

Quantitative Analysis for Management

9th Edition

Bonini

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NINTH EDITION

QUANTITATIVE ANALYSIS FOR MANAGEMENT

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For Managers and Future Managers

The first edition of this book in 1961 was the pioneering text in the application of quantitative analysis to management. It attempted to bridge the gap between the newly developed analytic methods and applied business disciplines. Over the years we have maintained this focus through eight subsequent editions.

In recent years the popularity of quantitative methods might appear to be declining. The current business press touts approaches such as *Reengineering*, *Total Quality Management (TQM)*, or *Supply Chain Management* as the keys to business success. But all this is somewhat misleading as it relates to the value of quantitative analysis. First of all, in many instances the implementation of these heralded approaches relies partially on using the tools and methods presented in this book. And while these new approaches have been in the limelight, the continuing success of quantitative analysis in making business and other organizations more efficient and effective has been overlooked. Because quantitative methods have been so widely utilized over the years, they have become routine and are taken for granted in many organizations. They just do not get the same press coverage as the newer ideas.

We think it is important for you, the reader, to be aware of the continuing successful use of quantitative methods. Hence we have included material in each chapter describing a recent application of the techniques in that chapter. These often involve savings of millions of dollars to the companies involved. We call these “Motivating Examples,” and our aim is to make you aware that there is still ample opportunity for successful use of these methods. You should also briefly review the problems, and especially the cases, at the end of each chapter. These represent real applications—usually greatly simplified into problem format.

We authors have kept our enthusiasm for the value and role of quantitative analysis over the 36 or so years of the life of this text. We hope some of the enthusiasm will be contagious.

For Instructors

This book is the ninth edition of *Quantitative Analysis for Business Decisions*. This edition is a major revision—sufficiently major that the title has been changed to *Quantitative Analysis for Management*. Major changes include format, chapter coverage, motivating examples, and spreadsheet friendliness.

The first edition, over 35 years ago, was a pioneering approach to applying quantitative techniques to managerial problems. As stated in the original preface, one purpose of the book was to “act as a connecting force between the mathematical courses on the one hand and the applied business courses on the other.” Over the years courses in *Quantitative Analysis* have served that role. But in recent times, business curricula have changed and that “connecting force” has often been merged into the applied courses themselves—especially into the Operations or Production course. It is with this change in mind that we undertook this revision.

The format has been altered so that each chapter is as self-contained as possible. We anticipate that some professors will use this book in its entirety but others may select a subset of chapters to be included in a “course reader”, possibly with material from other Irwin texts or that of other publishers. We have eliminated virtually all chapter cross-references and have moved the “answers” section of the book, “Practice Problems,” to the end of each chapter. The new one-color format has been selected with this use in mind.

We have also made most chapters substantially larger, by combining smaller chapters in the previous edition. This results in fewer chapters, more cohesion within each chapter, and again ease of use if an instructor wishes to create a unique course reader by selecting among different materials.

Each chapter now opens with one or more Motivating Examples which are brief vignettes of applications of quantitative models to real-world decision situations. These are designed to show the reader that these methods of analysis can and do have real payoff in actual business settings, hence providing motivation to undertake the effort to understand them.

The entire book has been made “spreadsheet-friendly” throughout. We have focused on Excel® and have added many examples of the use of spreadsheets in quantitative modeling. We have also added Appendixes with more detail on the use of Excel for both simulation and the solution of linear programming problems using Solver®.

We have also added a new chapter on Forecasting, covering Exponential Smoothing, Regression, New Product Forecasting, and Forecast Error Measurement.

The Decision Analysis material has been combined into two chapters, and discussion of stock options and bias in estimating probabilities has been added.

The Inventory Control and Management material has been combined into a single chapter and now includes material on Tradeoff Curves for Customer Service vs. Inventory Investment and a brief discussion of Supply Chain Management issues, including risk pooling effects.

The Queuing chapter has been extensively revised to include modern treatment of arrivals and services, focusing on the interarrival time and service time distributions and including treatment of general service times, loss systems, and a brief introduction to networks of processing systems.

Many new problems have been added to this edition. One major strength of previous editions was the quality and quantity of the problems, and we have retained the best of the best in this edition.

As always, we have attempted to make changes that are consistent with an objective described in the preface of the first edition—to make the material understandable to a reader who does not have an extensive mathematical background.

We thank the many users of previous editions who have taken the time to point out errors and inconsistencies and have offered suggestions for improvement. This assistance is greatly appreciated.

Although Lawrence Fouraker and Robert Jaedicke are no longer listed as authors, we acknowledge that a considerable percentage of the book carries forward their words and ideas.

**Charles P. Bonini
Warren H. Hausman
Harold Bierman, Jr.**

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EXTRACTS FROM THE PREFACE TO THE FIRST EDITION

The administration of a modern business enterprise has become an enormously complex undertaking. There has been an increasing tendency to turn to quantitative techniques and models as a potential means for solving many of the problems that arise in such an enterprise. The purpose of this book is to describe a representative sample of the models and their related quantitative techniques. It is hoped that this book will serve as a basis for a course . . . that acts as a connecting force between the mathematical courses on the one hand and the applied business courses on the other.

This is an introductory work in the application of mathematics to problems of business. It is not an introductory work to the mathematics which are being applied. We have summarized—in a rather rough and ready manner by a mathematician's standards—some of the mathematical tools employed. Our purpose is to get our notation and a few basic relationships before the reader rather than to teach him mathematics.

We have attempted to minimize the amount of mathematical training required to read this book . . . a reader who does not have formal training in these areas should not think that this book is beyond his ability.

The book is an attempt to consider techniques which treat quite sophisticated and difficult problems; so, even though we tried to choose the simplest means of exposition—avoiding proofs and much of the characteristic rigor of such treatments—the essential subtlety of the techniques remains. These attributes can be understood only by patient application of effort over a protracted period of time.

Harold Bierman, Jr.
Lawrence E. Fouraker
Robert K. Jaedicke

BRIEF CONTENTS

PART I

MODELING AND OPTIMIZATION

- 1 Introduction to Analysis and Model Building 2
- 2 Introduction to Linear Programming 40
- 3 Solution of Linear Programming Problems 76
- 4 Special Topics in Mathematical Programming 140

PART II

DECISION ANALYSIS

- 5 Introduction to Probability 190
- 6 Decision Making under Uncertainty 240
- 7 Decision and Risk Analysis 296

PART III

APPLICATION AREAS

- 8 Inventory Control and Management 332
- 9 Queuing Theory: Congestion in Processing Systems 380
- 10 Simulation 410
- 11 PERT: Program Evaluation and Review Technique 448
- 12 Forecasting 472

Appendix of Tables 511

Index 536

PART I

MODELING AND OPTIMIZATION

1 Introduction to Analysis and Model Building 2

Motivating Example: *Modeling Coast Guard Operations* 2

Decisions 3

Abstraction and Simplification 4

Model Building 5

Solutions 5

Errors 5

Model-Building Techniques 6

Qualitative Factors 6

Classification of Models 7

Simple Problems 7

Complex Problems 7

Dynamic Problems 7

Decision Support Systems 7

Basic Modeling Concepts 9

Decision Variables 9

Exogenous Variables 9

Policies and Constraints 10

Performance Measures 10

Intermediate Variables 10

The Model and Relationships between Variables 10

An Example: A Model of a Plywood Mill 11

Relationships: The Influence Diagram 12

Physical Relationships 13

Financial Relationships 14

Analysis Using the Model 15

Implementing the Model on a Computer 15

Formulas for Other Quarters 19

Examples of Analysis Using the Model 19

Sensitivity Analysis 23

An Example: *The New York Times*

Model 24

Appendix Present Value and the Time Value of Money 25

Bibliography 25

Practice Problems 26

Problems 26

More Challenging Problems 27

Case 1-14: *Patawa Development Case* 29

Case 1-15: *Super Spuds, Inc.* 31

Case 1-16: *Chase Manufacturing* 32

Case 1-17: *Gotham City Times* 35

Solutions to Practice Problems 38

2 Introduction to Linear Programming 40

Motivating Example: *Tata Iron and Steel Company—India* 40

Formulation of Linear Programming Problems 43

Example 1: A Product Mix Problem 43

Example 2: A Transportation Problem 44

Example 3: A Blending Problem 46

Example 4: A Scheduling Problem 49

Example 5: An Integrated Corporate Planning Model 51

The Art of Formulating Linear Programming Models 53

Tata Iron and Steel Company—India (continued) 55

Additional Applications of Linear Programming 56

Limitations of Linear Programming 56

Bibliography 57

Practice Problems 57

Problems 59

More Challenging Problems 63
Case 2-28: *Impala Gold Company* 69
Case 2-29: *Racy's Department Store* 70
Case 2-30: *Daguscahonda Mines Corporation* 71
Case 2-31: *Maryland Department of Natural Resources* 72
Solutions to Practice Problems 73

3 Solutions of Linear Programming Problems 76

Motivating Example: *Optimal Leases at GE Capital* 76
Graphic Solution 76
Sensitivity Analysis on the Constraints 82
Shadow Prices 83
Right-hand Side (RHS) Ranges 87
Sensitivity Analysis—New Product Evaluation 89
Sensitivity Analysis—Objective Function Coefficients 90
Minimization 92
Algebraic Approach 94
Computer Solution of Linear Programming Problems 96
Another Example—Minimization 102
Interpreting Alternate Solutions and Degeneracy 102
Appendix A Suggestions for Using Excel Solver 105
Appendix B Use of LINDO for Linear Programming Problems 109
Bibliography 111
Practice Problems 112
Problems 113
More Challenging Problems 122
Solutions to Practice Problems 129

4 Special Topics in Mathematical Programming 140

Motivating Example: *Fleet Scheduling at Delta Airlines* 140
Integer Programming 141
Work Crew Scheduling at McDonald's 142
Formulation of Integer Programming Problems 143
The Fixed-Charge Problem 143
Batch Size Problem 144
Either-Or Constraints 144

Examples of Integer Formulations 145
A Capital Budgeting Problem 145
A Capacity Expansion Problem 147
Factory Size and Location 148
Solutions of Integer Programming Problems 150
Using Solver for Integer Programming Problems 151
General Optimization 154
General Search Procedures 154
An Example Using Solver 155
Cautions in the Use of Nonlinear Programs 157
Multiple Objectives and Goal Programming 158
Approach 1: Single Objective with Others as Constraints 159
Approach 2: Define Tradeoffs among Objectives 160
Approach 3: Goal Programming 161
Approach 4: Priority Programming 162
Appendix The Branch and Bound Algorithm 164
Bibliography 172
Practice Problems 172
Problems 174
More Challenging Problems 178
Case 4-21: *Allen Company* 182
Case 4-22: *Rodney Development Company* 184
Solutions to Practice Problems 185

PART II

DECISION ANALYSIS

5 Introduction to Probability 190

Motivating Example: *Modeling Space Shuttle Tiles* 190
Objective and Subjective Probabilities 191
Basic Statements of Probability 192
Mutually Exclusive Events 193
Independent Events 193
Dependent Events 194
Conditional, Marginal, and Joint Probabilities 195
Revision of Probabilities 200
Random Variables and Probability Distributions 204

Cumulative Mass Functions	206
Cumulative Distribution Functions	207
The Expected Value of a Random Variable	208
The Variance and Standard Deviation of a Random Variable	210
Multivariate Probability Distributions	212
Sums of Random Variables	213
A Constant Times a Random Variable	213
The Bernoulli Process and the Binomial Distribution	217
The Binomial Probability Distribution	218
The Binomial Probability Function	219
Binomial Probabilities on Spreadsheets	219
The Normal Probability Distribution	222
Right and Left Tails	224
The Standardized Normal Variable and Normal Probability Tables	225
Normal Probabilities on Spreadsheets	237
Bibliography	227
Practice Problems	228
Problems	229
More Challenging Problems	233
Solutions to Practice Problems	236

6 Decision Making under Uncertainty 240

Motivating Example: <i>Investment in a Major Transmission System</i>	240
Conditional Value	241
The Loss Table	243
Expected Monetary Value	244
Expected Opportunity Loss	245
Risk in Decision Making	246
Expected Profit with Perfect Predictions	247
Expected Value of Perfect Information	248
Interpretation of EVPI	249
Sensitivity Analysis of Subjective Probabilities	250
Decision Trees	251
Decision Tree for Grocer's Problem	251
Influence Diagram	254
Analysis of the Decision Problem	255
Developing the Decision Tree	256
Stock Options and Decision Analysis	259

Revision of Probabilities	260
<i>Capital Investment Decisions as Options</i>	261
The Value of Imperfect Information	261
Determining Probabilities	263
The Value of the Survey Information	268
Decision Analysis on Personal Computers	268
Conclusion	269
Bibliography	269
Practice Problems	269
Problems	272
More Challenging Problems	278
Case 6-41: <i>Mailmart</i>	283
Case 6-42: <i>Wabash Ski Area</i>	285
Case 6-43: <i>Particular Motors</i>	286
Case 6-44: <i>Able Medical Clinic</i>	288
Case 6-45: <i>Telco</i>	289
Solutions to Practice Problems	290

7 Decision and Risk Analysis 296

Motivating Example: <i>Decision and Risk Analysis at Du Pont</i>	296
Dominance	298
Dominance in Decision Trees	300
Use of Risk Profiles in Decision Analysis	303
Utility as a Basis for Decision Making	305
Derivation of a Utility Function for Money	305
The Shape of Utility Functions	306
Assessing a Utility Function	307
Using Utility Functions	310
Certainty Equivalents	310
Utility Analysis in Decision Trees	311
Risk Premiums	312
Cautions in the Use of Decision Analysis	314
Problem Framing	315
Biases in Estimating Probabilities	315
Limitations of Utility Theory	317
Appendix The Exponential Utility Function	319
Bibliography	320
Practice Problems	321
Problems	322
More Challenging Problems	324
Solutions to Practice Problems	326

PART III

APPLICATION AREAS

8 Inventory Control and Management 332

- Motivating Example: *Supply Chain Management at Hewlett-Packard* 332
- Section I: ABC Analysis 333
 - Performing an ABC Analysis 335
 - Cautions Regarding ABC Analysis 336
- Section II: The Economic Order Quantity with Known Demand 336
 - Sensitivity of Costs to Errors in Q 339
- Quantity Discounts 340
 - Blanket Orders 341
- Just-in-Time Inventory Systems 341
 - Inventory Turnover 342
- Section III: Inventory Control with Reordering and Uncertain Demand 344
- Shortage Cost Model 346
- The Assumptions 346
- The Model 346
- Optimal Order Point—A Marginal Approach 347
 - Computing the Standard Deviation of Lead Time Demand (σ_M) 350
 - Total Expected Cost 350
- Service Level Model 351
- Tradeoff Curves 353
 - Cautions on Using Service Level Models 354
 - Other Shortage Measures 355
 - Just-in-Time Systems 355
- Supply Chain Management 356
- Section IV: Inventory Control with Uncertainty and No Reordering 358
- A Marginal Approach 359
- Cost of Ill Will 362
- Using a Continuous Probability Distribution 363
 - Normal Probabilities on Spreadsheets 365
 - Relevant Costs 365
- Appendix** The Determination of the Optimum Order Point and Order Size 366
- Bibliography 368
- Practice Problems 369
- Problems 370

- More Challenging Problems 372
- Solutions to Practice Problems 377

9 Queuing Theory: Congestion in Processing Systems 380

- Motivating Example: *Appointment Scheduling at Lourdes Hospital* 380
- An Example of a Processing System 382
 - Experience and Queues 383
- System Structure 384
 - Loss Systems versus Queuing Systems 384
 - Arrivals 384
 - Services 384
 - Single Station or Network of Stations 384
 - Number of Servers 384
 - Queue Discipline 385
 - Measures of Performance 385
- Notation 385
- A Single-Server Queuing Model ($M/G/1$) 387
 - Some Special Cases for the Single-Server Queue 389
- Queuing System Behavior 390
 - A More General Model for the Single Channel Queue—The $G/G/1$ Queue 391
 - Effects of Variability in Arrivals and Services 391
- Multiple Servers: The $M/M/c$ Model 391
 - A More General Model—The $G/G/c$ Queue 392
 - Pooling Efficiencies in Queuing Systems 393
- Loss Systems 394
 - The $M/G/c$ Loss System 395
- Scheduling and Priorities in Processing Systems 397
- Networks of Queues 397
- Appendix** Markov Distributions (Poisson and Exponential) 401
- Bibliography 403
- Practice Problems 403
- Problems 404
- More Challenging Problems 405
- Solutions to Practice Problems 407

10 Simulation 410

Motivating Example: *Three Applications of Simulation* 410

Probabilistic Simulation 411

Simulation and Computers 415

Simulation and Inventory Control 416

Risk Analysis 418

Simulation with Continuous

Probability Distributions 421

Graphical Method 422

Computer Generation of Random

Variables 423

Simulation of Complex Systems 423

Appendix 1 Algebraic Method to Generate Random Variables 426

Appendix 2 Monte Carlo Simulation on Spreadsheets 426

Bibliography 438

Practice Problems 439

Problems 439

More Challenging Problems 440

Problems for Computer Simulation 441

Solutions to Practice Problems 447

11 PERT: Program Evaluation and Review Technique 448

Motivating Example: *Oil Platforms in the North Sea* 448

Information Requirements 449

Case I: Known Activity Times 450

Network Diagram 450

The Critical Path 451

Finding the Critical Path 451

Slack and Critical Path 453

Time-Cost Trade Offs 455

Case II: Uncertain Activity Times 458

Multiple Time Estimates for Uncertain Activity Times 458

Simulation of PERT Networks:

Project Duration 461

Simulation of PERT Networks:

Total Cost 463

Evaluation of PERT 465

Bibliography 466

Practice Problems 466

Problems 467

More Challenging Problems 468

Solutions to Practice Problems 471

12 Forecasting 472

Motivating Example: *Forecasting at L. L. Bean* 472

Section I: Time Series Methods 473

Moving Averages 473

Exponential Smoothing 475

Why the Name? 479

Add Linear Trend 480

Seasonal Factors 482

Using Seasonal Factors 484

Model Initialization 487

Smoothing Constant Values 488

Section II: Regression Models 489

Simple Linear Regression Models 489

Performing Regression Using Excel 491

Multiple Regression Models 492

Cautions 495

Section III: New Product Forecasting 497

Section IV: Forecast Error

Measurement 499

Appendix 1 Exponential Smoothing on Spreadsheets 500

Appendix 2 Trend Estimation in Excel 500

Bibliography 503

Practice Problems 503

Problems 504

More Challenging Problems 505

Case 12-19: *Quality Kitchens*

Meat Loaf Mix 506

Solutions to Practice Problems 509

Appendix of Tables 511

Table A: The Standardized Normal Distribution Function 511

Table B: $N(D)$ —Standard Normal Distribution Loss Function 512

Table C: Cumulative Binomial Distributions 513

Index 536

I MODELING AND OPTIMIZATION

-
- 1 Introduction to Analysis and Model Building 2
 - 2 Introduction to Linear Programming 40
 - 3 Solution of Linear Programming Problems 76
 - 4 Special Topics in Mathematical Programming 140

Modeling Coast Guard Operations¹

The United States Coast Guard has responsibility to maintain more than 50,000 aids to navigation (including buoys, lights, and day beacons) located on U.S. waterways. Maintenance involves verifying a buoy's location, replacing missing letters or numbers, and repainting; this work is generally carried out once a year.

The Coast Guard uses two types of vessels to perform this maintenance: seagoing tenders and coastal tenders. Seagoing tenders cost nearly twice as much as coastal tenders. The entire fleet was due for replacement, and a quantitative model was developed to analyze both the scheduling of the fleet and its desired composition. The modeling effort used tools described in this book and took into account the required maintenance work, the distance to be traveled to reach each buoy, and the complete life-cycle cost (including acquisition cost of vessels and operating costs) of each type of vessel.

Various complications existed in this study. It was important to allow for the differing capabilities of each type of vessel (seagoing versus coastal tender), and the routing of vessels to buoy locations. The effects of bad weather were modeled by estimating the annual hours lost due to bad weather, depending on

whether the buoys being serviced were fully exposed to weather, partially exposed, or protected. Furthermore, since these tenders were also used for other operations such as environmental response, search and rescue, and law enforcement, the Coast Guard had determined that at least 16 seagoing tenders were required.

After the modeling effort was completed, it was validated by "forecasting" current operations and comparing the model's output with actual operations. The model was then used to deal with the question of the optimal composition and operation of a replacement fleet. The model's results were that 16 seagoing tenders, 14 coastal tenders, and one stern-loading buoy boat would provide sufficient coverage, if scheduled efficiently; this configuration has 7 fewer vessels in total, with 10 fewer seagoing vessels (which are the most expensive) compared to the current fleet. Compared with a direct replacement strategy of the existing fleet, the model generated a savings of \$350 million in capital acquisition costs.

¹Mark Bucciarelli and Kip Brown, "A Desktop-OR Success: Modeling Coast Guard Buoy Tender Operations," *Interfaces*, July–August 1995, pp. 1–11.

1 INTRODUCTION TO ANALYSIS AND MODEL BUILDING

This book is about managerial decision making. Managerial decision making is a process whereby management, when confronted by a problem, selects a specific course of action, or “solution,” from a set of possible courses of action. Since there is often some uncertainty about the future, we cannot be sure of the consequences of the decision that is chosen, and we cannot be sure that the decision chosen will produce the best outcome. Furthermore, the problem may be quite complex because there are either a large number of alternatives to consider or many factors to take into account.

This book presents a general approach for managers to use when faced with decision problems, as well as specific quantitative tools for particular types of problems.

Decisions

A manager wants to choose that course of action that will be most effective in attaining the goals of the organization. In judging the effectiveness of different possible decisions, we must use some criterion or performance measure. The most commonly used performance measure in making decisions is a monetary unit, such as dollars, but we shall see in the following chapters that for some decisions, the use of dollars in judging the relative merits of different courses of action would not be adequate.

The following general process of solution is common to all types of decision situations:

1. Establish the *criterion* to be used. For example, in a simple situation the criterion may be to choose the act that maximizes profit.
2. Select a set of *alternatives* for consideration.
3. Determine the *model* to be used and the values of the parameters of the process. For example, we may decide that an adequate expression for total expenses is:

$$\text{Total expenses} = a + b(\text{units sold})$$

The parameters are a and b , and their values would have to be determined in order to use the model.

a = Fixed cost for the period or project

b = Variable (incremental) cost per unit

4. Determine which alternative *optimizes* (i.e., produces the best value for) the criterion established above in step 1.

Example

We can sell 1,000 units of product to the government at a price of \$50 per unit. Should the order be accepted? The firm has excess capacity.

1. We shall use the profit maximization criterion.
2. The alternatives are to (a) accept the order or (b) reject the order. In accordance with our profit criterion, we shall accept the order if it increases profit or reject the order if it does not increase profit.
3. We need to know the incremental expenses of producing the 1,000 units. The relevant expense model is:

$$E = a + 1,000b$$

Assume that special dies costing \$5,000 will have to be bought (a is equal to \$5,000) and that the variable costs of producing a unit are \$30 (b is equal to \$30). Then the total relevant expenses of filling the order are \$35,000 (equal to \$5,000 plus \$30,000).

4. A comparison of the incremental revenues, \$50,000, and incremental expenses, \$35,000, indicates that we should accept the order. Profit will be greater by \$15,000 if we “accept” compared with the alternative “refuse the order.”

In the above example, we used basic knowledge and simple computational techniques. However, in dealing with more complex problems, we might need to use other tools of quantitative analysis, including calculus, probability, statistics, and mathematical programming.

We shall now consider some aspects of model building.

Abstraction and Simplification

Real-world problems tend to be enormously complex. There are literally an uncountable number of inherent “facts” in any empirical situation. Further, every potential course of action starts a chain of cause, effect, and interaction that logically is without end.

Consider the problem of constructing a building. An endless amount of time could be devoted to gathering factual information about this situation: for example, the precise location and physical characteristics of the building; a detailed study of the climatic conditions of the potential sites and the influence these will have on construction costs; the sources of the funds used and their cost. The decision maker might decide to consider specifically and in detail all other potential uses of the funds in this period and in future periods. If our decision maker adopts a strategy of collecting *all* the facts before acting, it follows that no action will take place. The human mind cannot consider every aspect of an empirical problem. Some attributes