

# Operations Research

## Homework 8

Due in class Wednesday, November 16, 2016

1. (From *HL, Exercise 15.3-4.*) Consider the decision analysis problem with the following payoff table (in units of thousands of dollars) under risk-neutral valuation:

Alternative	State of Nature		
	$S_1$	$S_2$	$S_3$
$A_1$	-100	10	100
$A_2$	-10	20	50
$A_3$	10	10	60
Prior Probability	0.2	0.3	0.5

- (a) Which alternative should be chosen? What is the resulting expected payoff?
- (b) You are offered the opportunity to obtain information which will tell you with certainty whether the first state of nature  $S_1$  will occur. What is the maximum amount you should pay for the information? Assuming you will obtain the information, how should it be used to choose an alternative? What is the resulting expected payoff (excluding the payment)?
- (c) You are offered the opportunity to obtain information which asserts the true state of nature with an accuracy of 60% and wrongly identifies one of the other possible states of nature in %20 of cases each. What is the maximum amount you should pay for the information? Assuming you will obtain the information, how should it be used to choose an alternative? What is the resulting expected payoff (excluding the payment)?