

As a result, the utility company raised more money on better terms. Another insurer financed the purchase of airplanes in Canada and a management buy-out in Britain. Yet another, teamed up with a banker and promised to supply a French firm with operating cash in times of recession. I have been impressed by the scope and depth of the examples, so I will repeat that there are pages and pages of examples. After examining and critically analyzing them, the student of risk financing will develop an insight into the process of innovating and effective alternative solutions for financing a firm's exposure to risk.

Strategy, Value, and Risk—The Real Options Approach, by Jamie Rogers, 2002, New York: Palgrave Macmillan

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In the insurance industry, there are many examples of options to expand and options to abandon. Insurance companies cannot afford to ignore such options. Any serious attempt to valuation of insurance companies now entails a valuation of the embedded and expansion options.

In early 2002, the *Economist* magazine issued a scathing report on the insurance giant AIG. It claimed that by looking at "best in each line of business" and adding them up, the value of AIG should have been less than half of its market value. It claimed that as a result, AIG was severely overvalued. In a strong criticism of the *Economist* report, Bernstein (http://www.economist.com/finance/aig_bernstein.pdf) showed that the analysis by the consultant hired by the *Economist* was deeply flawed. The consultants did not take into account the expansion options of the giant AIG.

How much would such options be worth? For general insurance and life insurance businesses of the AIG, these options have values approximately equal to their embedded and franchise values. In case of financial products, the real option value was even bigger. In sum, real option value embedded in insurance companies is not little add on. It is one of the main events (see, for a practical application of a real-life takeover valuation using real options, <http://allman.rhon.itam.mx/~tapen/ArredondoSinha.PDF>). Thus, the use of real options can be quite useful for insurance industry.

The professed purpose of this little book is "provide a background to the concept and method of real options." The author, Jamie Rogers is a consultant with PricewaterhouseCoopers, New York with their financial risk management practice.

The book is divided into thirteen chapters in four parts. A brief introduction sets the stage. It talks about Schumpeter's thesis of creative destruction. With a brief discussion of value and risk, it launches the case for real options as the value for the flexibility of a project. Part I has four chapters discussing the evolution of strategy, value, and risk.

Chapter 1 (of three pages) begins with an overall view about strategy. Chapter 2 gives a four-page summary of net present value. Chapter 3 is an equally brief two-page summary of investment risk. Chapter 4 discusses three strategic case studies: one of information technology, one for energy, and one for the introduction of a new (and expensive) drug by a pharmaceutical company using discounted cash flow analysis.

Part II contains three chapters with the general theme of developments in strategy, value, and risk.

Chapter 5 discusses strategy in a generic fashion. Chapter 6 provides a brief introduction of the types of real options. Chapter 7 talks about risk in general.

Part III contains four chapters that show the methods of quantifying real options.

Chapter 8 discusses elementary options. Chapter 9 discusses time series methods (ARCH and GARCH) and then goes on to introduce the notion of volatility. The discussion of the time series method is never discussed again in the book. Chapter 10 briefly introduces the Black-Scholes model only to be dismissed in favor of a trinomial approximation. Chapter 11 discusses how to implement real options but all in theory. Thus, the reader is left with no clue as to how to do it practically.

Part IV has two chapters with three case studies.

The three case studies are revisited with the consideration of the real options. As expected, the real options increase the projects.

The book is very economical in terms of words. The entire book is of 134 pages (excluding a long index). If we count the blank pages, figures, tables, and graphs, it is even shorter. As a nice introduction to the topic, the book does a good job. But the brevity also makes some things very sketchy. For example, the discussion of theory should have been supplemented with examples. Many other competing titles have them. In fact, many other books on real options come with CDs where templates are set up for Microsoft Excel. This becomes very useful for using it in the classroom.

I find it quite unacceptable to have such a book priced at \$180. This is not the fault of the author. As we know, authors never get to set the price, publishers do.

What I found even more objectionable is false advertising by the publisher. In the website of Palgrave, they list the following items for the book: Introduction, The Development of Strategy, Valuation, and Measuring Risk, Three Strategic DCF Case Studies, Real Options, Developments in Strategy, Developments in Risk Management, Quantifying Real Options, Three Strategic Real Options Case Studies, Conclusion, and Practical Implications.

One glance at the book shows this is not what we get in the book. The chapters are different. Even more objectionable is that the website says that the book contains 250 pages. It does not. Thus, unless you can literally get your hands on the book, trying to buy it on the Internet can be deceptive. *Caveat emptor.*

The Development and Regulation of Nonbank Financial Institutions, by Jeffrey Carmichael and Michael Pomerleano, March 2002, World Bank

Reviewer: Kathleen S. McNichol, MBA, CPCU, ARM, La Salle University, Philadelphia, PA

How important are nonbank financial institutions to the success of emerging economies? What role does regulation of these institutions play to ensure this success? These and other questions are addressed by Carmichael and Pomerleano in *The Development and Regulation of Nonbank Financial Institutions* published by The World

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