Stochastic Processes, Quiz 4, 2024 Fall

Solution and Grading

- Duration: 40 minutes
- Weight: 10% of final grade
- Closed material, No calculator

- Name: _____
- Student ID: _____
- E-mail: _____ @seoultech.ac.kr

- Write legibly.
- Justification is necessary unless stated otherwise.

#1. Next month's production at a manufacturing company will use a certain solvent for part of its production process. The company need to prepare solvent in prior and the demand of solvent is random. Check the following assumptions:

- Assume that there is an ordering cost of \$1,500 incurred whenever an order for solvent is placed.
- The solvent costs \$50 per liter. Due to short product life cycle, unused solvent cannot be used in following months.
- There will be a \$15 disposal charge for each liter of solvent left over at the end of the month.
- If there is a shortage of solvent, the production process is seriously disrupted at a cost of \$100 per liter short.
- The demand is estimated as $\mathbb{P}(D = 300) = 0.2, \mathbb{P}(D = 500) = 0.4, \mathbb{P}(D = 700) = 0.3$, and $\mathbb{P}(D = 900) = 0.1$

After some careful analysis, the optimal (S, s) policy is obtained where $S = 500$ and $s = 444$. If the current inventory level is 450 liters, then what is the expected total operating cost for the next month? (Hint: First you need to decide whether or not to make an order.) `[10pts]`

Based on the (S, s) policy, the optimal course of action is not making an order. Thus, the expected total operating cost can be written as:

$$\begin{aligned} \mathbb{E}[\text{Total Cost}] &= \mathbb{E}[\text{Order cost}] + \mathbb{E}[\text{Shortage cost}] - \mathbb{E}[\text{Disposal cost}] \\ &= 0 + 100\mathbb{E}[(D - 450)^+] + 15\mathbb{E}[(450 - D)^+] \\ &= 0 + 100 \cdot 140 + 15 \cdot 30 = 14450 \end{aligned}$$

Difficulty: Medium-Hard