

Table of contents

- Chapter 1: What decision analysis is about 1**
 - 1.0 Summary 1
 - 1.1 Why is decision making difficult? 1
 - 1.2 Basic principles of decision analysis 3
 - 1.2.1 Striving for rationality 3
 - 1.2.2 Procedural rationality 5
 - 1.2.3 Consistency of the decision foundation 6
 - 1.2.4 Decomposition 9
 - 1.2.5 Subjectivity 10
 - 1.2.6 Incomplete knowledge and the concept of dominance 12
 - 1.3 Applications and practical relevance of decision analysis 13
 - Case Study: New business appraisal 16

- Chapter 2: Structuring the decision problem 19**
 - 2.0 Summary 19
 - 2.1 The basic structure 20
 - 2.2 The modeling of alternatives 20
 - 2.2.1 The problem of finding alternatives 20
 - 2.2.2 The set of alternatives 21
 - 2.2.3 One-level and multi-level alternatives 22
 - 2.3 Modeling the states of the world 23
 - 2.3.1 Uncertainty and probability 23
 - 2.3.2 Combined events or states (scenarios) 24
 - 2.3.3 The multiplication rule 25
 - 2.3.4 Event trees 27
 - 2.3.5 The addition rule 30
 - 2.3.6 The cause tree 30
 - 2.3.7 The dependence of the uncertainty model on the objectives 32
 - 2.4 The modeling of consequences 33
 - 2.5 The modeling of preferences 33
 - 2.5.1 Objectives and preferences 33
 - 2.5.2 Conflict of objectives 34
 - 2.5.3 Risk preferences 35
 - 2.5.4 Time preferences 35
 - 2.5.5 Modeling preferences by functions 35
 - 2.6 Recursive modeling 36
 - 2.7 Visualization of decision situations under uncertainty 38
 - 2.7.1 Benefits of graphical representations 38
 - 2.7.2 The influence diagram 39
 - 2.7.3 The decision matrix 44
 - 2.7.4 The decision tree 45
 - 2.7.5 Connection between decision matrix and decision tree 50

Questions and exercises	51
Case Study 1: Bidding for the “Kuniang”	55
Case Study 2: A Scenario analysis about the development of global energy consumption and methods of power generation in the near future	57
Chapter 3: Generating objectives and hierarchies	59
3.0 Summary	59
3.1 The relevance of objectives	59
3.2 The generation of objectives	60
3.3 Fundamental objectives and means objectives	61
3.3.1 Elimination of means-ends relations.....	61
3.3.2 Context-dependence of fundamental objectives	63
3.4 Requirements for a system of objectives	65
3.5 Hierarchies of objectives	67
3.5.1 Higher-level objectives and lower-level objectives	67
3.5.2 Top-down- and bottom-up-procedure.....	68
3.5.3 Development of a system of objectives	69
3.6 Attributes	72
3.6.1 Types of attributes	72
3.6.2 Desirable properties of attributes	74
3.6.3 Determining suitable attributes.....	76
Questions and exercises	77
Case Study: Career Planning Support at ICI.....	79
Chapter 4: Generating and preselecting alternatives.....	81
4.0 Summary	81
4.1 The generation of promising alternatives	81
4.2 Cause-effect analyses	82
4.2.1 Creating alternatives by means of a quantitative impact model	82
4.2.2 Alternatives as a combination of measures.....	85
4.3 Ideal alternatives.....	87
4.4 Context enlargement.....	88
4.5 Decomposition of tasks	88
4.6 Multi-level alternatives.....	90
4.7 Creativity techniques for groups.....	92
4.7.1 Brainstorming	92
4.7.2 Nominal group technique	93
4.8 Preselection of alternatives	93
4.8.1 The need for preselection.....	93
4.8.2 Restrictions and aspiration levels	94
4.8.3 Dominance.....	95
Case Study: Mexico City Airport.....	101

Chapter 5: Decision making under certainty with one objective	107
5.0 Summary	107
5.1 Value function and preference	107
5.2 Methods for determining value functions	113
5.2.1 Introduction	113
5.2.2 The direct-rating method	115
5.2.3 The difference standard sequence technique	117
5.2.4 The bisection method	119
5.2.5 Comparison of methods, consistency checks and non-monotonic value functions	120
5.3 Incomplete information	122
Questions and exercises	123
Chapter 6: Decision making under certainty and with multiple objectives: multiattribute value functions	125
6.0 Summary	125
6.1 Value functions for multiple attributes	125
6.2 The additive model	126
6.3 Requirements for the applicability of the additive model	129
6.4 Determination of the weights	134
6.4.1 The attribute value functions in the example “Choosing a job” ..	134
6.4.2 Determination of the weights by use of the trade-off method	135
6.4.3 Determination of the weights by use of the swing method	139
6.4.4 Determination of the weights by use of the direct-ratio method ..	140
6.4.5 Application of multiple methods and alternative procedures	141
6.5 Incomplete information about the weights	142
6.5.1 Handling of inconsistent or incomplete information	142
6.5.2 Error minimization	143
6.5.3 Dominance test	144
6.5.4 Sensitivity analyses of the weights	149
6.6 The dependence of the weights on the attribute range	151
6.7 Cognitive biases in the determination of the weights	154
6.7.1 The range effect	154
6.7.2 The splitting effect	155
Questions and exercises	155
Case Study 1: Safety standards for oil tankers	162
Case Study 2: Choosing and office location through even swaps	165
Chapter 7: The generation of probabilities	169
7.0 Summary	169
7.1 Interpreting probabilities	169
7.1.1 The subjectivistic interpretation	169
7.1.2 The frequentist interpretation	170
7.1.3 The uniform prior interpretation	171
7.1.4 Subjective and objective probabilities	172

7.2	The need to quantify probabilities	173
7.3	The measurement of subjective probabilities	177
7.3.1	Probability and distribution functions.....	177
7.3.2	Measurement methods.....	180
7.3.3	Consistency checks and the reduction of error	186
7.3.4	The calculation of probabilities	187
7.4	Bayes' theorem.....	187
7.5	Biases in the generation of subjective probabilities.....	193
7.5.1	Introduction	193
7.5.2	Incomplete or inappropriate data base	194
7.5.3	Inappropriate processing of probabilities	195
7.5.4	Insufficient critique of one's own judgment.....	197
	Questions and exercises	199
	Case Study: Immediate appendix surgery?.....	203
Chapter 8: Simulation of an objective variable's probability distribution ..		205
8.0	Summary	205
8.1	Basic principles of simulation	205
8.2	Interpretation of the simulation results	209
8.2.1	Economic interpretation	209
8.2.2	Methodological interpretation	212
8.3	Conducting a simulation.....	215
8.3.1	Transformation of a random number into a realization of the causal variable	215
8.3.2	Flowchart.....	217
8.3.3	The boomerang example in the continuous case	217
8.4	Modeling interdependencies between causal variables	221
8.4.1	Conditional probability distributions.....	221
8.4.2	Assessing causing variables	221
8.4.3	Modeling interdependencies using correlation matrices.....	222
	Questions and exercises	226
	Case Study 1: Bidding for butter.....	230
	Case Study 2: Portfolio choice.....	232
Chapter 9: Decisions under risk and one objective		235
9.0	Summary	235
9.1	Evaluation of risky alternatives	235
9.2	The theory of expected utility.....	238
9.2.1	Expected utility.....	238
9.2.2	Axiomatic foundation of utility theory	240
9.2.3	The three-outcome-diagram.....	245
9.2.4	Subjective expected utility theory.....	250
9.3	Basic concepts of utility theory	251
9.3.1	Certainty equivalent.....	251
9.3.2	The risk attitude	252

9.3.3	The Arrow/Pratt measure of risk aversion	255
9.3.4	Risk attitudes of selected utility functions	256
9.4	The determination of the utility function	259
9.4.1	The basic-reference-lottery	259
9.4.2	Bisection version of the variable certainty equivalent method	261
9.4.3	Quantile version of the variable certainty equivalent method	263
9.4.4	Variable probability method	264
9.4.5	Method of equal utility differences	266
9.4.6	Trade-off method for utility functions	266
9.4.7	Consistency check	269
9.4.8	Determination of the utility function on the basis of the decision maker's risk attitude	270
9.5	Computation of the optimal alternative	273
9.6	Utility theory and risk	277
9.6.1	Connection between value and utility function	277
9.6.2	Risk definition for equal expected value of lotteries	278
9.6.3	Utility – A function of value and risk?	279
	Questions and exercises	282
	Case Study: Petroleum and natural gas exploration at the Phillips Petroleum Company	288

Chapter 10: Decision under risk: incomplete information and multiple objectives	291	
10.0	Summary	291
10.1	Model for decision under risk and incomplete information as well as sensitivity analysis	291
10.2	Incomplete information concerning the probabilities $P(I)$ or utility function $U(I)$	293
10.2.1	Incomplete information concerning the probabilities: $P(I)$	293
10.2.2	Incomplete information concerning the utility function $U(I)$..	296
10.3	Sensitivity analyses	303
10.4	Decision making under multiple objectives	305
10.4.1	The additive model	305
10.4.2	Condition for the additive model: additive utility independence	306
10.4.3	The multiplicative model	308
10.4.4	Condition for the multiplicative model: mutual utility independence	310
	Questions and exercises	311
	Case Study 1: Nine-digit zip codes	318
	Case Study 2: Stockpiling of a blood bank	321

Chapter 11: Time preferences under certain expectations323

- 11.0 Summary 323
- 11.1 The problem of time preference 323
- 11.2 The additive intertemporal value function..... 324
 - 11.2.1 Derivation of the intertemporal value function..... 324
 - 11.2.2 Discussion of assumptions for the additive intertemporal value functions..... 327
- 11.3 Special types of the additive intertemporal value function 328
 - 11.3.1 Identical value functions for each period..... 328
 - 11.3.2 The discounting model 330
 - 11.3.3 The Harvey model 333
 - 11.3.4 A comparison of the two axiom systems and an alternative model 335
- 11.4 Evaluation of payment sequences..... 339
- Questions and exercises 341

Chapter 12: Group decisions345

- 12.0 Summary 345
- 12.1 Benefits and problems of group decisions 345
 - 12.1.1 Adverse group effects 346
 - 12.1.2 Potential remedies..... 347
- 12.2 Joint structuring of the decision problem 348
- 12.3 Generation of a common system of objectives 350
- 12.4 Generation of group value functions 351
 - 12.4.1 Aggregating individual single value functions 351
 - 12.4.2 Generating common attribute weights 355
- 12.5 Dominance tests..... 356
 - 12.5.1 Considering the complete range of evaluations 358
 - 12.5.2 Reducing the range of evaluation intervals..... 359
 - 12.5.3 Example 359
- 12.6 Generating joint probability evaluations..... 361
 - 12.6.1 Simple aggregation of individual estimations..... 362
 - 12.6.2 Aggregation of individual estimations using prediction markets 365
- 12.7 Making a group decision 367
- Questions and exercises 367

Chapter 13: Descriptive aspects of decision making371

- 13.0 Summary 371
- 13.1 Descriptive preference theories and rational behavior..... 371
- 13.2 Examples of intuitive behavior not in line with utility theory 373
 - 13.2.1 Bias in probability estimates..... 374
 - 13.2.2 The Ellsberg paradox..... 375
 - 13.2.3 Reference point effects 377
 - 13.2.4 The Allais paradox and certainty effects 379

13.2.5	Overview of decision behavior phenomena.....	381
13.2.6	Importance of preferences deviating systematically from utility theory	387
13.3	Descriptive theories	390
13.3.1	Support theory	390
13.3.2	Rank-dependent utility theories	392
13.3.3	Cumulative Prospect Theory	397
13.3.4	Further theories – disappointment and regret	416
13.3.5	Current developments in the area of descriptive decision theory.....	421
13.4	Conclusion.....	422
	Questions and exercises	423
	References	429
	Index	445



<http://www.springer.com/978-3-642-02850-2>

Rational Decision Making

Eisenführ, F.; Weber, M.; Langer, Th.

2010, XIV, 447 p. 116 illus., Softcover

ISBN: 978-3-642-02850-2