

The dynamics of cost-plus pricing

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First published: March/April 1992

<https://doi.org/10.1002/mde.4090130207>

Citations: 25

Abstract

Researchers report a sizable number of companies that use cost-plus pricing. While such a policy is normatively suspect, it is simple, conventional, and occasionally mandated by regulation. This paper investigates cost-plus pricing as a dynamic adjustment process. As a dynamic policy, cost-plus pricing is more flexible than has commonly been realized. When firms have constant or decreasing average costs, dynamic cost-plus pricing typically exhibits rapid convergence to the attracting member of a pair of fixed points. If the average cost function is sufficiently U-shaped, complicated and chaotic dynamics can emerge.

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