GLOSSARY

Absolute advantage A firm, person, organization or country has an absolute advantage if it can obtain a benefit at a lower cost than other firms, people, organizations or countries. For example, Costa Rica has an absolute advantage in the growing of bananas *vis-à-vis* Europe.

Acceptance credit (bank bill) An institution (e.g. bank) commits itself to the payment of a sum of money in the future as stated in the acceptance credit document. The borrower is given this document in return for a promise to pay a sum on the maturity date to the institution. The acceptance credit can be sold in the discount market to obtain funds for the borrower.

Accounting rate of return A measure of project SBU or firm profitability. Profit divided by assets devoted to the project (or entire business).

Accounting standards A set of formal rules and conventions set by the accounting profession to calculate accounting numbers.

Acid test *See* Quick ratio

Additivity Able to add up.

Administration An administrator takes over the running of a distressed company to help it survive and avoid liquidation.

Affirmative covenants Loan agreement conditions, e.g. a statement that a bond will pay regular dividends.

Ageing schedule The total debtor figure is broken down to show how long invoices have been outstanding (remained unpaid).

Agency Acting for or in the place of another with his/her/their authority.

Agency costs Costs of preventing agents (e.g. managers) pursuing their own interests at the expense of their principals (e.g. shareholders). Examples include contracting costs and costs of monitoring. In addition there is the agency cost of the loss of wealth caused by the extent to which prevention measures have not worked and managers continue to pursue non-shareholder wealth goals.

Agent A person who acts for or in the place of another with that other person's authority.

Aggressive shares Shares having a beta value greater than 1.

AGM *See* Annual general meeting.

Allocation of capital The mechanism for selecting competing investment projects leading to the production of a mixture of goods and services by a society. This can be influenced by the forces of supply and demand; and by central authority direction.

Allocational efficiency of markets Efficiency in the process of allocating society's scarce resources between competing real investments.

Allotment In a new issue of shares, if more shares are demanded at the price than are available, they may be apportioned (allotted) between the applicants.

Alternative Investment Market (AIM) The lightly regulated market operated by the London Stock Exchange, focussed particularly on smaller, less well-established companies.

All-paper deal When a bidder offers to buy shares in a target the payment is entirely in the form of shares in the bidder.

American Depositary Receipts (ADRs) Depositary receipts issued in the USA.

AMEX The American Stock Exchange. Trades equities, options and exchange traded funds.

American-style option An option which can be exercised by the purchaser at any time up to the expiry date.

Amortization The repayment of a debt by a series of instalments.

Amortization of assets The reduction in book value of an intangible asset such as goodwill.

Analyst A researcher of companies' prospects and predictor of their share price performance.

Angel *See* Business angel.

Annual equivalent annuity (AEA) A regular annual amount which is equivalent, in present value terms, to another set of cash flows.

Annual general meeting (AGM) A limited company must hold in each calendar year an annual general meeting. It is an opportunity for shareholders to meet and talk with each other and with those who run the company on their behalf. The managers give an account of their stewardship. All shareholders are entitled to attend and vote.

Annual percentage rate (APR) The true annual interest rate charged by a lender. It takes full account of the timing of payments of interest and principal.

Annual results Annual company accounts. This term is often used for the preliminary results.

Annuity An even stream of payments (same amount each time) over a given period of time.

Arbitrage The act of exploiting price differences on the same instrument or similar securities by simultaneously selling the overpriced security and buying the underpriced security.

Arbitrage pricing theory (APT) A type of multi-factor model which relates return on securities to various non-diversifiable risk factors. The expected return on any risky security is a linear combination of these factors.

Arithmetic mean The average of a population equals the sum of the observations divided by the number of observation.

Articles of Association Internal rules governing acompany. Can be unique to company.

Asset In the financial market an asset is anything that can be traded as a security, e.g. share, option, commodity, bond.

Asset allocation An investment methodology which specifies the proportion of funds to be invested in different asset classes, e.g. property, shares, bonds.

Asset-backed securities *See* Securitization.

Asset backing The value of the assets held in the business – often measured on a per share basis.

Asset class Assets types, e.g. bonds, shares.

Asset liquidity The extent to which assets can be converted to cash quickly and at a low transaction cost.

Asset lock-up In a hostile takeover situation, the target sells to a friendly firm those parts of the business most attractive to the bidder.

Asset transformers Intermediaries who, by creating a completely new security – the intermediate security – mobilize savings and encourage investment. The primary security is issued by the ultimate borrower to the intermediary, who offers intermediate securities to the primary investors.

Associated company A company in which an investor (usually a holding company) holds a participating interest and exercises significant influence over the entity. 'Interest' includes shares, options and convertible securities. 'Participating' means the interest is held on a long-term basis and there is significant influence. Usually a 20 percent or more holding of the shares is presumed to be participating.

Asymmetric information One party in a negotiation or relationship is not in the same position as other parties, being ignorant of, or unable to observe, some information which is essential to the contracting and decision-making process.

At-the-money option The current underlying price is equal to the option exercise price.

Audit committee A committee of company directors responsible for validating their company's financial figures, e.g. by appointing effective external auditors.

Auditor Auditors determine whether the company's financial statements are misleading and whether the accounts shows a true and fair view.

Authorized share capital The maximum amount of share capital that a company can issue. The limit can be changed by a shareholder vote.

Average collection period (ACP) The average number of days it takes to collect debts from customers. The total debtors outstanding divided by the average daily sales.

Back office That part of a financial institution which deals with the settlement of contracts, accounting and management information processes.

Bad debts Debts that are unlikely to be paid.

Balance of payments A record of the payment for goods and services obtained by a country and other transfers of currency from abroad and the receipts for goods and services sold and other transfers of currency abroad. The balance on the current account (visible trade and invisible trade) is the difference between national income and national expenditure in the period. The capital account is made up of such items as the inward and outward flow of money for investment and international grants and loans.

Balance sheet Provides a picture of what a company owned and is owed on a particular day in the past. It summarizes assets and liabilities.

Balloon repayment on a loan The majority of the repayment of a loan is made at or near the maturity date, with the final payment substantially larger than the earlier payments.

Ballot In a new issue of shares when a company floats on a stock exchange if the demand is greater than supply, the shares are allocated to some applicants but not others, selected at random.

Bancassurance Companies offering both banking and insurance.

Bank covenants *See* covenants.

Bank for International Settlements (BIS) Controlled by central banks, the BIS was established to assist international financial co-ordination. It promotes international monetary co-ordination, provides research and statistical data, co-ordination and trusteeship for intergovernmental loans, and acts as a central bank for national central banks, accepting deposits and making loans.

Bank of England The central bank of the United Kingdom, responsible for monetary policy. It oversees the affairs of other financial institutions, issues banknotes and coins, manages the national debt and exchange rate, and is lender of last resort.

Bank of England index Shows the extent to which a currency has strengthened or weakened against sterling since 1990.

Barriers to entry The obstacles that a company entering a market for the first time has to overcome to do well in that market.

Base case strategy A continuation of current strategy.

Base rate The reference rate of interest that forms the basis for interest rates on bank loans, overdrafts and deposit rates.

Basic (FRS 3) earnings per share Includes deductions from profit of one-off exceptional items and goodwill amortization.

Basis point One-hundredth of 1 percent, usually applied to interest rates.

Bear An investor who takes the view that prices are likely to fall.

Bear fund Designed to do well when shares are falling in price.

Bearer bond The ownership of a bond is not recorded on a register. Possession of the bond is sufficient to receive interest, etc.

Bells and whistles Additional features placed on derivatives or securities such as bonds that are designed to attract investors.

Benchmark index An index of shares or other securities that sets a standard for fund manager performance, e.g. a fund manager controlling a portfolio of pharmaceutical shares would measure performance against a pharmaceutical index. This is calculated by an independent person to be representative of the sector.

Benefit–cost ratio A measure of present value per £ invested. Benefit–cost ratio = Net present value divided by Initial outlay.

Beta This measures the systematic risk of a financial security. In the capital asset pricing model it is a measure of the sensitivity to market movements of a financial securities return, as measured by the covariance between returns on the asset and returns on the market portfolio divided by the variance of the market portfolio. In practice a proxy (e.g. FTSE 100 index) is used for the market portfolio.

Bid premium The additional amount an acquirer has to offer above the pre-bid share price to succeed in a takeover offer.

Bid price The price at which a market maker will buy shares or a dealer in other markets will buy a security or commodity.

Bid-offer spread The difference between the market-maker's buy and sell prices.

Bill of exchange A document which sets out a commitment to pay a sum of money at a specified point in time, e.g. an importer commits itself to paying a supplier. Bills of exchange may be discounted – sold before maturity for less than face value.

BIMBO A buy-in management buyout. A combination of a management buyout and a buy-in. Outside managers join forces with existing managers to take over a company, subsidiary or unit.

Black Monday 19 October 1987, the date of a large fall in stock market prices.

Black Wednesday 16 September 1992, a day of severe currency turbulence when sterling and the Italian lira devalued significantly and were forced to leave the exchange rate mechanism.

Blue chip The shares with the highest status as investments. Regarded as safest (often mistakenly).

Board of Directors People elected by shareholders to run a company.

Bond A debt obligation with a long-term maturity, usually issued by firms and governments.

Bond covenants *See* Covenants

Bonus issue *See* Scrip issue.

Book-building A book runner invites major institutional investors to suggest how many shares they would be interested in purchasing and at what price in a new issue or secondary issue of shares. This helps to establish the price and allocate shares.

Book-to-market equity ratio The ratio of a firm's balance sheet value to the total market value of its shares.

Book value Balance sheet value. Can be expressed on a per share basis.

Bootstrapping game *See* Price-earnings ratio game.

Borrowing capacity Limits to total borrowing levels imposed by lenders, often determined by available collateral.

Bottom line Profit attributable to the shareholders.

Bought deal An investment bank buys an entire security issue (e.g. shares) from a client corporation raising finance. The investment bank usually intends to then sell it out to institutional clients within hours.

Bourse Alternative name for a Stock Exchange. Used particularly in continental Europe.

Break-even analysis Analyzing the level of sales at which a project, division or business produced a zero profit (accounting emphasis).

Break-even NPV The extent to which a single variable can change before the NPV of a proposed project switches from positive to negative (or vice versa).

Broker Assists in the buying and selling of financial securities by acting as a 'go-between', helping to reduce search and information costs.

Bubble An explosive upward movement in financial security prices not based on fundamentally rational factors, followed by a crash.

Budget (national) Sets out government expenditure and revenue for the financial year. In the UK it is presented by the Chancellor of the Exchequer to the British Parliament.

Buffer stock Stock held to reduce the negative effects (stock-out costs) of an unusually large usage of stock.

Building society A UK financial institution, the primary role of which is the provision of mortgages. Building societies are non-profit-making mutual organizations. Funding is mostly through small deposits by individuals.

Bulge bracket A leading investment bank.

Bull An investor taking the view that prices will rise.

Bulldog A foreign bond issued in the UK.

Bullet bond A bond where all the principal on a loan is repaid at maturity.

Bulletin board A computer-based site for infrequently traded shares on which investors (via brokers) can display their unfilled orders in the hope of finding a match.

Business angels Wealthy individuals prepared to invest between £10,000 and £250,000 in a start-up, early-stage or developing firm. They often have managerial and/or technical experience to offer the management team as well as equity and debt finance. Medium- to long-term investment in high-risk situation.

Business risk The risk associated with the underlying operations of a business. The variability of the firm's operating income, before interest income: this dispersion is caused purely by business-related factors and not by the debt burden.

BVCA British Venture Capital Association.

Cadbury report The Committee on the Financial Aspects of Corporate Governance chaired by Sir Adrian Cadbury made recommendations on the role of directors and auditors, published in 1992.

Call option This gives the purchaser the right, but not the obligation, to buy a fixed quantity of a commodity, financial instrument or some other underlying asset at a given price, at or before a specified date.

Called-up (issued) share capital The total value of shares sold by a company when expressed at par or nominal value.

Cap An interest rate cap is a contract that effectively gives the purchaser the right to set a maximum level for interest rates payable. Compensation is paid to the purchaser of a cap if interest rates rise above an agreed level.

Capital asset pricing model (CAPM) An asset (e.g. share) pricing theory which assumes that financial assets, in equilibrium, will be priced to produce rates of return which compensate investors for systematic risk as measured by the covariance of the assets' return with the market portfolio return (i.e. beta).

Capital budgeting The process of selecting long-term capital investments.

Capital expenditure The purchase of long-lived (more than one year) assets (that is, fixed assets).

Capital gearing The extent to which the firm's total capital is in the form of debt.

Capital lease *See* Leasing.

Capital market Where those raising finance can do so by selling financial investments to investors, e.g. bond, shares.

Capital rationing When funds are not available to finance all wealth-enhancing (positive NPV) projects.

Capital structure The proportion of the firm's capital which is equity or debt.

Capitalization (1) An item of expenditure is taken on to the balance sheet and capitalized as an asset rather than written off against profits. (2) Short for market capitalization.

Capitalization factor A discount rate.

Capitalization issue *See* Scrip issue.

Capitalization rate Required rate of return for the class of risk.

Capped bonds The floating interest rate charged cannot rise above a specified level.

Cartel A group of firms entering into an agreement to set mutually acceptable prices for their products.

Cash-conversion cycle The stock-conversion period plus the debtor-conversion period minus the credit period granted by suppliers. It focusses on the length of time between the company's outlay on inputs and the receipt of money from the sale of goods.

Cash cow A profitable company with low growth and stable market conditions with low investment needs. The company's competitive strength enables it to produce surplus cash.

Cash settlement In the derivative market some contracts are physically settled at expiry date (e.g. pork bellies are delivered in return for cash under the derivative contract). However, many derivatives are not physically delivered, rather a cash difference representing a gain or loss on the closed derivative position passes hands.

CBOT Chicago Board of Trade.

Central bank A banker's bank and lender of last resort, which controls the credit system of an economy, e.g. controls note issue, acts as the government's bank, controls interest rates and regulates the country's banking system.

Certificate of deposit (CD) A deposit is made at a bank. A certificate confirming that a deposit has been made is given in return to the lender. This is normally a bearer security. The CD can then be sold in the secondary market whenever a firm needs cash.

CHAPS (Clearing House Automated Payment System) The UK same-day interbank clearing system for sterling payments.

Characteristic line The line that best relates the return on a share to the return on a broad market index.

Chicago Board of Trade (CBOT) The futures and options exchange in Chicago, USA – the world's oldest (established 1848).

Chicago Board Options Exchange (CBOE) The largest options exchange in the world, trading options on shares, indices and interest rates.

Chicago Mercantile Exchange (CME) An exchange which trades a wide range of currency futures and options, interest rate futures and options, commodity futures and options, and share index futures and options.

Chief executive's review (operational review) A comment, contained in a company's annual report and accounts, on performance, strategy and managerial intentions.

CHIPS (Clearing House Interbank Payment System) The US system for US dollar payment between banks.

City Code on Takeovers and Mergers Provides the main governing rules for companies engaged in merger activity. Self-regulated and administered by the Takeover Panel.

City of London A collective term for the financial institutions located in the financial district to the east of St Paul's Cathedral in London (also called the Square Mile). However, the term is also used to refer to all financial institutions, wherever they are located.

Claw back Existing shareholders often have the right to reclaim shares sold under a placing as though they were entitled to them under a rights issue.

Clean price On a bond the prices are general quoted 'clean' that is without taking account of the accrued interest since the last coupon payment.

Clearing bank Member of the London Bankers' Clearing House, which clears checks, settling indebtedness between two parties.

Clearing house An institution which settles mutual indebtedness between a number of individuals or organizations. The clearing house may also act as a counterparty.

Clientele effects In dividend theory the level of dividend may be influenced by shareholders preferring a dividend pattern which matches their consumption pattern or tax position.

Closed-end funds Collective investment vehicles (e.g. investment trusts) that do not create or redeem shares on a daily basis in response to increases and decreases in demand. They have a fixed number of shares for lengthy periods.

Closing out a futures position The act of taking a second action in the futures market (say selling the future) which is exactly opposite to the first action (say buying the future). Also called reversing the trade.

Coefficient of determination, R-squared For single linear regression this is the proportion of variation in the dependant variable that is related to the variation in the independent variable.

Collateral Property pledged by a borrower to protect the interests of the lender.

Commercial bill (bank bill or trade bill) A document expressing the commitment of a borrowing firm to repay a short-term debt at a fixed date in the future.

Commercial paper (CP) An unsecured note promising the holder (lender) a sum of money to be paid in a few days – average maturity of 40 days. If they are denominated in foreign currency and placed outside of the jurisdiction of the authorities of that currency then the notes are euro-commercial paper.

Commitment fee A fee payable in return for a commitment by a bank to lend money.

Commodity product Undifferentiated compared with competitor offerings in any customer-important way by factors such as performance, appearance, service support, etc.

Common stock The term used in the USA to describe ordinary shares in a company.

Companies Acts The series of laws enacted by Parliament governing the establishment and conduct of incorporated business enterprises. The Companies Act 1985 consolidated the Acts that preceded it.

Companies House The place where records are kept of every UK company. These accounts, etc. are then made available to the general public.

Company registrar *See* Registrar.

Comparative advantage A firm or a country has a comparative advantage in the production of good X if the opportunity cost of producing a unit of X, in terms of other goods forgone, is lower, in that country compared with another country, or in that firm compared with another firm.

Competition Commission The Commission may obtain any information needed to investigate possible monopoly anti-competitive situations referred to it. It may then block the anti-competitive action.

Competitive advantage (edge) The possession of extraordinary resources that allow a firm to rise above the others in its industry to generate exceptional long run rates of return on capital employed.

Competitive floor Where competition between companies in an industry is so strong that shareholders receive a rate of return that only just induces them to put money into the firm and hold it there.

Competitive position The competitive strength of the firm *vis-à-vis* rivals in a product market.

Complementary product One that is generally bought alongside the product in question.

Compound interest Interest is paid on the sum which accumulates, whether or not that sum comes from principal or from interest received.

Compound return The income received on an investment is reinvested in the investment and future returns are gained on both the original capital and the plowed-back income.

Concert party A group of investors, acting together or under the control of one person, which buys shares in a company.

Conflict of preferences There is a conflict of preferences between the primary investors wanting low-cost liquidity and low risk on invested funds, and the ultimate borrowers wanting long-term risk-bearing capital.

Conglomerate bank A bank with a wide range of activities, products and markets.

Conglomerate merger The combining of two firms which operate in unrelated business areas.

Consideration The price paid for something.

Consolidated accounts All the income, costs, assets and all the liabilities of all group companies, whether wholly or partially owned, are brought together in the consolidated accounts.

Consolidation of shares The number of shares issued by a company is reduced and the nominal value of each remaining share rises.

Consumer price index (CPI) The main US measure of general inflation.

Continuing obligations Standards of behavior and actions required of firm's listed on the London Stock Exchange, enforced by the United Kingdom Listing Authority.

Contractual theory Views the firm as a network of contracts, actual and implicit, which specify the roles to be played by various participants. Most participants bargain for low risk and a satisfactory return. Shareholders accept high risk in anticipation of any surplus returns after all other parties have been satisfied.

Controlling shareholder One with 30 percent or more of the voting capital, or any shareholder able to control the composition of the board of directors.

Conventional cash flows Where an outflow is followed by a series of inflows, or a cash inflow is followed by a series of cash outflows.

Convergence The coming together of the futures price and the underlying share price in the final trading day of a futures contract.

Conversion premium The difference between the current share price and the conversion price, expressed as a percentage of the current share price for convertible bonds.

Conversion price The share price at which convertible bonds may be converted.

Conversion ratio The nominal (par) value of a convertible bond divided by the conversion price. The number of shares available per bond.

Conversion value The value of a convertible bond if it were converted into ordinary shares at the current share price.

Convertible bonds Bonds which carry a rate of interest and give the owner the right to exchange the bonds at some stage in the future into ordinary shares according to a prearranged formula.

Convertible loan stock Same definition as convertible bond.

Convertible preferred stock A preferred share that can be changed into another type of security, e.g. an ordinary share.

Coredeal An international exchange for international debt-related securities, owned by the International Securities Markets Association (ISMA).

Corporate bond A bond issued by a company.

Corporate broker Stockbrokers that act on behalf of companies quoted on an exchange. For example, providing advice on market conditions or representing the company to the market. Corporate brokers are knowledgeable about the share and other financial markets. Advise companies on fund raising (e.g. new issues). Try to generate interest among investors for the company's securities. Stand prepared to buy and sell companies' shares.

Corporate finance department of investment banks The department assisting firms in raising funds (e.g. rights issues, bond issues) and managing their finances.

Corporate governance The system of management and control of the corporation, e.g. the number and power of independent non-executive directors.

Corporate raider An organization that makes hostile takeover approaches for quoted companies.

Corporate value The present value of cash flows within the planning horizon plus the present value of cash flows after the planning horizon. Plus the value of saleable assets not required for cash-flow generation.

Corporate venturing Large companies fostering the development of smaller enterprises through, say, joint capital venture or equity capital provision.

Corporation tax A tax levied on the profits of companies.

Correlation coefficient A measure of the extent to which two variables show a relationship, expressed on a scale of –1 to +1.

Cost leadership strategy Standard no-frills product. Emphasis on scale economics and other cost advantages.

Cost of capital The rates of return that a company has to offer finance providers to induce them to buy and hold a financial security.

Counterparty The buyer for a seller or the seller for a buyer.

Counterparty risk The risk that a counterparty to a contract defaults and does not fulfil obligations.

Coupons An attachment to a bond or loan notes document which may be separated and serve as evidence of entitlement to interest. Nowadays it refers to the interest itself.

Covariance The extent to which two variables move together.

Covenant A solemn agreement.

Covered call option writing Writing a call option on an underlying when the writer owns at least the number of underlying securities included in the option.

Covered warrants The same as warrants except that financial institutions issue them selling the right to buy or sell shares in industrial and commercial companies.

Creative accounting The drawing up of accounts which obey the letter of the law and accounting body rules but which involve the manipulation of accounts to show the most favorable profit and balance sheet.

Credit period The average length of time between the purchase of inputs and the payment for them. Equal to the average level of creditors divided by the purchases on credit per day.

Credit rating An estimate of the quality of a debt from the lender viewpoint in terms of the likelihood of interest and capital not being paid and of the extent to which the lender is protected in the event of default. Credit rating agencies are paid fees by companies, governments, etc. wishing to attract lenders.

Credit risk The risk that a counterparty to a financial transaction will fail to fulfil their obligation.

Credit union A non-profit organization accepting deposits and making loans, operated as a co-operative.

Creditor One to whom a debt is owed.

Crest An electronic means of settlement and registration of shares following a sale on the London Stock Exchange.

Crown jewels defense In a hostile merger situation, the target sells off the most attractive parts of the business.

Cum-dividend When an investor buys a government **bond** when it is still designated cum-dividend he/she is entitled to the accrued interest since the last coupon was paid. A **share designated cum-dividend** indicates that the buyer will be entitled to a dividend recently announced by the company.

Cum-rights Shares bought on the stock market prior to the ex-rights day are designated cum-rights and carry to the new owner the right to subscribe for the new shares in the rights issue.

Cumulative If a payment (interest or dividend) on a bond or share is missed in one period those securities are given priority when the next payment is made. These arrears must be cleared up before shareholders received dividends.

Currency swap *See* Swap.

Current assets Cash and other assets that can be rapidly turned into cash. Includes stocks of raw materials, partially finished goods and finished goods, debtors and investments expected to be sold within one year.

Current asset value (net) Current assets (cash, accounts receivable, inventory) minus current liabilities (also called working capital).

Current liabilities Amounts owed that the company expects to have to pay within the next year.

Current ratio The ratio of current liabilities to the current assets of a business.

Cyclical companies (shares) Those companies in which profits are particularly sensitive to the growth level in the economy, which may be cyclical.

Cyclical industries Those industries in which profits are particularly sensitive to the growth level in the economy, which may be cyclical.

Daily Official List (DOL) The daily record setting out the prices of all trades in securities conducted on the London Stock Exchange.

Darling A stock market darling is a company which receives a lot of attention and is regarded as very attractive.

Dawn raid An acquirer acts with such speed in buying the shares of the target company that the raider achieves the objective of a substantial stake in the target before its management has time to react.

Debentures Bonds issued with redemption dates a number of years into the future. Usually secured against specific assets (mortgage debentures) or through a floating charge on the firm's assets.

Debt capital Capital raised with (usually) a fixed obligation in terms of interest and principal payments.

Debtor conversion period The average number of days to convert customer debts into cash. Equal to the average value of debtors divided by the average value of sales per day.

Debtors Those who owe a debt.

Declining (reducing) balance method of depreciation The amount an asset is depreciated declines from one year to the next as it is determined by a constant percentage of the assets' depreciated value at the start of each year.

Deep discounted bonds Bonds sold well below par value.

Deep discounted rights issue A rights issue price is much less than the present market price of the old shares.

Default A failure to make agreed payments of interest or principal.

Defensive industries Those industries where profits are not particularly sensitive to the growth level in the economy.

Defensive shares Having a beta value of less than 1.

Deferred ordinary shares Rank below preferred ordinary shares for dividends. So, if profits are low deferred ordinary holders may not receive a dividend.

Dematerialization Traditionally the evidence of financial security ownership is by written statements on paper (e.g. share certificates). Increasingly such information is being placed on electronic records and paper evidence is being abandoned.

Demerger The separation of companies or business units that are currently under one corporate umbrella. It applies particularly to the unraveling of a merger.

Depositary receipts Certificates, representing evidence of ownership of a company's shares held by a depository. They can be bought and sold.

Derivative A financial asset, the performance of which is based on (derived from) the behavior of the value of an underlying asset.

Deutsche Borse The German Stock Exchange based in Frankfurt.

Differentiated product One that is slightly different in significant ways than those supplied by other companies.

Differentiation strategy The unique nature of the product/service offered allows for a premium price to be charged.

Diluted earnings per share A measure of profits per share for the year that takes into account any additional shares that may be issued in the future under executive share option schemes and other commitments.

Direct foreign investment The purchase of commercial assets in another country such as factories and industrial plant for productive purposes.

Directors dealings The purchase or sale of shares in their own company. This is legal (except at certain times of the company's year or before announcements). Some investors examine directors dealings to decide whether to buy or sell.

Directors report Information and commentary on company performance and other matters contained in a company's annual report and accounts.

Dirty price On a bond a buyer pays a total of the clean price and the accrued interest since the last coupon payment.

Disclosure of shareholdings If a stake of 3 percent or more is held by one shareholder in a UK public company, then this has to be declared to the company.

Discount (a) The amount below face-value at which a financial claim sells, e.g. bill of exchange or zero coupon bond. (b) The extent to which an investment trust's shares sell below the net asset value. (c) The amount by which a future value of a currency is less than its spot value. (d) The action of purchasing financial instruments, e.g. bills, at a discount. (e) The degree to which a security sells below its issue price in the secondary market.

Discount house An institution that purchases promissory notes and resells them or holds them until maturity.

Discount market deposit Money deposited with a London discount house. Normally repayable at call or very short term. Clearing banks are the usual depositors.

Discount rate (1) The rate of return used to discount cash flows received in future years. It is the opportunity cost of capital given the risk class of the future cash flows. (2) The rate of interest some central banks lend money to the banking system.

Discounted cash flow Future cash flows are converted into the common denominator of time zero money by adjusting for the time value of money.

Discounted payback The period of time required to recover initial cash outflow when the cash inflows are discounted at the opportunity cost of capital.

Discounting The process of reducing future cash flows to a present value using an appropriate discount rate.

Disintermediation Borrowing firms bypassing financial institutions and obtaining debt finance directly from the market.

Diversifiable risk *See* Unsystematic risk.

Diversification To invest in varied projects, enterprises, financial securities, etc.

Divestiture To remove assets from a company or individual.

Dividend The profit paid to ordinary shareholders, usually on a regular basis.

Dividend cover The number of times net profits available for distribution exceed the dividend actually paid or declared. Earnings per share divided by gross dividend per share *or* total post-tax profits divided by total dividend payout.

Dividend per share The total amount paid or due to be paid in dividends for the year (interim and final) divided by the number of shares in issue.

Dividend policy The determination of the proportion of profits paid out to shareholders, usually periodically.

Dividend reinvestment plan (DRIP) A shareholder receives shares in lieu of a cash dividend. This avoids the cost and trouble of receiving cash and then reinvesting.

Dividend yield The amount of dividend paid on each share as a percentage of the share price.

Dividend valuation models (DVM) These methods of share valuation are based on the premise that the market value of ordinary shares represents the sum of the expected future dividend flows, to infinity, discounted to present value.

Divisible projects It is possible to undertake a fraction of a project.

Divorce of ownership and control In large corporations shareholders own the firm but may not be able to exercise control. Managers often have control because of a diffuse and divided shareholder body, proxy votes and apathy.

Dominance When one (investment) possibility is clearly preferable to a risk-averse investor because it possesses a better expected return than another possibility for the same level of risk.

Dow or Dow Jones Industrial Average The best known index of movements in the price of US stocks and shares. There are 30 shares in the index.

Drawdown arrangement A loan facility is established and the borrower uses it (takes the money available) in stages as the funds are required.

Early-settlement discount The reduction of a debt owed if it is paid at an early date.

Early-stage capital Funds for initial manufacturing and sales for a newly formed company. High-risk capital available from entrepreneurs, business angels and venture capital funds.

Earn-out The purchase price of a company is linked to the future profits performance. Future instalments of the purchase price may be adjusted if the company performs better or worse than expected.

Earning power The earning (profit) capacity of a business in a normal year. What the company might be expected to earn year after year if the business conditions continue unchanged.

Earnings guidance A company guiding analysts to estimates of profits for the current period.

Earnings multiple Price earnings ratio.

Earnings per share (EPS) Profit after tax and interest divided by number of shares in issue.

Earnings yield Earnings per share divided by current market price of share.

EASDAQ (European Association of Securities Dealers Automated Quotation) A Europe-wide stock exchange aimed at innovative, young and fast-growing companies. Now closed.

EBIT A company's earnings (profits) before interest and taxes are deducted.

EBITDA Earnings before interest, taxation, depreciation and amortization. Or as cynics have it: Earnings Before I Tricked The Dumb Auditor.

Economic franchise Pricing power combined with strong barriers to entry. The strength and durability of an economic franchise is determined by (a) the structure of the industry, (b) the ability of the firm to rise above its rivals in its industry and generate exceptional long run rates of return on capital employed.

Economic book value A term used by Stern Stewart and Co. It is based on the balance sheet capital employed figure subject to a number of adjustments.

Economic order quantity (EOQ) The quantity of inventory items (e.g. raw material) to order on each occasion which minimizes the combined costs of ordering and holding stock.

Economic profit (EP) For a period the economic profit is the amount earned by a business after deducting all operating expenses and a charge for the opportunity cost of the capital employed.

Economic risk The risk that a company's economic value may decline as a result of currency movements causing a loss in competitive strength.

Economic value added (EVA) Developed by Stern Stewart and Co. A value-based metric of corporate performance which multiplies the invested capital (after adjustments) by the spread between the (adjusted) actual return on capital and the weighted cost of capital. The adjustments are to the profit figures to obtain the actual return and to the balance sheet to obtain the invested capital figure.

Economies of scale Larger size of output often leads to lower cost per unit of output.

Economies of scope The ability to reduce unit costs of an item by sharing some costs between a number of product lines, e.g. using the same truck to deliver both ketchup and beans to a store.

Ecu (European currency unit) A composite of European Union (EU) member states' currencies weighted by the member state's share of EU output.

EDX London An equity derivative exchange based in London owned by the London Stock Exchange and OM AM of Sweden.

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

Efficient stock market (Efficient market hypothesis, EMH) Prices rationally reflect available information. The efficient market hypothesis (EMH) implies that new information is incorporated into a share price (a) rapidly, and (b) rationally. In an efficient market no trader will be presented with an opportunity for making an abnormal return, except by chance.

EGM *See* Extraordinary general meeting.

Electronic settlement Transferring shares from sellers to buyers without certificates – computer entry only.

Electronic funds transfer at a point of sale (EFTPOS) A computerized system allowing the automatic transfer of money from a buyer to a seller of goods or services at the time of sale.

Emerging markets Security markets in newly industrializing countries with capital markets at an early stage of development.

Employee share ownership plans (ESOP) Schemes designed to encourage employees to build up a shareholding in their company.

Endowment policies Insurance policies in which a lump sum is payable, either at the end of the term of the policy or on death during the term of the policy.

Endowment saving schemes Life assurance schemes with the additional feature of a huge lump sum payment at the end of a period, should the policyholder survive. One important use is for the repayment of house mortgages.

Enfranchisement Granting voting rights to holders of non-voting shares.

Enterprise investment scheme (EIS) Tax relief is available to investors in qualifying company shares (unquoted firms not involved in financial investment and property).

Enterprise value The sum of a company's total equity market capitalization and borrowings.

Entrepreneur Defined by economists as the owner-manager of a firm. Usually supplies capital, organizes production, decides on strategic direction and bears risk.

Equilibrium in markets When the forces of supply and demand are evenly balanced.

Equities An ownership share of a business, each equity share represents an equal stake in the business.

Equitization An increasing emphasis placed on share (equity) finance and stock exchanges in economies around the world. A growing equity culture.

Equity kicker (sweetener) The attachment of some rights to participate in and benefit from a good performance (e.g. exercise option to purchase shares) to a bond or other debt finance. Used with mezzanine finance.

Equity-linked bonds *See* Convertible bonds.

Equity shareholder's funds *See* Shareholder's funds.

Euro The name of the new single European currency.

Euro medium-term notes (EMTN) *See* Medium-term note.

Euromarkets Markets outside of the jurisdictions of any country; often termed international securities markets. No connection with the new currency in the eurozone. Euromarkets began in the late 1950s.

Euro-commercial paper *See* Commercial paper.

Euro-security markets Informal (unregulated) markets in money held outside the jurisdiction of the country of origin, e.g. Swiss Francs lending outside of the control of the Swiss authorities – perhaps the Francs are in London.

Eurobond Bond sold outside the jurisdiction of the country in whose currency the bond was denominated. For example, a bond issued in Yen outside of Japan.

Eurocurrency Currency held outside its country of origin. For example, Australian dollars held outside of Australia. Note: this market existed long before the creation of the new currency in the eurozone. It has no connection with the euro.

Eurodollar A deposit or credit of dollars held outside of the regulation of the US authorities, say in Tokyo, London or Paris. No connection with the currency in the eurozone.

European exchange rate mechanism (ERM) A system set up by members of the European Union which restricts the movement of the currencies of those member states belonging to the system.

European Monetary Union (EMU) A single currency with a single central bank having control over interest rates being created for those EU Member States which join. The process of moving towards a monetary union began in 1999.

Euronext The combined financial stock market comprising of the French, Dutch, Belgium and Portuguese bourses.

Euronext.liffe Euronext, the organization combining the French, Dutch, Belgium and Portuguese stock markets, bought LIFFE and renamed it Euronext.liffe.

European-style options Options which can only be exercised by the purchaser on a predetermined future date.

Eurozone Those countries that joined together in adopting the euro as their currency.

Event risk The risk that some future event may increase the risk on a financial investment, e.g. an earthquake event affects returns on Japanese bonds.

Ex-ante Intended, desired or expected before the event.

Ex-coupon A bond sold without the right to the next interest payment.

Ex-dividend When a share or bond is designated ex-dividend a purchaser will not be entitled to a recently announced dividend or the accrued interest on the bond since the last coupon – the old owner will receive the dividend (coupon).

Ex-post The value of some variable after the event.

Ex-rights When a share goes 'ex-rights' any purchaser of a share after that date will not have a right to subscribe for new shares in the rights issue.

Ex-rights price of a share The theoretical market price following a rights issue.

Exceptional items Gains or costs which are part of the company's ordinary activities but are either unusual in themselves or have an exceptionally large impact on profits that year.

Exchange controls The state controls the purchase and sale of currencies by its residents.

Exchangeable bond A bond that entitles the owner to choose at a later date whether to exchange the bond for shares in a company. The shares are in a company other than the one that issued the bonds.

Exchange rate The price of one currency expressed in terms of another.

Exclusive franchise *See* Economic franchise.

Execution-only brokers A stockbroker who will buy or sell shares cheaply but will not give advice or other services.

Exercise price (strike price) The price at which an underlying will be bought (call) or sold (put) under an option contract.

Exit The term used to describe the point at which a venture capitalist can recoup some or all of the investment made.

Exit barrier A factor preventing firms from stopping production in a particular industry.

Exotic A term used to describe an unusual financial transaction, e.g. exotic option, exotic currency (i.e. one with few trades).

Expansion capital Companies at a fast-development phase needing capital to increase production capacity, working capital and capital for the further development of the product or market. Venture capital is often used.

Expected return The mean or average outcome calculated by weighting each of the possible outcomes by the probability of occurrence and then summing the result.

Expectations hypothesis of the term structure of interest rates (yield curve) Long-term interest rates reflect the market consensus on the changes in short-term interest rates.

Expectations theory of foreign exchange The current forward exchange rate is an unbiased predictor of the spot rate at that point in the future.

Experience curve The cost of performing a task reduces as experience is gained through repetition.

Expiry date of an option The time when the rights to buy or sell the option cease.

External finance Outside finance raised by a firm, i.e. finance that it did not generate internally, for example through profits retention.

External metrics Measures of corporate performance which are accessible to individuals outside the firm and concern the performance of the firm as a whole.

Extraordinary general meeting (EGM) A meeting of the company (shareholders and directors) other than the annual general meeting. It may be convened when the directors think fit. However, shareholders holding more than 10 percent of the paid-up share capital carrying voting rights can requisition a meeting.

Extraordinary resources Those that give the firm a competitive edge. A resource, which when combined with other (ordinary) resources enables the firm to outperform competitors and create new value generating opportunities. Critical extraordinary resources determine what a firm can do successfully.

Face value *See* Par value.

Factor model A model which relates the returns on a security to that security's sensitivity to the movements of various factors (e.g. GDP growth, inflation) common to all shares.

Factor risk/Non-factor risk A factor risk is a systematic risk in multi-factor models describing the relationship between risk and return for fully diversified investors. Non-factor risk is unsystematic risk in multi-factor models.

Factoring To borrow against the security of trade debtors. Factoring companies also provide additional services such as sales ledger administration and credit insurance.

Fair game In the context of a stock market it is where some investors and fund raisers are not able to benefit at the expense of other participants. The market is regulated to avoid abuse, negligence and fraud. It is cheap to carry out transactions and the market provides high liquidity.

Fair value The amount an asset could be exchanged for in an arm's-length transaction between informed and willing parties.

Fallen angel Debt which used to rate as investment grade but which is now regarded as junk, mezzanine finance or high-yield finance.

Filter approach to investment A technique for examining shares using historic price trends. The trader focusses on the long-term trends by filtering out short-term movements.

Final dividend The dividend announced with the annual accounts. The final dividend plus the interim dividend make the total dividend for the year for a company that reports results every six months.

Finance house A financial institution offering to supply finance in the form of hire purchase, leasing and other forms of instalment credit.

Finance lease (also called **capital lease** or **full payout lease**) The lessor expects to recover the full cost (or almost the full cost) of the asset plus interest, over the period of the lease.

Financial assets (securities) Contracts that state agreement about the exchange of money in the future.

Financial distress Obligations to creditors are not met or are met with difficulty.

Financial gearing (leverage) *See* Gearing.

Financial risk The additional variability in a firm's returns to shareholders which arises because the financial structure contains debt.

Financial Services Authority (FSA) The chief financial services regulator in the UK.

Financial Services and Markets Act The 2000 Act (and orders made under it) form the bedrock of financial regulations in the UK.

Financial slack Having cash (or near-cash) and/or spare debt capacity available to take up opportunities as they appear.

Financing gap The gap in the provision of finance for medium-sized, fast-growing firms. Often these firms are too large or fast growing to ask the individual shareholders for more funds or to obtain sufficient bank finance. Also they are not ready to launch on the stock market.

Finished goods inventory period The number of days for which finished goods await delivery to customers. Equal to the average value of finished goods in stock divided by the average goods sold per day.

Fisher's equation The money rate of return m is related to the real rate of return h and the expected inflation rate i through the following equation: $(1 + m) = (1 + h)(1 + i)$.

Fixed assets Those not held for resale, but for use in the business.

Fixed charge (e.g. **fixed charged debenture or loan**) A specific asset(s) is assigned as collateral security for a debt.

Fixed exchange rate The national authorities act to ensure that the rate of exchange between two currencies is constant.

Fixed-interest securities Securities such as bonds on which the holder receives a predetermined interest pattern on the par value (e.g. gilts, corporate bonds, eurobonds).

Fixed-rate borrowing (fixed interest) The interest rate charge is constant throughout the period of the loan.

Flat rate The rate of interest quoted by a hire purchase company (or other lender) to a hiree. This fails to reflect properly the true interest rate being charged as measured by the annual percentage rate (APR).

Flat yield *See* Yield.

Float The difference between the cash balance shown on a firm's checkbook and the bank account. Caused by delays in the transfer of funds between bank accounts.

Floating charge The total assets of the company or an individual are used as collateral security for a debt.

Floating exchange rate A rate of exchange which is not fixed by national authorities but fluctuates depending on demand and supply for the currency.

Floating rate notes (FRNs) Notes issued in which the coupon fluctuates according to a benchmark interest rate charge (e.g. LIBOR). Issued in the Euromarkets generally with maturities of 7 to 15 years. Reverse floaters: the interest rate declines as LIBOR rises.

Floating-rate borrowing (floating interest) The rate of interest on a loan varies with a standard reference rate, e.g. LIBOR.

Floor An agreement whereby, if interest rates fall below an agreed level, the seller (floor writer) makes compensatory payments to the floor buyer.

Flotation The issue of shares in a company for the first time on a stock exchange.

Focus strategy The selection of a segment in the industry to serve to the exclusion of others.

'Footsie' Nickname for FTSE 100 index. Trade marked.

Foreign banking Transactions in the home currency with non-residents.

Foreign bond A bond denominated in the currency of the country where it is issued when the issuer is a non-resident.

Foreign exchange control Limits are placed by a government on the purchase and sale of foreign currency.

Foreign exchange markets (Forex or FX) Markets that facilitate the exchange of one currency into another.

Forex A contraction of 'foreign exchange'.

Forfeiting A bank purchases a number of sales invoices or promissory notes from an exporting company; usually the importer's bank guarantees the invoices.

Forward A contract between two parties to undertake an exchange at an agreed future date at a price agreed now.

Forward-rate agreement (FRA) An agreement about the future level of interest rates. Compensation is paid by one party to the other to the extent that market interest rates deviate from the 'agreed' rate.

Founders' shares Dividends are paid only after all other categories of equity shares have received fixed rates of dividend. They usually carry a number of special voting rights over certain company matters.

Free cash flow Cash generated by a business not required for operations or for reinvestment. Profit before depreciation, amortization and provisions, but after interest, tax, capital expenditure on long-lived items and increases in working capital – necessary to maintain the company's competative position and accept all value generating investments.

Free float The proportion of a quoted company's shares not held by those closest (e.g. directors, founding families) to the company who may be unlikely to sell their shares.

Frequency function (probability or frequency distribution) The organization of data to show the probabilities of certain values occurring.

Friendly mergers The two companies agree to the merger.

Friendly Society A mutual (co-operative) organization involved in saving and lending.

FTSE 100 share index An index representing the UK's 100 largest listed shares.

FT-SE Actuaries All-Share Index (the 'All-Share') The most representative index of UK shares, reflecting over 700 companies' shares.

FTSE International (*Financial Times* and the London Stock Exchange) This organization calculates a range of share indices published on a regular (usually daily) basis.

Full-payout lease *See* Leasing.

Fund management Investment of and administering a quantity of money, e.g. pension fund, insurance fund, on behalf of the fund's owners.

Fund raising Companies can raise money through rights issues, etc.

Fundamental analysts Individuals that try to estimate a share's true value, based on future returns to the company.

Fundamental beta An adjustment to the risk premium on the average share, developed by Barr Rosenburg and others, which amalgamates a number of operating and financial characteristics of the specific company being examined.

Fungible Interchangeable securities; can be exchanged for each other on identical terms.

Future A contract between two parties to undertake a transaction at an agreed price on a specified future date.

GAAP Generally accepted accounting principles. United States accounting rules for reporting results.

GDP (nominal, real) Gross domestic product, the sum of all output of goods and services produced by a nation. Nominal means including inflation, and real means with inflation removed.

Gearing (financial gearing) The proportion of debt capital in the overall capital structure. Also called leverage. High gearing can lead to exaggeratedly high returns if things go well or exaggerated losses if things do not go well.

Gearing (operating) The extent to which the firm's total costs are fixed. This influences the break-even point and the sensitivity of profits to changes in sales level.

General inflation The process of steadily rising prices resulting in the diminishing purchasing power of a given nominal sum of money. Measured by an overall price index which follows the price changes of a 'basket' of goods and services through time.

General insurance Insurance against specific contingencies, e.g. fire, theft and accident.

Geometric mean The geometric mean of a set of n positive numbers is the nth root of their product. The compound rate of return, e.g. the geometric mean of 2 and 5 is $\sqrt{2 \times 5} = \sqrt{10} = 3.16$.

Gilts (gilt-edged securities) Fixed-interest UK government securities (bonds) traded on the London Stock Exchange. A means for the UK government to raise finance from savers. They usually offer regular interest and a redemption amount paid years in the future.

Globalization The increasing internationalization of trade, particularly financial product transactions. The integration of economic and capital markets throughout the world.

Goal congruence The aligning of the actions of senior management with the interests of shareholders.

Going concern A judgment as to whether a company has sufficient financial strength to continue for at least one year. Accounts are usually drawn up on the assumption that the business is a going concern.

Going public A phrase used when a company becomes quoted on a stock exchange (the company may have been a public limited company, plc, for years before this).

Going long Buying a financial security (e.g. share) in the hope that its price will rise.

Going short *See* short selling.

Golden handcuffs Financial inducements to remain working for a firm.

Golden parachutes In a hostile merger situation, managers will receive large pay-offs if the firm is acquired.

Golden shares Shares with extraordinary special powers over the company, e.g. power of veto over a merger.

Good growth When a firm grows by investment in positive performance-spread activities.

Goodwill An accounting term for the difference between the amount that a company pays for another company and the market value of the other company's assets. Goodwill is thus an intangible asset representing things like the value of the company's brand names and the skills of its employees.

Grace period A lender grants the borrower a delay in the repayment of interest and/or principal at the outset of a lending agreement.

Greenbury report Recommendations on corporate governance.

Greenmail Key shareholders try to obtain a reward (e.g. the repurchase of their shares at a premium) from the company for not selling to a hostile bidder or becoming a bidder themselves.

Greenshoe An option that permits an issuing house, when assisting a corporation in a new issue, to sell more shares than originally planned. They may do this if demand is particularly strong.

Gross dividend yield

$$\frac{\text{Gross (before tax) dividend per share}}{\text{Share Price}} \times 100$$

Gross domestic product *See* GDP.

Gross margin *See* Gross profit margin.

Gross profit Turnover less cost of sales.

Gross profit margin (gross margin) Profit defined as sales minus cost of sales expressed as a percentage of sales.

Gross present value The total present value of all the cash flows, excluding the initial investment.

Growth industries Those industries which grow almost regardless of the state of the economy.

Guaranteed loan stock An organization other than the borrower guarantees to the lender the repayment of the principal plus the interest payment.

Hampel report A follow-up to the Cadbury and Greenbury reports on corporate governance. Chaired by Sir Ronald Hampel and published in 1998.

Hang Seng Index Main index for Hong Kong shares.

Hard capital rationing Agencies external to the firm will not supply large amounts of investment capital, even though positive NPV projects are identified.

Hard currency A currency traded in a foreign exchange market for which demand is persistently high.

Headline (underlying, adjusted or normalized) earnings per share Directors produce these profit per share numbers by excluding one-off costs, exceptional items and goodwill amortization to show underlying profit per share trend (or just to make the managerial performance look better).

Hedge fund A collective investment vehicle that operates free from regulation allowing it to take steps in managing a portfolio that other fund managers are unable to take, e.g. borrow to invest, shorting the market.

Hedging Reducing or eliminating risk by undertaking a countervailing transaction.

Herstatt risk In 1974 the German bank Herstatt was closed by the Bundesbank. It had entered into forex transactions and received deutschmarks from counterparties in European time, but had not made the corresponding transfer of US dollars to its counterparties in New York time. It is the risk that arises when forex transactions are settled in different time zones.

Higgs Committee Report Recommendations on corporate governance published in 2003.

High-yield shares (yield stocks) Shares offering a high current dividend yield because the share price is low due to the expectation of low growth in profits and dividends. Sometimes labeled value shares.

High-yield debt *See* Mezzanine finance or Junk bonds.

Hire-purchase (HP) The user (hiree) of goods pays regular instalments of interest and principal to the hire-purchase company over a period of months. Full ownership passes to the hiree at the end of the period (the hiree is able to use the goods from the outset).

Holding company *See* Parent company.

Holding period returns Total holding period returns on a financial asset consist of (a) income, e.g. dividend paid, and (b) capital gain – a rise in the value of the asset.

Homemade dividends Shareholders creating an income from shareholdings by selling a portion of their shareholding.

Horizontal merger The two companies merging are engaged in similar lines of activity.

Hostile merger The target (acquired) firm's management is opposed to the merger.

Hubris Overweaning self-confidence.

Hurdle rate The required rate of return. The opportunity cost of the finance provider's money.

Impact day The day during the launch of a new issue of shares when the price is announced, the prospectus published and offers to purchase solicited.

Income gearing The proportion of the annual income streams (i.e. pre-interest profits) devoted to the prior claims of debt holders. The reciprocal of income gearing is the interest cover.

Income statement Alternative title for profit and loss account.

Income yield *See* Yield.

Incorporation The forming of a company, including the necessary legal formalities.

Incremental fixed capital investment Investment in fixed assets which adds to the stock of assets and does not merely replace worn-out assets.

Independent director One that is not beholden to the dominant executive directors. Customers, suppliers or friends of the founding family are not independent, for example.

Independent variables The two variables are completely unrelated; there is no co-movement.

Index *See* Market index.

Index option An option on a share index, e.g. FTSE 100 or Standard and Poor's 500.

Index trackers Collective investment funds (e.g. unit trusts) which try to replicate a stock market index rather than to pick winners in an actively managed fund.

Industry attractiveness The economics of the market for the product(s) part of which is determined by industry structure.

Industry structure The combination of the degree of rivalry within the industry among existing firms; the bargaining strength of industry firms with suppliers and customers; and the potential for new firms to enter and for substitute products to take customers. The industry structure determines the long run rate of return on capital employed within the industry.

Inflation The process of prices rising.

Informal venture capitalist An alternative name for business angel.

Informed investors Those that are highly knowledgeable about financial securities and the fundamental evaluation of their worth.

Initial margin An amount that a derivative contractor has to provide to the clearing house when first entering upon a derivative contract.

Initial public offering (IPO) 'New Issue' The offering of shares in the equity of a company to the public for the first time.

Inland Revenue The principal tax-collecting authority in the UK.

Insider trading (dealing) Trading shares, etc. on the basis of information not in the public domain.

Instalment credit A form of finance to pay for goods or services over a period through the payment of principal and interest in regular instalments.

Institutional neglect Share analysts, particularly at the major institutions, may fail to spend enough time studying small firms, preferring to concentrate on the larger 100 or so.

Institutionalization The increasing tendency for organizational investing, as opposed to individuals investing money in securities (e.g. pension funds and investment trusts collect the savings of individuals to invest in shares).

Insurable risk Risk that can be transferred through the payment of premiums to insurance companies.

Intangible assets Those that you cannot touch.

Interbank brokers Brokers in the forex markets who act as intermediaries between buyers and sellers. They provide anonymity to each side.

Interbank sterling The money market in which banks borrow and lend sterling among themselves.

Interest cover The number of times the income of a business exceeds the interest payments made to service its loan capital.

Interest rate parity (IRP) of exchange rate determination The interest rate parity theory holds true when the difference between spot and forward exchange rates is equal to the differential between interest rates available in the two currencies.

Interest rate risk The risk that changes in interest rates will have an adverse impact.

Interest rate swap *See* Swap.

Interest yield *See* Yield.

Interim dividend A dividend related to the first half-year's trading.

Interim profit reports A statement giving unaudited profit figures for the first half of the financial year, shortly after the end of the first half-year.

Intermediaries offer A method of selling shares in the new issue market. Shares are offered to financial institutions such as stockbrokers. Clients of these intermediaries can then apply to buy shares from them.

Intermediate debt *See* Mezzanine finance or Junk bonds.

Internal metrics Measures of corporate performance available to those inside the company. They can be used at the corporate, SBU or product line level.

Internalization of transactions By bringing together two firms at different stages of the production chain in a vertical merger, an acquirer may achieve more efficient co-ordination of the different levels.

International Petroleum Exchange (IPE) The energy futures and options exchange in London.

International Securities Market Association (ISMA) A self-regulatory organization designed to promote orderly trading and the general development of the Euromarkets.

In-the-money option An option with intrinsic value. For a call option the current underlying price is more than the option exercise price. For a put option the current price of the underlying is below the exercise price.

Intrinsic value (company) The discounted value of the cash that can be taken out of a business during its remaining life.

Intrinsic value (options) The pay-off that would be received if the underlying is at its current level when the option expires.

Introduction A company with shares already quoted on another stock exchange, or where there is already a wide spread of shareholders, may be introduced to the market. This allows a secondary market in the shares.

Inventory *See* Stock.

Investment bank Banks that carry out a variety of financial services, usually excluding high street banking. Their services are usually fee based, e.g. fees for merger advice to companies.

Investment grade debt Debt with a sufficiently high credit rating to be regarded as safe enough for some institutional investors.

Invoice An itemized list of goods shipped, usually specifying the terms of sale and price.

Invoice discounting Separate (or a select few of) invoices are pledged to a finance house in return for an immediate payment of up to 80 per cent of the face value.

IOU A colloquialism intended to mean 'I owe you'. The acknowledgement of a debt.

Irredeemable Financial securities with no fixed maturity date at which the principal is repaid.

Irrelevancy of the dividend proposition (by Modigliani and Miller) If a few assumptions can be made, dividend policy is irrelevant to share value.

Issued share capital That part of a company's share capital that has been subscribed by shareholders, either paid up or partially paid up.

Issuing house *See* Sponsor.

Joint stock enterprise The capital is divided into small units, permitting a number of investors to contribute varying amounts to the total. Profits are divided between stockholders in proportion to the number of shares they own.

Junior debt *See* Subordinated debt.

Junk bonds Low-quality, low credit-rated company bonds. Rated below investment grade. Risky and with a high yield.

Just-in-time stock holding Materials and work-in-progress are delivered just before they are needed and finished goods are produced just before being sent to customers.

Lagging The postponement of a payment beyond the due date.

Laissez-faire The principle of the non-intervention of government in economic affairs.

Lead manager In a new issue of securities (e.g. shares, bonds, syndicated loans) the lead manager controls and organizes the issue. There may be joint lead managers, co-managers and regional lead managers.

Lead time The delay between placing an order with a supplier and the order being delivered.

Leading The bringing forward from the original due date of the payment of a debt.

Leasing The owner of an asset (lessor) grants the use of the asset to another party (lessee) for a specified period in return for regular rental payments. The asset does not become the property of the lessee at the end of the specified period. Finance lease (the leasing agreement is for 90% of the value of the asset); Operating lease (the leasing agreement is short term – much less than the life of the asset).

Leverage *See* Gearing.

Leveraged buyout (LBO) The acquisition of a company, subsidiary or unit by another, financed mainly by borrowings.

Leveraged recapitalizations The financial structure of the firm is altered in such a way that it becomes highly geared.

LIBOR (London Interbank Offered Rate) The rate of interest offered on loans to highly rated (low-risk) banks in the London interbank market for a specific period (e.g. three months). Used as a reference rate for other loans.

Life cycle stage of value creation The longevity of competitive advantage and favorable industry economics can be represented in terms of a life cycle with four stages: development, growth, maturity and decline. In the early stages superior long-term value performance is expected because of a sustainable competitive advantage and favorable long-term industry economics.

Life insurance Insurance against death. Beneficiaries receive payment upon death of the policyholder or other person named in the policy. Endowment policies offer a savings vehicle as well as cover against death.

LIFFE CONNECT™ The computer system used by euronext.liffe for trading derivatives.

LIFFE (London International Financial Futures and Options Exchange) The main derivatives exchange in London – now called euronext.liffe.

Limited companies (Ltd) 'Private' companies with no minimum amount of share capital, but with restrictions on the range of investors who can be offered shares. They cannot be quoted on the London Stock Exchange.

Limited liability The owners of shares in a business have a limit on their loss, set as the amount they have committed to invest in shares.

Liquidation of a company The winding-up of the affairs of a company when it ceases business. This could be forced by an inability to make payment when due or it could be voluntary when shareholders choose to end the company. Assets are sold, liabilities paid (if sufficient funds) and the surplus (if any) is distributed to shareholders.

Liquidity The degree to which an asset can be sold quickly and easily without loss in value.

Liquidity risk The risk that an organization may not have, or may not be able to raise, cash funds when needed.

Liquidity-preference hypothesis of the term structure of interest rates The yield curve is predominately upward sloping because investors require an extra return for lending on a long-term basis.

Listed companies Those on the Official List of the London Stock Exchange.

Listing agreement The UK Listing Authority insists that a company signs a listing agreement committing the directors to certain standards of behavior and levels of reporting to shareholders.

Listing particulars *See* Prospectus.

Lloyds Insurance Market A medium-sized insurance business in London founded over two centuries ago. 'Names' supply the capital to back insurance policies. Names can now be limited liability companies rather than individuals with unlimited liability to pay up on an insurance policy.

LME London Metal Exchange.

Loan stock A fixed-interest debt financial security. May be unsecured.

Local authority deposits Lending money to a UK local government authority.

London Clearing House (LCH) Settles mutual indebtedness between a number of organizations. It settles ('clears') trades for LIFFE traders, for example, and guarantees all contracts. It often acts as counterparty to all trades on an exchange.

London Metal Exchange (LME) Trades metals (e.g. lead, zinc, tin, aluminum and nickel) in forward and option markets.

London Stock Exchange (LSE) The London market in which securities are bought and sold.

London Traded Option Market (LTOM) Options exchange which merged with LIFFE in 1992.

Long-form report A report by accountants for the sponsor of a company being prepared for flotation. The report is detailed and confidential. It helps to reassure the sponsors when putting their name to the issue and provides the basis for the short-form report included in the prospectus.

Long position A positive exposure to a quantity. Owning a security or commodity; the opposite of a short position (selling).

Long-range structural analysis A process used to forecast the long-term rates of return of an industry.

Low-grade debt *See* Mezzanine finance or Junk bonds.

Low yield shares (stocks) Shares offering a relatively low dividend yield expected to grow rapidly. Often labeled growth stocks.

Ltd Private limited company.

M & A Merger and acquisition.

Macro economics The study of the relationships between broad economic aggregates: national income, saving, investment, balance of payments, inflation taxation, etc.

Maintenance margin (futures) The level of margin that must be maintained on a futures account (usually at a clearing house). Daily marking to market of the position may reveal the necessity to put more money into the account to top up to the maintenance margin.

Management buy-in (MBI) A new team of managers makes an offer to a company to buy the whole company, a subsidiary or a section of the company, with the intention of taking over the running of it themselves. Venture capital often provides the major part of the finance.

Management buyout (MBO) A team of managers makes an offer to its employers to buy a whole business, a subsidiary or a section so that the managers own and run it themselves. Venture capital is often used to finance the majority of the purchase price.

Managementism/Managerialism Management not acting in shareholders best interests by pursuing objectives attractive to the management team. Three levels:

(a) dishonest managers;

(b) honest but incompetent managers;

(c) honest and competent but as humans are subject to the influence of conflicts of interest.

Mandatory bid If 30 percent or more of the shares of a company are acquired the holder is required under Takeover Panel rules to bid for all the company's shares.

Margin (futures) Money placed aside to back a futures purchase or sale. This is used to reassure the counterparty to the future that money will be available should the purchaser/seller renege on the deal.

Marché à Terme d'Instruments Financiers (MATIF) The French futures and options exchange.

Market capitalization The total value at market prices of the shares in issue for a company (or a stock market, or a sector of the stock market).

Market in managerial control Teams of managers compete for control of corporate assets, e.g. through merger activity.

Market index A sample of shares is used to represent a share (or other) market's level and movements.

Market makers Organizations that stand ready to buy and sell shares from investors on their own behalf at the center of the London Stock Exchange's quoted-driven system of share trading.

Market portfolio A portfolio which contains all assets. Each asset is held in proportion to the asset's share of the total market value of all the assets. A proxy for this is often employed, e.g. the FTSE 100 index.

Market power The ability to exercise some control over the price of the product.

Market risk *See* Systematic risk.

Market segmentation hypothesis of the term structure of interest rates The yield curve is created (or at least influenced) by the supply and demand conditions in a number of sub-markets defined by maturity range.

Market to book ratio (MBR) The market value of a firm divided by capital invested.

Market value added The difference between the total amount of capital put into a business by finance providers (debt and equity) and the current market value of the company's shares and debts.

Marking to market The losses or gains on a derivative contract are assessed daily in reference to the value of the underlying price.

Matador A foreign bond issued in Spain.

Matching The company matches the inflows and outflows in different currencies created by overseas trade, etc., so that it is only necessary to deal on the currency markets for the unmatched portion of the total transactions.

Matching principle The maturity structure of debt matches the maturity of projects or assets held by the firm. Short-term assets are financed by short-term debt and long-term assets are financed by long-term debt.

Matched-bargain systems *See* Order-driven trading system.

Maturity date The time when a financial security (e.g. a bond) is redeemed and the par value is paid to the lender.

Maturity structure The profile of the length of time to the redemption and repayment of a company's various debts.

Maturity transformation Intermediaries offer securities with liquid characteristics to induce primary investors to purchase or deposit funds. The money raised is made available to the ultimate borrowers on a long-term, illiquid basis.

Maximization of long-term shareholder wealth The assumed objective of the firm in finance. It takes into account the time value of money and risk.

Mean (a) arithmetic mean: a set of numbers are summed, and the answer is divided by the number of numbers; (b) geometric mean: calculated as the nth root of the product of n number, e.g. the geometric mean of 2 and 5 is $\sqrt{2 \times 5} = \sqrt{10} = 3.16$.

Mean-variance rule If the expected return on two projects is the same but the second has a higher variance (or standard deviation), then the first will be preferred. Also, if the variance on the two projects is the same but the second has a higher expected return, the second will be preferred.

Medium-term note (MTN) A document setting out a promise from a borrower to pay the holders a specified sum on the maturity date and, in many cases, a coupon interest in the meantime. Maturity can range from nine months to 30 years. If denominated in a foreign currency, they are called Euro medium-term notes.

Memorandum of Association Lays down the rules which govern a company and its relations with the outside world, e.g. states the objective of the company.

Merchant banks *See* Investment bank.

Merger The combining of two business entities under common ownership.

Metric Method of measurement.

Minority shareholder A shareholder who owns less than 50 percent of a company.

Mezzanine finance Unsecured debt or preference shares offering a high return with a high risk. Ranked behind secured debt but ahead of equity. It may carry an equity kicker.

Mobilization of savings The flow of savings primarily from the household sector to the ultimate borrowers to invest in real assets. This process is encouraged by financial intermediaries.

Model Code for Directors' Dealings London Stock Exchange rules for directors dealing in shares of their own company.

Modified internal rate of return (MIRR) The rate of return which equates the initial investment with a project's terminal value, where the terminal value is the future value of the cash inflows compounded at the required rate of return (the opportunity cost of capital).

Monetary policy The deliberate control of the money supply and/or rates of interest by the central bank.

Money cash flow All future cash flows are expressed in the prices expected to rule when the cash flow occurs.

Money market Wholesale (large amounts) financial markets in which lending and borrowing on a short-term basis takes place (< 1 year).

Money rate of return The rate of return which includes a return to compensate for inflation.

Monopoly One producer in an industry. However for Competition Commission purposes a monopoly is defined as a market share of 25 percent.

Moral hazard The presence of a safety net (e.g. insurance policy) encourages adverse behavior (e.g. carelessness).

Mortgage debentures Bonds secured using property as collateral.

Mutual funds A collective investment vehicle the shares of which are sold to investors – a very important method of investing in shares in the USA.

Mutually-owned organizations Organizations run for the benefit of the members (usually the same as the consumers of the organization output) and not for shareholders. Examples include some insurance organizations, building societies and the co-operative societies.

Naked call option writing *See* Uncovered call option writing.

NASDAQ (National Association of Securities Dealers Automated Quotation System) A series of computer-based information services and an order execution system for the US over-the-counter securities (e.g. share) market.

National savings Lending to the UK government through the purchase of bonds, and placing money into savings accounts.

Near-cash (near-money) Highly liquid financial assets but which are generally not usable for transactions and therefore cannot be fully regarded as cash.

Negative covenants Loan agreements conditions that restrict the actions and rights of the borrower until the debt has been repaid in full.

Negotiability (1) Transferable to another – free to be traded in financial markets. (2) Capable of being settled by agreement between the parties involved in a transaction.

Net assets (Net worth) Net asset value (NAV) Total assets minus all the liabilities. Fixed assets, plus stocks, debtors, cash and other liquid assets, minus long- and short-term creditors.

Net current assets The difference between current assets and current liabilities.

Net operating cash flow Profit before depreciation, less periodic investment in net working capital.

Net present value (NPV) The present value of the expected cash flows associated with a project after discounting at a rate which reflects the value of the alternative use of the funds.

Net profit Profit after tax.

Net realizable value What someone might reasonably be expected to pay less the costs of the sale.

Netting When subsidiaries in different countries settle intra-organizational currency debts for the net amount owed in a currency rather than the gross amount.

New entrant A company entering a market area to compete with existing players.

New issue The sale of securities, e.g. debentures or shares, to raise additional finance or to float existing securities of a company on a stock exchange for the first time.

Newstrack A small company news service and a place where share prices for companies trading on OFEX are posted.

Niche company A fast growing small to medium-sized firm operating in a niche business with high potential.

Nikkei 225 Stock Average A share index based on the prices of 225 shares quoted on the Tokyo Stock Exchange.

Nil paid rights Shareholders may sell the rights to purchase shares in a rights issue without having paid anything for these rights.

Noise trading Uninformed investors buying and selling financial securities at irrational prices, thus creating noise (strange movements) in the price of securities.

Nominal return The return on an investment including inflation. If the return necessary to compensate for the decline in purchasing power of money (inflation) is deducted from the nominal return we have the real rate of return.

Nominal value *See* Par value.

Nominated adviser (Nomad) Each company on the AIM has to retain a nomad. They act as quality controllers, confirming to the London Stock Exchange that the company has complied with the rules.

Nominated brokers Each company on the AIM has to retain a nominated broker, who helps to bring buyers and sellers together and comments on the firm's prospects.

Non-executive director A director without day-to-day operational responsibility for the firm.

Non-voting shares A company may issue two or more classes of ordinary shares, one of which may be of shares that do not carry any votes.

Normal rate of return A rate of return that is just sufficient to induce shareholders to put money into the firm and hold it there.

Normalized earnings per share *See* Headline earnings per share.

Note (promissory note) A financial security with the promise to pay a specific sum of money by a given date, e.g. commercial paper, floating rate notes. Usually unsecured.

NYSE The New York Stock Exchange.

Objective probability A probability that can be established theoretically or from historical data.

OFEX An unregulated share market offering a secondary market trading facility.

Off-balance-sheet finance Assets are acquired in such a way that liabilities do not appear on the balance sheet, e.g. some lease agreements permit the exclusion of the liability in the accounts.

Offer document A formal document sent by a company attempting to buy all the shares in a target firm to all the shareholders of the target setting out the offer.

Offer for sale A method of selling shares in a new issue. The company sponsor offers shares to the public by inviting subscriptions from investors. (a) Offer for sale by fixed price – the sponsor fixes the price prior to the offer. (b) Offer for sale by tender – investors state the price they are willing to pay. A strike price is established by the sponsors after receiving all the bids. All investors pay the strike price.

Offer for subscription A method of selling shares in a new issue. The issue is aborted if the offer does not raise sufficient interest from investors.

Offer price The price at which a marketmaker in shares will sell a share, or a dealer in other markets will sell a security or asset.

Office of Fair Trading The Director-General of Fair Trading has wide powers to monitor and investigate trading activities and to refer monopoly or anti-competitive situations to the Competition Commission.

Official List (OL) The daily list of securities admitted for trading on the London Stock Exchange. It does not include securities traded on the Alternative Investment Market (AIM).

Offshore investment Outside of UK jurisdiction and financial regulation, usually in tax havens.

Oligopoly A small number of producers in an industry.

Onshore fund A fund authorized and regulated by the regulator in the investor's home country.

Open-ended funds The size of the fund and the number of units depends on the amount investors wish to put into the fund.

Open interest The sum of outstanding long and short positions in a given futures or option contract.

Open offer New shares are sold to a wide range of external investors (not existing shareholders). However, under claw back provisions existing shareholders can buy the shares at the offer price if they wish.

Open outcry Where trading is through oral calling of buy and sell offers by market members.

Open-ended investment companies (OEIC) Collective investment vehicles with one price for investors. OEICs are able to issue more shares if demand increases from investors, unlike investment trusts. OEICs invest the finance raised in securities, primarily shares.

Operating gearing *See* Gearing.

Operating lease The lease period is significantly less than the expected useful life of the asset.

Operating margin *See* Operating profit margin.

Operating profit (operating income) The income remaining after paying all costs other than interest.

Operating profit margin (operating margin, trading margin) Operating profit as a percentage of sales.

Operational efficiency of a market The cost to buyers and sellers of transactions in securities on the exchange.

Opportunity cost The value forgone by opting for one course of action; the next best use of, say, financial resources.

Opportunity cost of capital The return that is sacrificed by investing finance in one way rather than investing in an alternative of the same risk class, e.g. financial security.

Option A contract giving one party the right, but not the obligation, to buy or sell a financial instrument, commodity or some other underlying asset at a given price, at or before a specified date.

Option premium The amount paid by an option purchaser (holder) to obtain the rights under an option contract.

Order book system *See* Order-driven trading system.

Order-driven trading system Buy and sell orders for securities are entered on a central computer system, and investors are automatically matched according to the price and volume they entered (also called matched bargain systems) – SETS is an example.

Ordinary resources Those that give the firm competitive parity. They provide a threshold competence.

Ordinary shares The equity capital of the firm. The holders of ordinary shares are the owners and are therefore entitled to all distributed profits after the holders of debentures and preference shares have had their claims met.

Organic growth Growth from within the firm rather than through mergers.

Out-of-the-money option An option with no intrinsic value. For a call option the current price of the underlying is less than the exercise price. For a put option the current price of the underlying is more than the exercise price.

Over-allotment issue Same as Greenshoe.

Over-capacity An industry or company has significantly more capacity to supply product than is being demanded.

Overdraft A permit to overdraw on an account (e.g. a bank account) up to a stated limit; to take more out of a bank account than it contains.

Overhang Share price is depressed because of an anticipated sale of a large block of shares.

Overhead The business expenses not chargeable to a particular part of the work or product.

Oversubscription In a new issue of securities investors offer to buy more securities (e.g. shares) than are made available.

Over-the-counter trade (OTC) Securities trading carried on outside regulated exchanges. Allows tailor-made transactions.

Overtrading When a business has insufficient finance to sustain its level of trading. A business is said to be overtrading when it tries to engage in more business than the investment in working capital will allow. This can happen even in profitable circumstances.

Owner earnings Reported earnings plus depreciation, depletion, amortization and certain other non-cash charges less the amount of expenditure for plant and machinery and working capital, etc. that a business requires to fully maintain its long-term competitive position, its unit volume and invest in value generating opportunities.

PacMan defense In a hostile merger situation the target makes a counter bid for the bidder.

Par value (**nominal** or **face value**) A stated nominal value of a share or bond. Not related to market value.

Partnership An unincorporated business formed by the association of two or more persons who share the risk and profits.

Parent company (holding company) The one that partially or wholly owns other companies.

Pathfinder prospectus In a new issue of shares a detailed report on the company is prepared and made available to potential investors a few days before the issue price is announced.

Payback The period of time it takes to recover the initial cost of a project.

Payout ratio The percentage of after-tax profit paid to shareholders in dividends.

Pecking order theory of financial gearing Firms exhibit preferences in terms of sources of finance. The most acceptable source of finance is retained earnings, followed by borrowing and then by new equity issues.

Pension funds These manage money on behalf of members to provide a pension upon the member's retirement. Most funds invest heavily in shares.

Pension holiday When a pension fund does not need additional contributions for a time, it may grant the contributors, e.g. companies and/or members, a break from making payments.

Perfect competition (perfect market) Entry to the industry is free and the existing firms have no bargaining power over suppliers or customers. Rivalry between existing firms is fierce because products are identical. The following assumptions hold:

(a) there is a large number of buyers;

(b) there is a large number of sellers;

(c) the quantity of goods bought by any individual transaction is so small relative to the total quantity traded that individual trades leave the market price unaffected;

(d) the units of goods sold by different sellers are the same – the product is homogeneous;

(e) there is perfect information – all buyers and all sellers have complete information on the prices being asked and offered in other parts of the market; and

(f) perfect freedom of exit from the market.

Perfect hedge Eliminates risk.

Perfect market *See* Perfect competition.

Performance spread The percentage difference between the actual rate of return on an investment and the required rate given its risk class.

Perpetuity A regular sum of money received at intervals forever.

Personal equity plan (PEP) Personal investment vehicle with tax advantages. Directed mostly to encourage investment in quoted shares.

Physical delivery Settlement of a futures contract by delivery of the underlying.

Placing A method of selling shares and other financial securities in the primary market. Securities are offered to the sponsors' or brokers' private clients and/or a narrow group of institutions.

Planning horizon The point in the future after which an investment will earn only the minimum acceptable rate of return.

Plc Public limited company.

Poison pills Actions taken, or which will be taken, which make a firm unpalatable to a hostile acquirer.

Political risk Changes in government or government policies impacting on returns and volatility of returns.

Pooled funds Organizations (e.g. unit trusts) that gather together numerous small quantities of money from investors and then invest in a wide range of financial securities.

Portfolio A collection of investments.

Portfolio investment Investments made in other countries in bonds and shares. An alternative form of foreign investment is direct investment, buying commercial assets such as factory premises and industrial plant.

Portfolio optimizer A computer program designed to select an optimal portfolio in terms of risk and return.

Portfolio theory Formal mathematical model for calculating risk returns trade-offs as securities are combined is a portfolio.

Portfolio planning Allocating resources to those SBUs and product/customer areas offering the greatest value creation, while withdrawing capital from those destroying value.

Post-completion audit The monitoring and evaluation of the progress of a capital investment project through a comparison of the actual cash flows and other benefits with those forecast at the time of authorization.

Pre-emption rights The strong right of shareholders of UK companies to subscribe for further issues of shares. *See* Rights issue.

Preference share These normally entitle the holder to a fixed rate of dividend but this is not guaranteed. Holders of preference shares precede the holders of ordinary shares, but follow bond holders and other lenders in payment of dividends and return of principal. *Participating preference share*: share in residual profits. *Cumulative preference share*: share carries forward the right to preferential dividends should it be missed for a year(s). *Redeemable preference share*: a preference share with a finite life. *Convertible preference share*: may be converted into ordinary shares.

Preferred ordinary shares Rank higher than deferred ordinary shares for an agreed rate of dividend.

Preliminary annual results, Preliminary profit announcements (prelims) After the year-end and before the full reports and accounts are published, a statement on the profit for the year and other information is provided by companies quoted on the London Stock Exchange.

Premium (on an option) The amount paid to an option writer to obtain the right to buy or sell the underlying.

Present value Future cash flow is discounted to time zero.

Pre-tax margin *See* Pre-tax profit margin.

Pre-tax profit Profit on ordinary activities before deducting taxation.

Pre-tax profit margin (pre-tax margin) Profit after all expenses including interest expressed as a percentage of sales.

Price discovery The process of forming prices through the interaction of numerous buy and sell orders in an exchange.

Preservation approach to merger integration Little is changed in the acquired firm in terms of culture, systems or personnel. General management skills might be transferred from the parent along with strict financial performance yardsticks and demanding incentive schemes.

Press Collective name for newspapers and periodicals.

Price-earnings ratio (PER) Share price divided by earnings per share.

Historic PER: Share price divided by most recently reported annual earnings per share.

Forward (prospective) PER: Share price divided by anticipated annual earnings per share.

Price-earnings ratio game (bootstrapping) Companies increase earnings per share by acquiring other companies with lower price-earnings ratios than themselves. Share price can rise despite the absence of economic value gain.

Price-sensitive information That which may influence the share price or trading in the shares.

Price to book ratio (market to book) The price of a share as a multiple of per share book (balance sheet) value.

Pricing power An ability to raise prices even when product demand is flat without the danger of losing significant volume or market share.

Primary investors The household sector contains the savers in society who are the main providers of funds used for investment in the business sector.

Primary market A market in which securities are initially issued.

Principal (a) The capital amount of a debt, excluding any interest. (b) A person acting for their own purposes accepting risk in financial transactions, rather than someone acting as an agent for another.

Principal–agent problem In which an agent, e.g. a manager, does not act in the best interests of the principal, e.g. the shareholder.

Private equity Share capital invested in companies not quoted on an exchange.

Private limited company (Ltd) A company which is unable to offer its shares to the wider public.

Privatization The sale to private investors of government-owned equity (shares) in nationalized industries or other commercial enterprises.

Profitability index A measure of present value per pound invested.

Profit and loss account Records whether a company's sales revenue was greater than its costs.

Profit margin Profits as a percentage of sales.

Pro forma earnings Projected or forecast earnings. These are not audited and may be unreliable.

Project appraisal The assessment of the viability of proposed long-term investments in real assets within the firm.

Project finance Finance assembled for a specific project. The loan and equity returns are tied to the cash flows and fortunes of the project rather than being dependent on the parent company/companies.

Promissary note A borrower issues a note containing a promise to pay a sum of money on the redemption date. It will be sold at a discount prior to the redemption date.

Proprietary transactions A financial institution, as well as acting as an agent for a client, may trade on the financial markets with a view to generating profits for itself, e.g. speculation on forex.

Prospectus A document containing information about a company (unit trust/OEIC), to assist with a new issue (initial public offering) by supplying detail about the company and how it operates.

Provision Sum set aside in accounts for anticipated loss or expenditure.

Proxy votes Shareholders unable to attend a shareholders' meeting may authorize another person, e.g. a director or the chairman, to vote on their behalf, either as instructed or as that person sees fit.

Public limited company (Plc) A company which may have an unlimited number of shareholders and offer its shares to the wider public (unlike a limited company). Must have a minimum share value of £50,000. Some Plcs are listed on the London Stock Exchange.

Purchasing power parity (PPP) theory of exchange rate determination Exchange rates will be in equilibrium when their domestic purchasing powers at that rate of exchange are equivalent.

Put option This gives the purchaser the right, but not the obligation, to sell a financial instrument, commodity or some other underlying asset at a given price, at or before a specified date.

Quota Quantitative limits placed on the importation of specified goods.

Quick asset value (net) Current assets minus inventory stock minus current liabilities.

Quick ratio (acid test) The ratio of current assets, less stock, to total current liabilities.

Quoted Those shares with a price quoted on a recognized investment exchange, RIE (e.g. the Official list of the London Stock Exchange).

Quote-driven trading system Marketmakers post bid and offer prices on a computerized system.

Random walk theory The movements in (share) prices are independent of one another; one day's price change cannot be predicted by looking at the previous day's price change.

Ranking (debt) Order of precedence for payment of obligations. Senior debt receives annual interest and redemption payments ahead of junior (or subordinated) debt. So, if the company has insufficient resources to pay its obligation the junior debt holders may receive little or nothing.

Rappaport's value drivers The seven key factors which determine value are: (1) Sales growth rate. (2) Operating profit margin. (3) Tax rate. (4) Incremental fixed capital investment. (5) Incremental working capital investment. (6) The planning horizon. (7) The required rate of return.

Raw materials stock period The average number of days raw materials remain unchanged and in stock. Equal to the average value of raw materials stock divided by the average purchase of raw materials per day.

Real assets Assets used to carry on a business. These assets can be tangible or intangible.

Real cash flows Future cash flows are expressed in terms of constant purchasing power.

Real option An option to undertake different courses of action in the real asset market (strategic and operational options), as opposed to an option on financial securities or commodities.

Real rate of return The rate that would be required in the absence of inflation.

Recapitalization A change in the financial structure, e.g. in debt/equity ratio.

Receiver A receiver takes control of a business if a debtor successfully files a bankruptcy petition. The receiver may then sell the company's assets and distribute the proceeds among the creditors.

Recognized investment exchange (RIE) A body authorized to regulate securities trading in the UK, e.g. the London Stock Exchange.

Recourse If a financial asset is sold (such as a trade debt), the purchaser could return to the vendor for payment in the event of non-payment by the borrower.

Redemption The repayment of the principal amount, or par value, of a security (e.g. bond) at the maturity date.

Redemption yield *See* Yield.

Registrar An organization that maintains a record of share ownership for a company. It also communicates with shareholders on behalf of the company.

Regulatory News Service (RNS) A system for distributing important company announcements and other price-sensitive financial news run by the London Stock Exchange.

Relationship banking A long-term, intimate and relatively open relationship is established between a corporation and its banks. Banks often supply a range of tailor-made services rather than one-off services.

Rembrandt A foreign bond issued in The Netherlands.

Repayment holiday *See* Grace period.

Rescheduling Rearranging the payments made by a borrower to a lender – usually over a long period.

Residual theory of dividends Dividends should only be paid when the firm has financed all its positive NPV projects.

Resistance line A line drawn on a price (e.g. share) chart showing the market participants' reluctance to push the price below (or above) the line over a period of time.

Resolution A proposal put to the vote at a shareholders' meeting.

Resolution of uncertainty theory of dividends The market places a greater value on shares offering higher near-term dividends because these are more certain than more distant dividends.

Restructuring costs The costs associated with a reorganization of the business, e.g. closing factories, redundancies.

Retail banking Banking for individual customers or small firms, normally for small amounts. High-volume/low-value banking.

Retail Service Providers (RSPs) Some market makers also offer automated computer dealing service to investors as RSPs – *see* Real time dealing.

Retention ratio Retained profits for the year as a proportion of profits after tax attributable to ordinary shareholders for the year.

Return on capital employed (ROCE); return on investment (ROI) Traditional measures of profitability. Profit return divided by the volume of resources devoted to the activity. Resources usually includes shareholders funds, net debt and provisions. Cumulative goodwill, previously written off, may be added back to the resources total. *See also* Accounting rate of return.

Return on equity (ROE) Profit attributable to shareholders as a percentage of equity shareholders funds.

Revaluation reserve A balance sheet entry that records accumulated revaluations of fixed assets.

Reverse floating rate notes *See* Floating rate notes.

Revolving credit An arrangement whereby a borrower can draw down short-term loans as the need arises, to a maximum over a period of years.

Revolving underwriting facility (RUF) A bank underwrites the borrower's access to funds at a specified rate in the short-term financial markets throughout an agreed period.

Reward-to-variability ratio Alternative name for Sharpe ratio.

Reward-to-volatility ratio An alternative name for Treynor's ratio.

Rights issue An invitation to existing shareholders to purchase additional shares in the company in proportion to their existing holdings.

Risk A future return has a variety of possible values. Sometimes measured by standard deviation.

Risk averter Someone who prefers a more certain return to an alternative with an equal return but which is more risky.

Risk lover (seeker) Someone who prefers a more uncertain alternative to an alternative with an equal but less risky outcome.

Risk management The selection of those risks a business should take and those which should be avoided or mitigated, followed by action to avoid or reduce risk.

Risk transformation Intermediaries offer low-risk securities to primary investors to attract funds, which are then used to purchase higher-risk securities issued by the ultimate borrowers.

Risk-free rate of return (RFR) The rate earned on riskless investment, denoted r_f. A reasonable proxy is the lending rate to a reputable government.

Risk-return line A line on a two-dimensional graph showing all the possible expected returns, i.e. standard deviation combinations, available from the construction of portfolios from two assets. This can also be called the two-asset opportunity set or feasibility set.

Roadshow Companies and their advisers make a series of presentations to potential investors, usually to entice them into buying a new issue of securities.

Rolled-over overdraft Short-term loan facilities are perpetuated into the medium term and long term by the regular renewal of the facility.

Rolling settlement Shares and cash are exchanged after a deal had been struck a fixed number of days later – usually after three days – rather than on a specific account day.

RPI (retail price index) The main UK measure of general inflation.

R-squared, R^2 *See* Coefficient of determination.

Running yield *See* Yield.

Safe haven Investing in a safe secure investment in time of trouble, such as major financial turmoil. UK or US government bonds and Treasury bills are usually regarded as safe havens.

Sale and leaseback Assets (e.g. land and buildings) are sold to another firm (e.g. bank, insurance company) with a simultaneous agreement for the vendor to lease the asset back for a stated period under specific terms.

Sales ledger administration The management of trade debtors: recording credit sales, checking customer creditworthiness, sending invoices and chasing late payers.

Samurai bonds A foreign bond issued in Japan.

S&P 500 Standard and Poor's index of 500 leading US shares.

Satisficed When a contributor to an organization is given just enough of a return to make their contribution, e.g. banks are given contracted interest and principal, and no more.

Scaledown In a new issue, when a company floats on a stock exchange, if demand is greater than supply at the offer price the applicants receive less than what they applied for.

Scenario analysis An analysis of the change in NPV brought about by the simultaneous change in a number of key inputs to an NPV analysis. Typically a 'worst case scenario', when all the changes in variables are worsening, and a 'best case scenario', when all the variable changes are positive, are calculated.

Scrip dividends Shareholders are offered the alternative of additional shares rather than a cash dividend.

Scrip issue The issue of more shares to existing shareholders according to their current holdings.

SEAQ (Stock Exchange Automated Quotation System) A computer screen-based quotation system for securities where marketmakers on the London Stock Exchange report bid-offer prices and trading volumes, and brokers can observe prices and trades.

SEAQI (Stock Exchange Automated Quotation International) A computer screen-based quotation system for securities that allows marketmakers in international shares based on the London Stock Exchange to report prices, quotes and trading volumes.

Seasoned Equity Offerings (SEOs) Companies that have been on a stock exchange for some time selling new shares, e.g. via a rights issue.

SEATS plus (Stock Exchange Alternative Trading Service) A London Stock Exchange system for trading less liquid securities where there is either a single, or no, marketmaker. Displays marketmaker prices and/or current public orders.

Secondary market Securities already issued are traded between investors.

Securities and Exchange Commission (SEC) The US federal body responsible for the regulation of securities markets (exchanges, brokers, investment advisers, etc.).

Securities house This may mean simply an issuing house. However, the term is sometimes used more broadly for an institute concerned with buying and selling securities or acting as agent in the buying and selling of securities.

Securitization Financial payments (e.g. a claim to a number of mortgage payments) which are not tradeable can be repackaged into other securities (e.g. a bond) and then sold. These are called asset-backed securities.

Security (1) A financial asset, e.g. a share or bond. (2) Asset pledged to be surrendered in the event of a loan default.

Security market line (SML) A linear (straight) line showing the relationship between systematic risk and expected rates of return for individual assets (securities). According to the capital asset pricing model the return above the risk-free rate of return for a risky asset is equal to the risk premium for the market portfolio multiplied by the beta coefficient.

SEDOL Stock Exchange Daily Official List. A journal published daily giving prices and deals for shares on London's Official List.

Seedcorn capital The financing of the development of a business concept. High risk; usually provided by venture capitalists, entrepreneurs or business angels.

Self-regulation Much of the regulation of financial services in the UK is carried out by self-regulatory organizations (SROs), i.e. industry participants regulate themselves within a light-touch legislated framework.

Semi-annual Twice a year at regular intervals.

Semi-strong efficiency Share prices fully reflect all the relevant, publicly available information.

Senior debt *See* Subordinated debt.

Sensitivity analysis An analysis of the effect on project NPV of changes in the assumed values of key variables, e.g. sales level, labour costs. Variables are changed one at a time. It is a 'what-if' analysis, e.g. what if raw material costs rise by 20 percent?

Serious Fraud Office (SFO) Investigates and prosecutes crimes of serious fraud in the UK.

Sequence A computerized share trading platform introduced by the London Stock Exchange in 1996.

SETS (Stock Exchange Electronic Trading Service) An electronic order book-based trading system for the London Stock Exchange. Brokers input buy and sell orders directly into the system. Buyers and sellers are matched and the trade executed automatically. The system was used for the largest UK shares and the Stock Exchange plans to increase the number of shares on SETS – eventually SEAQ might be completely replaced.

Settlement The completion of a transaction, e.g. upon expiry of a future, the underlying is delivered in return for a cash payment.

Settlement price The price calculated by a derivatives exchange at the end of each trading session as the closing price that will be used in determining profits and losses for the marking-to-market process for margin accounts.

Share Companies divide the ownership of the company into ordinary shares. An owner of a share usually has the same rights to vote and receive dividends as another owner of a share.

Share buy-back The company buys back a proportion of its shares from shareholders.

Share certificate A document showing ownership of part of the share capital of a company.

Share market Institutions which facilitate the regulated sale and purchase of shares; includes the primary and secondary markets.

Share option scheme Employees are offered the right to buy shares in their company at a modest price some time in the future.

Share premium account A balance sheet entry represented by the difference between the price received by a company when it sells shares and the par value of those shares.

Share repurchase The company buys back its own shares.

Share split (stock split) Shareholders receive additional shares from the company. The nominal value of each share is reduced in proportion to the increase in the number of shares, so the total book value of shares remains the same.

Shareholders' funds The net assets of the business (after deduction of all short- and long-term liabilities and minority interests) shown in the balance sheet.

Shareholder value analysis A technique developed by Rappaport for establishing value creation. It equals the present value of operating cash flows within the planning horizon *plus* the present value of operating cash flows after the planning horizon *plus* the current value of marketable securities and other non-operating investments less corporate debt.

Shareholder wealth maximization The maximizing of shareholders' purchasing power. In an efficient market, it is the maximization of the current share price.

Sharpe ratio A measure relating risk and return. The extent to which a portfolio's (or share's) return has been greater than a risk-free asset divided by its standard deviation.

Shell company A company with a stockmarket quotation but with very little in the way of real economic activity. It may have cash but no production.

Short position In a derivative contract the counterparty in a short position is the one that has agreed to deliver the underlying.

Short selling The selling of financial securities (e.g. shares) not yet owned, in the anticipation of being able to buy at a later date at a lower price.

Short-term interest rate future (colloquially known as **short sterling**) The three-month sterling interest rate future contract traded on LIFFE. Notional fixed-term deposits for three-month periods starting at a specified time in the future.

Short-termism A charge leveled at the financial institutions in their expectations of the companies to which they provide finance. It is argued that long-term benefits are lost because of pressure for short-term performance.

Shorting Same as Short Selling.

Shorts UK government bonds (gilts) with less than five years to maturity.

Sight bank account (current account) One where deposits can be withdrawn without notice.

Sigma A measure of dispersion of returns, standard deviation.

Signaling Some financial decisions are taken as signals from the managers to the financial markets, e.g. an increase in gearing, or a change in dividend policy.

Simple interest Interest is paid on the original principal: no interest is paid on the accumulated interest payments.

Sinking fund Money is accumulated in a fund through regular payments in order eventually to repay a debt.

Small firm effect The tendency of small firms to give abnormally high returns.

Soft capital rationing Internal management-imposed limits on investment expenditure.

Solvency The ability to pay legal debts.

South Sea Bubble A financial bubble (*see* Bubble) in which the price of shares in the South Sea Company were pushed to ridiculously high levels on a surge of over-optimism in the early eighteenth century.

Special dividend An exceptionally large dividend paid on a one-off basis.

Special purpose entity Companies set these up as separate organizations for a particular purpose. They are designed so that their accounts are not consolidated with the rest of the group.

Special resolution A company's shareholders vote at a AGM or EGM with a majority of 75 percent of those voting. Normally special resolution are reserved for important changes in the constitution of the company. Other matters are dealt with by way of ordinary resolution (50 percent or more of the votes required).

Specific inflation The price changes in an individual good or service.

Special drawing rights (SDRs) A composite currency designed by the International Monetary Fund (IMF). Each IMF member country is allocated SDRs in proportion to its quota.

Specific inflation The price changes in an individual good or service.

Speculative motive for holding cash This means that unexpected opportunities can be taken immediately.

Speculators Those that take a position in financial instruments and other assets with a view to obtaining a profit on changes in their value.

Sponsor Lends its reputation to a new issue of securities, advises the client company (along with the issuing broker) and co-ordinates the new issue process. Sponsors are usually merchant banks or stockbrokers. Also called an issuing house.

Spot market A market for immediate transactions (e.g. spot forex market, spot interest market), as opposed to an agreement to make a transaction some time in the future (e.g. forward, option, future).

Spread The difference between the price to buy and the price to sell a financial security. Market makers quote a bid-offer spread for shares. The lower price (bid) is the price an investor receives if selling to the market maker. The higher (offer) price is the price if the investor wishes to buy from the market maker.

Stakeholder A party with an interest in an organization, e.g. employees, customers, suppliers, the local community.

Standard and Poors 500 (S & P 500) An index of US shares.

Standard deviation A statistical measure of the dispersion around an average. A measure of volatility. The standard deviation is the square root of the variance. A fund or a share can be expected to fall within one standard deviation of its average two-thirds of the time if the future is like the past.

Start-up capital Finance for young companies which have not yet sold their product commercially. High risk; usually provided by venture capitalists, entrepreneurs or business angels.

Statutory Established, regulated or imposed by or in conformity with laws passed by a legislative body, e.g. Parliament.

Sterling bonds Corporate bonds which pay interest and principal in sterling.

Stock Another term for inventory of raw materials, work-in-progress and finished items.

Stocks and shares There is some lack of clarity on the distinction between stocks and shares. Shares are equities in companies. Stocks are financial instruments that pay interest, e.g. bonds. However, in the USA shares are also called 'common stocks' and the shareholders are sometimes referred to as the stockholders. So when some people use the term stocks they could be referring to either bonds or shares.

Stock exchange A market in which securities are bought and sold. In continental Europe the term bourse may be used.

Stock Exchange Automated Quotations See SEAQ.

Stock market See Stock Exchange.

Stock-out costs The cost associated with being unable to draw on a stock of raw material, work-in-progress or finished goods inventory (loss of sales, profits and goodwill, and also production dislocation).

Straight bond One with a regular fixed rate of interest and without the right of conversion (to, say, shares).

Strategic business unit (SBU) A business unit within the overall corporate entity which is distinguishable from other business units because it serves a defined external market where management can conduct strategic planning in relation to products and markets.

Strategic analysis The analysis of industries served by the firm and the company's competitive position within the industry.

Strategy Selecting which product or market areas to enter/exit and how to ensure a good competitive position in those markets/products.

Strategy planes chart Maps a firm's, SBU's or product line's position in terms of industry attractiveness, competitive advantage and life-cycle stage of value potential.

Strike price (1) In the offer for sale by a tender it is the price which is chosen to sell the required quantity of shares given the offers made. (2) The price paid by the holder of an option when/if the option is exercised. *See* Exercise price.

Strong form efficiency All relevant information, including that which is privately held, is reflected in the share price.

Subjective probability Probabilities are devised based on personal judgment of the range of outcomes along with the likelihood of their occurrence.

Subordinated debt A debt which ranks below another liability in order of priority for payment of interest or principal. Senior debt ranks above junior debt for payment.

Subsidiary A company is a subsidiary of another company if the parent company holds the majority of the voting rights, or has a minority of the shares but has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters or it has the right to exercise a dominant influence.

Subscription rights A right to subscribe for some shares.

Summary financial statement Companies often send small investors a summary of the financial statements rather than the full report and accounts. This suits many investors and saves the company some money. However, an investor is entitled to receive a full annual report and accounts. It may be necessary to make a request for this.

Sunk cost A cost the firm has incurred or to which it is committed that cannot be altered. This cost does not influence subsequent decisions and can be ignored in, for example, project appraisals.

Super normal returns A rate of return above the normal rate.

Survivorship bias In empirical studies of share price performance the results may be distorted by focussing only on companies which survived through to the end of the period of study. Particularly poor performers (i.e. liquidated firms) are removed from the sample, thus biasing the results in a positive direction.

Swap An exchange of cash payment obligations. An interest rate swap is where one company arranges with a counterparty to exchange interest rate payments. In a currency swap the two parties exchange interest obligations (receipts) for an agreed period between two different currencies.

Swaption An option to have a swap at a later date.

Symbiosis type of post-merger integration Large differences between acquired and parent firms in culture, systems, etc. are maintained. However, collaboration in communications and the cross-fertilization of ideas are encouraged.

Syndicated loan A loan made by one or more banks to one borrower.

Synergy A combined entity (eg. two companies merging) will have a value greater than the sum of the parts.

Systematic (undiversifiable or market) risk That element of return variability from an asset which cannot be eliminated through diversification. Measured by beta. It comprises the risk factors common to all firms.

Takeover (acquisition) Many people use these terms interchangeably with merger. However, some differentiate takeover as meaning a purchase of one firm by another with the concomitant implication of financial and managerial domination.

Takeover Panel The committee responsible for supervising compliance with the City Code on Takeovers and Mergers.

Tangible assets Those that have a physical presence.

Tariff Taxes imposed on imports.

Tax allowance An amount of income or capital gain that is not taxed.

Tax avoidance Steps taken to reduce tax that are permitted under the law.

Tax evasion Deliberately giving a false statement or omitting a relevant fact.

Tax haven A country or place with low rates of tax.

Taxable profit That element of profit subject to taxation. This frequently differs from reported profit.

techMARK The London Stock Exchange launched techMARK in 1999. It is a subsection of the shares within the Official List. It is a grouping of technology companies. It imposes different rules on companies seeking a flotation from those which apply to the other companies on the Official List (e.g. only one year's accounts is required).

Tender offer A public offer to purchase securities.

Term loan A loan of a fixed amount for an agreed time and on specified terms, usually with regular periodic payments. Most frequently provided by banks.

Term structure of interest rates The patterns of interest rates on bonds with differing lengths of time to maturity but with the same risk. Strictly it is the zero-coupon implied interest rate for different lengths of time. *See also* Yield curve.

Terminal value The forecast future value of sums of money compounded to the end of a common time horizon.

Tick The minimum price movement of a future or option contract.

Tier one ratio of core capital That part of a bank's capital defined as shareholders' equity plus irredeemable and non-cumulative preference shares.

Tiger economies The first four newly industrialized economies in Asia: Taiwan, South Korea, Singapore and Hong Kong (also referred to as dragon economies).

Time value That part of an option's value that represents the value of the option expiring in the future rather than now. The longer the period to expiry, the greater the chance that the option will become in-the-money before the expiry date. The amount by which the option premium exceeds the intrinsic value.

Time value of money A pound received in the future is worth less than a pound received today – the value of a sum of money depends on the date of its receipt.

Total shareholder return (TSR) The total return earned on a share over a period of time: dividends per share plus capital gain divided by initial share price.

Trade credit Where goods and services are delivered to a firm for use in its production and are not paid for immediately.

Trade debtor A customer of a firm who has not yet paid for goods and services delivered.

Trading floor A place where traders in a market (or their representatives) can meet to agree transactions face to face. However investment banks often have 'trading floors' where they 'meet' counterparties on other trading floors to conduct transactions via the telephone or computer.

Trading margin *See* Operating profit margin.

Traditional option An option available on a security with an exercise price fixed as the market price on the day the option is bought. All such options expire after three months and cannot be sold to a secondary investor.

Transaction risk The risk that transactions already entered into, or for which the firm is likely to have a commitment in a foreign currency, will have a variable value in the home currency because of exchange rate movements.

Transactional banking Banks compete with each other to offer services at the lowest cost to corporations, on a service-by-service basis.

Transactional motive for holding cash Money is used as a means of exchange; receipts and payments are rarely perfectly synchronized and therefore an individual or business generally needs to hold a stock of money to meet expenditure.

Translation risk This risk arises because financial data denominated in one currency are then expressed in terms of another currency.

Treasury UK government department responsible for financial and economic policy.

Treasury bill A short-term money market instrument issued (sold) by the central bank, mainly in the UK and USA, usually to supply the government's short-term financing needs.

Treasury management To plan, organize and control cash and borrowings so as to optimize interest and currency flows, and minimize the cost of funds. Also to plan and execute communications programs to enhance investors' confidence in the firm.

Treynor's ratio A measure relating return to risk. It is the return on a portfolio (or share) minus the risk-free rate of rate of return divided by beta.

TRRACK system A system to assist the analysis of a company's extraordinary resources under the headings: tangible; relationships; reputation; attitude; capabilities; and knowledge.

Trust deed A document specifying the regulation of the management of assets on behalf of beneficiaries of the trust.

Trustees Those that are charged with the responsibility for ensuring compliance with the trust deed.

Tulipmania A seventeenth-century Dutch bubble. *See* Bubble.

Ultimate borrowers Firms investing in real assets need finance which ultimately comes from the primary investors.

Uncertainty Strictly (in economists' terms), uncertainty is when there is more than one possible outcome to a course of action; the form of each possible outcome is known, but the probability of getting any one outcome is not known. However, the distinction between risk (the ability to assign probabilities) and uncertainty has largely been ignored for the purposes of this text.

Unconditionality In a merger, once unconditionality is declared, the acquirer becomes obligated to buy. Target shareholders who accepted the offer are no longer able to withdraw their acceptance.

Uncovered (naked) call option writing Writing a call option on an underlying when the writer does not own the underlying securities included in the option.

Unconventional cash flows A series of cash flows in which there is more than one change in sign – more than one switch from inflows to outflows or outflows to inflows.

Underlying The subject of a derivative contract.

Underlying earnings per share *See* Headline earnings per share.

Underwriters These (usually large financial institutions) guarantee to buy the proportion of a new issue of securities (e.g. shares) not taken up by the market, in return for a fee.

Undifferentiated product One that is much the same as that supplied by other companies.

Undiversifiable risk *See* Systematic risk.

Uninformed investors Those that have no knowledge about financial securities and the fundamental evaluation of their worth.

Unit trust An investment organization that attracts funds from individual investors by issuing units to invest in a range of securities, e.g. shares or bonds. It is open ended, the number of units expanding to meet demand.

United Kingdom Listing Authority (UKLA) This organization is part of the Financial Services Authority and rigorously enforces a set of demanding rules on companies joining the stock market and in subsequent years.

Universal banks Financial institutions involved in many different aspects of finance including retail banking and wholesale banking.

Unlisted Shares and other securities not on the Official List of the London Stock Exchange are described as unlisted.

Unlisted Securities Market (USM) A lower-tier (less stringently regulated) market for shares in London, which ceased in 1996.

Unquoted Those shares with a price not quoted on a recognized investment exchange, RIE (e.g. the Official List or AIM of the London Stock Exchange).

Unsecured A financial claim with no collateral or any charge over assets of the borrower.

Unsystematic (unique or diversifiable) risk That element of an asset's variability in returns which can be eliminated by holding a well-diversified portfolio.

Utility The satisfaction, pleasure or fulfilment of needs derived from consuming some quantity of a good or service.

Valuation risk (price risk) The possibility that, when a financial instrument matures or is sold in the market, the amount received is less than anticipated by the lender.

Value action pentagon This displays the five actions for creating value: (1) Increase the return on existing capital. (2) Raise investment in positive spread units. (3) Divest assets from negative spread units to release capital for more productive use. (4) Extend the planning horizon. (5) Lower the required rate of return.

Value chain The interlinking activities that take place within an organization or between organizations in the process of converting its inputs into its outputs. Identifying these activities and finding ways to perform them more efficiently is a way for companies to gain competitive advantage over their rivals.

Value creation: four key elements The four key elements are: (1) Amount of capital invested. (2) Actual rate of return on capital. (3) Required rate of return. (4) Planning horizon (for performance-spread persistence).

Value creation profile An analysis of the sources of value creation within the firm from its products and market segments, which maps value creation against the proportion of capital invested.

Value creation quotient (VCQ) An external value metric developed by Rory Knight. The market value of equity and the balance sheet value of debt divided by the cumulative capital raised and retained (debt plus equity).

Value drivers Crucial organizational capabilities, giving the firm competitive advantage. Different from Rappaport value drivers.

Value investing The identification and holding of shares which are fundamentally undervalued by the market, given the prospects of the firm.

Value-based management A managerial approach in which the primary purpose is long-term shareholder wealth maximization. The objective of the firm, its systems, strategy, processes, analytical techniques, performance measurements and culture, have as their guiding objective long-term shareholder wealth maximization.

Vanilla bond *See* Straight bond.

Variable costs Costs that rise or fall with company output and sales.

Variable rate bond (loan) The interest rate payable varies with short-term rates (e.g. LIBOR six months).

Variance A measure of volatility around an average value. It is the square of the standard deviation.

Variation margin The amount of money paid after the payment of the initial margin required to secure an option or futures position, after it has been revalued by the exchange or clearing house.

Vendor placing Shares issued to a company to pay for assets, or issued to shareholders to pay for an entire company in a takeover are placed with investors keen on holding the shares in return for cash. The vendors can then receive the cash.

Venture and development capital investment trusts (VDCIT) Standard investment trusts (without tax breaks) with a focus on more risky developing companies.

Venture capital (VC) Finance provided to unquoted firms by specialized financial institutions. This may be backing for an entrepreneur, financing a start-up or developing business, or assisting a management buyout or buy-in. Usually it is provided by a mixture of equity, loans and mezzanine finance. It is used for medium-term to long-term investment in high-risk situations.

Venture capital trusts (VCTs) An investment vehicle introduced to the UK in 1995 to encourage investment in small and fast-growing companies. The VCT invests in a range of small businesses. The providers of finance to the VCT are given important tax breaks.

Vertical merger Where the two merging firms are from different stages of the production chain.

Virt-x A share market operating electronically across borders. It mostly trades large Swiss company shares (it is part owned by SWX Swiss Exchange). It is a recognized Investment Exchange supervised by the FSA in the UK.

Volatility The speed and magnitude of price change over time, measured by standard deviation or variance.

Volume transformation Intermediaries gather small quantities of money from numerous savers and repackage these sums into larger bundles for investment in the business sector or elsewhere.

Warrant A financial instrument which gives the holder the right to subscribe for a specified number of shares or bonds at a fixed price at some time in the future.

Weak form efficiency Share prices fully reflect all information contained in past price movements.

Weighted average cost of capital (WACC) The weighted average cost of capital (the discount rate) is calculated by weighting the cost of debt and equity in proportion to their contributions to the total capital of the firm.

Wealth added index (WAI) A value metric devised and trademarked by Stern Stewart and Co. It measures the increase in shareholders' wealth through dividend and capital gains over a number of years after deducting the cost of equity capital, defined as the return required for shares of that risk class.

White knight A friendly company which makes a bid for a company that is welcome to the directors of that target company, which is the subject of a hostile takeover bid.

Wholesale bank *See* Investment bank.

Wholesale financial markets Markets available only to those dealing in large quantities. Dominated by interbank transactions.

Winding up The process of ending a company, selling its assets, paying its creditors and distributing the remaining cash among shareholders.

Winner's curse In winning a merger battle, the acquirer suffers a loss in value because it overpays.

Withholding tax Taxation deducted from payments to non-residents.

Working capital The difference between current assets and current liabilities – net current assets or net current liabilities.

Working capital cycle Typically, investment in raw materials, work-in-progress and finished goods is followed by sales for cash or on credit. Credit sales funds are usually collected at a later date. Investment is needed at each stage to finance current assets. The cycle may be expressed in terms of the length of time between the acquisition of raw materials and other inputs and the flow of cash from the sale of goods.

Work-in-progress period The number of days to convert raw materials into finished goods. Equal to the average value of work-in-progress divided by the average cost of goods sold per day.

Write down (write off) Companies change the recorded value of assets when they are no longer worth the previously stated value.

Writer of an option The seller of an option contract, granting the right but not the obligation to the purchaser.

Writing-down allowance (WDA) (capital allowance) Reductions in taxable profit related to a firm's capital expenditure (e.g. plant, machinery, vehicles).

Yankee A foreign bond issued in the USA.

Yield The income from a security as a proportion of its market price. The flat yield (interest yield, running yield and income yield) on a fixed interest security is the gross interest amount, divided by the current market price, expressed as a percentage. The redemption yield or yield to maturity of a bond is the discount rate such that the present value of all cash inflows from the bond (interest plus principal) is equal to the bonds current market price.

Yield curve A graph showing the relationship between the length of time to the maturity of a bond and the interest rate.

Yield stock *See* High yield shares.

Zero cost option A combination of option purchase and option writing. The price of the written option (premium) is the same as the price (premium) paid for the option that is purchased, so the net cost is zero.

Zero coupon bond (preference share) A bond that does not pay regular interest (dividend) but instead is issued at a discount (i.e. below par value) and is redeemable at par, thus offering a capital gain.