Real option in a technology firm

Student’s Name

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Date

**Introduction**

E-commerce business is new business trend globally because of its profitability. The decision to invest in e-commerce business is based on the strategy of the company to increase its profit base. However, before any investment is made it is important to evaluate the value of a company for the right decision to be made. This report, therefore, presents some of the key decisions made by the management before the investment is made to avoid exposing the firm to several risks.

The Chief Finance Officer (CFO) decided to use 25% as the cost of capital to increase the stake of the company and to limit risk, which the company could face in the partnership. The cost of capital is the rate of return, which could have been earned or the company’s firm both equity and debts.

The expected net profit value (NPV) of the firm =

Cash flow – initial investment

 (1+i) t

 ( 14.0m ) – 8.0 million

(1+25%) 2

9.3-8

 NPV = 1.3million.

The net profit value of the company is expected to be 1.3 million after a period of two years of investment.

However, based on the proposal structure, the value of the company is expected to reduce after a period of two years. And therefore, the company should consider two scenarios in making the investment decision. First, it would not be a viable decision to invest in the company since its value is expected to reduce after a period of years. The company should, therefore, reject the proposal for the structured investment method. It would be advisable to finance the company through equity or through debt and common equity, which would ensure that the company is maintaining the capital structure (Majaski, 2019). It would limit exposing the firm to a great risk of loses, which is being incurred by the partner company.

The proposal deal of purchasing equity from the tech would a good for the company. First, purchasing equity limits the company from several risks. It is noted that the 2nd of operations the tech firm failed to make a profit and therefore, its values reduces. By purchasing equity, the company would be in business with the tech firm for a specific period. It prevents the company from losing its investment even if the company make several loses in the market. This, therefore, would be the best decision for the company regarding the business partnership.

# References

MAJASKI, C. (2019). Cost of Capital vs. Discount Rate: What's the Difference? *https://www.investopedia.com/ask/answers/052715/what-difference-between-cost-capital-and-discount-rate.asp*, 2-15.