

# Value of the firm essay

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**REAL OPTION:** It is an alternative choice for the investor to assess its investment opportunity. These options are neither a derivative nor reported in the balance sheet but the potential investor knows the importance of real option. The basic theme of real options is to provide the window of flexibility in the uncertain times to the investor. The valuation of real options also helps in the strategic management. Moreover, Real options also minimize the downside risk. **VALUE TO THE FIRM:** Real options often help the financial manager or any decision-maker in reaching an optimal investment decision, keeping in view that real options cannot be replaced with traditional DCF models.

It is more often the case that some real options lead to a different investment decision as compared to DCF analysis (Stout, Xie, Qi, 2008, pg 9). Real options also debates on issues like uncertainties related with price, demand, technology etc. Real options also added values in the prosperity of the firm like intimate good fortune and rectify losses (Brealey and Myers 2001).

Real options do have a negative side though, which is that it might make the decision making process more complex. In this case one can suggest that when the financial manager incorporates more factors, and uses multiple techniques in capital budgeting the more confusing and complicated the scenario would become reducing his or her ability or chances to make accurate decisions. From the view point of valuation, real options are important because they permit managers to react quickly in accordance to the scenario the face (Stout, Xie, Qi, 2008, pg 1). **REFERENCE**Brealey, Richard A.

, Myers, Stewart C. & Marcus, Alan J. (2001). Corporate Finance. McGraw-Hill.  
Stout, David E., Xie, Yan Alice and Qi, Howard (2008).

Improving capital budgeting decisions with real options. Management  
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