Glossary of key terms

acid test Quick assets (current assets excluding stocks) divided by current liabilities measures the ability of the business to pay creditors in the short-term.

balanced scorecard An approach to the provision of information to management to assist strategic policy formulation and achievement. It emphasises the need to provide the user with a set of information which addresses all relevant areas of performance in an objective and unbiased fashion. The information provided may include both financial and non-financial elements, and cover areas such as profitability, customer satisfaction, internal efficiency and innovation.

cash interest cover Net cash inflow from operations plus interest received, divided by interest paid, calculates the number of times the interest payable is covered by cash flow available for such payments.

creditor days Average trade creditors divided by average daily purchases on credit terms indicates the average time taken, in calendar days, to pay for supplies received on credit.

cross-sectional analysis Cross-sectional analysis provides a means of providing a standard against which performance can be measured and uses ratios to compare difference businesses at the same points in time (see inter-firm comparison).

current ratio Current assets divided by current liabilities is an overall measure of liquidity.

debt/equity ratio A gearing ratio that relates to financial gearing, which is the relationship between a company's borrowings, which includes both prior charge capital and long-term debt, and its ordinary shareholders' funds (share capital plus reserves).

debtor days Average trade debtors divided by average daily sales on credit terms indicates the average time taken, in calendar days, to receive payment from credit customers.

defensive interval Quick assets (current assets excluding stocks) divided by average daily cash from operations shows how many days a business could survive at its present level of operating activity if no inflow of cash was received from sales or other sources.

dividend cover Earnings per share divided by dividend per share indicates the number of times the profits attributable to the equity shareholders cover the actual dividends payable for the period.

EBITDA Earnings before interest, tax, depreciation, and amortisation.

gearing Financial gearing calculations can be made in a number of ways. Gearing is generally seen as the relationship between a company's borrowings, which include both prior charge capital (capital having a right of interest or preference shares having fixed dividends) and long-term debt, and its ordinary shareholders' funds (share capital plus reserves).

horizontal analysis (or **common size analysis**) An analysis of the profit and loss account (or balance sheet) that allows a line-by-line analysis of the accounts with those of the previous year. It may provide over a number of years a trend of changes showing either growth or decline in these elements of the accounts through calculation of annual percentage growth rates in profits, sales, stock or any other item.

interest cover Profit before interest and tax divided by interest payable, calculates the number of times the interest payable is covered by profits available for such payments. It is particularly important for lenders to determine the vulnerability of interest payments to a drop in profit.

inter-firm comparison Systematic and detailed comparison of the performance of different companies generally operating in a common industry. Normally the information distributed by the scheme administrator (to participating companies only) is in the form of ratios, or in a format, which prevents the identity of individual scheme members from being identified.

mission The mission of an organisation, not necessarily written, is its general sense of purpose and underlying inherent beliefs, that creates and reflects a 'common thread', common values and culture throughout the organisation. An organisation's written mission statement usually includes a summary of goals and policies together with its purpose and what business it is in, what it provides and for whom its exists, its values and commitment to its employees and suppliers, its policies and behaviour standards and principles of business, quality and professionalism, and its strategy and long-term vision.

non-financial performance indicators Measures of performance based on non-financial information which may originate in and be used by operating departments to monitor and control their activities without any accounting input. Non-financial performance measures may give a more timely indication of the levels of performance achieved than do financial ratios, and may be less susceptible to distortion by factors such as uncontrollable variations in the effect of market forces on operations.

operating gearing The relationship of fixed costs to total costs. The greater the proportion of fixed costs, the higher the operating gearing, and the greater the advantage to the business of increasing sales volume. If sales drop, a business with high operating gearing may face a problem from its high level of fixed costs.

price/earnings ratio (P/E) The market price per ordinary share divided by earnings per share shows the number of years it would take to recoup an equity investment from its share of the attributable equity profit.

return on capital employed (ROCE) ROCE, or return on investment (ROI), is the profit before interest and tax divided by average capital employed. It indicates the profit-generating capacity of capital employed.

return on investment (ROI) See return on capital employed (ROCE).

stock days Stocks value divided by average daily cost of sales calculates the number of days stocks at the current usage rate.

SWOT analysis Performing a SWOT analysis is a means of gaining a clear picture of the Strengths, Weaknesses, Opportunities, and Threats, which made the organisation what it is. SWOT analysis can apply across diverse management functions and activities, but is particularly appropriate to the early stages of formulating strategy.

top-down process A top-down approach usually relates to a particular type of budgeting process where a budget allowance is set or imposed without permitting the ultimate budget holder to have the opportunity to participate in the budgeting process.

vertical analysis An analysis of the profit and loss account (or balance sheet) in which each item is expressed as a percentage of the total. The vertical analysis provides evidence of structural changes in the business such as increased profitability through more efficient production.

weighted average cost of capital (WACC) The average cost of the company's finance (equity, debentures, bank loans) weighted according to the proportion each element bears to the total pool of capital. Weighting is usually based on market valuations, current yields and costs after tax.