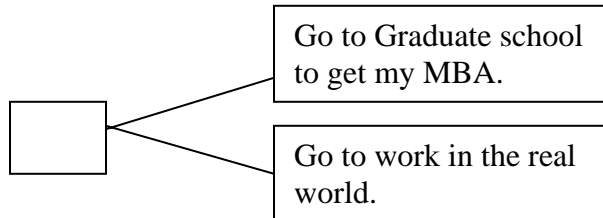


Decision tree is basically a representation of all the possible alternatives and their consequences which are being presented graphically.

Example:

A Decision Tree with two choices.



- A box is used to show a choice that the manager has to make.
- Lines connect outcomes to their choice or probability outcome.

Now you have two choices whether to go to the school or to go to work. And you have to analyze the costs associated to both alternatives and perform a sort of cost benefit analysis. What are some of the costs we should take into account when deciding whether or not to go to business school?

Evaluation of the decision:

Choice # 1:

2 Years of tuition: Rs. 55,000, 2 years of Room/Board: Rs. 20,000; 2 years of Opportunity Cost of Salary = Rs.100, 000
Total = Rs.175, 000.

PLUS → expected 5 year salary after Business School = Rs.600, 000.

NPV (Net present value) (business school) = Rs.600, 000 - Rs.175, 000 = Rs.425, 000
(NPV= is the difference between the present value of cash inflows and the present value of cash outflows).

Choice # 2:

First two year salary = Rs.100, 000 (from above), minus expenses of Rs.20, 000.

Final five year salary = Rs.330, 000

NPV (no business school) = Rs.410, 000

On evaluation of both the choices we will move towards our best possible decision with the help of decision tree.