Independent Final Report

Determinants of Pricing Strategy: A Case Study of the Ethiopian Leather Industry

by

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August, 2018

Independent Final Report

Presented to

Ritsumeikan Asia Pacific University

In Partial Fulfillment of the Requirements for the Degree of

Master of Business Administration

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Certification

I, Umer Jemil Abdela (Student ID 52116612) hereby declare that the contents of this Independent Final Report are original and true, and have not been submitted at any other university or educational institution for the award of degree or diploma.

All the information derived from other published or unpublished sources has been cited and acknowledged appropriately.

Umer Jemil Abdela

2018/05/31

Acknowledgements

Any accomplishment requires the support of others and this research work is not different. First and for most, I would like to extend my gratitude and respect to my supervisor, professor Lailani L. Alcantara who has given me moral and constructive advice.

I also would like to thank the people and government of Japan for giving me the opportunity to study in APU. Last but not least I am grateful to the general managers of the studied companies who have given me the chance to conduct my research.

Abstract

Pricing decision is one of the essential marketing element which affects the company profitability as well as cost-effectiveness directly and within a short-term implementation period. Regardless of the significance, a price has on the performance of a business, it looks that such a variable has not received appropriate attention from researchers and marketing specialists. Furthermore, similar to many other disciplines most of the studies on pricing strategy are conducted in the advanced market. Although some studies are conducted in an emerging market, however, it's very few. Particularly in Ethiopia published research works on pricing strategy are a handful. This research work aimed to study the pricing strategy and its impact on the performance of the business. It takes the Ethiopian leather industry as a case since the sector is attractive and competitive due to the availability of huge resource and some other related comparative advantages. It is also important to mention that due to the broadness of the sector this research is mainly focused on the downstream value chain members of the Ethiopian leather industry, namely tanneries and medium and large-scale footwear manufacturers. Three companies in the tanning industry and four medium and large-scale footwear manufacturers were studied. The result indicates that the companies are practicing the cost-based pricing method to determine the unit selling price of the factories product as the cost of production is the dominant factor used to set price. The cost-based pricing strategy contributes to the positive performance of the studied companies however, it's important to take into account the effect of different factors upon the performance of the Ethiopian leather industry because of the complex nature of the sector.

The country business climate features including resource, infrastructure, institutional constraints, and import dependence directly affect the performance of the business.

Keywords: Pricing strategy, Business performance, pricing determinants.

CHAPTER I: INTRODUCTION

1.1 Background of the Study

Developing a marketing strategy is essential to the success of any business. Without having a marketing strategy it's difficult for firms to address the customers need and generate profit. Various businesses are implementing different marketing strategy which is compatible with their business model and market environment. Among these strategies, marketing mix is the vital one. In implementing a marketing strategy managers are expected to take a decision with regard to the marketing mix. According to Kotler and Armstrong definition "the marketing mix is the set of tactical marketing tools product, price, place, and promotion that the firm blends to produce the response it wants in the target market" (Kotler & Armstrong, 2011, p. 51). "Among the four marketing mix pricing is unique and the most significant to make the organization profitable since it is the only element in the marketing mixes that produce revenue; all other elements represent cost" (Kotler & Armstrong, 2011, p. 290). It is also the most flexible element among the 4ps which affect the company's profitability as well as cost-effectiveness directly and within a short-term implementation period (Simon, Bilstein, & Luby, 2008).

Regardless of the significance, a price has on the performance of a business, it looks that such a variable has not received appropriate attention from researchers and marketing specialists (Avlonitis & Indounas, 2006). Usually, in marketing, the main emphasis is employed on other marketing mixes such as new product development strategies, distribution strategies, and communication strategies. Many researchers consider that the pricing practice in organizations has largely been ignored by managers and professionals and that price is commonly set by estimation and not by systematic means (Bruck, 2010; Cram, 2006; Eugster, Kakkar & Roegner, 2000; Hinterhuber, 2004).

Price is also an important strategic element in many markets, in spite of an increase in the significance of non-price factors; it is still the major factor of consumer choice (Kotler & Armstrong, 2011). Similar to many other disciplines most of the studies on pricing strategies are conducted in a developed market (Cabrales & Martin, 2007; Balaji & Ragavhan, 2007; Ros, 2010; Volpe, 2011). Although some studies are conducted in emerging markets, however, it's very few, particularly in Ethiopia; published research works on pricing strategies are a handful. Therefore, there is a need for more studies regarding pricing strategy to fill the knowledge gap.

By taking the above-discussed issues into consideration, this research is a study of pricing strategy and its impact on the performance of the business. It takes the Ethiopian leather industry as a case since the sector is attractive and competitive due to the availability of huge resource and some other related comparative advantages. For the sake of comprehensive understanding, the world leather market and the Ethiopian leather industry are respectively elaborated in detail. Because of the nature and type of the research, the study follows a qualitative approach. It is also important to mention that due to the broadness of the sector this research is mainly focused on the downstream value chain members of the Ethiopian leather industry, namely tanneries and medium and large-scale footwear manufacturer.

1.2 Statement of the Problem

Unlike the international leather market, various internal and external factors are hindering the Ethiopian leather industries not to use the country's comparative advantage effectively (Leather Industry Development Institute (LIDI). It is obvious that the threats to the sector are challenging the companies pricing practice either directly or indirectly since the determination of price is based on a number of internal and external factors. Studying the impact of the internal problems and external challenges on the pricing practice of the industries is vital to understand the sector and to overcome the problems. By considering this argument, this study focuses on the pricing practice of the sector and its impact on the performance of the business.

Research question

- How is price determined in the Ethiopian leather industry and how does it affect the performance of downstream value chain members of the industry?

1.3. Objective of the Study

The general objective of this research work is to assess the pricing practice of the Ethiopian leather industry and its impact on the performance of the business. The study also has the following specific objectives.

- To identify the major factor that affects the pricing practice of the sector.
- To identify the profit share of the value chain members.
- To identify the challenges of the value chain members in determining a price.

- To recommend ways to overcome the challenges of the pricing strategy used.

1.4 Scope of the Study

These research primarily aims to study the pricing practice and its impact on the performance of Ethiopian leather industry. However, due to the broadness of the sector, the main focus would be on the downstream value chain members of the industry such as tanning industries, and footwear manufacturers. The performance of the industries is assessed with respect to either profit or market share. Special attention is given to the marketing department of the industries since they are a key participant in setting the price of the company's product.

1.5 Organization of the Paper

This research paper includes five chapters. The current chapter provides an introduction that includes the background of the study, statement of the problem, the objective of the study and scope and limitation of the study. Chapter two presents a review of relevant literature. Chapter three deals with research methodology through which the study approach to answering the research question. Chapter four presents detail findings, discussion, and analysis, and the last chapter provide a sound conclusion and recommendation.

Chapter II

2.1 Literature review

The application of marketing concept primarily revolves around the implementation of the 4ps (product, price, place, and promotion). Marketing research and literature have been mostly focused on these vital elements of marketing practice, however, attention given to price is little compared to the other three variables (Avlonitis & Indounas, 2006). Therefore, some studies (Liozu and Hinterhuber, 2012) underlined the need for more research to fill the knowledge gap. According to the authors, less than 2% of all published articles in marketing journals are focused on pricing.

Despite the growing importance of non-price factors, market share or profitability is still largely determined by the pricing practice of the companies. Price can be defined in many ways. “In the narrowest sense price is the amount of money charged for a product or service” (Kotler & Armstrong, 2011, p. 290). Traditionally the buying decision of customers is mostly affected by the level of price. This scenario is still common especially in poorer nations, among poorer groups, and with a commodity product.

According to Monroe (2003), determining pricing strategy is one of the most vital decisions of management because it has a direct impact on profitability and the company’s market share along with their market competitiveness. Thus, developing and defining price is not an easy job but it’s a difficult and challenging task since the managers associated with this procedure must see how their customers perceive the costs, how to build up the perceived value, what are the intrinsic and relevant expenses to conform to this necessity, and additionally consider the pricing objective of the organization and their competitive position in the market (Monroe, 2003). In determining price, companies need to properly address important internal and external factors, which are called pricing determinants. Internal factors incorporate cost, organizational consideration, marketing objectives and marketing mix strategies while the external factors incorporate demand, nature of market competition, macroeconomic trends, market segment and consumer behavior and perception (Forman & Hunt, 2005, p. 133; Smit, 2012, p. 320-322). Based on the above, it can be argued that failure to consider the internal and external factors in determining price will damage the profitability or cost-effectiveness of firms.

Pricing strategy varies considerably among sector and market situation, however, researchers mostly agree that pricing strategy can be categorized into three big groups i.e. cost-based, value-based, and competition-based pricing strategy. According to Nagle and Holden (2003) in order to reach the optimal price, there must be a balanced consideration of information, perception and intrinsic behavior of the 3C's of this process (Cost, Competition, and Customers). The management of such information is a critical aspect for the success of the pricing strategy and the price settlement. In some cases, these practices have also been designated as pricing methods (Avlonitis, Indounas, & Gounaris, 2005). Value-based pricing is a pricing strategy that the managers make decisions based on the perception of benefits from the item being provided to the customer and how these benefits are perceived and weighted by the customers in relation to the price they pay (Ingenbleek, Frambach, & Verhallen, 2010). Applying pricing based on the customer perception is a more modern approach. It is considered as a superior pricing strategy than other (Nagle &

Holden, 2003). Monroe (2002, p. 36) observes that: ‘‘ . . . the profit potential for having a value-oriented pricing strategy that works is far greater than with any other pricing approach’’. Similarly, Cannon and Morgan (1990) recommend value pricing if profit maximization is the objective, and Docters et al. (2004, p. 16) refer to value-based pricing as ‘‘one of the best pricing methods’’. Competition-based pricing relies on competitor's information such as pricing strategies and levels, as well as behavior expectations observed in real competitors and/or potential to determine adequate pricing strategies and levels to be practiced by the company (Liozu & Hinterhuber, 2012). According to Liozu, Boland, Hinterhuber, and Perelli (2011) study, managers utilize their knowledge and experiences, models of costs, contribution margin goals, and well-structured profit goals in order to execute competition-based pricing strategy. Furthermore, those companies who implement competition-based pricing were strongly considering the prices of their main competitors while adding a price reward by always sharing the decision based on the manager's intuition, which is not a scientific method to define prices. In this sense compared to the other pricing strategy, it's considered risky because the company does not effectively have clear cost or profit information from its competitor who, in some instances, may be working with very low margins (Nagle &Holden, 2003). Cost-based pricing is the most simple and popular method for setting prices. Historically, it is the most common pricing strategy because it carries a sense of financial prudence (Simonet al., 2008). According to a study conducted in 187 UK and 90 Australian companies three factors such as intensity of competition, company size, and type of industries can interfere with a cost-based pricing strategy (Guilding, Drury, & Tayles, 2005).

The price level is also another important element that affects a firm's profitability. According to Hinterhuber (2004), the effect of price levels on profitability is high, which means that even the impact of small increases of price on profits and corporate profitability by far exceeds the impact of other influences in managing best results.

This research work attempts to study the application of the pricing strategies and their impact on the performance of the business in an emerging market particularly Ethiopian leather market by taking the above-discussed arguments and theoretical perspectives into consideration.

Chapter III

3.1 Methodology

This study assesses the pricing practice and its impact on the performance of the business by taking the downstream value chain members of the Ethiopian leather industry as a case. The research is designed to use a qualitative research method and follow a descriptive approach. Both primary and secondary data are utilized to answer the basic research question. The researcher used various sources to gather the required data.

3.2 Samples

The initial target population of this research was the Ethiopian leather industry which incorporates a substantial number of players. These players can be broadly classified into two large group's, i.e. upstream value chain members (such as livestock farmers and pastorals, livestock traders, household, slaughtering and meat processing firms) and downstream value chain members (such as private traders, tanning industries, and leather transformation industries). The downstream value chain members comprise a total of approximately 1571 players whereas the upstream value chain includes millions of players. Due to the extensive nature of the sector, the researcher reached to target populations that have a direct role in the leather industry. Based on this criterion the target population of the study is downstream value chain members of the leather industry which includes a total of approximately 50 companies.

This research is qualitative and uses purposive sampling approach. Therefore, companies who are fit for the objective of the study and also who are willing to participate in the research are taken as a sample for the study. According to the Ethiopian Leather Development Institute, there are currently 29 tanneries and 21 medium and large-scale footwear manufacturers operating in the country. Among this, three companies in the tanning industry and four medium and large-scale footwear manufacturers are taken as a sample of the study, which makes 10% of the countries tanning industries and 19% of the countries medium and large-scale footwear manufacturers.

3.3 Method of Data Collection

The first step of data collection was to develop a comprehensive collection of publicly accessible sources of data. The researcher conducted a preliminary study of the Ethiopian leather industry through an extensive collection of archival data on the countries leather sector and also from some prior studies. Most of this data comes from websites of the governmental institute who are in charge of the countries leather industry such as the Ethiopian Leather Industry Association (elia) and Leather Industry Development Institute (LIDI). Additionally, secondary data are also gathered from international web sources, i.e. world statistical compendium.

Following the collection of secondary data, a structured interview was conducted with the selected companies. An invitation letter was electronically sent to companies in order to get permission to participate in the research. The letter includes a descriptive text which requested that the interview would be directed to the person in charge of defining the price of the company’s product or someone who acted directly in the pricing process. In spite of a large number of downstream value chain members, only a few of them accepted the interview request due to company policy and other related matters.

Interviews commonly lasted for about one hour and some were recorded with permission. The recordings were translated verbatim. The researcher exchanged emails with some of the interviewees to confirm the correctness of the transcription and the trustworthiness of the interpretation. Except for Sheba Leather Industry plc, all the respondents were working in a management position.

The interview was conducted during February. Some of the interviews were executed through telephone calls. At the end of the process, the researcher was able to conduct an interview with three tanning industries and four medium and large-scale footwear manufacturers. The researcher was also received internal company documents such as company profile, cost estimation model, cost structure, and other related documents from the interviewees.

The interview consisted of 11 questions, primarily developed for the sake of finding the answer to the basic research question. During the interview, much emphasis was given to questions directly addressing the basic research question and specific objective of the study.

3.4 Data Analysis Process

The data collected through the interview was analyzed using qualitative analysis method. Description of the phenomena and interpretation of the interviewee response approach were utilized. Furthermore, the data collected were elaborated in figures, graphs, and tables. All the interviews were discussed and interpreted separately along with the companies profile and summarized under the finding section.

Chapter IV

4.1 Data analysis

There have been limited publications on the leather sector of Ethiopia. The researcher utilized publicly available documents and web sources to examine the current situation of the leather industry. Both the world and Ethiopian leather industry are elaborated in details in this chapter, followed by interview findings to discuss the determinants of price in the case of Ethiopian leather industry.

4.1.1 Overview of the International Leather Market

The leather products are among the world most exchanged items. It is contribution to the world economy is vital. The value of the worldwide leather trade is close to $100 billion annually (World Statistical Compendium 1993-2012, 2012-2014).

The leather is considered as a renewable resource based on a by-product of the meat and dairy industries. It is a highly versatile material used for various ranges of products including shoes, bags, jackets, gloves, and car and aircraft seats. Regardless of being a substantial business in it, the operation of the leather industry entirely depends on the global agriculture industry from which hides and skins are obtained as a by-product. Therefore, the consumption of meat and also the type of meat being consumed is determining the availability of raw material to the leather industry. As we can see from the following table more than 60% of the raw material utilized by the world leather industry is bovine.

Table 1 worlds Share of leather raw material by type.

Type	%
Bovine	66
Sheep	15
Pig	11
Goat	7
Other	1-2

Source: World Statistical Compendium 1993-2012

The majority of world leather production is owned by China, India, Brazil, and Italy (World Statistical Compendium 1993-2012). The economic environment and purchasing power have a great impact on the world leather industries. Europe and the United States are the biggest markets for quality leather products (bestleather.org). Local markets in developing countries are provided with second or third quality leather (bestleather.org).

4.1.2 The Leather Industry in Ethiopia

The Livestock Resource

Ethiopia has Africa's second biggest livestock population and world fifth cattle population (FAOstat.org, 2013). According to the central statistics agency report, the population of Ethiopia livestock is more than 100 million i.e. 54 million cattle's, 25.5 million sheep's, 24 million goats, 7 million donkeys, 2 million horses and 1 million camels (central statistics agency of the Federal Democratic Republic of Ethiopia (CSA, FDRE, 2013). Most of the livestock's populations are owned by smallholder farmers and pastoralists. The highland agricultural based system of livestock production of the country includes nearly 80% of cattle, 75% of sheep and 30% of goat population (Ethiopian Leather Industry Association (elia.org). These big numbers of livestock population concede the country and its leather industry with a big potential in hides and skins which can place Ethiopia among the world's leading countries in leather production and export.

The Raw Hides and Skins

Rural areas provide around 80% of all hides and skins to the leather industry through private traders. Slaughtering and meat processing firms which are located in major towns and cities contribute the remaining 20% **(**Ethiopian Leather Industry Association (elia.org). Private traders play an extraordinary role in delivering raw hides and skins to the leather industries. According to the Ethiopian Leather Industry Association, there are around 1500 registered private traders who are involved in collection and delivery of hides and skins through the operation of rural operation network. It is a long chain network (small collectors, small traders, middle and heavy suppliers) which serves as a bridge between the source of raw material and the leather industry mostly tanneries of the country. The high quality of the Ethiopia sheepskins is also recognized by the international leather market. The country sheepskins are sought for high class and high-value glove leather and the goat skins are equally recognized to be the finest for suede making for garments and footwear. In fact, the international leather market has coined special names for these two varieties of skins after two local places SELALLIE and BATI. The sheepskins are referred to as SELALLIE genuine and the goat skins BATI genuine which are offered premium price over all others (Ethiopian Leather Industry Association **(**elia.org).

Despite the availability of huge livestock resource in the country hides and skins are not considered as raw material to leather industries, is perceived more as a by-product of meat or simply as waste. Especially in rural areas, even the meat itself is not the main purpose of animal's husbandry because the farmer needs the animal for a productive purpose more than selling them into the market e.g. for agricultural work, milk provision and other. As a result, huge numbers of animals are detained for five to seven years or more to meet these purposes and animals this old do not produce the best meat and their hides and skins are usually so shabby that they have limited value to the leather industry. These collected hides and skins would then need to travel through long and complex channels. The following figure shows the value chain of Ethiopian leather industry.

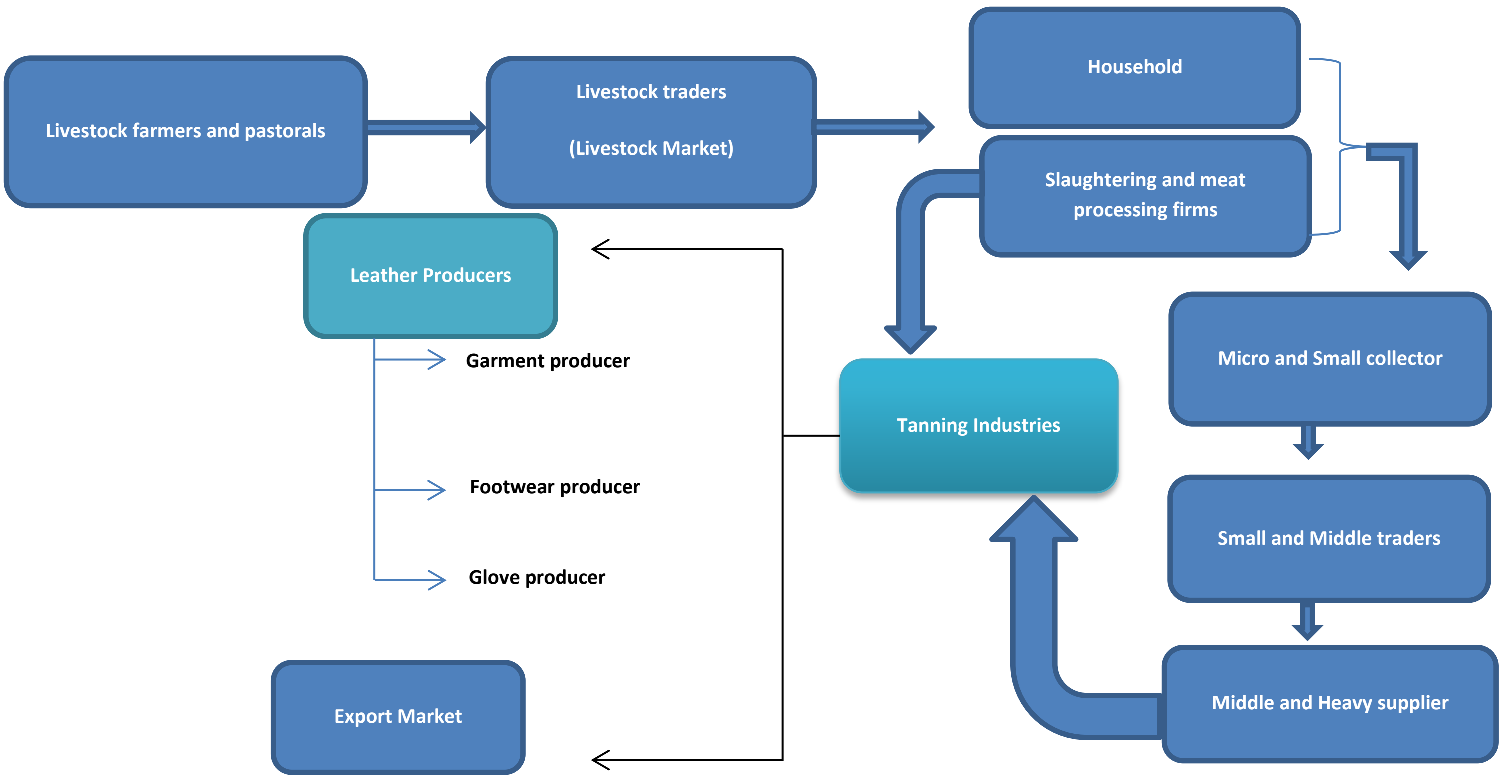


Figure 1 Value Chain of Ethiopian Leather Industry.

Elaborated by the Author

As illustrated in the above figure, the upstream section of the value chain includes farmers and pastorals who source raw material for the leather sector. Therefore, any quality and production related problems in the upstream section have a direct and great impact on the leather sector. As mentioned earlier, the majority of the raw hides and skins are collected and transported to tanning industries by private traders and a small number of hides and skins are directly delivered to tanning industries by slaughtering and meat processing firms. Around 8.5 million pieces of sheepskin, 7 million pieces of goatskin and 1.2 million pieces of hides are supplied to the tanneries per annum (Ethiopian Leather Industry Association **(**elia.org).The following map shows the location of major hides and skins production areas.

Figure 2 The location of hides and skins production in Ethiopia.

The star mark indicates the location of hides and skins production in Ethiopia. As illustrated earlier the country's tanning industries obtain the majority of hides and skins from rural areas through private traders.

In addition to bad perception toward hides and skins, the livestock resource in Ethiopia is underutilized due to low off-take rate which is 13.87% for cattle, 40.29 % for sheep and 27.34% for goat (Leather Industry Development Institute (LIDI, 2017). As reported by Leather Industry Development Institute (2015) there are three main reasons that caused the low off-take rate of livestock's resource. A high animal death rate due to poor husbandry practices is mentioned as one of the root cause of low off-take rates. The second cause is associated to the lowest meat consumption of Ethiopian due to several reasons such as low per capita incomes, high domestic meat prices and the fasting days by the Orthodox Christians, which means that approximately 43% of the population does not consume meat products for over 200 days per year. Moreover poor performance of the country meat export business makes the livestock resource to be underutilized.

The quality of hides and skins are appreciated after shaving the hides and skins and treating them with chemicals, this situation led tanneries not to impose clear price differentiation between the level of quality of the hides and skins they receive from private traders. The quality and price determination between traders and tanners is depended on visual inspection. Size and major defects such as knife cuts, major bleedings or visible skin diseases on the internal side of hides and skins are the basic criteria for setting a price.

Tanning

Tanneries are industrial plants that use large-scale infrastructure and machines in order to transform raw materials into processed goods by large quantities (raw hides and skins into wet-blue or finished leather). As a result, they need a substantial initial investment and hence the cost structure is characterized by outstanding fixed costs, which then require large production volumes to be amortized.

The Ethiopian tanning industry is made of both tanneries that have amortized their initial investment a long time ago and tanneries that are still in their early years. Currently, there are 29 tanneries operating in the country. All the tanneries operating in the country are privately owned. Operative tanners have a daily total installed capacity of around 127,700 pieces of skins and 7200 pieces of hides (Leather Industry Development Institute (LIDI). The following table and map show the lists of 29 tanning industries in Ethiopia and their location respectively.

Table 2 Lists of Tanning Industries in Ethiopia.

No.	Company Name	No	Company Name
1.	Addis Ababa Tannery S/C	16.	Modjo Tannery
2.	Bale Tannery	17.	Sheba Leather Industry PLC
3.	Batu Tannery	18.	Walia Leather and Leather Products PLC
4.	Blue Nile Tannery (Gaffar Enterprise)	19.	Davimpex Bihir Dar Tannery PLC
5.	Colba Tannery	20.	Crystal Tannery Sh.co
6.	Debre Brehan Tannery PLC	21.	China Africa overseas Leather Production S.C
7.	Dire Industries PLC	22.	DX Industries PLC
8.	Ethio-Leather Industry PLC (ELICO)	23.	East Africa Tannery PLC
9.	Ethiopia Tannery S/C	24.	Friendship Tannery PLC
10.	Gellan Tannery PLC	25.	Farida Tannery
11.	Hafde Tannery	26.	Habesha Tannery
12.	Hora Tannery	27.	New Wing Addis Tannery PLC
13.	Kombolcha Tannery S/C	28.	United Vasan Tannery
14.	Mersa Tannery PLC	29.	Jian Xin Zhang Tannery PLC
15.	Mesaco Global PLC		

Source: Ethiopian Leather Industry Development Institute (LIDI)

Figure 3 The location of tanning industries in Ethiopia.

The star mark indicates the location of Ethiopian tanning industries which are listed in the above table. Most of the tanning industries are located at MODJO which is 80km away from the capital city of the country, Addis Ababa.

Leather Manufacturers

The government of Ethiopia is trying to encourage the development of the local leather manufacturing industry by implementing various incentives and measures. Among the measures, 150% taxation on raw and semi-processed leather exports is the major one. This tax policy led the tanning industries to expand their business into finished leather production. The leather transformation industry mostly comprises producers who are involved in the production of garment, glove, and footwear. Footwear producers constitute the large portion of the Ethiopian leather transformation industry.

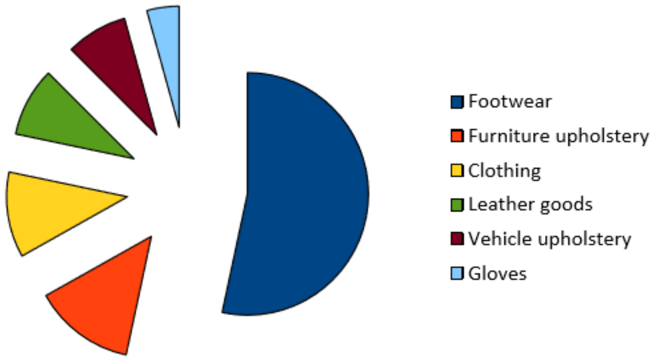


Figure 4 Repartition of Ethiopian finished leather goods in 2010.
Source: Ethiopian Leather Industry association (ELIA)

The cost structure of the leather transformation industry is predominately affected by the price of semi-processed leathers. It is primarily dependent on the tanning industries since more than 90% of operating cost is material purchase manly semi-processed leather. Factories use their best products for the export market while low-quality products serve the local market. However, there is fierce competition in both markets.

Footwear Industries

The leather footwear is the fast-growing industry in Ethiopia. There are numerous internal and external factors that contribute to the growth of the sector. Availability of huge raw material and cheap labor force are played a remarkable role by giving the country comparative advantage than other countries (Leather Industry Development Institute (LIDI). Especially the low wage rate in Ethiopia makes the shoe industries eye-catching since the industry is labor intensive. Some previous studies show that the growth of the Ethiopian footwear industry is also a result of an improvement in the internal competence of the companies particularly in the area of design, quality, and also marketing system (Sonobe, John, Akoten & Otsuka, 2010). Furthermore, various policy measures from the government such as financial incentives through tax holiday and reduction, the 150% export tax on raw and semi-processed leather exporters played a big role to make the sector attractive.

The Ethiopian footwear industry can be broadly classified into two categories. These are smaller manufacturers who are producing to serve only the local market and medium and large-scale manufacturers who are producing to serve both the local and foreign market. The following table shows the lists of the Ethiopian medium and large-scale footwear manufacturers.

Table 3 Lists of footwear manufacturers in Ethiopia.

No.	Company Name	No.	Company Name
1.	Anbessa Shoe S.C	12.	ELICO (Fontanina shoe factory)
2.	Ethio-Leather Footwear	13.	George Shoe Factory
3.	Ok Jamaica Shoe Factory	14.	Huajian International shoe city (Eth) PLC
4.	Kangaroo Shoe Factory	15.	Modern Zege Shoe Factory
5.	Ramsie Shoe Factory	16.	Mohan PLC
6.	Ras Dashen Shoe Factory	17.	New Wing-Addis Shoe Factory
7.	Tikur Abaay shoe S/C	18.	New Wing-Ara Shoe Factory
8.	Wallia Shoe Factory	19.	Oliberte Shoe Factory
9.	Bostex Shoe Factory	20.	Sheba Leather Industry Plc
10.	Crystal Shoe Factory	21.	Park Shoe and Leather product
11.	Dire Industries (peacock Shoe factory)		

Source: Ethiopian Leather Industry Development Institute (LIDI)

Unlike the international leather market, the Ethiopian leather sector is exposed to countless threats. Some of these threats are discussed in the above preliminary study however, they are also addressed during the interview session for the purpose of detail understanding and validity of the preliminary study result. It is obvious that these threats have a direct or indirect impact on the profitability or cost-effectiveness of the leather product producers. In other words, the pricing practice of the companies is subjected to the threats since price should be set after the consideration of all internal and external factors.

4.1.3 Pricing Determinants

In this section, all the interviews are presented and interpreted separately along with the companies' profile. It includes a considerable number of interview statements in order to support the researcher interpretation.

Kangaroo Footwear Manufacturing Industry

Kangaroo Footwear Manufacturing Industry is a private limited company. It was established in 1990 to serve the local and export market with a maximum production capacity of 1600 pairs of shoes per day. It is located in Addis Ababa capital city of Ethiopia. Currently, the company has around 320 employees, of which 200 are females.

Kangaroo Shoe is producing a different type of formal and casual footwear for different market segments. The major products from footwear comprise Clark shoe, sender shoe, lasted shoe, moccasin shoe, sports shoe, lady shoe, safety shoe and children's shoe.

An Interview was conducted with the marketing manager of the company. It is presented and interpreted as follows.

Manufacturing a given product at extremely low cost and selling at a cheap price does not necessarily ensure the company to make enough profit to maintain the business since the profitability of a firm is affected by a wide range of factors. Specifically, due to the complex nature of the Ethiopian leather sector, firms must assess their performance from a broader perspective. Marketing strategy is among the important elements that need to be taken into consideration in order to survive and compete in the market. Accordingly, Kangaroo Shoe Factory installed marketing and sales department under the supervisions of marketing manager as part of its organizational structure. These two departments are primarily in charge of marketing research, promotion and sales activities of the company. However, pricing practice which is one of the marketing functions of a firm is predominately executed by the design, production and finance departments and the final price is approved by the top management. The involvement of the marketing department in determining the price of the firm's product is limited and it is mainly through feedback provision. The marketing manager stated that there is a long procedure used to determine a price of the company product:

"Production of any shoe starts from model or design preparation. In our company, the shoe model is developed by product design and development department through the consideration of market demand. But, in the case of export market customers come up with their own shoe model. Based on the model the department developed a prototype or sample of the intended shoe model. Following the model preparation list of raw material necessary to produce the sample product is prepared using AutoCAD software and sent to the finance department for the purpose of cost estimation. Finance department estimates the cost of each raw material based on the actual market price and then sent to the production department. The Production department is responsible for further cost estimation task and sample production test. In this stage, particularly the cost of a sole is added to the pre-prepared cost estimation and sent to the top management to decide the profit marge or finale price."

The top management team decides the profit margin in view of the market situation and opinion of the top management of different departments mostly marketing and production. The profit margin ranges from ten to fifty percent yet usually the company employed fifteen percent profit margin. The following diagram shows the cost estimation method of Kangaroo Footwear Manufacturing Industry.

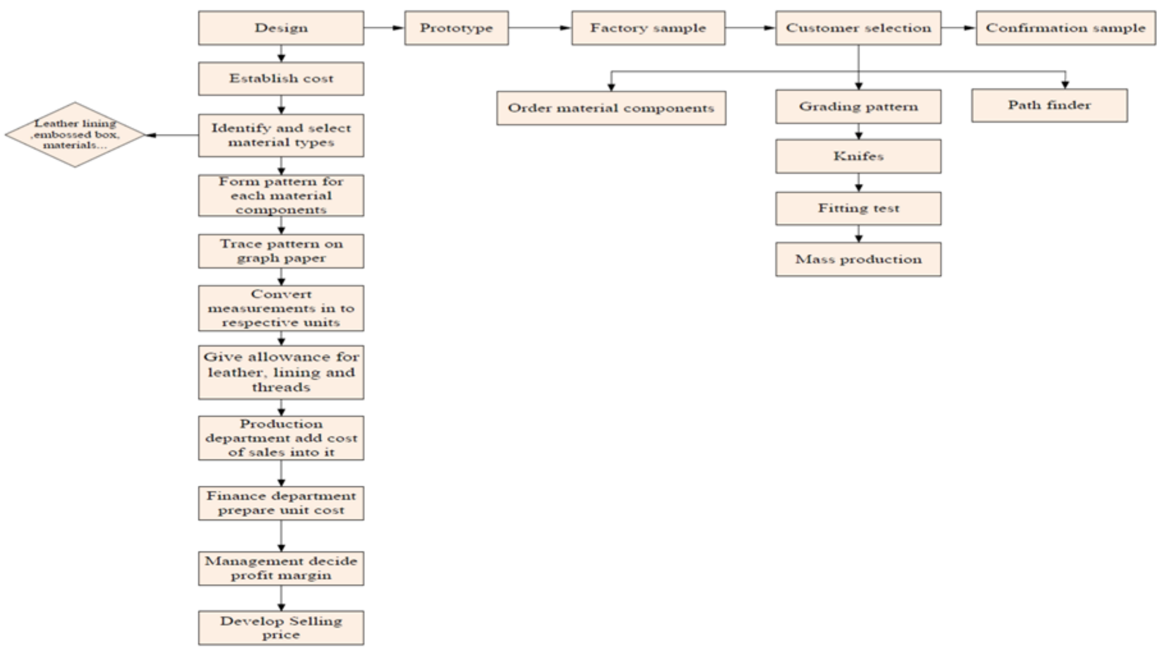


Figure 5 Cost estimation method of Kangaroo Footwear Manufacturing Industry.

(Source: Internal company document)

Kangaroo Shoe considers several factors in determining the price of its product. Among this, the cost of production is the dominant one:

"Our company basically implements cost-based pricing strategy. Raw material, overhead, direct and indirect labor costs are estimated and measured strictly to set our

profit margin, however, the company also considers the market condition and sales outlets location to determine a price."

Raw material constitutes the large portion of the company production cost followed by overhead mostly depreciation. The following figure shows the cost structure of Kangaroo Footwear Manufacturing Industry.

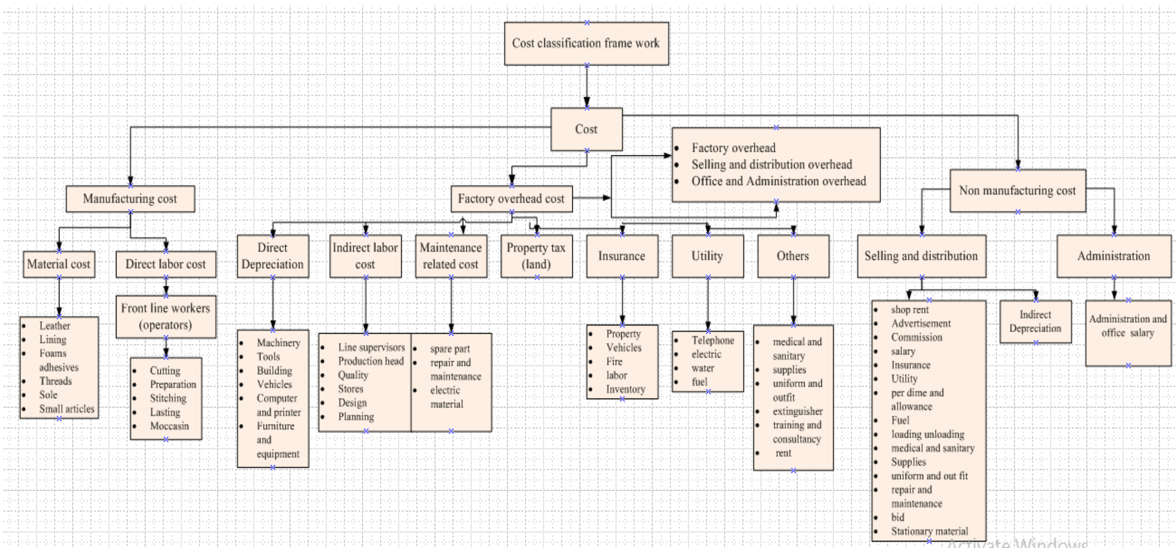


Figure 6 Kangaroo Footwear Manufacturing Industry cost classification framework.

(Source: Internal company document)

According to the marketing manager selling and administration cost cover 24.1% of total cost. Among the costs of selling and distribution, rent cost constitutes the large percentage which is 43% and from administration salary, wages and benefits cover 54% of the total one. The company primarily considers the return on investment in setting price. The marketing manager said, *"Our main objective in setting a price is to make a profit. Of course, there are some situations that force us to drop our profit margin, though making the company profitable is our first priority."*

However, during the time of establishment, the company major concern was sales volume:

"We used to sell our product at a very cheap price compared to other producers. This made our profit margin very small yet the strategy helped us to penetrate the leather shoe market and to get a good market share. Currently, we are among the large producers of a leather shoe and also we have a good reputation in the market."

As mentioned earlier kangaroo Shoe is producing different types of formal and casual footwear for different market segments. Price is considered as one of the tools to attract the target customers. As specified by the marketing manager the company is producing more than fifty-two kinds of shoe for a different age group:

"We are producing and selling various types of shoe to almost all age group. But the young age group is our main market segment. We use price as a strategy to satisfy our customers since most of the population in Ethiopia are price sensitive due to the low-income level. In addition, making our products available throughout the country is also the other strategy we employed to meet customers demand. The number of our sales shop is increasing rapidly to help this strategy."

The manager also added that the production and pricing of a product are strongly supported by market research. Sales outlets are opened after in-depth research about the customer demand of the intended market. However, the market research is not implemented in a scientific way. This led to the missing of important elements that have a great impact on the profitability of the company. Currently, the company has 13 selling shops throughout the country. According to the company six-month profit loss analysis report selling shop management is weak with respect to customer demand and location. The 2017 selling shop profit and loss analysis over the last six month clarify that 5 shops are in loss. It indicates that they are not managing well and the problem is beyond the issue of pricing. However, since other marketing variables are not within the scope of this paper, it will not be discussed here.

The Ethiopian government is implementing various policies and regulations to promote the leather transformation industry. The 150% export tax on raw and semi-processed leather exporting industries is among the policies. As stated by the marketing manager the new tax policy doesn't have a direct impact on the company either in terms of pricing strategy or in other marketing function. Yet it affects the market share of the company by increasing the competition due to the entry of new shoe producer from tanning sector. At the same time, it helps leather transformation industries to get enough amount of semi-processed leather. Irrespective of the new tax policy, the export market is not attractive to kangaroo Shoe:

"We make a better profit from the local market than the export market but the government wants us to fully engage in the export market, while, the situation is not attractive. For instance, we are selling an average quality shoe to the local market at a

price ranging from $18 to $29 but the same type of shoe with high-quality material costs $15 to $25 in export market; this is a loss."

In spite of the low performance of selling shops, the company is generating a good profit. According to the manager and internal company document, 23% of the country market share is held by kangaroo Shoe Factory.

As explained earlier market research and promotion department is primarily responsible for marketing related activities of the firm namely distribution, promotion, market research, customer survey and other related tasks:

"Our marketing professionals are regularly conducting market research and provide their report to the production department. We also installed a suggestion system in each shopping center to encourage customers to give their comments freely. The customer feedbacks together with market research summarized and presented in every management meeting. In the case of the B2B_market, our marketing officers meet the focal or salesperson of the company and collect all feedbacks from both company or individual level."

Several internal and external factors are challenging the profitability of the company. The marketing manager said that a lack of skilled or experienced personnel including in the area of marketing and finance is seriously challenging the task of pricing:

"The price-setting mechanism of the firm is not properly considering the actual production system. We really need systems that help us to crosscheck and confirm the

estimated cost against the actual cost of production. These tasks need professional personnel in the area of production, marketing, and finance.”

There are also a number of external issues that challenge the profitability as well as the survival of the firm. According to the marketing manager, time-consuming and complicated logistic and custom service, lack of skilled manpower, and shortages of foreign currency are the major ones. Solving most of these problems require the involvement of an external body like government.

Ethio-Leather Industry PLC. (ELICO)

Ethio-Leather Industry PLC. (ELICO) was established in 1997 as the leather wing of MIDROC Ethiopia (the biggest business group in Ethiopia) to manage and operate two tanneries and a leather garment and leather goods manufacturing factory that were acquired from the Ethiopian privatization agency. The company has provided about 1300 employment opportunities. Ethio-Leather Industry has a capacity of producing around 25 square feet of leather on average from each bovine hide manufacturing unit, 4.5 square-feet from sheepskins and about five square-feet from a goat. The company also produces and export finished sports and dress gloving leather from sheepskin, finished shoe upper from goat and sheepskin, finished goat suede, and cowhides crust.

An interview was conducted with the marketing manager. It is presented and interpreted as follows.

Similar too other observed Ethiopian leather producing industries marketing departments of the Ethio-Leather Industry has an important role in the determination of price. As the marketing manager stated, in both shoe and tanning business unit pricing decision is conducted through the involvement of many departments:

"Several departments are involved to decide the price of our product. The price setting procedure is started by the cost estimation of the intended product. Corporate service and planning department are primarily responsible to prepare the list of costs used to produce the needed product by considering the actual market price of the necessary raw materials. Following the cost estimation, a profit margin is decided. Marketing department proposes a profit margin and the final price is decided by the top management."

The company has a standard percentage of profit margins but, it doesn't use the standard regularly due to a fluctuation of production cost and dynamic nature of the market. On the contrary, in the case of an export market, the company is a price taker. The customers come with their own price and product specification. The manager also added that price is set based on the distribution distance. A certain amount is added to the price of each product that is sold out of the capital city of the country. The basic reason for adding a certain amount of price on each product is to compensate for the cost of transportation in providing the factory product to the required place. As we can understand from the above explanation cost of production is the major internal factor used to decide the price of the company product. Yet for the export business, the international market price is an external factor that decides the price of the product. In addition, competition is also taken into consideration to decide the profit margin.

The cost structure of the company is broadly classified into two parts i.e. production and service provision cost. Production cost, particularly raw material make up the large portion:

"We spend various costs to produce and sell our product. Material cost mostly raw leather and chemical to the tanning business unit and semi-processed leather and accessory to the shoe business unit cover more than 80% of the production cost. The remaining cost goes for utility, manpower, logistics and for other minor tasks."

Companies set their price with the aim of a certain business objective. According to the marketing manager, the main objective of the factory in setting its price is to acquire a certain return on investment. In this case partly to satisfy the needs of customers but more importantly to achieve a pre-determined level of return on the capital investment involved:

"It's obvious that the goal of pricing our product is to make a profit. Sometimes we revise our profit margin depending on the market condition nonetheless in any case our main target is to acquire a certain return on our investment."

As explained by the marketing manager the introduction of the 150% export tax policy on raw and semi-process leather exporting industries certainly forces the tanning business unit to focus on finished leather production. However, its impact on the shoe business unit is indirect. Currently, the tanning business unit is only serving the local market due to the new export tax:

"The tax policy is mainly targeting the tanning industries. After the introduction of the policy, our company decided to give more attention to the local market opportunity and to the shoe business unit."

Taking in to account the effects of different factors upon its performance the factory estimated sales both in volume and value for the last 10 years. According to the manager, the actual sales performance of the company is beyond the plan. Therefore, the company is succeeding to set an appropriate selling price by carefully analyzing the economic variables. During the last 10 years, the company has been able to sell what it was planned. The manager stated that the company pricing strategy plays a greater role to achieve what it plans to sell in the future.

Better design and low price shoe are considered as the company unique selling proposition that used to attract customers. As emphasized by the marketing manager,

"The shoe model is the important factor that gives our company a competitive advantage than many other competitors. We regularly launch new shoe model to the market since customer became more interested in the design of the shoe than its durability. We have a very good reputation in the area of fashion shoes. Moreover, compared to many other producers our product is relatively cheap. This is basically because of the new production technology that we installed two years ago."

The company mostly utilizes a suggestion system to assess the satisfaction of the customer; in addition, a market research is conducted to identify potential market and threats:

"Our marketing staffs are primarily responsible for market-related tasks. We gather customer feedback and complaints using a suggestion system which is installed in each shop outlet. A market research is also conducted regularly to support the company sales."

According to the 2017 annual report of the company several internal and external factors are threatening the profitability and future growth of the company. Currently, the company is preparing a strategic plan to tackle the threats in collaboration with many other external bodies like governmental institutes who are in charge of the country leather industry. Shortage of educated and skilled manpower in many areas of the operation including marketing, lack of proper information about the competitor price and market situation and continuous increase of cost of raw material are the major serious internal problems that challenge the company performance. The external threats are much serious than the internal problem due to its complex and broader nature. Shortage and seasonality of quality raw material, shortage of foreign currency, fluctuation of power supply, poor and costly logistic service are some of the major threats to the company.

Sheba Leather Industry plc.

Sheba Leather Industry Plc. is a company that strives to produce and sell leather products to local and international market. It is one of the sixteen companies under the group of the Endowment Fund for Rehabilitation of Tigray (EFFORT). The company is established in 2001 with paid-up capital of 118 million Ethiopian Birr. It is located in the northern part of Ethiopia, Tigray regional state. The region is known for the best origin of hides and skins.

Sheba Leather Industry plc. Integrated tanning and shoe business unit. The tanning business unit has the capacity to process and finish 6000 skins and 600 hides per day. Whereas the shoe business unit has the capacity to produce 800 to 1200 pairs of all type of shoe per day.

An interview was conducted with the production supervisor of the company. It is presented and interpreted as follow.

An increase in the competition of leather industries motivate Sheba Leather to give high attention to marketing related tasks since only producing a quality product does not guarantee the profitability of the company. As stated by the supervisor, the marketing department is among the key players in the company price determination activity. Several departments are involved in price setting practice of both tanning and shoe business unit. However, R&D and marketing department are primarily in charge of the pricing task and the final price is approved by the general manager after top management discussion:

"Our price determination process for tanning and shoe business unit can be broadly classified into two parts. This classification is based on the company production strategy (i.e. customer based and company based production) and market segment (i.e. export and local market)."

Generally speaking, there are six main steps in price setting strategy of Sheba Leather. These procedures are applied in both production units:

"Our price setting task starts from the preparation of sample product or model of the product. For the local market, sample product is commonly prepared by the company

particularly R&D in consideration of customer demand yet for export market the sample is usually provided by the customer with a fixed price level. Then based on the sample product detail cost estimation is carried out in consideration of the actual market price of the necessary raw material. The sample product with detail cost estimation result is sent to the production department for the purpose of a pre-production test. The company employs this strategy for the sake of confirmation. Using this process the cost and quality standard of the sample product is checked against the actual production process. After pre-production test, the profit margin is set by discussion among R&D and other departments particularly marketing. Finally, the proposed profit margin is presented to the general manager and the general manager approved the profit margin after having a discussion with the top management team."

Marketing department plays an important role in setting appropriate profit margin by providing necessary information regarding the market condition since setting high profit-margin without consideration of the market may lead to a loss. Nevertheless, for the export market, the profit margin depends on the customer proposed price level. From this, we can understand that the export market of the firm is governed by international market price and quality standards. The supervisor also added that after the price is decided the firm directly starts production or advertisement of the new product. The decision depends on the type of the product as well as the market segment. For export market usually, the new product is advertised to potential customers before actual production. In this case, the company first receives a production order from a customer and produce as per the order. The company also makes price level adjustment particularly the local market price in the case of sales decline and fashion change.

Sheba leather considers various internal and external factors in determining a price of its product. Cost is the dominant element that takes into consideration to set price:

"Our company considers numerous internal and external factors to decide the profit margin. For the tanning business unit cost of production is the primary factor used to set price. Yet market condition and the company marketing strategy are also considered. In the case of shoe business unit production cost and international market price are the two main factor used to determine a price. In addition purchasing power of customer, sales outlets location and other related aspects are also taken into consideration as an external factor to set a price of shoe for a local market."

The company cost structure is mostly comprised of material cost particularly leather and chemical:

"Our Company is spending various types of cost to produce the needed product. For the tanning business unit raw leather (hides and skins) and chemical costs are the major one. Similarly, for shoe business unit semi- processed leather and accessories costs make up the large portion furthermore labor, utility and depreciation are also among the list of costs which are stated in the company cost structure model especially depreciation constitute the large percentage of tanning cost next to material."

Profit is the primary concern of the company in determining a price. This objective is realized through the delivery of quality products at an affordable price:

"Our primary objective in setting price is to maximize profit but this doesn't mean that setting a high price. We are striving to provide a quality product at an affordable price. To meet this objective the company is implementing various technologies, systems and improvement ideas that help us to reduce unnecessary production and service cost."

Similar too many others tanning companies the 150% export tax policy on raw and semi-processed leather exporting industries forced Sheba Leather Industry to give full attention to the local market opportunity and to the shoe business unit. Following the introduction of the tax policy the company reduced the amount of semi-processed leather export and gradually decided to stop exporting and start servicing only the local market, on the contrary, the shoe business unit starts giving more attention to the export market. Currently, the export share of the shoe business unit is higher than the local market share:

"I think the export tax policy is helping us to look our company from a broader perspective. Making profit by hurting the country economy is harm to the long-term survival of a business. Local leather product manufacturing firms used to face difficulty to get enough raw materials (semi-processed leather) since almost all tanning industries were exporting much of their product by neglecting the local market demand but now the situation is changed. After the introduction of export tax policy, a number of new companies enter the leather market and the tanning industries shift to production of a finished leather product. This scenario motives the leather market by bringing competition

among the industries. We implemented various improvement ideas in the production and management system of the company and start making a better profit than the previous time. I think the change in export tax policy is among the external factor that motivates the reformation of the company."

Sheba Leather Industry has a better competitive advantage than many other shoe manufacturing industries since the company incorporates both tanning and shoe business unit. This competitive advantage helps the company to deliver its product to the intended customer on time. Particularly for export market delivery time is a key factor to get a customer. According to the supervisor, many of the countries leather shoe producers have a bad image regarding delivery time. Difficulty to get enough raw materials on time is one of the root causes that contribute to the delivery time delaines. From this perspective, truthful delivery time can be taken as the unique selling proposition of the company:

"Our company particularly shoe business unit is among the best companies who are delivering there product on time since the company has both tanning and shoe business unit. The shoe plant can easily get raw material from the tanning section, however, this is not common in many Ethiopian shoe industries. Most of them don't have their own tanning industry. In addition to delivering time our product is also known for its durability and better design."

As mentioned above due to the increase of market competition and sales decline, Sheba Leather starts giving better attention to marketing related tasks. Broadly speaking the marketing department of Sheba Leather has three main tasks i.e. promotion of the company product through various ways (TV advertisement, showroom, local and international symposium and other activities), assessment of customer satisfaction through direct customer contact particularly in case of company-level sales and customer feedback collection system which is installed in each sales outlet owned by independent agent, wholesaler and retailers and the third main responsibility is market research.

Similar too many other downstream value chain member of Ethiopian Leather Industries Sheba Leather is facing a number of internal and external challenges that have a direct or indirect impact on the profitability and cost-effectiveness of the company. As stated by the supervisor skill gap is among the major internal challenges of the firm. This skill gap is common in almost all department of the firm:

"Our staffs who are involved in pricing practice are not well experienced and educated. Sometimes this limitation led to a failure to consider the key factors in determining a price. The price of the company product is also higher compared to other producer and this is mainly due to the high production cost. Solving this issue required skilled and educated personnel in the area of leather production. Furthermore, poor utilization of a resource, low productivity, and difficulty to satisfy the market demand because of low production capacity are some of the internal challenges of the firm."

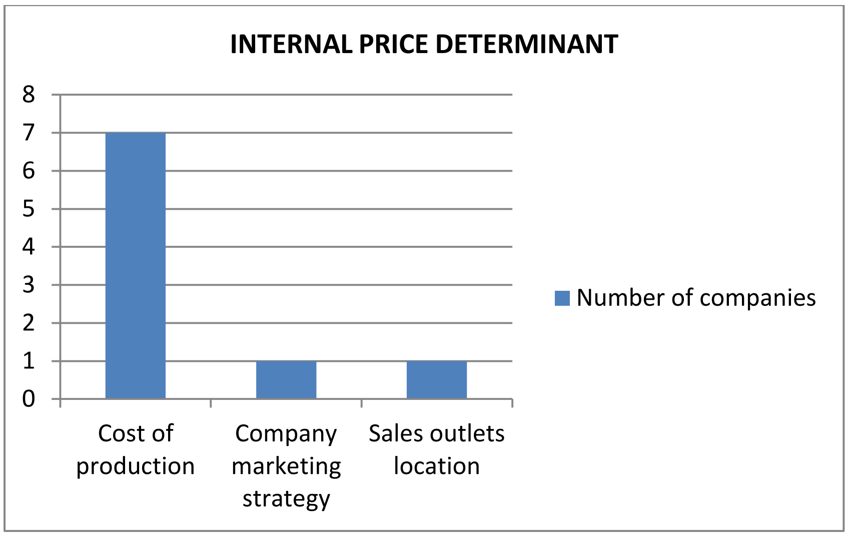
Apart from this, there are also a number of challenges which are beyond the control of the company. Power interruption, shortage of foreign currency (dollar), shortage and quality problem of hides and skins, the absence of local chemical and accessory producers, and long and costly logistic service particularly in the case of export and import business are among the major external factors that affect the profitability and long-term existence of the firm.

4.2 Findings and Discussion

The above discussion and interpretation of interview data illustrated that the studied companies namely tanneries and medium and large-scale footwear manufacturing industries of Ethiopia are employing three main procedures to determine price, such as preparation of sample product, preparation of a list of necessary costs used to produce the needed products (cost estimation) and adding of profit margin. Several departments are involved in the pricing practice. However, in almost all companies marketing department plays a vital role by proposing a profit margin or evaluating the proposed profit margin against the actual market situation. All companies have a different cost estimation methods and the department in charge of the cost estimation task is different in each company. Numerous internal and external factors are taken into consideration when determining price, yet in all companies the cost of production is the dominant factors that used to set the price. By considering this fact, we can say that the studied companies are practicing the cost-based pricing method to determine the unit selling price of the factory's product. This is the most elementary pricing method that adds a standard mark up to the cost of overall material, labor, factory overheads and other expenses to determine the total cost of the factory. It is also the commonly practiced pricing strategy because it carries a sense of financial prudence (Simonet al., 2008). Showing customers enough value on product and service is vital to those who are implementing cost-based pricing strategy in order to justify the price charged by the company (Urdan, 2005). Based on a study conducted by Milan et al. (2013)

on 84 companies there is a greater focus on price setting based on costs. Furthermore, this strategy encourages the companies to utilize a better expenditure technique.

The following graph shows the list of internal and external factors considered in determining price with their weigh.



As shown in the graph the cost of production is the dominant internal factor used to determine price in the studied company. Marketing strategy and sales outlets locations are also taken as second criteria to decide the profit margin.

Figure 7 Internal pricing determinates of the studied companies.

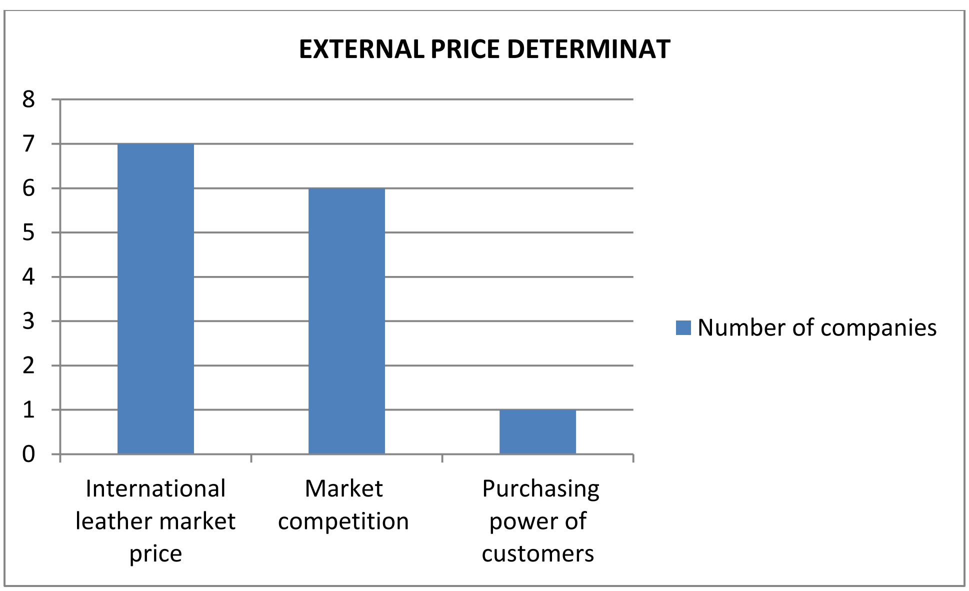


Figure 8 External pricing determinates of the studied companies.

As depicted in the above graph international leather market price and competition are taken as the major external factors considered in determining a price of the leather product. Specifically for the export market, the price of the product is set by the international market or customer; therefore, exporters are always price taker whereas the market or customers are a price setter. In such cases reduction of unnecessary production cost is the primary means to maximize profit. On the other hand market competition and purchasing power are taken as an external factor used to determine a price of the local market next to the cost of production. The following table and figure summarize the pricing practice of the studied companies respectively.

Table 4 Summery of the pricing practice of the studied companies.

No.	Company name	Internal factors	External factors	Participant	Performance		
					Profit	Market share	Sales plan ACHV
1.	Kangaroo Footwear Manufacturing Industry	Cost of production	*Market condition *Sales outlet location	*Marketing dep *Design dep *Production dep *Finance dep *Top management team	Positive	23%	-
2.	Ethio-Leather Industry PLC. garment and leather goods manufacturing plan 1	*Cost of production *Distribution distance	*Competition *International leather market price (particularly for export market)	*Corporate service dep *Planning dep *Marketing dep *Top management team	Positive	-	100%
3.	Ethio-Leather Industry PLC. garment and leather goods manufacturing plan 2	*Cost of production *Distribution distance	*Competition *International leather market price (particularly for export market)	*Corporate service dep *Planning dep *Marketing dep *Top management team	Positive	-	100%
4.	Ethio-Leather Industry PLC tanning business unit 1	Cost of production	Market condition	*Corporate service dep *Planning dep	Positive	-	100%

				*Marketing dep *Top management team			
5.	Ethio-Leather Industry PLC tanning business unit 2	Cost of production	Market condition	*Corporate service dep *Planning dep *Marketing dep *Top management team	Positive	-	100%
6.	Sheba leather Industry plc. shoe business unit	*Cost of production *Company marketing strategy	*International leather market price (particularly for export market) *Market condition *Purchasing power of target customers *Sales outlets location	*R&D dep *Marketing dep *General manager	Positive	-	-
7.	Sheba leather Industry plc. tanning business unit	*Cost of production	*Market condition	*R&D dep *Marketing dep *General manager	Positive	-	-

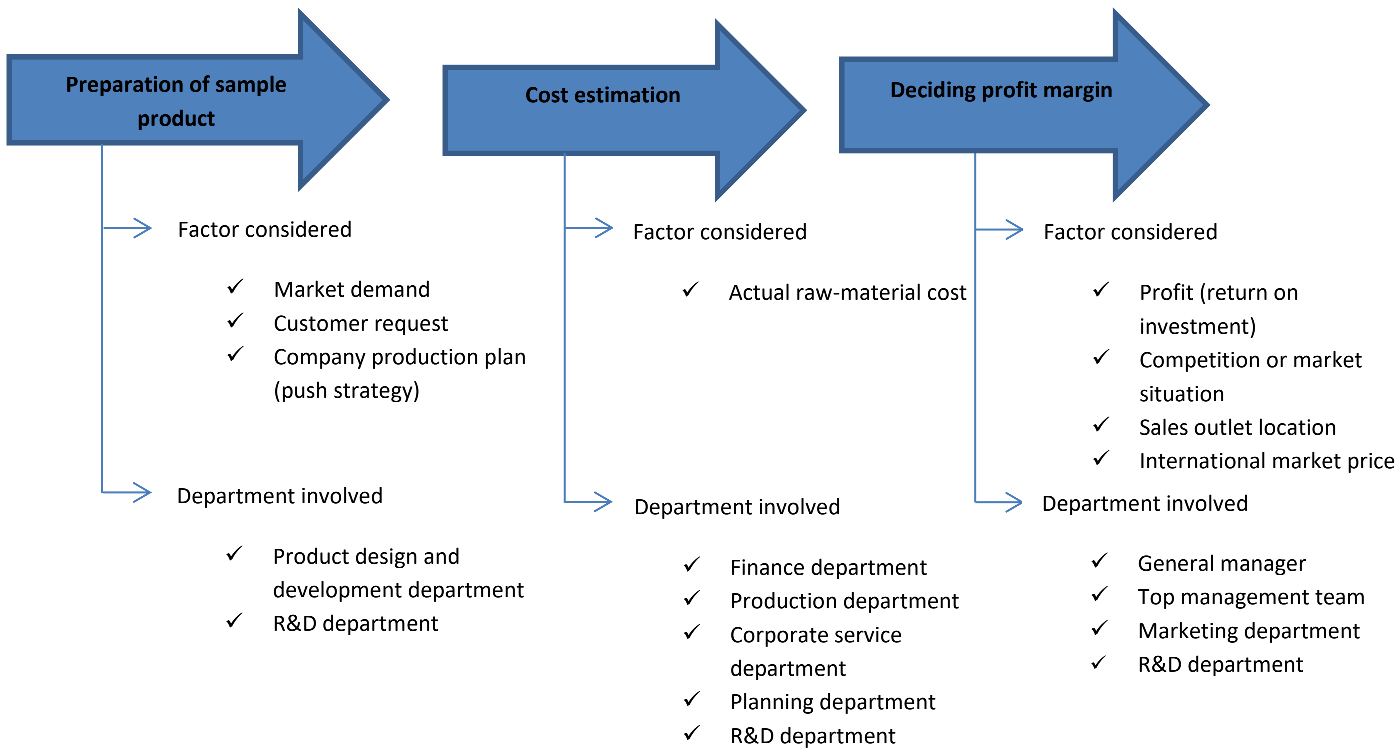


Figure 9 Price determination models of the studied companies.

Elaborated by the author

The cost structure of the Ethiopian Leather Industry is composed of a wide variety of fixed and variable costs however raw leather and chemical constitute the large portion of the industry cost structure. The following tables show the list of tanning and footwear production cost respectively.

Table 5 The cost structure of the studied tanning companies.

Fixed Costs	Variable Costs
Machinery	Chemical
Land & Facilities	Labor
Working capital	Utility
Depreciation	RHS (raw hides and skins)
	Machinery upkeep
	Holding and logistic costs

Table 6 The cost structure of the studied Ethiopian footwear manufacturing industries with estimated weight.

Type of cost	Weight
Raw material (semi-processed leather)	◎
Shoe components	○
Utility	○
Maintenance and repair	○
Labor direct	△
Labor overheads	△
Administration cost	△
Cost of marketing and distribution	△
Depreciation	△

Judgment ◎……3 points, ○…….2 points, △…..1 points

As shown in the above table, the raw material purchase is the main cost Ethiopian footwear manufacturing industries have to face. It represents more than 85% of the operating costs. Therefore, there is a strong dependence on the tanneries and on the quality and quantity of the skin they can produce.

This dependence is the core of many issues. First, the footwear manufacturing industries procure very different skins. The quality and quantity are very variable. There is no incentive for the farmers or the traders to take good care of the animals; hence, the skins come in different conditions. Sometimes, it is hard for the footwear manufacturer to get sufficient skins. As there is, at the moment, no contract between traders and factories, the quantity of inputs can also be highly variable.

Therefore, the lack of contracts or incentives for good skins creates an input problem. Nevertheless, the Ethiopian leather industries have other benefits that can prove attractive to potential investors. Firstly, the labor cost is low and represents as seen in the previous table, a very low percentage of the total production costs. But then again, the workforce is generally under qualified and needs a training that generally lasts 6 months.

It is important to take into account the effects of different factors on the performance of the Ethiopian leather industry since the sector has a complex nature. The countries business climate features including resource, infrastructure, institutional constraints, and import dependence directly affect the performance of the business. The industry suffers from a low penetration on the international market due to lack of competitiveness in terms of selling price. Therefore the profitability or market share of the studied companies is influenced by several factors. However, marketing practice particularly pricing decision can be taken as one of the factors contributes to the performance of the business. According to the marketing manager of Ethio-Leather Industry Plc. the companies pricing strategy is played a remarkable role to achieve the 10 years sales plan. Based on this, we can say that the concerned bodies responsible for pricing decision consider the market condition and purchasing power of the customer when determining a price. Similarly, pricing decision also contributes to the performance of other studied companies since emerging market like Ethiopia is highly vulnerable to price. For instance Sheba Leather Industry plc. is performing well in terms of profitability. Pricing strategy is one of the factors contributes to the good performance of the company since the low price is one of the unique selling proposition of the company. In spite of the low performance of selling shop, kangaroo Footwear Manufacturing Industry is also generating a good profit. According to the marketing manager pricing and other marketing activities are among the important contributing factors.

Through its 150% taxation on raw and semi-processed leather exporters, the Ethiopian government has clearly decided to encourage the development of the local leather transformation industry. This industry mostly consists of transforming leather into shoes, gloves, and garments. Nevertheless, the tax policy doesn't have a direct impact on the studied footwear manufacturing companies either in terms of pricing strategy or in other marketing functions. However, it contributes to the growth of competition among the leather transformation industries by forcing the tanning industries to expand their business to leather product manufacturing. The tax policy also assisted the provision of abundant and quality semi-process leather to the footwear manufacturing sector. Conversely, for the tanning sector, the introduction of the tax policy has created some drawback. After the introduction of the 150% export tax on raw and semi-processed leather exporting industries, tanneries were forced to vertically integrate the entire tanning process, thus causing discrepancies in the processing capacity between raw, wet-blue and finished leather. In addition, the sector suffers from disinvestment because the tanneries are rarely their owner's core business. As a result, the sector is slowed down and is less competitive than it could be.

Despite the availability of huge livestock resource and government initiatives to help the sector Ethiopian Leather Industry still have strong difficulties to produce a quality leather product that meet quality standards and that would allow the industries to enter the highly competitive international market. Several internal and external challenges are mentioned by the companies during the interview sessions. Lack of skilled and educated staff is the common problem that challenges the pricing as well as other operations of the companies. In some studied companies, the price determination task is not properly considered the actual cost of production. This leads to failure to maintain the financial prudence of the pricing strategy. In addition, underutilization of resource, poor delivery time, lack of proper information about the market and continuous increase of raw material cost are also the common internal problems raised by the respondents. However, from the interviews and company annual report the external factors that affect the company's performance are more challenging than internal factors. The following is a summary of the external challenges that are raised by respondents during the interview.

- The quality issue and its link to the export share in output

Rawhides and skins quality is one of the main issues in the leather industry, as it was constantly put forward by the several managers interviewed during data collection, poor quality hides, and skins is the major challenge of the Ethiopian Leather Industry. High-quality hides and skins can be exported or used for exportable finished goods, while low-quality hides and skins serve the local market only.

- ❖ Dependency on costly imported chemicals

Due to a poor chemical and footwear accessory industries, Ethiopian tanneries and footwear manufacturers have to import their chemicals and accessories from foreign countries, which are very often non-African. This lead to two main issues. The first is that tanneries are highly sensitive to the chemicals price variations on the international market. Secondly, the logistics of acquiring inputs is more complex and requires more working capital. Indeed, the cost of importing chemicals has drastically increased over the past decade, particularly after the oil price hike of 2008, which led to considerable operating costs increases all over Ethiopia.

- ❖ Seasonality in raw hides and skins supply

One major specificity of the Ethiopian tanneries is that their raw hides and skins supply can be very irregular. During holidays periods raw hides and skins are available in large quantities which lowers their price and with a long period of shortage they can be used when prices skyrocket.

This has two main consequences: the necessity for the tanneries to buy and possess large stocks of raw hides and skins (during holidays periods), and the emergence of competition between tanneries for the best quality of raw hides and skins at the lowest price (during shortage periods). The first one can be illustrated by the impact of holding costs on the tanneries' profitability as well as by a significant share of the working capital in the fixed costs. Evidence for the second can be found when assessing the impact of the raw hides and skins price variation on the tanneries' profitability.

❖ The lack of competitiveness in terms of selling costs

Because of the different problems mentioned, Ethiopia struggles to be competitive in the international market. The prices its industry can offer remain high compared with other producers, especially in Asia.

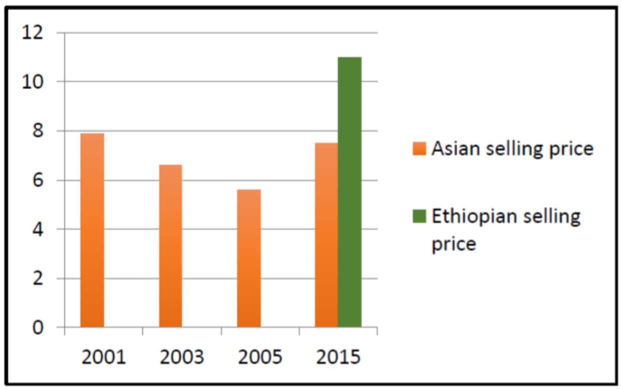


Figure 10 Different price (in USD) for European imports from Asia or Ethiopia.

Future trends in the world leather and leather products Industry and trade (united nation's Industrial development organization-Vienna, 2010)

❖ logistics and trade facilitation issues

Another factor that might explain the Ethiopian Leather Industry difficulties to deal with international competition is the Ethiopian poor infrastructure which makes the logistics complicated, time-consuming and costly for them when exporting their output or importing raw material. Most products have to go through Djibouti to be shipped to their final destination, and this process, according to local factory owners, takes at least 3 weeks. Other products are sent by plane, but the costs are much higher. External trade is much more costly in Ethiopia than in many countries and it takes much longer to import and export, thus diminishing the leather industry's international competitiveness. Furthermore, power interruption and a shortage of foreign currency are also challenging the sector. Many efforts have been made by the government to improve logistics. These include the establishment of dry ports, a multi-modal transport system in 2011, industrial zones and economic operators authorized by the customs authority. However, not all these efforts have been effective and logistic obstacles remain.

CHAPTER V

5.1 Conclusion and Recommendation

There are a number of price-setting mechanisms that are available for any business organization. The studied companies employ a cost-based pricing method to determine the unit selling price of the factory's product. This is the most elementary pricing method that adds a standard mark up to the cost of production and service. Preparation of sample product, cost estimation, and adding of profit margin are the three main procedures utilized to set price. Several departments are involved in setting the price of the product being sold by the studied companies nevertheless, in all cases marketing department is played a significant role by assessing the profit margin against the actual market condition and the final price is approved by the top management. Irrespective of this fact, lack of proper information about the market and continuous increase of raw material cost are challenging the pricing strategy of the companies. On the other hand for the export market, the price and product specification are set by the international market.

Compared to other countries in the world, Ethiopia's main comparative advantage lies in the size of its livestock which, at first glance, seems to grant the leather industry with a big potential in the size of the supply. However, the Ethiopian agriculture only perceives hides and skins as a by-product from meat consumption. This perception is favorable to the appearance of many structural problems preventing the leather industry from thriving throughout its value chain and inducing major complications and barriers on the quality and quantity of the leather. Furthermore, the industry is facing numerous challenges that need special attention from the government. Therefore it’s important to take into account the effects of different factors on the performance of the Ethiopian leather industry. The country business climate features including resource, infrastructure, institutional constraints, and import dependence directly affect the performance of the business. Yet pricing strategy can be taken as one of the internal factors contributes to the positive business performance of the studied companies in relation to profit, market share and sales volume.

This research work also shed light on various factors that prevent Ethiopia from being a competitive actor in the international leather business. The business model has to evolve in a hazardous environment characterized by seasonality in raw hides and skins supply, which in addition to logistic issues causes raw hides and skins shortages, hence raw hides and skins substantial price variations, and quality issues. Furthermore, the tanning process involves a heavy chemical process which ties up tanneries to imported chemicals that increase costs and can cripple their operations in case of logistic or market issues. Most importantly, the lack of an institutional entity able and willing to modernize the agriculture sector has a noxious impact on the Ethiopian leather quality. The location of Ethiopia also highly prevents the country from being a competitor on the international market due to high transportation time and costs. Last, the relatively weak institutional situation of the country adds high transaction costs, thus enabling Ethiopia to be a competitor in terms of prices. Ethiopia’s future leather industry therefore highly depends on deeper transformations in the country, including a modernized agriculture.

From the major finding and the conclusion made, the researcher would like to forward the following recommendation that may overcome the challenges related to pricing strategies and other issues that affect the performance of the Ethiopian leather industry

- The marketing mix strategy particularly the pricing decision should be considered with that of the total marketing mix such as product design, distribution and promotional decision to form a consistent and effective marketing program since in almost all studied companies cost of production is the only dominant factor considered in determining a price.
- The studied companies mostly used cost-based pricing strategy. It is the most simple and popular method to set price since it carries a sense of financial prudence, however, companies who are implementing cost-based pricing strategy are facing challenges during an increase in the cost of raw material by forcing them to increase their price. A continuous increase in the price of a product has a negative impact on the performance of the business, therefore; the companies should start looking for means to reduce unnecessary production costs as well as other appropriate pricing strategies.
- In order to solve a human resource capacity problem, the companies need to start by identifying organizational skill gap. It is crucial to know where your employees lack the skills to perform their tasks efficiently. One of the basic ways to do this is an employee’s competence level test. After the evaluation, the company should conduct effective training and development program which not only to provide the

necessary expertise and knowledge but also allow employees to be competent in applying what they are learning in their day-to-day jobs.

- As mentioned above the Ethiopian leather industry unlike in more developed countries are transformation plants which have to process raw material of highly hazardous quality into products that must meet international quality standards in order to be exported. The ones who bear the greatest responsibility in developing high-quality raw hides and skins to the tanneries are the livestock farmers and slaughtering firms including household slaughters since they are a source of raw material to tanneries. Therefore, the Ethiopian government should implement a comprehensive plan that can address structural upstream problems facing the leather industry such as improving traditional animal husbandry practices, educating hides and skins handlers to avoid quality deterioration and other. This will allow the Ethiopian leather industry to compete in terms of quality internationally. In addition, the government should create more incentive to attract investors and improve infrastructural and logistic related problems.

As emphasized in the above discussion wide varieties of factors are contributed to the good and poor performance of the Ethiopian leather industry. Pricing practice can be taken as one of the factors. By considering this matter improving the performance of the country's leather industry requires a deeper transformation of the whole value chain.

While careful considerations were taken, some of the primary data collection of the study has relied on telephone interviews. Future studies can use alternative ways such as personal interviews or ethnographic research to collect more data and offer new insights. Furthermore, the inability to address the whole value chain and to incorporate a good number of participants in the research gives an incomplete picture of the pricing practice of the sector. Likewise, inaccessibility of recent and broader information creates difficulty to better understand the performance of the sector. Therefore, it’s highly recommended to consider this matter in the future study of pricing practice of the Ethiopian leather sector.

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APPENDICES

List of interview questions

1. Who is the responsible department to set price and what are the procedures for determining price?

2. What are the internal and external factors considered in determining price and how do you weigh them?

3. Could you give me some explanation about the cost structure of your company?

4. What is the objective of your pricing strategy or what do you want to communicate with your pricing strategy?

5. Who are your target customers and the use of price to attract the target customers?

6. What is your view about the 150% export tax policy on raw and semi-process leather exporting industries and its impact on your company with respect to price?

7. How are you satisfied with your profit performance?

8. What is the unique selling proposition or competitive strength of your company?

9. How do you assess the market and customers' satisfaction?

10. What are the current internal challenges in relation to pricing practice?

11. What are the challenges of the industry that need to be addressed by an external body like government?