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Bloomington
European Business Administration

**“Applicability of Real Option Valuation
for High-Risk Investments”**

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of the requirements for the degrees of

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Vorwort

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Prof. Dr. Ottmar Schneck

Preamble

This thesis gives me the opportunity to deepen my knowledge of financial valuation that I have acquired during the last 3 years of study and work. After applying traditional DCF and EVA analysis during my internship with Stern Stewart and various finance classes, I have become particularly interested in real option valuation as an approach to capture the inherent value of strategic positioning and managerial flexibility. These values are not systematically accounted for by traditional methodologies.

In the wake of increasing uncertainty and volatility in the capital markets, supporters of real option analysis maintain that this approach to financial valuation takes into account option values that are disregarded or not properly quantified by other methodologies. The recent woes in the world's stock markets, especially in the Internet and technology sector, not only reflect Alan Greenspan's "irrational exuberance" but also illustrate the volatility within the values of strategic premiums and call for innovative valuation approaches. During the latest stock market boom, the substantial market capitalization of technology firms could not be justified by DCF models and analysts invented new ratios such as price-to-revenue or price-to-growth to account for future opportunities and options in the new economy. Real option analysis claims to consider flexibility inherent in the decision making process for capital budgeting and real asset investments. Working on this thesis helps me to develop a profound understanding of an approach that may become increasingly important for the valuation of high-risk investment in the corporate world.

Joerg Michael Adams, Bloomington, March 30, 2003

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