

**BLACKWELL**

**ENCYCLOPEDIA  
DICTIONARY  
OF FINANCE**

**EDITED BY  
DEAN PAXSON and  
DOUGLAS WOOD**

---

*The Blackwell Encyclopedia of Management editors:*  
Professor Cary L. Cooper and  
Professor Chris Argyris

 **BLACKWELL**  
Publishers

THE BLACKWELL ENCYCLOPEDIA OF MANAGEMENT

EDITED BY CARY L. COOPER AND CHRIS ARGYRIS

*Blackwell Encyclopedic Dictionary of Accounting*

Edited by A. Rashad Abdel-khalik

*Blackwell Encyclopedic Dictionary of Strategic Management*

Edited by Derek F. Channon

*Blackwell Encyclopedic Dictionary of Management Information Systems*

Edited by Gordon B. Davis

*Blackwell Encyclopedic Dictionary of Marketing*

Edited by Barbara R. Lewis and Dale Littler

*Blackwell Encyclopedic Dictionary of Managerial Economics*

Edited by Robert McAuliffe

*Blackwell Encyclopedic Dictionary of Organizational Behavior*

Edited by Nigel Nicholson

*Blackwell Encyclopedic Dictionary of International Management*

Edited by John J. O'Connell

*Blackwell Encyclopedic Dictionary of Finance*

Edited by Dean Paxson and Douglas Wood

*Blackwell Encyclopedic Dictionary of Human Resource Management*

Edited by Lawrence H. Peters, Charles R. Greer, and Stuart A. Youngblood

*Blackwell Encyclopedic Dictionary of Operations Management*

Edited by Nigel Slack

*Blackwell Encyclopedic Dictionary of Business Ethics*

Edited by Patricia H. Werhane, and R. Edward Freeman

# **The Blackwell Encyclopedic Dictionary of Finance**

Edited by Dean Paxson and Douglas Wood

Manchester Business School



Disclaimer:

*Some images in the original version of this book are not available for inclusion in the netLibrary eBook.*

Copyright © Blackwell Publishers Ltd, 1997, 1998

Editorial Organization © Dean Paxson and Douglas Wood, 1997, 1998

First published 1997

First published in paperback 1998

2 4 6 8 10 9 7 5 3 1

Blackwell Publishers Inc.

350 Main Street

Malden, Massachusetts 02148

USA

Blackwell Publishers Ltd

108 Cowley Road

Oxford OX4 1JF

UK

All rights reserved. Except for the quotation of short passages for the purposes of criticism and review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the publisher.

Except in the United States of America, this book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, resold, hired out, or otherwise circulated without the publisher's prior consent in any form of binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

*Library of Congress Cataloging-in-Publication Data*

The Blackwell encyclopedic dictionary of finance / edited by Dean Paxson and Douglas Wood.

p.      cm

Originally published as a volume in The Blackwell encyclopedia of management, 1997

Includes bibliographical references and index.

ISBN 1-55786-912-X (alk. paper)

ISBN 0-631-21188-8 (pbk. : alk. paper)

1. Finance-- Dictionaries. I. Paxson, Dean. II. Wood, Douglas.

HG151.B49 1998  
332'.03—dc21

98-26082  
CIP

*British Library Cataloguing in Publication Data*

A CIP catalogue record for this book is available from the British Library.

Typeset in 9 1/2 on 11pt Ehrhardt by Page Brothers, Norwich  
Printed in Great Britain by T. J. International Ltd, Padstow, Cornwall

This book is printed on acid-free paper

# CONTENTS

Preface .....	9
A .....	18
Agency Theory .....	18
Artificial Neural Networks .....	21
Asset Allocation.....	24
Asset Pricing .....	26
B.....	34
Bankruptcy.....	34
Banks as Barrier Options .....	38
Bid–Ask Spread .....	41
Black–Scholes.....	43
C.....	45
Capital Adequacy.....	45
Capital Structure .....	51
Catastrophe Futures and Options.....	55
Commodity Futures Volatility .....	57
Conditional Performance Evaluation.....	60
Consolidation .....	64
Contagion.....	68
Contingent Claims .....	70
Convenience Yields .....	72
Convertibles.....	78
Corporate Governance .....	81
Corporate Takeover Language.....	85
Cost of Capital .....	88
D .....	91
Debt Swaps .....	91
Deposit Insurance .....	95
Discounted Cash Flow Models.....	100
Disinvestment Decisions.....	103
Dividend Growth Model.....	106
Dividend Policy .....	109
E.....	113
Electronic Banking .....	113
Electronic Payments Systems .....	120
Embedded Inflation.....	124
Ethics in Finance.....	127
Eurocredit Markets .....	133
Event Studies .....	137
Exotic Options .....	141
Expectations.....	146

Experimental Asset Markets .....	149
F .....	152
Fat Tails in Finance.....	152
Financial Distress.....	161
Foreign Exchange Management .....	165
Foreign Exchange Markets .....	168
Futures and Forwards.....	176
Fuzzy Logic .....	178
G .....	180
Game Theory in Finance.....	180
Growth by Acquisition.....	187
H .....	191
Hedging.....	191
I .....	194
Initial Public Offerings (IPOS) .....	194
Insider Trading Law (US).....	198
Insurance.....	200
Insurance Derivatives.....	206
International Initial Public Offerings .....	212
Investment Banking .....	216
Iowa Electronic Market.....	219
L .....	223
Leasing.....	223
Log Exponential Option Models.....	226
M.....	229
Market Efficiency .....	229
Mergers and Acquisitions .....	234
Mutual Funds .....	245
N .....	247
Noise Trader .....	247
Note Issuance Facilities .....	251
P .....	254
Persistence of Performance.....	254
Portfolio Management .....	259
Portfolio Performance Measurement .....	266
Price/Earnings Ratio .....	275
Privatization Options .....	277
Program Trading .....	282
Project Financing .....	284
R.....	287
Real Options .....	287
Regulation of US Equity Markets.....	294
Restructuring and Turnaround .....	297
Retail Banking .....	301

Risk Analysis .....	306
Rollover Risk .....	308
S .....	311
Scrip Dividend .....	311
Securitization .....	313
Share Repurchases .....	317
Short-Termism .....	319
Sovereign Risk .....	325
Speculation .....	328
Stability of Returns .....	331
State-Contingent Bank Regulation .....	334
Stochastic Processes .....	337
Stock Market Indices .....	340
Syndicated Euroloans .....	343
T .....	346
Tactical Asset Allocation .....	346
Term Structure Models .....	348
Time Series Analysis .....	357
Transaction Costs .....	359
Transition Economies .....	361
V .....	366
Valuing Flexibility .....	366
Venture Capital .....	370
Volatility .....	376
Volatility Risk Pricing .....	381
Volatility Smile .....	384
W .....	387
Warrants .....	387



## **Preface**

Although the basic purposes of finance, and the nature of the core instruments used in attaining them, are relatively constant, recent years have seen an explosion in complexity of both products and techniques.

A number of forces are driving this explosion. The first is internationalization encompassing a dramatic growth in the number of countries with stock markets, convertible currencies and a positive regime for foreign investors. For a number of years the more adventurous institutional and private investors have been increasing the proportion of their investments in foreign markets in general and emerging markets in particular in search of growth, higher returns and better diversification. Reflecting this, finance has begun the long process of overhauling the traditionally domestic measurement of risk and return. In the new world order in which the next generation is likely to see an unprecedented transfer of economic power and influence from slow growing developed economies to the high growth tigers in Asia and the Pacific Rim, the ability of financial markets to recognize and accommodate the changes will be a priority.

The second change has come from dramatic falls in the costs of both information and transaction processing. More information is available and it is available more quickly in more places. Improved databases allow sophisticated analysis that would have been impossible a few years ago and data intensive artificial intelligence techniques allow a much richer array of market structures to be considered. The switch to electronic systems of transactions and trading has dramatically lowered costs, allowing increased arbitrage and stimulating the widespread use of complex new derivative products and products offering potentially an infinity of combinations of underlying products. It is no exaggeration to claim that these new techniques and instruments can be used to provide a proxy for any underlying traded instrument.

This power is increasingly used in the marketplace to provide the financial community with new choices, including performance guarantees and indexed products. The development of traded instruments provides an ability to pinpoint exposures precisely and this has led to a new science of risk management, where the net exposures of a portfolio of risky assets such as securities or bank loans can be estimated and, where required, selectively or completely hedged by buying opposite exposures in the marketplace. Not surprisingly, this encyclopedic dictionary reflects these new techniques which are inexorably creating a world in which financial assets are priced in a seamless global marketplace.

New technology has helped in selecting entries for the dictionary. A word count of titles in finance and business journals was used to identify the frequency with which particular terms appeared and this was used as a primary guide to the priority and length of entries. To accommodate new topics such as real options that are only just emerging into the literature, we also included some entries where interest was growing rapidly towards the end of the search period.

In compiling the dictionary we have been privileged in the support we have received from a wide range of distinguished contributors who have taken the time from a busy programme of research and publication to summarize the often voluminous literature in their specialist areas into an accessible form. Inevitably the technical content of some of the entries reflects the rocket science development in the areas covered, but all entries provide an initial definition and bibliographic references for the less expert.

Finally, we would like to thank Joanne Simpson and Catherine Dowie for their support for this project. The demands of monitoring and recording the progress of contributions as they passed from commissioning through each stage of the editing process to final completion provided an essential foundation to the project.

DEAN PAXSON  
DOUGLAS WOOD