

Investment Timing, Asymmetric Information, and Audit Structure: A Real Options Framework¹

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Abstract: This paper examines the investment strategy by incorporating an audit technology in the real options model in the presence of agency conflicts due to asymmetric information when the owner delegates the adoption of investment to the manager who holds private information. The implied trigger to adopt the investment in the audit setting is higher than that in the first-best full-information setting, while it is lower than that in the no-audit setting under asymmetric information which is corresponding to the setting in Grenadier and Wang (2005). That is, to incorporate the audit technology always enables the manager to hasten the trigger to adopt the investment, compared to that in the no-audit setting. Furthermore, the agency cost in the audit setting may be lower than that in the no-audit setting.

Keywords: Real Options; Asymmetric Information; Agency Conflicts; Audit.

JEL classification: G13; D82.

Reference:

Grenadier, S.R., and Wang, N., 2005. Investment Timing, Agency, and Information. *Journal of Financial Economics*, 75, 493-533.

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