
Table of Contents

1	Introduction	1
1.1	Motivation and Problem Definition	1
1.2	Research Objective and Modeling Approach	5
1.3	Structure	6
2	Literature Review	9
2.1	New Product Development	9
2.1.1	NPD Process Characteristics	10
2.1.2	Types of Uncertainty and Possible Responses	12
2.1.3	Information Generation and Updating	14
2.2	Decision Models with Information Updating	17
2.2.1	Foundations of Decision Theory and Information Updating	18
2.2.2	Bayesian Analysis	20
2.2.2.1	Foundations and Basic Ideas	20
2.2.2.2	Applications in Supply Chain Management Literature	22
2.2.3	Updating Mechanisms in R&D Models	24
2.3	Real Options Analysis	26
2.3.1	Shortcomings of Traditional Valuation Methods	27
2.3.2	Real Options	29
2.3.3	Valuation of Real Options	32
2.3.4	Models and Applications for R&D Projects	35
2.3.5	Attempts of Combining Bayesian Analysis and Real Options	37
2.4	Summary	38
3	Model Description	41
3.1	Basic Model	41

3.1.1	General Structure and Development Uncertainty	42
3.1.2	Managerial Options and Development Costs	43
3.1.3	Market Uncertainty and Market Payoff	44
3.1.4	Value Function and Dynamic Program	46
3.1.5	Multidimensional State Space	47
3.1.6	Summary	50
3.2	Bayesian Updating	51
3.2.1	Basic Concepts of Bayesian Analysis and Inference	51
3.2.2	Mean Update	54
3.2.2.1	General Properties	54
3.2.2.2	Multidimensional Case	59
3.2.3	Variance Update	61
3.2.3.1	General Properties	61
3.2.3.2	Multidimensional Case	65
3.2.4	Mean and Variance Update	66
3.2.4.1	General Properties	66
3.2.4.2	Illustrative Numerical Example	72
3.2.4.3	Multidimensional Case	74
3.2.5	Summary	76
3.3	Information Updating Valuation Model	77
3.3.1	General Structure	77
3.3.1.1	Posterior Project Value	79
3.3.1.2	Expected Project Value	80
3.3.2	Value of Information	82
3.3.3	Optimal Updating Point in Time	85
3.3.4	Multidimensional State Space	86
3.3.5	Summary	87
4	Model Properties	89
4.1	Basic Properties	90
4.2	Properties for a Specific Signal	95
4.2.1	Posterior Project Value	95
4.2.1.1	Mean Change	96
4.2.1.2	Variance Change	98
4.2.1.3	Mean and Variance Change	101
4.2.2	Value of Information	103
4.3	Properties in Expectation of a Signal	106
4.3.1	Expected Project Value	106
4.3.2	Expected Value of Information	111
4.4	Summary	114

5	Numerical Study	117
5.1	Analysis Framework	118
5.1.1	Base Case	118
5.1.2	Description of Experiments	123
5.2	Numerical Results and Comparative Statics	126
5.2.1	Analysis in Presence of a Specific Signal	127
5.2.1.1	Effects of a Mean or a Variance Update	127
5.2.1.2	Effects of a Simultaneous Mean-Variance Update	129
5.2.2	Analysis in Expectation of a Signal	135
5.2.2.1	Optimal Managerial Policy	135
5.2.2.2	Cost Structure Changes	142
5.2.2.3	Optimal Updating Point in Time	146
5.3	Summary	152
6	Conclusion	155
6.1	Contribution to Current Research	156
6.2	Managerial Implications	158
6.3	Possible Extensions and Future Research	161
	Statistical Distributions	163
A.1	Univariate Distributions	163
A.1.1	Normal - $N(\mu, \sigma^2)$	163
A.1.2	Gamma - $G(\alpha, \beta)$	163
A.1.3	Inverse Gamma - $IG(\alpha, \beta)$	164
A.1.4	t (or Student's t) - $St(\mu, \sigma^2, \alpha)$	164
A.2	Multivariate Distributions	164
A.2.1	Multivariate Normal - $N_k(\mu, \Sigma)$	164
A.2.2	Multivariate t - $St_k(\mu, \Sigma, \alpha)$	165
A.2.3	Wishart - $Wi_k(\Omega, \alpha)$	165
	Supplement to Performance Variability Limitation	167
	Supplement to Mean-Variance Update	171
	Program Listing	177
D.1	Project Value	177
D.2	Posterior Project Value	180
D.3	Expected Project Value	185
	References	195
	Index	207