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Pricing and product line strategy in a supply chain with risk-averse players

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ABSTRACT

We study the pricing and product line strategy of a risk-averse manufacturer who sells her products through a risk-averse retailer. We identify the conditions under which the manufacturer extends her product line or replaces the old product with a new product, and find that (i) a higher retailer's risk aversion decreases the retail price but increases the unit wholesale price; (ii) the manufacturer extends the product line if the price caps for both products are sufficiently high, both her risk aversion and product substitutability are sufficiently low; (iii) the manufacturer discontinues the old product if the relative price cap of the new product to the old product is sufficiently high, her risk aversion is medium, and product substitutability are sufficiently high. Further, we find that: (i) the decentralization of supply chain may increase product line length if the retailer's risk aversion, and product substitutability are sufficiently high; otherwise, it may decrease product line length; (ii) the endogenization of quality design increases the motivation to introduce a new product; and (iii) the manufacturer extends or replaces the product line if quality cost is not too high.

Key words: Supply chain management; Product line extension; Risk aversion; Quality design; Game theory

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