On options

Decisions, decisions, decisions. What to opt for and how to decide on it? With the help of the so-called options approach this article tries to tackle strategic decision-making from the viewpoint of individuals.

Accelerated by an ever-changing environment, the options approach incorporates uncertainty, irreversibility of developments and the possibility to delay decisions into its calculus.

Options are generally described as rights but not obligations to take decisions in the future. This is critical as many decisions we take must be regarded as irreversible or at least hardly reversible.

A decision to buy a house or a used car, or to take up a job offer may prove to be a bad one as better alternative options may materialize or simply because more information becomes available at a later stage – after the decision has been taken. Path dependency also means that a decision taken at one point in time will affect the future course of action and will also limit alternative options that may have existed in the past. After all most people can only buy a limited number of houses or cars.

It is furthermore important to realize that decisions can usually be made at more than just one point in time (e.g. today, in two weeks, after one year). This ability to delay them can be very valuable, particularly at times of uncertainty and volatility. Volatility usually means that risks and rewards fluctuate sharply. Although most people shy away from uncertainty and tend to decide early on, it may well be worthwhile to postpone a decision. Market conditions may improve, some of the risks related to a decision may be resolved and better employment offers may materialize.

The key word here is flexibility. Upholding it may allow for a more judged decision in future. Giving it up most certainly has a value to the other party (house seller, car dealer or employer). But beware: If an option is close to expiration, its value decreases sharply. To give an example: If you have two alternative offers to buy a car, it makes sense to bargain with the sellers. The longer you wait, the more likely it is that the seller needs to make his quota, you learn more about the car and its flaws, new car models are around the corner or the offered car simply loses value (depreciation). However, if the alternative offer is about to expire it may be necessary to exercise the option at once, to avoid being stuck with only one alternative and hence no choice.

So what are the lessons learned?

1. Keep as many options as possible.
2. Don’t commit too early if you have alternative options.
3. Deal with some uncertainty, the rewards may well be worthwhile.
4. If possible decide in stages. This may allow you to keep some extra flexibility.

Do not forget that all options are valuable. But, once a decision is taken all other related options have a zero value. Like the old saying goes: Don’t put all your eggs in one basket.