

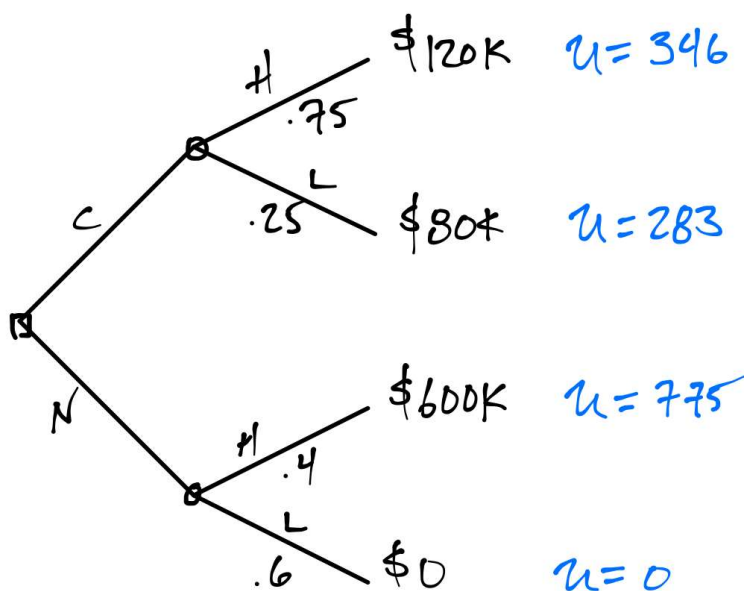
Solution: Risk averse manager

Initial data

Action	State	Probability	Gross Payoff
C	H	75%	\$220,000
C	L	25%	\$180,000
N	H	40%	\$700,000
N	L	60%	\$100,000

Net payoffs and utilities of each endpoint:

Action	State	Probability	Net Payoff	Utility
C	H	75%	\$120,000	346
C	L	25%	\$80,000	283
N	H	40%	\$600,000	775
N	L	60%	\$0	0



Computing the expected utilities:

$$EU_C = 0.75 * 346 + 0.25 * 283 = 330$$

$$EU_N = 0.40 * 775 + 0.60 * 0 = 310$$

The manager would choose C

Computing the expected values:

$$EV_C = 0.75 * \$120,000 + 0.25 * \$80,000 = \$110,000$$

$$EV_N = 0.40 * \$600,000 + 0.60 * \$0 = \$240,000$$

A risk-neutral manager would strongly prefer N