

Effects of Product Pricing on Business Failure

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Abstract

The paper examined the impact of product pricing on business failure in Nigeria, using some table water producing and packaging companies in Alimosho/Ejigbo area of Lagos State as a case study. The research methods adopted were survey research design and oral interview. Fifty six companies judgmentally selected through cluster sampling techniques, completed and returned their questionnaires. The questionnaires were analyzed using descriptive and chi-square statistical tools. Some of the findings were that majority of the managers are women, of middle age and well educated and that the sub-sector is contributing significantly to economic empowerment and employment generation. Additionally, it was discovered that management inexperience in product pricing, increasing cost of factor inputs where price is constant, intermittent price war and consumers' resistance to price increases all have significant relationship with business failure. The conclusions indicated among others, that appropriate product pricing is a key management function which if inappropriately handled could result in business failure.

Key Words: Product pricing, Price war, Management Inexperience, Customers resistance, Business failure,

1.0 Introduction

The main aim of every private enterprise organization is of a commercial nature, such as profit, return on capital employed, market standing or sales level (Mullins, 2010). The process of achieving this objective is through the production of goods or delivery of services necessary to meet identified customers' needs and wants. No matter what is produced, goods or services, the producer communicates to the market the company's intended value positioning of this product through the pricing mechanism (Kotler and Keller, 2009). Expectedly, the price a company will offer its products should adequately cover all costs with some level of margin of profit. This price is not expected to be static over a long period of time given changes in economic conditions and indicators such as, inflation, rising prices of other cost inputs and increasing general cost of living. Therefore, a situation where a company's factor input costs have been rising consistently for some years, but the company is unable to adequately adjust its prices to reflect these changes creates some serious challenges for such company's survival and profitability. The challenge becomes more worrisome where the company's inability to effect the desired price changes is caused by environmental imperatives beyond the company's control.

For some time now, the manufacturing sector- the multinationals, the local large and the medium and small scale companies inclusive- has been facing very difficult times and dwindling fortunes.

The environmental challenges arising from general infrastructural decay, depreciating naira, insecurity, and multiple- taxation, among others are responsible for the near comatose state of the sector (Ogundele, 2007). Omo-Ettu (2011) called it the vicissitudes of the business environment. Specifically, the small and medium scale industries appear to be mostly affected (Nworah, 2006). Unlike the multinationals and large indigenous companies that may have easy access to credit, and could fall back on reserves; the small and medium scale enterprises (SMEs) lack adequate collateral for bank borrowing, often find it extremely difficult to access funds from specialized financial agencies, and therefore are far more susceptible to these forces.

As a fall-out from the above, it has been observed that many companies in the table water sub-sector of the food industry appear not to be doing well. Some even die less than six months of opening shop. Examples abound around IkotunEgbe or Ejigbo in Alimosho Local Government Area of Lagos State; here one would likely see many sachet (Pure) water factories that had closed shop. Recently, there was an advert (in nairaland.com, May, 2011) of a sale of all the fixed assets (except land) of a liquidating table water company. Also in the Punch Newspaper of Monday, May 30, 2011 on page 48, was an advert for a sale of a small scale Purpose- Built Factory including Land and Building, Plants, Machinery and Equipment. However, whereas many of these companies are collapsing, many others are springing up.

Apart from the above general challenges, one notable cause seems to be the price of the product which has remained stagnant for close to two decades, whereas the prices of other factor inputs are rising on monthly, and for some like diesel, on weekly basis. Our interest is therefore aroused as to what impact this sub-sector's pricing mechanism may have on the noted glitches in this all-important sector of the economy. To properly situate the impact of this isolated construct, we consider the following levels of analysis that define organizational performance: operating macro business environment, internal business analysis, industry analysis and competitive situation, market (customer) structure, role of business associations, and business ethics and corporate social responsibility. Dimensions of organizational performance include both quantitative and qualitative factors. Examples of quantitative factors are; return on investment, turnover, sales volume, productivity, profitability, market share, cost performance (fixed cost, variable cost, and overheads), profit-before-tax, account ratios, sales growth, total assets and resource utilization. Qualitative factors are; efficiency, quality of product or service, flexibility, positive cultural transformation, innovation, customer satisfaction, internal business operations, community satisfaction, shareholders/stakeholders satisfaction, competitive position, and employee satisfaction. Our variables of choice, mainly qualitative, hopefully, will give reasonable conclusions given the rudimentary stage of record keeping in the sub-sector; while future research is expected to be more inclusive.

It has been said that one of the secrets to business success is pricing your products properly. If you price your products correctly, that can enhance how much you sell, and contribute in creating the foundation for a business that will prosper. However, should you get your pricing strategy wrong, you may then create problems that your business may never be able to overcome. Put differently, inappropriate product pricing is an invitation to business failure, which refers to a company ceasing its operations following its inability to make a profit or to bring in enough revenue to cover its expenses. The final step is always that the business runs out of cash, which has been said to define business failure (Moen, 2001-10).

1.1 Objectives of the Study

- To examine whether management inexperience in appropriate product pricing may result in business failure.
- To investigate whether producers' inability to reflect increases in the price of factor inputs in product prices contribute to business failure.
- To evaluate whether price-war among producers can orchestrate business failure.
- To investigate if customers' resistance to price increases can cause business failure.

1.2 Research Hypotheses

Ho: There is no significant relationship between management inexperience in appropriate product pricing and business failure

Ho: There is no significant relationship between price-war among competing Firms and business failure

Ho: There is no significant relationship between consumers' resistance to price increases and business failure

2.0 Theoretical Framework

The Price Theory is considered relevant for our analysis in this study. The concept of price runs through the schools of economic thought starting from classical economists like Adam Smith, David Ricardo, Thomas Malthus and John Stuart Mill to neo-classicists like Alfred Marshall, Karl Marx, John Maynard Keynes and Milton Friedman, and to global times economists like Amartya Sen, Joseph Stiglitz and Paul Krugman (Blaug, 1987). Among all these authors, price had a role to play in their macro and micro analyses of the economy, at the different times and economic conditions they lived.

Price theory, often called economic theory, asserts that in a free market economy the market price reflects interactions between supply and demand: price is set so as to equate the quantity being supplied and that being demanded. In turn, these quantities are determined by the marginal utility (Menger, 1871) of the assets to different buyers and sellers. In reality, the price may be distorted by other factors, such as tax and other government regulations. Specifically, price theory is in the domain of microeconomics which is a branch of economics that studies how the individual parts of the economy, the household and the firms, make decisions to allocate limited resources, typically in markets where goods and services are being bought and sold (Marchant & Snell, 2007).

Embedded in the general price theory are other sub theories such as; labour theory of value, theory of production, theory of marginal utility, and the general theory of demand and supply. There are also some other sub laws as the law of one price and price and value-the paradox of value (diamond-water paradox). Smith (1776) and Ricardo (1817) were apostles of the labour theory of value: the value of an object was reliant on the labour that had gone into producing it, including any training or investment that supplemented the labour.

The theory of labour focused on value in exchange i.e., on relative market prices of goods. Differences in market price of goods can be traced to differences in amount (and quantity) of labour used in production. In the long run, prices are determined by the sum of direct and indirect labour costs. The Marxists (Amit, 1969) posit that labour is the ultimate source of all value and ought to receive all the rewards of the productive process. However a critique by the neoclassical economists noted that the labour theory of value could not explain fluctuating values for different kinds of labour (skilled and unskilled) that produce varying outputs, nor did it explain how found (artificial) goods could be more valuable than extracted goods (Menger, 1871). A historical perspective to, and synthesis of the divergent views on the labour theory of value was given by Gordon (1959) to the effect, firstly, that the most well known proponent of such theory was probably Adam Smith. Secondly, that it seemed undeniable that all the major neoclassical economists and Marx explicitly rejected the labour theory of price as originally constructed. A somewhat different theory of cost-determined prices was provided by the “neo-Ricardian school” of Piero Sraffa and his followers who distinguished between sectors with cost-determined prices (such as manufacturing and services) and those with demand-determined prices (such as agriculture and raw materials extraction). He equated this theory to modern day theories of mark-up pricing, full-cost pricing or administrative pricing. Other economists, Hall and Hitch (1939) have found that the evidence gathered in surveys of businessmen supported such theories.

Production theory states that the price of an object or condition is determined by the sum of the costs of resources that went into making it. The costs can compose any of the factors of production (including labour, capital or land) and taxation. The theory makes the most sense under assumptions of constant returns to scale and the existence of just one non-produced factor of production. Under these assumptions, the long run price of a commodity is equal to the sum of the cost of inputs into that commodity, including interest charges (Hall and Hitch, 1939). Marginal utility as a source of value meant that the perceived need for an object was seen to be dictating the value on an individual rather than a general level. The implication is that the individual mind is the source of economic value: That the marginal utility of goods, rather than the labour inputs that went into making them, is the source of their value. The marginalist theory solved the diamond –water paradox that had been puzzling classical economists: the fact that mankind finds diamond to be far more valuable than water although water is far more important. Menger (1871) further stressed uncertainty in the making of economic decisions, rather than relying on “homo economicus” or the rational man who was fully informed of all circumstances impinging on his decisions. This was a deviation from the classical and neoclassical thought. As production takes time, then producers have no certainty on the supply or demand for their product. Thus the price of the finished product bears no resemblance to the costs of production, since the two represented market conditions at very different points in time.

This position deviates from Ricardo and his followers’ emphasis on cost of production when analyzing the factors that determine exchange value. Marshall (1890) in his general theory of demand and supply emphasized the use of demand and supply functions as tools of price determination (previously discovered independently by Cournot (Tullberg & Rita, 2008)). The demand and supply model is one of the most simple, yet important and useful economic models capable of addressing business and government policy issues. The demand and supply curves specify the relationship between the quantity demanded by buyers and supplied by sellers, and the price of the good. When a commodity is for sale at multiple locations, the law of one price is generally believed to hold. This essentially states that the cost difference between the locations cannot be greater than that representing shipping, taxes, other distributing costs, etc. In the case of majority of consumer goods and services, the distribution costs are quite a high proportion of the overall price, so the law may not be very useful. In practice, it may well make economic sense to offer a product or service for sale at a higher price in a wealthy area than in a deprived area as the marginal utility of the asset for purchasers will be higher in the former.

This theory, like many other theories, was founded based on certain assumptions. The three basic assumptions, which are fundamental economic ones, although certain branches of neoclassical theory may have different approaches (Weintraub, 2007) are that:

- 1) People have rational preferences among outcomes that can be identified and associated with a value
- 2) Individuals maximize utility and firms maximize profit
- 3) People act independently on the basis of full and relevant information

3.0 Methodology

This study evaluated the impact of product pricing on business failure in Nigeria in some table water producing and packaging company. The study adopted a survey research design, using a combination of stratified and judgmental sampling techniques. The questionnaire was administered to 56 proportionately and judgmentally selected companies on the basis of location. The questionnaires were hand delivered and completed by either the owner of the company or the operating officer. The scales in the questionnaire were content validated and have a reliability correlation of 0.91. The data collected was analysed using descriptive statistics and chi-square distribution.

Business failure and management inexperience

	Observed N	Expected N	Residual
2.00	21	100.8	-79.8
3.00	52	100.8	-48.8
4.00	137	100.8	36.2
5.00	130	100.8	29.2
6.00	164	100.8	63.2
Total	504		

Test Hypothesis 1

TEST STATISTICS

Business failure and Management inexperience	
Chi-Square	147.885 ^a
Df	4
Asymp. Sig.	.000

The table above shows the result of the Chi-Square SPSS analysis. The P-Value is 147.885, while the critical (Table value) of $X^2 = 0.05$ at $df = 4$ is 9.488. This shows that statistically, the calculated value is higher than the critical value and therefore we reject the null hypothesis and accept the alternative hypothesis which says that there is a significant relationship between management inexperience in appropriate product pricing and business failure.

Testing of Hypothesis 2

The hypothesis is restated and the two variables i.e., price war among competing firms and business failure, are tested with SPSS using Chi-Square statistics, adopting the various questions earlier indicated against hypothesis 3. The result of the test is analyzed, and a decision taken as to accept or reject the null or alternative hypothesis.

Test of Hypotheses 2

Price war and business failure

	Observed N	Expected N	Residual
2.00	16	75.6	-59.6
3.00	43	75.6	-32.6
4.00	121	75.6	45.4
5.00	74	75.6	-1.6
6.00	124	75.6	48.4
Total	378		

Test Statistics

	Pricewarandbusinessfailure
Chi-Square	119.328 ^a
dfAsymp. Sig.	4

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 75.6.

The table above shows the result of the Chi-Square SPSS analysis. The P-Value is 119.328, while the critical (Table value) of $X^2 = 0.05$ at $df = 4$ is 9.488. This shows that statistically, the calculated value is higher than the critical value and therefore we reject the null hypothesis and accept the alternative hypothesis which states that there is a significant relationship between price-war among competing firms and business failure.

Test of Hypotheses 3

Consumer resistance to price increases and business failure

	Observed N	Expected N	Residual
2.00	13	49.6	-36.6
3.00	22	49.6	-27.6
4.00	68	49.6	18.4
5.00	42	49.6	-7.6
6.00	103	49.6	53.4
Total	248		

Test statistics

	Consumer resistance to price increases and business failure
Chi-Square	107.847 ^a
Df	4
Asymp. Sig.	.000

a. 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 49.6.

The table above shows the result of the Chi-Square SPSS analysis. The P-Value is 107.847, while the critical (Table value) of $X^2 = 0.05$ at $df = 4$ is 9.488. This shows that statistically, the calculated value is higher than the critical value and therefore we reject the null hypothesis and accept the alternative hypothesis which states that there is a significant relationship between consumers' resistance to price increases and business failure.

4.0 Discussion of Findings

Hypothesis 1 tested whether there is or no significant relationship between appropriate product pricing and business failure. The conclusion was positive. This was revealed by the variables tested in the hypothesis.

This result is supported by Kotler and Keller (2009), Toftoy (2010), David (2009), Ferrell and Pride (1989), and Analoui and Karami (2003).

Hypothesis 2 was an evaluation of the effect of price war on competing firms. Questions thirteen to seventeen related to the hypothesis. There was a consensus by respondents that price war could orchestrate business failure in the long run. The hypothesis result was positive. Empirical studies in other countries [Rao, Bergen & Davis (2000); Heerde, Gijsbrechts & Pauwels (2008), and Gielens, Linda, Gucht, Jan-benedict Steenkamp & Dekimpe (2008)] all supported the fact that price war often harm marginal producers, contract competition and end up introducing monopoly and oligopoly institutions with their consequences.

Finally, hypothesis 3 tested whether consumers' resistance to price increases causes business failure. Respondents overwhelmingly agreed. The end point for every productive endeavour is to satisfy consumer needs and wants. Josh, (2005), Oyedijo, Ogundele, Idris & Aliu (2010), Perreault & McCarthy (2005), and Swarming (2006) concurred. Whenever consumers refuse to purchase a product because of its price increase, the producer has no choice but retain the old price; otherwise he is out of business.

Majority of the respondents agreed that business failure results in loss of confidence; very strongly agree that it has serious health implications; were divided that it could provide better opportunity elsewhere, but seem to disagree that business failure is highest in small businesses. Literature supports the views that business failure has both physical and psychological consequences (Hisrich, Peters & Sheperd, 2008 and Bruno, McQuarrie & Torgrimson, 1992). According to Dun & Bradstreet (D&B) reports, the failure rate for new businesses was estimated at around 70 percent to 80 percent in the first year of operation (Bygrave & Zacharkis, 1997), but Deeson (1972) talked about the failed giants like Enron, WorldCom, etc.

5.0 Summary of the Study

This research has examined the impact of product pricing as one of the causative factors in business failure, using bottled water production and packaging in some catchment area in Lagos State as a study. The objectives of the study were set out, so also was the methodology for achieving them. Relevant literature was reviewed on the subject matter. There was a consensus of opinion among authors that appropriate product pricing is a key management function and an important decision tool in achieving organizational effectiveness. Emphasis was laid that product pricing must encapsulate issues relating to the environment, business internal competences, competition, customers and general stakeholders' interests (references could be made to Kotler and Keller (2009); Hisrich, Peters, and Sheperd (2008); Analoui and Karami (2003), and Ogundele (2007)).

5.1 Conclusion

The essence of drawing a conclusion is to appreciate the implications of the study for policy decisions and to identify areas for future research. This conclusion is divided into two findings arising from the analyzed questionnaire and those from comments of practitioners. From the study we found that business managers are not mere profit maximizers; rather they consider other extraneous, though important, factors in their price setting decisions. This is at variance with the postulations of the classical price theory of Smith (1776) and Ricardo (1890). The businesses have entrepreneurial orientation and are predominantly family-based. A lot of suspicion and secrecy pervade the operating environment. Every 'visitor' is first treated with suspicion until one's mission is known. It was like someone is breaking the law and is always on the look out for law enforcement agencies. It was evident that cooperation and interaction among producers were severely limited. Therefore, not much is expected from a divided house.

Being part of the larger small scale industry (SMEs), its contribution to the economic development of the country is incontestable. This is by way of employment generation, product quality and development, competitive spirit and socio-economic relevance in its operating communities. It is concluded that for any business to be efficient and effective, the issue of product (goods or services) pricing must be taken seriously. More so now that the internet has commoditized almost every product and price has become almost the most important purchase consideration. Equally of note is that empirical evidence has shown that price war, in the long run, is an ill-wind that does nobody any good. It defeats corporate objectives of associations, shrinks the market size, kills marginal producers and produces uncompetitive firms. Consumers' resistance of either proposed or actual product price increases is a knell that summons any affected organization to death. Majority of the respondents very strongly agree.

As earlier indicated in the research methods under chapter three, we had oral interview with three past executives of Association of Table Water Producers (ATWAP). The interview produced the following enlightening conclusions: That the business of table water is unprofitable in Lagos, except you have the capability to influence your prices like the multinationals and to some extent, the local large companies. Attention was drawn to the fact that since 1993, that the price of sachet water has remained the same in Lagos State whereas, some factor input prices had quadrupled. That the sub-sector is not growing because of lack of cooperation among producers, they cited the 2008 aborted effect by its association to increase the sachet water price. That government and its agencies are contributing significantly in the collapse of many table water producing companies, they cited an instance where a marginal producer is forced to pay as high as one hundred and fifty thousand naira, inclusive of tax, if his truck is towed for say traffic obstruction. Often times, some companies abandon such trucks while some fold up as a result of such payment. That poor infrastructure especially power, is continuously increasing cost of doing business, while bad roads contribute to the wear and tear of their trucks thereby increasing cost of maintenance. Of great concern to them is the increasing militancy of their host communities in forcing their businesses to be socially responsible, even when business is not doing well. On a fatalistic note, they predicted that their poor financial position will not improve until their few surviving members will see the need to unite to fight for their survival and perhaps growth.

From these afore-mentioned comments, the apparent conclusion is that, small businesses generally, and table water producers in particular, provide very important health services that every stakeholder must deliberately work to make them survive and continue doing business profitably. One would not want to imagine the resurgence of water borne diseases with their debilitating consequences.

5.2 Recommendations

The conclusions arising from the findings in our data analysis and hypotheses testing now give impetus to make recommendations for a better organizational management and future survival and growth of the sub-sector.

- The plethora of management and marketing literature reviewed all emphasized the importance of appropriate product pricing in achieving business efficiency and effectiveness. There was also the need for managers to be strategic in planning even at the small business level. To what extent this is being effectively done appears debatable given the spate of lamentations by operators in poor business performance. Hitherto, strategic management was limited to large organizations; it has now traversed all sizes of businesses for better result in developed countries. We need to take a cue.

- Businesses are increasingly becoming more dynamic, globally oriented, and competitively unprotected. The advancement in information technology, transportation and communication has come with it no clear location advantage to businesses. Survival now depends on being fleet-footed, compact, internet savvy and ability to operate competitively globally. This is a challenge to small and self-perceived local businesses.
- Respondents preponderantly agreed that price war in the long run becomes a ‘Frankenstein-monster’ that ended up destroying its creator, in this case competing firms. If only small business operators would know that mere turnover is not synonymous with profitability, then would they begin to rethink before embarking on price cutting and price war. It is therefore recommended that more knowledge be sought in the area of business/management accounting.
- Concern for the environment is now assuming a global dimension. The demand for cleaner and safer environment is increasing and that appears to be the trend. Previous catastrophic industrial accidents of global proportions would not be easily forgotten. Locally, communities are becoming more militant in forcing businesses to become socially responsible. Businesses are advised in their own interest, to be compliant.
- Business associations are expected to play catalytic role in bonding their members to achieve collective beneficial objectives. However what often obtains is selfish empire-building by the officials who will do every thing to perpetuate their tenure. The result has always been formation of parallel associations and internal indiscipline. Small businesses are advised to bond together to make it easier to achieve economic and political power required to influence economic decisions.
- Small business operators are encouraged to diversify, either forward or backward as a way of reducing concentration risk, achieve milestone in cost reduction and leverage in dealing with suppliers and/or other distribution chain members.
- An astute business operator who has conscientiously done his comprehensive and inclusive costing would know if the business can buy its way, otherwise to be courageous enough to liquidate the current line and move on to another line of business with better prospects.

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