A Wholesaler's Optimal Quantity Discount Policy for Deteriorating Items

Hidefumi Kawakatsu

***Abstract*—We discuss a quantity discount problem between a seller (wholesaler) and a buyer (retailer). The seller purchases products from an upper-leveled supplier (manufacturer) and then sells them to the buyer who faces her customers' demand. The seller attempts to increase her profit by controlling the buyer's order quantity through a quantity discount strategy and the buyer tries to maximize her profit considering the seller's proposal. In this study, we focus on the case where both the seller's and the buyer's inventory levels of the product are continuously depleted due to the combined effects of its demand and deterioration. The deterioration rate is assumed to be a constant fraction of the on-hand inventory. We formulate the above problem as a Stackelberg game between the seller and buyer to analyze the existence of the seller's optimal quantity discount pricing policy which maximizes her total profit per unit of time. Numerical examples are presented to illustrate the theoretical underpinnings of the proposed formulation.**

***Index Terms*—quantity discount, deterioration items, total profit, Stackelberg game.**

I. Introduction

Quantity discount schedule have been widely used by sellers in order to reduce their total transaction costs associated with ordering, shipment and inventorying. Monahan[1] formulated the transaction between the seller and the buyer (see also [2], [3]), and proposed a method for determining an optimal all-unit quantity discount policy with a fixed demand. Lee and Rosenblatt[4] generalized Monahan's model to obtain the "exact" discount rate offered by the seller, and to relax the implicit assumption of a lot-for-lot policy adopted by the seller. Parlar and Wang[5] proposed a model using a game theoretical approach to analyze the quantity discount problem as a perfect information game. For more work: see also Sarmah et al.[6]. These models assumed that both the seller's and the buyer's inventory policies can be described by classical economic order quantity (EOQ) models. The classical EOQ model is a cost-minimization inventory model with a constant demand rate. It is one of the most successful models in all the inventory theories due to its simplicity and easiness.

In many real-life situations, retailers deal with perishable products such as fresh fruits, food-stuffs and vegetables. The inventory of these products is depleted not only by demand but also deterioration. Yang[7] has developed the model to determine an optimal pricing and a ordering policy for deteriorating items with quantity discount which is offered by the vendor. However, his model assumed that the deterioration rate at the vendor's store is equal to its rate at the retailer's store, and focused on the case where both the buyer's and vendor's total profits can be approximated using Taylor series expansion.

In this study, we discuss a quantity discount problem between a seller (wholesaler) and a buyer (retailer) under circumstances where both the wholesaler's and the retailer's inventory levels of the product are continuously depleted due to the combined effects of its demand and deterioration. We also consider the case where the deterioration rate at the wholesale store is smaller than its rate at the retail store. The wholesaler purchases products from an upper-leveled supplier (manufacturer) and then sells them to the retailer who faces her/his customers' demand. The wholesaler is interested in increasing her/his profit by controlling the retailer's order quantity through the quantity discount strategy. The retailer attempts to maximize her/his profit considering the wholesaler's proposal. We formulate the above problem as a Stackelberg game between the wholesaler and the retailer to show the existence of the wholesaler's optimal quantity discount pricing policy which maximizes her/his total profit per unit of time. Numerical examples are presented to illustrate the theoretical underpinnings of the proposed model.

II. Notations and Assumptions

The wholesaler uses a quantity discount strategy in order to improve her/his profit. The wholesaler proposes, for the retailer, an order quantity per lot along with the corresponding discounted wholesale price, which induces the retailer to alter her/his replenishment policy. We consider the two options throughout the present study as follows:

Option V_1**:** The retailer does not adopt the quantity discount proposed by the wholesaler. When the retailer chooses this option, she/he purchases the products from the wholesaler at an initial price in the absence of the discount, and she/he determines her/himself an optimal order quantity which maximizes her/his own total profit per unit of time.

Option V_2**:** The retailer accepts the quantity discount proposed by the wholesaler.

The main notations used in this paper are listed below:

Q_i**:** the retailer's order quantity per lot under Option $V_i (i = 1, 2)$.

S_i**:** the wholesaler's order quantity per lot under Option $V_i (i = 1, 2)$.

T_i**:** the length of the retailer's order cycle under Option $V_i (i = 1, 2)$.

h_s, h_b**:** the wholesaler's and the retailer's inventory holding costs per item and unit of time, respectively.

a_s, a_b**:** the wholesaler's and the retailer's ordering costs per lot, respectively.

$\xi(T_i)$**:** the shipment cost per shipment from the wholesaler to the retailer.

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H. Kawakatsu is with Department of Economics & Information Science, Onomichi University, 1600 Hisayamadacho, Onomichi, Hiroshima 722-8506 Japan (corresponding author to provide phone: +81-848-22-8312 (ex.617); fax: +81-848-22-5460; e-mail: kawakatsu@onomichi-u.ac.jp).

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c_s**:** the wholesaler's unit acquisition cost (unit purchasing cost from the upper-leveled manufacturer).

p_s**:** the wholesaler's initial unit selling price, i.e., the retailer's unit acquisition cost in the absence of the discount.

y**:** the discount rate for the wholesale price proposed by the wholesaler, i.e., the wholesaler offers a unit discounted price of $(1-y)p_s$ $(0 \leq y < 1)$.

p_b**:** the retailer's unit selling price, i.e., unit purchasing price for her/his customers.

θ_s**,** θ_b **:** the deterioration rates at the wholesaler's store and the retailer's store, respectively $(\theta_s < \theta_b)$.

μ**:** the constant demand rate of the product.

The assumptions in this study are as follows:

1) Both the wholesaler's and the retailer's inventory levels of the product are continuously depleted due to the combined effects of its demand and deterioration.
2) The rate of replenishment is infinite and the delivery is instantaneous.
3) Backlogging and shortage are not allowed.
4) The quantity of the item can be treated as continuous for simplicity.
5) Both the wholesaler and the retailer are rational and use only pure strategies.
6) The shipment cost is characterized by economies of density[8], i.e., the shipment cost per shipment decreases as the retailer's lot size increases. We assume, for simplicity, that $\xi(T_i) \equiv \beta - \alpha Q_i(T_i)$ (> 0).
7) The length of the wholesaler's order cycle is given by $N_i T_i$ under Option V_i $(i = 1, 2)$, where N_i is a positive integer. This is because the wholesaler can possibly improve her/his total profit by increasing the length of her/his order cycle from T_i to $N_i T_i$. In this case, the wholesaler's lot size can be obtained by the sum of N_i times of the retailer's lot size and the cumulative quantity of the waste product to be discarded during $[0, N_i T_i]$.

III. RETAILER'S TOTAL PROFIT

This section formulates the retailer's total profit per unit of time for the Option V_1 and V_2 available to the retailer.

A. Under Option V_1

If the retailer chooses Option V_1, her/his order quantity per lot and her/his unit acquisition cost are respectively given by $Q_1 = Q(T_1)$ and p_s, where p_s is the unit initial price in the absence of the discount. In this case, she/he determines her/himself the optimal order quantity $Q_1 = Q_1^*$ which maximize her/his total profit per unit of time.

Since the inventory is depleted due to the combined effect of its demand and deterioration, the inventory level, $I^{(b)}(t)$, at time t during $[0, T_1)$ can be expressed by the following differential equation:

$$dI^{(b)}(t)/dt = -\theta_b I^{(b)}(t) - \mu. \tag{1}$$

By solving the differential equation in Eq. (1) with a boundary condition $I^{(b)}(T_1) = 0$, the retailer's inventory level at time t is given by

$$I^{(b)}(t) = \rho \left[e^{\theta_b (T_1 - t)} - 1 \right], \tag{2}$$

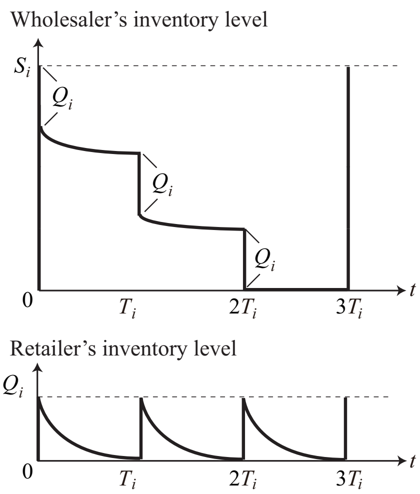

Fig. 1. Transition of Inventory Level ($N_i = 3$)

where $\rho = \mu/\theta_b$.

Therefore, the initial inventory level, $I^{(b)}(0)$ $(= Q_1 = Q$ (T_1), in the order cycle becomes

$$Q(T_1) = \rho \left(e^{\theta_b T_1} - 1 \right). \tag{3}$$

On the other hand, the cumulative inventory, $A(T_1)$, held during $[0, T_1)$ is expressed by

$$A(T_1) = \int_0^{T_1} I^{(b)}(t) dt = \rho \left[\frac{(e^{\theta_b T_1} - 1)}{\theta_b} - 1 \right]. \tag{4}$$

Hence, the retailer's total profit per unit of time under Option V_1 is given by

$$\begin{aligned} \pi_1(T_1) &= \frac{p_b \int_0^{T_1} \mu dt - p_s Q(T_1) - h_b A(T_1) - a_b}{T_1} \\ &= \rho(p_b \theta_b + h_b) - \frac{\left(p_s + \frac{h_b}{\theta_b} \right) Q(T_1) + a_b}{T_1}. \end{aligned} \tag{5}$$

In the following, the results of analysis are briefly summarized:

There exists a unique finite $T_1 = T_1^*$ (> 0) which maximizes the $\pi_1(T_1)$ in Eq. (5). The optimal order quantity is therefore given by

$$Q_1^* = \rho \left(e^{\theta_b T_1^*} - 1 \right). \tag{6}$$

The total profit per unit of time becomes

$$\pi_1(T_1^*) = \rho \left[(p_b \theta_b + h_b) - \theta_b \left(p_s + \frac{h_b}{\theta_b} \right) e^{\theta_b T_1^*} \right]. \tag{7}$$

B. Under Option V_2

If the retailer chooses Option V_2, the order quantity and unit discounted wholesale price are respectively given by $Q_2 = Q_2(T_2) = \rho \left(e^{\theta_b T_2} - 1 \right)$ and $(1-y)p_s$. The retailer's total profit per unit of time can therefore be expressed by

$$\begin{aligned} \pi_2(T_2, y) = \rho(p_b \theta_b + h_b) \\ - \frac{\left[(1-y)p_s + \frac{h_b}{\theta_b} \right] Q_2(T_2) + a_b}{T_2}. \end{aligned} \tag{8}$$

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IV. WHOLESALER'S TOTAL PROFIT

This section formulates the wholesaler's total profit per unit of time, which depends on the retailer's decision. Figure 1 shows both the wholesaler's and the retailer's transitions of inventory level in the case of $N_i = 3$.

A. Total Profit under Option V_1

If the retailer chooses Option V_1, her/his order quantity per lot and unit acquisition cost are given by Q_1 and p_s, respectively. The length of the wholesaler's order cycle can be divided into N_1 shipping cycles ($N_1 = 1, 2, 3, \cdots$) as described in assumption 7), where N_1 is also a decision variable for the wholesaler.

The wholesaler's inventory is depleted only due to deterioration during $[(j-1)T_1, jT_1)$ in jth shipping cycle ($j = 1, 2, \cdots, N_1$). Therefore, the wholesaler's inventory level, $I^{(s)}(t)$, at time t can be expressed by the following differential equation:

$$dI^{(s)}(t)/dt = -\theta_s I^{(s)}(t), \tag{9}$$

with a boundary condition $I^{(s)}(jT_1) = z_j(T_1)$, where $z_j(T_1)$ denotes the remaining inventory at the end of the jth shipping cycle. By solving the differential equation in Eq. (9), the wholesaler's inventory level, $I^{(s)}(t) = I_j^{(s)}(t)$, at time t in jth shipment cycle is given by

$$I_j^{(s)}(t) = z_j(T_1) e^{\theta_s (jT_1 - t)}. \tag{10}$$

It can easily be confirmed that the inventory level at the end of the $(N_1 - 1)$th shipping cycle becomes Q_1, i.e. $z_{N_1-1}(T_1) = Q_1$, as also shown in Fig. 1. By induction, we have

$$z_j(T_1) = Q(T_1)\left[e^{(N_1-j)\theta_s T_1} - 1\right] / \left[e^{\theta_s T_1} - 1\right]. \tag{11}$$

The wholesaler's order quantity, $S_1 = S(N_1, T_1)$ $(= z_0(T_1))$ per lot is then given by

$$S(N_1, T_1) = Q(T_1)\left[e^{N_1\theta_s T_1} - 1\right] / \left[e^{\theta_s T_1} - 1\right]. \tag{12}$$

On the other hand, the wholesaler's cumulative inventory, $B_j(T_1)$, held during jth shipping cycle is expressed by

$$\begin{aligned} B_j(T_1) &= \int_{(j-1)T_1}^{jT_1} I_j^{(s)}(t)dt \\ &= \frac{Q(T_1)}{\theta_s}\left[e^{(N_i-j)\theta_s T_1} - 1\right]. \end{aligned} \tag{13}$$

The wholesaler's cumulative inventory, held during $[0, N_1T_1)$ becomes

$$\begin{aligned} B(N_1, T_1) &= \sum_{j=1}^{N_1-1} B_j(T_1) \\ &= \frac{Q_1(T_1)}{\theta_s}\left(\frac{e^{N_1\theta_s T_1} - 1}{e^{\theta_s T_1} - 1} - N_1\right). \end{aligned} \tag{14}$$

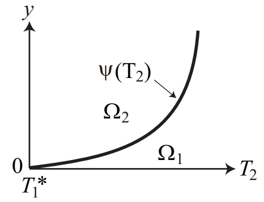

Fig. 2. Characterization of retailer's optimal responses

Hence, for a given N_1, the wholesaler's total profit per unit of time under Option V_1 is given by

$$\begin{aligned} P_1(N_1, T_1^*) &= \frac{1}{N_1T_1^*}\cdot\big[p_sN_1Q(T_1^*) - N_1\xi(T_1) \\ &\qquad -c_sS(N_1,T_1^*) - h_sB(N_1,T_1^*) - a_s\big] \\ &= \frac{\left(p_s + \frac{h_s}{\theta_s} + \alpha\right)Q(T_1^*) - \beta}{T_1^*} \\ &\quad - \frac{\left(c_s + \frac{h_s}{\theta_s}\right)S(N_1,T_1^*) + a_s}{N_1T_1^*}. \end{aligned} \tag{15}$$

B. Total Profit under Option V_2

When the retailer chooses Option V_2, she/he purchases $Q_2 = Q(T_2)$ units of the product at the unit discounted wholesale price $(1-y)p_s$. In this case, the wholesaler's order quantity per lot under Option V_2 is expressed as $S_2 = S(N_2, T_2)$, accordingly the wholesaler's total profit per unit of time under Option V_2 is given by

$$\begin{aligned} P_2(N_2, T_2, y) &= \frac{1}{N_2T_2}\cdot\big[(1-y)p_sN_2Q(T_2) - N_2\xi(T_2) \\ &\qquad -c_sS(N_2,T_2) - h_sB(N_2,T_2) - a_s\big] \\ &= \frac{\left[(1-y)p_s + \frac{h_s}{\theta_s} + \alpha\right]Q(T_2) - \beta}{T_2} \\ &\quad - \frac{\left(c_s + \frac{h_s}{\theta_s}\right)S(N_2,T_2) + a_s}{N_2T_2}, \end{aligned} \tag{16}$$

where

$$Q(T_2) = \rho\left(e^{\theta_b T_2} - 1\right), \tag{17}$$

$$S(N_2, T_2) = Q(T_2)\left[e^{N_2\theta_s T_2} - 1\right] / \left[e^{\theta_s T_2} - 1\right]. \tag{18}$$

V. RETAILER'S OPTIMAL RESPONSE

This section discusses the retailer's optimal response. The retailer prefers Option V_1 over Option V_2 if $\pi_1^* > \pi_2(T_2, y)$, but when $\pi_1^* < \pi_2(T_2, y)$, she/he prefers V_2 to V_1. The retailer is indifferent between the two options if $\pi_1^* = \pi_2(T_2, y)$, which is equivalent to

$$y = \frac{\left(p_s + \frac{h_b}{\theta_b}\right)\left[Q(T_2) - \rho\theta_bT_2e^{\theta_bT_1^*}\right] + a_b}{p_sQ(T_2)}. \tag{19}$$

Let us denote, by $\psi(T_2)$, the right-hand-side of Eq. (19). It can easily be shown from Eq. (19) that $\psi(T_2)$ is increasing in T_2 $(\geq T_1^*)$.

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VI. WHOLESALER'S OPTIMAL POLICY

The wholesaler's optimal values for T_2 and y can be obtained by maximizing her/his total profit per unit of time considering the retailer's optimal response which was discussed in Section V. Henceforth, let Ω_i $(i = 1, 2)$ be defined by

$$\Omega_1 = \{(T_2, y) \mid y \le \psi(T_2))\},$$
$$\Omega_2 = \{(T_2, y) \mid y \ge \psi(T_2))\}.$$

Figure 2 depicts the region of Ω_i $(i = 1, 2)$ on the (T_2, y) plane.

A. Under Option V_1

If $(T_2, y) \in \Omega_1 \setminus \Omega_2$ in Fig. 2, the retailer will naturally select Option V_1. In this case, the wholesaler can maximize her/his total profit per unit of time independently of T_2 and y on the condition of $(T_2, y) \in \Omega_1 \setminus \Omega_2$. Hence, the wholesaler's locally maximum total profit per unit of time in $\Omega_1 \setminus \Omega_2$ becomes

$$P_1^* = \max_{N_1 \in N} P_1(N_1, T_1^*), \tag{20}$$

where N signifies the set of positive integers.

B. Under Option V_2

On the other hand, if $(T_2, y) \in \Omega_2 \setminus \Omega_1$, the retailer's optimal response is to choose Option V_2. Then the wholesaler's locally maximum total profit per unit of time in $\Omega_2 \setminus \Omega_1$ is given by

$$P_2^* = \max_{N_2 \in N} \hat{P}_2(N_2), \tag{21}$$

where

$$\hat{P}_2(N_2) = \max_{(T_2, y) \in \Omega_2 \setminus \Omega_1} P_2(N_2, T_2, y). \tag{22}$$

More precisely, we should use "sup" instead of "max" in Eq. (22).

For a given N_2, we show below the existence of the wholesaler's optimal quantity discount pricing policy $(T_2, y) = (T_2^*, y^*)$ which attains Eq. (22). It can easily be proven that $P_2(N_2, T_2, y)$ in Eq. (16) is strictly decreasing in y, and consequently the wholesaler can attain $\hat{P}_2(N_2)$ in Eq. (22) by letting $y \to \psi(T_2) + 0$. By letting $y = \psi(T_2)$ in Eq. (16), the total profit per unit of time on $y = \psi(T_2)$ becomes

$$\begin{aligned} P_2(N_2, T_2) = &\ \rho\,(p_s + h_b/\theta_b)\,\theta_b e^{\theta_b T_1^*} \\ &- \frac{1}{N_2 T_2} \cdot \big[C \cdot S(N_2, T_2) - H(N_2) Q(T_2) \\ &\qquad + (a_b + \beta) N_2 + a_s\big], \end{aligned} \tag{23}$$

where

$$C = (c_s + h_s/\theta_s), \tag{24}$$
$$H(N_2) = (h_s/\theta_s - h_b/\theta_b + \alpha) N_2. \tag{25}$$

Let us now define $L(T_2)$ as follows:

$$\begin{aligned} L(T_2) \equiv &\ C\theta_s T_2 Q(T_2) \\ &\times \frac{N_2 e^{N_2\theta_s T_2}(e^{\theta_s T_2} - 1) - e^{\theta_s T_2}(e^{N_2\theta_s T_2} - 1)}{(e^{\theta_s T_2} - 1)^2} \\ &+ \big[\rho\theta_b e^{\theta_b T_2} T_2 - Q(T_2)\big] \\ &\times \left[C \frac{e^{N_2\theta_s T_2} - 1}{e^{\theta_2 T_2} - 1} - H(N_2)\right]. \end{aligned} \tag{26}$$

We here summarize the results of analysis in relation to the optimal quantity discount policy which attains $\hat{P}_2(N_2)$ in Eq. (22) when N_2 is fixed to a suitable value.

1) $N_2 = 1$:
- $(c_s + h_b/\theta_b - \alpha) > 0$:
  In this subcase, there exists a unique finite $\tilde{T}_2$ $(> T_1^*)$ which maximizes $P_2(N_2, T_2)$ in Eq. (23), and therefore (T_2^*, y^*) is given by
  $$(T_2^*, y^*) \to (\tilde{T}_2, \tilde{y}), \tag{27}$$
  where $\tilde{y} = \psi(\tilde{T}_2)$.
  The wholesaler's total profit then becomes
  $$\begin{aligned} \hat{P}_2(N_2) = &\ \rho\theta_b\big[(p_s + h_b/\theta_b)\, e^{\theta_b T_1^*} \\ &- (c_s + h_b/\theta_b - \alpha)\, e^{\theta_b T_2^*}\big]. \end{aligned} \tag{28}$$
- $(c_s + h_b/\theta_b - \alpha) \le 0$:
  In this subcase, the optimal policy can be expressed by
  $$(T_2^*, y^*) \to (\hat{T}_2, 1), \tag{29}$$
  where $\hat{T}_2$ $(> T_1^*)$ is the unique finite positive solution to $\psi(T_2) = 1$.
  The wholesaler's total profit is therefore given by
  $$\hat{P}_2(N_2) = -\frac{(c_2 - \alpha) Q(\hat{T}_2)}{\hat{T}_2} - \beta - a_s. \tag{30}$$

2) $N_2 \ge 2$:
   Let us define $T_2 = \tilde{T}_2$ $(> T_1^*)$ as the unique solution (if it exists) to
   $$L(T_2) = (a_b + \beta) N_2 + a_s. \tag{31}$$
   In this case, the optimal quantity discount pricing policy is given by Eq. (27).

C. Under Option V_1 and V_2

In the case of $(T_2, y) \in \Omega_1 \cap \Omega_2$, the retailer is indifferent between Option V_1 and V_2. For this reason, this study confines itself to a situation where the wholesaler does not use a quantity discount policy $(T_2, y) \in \Omega_1 \cap \Omega_2$.

D. Optimal value for N_i

We here derive a lower and upper bound for the optimal value of $N_i = N_i^*$ $(N_i^* = 1, 2, 3, \cdots)$ which attains P_i^* $(i = 1, 2)$ in Eqs. (20) and (21).

Let $K(T_i^*)$ be defined by

$$K(T_i^*) \equiv (c_s + h_s/\theta_s) Q(T_i^*)/(e^{\theta_s T_i^*} - 1). \tag{32}$$

In the following, the results of analysis are briefly summarized:

1) Lower bound $N_i = N_i^{(L)}(T_i^*)$ $(\le N_i^*)$:
- $(e^{\theta_s T_i^*} - 1)^2 \ge a_s/K(T_i^*)$:
  $N_i^{(L)}(T_i^*) = 1$.
- $(e^{\theta_s T_i^*} - 1)^2 < a_s/K(T_i^*)$:
  There exists a unique finite $N_i^{(L)}(T_i^*)$ (≥ 1) which is the solution to
  $$\begin{aligned} &N_i e^{N_i\theta_s T_i^*}(e^{\theta_s T_i^*} - 1) \\ &\quad - (e^{N_i\theta_s T_i^*} - 1) = a_s/K(T_i^*). \end{aligned} \tag{33}$$

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TABLE I
SENSITIVITY ANALYSIS

(a) Under Option V_1

a_s	Q_1^*	p_1	$S_1^*(N_1^*)$	P_1^*
500	47.35	300.00	47.35(1)	910.75
1000	47.35	300.00	99.09(2)	861.24
2000	47.35	300.00	99.09(2)	804.78
3000	47.35	300.00	155.61(3)	752.21

(b) Under Option V_2

a_s	Q_2^*	p_2^*	$S_2^*(N_2^*)$	P_2^*
500	107.63	285.01	107.63(1)	998.56
1000	117.65	281.63	117.65(1)	972.8
2000	135.77	275.49	135.77(1)	926.23
3000	152.04	270.04	152.04(1)	884.43

2) Upper bound $N_i = N_i^{(U)}(T_i^*)$ $(\geq N_i^*)$:
There exists a unique finite $N_i^{(U)}(T_i^*)$ $(\geq N_i^{(L)}(T_i^*))$ which is the solution to

$$N_i e^{(N_i-1)\theta_s T_i^*}(e^{\theta_s T_i^*}-1) -(e^{N_i\theta_s T_i^*}-1) = a_s/K(T_i^*). \quad (34)$$

The above results indicate that the optimal N_i^* satisfies

$$1 \leq N_i^{(L)}(T_i^*) \leq N_i^* < N_i^{(U)}(T_i^*). \quad (35)$$

VII. NUMERICAL EXAMPLES

Table I reveals the results of sensitively analysis in reference to Q_1^*, p_1 $(= p_s)$, S_1^* $(= S(N_1^*, T_1^*))$, N_1^*, P_1^*, Q_2^* $(= Q(T_2^*))$, p_2^* $(=(1-y^*)p_s)$, S_2^* $(= S(N_2^*, T_2^*))$, N_2^*, P_2^* for $(c_s, p_s, p_b, a_b, h_s, h_b, \theta_s, \theta_b, \mu, \alpha, \beta) = (100, 300, 600, 1200, 1, 1.1, 0.01, 0.015, 5, 2, 1000)$ when $a_s = 500$, 1000, 2000 and 3000.

In Table I(a), we can observe that both S_1^* and N_1^* are non-decreasing in a_s. As mentioned in Section II, under Option V_1, the retailer does not adopt the quantity discount offered by the wholesaler, which signifies that the wholesaler cannot control the retailer's ordering schedule. In this case, the wholesaler's cost associated with ordering should be reduced by increasing her/his own length of order cycle and lot size by means of increasing N_1.

It is seen in Table I(b) that, under Option V_2, S_2^* increases with a_s, in contrast, N_2^* takes a constant value, i.e., we have $N_2^* = 1$. Under Option V_2, the retailer accepts the quantity discount proposed by the wholesaler. The wholesaler's lot size can therefore be increased by stimulating the retailer to alter her/his order quantity per lot through the quantity discount strategy. If the wholesaler increases N_2 one step, her/his lot size also significantly jumps up since N_2 takes a positive integer. Under this option, the wholesaler should increase her/his lot size using the quantity discount rather than increasing N_2 when a_s takes a larger value.

We can also notice in Table I(b) that we have $P_1^* < P_2^*$.

VIII. CONCLUSION

In this study, we have discussed a quantity discount problem between a wholesaler and a retailer under circumstances where both the wholesaler's and the retailer's inventory levels of the product are continuously depleted due to the combined effects of its demand and deterioration. The wholesaler is interested in increasing her/his profit by controlling the retailer's order quantity through the quantity discount strategy. The retailer attempts to maximize her/his profit considering the wholesaler's proposal. We formulate the above problem as a Stackelberg game between the wholesaler and the retailer to show the existence of the wholesaler's optimal quantity discount policy that maximizes her/his total profit per unit of time. We first show the retailer's optimal response, and then clarify the existence of the wholesaler's optimal quantity discount policy. This study assumes the inventory holding cost to be independent of the purchase cost of the item. In the real circumstances, however, the inventory holding cost depends on its purchase cost, and then its cost should be expressed in terms of a percentage of the item's value. Taking account of such factor is an interesting extension.

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