REAL OPTIONS I: TESTS

A viable investment today?

- A small start up company has come up with a new cell phone technology that promises to speed up download speeds and create a smoother interface. The cost of implementing the technology is expected to be $ 2 billion and the present value of the expected cash flows from it is only $1.5 billion. Should they implement the technology now?
  - Yes
  - No
- Now assume that you work for an established cell phone manufacturer (Apple or Samsung). Would you be willing to pay for this non-viable technology, assuming that the company has patented it and has many years left on the patent life?
  - Yes
  - No
- Explain.

Determinants of value…

- Assuming that you would be willing to buy this non-viable technology, explain how each of the following will affect how much you would be willing to pay?
- Increase in number of years left on the patent life
  - I would pay more
  - I would pay less
- Higher uncertainty about future markets/ cash flows
  - I would pay more
  - I would pay less

Developing the technology…

- Assume that you do buy the technology and that it becomes viable (PV of cash flows > Cost of implementation). Would you develop the technology immediately?
  - Yes
  - No
- Explain. (What is the trade off that you are making?)