

Regents Park Publishers

Business Statistics



T1LM6

**Probability and
Probability Distribution**

Module Goals

After completing this Module, you should be able to:

- Explain three approaches to assessing probabilities
- Apply common rules of probability
- Use Bayes' Theorem for conditional probabilities
- Distinguish between discrete and continuous probability distributions
- Compute the expected value and standard deviation for a discrete probability distribution

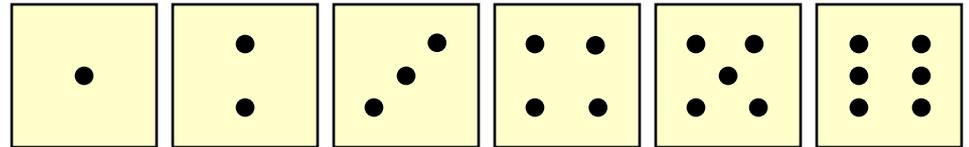
Important Terms

- **Probability** – the chance that an uncertain event will occur (always between 0 and 1)
- **Experiment** – a process of obtaining outcomes for uncertain events
- **Elementary Event** – the most basic outcome possible from a simple experiment
- **Outcome** – a particular result of an experiment
- **Sample Space** – the collection of all possible elementary outcomes

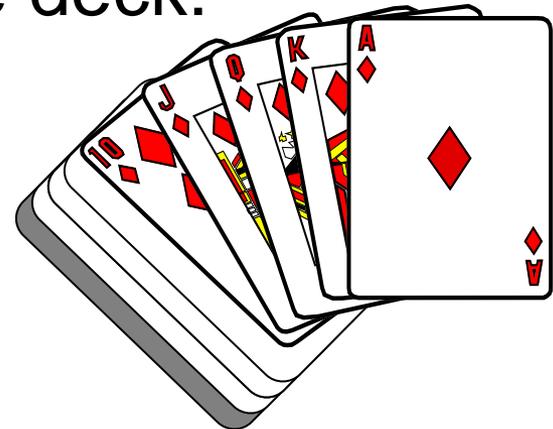
Sample Space

The **Sample Space** is the collection of all possible outcomes

e.g. All 6 faces of a die:



e.g. All 52 cards of a bridge deck:



Events

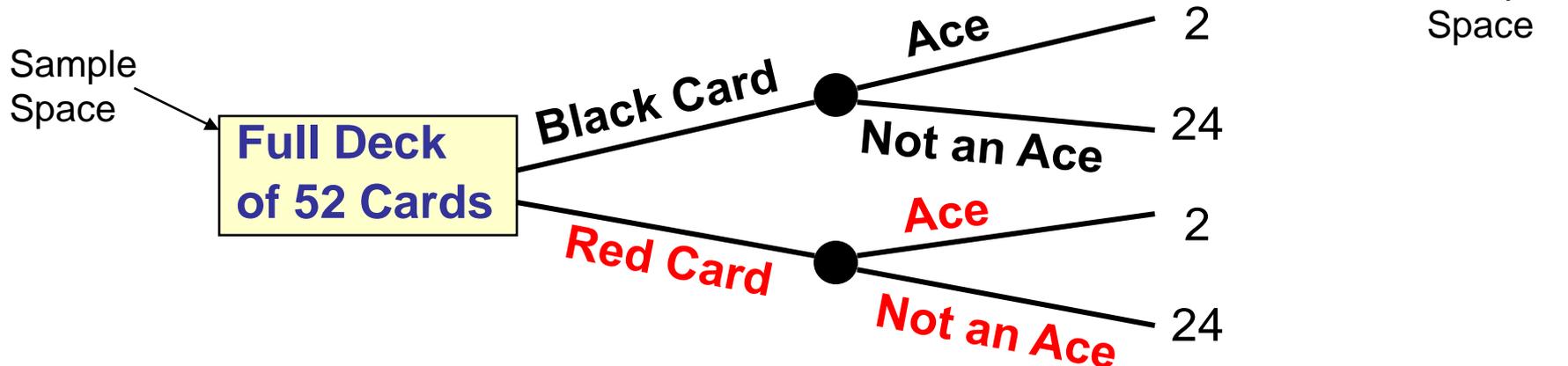
- **Elementary event** – An outcome from a sample space with one characteristic
 - Example: A red card from a deck of cards
- **Event** – May involve two or more outcomes simultaneously
 - Example: An ace that is also red from a deck of cards

Visualizing Events

■ Contingency Tables

	Ace	Not Ace	Total
Black	2	24	26
Red	2	24	26
Total	4	48	52

■ Tree Diagrams



Elementary Events

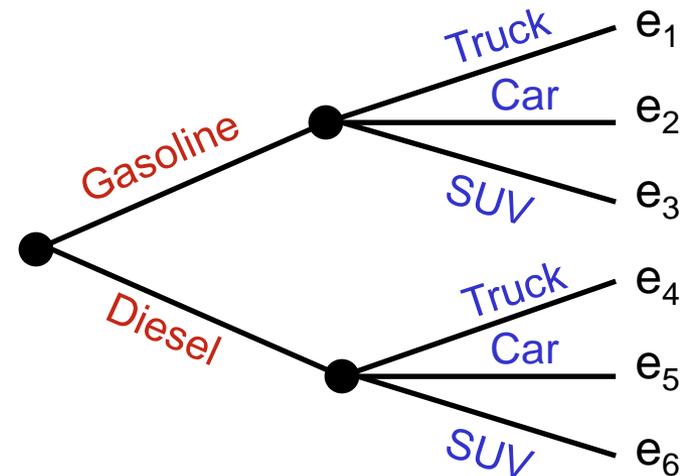
- A automobile consultant records **fuel type** and **vehicle type** for a sample of vehicles

2 Fuel types: **Gasoline, Diesel**

3 Vehicle types: **Truck, Car, SUV**

6 possible elementary events:

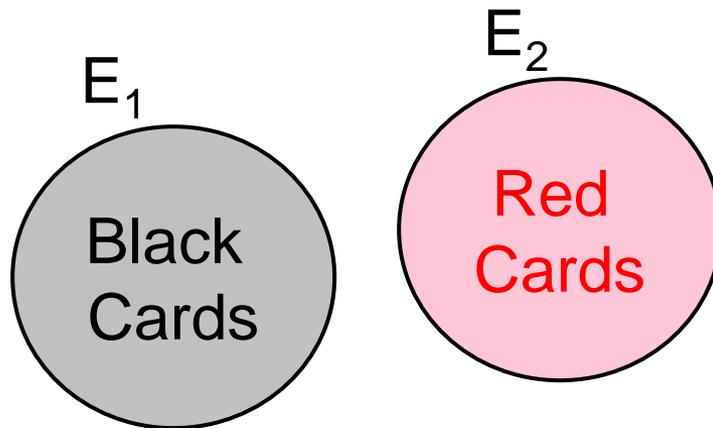
e_1	Gasoline, Truck
e_2	Gasoline, Car
e_3	Gasoline, SUV
e_4	Diesel, Truck
e_5	Diesel, Car
e_6	Diesel, SUV



Probability Concepts

■ Mutually Exclusive Events

- If E_1 occurs, then E_2 cannot occur
- E_1 and E_2 have no common elements



A card cannot be Black and Red at the same time.

Probability Concepts

- **Independent and Dependent Events**
 - **Independent:** Occurrence of one does not influence the probability of occurrence of the other
 - **Dependent:** Occurrence of one affects the probability of the other

Independent vs. Dependent Events

- **Independent Events**

E_1 = heads on one flip of fair coin

E_2 = heads on second flip of same coin

Result of second flip does not depend on the result of the first flip.

- **Dependent Events**

E_1 = rain forecasted on the news

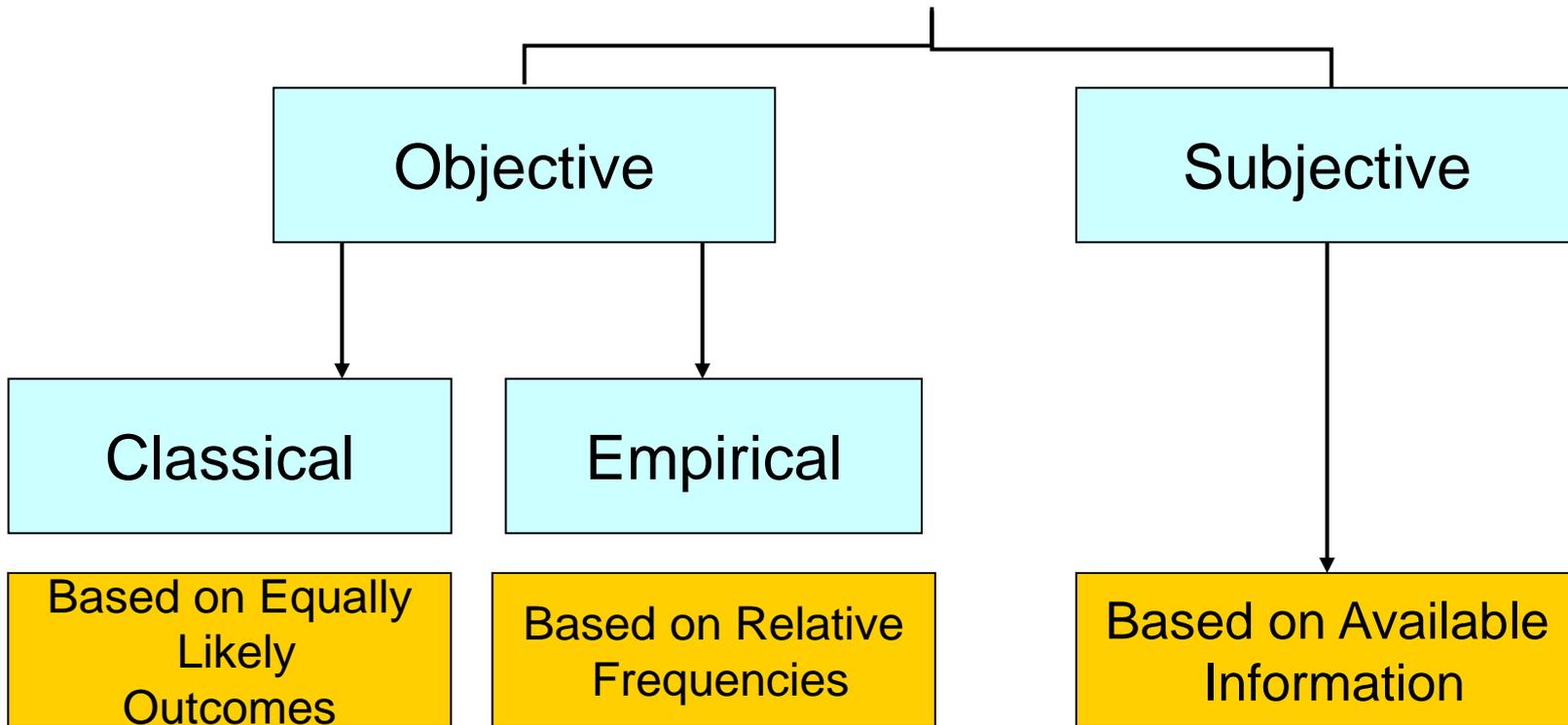
E_2 = take umbrella to work

Probability of the second event is affected by the occurrence of the first event

Law of Large Numbers

Over a large number of trials, the empirical probability of an event will approach its true probability.

Approaches to Probability



Assigning Probability

- Classical Probability Assessment

$$P(E_i) = \frac{\text{Number of ways } E_i \text{ can occur}}{\text{Total number of elementary events}}$$

- Relative (Empirical) Frequency of Occurrence

$$\text{Relative Freq. of } E_i = \frac{\text{Number of times } E_i \text{ occurs}}{N}$$

- Subjective Probability Assessment

An opinion or judgment by a decision maker about the likelihood of an event

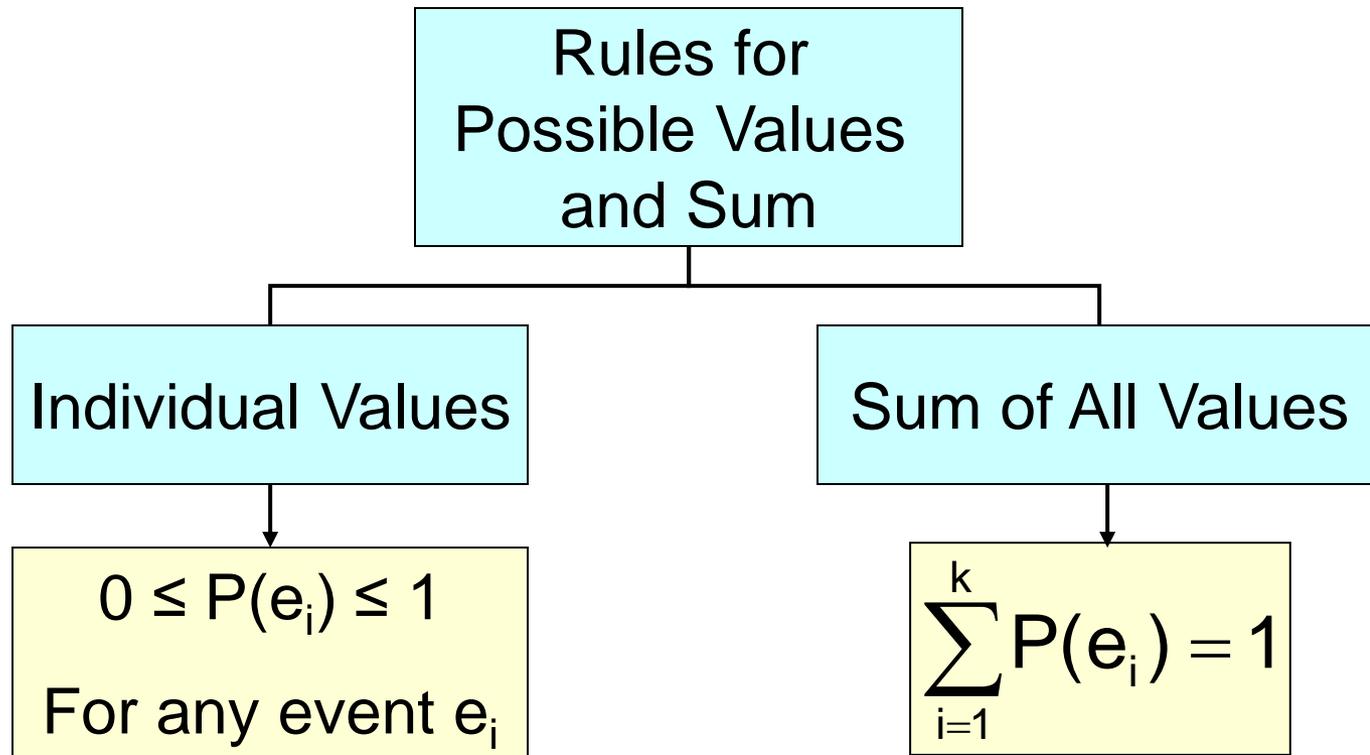
Subjective Concept of Probability

The likelihood (probability) of a particular event happening that is assigned by an individual is based on whatever information is available.

Empirical Probability

The probability of an event happening is a fraction of the time similar events happened in the past.

Rules of Probability



where:

k = Number of elementary events
in the sample space

e_i = i^{th} elementary event

Addition Rule for Elementary Events

- The probability of an event E_i is equal to the sum of the probabilities of the elementary events forming E_i .
- That is, if:

$$E_i = \{e_1, e_2, e_3\}$$

then:

$$P(E_i) = P(e_1) + P(e_2) + P(e_3)$$

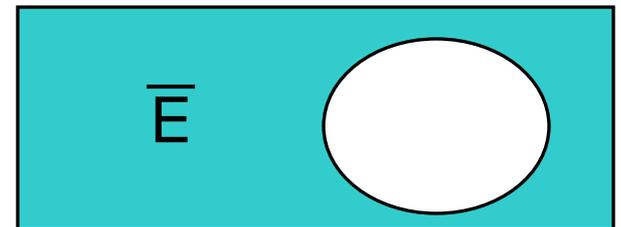
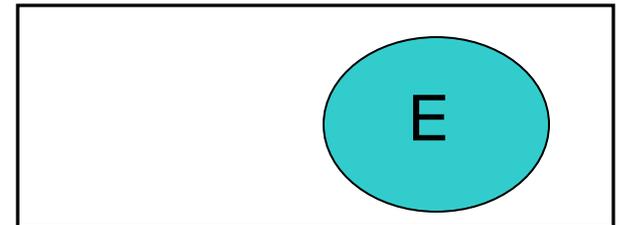
Complement Rule

- The **complement** of an event E is the collection of all possible elementary events **not** contained in event E . The complement of event E is represented by \bar{E} .

- **Complement Rule:**

$$P(\bar{E}) = 1 - P(E)$$

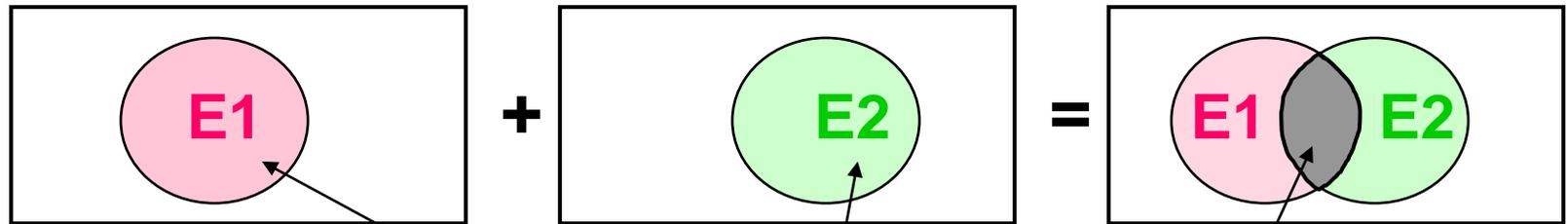
Or, $P(E) + P(\bar{E}) = 1$



Addition Rule for Two Events

■ Addition Rule:

$$P(E_1 \text{ or } E_2) = P(E_1) + P(E_2) - P(E_1 \text{ and } E_2)$$



$$P(E_1 \text{ or } E_2) = P(E_1) + P(E_2) - P(E_1 \text{ and } E_2)$$

Don't count common elements twice!

Addition Rule Example

$$P(\text{Red or Ace}) = P(\text{Red}) + P(\text{Ace}) - P(\text{Red and Ace})$$

$$= 26/52 + 4/52 - 2/52 = 28/52$$

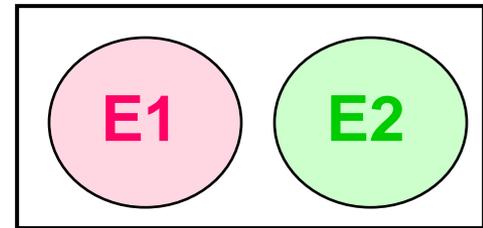
Type	Color		Total
	Red	Black	
Ace	2	2	4
Non-Ace	24	24	48
Total	26	26	52

Don't count
the two red
aces twice!

Addition Rule for Mutually Exclusive Events

- If E_1 and E_2 are mutually exclusive, then

$$P(E_1 \text{ and } E_2) = 0$$



So

$$\begin{aligned} P(E_1 \text{ or } E_2) &= P(E_1) + P(E_2) - \underbrace{P(E_1 \text{ and } E_2)}_{= 0 \text{ if mutually exclusive}} \\ &= P(E_1) + P(E_2) \end{aligned}$$

Conditional Probability Example

- Of the cars on a used car lot, 70% have air conditioning (AC) and 40% have a CD player (CD). 20% of the cars have both.
- What is the probability that a car has a CD player, given that it has AC ?

i.e., we want to find $P(\text{CD} \mid \text{AC})$

Conditional Probability Example

(continued)

- Of the cars on a used car lot, **70%** have air conditioning (AC) and **40%** have a CD player (CD). **20%** of the cars have both.

	CD	No CD	Total
AC	.2	.5	.7
No AC	.2	.1	.3
Total	.4	.6	1.0

$$P(\text{CD} | \text{AC}) = \frac{P(\text{CD and AC})}{P(\text{AC})} = \frac{.2}{.7} = .2857$$

Conditional Probability Example

(continued)

- Given AC, we only consider the top row (70% of the cars). Of these, 20% have a CD player. 20% of 70% is about 28.57%.

	CD	No CD	Total
AC	.2	.5	.7
No AC	.2	.1	.3
Total	.4	.6	1.0

$$P(\text{CD} | \text{AC}) = \frac{P(\text{CD and AC})}{P(\text{AC})} = \frac{.2}{.7} = .2857$$

Multiplication Rule

- Multiplication rule for two events E_1 and E_2 :

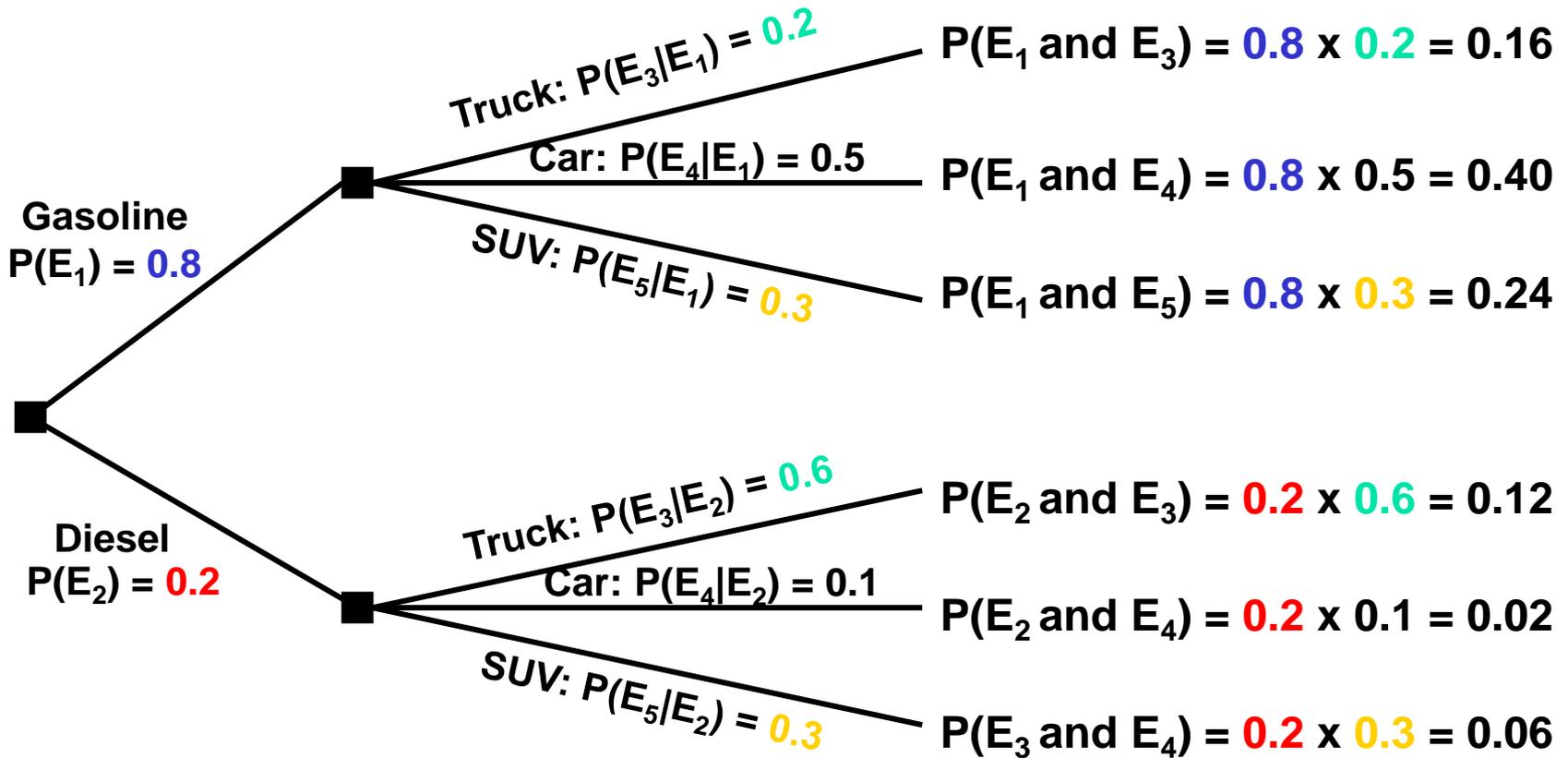
$$P(E_1 \text{ and } E_2) = P(E_1)P(E_2 | E_1)$$

Note: If E_1 and E_2 are independent, then $P(E_2 | E_1) = P(E_2)$ and the multiplication rule simplifies to

$$P(E_1 \text{ and } E_2) = P(E_1)P(E_2)$$

Tree Diagram Example

Multiplication Rule



Bayes' Theorem Example

- A drilling company has estimated a 40% chance of striking oil for their new well.
- A detailed test has been scheduled for more information. Historically, 60% of successful wells have had detailed tests, and 20% of unsuccessful wells have had detailed tests.
- Given that this well has been scheduled for a detailed test, what is the probability that the well will be successful?



Bayes' Theorem Example

(continued)

- Let S = successful well and U = unsuccessful well
- $P(S) = .4$, $P(U) = .6$ (prior probabilities)
- Define the detailed test event as D
- Conditional probabilities:

$$P(D|S) = .6$$

$$P(D|U) = .2$$



- Revised probabilities

Event	Prior Prob.	Conditional Prob.	Joint Prob.	Revised Prob.
S (successful)	.4	.6	$.4 * .6 = .24$	$.24 / .36 = .67$
U (unsuccessful)	.6	.2	$.6 * .2 = .12$	$.12 / .36 = .33$

Sum = .36

Bayes' Theorem Example

(continued)

- Given the detailed test, the revised probability of a successful well has risen to **.67** from the original estimate of .4



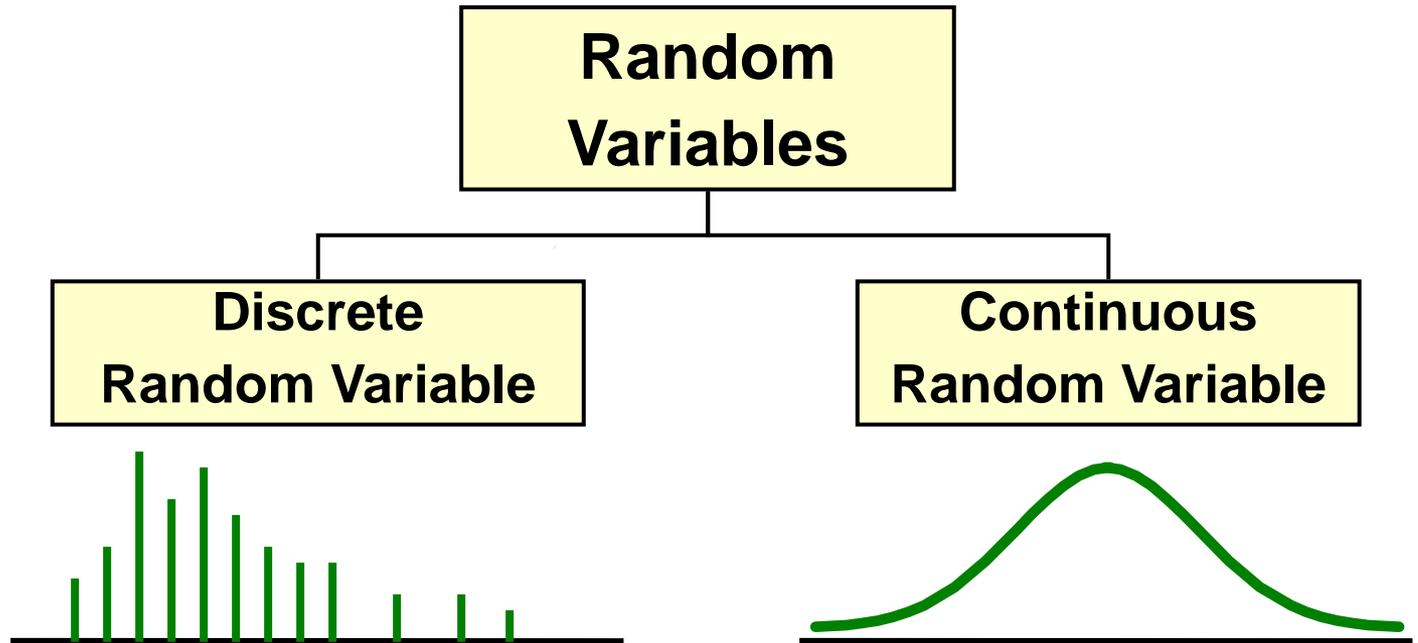
Event	Prior Prob.	Conditional Prob.	Joint Prob.	Revised Prob.
S (successful)	.4	.6	$.4 * .6 = .24$	$.24 / .36 = .67$
U (unsuccessful)	.6	.2	$.6 * .2 = .12$	$.12 / .36 = .33$

Sum = .36

Introduction to Probability Distributions

■ Random Variable

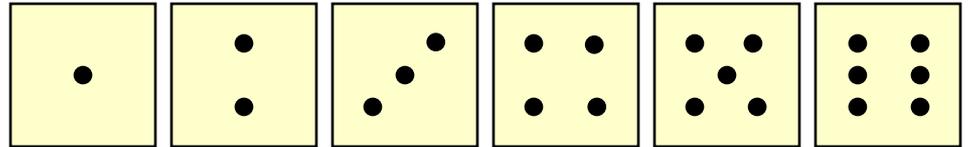
- Represents a possible numerical value from a random event



Discrete Random Variables

- Can only assume a countable number of values

Examples:



- **Roll a die twice**

Let x be the number of times 4 comes up
(then x could be 0, 1, or 2 times)

- **Toss a coin 5 times.**

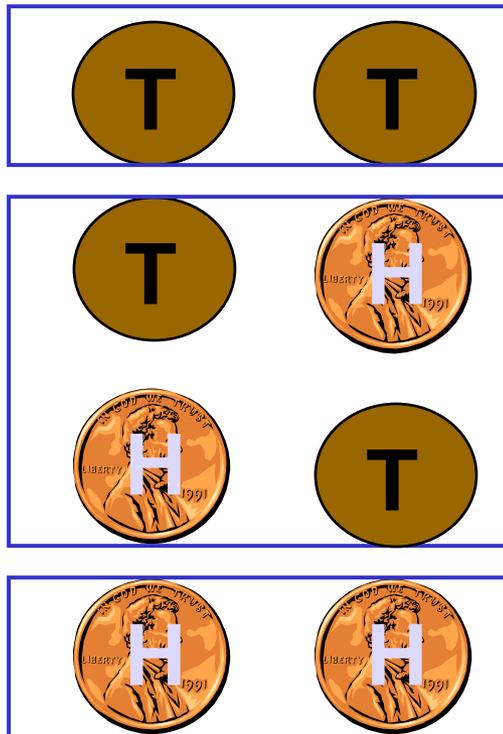
Let x be the number of heads
(then $x = 0, 1, 2, 3, 4, \text{ or } 5$)



Discrete Probability Distribution

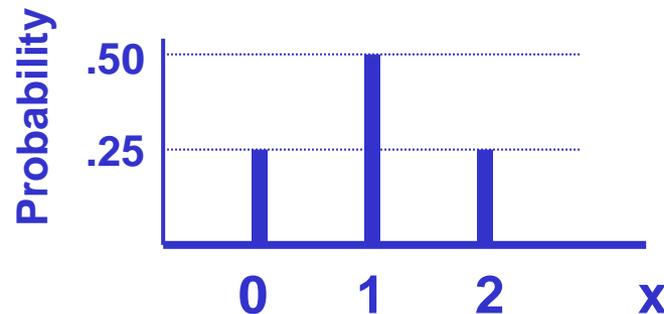
Experiment: Toss 2 Coins. Let $x = \#$ heads.

4 possible outcomes



Probability Distribution

<u>x Value</u>	<u>Probability</u>
0	$1/4 = .25$
1	$2/4 = .50$
2	$1/4 = .25$



Discrete Random Variable Summary Measures

- **Expected Value** of a discrete distribution
(Weighted Average)

$$E(x) = \sum x_i P(x_i)$$

- **Example:** Toss 2 coins,
 $x = \#$ of heads,
compute expected value of x :

$$E(x) = (0 \times .25) + (1 \times .50) + (2 \times .25) \\ = 1.0$$

x	P(x)
0	.25
1	.50
2	.25

Example

Coin Toss
Experiment

Module Summary

- Described approaches to assessing probabilities
- Developed common rules of probability
- Used Bayes' Theorem for conditional probabilities
- Distinguished between discrete and continuous probability distributions
- Examined discrete probability distributions and their summary measures

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End