



The Engineering Economist >

A Journal Devoted to the Problems of Capital Investment

Volume 47, 2002 - [Issue 4](#)

390 | 27

Views | CrossRef citations to date | 0 Altmetric

ARTICLES

A BETTER UNDERSTANDING OF WHY NPV UNDERVALUES MANAGERIAL FLEXIBILITY

STEVEN P. FEINSTEIN & DIANE M. LANDER

Pages 418-435 | Published online: 31 May 2007

Cite this article <https://doi.org/10.1080/00137910208965043>

Sample our
Economics, Finance,
Business & Industry Journals
>> [Sign in here](#) to start your access
to the latest two volumes for 14 days



Citations

Metrics

Reprints & Permissions

Read this article

Share

ABSTRACT

The Real Options paradigm addresses the valuation of managerial flexibility in capital budgeting. Despite the great strides achieved by researchers in this field, many financial analysts have chosen not to adopt this new paradigm due to a lack of comfort with the approach and the mathematical complexity of the valuation models. This article shows how some projects with real options can be valued using simple and familiar tools-discounting expected cash flows after adjusting the discount rate. Unless the discount rate is adjusted to account for the impact of real options on risk, a traditional net present value (NPV) analysis misses the value of flexibility. By narrowing the gulf between Real Options analysis and more familiar tools, the weighted average discount rate (WADR) approach introduced in this paper may help novices better understand the Real Options paradigm, which subsequently may gain the wider acceptance it deserves. Though the WADR approach is practical only for simple real

options, comfort with the approach may encourage analysts to pursue more advanced and robust real option valuation techniques for more complex applications.

Related research ⓘ

People also read

Recommended articles

Cited by
27

Information for

Authors

R&D professionals

Editors

Librarians

Societies

Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

Open access

Overview

Open journals

Open Select

Dove Medical Press

F1000Research

Help and information

Help and contact

Newsroom

All journals

Books

Keep up to date

Register to receive personalised research and resources by email

 Sign me up

