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Abstract

Although the academic literature on real options has grown enormously over the past three decades, the adoption of formal real option valuation models by practitioners appears to be lagging. Yet, survey evidence indicates that managers' decisions are near optimal and consistent with real option theory. We critically review real options research and point out its strengths and weaknesses. We discuss recent contributions published in this issue of the journal and highlight avenues for future research. We conclude that, in some ways, academic research in real options has catching up to do with current practice.

JEL classification: G13; G31

Keywords: Real option; Capital budgeting

1 Introduction

This article provides a critical review of research in real options. A comparison with research in financial options may be a good starting point. Financial options have been traded for many centuries. Vanilla options are written on a traded asset or security such as a commodity, currency, stock or index. Option contracts can be clearly defined in a couple of lines and are highly standardized. The prices for these contracts are set in option markets. Kairys and Valerio (1997) and Moore and Juh (2006) provide evidence that option markets were fairly sophisticated and efficient more than a century before the Black-Scholes model became available. Research in options and derivatives

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