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Moderating Effect of Inflation on the Relationship Between Pricing Strategies and Profitability of Small and Medium Scale Enterprises (SMES) in Kano Metropolis, Nigeria

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ABSTRACT

The study examined the moderating effect of inflation on the relationship between cost based, value based and competition-based pricing strategies and profitability of small and medium scale enterprises (SMEs) in Kano Metropolis. A cross-sectional survey research design was employed. Target population of the study is 594 SMEs, registered across ten industrial estates in Kano. A sample of 239 SMEs was selected using Taro Yamane formula using Cluster sampling technique. Data were collected through a structured questionnaire, and analysed using SPSS version 21 for preliminary studies and Smart PLS 4.0 for Structural Equation Modelling (SEM). The study examined three pricing strategies (cost-based, value-based, and competition-based) and their relationships with profitability, moderated by inflation. Inflation significantly moderates the relationship between competition-based pricing and profitability (β=-0.306, $p<0.05$) and value-based pricing and profitability (β=0.151, $p<0.05$), but not between cost-based pricing and profitability. Implications for SMEs include optimizing cost-based pricing, enhancing market research for value-based pricing, and adapting strategies to inflationary pressures. The study recommends that policy makers support SMEs by providing resources for market research and competitive analyses and strategies can help SMEs optimize their pricing strategies, improve profitability amidst changing economic conditions in Kano Metropolis.

Introduction

Profitability is the cornerstone of any business endeavour, regardless of size or industry, as it signifies a business's ability to generate consistent earnings over time. For small and medium scale enterprises (SMEs), which are regarded as the backbone of Nigeria's economy, profitability is essential for continuous growth and sustainability. Profitable SMEs not only create value and provide employment opportunities but also contribute significantly to economic development and social welfare. In Nigeria, where SMEs constitute 97% of all businesses, contribute 46% to the nation's GDP, and provide 84% of jobs, their profitability is crucial for maintaining economic stability (NBS/SMEDAN, 2017).

However, achieving profitability presents a significant challenge for many SMEs in Nigeria. Studies reveal that 95% of SMEs fail within their first year, mostly due to profitability problems

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(Abubakar & Junaidu, 2019). This underscores the need to explore key factors driving profitability of SMEs. Among the key drivers of profitability are pricing strategies, which are the methods businesses use to set the prices of their goods or services. Strategic pricing has a more immediate and direct effect on profitability compared to other measures like cost reduction or market expansion (Hinterhuber, 2023).

Pricing strategies are typically categorized into cost-based, competition-based, and value-based. Cost-based pricing involves setting prices by adding a mark up to the cost of production, ensuring that businesses cover their costs. Competition-based pricing is based on aligning prices with competitors, enabling businesses remain competitive. Value-based pricing sets prices according to the perceived value of the product or service to the customer, offering potential for higher profitability if executed effectively. Pricing strategies are effective instruments for enhancing profitability by establishing revenue generation methods while controlling cost structures and market demand, however, their effectiveness is influenced by external factors such as inflation.

Inflation refers to the sustained increase in the general price level of goods and services in an economy, leading to a reduction in the purchasing power of consumers. For SMEs, inflation presents multiple challenges, such as rising input costs, higher labour expenses, and fluctuating consumer demand, which can erode profit margins and complicate pricing decisions. Despite its importance, few studies have examined the moderating effect of inflation in the relationship between pricing strategies and profitability, leaving a critical gap in understanding how SMEs adjust their pricing strategies in volatile environments.

The relevance of inflation as the most significant macroeconomic factor influencing Nigeria's present economic condition cannot be overemphasised; inflation rates have remained volatile due to factors such as exchange rate fluctuations, fuel price increases, and macroeconomic instability (Simon et al., 2019). In Kano metropolis, a major hub for SMEs, inflation significantly affects business operations. Yet, much of research in Nigeria focused on SMEs in southern Nigeria neglecting SMEs in Northern regions like Kano, with its unique socio-economic context.
This study addresses these gaps by applying Structural Equation Modelling (SEM), an advanced technique that captures the complex interactions between pricing strategies, profitability and inflation among SMEs in Kano metropolis Other specific objectives are to examine the:

i. moderating effect of inflation on the relationship between Cost Based Pricing Strategy and Profitability of SMEs in Kano metropolis;
ii. moderating effect of inflation on the relationship between Value Based Pricing Strategy and Profitability of SMEs in Kano metropolis;
iii. moderating effect of inflation on the relationship between Competition Based Pricing Strategy and Profitability of SMEs in Kano metropolis.

The study provides an empirical foundation for understanding how SMEs can adapt their pricing strategies to remain profitable in the face of inflationary pressures, advances methodological rigor by applying SEM, and fills a regional gap in literature, offering context specific insights for SME managers, policymakers, and researchers.

Literature Review

Conceptual Review

This subsection reviews the related concepts on the subject matter of the study in order to identify the principles behind the operationalisation of variables from the current body of knowledge.

Profitability of SMEs

Profitability is crucial for the survival, growth, and sustainability of small and medium-sized enterprises SMEs. SMEs are the backbone of many economies, contributing significantly to employment, innovation, and economic growth (Rashid, 2019). A profitable SME not only secures its financial future but also supports the community through job creation and local investment, fostering economic stability and resilience. Profitability enables SMEs to reinvest in innovation, expand their operations, and adapt to changing market demands. This reinvestment cycle is essential for economic development, as it supports growth, enhances productivity, and ultimately strengthens the SME sector's contribution to the economy (Nguyen et al, 2021).

As global competition intensifies and technology advances, SMEs must remain competitive to survive. Profitability is closely tied to an organization's resilience in facing competition, making it a key focus for managers and entrepreneurs. By prioritizing profitability, SMEs can achieve competitive pricing, develop high-quality products, and secure a larger market share. Profitability is thus not merely an outcome of efficient operations but a necessary condition for SMEs' ongoing competitiveness and market presence. A profitable SME is better positioned to reinvest in itself, improve product offerings, and respond to customer needs, all of which are critical for sustained business success (Ahinful et al., 2021).

Pricing Strategies

Various pricing strategies are available for consideration by an organization based on its aims and objectives. The techniques employed by companies to determine their prices are diverse, but they can be broadly classified into cost-based pricing, competition-based pricing, and customer/value-based pricing (Olawale & Joel, 2017). The optimal pricing strategy for an SME varies depending on factors such as the firm's nature, target market, and competition. To establish effective pricing, businesses should aim for prices that are both profitable and competitive, avoiding excessively low prices that hinder profitability while ensuring competitiveness to attract customers. Additionally, it is crucial to assess the competitive environment and consider the target market's price sensitivity, as this may necessitate lower pricing (Hoch & Rao, 2020). Assessing the competitive environment is vital so as to avoid pricing products too high or low relative to competitors.

A growing body of research underscores the critical role of pricing strategies in the success of SMEs (Dangisso, 2019; Rashid, 2019 and Al-Shakhsheer et al., 2017). Similarly, Bello et al. (2021) identified pricing strategies as critical to the growth of Nigerian SMEs, enhancing the likelihood of long-term survival. Aguilar et al. (2024) noted that SMEs employing value-based pricing techniques tend to achieve higher success rates and better goal attainment. This underscores the need for SMEs to continuously assess their pricing strategies to remain competitive.

However, contemporary challenges like inflation can complicate the pricing landscape for SMEs. Inflation exerts a strong negative influence on profitability, necessitating that SMEs adopt flexible pricing strategies that can adapt to changing economic conditions.

Moreover, the competitive environment can become more intense during inflationary periods, as businesses fight to retain customers while managing rising costs. In this context, SMEs must carefully analyze their pricing strategies to avoid losing market share. For example, those that adopt a cost-plus pricing approach may struggle if their competitors implement value-based pricing, which focuses more on customer perceptions and willingness to pay. Thus, the ability to balance cost management with perceived value becomes critical for SMEs navigating the complexities of inflation.

Cost based Pricing Strategy

Cost-based pricing is the simplest and most commonly used approach to setting prices. It has historically been the most popular pricing strategy because it exudes a sense of financial caution (Martin and Sayrak 2019; Amaral & Guerreiro, 2019). The notion of cost is intrinsically linked to an organization's profitability, which is heavily reliant on the correct selection of cost components and the choice to make cost adjustments. In order to ascertain the lowest price at which a business may turn a profit, the cost-based approach mostly depends on accounting data. The selling price of a product is determined by applying a mark-up margin to the cost determined by the standard cost account approach (Sunarni & Ambarriani, 2019). This strategy guarantees a set amount of profit as well as the payment of all production and operating expenses. Studies by Cant et al., (2017) reveal that factors like macroeconomic conditions, customer relations, and competitor information heavily influence cost-based pricing strategies.

Various techniques within cost-based pricing allow businesses to craft pricing strategies to specific goals and contexts (Aguilar et al., 2024). Target return pricing, for instance, sets prices to achieve a specified return on investment and is common among high capital industries like utilities and automotive manufacturing. However, it is less effective for companies with lower capital investments, as it does not account for demand fluctuations, risking losses on unsold products. Break-even pricing is another form, where prices are set at a level where total revenue equals total costs, indicating the minimum price required for profitability. By analyzing sales volumes and expected revenues, this method helps firms pinpoint profitable price points.

For SMEs, cost-based pricing strategy offers an accessible approach, especially for firms that lack the resources for in-depth market analysis. By ensuring that production costs are covered, this approach promotes financial stability, a valuable benefit for SMEs operating with tight margins. Though cost-based pricing strategy can offer a reliable foundation for establishing pricing, its limitations regarding market demand and competitive dynamics make it essential to stay attuned to market shifts. For long-term success, cost-based pricing strategy may serve as a useful starting point, but it requires regular adjustments to align with changing customer and competitive conditions.

Value-Based Pricing Strategy

Value-based pricing is a strategy that sets prices based on the perceived value a product or service holds for the customer, as opposed to cost or competitor-based pricing. This approach emphasizes understanding and leveraging the benefits and advantages the product offers, allowing prices to reflect what customers are willing to pay. By anchoring prices in perceived value, companies align their offerings with customer needs, preferences, and willingness to pay, potentially enabling stronger profitability and customer loyalty (Tahat, 2023). The customer-oriented nature of value-based pricing centers on prioritizing customer perceptions. Businesses employing this strategy focus on customer needs, desires, and financial sensitivities, engaging in thorough research to develop a deep understanding of the target audience.

The advantages of value-based pricing are notable, starting with higher profit margins. Since prices are based on perceived value rather than cost, businesses often command higher prices, particularly where consumers are willing to pay for quality or unique features. This approach also fosters customer loyalty, as those who feel they are receiving value are more likely to become repeat buyers and promote the brand through word of mouth.
However, value-based pricing presents several challenges. Its implementation can be complex, as perceived value is often subjective and varies across customer segments. Businesses may face difficulties in assessing and quantifying this perception accurately. In markets with varying perceptions of value, setting a single price point that captures the value across segments can be challenging, especially if some customers are more price-sensitive than others. A risk

of overpricing exists if a company overestimates the value customers attribute to its offering, potentially leading to a decline in sales. This approach also demands significant resources for research, customer engagement, and continual analysis, which can be particularly challenging for SMEs with limited budgets.

For SMEs in Nigeria, where consumer behavior may be influenced by cultural and economic factors, value-based pricing offers an avenue to resonate more deeply with customers. By highlighting the benefits and unique value of their products or services, SMEs can justify premium pricing, thus gaining customer loyalty. This strategy aligns well with the economic and cultural landscape in Nigeria, where businesses that effectively communicate their value proposition can foster sustained consumer relationships (Taiwo and Esonmu, 2023).

In inflationary periods, value-based pricing can offer resilience. Because prices are tied to perceived value rather than production costs, companies adopting this strategy may be somewhat insulated from inflationary pressures. This approach, allows businesses to maintain or even expand profit margins when customers still perceive high value despite economic fluctuations.

Competition based Pricing Strategy

Competition-based pricing, is a strategy where businesses set their prices based primarily on the prices of competing products or services in the market (Liozu & Hinterhuber, 2013). This strategy is sometimes referred to as going-rate or parity pricing strategy; it focuses on aligning a product's price with those of rivals, particularly market leaders, rather than relying on internal cost structures. Key considerations in this pricing method include competitors' pricing, observed market behaviors, and anticipated competitor responses (Olawale & Joel, 2017).

Due to the competitive nature of the strategy, prices are often dynamic and may fluctuate based on market demand, competitor activity, or broader economic shifts. This flexibility allows businesses to respond to changes such as the entry of new competitors or inflation. While competitive pricing is based on competitors' prices, businesses must ensure that their products or services offer enough value to justify this pricing approach. A well-defined value proposition helps maintain customer loyalty, even in competitive markets.

Businesses can position their prices in three primary ways: pricing below competitors, matching competitors, or setting prices above them (Raja et al., 2020). Pricing below competitors, often known as a loss leader strategy, can attract customers initially, with the intent to generate profitability from supplementary products. Parity pricing, by matching the market rate, allows businesses to maintain competitive parity while potentially differentiating through added value or marketing efforts. Premium pricing requires a unique value proposition that justifies higher prices, where high quality or exclusive features warrant the premium, and the focus is on value differentiation rather than cost competition.

By aligning prices with competitors, businesses ensure their offerings remain attractive to consumers, reducing the likelihood of losing market share. In price-sensitive markets, competitive pricing often results in higher sales volumes, as customers seek out products offering the best value. This strategy also simplifies the pricing process, requiring less in-depth cost analysis and focusing instead on competitor benchmarks. For new entrants, setting prices similar to competitors can help them gain initial market acceptance and attract customers from established players.

However, constantly adjusting prices to match competitors can lead to lower profit margins, especially if businesses fail to account for their own costs (Nagle et al., 2016). Aggressive price competition can trigger a price war, where companies' lower prices to gain market share. Such scenarios ultimately reduce profit margins for all competitors and can harm smaller firms

disproportionately. Focusing solely on competitors' prices may lead to commoditization and a loss of the unique value proposition, weakening customer loyalty.

For SMEs, competition-based pricing strategy is particularly practical in highly competitive markets with established players. In Nigeria, where the SME sector is highly competitive, businesses can leverage competitive pricing to stay relevant and responsive to market changes. By analyzing competitor prices, SMEs can position themselves effectively, attract customers, and make timely adjustments (Adudu et al., 2021). However, SMEs must carefully balance competitive pricing with profitability, as maintaining low prices may strain their margins.

Inflation

Inflation is the rate at which the general price level for goods and services rises, leading to a reduction in purchasing power (Nnena et al., 2020). Typically expressed as a percentage increase over a specific period, often annually, inflation affects various economic factors, including consumer behavior, business planning, and overall economic stability. Understanding inflation is crucial for businesses and policymakers as it influences economic decisions, investment strategies, and pricing approaches. As a macroeconomic phenomenon, inflation represents the steady increase in an economy's overall price level over time. A positive inflation rate signals a decline in purchasing power, as each unit of currency buys fewer goods and services. This phenomenon has significant impacts on small and medium-sized enterprises (SMEs), affecting their financial and operational decisions. Okeke et al. (2022) and Chiani (2022) further confirm inflation's adverse effects on SME profitability, adding to the challenges of competitiveness in inflationary environments.

Inflation manifests in various forms that differently affect businesses and economies. Demand-Pull Inflation arises when demand for goods and services exceeds supply. This may stem from increased consumer spending, government expenditure, or investment, prompting producers to raise prices. Cost-Push Inflation results from rising production costs, such as wages, raw materials, and energy. Higher production costs are often passed on to consumers, causing inflation. Built-In Inflation, also known as wage-price inflation, occurs when businesses raise prices in response to wage increases. As employees demand higher wages to keep up with the cost of living, businesses may respond by raising prices to maintain profit margins, creating a wage-price cycle.

Inflation is commonly measured through indices like the Consumer Price Index (CPI) and the Producer Price Index (PPI). These indices track changes in the prices of a selected basket of goods and services, providing insight into overall inflation rates. However, inflation perceptions vary based on individual and organizational experiences and economic contexts. In this research, inflation is measured as perceived by management, reflecting their insights and experiences within their operational environments.

Inflation has significantly shaped Nigeria's business environment recently. Nigeria's annual core inflation rate reached 19.2% in January 2023 from 18.5% in December 2022—a 16-year high (NBS, 2021). Factors like Naira depreciation, the COVID-19 pandemic, high transportation costs, floods, and insecurity have all contributed to Nigeria's high inflation rate. Inflation impacts various economic aspects, affecting purchasing power, business costs, investment decisions, and interest rates, as a macroeconomic force, it often strains SMEs more than larger firms, which can better absorb inflationary pressures. Consequently, SMEs frequently adjust their pricing strategies to remain competitive, impacting their profitability directly. This study specifically examines how inflation, by management, moderates the relationship between pricing strategies and SME profitability in Kano, Nigeria.

Profitability, Pricing and Inflation

In the field of economics, price, inflation, and profitability are all closely intertwined. The significance of these elements increases when one takes into account their influence on the financial well-being of SMEs. As previously mentioned, inflation is the overall rise in an economy's price level over a certain period of time. The buying power of money declines as a result of these price increases (Oleka et al., 2015). Inflation has a knock-on effect on many aspects of corporate operations, impacting things like expenses, pricing choices, and eventually profitability (Ali & Ibrahim, 2018).

The impact of inflation on costs is where the relationship between it and profitability starts. Businesses incur higher costs as a result of inflation-driven pricing increases (Ugwu et al., 2023). These may be indirect expenses like finance costs brought on by rising interest rates, or they could be direct expenditures like labour, raw materials, rent, and utilities. Profit margins are compressed when inflation rises more quickly than a company can raise its pricing. It is especially difficult for SMEs with little financial cushion and bargaining leverage to absorb these charges, which can seriously hurt their profitability.

Apart from the immediate impact on costs, inflation also has an indirect influence on profitability by influencing revenues. This introduces the subject of price. In a situation of inflation, businesses may need to raise their prices in order to preserve or enhance their profitability (Ugwu et al., 2023). Nonetheless, this tactic may provide two results. Profitability is preserved or even increased if the market accepts the price rise. However, if price increases result in a sharp decline in demand, sales volumes, overall revenues, and profitability may suffer as a result.

Inflation also affects the firm's pricing tactics and other strategic decision-making. It is critical for businesses, particularly SMEs, to review their pricing strategies during an inflationary era. A variety of pricing techniques, including value-based pricing, cost-plus pricing and competitive pricing, may be investigated by businesses. Such strategies must take into consideration the rate of inflation, competitive dynamics, and consumer demand elasticity. Notwithstanding the challenges posed by inflation, SMEs may maintain profitability with the support of a suitable and flexible pricing strategy. To fully benefit from a pricing strategy, Kawira (2021) suggests that in addition to considering firm-wide factors that may influence the anticipated outcomes of a price choice, pricing decisions also take these factors into consideration.

Because of its effects on the financial system, inflation can have an indirect impact on pricing and profitability. An increase in interest rates frequently follows higher inflation, and thus raises the cost of capital. This may dramatically raise the financial costs for SMEs that rely on external funding for operations or expansion, further straining profit margins. In order to counter the increasing financial burden, SMEs may therefore be forced to re-evaluate their pricing strategy and perhaps raise their rates.
Inflation can have a significant impact on an organization's profitability because it lowers money's purchasing power, raises operating costs, makes it harder to obtain capital because of high interest rates, and decreases consumer spending, all of which can have a negative effect on a company's profitability (Ali & Ibrahim, 2018). Prices for products and services grow during inflation, and SMEs risk having much smaller profit margins if their pricing strategies are not adjusted correspondingly. Due to their lack of resources, lack of negotiating strength, and incapacity to pass on rising costs to clients in comparison to bigger businesses, SMEs are especially susceptible to inflation. The fact that many SMEs operate in unregulated informal industries and are subject to various hazards, such as price volatility, exacerbates the problem. Since they frequently face out against big businesses that can afford to withstand the consequences of inflation, they are likewise impacted by the market's competitiveness. SMEs

may manage the problems of inflation and retain profitability by using efficient pricing strategies.

Review of Empirical Studies

Numerous empirical studies have looked at the effectiveness of pricing strategies for SMEs amid inflation as well as the link between a firm's financial performance and profitability. The goal of this assessment is to pinpoint important discoveries and topics that will shed light on the intricate connection between inflation, pricing, and profitability.

Studies in Emerging Markets

The available empirical data indicates that there is a complex and situation-specific link between pricing strategies and profitability. The distinctive challenges and opportunities within emerging markets have drawn considerable attention with numerous studies set in large firms, developed markets, and SMEs under a variety of contexts. This section reviews key studies across diverse sectors to explore how businesses navigate the dynamic interactions between pricing strategies, profitability and inflation.

Al-Shakhsheer et al. (2017) applied qualitative methods in Jordan's hotel sector, finding that premium and discount pricing affect revenue and market penetration differently in unstable environments. Olawale and Joel (2017) investigated the factors that influence pricing strategy in the non-financial sector of Nigeria. The study, which used quantitative methodologies, found that pricing strategy is influenced by a number of factors, including market demand, replacement availability, customer perception, company objectives, and cost of sales, macroeconomic trends, and market segmentation. However, these studies did not focus on SMEs and did not take the moderating influence of inflation rate into account.

Jacque's King (2018) analysed marketing strategies in small restaurants, highlighting the importance of brand uniqueness and word-of-mouth for sustained profitability. Meanwhile, Sunarni and Ambarriani (2019) examined pricing strategies used by manufacturing companies in Yogyakarta, Indonesia, demonstrating variations in goals and elements impacting price choices according to market penetration and scale. Goodie-Okio (2022) looked on the marketing efficacy and pricing policies of Nigerian telecom companies in Port Harcourt using a descriptive methodology. The study discovered a favourable correlation between marketing success and cost and value-based pricing, showcasing how success of organisational marketing may be better understood in relation to customised pricing strategies. These studies contribute to understanding pricing practices however, they do not consider SME sector or inflation's moderating role.

Studies on SMEs, such as Manuere et al. (2015) looked at the connection between company success and strategic pricing in Zimbabwe. The study looked at different pricing targets and how they affected organisational results using a quantitative methodology. The results emphasised how crucial it is to match pricing strategies with company goals and market conditions in order to improve performance. Rashid (2019) examined the correlation between competitive pricing and financial performance under volatile conditions of Nigerian SMEs; however, it was not determined whether the rate of inflation would have a moderating influence on the relationship between pricing strategy and SMEs' profitability. Similarly, Agbaeze et al. (2020) investigated how pricing practice management affected the sustainability and performance of Nigerian supermarkets. The study discovered that various pricing strategies, such as cost-, value-, and competition-informed pricing, had differing levels of positive impacts on sustainability and performance. Highlighting the challenges SMEs face in adapting pricing strategies amid inflation and other economic pressures, Mohammed (2022) investigates factors that influence pricing decisions, concluding that SMEs need to be competent at managing these factors to achieve pricing objectives that support profitability. These studies emphasise how

crucial it is to match pricing strategies with certain moderating factors; however, it was not determined whether the rate of inflation would have a moderating influence on the relationship between pricing strategy and SMEs' profitability.

Studies on the Effect of Inflation on Pricing and Profitability

Dangisso (2019) investigates the effect of marketing and pricing challenges on SME performance in Ethiopia, identifying inflation as a significant external factor that exacerbates pricing difficulties. This study demonstrates that inflation can challenge both competition-based and cost-based pricing strategies by reducing consumer purchasing power and increasing operational costs. Similarly, Bottone et al. (2021) looked at the pricing strategies and inflation forecasts of banks. The study discovered that competitor's pricing techniques and the anticipated length of economic recovery have an effect on enterprises' pricing practices. Expected persistence of the pandemic's macroeconomic consequences also affected firms' inflation predictions. But because the study focused on banks, it ignored the pricing methods of SMEs.

For SMEs, which often lack buffers against inflationary pressures, this challenge is particularly acute. Oleka et al., (2015) used Ordinary Least Squares (OLS) to analyze Nigerian banks, showing that inflation reduces financial profitability by eroding valuation and return on equity. Ahmed and Suleiman (2021) employed survey methods to examine the influence of inflation on SMEs in Nigeria, highlighting that inflation raises operational costs, which erodes profit margins for SMEs that cannot adjust prices swiftly due to market constraints Okeke et al. (2022) used regression analysis on Nigerian SME data to show that inflation, interest, and currency rates negatively affect profitability. Although these studies confirm inflation's financial impact on SMEs, they do not explore inflation's role as a moderator in the relationship between specific pricing strategies and profitability. This research bridges this gap by examining these specific pricing strategies and how inflation moderates their effect on profitability, providing practical recommendations for SMEs under similar economic pressures.

Theoretical Framework

Theory offers a framework for analysing and interpreting research topics. Understanding the relationships between pricing strategies, inflation, and the profitability of SMEs may be accomplished by Dynamic capability theory.

Dynamic capability theory (DCT)

DCT is a strategic management framework that delves into how organizations, including SMEs, can cultivate and uphold a competitive edge in constantly evolving and developing landscapes. It builds upon the resource-based view (RBV) of the firm, which underscores the significance of internal resources and capabilities in achieving sustained competitive advantage. However, while RBV concentrates on static resources, DCT extends this by stressing the importance of dynamic capabilities, the capacity to adapt and evolve in response to changing circumstances.

Dynamic capabilities refer to the procedures and routines that organizations employ to integrate, construct, and reconfigure their resources to cope with swiftly changing environments. This encompasses activities such as identifying environmental shifts, capitalizing new opportunities, and altering internal resources and procedures. Teece et al. (1997) outlined three key processes involved in dynamic capabilities:

i. Sensing: Recognizing changes in the external environment and understanding their implications for the organization.
ii. Seizing: Acting on opportunities and threats identified through sensing, including through innovation, strategic partnerships, or other means.

iii. Reconfiguring: Changing the organization's resource base, internal structures, and processes in response to changes identified through sensing and seizing.

DCT emerged in the 1990s as a response to the limitations of traditional strategic management theories, such as the resource-based view (RBV), which primarily focused on the static allocation of resources rather than the dynamic processes of adaptation and change. The foundational work on DCT is often attributed to David Teece, along with Gary Pisano and Amy Shuen. Teece's seminal paper, "Dynamic Capabilities and Strategic Management" (1997), provided a comprehensive framework for understanding how organizations can develop capabilities to adapt to changing environments. DCT gained prominence as researchers and practitioners recognized the increasing importance of agility and responsiveness in a rapidly changing business landscape characterized by globalization, technological advancement, and increased market turbulence.

Over the years, DCT has been applied across various domains, including innovation management, strategic management, and organizational theory. It has provided valuable insights into how firms can sustain competitive advantage by continuously renewing and adapting their capabilities. In the context of SMEs, DCT offers a particularly relevant framework for understanding how these organizations can thrive in the face of resource constraints and uncertainty. By focusing on their ability to sense, seize, and reconfigure opportunities, SMEs can enhance their profitability, competitiveness and resilience in dynamic environments.

Overall, dynamic capability theory has become a widely recognized and influential perspective within the field of strategic management, offering valuable insights into the processes of organizational adaptation and innovation.

Methodology

The Study Area

Kano State, located in Northern Nigeria, is the second-biggest metropolis after Lagos and serves as the commercial hub. With over 9,383,682 million residents, Kano is the most populous state in Nigeria. The city has industries in textiles, tanning, footwear, cosmetics, plastics, agricultural tools, pharmaceuticals, food, and dairy products. Kano offers tax exemptions and advantageous legislation, making it a hospitable business environment.

Source of Data

The study utilized primary data from structured questionnaires administered to registered SME owners and employees, ensuring validity, reliability, and objectivity, making it valuable for surveys.

Population of the Study

The study focuses on 594 SMEs registered in 10 industrial areas in Kano Metropolis, chosen based on their well-organized structure and full-time employees. The areas include Challengeawa, Sharada Phase I, II, III, Sharada Janbulo Ssi, Zara Road, Rice Mills Cluster Kwanar Dawaki, Incubation Center, Hadeja Road, Gunduwawa& Tokarawa Area, Kano Free Trade Zone, Bompai Industrial Area, and Dakata Small Scale.

Sample size and Sampling Techniques

Taro Yamane formula (1967) was applied, a method widely used for sampling finite populations. Given the total population of 594 SMEs across 10 industrial areas in Kano, and a margin of error set at 5% (0.05), the sample size calculation was conducted as follows:

$$\frac{N}{1+N.e^2} = \frac{594}{1+594(0.05)^2} = 239$$

A sample of 239 SMEs was obtained using a stratified sampling technique, dividing the total number of SMEs in each area by the overall population of 594, and then multiplying by the sample size to ensure proportional representation across all industrial areas. The calculation for determining the sample from each area was:

$$n_{i=\left(\frac{N_i}{N}\right)} \times 239$$

Where: n_i represents the sample size for each industrial area,
N_i is the number of SMEs in each specific industrial area, and
N is the total SME population (594).

Method of Data Collection

Primary data was gathered through a predefined set of questions using a self-administered questionnaire, which is an effective tool for capturing respondents' thoughts, feelings, emotions, and perceptions. The measurements of the variables' relevant subjects were drawn from research published on connected topics and were adapted from Agbazea et al. (2020) and Cant et al. (2016) to suit the research objectives. The measurement of profitability consisted of 3 items, while pricing strategies included three factors and items: cost-based pricing (3 items), value-based pricing (2 items), and competition-based pricing (2 items). Inflation was measured using (3 items). The questionnaire items contained revised items related to the constructs, measured on a five-point Likert scale ranging from strongly agree (5) to strongly disagree (1). Respondents were selected proportionally from each of the ten identified industrial areas. All 239 copies of the questionnaires were duly administered and retrieved.

Variables of the Study and their Measurements

There are three sets of variables used in the study. Cost based pricing strategy, Value based pricing strategy and competition-based pricing strategy were the independent variables in the study whereas profitability was the dependent variable. Inflation was taken as moderating variables, which influences the relationship between pricing strategy and SME profitability.
The dependent variable of the study, profitability was measured as the Owner/ Manager's perception of an SME's ability to make a profit over time, as used by (Chapagain, 2021; Ahinful et al., 2021). Cost based, value based and competition-based pricing strategies are measured as the degree to which Owner /Managers perception of the pricing strategy employed by SME as used by (De Toni et al., 2017; Chepkemoi, 2020; Agbaeze et al., 2020; Goodie-Okio, 2022). Inflation is also measured as Owner /Managers perception on the general rise of price level for goods and services, leading to a reduction in purchasing power.

Method of Data Analysis

The Statistical Package for the Social Sciences (SPSS) version 23 was used for the preliminary studies and Smart PLS 4.0 was used to analyze the data. Both packages offer the necessary flexibility and functionality to handle complex data. Structured equation modeling (SEM) was used for hypothesis testingto examine the relationships between pricing strategies, inflation, and SME profitability. A series of statistical procedures was adopted to answer the research questions modelled and to test the hypotheses. This involves descriptive analysis to explore the results in the form of frequency tables such as the characteristics of the SMEs and demographic data.

Partial Least Squares Structural Equation Modeling (PLS-SEM)

PLS-SEM combines component analysis and regression, enabling simultaneous analysis of correlations between measurement indicators and latent constructs, which adds depth to hypothesis testing (Hair et al., 2017). This hybrid model incorporates both measurement and structural components. The measurement model specifies the relationship between latent constructs and their observed indicators, while the structural model focuses on associations among constructs. In this study, the measurement model examines how the specific survey items represent pricing strategy constructs, while the structural model assesses how these constructs relate to profitability. The measurement model was validated by assessing collinearity, internal consistency, convergent validity, and discriminant validity. The structural model was then evaluated through path coefficients, R^2 values, p-values, t-values, point estimates, and explained variance.
PLS-SEM was chosen for this analysis due to its adaptability, robustness, and depth making it an ideal choice for this study.

Model Specification

Functionally, the relationship among the variables was expressed thus:
$P_{i} = ß_0 + ß_1CP_i + ß_2VP_i + ß_3CoP_i + ß_4(CP \times PI_i) + ß_5\ (VP_i \times PI_i) + ß_6(CoP_i \times PI_i) + \varepsilon_i$
Where:
P = Profitability
CP = Cost Based Pricing Strategy
VP = Value Based Pricing Strategy
CoP = Competition Based Pricing Strategy
I = Inflation
$ß_0$ = Constant
$ß_1$-$ß_3$ = Coefficients of the explanatory variables
$ß_4$-$ß_6$ = Coefficients of the moderating variables
ε = Error term
i = Number of respondents

Data Presentation and Analysis

Descriptive Statistics for Computed Variables

Descriptive statistics provides fundamental insights into the characteristics of the data used in analysis. It helps researches effectively summarise the data to enhance comprehension. These consist of mean, standard deviation, minimum and maximum of the variables of the study.

Table 1: Descriptive Statistics

	Mean	Std. Deviation	Skewness	Kurtosis	**Cramér-von Mises p-value**
Profitability	4.1562	0.79197	-1.2510	1.4610	0.0000
Cost Based Pricing Str	3.9861	0.79611	-1.1070	1.0880	0.0000
Value Based Pricing Str	4.0669	0.77495	-1.2770	1.8810	0.0000
Competition Based Pricing Strategy	3.7092	1.13026	-1.0120	0.2840	0.0000
Inflation	4.1897	0.73989	-1.0700	1.0130	0.0000

Source: SPSS Output, 2024

Table 1 provides descriptive statistics for variables related to profitability. The profitability shows a mean score of 4.1562, with a median of 4.3333, indicating a slightly negatively skewed

distribution (skewness = 1.2510). The standard deviation (0.792) suggests a variability around the mean. The kurtosis value (1.461) indicates a distribution that is closer to normal, and the Cramér-von Mises p-value (0.0000) is relatively low, indicating potential deviation from normality.

Cost-Based Pricing Strategy has a mean score of 3.9861and a median of 4.000, indicating a similar distribution to profitability but with slightly lower mean and median values. The skewness (-1.1070) suggests a negative skew, and the standard deviation (0.79611) indicates some degree of variability. The Cramér-von Mises p-value (0.000) is relatively low, indicating potential deviation from normality.

Value-Based Pricing Strategy has a mean score of 4.0669and a median of 4.000, with a standard deviation of 0.77495. The skewness (-1.2770) indicates a slight negative skew, and the kurtosis (1.8810) suggests a distribution slightly more peaked than normal. The Cramér-von Mises p-value (0.000) is relatively low, indicating potential deviation from normality.

Competition-Based Pricing Strategy has a mean score of 3.7092and a median of 4.000, with a standard deviation of 1.13026. The skewness (-1.0120) indicates a slight negative skew, and the kurtosis (0.2840) suggests a distribution slightly more peaked than normal. The Cramér-von Mises p-value (0.000) is relatively low, indicating potential deviation from normality.

Finally, Inflation has a mean score of 4.1897and a median of 4.3333, with a standard deviation of 0.73989. The skewness (-1.0700) indicates a slight negative skew, and the kurtosis (1.0130) suggests a distribution slightly more peaked than normal. The Cramér-von Mises p-value (0.000) is relatively low, indicating potential deviation from normality. However, using PLS-SEM allows for handling non normal data effectively (Sürücü & Maslakçı, 2020).

Data Analysis: Partial Least Squares (PLS-SEM)

This study employs a two-stage approach to Structural Equation Modeling (SEM) using Partial Least Squares (PLS), using Smart PLS 4 as the analytical tool. The SEM process begins with the measurement model, followed by the structural model (Hair et al., 2014). The measurement model stage involves assessing the reliability and validity of the observed indicators in representing the latent constructs. This includes evaluating individual item reliability, internal consistency reliability such as Cronbach's alpha and composite reliability, convergent validity AVE, and discriminant validity using metrics like the HTMT ratio and Fornell-Larcker criterion. These assessments ensure that the indicators accurately reflect their respective constructs.

After validation of the measurement model, the analysis proceeds to the structural model to examine hypothesized relationships among latent constructs. This includes evaluating the strength and significance of the paths between constructs to determine direct, indirect, and moderating effects. Path coefficients are used to interpret the model's explanatory power and the interactions among variables. This two-stage approach enables a rigorous evaluation of measurement properties and theoretical relationships, supporting a robust assessment of the proposed model (Purwanto & Sudargini, 2021).

Measurement Model

This study examines four exogenous constructs: Cost based pricing strategy has 3 items, competition-based pricing strategy has 2 items, value-based pricing strategy has 2 items and the moderator inflation, has 3 items. The endogenous construct is profitability of SMEs in Kano Metropolis having 3 items.

Structural Model I: Direct Relationships

The structural model analyzes the direct relationships between exogenous and endogenous latent variables. The primary objective is to test the hypothesized relationships between the independent and dependent variables using PLS-SEM. This is shown in figure 2

Figure 1: Path Algorithm

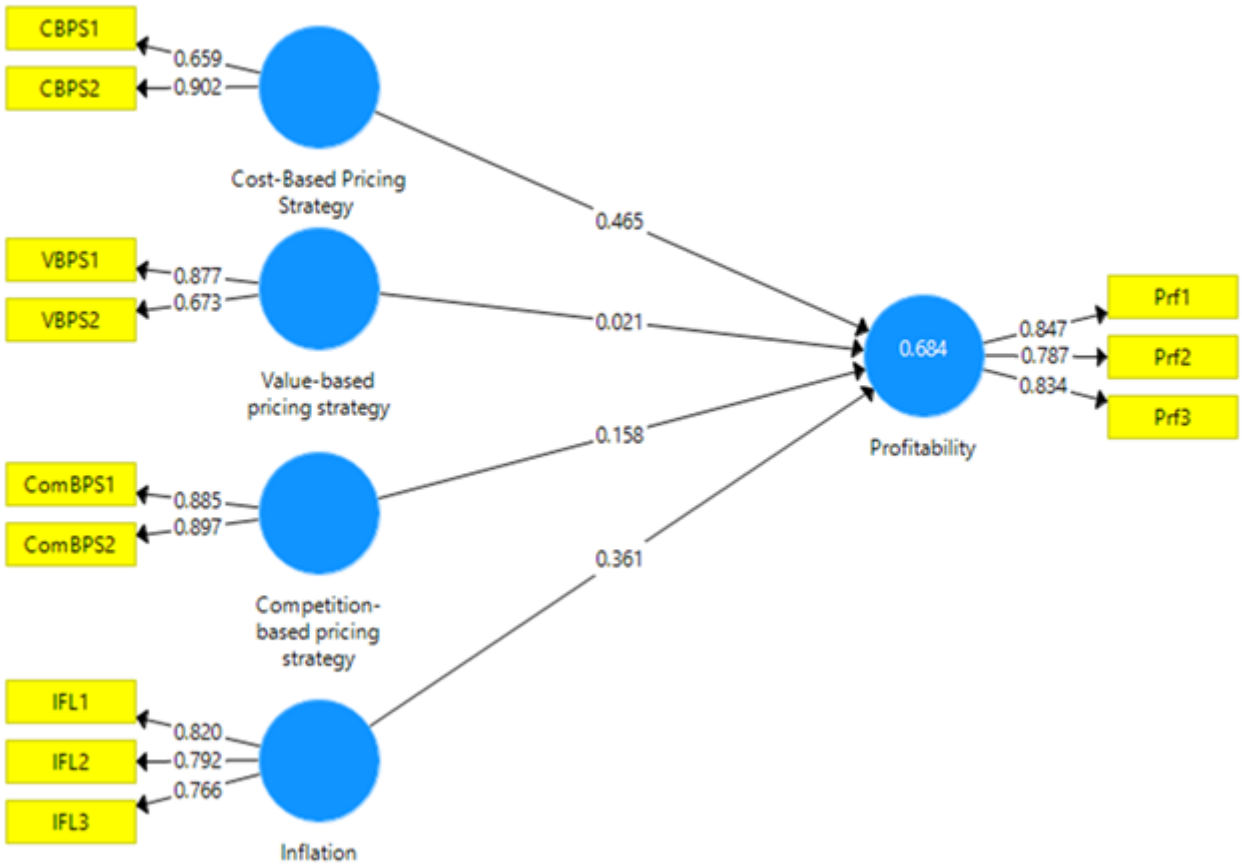

Figure 2: Structural Model II (Moderating Effect)

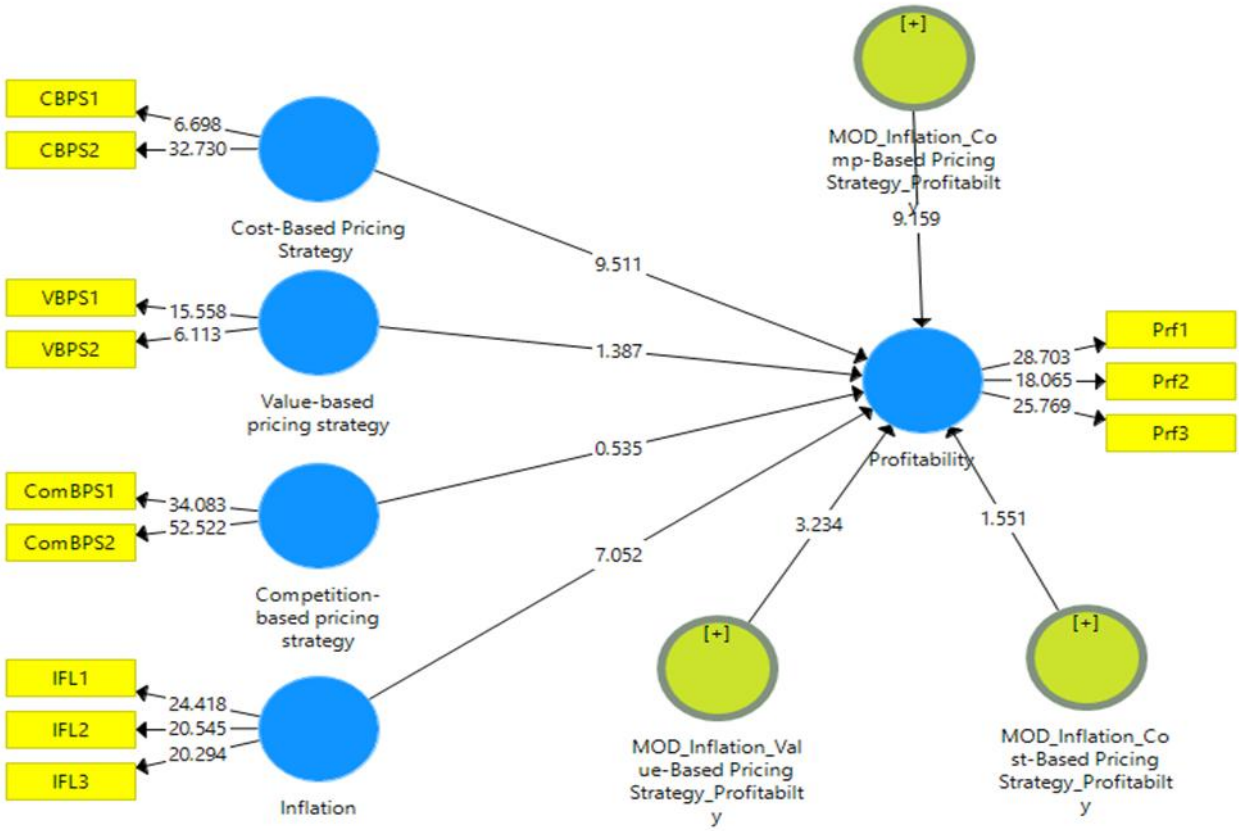

Figure 2: Path Algorithm showing the moderating effect of inflation on the relationship between cost based, value based, competition-based pricing strategies and profitability of SMEs in Kano Metropolis.

Construct Reliability and Validity

To improve the validity and reliability of the study, several robustness tests were conducted. Reliability was tested using Cronbach's Alpha and Composite reliability. Convergent validity was tested using Average Variance Extracted (AVE) and Discriminant validity was tested with The HTMT ratio and Fornell-larcker Creterion.

Correlation Analysis

The correlation measures the strengths and direction between the dependent variable profitability and the independent variables; cost based, value based and competition-based pricing strategies of the study as well as the independent variables between themselves. This is presented in Table 2.

Table 2: Correlation Matrix

	Inflation	Competition based pricing strategy	Cost-Based Pricing Strategy	Profitability	Value-based pricing strategy
Inflation	1				
Competition-based pricing strategy	0.617	1			
Cost-Based Pricing Strategy	0.474	0.434	1		

Profitability	0.688	0.592	0.715	1	
Value-based pricing strategy	0.442	0.459	0.501	0.486	1

Source: SPSS output, 2024

Table 2 indicates a strong positive correlation of 0.715 between cost-based pricing strategy and profitability. This suggests that businesses that effectively implement cost-based pricing strategies tend to experience higher levels of profitability. This result also implies that accurate cost assessment and management are critical for SMEs towards setting prices that not only cover costs but also ensure profitability (Adawia et al., 2021; Dangisso, 2019)

The correlation coefficient of 0.486 between value-based pricing strategy and profitability reveals a moderate positive relationship. This indicates that aligning prices with the perceived value to customers can lead to increased profitability. SMEs that focus on delivering value and setting prices based on customer perceptions of value will experience better profitability outcomes (Tahat, 2023; Hinterhuber & Liozu , 2013). This involves leveraging customer insights and value propositions in pricing decisions.

Table 2 also shows a strong positive correlation of 0.592 between competition-based pricing strategy and profitability. This indicates that SMEs should continuously analyze competitors' pricing strategies and adjust their own prices to remain competitive and enhance profitability (Adudu et al. 2021).

A moderate positive correlation of 0.434 between cost-based and competition-based pricing strategies suggests that businesses employing cost-based pricing may also consider competitive pricing strategies. This indicates that SMEs may benefit from integrating both cost-based and competition-based approaches in their pricing strategies to balance cost management with competitive positioning (Gencler, 2018).

A strong positive correlation of 0.592 between value-based and competition-based pricing strategies shows that firms employing value-based pricing strategies also tend to adjust their pricing in response to competitive pressures. SMEs could consider both customer value perception and competitive pricing dynamics when developing their pricing strategies.
A moderate positive correlation of 0.501 is indicated between cost-based and value-based pricing strategies, indicating that businesses might use both approaches depending on their market strategies and conditions.

The relationship between Inflation and Cost-Based Pricing Strategy is positive with moderate correlation coefficient value of 0.474, indicating that SMEs may adjust their cost-based pricing strategies in response to inflationary pressures to maintain profitability.
Table 2 also shows a moderate positive correlation of 0.459 between inflation and value-based pricing strategy, suggesting that SMEs should consider how inflation affects customer value perceptions and adjust their pricing strategies accordingly.
A strong positive correlation of 0.617 between inflation and competition-based pricing strategy shows that SMEs are likely to adopt competitive pricing strategies during inflationary periods to maintain market position and profitability.

Test of Hypothesis and Discussion of Findings

The overall objective of this research is to examine the moderating effect of inflation on the relationship between pricing strategies (cost based, value based and competition based) and profitability of small and medium scale enterprises in Kano Metropolis. Thus, the hypotheses are tested and discussed as follows:

Hypothesis 1

Ho_1: *Inflation does not have any significant effect on the relationship between Cost Based Pricing Strategy and Profitability of SMEs in Kano Metropolis.*

The relationship between cost-based pricing strategy and profitability is not affected by inflation as indicated by a parameter estimate of -0.073 and a non-significant p-value of 0.121 at 5% level of significance. This suggests that while there is a negative association between cost-based pricing strategy and profitability, inflation does not significantly strengthen or weaken this relationship in a statistically meaningful way for SMEs in Kano. The parameter estimate of -0.073 indicates a slight negative relationship between cost-based pricing strategy and profitability, suggesting that businesses relying on this approach may experience slightly lower profitability as costs increase. However, the non-significant p-value of 0.121 implies that this relationship is not statistically robust enough to conclude that inflation significantly moderates the effectiveness of cost-based pricing in influencing profitability. As such, the study fails to reject the null hypothesis, upholding that inflation does not moderate the relationship between cost-based pricing strategy and profitability of SMEs in Kano metropolis

Hypothesis 2

Ho_2: *Inflation does not have any significant effect on the relationship between Value Based Pricing Strategy and Profitability of SMEs in Kano Metropolis.*

Inflation plays a significant moderating role in the relationship between value-based pricing strategy and profitability, as evidenced by a parameter estimate of 0.151 and a significant p-value of 0.001 at the 5% level of significance. This indicates that inflation strengthens the positive association between adopting a value-based pricing strategy and achieving higher profitability for businesses in the region. The parameter estimate of 0.151 suggests a positive relationship between value-based pricing strategy and profitability, implying that businesses implementing this approach may experience increased profitability as they align prices more closely with customer perceptions of value. Furthermore, the significant p-value of 0.001 indicates strong statistical evidence that inflation enhances this relationship, implying that as inflation rises, the benefits of value-based pricing in boosting profitability become more pronounced in SMEs in Kano metropolis. As such the study rejects the null hypothesis which states that inflation does not significantly moderate the relationship between pricing strategy and profitability of SMEs in Kano metropolis.

Hypothesis 3

Ho_3: *Inflation does not have any significant effect on the relationship between Competition Based Pricing Strategy and Profitability of SMEs in Kano Metropolis.*

Inflation plays a crucial moderating role in the relationship between competition-based pricing strategy and profitability, as indicated by a parameter estimate of -0.306 and a significant p-value of 0.000 at the 5% level of significance for SMEs in Kano Metropolis. This suggests that inflation exerts a strong negative influence on the effectiveness of competition-based pricing in enhancing profitability for businesses operating in the region. The parameter estimate of -0.306 indicates a negative relationship between competition-based pricing strategy and profitability moderated by inflation. This implies that as inflation increases, the impact of competitive pricing on profitability diminishes. Moreover, the significant p-value of 0.000 underscores the statistical robustness of this relationship, indicating strong evidence against the null hypothesis that inflation does not moderate the relationship between competition-based pricing strategy and profitability of SMEs in Kano metropolis. Thus, the study rejects the null hypothesis.

Discussion of findings

The relationship between pricing strategies and profitability among SMEs in Kano metropolis reveals nuanced insights when examined through different lenses: cost-based pricing strategy, value-based pricing strategy, competition-based pricing strategy, and their interaction with inflation. Each strategy operates within a unique economic and market context, influencing profitability outcomes in varying degrees.

Inflation as a Moderating Factor

Inflation plays a crucial role in moderating the relationships between pricing strategies and profitability for SMEs in Kano metropolis. The analysis indicates varying impacts based on the pricing strategy employed. The parameter estimate of -0.073 and a non-significant p-value of 0.121 suggest a slight negative association between cost-based pricing strategy and profitability moderated by inflation. While inflation influences input costs and operational expenses, its direct effect on the relationship between cost-based pricing and profitability is not statistically significant. Businesses must integrate robust cost management practices to mitigate inflationary pressures effectively, thus, managing their internal resources effectively. However, the study revealed that inflation does not significantly moderate this relationship. This suggests that SMEs in Kano may lack the dynamic capabilities necessary to adjust cost structures effectively in response to inflationary pressures. This finding diverges from studies like Temitayo and Adegbie (2020), which identified inflation as a critical disruptor of cost-based pricing strategies. The localized nature of Kano's SMEs, with their reliance on stable, regional supply chains, might explain this discrepancy, as it provides some cushion from external inflationary shocks.

The parameter estimate of 0.151 and a significant p-value of 0.001 indicate that inflation strengthens the positive association between value-based pricing strategy and profitability. As inflation rises, businesses adopting value-based pricing may enhance profitability by aligning prices more closely with perceived customer value. This underscores the adaptive nature of value-based pricing in responding to economic fluctuations like inflation and consumer behaviour changes in accordance with the dynamic capability's theory.
This finding aligns with Dynamic Capability Theory, which highlights the adaptability of firms to align their strategies with customer perceptions during volatile economic conditions. Kano SMEs were able to leverage customer-perceived value to maintain or enhance profitability during inflation, supporting insights from Aguilar et al. (2024) and Hinterhuber & Snelgrove (2017).

The parameter estimate of -0.306 and a significant p-value of 0.000 indicate that competitive pricing's impact on profitability diminishes as inflationary pressures increase. Businesses adjusting prices based on market rates may face reduced profit margins amid rising costs and constrained consumer purchasing power. This highlights the critical importance of considering inflationary trends and economic stability when formulating pricing strategies in a volatile market environment like Kano metropolis.

Conclusion and Recommendations

The study examines at the relationship between pricing strategies, inflation, and profitability among SMEs in Kano Metropolis. It demonstrates that value-based pricing strategies have a stronger positive link with profitability, particularly when inflation is taken into account. This shows that SMEs should prioritize customer value-driven pricing above cost-based approaches to maintain profitability during economic downturns. Inflation also has a significant negative impact on profitability, illustrating SMEs' vulnerability to macroeconomic forces. The study adds to the worldwide conversation about SME sustainability by incorporating pricing strategies, inflation, and profitability into a comprehensive theoretical framework. It

encourages targeted interventions and collaboration among SMEs, policymakers, and stakeholders to develop a resilient and sustainable SME sector. The study recommends that SMEs conduct market research to refine value-based pricing strategies during inflation, develop training programs for dynamic capabilities, establish price stabilization funds, offer tax breaks for R&D, implement systems for monitoring economic indicators, and use financial planning frameworks for inflation forecasting and scenario planning. These techniques can boost profitability while mitigating the impact of inflation on pricing tactics. In addition, SMEs should use financial modeling to evaluate the impact of inflation on costs and revenues.

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