Incorporating Pricing into the Marketing Curriculum
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Abstract

Although business executives have recognized the importance of pricing in the profitability of their companies, pricing remains a neglected area in the marketing curriculum. This paper addresses the apparent conflict between the interest shown by business executives in pricing and that shown by marketing academics. We explore the coverage of pricing topics in marketing and in several other disciplines and discuss why this coverage is inadequate. An outline of various pricing topics that we believe should be covered in a marketing pricing course is then presented.

Business executives are increasingly recognizing the importance of pricing in maintaining and improving the profitability of their companies. For example, only half of the marketing executives surveyed in an early 1960s study considered pricing among their firm's five most important marketing activities (Udell, 1964). Two decades later, marketing executives rated pricing and price competition as the number-one problem facing marketing executives (Fleming Associates, 1983). More recent evidence indicates this is still true today. In a 1986 survey conducted by McDaniel and Hise (1984), 35.6% of a group of chief executive officers of U.S. industrial corporations rated pricing as very important and 32.2% rated it as important. Only 3% of these executives rated pricing strategies as unimportant.

On the other hand, pricing appears to be a neglected area in the academic curriculum of most marketing departments across the country. McDaniel and Hise (1984) reviewed 75 undergraduate catalogs of four-year colleges and universities and found that only three marketing departments offered a pricing course and only one of those departments required a pricing course. We conducted a similar survey of 1988 catalogs of four-year colleges and universities and found that 9 out of 250 marketing departments offered some type of pricing course.

This paper addresses the apparent conflict between the interest shown by business executives in pricing and that shown by marketing academics. In the first section, we explore the coverage of pricing topics in marketing and in those other disciplines where it receives attention. We discuss why we believe this coverage to be inadequate in the second section. Finally, we use the discussion in this section to recommend in the third section various topics that we believe should be covered in a marketing course on pricing strategies.

CURRENT ACADEMIC COVERAGE

One explanation for the lack of a separate marketing course on pricing may be the assumption that there is adequate and consistent treatment of pricing issues among the various business disciplines. Topics in pricing are generally discussed not only in marketing, but also in accounting, economics, and to a lesser degree, finance. We surveyed textbooks and, in some cases, course syllabi to determine the content of pricing discussions in each of these disciplines. Our purpose in doing so was twofold. First, we wanted to determine the breadth and the depth of the pricing coverage in each of the disciplines. Second, we wanted to determine whether pricing techniques are taught consistently across the various disciplines.

Marketing

Marketing students are first introduced to pricing as a marketing activity in the principles of marketing course taught by most institutions. Pricing is typically addressed as one of the 4 Ps of marketing, and discussion of it is given equal time with the other Ps. In most textbooks, the contribution of economics to the theory and practice of pricing is discussed. Hence, reference is made to the role of costs, consumer demand, and the competitive environment in pricing decisions, in addition to a discussion of the relationship of pricing to the other marketing functions. However, because of the survey nature of the course, coverage of these topics is nondetailed and represents an introduction only.

The similarity between the time spent on pricing issues as contrasted with the other functions of marketing usually ends in the principles course. As mentioned in the introduction, only 3.6% of the marketing departments surveyed in 1988 offered a course on pricing. We requested the syllabi for these courses in order to survey the content of them. We received syllabi for six of the nine courses. Only one of the six courses (entitled "Price Theory and Strategy") devotes the entire semester to pricing issues and the role of pricing in the marketing mix. (This course covers material found in Nagle (1987). Nagle is an excellent book on pricing for marketers.) The other five combined product and pricing strategies into a one semester course, and the amount of time spent discussing pricing varies from one week to seven weeks.

Economics

The importance of price to economists is readily apparent by noting the substitution of the phrase "price theory" for microeconomic theory. Because of their focus on price, economists have produced the largest body of literature dealing with price issues. The economic theory developed in this literature typically examines the influence of market structure and other environmental variables on an observed market price. By then analyzing the relationship between this price and various measures of costs, the economist judges the relative efficiency of a particular market.

An economics course in which one might expect to find emphasis on pricing issues and that business students are often required to take is managerial economics. We conducted a survey of nine current managerial economics textbooks and found that eight of the nine textbooks devote one chapter or less to pricing. Incremental analysis in pricing is stressed in the pricing discussions, and this approach is contrasted to full cost and markup pricing. Considerable time is usually spent analyzing how the various types of costs and the price elasticity of demand affect the profit-maximizing price.

Accounting

The amount of space devoted to a discussion of pricing in managerial accounting textbooks varies from five pages to two chapters. The majority advocate pricing based upon incremental analysis and contrast this to the "less desired" full-costing approach. Distinction is made between long run and short run pricing decisions and hence between the meaning of incremental costs in the long run versus the short run. Emphasis is placed on cost-volume-profit analysis, and brief mention is made in some of the books as dependent on market structure, elasticity of demand, and other variables. (See, for example, Garrison (1983)). A small minority of managerial accounting textbooks present the full-costing approach to pricing. They argue in their presentation that even if allocated costs are irrelevant for certain purposes, they are not irrelevant for all
purposes since the firm must cover all costs in the long run to remain in business. (See, for example, Anthony and Reece (1983).)

Finance

The theoretical models in finance draw extensively on economic theory, especially in analyzing the role of prices in financial markets. Considerable time is spent analyzing how product prices are determined in the various financial markets, and little concern is given to pricing strategies of individual financial institutions. This reflects not only the perception that market forces determine financial prices, but it also reflects the pervasive regulation of pricing of bank services prior to the 1980s. With the recent deregulation of this industry and the move of the industry to integrate marketing into its operations, pricing is of increasing importance. Recent textbooks on bank management make brief mention of pricing issues as it concerns bank services. (See, for example, Johnson and Johnson (1988).) Much of the discussion focuses on the accurate measurement of credit risk. This reflects a cost-based approach to pricing, since a higher risk implies greater expected cost to the bank.

Adequacy of Coverage

Whether the coverage of pricing in these disciplines is adequate depends upon the nature of pricing in the marketing activities of the firm. Pricing decisions have in the past been based on static concepts of maintaining firm profitability. Firms tended to set price based on production costs, allowing them to earn a target rate of return over the long run for some predicted level of output. This price was unlikely to vary in response to short term changes in costs or demand. Within this framework, students, in the past, needed little formal instruction in pricing; instruction in costing was sufficient to develop a pricing strategy for a firm.

However, as noted in the introduction, the role of pricing in firm operation has changed dramatically during the last two decades. A 1977 article in Business Week heralds the emergence of widespread flexible pricing policies by major corporations. According to this article, companies have abandoned the idea of cost-plus pricing and are now aggressively pursuing flexible pricing strategies across time, customer segments, geographical regions, and products.

Part of this new view of pricing as an important marketing activity stems from the acceptance by both practitioners and academicians of the use of incremental analysis in pricing decisions. As seen from the brief review above, each of the disciplines spends considerable time on the appropriate cost measures to use in pricing, and theoretically the various treatments of costs in the pricing decision appear to be consistent. (For further discussion on the viewpoint of various disciplines of the role of costs in pricing, see Bruegelmann, Haasely, Schiff, and Wolfangel (1986).) Nevertheless, there is likely to be confusion among students over the correct categorization of the various costs used in making pricing decisions. A comparison of discussions on relevant costs in various textbooks reveals conflicting terminology both across disciplines and even across textbooks within the same discipline. For example, costs are categorized as direct or indirect, sunk or variable, full or marginal, fixed or variable, and relevant or irrelevant.

Treating the pricing decision as an activity based solely on costs still does not adequately address the issue of pricing in the marketing mix. Consumer valuation and the competitive environment in which the firm operates are equally as important as costs in setting price. Here economic theory has much to contribute because of its focus not only on incremental analysis, but also on demand relationships and market structure. Applicability to actual pricing actions is limited, however, for several reasons. First, economic theory tends to assume that price is the most important determinant of demand, and that it is relatively isolated from other factors affecting demand. As such, pricing is not perceived as an integral part of the marketing mix requiring coordination with the other functions of marketing. Second, the assumption typically made in economic theory that the firm knows the underlying demand and cost functions is unrealistic for most firms. In many pricing situations, the first challenge faced by the marketer will be obtaining the relevant data.

Proposed Topics for a Pricing Course

The shortcomings discussed above lead us to believe that a pricing course taught by marketing faculty would be a useful addition to marketing curricula. Although pricing is not currently taught in such a manner, the question remains as to where it is not currently taught. One purpose of the course would be to integrate the contributions made by each of the disciplines toward the theory and practice of pricing. This could not only resolve any confusion that exists over the meaning of relevant costs but also this integration produces a more holistic view of pricing than that given by each of the individual disciplines. The student may have been exposed to various pricing techniques and strategies, but use of this knowledge will only come by tying the concepts together and presenting them in an applied framework. Within this framework, the importance and interdependence of pricing in the overall marketing activities of a firm can then be stressed.

Below we outline the topics that we believe are relevant to a student studying pricing. We have tried to take the contribution of the various disciplines towards pricing and incorporate them into a course that views price as an integral part of the marketing mix. We have based the course on the view that understanding the external environment in which a firm operates is at least as important as understanding the internal nature of costs. Therefore, the proposed course covers not only the "correct" methods of cost-based pricing but also the dependence of pricing strategies on such things as the environment in which the firm operates. (We suggest as a textbook for the course Nagle (1987).)

Cost-Based Pricing

This section gives the underlying background theory on the role of costs in pricing decisions. The focus in this section of the class should be on which costs are relevant to the firm in pricing decisions in the short run and in the long run. Costs should be defined in terms of avoidable, incremental, sunk, and forward looking instead of the often used variable and fixed cost definitions to resolve the confusion over the categorization of costs. The student can then be instructed on how to use these costs to set a lower boundary on price. The techniques of breakeven analysis and the calculation of the contribution margin can also be included in this section for determining the sensitivity of profits to changes in price.

Response of Buyers to Pricing Strategies of the Firm

One of the most important factors influencing the pricing strategy of the firm is the degree of buyer sensitivity to price. Factors that influence price sensitivity are illustrated and the student is instructed in how to measure price sensitivity in situations where resources do not allow a detailed and rigorous analysis. Research techniques designed to measure price sensitivity when sufficient resources are available should also be presented. Issues of market segmentation and the identification of different types of buyers can also be discussed here since buyer response varies across segments. Finally, a thorough treatment of buyer's response to pricing strategies must include the psychology of pricing since recent research in psychology and marketing indicates that perception and mental evaluation play a large role in buyer's response to pricing.
The Role of Market Structure in Pricing Strategies of the Firm

In order to understand how competitors or potential competitors will respond to price changes it is necessary to understand the market structure of the industry in which the firm operates. The market structure includes such variables as the number of firms, the barriers to entry, and the extent of product differentiation. The role of each of these factors in the effect of price changes on the ultimate sales of the firm is discussed in detail and students are taught methods of evaluating the market structure of an industry.

Formulating the Pricing Strategy and the Role of Market Segmentation in the Pricing Strategy

This section involves combining the analysis into a coherent pricing strategy. The concept of economic value analysis is a helpful tool in integrating the role of costs, buyer response, and market structure (see Nagle, 1987), and the student can be instructed in how to determine the economic value of all the segments that comprise the market to develop an economic value profile of the market. This then suggests to the firm the price level at which the product is competitive for each market segment. Coverage should also include peakload pricing, two-part tariffs, volume discounts, block pricing, price segmentation by product design, tie-ins, metering, and transfer pricing.

Pricing Consistently With the Marketing Mix

Pricing decisions must be coordinated with the other elements of the marketing program of the firm. A firm must be aware of changes in revenues and costs not only for the product being priced but also for other products affected by the price change. Advertising must be coordinated with pricing strategies since advertising will affect the economic value of a good. The use of price as a promotional tool can also be an important component in the marketing strategy of the company. Considerable discussion should be spent on devising a pricing strategy consistent with the overall marketing strategy of the firm.

Special Pricing Topics

Although the basics of pricing is the same for most products and services, the student would be served by presenting some special pricing situations where pricing strategy might be more complicated or might differ somewhat from the analysis presented in the rest of the course. Therefore, to complete the analysis of pricing special coverage could be given to topics such as service pricing, international pricing, and pricing under uncertainty.

Antitrust Considerations in Pricing

Kelley (1988) has noted that antitrust issues are covered only briefly in most marketing textbooks and in the marketing curriculum in general. Since many antitrust issues are concerned with pricing, coverage of the antitrust laws is absolutely necessary in a pricing class.

CONCLUSION

In this paper, we propose that a pricing course be offered in marketing curriculums that builds from the existing knowledge in accounting, economics, and marketing but that is presented from the viewpoint of the marketing manager. Evidence shows that the private sector believes that pricing is an integral and important aspect of managerial decisions. In addition, pricing has been studied in depth in the disciplines of accounting, marketing, and economics. However, most marketing curriculums cover pricing only briefly and little applied analysis is presented. We believe that each of the various disciplines studying pricing offers both insight and tools to the manager who must formulate optimal pricing strategies. However, this knowledge must be integrated into a cohesive framework that is consistent with each of the other marketing activities.

REFERENCES


"Flexible Pricing" (1977), Business Week, (December 12), 78-88.


