Diana Zuhroh_IMPLEMENTATION OF STRATEGIC PRICING MODEL in FASHION-BASED CREATIVE INDUSTRY

by UNMER Fakultas Hukum

IMPLEMENTATION OF STRATEGIC PRICING MODEL in FASHION-BASED CREATIVE INDUSTRY

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Abstract

This study aims to obtain empirical evidence of cost structure and implementation of competitive strategy in order to determine the selling price using strategic pricing model for fashion-based creative industry. The research method used was a survey using questionnaires with respondents from practitioners of Small and Medium Enterprises (SME) in East Java. Questions in the questionnaire are: cost structures along the downstream, upstream, and production costs, as well as policies related to the implementation of competitive strategies; tend to low cost or differentiation. Data analysis is descriptive quantitative, and for the separation of SMEs which is implement Low Cost or Differentiation strategy using model developed by Jermias and Ghani (2005). A total of 78 questionnaires returned and were eligible for further process. The results of this study show that most of SMEs (60%) have been exporting their products, and they consider the products from China is the main competitors. SMEs that have used social media for promotion and sales are 57%. The downstream cost structure of most SMEs are design and model development cost. Production costs includes the cost of raw materials, labor costs and other costs. While, upstream costs includes: marketing costs, product returns, and compensation costs. A 40% of SMEs implement competitive strategy tend to differentiation, and the rest uses strategy tend to Low Cost. With this results, the using the traditional model to set the selling price that has been applied by SMEs based on fashion need to be improved. It is suggested to use strategic price model, especially for SMEs which are implementing differentiation strategy. This means, the selling price strategy implemented by SMEs have to consider the strategy and its position in the product life cycle (Blocher et al, 2010: 566). This because theoretically, strategic pricing model is considered more appropriate for companies which are implementing differentiation strategies. While, SMEs which are implementing Low Cost strategy, using traditional selling price model is still considered appropriate. The results of this study is useful for development of pricing theory, in particular for SMEs. This result is also useful for the development of SMEs in order to improve competitive advantage from the aspect of price, so, the SME's product will be able to compete with imported products.

Keywords: differentiation, low cost, strategic pricing, competitive advantage

Introduction

Indonesia with the fourth largest population in the world, actually has enormous potential in the sector of creative economy. The growth of creative use increased by an average of 10.5% per year during 2010-2013, and could absorb approximately 10,6% of the total national workforce (Ministry of Tourism and Creative Economy of the Republic of Indonesia, 2014: ii). The strategy of creative economy development has been prepared by the government by establishing the following four principles (Ministry of Tourism and Creative Economy of RI, 2014: vii):

1. Mastery in science and technology through the empowerment of creative human resources by increasing the ability to acquire and utilize science. Therefore, mastery of technology is very important in the development of creative economy.
2. "Design thinking" as a culture that must be developed at all levels of society.
3. Maintaining art and culture.
4. Utilization of media as a means to increase literacy and public appreciation of local resources, works and creative products.

In the development of creative economy, the government has set fifteen priority sectors: (1) architecture, (2) design, (3) film, video, and photography; (4) culinary; (5) craft; (6) fashion (7) music, (8) publications, (9) interactive games, (10) advertising, (11) research and development, (12) visual arts, (13) performing arts, (14) information technology and (15) television and radio. Of the 15 sectors in the creative industry, the three main sectors and the largest are the culinary, fashion and craft industries (http://ranahberita.com). As stated by Muslikah (2014), fashion industry becomes a potential and superior industry for Indonesia's GDP and as a potential solution to overcome the number of unemployed in Indonesia.

The Government, through the Ministry of Tourism and Creative Economy defines fashion in the creative economy as "a lifestyle in appearance that reflects self or group identity". The scope of industry in fashion includes: clothing design, footwear, fashion accessories, clothing production and accessories, consultation for fashion product line and fashion product distribution (Ministry of Trade, 2008). However in reality, this sector is still facing a major problem. Conclusion from the various studies have conducted, the problems that are still faced by this sector are: inadequate formal and non formal education (http://ranahberita.com), a very tight competition with imported products (Kontan, July 7, 2014), inefficiency that causes low competitiveness of Indonesian products in global markets (Kompas, December 2014), and lack of access to additional capital or funding (Bank Indonesia Malang, 2013). To survive, employers use various strategies, a way that can be done is by setting a special price (Kontan, 6 November 2014). Often, this way is not based on a clear or rational reason.

In order to improve competitiveness and to win the competition, various seminars have been held and various studies have been conducted. The proposed solutions generally relate to: promotion, brand development, mentoring or coaching with a cluster approach (Muslikah, 2014), management coaching to gain easy access to banks, quality improvement, and improvement of design motives (Bank Indonesia Malang, 2013, 2014). In addition, on a macro scale, action plans have also been made by the government, including: the ease of obtaining Intellectual Property Rights (HAKI), access to international marketing, and various conveniences provided to entrepreneurs and other parties related to the fashion industry (Ministry Industry, 2009).

This research is conducted to obtain the best model of selling price determination for fashion-based creative industry in order to provide solution for creative industry development through improvement of pricing policy. This solution is no less important than some that have been proposed before. As expressed by Kotler, et al. (2009: 77), businesses that use price as a strategic tool to win the competition will generate more profit compared to businesses that only let the cost or market determine their pricing.

During this time, generally selling price determination is done traditionally (which only focus on production cost). Past research has proved that traditional selling prices are considered less suitable for business growth with tight competition (Hogan and Nagle, 2005; Micu and Micu, 2006). Therefore, in the situations where competition is very tight, the determination of the selling price should consider the determinants of competition, including: competitor's product selling price, product lifecycle and cost lifecycle (Blocher et al 2010: 545 -564). Strategic Pricing Model Based on Product Life and Cost Cycle is considered more appropriate to be used in business environment that is facing a very tight competition. This model is chosen because, basically, price is not static but very dynamic. Thus, it must be constantly adjusted to the external factors, especially customer and competitors' products.

In implementation of strategy and strategic pricing model, management needs an adequate management accounting system. It plays an important role in providing both financial and non-financial information required by management for both operational and strategic decision-making. The management accounting system should also be able to play a supporting role in realizing the strategy which is chosen by the organization as provider useful information for planning, directing and encouraging efforts to achieve organizational goals (Langfield-Smith, 2006: 243). This condition should be achieved by SMEs because in reality, it also faces a very tight competition such as that happened to large-scale companies.

Based on the above explanation, then the formulation of this research problems are:

1. How is the cost structure in the fashion-based creative industry in the life cycle cost ?

2. How is the implementation of business strategy by fashion-based creative industry ?

3. How is the strategic pricing model based on the cost-lifecycle for fashion-based creative industry product in accordance with implementation of competitive strategy ?

This study is the first year of research that is planned to be conducted for 3 years with funding from the government. The results of this research are useful in developing the theory of selling price determination that considering competitive strategy, product lifecycle and cost life cycle. In addition, the results of this study are also useful for formulating models of SME coaching in order to be able to compete with products from other countries.

Theoretical Background

Fashion-Based Creative Industry

The understanding of fashion in the broad sense as (1) a combination of styles that have a tendency to change and display updates, (2) an acceptable, popular choice, and is used by the majority of the public; (3) a way to be accepted by society as a symbol of expression of a certain identity so as to give confidence in the appearance of the wearer; (4) not only about dressing, imaging or designing clothing, but also the role and meaning of clothing in social action (Ministry of Tourism and Creative Economy, 2014: 222). Based on that meaning, especially the first meaning, it can be concluded that fashion is not something static or fixed, but changes over time because the fashion always displays an update. This means, in fashion there is also a cycle: appear, favored and finally abandoned by the wearer.

Along with the development of society, the fashion industry is also growing, from just a home-based activity to a large-scale industry. The scope of fashion can be divided by process type, volume, product type, product function, and market segment. Business fields created from the fashion industry include: (Muslikah, 2014): textile, leather, knitting and apparel manufacturing company, trading (distributor) of local and international fashion products (export and import), as well as services specifically designers and model. The chain of fashion industry has a very wide range, especially textile-based fashion products supported by raw material and other materials are widely available in Indonesia (MINISTRY OF INDUSTRY, 2009).

Competitive strategy

A competitive strategy is an offensive or defensive action to create a defendable position in the industry to face competition and earn high returns (Porter 1993: 31). There are three strategies that are usually used by the company are: differentiation, low cost advantages (low cost) and focus. Differentiation strategy is the effort to differentiate the products or services offered by the company by creating something that is felt new and unique by the whole industry (Porter 1993: 33). This uniqueness is expected to increase customer loyalty which in turn brings the company to a higher profit margin than its competitors (Porter 1993: 34). Low cost strategy is a strategy used to win the competition by relying on low overall cost so that a company achieve efficiency compared to competitors. Efficiency is achieved through strict control over overhead costs, research and development costs, service, sales, advertising and other costs (Porter, 1993: 32).

Strategic Pricing Determination

Strategic pricing is a pricing aimed to improve profitability, not only from increased sales volume, but also by emphasizing increasing value for customers (Dolan and Gourville, 2009, Strategic Edge LLC, 2008). Strategic pricing determination requires information concerning with customer, competitors and costs (Lansiluoto, et al, 2007). In addition, the determination of the strategic selling price is also a pricing strategically, which means, to win the competition, the pricing is always associated with the competition strategy chosen by the company (Micu and Micu, 2006).

According to Blocher et al. (2010, 567), the determination of a strategic pricing assists management in determining the price of a product or service based on a cost lifecycle, or based on its position throughout the product lifecycle. This means, the price is not static but very dynamic because it must be constantly adjusted to the external factors, especially customers and competitors' products. Strategic pricing proved to assist the management of SME companies in improving financial and non financial performance (Manuere, et al, 2015).

The main difference between traditional selling price determination and strategic price setting is in the response or management reaction to market conditions. This means strategic pricing requires decisions that link or relate marketing and financial factors. The strategic pricing is based on the following concepts (Strategic Edge, LLC, 2008):

1. In an era of competition that marked by increasingly homogeneous products, customers are only willing to pay for goods that give them value or optimal benefits.
2. Companies need to understand the market segment for their products. In the midst of the dynamics of competition, this understanding should be the basis for the company to set a price that is balanced with the needs of customers.

Meanwhile, according to Kiokue (2012), the purpose of strategic pricing are:

1. Goals that are oriented to Profit or profit maximization.
2. Goals that is oriented to the volume. The price is set in such a way as to achieve the target sales volume or market share.
3. Image-oriented goals, that means: firms set high prices to establish or maintain prestigious images. Meanwhile, low price can be used to form a certain image value (image of value).
4. Price-oriented goals. This goal is usually used by companies that have a price-sensitive customers.

Strategic Pricing Based on Cost Lifecycle and Product Lifecycle.

According to Blocher et al, (2010.546), strategic pricing is the process of determining the selling price that considering two factors: cost lifecycle and product lifecycle. Cost lifecycle is a series of activities within the organization starting from research and development activities, design, production, marketing / distribution and customer service, as shown in Figure 1 below:

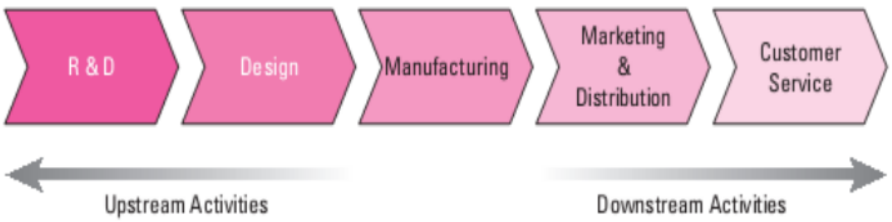

Figure 1
Cost Lifecycle
Source: Blocher et al, 2010: 564

Based on the figure, upstream activities are a series of activities consisting of research / development and design activities, while downstream activities include marketing / distribution activities and customer service. The lifecycle costing is the method used to identify and monitor the cost of products along the cost lifecycle. The traditional system only takes into account the costs at the third stage or the production stage. Meanwhile, according to Blocher et al, (2010.564), product lifecycle is a product life cycle that starts from the introduction, growth, maturity and decline stage and is subsequently withdrawn from the market, as shown in Figure 2 below:

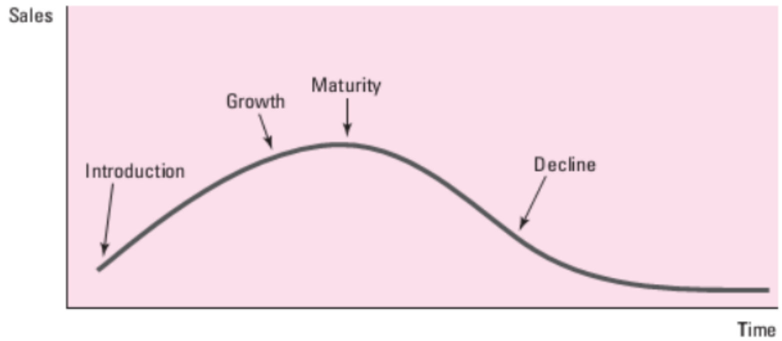

Figure 2
Product Lifecycle.
Blocher et al, 2010:565

Based on the product position in the product lifecycle, then the selling price is determined using the following formula (Blocher et al, 2010.565):

$$\text{Price}=\frac{Full\ life-cycle\ cost}{(1-Desired\ life\ \ cycle\ margin\ percentage)} \quad \ldots \quad (1)$$

Next, after the sale price can be calculated, in determining the strategic price that will be implemented, management must consider the position of the product in the life cycle, with the following details (Blocher et al, 2010: 566):

1. Introduction stage. At this stage the price should be set higher to cover the cost of desian, research / development and marketing costs. High price is possible because the competition is considered still not too tight.
2. Growth. Although the sales volume gradually increased, at this stage the competition began to increase because similar products in the market also began to increase so that the price becomes very competitive. Under these conditions the price should still be set high.
3. Maturity. At this stage, sales are still increase, though slower. Price follows the competitors, in other words, the company starts to apply price taker policy, no longer as a price setter.

4. Decline. Sales are declining at this stage as well as prices that are starting to be lowered. To avoid losses, management must focus on efficient costs in the downstream and upstream.

The implementation of strategic pricing determination that is associated with competitive strategy implemented by the company, according to Blocher et al (2010: 564) are as follows:

1. For products with a low cost strategy, the determination of the selling price is based on cost that emphasizes cost efficiency.
2. For products with differentiation strategies, the determination of the strategic pricing can be done with the following policy (Blocheret al, 2010, 564):
    a. The price is set high for a particular customer group, and the price is lower for the other group (skimming).
    b. The price is set low to capture a larger market share (penetration).
    c. In order to build a special long term relationship with customers, the price set is tailored to the specific consumer needs (value-pricing).

Research Methods.

Unit of Analysis.

The object of this study is SMEs engaged in the fashion sector which includes: companies that make products made from batik and embroidered products, garments and other creative industries related to fashion.

Operational Definition of Research Variables.

Variables of this research is: strategic pricing. The operational definition of "Strategic Pricing" is the determination of the selling price that consider competitive strategy, upstream, producyion, and downstream cost, and also product position in product lifecycle.

Respondents, Data Collection Methods, and Data Analysis Techniques.

Research respondents, research data collection, and data analysis techniques are presented in the following table:

1.	Method of collecting data	Questionnaire.
2.	Respondents	Owners or entrepreneurs of fashion-based SMEs
3	Questions in the questionnaire	1. The general profile of the respondents, include: product type, domestic marketing, export destination countries, and main competitor countries. 2. Cost structures along the downstream, upstream, and production costs. 3. Policies related to the implementation of competitive strategies; tend to low cost or differentiation, consist of 8 questions, with the details: a. For differentiation strategy, questions were about policies directed to create unique products and services for consumers. b. For the low cost strategy, questions were related to the policy directed in achieving efficiency and low pricing. Respondents were asked to answer questions with answer option 1: never applied, up to 5: always applied. 4. Questions relating to accounting records used includes: accounts receivable records, note payable records, cash inflow and outflow records, incoming and outgoing goods records. Respondents were asked to answer questions with answer option 1. Not important, up to 5: very important. 5. Preparation of Financial Statements. Questions asked about whether the respondent has prepared financial statements on a regular basis.
5	Data analysis	Quantitative descriptive statistics

Stages of Data Analysis.

1. Identify downstream, production, and upstream costs incurred by respondents

2. Analyze the characteristics of business strategies implemented by SMEs to achieve competitive advantage, namely Low Cost or Differentiation strategy using the following steps:

a. When tabulating the respondents' answers, in order to obtain calculations that can be used to separate the implementation of competitive strategies, it was used the opposite scale, the details are:

   1). Differentiation strategy: never applied (1) - applied intensively (5)

   2). Low Cost strategy: never applied (5) – applied Intensivelly (1)

b. Identify business units that implement Low Cost and Differentiation strategies using the following procedures (Jermias and Gani, 2005): if the average score of the answer is higher than the mean, the business unit is considered to implement a strategy which is tend to differentiate. Conversely, if the average score of an answer is lower than the mean, the business unit is considered to implement a strategy which is tend low cost.

c. Based on the analysis in step 2 then the analysis of the strategic pricing that should be applied by SMEs was done by considering the upstream, production, and downstream cost structure and product position in the product lifecycle.

Results and Discussion of Results of the Research

Descriptive Analysis

A total of 78 questionnaires were answered and returned by the respondents. From the analysis, 60% of respondents have exported their products to overseas market and 40% planed to export. The largest export destination is the countries around Asia. Types of products includes: batik products, garment with batik as raw materials, various embroidery products, knitting products, shoes, bags, and accessories products, such as jilbab (hijab). For hijab products, they are generally exported to Brunei, Malaysia and some countries where some of its population are Muslim. Most respondents (approximately 57%) know that their products have a competitor, and the hardest is the product from China.

Upstream, Production and Downstream Costs

In accordance with figure 1, the downstream costs incurred by SMEs in the fashion industry include survey or research costs (especially customers or markets) and design or model making. A total of 25 respondents or 24% of respondents spend on customer research to obtain information about products that are in demand by customers. With regard to the cost of design, model, or motive, 49 respondents or 67% of the respondents incurred costs to get designs or motifs that suit the interests of customers. In addition, a total of 33 or 45% of respondents paid employees who specifically create a design or model, or a particular motif that is in demand by customers.

Respondents' answer about the cost of production shows, 100% of respondents spend on raw materials, indirect materials, labor costs and other costs such as telephone, water, electricity, and packing costs. A total of 58% of respondents take into account: depreciation expenses (or at least the cost of using fixed assets), especially for buildings, machinery, and equipment used in the production process. Meanwhile, 25% of respondents spent on transportation costs of purchasing raw materials and other materials.

Respondents' responses related to downstream costs indicate that 65.3% of SME owners pay a fee for promotion. Of these, 49% of SMEs do promotion through social media, such as instagram, facebook, and web, in addition, 25% utilize certain events such as exhibitions. Based on respondents' answers, 8% promoted by distributing brochures, and the rest do promotions through mass media (newspapers, magazines, etc.), as well as radio. Meanwhile, 45% of respondents have made online sales. In order to provide the best service for customers, respondents also issue some after-sales service fees. In more detail, 53% of respondents received returns on products from customers and 48% of respondents were willing to provide compensation or replacement of products to customers.

Implementation of Competitive Strategies.

In the previous section have described about the SME separation procedure that implements low cost and differentiation strategies. Using the procedure, the study obtained results: 38 SMEs implemented a differentiation strategy and out of these 20 SMEs exported the product and the rest (18 SMEs) planned for export. Thus, SMEs that implement low cost strategies are 35 SMEs, and 6 SMEs among them have been exporting products.

Analysis of Strategic Pricing

This section describes the 4th stage data analysis, as well as the discussion of research results. As explained in the theoretical review, the strategic pricing is determined using the formula 1. In addition, theoretically, the strategic pricing model should be used by SMEs that implement differentiation strategies.

This study found that there are SMEs implementing differentiation strategies (± 60%). Therefore, to these SMEs, then the model of strategic pricing determination should be used by SMEs. The steps required in applying the model are as follows:

Stage 1. Sums up all costs incurred which consist of costs along the upstream, production, and downstream.

Step 2. Determining the desired margin or profit level

Stage 3. Enter in the formula :

$$\boxed{\text{Price} = \frac{Full\ life - cycle\ cost}{(1 - Desired\ \ life\ \ cycle\ margin\ \ percentag\ e)}}$$

Stage 4. Once the "Price" is obtained, the owner of the SME identifies its product position in the lifecycle cost: newly introduced (introduction), begins to grow, popular or peaks in sales (maturity), and declines. The price is determined by its position in the lifecycle cost. At this stage, SMEs need to understand the position of their products to implement strategic pricing policies, which are detailed as follows:

a. If the product position has just been launched or introduced to the market / customer (introduction), then SMEs should apply skimming policy, that is, the price can be set high or expensive. This can be done by setting a high percentage of margin. This policy is taken with the consideration that customer of this product is highly emphasized on the uniqueness so that the price factor does not affect the interest to buy.

b. Furthermore, if the product began to be favored (growth), at that time competitor also start to be exist. At this stage that is marked by the increase of sales, the price can still be set high, even higher than the competitors.

Stages a and b are required to cover costs that include: research costs (if any), modeling, design, or motive costs.

c. Furthermore, when sales have peaked, which is marked by very high demand or sales, SMEs begin to apply the policy as a price taker with a slight decrease in price. This policy is taken so that the price has been set not too much different from the competitors. In implementing this policy SMEs can implement penetration strategies by starting to lower prices, at least equal to competitors. Another policy that can be chosen is to apply different prices between one customer group and another customer (value pricing). This policy is tailored to conditions of customer and competition.

To be able to run these stages there should be adequate accounting records, especially for recording upstream, production, and downstream costs. However, based on an analysis of the accounting system and the process of preparing the financial statements shows that 52% of the SMEs in the sample of this study have not yet prepared the financial statements. This means that these SMEs also do not have a cost record. Based on the analysis of the use of accounting records by SMEs, most of them responded that records of accounts receivable, debt, cash outflow and cash inflow were important notes, with the scale ranging from "important" to "very important". These results support the conclusion of research conducted by Andarwati (2016) that for SMEs, financial statements are still not considered important, meanwhile, supporting reports are important to them.

Based on these findings, this study will be continued. The detailed agenda for second year research is in the following table:

<table>
<tr><td colspan="3">a. Provide accounting training and financial report preparation to SMEs that have became the sample of this research. Training materials include: simple accounting cycles, recapitulation of each type of cost, customer records, and notes of competitor identification.</td></tr>
<tr><td colspan="3">b. Socialization of Implementation of Strategic Price Model.</td></tr>
<tr><td>1</td><td>Target</td><td>Entrepreneurs or owners of SMEs in the fashion sector that are implementing differentiation strategies.</td></tr>
<tr><td>2</td><td>Aim</td><td>Main:
a. Introducing of a strategic pricing model and the training of its use.
b. Assistance and monitoring of model implementation.
Additional :
To capture the opinion of the entrepreneur to improve the model.</td></tr>
<tr><td>3</td><td>Implementation</td><td>Formed 3 groups, each consisting of 5 entrepreneurs. Group formation based on type of product, consists of:
Group 1: batik cloth,
Group 2: embroidery, garment, and hijab
Group 2: shoes, bags, and other products from leather</td></tr>
<tr><td>4</td><td>Expected results</td><td>Main: A good understanding of the strategic pricing model and willingness to apply the model.
Additional: SMEs have and implement better accounting systems and able to prepare financial statements. So they have access credit from banks or other formal financial institutions.</td></tr>
</table>

After the second year, it is expected strategic pricing model will be applied by fashion-based SMEs, especially SMEs who's the products are rely on uniqueness. With the implementation of this model, SMEs will be able to set a selling price that is more appropriate to product characteristics, competition and cost characteristics. The next expected result is a better competitive advantage for fashion-based SMEs. In the following year, the third year will be further research to obtain empirical evidence about the interest of SMEs to apply this model using theory of Planned Behavioral (TPB).

Conclusion

SMEs in the fashion sector mostly implement differentiation strategies that promote uniqueness. The cost structure in the fashion sector SMEs is, for upstream, consist of cost of design and modeling, or motives, and for production costs including raw materials, indirect materials, labor costs and other costs. As for downstream costs include marketing costs, product returns, and compensation costs. SMEs implementing differentiation strategies should apply a strategic pricing model. This means that in determining the selling price of SMEs need to consider the position of the product in the cost life cycle and apply the policy of skimming, penetration, or value pricing.

Theoretically this model is considered appropriate for SMEs that implement differentiation strategy that puts the uniqueness. This study actually produces findings that show the SME sector is not ready to apply this model. This is because most MSMEs do not yet have a recording or accounting system that allows the availability of information related to downstream, production and upstream costs. Since this research is the first year of the 3-year planed, then in the second year, will be continued with the assistance of SMEs in preparing the accounting system. In addition, the socialization of pricing strategy model and application of the model training will also be conducted.

5

Limitations of the Research.

The respondents of this study are the owners or managers of SMEs that are very heterogeneous in terms of education and knowledge. This leads to a very varied understanding of the question items in the questionnaire, and then has the potential for validity and reliability of answers. In addition, the number of representative samples for this study can not be determined because the SME data of the fashion sector in East Java is still not available.

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