

Strategic real options in area development projects: Reflections on the Finnish background

Area development projects are large building projects that aim for relatively large areas to be constructed in a concentrated time frame. Finnish municipalities have tended to favor area development projects due to the related, normally positive, indirect cash flow effects for municipalities, e.g., positive tax income effects, and the fact that they speed-up the municipal development. Area development projects, however, also include economic risks to the municipalities that can be caused by, e.g., changes in the population demographics in the developed areas that change cash flows adversely.

This paper describes the presently used, traditional area development policy model of the Finnish municipalities and discusses the

creation of possible new policies through an analysis of strategic level real options available to municipalities. The strategic level real options allow municipalities to change their involvement in these projects in a way that can lead to a lower economic risk level and higher revenues. The traditional involvement of municipalities in area development projects is quite restricted, and an extension of the municipalities' involvement should be analyzed to find the best involvement strategy for each project. Such analysis can be made based on analyzing combinations of strategic level real options that are the building blocks of involvement strategies.

Area development projects can most often be divided into three separate phases according to the conducted activities: planning and zoning, construction, and post-construction. We show a mapping of available strategic level real options for each project stage and show how they can be used to manage the risk level and to maximize profitability for the municipality within each stage.

As most municipalities in Finland are facing tight financial times (AD 2009) they may be very risk averse. This may cause them to be reluctant to favor the start of new area development projects, which again delays municipal development, and may even delay growth in the aggregate level. It is important to show that by changing the involvement strategy reaching a lower risk level can be possible. A lower risk level of area development project involvement may increase municipalities' willingness to accept new area development projects. ■