

# The effect of pricing policy on the performance of non-financial firms in Nigeria

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## Abstract

This study examines the effect of pricing policy on firm performance in Nigeria, using data from 101 non-financial companies listed on the Nigerian Stock Exchange (NSE) in 2013. The cross-sectional data were obtained from the annual reports of the sampled firms and were analysed by means of regression modelling. The results revealed that cost of sales and company objectives both have a significant positive effect on return on assets. As for the control variables, the impact of market demand and availability of a close substitute also have a significant positive effect on return on assets, while the impact of the market segment, the macroeconomic trend and consumer perception are all statistically insignificant. These results suggest that an effort should be made to reduce production costs in order to maximize profit.

## Keywords:

Pricing policy, Cost of sales, Company objectives, Demand, Macroeconomic trend, Consumer perception.

## JEL classification:

G32, M21.

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# El efecto de la Política de Precios en el rendimiento de las empresas nigerianas no financieras

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## Resumen

Este artículo examina el efecto de la política de precios en el rendimiento de las empresas nigerianas. Para ello se utiliza la información procedente de 101 empresas que cotizan en la Bolsa nigeriana. Los datos, de sección cruzada, se obtuvieron de los informes anuales de las compañías estudiadas. Para cumplir el objetivo perseguido se utilizan modelos de regression. Los resultados obtenidos ponen de manifiesto que el coste de ventas y los objetivos de la compañía tienen un efecto positivo significativo en la rentabilidad de los activos. Por lo que se refiere a las variables de control, el impacto de la demanda de mercado en dicha rentabilidad y la disponibilidad de un sustitutivo similar tienen también un efecto positivo y significativo en el rendimiento, mientras que el impacto en él del segmento de mercado, la tendencia macroeconómica y la percepción del consumidor es no significativo. Estos resultados sugieren hacer un esfuerzo en la reducción de los costes de producción en aras de la maximización de beneficios.

## Palabras clave:

Política de precios, coste de ventas, objetivo de la empresa, demanda, tendencia macroeconómica, percepción del consumidor.

## ■ 1. Introduction

Businesses today all face the challenge of how to maximize shareholders' returns while also remaining competitive and relevant in a volatile and ever-changing market. The drive to maximize profits and retain a position in the market imposes a number of duties on managers. One of their major responsibilities is to make pricing decisions. The ultimate goal of any pricing decision is to enable an organization to achieve its objectives, and these may vary depending on the nature of the business. For profit-oriented businesses, the major goal is profit maximization, and this can be strongly affected by pricing policies.

Organizations can achieve profit maximization through different means: cost reduction, boosting market share, entering new markets, and setting high prices, among others. In the strategic management school of thought, an organization's business-level strategy may focus on cost leadership or product differentiation as ways of achieving its objectives. The cost leadership strategy is where an organization seeks to reduce costs to levels below that of its competitors, while the product differentiation strategy is targeted at distinguishing a product from other, similar products on the market. The economic theory holds that every product has a specific market, irrespective of the business-level strategy adopted by an organization.

Pricing is one of the four Ps of marketing and refers to the process of attaching a monetary value to a product or service. Price can also be described as the consideration given and received by the customer and the seller, respectively, in the exchange of goods and services. The pricing policy is a crucial decision for any business organization; a company's survival and profitability depend on its pricing decisions as price is the only element in the marketing mix that produces revenue and consequently generates profit (Kotler and Keller, 2006). Effective pricing management is a vital tool for a business to achieve its targets and may help it meet long-term organizational goals. Pricing policy, if properly planned and evaluated, can be a competitive weapon in a dynamic and ever-changing market. It is therefore evident that an important managerial responsibility is setting and adopting the most advantageous pricing policy.

Hilton (2005), observed that both the market forces of supply and demand as well as the cost of production have a significant effect on determining prices, but there are other variables that also influence pricing decisions, including manufacturer pricing objectives, the economic situation, competitors and the availability of a close substitute. Thus, price management is a crucial element in an organization's marketing mix and competitive strategy, and a key determinant of its performance. Similarly, price is the measure by which consumers (industrial and household) judge the value of an offering, and it strongly influences brand selection among competing alternatives (Shiple and Jobber, 2001). A

rational consumer compares prices before making a consumption decision. However, it is worth noting that the price of any commodity should be justified by its value.

There is a range of opinions in the literature regarding pricing decisions; the reasons why different companies can offer an identical product of the same quality in the same market but at different prices have still not been decisively determined, and there are conflicting arguments on the determinants of pricing policy. The failure of many organizations could be attributed to their inability to make effective pricing decisions, and even though pricing is a fundamental strategic decision, many organizations still struggle to identify the factors that influence price.

To the best of our knowledge, most studies on pricing policy have been carried out in developed economies (Cabrales and Jiménez-Martín, 2007; Balaji and Ragavhan, 2007; Ros, 2010; Volpe, 2011) while only a few studies have focused on emerging economies (Avlonitis and Indounas, 2005; Popa and Ciobanu, 2014). In Nigeria, there are very few studies on pricing policy (see Obigbemi, 2010) and, to the best of our knowledge, none of them include quantitative empirical results. This paper aims to address this gap by providing empirical evidence on pricing policy in Nigeria, although there is still a need for more research in this area.

After this brief introduction, Section 2 is devoted to a review of the empirical literature on the topic, Section 3 presents the research methodology, Section 4 focuses on data analysis and describes the main results obtained, and Section 5 concludes.

## ■ 2. Empirical literature review

Kajisa and Akiyama (2004) examined rice pricing policies in Thailand, Indonesia and the Philippines from 1960-1990, showing that price stabilization has been a major policy achievement but that stabilization was not necessarily maintained over the entire study period. The study also revealed that political factors such as entry into the GATT, increase in per capita GDP and achievement of rice self-sufficiency are the major determinants of rice pricing policy, but the ways in which these determinants have impacted policy differ among these countries. Katta and Sethuraman (2005) studied the problem of designing a profit maximizing pricing-scheduling policy for a capacity-constrained service facility with a heterogeneous base of delay-sensitive customers. They examined the issue of determining pricing and scheduling for customers, with the objective of maximizing the facility's profits, when the customers' time-sensitivity and perception of service value are unknown to the company. The main conclusion they arrived at is that under certain conditions it might be beneficial to pool customers of different characteristics together and treat them equally, since the customers themselves select their

service class. In their study of 170 Greek companies from six different service sectors, Avlonitis and Indounas (2005) explored the pricing objectives that service companies pursue along with the different pricing methods they adopt to set their prices. The data were collected through personal interviews. The study revealed that the vast majority of the sample adopts a cost-plus pricing method, that pricing is based on average market price, and that pricing objectives and pricing method are closely related.

Huang *et al.* (2007) carried out a two-stage modelling process to estimate the determinants of price elasticity for store and national brands of cheese in the period 2000-2002. Results showed that several factors affect price sensitivities and also that shoppers in low-cost stores are more price sensitive than those in more expensive stores. They also suggested that greater market share does not reduce the price elasticity for store brands.

Balaji and Ragavhan (2007) examined the influence of psychological pricing on price rigidity in the US retail sector from 1989 to 1997. The data used in the study was a set of 399 weekly observations of retail prices for 10 brands of breakfast cereals across six stores. An ANOVA analysis indicated that the pricing strategies adopted by the brands differ significantly. More specifically, the authors concluded that brands drive pricing strategy and the stores at the individual level do not follow differential pricing strategies, thus indicating that pricing strategy is determined at a more aggregate level. Cabrales and Jiménez-Martín (2007) examined price determination in pharmaceutical markets using data for 25 countries, six years and a comprehensive list of products from the MIDAS IMS database. The study revealed that market power and the quality of the product have a significantly positive impact on prices. The study also showed that US companies' prices are not significantly higher than those of other countries with similar income levels.

Ogbadu (2009) investigated how firms can achieve profitability through effective management of materials. He used a sample of 94 employees at Benue Brewery Ltd, Makurdi, Nigeria. The results revealed a need to take materials management into account and indicated that for a company to be profitable, it should manage its materials appropriately.

Ros (2010) examined the main determinants of pricing in the Mexican domestic airline sector, using ordinary least square (OLS) regression to analyse data from 10 airlines. The results of the study revealed that the existence of at least one low-cost carrier on a route is associated with prices that are approximately 30 percent lower overall. Moura and Junior (2010) studied the frequency of price changes in Brazilian companies in 2007, surveying 281 Brazilian firms and using OLS regression to carry out the analysis. They found that wage duration, the degree of competition, product specialization, the elasticity of demand and economic sector dummies mostly explained price change duration. The empirical results do not refute time-dependent models since those are con-

sistent with different price durations across firms; however, they do refute some fairly commonly-used macroeconomic modelling for monetary policy evaluation.

Obigbemi (2010) investigated the impact of a price change on the sales turnover of selected SMEs in Ogun and Lagos in Nigeria, using data from 200 respondents. A Student *t*-test revealed the existence of a relationship between a change in cost of sales and turnover. The paper recommended frequent and adequate monitoring of SMEs as well as employing the services of price experts when making pricing decisions.

Breitenfellner *et al.* (2010) examined some 30 potential determinants of crude oil prices for the period 1983-2008. The findings of the study suggested that the significance of individual factors varies over time, i.e. no single factor dominates or remains unchanged in terms of significance during the entire period under review. Volpe (2011) used OLS regression to evaluate the performance of US supermarkets by considering pricing strategies, competition from hypermarkets and private labels. The main finding of the article was that performance is shown to significantly improve in stores operating near competitors with similar pricing strategies.

Srinivasan (2012) examined the fundamental determinants of share prices in India. The study used panel data consisting of annual time series over the period 2006-2011 for the six major sectors of the Indian economy: manufacturing, energy, IT, industrial, pharmaceutical and commercial banking. He estimated both fixed and random effects models, and showed that earnings per share and the price-earnings ratio are the major determinants of share prices in the abovementioned industries. In addition, size is a significant factor in determining the share prices in all sectors except manufacturing. Stevens (2012) presented the dynamic price-setting problem of a firm that cannot observe market conditions for free. The study found that the firm optimally selects to only infrequently undertake policy reviews, and that between reviews the firm implements a simple pricing policy based on a small set of prices.

Sudiyatno *et al.* (2012) investigated the role of company performance in determining the direction of the relationship between company policies and company value. The study was conducted with a sample of manufacturing firms listed on the Indonesia Stock Exchange (IDX) in the period 2008-2010. This panel data set was analysed using regression methods. The results revealed that (i) financial leverage has a negative impact on company performance but a significant positive effect on the value of the company; (ii) incentives for managers have an insignificant positive effect on both company performance and the value of the company; (iii) capital expenditure has a significant positive effect on company performance but its impact on firm value is statistically insignificant; and (iv) the company's performance has a positive and significant effect on the value of the company.

Eptimehin and Ekundayo (2012) examined the impact of risk pricing on the profitability of the Nigerian insurance market, and also the relationship between operating expenses and profitability in the non-life insurance market in Nigeria. The results of the study revealed that the economy, competition and government regulation affect risk pricing. It was also noted that operating expenses is strongly correlated with profitability and should be properly managed and controlled to achieve profit maximization.

Yazdani *et al.* (2013) addressed the issue of pricing strategies and goals in industrial marketing. They classified the factors affecting price into internal and external elements and also highlighted four policies for adjusting prices: geographical pricing, price discounts and cost deductions, advance pricing and discriminatory pricing.

Sarumathi (2013) focused on the factors determining e-pricing policies. According to the paper's findings, the only element in the marketing mix that produces revenue is price. The managerial tasks involved in pricing a product include establishing the pricing objectives, identifying the price-governing factors, ascertaining their relevance and importance, determining the product value in monetary terms and formulating price policies. In addition, the study also showed that strategies, demand and firms' competitive ability are affected by the price of the product. Finally, the study revealed the factors determining the price of a company's product and categorized them into internal factors (the firm's desired market positioning, product characteristics, cost of sales, marketing costs and product turnaround rate) and external factors (customer bargaining power, major suppliers' bargaining power, competitors' pricing policy, government controls, and social considerations).

Sije and Oloko (2013) examined the relationship between penetration pricing strategy and SME performance in Kenya. Data were sourced from employees of selected SMEs in Kenya's food industry. The results of the study showed a strong positive correlation between penetration pricing and performance. The study therefore concluded that the SMEs should place more emphasis on using a penetration pricing strategy, as there is significant relationship between penetration pricing strategy and the number of customers, quality of food and service, and customer loyalty. Popa and Ciobanu (2014) identified the financial factors that impact on the functionality and profitability of SMEs in Romania by using a sample of 35 SMEs for the period 2009-2012. The results of the OLS regression estimated showed that managerial investment decisions can decisively affect SME profitability, especially in a period of economic instability.

Biobele and Johnny (2014) evaluated the extent to which price harmonization affects companies' profitability, and tried to ascertain whether there was a material difference between price discrimination and price harmonization in terms of their effect on companies' profitability. The data used in the study was collected from five commercial banks

in Cross River State, Nigeria. The results revealed that price harmonization significantly affects companies' profitability and that there is a significant difference between the effects of price discrimination and price harmonization on the profits of the selected firms. Finally, Pulaj *et al.* (2015) examined the relationship between competitive strategies and organizational performance using a sample of 110 companies. The data were collected using questionnaires and analysed with ANOVA. The authors found that cost leadership, differentiation and focus strategies have significant positive effects on performance.

### ■ 3. Data, variables and model specification

As outlined in the methodology section, this article investigates the effect of pricing policy on firm performance in Nigeria using 101 non-financial companies belonging to 10 different sectors, listed on the NSE in 2013. Companies from the financial sector were excluded from the analysis because (i) they define cost and profit differently, and (ii) they are highly regulated. In order to achieve our objective, we estimated a regression model, having checked previously for heteroskedasticity in the variables. Return on assets (*ROA*) was used as a proxy for performance, while cost of sales (*COS*) and company objectives (*OBJ*) were used as proxies for pricing policy. Demand (*DD*), macroeconomic trends (*MT*), market competition (*MC*), market segment (*MS*) and consumer perception (*CP*) acted as control variables. More specifically, *COS* is used in logarithmic form and *OBJ* is measured by the ratio of profit after tax to revenue. *DD* is represented by the log of the closing inventory because demand directly affects the inventory levels of any organization. The other four control variables are external factors represented by multinomial factors with three levels that can be seen in Table 1.

● **Table 1. Description of variables**

Variables	Description
<b>Dependent variable</b>	
Return on assets	The ratio of net profit after tax to total assets.
<b>Independent variables</b>	
Cost of production ( <i>COS</i> )	Natural logarithm of cost of sales.
Company's objectives ( <i>OBJ</i> )	The ratio of profit after tax to revenue.
<b>Control variables</b>	
Demand ( <i>DD</i> )	Natural logarithm of closing inventory.
Market competition ( <i>MC</i> )	1 when there is a close substitute available, 0 when there is no substitute and when there are many competitor substitutes.
Macroeconomic trend ( <i>MT</i> )	1 if highly affected by inflation, exchange rate and high interest rate, if minimally affected and 0 if not affected at all.
Market segment ( <i>MS</i> )	International market = 1. Local market = . State or regional market = 0.
Consumer perception ( <i>CP</i> )	Strong preference = 1. Preference = . Weak preference = 0



In order to measure the effect of pricing policy on firm performance in Nigeria, the following linear regression models were estimated:

$$ROA_i = \beta_0 + \beta_1 COS_i + \beta_2 OBJ_i + e_i \quad (1)$$

$$ROA_i = \beta_0 + \beta_1 COS_i + \beta_2 OBJ_i + \beta_3 DD_i + e_i \quad (2)$$

$$ROA_i = \beta_0 + \beta_1 COS_i + \beta_2 OBJ_i + \beta_3 DD_i + \beta_4 MC_i + \beta_5 MT_i + \beta_6 MS_i + \beta_7 CP_i + e_i \quad (3)$$

where  $i$  represents the specific firm included,  $\beta_0 - \beta_7$ , are regression parameters and  $e$  is the error term.

## 4. Data analysis and results

Table 2 shows the descriptive statistics of the variables used in this study and Table 3 shows the correlation matrix; it can be observed that there is a positive correlation between the two explanatory variables and with the independent variable. Although the correlation between  $COS$  and  $DD$  is high, the centred variance inflation factor values (3.2231 and 3.1568, respectively) reject the hypothesis of serious multicollinearity. Finally, it can be observed that the correlations between control variables are very low, as is their correlation with the explanatory and the explained variables.

● **Table 2. Descriptive statistics**

	Mean	Median	Minimum	Maximum	Standard deviation
<i>ROA</i>	0.03	0.04	-0.68	0.47	0.14
<i>COS</i>	6.51	6.48	2.61	8.81	1.01
<i>OBJ</i>	0.03	0.03	-2.10	5.96	0.72
<i>DD</i>	5.73	5.84	2.50	7.61	1.08
<i>MC</i>	0.60	0.50	0.00	1.00	0.37
<i>MT</i>	0.52	0.50	0.00	1.00	0.33
<i>MS</i>	0.60	0.50	0.00	1.00	0.58
<i>CP</i>	0.46	0.50	0.00	1.00	0.35
<i>N</i>	101	101	101	101	101

SOURCE: AUTHORS' COMPUTATIONS

Table 3 lists the OLS estimates of model specifications (1), (2) and (3). Table 4 shows the result of the Breusch-Pagan-Godfrey heteroskedasticity test, which was carried out due to the cross-sectional nature of the data. As can be seen, the null of homoscedasticity is not rejected. In the estimates from model 1,  $COS$  and  $OBJ$  have a significant positive effect on  $ROA$ . When including  $DD$  as a control variable (model 2), the impact of  $COS$  on  $ROA$  becomes insignificant, while that of  $OBJ$  continues to be positive and significant. The control variable also has a positive (significant) effect on  $ROA$ . In model 3, the impacts of  $COS$ ,  $OBJ$  and  $DD$  are the same as in model 2.

As for the rest of the control variables, only *MC* was found to be significant. Unfortunately, the adjusted *R*-squared value is not as high as desired.

● **Table 3. Correlation Matrix**

	<i>ROA</i>	<i>COS</i>	<i>OBJ</i>	<i>DD</i>	<i>MC</i>	<i>MT</i>	<i>MS</i>	<i>CP</i>
<i>ROA</i>	1.00							
<i>COS</i>	0.24	1.00						
<i>OBJ</i>	0.45	0.07	1.00					
<i>DD</i>	0.30	0.81	0.00	1.00				
<i>MC</i>	0.12	-0.02	-0.16	0.03	1.00			
<i>MT</i>	-0.04	0.13	-0.09	0.00	0.31	1.00		
<i>MS</i>	-0.01	-0.09	-0.06	-0.05	0.03	0.09	1.00	
<i>CP</i>	-0.01	0.01	0.08	0.10	0.26	0.22	0.10	1.00
<i>N</i>	101	101	101	101	101	101	101	101

SOURCE: AUTHORS' COMPUTATIONS

### Regression Model

	Model 1	Model 2	Model 3
<i>C</i>	-0.16** (0.08)	-0.17** (0.08)	-0.20** (0.08)
<i>COS</i>	0.03** (0.01)	-0.01 (0.02)	-0.01 (0.02)
<i>OBJ</i>	0.08* (0.02)	0.09* (0.02)	0.09* (0.02)
<i>DD</i>		0.05** (0.02)	0.05** (0.02)
<i>MC</i>			0.09** (0.03)
<i>MT</i>			-0.01 (-0.04)
<i>MS</i>			0.01 (0.02)
<i>CP</i>			-0.06 (0.03)
<i>R</i> squared	0.24	0.29	0.34
Adj. <i>R</i> squared	0.23	0.27	0.29
S.E regression	0.12	0.12	0.11
<i>F</i> statistic	15.88	13.34	7.09
Prob. value	0.000	0.000	0.000
Obs.	101	101	101

\*SIGNIFICANT AT 1%, AND \*\*SIGNIFICANT AT 5%. STANDARD ERROR IN PARENTHESES

● **Table 4. Heteroskedasticity test: Breusch-Pagan-Godfrey**


<i>F</i> -statistic	1.300119	Prob. F(3,97)	0.2789
Obs* <i>R</i> -squared	3.904209	Prob. Chi-Square(3)	0.2720

## ■ 5. Conclusion

This article investigates the effect of pricing policy on firm performance in Nigeria using 101 non-financial companies listed on the NSE in 2013. The cross-sectional data were obtained from the 2013 annual reports of the sampled firms and were analysed by means of regression modelling. Return on assets was used as a proxy for performance, while cost of sales and company objectives proxied pricing policy. Demand, macroeconomic trends, market competition, market segment and consumer perception were used as control variables. The results obtained revealed that cost of sales has an insignificant negative effect on return on assets, while the impact of company objectives is significant and positive. On the other hand, market demand and availability of a close substitute have a significant positive effect on the proxy for performance; however, the corresponding impacts of the market segment, market competition, macroeconomic trends and consumer perception are all insignificant. These results suggest that an effort should be made to reduce the cost of production, by putting the focus on cost minimization objectives, in order to maximize profit. Strategies that focus on increasing market demand and creating new markets for existing products are also recommended. If possible, firms should extend their market to international consumers, while policy-makers should concentrate on reducing inflation, exchange and interest rates. Although macroeconomic trends turned out to be insignificant, effective management of these rates could be positive for firm performance.

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