly presented. This pricing policy should be compared with the policies of the major competitors. The gross profit margin between manufacturing and final sale costs should be calculated and consideration should be given as to whether this margin is large enough to allow for distribution, sales, warranties, service expenses, amortisation of development and equipment costs and profit.

Attention should also be given to justifying any price increases over competitive items on the basis of newness, quality, warranty or service.

5.4.3 Equilibrium price

Pricing would have been easier if the demand and supply were able to determine the price that may satisfy both the seller and the buyer. It would not have been necessary to use other pricing methods because the seller and the buyer could both determine the price. The equilibrium price was always going to be determined by the market forces at the point or price where quantity demanded and supplied are equal. This price theory concept does not meet all the requirements of the parties involved. The seller may not be able to recover costs and make profit because the buyer may press for the lowest price possible. It is also difficult to estimate demand, which is important to establish whether the business may breakeven or make profit. The shortcomings of the price theory concept made it necessary for businesses, including SMEs, to turn to other pricing methods.

5.4.4 Pricing objectives

Zimmerer and Scarborough (2005:200) state that, when pricing any new product, small business owners should try to satisfy three objectives, which are getting the product accepted, maintaining market share as competition grows and earning a profit.

It is important for SME managers to make sure that their prices will elicit the required demand of the products. The revenue should be enough to pay for total costs and make profit. This is critical for the SMEs because pricing may sometimes be the main, if not the only, revenue source that may help the business to grow to its potential. It is also important to maintain or gain market share even in stiff competition. Gaining market share may in the long-run bolster revenue and profit of the business. Bearing in mind the fact that pricing may determine the business destination, pricing objectives should be clear from the beginning and they should also be achievable.

5.4.5 Factors affecting pricing

Prices are not set in a vacuum. There is a way to determine the right price in small and medium-sized enterprises. Several factors need to be considered and they include cost, demand, competition and profit. These factors influence the pricing decision. The manager will consider the amount of profit he or she wants to earn when determining the price of the product. Perceived-value is important for a customer to make a decision to buy. Buyers will buy from the competitors if they deem your product to be expensive (Townsley, 2003:189).

Le Roux *et al.* (1999:348) cite that SMEs usually base their price on the principle of costs, the idea being to recover costs and make a profit. Besides costs and profit, environmental factors, the type of product being offered, the target market and the competitors in the market need to be considered when setting the selling price.

Pricing may impact on the decision of the customer to buy the enterprise's product. People often compare the prices of the same products offered by different companies. In developing a marketing strategy SMEs should consider the cost structure of the enterprise, an assessment on what the market will bear and the desired image the company wants to create for its customers. There is a belief that the right price for a product depends on these three factors mentioned above (Analoui & Karami, 2003:247).

According to Kuratko and Hodgetts (2004:253), many entrepreneurs, even after marketing research is conducted, are unsure of how to price their products. A number of factors affect this decision and they include the degree of competitive pressure, the availability of sufficient supply, seasonal or cyclical changes in demand, distribution costs, the product's life-cycle stage, changes in production costs, prevailing economic conditions, customer services provided by the seller, the amount of promotion done and the market's buying power. Obviously, the ultimate price decision will balance many of these factors and, usually, will not satisfy all conditions. However, awareness of the various factors is important. Other considerations, sometimes overlooked, are psychological in nature and they include the following:

- The quality of a product in some situations is interpreted by customers according to the level of the item's price.
- Some customers shy away from purchasing a product where no printed price schedule is available.
- An emphasis on the monthly costs of purchasing an expensive item often results in greater sales than an emphasis on total selling price.
- Most buyers expect to pay even-numbered prices for prestigious items and odd-numbered prices for commonly available goods.
- The greater the number of meaningful customer benefits the seller can convey about a given product, generally the less will be the price resistance.

According to Chaston and Mangles (2002:182), it is becoming increasingly evident that the primary reason individuals utilise the Internet in the search for products is that they perceive the technology may permit them to purchase lower priced goods. The fact that Internet customers are more price conscious than their terrestrial counterparts has some worrying implications for SMEs. Prior to the arrival of Internet, customers encountered severe problems if seeking to acquire detailed information on competitive offerings prior to reaching a purchase decision and this gave sellers an advantage. The advent of Internet means that customers may use different websites to rapidly compare prices and features on thousands of products. The outcome of this situation is that SMEs are beginning to find that their pricing strategies are becoming much more transparent to potential customers. The outcomes for SMEs are a reduced ability to command a premium, a tendency for products to become commodities and a weakening in customer loyalty. As with most business scenarios, what may pose a threat to one individual may be seen by someone else as an opportunity. Such is the case with the Internet's ability to rapidly communicate pricing information as the basis for stimulating sales. An entrepreneur who recognises the potential opportunity associated with Internet price transparency may utilise it to the enterprise's advantage.

5.4.6 Pricing strategies and methods in the product life cycle

Kuratko and Hodgetts (2004:253) state that pricing procedures differ depending on the nature of the venture. Pricing for the product life cycle, however, might be applied to any type of business, including SMEs. Table 5.1 demonstrates the basic steps of developing a pricing system and indicates how that system should relate to the desired pricing goals. With the general outline in the table, potential entrepreneurs may formulate the most appropriate pricing strategy.

Table 5.4 – Pricing strategies and methods of different product life cycle stages

Product life cycle stage	Pricing strategy or method	Reasons/effects
Introductory stage		
• Unique product	**Skimming** – deliberately setting a high price to maximise short-term profits.	Initial price set high to establish a quality image, to provide capital to offset development costs and to allow for future price reductions to handle competition.
• Non-unique product	**Penetration** – setting prices at such a low level that products are sold at a loss.	Allow quick gains in market share by setting price below competitors' prices.
Growth stage	**Consumer pricing** – combining penetration and competitive pricing to gain market share; depends on consumer's perceived-value of product.	Depends on a number of potential competitors, size of total market and distribution of that market.
Maturity stage	**Demand oriented pricing** – A flexible strategy that bases pricing decisions on the demand level for the product.	Sales growth decline and customers are very price-sensitive.
Decline stage	**Loss leader pricing** – pricing the product below cost in an attempt to attract customers to the other products.	Product possesses little or no attraction to customers and the idea is to have low prices to bring customers to newer product lines.

Source: Adapted from Kuratko and Hodgetts (2004:261).

The pricing decision for a new product is sometimes oversimplified as a 'high-low' or 'skimming versus penetration' choice. The actual effect of pricing on ultimate success is much more complex, and one should consider not only price level, but also the timing of the launch, the logistics and inventory strategy, the extent of market research, testing and planning. Some products are related to greater success than others. The most profitable and competitively successful products contain launches supported by solid market research and marked by good timing decisions. By contrast, the least profitable or successful products are higher price launches unsupported by adequate research (Calantone & Di Benedetto, 2007:4).

5.4.7 Pricing approaches in SMEs

Murphy (1996:129) cites that SMEs should learn to think of pricing as a method whereby prices are set with regard to costs, profit targets, competition and the perceived-value of the products. Three types of pricing methods pertinent to SMEs are cost related market related and competitor related pricing.

According to Schaper and Volery (2004:249), there are several pricing options available to new and existing SMEs and they include going-rate, cost-plus, maximum, perceived and loss leader pricing. Maximum pricing policy is a situation where vendors charge the most they believe the market can bear. This is suitable in situations where the supply of an item or service is limited, or where an oligopoly or monopoly exists because the sellers may then be able to command whatever prices they wish to justify. Perceived pricing is when sales price is fixed on the basis of what customers believe an object is worth. Sometimes businesses deliberately offer a product at its cost or even less. In some retail operations, loss leader items are intentionally used to lure prospective customers into the store, in the hope that they may also buy other items that have a reasonable profit margin.

SME managers should use different tactics in pricing their products. These tactics help to ensure that the business becomes more profitable. They may be used to achieve certain objectives like to gain market share, sustain business in stiff competitive environment, target return and maximise profit. Some of these objectives may be short-term whilst others may be long-term. Pricing tactics may be used to clear the old or obsolete stock by way of discount.

Tung *et al.* (1997:53) state that the fastest and most effective way for an enterprise to achieve maximum profit is to get its price right. Given the importance of price in generating revenues and profits for a company, the approach used by enterprises in price setting has been relatively unsophisticated. In an attempt to identify problems and strategies in marketing, it was found that cost-oriented pricing was the most popular approach used by SMEs. Although this method offers some advantages, the simplistic nature of cost-oriented pricing is not effective in a complex and competitive business world.

In practice, SME managers employ some form of cost-plus pricing while bearing in mind a number of secondary effects. It has been suggested that most small businesses may base pricing on a combination of what the market will bear and cost-plus. It is also found that cost-plus percentage pricing was very much influenced by competition and demand (Carson *et al.*, 1998:75).

SME managers should know what competitors are charging and take that into account. They have to be cognisant of what competitors are doing and offer something better which may be in the form of price, service or location if they are going to succeed. When analysing competitors, one should know whether the products are superior, inferior or similar to those of competitors. Managers need to check which of the competitors seem to be doing well and find out whether price is the reason, and if not, what gives them the competitive edge (Strauss, 2005:105).

Zimmerer and Scarborough (2005:200) state that SME managers have three basic strategies to choose from in establishing the new product's price. These strategies include sliding down the demand curve, penetration and skimming pricing. Pricing tactics that entrepreneurs may use to set prices of established products involve price lining, leader, geographical, and multiple pricing. Multiple pricing is a technique used in offering customers discount if they purchase in large quantities.

Small and medium-sized enterprises may use a variety of pricing methods and tactics in different situations. It should be remembered that when developing a pricing strategy in any circumstances it should be compatible with the enterprise's overall marketing strategy. Small businesses may use a number of pricing strategies to achieve their growth goal. All the strategies have the potential of producing a profit and most are tied to the critical relationship of price-to-sales volume. Each strategy has its advantages and disadvantages and could be applied in certain circumstances. Small businesses may combine different strategies and tactics for developing an effective pricing strategy. Pricing strategies and tactics include skimming, penetration, discount, price lining, leader, geographical and psychological pricing (Analoui & Karami, 2003:253).

A line of thought in the area of small business pricing is that the manager's intuition and experienced judgement will be the dominant factor. The founder's feel for the market may be the only guide to consumer needs. A lack of marketing experience and orientation on the part of managers may account for their resorting to intuition when deciding on a price. The apparent absence of a technical approach to pricing in the small enterprise has led some writers on the subject to contend that pricing be treated as more of a managerial art than a science. Indeed this notion of pricing as an art is not exclusive to small business (Carson *et al.*, 1998:76).

According to Strauss (2005:105), product pricing is part art, part skill and all perception. A person may pay a price for the product if he or she perceives that it is worth that price. If not, one will never make a sale. One needs to find the magic equilibrium point where customers perceive value and the SME manager perceives price.

In many instances SMEs are faced with competition more than large enterprises. The retailer and wholesalers have many businesses operating in the same area, the majority of which are SMEs. Large enterprises in this category are very few. There are SMEs in the close-set and they are easily accessible. This allows buyers to look around and compare prices. Depending on the kind of market one is serving, buyers may opt for lower prices if they think the benefits in the product are the same or higher prices if they perceive more value in one's products. Because of stiff competition in this business environment the pricing of products should be both quantitative and qualitative. Both financial and marketing factors need to be taken into account when pricing the products. To remain competitive in the market, managers should use appropriate pricing methods to determine the right price.

5.5 Summary

Pricing is a quandary for most SME managers because there are no hard-and-fast rules on what to charge for a product. Since pricing is such an important component of the marketing mix, one needs to take time to research and strategically determine the appropriate price for the product in the market. Costs and profit are two components of price. What competitors are charging and how customers perceive the enterprise's price are two elements that bear serious consideration. One needs to keep in mind though that pricing may be subjective. What works for one company may not be the answer for the other. Managers need to figure out what is best for their businesses in setting prices of the products (Axman, 2003:267).

Price setting involves more than just dealing with customers' perceptions about a product and their willingness to spend. It is also closely related to the enterprise's capacity to meet its own costs and to generate a reasonable return for the owners. An understanding of the principles which govern the mechanics of pricing may help astute business owners find a price which not only is acceptable in the marketplace, but also meet their own financial goals. Managers should do breakeven analysis which allows them to calculate the point at which the business generates enough revenue to meet all of its costs. Beyond that level, any additional items that will be sold will generate a certain amount of profit. However, if sales fall below that point then the business will run at a loss. Managers should know that prices should be perceived as giving value for money. They should strive for the best possible pricing method that may enable them to determine the right price and achieve their goals.

Although SME managers appear to be in favour of cost-oriented pricing, other pricing methods may also be relevant for their situations. They need to understand the factors that influence pricing in their business sector and consider them when pricing. They should establish pricing objectives that emanate from the overall company strategy. Pricing policies should be explicit and documented. Pricing strategies that may take a form of market penetration or "skimming the cream," should be pursued. Different pricing tactics should also be used to attract and persuade customers to buy the products. In the next chapter the empirical study is done to verify the literature viewpoints. The SME managers have been interviewed to give the practical perspective on how they price their products.

CHAPTER 6

RESEARCH METHODOLOGY AND FINDINGS

6.1 Introduction

The methodology applied is both quantitative and qualitative in nature. A comprehensive literature review has given the background of pricing and price determination. The research instrument engaged to gather the empirical evidence is a questionnaire. The empirical research was conducted in 2005 and the latest information available from the Bureau of Research at the University of South Africa, which has been used for this study, was for October 2004.

According to Kotler and Armstrong (2006:105), research is the systematic design, collection, analysis, reporting and interpreting of information on identified problems by utilising acknowledged scientific methods for the accumulation of information to facilitate decision-making. Once the research problem has been defined, the researcher should determine the exact information needed, and develop a plan for gathering it efficiently. The research plan may call for gathering secondary data, primary data, or both. Secondary data consists of information that already exists somewhere, having been collected for another purpose. Primary data consists of information collected for the specific purpose on hand. Researchers usually start by gathering secondary data which may provide a good starting point for the research and often help to define research problems. In most cases, however, the collection of primary data is necessary and important. Just as the researcher should carefully evaluate the quality of secondary information, they also should take great care when collecting primary data. They need to make sure that it will be relevant, accurate, current and unbiased.

According to Lind and Mason (1994:59), it will be very expensive and time-consuming to check and verify the outside diameter of the data collected in a large population. Therefore, a sample of data might be selected and the mean outside diameter calculated in order to estimate the mean diameter of all the data collected. Kotler and Armstrong (2006:115) mention that researchers usually draw conclusions about large groups by studying a small sample of the total population. Ideally, the sample should be representative so that the researcher can make accurate estimates of the thought and response of the larger population. They further state that the questionnaire is by far the most common research instrument, whether administered in person, by phone or online. Questionnaires are very flexible because there are many ways to ask questions. Closed-end questions include all the possible answers, and subjects make choices among them. Open-end questions allow respondents to answer in their own words.

Secondary data has been collected and it was used as the point of departure for the study. A plan for primary data collection or empirical study which calls for a number of decisions on research approaches, contact methods, sampling plan and research instruments was developed. Research approaches used for gathering primary data is survey. Information was collected through personal interview. A sample of data was selected to represent the population as a whole. Designing the sample required three decisions which include, who are to be surveyed, how many people should be surveyed, and how should the people in the sample be chosen. The instrument that was used to collect primary data is the questionnaire.

The data was secured by means of a 6-page questionnaire with 22 questions. An effort was made to avoid leading and ambiguous questions, paying particular attention to the wording and the sequence of questions and ensuring a professional style and format. Adopting various kinds of scales such as binary, ordinal and Likert the information was collected. Furthermore, before using the questionnaire for data collection, a detailed pretest based on personal interviews among 2 academics and 10 SME managers was undertaken in order to increase its validity. This pilot study, in reference to the questionnaire, was done in order to eliminate ambiguity, improve the lucidness of unclear questions and to carefully select and adjust the questions. Every precaution was taken to ensure that the respondents understood the questions. Biased or leading questions were avoided so that feedback of good quality could be obtained. Moreover, the questionnaire was designed in such a way that data for specific pricing practices could be collected and to ensure that the respondents give answers to the same kind of questions.

Strydom *et al.* (2002:158) indicate that the value of information is greatly influenced by how well a sample represents the total population. A sample that is not representative of the total population may not give a true picture of that population and is, therefore, plagued with problems of validity and reliability. Researchers seldom study the whole population, but usually study a sample of the population. The important factors to be considered in sampling are whether the sample is representative of the total population and if the sample was taken in a random order. The characteristics of the sample may determine whether it is representative, while the sampling procedure may be indicative of random selection. The approaches to the sampling procedure include random and non-random sampling. Random sampling, also known as probability sampling is regarded as the best way to ensure a representative sample because every member of the population has a known and equal chance of being included in the sample. Random sample methods include simple random, stratified random, cluster and systematic sampling.

Systematic sampling, which is known to deliver the most representative samples of the sampling methods, has been applied. The population consists of 1334 small and medium-sized businesses according to the list received from the Bureau of Research at the University of South Africa. Different business sectors of SMEs were identified, namely, accommodation, import, export, construction, financial institutions, manufacturers and services enterprises. To determine the systematic sample every third entry of the population data was selected. However, where the number of enterprises in a business sector was less than 10, in this instance, accommodation and financial institutions all the enterprises were included in the sample. This was to give these business sectors reasonable numbers of representation in the sample. A total sample of 400 SMEs which makes 30% (400/1334) of the total population of 1334 SMEs was obtained (see table 6.1).

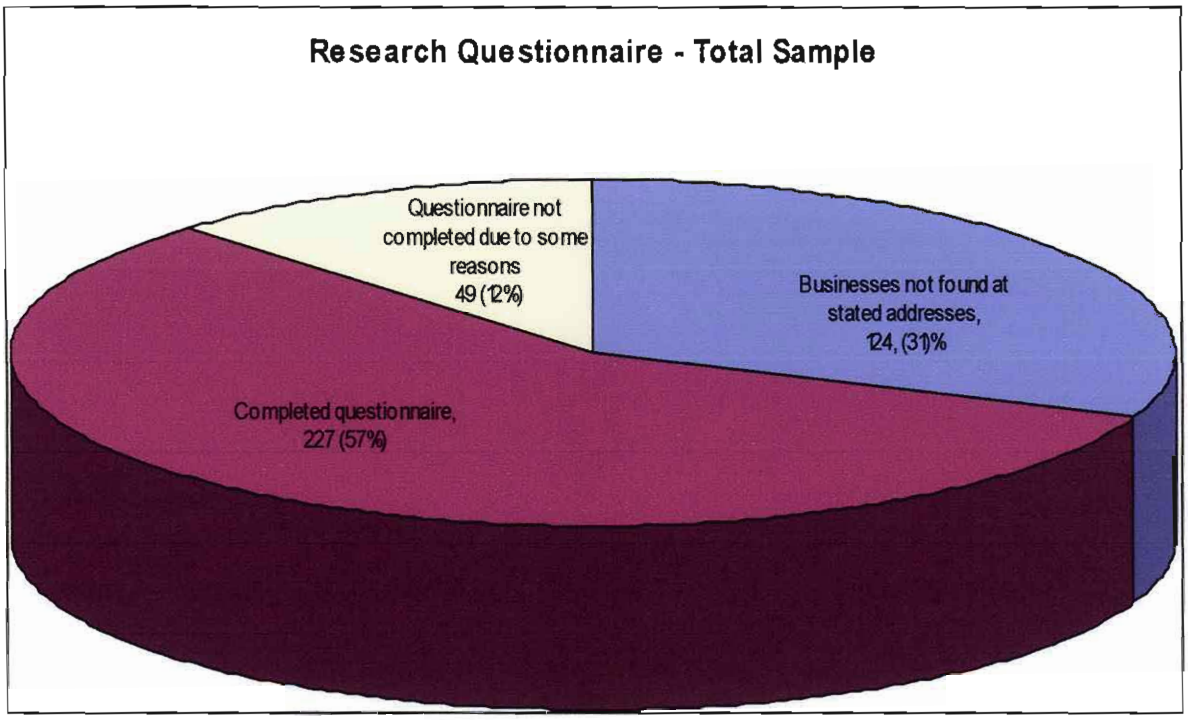
Table 6.1 – Types of businesses in the total population

Business sector	Types of businesses	Population	Sample as % of population
Business services	Architecture, accounting, law engineering, and marketing enterprises	184	27%
Construction enterprises	Air conditioning, building, carpentry, electrical, fencing, decoration, glassworks, metal works and plumbing.	63	40%
Exporters	Any enterprise involved in the exportation of products	48	42%
Financial institutions	Stockbrokers	6	100%
Accommodation	Hotels and guesthouses	6	100%
Importers	Enterprises involved in the importation of products	126	32%
Manufacturers	Manufacturers of different products	323	29%
Wholesalers and retailers	Groceries, gift, jewellers, spares, furnishers, saloon, locksmith, hardware, pharmacies, clothing, books, butcheries, florists, stationers, computers, bakeries, confectioners, fruit and vegetable, footwear, liquor stores, cafes, and other wholesale and retail businesses	578	28%
Total		**1334**	**30%**

Source: Own work.

Copies of the questionnaire, addressed to the managers of the business entities, were hand-delivered to the different physical addresses and 124 of the sample were not found at stated addresses despite the fact that the data obtained from the Bureau of Research at the University of South Africa was less than a year old. Copies of the questionnaire addressed to managers were then handed to only 276 small and medium-sized enterprises. This shows how difficult it is to trace SMEs in their official physical addresses. The assumption that could be made is either the business has relocated or ceased operation. Although this is not the area of the study, it is of great concern not to be able to trace these businesses, taking into account the fact that there is a high failure rate in the small and medium-sized business sector. A week after the questionnaire was hand-delivered to the enterprises, telephone calls were made to make appointments for personal interviews. When telephone calls were made for physical visits and personal interviews, only 227 out of 276 managers responded positively and agreed to the interview whilst 49 businesses did not agree to the interview. The managers who did not agree to the interview were either suspicious about the reason for the survey or cited time constraint as the reason not to agree to the interview. Notwithstanding, the managers who were interviewed constitute approximately 82% (227/276) of the businesses that were found at their physical addresses.

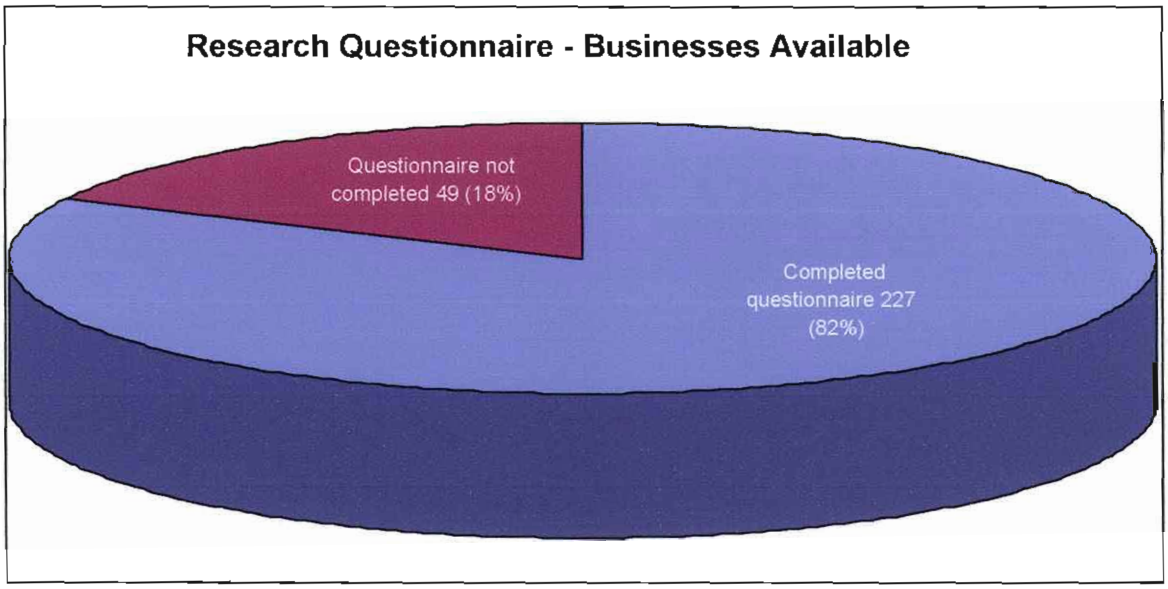
Figure 6.1 - Sample data



Source: Own work.

It was stated in the letter, accompanying the questionnaire, that the questionnaire is part of an extensive research study undertaken to investigate the phenomenon of identifying pricing methods used by small and medium-sized enterprises. The managers were assured that all information will be treated as extremely confidential and will only be used for academic purpose. It was further stated that the questionnaire is part of the thesis to enable the researcher to satisfy the requirements of the degree with the North-West University. This was an attempt to encourage the managers to participate in the interviews. Despite all the explanations and attempts, 49 managers did not agree to the interview.

Figure 6.2 - Businesses available



Source: Own work.

6.2 Structure of the questionnaire

The questionnaire has both structured and unstructured questions. The first part relates to the number of employees, Standard Industrial Classification, form of business, turnover and the position of the person responsible for pricing. The nominal scale method, where the person completing the questionnaire has to choose only one answer that is applicable to his or her business, was used for this part. The rest of the questionnaire focuses on the pricing matters such as documented pricing policy, determination of prices by market forces, pricing objectives, factors influencing pricing, cost-based pricing methods, pricing strategies, pricing tactics, importance of pricing, cost-based pricing, buyer-based pricing, competition-based pricing, revenue percentages, different views regarding product pricing, whether it is easy or difficult to price product range, departments involved in pricing and pricing as a crucial, critical and complex element in the business. In this section there are both standard four-point or summated-rating scale and open-ended questions. The open-ended questions gave managers an opportunity to add their own views where applicable. Other questions needed either 'yes' or 'no' answers or selecting one out of two or more possible answers. The main purpose of the questions was to get the views of the interviewees in relation to pricing decisions.

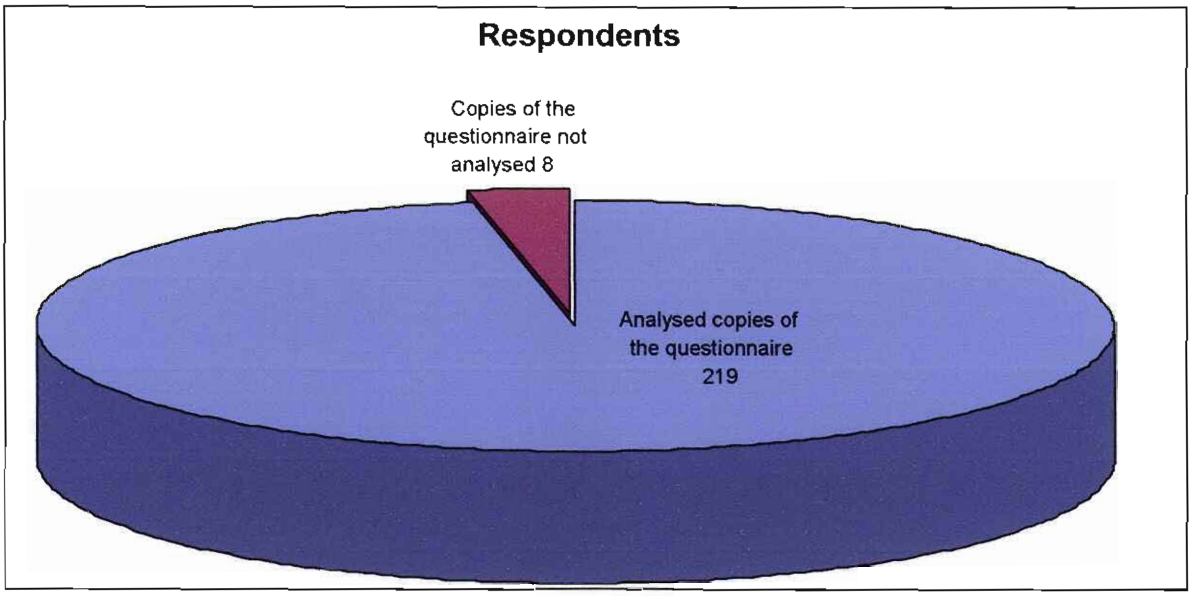
Precaution was taken to ensure that the respondents understood the questions. During the pilot study, some of the respondents indicated that they would like the option of "other" which may allow them some flexibility in case they want to add something relevant but inadvertently omitted in a particular section. Provision was made under "other" to allow the interviewees who would like to add something and only few gave some input across all sections. The respondents were also requested to specify their items under "other". In all cases where the respondents did not have an answer the benefit was given to them because the researcher did not want to be seen to be giving answer as opposed to gathering information regarding pricing in SMEs.

The results have been captured on the computer, coded, edited and analysed by Statistical Consultation Service of the North-West University, Potchefstroom Campus. The programme used is The SAS System for Windows Release 9.1 TS Level 1M0.

Frequency distribution is the grouping of data into categories showing the number of observations in each mutually exclusive category. It is a very useful statistical tool for organising a mass of observations into some meaningful form (Lind and Mason, 1994:22). The raw data has been collected from the sample frame of small and medium-sized enterprises around Johannesburg CBD which include Bertrams, Braamfontein, Braam Park City Suburban, Doornfontein, Ferreirasdorp, Highlands, Hillbrow, Jeppestown, Joubert Park, Marshalltown, New Doornfontein, Newtown, Salisbury Claims, Troyeville and

Wolhuter Droste Park. Frequency procedure was performed on all questions in the questionnaire. The questions are arranged in a descending order and each question has its own table for better interpretation. There were 227 copies of the questionnaire that were completed during the interview with SME managers, of which 8 were not in line with the definition of small and medium-sized enterprises used for this research. They were, therefore, not included in the analysis. Only 219 copies were used for the findings.

Figure 6.3 - Response rate of the questionnaire



Source: Own work.

There are frequencies missing which means that some of the managers that were interviewed did not have a view or an opinion in the sections concerned. To avoid the possibility of giving leading answers, the interviewer gave the interviewee the benefit of the doubt and left the space blank. The difference between the total number of frequency and 219 will represent the frequency missing number. This was insignificant but the results include those missing. Notwithstanding all this, the information gathered was used to draw a meaningful conclusion. The respondents who used the option to give their views under "other" were requested to specify their views. There are situations where their views could be matched with those already stated, and in the circumstance the necessary view was added to the relevant section. For example, in table 6.3, the respondents indicated sole-owner and (Pty) Ltd., under "other", and these were added to the numbers in sole-proprietorship and Private Company, respectively.

The results of the empirical study are discussed below. Questions 1 to 7 required the respondent to choose what is applicable to his or her business, 8 to 16 required the managers to indicate on a scale of 1 to 4 (where 1 = not important at all, 2 = least important, 3 = important and 4 = very important) what is most applicable to their businesses and 17 to 22 are open-ended type of questions. In questions 8 to 16, the percentages of not important at all (1) and least important (2) were combined to form a bottom box column whilst important (3) and very important (4) were also combined to form a top box column. These percentages are based on the number of managers who responded to particular questions. The numbers of respondents, per size of class, were also added together and are reflected in these boxes. The analyses may refer to these boxes where applicable.

6.3 Reliability

When interrelated items are summed to obtain an overall score for each respondent, Cronbach's coefficient alpha estimates the reliability of this type of scale by determining the internal consistency of the test or the average correlation of items within the test. Cronbach Alpha larger than 0,7 is considered to be reliable but anything larger than 0,5 is considered as significant and acceptable (Field, 2005:666). The reliability of the data is tested and this is reflected in table 6.34.

6.4 Frequency analysis

6.4.1 Number of employees

The National Small Business Amendment Act No. 29 of 2004, generally, defines small enterprise as a business with not more than 200 employees, except for agricultural sector in which employees should not exceed 100. However, this may not be taken as a conclusive definition because the Act identifies small, medium and micro enterprises according to the SIC, size of class, total paid employees, total turnover, and total gross asset value excluding fixed property. Only 219 businesses, out of 227, satisfied the requirements of the Act and they were, therefore, considered for analysis.

Table 6.2 – Number of employees

	Medium	Small	Very small	Frequency	Percentage
1.1. Less than 200 employees	71	62	86	219	96%
1.2. Over 200 employees				8	4%
Total	**71**	**62**	**86**	**227**	**100%**

6.4.2 Standard Industrial Classification

The SMEs analysed consist of 71 medium-sized, 62 small and 86 very small businesses and these represent 33%, 28% and 39% of 219 businesses, respectively. There is no manager that was interviewed from micro businesses and this was inadvertent. There is no manager from mining and quarrying that has been interviewed. Medium-sized businesses are in majority in manufacturing (100%), construction (89%) and wholesale trade, commercial agents and allied services (55%). Small businesses are dominating agriculture (62%) and community, social and personal services (56%) whilst very small businesses are in majority in electricity, gas and water (60%), retail and motor trade and repair services (66%), catering, accommodation and other trade (55%) and transport (100%). Finance and business services reflect 50% under small and 50% under very small businesses. Table 6.3 has more information regarding size of class, number of businesses, percentages in respective sectors and the categories of paid employees and total turnover.

Table 6.3 – Business classification

	Frequency	Percentage	Total full-time equivalent of paid employed	Total turnover
2.1. Agriculture or Agribusiness (poultry, fruit and vegetable businesses)	**8**	**4%**		
2.1.1 Medium	2	25%	100	R5m
2.1.2 Small	5	63%	50	R3m
2.1.3 Very small	1	13%	10	R0.50m
2.1.4 Micro	0	0%	5	R0.20m
2.2. Mining and quarrying	**0**	**0%**		
2.2.1 Medium	0	0%	200	R13m
2.2.2 Small	0	0%	50	R6m
2.2.3 Very small	0	0%	20	R5.1m
2.2.4 Micro	0	0%	5	R0.20m
2.3. Manufacturing	**24**	**11%**		
2.3.1 Medium	24	100%	200	R64m
2.3.2 Small	0	0%	50	R32m
2.3.3 Very small	0	0%	20	R6m
2.3.4 Micro	0	0%	5	R0.20m
2.4. Electricity, gas and water (electrical appliances and coupons, and filling stations)	**10**	**5%**		
2.4.1 Medium	2	20%	200	R26m
2.4.2 Small	2	20%	50	R6m
2.4.3 Very small	6	60%	20	R3m
2.4.4 Micro	0	0%	5	R0.20m
2.5. Construction	**9**	**4%**		
2.5.1 Medium	8	89%	200	R51m
2.5.2 Small	1	11%	50	R13m
2.5.3 Very small	0	0%	20	R5.10m
2.5.4 Micro	0	0%	5	R0.20m
2.6. Retail and motor trade and repair services	**95**	**43%**		
2.6.1 Medium	5	6%	200	R26m
2.6.2 Small	27	28%	50	R13m
2.6.3 Very small	63	66%	20	R3m
2.6.4 Micro	0	0%	5	R0.20m
2.7. Wholesale trade, commercial agents and allied services	**40**	**18%**		
2.7.1 Medium	22	55%	200	R13m
2.7.2 Small	18	45%	50	R6m
2.7.3 Very small	0	0%	20	R1m
2.7.4 Micro	0	0%	5	R0.20m
2.8. Catering, accommodation and other trade (Hotels, catering and events management)	**20**	**9%**		
2.8.1 Medium	6	30%	200	R39m
2.8.2 Small	3	15%	50	R10m
2.8.3 Very small	11	55%	20	R4m
2.8.4 Micro	0	0%	5	R0.20m
2.9. Transport, storage and communications	**2**	**1%**		
2.9.1 Medium	0	0%	200	R26m
2.9.2 Small	0	0%	50	R13m
2.9.3 Very small	2	100%	20	R3m
2.9.4 Micro	0	0%	5	R0.20m

	Frequency	Percentage	Total full-time equivalent of paid employed	Total turnover
2.10. Finance and business services (accountants and business consultants)	**2**	**1%**		
2.10.1 Medium	0	0%	200	R39m
2.10.2 Small	1	50%	50	R19m
2.10.3 Very small	1	50%	20	R4m
2.10.4 Micro	0	0%	5	R0.20m
2.11. Community, Social and Personal services (architects, lawyers, engineers, and recruiting agents)	**9**	**4%**		
2.11.1 Medium	2	22%	200	R51m
2.11.2 Small	5	56%	50	R13m
2.11.3 Very small	2	22%	20	R5m
2.11.4 Micro	0	0%	5	R0.20m
Total	**219**	**100%**		
2.12.1 Medium	71	33%		
2.12.2 Small	62	28%		
2.12.3 Very small	86	39%		
2.12.4 Micro	0	0%		

6.4.3 Form of business

It is clear from table 6.4 that sole-proprietorships (32%), close corporations (32%) and private companies (27%) appear to be dominating the sector. Partnerships made 9% of the respondents. There are 5 respondents who showed their forms of business under "other" and 3 of these are sole-owners and 2 are (Pty) Ltd., and they have been added to sole-proprietorship and private company columns, respectively. The majority of medium-sized businesses (82%) are private companies. Close corporations make up 74% of small businesses whilst very small businesses are composed of 79% sole-proprietorships.

Table 6.4 – Form of business

	Medium	Small	Very small	Percentage	Frequency
3.1. Sole-proprietorship		3	68	71	32%
3.2. Partnership		13	6	19	9%
3.3. Close corporation	13	46	12	71	32%
3.4. Private company	58			58	27%
3.5. Other (specify)					
Total	**71**	**62**	**86**	**219**	**100%**

6.4.4 Pricing responsibility

The question was looking at who is responsible for pricing in the business. Table 6.5 shows that managers (41%) and owner-managers (48%) responsible for pricing, together, account for 89% of the respondents. Four managers indicated under "other" that transport association (2) and franchiser (2) are also responsible for pricing. Eight managers did not want to commit themselves on who is responsible for pricing in their businesses, and this missing frequency makes 4%. In 92% of medium-sized businesses managers are responsible for pricing whilst owner-managers are responsible for pricing in 50% and 88% of small and very small businesses, respectively.

Table 6.5 – Pricing responsibility

	Medium	Small	Very small	Frequency	Percentage
5.1. Manager	65	25		90	41%
5.2. Owner-manager		31	76	107	48%
5.3. Wholesalers / Producers / Supplier		3	1	4	2%
5.4. Independent Consultant(s)	2			2	1%
5.5. Government	4			4	2%
5.6. Other (transport association and franchiser)		2	2	4	2%
5.7. Missing frequency		1	7	8	4%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.5 Documented pricing policy

Table 6.6 shows that 38% has documented pricing policies while 58% does not have. Nine (4%) managers did not indicate whether they have documented pricing policies or not. All very small business managers (79) that responded to this question indicated that they do not have documented pricing policies whilst the majority of small businesses and all of the medium-sized businesses (71) indicated that they have documented pricing policies.

Table 6.6 – Pricing policy documentation

	Medium	Small	Very small	Frequency	Percentage
6.1. With documented pricing policy	71	55		84	38%
6.2. Without documented pricing policy		5	79	126	58%
6.3. Missing frequency		2	7	9	4%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.6 Determination of prices by market forces

The respondents who allow market forces to determine prices make 49%, and those that do not are 47%. However, 8 (4%) of the respondents did not indicate whether they allow market forces to determine price or not (see table 6.7). The majority of medium-sized (94%) and small (66%) businesses allow market forces to determine prices whilst those of very small businesses (92%) do not allow market forces to determine prices.

Table 6.7 – Price determination by demand and supply

	Medium	Small	Very small	Frequency	Percentage
7.1. Allow market forces to determine prices	67	41		108	49%
7.2. Does not allow market forces to determine prices	4	20	79	103	47%
7.3. Missing frequency		1	7	8	4%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.7 Pricing objectives

The top box of table 6.8 reflects that the respondents consider target return on investment (92%), target markup on cost (91%), price stabilisation (77%), market share target (82%) and matching competitors' prices (81%) to be 'important' and 'very important'. Some of the respondents (12) indicated their pricing objectives under "other". The pricing objectives include survival (2), to prevent new entrants (1), ensure adequate cash flow (1), maximise sales revenue (1), maximise profit (4) and recovery of all costs (3).

All managers of medium-sized businesses consider target return on investment, target markup on cost and matching competitors' prices to be very important whilst the majority of small and very small businesses regard them as important. The majority of managers of medium-sized businesses regard price stabilisation and market share target as very important whilst the majority of small businesses view them as important. The greater part of very small businesses (51%) consider market share target to be important. However, price stabilisation is regarded as important and least important by 40% and 41% of very small businesses, respectively.

Table 6.8 – Pricing objectives

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
8.1. Target return on investment	**11**	**5%**	7	**3%**	**112**	**53%**	**81**	**39%**	**8%**	**92%**
Medium							71			71
Small					48		10			58
Very small	11		7		64				18	64
8.2. Target markup on cost	**3**	**1%**	**16**	**8%**	**95**	**46%**	**93**	**45%**	**9%**	**91%**
Medium							71			71
Small					34		22			56
Very small	3		16		61				19	61
8.3. Price stabilisation	**15**	**7%**	**33**	**16%**	**101**	**48%**	**60**	**29%**	**23%**	**77%**
Medium					11		60			71
Small					58					58
Very small	15		33		32				48	32
8.4. Market share target	**15**	**7%**	**22**	**11%**	**99**	**49%**	**67**	**33%**	**18%**	**82%**
Medium					4		67			71
Small					56					56
Very small	15		22		39				37	39
8.5. Matching competitors' prices	**16**	**8%**	**24**	**11%**	**83**	**39%**	**90**	**42%**	**19%**	**81%**
Medium							71			71
Small					42		19			61
Very small	15		24		41				39	41
8.6. Other	**2**	**17%**	**1**	**8%**	**6**	**50%**	**3**	**25%**	**25%**	**75%**
Medium					1		3			4
Small					4					4
Very small	2		1		1				3	1

6.4.8 Pricing tactics

This question was to establish the degree of importance regarding pricing tactics. The result of the respondents in the top box of table 6.9 indicates that pricing relative to competition (88%), uniform prices to buyers (81%), quantity discounts (61%) cash discounts (55%) were considered to be important and very important by the majority whilst the bottom box reflects that trade discounts (56%) and geographical price (74%) were considered to be not important at all and least important by the majority.

All managers of medium-sized businesses consider pricing relative to competition to be very important whilst the majority of small (56%) and very small (67%) businesses consider it important, respectively. The majority of medium-sized (97%) and small (65%) businesses consider uniform prices to be important whilst 48% of managers in very small businesses regard them as very important. Quantity discount is regarded by the majority of medium-sized (66%), small (97%) and very small (65%) business as very important, important and least important, respectively. Trade discount is regarded by the majority of medium-sized (95%), small (57%) businesses and all very small businesses as important, least important and not important, respectively. Cash discount is regarded by the majority of medium-sized (69%) and small (54%) businesses as important whilst 53% of very small businesses consider it least important. The majority of medium-sized business managers (51%) consider geographical pricing to be important whilst those of small (58%) and very small (53%) businesses consider it not important.

Table 6.9 – Pricing tactics

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
9.1. Pricing relative to competition	**12**	**6%**	**14**	**6%**	**93**	**43%**	**98**	**45%**	**12%**	**88%**
Medium							71			71
Small					34		27			61
Very small	12		14		59				26	59
9.2. Uniform prices to buyers	**16**	**8%**	**23**	**11%**	**111**	**52%**	**62**	**29%**	**19%**	**81%**
Medium					69		2			71
Small					39		21			60
Very small	16		23		3		39		39	42
9.3. Quantity discounts	**28**	**14%**	**53**	**25%**	**82**	**39%**	**47**	**22%**	**39%**	**61%**
Medium					24		47			71
Small			2		58				2	58
Very small	28		51						79	
9.4. Trade discounts	**83**	**39%**	**35**	**17%**	**56**	**27%**	**35**	**17%**	**56%**	**44%**
Medium					36		35			71
Small	6		35		20				41	20
Very small	77								77	
9.5. Cash discounts	**37**	**18%**	**55**	**27%**	**81**	**39%**	**33**	**16%**	**45%**	**55%**
Medium					38		33			71
Small			14		43				14	43
Very small	37		41						78	
9.6. Geographical price	**82**	**46%**	**48**	**28%**	**36**	**20%**	**11**	**6%**	**74%**	**26%**
Medium			24		36		11		24	47
Small	36		24						60	
Very small	46								46	

6.4.9 Factors influencing pricing

Combinations of 'important' and 'very important' factors influencing pricing, as reflected in the top box of table 6.10, are cost (98%), competitors' prices (87%), buyer behaviour (82%), economic climate (57%) and government legislation (64%). Fourteen of the respondents indicated their factors influencing pricing under "other". These factors include product quality (4), Customers' ability and willingness to buy (7), ethical constraints (1), and price sensitivity (2).

The majority of managers in medium-sized (94%), small (73%) and very small (92%) businesses regard cost as very important. The majority of small (75%) and very small (53%) businesses regard competitors' prices as very important whilst 44% medium-sized businesses regard them as important. The greater part of medium-sized businesses (97%) considers buyer behaviour to be very important whilst all small and 55% of very small businesses regard it as important. The majority of medium-sized (59%) and small businesses (52%) consider economic climate to be very important and important, respectively whilst 45% of very small businesses consider it not important. Government legislation is regarded by the majority of medium-sized businesses (70%) and very small (57%) as very important and least important, respectively whilst all small businesses regard them important.

Table 6.10 – Pricing factors

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
10.1. Costs	**0**	**0%**	**4**	**2%**	**52**	**24%**	**161**	**74%**	**2%**	**98%**
Medium			4		29		38		4	67
Small					17		45			62
Very small					6		78			85
10.2. Competitors' prices	**9**	**5%**	**18**	**8%**	**82**	**38%**	**106**	**49%**	**13%**	**87%**
Medium	9		18		31		23		27	54
Small					14		42			56
Very small					37		41			78
10.3.Buyer behaviour	**7**	**4%**	**30**	**14%**	**108**	**50%**	**69**	**32%**	**18%**	**82%**
Medium					2		69			71
Small					61					61
Very small	7		30		45				37	45
10.4. Economic climate	**37**	**18%**	**53**	**25%**	**77**	**37%**	**42**	**20%**	**43%**	**57%**
Medium					29		42			71
Small	1		26		32				27	32
Very small	36		27		16				63	16
10.5. Government legislation	**29**	**15%**	**43**	**21%**	**83**	**40%**	**50**	**24%**	**36%**	**64%**
Medium					21		50			71
Small					59					59
Very small	29		43		3				72	3
10.6. Other (specify)	5	**35%**	**0**	**0%**	**8**	**57%**	**1**	**8%**	**35%**	**65%**
Medium										
Small	1				3		1		1	4
Very small	4				5				4	5

6.4.10 Cost-based pricing methods

Cost-based pricing methods include full-cost (97%), contribution (83%) and activity-based cost pricing (87%) when important and very important are combined (see top box of table 6.11). The other cost-based pricing methods indicated by nine respondents under "other" include cost-plus pricing (4) breakeven pricing (3) and marginal cost pricing (2).

The majority of small (66%) and very small (93%) businesses consider full-cost pricing to be very important whilst 63% of medium-sized businesses consider it to be important. A larger number of medium-sized businesses regard contribution pricing and activity-based pricing as very important whilst the majority of small (66%) and very small (93%) businesses consider them to be important.

Table 6.11 – Pricing methods based on cost

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
11.1.Full-cost pricing	**1**	**0%**	**6**	**3%**	**71**	**34%**	**132**	**63%**	**3%**	**97%**
Medium	1		6		45		19		7	64
Small					20		39			59
Very small					6		74			80
11.2. Contribution pricing	**15**	**7%**	**21**	**10%**	**105**	**53%**	**59**	**30%**	**17%**	**83%**
Medium					12		59			71
Small					56					56
Very small	15		21		37				36	37
11.3.Activity-based cost pricing	**13**	**6%**	**13**	**7%**	**93**	**45%**	**86**	**42%**	**13%**	**87%**
Medium							71			71
Small					42		15			57
Very small	13		13		51				26	51
11.4. Other (specify)	**3**	**33%**	**0**	**0%**	**6**	**67%**	**0**	**0%**	**33%**	**67%**
Medium										
Small	3				6				3	6
Very small										

6.4.11 Pricing strategies

The bottom box of table 6.12 reflects that 68% of the respondents indicate that skimming pricing is not important at all and least important whilst 71% in the top box shows that penetration pricing is important and very important. The top box also reflects that 77% of the respondents find both skimming and penetration pricing important and very important for their businesses. Seventeen of the respondents indicated additional pricing strategies under "other". These factors include product line pricing (2), generic pricing strategy (7), captive-product (1), product bundle pricing (2), price unbundling (1), promotional pricing (2) and reference pricing (2).

Skimming is considered by the majority of medium-sized (66%), small (77%) and very small (89%) businesses to be important, least important and not important, respectively. The greater part of medium-sized businesses (75%) regard penetration pricing as very important whilst the majority of small (64%) and very small (51%) businesses regard it as important.

Table 6.12 – Pricing strategies

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%		
12.1. Skimming pricing	**68**	**36%**	**59**	**32%**	**48**	**25%**	**14**	**7%**	**68%**	**32%**
Medium	1		9		47		14		10	61
Small	12		43		1				55	1
Very small	55		7						62	
12.2. Penetration pricing	**18**	**9%**	**39**	**20%**	**90**	**45%**	**51**	**26%**	**29%**	**71%**
Medium			3		17		51		3	68
Small	5		16		38				21	38
Very small	13		20		35				33	35
12.3. Both skimming and penetration pricing	**17**	**9%**	**23**	**14%**	**57**	**48%**	**24**	**29%**	**23%**	**77%**
Medium					47		24			71
Small	5		22						27	
Very small	12		1						13	
12.4. Other (specify)	**3**	**17%**	1	**6%**	9	**53%**	**4**	**24%**	**23%**	**77%**
Medium										
Small			1		9		4		1	13
Very small	3								3	

6.4.12 Importance of pricing

The respondents consider highest revenue earner (93%), contributes to the strategy (92%), recovery of business costs (98%), a tool to prevent competition (54%), competitive advantage (82%), product differentiation (53%) and increase or decrease demand (82%) to be important and very important according to the top box of table 6.13. Ten of the respondents added under "other" the determination of gross profit (2), profitability (4), business success or failure (1) and value (3).

Pricing as the highest revenue earner is considered by the majority of medium-sized (61%) and small (53%) businesses as important whilst all very small businesses regard it as very important. All medium-sized businesses consider contribution to the strategy and determination of demand to be very important whilst the majority of small and very small businesses consider them to be important. The greater part of medium-sized businesses (79%) regard recovery of costs as important whilst the majority of small (80%) and all very small businesses regard it as very important. Tool to prevent competition is regarded by medium-sized businesses (55%) as very important whilst small and very small businesses show a reasonable spread between least important and important. Most of the managers in medium-sized businesses (65%) consider competitive advantage to be very important whilst 51% of very small and all small businesses regard it as important. The majority of medium-sized (54%) and small (69%) businesses regard product differentiation as important whilst 51% of very small businesses regard it as least important.

Table 6.13 – Pricing importance

	Not important at all 1		**Least important 2**		**Important 3**		**Very important 4**		**Bottom Box**	**Top Box**
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
13.1. The highest revenue earner	**3**	**1%**	**12**	**6%**	**70**	**32%**	**133**	**61%**	**7%**	**93%**
Medium	3		12		37		19		15	56
Small					33		29			62
Very small							85			85
13.2. Contributes to the strategy	**2**	**1%**	**15**	**7%**	**124**	**57%**	**77**	**35%**	**8%**	**92%**
Medium							71			71
Small					56		6			62
Very small	2		15		68				17	68
13.3. Recovery of business costs	**3**	**1%**	**3**	**1%**	**68**	**32%**	**142**	**66%**	**2%**	**98%**
Medium	3		3		56		9		6	65
Small					12		49			61
Very small							84			84
13.4. Tool to prevent competition	**26**	**12%**	**74**	**34%**	**77**	**36%**	**39**	**18%**	**46%**	**54%**
Medium			6		26		39		6	65
Small	9		30		22				39	22
Very small	17		38		29				55	29
13.5. Competitive advantage	**11**	**5%**	**28**	**13%**	**130**	**61%**	**46**	**21%**	**18%**	**82%**
Medium					25		46			71
Small					61					61
Very small	11		28		44				39	44
13.6. Product differentiation	**41**	**19%**	**61**	**28%**	**80**	**38%**	**33**	**15%**	**47%**	**53%**
Medium					38		33			71
Small			19		42				19	42
Very small	41		42						83	
13.7. Increase or decrease demand	**14**	**6%**	**25**	**12%**	**78**	**36%**	**99**	**46%**	**18%**	**82%**
Medium							71			71
Small					34		28			62
Very small	14		25		44				39	44

6.4.13 Cost-based pricing

The top box of table 6.14 reflects the following as important and very important:

- Recovery of costs (98%).
- Determines breakeven point (93%).
- Determination of profit or loss (98%).
- Ignores buyers' ability to pay (71%).
- Ignores competition (76%).

Nine of the respondents indicated under "other" some additional important factors in cost-based pricing which include the value of the product (2) demand (5) and customers' willingness to buy (2).

The recovery of all costs and determination of profit or loss are considered by the majority of medium-sized businesses (77%) to be important whilst all small and very small businesses regard them as very important. All medium-sized and small businesses consider determination of breakeven point to be very important whilst the majority of very small businesses (78%) consider it to be important. The greater part of medium-sized businesses (54%) regards ignorance of buyers' ability to pay as very important whilst the 95% of small and 46% of very small businesses regard it as important and least important respectively. Ignorance of competition is regarded by most medium-sized businesses (86%) as very important whilst all small businesses regard it as important. There is a reasonable spread between least important and important for ignorance of competition in very small businesses.

Table 6.14 – Cost-based pricing

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
14.1. Recovery of all costs	**0**	**0%**	**3**	**2%**	**55**	**25%**	**160**	**73%**	**2%**	**98%**
Medium			3		55		13		3	68
Small							62			62
Very small							85			85
14.2. Determines breakeven point	**4**	**2%**	**12**	**5%**	**71**	**34%**	**124**	**59%**	**7%**	**93%**
Medium							71			71
Small					9		51			60
Very small	4		12		62		2		16	64
14.3. Determination of profit/loss	**1**	**1%**	**2**	**1%**	**54**	**25%**	**158**	**73%**	**2%**	**98%**
Medium	1		2		54		14			68
Small							61			61
Very small							83			83
14.4. Ignores buyers' ability to pay	**22**	**10%**	**39**	**19%**	**111**	**53%**	**38**	**18%**	**29%**	**71%**
Medium					33		38			71
Small			3		58				3	58
Very small	22		36		20				58	20
14.5. Ignores competition	**14**	**7%**	**36**	**17%**	**104**	**48%**	**61**	**28%**	**24%**	**76%**
Medium					10		61			71
Small					61					61
Very small	14		36		33				50	33
14.6. Other (specify)	**2**	**22%**	**0**	**0%**	**6**	**67%**	**1**	**11%**	**22%**	**78%**
Medium										
Small					4		1			5
Very small	2				2				2	2

6.4.14 Buyer-based pricing

The top box of table 6.15 shows that the buyer-based pricing factors include determination of customers' ability to pay (81%), determination of demand (92%), indication of customers' perception of value (80%), competitive advantage (82%), ignores cost implications (80%) and ignores competition (73%). The respondents, who indicated some important factor for buyer-based pricing under "other", are eight. All of them mentioned the recovery of cost.

All managers of medium-sized businesses regard the determination of customers' ability to pay as very important whilst 87% and 53% of small and very small businesses regard it as important, respectively. All managers of medium-sized and 65% small businesses consider determination of demand to be very important whilst 81% of very small businesses regard it as important. The majority medium-sized businesses (99%) consider indication of customers' perception of value to be very important whilst all small and 49% of very small businesses regard it as important. The majority of managers in medium-sized businesses (56%) consider competitive advantage to be very important whilst all small businesses and 53% of very small regard it as important. Ignorance of cost is considered by all very small businesses and the majority of small business (81%) to be very important and important, respectively. However, medium-sized businesses are even at 38% for least important and important. All managers of medium-sized businesses consider ignorance of competition to be very important whilst the majority of small (95%) and 50% of very small businesses regard it as important and least important respectively.

Table 6.15 – Buyer-based pricing

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
15.1. Determination of the customers' ability to pay	9	4%	31	15%	99	45%	79	36%	19%	81%
Medium							71			71
Small					54		8			62
Very small	9		31		45				40	45
15.2. Determination of demand	5	3%	11	5%	90	41%	111	51%	8%	92%
Medium							71			71
Small					22		40			62
Very small	5		11		68				16	68
15.3. Indication of customers' perception of value	4	2%	38	18%	104	48%	70	32%	20%	80%
Medium					1		70			71
Small					62					62
Very small	4		38		41				42	41
15.4. Gives competitive advantage	14	6%	25	12%	137	63%	40	19%	18%	82%
Medium					31		40			71
Small					62					62
Very small	14		25		44				39	44
15.5. Ignores the cost implications	17	8%	27	12%	75	36%	92	44%	20%	80%
Medium	17		27		27				44	27
Small					48		11			59
Very small							81			81
15.6. Ignores competition	17	8%	40	19 %	82	39 %	71	34 %	27%	73 %
Medium							71			71
Small					59					59
Very small	17		40		23				57	23
15.7. Other (specify)	1	12 %	0	0%	6	75 %	1	13 %	12%	88 %
Medium										
Small	1				6		1		1	7
Very small										

6.4.15 Competition-based pricing

The top box of table 6.16 reflects that the majority of respondents indicated that competition-based pricing factors make pricing easier as there are ruling prices (72%), helps to prevent price wars (69%), ignores buyers' ability to pay (69%) and ignores the cost implications (85%) are important and very important. Eight of the respondents indicated their factors influencing pricing under "other". These factors include cost recovery (6), and the customers' perception of value (2).

The majority of medium-sized businesses (58%) regard the ruling price as least important whilst those of small (58%) and very small (52%) businesses consider it important. Most of the managers of medium-sized (56%) and all small businesses regard prevention of price wars as important whilst very small businesses (54%) consider it to be least important. Ignorance of buyers' ability to pay is regarded by the majority of medium-sized (58%), all small and 65% very small businesses to be very important, important and least important, respectively. Ignorance of cost implications is considered by the majority of medium-sized (54%) and small (74%) businesses to be important whilst those of very small businesses (91%) regard it as very important.

Table 6.16 – Competition-based pricing

	Not important at all 1		Least important 2		Important 3		Very important 4		Bottom Box	Top Box
	Frequency	%	Frequency	%	Frequency	%	Frequency	%	%	%
16.1. Makes pricing easier as there is ruling price	**17**	**8%**	**41**	**20%**	**90**	**42%**	**64**	**30%**	**28%**	**72%**
Medium	17		41		13				58	13
Small					34		25			59
Very small					43		39			82
16.2. Helps to prevent price wars	**23**	**11%**	**44**	**20%**	**114**	**54%**	**31**	**15%**	**31%**	**69%**
Medium					40		31			71
Small					60					60
Very small	23		44		14				67	14
16.3. Ignores buyers' ability to pay	**14**	**7%**	**51**	**24%**	**101**	**49%**	**41**	**20%**	**31%**	**69%**
Medium					30		41			71
Small					57					57
Very small	14		51		14				65	14
16.4. Ignores the cost implications	**14**	**7%**	**19**	**8%**	**88**	**43%**	**86**	**42%**	**15%**	**85%**
Medium	14		19		38				33	38
Small					43		15			58
Very small					7		71			78
16.5. Other (specify)	**2**	**24%**	**1**	**13%**	**4**	**50%**	**1**	**13%**	**37%**	**63%**
Medium										
Small	2				3		1		2	4
Very small			1		1				1	1

6.4.16 Revenue percentages

This question was to establish what percentage of total revenue comes from core products. The overwhelming majority of the businesses (98%), as reflected in table 6.17, derive more than 50% of their revenue from the core products. This shows how important the pricing of core products is to these businesses. Three (1%) of the businesses that completed the questionnaire did not indicate the percentage contributed by the pricing of core products to their total revenue, and this is reflected as missing frequency.

All managers in small and very small businesses and the overwhelming majority in medium-sized (97%) businesses state that they derive more than 50% of their revenue from their core products.

Table 6.17 – Contribution of core products to total revenue

	Medium	Small	Very small	Frequency	Percentage
17.1. Less than 50%				0	0%
17.2. 50%	2			2	1%
17.3. More than 50%	69	62	83	214	98%
17.4. Missing frequency			3	3	1%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.17 Different views regarding product pricing

The respondents were asked whether they find it easy or difficult to price their products. From table 6.18 it is clear that 47% of the managers find it easy to price their products while 21% find it difficult. The 29% of the respondents find it sometimes easy and sometimes difficult to price their products. There is 7 (3%) missing frequency in this section.

The majority of managers in very small (52%) and small (74%) businesses find it easy to price their products whilst 80% of medium-sized businesses indicate that it is sometimes easy and sometimes difficult to price their products.

Table 6.18 – Managers finding it easy or difficult to price

	Medium	Small	Very small	Frequency	Percentage
18.1. Easy to price	11	46	45	102	47%
18.2. Difficult to price	3	10	34	47	21%
18.3. Sometimes easy and sometimes difficult	57	5	1	63	29%
18.4. Missing frequency		1	6	7	3%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.18 Reasons that make pricing easy

This question was to establish why it is easy to price the products. There are different reasons cited by the managers and they are listed below. Most of the respondents, 57%, indicate that adding markup percentage to the cost price makes pricing easy. The total frequency in table 6.19 does not reflect the number 102 as in table 6.19 but 150. This is because some of the managers stated more than one reason that make pricing easy. The majority of medium-sized businesses (66%) indicate that they just add markup to their cost and this make it easier for them to price their products.

Table 6.19 – Reasons that make pricing easy

	Medium	Small	Very small	Frequency	Percentage
19.1. Price recommended by supplier		1	4	5	3%
19.2. Adding markup percentage to the cost price	51	24	11	86	57%
19.3. Business experience	2	3	6	11	7%
19.4. Price determined by the Government	4			4	3%
19.5. No competition	1			1	1%
19.6. Using prevailing market prices		21	9	30	20%
19.7. Using computerised pricing system	13			13	9%
Total	**71**	**49**	**30**	**150**	**100%**

6.4.19 Reasons that make pricing difficult

Additional information to determine the reasons for difficulty in pricing products or services has been sought. In response to why the respondents found it difficult to price their products, the reasons in table 6.21 were stated. However, competition, which reflects 66%

of the respondents, appears to be the prime factor that makes it difficult for the managers when pricing their products. Table 6.20 above reflects that a total of 48 managers indicate that it is difficult to price but the frequency in table 6.20 below reflects a total of 77. This is as a result of some of the managers citing more than one reason. Seventy-three percent of medium-sized businesses state that competition makes it difficult for them to price their products.

Table 6.20 - Reasons that make pricing difficult

	Medium	Small	Very small	Frequency	Percentage
20.1. Customer affordability	9			9	12%
20.2. Price sensitivity	1	1		2	3%
20.3. Alternative supplier	2			2	3%
20.4. Recovery of all costs		2		2	3%
20.5. Competition	52			52	66%
20.6. Price fluctuation	7	3		10	13%
Total	**71**	**6**		**77**	**100%**

6.4.20 Departments involved in pricing

Although some of the managers indicated during the pilot stage that there are other departments in their organisations that take part in pricing, very few respondents completed this section. This may be attributed to the fact that either the manager or owner-manager, in most of the SMEs, determines prices bearing in mind the size of the business. The missing frequency (192) which makes 88% is, therefore, higher than in other sections (see table 6.21). It is only managers of medium-sized businesses that mentioned different departments that are involved in pricing.

Table 6.21 – Departments involved in pricing

	Medium	Small	Very small	Frequency	Percentage
21.1. Marketing	8			8	4%
21.2. Finance	9			9	4%
21.3. Sales	7			7	3%
21.4. Purchasing	3			3	1%
21.5. Missing frequency	44	62	86	192	88%
Total	**71**	**62**	**86**	**219**	**100%**

6.4.21 Pricing as a crucial, critical and complex element in the business

The managers were required to indicate whether they agree or disagree with the statement '*pricing is a crucial, critical and complex element in the business*', and to explain their answers. The number that responded to the question is 192, of which 189 (86%) agreed with the statement whilst 3 (1%) disagreed and 28 (13%) represent missing frequency. The 3 managers that disagreed have not stated their reasons. Those who agreed stated that the reasons in table 6.23 make pricing crucial, critical and complex. Although there is quite a spread in the answers, 32% of the respondents mention failure, success and profitability while 19% cites survival and sustainability. The majority of managers in very small (70%), small (98%) and medium-sized (96%) businesses agree that pricing is a crucial, critical and complex element in the business.

Table 6.22 – Pricing as a crucial, critical and complex element in the business

	Medium	Small	Very small	Frequency	Percentage
22.1. A crucial, critical and complex element of business	68	61	60	189	86%
22.2. Not a crucial, critical and complex element of business	3			3	1%
22.3. Missing frequency		1	26	27	13%
Total	**71**	**62**	**86**	**219**	**100%**

Table 6.23 – Reasons that make pricing a crucial, critical and complex element

	Medium	Small	Very small	Frequency	Percentage
23.1. Failure, success and profitability	24	11	28	63	34%
23.2. Survival and sustainability	4	19	12	35	19%
23.3. Growth	12	2		14	7%
23.4. Competition	17	6	5	28	15%
23.5. Customers' perception of value	9	6	2	17	9%
23.6. Sales and demand	5	17	9	31	16%
Total	**71**	**61**	**56**	**188**	**100%**

6.5 The means procedure

Questions 8 to 16 required the managers to indicate on a scale of 1 to 4 (where 1 = not important at all, 2 = least important, 3 = important and 4 = very important) what is most applicable to their businesses. Bearing in mind the degree of importance and how the managers' answers varied, it was found necessary to determine the mean and standard deviation respectively. The mean indicates how strong the sample group or respondents felt about the item or the statement. The sample standard deviation is used as a measure to compare the spread in two or more sets of observation.

6.5.1 Pricing objectives

The mean values in table 6.24 show that the majority of respondents indicate that different categories of the pricing objectives are either important or very important. It is evident that the two most important objectives are target markup on cost and (3,34) and target return on investment (3,25) and they are related to cost and profit. The standard deviations are relatively small as there is high degree of uniformity within the respondents.

Table 6.24 – Pricing objectives

Variable	Number	Minimum	Maximum	Mean	Standard Deviation
8.1.Target return on investment	211	1	4	3,25	0,75
8.2. Target markup on cost	207	1	4	3,34	0,69
8.3. Price stabilisation	209	1	4	2,99	0,86
8.4. Market share target	203	1	4	3,07	0,86
8.5. Matching competitors' prices	213	1	4	3,16	0,90
8.6. Other (see Section 6.4.8)	12	1	4	2,83	1,03

6.5.2 Pricing tactics

The mean values in table 6.25 demonstrate that the majority of respondents indicated that the pricing tactics are important and very important except for geographical price (1,86) whose mean value shows that it is not important. The two most important are pricing relative to competition (3,28) and charging uniform price to all buyers (3,03%). Except for trade discounts, the standard deviations for pricing tactics are relatively small and this shows a high degree of uniformity within the respondents. Trade discounts have a fair spread in scale of 1 to 4 (See table 6.25).

Table 6.25 – Pricing tactics

	Number	Minimum	Maximum	Mean	Standard Deviation
9.1.Pricing relative to competition	217	1	4	3,28	0,81
9.2.Uniform prices to buyers	212	1	4	3,03	0,84
9.3. Quantity discounts	210	1	4	2,70	0,96
9.4. Trade discounts	209	1	4	2,21	1,14
9.5. Cash discounts	206	1	4	2.53	0,97
9.6. Geographical price	177	1	4	1,86	0,95

6.5.3 Factors influencing pricing

The mean scores of factors influencing pricing in table 6.26 show that the three most important factors are pricing relative to cost (3,72), competition (3,33) and buyer behaviour (3,12). Economic climate has the lowest mean (2,59) and this shows that the majority of respondents considered it to be least important and important. There is a high degree of uniformity within the respondents in the factors influencing pricing except for economic climate with a standard deviation of 1,00 which reflects a fair spread in a scale of 1 to 4.

Table 6.26 – Factors influencing pricing

	Number	Minimum	Maximum	Mean	Standard Deviation
10.1. Costs	217	2	4	3,72	0,49
10.2. Competitors' prices	215	1	4	3,33	0,80
10.3. Buyer behaviour	214	1	4	3,12	0,76
10.4. Economic climate	209	1	4	2,59	1,00
10.5. Government legislation	205	1	4	2,75	0,98
10.6. Other (see Section 6.4.10)	14	1	4	2,36	1,08

6.5.4 Cost-based pricing methods

The mean scores of all cost-based pricing methods which are full-cost pricing (3,59), contribution pricing (3,04) and activity-based cost pricing (3,23) are very important. The standard deviations are small as there is a high degree of uniformity within the respondents (See table 6.27).

Table 6.27 - Cost-based pricing methods

	Number	Minimum	Maximum	Mean	Standard Deviation
11.1. Full-cost pricing	210	1	4	3,59	0,57
11.2. Contribution pricing	200	1	4	3,04	0,84
11.3. Activity-based cost pricing	205	1	4	3,23	0,83
11.4. Other (see Section 6.4.11)	9	1	3	2,33	1,00

6.5.5 Pricing strategies

The mean scores of pricing strategies in table 6.28 show that the most important strategy is penetration pricing (2,88). The standard deviations are small as there is high degree of uniformity within the respondents.

Table 6.28 – Pricing strategies

	Number	Minimum	Maximum	Mean	Standard Deviation
12.1. Skimming pricing	189	1	4	2,04	0,96
12.2. Penetration pricing	198	1	4	2,88	0,90
12.3.Both skimming and penetration pricing	121	1	4	2.73	0,94
12.4. Other (see Section 6.4.12)	17	1	4	2,82	1,01

6.5.6 Important factors of pricing to the business

The mean scores of factors that make pricing important in table 6.29 show that the four most important factors are relative to revenue, strategy, costs and demand. More specifically, the most important factors are highest revenue earner (3,53), contributes to the business strategy (3,27), recover its costs (3,62) and determination of demand (3,21). The standard deviations of important factors of pricing reflect a high degree of uniformity within the respondents (See table 6.29).

Table 6.29 – Importance of pricing

	Number	Minimum	Maximum	Mean	Standard Deviation
13.1. The highest revenue earner	218	1	4	3,53	0,67
13.2.Contributes to the strategy	218	1	4	3,27	0,62
13.3. Recovery of business costs	216	1	4	3,62	0,59
13.4. Tool to prevent competition	216	1	4	2,60	0,92
13.5. Competitive advantage	215	1	4	2,98	0,74
13.6. Product differentiation	215	1	4	2,45	0,97
13.7. Increase or decrease demand	216	1	4	3,21	0,89
13.8. Other (see Section 6.4.13)	10	1	4	3,10	1,20

6.5.7 Cost-based pricing

The mean values of recovery of costs (3,72),) the determination of profit or loss (3,72) and the determination of breakeven point (3,49) in table 6.30 shows that the majority of the respondents indicated that these factors are very important. The standard deviations show a high degree of uniformity within the respondents.

Table 6.30 – Cost-based pricing

	Number	Minimum	Maximum	Mean	Standard Deviation
14.1. Recovery of all costs	218	1	4	3,72	0,48
14.2.Determines break-even point	211	1	4	3,49	0,69
14.3.Determination of profit/loss	215	1	4	3,72	0,50
14.4.Ignores buyers' ability to pay	210	1	4	2,79	0,86
14.5. Ignores competition	215	1	4	2,99	0,85
14.6. Other (see Section 6.4.14)	9	1	4	2,67	1,00

6.5.8 Buyer-based pricing

The mean scores of buyer-based pricing in table 6.31 show that the four most important factors are relative determination of demand (3,41), cost implications (3, 15), customers' ability to pay (3,14) and customers' perception of value (3,11) and determination demand. The standard deviations are small as there is a high degree of uniformity within the respondents.

Table 6.31 – Buyer-based pricing

	Number	Minimum	Maximum	Mean	Standard Deviation
15.1. Determination of the customers' ability to pay	218	1	4	3,14	0,81
15.2. Determination of demand	217	1	4	3,41	0,70
15.3. Indication of customers' perception of value	216	1	4	3,11	0,75
15.4.Gives competitive advantage	216	1	4	2,94	0,75
15.5. Ignores the cost implications	211	1	4	3,15	0,93
15.6. Ignores competition	210	1	4	2,99	0,93
15.7. Other (see Section 6.4.15)	8	1	4	2,88	0,83

6.5.9 Competition-based pricing

The mean scores of competition-based pricing in table 6.32 show that the most important factor is cost implications (3,19). The standard deviations reflect a high degree of uniformity within the respondents.

Table 6.32 – Competition-based pricing

	Number	Minimum	Maximum	Mean	Standard Deviation
16.1.Makes pricing easier as there is ruling price	212	1	4	2,95	0,90
16.2. Helps to prevent price wars	212	1	4	2,72	0,84
16.3.Ignores buyers' ability to pay	207	1	4	2,82	0,83
16.4. Ignores the cost implications	207	1	4	3,19	0,86
16.5. Other (see Section 6.4.16)	8	1	4	2,50	1,07

6.6 Cronbach alpha

Sections 8 to 16 have several variables and the relationship among these variables has been tested. All sections in table 6.33, except pricing strategies, have a Cronbach alpha larger than 0,7 and they are, therefore, considered to be reliable. However, pricing strategies are considered to be significant and acceptable because their Cronbach alpha of 0,65 is greater than 0,5 (see paragraph 6.3 above).

Table 6.33 – Cronbach alpha

	Cronbach alpha
8. Pricing objectives	0,95
9. Pricing tactics	0,72
10. Factors influencing pricing	0,81
11. Cost-based pricing methods	0,84
12. Pricing strategies	0,65
13. The importance of pricing to the business	0,95
14. Cost-based pricing	0,83
15. Buyer-based pricing	0,91
16. Competition-based pricing	0,91

6.7 Means of the factors

The means of variables in each section, namely, sections 8 to 16, in tables 6.25 to 6.32, respectively, are added together to compile a factor representing the importance of each section according to the managers. These factors are then divided by the number of the variables in each section to indicate the importance of each section on the original 4-point Likert measuring scale. It is evident from table 6.34 that all the sections are regarded as important as all averages are above 2,5.

Table 6.34 – Means of factors

	Mean / Number of Questions
8. Pricing objectives	3,16
9. Pricing tactics	2,63
10. Factors influencing pricing	3,11
11. Cost-based pricing methods	3,29
12. Pricing strategies	2,57
13. The importance of pricing to the business	3,10
14. Cost-based pricing	3,34
15. Buyer-based pricing	3,12
16. Competition-based pricing	2,92

6.8 T-tests

According to Ellis and Steyn (2003:51), statistical significance tests have a tendency to yield small *p*-values, indicating significance, as the size of the data sets increases. The effect size is independent from the sample size and is a measure of practical significance. It may be understood as a large enough effect to be important in practice and is in this case defined as the standardised differences in means. The advantage of drawing a random sample is that it enables one to study the properties of a population with the time and money available. In such cases the statistical significance tests, for example t-tests, are used to show that the results, difference between two means, are significant. The *p*-value is a criterion of this, giving the probability that the obtained value, or more extreme, could be obtained under the assumption that the null hypothesis is true. The null hypothesis is where there is no difference between the population mean. The *p*-values smaller than 0,05 are considered to be statistically significant.

The T-test determines if there is a difference in the means of factors compiled from sections 8, 9, 10, 11, 12, 13, 14, 15 and 16 for some identifying variables, namely, size of the business in monetary terms (turnover), the person responsible for pricing, whether the business has a documented pricing policy and whether the market forces are allowed to determine prices. *P*-values are determined to establish if there is statistical significance in the difference between the averages of the sections. Those that are statistically significant may be tested further to find out if they are practically significant and this may be achieved by calculating the effect size $d = \frac{|\bar{x}_1 - \bar{x}_2|}{s_{\max}}$, where $|\bar{x}_1 - \bar{x}_2|$ is the difference between $\bar{x}_1$ and $\bar{x}_2$ without taking the sign into consideration and $s_{\max}$ = maximum of s_1 and s_2, the sample standard deviations. The guidelines to interpret effect sizes as small, medium and large, is approximately 0.2, 0.5, and 0.8, respectively. Large will mean that there is practical significance. The effect sizes are between 0.27 and 0.55 and they are, therefore, small and medium.

6.8.1 T-test according to Question 4 - Who is responsible for pricing in your organisation?

The *p*-value of factors influencing pricing (0,01) is statistically significant. The effect size (0,4), which is medium, reflects a substantial difference in the factors influencing pricing between owner-managers and managers. However, it is not practically significant because it is less than 0,8 (see table 6.36).

Table 6.35 - T-test for who is responsible for pricing

	Manager		Owner-manager			
	Mean	Standard Deviation	Mean	Standard Deviation	*P*-value	Effect Size
8. Pricing objectives	19,1	3,2	19,0	3,4	0,87	0,0
9. Pricing tactics	15,8	3,1	15,7	4,0	0,80	0,0
10. Factors influencing pricing	18,1	2,8	19,2	3,1	0,01	0,4
11. Cost-based pricing methods	13,2	2,3	13,3	2,3	0,71	0,1
12. Pricing strategies	10,1	2,6	10,3	2,9	0,53	0,1
13. The importance of pricing to the business	25,2	3,3	24,7	4,2	0,31	-0,1
14. Cost-based pricing	20,4	2,6	19,9	2,8	0,19	-0,2
15. Buyer-based pricing	22,3	3,5	21,9	3,8	0,41	-0,1
16. Competition-based pricing	14,8	2,7	14,5	3,4	0,48	-0,1

6.8.2 T-test according to Question 5 - Does your business have a documented pricing policy?

The *p*-values in table 6.37, except for cost-based pricing methods (0,06), are statistically significant. Their effect sizes are medium. However, they are not practically significant because they are less than 0,8.

Table 6.36 – T-test for documented pricing policy

	With documented pricing policy		Without documented pricing policy			
	Mean	Standard Deviation	Mean	Standard Deviation	*P*-value	Effect Size
8. Pricing objectives	19,9	2,5	18,4	3,6	<0,01	-0,4
9. Pricing tactics	16,4	3,6	15,2	3,7	0,02	-0,3
10. Factors influencing pricing	19,3	3,0	18,2	3,0	0,01	-0,4
11. Cost-based pricing methods	13,6	2,4	12,9	2,5	0,06	-0,3
12. Pricing strategies	10,9	2,6	9,9	2,8	0,01	-0,3
13. The importance of pricing to the business	26,0	3,1	24,1	4,1	<0,01	-0,5
14. Cost-based pricing	20,7	2,7	19,6	2,7	<0,01	-0,4
15. Buyer-based pricing	22,8	3,2	21,2	3,9	<0,01	-0,4
16. Competition-based pricing	15,6	2,7	13,8	3,2	<0,01	-0,6

6.8.3 T-test according to Question 6 - Do you allow market forces to determine prices?

The p-value of pricing objectives (0,03) is statistically significant. The effect size (0,3) is not practically significant because it is less than 0,8. The p-values of pricing tactics and factors influencing pricing, in table 6.38, reflect null hypothesis. However, the other p-values are statistically insignificant.

Table 6.37 – T-test for price determination by market forces

	Market forces allowed to determined prices		Market forces not allowed to determined prices			
	Mean	**Standard Deviation**	**Mean**	**Standard Deviation**	***P*-value**	**Effect Size**
8. Pricing objectives	19,5	2,5	18,5	3,9	0,03	-0,3
9. Pricing tactics	16,7	3,2	14,6	3,9	0,00	-0,5
10. Factors influencing pricing	19,4	2,6	17,8	3,2	0,00	-0,5
11. Cost-based pricing methods	13,0	2,3	13,3	2,6	0,51	0,1
12. Pricing strategies	10,3	2,4	10,2	3,1	0,79	0,0
13. The importance of pricing to the business	25,1	3,3	24,5	4,3	0,20	0,2
14. Cost-based pricing	20,0	2,7	20,0	2,9	0,93	0,0
15. Buyer-based pricing	22,0	3,5	21,6	4,01	0,48	-0,1
16. Competition-based pricing	4,6	3,2	14,5	3,0	0,87	0,0

6.9 Summary

After costs, which the study found to be the first factor to be taken into account by the majority of the enterprises, other points which emerged as significant in price setting included competition, customer awareness and specifically buyers' behaviour, economic climate and legislation. Interestingly, the study revealed that many SMEs did not appear to be using skimming strategy, but this is explained by the fact that they tended to avoid price wars. In some cases the managers considered factors like revenue, penetration strategy, competitive advantage and product differentiation as being of greater importance and relied more on non-price competition, emphasising some other aspects of their offering and commonly better quality. Appendix D reflects the supporting visual displays of results for tables 6.2 to 6.23.

There is now an indication of how SME managers are pricing products in their respective businesses. The frequencies, means, standard deviations, Cronbach coefficient alpha, means of the factors, t-tests' p-values and effect sizes have been analysed. This empirical study now affords one the opportunity to discuss and interpret the data. Discussion and interpretation are done in the next chapter.

CHAPTER 7

DISCUSSION AND INTERPRETATION

7.1 Introduction

The empirical research concentrated on pricing in the small and medium-sized enterprises. The purpose of the empirical study was to investigate, through the use of a questionnaire, the pricing methods used by SMEs. In this study qualitative research methods provided a useful and practical application of research methods for investigating complex, indistinct managerial decision-making in the context of SME managers carrying out pricing decisions. Qualitative methods provided a means of identifying the key components in a given research topic within the context of occurrence and provide the opportunity of exploring key issues further and increasing the depth and width of the research focus. They allowed for the changing and evolving nature of pricing decision-making and activity and helped explain the importance of pricing in the context of the SME environment. Respondents were in some instances allowed to explain pricing in their own way of understanding and since the price issue was of prime importance to these enterprises, most empirical data was gathered without prompting. Where prompting was necessary the language used by the interviewer was carefully constructed to avoid using business jargon or the language that the respondents may not understand and possible leading questions. The questions were designed to gather data about demographics and pricing practices and the findings are discussed and interpreted in this chapter. Where there are significant differences among medium-sized, small and very small businesses, the matters are discussed separately under the appropriate heading and in case of similarities they are discussed within the same sections.

7.2 Definition of small and medium-sized enterprises

A detailed analysis is reflected in table 6.3 on page 127. It shows a sector or sub-sector according to Standard Industrial Classification, size of class, total paid employees and total turnover. This is in line with the definition of the National Small Business Amendment Act No. 29 of 2004. This gives a clear indication of what is medium-sized, small or very small business from the South African perspective. Although this criterion is clear, it might be inconsistent with the criteria or definitions of other countries but the UK's definition is somehow in line with the one of South Africa as indicated by Bridge *et al.* (2003:182). It is, therefore, important to have a single, distinct and universally acceptable definition of SMEs. The number of employees may be the most suitable determination of the business sector. It is simple and easily determinable at any point in time. Turnovers are not static and may differ from year to year. The historical data may not necessarily give the current financial position of an enterprise.

Annual turnovers in SMEs differ drastically as reflected in table 6.3 on page 127 and some are very low. This gives small and very small businesses an opportunity to improve their turnovers through appropriate pricing and optimise their financial results.

7.3 Medium-sized enterprises

Medium-sized businesses account for 33% of the interviewed sample. The majority of businesses in this size of class are from construction and wholesale trade, commercial agents and allied services sectors. However, all businesses in the manufacturing sector are in this size of class. The majority of medium-sized businesses are private companies. The managers are responsible for pricing in most of these businesses. The majority has documented pricing policies and they allow market forces to determine prices. The largest part of these businesses derive more than 50% of revenue from pricing of core products, they found pricing to be sometimes easy and sometimes difficult and very few has different departments involved in pricing.

The pricing objectives are presented in table 6.8 on page 131, where it can be seen that all objectives are very important to the majority of medium-sized businesses. More specifically, the most important objectives to all managers are target return on investment, target markup on cost and matching competitors' prices. It can be seen from table 6.9 on page 132 that the two most important pricing tactics are those that are related to competition and quantity discounts. The other pricing tactics are just considered to be important. All the pricing factors are considered to be important and the most important factor is buyers' behaviour. With cost-based pricing methods, activity-based cost pricing is the most popular, despite the fact that full-cost and contribution pricing methods are also considered to be important. Penetration pricing is the most-liked pricing strategy. All pricing factors in table 6.13 on page 137 are considered to be important but the two most important factors are contribution to the strategy and determination of demand. In general, cost-based, buyer-based and competition-based pricing are very popular in medium-sized businesses. The pricing objectives, tactics, strategies and other factors which are pursued are fundamentally quantitative and qualitative in nature with emphasis given on cost-based and buyer-based pricing. On the other hand, it is noteworthy that the competition-based pricing is less important in these businesses.

It was revealed during the interview that the managers of medium-sized businesses approach pricing in, somehow, a systematic way. They basically understand different pricing factors and methods and some issues underlying pricing in their businesses. They showed a better understanding of the subject when compared to small and very small businesses managers. These businesses are not dominated by owner-managers and this may be a sign of managers being appointed by shareholders or owners based on their experience and qualifications. Their understanding of the subject may be attributed to this.

7.4 Small enterprises

Small businesses account for 28% of the respondents. They are dominating in agriculture and community, social and personal services sectors. Table 6.3 on page 127 has more information regarding size of class, number of businesses, percentages in respective sectors and the categories of paid employees and total turnover. However, finance and business services reflect 50% of these businesses. The majority of businesses in this size of class are close corporations. The owner-managers are responsible for pricing in 50% of small businesses whilst managers are responsible for pricing in 40% of these businesses. This shows that most of the managers are responsible for pricing. The majority has documented pricing policies and they allow market forces to determine prices. The largest part of small businesses derives more than 50% of revenue from pricing core products. They find it easy to price their products.

The pricing objectives are presented in table 6.8 on page 131 where it can be seen that the majority of small businesses consider all objectives to be important. This also applies to pricing tactics, pricing factors, cost-based pricing methods and pricing importance which are considered to be important by most managers. Penetration pricing is the most popular in the pricing strategies. In general, cost-based, buyer-based and competition-based pricing are very popular in small businesses. The pricing objectives, tactics, strategies and other factors which are pursued are fundamentally quantitative and qualitative in nature with emphasis given on cost-based, buyer-based and competition-based pricing.

7.5 Very small enterprises

Very small businesses account for 39% of the sample. The majority of businesses in this size of class are electricity, gas and water, retail and motor trade and repair services, catering, accommodation and other trade and transport sectors. Finance and business services reflect 50% of these businesses. The majority of very small businesses are sole-proprietorships. The owner-managers are responsible for pricing in the larger part of these businesses. Managers of very small businesses indicated that they do not have documented pricing policies and their prices are not determined by market forces. They derive more than 50% of revenue from pricing. The majority of managers in this size of class find pricing to be easy because they use their experience and just add markup.

The absence of documented pricing policies may give an impression that prices in very small businesses are often based on hunches and that the managers' intuition and experienced judgement may be the dominant factor in pricing. This may also cause a threat in business continuity insofar as the pricing is concerned. The new manager may either have to reinvent the wheel or deviate completely from the previous pricing policy, which might have been successful.

The pricing objectives are presented in table 6.8 on page 131 where it can be seen that most of very small business managers regard all objectives, except price stability as important. More specifically, the most important objectives to managers are target return on investment and target markup on cost. It can be seen from table 6.9 on page 132 that the only important pricing tactics are those that are related to competition and uniform price to buyers. The pricing factors that are considered to be important are cost, competition and buyers' behaviour and the most popular is cost. All cost-based pricing methods are considered to be important. Penetration pricing is the most-liked pricing strategy. The pricing factors in table 6.13 on page 137 that are considered to be important include pricing as the highest revenue earner, contribution to the strategy, recovery of business costs, competitive advantage and determination of demand but the two most important factors are pricing as the highest revenue earner and recovery of business costs. In general, cost-based, buyer-based and competition-based pricing are very popular in very small businesses. The pricing objectives, tactics, strategies and other factors which are pursued are fundamentally quantitative rather than qualitative in nature with a particular emphasis given on costs. The pricing method which is adopted by the majority of the companies refers to the traditional cost-plus method.

7.6 Pricing responsibility

The overwhelming majority indicated that the management is responsible for pricing in their respective businesses. This in line with what is cited by Jain (2001:323) management should decide the strategic significance of pricing in the marketing mix. Horngren *et al.* (2003:422) also alluded to the fact that pricing decisions are management decisions about what to charge for the products. This does not suggest that managers should make pricing decisions without consultation. SME managers should engage other stakeholders in determining prices. Suppliers may have their recommended prices but this should not override the managers' decisions which may take into account some hidden cost that the wholesalers may not be aware of. Independent consultants may also need the managers' input because they may understand the business and the market environment better. The manager should be able to say what his product is worth and communicate its value to the potential customers, even in a competitive environment. The managers should be capable of blending cost with value to attract more customers.

7.7 Determination of prices by market forces

Although the majority of managers of medium-sized and small businesses indicated that they allow demand and supply to determine prices in their businesses it is difficult to justify or apply this in practice. The economic pricing theory concept may ignore other pricing objectives, especially qualitative ones, as it is based on a profit maximisation objective. The value of the product, which is important to the buyers, may be cited as an example. Managers may find themselves in the situation where they find it difficult to estimate demand at various price levels. They may comprehend the supply side of the pricing equation through cost structures but not the demand. The practical limitations inherent in price theory have forced businesses to turn to other techniques or pricing approaches which may help the companies to achieve their respective pricing objectives and the overall business objectives.

7.8 Different views in product pricing

The following response was common among many managers who were interviewed and asked to give reasons that make pricing easy or difficult: "*We just add markup to the cost price to make the required profit.*" The major concern with competition was the hawkers who sell their products in their doorsteps. "*They may afford to sell at lower prices because they do not have overhead costs. They do not pay rent, electricity and other costs*" that are paid by formal sector businesses. This is a confirmation that cost-based pricing is a simplistic traditional pricing method as one just add markup to the cost. It is very important to ensure that all the costs are included before adding a markup. A percentage may be deceiving if the manager is only adding it to the price of the supplier and not taking other hidden costs into account. A number of hawkers in areas like Johannesburg are obviously affecting the formal businesses and their prices and this pose a serious challenge, especially in pricing decisions.

7.9 Statistical facts

The mean values in tables 6.24 to 6.32 on pages 147 to 151 show that the majority of respondents indicate that the variables in different categories of pricing are either important or very important except for geographical pricing (1,86) and skimming pricing (2,04) in tables 6.25 in page 148 and 6.28 in page 149, respectively. The standard deviations are relatively small and the degree of uniformity within the respondents is, therefore, high. An examination of the correlation matrix of the variables in table 6.33 on page 152 revealed that the variables in their respective categories are interrelated. The reliability for pricing variables measured by Cronbach alpha is, therefore, considered as satisfactory. The means of factors in table 6.34 on page 152 show that all the sections are regarded as important as all averages are above 2,5. The t-tests or the standardised differences in means show that the difference between means, are insignificant. The *p*-values reflect the null hypothesis, statistical significance and statistical insignificance in the differences between the means of sections 8 to 16 on pages 154 and 155. Those that are statistically significant were tested further and they were found to be practically insignificant because their effect sizes are below 0.8. These suggest that the results reported here are not due to chance.

The mean scores of pricing variables are presented in table 6.24 on page 147, where it can be seen that the two most important objectives which are target markup on cost (3,34) and target return on investment (3,25) are related to cost and profit. This may be attributed to the reason associated with optimising financial results in reality. The two most important tactics are pricing relative to competition (3,28) and charging uniform price to all buyers (3,03%) (See table 6.25 on page 148). The mean scores of factors influencing pricing in table 6.26 on page 148 show that the three most important factors are relative to cost (3,72), competition (3,33) and buyer behaviour (3,12). This may be attributed to the importance that they attach in ensuring that they sell their products, recover costs and make profit. The mean scores of cost-based pricing methods in table 6.27 on page 149 show that all three methods, full-cost pricing (3,59), contribution pricing (3,04) and activity-based cost pricing (3,23) are very important and they are all relative to cost. This may be attributed to the importance that they attach in ensuring the recovery of costs and making profit. The mean scores of pricing strategies in table 6.28 on page 149 show that the most important strategy is penetration pricing (2,88). This may be attributed to the importance that they attach in ensuring that they improve the market share. The mean scores of factors that make pricing important in table 6.29 on page 150 show that the four most important factors are relative to revenue, strategy, costs and demand. More specifically, the most important factors are highest revenue earner (3,53), contributes to the business strategy (3,27), recover its costs (3,62) and determination of demand (3,21).

7.9.1 Pricing objectives

The *p*-value of pricing objectives in relation to who is responsible for pricing in the organisation (0,87) in tables 6.35 on page 154 are considered to be statistically insignificant. However, the *p*-values relating to documented pricing policy (<0,01) and allowing market forces to determine prices (0,03) in tables 6.36 on page 154 and 6.37 on page 155, respectively, are statistically significant but the effect sizes, -0,4 and -0,3, reflect that they are not practically significant.

7.9.2 Pricing tactics

The *p*-value of pricing tactics in relation to who is responsible for pricing in the organisation (0,80) in tables 6.35 on page 154 is considered to be statistically insignificant. However, the *p*-value relating to documented pricing policy (0,02) in tables 6.36 on page 154 is statistically significant but the effect size (-0,3) is not practically significant. The *p*-value related to allowing market forces to determine prices (0,00) in table 6.37 on page 155 reflects null hypothesis and the effect size (-0,5) is practically insignificant.

7.9.3 Factors influencing pricing

The *p*-values relating to who is responsible for pricing in the organisation (0,01) and documented pricing policy (0,01) in tables 6.35 on page 154 and 6.36 on page 154, respectively, are statistically significant but the effect sizes, 0,4 and -0,4, show that they are not practically significant. The *p*-value of allowing market forces to determine prices (0,00) in table 6.37 on page 155 reflects null hypothesis and the effect size (-0,5) is practically insignificant.

7.9.4 Cost-based pricing methods

The *p*-values of cost-based pricing methods in relation to who is responsible for pricing in the organisation (0,71), documented pricing policy (0,06) and allowing market forces to determine prices (0,51) in tables 6.35 on page 154, 6.36 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant.

7.9.5 Pricing strategies

The *p*-values of pricing strategies in relation to who is responsible for pricing in the organisation (0,53) and allowing market forces to determine prices (0,79) in tables 6.35 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant. However, the *p*-value relating to documented pricing policy (0,01) in table and 6.36 on page 154 are statistically significant but the effect sizes, -0,4 and -0,3, show that they are practically insignificant.

7.9.6 Importance of pricing

The *p*-values of importance of pricing in relation to who is responsible for pricing in the organisation (0,31) and allowing market forces to determine prices (0,20) in tables 6.35 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant. However, the *p*-value relating to documented pricing policy (<0,01) in table 6.36 on page 154 is statistically significant but the effect size (-0,5) shows that it is not practically significant.

7.9.7 Cost-based pricing

The p-values of cost-based pricing in relation to who is responsible for pricing in the organisation (0,19) and allowing market forces to determine prices (0,93) in tables 6.35 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant. However, the p-value relating to documented pricing policy (<0,01) in table 6.36 on page 154 is statistically significant but the effect size (-0,4) shows that it is not practically significant.

7.9.8 Buyer-based pricing

The p-values of buyer-based pricing in relation who is responsible for pricing in the organisation (0,41) and allowing market forces to determine prices (0,48) in tables 6.35 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant. However, the p-value relating to documented pricing policy (<0,01) in table 6.36 is statistically significant but the effect size (-0,4) shows that it is not practically significant.

7.9.9 Competition-based pricing

The p-values of competition-based pricing in relation who is responsible for pricing in the organisation (0,48) and allowing market forces to determine prices (0,87) in tables 6.35 on page 154 and 6.37 on page 155, respectively, are considered to be statistically insignificant. However, the p-value relating to documented pricing policy (<0,01) in table 6.36 page 154 is statistically significant but the effect size (-0,6) shows that it is not practically significant.

7.10 Pricing approaches

The frequency distribution for pricing methods are presented in tables 6.14, 6.15 and 6.16 on pages 139, 141 and 142, respectively, where it can be seen that the most popular pricing method is cost-based pricing followed by buyer-based pricing and then competition-based pricing and their mean scores are 3,34, 3,12 and 2,92, respectively. The emphasis given to the pricing methods is not surprising given the fact that cost, buyer behaviour and competition are found to be the most popular pricing factors in all classes of SMEs. These findings may be attributed to the fact that the companies in the sample may believe that there is no single pricing method that may, simultaneously, cover their costs, levy competitive prices and thus satisfy the existing customers' needs and attract new customers. The managers appear to be using more than one pricing method maybe due to the complexity of pricing decisions.

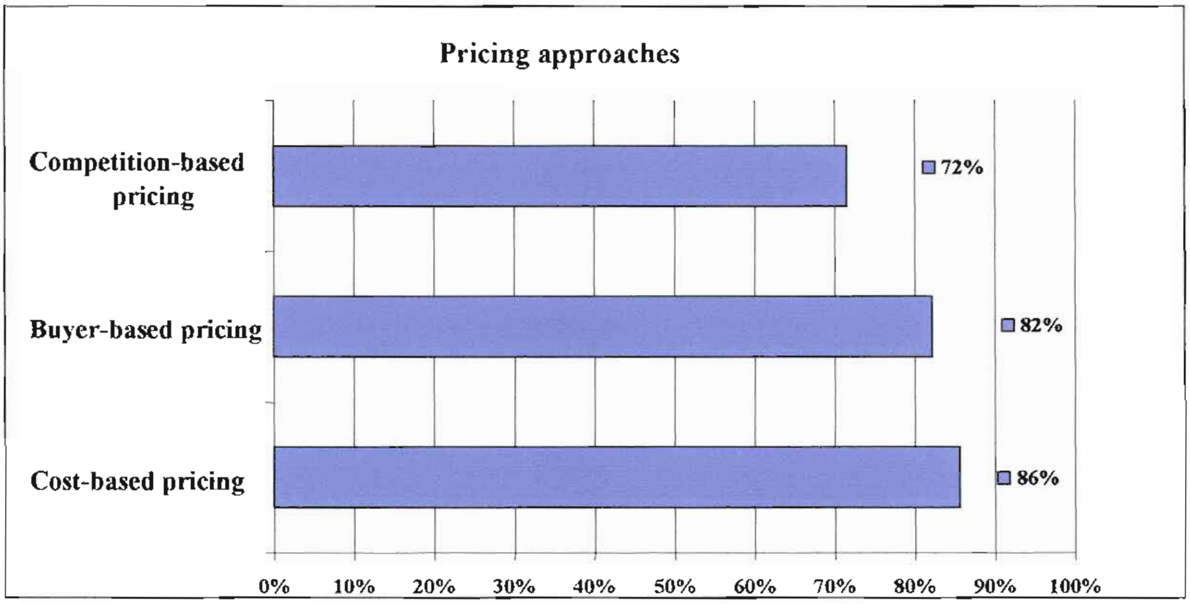
Table 7.1 and figure 7.1 show the average percentages of top boxes in tables 6.14 on page 139, 6.15 on page 141 and 6.16 on page 142 reflected as sections 14, 15 and 16, respectively. It is evident that the variables under cost-based pricing (average 86%) were considered to be more important than buyer-based pricing (82%) and competition-based pricing (72%) by the majority of SME managers. It is imperative that an enterprise makes profit and this may only be the case if costs are known and considered when pricing products. Competition should also be considered to avoid pricing products out of the market. Notwithstanding, the appropriate pricing method may be effective if the business blend cost and value to elicit the required demand, generate the required revenue and maximise profit.

Table 7.1 – Pricing approaches

	1	2	3	4	5	6	7	Average
14. Cost-based pricing	98%	93%	98%	71%	76%	78%		86%
15. Buyer-based pricing	81%	92%	80%	82%	80%	73%	88%	82%
16.Competition-based pricing	72%	69%	69%	85%	63%			72%

Source: Own work

Figure 7.1 – Pricing approaches

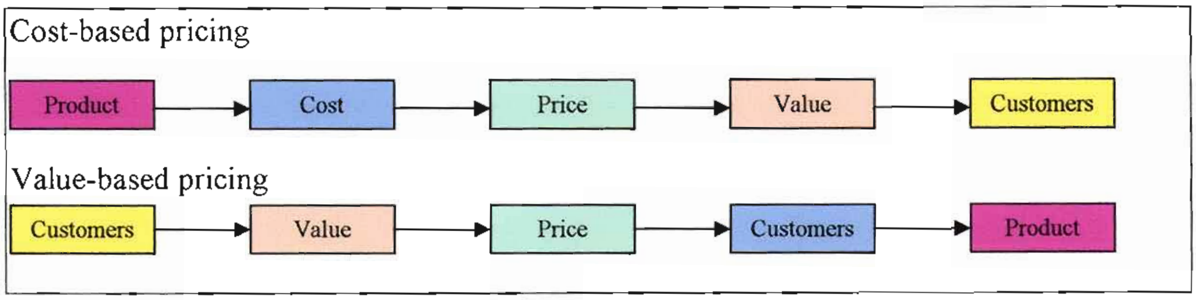


Source: Own work

7.11 Cost-based pricing versus value-based pricing

The buyer-based pricing (82%) came second, after cost-based pricing (86%) in terms of importance (see table 7.1 and figure 7.1). This shows that, although cost-based pricing remains the most popular, buyer-based pricing appears to be also popular as the percentages are closer. It is, therefore, found necessary to discuss them further and reflect their processes as indicated in figure 7.2 below. Cost-based pricing method focuses more on cost, revenue and profit. The buyer-based encompasses both value pricing and perceived-value pricing. Value-based pricing focuses on how much value one's product or service provides to the customer, rather than how much it costs to make the product or how much profit may be made from the product. It is driven by customer value evaluation rather than competitors' actual or expected pricing practices, and also by measurable value provided to customers and not by customers' expressed willingness to pay. It is interesting to note that the managers have their customers in mind when pricing their products.

Figure 7.2 – Cost-based pricing versus value-based pricing



Source: Nagle and Holden (2002:4).

None of the pricing approaches, discussed above, fulfils simultaneously the considerations of demand and supply, profit, unique product characteristics and cost structure. This does not mean that the above pricing approaches are not useful. Rather, it reflects the complexity of pricing in the real business world. In fact, pricing is one of the most critical pressures of SME managers. Although it may be too much to expect a single pricing approach to include all the pricing considerations, there exists a need for a better pricing approach. Two observations can be made from the pricing approaches reviewed in previous sections. First, a complete pricing model is likely to be complicated because more pricing variables have to be included. Second, instead of using one single pricing approach, a better way may be the use of a group of pricing approaches to set product prices.

7.12 Integrated pricing

Table 7.2 shows the average percentages of the top boxes from tables 6.8 to 6.16 and how these averages are determined. The top boxes as indicated in Chapter 6, represents the combination of the percentages of important (3) and very important (4) columns. The average column of table 7.2 shows the contribution made by each size of class together with the total average percentages per section. The contribution of medium-sized and small businesses are pretty even whilst that of very small is the lowest in all categories, except for competition-based pricing where the contribution is better that the one of medium-sized businesses.

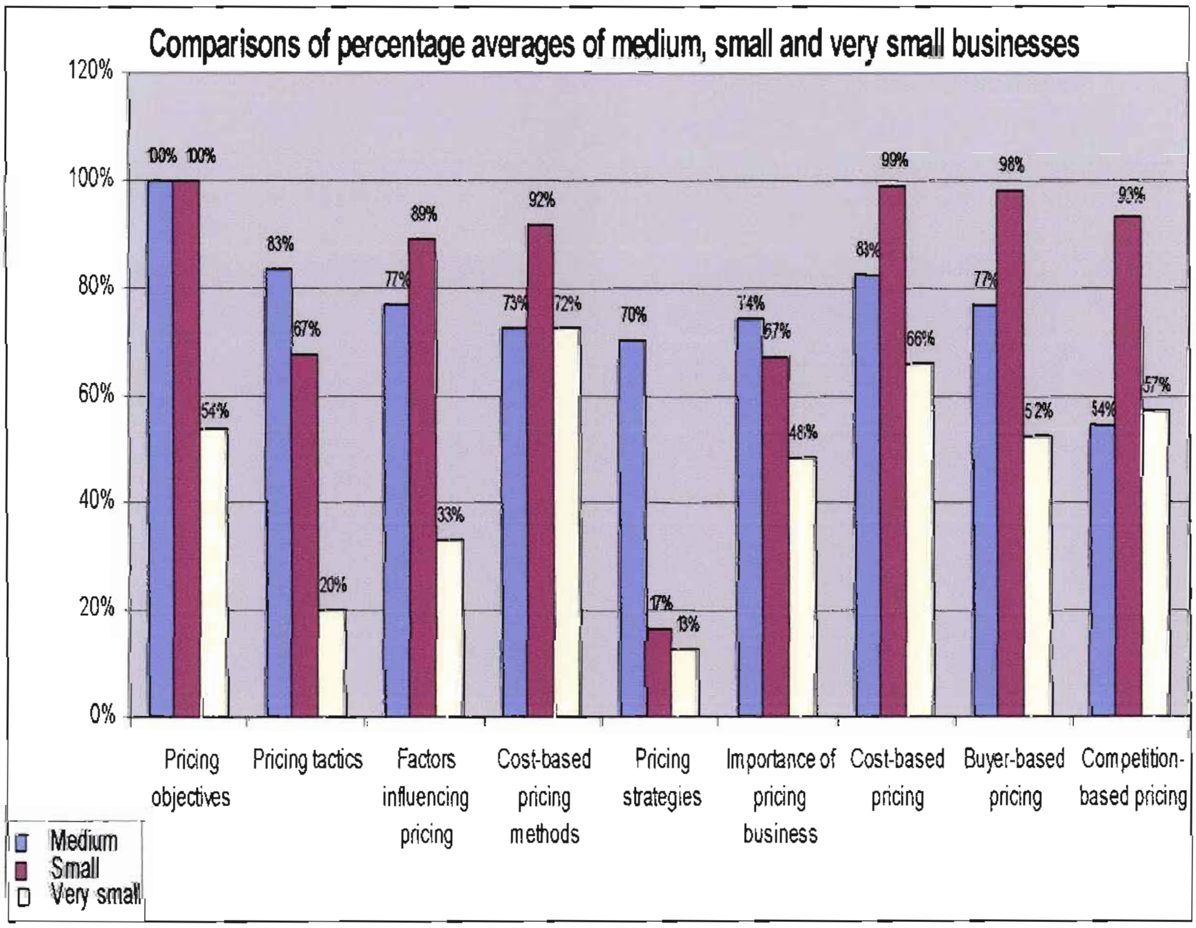
Table 7.2 – Integrated pricing

	1	2	3	4	5	6	7	8	Average
8.Pricing objectives	**91%**	**91%**	**77%**	**82%**	**81%**	**75%**			**83%**
Medium	34%	34%	34%	35%	33%	33%			34%
Small	27%	27%	28%	28%	29%	33%			29%
Very small	30%	29%	15%	19%	19%	8%			20%
9.Pricing tactics	**88%**	**82%**	**61%**	**44%**	**55%**	**27%**			**59%**
Medium	33%	33%	34%	34%	34%	27%			33%
Small	28%	28%	28%	10%	21%	0%			19%
Very small	27%	20%	0%	0%	0%	0%			8%
10.Factors influencing pricing	**98%**	**87%**	**83%**	**57%**	**65%**	**64%**			**76%**
Medium	31%	25%	33%	34%	35%	0%			26%
Small	29%	26%	29%	15%	29%	29%			26%
Very small	39%	36%	21%	8%	1%	36%			23%
11.Cost-based pricing methods	**97%**	**82%**	**87%**	**67%**					**83%**
Medium	30%	36%	35%	0%					25%
Small	28%	28%	28%	67%					38%
Very small	38%	19%	25%	0%					20%
12.Pricing strategies	**33%**	**71%**	**59%**	**76%**					**60%**
Medium	32%	34%	59%	0%					31%
Small	1%	19%	0%	76%					24%
Very small	0%	18%	0%	0%					4%
13.Importance of pricing business	**93%**	**92%**	**97%**	**54%**	**82%**	**53%**	**82%**	**80%**	**79%**
Medium	26%	33%	30%	30%	33%	33%	33%	0%	27%
Small	28%	28%	28%	10%	28%	20%	29%	80%	31%
Very small	39%	31%	39%	13%	20%	0%	20%	0%	20%
14.Cost-based pricing	**99%**	**92%**	**99%**	**71%**	**77%**	**78%**			**86%**
Medium	31%	34%	32%	34%	33%	0%			27%
Small	28%	28%	28%	28%	28%	56%			33%
Very small	39%	30%	39%	10%	15%	22%			26%
15.Buyer-based pricing	**82%**	**93%**	**81%**	**82%**	**79%**	**73%**	**88%**		**82%**
Medium	33%	33%	33%	33%	13%	34%	0%		25%
Small	28%	29%	29%	29%	28%	28%	88%		37%
Very small	21%	31%	19%	20%	38%	11%	0%		20%
16.Competition-based pricing	**73%**	**68%**	**69%**	**84%**	**63%**				**71%**
Medium	6%	33%	34%	18%	0%				18%
Small	28%	28%	28%	28%	50%				32%
Very small	39%	7%	7%	38%	13%				20%

Source: Own work.

Figure 7.3 highlights the average percentages in a graphic representation and make the comparison among the three classes of size in terms of the importance of different categories. Medium-sized businesses consider all categories to be important. The percentages below 50% show that the majority in a class of business did not consider the category to be important. This is the case with pricing strategies in small businesses and pricing tactics, factors influencing price, pricing strategies and the importance of pricing in very small businesses. Pricing objectives, followed by cost-based pricing are regarded as the most important by medium-sized and small businesses. The most important category for very small businesses is cost-based pricing methods. The managers of these businesses tend to concentrate more on tangible matter than the intangibles. Another observation is that there is a fair amount of consistency and some kind of relationship between medium-sized and small businesses in answering the questions but with very small businesses there is a serious fluctuation. This may be attributed to the fact that medium-sized and small businesses show some maturity and consider almost all pricing factors to be important whilst very small businesses focus more on measurable factors.

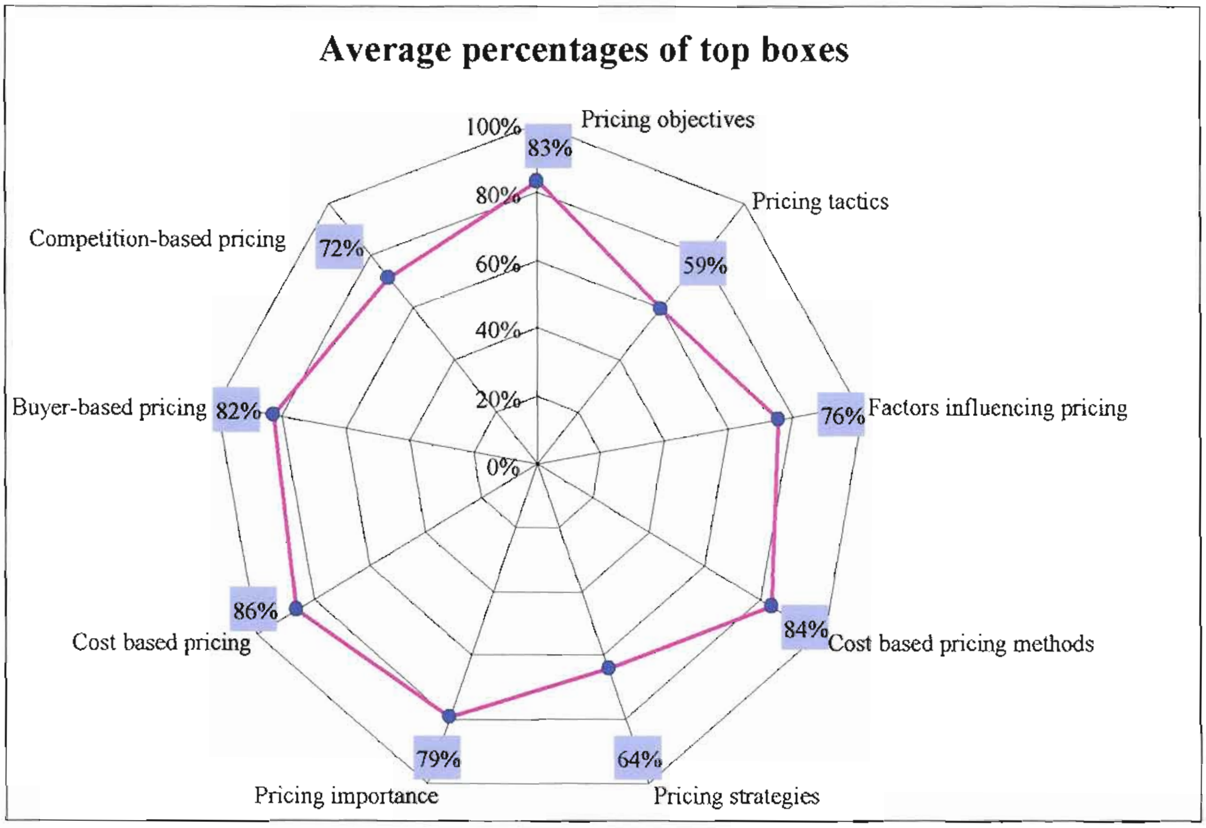
Figure 7.3 – Comparisons of percentage averages



Source: Own work.

Figure 7.4, which is a summary of table 7.3, provide an opportunity to look at a possible integrated approach to pricing. The blank spaces in table 7.2 are as a result of questions having different numbers of options. For example, pricing objectives has six options only. Hence the blank spaces in columns 7 and 8. There is no doubt that, when pricing a product one needs to take all pricing factors into account. This is also supported by the average percentages in figure 7.4 that reflect how important they are to SME managers when pricing their products. The lowest average percentage is 54% and this shows how the majority of managers value these pricing factors. Pricing model that encompasses all the factors necessary for pricing could be ideal for SMEs.

Figure 7.4 – Integrated pricing



Source: Own work.

The proposed integrated pricing approach provides useful guidelines for product pricing. Compared with the other product pricing approaches, the proposed pricing approach considers simultaneously the crucial aspects of pricing which may include:

- Pricing objectives

- Pricing tactics and client-oriented profit maximisation
- Factors influencing pricing and product characteristics
- Pricing strategies
- Pricing importance and revenue maximisation
- Cost-based pricing and internal cost-profit structure
- Buyer-based pricing and client-oriented price/demand sensitivity
- Competition-based pricing and market competitiveness

One potential caveat of the suggested approach is its complexity, which basically contains three different singular pricing approaches which are cost-based, buyer-based and competition-based pricing. However, this result is just a reflection of pricing reality. Another feature of the proposed pricing approach is its logical way to deal with pricing complexity. In fact, the complexity of the synthetic approach is no more complex than the single differentiation premium approach. The price sensitivity of a specific client can be found from historical data or through trial and error. Thus, once the solutions of the complexity of the premium approach are developed, then, the complexity of the multi-step synthetic pricing approach will eventually decrease.

7.13 Summary

The findings indicate that the enterprises in our sample tend to regard the quantitative objectives as being more significant than the qualitative ones, especially in the very small businesses. This may be associated with the importance that they attach in ensuring that the profit is maximised. An excessive emphasis on quantitative objectives may risk the long-term position of an enterprise in the market as indicated by Avlonitis and Indounas (2004:344). Furthermore, the mean values indicate that SMEs seem to pursue more than one of the pricing objectives, tactics, factors, strategies and approaches perhaps due to the complexity that characterises pricing decisions. It should be borne in mind that although the mean scores of the quantitative nature outweigh the qualitative ones, medium-sized and small businesses balanced the two well but very small businesses overemphasised tangible factors.

The study confirms that the pricing factor analysed are associated with the pricing methods. The SMEs' pricing decisions are dominated by the two factors of covering costs and value perception across the size of class. Although competition is often mentioned, it is not emphasised as cost and customer demand or perception of value. It could be argued that, because these enterprises are relatively small and do not have significant resources, perhaps they should be dominated by competition-based pricing as opposed to buyer-based pricing. However, this is not the case. Customer demand or perception of value appears to be taking priority, despite the fact that competition and its effects on pricing also receive a great deal of attention from SME managers. It may be concluded that cost should be blended with the value perceived in the price. It should be noted that the cost issue is undoubtedly, more complex than simply covering costs. SMEs have considerable cost commitments in plant and hardware and in the ongoing well-being of the business. Since they inevitably have limited financial resources, particularly if the business is growing with the inevitable time-lag of income to costs, there may be in constant and considerable pressures of cash flow. Notwithstanding all these, the most important thing is to adopt an integrated pricing method.

CHAPTER 8

CONCLUSIONS AND RECOMMENDATIONS

8.1. Introduction

The purpose of the study is to investigate the different pricing methods used by small and medium-sized businesses. The study is also intended to give entrepreneurs an opportunity to appreciate the role and importance of price and pricing in their businesses, and in turn give pricing the deserved attention by improving the approach to pricing, based on the recommendations. Literature and empirical studies were undertaken. The literature gave the background of pricing across the business spectrum and some were specific to the SME sector. The views of SME managers were also sought through the questionnaire. The empirical study now affords the researcher an opportunity to reflect on the findings and draw conclusions on what the respondents have alluded to, and where necessary come up with recommendations.

8.2 Conclusions

The definition of SMEs from South African perspective is very clear although the turnover and the balance sheet figures may be based more on historical data. The study shows that the formal sector of SMEs is dominated by medium-sized, small and very small businesses seeing that no micro business was found in the sample. There is no significant difference in terms of the number of businesses among the size of class. Retail and motor trade and repair services were without a doubt the most common respondents according to SIC, followed by wholesale trade, commercial agents and allied services. The forms of business dominating medium-sized, small and very small businesses are private companies, close corporations and sole-proprietorships, respectively. Managers are responsible for pricing as expected and in all cases they are the respondents to the questionnaire. This inspires confidence on the validity of data for every business in the interviewed sample.

Very small businesses do not have documented pricing policies and they also do not allow market forces to determine prices. However, pricing objectives, tactics, strategies, factors influencing pricing, cost-based pricing, buyer-based pricing and competition-based pricing are important to all classes of SMEs. They also consider pricing to be crucial, critical and complex based on the reasons stated in table 6.23.

The findings of the study indicate that the companies in our sample have understood the significance of taking into consideration those factors associated with costs, buyers and competition to make effective pricing decisions. Price is often the primary concern of many SMEs. It is a pervasive feature, penetrating other areas of the business. From the summary of the literature allied to the empirical evidence from this study, a number of key areas were identified regarding price and its application and importance in an SME context. The overriding perception derived from the findings in this study is that most of the decisions are not taken in an isolated or discrete circumstance. Pricing decision-making is an all-encompassing way of doing business. There is no doubt that successful pricing can only be achieved when a multiplicity of factors are considered and managed and different pricing methods are applied. The conclusion that can be made is that the managers are aware of different pricing methods and they mostly prefer cost-based pricing, followed by buyer-based pricing and then competition-based pricing.

It was observed during the interviews that the managers, especially those of medium-sized and some of the small businesses, behave precisely in well thought-out fashion. This is not necessarily the case with very small businesses managers who sometimes do not appear to manage their businesses in a textbook or functional way. They are more likely to take pricing decisions in a haphazard and apparently chaotic way as opposed to any orderly, sequential and structured fashion. They may dictate the pricing approaches employed by their businesses and in some cases price setting may be based on their gut feeling. This kind of pricing practice may lead to less than optimal financial results.

Prices are the key to revenue in SMEs. They are responsible for the survival, sustainability and growth of these businesses. It has been noted that cost is one of the factors that managers accentuate, irrespective of the size of class. The simplistic nature of cost-oriented pricing may not be effective in a complex and competitive business world. Despite the dangers of only using costs as a basis for price, costs should set the lower limit for price. Appropriate pricing, based on the value of the product is very important even in a very competitive environment. Although it may be wise to accept competitive prices as the starting point for any development of a marketing strategy, this does assume, however, and possibly wrongly so, that competitors have got their sums right. This may have impact on profit margins as the costs may be different. Although managers should not compromise the product's worth by matching competition, they need to guard against overemphasising costs. There is potential to use an integrated pricing method in these businesses.

Many SMEs do not appear to be exhibiting a flexible approach to pricing by charging different customers different prices for the same products, maybe according to their geographical location. They tend to charge one price for all customers. They also have the ability to alter their prices quicker than large businesses should situation arise. There is potential to use an integrated pricing method because they take factors like cost, demand and competition into account.

Although the present study may represent the first attempt to examine empirically the pricing methods in the SME sector, the reader should treat its findings with caution. More specifically, the context of the study, South Africa, is an obvious limitation since it limits the ability to generalise the results in other countries. Thus, future research that replicates the current study in other countries could further improve understanding of the concepts presented in the study.

8.3 Recommendations

The recommendations done may sometimes be relevant to a particular size of class, but because some few businesses from other classes also lacked in those areas it was found necessary to make general recommendations. This is also bearing in mind that different organisations, irrespective of size of class, may benefit from this study.

8.3.1 Recommendation 1 – Value pricing

An important consideration for all classes of SMEs is to offer value for money. Typically, this takes two forms. One is offering a product of good quality at a lower price. Another method is to provide value for money by charging a high price, but incorporating some aspect of added value to warrant having a higher price and to induce people to buy the product.

8.3.2 Recommendation 2 – Perceived value pricing

Managers should focus more on understanding customers' value drivers in order to price effectively. They should always have their customers in mind and should endeavour to adapt the cost to their customers' needs. It is the perceived value that may attract customers to the store to buy the products.

8.3.3 Recommendation 3 – Competitive pricing

SME managers should price products according to the value the product brings to its user. To determine the monetary value of a product, SME managers need to introduce the concept of customer reference product. Customer reference product is the second best alternative to the product to be priced. In principle, the maximum price that could be set is the price that makes the customer ignores the monetary difference between the new product and the reference product.

8.3.4 Recommendation 4 – Value pricing and cost justification

SME managers should communicate the value of the product to customers rather than emphasising or justifying costs which may give a wrong perception.

8.3.5 Recommendation 5 – Matching competitors' prices

Managers should build customer patronage by highlighting the enterprise's total offering rather than strictly on price appeal. They should match the prices charged by nearby competitors on identical items unless the enterprise's customers perceive a difference in the quality and quantity of extras provided.

8.3.6 Recommendation 6 – Price bundling

The deliberate decision of companies to set their prices higher than the competition should be supplemented by offering some kind of added value. This takes a number of forms, for example, through offering superior customer service, a better quality product, improved delivery or more features.

8.3.7 Recommendation 7 – Product differentiation and pricing

The business should in some way try to differentiate its product, or more precisely, its total offering. This concept of offering a unique package in return for a relatively higher price may attract much support. The better the enterprise can differentiate its product from those of its competitors, the more justification for commanding a higher price.

8.3.8 Recommendation 8 – Coherent pricing strategy

A manager should develop a coherent pricing strategy in order to make effective pricing decisions. This approach should address many factors that reflect the fundamental and significance of pricing. Managers may gain a lot by placing more emphasis on such a tactic and implement relevant pricing methods.

8.3.9 Recommendation 9 – Integrated pricing approach

Managers should strive to move away from simplistic cost-plus pricing, which disregards market conditions, and they should take into account all the necessary steps in their pricing process. A customer orientation should be integrated within a more general market orientation approach where the pricing practices of competitors are also taken into consideration, including cost. Setting a price above the market average is justified only when a higher quality service is offered. Moreover, managers have much to gain from adopting an integrated pricing approach. This may help the company to reflect more accurately the pricing requirements of its market characteristics and conditions.

8.3.10 Recommendation 10 – Incorporating technical skills

Managers should involve people with necessary technical skills, like costing and accounting, should be involved to successfully determine prices. These skills may complement the experience and knowledge of the managers.

8.3.11 Recommendation 11 – Documentation of pricing policies

Managers, especially those of very small businesses, should ensure continuity, in case of retirement or death, by documenting the pricing policy. This may reflect some degree of professionalism. The pricing policy should specify what should be done and what should not be done taking into account the legislations related to pricing.

8.3.12 Recommendation 12 – Contribution to pricing research

SME managers should co-operate with researchers and even sponsor projects that may help to research pricing in the business sector, further. They need the information to learn more about how pricing may determine success or failure in their businesses. The government and business schools should also be requested to assist in undertaking research projects.

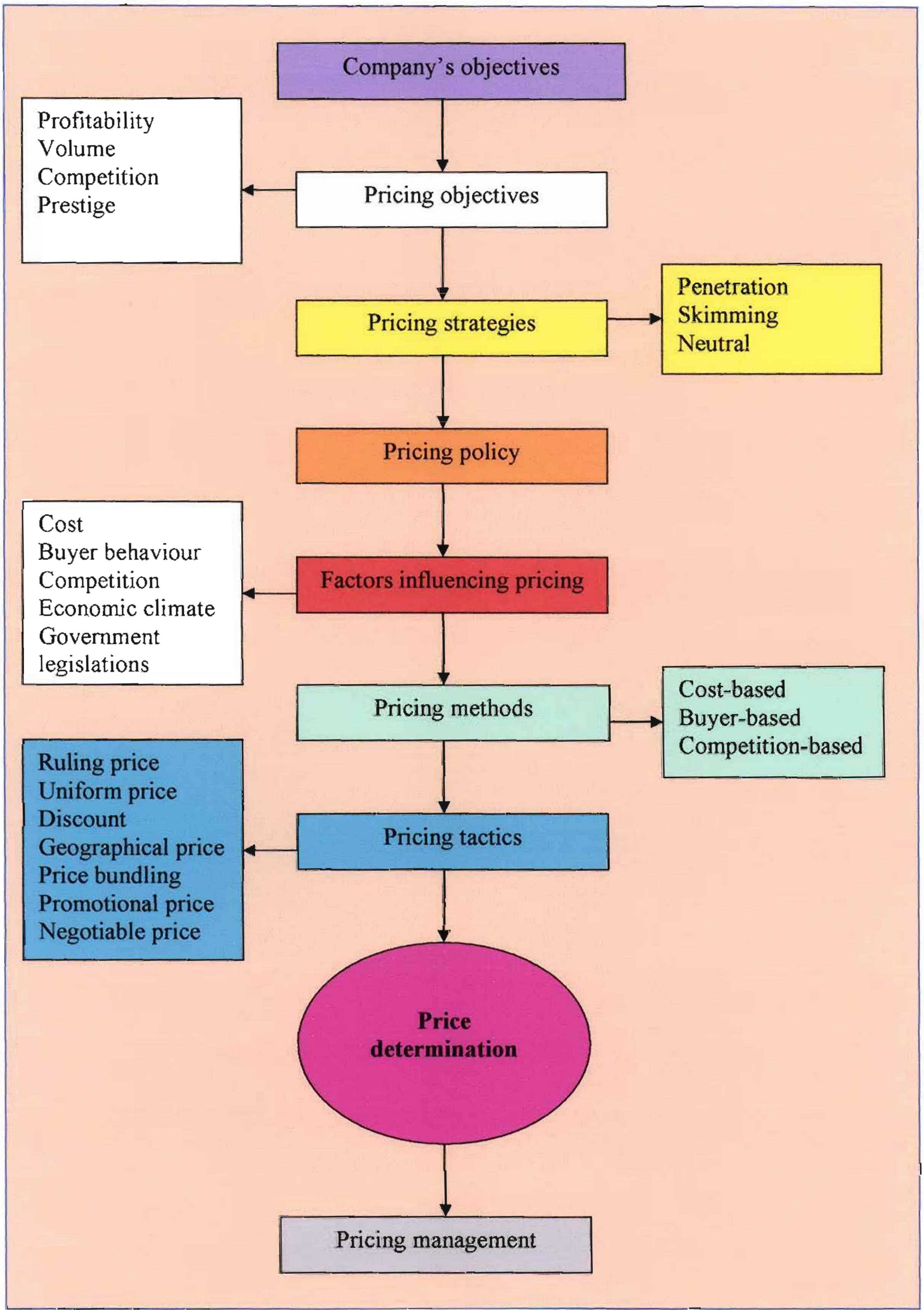
8.3.13 Recommendation 13 – Education on pricing approach

Educators should recognise and offer a course on an integrated pricing approach. This should be supported by further empirical studies to explore the concept further.

8.3.14 Recommendation 14 – Researcher's proposed model

The researcher has developed the model in Figure 8.1 below, called the integrated pricing model, which is recommended for all SME managers. The development of this model is based on the integration of the factors that need to be considered when pricing products. The pricing approaches that have been explored look at different factors collectively. It has become apparent that the managers need an integrated pricing method that may help them not to leave any factor or area outside when setting prices. All pricing aspects, as indicated in the model, should be brought together as components of integrated pricing approach. This may lead to effective pricing and ultimately to optimal financial results. It should always be borne in mind that prices are set in order to realise the overall company's objective. The proposed integrated pricing model may be the answer to the question of how to price products in the small and medium-sized enterprises effectively.

Figure 8.1 – Integrated pricing model



Source: Own work.

8.4 Problems encountered

It is of great concern to note that pricing is not given the attention it deserves by SME academics. The literature on SMEs does not give much on pricing. The books and journals for pricing in SMEs are very limited and those that address pricing have just a small section. There seems to be a lack of interest in pricing among SME academics which has brought to suggest that it is a neglected element of the business in this business sector. It has been difficult to access information regarding pricing in SMEs but this did not prevent the research from being done thoroughly. The validity and reliability of the data are also not affected by this.

The questionnaire was hand-delivered to different physical addresses of the businesses but 124 out of a sample of 400 were not found at the stated addresses despite the fact that the data was less than a year old. This shows how difficult it is to trace SMEs at their registered physical addresses. The assumption that could be made is either the business has relocated or ceased operation. Although this is not the area of the study, it is of great concern not to be able to trace these businesses at their official addresses. The failure to trace them made it difficult for the researcher as copies of the questionnaire were returned. Notwithstanding the fact that telephone calls were made after a week to arrange for personal interviews, 49 out of 276 managers did not agree to the interview. They were either suspicious about the reason for the survey or cited time constraint as the reason for not completing the questionnaire.

There were frustrating moments when managers refused to complete the questionnaire and others were sometimes busy with customers and one had to wait for a long time before they may assist in completing the questionnaire. Pricing is obviously a sensitive subject for business owners and managers from a strategic point of view. It is imperative for the manager to fully understand the purpose of the survey before they could make an informed decision.

8.5 Areas for further research

Pricing will always be a challenging area. Perhaps future answers will come less from thinking of the price as the point of a single transaction and more from seeing pricing as a means of securing customer loyalty. Certainly, this is not an easy task and necessitates a different mentality towards pricing that will favour formal market research in order to understand customers' attitudes and needs. Such an approach may improve the quality of pricing decisions. Pricing research should go beyond estimating price elasticity or sensitivity and focus more on understanding customers' value drivers.

Further studies should determine the following:

- The degree of association between the setting of pricing objectives and an enterprise's financial performance.
- The association between a profit goal cited as a prime objective and a company's performance needs to be investigated.
- The extent of the relationship between pricing objectives and the nature of competition could be determined.
- The analysis of the relationship between prime pricing objectives and enterprise size.
- Identifying any significant differences between pricing behaviour in South Africa and other countries.
- The effectiveness of an integrated pricing approach in the business sector.

Marketers have not written much about relationship pricing. This is the area that may be researched because it may be more appropriate for SMEs because they are in a better position when compared to large conglomerates with regard to relationship pricing. The managers' interaction with customers is at a very high level in the SME sector. Cross-subsidisation is another concept that needs to be researched further in order to price appropriately. It may give managers an opportunity to reprice their products and in need unbundle prices. Tiered rate and ad valorem pricing methods need to be studied thoroughly and recommended for SMEs in applicable situations.

8.6 Summary

It is important at this stage to reflect at the objective of the study, namely, to investigate the pricing methods used by small and medium-sized enterprises. The marketing and pricing literature does not draw much distinction on pricing approaches of SMEs and those of the commercial or corporate organisations. There is literature that is specifically addressing pricing from the SMEs' point of view but it is very limited. However, the empirical study was focusing purely on SMEs which are defined as per Small Business Amendment Act No. 29 of 2004 and the results should be interpreted from this perspective. The research results are in line with the objective of the study. It has addressed issues like the pricing objectives, tactics, policies, strategies, factors affecting pricing, general pricing approaches and price determination.

Cost, competition and market demand appear to be of prime importance to the SME managers, when pricing their products. However, the dominating factor is cost followed by perception of value. Managers would like to recover the costs and ultimately make profit. However, they cannot ignore competition and the buyers' perception of value. Competition is more of a threat to them and they need to keep it in mind when pricing their products. No manager may afford to price his or her products out of the market because of possible loss of sales. Customers should also be taken into account when pricing one's products. Although cost, competition and customer demand are sometimes looked at in isolation, they may be considered simultaneously when pricing products. These should not be the only variables considered in the pricing decision. Other factors that should not be overlooked include economic conditions, government legislations, political factors, price stability, market share, profit margin, survival, growth, penetration and skimming.

The qualitative and quantitative methodology has been applied in the study. The statistical analysis helped to verify the validity and reliability of the data. The research should contribute to the science of business management by giving the above recommendations to existing and prospective entrepreneurs as alternatives to pricing of their products. The recommendations are made for specific action in order to effectively and successfully improve the pricing methods used by SME managers. The document should be of value to those who will peruse it. It should add value to the potential users who may include managers of small and medium-sized enterprises and conglomerates, academics, researchers and the public at large.

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APPENDIX A

PRICING PROCESS CHECKLIST

Pricing process checklist

Pricing objective	**Important factors**	**Proposed Pricing approaches**	**Advantages**	**Disadvantages**
Quantitative objectives Those that are related to the firm's profits, sales, market share, cost coverage and production output	Costs and demand	Profit-oriented Sales-oriented, Market-oriented Cost-oriented	The observation that they may be measured easily and straightforwardly	An excessive emphasis solely on quantitative objectives may even risk the long-term position of a firm in the market
Qualitative objectives The relationship with customers, competitors and distributors The long-term survival of the firm The achievement of social goals.	Demand and competition Demand and costs Customers' perception	Market-oriented, Perceived-value Competition Tactical and psychological Tactical and psychological	Loyalty from the relationships Sustainability of operation Building the image of a business	Sometimes difficult to measure
Profit-oriented Profit maximisation, satisfactory profits and target return on investment.		Markup, breakeven and target return	Achieving company's financial objectives Sustainability of operation	May ignore other factors like customers and competition

Sales-oriented Market share acquisition Maximising current revenue Maximising sales growth Product quality leadership in mind and maintaining price image		Market-oriented Market-oriented Market -oriented Perceived-value and value-based	Maximum profit Maximum profit Maximum profit Preferred to competitors	Lower income per product item Lower income per product item Lower income per product item May be very costly
Status quo To maintain existing prices or to meet competition's prices	Competition	Competitor-based approach	Avoid price wars and price stability	May ignore customers and costs
Recovering costs	Costs	Cost-based approach	Sustainability of operation	May ignore other factors like customers and competition
Product differentiation	Competition Product quality, consumer interpretation of pricing as status or value	Competitor-based approach and perceived-value Tactical and psychological	Positioning product advantageousl y among competitive look alike products Discourage new entrants	May ignore other factors like customers and cost
Market skimming	Product quality Consumer interpretation of pricing as status	Perceived-value Value pricing	Milking cash cow Skim the	Encourage new entrants due to high prices

	or value	Skimming	cream Increase profits Customers perceive value	
Market penetration	Product demand Willingness and customers' ability to buy	Penetration Market-based approach	Increase sales Long-term profitability due to gained market share	Low profit per product item. Possible price wars
A speedy exit of marginal competitors	Competition	Competitor-based approach	Discourage entrants, discourage price-cutting and stabilise market prices	Low profits

APPENDIX B

PILOT QUESTIONNAIRE

AN INVESTIGATION INTO THE PRICING METHODS USED

BY

SMALL AND MEDIUM-SIZED ENTERPRISES

Pilot Questionnaire

Dear Pricing Manager/Officer

The following questionnaire is part of an extensive research study undertaken to investigate the phenomenon of identifying pricing methods used by different business sectors. It will be appreciated if you could complete it with the interviewer, who will visit your store, as thoroughly as possible.

Please note that all information will be treated as extremely confidential and will only be used for academic purposes.

Your cooperation in this regard will be highly appreciated.

Yours faithfully

Hamilton Tshegofatso Gape
Telephone: (011) 240-0820
Cell-phone: 083 645 2687

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Instructions for completion

1. Please answer all questions regarding your business as honest and objective as possible.
2. Please reflect your most accurate answer.
3. You may give an answer for more than one box if it is applicable to your organisation.
4. Where asked to comment or specify, please keep it brief but comprehensive.

1 In what sector according to the Standard Industrial Classification would you classify your business?

1.1. Agriculture	
1.2. Catering, accommodation and other trade	
1.3. Community, social and personal services	
1.4. Construction	
1.5. Electricity, gas and water	
1.6. Finance and business services	
1.7. Manufacturing	
1.8. Mining and quarrying	
1.9. Retail and motor trade and repair services	
1.10. Transport, storage and communications	
1.11. Wholesale trade, commercial agents and allied services	
Total	

2 Form of business?

2.1. Sole proprietor	
2.2. Partnership	
2.3. Close Corporation	
2.4. Private Company	
2.5. Public Company	
Total	

3 What is the size of your business?

3.1. Small and medium sized enterprise (turnover up to R5 million)	
3.2. Commercial (turnover greater than R5 million but not greater than R100 million)	
3.3. Corporate (turnover greater than R100 million)	
Total	

4 Who is responsible for pricing in your organisation?

4.1. Managing Director	
4.2. Financial Department	
4.3. Marketing / Sales Department	
4.4. Owner Manager	
Total	

5 Which factors influence pricing in your business?

5.1. Costs	
5.2. Competitors' prices	
5.3. Buyer Behaviour	
5.4. Economic climate	
5.5. Government Legislation	
Total	

6 Which of the following are your pricing objectives?

6.1. Target return on investment	
6.2. Target markup on cost	
6.3. Price stabilisation	
6.4. Market share target	
6.5. Matching competitors'	
Total	

7 Which costing system do you use in price setting?

7.1. Full cost pricing	
7.2. Contribution pricing	
7.3. Both full cost and contribution cost pricing	
7.4. Activity based cost pricing	
Total	

8 Indicate pricing policies that your organisation is pursuing

8.1. Pricing relative to competition	
8.2. Uniformity of prices to different buyers	
8.3. Quantity discounts	
8.4. Trade discounts	
8.5. Cash discounts	
8.6. Geographical price	
Total	

9 Which pricing strategies do you use when launching a new product?

9.1. Charge the highest price possible (Skimming)	
9.2. Charge the lowest price possible (Penetration)	
9.3. Both skimming and penetration pricing	
Total	

10 Which of the following factors do you take into account in actual price setting?

10.1. Use cost plus pricing	
10.2. Use break-even analysis	
10.3. Estimate demand	
10.4. Analyse competitors' prices	
Total	

11 What percentage of total revenue does pricing of core products contribute to your business?

11.1. Less than 50%	
11.2. 50%	
11.3. More than 50%	
Total	

12 Which transfer pricing method do you apply?

12.1. Cost based transfer pricing	
12.2. Market related transfer pricing	
12.3. Negotiated transfer prices	
Total	

13 Do you find it easy or difficult to price your product range?

13.1. Easy to price	
13.2. Difficult to price	
13.3. Sometimes easy and sometimes difficult	
Total	

14 Explain in your own words why do you find it easy to price your products

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15 Explain in your own words why do you find it difficult to price your products

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16 Briefly explain the role played by different departments in pricing decision

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17 List the advantages and disadvantages of cost based pricing

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18 List the advantages and disadvantages of buyer based pricing

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19 List the advantages and disadvantages of competitor based pricing

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APPENDIX C

QUESTIONNAIRE

AN INVESTIGATION INTO THE PRICING METHODS USED

BY

SMALL AND MEDIUM-SIZED ENTERPRISES

Questionnaire

Dear Manager

The following questionnaire is part of an extensive research study undertaken to investigate the phenomenon of identifying pricing methods used by Small and Medium-Sized Enterprises. It will be appreciated if you could complete it with the interviewer, who will visit your store, as thoroughly as possible.

Please note that all information will be treated as extremely confidential and will only be used for academic purposes.

Your cooperation in this regard will be highly appreciated.

Yours faithfully

Hamilton Tshegofatso Gape
Telephone: (011) 240-0820
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Instructions for completion

1. Please answer all questions regarding your business as honest and objective as possible.
2. Please reflect your most accurate answer.
3. You may give an answer for more than one box if it is applicable to your organisation.
4. Where asked to comment or specify, please keep it brief but comprehensive.

1 In what sector according to the Standard Industrial Classification would you classify your business?

1.1. Agriculture	
1.2. Catering, accommodation and other trade	
1.3. Community, social and personal services	
1.4. Construction	
1.5. Electricity, gas and water	
1.6. Finance and business services	
1.7. Manufacturing	
1.8. Mining and quarrying	
1.9. Retail and motor trade and repair services	
1.10. Transport, storage and communications	
1.11. Wholesale trade, commercial agents and allied services	
1.12. Other (specify)	

2 How many people are employed by your business?

2.1. Number of staff members	

3 What is the size of your business in Rand value?

3.1. Turnover	

4 What form of business are you in?

4.1. Sole proprietor	
4.2. Partnership	
4.3. Close Corporation	
4.4. Private Company	
4.5. Other (specify)	

5 Who is responsible for pricing in your organisation?

5.1. Manager	
5.2. Owner Manager	
5.3. Wholesalers / Producers / Supplier	
5.4. Independent Consultant(s)	
5.5. Government	
5.6. Other (specify)	

6 Does your business have a documented pricing policy?

☐ **Yes** ☐ **No**

7 Do you allow market forces (demand and supply) to determine prices?

☐ **Yes** ☐ **No**

8 Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), how important the following *pricing objectives* are to your organisation.

	Not important at all 1	Least important 2	Important 3	Very important 4
8.1. Target return on investment				
8.2. Target markup on cost				
8.3. Price stabilisation				
8.4. Market share target (Gaining market share by increasing sales volume)				
8.5. Matching competitors' prices				
8.6. Other (specify)				

9 Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), how important are the following *pricing tactics* to your organisation.

	Not important at all 1	Least important 2	Important 3	Very important 4
9.1. Pricing relative to competition				
9.2.Uniformity of prices to different buyers				
9.3. Quantity discounts				
9.4. Trade discounts				
9.5. Cash discounts				
9.6. Geographical price				

10 Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), how important are the following *factors* in pricing your products.

	Not important at all 1	Least important 2	Important 3	Very important 4
10.1. Costs				
10.2. Competitors' prices				
10.3. Buyer behaviour				
10.4. Economic climate				
10.5. Government Legislation				
10.6. Other (specify)				

11 Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), how important are the following *cost based pricing methods* to your business.

	Not important at all 1	Least important 2	Important 3	Very important 4
11.1. Full cost pricing				
11.2. Contribution pricing				
11.3. Activity based cost pricing				
11.4. Other (specify)				

12 **Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), how important are the following *pricing strategy* to your business when launching a new product.**

	Not important at all 1	Least important 2	Important 3	Very important 4
12.1. Charge the highest price possible (Skimming)				
12.2.Charge the lowest price possible (Penetration)				
12.3. Both skimming and penetration pricing				
12.4. Other (specify)				

13 **Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), the degree of importance of the following *factors* to pricing in your business.**

	Not important at all 1	Least important 2	Important 3	Very important 4
13.1. Price is the highest revenue earner for the business				
13.2. Price helps contributes to the overall strategy of the business				
13.3. Price enable the business to recover its costs				
13.4. Price could be used as a tool to prevent competitors from entering the industry				
13.5. Price could be used for competitive advantage				
13.6. Price could be used to differentiate products from those of competitors				
13.7. Price could be used to increase or decrease demand				
13.8. Other (specify)				

14 **Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), the degree of importance of the following *cost based pricing factors* to your business.**

	Not important at all 1	Least important 2	Important 3	Very important 4
14.1. Recovery of all costs				
14.2. Determination of break-even point				
14.3. Determination of profit or loss				
14.4. Ignores the buyers' ability to pay				
14.5. Ignores the role of competition				
14.6. Other (specify)				

15 **Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), the degree of importance of the following *buyer based pricing factors* to your business.**

	Not important at all 1	Least important 2	Important 3	Very important 4
15.1. Determination of the customers' ability to pay				
15.2. Determination of the level of demand				
15.3. Indication of customers' perception of value				
15.4. Gives competitive advantage				
15.5. Ignores the cost implications				
15.6. Ignores the role of competition				
15.7. Other (specify)				

16 **Please indicate, in a scale of 1 to 4 (where 1 = not important at all and 4 = very important), the degree of importance of the following *competitor based pricing factors* to your business.**

	Not important at all 1	Least important 2	Important 3	Very important 4
16.1. Makes pricing easier as there is ruling price				
16.2. Helps to prevent price wars				
16.3. Ignores the buyers' ability to pay				
16.4. Ignores the cost implications				
16.5. Other (specify)				

17 **What percentage of total revenue does pricing of core products contribute to your business?**

17.1. Less than 50%	
17.2. 50%	
17.3. More than 50%	

18 **Do you find it easy or difficult to price your product range?**

18.1. Easy to price	
18.2. Difficult to price	
18.3. Sometimes easy and sometimes difficult	

19 **Explain in your own words why do you find it easy to price your products**

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20 Explain in your own words why do you find it difficult to price your products

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21 Briefly explain the role played by different departments in pricing decision

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22 Pricing is a crucial, critical and complex element in the business. Do you agree with this statement? Please explain your answer.

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APPENDIX D

SUPPORTING VISUAL DISPLAY OF RESULTS

Table 6.2 – Number of employees

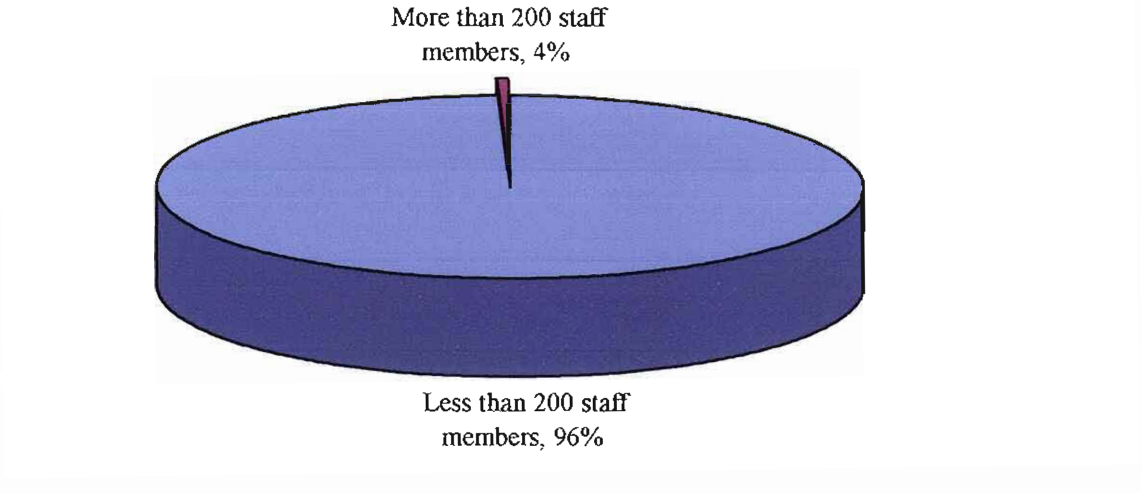


Table 6.3 – Business classification

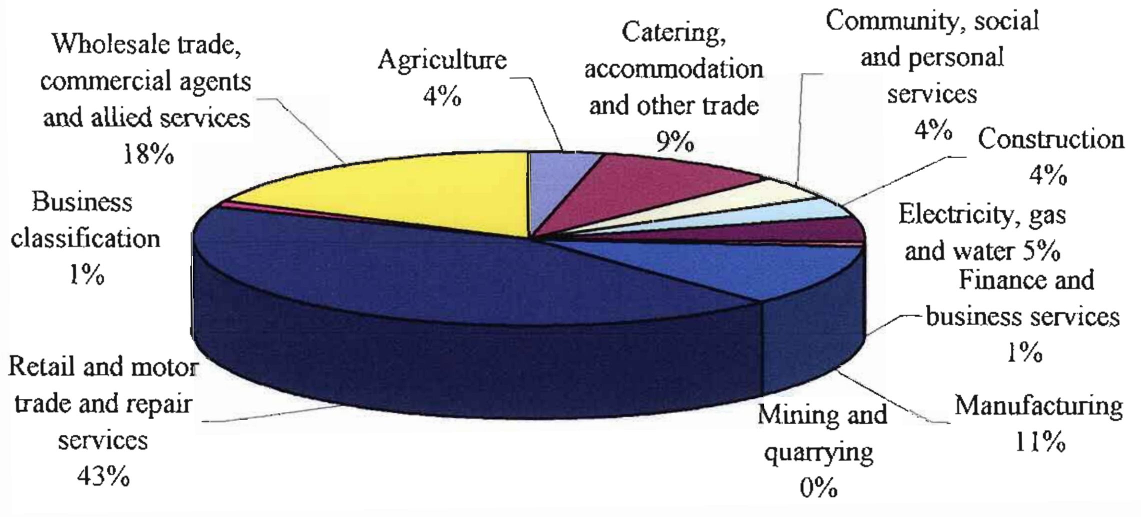


Table 6.4 – Form of business

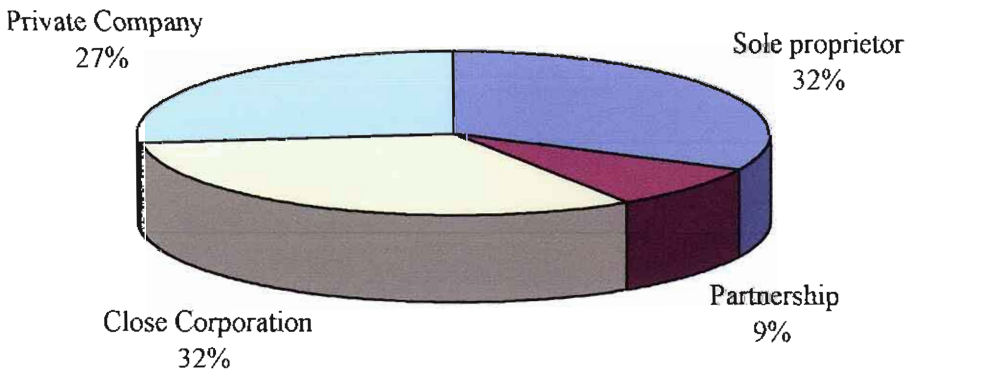


Table 6.5 – Pricing responsibility

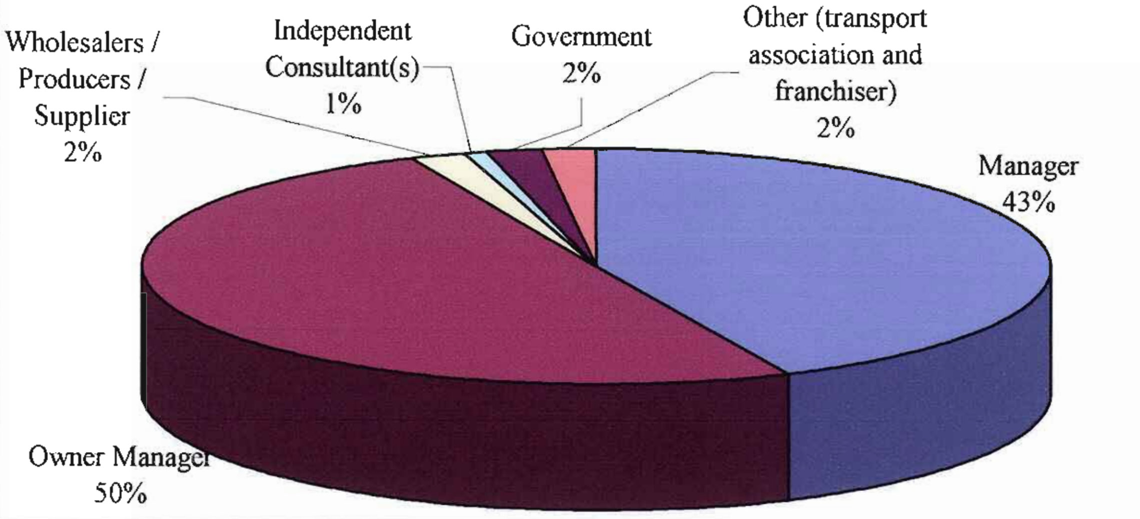


Table 6.6 – Pricing policy documentation

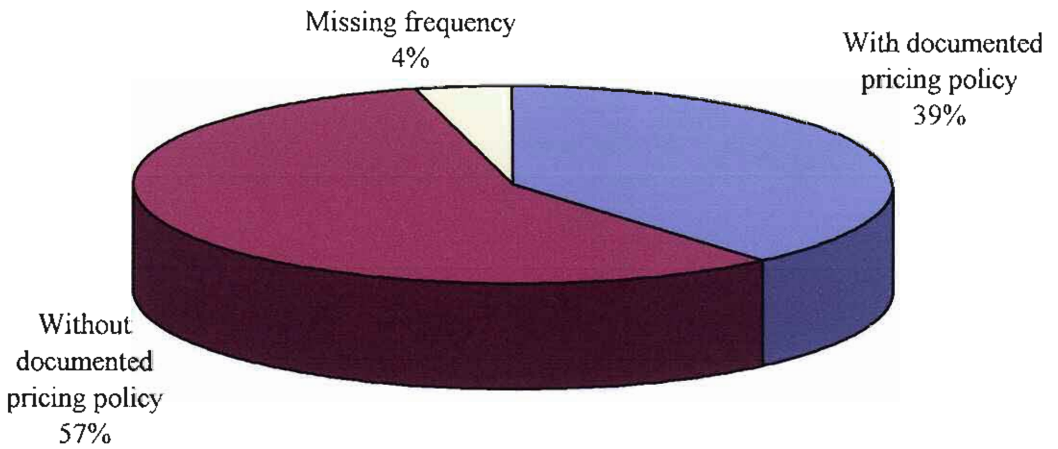


Table 6.7 – Price determination by demand and supply

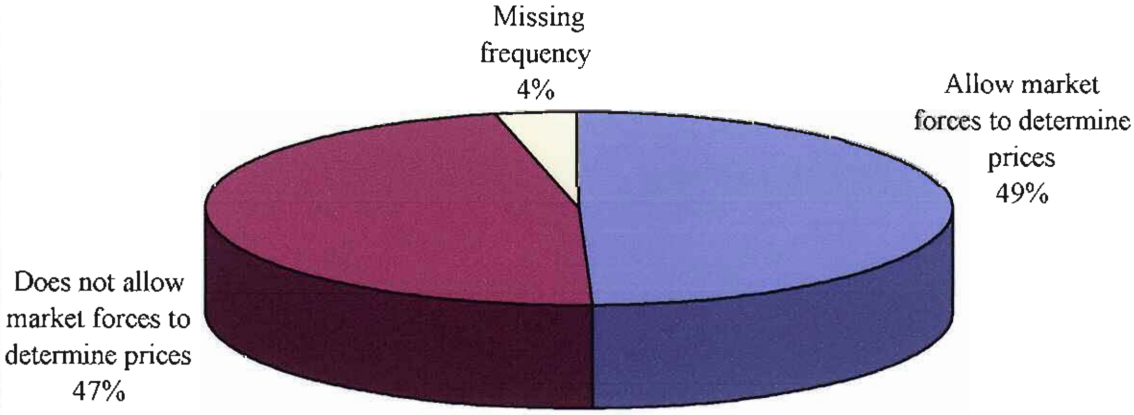


Table 6.8 – Pricing objectives

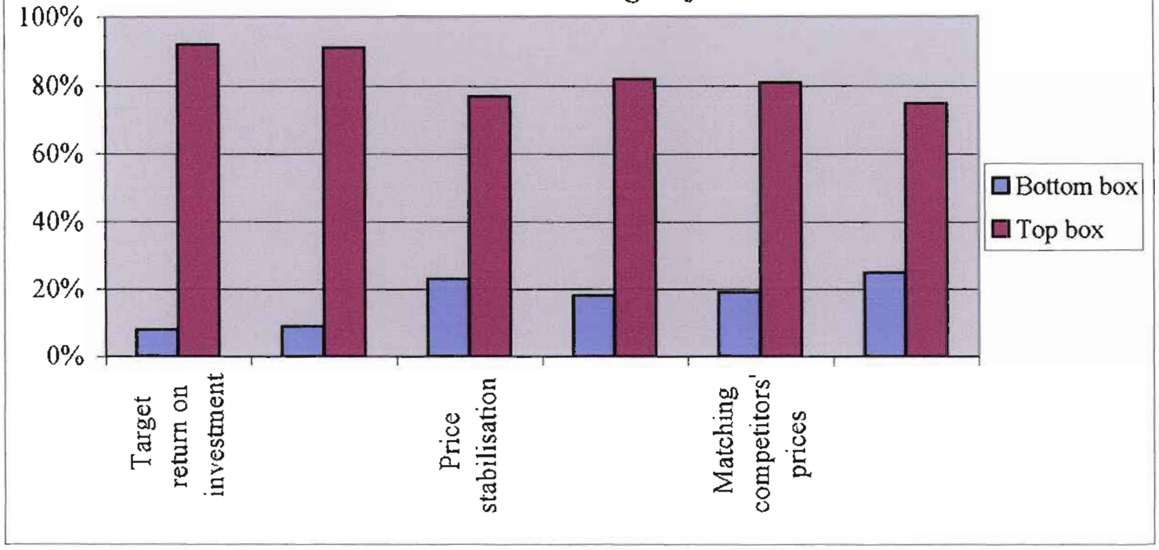


Table 6.9 – Pricing tactics

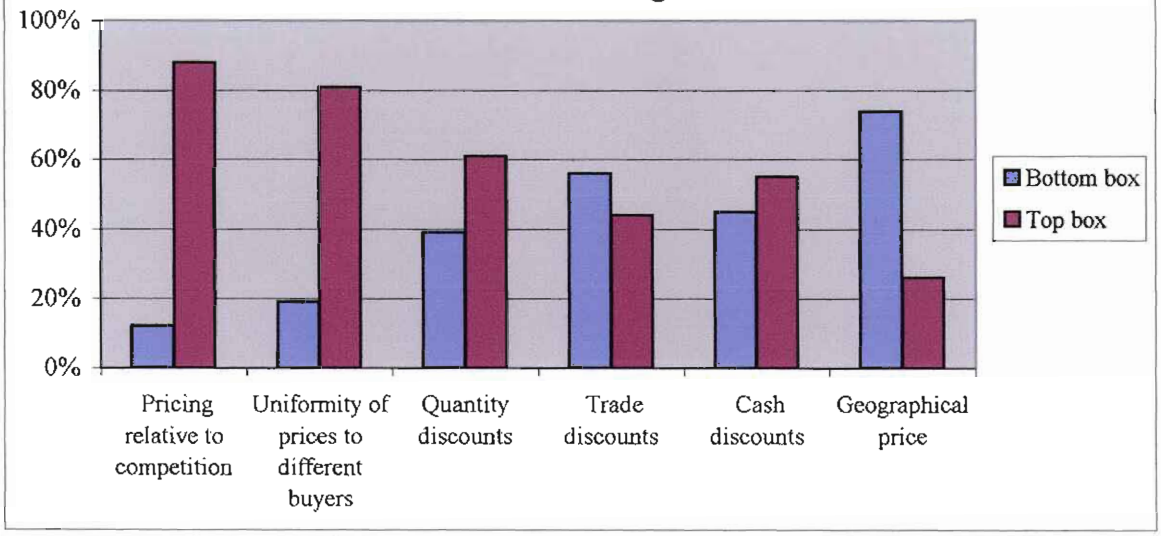
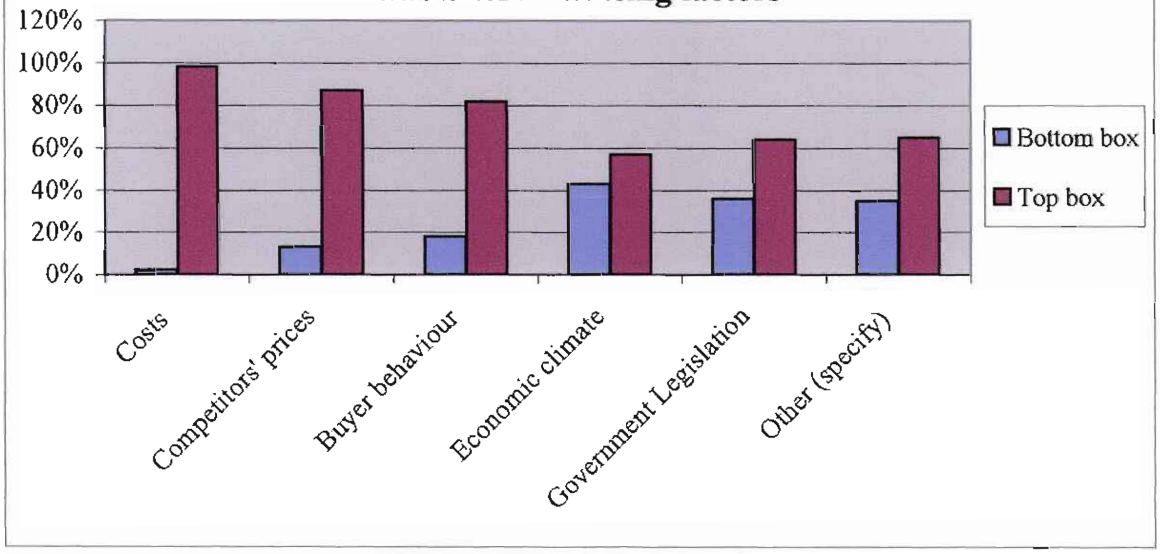


Table 6.10 – Pricing factors



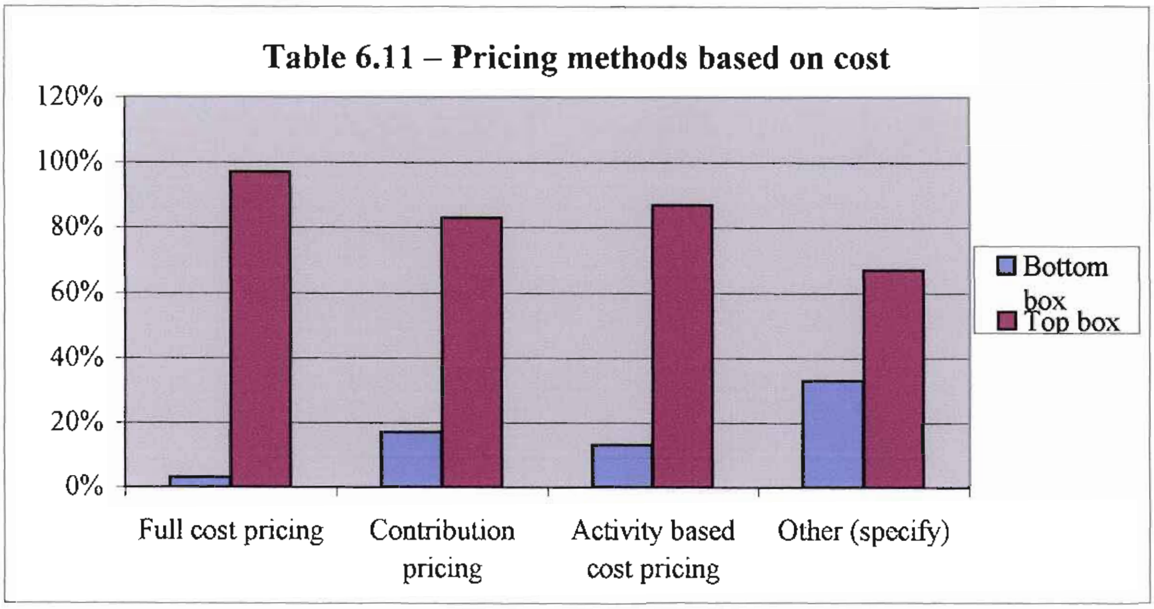


Table 6.11 – Pricing methods based on cost
120%
100%
80%
60%
40%
20%
0%
Full cost pricing
Contribution pricing
Activity based cost pricing
Other (specify)
Bottom box
Top box

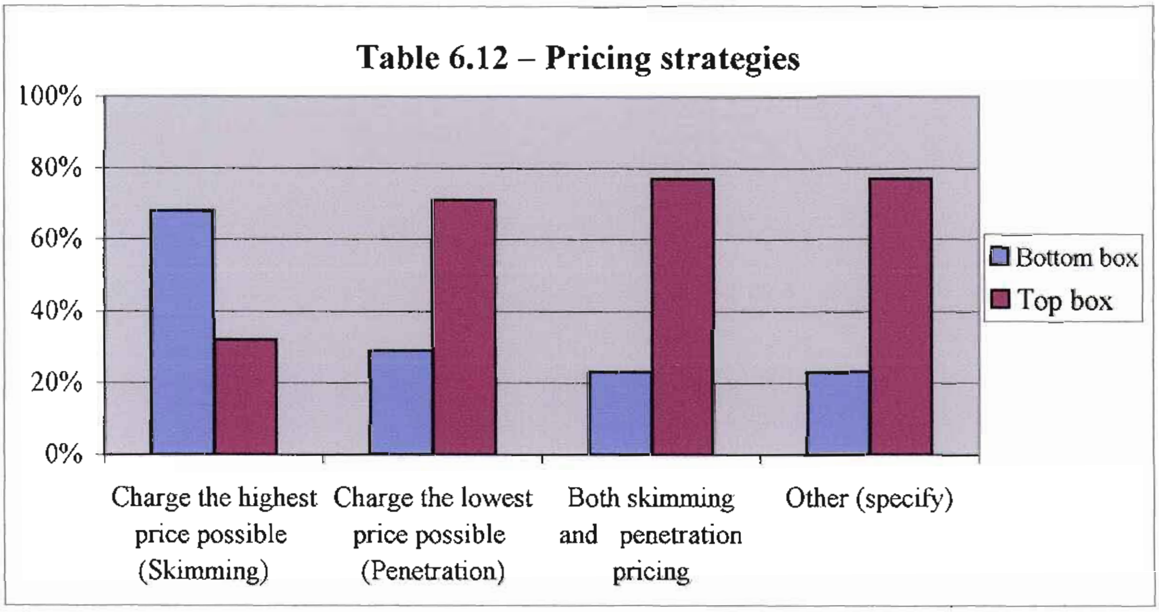


Table 6.12 – Pricing strategies
100%
80%
60%
40%
20%
0%
Charge the highest price possible (Skimming)
Charge the lowest price possible (Penetration)
Both skimming and penetration pricing
Other (specify)
Bottom box
Top box

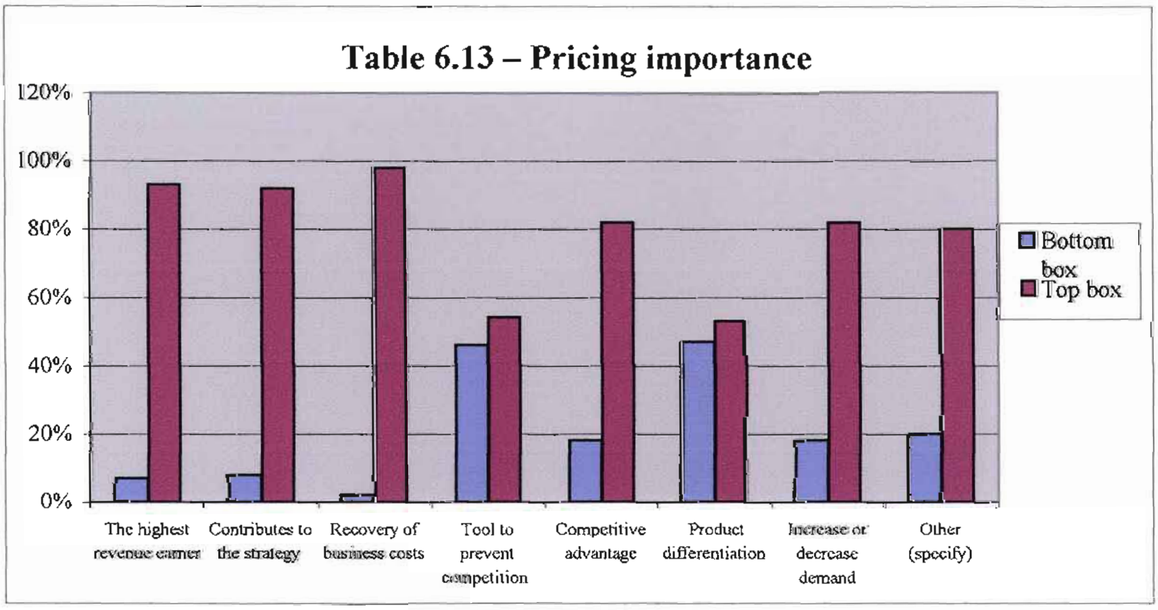


Table 6.13 – Pricing importance
120%
100%
80%
60%
40%
20%
0%
The highest revenue earner
Contributes to the strategy
Recovery of business costs
Tool to prevent competition
Competitive advantage
Product differentiation
Increase or decrease demand
Other (specify)
Bottom box
Top box

Table 6.14 – Cost-based pricing

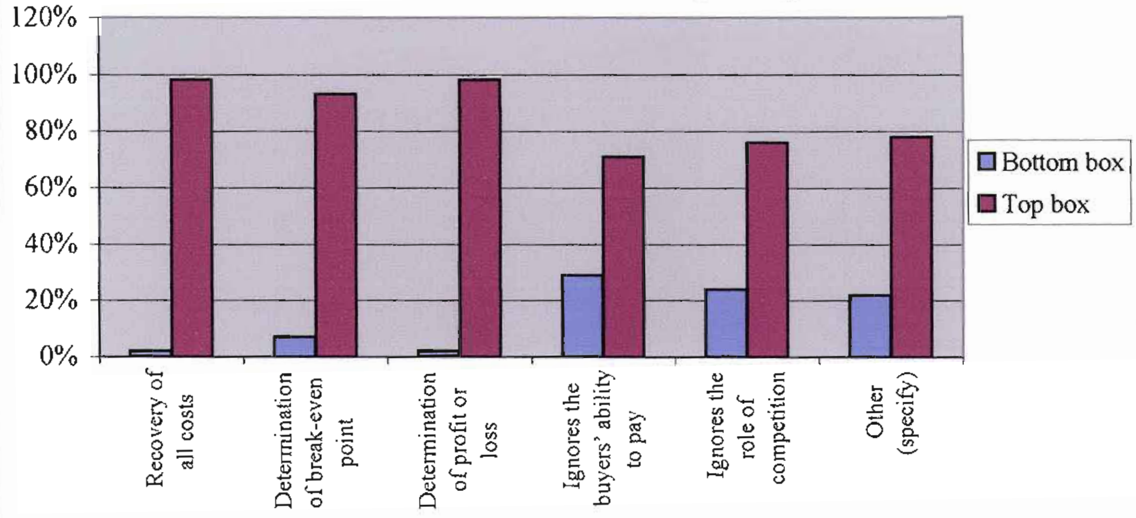


Table 6.15 – Buyer-based pricing

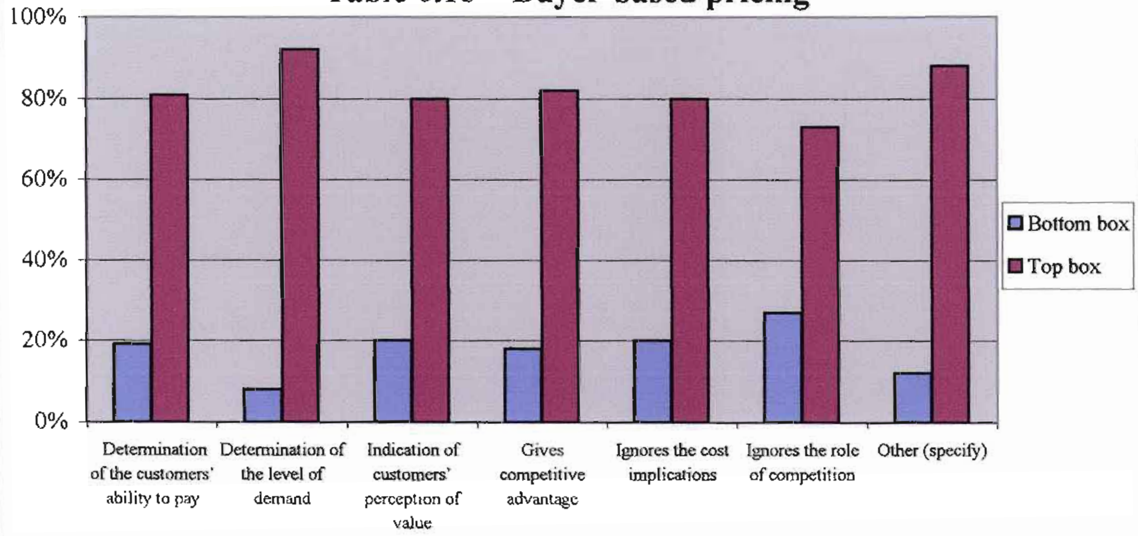


Table 6.16 – Competition-based pricing

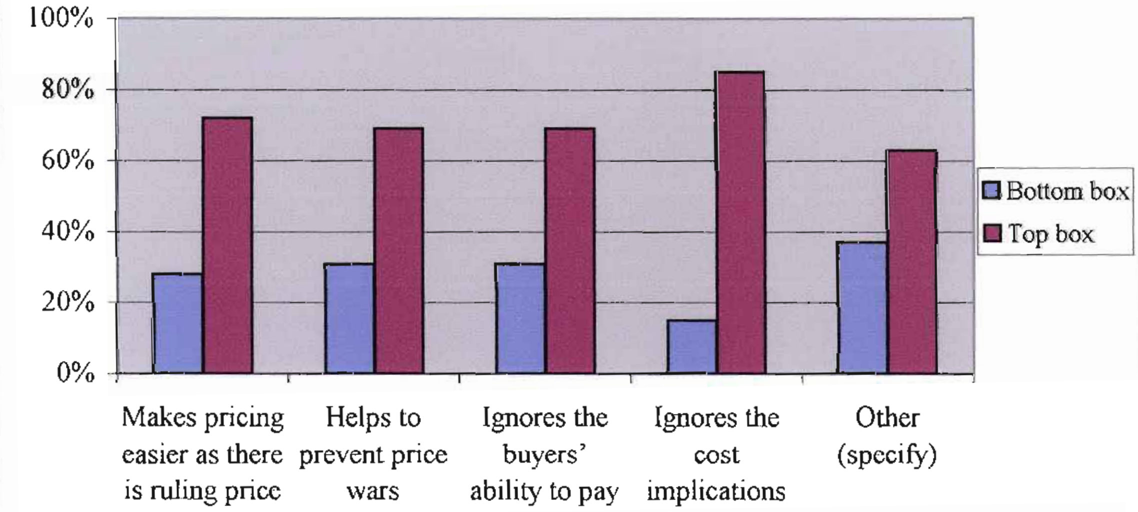


Table 6.17 – Contribution of core products to total revenue

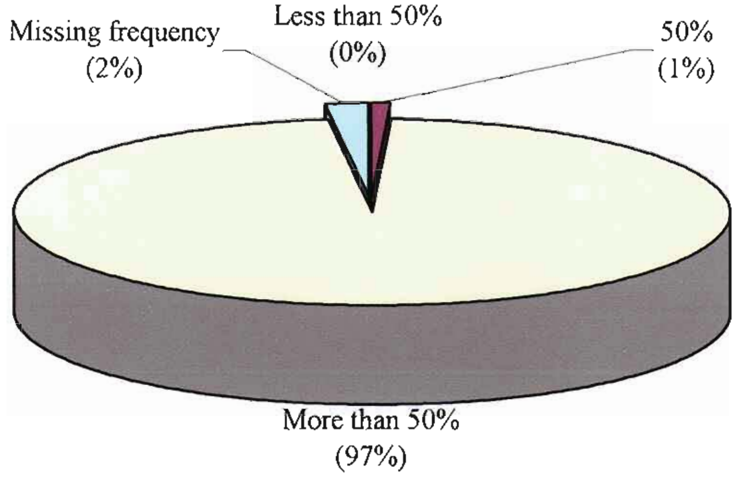


Table 6.18 – Managers finding it easy or difficult to price

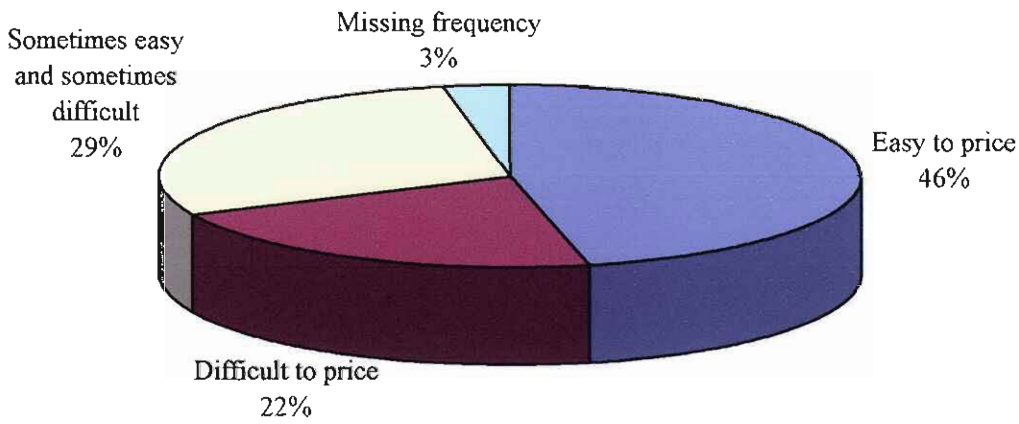


Table 6.19 – Reasons that make pricing easy

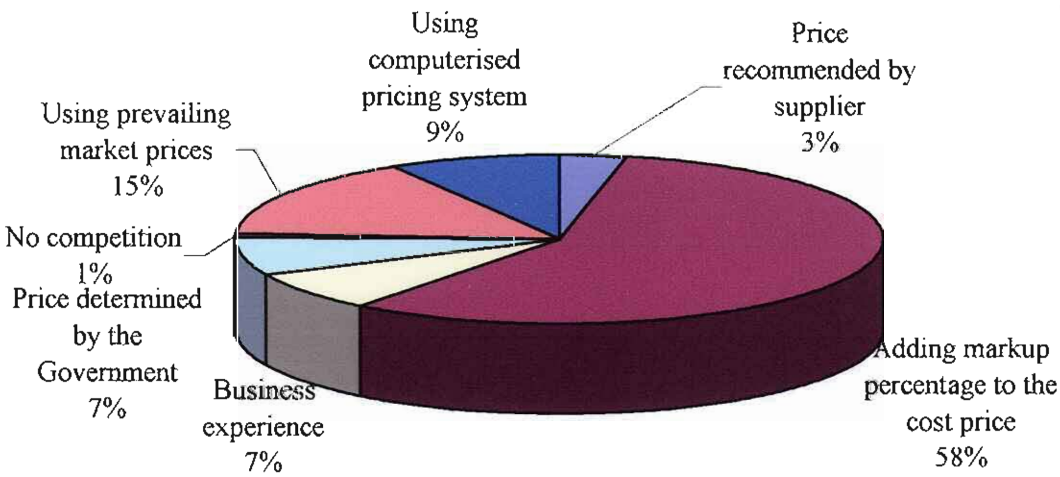


Table 6.20 - Reasons that make pricing difficult

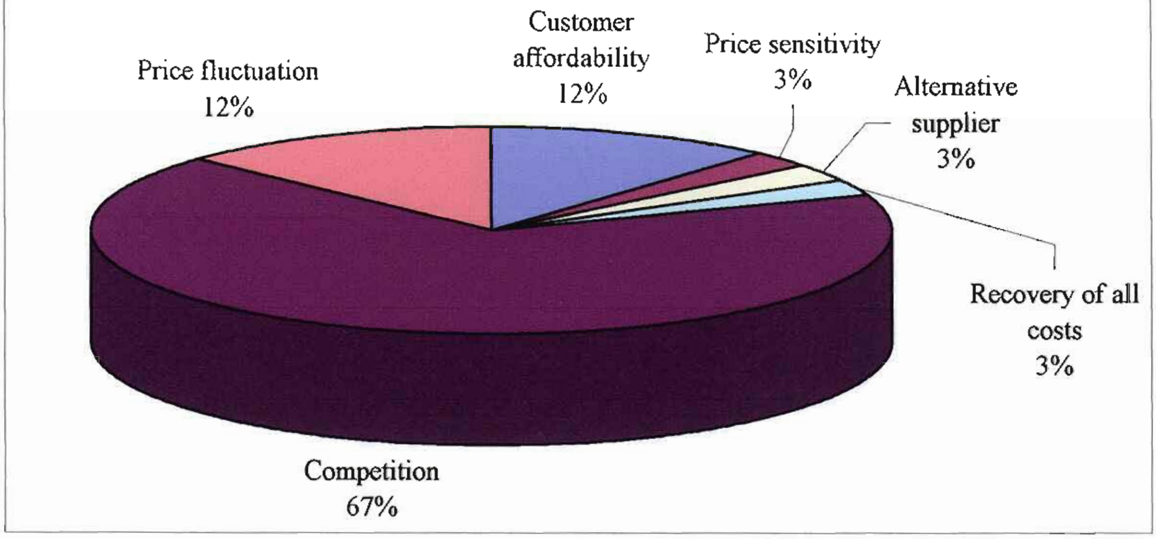


Table 6.21 – Departments involved in pricing

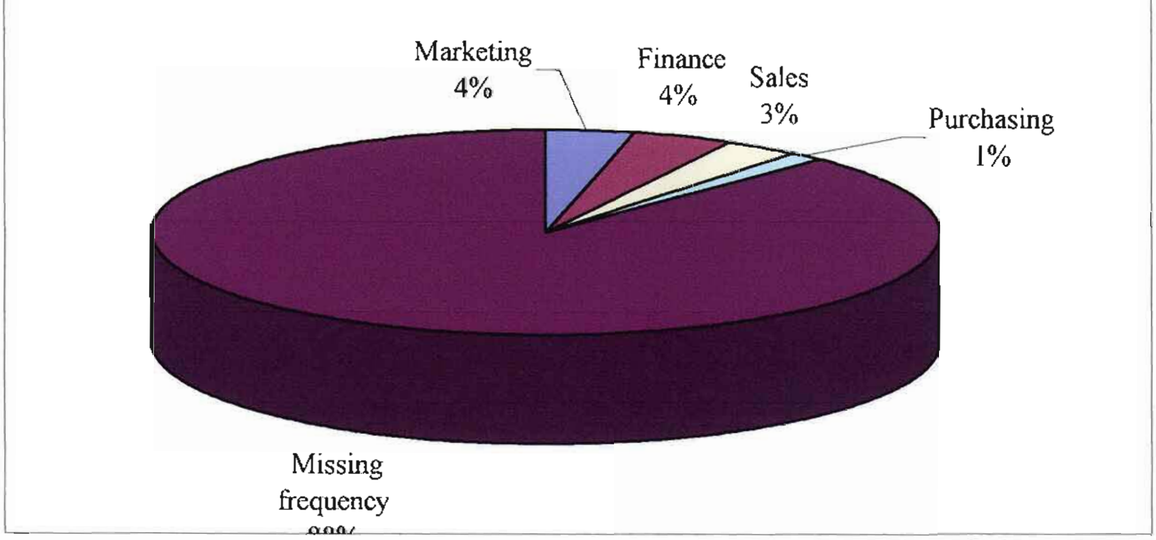


Table 6.22 – Pricing as a crucial, critical and complex element in the business

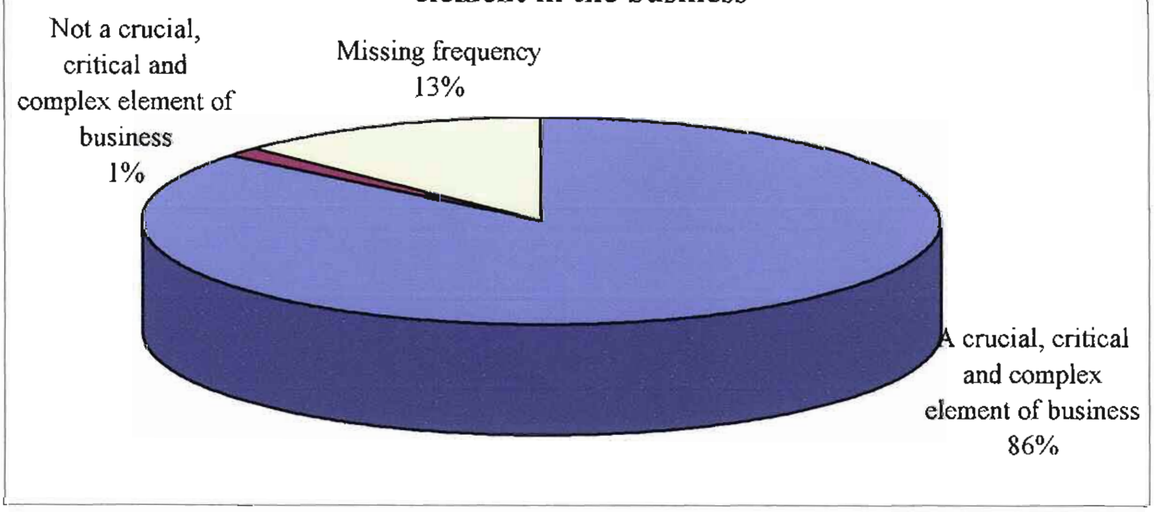
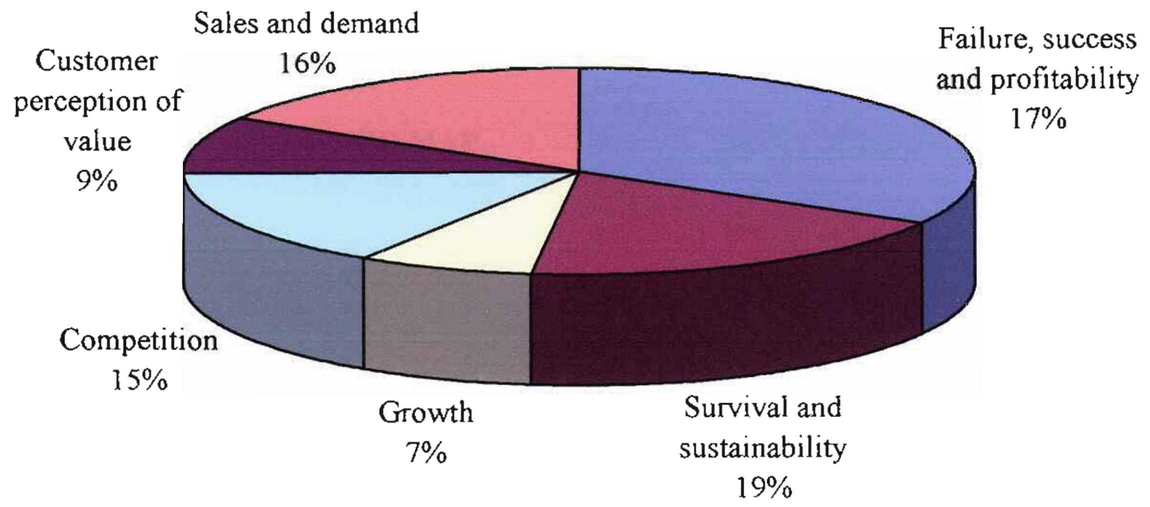
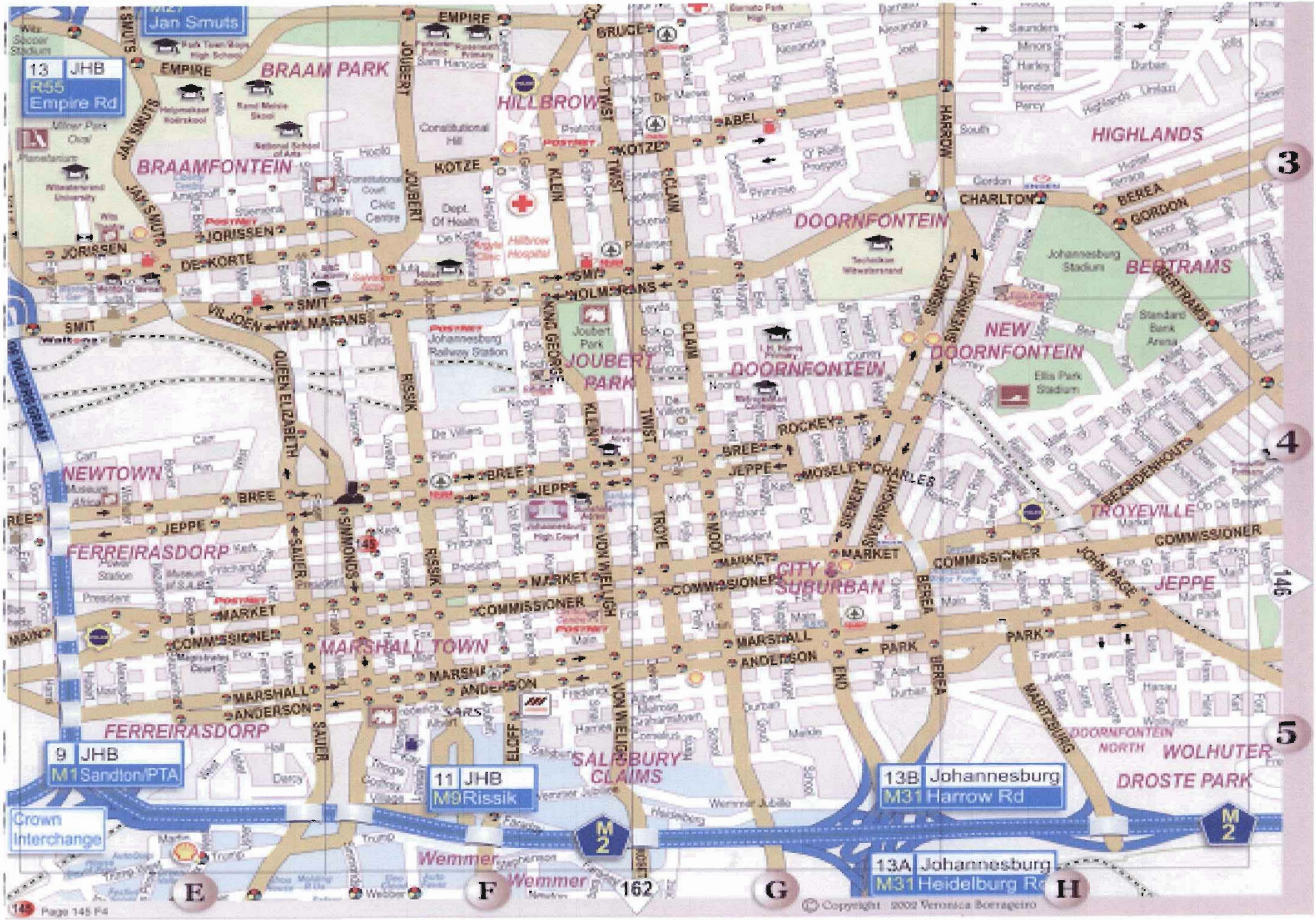


Table 6.23 – Reasons that make pricing a crucial, critical and complex element



APPENDIX E

JOHANNESBURG CBD MAP



13 JHB R55 Empire Rd
M27 Jan Smuts
9 JHB M1 Sandton/PTA
11 JHB M9 Rissik
13B Johannesburg M31 Harrow Rd
13A Johannesburg M31 Heidelburg Rd
Crown Interchange
BRAAM PARK
BRAAMFONTEIN
HILLBROW
HIGHLANDS
DOORNFONTEIN
BERTRAMS
NEW DOORNFONTEIN
JOUBERT PARK
TROYEVILLE
JEPPE
CITY & SUBURBAN
NEWTOWN
FERREIRASDORP
MARSHALL TOWN
SALISBURY CLAIMS
DOORNFONTEIN NORTH
WOLHUTER
DROSTE PARK
Wemmer
EMPIRE
JAN SMUTS
JORISSEN
DE KORTE
SMIT
WOLMARANS
VILJOEN
JOUBERT
KOTZE
ABEL
KLEIN
TWIST
CLAIM
BRUCE
HARROW
CHARLTON
BEREA
GORDON
SIEMERT
SIVEWRIGHT
QUEEN ELIZABETH
RISSIK
KING GEORGE
ROCKEY
BREE
JEPPE
MOSELEY
CHARLES
BEZUIDENHOUT
COMMISSIONER
JOHN PAGE
MARKET
MARSHALL
ANDERSON
PARK
END
MAITLAND
MOOI
TROYE
VON WIELLIGH
SIMMONDS
SAUER
ELOFF
MARITZBURG
DE VILLIERS GRAAF
Johannesburg Stadium
Standard Bank Arena
Ellis Park Stadium
Johannesburg Railway Station
Constitutional Hill
Hillbrow Hospital
Civic Centre
Technikon Witwatersrand
Witwatersrand University
Johannesburg High Court
M2
146
162
3
4
5
E
F
G
H
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APPENDIX F

Confirmation letter from UNISA Bureau of Market Research

UNISA bureau of market research

14 August 2006

Tel (012) 429-3157
Fax (012)429-3170

To whom it may concern,

This letter is to certify that Mr Hamilton Gape obtained certain records from the Bureau of Market Research's (BMR) Manufactures Register to the value of R 1000,00 (one thousand rand) for purposes of a study.

Kind regards,

Prof H de J van Wyk

CERTIFIED TO BE A TRUE COPY OF THE ORIGINAL, WITHOUT PRIMA FACIE ALTERATIONS OR AMENDMENTS

Bureau of Market Research (BMR)
University of South Africa
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www.unisa.ac.za/bmr
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APPENDIX G

Confirmation letter from Statistical Consultation Service of the North-West University

YUNIBESITI YA BOKONE-BOPHIRIMA
NORTH-WEST UNIVERSITY
NOORDWES-UNIVERSITEIT

Privatebag X6001 Potchefstroom 2520
Tel (018) 299 1111 Fax (018) 299 2799
http://www.puk.ac.za

Statistical Consultation Services
Tel: (018) 299 2550

Faxs: (018) 299 2557

6 April 2006

To whom it may concern

Re: Dissertation Mr. H. Gape

We hereby confirm that the Statistical Consultation Service of the North-West University has analysed the data and assisted with the interpretation of the results.

Kind regards

DR. S M ELLIS