Real Options 2

Solution

I)

A\B	Invest early	Delay
Invest early	**400 +, 400 -**	**700 +, 100**
Delay	**100, 700 -**	**500, 500**

Each firm's dominant strategy is to invest early. Therefore, in equilibrium, both invest early (prisoner's dilemma).

II)

A\B	Invest early	Delay
Invest early	**400, 400**	**300, 500 -**
Delay	**500 +, 300**	**500 +, 500 -**

Each firm's dominant strategy is to delay. Therefore, in equilibrium, both delay.

Therefore, legal contracts can support an agreement to both delay (the option to delay), thus alleviating the problem of the effects of product market competition on the option to delay.