Applied Corporate Governance

People Planet Profit

GLOSSARY OF TERMS

Eight pages of strategic and financial management definitions to help you understand the more technical aspects of corporate governance

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The terms defined in the following pages are all in general use in strategic planning and financial management

Acquisition: a method of combination of companies or parts thereof, where there is a transfer of ownership of at least one of the combined companies and substantial resources leave the combined group as consideration for that transfer

Assets: for a company or business: Total assets equals current assets plus fixed assets

Break-even analysis: to determine the additional sales that must be generated by an investment to leave a company at least as profitable as it would have been without the investment. It focuses on four aspects of the investment decision: fixed costs, variable costs, price and unit sales. When the investment is an entire business the break-even point is when total revenue equals total costs and therefore when profit is at zero.

Business: or Strategic Business Unit (SBU) or Business Unit, sells products or services. They compete in industries. They are owned by companies.

Business advantage: analogous to competitive advantage but used at all levels: the corporate level, the business level, the operational level. Often used in the context of "sources of business advantage": simply those sources/factors which allow an organisation (private sector or public sector) to be successful, relative to competitors or alternative options.

Business plan: comprises the strategic plan and implementation plan for a strategic business unit.

Business strategy/competitive strategy: the strategy followed by a business unit/division – see Strategy. Focuses on how to create and sustain competitive advantage.

Business strength/industry attractiveness matrix: similar to the growth-share matrix. Businesses are plotted on a grid to reflect their strengths and the attractiveness of the industry they are in. depending on the cell which the industry falls into, it recommends a build strategy, a hold strategy or a harvest strategy.

Buyer: or customer. Purchases from a business which is competitive in a market.

Buyer power: one of the five forces that determine the level of return on investment in an industry. It refers to the ability of a given buyer group to reduce the returns that can be earned in selling to that buyer group. They achieve this by bargaining down prices, by requiring high levels of service, by holding ready inventory etc.

Capital employed: the sum of Total Equity and Long Term Debt. Equals Net Assets.

Cash cow: one of four generic businesses when mapped on a growth-share matrix. A cash cow contributes a significant positive cash flow to the company and is characterised by a high relative market share (RMS) in a low growth industry.

Cash flow: is the difference between a company's or business's cash inflow and cash outflow over some period of time. It is not the same as net profit since it does not include depreciation expense and is not calculated on an accrual basis.

Company: an incorporated organisation. It exists when two or more persons become associated for a lawful purpose by subscribing their names to a memorandum of association or otherwise comply with the Companies Act. Companies own one or more businesses. Major legal classifications in the UK include: Public Limited Company (or PLC), quoted or unquoted, Private Limited Company (or Ltd), closely controlled (close) or not close, and Companies limited by Guarantee.

Competitive advantage: usually in the context of "sources of competitive advantage": simply those sources/factors which allow one business to be more successful (typically more profitable) than its competitors. Analysed at the level of a business unit., Competitive Advantage should be sustainable.

Competitive forces: five generic forces that determine the level of return on investment in an industry: Buyer Power, Supplier Power, Substitutes Threat, New Entry Threat, and Existing Competitor Rivalry.

Competitor analysis: a systematic study of the capabilities, current strategies, goals and assumptions of all competing businesses in an industry. Often includes a more detailed focus on one or two specific competitors.

Concentration: this refers to the number of competing businesses in an industry. A high level of concentration means that there are few competitors.

Conglomerate: a diversified company. A company with many interests.

Corporate plan: this comprises the strategic plan and implementation plan for a company or group (compare with business plan)

Corporate strategy, portfolio strategy: the strategy followed by a company – see Strategy. It focuses on the overall corporate direction and the mix of businesses.

Cost leadership: one of the three generic strategies.

Cost of capital: this is the minimum rate of return required by suppliers of funds to a business or company to justify investment. It is equal to a risk-free rate plus a risk premium to allow for country risk, industry risk and specific business risk.

Cost structure: a breakdown of the expenditure and expenses made to produce and sell a product or service or to operate a business. Costs are usually classified according to either activity or value added stage and the mix.

Critical competence: the minimum level of performance/capability needed for a business to undertake an activity in an industry.

Customer: a buyer. One who purchases from a business in a market.

DCF: Discounted Cash Flow. A method for taking the time value of money into consideration when evaluating cash flow streams. It allows calculation of the Net Present Value (NPV).

Debt: for a company or business: Total debt equals the sum of current loans/borrowings (ie that are payable within one year) and long term loans/borrowings (ie that are payable after one year).

Debt/equity ratio: for a company or business: Total Debt divided by Total Equity.

Differentiation: one of the three generic strategies, it refers to the presence of any significant basis, other than price, for choosing one company's product over another's. it is distinct from the focus strategy in that it must operate over a wide geographic or demographic market.

Direct costs: expenses incurred by a company or business by its production function when producing goods or services. For example for a manufacturing company, including raw materials, shop floor (direct) labour and direct overheads.

Diseconomies of scale: an increase in the cost per unit of an activity as the number of units produced or handled increases.

Distinctive competence: another term for competitive advantage. It has two components: critical competence and enabling competence.

Diversification: the incorporation of several different businesses within a company.

Dog: one of four generic businesses when mapped on a growth-share matrix, it makes a low or negative cash contribution to the business and is characterised by a low RMS in a low growth industry.

Drivers of change: typically: technology, economics, demographics and politics.

Economies of scale: this refers to reductions in the cost of an activity as the number of units of product involved in a given time period increases. This results from being able to carry out the activity in a different and more effective way.

Enabling competence: the level of performance/capability needed for a business to be successful (typically profitable) in an industry.

Entry barriers: a characteristic of an industry which raises the cost of establishing a viable competitive position for new competitors.

Entry threat: one of the five competitive forces. The threat of a new competitor(s) entering the industry.

Equity/shareholders funds: Total Equity equals the sum of issued share capital plus retained profits plus reserves. This equals Total Assets minus Total Debt.

Exit barrier: a structural factor that makes it expensive or risky for a business to leave an industry, even if it is earning a low or negative return on investment.

Experience curve: the observed tendency for the unit cost of a product to decline as cumulative production increases. Reasons include: increased labour efficiency, process improvements, product improvements, economies of scale and learning curve effects.

Functional plan: comprises the strategic plan and implementation plan for a functional department (foe example Marketing) within a business unit – (compare with Corporate Plan and Business Plan).

Functional strategy: the strategies followed by departments within a business unit, ie Marketing, Production, Finance etc.

Gap analysis: analysis of the gap between a business's strengths and weaknesses versus the opportunities and threats it faces.

Gearing ratio: see Debt/Equity Ration.

Generic strategy: typically there are considered to be three: cost leadership, differentiation and focus. The cost leadership strategy involves concentration on expenses to achieve the lowest cost per nit of production. The differentiation strategy involves attempts to convince the consumer that the product is unique. The focus strategy has a smaller scope, for example one customer segment or one geographical location. It can involve cost leadership or differentiation for that smaller segment/location.

Goals: or objectives or aims. The outcome required after full implementation of a strategy. Can be at the Corporate, Business or Functional level.

Growth-share matrix: a grid relating the relative market share of a business to the rate of sales growth in the industry in which the business competes. Stresses the importance of achieving high RMS and draws on the Experience Curve Theory. Therefore most applicable when the main generic strategy being pursued is cost leadership.

Horizontal integration: occurs when a company participates in several similar or identical businesses, often by acquisition.

Implementation plan: part of a Business Plan or Corporate Plan. Typically is an action plan which describes how the strategy will be achieved: when, where, who, how.

Indirect costs: expenses incurred by a company or business, by its non-production functions. For example, for a manufacturing company, it includes office/salaried labour, financing costs and indirect overheads.

Industry: a group of businesses that sell similar products or services.

Industry analysis: or structural analysis. This identifies and analyses the structural factors which determine the competitive forces in an industry.

Industry structure: the configuration of fundamental economic and technical characteristics that determine the nature and intensity of competitive forces. The individual characteristics are called structural factors.

Issue analysis: is a structured method of identifying the Pareto issues, sub-issues and so on.

Issues: long term changes which have occurred or are predicted to occur and will influence a sector or an industry or a company or a business. They can be external or internal.

Liabilities: for a company or business: Total Debt plus Total Equity.

Market: where buyers and suppliers interact. Generally can be described by the forces of supply and demand. If a buyer purchases from a business, the business is then acting as a supplier. If a supplier sells to a business, the business is then acting as a buyer.

Market share: the sales of business stated as a percentage of total industry sales.

Merger: a method of combination of companies, or parts thereof, where the shareholders of the individual companies continue, or could continue, holding shares in the combined group and not more than 10% of the consideration is in a form other than equity that leaves the combined group.

Mission statement: a summary statement of what a company or business's purpose and goals are, what businesses it will be in, what markets it will serve, what its values are, how the businesses will be managed, and how the company will grow. It is usually an abstraction of its corporate or business strategy and often attempts to be inspirational to the reader.

Net assets: total assets less current liabilities less provisions. Equals Capital Employed.

Niche: a selected buyer group. A niche strategy fro a business unit is often called a differentiation strategy or focus strategy.

Net present value: the value, whether positive or negative, that arises when a stream of cash flow is discounted

Non-user passives: consumers who do not currently buy from a company, but with no strong brand loyalty or affiliation, they could be persuaded to buy.

Non-user rejectors: consumers who actively reject company and refuse to buy their products/services.

organisation: groups of people and assets which won or operate one or more businesses. Includes Companies, Trusts, Partnerships, Sole Traders and Public Sector organisations.

Pareto: Prof. Pareto formulated the rule that with any organisation or with any problem, there are certain causes which account for the bulk of the effect. For example, 20% of the causes may account for 80% of the effect. Also called the 80: 20 rule. The principle is often used when the time frame is constrained and there is a need to identify rapidly the key issues.

Penetration chart: a technique for displaying the market share dynamics of a portfolio of business units. It relates the growth in business sales to that in the industry as a whole.

Pims programme: Profit Impact of Market Strategy. A multi-company project run for many years by MIT. It measures and analyses the impact of various strategies on the profitability of a business. The basis of the analysis is a confidential database of the past experience of the participating companies. A broad conclusion is that profitability is correlated with RMS.

Portfolio analysis: the use of certain matrices as a basis for evaluating businesses, and analysing the business mix. The matrices include the growth-share matrix, the business/industry attractiveness matrix and the strategic condition matrix.

Product life cycle: a concept for analysing stages in the sales history of a product or line of products in an industry. Five stages are represented on a curve (Introduction, Early growth, Late growth, Maturity and Decline).

Productivity: the number of units of output produced per unit of input. For a business, inputs are often classified as capital, labour and materials. These are also called factors.

Pre-tax profit: the net trading, which equals Total Revenue minus all operating expenses including depreciation, exceptional; (by way of size) items and finance charges, but before deducting tax, dividends , or extraordinary (unlikely to recur) items.

Quality: maximum customer satisfaction. Also see Total Quality and Total Quality Management.

Question mark: one of four generic strategies when mapped on to a growth-share matrix. It hs a relatively low RMS but is in a high growth industry.

Relative market share (RMS): the ratio of the sales of a given business to the sales of the competitor with the highest sales in that industry.

Rivalry: the pattern and intensity of competitive interaction among existing businesses in an industry. Rivalry is one of the five competitive forces that determine the level and variance of profitability among industries.

ROA (Rate of Return on Assets): the ratio of pre-tax profit divided by Total Assets, expressed as a percentage.

ROCE (Rate of Return on Capital Employed): the ratio of pre-tax profit divided by Capital Employed, expressed as a percentage.

ROE (Rate of Return on Equity): the ratio of pre-tax profit divided by Equity, expressed as a percentage.

ROS (Rate of Return on Sales): the ratio of pre-tax profit divided by Sales, expressed as a percentage.

Sector: a group of related industries. For example, the oil industry is in the energy sector.

Segmentation: the process of dividing a company into business units with meaningfully identifiable structural factors. Or the process of dividing a large group of customers in customer segments with similar purchasing characteristics.

Seven S framework: a framework for understanding the options in changing an organisation. They are divided into three "hard" Ss: strategy, structure and systems; and four "soft" Ss: skills, staff, style of management and shared values (similar to culture).

Shareholder funds: see Equity.

Star: one of four generic businesses when mapped on to a growth-share matrix. It makes a significant positive contribution to economic value. They usually have a high RMS in a high growth industry.

Strategic grid: a whole family of grids, often incorporating bubbles, each representing a business, aimed at describing the positioning of businesses in an industry.

Strategic group: a set of competitors in an industry following similar competitive strategies. Often shown as a cluster of "bubbles" on a strategic grid.

Strategic management: the process of administering a company of businesses such that it continuously formulates, adjusts and implements strategies.

Strategic plan: part of a Business Plan or Corporate Plan. Typically focuses on Mission, Vision, Objectives, Overall Strategy, Production, Procurement, Information Systems, Organisation, Finance and Risk Assessment.

Strategic planning: the discipline of creating a strategic plan.

Strategy: is identifying and resolving issues to create, sustain and renew long term business advantage. The outputs include reference to: an assessment of Position A, a recommendation of some future Position B, the route from A to B, and an outline of how this is to be implemented. The objective of strategy is to maximise the value of the company or business.

Structural analysis: see industry analysis.

Structural factors: a characteristic of an industry that affects the level and range of returns earned by competitors in that industry. Identifying the impact of the structural factors on each of the five competitive forces which shape the competitive environment of a business is the foundation of a structural analysis of an industry and of building a business strategy. Examples include: entry barriers, scale economics and switching costs.

Substitutes threat: one of the five competitive forces. The threat of new products or services from other industries substituting the existing product or service.

Supplier: sells to a business in a market.

Supplier power: one of the five competitive forces that determine the level and variance among industries. They can reduce the profitability of an industry by charging more for their products, by forcing the industry to invest to adapt to changes in the suppliers' products.

Switching costs: a one-off cost faced by a buyer (or business) when switching from one supplier's product to another.

SWOT analysis: analysis of the strengths, weakness, opportunities and threats for a business. Often combined with Gap Analysis.

Synergy: a measure of fit. Positive Synergy occurs when two or more businesses are combined in a company's portfolio so as to make the effect of their joint strategy more beneficial to value creation than the sum of their individual strategies.

Tactics: this is principally a short term operational statement. It is the short term analogue to strategy.

Total costs: Direct Costs plus Indirect Costs, or Fixed Costs plus Variable Costs

Total quality: achieving continuous maximum customer satisfaction. Also see Quality and Total Quality Management.

Total quality management: achieving continuous maximum customer satisfaction at minimum cost. Also see Quality and Total Quality.

Trend: world-wide, long term changes which have occurred or are predicted to occur and will influence many sectors.

User choosers: active and loyal consumers of a company's products/services

User passives: customers with no strong brand loyalty or affiliation, likely to be easily persuaded to buy from a competitor

Value: for a company or business or function: numerous definitions include: market capitalisation, net assets (book or revalued), equity, multiple of earnings (historic or forecast), discounted future earnings, break-up value, or value for tax purposes. For strategic purposes the value should be related to an amount agreeable by a buyer and a seller. Therefore for a company which is publicly traded, the common definition should be that value equals shareholder value (market capitalisation less market value of debt). In theory, the net present value of all future cash flows (after debt-holders have been paid) is equal to shareholder value. For a non-traded company or for a business in a multi-business company, some proxy measurement is required.

Value added: this refers to the difference between the cost of materials to a business and the price at which it sells its finished product. It equals all labour costs (including marketing labour, R & D labour etc) plus finance costs and profits. Alternatively, it equals revenue less all material costs (including marketing materials, R & D materials etc).

Value analysis: or Overhead Cost Reduction. Minimising the costs incurred when adding value to a product or service.

Value added chain: the breakdown of a product or service for value added into its various components.

Vertical integration: occurs when a company participates in more than one stage of a product's value added chain, often by acquiring these businesses.

Vision: Point B, where a company or business desires to be in the long term (for example 5 years on).

Working capital: a company's current assets minus its current liabilities.