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In Honor of the Nobel Laureates Robert C. Merton and Myron S. Scholes: A Partial Differential Equation That Changed the World

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Abstract

The Nobel Prize was given to Robert C. Merton and Myron S. Scholes for discovering a new method for determining the value of an option. This is known as the Black-Merton-Scholes option pricing formula. The purpose of this essay is to explain why the Black-Merton-Scholes option pricing formula is so important to the finance profession, the economics profession, the financial industry, and society at large. This is done by studying the history of the formula's development, the economic logic underlying the formula's derivation, and the formula's ramifications for the various professions.

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