Glossary

Note:
1. *Italicized* words are listed elsewhere in the glossary.
2. A number of Web sites contain comprehensive financial glossaries. See, for example, [www.finance-glossary.com](http://www.finance-glossary.com) and [www.duke.edu/~charvey/Classes/wpg/glossary.htm](http://www.duke.edu/~charvey/Classes/wpg/glossary.htm).

A

**Abnormal return**  Part of return that is not due to marketwide price movements.

**Absolute priority**  Rule in bankruptcy proceedings whereby senior creditors are required to be paid in full before junior creditors receive any payment.

**Accelerated depreciation**  Any depreciation method that produces larger deductions for depreciation in the early years of a project's life.

**Accounts payable** *(payables, trade debt)*  Money owed to suppliers.

**Accounts receivable** *(receivables, trade credit)*  Money owed by customers.

**Accrued interest**  Interest that has been earned but not yet paid.

**ACH**  Automated Clearing House.

**Acid-test ratio**  Quick ratio.

**Adjusted present value (APV)**  Net present value of an asset if financed solely by equity plus the present value of any financing side effects.

**ADR**  American depository receipt.

**Adverse selection**  A situation in which a pricing policy causes only the less desirable customers to do business, e.g., a rise in insurance prices that leads only the worst risks to buy insurance.

**Affirmative covenant**  Loan covenant specifying certain actions that the borrower must take.

**Agency costs**  Losses that arise when an agent (e.g., a manager) does not act solely in the interests of the principal (e.g., the shareholder).

**Agency theory**  Theory of the relationship between a principal, e.g., a shareholder, and an agent of the principal, e.g., the company's manager.

**Aging schedule**  Summary of age of receivables that are outstanding from each customer.

**AIBD**  Association of International Bond Dealers.

**All-or-none underwriting**  An arrangement whereby a security issue is canceled if the underwriter is unable to resell the entire issue.

**Alpha**  Measure of portfolio return adjusted for effect of market.

**Alternative minimum tax (AMT)**  A separately calculated minimum amount of tax that must be paid by corporations or individuals.

**American depository receipt (ADR)**  A certificate issued in the United States to represent shares of a foreign company.

**American option**  Option that can be exercised any time before the final exercise date (cf. European option).

**Amex**  American Stock Exchange.

**Amortization**  (1) Repayment of a loan by installments; (2) allowance for depreciation.

**AMT**  Alternative minimum tax.

**Angel investor**  Wealthy individual who provides capital for small start-up businesses.

**Annual percentage rate (APR)**  The interest rate per period (e.g., per month) multiplied by the number of periods in a year.

**Annuity**  Investment that produces a level stream of cash flows for a limited number of periods.

**Annuity due**  Annuity whose payments occur at the start of each period.

**Annuity factor**  Present value of $1 paid for each of \( t \) periods.

**Anticipation**  Arrangement whereby customers who pay before the final date may be entitled to deduct a normal rate of interest.

**Appraisal rights**  A right of shareholders in a merger to demand the payment of a fair price for their shares, as determined independently.

**Appropriation request**  Formal request for funds for a capital investment project.

**APR**  Annual percentage rate.

**APT**  Arbitrage pricing theory.

**APV**  Adjusted present value.

**Arbitrage**  Purchase of one security and simultaneous sale of another to give a risk-free profit.
“Arbitrage” or “risk arbitrage”  Often used loosely to describe the taking of offsetting positions in related securities, e.g., at the time of a takeover bid.

Arbitrage pricing theory (APT)  Model in which expected returns increase linearly with an asset’s sensitivity to a small number of pervasive factors.

Arranger  Lead underwriter to a syndicated loan.

Articles of incorporation  Legal document establishing a corporation and its structure and purpose.

Asian currency units  Dollar deposits held in Singapore or other Asian centers.

Asian option  Option based on the average price of the asset during the life of the option.

Asked price (offered price)  Price at which a dealer is willing to sell (cf. bid price).

Asset-backed securities  Securities issued by a special-purpose company that holds a package of assets whose cash flows are sufficient to service the bonds.

Asset stripper  Acquirer who takes over firms in order to sell off a large part of their assets.

Asymmetric information  Difference in information available to two parties, e.g., a manager and investors.

At-the-money option  Option whose exercise price equals the current asset price (cf. in-the-money option, out-of-the-money option).

Auction market  Securities exchange in which prices are determined by an auction process, e.g., NYSE (cf. dealer market).

Auction-rate preferred  A variant of floating-rate preferred stock where the dividend is reset every 49 days by auction.

Authorized share capital  Maximum number of shares that a company can issue, as specified in the firm’s articles of incorporation.

Automated Clearing House (ACH)  Private electronic system run by banks for high-volume, low-value payments.

Automatic debit  Direct payment.

Availability float  Checks deposited by a company that have not yet been cleared.

Aval  Bank guarantee for debt purchased by forfaiter.

Backwardation  Condition in which spot price of commodity exceeds price of future (cf. contango).

Balloon payment  Large final payment (e.g., when a loan is repaid in installments).

Bank discount  Interest deducted from the initial amount of a loan.

Banker’s acceptance (BA)  Written demand that has been accepted by a bank to pay a given sum at a future date (cf. trade acceptance).

Barrier option  Option whose existence depends on asset price hitting some specified barrier (cf. down-and-out option, down-and-in option).

Basel Accord  International agreement on the amount of capital to be maintained by large banks to support their risky loans.

Basis point (bp) .01%.

Basis risk  Residual risk that results when the two sides of a hedge do not move exactly together.

Bearer security  Security for which primary evidence of ownership is possession of the certificate (cf. registered security).

Bear market  Widespread decline in security prices (cf. bull market).

Behavioral finance  Branch of finance that stresses aspects of investor irrationality.

Benchmark maturity  Maturity of a newly issued Treasury bond.

Benefit–cost ratio  One plus profitability index.

Bermuda option  Option that is exercisable on discrete dates before maturity.

Best-efforts underwriting  An arrangement whereby underwriters do not commit themselves to selling a security issue but promise only to use best efforts.

Beta  Measure of market risk.

Bid price  Price at which a dealer is willing to buy (cf. asked price).

Big Board  Colloquial term for the New York Stock Exchange.

Bill of exchange  General term for a document demanding payment.

Bill of lading  Document establishing ownership of goods in transit.

Binomial method  Method for valuing options that assumes there are only two possible changes in the asset price in any one period.

Blue-chip company  Large and creditworthy company.

Blue-sky laws  State laws covering the issue and trading of securities.

BA  Banker’s acceptance.

Backdating  Discredited practice of using hindsight to select a grant date for at-the-money executive stock options when the stock price (and therefore exercise price) were unusually low.
Call provision: Provision that allows an issuer to buy back the bond issue at a stated price.

Cap: An upper limit on the interest rate on a floating-rate note.

CAPEX: Capital expenditure.

Capital asset pricing model (CAPM): Model in which expected returns increase linearly with an asset’s beta.

Capital budget: List of planned investment projects, usually prepared annually.

Capitalization: Long-term debt plus preferred stock plus net worth.

Capital lease: Financial lease.

Capital market: Financial market (particularly the market for long-term securities).

Capital market line: A plot of the set of portfolios with the highest Sharpe ratio. The line passes through the risk-free interest rate and the tangent efficient portfolio of risky assets.

Capital rationing: Shortage of funds that forces a company to choose between worthwhile projects.

Capital structure: Mix of different securities issued by a firm.

CAPM: Capital asset pricing model.

Captive finance company: Subsidiary whose function is to provide finance for purchases from the parent company.

Caput option: Call option on a put option.

CAR: Cumulative abnormal return.

CARDs (Certificates for Amortizing Revolving Debt): Pass-through securities backed by credit card receivables.

Carried interest: A proportion of the profits to which private equity partnerships, etc. are entitled.

Carry trade: Borrowing in country with low interest rate to re lend in another country with a higher rate.

CARS (Certificates of Automobile Receivables): Pass-through securities backed by automobile receivables.

Carve-out: Public offering of shares in a subsidiary.

Cascade: Rational herding in which each individual deduces that previous decisions by others may have been based on extra information.

Cash and carry: Purchase of a security and simultaneous sale of a future, with the balance being financed with a loan or repo.

Cash budget: Forecast of sources and uses of cash.

Cash cow: Mature company producing a large free cash flow.
Cash cycle The time from a firm’s payment for raw materials until the payment for the finished product from the customer.

Cash-deficiency arrangement Arrangement whereby a project’s shareholders agree to provide the operating company with sufficient net working capital.

Catastrophe bond (CAT bond) Bond whose payoffs are linked to a measure of catastrophe losses such as insurance claims.

CAT bond Catastrophe bond.

CBD Cash before delivery.

CD Certificate of deposit.

CDS Credit default swap.

CEO Chief executive officer.

Certainty equivalent A certain cash flow that has the same present value as a specified risky cash flow.

Certificate of deposit (CD) A certificate providing evidence of a bank time deposit.

CFTC Commodity Futures Trading Commission.

CFO Chief financial officer.

Chaebol A Korean conglomerate.

Chapter 7 Bankruptcy procedure whereby a debtor’s assets are sold and the proceeds are used to repay creditors.

Chapter 11 Bankruptcy procedure designed to reorganize and rehabilitate defaulting firm.

Check conversion When customer writes a check, information is automatically captured and his bank account immediately debited.

Check 21 Check Clearing for the 21st Century Act allows banks to process checks electronically.

CHIPS Clearinghouse Interbank Payments System.

Chooser option Holder decides whether it is a call option or put option.

Clean price (flat price) Bond price excluding accrued interest (cf. dirty price).

Clearinghouse Interbank Payments System (CHIPS) An international wire transfer system operated by a group of major banks for high-value dollar payments.

CLO Collateralized loan obligation. Also CDO (collateralized debt obligation) and CMO (collateralized mortgage obligation).

Closed-end fund Company whose assets consist of investments in a number of industrial and commercial companies.

Closed-end mortgage Mortgage against which no additional debt may be issued (cf. open-end mortgage).

CMOs Collateralized mortgage obligations.

COD Cash on delivery.

Collar An upper and lower limit on the interest rate on a floating-rate note.

Collateral Assets that are given as security for a loan.

Collateralized loan obligation (CLO) A security backed by a pool of loans and issued in tranches with different levels of seniority.

Collateralized mortgage obligations (CMOs) A variation on the mortgage pass-through security in which the cash flows from a pool of mortgages are repackaged into several tranches of bonds with different maturities.

Collateral trust bonds Bonds secured by common stocks or other securities that are owned by the borrower.

Collection float Customer-written checks that have not been received, deposited, and added to the company’s available balance (cf. payment float).

Commercial draft (bill of exchange) Demand for payment.

Commercial paper Unsecured notes issued by companies and maturing within nine months.

Commitment fee Fee charged by bank on an unused line of credit.

Common-size financial statements Balance sheet where entries are expressed as proportion of total assets and income statement where entries are expressed as a proportion of revenues.

Common stock Security representing ownership of a corporation.

Company cost of capital The expected return on a portfolio of all the firm’s securities.

Compensating balance Non-interest-bearing demand deposits to compensate banks for bank loans or services.

Competitive bidding Means by which public utility holding companies are required to choose their underwriter (cf. negotiated underwriting).

Completion bonding Insurance that a construction contract will be successfully completed.

Composition Voluntary agreement to reduce payments on a firm’s debt.

Compound interest Reinvestment of each interest payment on money invested to earn more interest (cf. simple interest).

Compound option Option on an option.

Concentration banking System whereby customers make payments to a regional collection center. The collection center pays the funds into a regional bank account and surplus money is transferred to the company’s principal bank.
Conditional sale  Sale in which ownership does not pass to the buyer until payment is completed.

Conglomerate merger  Merger between two companies in unrelated businesses (cf. horizontal merger, vertical merger).

Consol  Name of a perpetual bond issued by the British government. Sometimes used as a general term for perpetuity.

Contango  Condition in which spot price of a commodity is below that of the future (cf. backwardation).

Contingent claim  Claim whose value depends on the value of another asset.

Contingent project  Project that cannot be undertaken unless another project is also undertaken.

Continuous compounding  Interest compounded continuously rather than at fixed intervals.

Controller  Officer responsible for budgeting, accounting, and auditing in a firm (cf. treasurer).

Convenience yield  The extra advantage that firms derive from holding the commodity rather than the future.

Conversion price  Par value of a convertible bond divided by the number of shares into which it may be exchanged.

Conversion ratio  Number of shares for which a convertible bond may be exchanged.

Convertible bond  Bond that may be converted into another security at the holder’s option. Similarly convertible preferred stock.

Convexity  In a plot of a bond’s price against the interest rate, convexity measures the curvature of the line.

Corporate venturing  Practice by which a large manufacturer provides financial support to new companies.

Corporation  A business that is legally separate from its owners.

Correlation coefficient  Measure of the closeness of the relationship between two variables.

Cost company arrangement  Arrangement whereby the shareholders of a project receive output free of charge but agree to pay all operating and financing charges of the project.

Cost of (equity) capital  Opportunity cost of capital.

Counterparty  Party on the other side of a derivative contract.

Coupon  (1) Specifically, an attachment to the certificate of a bearer security that must be surrendered to collect interest payment; (2) more generally, interest payment on debt.

Covariance  Measure of the co-movement between two variables.

Covenant  Clause in a loan agreement.

Covered option  Option position with an offsetting position in the underlying asset.

Cramdown  Action by a bankruptcy court to enforce a plan of reorganization.

Credit default swap (CDS)  Credit derivative in which one party makes fixed payments while the payments by the other party depend on the occurrence of a loan default.

Credit derivative  Contract for hedging against loan default or changes in credit risk (e.g., credit default swap).

Credit rating  Debt rating assigned by a rating agency such as Moody’s or Standard & Poor’s.

Credit scoring  A procedure for assigning scores to borrowers on the basis of the risk of default.

Cross-default clause  Clause in a loan agreement stating that the company is in default if it fails to meet its obligation on any other debt issue.

Cum dividend  With dividend.

Cum rights  With rights.

Cumulative preferred stock  Stock that takes priority over common stock in regard to dividend payments. Dividends may not be paid on the common stock until all past dividends on the preferred stock have been paid.

Cumulative voting  Voting system under which a stockholder may cast all of his or her votes for one candidate for the board of directors (cf. majority voting).

Current asset  Asset that will normally be turned into cash within a year.

Current liability  Liability that will normally be repaid within a year.

Current ratio  Current assets divided by current liabilities—a measure of liquidity.

Current yield  Bond coupon divided by price.

Data mining (data snooping)  Excessive search to find interesting (but probably coincidental) behavior in a body of data.

DCF  Discounted cash flow.

DDM  Dividend discount model.

Dealer market  Securities exchange in which dealers post offers to buy or sell, e.g., Nasdaq (cf. auction market).

Dealer paper  Commercial paper sold through a dealer rather than directly by the company.

Death spiral convertible  Convertible bond exchangeable for shares with a specified market value.
**Discount** or

If a discount bond pays no interest, it is called a "pure" bond.

**Member of**

Other asset (e.g., a derivative)

Deducted from taxable income.

**Depreciation**

(1) Reduction in the book or market value of an asset; (2) portion of an investment that can be deducted from taxable income.

**Designated market maker**

Member of NYSE responsible for market in specified securities (formerly called "specialist").

**Diff**

Differential swap.

**Differential swap (diff, quanto swap)**

Swap between two LIBOR rates of interest, e.g., yen LIBOR for dollar LIBOR. Payments are in one currency.

**Digital option**

Option paying fixed sum if asset price is the right side of exercise price, otherwise zero.

**Dilution**

Diminution in the proportion of income to which each share is entitled.

**DIP financing**

Debtor-in-possession financing.

**Direct deposit**

The firm authorizes its bank to deposit money in the accounts of its employees or shareholders.

**Direct lease**

Lease in which the lessor purchases new equipment from the manufacturer and leases it to the lessee (cf. sale and lease-back).

**Direct payment (automatic debit, direct debit)**

The firm’s customers authorize it to debit their bank accounts for the amounts due (cf. direct deposit).

**Direct quote**

For foreign exchange, the number of U.S. dollars needed to buy one unit of a foreign currency (cf. indirect quote).

**Dirty price**

Bond price including accrued interest, i.e., the price paid by the bond buyer (cf. clean price).

**Discount bond**

Debt sold for less than its principal value. If a discount bond pays no interest, it is called a "pure" discount, or zero-coupon, bond.

**Discounted cash flow (DCF)**

Future cash flows multiplied by discount factors to obtain present value.

**Discount factor**

Present value of $1 received at a stated future date.

**Discount rate**

Rate used to calculate the present value of future cash flows.

**Discounted payback rule**

Requirement that discounted values of cash flows should be sufficient to pay back initial investment within a specified time.

**Discriminatory price auction**

Auction in which successful bidders pay the price that they bid (cf. uniform price auction).

**Disintermediation**

Withdrawal of funds from a financial institution in order to invest them directly (cf. intermediation).

**Dividend**

Payment by a company to its stockholders.

**Dividend discount model**

Model showing that the value of a share is equal to the discounted value of future dividends.

**Dividend reinvestment plan (DRIP)**

Plan that allows shareholders to reinvest dividends automatically.

**Dividend yield**

Annual dividend divided by share price.

**DOL**

Degree of operating leverage.

**Double-declining-balance depreciation**

Method of accelerated depreciation.

**Double-tax agreement**

Agreement between two countries that taxes paid abroad can be offset against domestic taxes levied on foreign dividends.

**Down-and-in option**

Barrier option that comes into existence if asset price hits a barrier.

**Down-and-out option**

Barrier option that expires if asset price hits a barrier.

**DRIP**

Dividend reinvestment plan.

**Drop lock**

An arrangement whereby the interest rate on a floating-rate note or preferred stock becomes fixed if it falls to a specified level.

**DTC**

Depository transfer check.

**Dual-class equity**

Shares with different voting rights.

**Dual-currency bond**

Bond with interest paid in one currency and principal paid in another.

**DuPont formula**

Formula expressing relationship between return on assets, sales-to-assets, profit margin, and measures of leverage.

**Duration**

The average number of years to an asset’s discounted cash flows.

**Dutch auction**

In a Dutch auction investors submit the prices at which they are prepared to buy (or sell) the security. The purchase price is the lowest price that allows the firm to sell (or buy) the specified amount of the security.
**G-6**

**Glossary**

**E**

EBIT  Earnings before interest and taxes.

EBITDA  Earnings before interest, taxes, depreciation, and amortization.

EBPP  Electronic bill presentment and payment.

Economic depreciation  Decline in present value of an asset.

Economic exposure  Risk that arises from changes in real exchange rates (cf. transaction exposure, translation exposure).

Economic income  Cash flow plus change in present value.

Economic rents  Profits in excess of the competitive level.

Economic value added (EVA)  A measure of residual income implemented by the consulting firm Stern Stewart.

Efficient market  Market in which security prices reflect information instantaneously.

Efficient portfolio  Portfolio that offers the lowest risk (standard deviation) for its expected return and the highest expected return for its level of risk.

EFT  Electronic funds transfer.

Electronic bill presentment and payment (EBPP)  Allows companies to bill customers and receive payments via the Internet.

Electronic funds transfer (EFT)  Transfer of money electronically (e.g., by Fedwire).

Employee stock ownership plan (ESOP)  A company contributes to a trust fund that buys stock on behalf of employees.

Enrenching investment  An investment that makes particular use of the skills of existing management.

EPS  Earnings per share.

Equipment trust certificate  Form of secured debt generally used to finance railroad equipment. The trustee retains ownership of the equipment until the debt is repaid.

Equity  (1)  Common stock and preferred stock. Often used to refer to common stock only. (2)  Net worth.

Equity-linked bond  Bond whose payments are linked to a stock market index.

Equivalent annual cash flow (or cost)  Annuity with the same present value as the company’s proposed investment.

ESOP  Employee stock ownership plan.

ETF  Exchange-traded fund.

Euribor  Euro interbank offered rate.

Euro interbank offered rate (Euribor)  The interest rate at which major international banks in Europe lend euros to each other.

Eurobond  Bond that is marketed internationally.

Eurocurrency  Deposit held outside the currency’s issuing country (e.g., euroyen, or eurodollar deposit).

Eurodollar deposit  Dollar deposit with a bank outside the United States.

European option  Option that can be exercised only on final exercise date (cf. American option).

EVA  Economic value added.

Event risk  The risk that an unanticipated event (e.g., a takeover) will lead to a debt default.

Evergreen credit  Revolving credit without maturity.

Exchange of assets  Acquisition of another company by purchase of its assets in exchange for cash or shares.

Exchange of stock  Acquisition of another company by purchase of its stock in exchange for cash or shares.

Exchange-traded fund (ETF)  A stock designed to track a stock market index.

Ex dividend  Purchase of shares in which the buyer is not entitled to the forthcoming dividend (cf. with dividend, cum dividend).

Exercise price (strike price)  Price at which a call option or put option may be exercised.

Expectations theory  Theory that forward interest rate (forward exchange rate) equals expected spot rate.

Expected return  Average of possible returns weighted by their probabilities.

Ex rights  Purchase of shares that do not entitle the owner to buy shares in the company’s rights issue (cf. with rights, cum rights, rights on).

Extendable bond  Bond whose maturity can be extended at the option of the lender (or issuer).

External finance  Finance that is not generated by the firm: new borrowing or an issue of stock (cf. internal finance).

Extra dividend  Dividend that may or may not be repeated (cf. regular dividend).

**F**

Face value  Par value.

Factoring  Arrangement whereby a financial institution buys a company’s accounts receivable and collects the debt.

Fair price provision  Appraisal rights.

Fallen angel  Junk bond that was formerly investment grade.

FASB  Financial Accounting Standards Board.

FCIA  Foreign Credit Insurance Association.
Forward interest rate  Interest rate fixed today on a loan to be made at some future date (cf. spot interest rate).
Forward rate agreement (FRA) Agreement to borrow or lend at a specified future date at an interest rate that is fixed today.
FRA  Forward rate agreement.
Free cash flow  Cash not required for operations or for reinvestment.
Free-rider problem  The temptation not to incur the costs of participating in a decision when one's influence on that decision is small.
FRN  Floating-rate note.
Full-payout lease  Financial lease.
Full-service lease (rental lease)  Lease in which the lessor promises to maintain and insure the equipment (cf. net lease).
Fundamental analysis  Security analysis that seeks to detect misvalued securities by an analysis of the firm's business prospects (cf. technical analysis).
Funded debt  Debt maturing after more than one year (cf. unfunded debt).
Futures contract  A contract to buy a commodity or security on a future date at a price that is fixed today. Unlike forward contracts, futures are traded on organized exchanges and are marked to market daily.

G
GAAP  Generally accepted accounting principles.
Gamma  A measure of how the option delta changes as the asset price changes.
Gearing  Financial leverage.
General cash offer  Issue of securities offered to all investors (cf. rights issue).
Gilt  A British government bond.
Golden parachute  A large termination payment due to a company's officers if they lose their jobs as a result of a merger.
Goodwill  The difference between the amount paid for a firm in a merger and its book value.
Governance  The oversight of a firm's management.
Gray market  Purchases and sales of securities that occur before the issue price is set.
Greenmail  Situation in which a large block of stock is held by an unfriendly company, forcing the target company to repurchase the stock at a substantial premium to prevent a takeover.
**Greenshoe option**  Option that allows the underwriter for a new issue to buy and resell additional shares.

**Growth stock**  Common stock of a company that has an opportunity to invest money to earn more than the opportunity cost of capital (cf. income stock).

**Haircut**  An additional margin of collateral for a loan.

**Hedge fund**  An investment fund charging a performance fee and open to a limited range of investors. Funds often follow complex strategies including short sales.

**Hedge ratio (delta, option delta)**  The number of shares to buy for each option sold to create a safe position; more generally, the number of units of an asset that should be bought to hedge one unit of a liability.

**Hedging**  Buying one security and selling another to reduce risk. A perfect hedge produces a riskless portfolio.

**Hell-or-high-water clause**  Clause in a lease agreement that obligates the lessee to make payments regardless of what happens to the lessor or the equipment.

**Highly leveraged transaction (HLT)**  Bank loan to a highly leveraged firm (formerly needed to be separately reported to the Federal Reserve Board).

**High-yield bond**  Junk bond.

**HLT**  Highly leveraged transaction.

**Holding company**  Company whose sole function is to hold stock in the firm’s subsidiaries.

**Horizontal merger**  Merger between two companies that manufacture similar products (cf. vertical merger, conglomerate merger).

**Horizontal spread**  The simultaneous purchase and sale of two options that differ only in their exercise date (cf. vertical spread).

**Hurdle rate**  Minimum acceptable rate of return on a project.

**IBF**  International banking facility.

**IMM**  International Monetary Market.

**Immunization**  The construction of an asset and a liability that have offsetting changes in value.

**Implied volatility**  The volatility implied by option prices.

**Imputation tax system**  Arrangement by which investors who receive a dividend also receive a tax credit for corporate taxes that the firm has paid.

**Income bond**  Bond on which interest is payable only if earned.

**Income stock**  Common stock with high dividend yield and few profitable investment opportunities (cf. growth stock).

**Indenture**  Formal agreement, e.g., establishing the terms of a bond issue.

**Indexed bond**  Bond whose payments are linked to an index, e.g., a consumer price index (see TIPS).

**Index fund**  Investment fund designed to match the returns on a stock market index.

**Indirect quote**  For foreign exchange, the number of units of a foreign currency needed to buy one U.S. dollar (cf. direct quote).

**Industrial revenue bond (IRB)**  Bond issued by local government agencies on behalf of corporations.

**Initial public offering (IPO)**  A company’s first public issue of common stock.

**Inside director**  Director who is also employed by the company.

**In-substance defeasance**  Defeasance whereby debt is removed from the balance sheet but not canceled (cf. novation).

**Intangible asset**  Nonmaterial asset, such as technical expertise, a trademark, or a patent (cf. tangible asset).

**Integer programming**  Variant of linear programming whereby the solution values must be integers.

**Interest cover**  Times interest earned.

**Interest rate parity**  Theory that the differential between the forward exchange rate and the spot exchange rate is equal to the differential between the foreign and domestic interest rates.

**Intermediation**  Investment through a financial institution (cf. disintermediation).

**Internal finance**  Finance generated within a firm by retained earnings and depreciation (cf. external finance).

**Internal growth rate**  The maximum rate of firm growth without external finance (cf. sustainable growth rate).

**Internal rate of return (IRR)**  Discount rate at which investment has zero net present value.

**International banking facility (IBF)**  A branch that an American bank establishes in the United States to do eurocurrency business.

**International Monetary Market (IMM)**  The financial futures market within the Chicago Mercantile Exchange.

**Interval measure**  The number of days that a firm can finance operations without additional cash income.

**In-the-money option**  An option that would be worth exercising if it expired immediately (cf. out-of-the-money option).

**Investment-grade bond**  Bond rated at least Baa by Moody’s or BBB by Standard and Poor’s or Fitch.
IOSCO International Organization of Securities Commissions.

IPO Initial public offering.

IRB Industrial revenue bond.

IRR Internal rate of return.

IRS Internal Revenue Service.

ISDA International Swap and Derivatives Association.


Issued share capital Total amount of shares that are in issue (cf. outstanding share capital).

J

Junior debt Subordinated debt.

Junk bond (high-yield bond) Debt that is rated below an investment-grade bond.

Just-in-time System of inventory management that requires minimum inventories of materials and very frequent deliveries by suppliers.

K

Keiretsu A network of Japanese companies organized around a major bank.

L

LBO Leveraged buyout.

Leveraged lease Lease in which the lessor finances part of the cost of the asset by an issue of debt secured by the asset and the lease payments.

Leveraged buyout (LBO) Acquisition in which (1) a large part of the purchase price is debt-financed and (2) the remaining equity is privately held by a small group of investors.

Legal capital Value at which a company’s shares are recorded in its books.

Legal defeasance Novation.

Lessee User of a leased asset (cf. lessor).

Lessor Owner of a leased asset (cf. lessee).

Letter of credit Letter from a bank stating that it has established a credit in the company’s favor.

Letter stock Privately placed common stock, so called because the SEC requires a letter from the purchaser that the stock is not intended for resale.

Leverage See financial leverage, operating leverage.

Leverage, total liabilities Total value of financial claims on a firm’s assets. Equals (1) total assets or (2) total assets minus net worth.

LILO London interbank offered rate.

Lessor Owner of a leased asset (cf. lessee).

Limit order Order to buy (sell) securities within a maximum (minimum) price (cf. market order).

Linear programming (LP) Technique for finding the maximum value of some objective function subject to stated linear constraints.

Line of credit Agreement by a bank that a company may borrow at any time up to an established limit.

Liquid asset Asset that is easily and cheaply turned into cash—notably cash itself and short-term securities.

Liquidating dividend Dividend that represents a return of capital.

Liquidation liability Limitation of a shareholder’s losses to the amount invested.

Limited liability Partnership in which some partners have limited liability and general partners have unlimited liability.

Linear hedge Purchase of a hedging instrument (e.g., a future) to hedge a short position in the underlying asset (cf. short hedge).

Liability bonds Bonds that pay a higher rate of interest if a high proportion of the population survives to a particular age.

Liquid yield option note (LYON) Zero-coupon, callable, puttable, convertible bond.

Loan origination fee Up-front fee charged by the lending bank.

Lockbox system Form of concentration banking. Customers send payments to a post office box. A local bank collects and processes the checks and transfers surplus funds to the company’s principal bank.

London interbank offered rate (LIBOR) The interest rate at which major international banks in London lend to each other. (LIBID is London interbank bid rate; LIMEAN is mean of bid and offered rate.)

Longevity bonds Bonds that pay a higher rate of interest if a high proportion of the population survives to a particular age.
Lookback option  Option whose payoff depends on the highest asset price recorded over the life of the option.

LP  Linear programming.

LYON  Liquid yield option note.

MACRS  Modified accelerated cost recovery system.

Maintenance margin  Minimum margin that must be maintained on a futures contract.

Majority voting  Voting system under which each director is voted upon separately (cf. cumulative voting).

Management buyout (MBO)  Leveraged buyout whereby the acquiring group is led by the firm’s management.

Mandatory convertible  Bond automatically convertible into equity, usually with a limit on the value of stock received.

Margin  Cash or securities set aside by an investor as evidence that he or she can honor a commitment.

Marked to market  An arrangement whereby the profits or losses on a futures contract are settled up each day.

Market capitalization  Market value of outstanding share capital.

Market capitalization rate  Expected return on a security.

Market model  Model suggesting a linear relationship between actual returns on a stock and on the market portfolio.

Market order  Order to buy or sell securities at the prevailing market price (cf. limit order).

Market risk (systematic risk)  Risk that cannot be diversified away.


Market value added  Difference between market value and book value of firm’s equity.

Maturity factoring  Factoring arrangement that provides collection and insurance of accounts receivable.

MBO  Management buyout.

MDA  Multiple-discriminant analysis.

Medium-term note (MTN)  Debt with a typical maturity of 1 to 10 years offered regularly by a company using the same procedure as commercial paper.

Merger  (1) Acquisition in which all assets and liabilities are absorbed by the buyer (cf. exchange of assets, exchange of stock); (2) more generally, any combination of two companies.

MIP (Monthly income preferred security)  Preferred stock issued by a subsidiary located in a tax haven. The subsidiary relends the money to the parent.

Mismatch bond  Floating-rate note whose interest rate is reset at more frequent intervals than the rollover period (e.g., a note whose payments are set quarterly on the basis of the one-year interest rate).

Modified accelerated cost recovery system (MACRS)  Schedule of depreciation deductions allowed for tax purposes.

Modified IRR  Internal rate of return calculated by first discounting later cash flows back to earlier periods so that there remains only one change in the sign of the cash flows.

Momentum  Characteristic of stocks showing persistent recent high returns.

Money center bank  A major U.S. bank that undertakes a wide range of banking activities.

Money market  Market for short-term safe investments.

Money-market deposit account (MMDA)  A bank account paying money-market interest rate.

Money-market fund  Mutual fund that invests solely in short-term safe securities.

Monoline  Insurance company that insures debtholders against the risk of default.

Monte Carlo simulation  Method for calculating the probability distribution of possible outcomes, e.g., from a project.

Moral hazard  The risk that the existence of a contract will change the behavior of one or both parties to the contract; e.g., an insured firm may take fewer fire precautions.

Mortality bonds  Bonds that pay a higher rate of interest if there is a sharp rise in the death rate.

Mortgage bond  Bond secured against plant and equipment.

MTN  Medium-term note.

Multiple-discriminant analysis (MDA)  Statistical technique for distinguishing between two groups on the basis of their observed characteristics.

Mutual fund  Managed investment fund whose shares are sold to investors.

Mutually exclusive projects  Two projects that cannot both be undertaken.

Naked option  Option held on its own, i.e., not used for hedging a holding in the asset or other options.

Operating cycle  The time from a firm’s initial purchase of raw materials until the payment from the customer for the finished product.

Operating lease  Short-term, cancelable lease (cf. financial lease).

Operating leverage  Fixed operating costs, so called because they accentuate variations in profits (cf. financial leverage).

Opportunity cost of capital (hurdle rate, cost of capital)  Expected return that is foregone by investing in a project rather than in comparable financial securities.

Option  See call option, put option.

Option delta  Hedge ratio.

Original issue discount debt (OID debt)  Debt that is initially offered at a price below face value.

OTC  Over-the-counter.

Out-of-the-money option  An option that would not be worth exercising if it matured immediately (cf. in-the-money option).

Outstanding share capital  Issued share capital less the par value of shares that are held in the company’s treasury.

Oversubscription privilege  In a rights issue, arrangement by which shareholders are given the right to apply for any shares that are not taken up.

Over-the-counter (OTC)  Informal market that does not involve a securities exchange.

Partnership  Joint ownership of business whereby general partners have unlimited liability.

Par value (face value)  Value of a security shown on the certificate.

Pass-through securities  Notes or bonds backed by a package of assets (e.g., mortgage pass-throughs, CARs, CARDs).

Path-dependent option  Option whose value depends on the sequence of prices of the underlying asset rather than just the final price of the asset.

Payables  Accounts payable.

Payback rule  Requirement that project should recover its initial investment within a specified time.

Pay-in-kind bond (PIK)  Bond that allows the issuer to choose to make interest payments in the form of additional bonds.

Payment float  Company-written checks that have not yet cleared (cf. availability float).
Poison pill  Includes a variety of takeover defenses, notably the right of existing shareholders to acquire stock at a discount if a bidder acquires a minimum number of shares.

Poison put  A covenant allowing the bondholder to demand repayment in the event of a hostile merger.

Pooling of interest  Method of accounting for mergers (no longer available in the USA). The consolidated balance sheet of the merged firm is obtained by combining the balance sheets of the separate firms (cf. purchase accounting).

Perpetuity  Investment offering a level stream of cash flows in perpetuity (cf. consol).

PIK  Pay-in-kind bond.

PN  Project note.

Payout ratio  Dividend as a proportion of earnings per share.

PBGC  Pension Benefit Guarantee Corporation.

P/E ratio  Share price divided by earnings per share.

PERC (Preferred equity redemption cumulative stock)  Preferred stock that converts automatically into equity at a stated date. A limit is placed on the value of the shares that the investor receives.

Privileged subscription issue  Rights issue.

Profitability index  Ratio of a project’s NPV to the initial investment.

Pro forma  Projected.

Project finance  Debt that is largely a claim against the cash flows from a particular project rather than against the firm as a whole.

Project note (PN)  Note issued by public housing or urban renewal agencies.

Promissory note  Promise to pay.

Prospect theory  A theory of asset pricing suggested by the observation of behavioral psychologists that investors have a particular aversion to losses even if very small.

Prospectus  Summary of the registration statement providing information on an issue of securities.

Protective put  Put option that is combined with holding in the underlying asset.

Proxy vote  Vote cast by one person on behalf of another.

Public warehouse (terminal warehouse)  Warehouse operated by an independent warehouse company on its own premises (cf. field warehouse).

Purchase accounting  Method of accounting for mergers. The assets of the acquired firm are shown at market value on the balance sheet of the acquirer (cf. pooling of interest).

Purchase fund  Resembles a sinking fund except that money is used only to purchase bonds if they are selling below their par value.

Put–call parity  The relationship between the prices of European put and call options.

Put option  Option to sell an asset at a specified exercise price on or before a specified exercise date (cf. call option).

PVGO  Present value of growth opportunities.
Pyramid Created by forming a holding company whose only asset is a controlling interest in a second holding company, which in turn has a controlling interest in an operating company.

Q

q Ratio of the market value of an asset to its replacement cost.

QIBs Qualified institutional buyers.

Quadratic programming Variant of linear programming whereby the equations are quadratic rather than linear.

Qualified Institutional buyers (QIBs) Institutions that are allowed to trade unregistered stock among themselves.

Quanto swap Differential swap.

Quick ratio (acid-test ratio) Measure of liquidity: (cash + marketable securities + receivables) divided by current liabilities.

R

Range forward A forward exchange rate contract that places upper and lower bounds on the cost of foreign exchange.

Ratchet bonds Floating-rate bonds whose coupon can only be reset downward.

Rate-sensitive bonds Bonds whose coupon rate changes as issuer’s credit-rating changes.

Real assets Tangible assets and intangible assets used to carry on business (cf. financial assets).

Real estate investment trust (REIT) Trust company formed to invest in real estate.

Real interest rate Interest rate expressed in terms of real goods, i.e., nominal interest rate adjusted for inflation.

Real option The flexibility to modify, postpone, expand, or abandon a project.

Receivables Accounts receivable.

Receiver A bankruptcy practitioner appointed by secured creditors in the United Kingdom to oversee the repayment of debts.

Record date Date set by directors when making dividend payment. Dividends are sent to stockholders who are registered on the record date.

Recourse Term describing a type of loan. If a loan is with recourse, the lender has a general claim against the parent company if the collateral is insufficient to repay the debt.

Red herring Preliminary prospectus.

Refunding Replacement of existing debt with a new issue of debt.

Registered security Security whose ownership is recorded by the company’s registrar (cf. bearer security).

Registrar Financial institution appointed to record issue and ownership of company securities.

Registration Process of obtaining SEC approval for a public issue of securities.

Regression analysis In statistics, a technique for finding the line of best fit.

Regular dividend Dividend that the company expects to maintain in the future.

Regulation A issue Small security issues that are partially exempt from SEC registration requirements.

REIT Real estate investment trust.

Rental lease Full-service lease.

Replicating portfolio Package of assets whose returns exactly replicate those of an option.

Repo Repurchase agreement.

Repurchase agreement (RP, repo, buy-back) Purchase of Treasury securities from a securities dealer with an agreement that the dealer will repurchase them at a specified price.

Residual income After-tax profit less the opportunity cost of capital employed by the business (see also Economic Value Added).

Residual risk Specific risk.

Retained earnings Earnings not paid out as dividends.

Return on equity Usually, equity earnings as a proportion of the book value of equity.

Return on investment (ROI) Generally, book income as a proportion of net book value.

Revenue bond Municipal bond that is serviced out of the revenues from a particular project.

Reverse convertible Bond that gives the issuer the right to convert it into common stock.

Reverse FRN (yield curve note) Floating-rate note whose payments rise as the general level of interest rates falls and vice versa.

Reverse split Action by the company to reduce the number of outstanding shares by replacing two or more of its shares with a single, more valuable share.

Revolving credit Legally assured line of credit with a bank.

Rights issue (privileged subscription issue) Issue of securities offered to current stockholders (cf. general cash offer).

Rights on With rights.

Risk premium Expected additional return for making a risky investment rather than a safe one.
**Road show** Series of meetings between a company and potential investors before the company decides on the terms of a new issue.

**ROI** Return on investment.

**Roll-over CD** A package of successive certificates of deposit.

**Round lot** A trade of 100 shares (cf. *odd lot*).

**RP** Repurchase agreement.

**R squared ($R^2$)** Square of the correlation coefficient—the proportion of the variability in one series that can be explained by the variability of one or more other series.

**Rule 144a** SEC rule allowing qualified institutional buyers to buy and trade unregistered securities.

**S**

**Sale and lease-back** Sale of an existing asset to a financial institution that then leases it back to the user (cf. *direct lease*).

**Salvage value** Scrap or resale value of plant and equipment.

**Samurai bond** A yen bond issued in Tokyo by a non-Japanese borrower (cf. *bulldog bond*, *Yankee bond*).

**SBIC** Small Business Investment Company.

**Scenario analysis** Analysis of the profitability of a project under alternative economic scenarios.

**Season datings** Extended credit for customers who order goods out of the peak season.

**Seasoned issue** Issue of a security for which there is an existing market (cf. *unseasoned issue*).

**SEC** Securities and Exchange Commission.

**Secondary issue** (1) Procedure for selling blocks of seasoned issues of stock; (2) more generally, sale of already issued stock.

**Secondary market** Market in which one can buy or sell seasoned issues of securities.

**Secured debt** Debt that, in the event of default, has first claim on specified assets.

**Securitization** Substitution of tradable securities for privately negotiated instruments.

**Security market line** Line representing the relationship between expected return and market risk.

**Self-liquidating loan** Loan to finance current assets. The sale of the current assets provides the cash to repay the loan.

**Self-selection** Consequence of a contract that induces only one group (e.g., low-risk individuals) to participate.

**Semistrong-form efficient market** Market in which security prices reflect all publicly available information (cf. *weak-form efficient market* and *strong-form efficient market*).

**Senior debt** Debt that, in the event of bankruptcy, must be repaid before subordinated debt receives any payment.

**Sensitivity analysis** Analysis of the effect on project profitability of possible changes in sales, costs, and so on.

**Serial bonds** Package of bonds that mature in successive years.

**Series bond** Bond that may be issued in several series under the same indenture.

**Shark repellant** Amendment to company charter intended to protect against takeover.

**Sharpe ratio** Ratio of portfolio’s *risk premium* to its risk (standard deviation).

**Shelf registration** A procedure that allows firms to file one registration statement covering several issues of the same security.

**Shogun bond** Dollar bond issued in Japan by a nonresident.

**Short hedge** Sale of a *hedging* instrument (e.g., a *future*) to hedge a long position in the underlying asset (cf. *long hedge*).

**Short sale** Sale of a security the investor does not own.

**Sight draft** Demand for immediate payment (cf. *time draft*).

**Signal** Action that demonstrates an individual’s unobservable characteristics (because it would be unduly costly for someone without those characteristics to take the action).

**Simple interest** Interest calculated only on the initial investment (cf. *compound interest*).

**Simulation** Monte Carlo simulation.

**Sinker** Sinking fund.

**Sinking fund (sinker)** Fund established by a company to retire debt before maturity.

**SIV (structured investment vehicle)** A fund that typically invested in mortgage-backed securities, which it financed by issuing senior and junior tranches of asset-backed commercial paper and longer-term notes.

**Skewed distribution** Probability distribution in which an unequal number of observations lie below and above the mean.

**SPE** Special-purpose entity.

**Special dividend (extra dividend)** Dividend that is unlikely to be repeated.

**Specialist** Designated market maker.

**Special-purpose entity** Partnerships established by companies to hold certain assets and obtain funding. May be used to obtain off-balance-sheet debt for the parent.

**Specific risk (residual risk, unique risk, unsystematic risk)** Risk that can be eliminated by diversification.
Spinning  The underwriter of an IPO unethically allots a portion of offering to senior management of a client company.

Spin-off  Distribution of shares in a subsidiary to the company’s shareholders so that they hold shares separately in the two firms.

Spot exchange rate  Exchange rate on currency for immediate delivery (cf. forward exchange rate).

Spot price  Price of asset for immediate delivery (in contrast to forward or futures price).

Spot rate  Interest rate fixed today on a loan that is made today (cf. forward interest rate).

Spread  Difference between the price at which an underwriter buys an issue from a firm and the price at which the underwriter sells it to the public.

Staggered board  Board whose directors are elected periodically, instead of at one time.

Standard deviation  Square root of the variance—a measure of variability.

Standard error  In statistics, a measure of the possible error in an estimate.

Standby agreement  In a rights issue, agreement that the underwriter will purchase any stock not purchased by investors.

Step-up bond  Bond whose coupon is stepped up over time (also step-down bond).

Stock dividend  Dividend in the form of stock rather than cash.

Stock split  “Free” issue of shares to existing shareholders.

Straddle  The combination of a put option and a call option with the same exercise price.

Straight-line depreciation  An equal dollar amount of depreciation in each period.

Strike price  Exercise price of an option.

Stripped bond (strip)  Bond that is subdivided into a series of zero-coupon bonds.

Strong-form efficient market  Market in which security prices reflect instantaneously all information available to investors (cf. weak-form efficient market and semistrong-form efficient market).

Structured debt  Debt that has been customized for the buyer, often by incorporating unusual options.

Subordinated debt (junior debt)  Debt over which senior debt takes priority. In the event of bankruptcy, subordinated debtholders receive payment only after senior debt is paid off in full.

Subprime loans  The most risky category of loans.

Sum-of-the-years’-digits depreciation  Method of accelerated depreciation.

Sunk costs  Costs that have been incurred and cannot be reversed.

Supermajority  Provision in a company’s charter requiring a majority of, say, 80% of shareholders to approve certain changes, such as a merger.

Sushi bond  A eurobond issued by a Japanese corporation.

Sustainable growth rate  Maximum rate of firm growth without increasing financial leverage (cf. internal growth rate).

Swap  An arrangement whereby two companies lend to each other on different terms, e.g., in different currencies, or one at a fixed rate and the other at a floating rate.

Swaption  Option on a swap.

Sweep program  Arrangement whereby bank invests a company’s available cash at the end of each day.

Swingline facility  Bank borrowing facility to provide finance while the firm replaces U.S. commercial paper with eurocommercial paper.

Syndicated loan  A large loan provided by a group of banks.

Systematic risk  Market risk.

Take-or-pay  In project finance, arrangement where parent company agrees to pay for output of project even if it chooses not to take delivery.

Take-up fee  Fee paid to underwriters of a rights issue on any stock they are obliged to purchase.

Tangent efficient portfolio  The portfolio of risky assets offering the highest risk premium per unit of risk (standard deviation).

Tangible asset  Physical asset, such as plant, machinery, and offices (cf. intangible asset).

Tax-anticipation bill  Short-term bill issued by the U.S. Treasury that can be surrendered at face value in payment of taxes.

T-bill  Treasury bill.

Technical analysis  Security analysis that seeks to detect and interpret patterns in past security prices (cf. fundamental analysis).

TED spread  Difference between LIBOR and U.S. Treasury bill rate.

Tender offer  General offer made directly to a firm’s shareholders to buy their stock.

10-K  Annual financial statements as filed with the SEC.

10-Q  Quarterly financial statements as filed with the SEC.
Tenor Maturity of a loan.

Terminal warehouse Public warehouse.

Term loan Medium-term, privately placed loan, usually made by a bank.

Term structure of interest rates Relationship between interest rates on loans of different maturities (cf. yield curve).

Throughput arrangement Arrangement by which shareholders of a pipeline company agree to make sufficient use of pipeline to enable the pipeline company to service its debt.

Tick Minimum amount the price of a security may change.

Time draft Demand for payment at a stated future date (cf. sight draft).

Times-interest-earned (interest cover) Earnings before interest and tax, divided by interest payments.

TIPS (Treasury Inflation Protected Securities) U.S. Treasury bonds whose coupon and principal payments are linked to the Consumer Price Index.

Toehold Small investment by a company in the shares of a potential takeover target.

Tolling contract In project finance, arrangement whereby parent company promises to deliver materials to project for processing and then to repurchase them.

Tombstone Advertisement listing the underwriters to a security issue.

Trade acceptance Written demand that has been accepted by an industrial company to pay a given sum at a future date (cf. banker’s acceptance).

Trade credit Accounts receivable.

Trade debt Accounts payable.

Tranche Portion of a new issue sold at a point in time different from the remainder or that has different terms.

Transaction exposure Risk to a firm with known future cash flows in a foreign currency that arises from possible changes in the exchange rate (cf. economic exposure, translation exposure).

Transfer agent Individual or institution appointed by a company to look after the transfer of securities.

Translation exposure Risk of adverse effects on a firm’s financial statements that may arise from changes in exchange rates (cf. economic exposure, transaction exposure).

Treasurer Principal financial manager (cf. controller).

Treasury bill (T-bill) Short-term discount debt maturing in less than one year, issued regularly by the government.

Treasury stock Common stock that has been repurchased by the company and held in the company’s treasury.

Trust deed Agreement between trustee and borrower setting out terms of a bond.

Trust receipt Receipt for goods that are to be held in trust for the lender.

Tunneling Actions by a controlling shareholder to transfer wealth out of the firm (e.g., by supplying goods at an inflated price).

Underpricing Issue of securities below their market value.

Underwriter Firm that buys an issue of securities from a company and resells it to investors.

Unfunded debt Debt maturing within one year (cf. funded debt).

Uniform price auction Auction in which all successful bidders pay the same price (cf. discriminatory price auction).

Unique risk Specific risk.

Unseasoned issue Issue of a security for which there is no existing market (cf. seasoned issue).

Unsystematic risk Specific risk.

Value additivity Rule that the value of the whole must equal the sum of the values of the parts.

Value at risk (VAR) The probability of portfolio losses exceeding some specified proportion.

Value stock A stock that is expected to provide steady income but relatively low growth (often refers to stocks with a low ratio of market-to-book value).

Vanilla issue Issue without unusual features.

VAR Value at risk.

Variable-rate demand bond (VRDB) Floating-rate bond that can be sold back periodically to the issuer.

Variance Mean squared deviation from the expected value; a measure of variability.

Variation margin The daily gains or losses on a futures contract credited to the investor’s margin account.

Vega A measure of how the option price changes as the asset’s volatility changes.

Venture capital Capital to finance a new firm.

Vertical merger Merger between a supplier and its customer (cf. horizontal merger, conglomerate merger).

Vertical spread Simultaneous purchase and sale of two options that differ only in their exercise price (cf. horizontal spread).
**VIX** A measure of the implied volatility of stocks in the S&P 500 Index.

**VRDB** Variable rate demand bond.

**W**

**WACC** Weighted-average cost of capital.

**Warehouse receipt** Evidence that a firm owns goods stored in a warehouse.

**Warrant** Long-term call option issued by a company.

**Weak-form efficient market** Market in which security prices instantaneously reflect the information in the history of security prices. In such a market security prices follow a random walk (cf. semistrong-form efficient market and strong-form efficient market).

**Weighted-average cost of capital (WACC)** Expected return on a portfolio of all the firm's securities. Used as hurdle rate for capital investment.

**White knight** A friendly potential acquirer sought out by a target company threatened by a less welcome suitor.

**Wi.** When issued.

**Winner's curse** Problem faced by uninformed bidders. For example, in an initial public offering uninformed participants are likely to receive larger allotments of issues that informed participants know are overpriced.

**With dividend (cum dividend)** Purchase of shares in which the buyer is entitled to the forthcoming dividend (cf. ex dividend).

**Withholding tax** Tax levied on dividends paid abroad.

**With rights (cum rights, rights on)** Purchase of shares in which the buyer is entitled to the rights to buy shares in the company’s rights issue (cf. ex rights).

**Working capital** Current assets and current liabilities. The term is commonly used as synonymous with net working capital.

**Workout** Informal arrangement between a borrower and creditors.

**Writer** Option seller.

**X**

**xd** Ex dividend.

**xr** Ex rights.

**Y**

**Yankee bond** A dollar bond issued in the United States by a non-U.S. borrower (cf. bulldog bond, Samurai bond).

**Yield curve** Term structure of interest rates.

**Yield curve note** Reverse FRN.

**Yield to maturity** Internal rate of return on a bond.

**Z**

**Zero-coupon bond** Discount bond making no coupon payments.

**Z-score** Measure of the likelihood of bankruptcy.