Editorial

Financial modelling as a bridging feature

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A feature issue on financial modelling is an issue of EJOR partly or wholly devoted to financial modelling. The intended frequency of feature issues on financial modelling is once or twice per year. Papers on financial modelling are solicited that help to solve financial-economic decision problems in practice. Papers may relate to new insights, both theoretical and empirical, into the environment in which decision makers operate, new tools available to the decision makers and to the integration of these tools within frameworks for financial-economic decision making. Papers that stimulate and strengthen the interaction between financial-economic theory and the practice of financial decision making, will be especially welcome.

Defined in the way just described, financial modelling is a feature strengthening the bridges between financial-economic theory and the practice of financial economic decision making.

Thusfar, the European Journal of Operational Research has published a number of special issues on Financial Modelling: Issue 74/2, edited by T. Martikainen, I. Virtanen and P. Yli-Olli; Issue 91/2, edited by E. Castagnoli and J. Spronk.

The present feature issue on financial modelling, edited by J. Spronk, is the second in a series of feature issues, published by the European Journal of Operational Research together with the EURO Working Group on Financial Modelling. The time elapsed between this and the preceding feature issue was longer than expected and hoped for. One main reason is that all papers had to go through a rather 'heavy' refereeing process since it is the policy of the EURO working group on financial modelling to reserve this valuable journal space for high quality papers only. Thus many papers had to be revised while others have been rejected (many of them because they did not fit within the scope of these feature issues as outlined above). Many other papers are still in the refereeing process. It may therefore be expected that the waiting time until the next feature issue is much shorter. We hope and believe that the editorial policy with respect to the feature issues leads to a long series of attractive issues.

The present issue offers a varied portfolio of contributions to financial modelling. In the first paper, R. Mansini and M.G. Speranza deal with the portfolio selection problem with minimum transaction lots. They show that the problem of finding a feasible solution is, independently of the risk function, NP-complete and propose some heuristics for finding a solution which is close to the optimum.

A.C. Soteriou and S.A. Zenios present a method for providing efficient and reliable cost estimates of bank products at the branch level, based on the non-parametric technique of Data Envelopment Analysis.

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S.E. Satchell and G.A. Christodoulakis build a simulation framework for modelling the deviation of observed option prices from the Black and Scholes prices. The methodology is applied to LIFFE options on German government bond futures.

Recently, the rough sets approach has received a lot of attention and has seen exciting developments. In their contribution, A.I. Dimitras, R. Slowinski, R. Susmanga, and C. Zopounides derive a set of decision rules for the prediction of business failure. The results for a sample of 80 Greek firms are compared with those of discriminant and logit analyses.

An important issue in financial decision making is the accuracy of forecasts by financial experts. A.C. Pollock, A. Macaulay, D. Onkal-Atay and M.E. Wilkie-Thomson use simulated currency series to evaluate the predictive performance of judgemental extrapolations.

In the paper by L. Peccati and E. Luciano some basic problems in inventory theory are studied from the financial perspective. More in particular, these authors address the influence of leverage on capital costs with in its turn, the influence on the present value of the inventory costs.

L.H.R. Alvarez considers both the optimal exit strategy and the valuation of stochastic cash flows of a firm facing demand uncertainty and potential excess supply. By relying on the standard theory of linear diffusions and ordinary non-linear programming, he derives the value of the rationally managed firm and the necessary conditions for optimal exit.

The final paper in this feature issue is by W.G. Hallerbach and H. Grootveld and focuses on the differences and similarities between using variance or a downside risk measure, taking both a theoretical and an empirical point of view. The paper gives answers to the question raised in the title: Variance versus downside risk: is there really that much difference?

The next feature issue is well underway and is Guest Edited by Jaap Spronk, Erasmus University, and Nico van der Wijst, The Norwegian University of Science and Technology (see the Call for Papers).