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A summary of chapter one and two

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**INTRODUCTION**

The basis of successful management is the effective of decision making. Effective decision – making occurs by accident rarely enough to make these decision – maker legendary the exceptions that prove the rule. In the majority of successful organizations ( and the organizations most likely to be durable), effective decisions – making must build upon the firm foundations of training and experience. Effective decisions – making is characterized by the adoption of structure decisions processes. This means no more than using a logical, sequential and ordered approach to solving problems . Managerial economics is the applications of what may be called scientific methods to business problems, illustrating the product and more importantly the methodology) of economic science to make better decisions. Better decisions are those that more effectively and confidently achieve the given objectives of the decisions maker. The point needs emphasizing, however, that effective decision – making requires more than the adoption of given techniques. Decisions – making can be made more effective simply by approaching problems in a logical and systematic way. Sometimes this will involve the use of mathematical or schematic models. More often, this approach means no more than the application of a little common sense.

The purpose of the following theme is to outline what may be called the decision analysistic method, which is completely general and can be applied to all sorts of problems. An understanding of this method is the key logical decisions making that spate the effective manager from the merely competent. There are many managers who claims not make important decisions based on flair and intuition, and with considerable success. Often however, this flair and intuition is no more than the decisions analytic method in a recognized form. Few of us can consist make successful consecutive decision by a “seat of the paints” approach. The growth of managerial economics is entirely due to the benefits that structured decisions making brings to the efficient utilization of resources.

**THE DECISIONS ANALYTIC APPROACH.**

A decision is the act of conscious choice amongst alternatives. The decisions analytic approach is no more than a structured method for making this choice and can be represented diagrammatically as five stage process (Gouge And S. Hill, 1979). The importance of each stage depends upon the particular decisions to be made. Many decision are repetitive and of little consequence so that it is hardly worth the trouble of spelling out each stage (although even them it is probably worth while formalize the decisions approach every now and then). The main point is that this frame work can be applied to all decision however large or small, and if fully understood and carefully applied, should lead to decision that are superior in the long run to any intuitive approach. Before discussion each stage in details.

**IDENTIFICATION**

A decision is necessary whenever there is a divergence between the expected outcome and the and the desired outcome. This involves identifying both what is likely to happen and what one would like to happen. For the business organization, the usual objective to increase profit, either by increasing revenue or by decreasing cost, or some combination of both. But the decision analytic method is applicable to any enterprise, whatever its objectives. For whatever the objectives, these can be best accomplished by using resources more efficiently, i.e. by making better decision ( J.D. Branford B.S. Stein, 1984).

Identification is more than just recognizing the need for a decision. It involves defining the problem explicitly, taking account of all of the factors that influence the problem. One common method of doing this is to construct a decision – model. As the name implies, this is just a simplified representation of the actual problem, designed to illustrate the essential relationships that influence the problem and omit those details which only obscure that problem of course, deciding what relationships are essential and which can be safely omitted is at the core of good model building. Models used for decisions making are either mathematical or schematic, both types will be encountered throughout later.

It is useful to define some terms. An act is the implementation of a particular decision. Even doing nothing may be an act if a decision has been made that this is the most appropriate behavior. And event is an occurrence beyond the control of the decision – maker. The choice of a judicious policy may influence events, but it is the nature of events that they can never be completely controlled in advance. An outcome is then the consequence of a particular combination of act event. An optional decision is the choice of that action which is expected to lead to the most preferred outcome.

**A FRAME WORK FOR DECISIONS.**

1. IDENTIFICATION
2. SEPEFICATION OF ALTERNATIVES
3. EVALUATION OF ALTERNATIVES
4. OPTIMISATION
5. IMPLEMENTATION

Mathematical type of model seeks to express relationships in the form of an equation, or series of equations, which can be manipulated to determine an optimal solution. The obvious difficult is in finding appropriate equation forms, and is one reason why forecasting is so important to decisions making. A more fundamental problems is that mathematical models are often restrictive because they require certain assumptions to be fulfilled. Many of the techniques introduced later are of mathematical form, and it is as important to understand the situations for which these models are applicable as it is to understand the technique themselves. Generally, the level of mathematical complexity required to find solutions is not very high, and can be mastered without great difficulty. The schematic model is just a way of expressing relationships diagrammatic form, and is usually descriptive in purpose. Rarely will diagrams be drawn with the precision required to find explicit solutions. More often diagrams are used to express relationships as an aid to understanding the decisions – situation, and are particular useful when a series of interacted decisions are to be made.

The basic purpose of either sort model is to similarity the decisions situations, so that various options can be considered on paper without the expense or impracticality of actual experimentation. Clearly the effectiveness of the model depends critically on its representation of the actual situation. Many disagreements about courses of actions stem from the different models (which may be implicit as well as explicit) on which decisions are based. One effective way of resolving disagreement to clarify the different models on which views are based ( S. Hull And P. Blyton, 1985).

**SPECIFICATION OF ALTERNATIVES**

To choose between alternatives, it is first necessary to determine the range of alternatives. The generation of alternatives usually involves reference back to previous decisions, research into possibilities and the exec rise of imagination.

At any moment the range of choice open to the decisions – maker may be infinite or at least very wide. However, many of the alternatives may not be feasible so that they may be easily (but carefully ) dismissed, reducing the set of possible alternatives to manageable proportions. To decide which alternatives are feasible involves categorizing the variables that influence the problems into those the decisions – maker can affect ( control variables and these beyond their influence ( uncontrolled variables). The distinction is similar to that between actions and events. A particular choice of action is feasible if it can subsequently be implemented.

In many situation the search for alterative is expensive in terms of the decisions - maker resources. Then, of course a decision must be made about the amount of resources to spend on generating alternatives by comparing the costs of search to the likely benefits that search would buy. Routine operating decisions are likely to be made with reference to some “rule of thumb” that has proved adequate in the past. In this case search activity is undertaken only if the performance associated with routine decisions begins to deteriorate. It is support and that the performance of the routine decisions rule is reviewed periodically from the desired outcome. (Gouge and S. Hill, 1979).

**EVALUATION OF ALTERNATIVES**

To make the decisions it is necessary to be able to arrange the alternatives into some kind of order corresponding to how well they are expected to achieve the desired objectives. To do this normally involves quantifying the alternatives so that a value or range of values can be attached to each one. The basic problem is one of information. For each alternatives action the decisions – maker must examine the possible events and estimate the corresponding potential outcomes. To attach a value to each outcome the relationships between the variables that determines the outcome and the outcome itself must be specified. Once this is achieved the value of future variable must be estimated. ( Gough And S. Hill, 1979).

Accuracy of these estimates plays an important role in determining different methods of preparing forecast. Once again collecting information consumer’s resources so that a decisions must be made about the allocation of resources to forecasting, which will in turn depends upon the importance of the initial decisions. A related problem is that of uncertainty. All decisions concern the future and are therefore uncertain. The nature of uncertainty, and various possible ways around this will be considered in more details later. At stage it is necessary to recognize that as well as estimating future variable we must also estimate how likely these future values are. This is a difficult question, but one that must be faced. It is better to make imperfect estimates in the face of uncertain than to ignore uncertainty altogether.

**OPTIMIZATION**

Various techniques are applied to the decisions model to determine the solution that best satisfies the chosen objectives. Information collected in the specification and evaluation of alternatives is applied to the model to examine the consequence of different actions. If the model is supplicated enough, solutions can be tested for sensitivity by allowing the variables of the model to change slight and then by re-examining the consequence of each action. In this way, a solution can be chosen by reference not only to its most likely outcome but also to the full range of possible consequence. The process of finding the best possible solutions from a range of alternatives is called optimization. (J. Dean, 1951).

Logic is applied to the model to generate solutions which can then be arranged in order of attractions. This order of attraction depends upon the specified criteria used to judge solutions. The basic point is that optimization is more a the method of approach than a particular technique. It consist of considering all possible solutions determining which are feasible evaluating these and arranging them in order. Choosing the best solutions should then be a relatively simple matter guided by objectives.

**IMPLEMENTATION**

The problem for the managerial economist normally ends with optimization. Not so the business manager. It is up to the manager to ensure that the solution is implemented, and to monitor the process of implementation. The success of the decision exercise does not depend on its sophistication or elegance, but on its impact on performance. ( J. Dean, 1951). The work of the decisions analysis is more likely to be viewed sympathetically and the proposed solution most likely to be successfully implemented, if the cooperation and coordination of other concern has been sought throughout the decisions process. It is essential to recognize that in complex organizations change does not occur instantaneously. Rather the organization moves slowly (and often grudgingly) from one situation to another. As well as offering solutions it is necessary to plan for the transitional period from the current situation to the future envisaged situation. At the same time the rest of the world does not stand still. The decisions environment needs close monitoring so that responses can be made to external changes as the decision plan. It is all too easy to find optimal solutions to a situation that no longer exists.

**CONCLUSION.**

You should now be aware of the coherence of the decision analytic approach, together with some indication of its potential usefulness. The decisions system outline is completely general and applicable to all decisions that can be made. Example of decisions making, as an application. Decision analysis – the overdraft.

You receive the following letter;

Dear Student,

Current Account- Overdrawn K10, 000.00

Your account has become overdrawn to the above figure although I can find no trace of the bank agreement to over draft facilities. Would you kindly give your earliest attention to adjustment?

Yours Sincerely,

Manager

Bank ABC.

You now have a problem, since the desired outcome (surplus) differs from the actual outcome ( over draft), so a decisions must be made. The first stage is to identify the problem. The initial step is to check that the problem exist by examining our account and ensuring the bank computer has not made a mistake ( rare but not impossible). Having confirmed that the problem is real, you then seek them to find a solution by writing a suitably groveling reply, pointing out all the unforeseen expenses you have recently incurred and all the hard work you have recently been doing forcing you to overlook the problem, and promising to give your earliest attention to adjacent. The next step is to build a decisions model. One simple model you could adopt is; Surplus: = Revenue – Expenditure

Given the model, alternatives are easily generated. You must increase revenues, or reduce expenditure, or some combination of the two. A schedule of alternatives may look like the following;

Increase Revenue Decrees Expenditure

Part Time job Less Entertainment

Borrow From Family Buy Less Books

Sell Motorcycle Sell Motor Cycle

Note that some entries occur twice – selling your motorcycle may booth increase revenue and decrease expenditure. Alternatively, if it means more public transport use it could increase revenue and expenditure having decided the alternatives they must now be evaluated. This involves estimating variables such as the wage – for part – time jobs the money you could save on books etc. Given reliable estimates of variables, the outcome correspond to each action can be estimated. As well as monetary values you would need to take account of the satisfaction or utility associated with each outcome ( for example, your motor cycle may be your most treasured objective, giving psychic income well in excess of its monetary value). It should then be possible to determine the optimal choice from alternatives, remembering to consider whether some combination of action. May be preferable to reliance on any single one. It may be necessary to define the best choice of action as that which is least painful! Having made a choice, it only remains to implement it with sufficient vigor to satisfy the objectives. As well as maintaining performance you should be alert to possible changes in the decisions environment (such as wage increase, telephone bills etc).

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