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Price Setting in Food SMEs: Which Role for Marketing Capability? An Empirical Analysis in Italy

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Abstract

Small and medium-sized enterprises (SMEs) are fighting for survival due to globalization, growing competition with big retailers, and strategies adopted by large industrial companies. Difficulties in pricing are also revealed in the literature. Therefore, appropriate activity is needed to be more a price maker than a taker, and to reach a better market power. On the other hand, market opportunities for SMEs are related to demand evolution toward food quality and traditional food products. To profit by such opportunities, SMEs need to focus on consumer requirements, by differentiating their products. In this way, firms could apply a premium price that justifies the peculiar value of the product, and that the consumer should be willing to pay. Nonetheless, the ability to influence the price is different among firms, and often depends on firm bargaining power. Indeed, horizontal and vertical competition highly affects the ability of price setting, especially for SMEs, due to their small dimension. In order to enhance their capability to decide the price, SMEs should focus mostly on marketing, as price setting is a significant component of the marketing mix. This paper aims to evaluate the relationship between marketing capability and price setting ability in traditional food SMEs, to outline the role to have well developed marketing activities. A survey was carried out, through an interactive questionnaire aimed at assessing SME marketing capabilities. The sample was composed by 130 Italian firms producing traditional food products. An ordinal regression model explained the relationship between the ability of firms to influence the price and the marketing capability. The analysis showed a good capability to affect the price setting for the Italian traditional SMEs. Moreover, we found that good marketing capabilities enhance the ability to be price maker, especially in relation to product differentiation and market research.

Keywords: *traditional food products, price setting, marketing capability, ordinal regression model*

JEL: L25, L66, M31, Q13

1 Introduction

The globalisation, the increasing power of big retailers, and the strategies developed by large companies are some of the elements that are characterising the European food market in the last years, generating the increase of competition. Small and medium-sized enterprises (SMEs), which represent the greater part of the food industry, have to survive in the market facing the growth of competition (Knight, 2000; Banterle *et al.*, 2009 and 2010). In particular, difficulties in pricing are found in SMEs and these problems could influence the economic performance. Indeed, the capacity of price setting very often depends on the bargaining power of the firm, which, in the food sector, is deeply related to horizontal and vertical competition, having a stronger effect on SMEs, due to their small dimension.

Nevertheless, SMEs could also profit by some opportunities linked to the changing consumer preferences towards quality and tradition of food products (Ilbery & Kneafsey, 2000; O'Reilly & Haines, 2004; Wirthgen, 2005; Gorton & Tregear, 2008; Blandon *et al.*, 2009). SMEs, developing strategies focused on product differentiation and improving marketing activities, could meet consumer requirements and also should be able to develop a better market power becoming more price makers than takers (McCartan-Quinn & Carson, 2003).

By setting the price, indeed, SMEs can communicate to the consumer the value of their product, and act on his purchasing behaviour (Monroe, 1990). Moreover, price decisions are related to firm internal organisation as well as external aspects (Panigyrakis, 1997).

This paper aims at evaluating the ability to be price maker for the Italian traditional SMEs. Moreover, we want to assess the relationship between the marketing capability and the ability of price setting. In particular the purpose is to outline if good marketing capabilities can lead to a better ability to set the price.

The data were collected through a questionnaire available on line in 130 Italian traditional food SMEs. Statistical analysis includes an ordinal regression model to assess the relationship between the marketing capabilities and the price setting ability.

The paper is organised as follows: in section 2 the conceptual framework is explained, section 3 provides the methodology utilised, in section 4 the results are discussed, and in section 5 the conclusions are set down.

2 Conceptual framework

The ability and the possibility to be price maker depend on a series of aspects both external and internal to the company (Panigyrakis, 1997). The external aspects influencing the price setting are the type of competition, the kind of distribution channel, and the width of geographical sale market. The internal aspects which can affect the price setting of food SMEs deal with market research activities, product differentiation, marketing strategy, production of PDO-PGI, and firm size (fig. 1).

The **type of competition** greatly affects the pricing power of a firm, depending on the number of firms operating in a particular sector, the firm size, product differentiation, and so on. The Italian food sector is characterised by imperfect competition, with the

presence of both large and small firms. The coexistence of these firms is possible insofar as they differentiate their products. In relation with price, firms can choose between mainly two strategies: price competition and non-price competition. While in the first case the firm acts on the quantity produced suffering the market price, in the second case it should enjoy greater price flexibility adding peculiar qualitative attributes to the products which justify a higher price.

The **kind of distribution channel** is also an important aspect affecting the price setting. Indeed, the concentration of distribution sector is increasing, the large retailers are growing, and they are assuming greater market power within the supply chain (Panigyrakis, 1997), generating a vertical competition with the industrial sector.

Moreover, the width of the **geographical sale market** could affect the pricing simply because the wider is the reference market the bigger is the number of competitors, and so minor is the chance to decide the price.

Regarding the internal aspects, in order to set the most appropriate strategy and find the right level of differentiation, it is necessary to analyse the market where the firm operates. Therefore, the firm has to enhance its **market research** activity to collect information on consumer preferences, and also on the situation of the marketplace and the environment which could affect the tastes of the final users (Kohli & Jaworski, 1990; Narver & Slater, 1990; Jaworski & Kohli, 1993; Kara *et al.*, 2005). Moreover, it is necessary for the firms to investigate the skills of their suppliers and the requirements of their retailers, in order to maintain a good qualitative level along the supply chain, as well as to observe the strategy adopted and the price charged by the competitors, being informed about the competing strategies, especially related to product positioning.

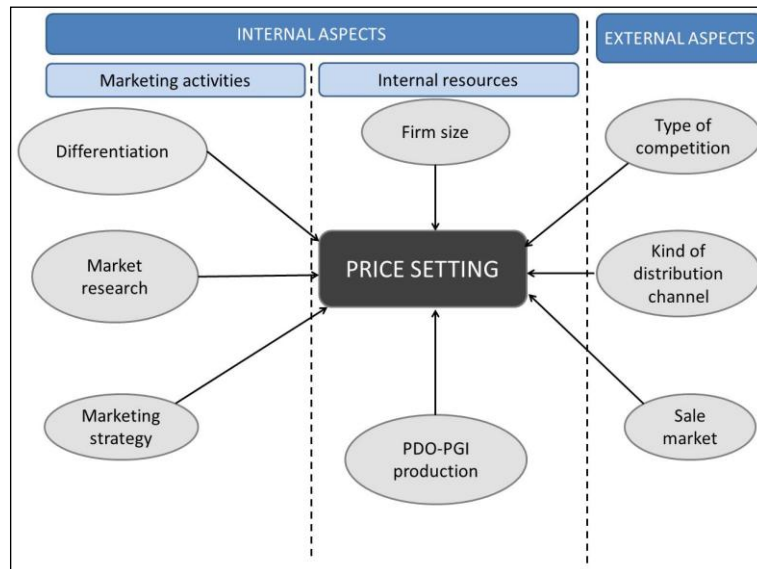


Figure 1. Aspects affecting food firm price setting

Once analysed the market, SMEs could decide which level of product **differentiation** they want to apply. Through differentiation, indeed, SMEs should be able to carve out a peculiar niche in the market beside large firms, as they could offer a product with specific features, for what the consumer is willing to pay a premium price (Kotler, 2004). This premium price justifies the fact that some characteristics are not offered by other competitors, and also guarantees the superior quality and value of the product (Kaleka, 2002; Albisu 1997). The price is, indeed, the way of communication with the consumer, who often evaluates whether buy a product or not, by comparing its price with that of the substitutes. In the mind of the consumer the price is translated into product quality and value (Panigyrakis, 1997).

Nevertheless, it is not enough to differentiate the products. If SMEs want to have success and survive beside large firms, the consumers should recognize the peculiar attributes given to the products and, thus, be loyal to these specific features.

In order to be closer to the consumer requirements, the **marketing strategy** plays the important role to act as a go-between between the internal organization of the firm and the market (Bagozzi, 1998). Therefore, the activities related with marketing strategy help SMEs in planning in advance, formulating clear objectives, choosing the most appropriate distribution channel, and in organizing in the best way the sale force. Marketing has also the function to “communicate” with the market and make the peculiar attributes of the products recognizable by the consumers.

In relation with traditional food products, another aspect influencing the price setting is represented by the **production of PDO/PGI products**, namely those products characterized by a certification concerning the origin of raw materials and the production process, which has to be connected to a specific geographic area (Tregear *et al.*, 1998). Even though this aspect represents a differentiation tool through what the consumer can recognize particular quality products, the fact that, usually, the firms producing PDO/PGI are also members of a consortium for protection and promotion of the brand could affect negatively the price setting. Indeed, when a firm produces foods certified by third parties, all the marketing activities are carried out by the consortium, including the pricing.

Finally, the **firm size** could affect the price setting, especially in the case of firms characterized by micro, small and medium dimensions. In the economic literature, it is found that SMEs lack appropriate tools for responding to increased market competition, and for dealing with competitors in national and international markets. They are weak in capability and bargaining power and lack other resources that multinational enterprises normally have (Knight, 2000; Gilmore *et al.*, 2001). Moreover, previous studies argue that SMEs often face shortage of time and resources, especially financial, and this makes the realisation of a market-oriented behaviour more difficult (Tregear, 2003; Spillan & Parnell, 2006). The lack of time results in a marketing activity not well organised. Moreover, few financial resources reduce the possibility to invest in marketing activities (McCartan-Quinn & Carson, 2003). All these issues are translated in a low capacity to plan in advance the marketing activity, to implement it regularly, and to set the price (Carson, 1990; McCartan-Quinn & Carson, 2003; Laforet, 2008). Nevertheless, an

appropriate activity in this sense is needed to be more price maker than taker, and reach a better market power (McCartan-Quinn & Carson, 2003).

In spite of the critical aspects mentioned above, in the literature there are also cases of successful SMEs, demonstrating that it is possible for small firms to act in a market oriented way, and have control on price setting (Kara *et al.*, 2005; Tregear, 2003).

Considering this conceptual background, the hypotheses which will be tested are the following:

- H1: Traditional food SMEs in Italy are able to be price maker, as the product is differentiated.
- H2: Good marketing capabilities positively affect the ability of price setting.
- H3: The vertical competition and the role played by large retailers affect the ability of price setting.

3 Methodological issues

A survey was conducted through an interactive questionnaire, available on-line, in order to evaluate the marketing activities of SMEs producing traditional food products. The questionnaire is composed by 22 questions, representing the variables described in table 1. The answers to the questions have been arranged in a multiple-choice format with rating or dichotomic scales.

The questionnaire is divided, according to recent economic literature, in different parts. The first part of questionnaire concerns general data of the firms interviewed (sector, membership to a consortium, number of employees, turnover, voluntary certifications, PDO/PGI products, distribution channels and geographical sale markets). The second part is related to the level of differentiation of the product. The third part investigates the firm market research with questions exploring if the firm collects information about the market where it operates. The fourth part, dealing with marketing strategy, investigates the firm objectives and the strategic choices regarding the product business and other marketing activities.

Table 1. Variable definition

Variable name	Description	Variable type	N	Mean	SD
DEPENDENT VARIABLE					
Influence on price setting	The company strongly influences the price of our products	scale (1-5)	129	3.40	1.31
INDEPENDENT VARIABLE					
Membership to a consortium	If the company is member of a consortium or cooperative value 1, otherwise 0	dummy (0-1)	112	0.67	0.47
Employees	Number of employees (<10; 10-49; 50-249; >250)	scale (1-4)	128	1.81	0.86
Turnover	Turnover (< 2 M€; 2-9 M€; 10-49 M€; 50-249 M€; >250 M€)	scale (1-5)	103	1.97	1.17
Voluntary quality certifications	Number of voluntary certification schemes that the company have implemented	scale (1-5)	113	2.38	1.31
PDO/PGI	PDO/PGI production value 1, otherwise 0	dummy (0-1)	126	0.69	0.46
Sector	Sector (1= Beverage; 2= cheese; 3= Prepared meat; 4= Canned food; 5= Others)	scale (1-5)	126	2.31	1.32
Distribution channels	Type of distribution channels (1= Supermarket; 2= Wholesalers; 3= Specialized shop/small grocery; 4= Direct sale)	scale (1-4)	128	2.24	1.11
Main sale markets	Major market (1= Local; 2= Regional; 3= National; 4= International)	scale (1-4)	129	2.77	0.89
Brand analysis	The company investigates the position of its brand in the market	scale (1-5)	129	2.78	1.33
Product tailoring according the consumer	The company tailors its products according to the needs of the consumer	scale (1-5)	130	3.68	1.28
Product differentiation	The company seeks to make its product different from that of competitors	scale (1-5)	130	4.02	1.19
Investment in promotion and advertising	The company invests in promotion and advertising	scale (1-5)	129	3.29	1.24
Supplier analysis	The company investigates the competencies/skills of our suppliers before we select them	scale (1-5)	130	3.92	1.11
Retailer analysis	The company investigates the requirements of our retailers	scale (1-5)	130	4.03	1.12
Competitor analysis	The company investigates the marketing strategy of our competitors	scale (1-5)	130	3.15	1.32
Market analysis	The company analyses any data and information about the market	scale (1-5)	130	3.71	1.22
Consumer analysis	The company analyses the requirement of our consumers	scale (1-5)	130	3.75	1.18
Strategy well-known inside firm	The company implements very strictly our marketing strategy	scale (1-5)	130	3.48	1.18
Investment in qualified sales forces	The company invests in dynamic and qualified sales force	scale (1-5)	129	3.68	1.37
Choice of distribution channel	The company chose the type of distribution according to our sales objective	scale (1-5)	127	3.96	1.18
Planning in advance	The company applies detailed marketing planning in advance	scale (1-5)	129	3.45	1.33

Except for the part of the questionnaire regarding the general data of the firms, in the other sections the firms had to answer with a Likert-scale from 1 to 5, reflecting, respectively, the worst capability and the best one. The questionnaire represents a self-evaluation tool addressed to marketing managers of the firms analysed. The sample is composed by 130 Italian firms producing traditional food products.

We analysed the ability of firms to influence the price setting, in order to understand if a good performance in the marketing activities is reflected in the price setting. We used an ordinal regression model, and the dependent variable is the firm price setting ability (scale 1-5, from low to high). The independent variables are those affecting marketing management capabilities, which are reported in table 1.

The proportional odds model for Ordinal Logistic Regression is estimated as follows (McCullagh, 1980):

$$c_j(X_i) = \ln \left\{ \frac{P(Y > j | X_i)}{P(Y \leq j | X_i)} \right\} = \beta_1 X_{i1} + \dots + \beta_k X_{ik} - \tau_{j+1} \quad [1]$$

with:

$i = 1, \dots, 130$; corresponds to number of firms of the sample,

$j =$ score from 1 to 5,

$k = 1, \dots, 8$; corresponds to number of independent variables,

$Y =$ response variable,

$X_i =$ independent variables (answers for each firm),

$\beta =$ regression coefficients,

τ = parameter referred to as “cut-points” between intervals of values of response variable.

In this model the β coefficients represent the log odds ratio of scoring $> j$ versus $\leq j$ for a one unit change in X . Definitions, means, and standard deviations of all variables employed in the model are reported in table 1. Before estimating the Ordinal Regression Model, we reduced the variables into factors using Principal Components Analysis (PCA).

4 Results

4.1 Descriptive analysis

The data were collected in 130 traditional food firms located in Italy. The 95.3% are SMEs: 43% are micro-sized firms, 37.5% are small, and 14.8% are medium (fig. 2). As the questionnaire was published on the web, also some large firms answered to the questions, and they constitute 4.7% of the sample. A similar situation is found for the turnover.

Most of the firms of the sample sell their products through supermarkets (35.9%), followed by those selling to wholesalers (19.5%) (fig. 3). The choice of small retailers is more limited. Indeed, only 18% of the sample sells to specialised shops or small groceries, and 15.6% carry out the direct sale. The majority of the sample sells in the national market (53.5%), followed by the international market (17.8%), the regional (16.5%), and the local one (12.4%).

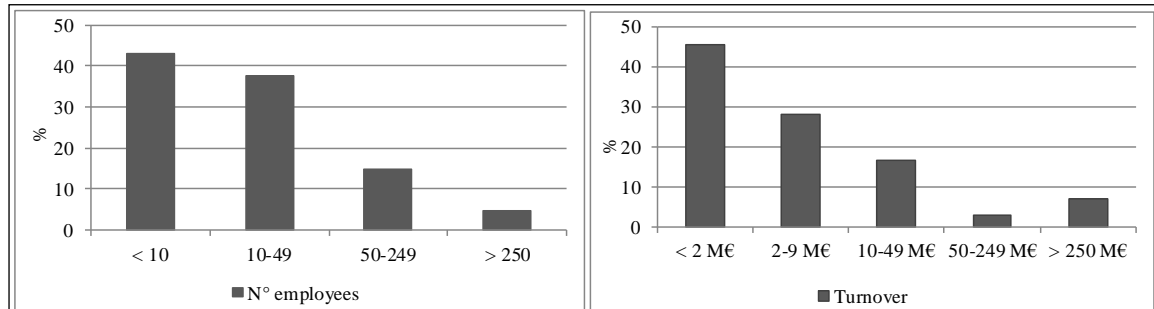


Figure 2. Size of the firms of the sample

Source: own calculations

Concerning the productive sector, the majority of the firms of the sample produce beverage (37.3%), in particular wine (fig. 4). Then, we found cheese (23.8%) and prepared meat (16.7%) producers. Canned foods are produced only by 7.9% of the sample, whereas the other sectors are included in the remaining 14.3%.

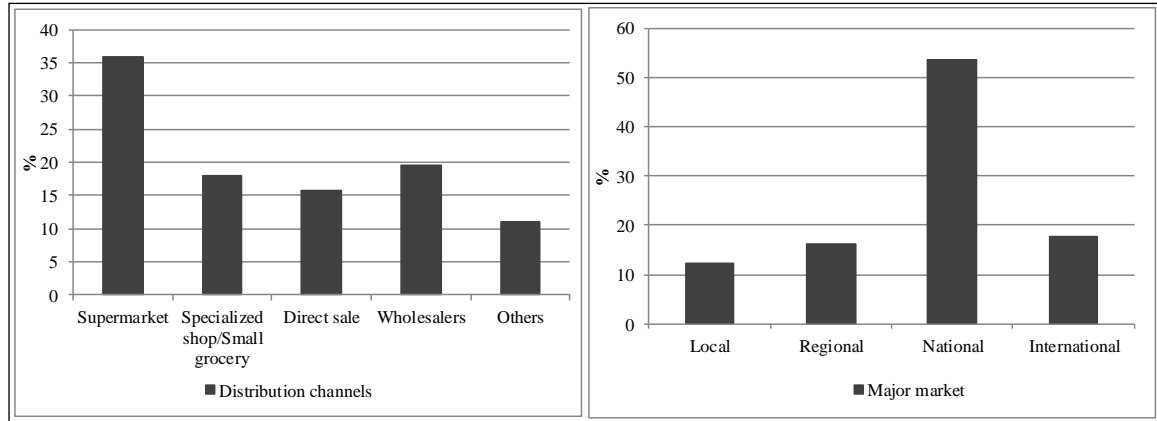


Figure 3. Distribution channels and geographical market of the firms of the sample

Source: own calculations

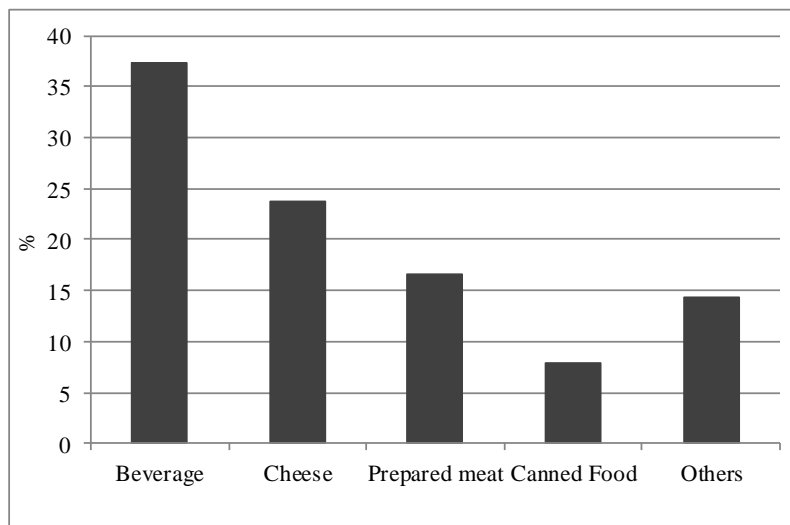


Figure 4. Food sectors represented in the sample

Source: own calculations

Regarding the ability to influence the price setting, 31.8% of the sample states that they often act on price decision, and 23.3% affirms that always can set the price of the products (fig. 5). On the opposite, 17.8% has influence on pricing only sometimes, 15.5% seldom, and 11.6% never. Therefore, 55% of the firms of the sample is able to set the price of the products. This fact demonstrates how firms, even micro or small sized, have some power to affect the price setting.

An aspect that should be considered in relation with price setting is the PDO/PGI production, as it is connected with the differentiation strategy. If a firm is able to profit of being located in a geographical area characterised by designation of origin, giving peculiar features to the products, it can also gain a premium price. Nevertheless, the PDO/PGI production is also related with the membership to a consortium, as firms producing certified products are often part of a consortium which has the function to

promote and protect the brand on the market. Therefore, this consortium carries out the marketing activities, including price setting, on behalf of the firms associated. As it can be seen in the figure 6, 47.6% of the firms producing PDO/PGI show a low ability to decide the price, whereas 64.1% of the sample, which does not produce certified products, asserts to be price maker.

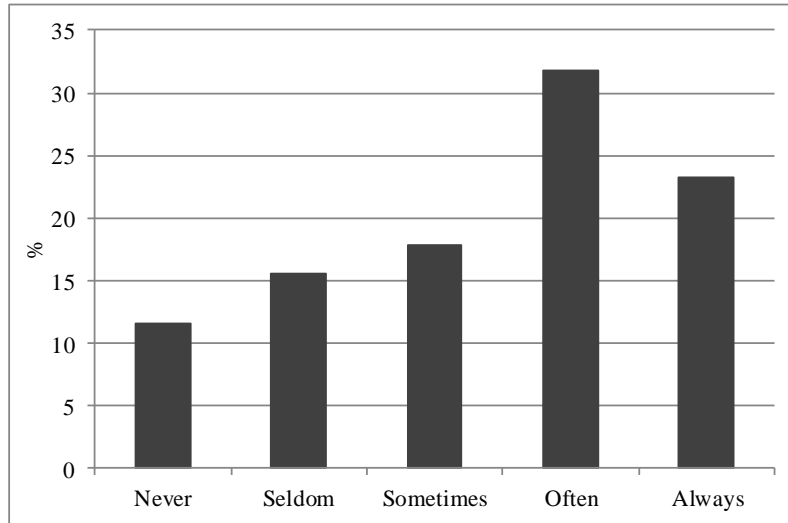


Figure 5. Influence on price setting of the firms of the sample

Source: own calculations

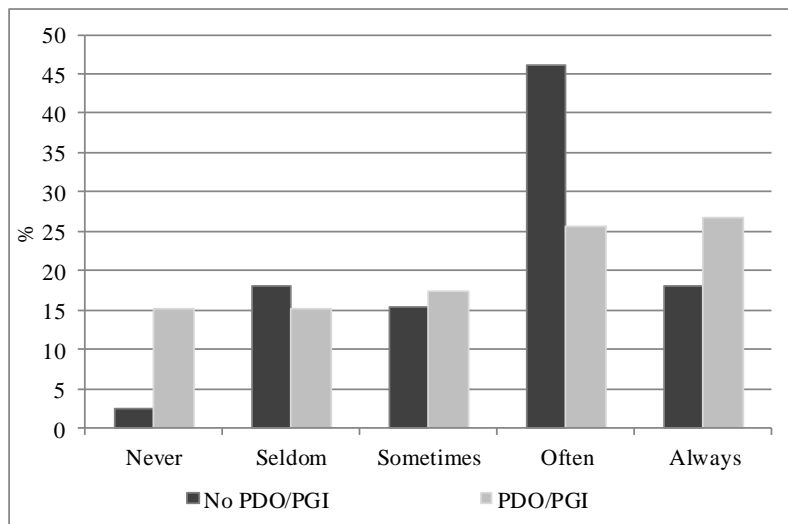


Figure 6. Relationship between the influence on price setting and the PDO/PGI production

Source: own calculations

4.2 Estimation results

Before estimating the Ordinal Regression Model, Principal Component Analysis (PCA) was applied to reduce the number of independent variables in the model, and to extract relevant factors that can explain the issues affecting the price setting. PCA is a linear transformation of the variables that assumes those factors able to explain all the variance in each variable. We extracted three factors with eigenvalues greater than 1, representing the differentiation (F1), composed by four items, the market research (F2), composed by five items, and marketing strategy (F3), composed by four items (table 2). Orthogonal rotation (Varimax) was carried out after the first extraction of factors. These factors have been used for the ordinal regression as independent variables together with other variables described in table 1.

To estimate equation [1] we utilized maximum likelihood estimation method. Adequate goodness of fit is shown by Pearson's Chi-Square Statistics and Nagelkerke's R^2 .

Estimates of model show that the membership to a consortium significantly affects the dependent variable, but it has a negative sign (tab. 3). Therefore, if the firm is part of a consortium, the price setting is assigned to the consortium, which has the function to carry out all the marketing activities.

Table 2. Factors resulted from PCA

<i>Factor 1 Differentiation (F₁)</i>		<i>Factor 2 Market research (F₂)</i>		<i>Factor 3 Marketing strategy (F₃)</i>	
Brand analysis	0.80	Supplier analysis	0.77	Strategy well-known inside firm	0.65
Product according the consumer needs	0.47	Retailer analysis	0.78	Investment in qualified sales forces	0.79
Product differentiation	0.68	Competitor analysis	0.68	Choice of distribution channel	0.75
Investment in promotion and advertising	0.68	Market analysis	0.78	Planning in advance	0.76
		Consumer analysis	0.46		
Keiser Meyer Olkin test:	0.58		0.76		0.61
Rotation method:	Varimax		Varimax		Varimax
Total Explained variance (%):	44.62		50.46		55.19
Bartlett Test	59.33		147.99		116.91
Sig.	0.00		0.00		0.00

Source: own calculations

The factor representing product differentiation is significant and positive. Indeed, the firms which develop and add to the products peculiar qualitative attributes are able to be price maker. They have the power to act on price setting, and thus they can gain a premium price.

The factor related to market research significantly influences the price setting, whereas the factor representing the marketing strategy does not affect the dependent variable. This can be correlated to the fact that the analysis about supplier skills, consumers and retailers requirements, together with the study of competitor strategy and the collection of information on the marketplace, play an important role for an adequate understanding of the products attributes the firms have to introduce, in order to decide the price of its products.

Nevertheless, it is interesting to note that PDO/PGI production does not affect the price setting. This means that, in the case of certified products, the role played by the

consortium concerning the price decision is stronger than the value given by the quality and origin attributes which characterise the PDO/PGI certification. Moreover, the variable representing the kind of distribution channels also does not influence the price setting, meaning that, in the Italian case, the market power owned by large retailers does not reduce the possibility to decide the price for the firms producing specialties.

Table 3. Estimate of the model

	Influence on price	
	β	Sig.
α_1	-2.807	0.003
α_2	-1.651	0.072
α_3	-0.623	0.489
α_4	1.162	0.197
Membership to a consortium	-0.947	0.084
Employees	-0.181	0.558
Voluntary quality certifications	-0.131	0.484
PDO/PGI	0.466	0.369
Distribution channels	0.201	0.360
Differentiation (F_1)	0.582	0.035
Market research (F_2)	0.771	0.015
Marketing strategy (F_3)	-0.336	0.232
Chi-Square	22.892	0.004
Pseudo R^2 (Nagelkerke)	0.238	

Source: own calculations

5 Conclusion

Regarding the first hypothesis, the analysis shows for the firms a good capability to affect the price setting. The majority of the sample (55.1%) declared that, often or always, decides the price of the products. From the descriptive analysis it was also found that there is a greater capability to influence the price for the firms which do not product PDO/PGI products. On the opposite, for the firms producing these kinds of certified products the possibility to decide the price is more difficult.

Moreover, the ordinal regression revealed that the membership to a consortium negatively affects the dependent variable: this result means that the firms assign to the consortium the management of marketing activities, including the price setting.

Concerning the second hypothesis, we found that good marketing capabilities enhance the ability to be price maker, especially in relation to the differentiation and market research. Indeed, the more a firm develops peculiar features and adds appropriate attributes to its products, the more it can gain a premium price. Thus, the consumer is willing to pay an additional amount to obtain to satisfy his particular needs.

Furthermore, the factor connected to market research activities is also significant and positive. Therefore, the knowledge of the marketplace is a driving force to be market oriented and, consequently, to be able to fix the price. Indeed, the collection of information about the agents of the supply chain as well as the consumers is an important element to obtain the necessary knowledge for developing the appropriate attributes for the differentiation and for conducting the most successful strategies.

Related to the third hypothesis, the regression analysis showed that, in our case, the large retailers have not effects on firm price decision.

An interesting managerial implication is that the improvement of market research activities and those related with the differentiation of the products, requires the effort of the firms to develop a more intensive organisation of marketing activities, both ex-ante and ex-post, trying to build up a system able to evaluate efficiently the targets of consumers and the kind of competitors the firms have to face with. This is a crucial point for SMEs which want to carve out a peculiar niche in the food market and survive beside large firms.

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