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PRICING STRATEGY AND FIRMS PROFITABILITY

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Abstract: *This paper summarizes the arguments and counterarguments within the scientific discussion on the issue price decision and its significantly impact on the firm profitability and market competitive position, pricing strategy considered to be fundamental tool for market growth, in today's extremely competitive market, adopting a pricing plan is essential. In response to the demands of the industry, several pricing models have been developed under the influence of multiples factors (organization and management attitude, product cost structure, industry, and gap between local and target markets). The purpose of this paper is to review the price objectives and price methods that were adopted to set prices as well as their impact on the profitability of the firms. One of the most crucial managerial choices is the definition of the price policy since it has an impact on business profitability and market competitiveness. Despite the essential role that costs play in businesses. The objectives of this research were to develop and evaluate a theoretical model that would illustrate how pricing strategy affects business profitability. This study used the theoretical literature review technique to answer the following question: how product pricing methods impact on firm profitability? though we found that the pricing objectives are a function of pricing formula and methods. More important we found that firms are positively influenced by the value-based pricing strategy and high price, in contras its negatively influenced by the low price, this implies that prices policies affected the profitability of the company hence, this explained the importance of strategic consideration of the pricing, strategies, methods and process must be critically evaluated by management. The research results can be useful as baseline to further develop model that enable firms to quantify the impact of pricing strategies.*

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Introduction

Pricing strategy can be regarded as an organization plan to objectively set prices in competitive basis in order to achieve its objectives, which linked to the implementation of pricing strategy and can be explained by its behaviour, execution and performance. (Walker & Ruekert, 1987). According to Porter1980, price implementation formed in way to achieve planned strategic pricing goals and objectives. Supposition of pricing strategy consider as interlinked part of organization dimension (Motivation, Mentality, and interpretation), (Dutton , 1988). Though, Mintzberg suggested that pricing strategy part of future action planned, which very sensitive to changes from internal and external factors observed from business environment.

Part of Marketing pillars (Pricing Strategies, Production Costs, Product Distribution & Promotional Costs), pricing is the only factor that bring in revenues instead of costs. Company usually does not define the prices for individual items. In fact, they implement wide, adaptive pricing tactic that in from of different promotional pricing such discounting as well as discriminatory pricing. When choosing pricing methods, firms take into account the three of marketing strategies (Costs, Customers, and Competitors). Though pricing might be a powerful weapon for achieving strategic business objectives, in other hand traditional pricing strategies such as cost-based pricing, Customer based pricing, and competitor-based pricing can limit a company's ability to drive profitable growth.

On other hand Nagle and Holden suggested that strategy configuration and strategic analysis are elements of pricing strategy, this set of activities of price planning may be share common factors such as time terms, future-looking, and target orientated. The result of pricing planning is tending to be complex and not standard in specific way. Planning strategy is not focus only on single transaction or event but a set of categories of marketing mix segments, classification, and competitions. Which all based on strategic agenda, the critic on the strategic agenda is can expose the strategic plan to such high instability, therefore the current pricing issues on strategic agenda, depend on the expected result of pricing problem on company's goals achievement. Therefore, firms' actions will be implemented if only managements believe that strategic pricing matters have reasonable impact on the firm. Because setting price directly associated with income, they considered significant part of strategic planning, and way of achieving competitive advantages position in the marketplace, hence giving pricing priority to any product within any industry will help the company to realize the product value.

Price decision not easy task and can be associated with speculation due to economic environments factors. Though rapid changes in information system, advancement in technology and product line volatility, one of the elements market professionals are encounter during the formation of pricing strategies. Failure to understand how these environmental factors impact on prices decision, which will increase the level of risk organization expose to. Having batter understanding of these factors and forces will lay the ground to improve decision making and pricing strategies.

The goal of pricing strategy is to setting product price that equivalent of the value buyer received, as well as guaranteed profit and positive return on investment. Vast majority of research focused on how managers set price on discovering the objectives used by managers in pricing decision, profit maximization common objective used by all firms, and some company used more than one price objective and rapid change over time. (Coe, 1983,88), this provides outline on what the firm trying to achieve but does not show how will achieve these objectives.in this regards Oxenfeldt (1979) argue that price objectives provide direction for implementation.

According to Toni, et al (2017), he suggested that price strategy influence the firm's performance particularly profit and find out that firms positively affected by value-based pricing at high level and negatively impacted by low price level, this confirms the importance of pricing strategy and manager must give it high priority at planning stage. Regardless of the importance of pricing strategy planning only two percent of the papers on main related Journals has cover this topic, majority of pricing strategies indicate price level related either to Cost, Customer value or Competition, out of these methods value-based approach rapidly emerged as leading method of pricing strategies in literature (Ingenbleek et al. 2003), and considered the best choice to profit maximization target, Monroe, 2002. Despite the recognise advantage of this method still some challenges holding back of its application and implementation. In this paper we will examine the orientation of price strategies and their objectives, and impact on the firm's profit.

Pricing Policy

In places where there are natural resource shortages, the public sector has turned to prices rather than only relying on taxes to raise money. For instance, the government in London has imposed fees on drivers who operate vehicles in congested regions and on major thoroughfares (Nagle & Müller, 2017). Managers need to receive training in creative pricing techniques. Instead, then reacting to adjusting the price, the pricing choice must be based on the customer's expectation. Unfortunately, most businesses still don't operate using this approach. As a result, quick market strategy modification is necessary (Nagle & Müller, 2017). The number of rivals and new sources of value for clients has expanded because of marketing globalization and accelerating technical progress, albeit this hasn't always translated into higher producer profits (Nagle & Müller, 2017).

According to Cooper et al. (2018), performance is the single factor that determines whether pricing is successful or unsuccessful. Therefore, multinational corporate leaders did not use separate goals when deciding on price. In 2015 research by Cunha and Rocha, the utilization of information, a strategic perspective, and management control behavior were examined in relation to the export practices of 24 companies with headquarters in Austria, Norway, and the United States.

They found that in multinational corporations, the sources of information and pricing control are more complex and diversified. They proved that price difficulties are global and not culturally specific as a result. They were unsuccessful, nevertheless, in explaining how pricing methods are influenced by behavior. Burkert et al. (2017) studied 125 Fortune 1000 companies' internal political structures in relation to interdepartmental cooperation and competition. They learned that several of the departments were perceived as being challenging to work with in terms of enhancing pricing tactics.

They learned that several of the departments were perceived as being challenging to work with in terms of enhancing pricing tactics. For instance, the accounting department will experience problems if cost information is sent slowly. Due to the widespread propensity to control price setting, the finance department will experience issues. Independence will erect obstacles for the sales division. The production department has a lot of items on hand for creating special promotions. Thus, they came to the conclusion that full cost recovery must be achieved over an extended period of time in order to remove all of these impediments, and pricing must be emphasized as a strategic activity.

Profitability

The profitability of a corporation is impacted by a number of variables. A meta-analysis of 320 published research was conducted by Porto & de Abreu (2018) to determine the relationships between financial performance and explanatory variables. They claimed that a company's profitability is unaffected by its size as assessed by its total assets. However, the company's market share has a favorable impact on its profitability. Therefore, industry entry obstacles have a beneficial impact (Asche et al. 2018, 2018). Sathyamoorthi et al. (2018) investigated how a company's financial standing affects performance.

The mix of variable and fixed costs is represented by operating leverage, which indicates that performance is positively impacted by overall cost. Compared to businesses with low operating leverage, businesses with high operational leverage see more unpredictability in ROS. It was discovered that these businesses perform above average in prosperous times and below average in difficult ones. According to a 2017 study by Singh et al., effective working capital management has a considerable impact on a company's profitability. Liquidity has been highlighted in another study as another element that affects profitability (Pervan et al. ,2019). They claimed that a high liquidity ratio has a beneficial impact on profitability since it lowers the danger of being unable to pay short-term obligations. Liquidity may aid businesses in adapting to shifting conditions, which has a favorable impact on profitability. According to Nagle & Müller (2017), outstanding performers typically spend more than their rivals do on selling, general, and administrative costs as well as R&D. Their extraordinary profitability will ultimately lead to larger margins per sale, which will help sales to increase without putting those margins at risk. As a result, the company's first objective should be profitable sales, not a driving expansion plan.

Pricing strategies

Cost based Pricing: cost plus pricing considered the oldest price method because it contains an actual financial information related to the product or service cost, arrived at by pricing every product or service to obtain a

reasonable return over the total cost, which mean way to make profit and achieve average financial performance. CBP approach discover prices mainly with data from costs of production (Dudu Oritsematosan & Edwin , 2014). The drawback with CBP that in some industries it not possible to arrive at the unit cost before setting price, because unit costs change variables over when the production volume increase, these changes implied important because percentage of fixed cost have to reallocated to arrive at the correct unite cost. According to Hinterhuber it does not consider the customers' willingness to pay the price. Either by simply adding specific amount to the product cost without reference to demand and condition, or by adding percentage of the total cost of production to arrive at profitable price that can cover up the administration cost as this percentage increase the net profit margin increase.

*Customer-based pricin*g is based on customers' willingness to pay, but this willingness might be unknown to the buyers (especially when the product is new, and its features are not yet fully understood).

Competitor-Driven pricing is dictated by competitive conditions, and it might lead to an excessive focus on market share and diminished emphasis on increasing profits. According to (Avlonitis & Indounas , 2005)they argue that the limited attention paid to the customer-based value pricing in context of pricing according to customers' needs, perceived value pricing as well as value pricing) is unexpected. Though, their findings may be due to the complexity and difficulty in define customers value, therefore companies keen to adopt the cost-based pricing method in which they will be able to cover their costs and impose competitive prices and speculating that this will meet the need of their customers and increase their customers.

To overcome barriers and restriction of traditional pricing structures, firms must implement strategic pricing. This Strategic pricing integrate date and information from relevant business functional such as finance, accounting, marketing, and sales to produce optimal pricing decisions. For instance, in process of forecasting market share and values using data from customers and rivals, the sale department will be the guide to connect this value to clients, hence theses departments should work together with economic/ accounting departments to arrive at accurate financial objectives related to profits target.

Table 1. Pricing Strategies

	Cost-based pricing	Competition-based pricing	Customer-value based pricing
Definition	Cost-based pricing approaches determine prices primary with data from cost accounting.	Competition- based pricing approaches use anticipated or observed price levels of competitors as primary source for price setting.	Customers Value based pricing approaches use the value of product or services delivers to a client as the main factor for setting prices.
Example	Cost-based pricing, markup pricing, target return pricing.	Parallel pricing, umbrella pricing, penetration/skim pricing. Pricing according to average market prices.	Perceived value pricing. Performance pricing.
Main strength	Data readily available.	Data readily available.	Dose take customers and their willingness to pay into account.
Main weaknesses	Dose not take competition in consideration. Dose not take customers and their willingness to pay into account.	Dose not take customers and their willingness to pay into account.	Data are difficult to obtain Customer value-driven pricing approach may lead to relatively high prices need to take long term profitability int consideration Customer value is not given, but needs to be communicated.
Overall evaluation	Overall weakness approach.	Sub-optimal approach for setting prices; appreciate for commodities (and only if products or services matter difficult to be differentiated).	Overall best approach, direct link to customers' needs.

Source: Hinterhuber (2008).

Pricing objectives

Since the pricing objectives provide direction for implementation and associated with overall company strategies and operation efficiency. According to literatures finding pricing objectives represented buy three majors' factors relating to their content, the enthusiasm level toward achieving goals and the implication of time horizon. First, within content context both quantitative and qualitative can be one of the variables of the firm objectives function. This embodied that quantitative objective not difficult to measured that included all objectives related to the company profit, sales, market share and cost. On the contrary, the qualitative objectives not numerical in concept and not easy to quantifies for instance relationships with stakeholders (customers, competitors, distributers).

Second, Despite the enthusiasm level for achievement, price objectives might be split over these objectives deployed to achieve maximum profitable result such as profit volume as well as sales. Nonetheless, these objectives not free from criticism as some scholars regards the idea of profit maximization unrealistic and difficult to achieves, this because of the limited data and information on hand of management and lack of communications within the firm (Keil , Reibstein, & Wittink , 2001). Third, in context of timeframe or horizon of achievement, pricing objectives can be either short or long-term. Short terms objectives attempt to meet specific goals in short timeframe, from 6 months to 1 year. Unlike, the result of long terms price objectives which would take longer time to achieve.

This might lead management to peruse short term pricing objectives which result in high risk of losing long term goals of market position. According to (Smith , 1995), that overall, for mentioned characteristics of price objectives propositions implies, the difficulty and the significant of price objectives decisions contemplating the idea that management need to consider more than one price objectives at same time. But not all the price objectives can go along with each other and there is some conflicted among them for instance, Keil suggested that boosting sales price objectives could lead to shrink in profit, and over emphasis on profit margin could be conflicted with social objectives. Result of research by (George & Kostis, 2005), confirmed that companies in service sectors perusing price objectives that qualitative to attract new customers and meet their needs and price objectives. More important the finding confirm that the pricing objectives associated with pricing strategies and tactics, specifically costumer and competition-based objectives found to be positively correlated with market median prices, and profit objectives pricing positively correlated with quality related objectives.

Table 2. Pricing objectives

Pricing objectives	Expected result
Profit maximization	Achievement of satisfactory profit
Sale maximization	Achievement of satisfactory sales
Market share maximization	Achievement of satisfactory market share
Market share increase	Cost coverage
Return on investment	Return on assets
Coverage of the existing capacity	Liquidity maintenance and achievement
Price differentiation	Service quality leadership
Distributors needs satisfaction	Creation of prestige's image for the company
Price stability in the market	Price wars avoidance
Sales stability in the market	Market development
Discouragement of new competitors entering the market	Price similarity with competitors
Maintenance of the existing customers	Customers' needs satisfaction
Determination of the fair price for customers	Attraction of new customers
Long term survival	Achievement of social goals

Source: George et al. (2005).

Pricing Strategies and Firms Profitability

Customer-Value Based Pricing: quality is the essence of customers value Rekettye (2019) "value creation can be explained by the equal or exceeded value paid by the buyer of product and service, according to (Juran & De Feo , 2010)this articulated by the dollar amount paid by the buyer, that include the result of process of value

transformation and firm strategy between engaged parties, which allocate the cost and benefit of the exchange product or services with customers.

(Payne & Frow, 2014) confirmed that the high ranked proposal embodied offer to the customers which increase the value in preferable solution than others offered by rivals. One of the practice fundamental of firm strategy is to set value-based pricing designed to meet customers expectation and satisfaction which will boost their profitability (Cressman , 2012), this regarded as modern approach to pricing strategy and indicated changes in the organization structure. In addition, (Ingenbleek , Debruyen , Frambach, & Verhallen , 2003)emphasis that perceived value of value-based pricing approach, together with information regarding the cost and rivals pricing, clearly related to products and service performance as well as the whole business. These scholars illustrated that the adoption of value-based pricing is a crucially important key pricing practice to achieve bigger returns and for creating some type of comparative advantage for the firms' benefit.

Cost-Based Pricing: CBP: is the easiest and common method to define and prices setting, because it's based on actual solid financial information related to the product cost, which include put profit margin on top of costs, as percentage of contribution margin of the proposed product or services. (Simon , Bilstein , & Luby , 2008). Initially, the revenue level is identified and then unit cost both (fixed and variable) calculated, second, reference the firm profit objectives to define the final prices. Therefore, people who involve in this procedure, have to highlight to customers kind of value on the products and services in order to support the prices to be paid buy customers (Urdan , 2005).

According to research conducted by (Guilding , Drury , & Tayles , 2005)found that three significant factors that can create major obstacle to CBS:

a) Competition intensity: in a highly competitive market, the intensity of competition may lead to a margin reduction and profit percentage due to the pressure to match their prices or below to price charged by rivals, though competitive pricing can add more cost of information to product at premium. With this arena, intense competition, firms who adopt differentiation strategy to their product and service and customised them according to customer need outline that significant of cost-plus pricing because customisation will lead to increase the price.

b) Firm size: price taker or make concepts embodied that fact that larger companies have more power to influence the prices, tendency to be the guider and act as price maker, even under the assumption of economic of scale.

c) Industry firms invest heavily more in fixed assets than service firms and spend more on overhead due to type of operation which are part of product costs. Therefore, it's difficult to accurately capture the individual product costs, which will lead to incompletely defined the cost of information and might result in higher total cost. Moreover, (Liousz , Boland , Hinterhuber , & Perelli, 2011) they suggested that small and medium size business setting their prices based on cost developed cost models, using contribution and profit margin target as part of their pricing.

Competition-Based Pricing: conducted by taken price level of competitors as main source of information and expected change buy closely watching rivals and other sources to set price levels be competing with. One of main advantage of this approach is taken into account the real price situation of the rivals but suffer from omitting demand concepts not considered. ((Liouz & Hinterhuber, 2012). According to (Heil & Helsen , 2001)intense competitive activities between rivals will potentially increase the risk of war price in market, though research show that pricing process conducted by company managements found that they used their knowledge and experience to set prices in addition to models of cost, margin objectives goals to produce profitable pricing model (Liousz , Boland , Hinterhuber , & Perelli, 2011).

In this sense, (Nagle & Holden, 2003) argue that these firms were strongly taken into account the price of their main rivals and adding a price increase by sharing the decision based on the management instinct, not based on scientific approach to set the prices. In this case, competition-based pricing strategies associated with very high

degree of risk because the firm have not clearly considered the cost of profit details of its competitors, who in some cases adopt very low margin.

In some instance, the rivals developed higher efficient production process, where the costs would not be matching, even under the scale of economic gains. Hence, by adopting such strategy, the firms are at risk of operating with minimum margins or negative one in some situation which will result in negative profits. In other hand price discounting strategies based on competition and increase sale volume tactic can also motivate the rivals to decrease their price while participating to exploit competition and start price war, which will decrease the profit margin and firm's profitability (Diamantopoulos , 2005). Despite highly competitive market sourced price information from rivals diminishing very quickly (Ingenbleek , Debruyen , Frambach, & Verhallen , 2003). In this situation its significant to manage the production capacity utilization that rivals must react to the price tactics and strategies determined by the firm, at the same time competitive markets can trigger price war and reduction profit margins (Simon et al., 2008).

Conclusion

First, one of the aims of this paper was to investigate the pricing objectives that firms follow with pricing methods that implemented and the extent to which the price objectives influence and associated with price method. Positive correlation found between the pricing objectives and methods, specifically the customer value-based objective as well as competition related objectives in line with market median price, on other hand products or service quality related objectives and profit maximization as well as sales boost objective found to be negatively corelated. In addition, return target pricing methods was associated with financial objectives that seek to meet profit and sales objectives, at the same time stability in market goals found to be negatively correlated with target pricing method. In contrast, the competition-based objectives were positively correlated with competition-based pricing methods which to set price below the market and rivals' prices.

Second, in order to outperform rivals, firms should make available set of excellent internal resources (Capability, Skills, experience and knowledge) due to the fact that price fixing capacity play major role to improve the firms performance (Liousz , Boland , Hinterhuber , & Perelli, 2011). Profitability and cost effectiveness of the firms are highly depended on the pricing strategies that envisage their internal resources what could be competitive advantages in context of customer's interest and needs and their ability to pay the asking prices. Low price can diminish profits because large volume of sales may net make up the low profit margin, same for high prices; giving up large portion of profit because of high margin per unit sold does not guarantee compensation for small quantity of sale. (Simon , Bilstein , & Luby , 2008).

Oure conclusions indicate that firms who are in favour customer vale-based pricing strategy, and set prices above competitors' prices, arguably within boundary of market circumstances they are in, normally achieve higher profit margin than their competitors who possibly implement competition-based pricing strategies with lower prices. In addition, innovated firms, inter the market with large volume of new product and made from imported materials result in higher profit margin, this implies that the higher consideration of customer value-based strategies for instance adding more innovation feature into new products, will increase the chance of boosting profit margin. Finally, it's important to highlight that value based pricing does not indicate setting higher prices for identical products/Services, but it encourage management to more insight of the customers need and understanding their apatite desire to pay among the market segments, as well as communicating this value in products features, set prices with differences in value perceived, interpret and influencing customer price curve and ultimately illustrate methods to profitably solve the difference in customers willingness to pay (Rudiger, 2004).

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