

## **THE EFFECTS OF IRREVERSIBILITY AND UNCERTAINTY ON BUSINESS INVESTMENTS: A NEW VIEW OF INVESTMENT**

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### **Abstract**

The article presents a survey of recent theoretical, as well as empirical, contributions concerning the business investments, which help to understand the investment decision making of the companies better. As shown, they emphasize the relevance of idiosyncratic factors affecting investment decisions such as the degree of irreversibility and uncertainty, whose interaction may generate an opportunity cost equivalent to the exercise of an option and so they add an important dimension to the neoclassical theory of investment (also called standard or orthodox theory of investment). This theory has not recognized the important qualitative and quantitative implications of this interaction, what can explain some of its failures. We investigate the irreversibility of investments and the impact this has on the nature of the relationship between investment and uncertainty in a way of empirical analysis. The empirical analysis uses firm – level data and is based on a survey of 53 automotive suppliers, which was carried out during the year 2011. We find supportive evidence for the fact that uncertainty is negatively associated with planned investments of the companies surveyed, which remains true also in the presence of irreversibility. At the end we demonstrate the core of the real options approach in a form of a practical example.

**Keywords:** investment, uncertainty, irreversibility

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