Glossary of Financial, Investment and Other Business Terms and Ratios

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Introduction

We have compiled this glossary of terms to assist you to understand the "jargon" which is used in business and investment. Several of the terms are interchangeable and may be duplicated – for example, terms used in corporate finance may equally be used in the process of raising finance.

Corporate Finance Terms

- **Accountants' Report** - a report prepared by a registered auditor on a company's historical financial information for publication in a prospectus or similar investment advertisement.
- **Acquisitions** – this happens when one company takes over another (either "friendly" or "hostile") by purchasing its assets or shares.
- **Adequacy of Working Capital** - The Stock Exchange requires that in any public document there should be a statement that, in the opinion of the directors, the company has adequate working capital for its present requirements. It is usual for the Reporting Accountants to review the support for this statement, which will include cash flow forecasts for at least twelve months ahead, and to write a Letter of Comfort on the adequacy of the working capital to both the sponsors and the directors of the company.
- **Admission and Disclosure Standards** - The London Stock Exchange's Admission and Disclosure Standards are for companies admitted or seeking to be admitted to trading.
- **Admission (or Admission to Trading) -** Admission to trading on the LSE markets for listed securities and 'admitted' and 'traded' shall be construed accordingly. LSE say that, for the avoidance of doubt, this does not include 'when issued dealings'.
- **The Alternative Investment Market (AIM)** - this is a market similar to the listed market operated by the Stock Exchange but for which the entry requirements are less onerous. Generally, the typical company applying for entry to AIM is smaller than those applying for a full listing and will have a shorter trading record. The principal advantages are that a smaller proportion of the issued capital is required to be held by the public, a three year trading record may be acceptable and less advertising is required.
- **Authorisation** - the process by which organisations are vetted and licensed to conduct investment business under the Financial Services and Markets Act 2000. Such organisations are known as Authorised Persons.
- **Big Bang -** 27 October 1986, when the LSE's new regulations took effect and the automated price quotation system was introduced.
- **Board Memorandum -** a Minute (and supporting papers if appropriate) adopted by the board of directors supporting forecasts, projections, working capital statements, valuations and other financial information.
- **Bonds** - debt securities issued by governments and companies as a means of raising capita which generally entitle the holder to a fixed-rate of interest during their life and repayment of the amount of the bond at maturity.
- **Bonus Issue** - the issue by a company of new shares which do not require any payment to be made by the shareholder. This has the effect of making the company's shares more marketable because of the increased number available and the lower market price.
- **Board of Directors** - groups of individuals who are elected by the shareholders of a company and empowered to carry out certain tasks for the benefit of their shareholders.
- **Burn Rate -** the rate at which a company (usually a new company) expends capital to finance overhead costs prior to the generation of positive cash flow. This is an important measure because unless the company starts generating positive cash flow, the venture capital funding will be exhausted, potentially forcing the company to close down.
- **Business Development Company (or BDC)** - a form of publicly traded private equity vehicle used in USA where there has been a group of publicly traded private equity firms that were registered as business development companies (BDCs) under the Investment Company Act of 1940. Typically, BDCs are structured similar to real estate investment trusts (REITs) in that the BDC structure reduces or eliminates corporate taxes. A BDC is a special investment vehicle designed to facilitate capital formation for small companies.
- **Call (covered warrant)** - a warrant that gives the holder the right, but not the obligation, to buy the underlying at a future date and specified price.
- **Call (option)** – an option that gives the buyer the right to buy an underlying asset at a future date at a specified price.

- **Call (warrant) -** a call warrant allows the holder to benefit from a rising market. It rises in value when the underlying asset rises in value.
- **Capitalisation Issue** - the issue by a company of new shares not requiring any payment to be made by the shareholder. It has the effect of making the company's shares more marketable because of the increased number available and the lower market price. A Capitalisation Issue is the same as a Bonus Issue and Scrip Issue.
- **Cash flow** - in general terms, money flowing in from sales minus money flowing out for expenses. A positive cash flow is essential for a business to survive.
- **Chinese Walls** - these are the supposed communication barriers between members or departments of the same financial institution. They are supposed to ensure that sensitive information is not leaked - from, for example, a corporate finance department involved in a takeover to a dealer who would be in a position to buy shares in the companies involved.
- **City Code -** The City Code on Takeovers and Mergers is published on the authority of the Panel on Takeovers and Mergers, whose members include representatives of a number of financial institutions which are professionally concerned in takeovers and mergers. The City Code sets out the general principles of conduct and lays down certain rules to be observed in takeover and merger transactions. It does not have the force of law but all public limited companies are expected to comply with it.
- **Closed-End Fund** - these funds have a fixed number of shares, which are listed on the LSE. The market price of the shares is determined by demand and supply factors. Investment trusts are closed-end funds.
- **Code of Market Conduct** – these are the standards that are to be observed in the UK markets. The Code is issued and enforced by the Financial Services Authority (FSA).
- **Combined Code** - the benchmark for best practice corporate governance. The code is amended to the Listing Rules.
- **Comfort Letter** - a Letter of Comfort is the term given to a letter supplied by any of the professional advisors to a company or its sponsors in support of a statement made in a document. Letters of Comfort are not published. They are usually supplied by the Reporting Accountants to the company and to the sponsors in connection with the company's indebtedness and adequacy of working capital.
- **Companies Acts –** the 1985, 1989 and 2006 Acts, the main pieces of legislation on company law.
- **Completion Meeting** - this is the meeting at which all documents connected with "going public" are completed, normally including the placing or underwriting agreement.
- **Consent Letter** - in relation to any document where there is a statement or report purporting to have been made by an expert, written consent will be required from the expert for the document containing the statement or report to be issued. Consent will usually be required from the sponsors and the Reporting Accountants to the issue of the document with the inclusion therein of any letters or reports and references to their names in connection with those letters and reports.
- **Consolidations** – this occurs when a company reduces the number of shares it has in circulation by consolidating its share capita; for example, shareholders would receive 2, 50p shares for every 1, £1 share held.
- **Continuing Obligations** - the requirements of The Stock Exchange (as were set out in the Yellow Book) were the obligations a company had to comply with once its securities had been admitted to listing. The General Undertaking covered similar ground for AIM companies. From 1 May 2000, these were replaced by the FSA Listing Rules.
- **Convertibles** - corporate securities (usually preferred shares or bonds) that are exchangeable for a set number of another form (usually common share) at a pre-stated price. Convertibles are appropriate for investors who want higher income than is available from common stock, together with greater appreciation potential than regular bonds offer. From the issuer's standpoint, the convertible feature is usually designed as a sweetener, to enhance the marketability of the stock or preferred.
- **Covenant** - promise in a trust indenture or other formal debt agreement that certain acts will be performed and other refrained from. Designed to protect the lender's interest, covenants cover such matters as working capital, debt-equity ratios, and dividend payments.
- **Cumulative Preference Shares** - these preference shares accumulate unpaid dividend, which is then paid out when the company next declares it or is able to pay a dividend
- **Derogation** - a waiver given by the Listing Authority in certain limited circumstances; for example, that inclusion of a particular item in listing

particulars is not required.

- **Development funding / capital** - venture capital provided after a company has become established, to fund an expansion of the business.
- **Disclosure Letter** - the disclosure letter lessens the Buyer's rights under warranties given by the Vendor by excluding the matter disclosed from the scope of the general warranty. Because it effectively increases the Buyer's risk, the Buyer may not accept all disclosures which the Vendor would like to make to it in the disclosure letter.
- **Divestment** - the disposal of a business or business segment.
- **Drafting Meeting** - the Meeting of parties concerned with an issue to draft the prospectus and other documents.
- **Earn-out** - a formula for calculating sale proceeds to be paid to a disposing management that relates an element of the proceeds to future earnings.
- **Enterprise Capital Fund -** under the Enterprise Capital Fund (ECF) scheme the Government will match Venture Capital funding pound for pound to help small and medium sized businesses grow.
- **Enterprise Investment Scheme (EIS)** - successor to the Business Expansion Scheme (BES) aimed at encouraging new equity investment in certain types of unquoted company by offering tax relief on investments by persons unconnected with the company.
- **Equity** - a shareholding in a company (usually "ordinary shares") other than preference shares etc.
- **Exit** - the route by which a venture capitalist realises their original investment, usually as a result of flotation or corporate purchase.
- **Financial Services and Markets Act 2000** - the regulations that govern the conduct of investment business in the United Kingdom.
- **Flotation** - the offer or issue for the first time by a company of some or all of its shares to the public to enable them to be dealt with on the Stock Exchange, Alternative Investment Market or the PLUS market.
- **Forecast** - a statement of management's best expectation of the most likely financial results made for a current, unexpired or future accounting period.
- **Full List** - The London Stock Exchange is the UK's major stock exchange and the most international of all exchanges world-wide, providing a portfolio of markets enabling companies large and small to raise capital and have their shares traded. The main London market is called the Full List.
- **Gearing** - broadly, the ratio of debt to equity in a company's capital structure.
- **General Undertakings** - when a company applies for its shares to be dealt in on the Stock Exchange, its Board is required to adopt the General Undertaking. This is an undertaking that the company will comply with the various rules and regulations which apply to the Market in which its shares are dealt.
- **Impact Day** - the day upon which the underwriting of an issue takes place and when the prospectus will be made available to the public. There will be some form of announcement to the press and an advertisement or other publicity (usually shortly afterwards) in one or more national newspapers.
- **Incorporated** - organised as a limited (or unlimited) company (or even an LLP).
- **Indebtedness / Indebtedness Date** - in any public document it is required that there should be a statement of the company's indebtedness at the most recent practicable date (generally no later than twenty eight days before the date of the document). Indebtedness, for the purpose of this disclosure, includes borrowings, bank overdrafts, liabilities under acceptances or acceptance credits, mortgages, charges, hire purchase, commitments, finance leases, guarantees or other material contingent liabilities.
- **Institutional investor** - an investor investing other than in a private capacity - normally a financial institution such as an insurance company.
- **Introduction -** an Introduction is a method of application for listing where marketing arrangements are not required because the securities to be listed are already of such an amount that that their adequate marketability when listed can be assumed.
- **Investigation** - the analysis of the operating and/or financial aspects of a business - the objective being to produce a report that will help or support the decision-making process.
- **IRR** - a basis by which to measure investor returns, being effectively the compounded annual rate of return on their investment, including interest, dividends and realisation profits. It is used, for example, by venture capitalists to measure achievement and in such cases the IRR is greatly affected by the timing of exit.

- **IPO (Initial public offering**) - the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPO's can be risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.
- **Issuing House** - an Issuing House is usually a merchant bank, stockbroker or other financial institution which sponsors an issue (see also sponsor).
- **Leveraged buy-out -** similar to a management buy-out or buy-in but without the same degree of direct equity participation by the managers. The term 'leverage' is another name for gearing, and is used to indicate the substantial levels of borrowings taken on by the acquisition vehicle to finance the acquisition, which is typically secured on the assets of the business being purchased.
- **Listing** - a Listing is the admission of securities to the Official List of securities, which are dealt in on the Stock Exchange.
- **Listing Particulars** - a document is required to be published as a condition of the admission of securities to listing. Its content was prescribed by the Yellow Book and under the Stock Exchange (Listing) Regulations but, from 1 May 2000, the Listing Requirements are prescribed by the FSA. An offer of securities by means of a document containing Listing Particulars is deemed to satisfy the Companies Act requirements for the contents of a prospectus.
- **Listing Rules (or FSA Listing Rules)** – the rules that which set out the conditions to be satisfied in order for securities to be admitted to the Official List. With effect from 1 May 2000, the London Stock Exchange's Listing Rules (commonly known as the "Yellow Book") ceased to be effective and have been replaced by the FSA Listing Rules. The London Stock Exchange has published Admission and Disclosure Standards (the "Standards") which set out the conditions to be satisfied in order for securities to be admitted to trading on its market for listed securities.
- **Loan-to-Own (or Distressed-Debt Strategy / Rescue Financing)** – a strategy used by private equity and other investors to purchase companies as an alternative to conventional asset, stock or merger transactions. In applying these strategies, creditors use their debt positions to take ownership of troubled companies which agree with their lenders and shareholders to dramatically strengthen their balance sheet by swapping the majority of their debt for equity. It provides an opportunity for investors to take control of a company without buying it outright, providing capital to a business that needs money to continue operating. The strategy can also be applied by Hedge Funds and Private Equity investors to acquire debt, and sometimes certain amounts of equity or management control, such as voting power or board seats, from a lender of a distressed company.
- **Long Form Report** - this is a report which is usually prepared by the Reporting Accountants after a detailed investigation into the company's affairs in order to provide the sponsors and other professional advisors with detailed information on the company and its affairs.
- **Marketing** - the sale of new or existing securities to public investors.
- **MBI** - it stands for Management Buy-in, the purchase of a business by an outside team of managers who have found financial backers and plan to manage the business actively themselves.
- **MBO -** it stands for Management Buy-Out, the purchase of a company by its management.
- **Merger** - the agreed joining together of two companies, usually in the same industry, to provide a new, combined, entity with control still reflected in the ownership shares of the original companies.
- **Mezzanine finance** - a form of finance falling between equity and debt. It is a flexible form of funding, typically used in a management buy-out to achieve the desired overall risk/return profile for investors. Frequently unsecured, it usually bears interest at a higher rate than secured loans and often carries an option to give the lender a stake in the equity.
- **Model Code** - the Model Code is a set of basic principles and rules drawn up by the Stock Exchange which provide guidance for directors of companies as to how they should act in regard to the buying and selling of securities in the companies of which they are directors.
- **NewCo** - a newly formed company set up as an acquisition vehicle, for example, in a management buy-out.
- **Offer for Sale / Offer for Sale by Tender** - one of the methods by which securities may be brought to the Stock Exchange. It is an offer to the public by a sponsor to sell securities already in issue or for which the sponsor has

agreed to subscribe. The offer may be at a fixed price or may invite tenders at different prices (subject to a minimum).

- **Offer for Subscription** - this is an offer by a company of its own securities to the public for subscription.
- **Operational Gearing** – this refers to the extent to which the firm's total costs are fixed. The higher the proportion of fixed costs relative to variable operating costs, the higher the operational gearing. This results in greater business risk. A retailer has high fixed costs relative to variable costs, so has a lot of business risk. If a business has no operational gearing, then operating profit would rise at the same rate as sales growth (assuming nothing else changed).
- **Pathfinder Prospectus** - in a new issue of shares, a detailed report on the company is prepared and made available to potential investors a few days before the issue price is announced.
- **Pink Form** - a preferential application form for shares (normally printed on pink paper) issued to shareholders and/or employees of a company, which will be treated preferentially in the allocation of those shares. The London Stock Exchange allows companies offering shares to the public to set aside up to 10% of the issue for applications from employees and, where a parent company is floating off a subsidiary, from shareholders of the parent company.
- **Placing** - the sale of (or obtaining subscription for) securities by a sponsor through the market and to their own clients. This is a concession which, in general, is only allowed where there is not likely to be a significant demand for securities.
- **Profit Forecast** - an estimate made by the directors of profits, which they expect the company to achieve in the current or subsequent accounting period. This will be accompanied by a list of the principal assumptions used by the directors in making the forecast and will be supported by letters issued by the Auditors and/or Reporting Accountants and the Issuing House.
- **Prospectus** - a document that deals with offer for sale, placing or subscription which is published or circulated. Its contents are governed by the Yellow Book and by the requirements of the Yellow Book and by the provisions of the Companies Act 1985.
- **Public Limited Company** - a public limited company wishing to commence trading is required, inter alia, to have an allotted share capital of a nominal value of not less than £50,000 (of which at least 25% must be paid up), and to have been registered as such.
- **Quotations Department** - the Quotations Department of the Stock Exchange provides advice and interpretation of the rules and regulations governing an entry to the Official List of the Stock Exchange or the Alternative Investment Market. All prospectuses for a flotation on these two markets are required to be approved by the Quotations Department, which will ensure that the Stock Exchange rules requiring sufficient disclosure in the document of all matters which are relevant to an investment decision are observed. The Quotations Department also monitors the subsequent compliance with the rules and regulations of the Stock Exchange.
- **Ratchet** - an incentive arrangement whereby a number of trigger points for future profits are set such that the managers get a bigger share of the equity if the company performs well and a lesser share if it performs badly.
- **Reporting Accountants** - the firm of Accountants (Registered Auditors) who report on the financial information contained in the prospectus and who deal with other accounting matters connected with the Issue. The Reporting Accountants are often the company's own Auditors, although this depends primarily on their experience of new issue and Stock Exchange work.
- **Second Lien Financing** - one of the biggest financing trends in recent years has been the move away from unsecured mezzanine credit to debt secured by a *second* priority security interest on all of the company's assets. Much of this "second lien" debt is coming from hedge funds and other private equity funds, although traditional lenders have also become active in the market. Second Lien Financing is a simple loan with a subordinated security (finance) structure or no security at all (unsecured debt), meaning that the borrower grants another provider of a finance instrument (such as a senior loan) priority over settlement of owed monies in case of an event of default. The arrangement fee and interest of a second lien financing package is higher than those of the senior loan of the same borrower because of increased risk for the lender.
- **Securitisation (or asset securitisation)** – essentially a method of raising debt finance. It involves the sale of income generating financial assets (such as loans, trade receivables and leases) by a company to a special purpose vehicle (SPV). The economic interest in the financial assets is transferred to investors via the securitisation process as part of which the assets are transferred to a special purpose vehicle that is normally separated from the borrower and can thus obtain a better rating from credit

rating agencies, than the borrower could. The assets concerned (loans, trade receivables and leases etc) are used as collateral backing for the issue of securities to third party investors.

- **Seed Capital** - In particular, seed capital is the term given to providing venture capital finance for the early stage development of ideas into products.
- **Short Form Report** - a report prepared by Reporting Accountants for inclusion in a prospectus (and certain other circulars to shareholders) setting out the information which is required to be published in conformity with the Companies Acts.
- **Sponsor** - the role of the Sponsor is to co-ordinate events and activities of other advisors involved in preparing a prospectus. He is also responsible for ensuring that the contents of the prospectus give a fair representation of the company and for advising on the appropriate market, the timing of the issue, arranging underwriting and other such matters.
- **Statements of Adjustments** - the Reporting Accountants are required to provide a written statement (which will be available for public inspection) setting out the adjustments made by them to the previously published audited accounts in arriving at the figures shown in the Accountants' Short Form Report.
- **Sub-Underwriting** - the Sponsor to the issue, which will normally underwrite its terms, may spread its financial risk by sub-underwriting a proportion of its total commitment with other financial institutions.
- **Takeover Panel** - the Panel on Takeovers and Mergers is a body representative of the financial organisations that are responsible for the preparation of the City Code. The duties of the Takeover Panel are to administer and enforce the rules and regulations embodied in the City Code. It can be consulted at any time to give rulings on points of interpretation of the City Code or for confidential consultation during a takeover or merger transaction.
- **Tax Clearances** - when a company raises new capital or makes any of its existing shares available to the public there may be taxation consequences. Accordingly, it will often be necessary to obtain clearances from HMRC that certain assessments to tax will not be made as a result of a transaction.
- **Tender** - in some circumstances the sponsors to an issue may advise a company to offer its shares for tender rather than making an offer for sale at a fixed price. This method (which indicates the minimum price and allows for applications at or above that price) is used where it is particularly difficult to indicate a price for a new issue which is fair to both purchaser and vendor. It can be used where there is no comparable listed company which can indicate a price for the shares, or where it is anticipated that there will be overwhelming demand for the shares.
- **The Stock Exchange** - the Stock Exchange (or London Stock Exchange) is the principal market place for trading in securities of companies, domestic or foreign, and in the direct or indirect debt obligations of governments. All applications for listing are required to be submitted by a member firm of LSE and approval for a listing is given by its Council.
- **Underwriting** - when securities are being offered to, or placed with, the public it is normal for the offer or placing to be underwritten. The Underwriter or Underwriters will usually be major financial institutions who undertake to acquire shares to the extent that the public does not take them up. In this context an underwriting agreement will be drawn up between the vendors of shares and the Underwriters (normally the Sponsor will underwrite the risk) and underwriting commission will be payable.
- **Underwriting Agreement (Placing Agreement)** - the agreement between the Underwriter, the directors, vendors of shares and the company that deals with the underwriting (or placing). This agreement normally contains warranties by the company, its directors and the vendors as to the information on the company disclosed in the prospectus and more generally, and indemnities to the company and the sponsor by the directors and the vendors in relation to the company's tax position.
- **Underwriting Commission** - commission paid to the Underwriter for entering into the underwriting agreement, normally at the rate of 2 per cent for an offer of sale (3 to 4 per cent in the case of a placing) out of which the underwriting will pay commission to the stockbrokers of 0.25 per cent and commission of 1.25 per cent to any sub underwriters.
- **Venture capital -** the concept of adding value to investments by participating in the management and offering advice. A wider definition would be risk investment in un-quoted companies with high growth potential. Venture capital can be broadly subdivided into seed or start up capital (used to bring a research idea to the development stage), second round finance for young companies (used to expand the range of products) and development capital for established companies (used to develop an

alternative product or expand through acquisition).

- **Verification / Verification Notes** - the procedures adopted to confirm the accuracy of statements made in the Listing Particulars/prospectus and to ensure that the view it presents of the company is fair and not misleading. Such procedures are designed to ensure that the directors of the company have discharged their responsibilities in issuing the listing particulars/prospectus (and ultimately to protect them), and normally evidenced by the solicitors to the issue requiring detailed notes or evidence to support all material statements.
- **Warrant** - type of security, usually issued together with a bond or preferred stock that entitles the holder to buy a proportionate amount of common stock at a specified price
- **Working Capital** - this is current assets less current liabilities, representing the required funds continually circulating, to finance stock, debtors, and work in progress.
- **Yellow Book** - the Yellow Book was the book entitled "Admission of Securities to Listing" issued by the London Stock Exchange. It set out the rules governing the admission of securities to listing together with notes for guidance on various aspects of the rules. This changed on 1 May 2000 (see Listing Rules).
- **Yield** – this is the return earned on an investment taking into account the annual income and its present capital value. There are a number of different types of yield, and in some cases different methods of calculating each type.
- **Yield to Maturity (YTM) -** this is the rate of return anticipated on a bond if it is held until the maturity date.

Raising Finance Terms

- **APR -** the annual percentage rate is a rate of interest that every financier must quote and must calculate in the same way, so that meaningful comparisons can be made.
- **Balloon repayment -** when the majority of the repayment of a loan is made at or near the maturity date, with the final payment substantially larger than the earlier payments. Used in the funding of fixed assets in a growing business.
- **Base rate -**he rate of interest which forms the basis for the charges for bank loans and overdrafts or deposit rates for commercial banks. Rates of interest charged by the banks on much of their lending to customers are set at margins over their own base rate - the size of the margin depends on the nature and status of the customer. A change in the base rate normally signifies a marked change in the level of short-term market interest rates hence the base rate is widely used as an indicator of the broad level of interest rates.
- **Bill of exchange -** a trade finance tool consisting of a written order that binds one party to pay a fixed sum of money to another party at a predetermined future date. However, the most common form bill of exchange is a cheque being a bill drawn on a bank and payable on demand.
- **Bullet -** a single repayment on a loan paid at maturity.
- **Business plan –** a plan setting out the objectives of the business and how they are to be achieved.
- **Capital repayment moratorium -** a period of time in which the interest accruing on the loan is covered, but no capital is repaid. Also sometimes referred to as a capital repayment holiday.
- **Cap -** example of a derivative (see below). A contract which effectively imposes a maximum on the interest rate payable where the rate is variable. It protects against increases in the bank's cost of funds, and is not concerned with the margin charged above this. A premium is charged, much as in an insurance policy.
- **Collar -** example of a derivative where the maximum and minimum effective rates payable are determined for a specified period.
- **Collateral** - asset pledged to a lender until a loan is repaid. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to pay off the loan.
- **Confidential invoice discounting -** a tool whereby invoices can be turned into cash. Invoices are sent to the lender, who will normally agree a cash injection of up to 85% of the outstanding invoices. The responsibility for collection remains with the client. This facility tends to be used when there is a growing demand for working capital.
- **Convertible -** in this context, a form of preference share, which can be converted into ordinary shares at a set future date. The expression can also be used in connection with a debt instrument that can be 'converted'.
- **Covenant -** a promise made in a formal legal agreement, that certain activities will or will not be carried out. Financial covenants agree the minimum financial performance ratios the borrower will achieve. Breach of covenants will constitute an event of default. Covenants are an integral part of all term commitments.
- **Covenant-lite loan (also called cov-lite loan)** – this is a loan with very light covenants or even no covenants at all. Their development usually goes in hand with increase leverage and an overheating of the loan markets as in 2007 when banks seems so keen to lend to private equity firms that they are dispensing with their usual covenants and safeguards.
- **Debt Service** - cash required in a given period, usually one year, for payments of interest and current maturities of principal on outstanding debt.
- **Derivative -** a 'stand-alone' contract to 'hedge' or protect a borrower's exposure to movements in financial markets, including interest rates, exchange rates, commodity prices etc.
- **Discounted -** using a bill of exchange, a lender may discount the bill by paying the borrower the amount of the bill, less the costs of funding and a percentage to reflect the interest charged.
- **Enterprise Capital Fund -** under the Enterprise Capital Fund (ECF) scheme the Government will match Venture Capital funding pound for pound to help small and medium sized businesses grow.
- **Event of default -** within a facility letter (see below), there will be a list of the lender's rights if the borrower fails to meet its obligations, or if a specified event occurs. The rights will typically include the cancellation of any further drawdowns under the facility, the liability becoming repayable on demand, and other conditions.
- **Facility letter -** the formal document setting out the mutual rights and obligations of lender and borrower.

- **Factoring** - there are many different types of factoring arrangements. An arrangement can be either confidential or disclosed to customers. Typically it involves the purchase of the trade debts owed to a business by a factoring company. This provides short term financing and may include the administration of the business' sales ledger by the factor who will be responsible for credit control and the despatch of statements. Because factoring involves the sale of the business' debtors it is only suitable for financing working capital and is normally most suitable for growing businesses. The cost will be more than an overdraft but your business may save money, for instance by not having to employ a credit controller. (See also invoice discounting).
- **Fixed rate -** an interest rate management tool, where the rate on a loan is agreed at drawdown for the life of the loan. Early repayment will involve meeting the bank's costs in 'breaking the fixture'.
- **Forward rate agreement -** a hedging tool which allows both the lender and the borrower to agree a rate of interest at a future date.
- **Gearing -** a fundamental analysis ratio of a company's level of long-term debt to its equity capital expressed in percentage form. Also referred to as leverage.
- **Grants** - whether or not grant finance is available will depend on factors such as where the business is located, whether it will create jobs and the purpose of the investment. Grants are normally preferable to other forms of finance. However there can be costs ill complying with the terms and conditions of the grant and you should research these carefully.
- **Hedge -** the term for protecting oneself from market movements. When raising finance, it is advisable to hedge against adverse interest rate movements.
- **Hire purchase -** a form of asset finance whereby the asset is acquired in the name of the borrower, but is generally charged as security to the lender. Effectively, a loan against the asset. The asset and the borrowing appear on the balance sheet, and tax treatment will reflect this. Every hire purchase contract has a peppercorn option payment at the end by which the borrower acquires unfettered legal title to the asset.
- **Invoice discounting** - a similar arrangement to factoring, but confidential - the customer should be unaware that the invoice has been discounted. The business usually retains responsibility for running the sales ledger and collecting debts.
- **IPO (Initial public offering**) - the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPO's can be risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.
- **Joint and Several Liability -** an undertaking by two or more people to be responsible, either individually or jointly, for any liability which may exist after any member or members have failed to meet their obligations. For example if a group of four people enter into a joint and several liability on a bank loan then, in the event of two of the members failing to meet their obligations, the remaining two members become fully responsible for the repayment of the loan.
- **Leasing -** An alternative means of asset finance, with the user (lessee) paying the lessor a rental for the use of the asset for a defined period. The two principal types of lease are Finance Leases and Operating Leases, and there are differences in accounting and tax treatment between the two. Unlike hire purchase financing, leasing contracts do not have a peppercorn option payment at the end by which the borrower acquires unfettered legal title to the asset.
- **Mezzanine debt -** a class of debt that ranks behind the senior debt. The pricing and/or terms reflect the higher risk to the lender.
- **Overdraft -** the simplest and most flexible method of borrowing money. An agreed line of finance, repayable on demand by the lender, but usually reviewable at least annually. A 'committed' overdraft is not repayable on demand, but is available for a period up to 364 days, usually subject to conditions and/or covenants.
- **Overtrading -** term used when a business is growing its sales faster than it can finance them, leading to insufficient cash being available to meet outgoings.
- **Participating preferred stock -** a type of preference share that, under certain conditions, gives holders the right to receive earnings payouts over and above the specified dividend rate.

- **Preference shares -** a type of share that has preference to ordinary shares by a fixed dividend (provided the company has distributable reserves), and over assets in the event of liquidation.
- **Private placement -** a way of raising capital by issuing shares to known clients of the advisers.
- **Prospectus -** a formal legal document describing details of a corporation, generally created for a public fund raising offering.
- **Redeemable -** a type of preference share which can be bought back by the company, usually at their option, at or over a specified period.
- **Retention of title** - the retention by a seller of goods of legal title to the goods until they have been paid for, even though possession of the goods is given to the buyer before that time.
- **Revolving credit facility** - a line of credit similar to an overdraft, but committed for longer than a year. Subject to meeting covenants, the line may be drawn and repaid at will.
- **Rights issue -** any share issue that will dilute the ownership of a given class of shareholder must be offered to that class in proportion to their existing shareholdings. This is known as a 'rights' issue.
- **Senior debt -** debt whose terms require it to be repaid before subordinated debt receives any payment.
- **Sensitivity analysis** - analysis of the sensitivity of predicted results to changes in the underlying assumptions.
- **Side letter -** as situations change, the terms of a loan may need to be altered. These changes will be explained in a side letter.
- **Syndication** - the process whereby a group of venture capitalists will each invest a portion of the amount of money required to finance a business.
- **Term loan -** a loan for a fixed amount with a fixed repayment schedule normally from a bank. It is most suitable for funding fixed assets and core borrowing. Although the interest rate may he slightly less than on an overdraft there is no opportunity to flex the amount of financing. When the level of financing required is likely to go up and down it is important to choose a form of finance which does not require you to pay for funds you are not using. Therefore a term loan is suitable for fixed assets, but not for working capital. The key advantages of a term loan are that you know when the repayments are and can budget accordingly and the APR may be lower.
- **Trade finance -** a term generally used to cover the multitude of means of financing international trade, using the instruments of that style of trade.

Accounting Terms

- **Absorption Costing** - a system of costing whereby products and services absorb a share of indirect costs such as insurance and rent in addition to their direct costs such as labour and raw materials. A direct cost can be specifically allocated to a product or service. An indirect or overhead cost such as the rent for a factory or an office cannot be directly attributed to a product or service.
- **Accounting Policies** - the specific approaches or methods chosen by companies to account for certain items, for example, the valuation of stocks or inventories and the calculation of depreciation.
- **Accounting Standards** - The accounting rules and guidelines issued by the Accounting Standards Board (ASB). The ASB reports to the Financial Reporting Council. New International Financial Reporting Standards came into effect during 2005.
- **Accounts Payable** - the US term for trade creditors – amounts due to suppliers.
- **Accounts Receivable** - the US term for trade debtors – amounts due from customers.
- **Accruals and Accrued Charges** - accruals / accrued charges are expenses such as rent and utility costs that have been included in a period's profit and loss account but have not been paid during the period.
- **Accrued Income -** accrued income is the opposite of an accrued charge. For example, cash received in advance from customers but before goods or services have been provided. Accrued income is treated as a current liability.
- **Accruals Basis** - an accounting convention in which transactions are reflected in the accounts of the period in which they take place, as opposed to the period in which payments are made or received.
- **Accumulated Depreciation or Amortisation** - the total depreciation or amortisation deducted from or provided against a fixed asset since the date it was purchased.
- **Acid-Test (or Quick Ratio or Liquid Ratio**) – this measures the ability of a company (and thus its strength) to use its near cash or quick assets to immediately extinguish or pay its current liabilities. This ratio is the most stringent measure of how well a company is covering its short-term commitments.
- **Activity Based Costing** - a technique for charging indirect costs such as purchasing to products and services. The factors affecting the level of indirect costs, for example, the number of purchase orders and the number of machinery set-ups are called cost drivers.
- **Amortisation** - the write off (or spread) of the cost of Intangible Assets over an agreed period, based on life expectancy or obsolescence. The term is also used to apply to a reduction in debt by periodic payments covering both interest charges and part of the principal.
- **Annual Report & Accounts (also known as Financial Statements) -** these comprise the directors' report to shareholders setting out, in both text and financial terms, details of the company's performance during the past year and the state of its finances and assets at the end of the financial year.
- **Assets** - Anything owned by the company having a monetary value; eg, 'fixed' assets like buildings, plant and machinery, vehicles (these are not assets if rented and not owned) and potentially including intangibles like trade marks and brand names, and 'current' assets, such as stock, debtors and cash.
- **Asset Turnover** - a performance measure used to assess the effectiveness with which a business uses its assets. It is calculated by dividing sales by capital employed. The higher the figure the better.
- **Associated Companies** - where a company has an interest in another company that represents more than 20%, but less than a majority, of the voting rights in that company's share capital, then this is called an investment in an "Associated Company". The profits of the investment are consolidated into the results of the investment holding company. Under a 20% interest only dividends received will feature in the holding company's accounts. Over a 50% interest, the investment is deemed to be a subsidiary company and its results and net assets will be fully consolidated in the holding company's own accounts.
- **Audit** - the annual inspection of a company's financial records and its financial statements conducted by an independent firm of registered auditors.
- **Auditors** - independent accountants appointed by a company's shareholders. Auditors are usually recommended by the company's directors, subject to approval by shareholders, at the Annual General Meeting.
- **Audit Committee** - a sub-committee of the board of directors. It is responsible for monitoring all the reporting, accounting, control and financial aspects of management

activities.

- **Audit Report** - the report on the 'truth and fairness' of financial statements. It is addressed to shareholders and prepared by the auditors.
- **Authorised Share Capital** - the total number of shares a company is authorised to issue by its Memorandum and Articles of Association. The amount of issued share capital must be equal to or less than the authorised share capital, i.e. a company cannot issue more shares than it is authorised to issue in its Articles.
- **Balance Sheet** - this is the statement featured in the Annual Report & Accounts that indicates the carrying value (but not necessarily the market or realisable value) of the company's assets and liabilities as at the end of its financial period (the Balance Sheet date) together with liabilities including financing debts and share capital.
- **Book Value** - the value of an asset as recorded in the financial statements. For a fixed asset it will be the original cost (unless amended by revaluation) less the depreciation that has so far been accumulated on it. This is called the net book value or written down value. The book value of an ordinary share is the sum of the ordinary share capital and reserves (the equity) divided by the number of issued shares.
- **Bond or Note** - interest bearing liabilities issued by organisations. They are a source of long term finance.
- **Break-Even Point** - the level of output or revenues at which total revenues equal total operating costs. Total operating costs are all costs excluding financing charges and tax.
- **Budget** - an annual (but it may be longer or shorter) financial plan covering; sales and costs, capital expenditure, cash inflows and outflows, assets and liabilities. It is a commitment to achieve a set of results during a specific future period.
- **Budgetary Control** - a short term financial planning system designed to ensure that actual results during the financial year are measured against the budgeted results. The differences or variances are then investigated and corrective actions are taken to ensure that, for the period as a whole, actual performance is as close to the budget as possible.
- **Capital Allowances** - in the UK, it is HMRC's equivalent of a company's depreciation charge. Depreciation is not an allowable expense deduction for tax purposes in the UK but capital allowances are granted on the purchases of certain fixed assets such as plant and machinery and industrial buildings. They have the effect of reducing taxable profit.
- **Capital Expenditure** - expenditure on fixed assets such as plant and equipment and on acquisitions, mergers and other long-term investments such as joint ventures. Net capital expenditure is capital expenditure less the cash proceeds from fixed asset and/or business disposals.
- **Capital Employed** - the funds employed by the company in its activities. This represents the value, in the Balance Sheet, of the company's share capital, reserves and debt. It can be expressed either before or after intangible assets, dependent upon the circumstances and requirement.
- **Capital Gearing or Gearing** - the proportion of borrowings in relation to Equity. It is commonly measured by the debt to equity ratio. The higher the debt/equity ratio, the higher a company's gearing. For this purpose, debt is normally defined as total borrowings or interest bearing obligations including leases less (a) cash balances and, (b) short-term investments such as cash deposits. In US terminology, gearing is known as financial leverage.
- **Capitalisation (or Market Capitalisation)** - the value of a company's equity based on the market price of its shares; it is, therefore, equal to the number of shares issued times their market price. Market capitalisation can be used to include the market value of all the company's traded securities, including bonds and debentures. Strictly speaking, this should be referred to as the enterprise value.
- **Capitalise** - this has a number of meanings: (1) the interest payable on borrowings for a building or maintenance expenditure on equipment is capitalised if, instead of being charged to the profit and loss account, it is added to the capital cost of the project or the equipment. In this sense, 'to capitalise' means to treat as an asset. The capitalised amount is depreciated as if it were a fixed asset. (2) Reserves are capitalised when retained profit is converted into share capital by way of a scrip or bonus issue. (3) to "capitalise a company" means putting cash into it in the form of share capital.
- **Capital and Reserves** - the proportion of a company's financing provided by shareholders. It consists of issued share capital, share premium, retained profit or retained earnings and any other reserves. Other terms for capital and reserves include equity, shareholders' interest, shareholders' funds, equity shareholders' funds, net assets and net worth.

- **Capital Budgeting** - this is the process for deciding how much will be spent on fixed assets in a particular financial period including an assessment of the financial viability of projects.
- **Capital Rationing** - a situation when there are more capital expenditure projects to invest in than there is cash available to finance them.
- **Capital Redemption Reserve** - this is a special type of reserve and, therefore, part of a company's equity. It is created when a company purchases some of its own shares – a share buy-back. A capital redemption reserve must be set up and be equal to the nominal value of the shares purchased.
- **Capital Structure** - this is the relative proportions of debt and equity in a company's balance sheet.
- **Cashflow** - the movement of cash in and out of a business from day-to-day direct trading and other non-trading or indirect effects, such as capital expenditure, tax and dividend payments.
- **Cash Flow Statement** - the statement in the Annual Report & Accounts that indicates, for the financial period, the sources of all cash, and the movement and availability of cash through and to the business.
- **Collection Period or Days Sales Outstanding** - this is the average length of time taken by a customer to pay a sales invoice. It is calculated by dividing trade debtors/receivables by annual sales times 365 days to give the average number of days for which the sales invoice has been unpaid.
- **Commercial Paper** - unsecured short-term borrowings normally for a maximum of one year.
- **Common Stock** - the US term for ordinary share capital.
- **Consistency** - a basic accounting concept – the accounting treatment of all items should be consistent from one accounting period to the next.
- **Consolidated or Group Accounts** - the financial statements are prepared for the parent company and its subsidiaries as if the parent company and the subsidiaries are all one entity. A parent company is a company which has one or more subsidiaries.
- **Contribution** - the difference between sales and direct or variable costs before charging indirect or fixed costs. Direct or variable costs may be called 'cost of sales.' Contribution may be called gross profit.
- **Contingent Liabilities** - Potential liabilities that the company could face in the future if certain circumstances should arise. Indicated in the Notes to the Accounts it will include, for example, the likely costs arising from guarantees given to third parties.
- **Convertible** - a bond, debenture, or preferred share which may be exchanged by the owner for ordinary shares in accordance with the terms of the issue.
- **Corporation Tax** - the tax levied on a company's taxable profit. Taxable profit is not the same as the 'profit before taxation' in the profit and loss account because various items are allowable and disallowable for tax purposes. An example of an allowable item is a capital allowance (the taxation equivalent of depreciation to encourage capital expenditure). Examples of disallowable items are depreciation and entertainment.
- **Cost / Cost Incurred** - the charge against revenues, sales or turnover made for the use or consumption of resources during an accounting period. The cost incurred is not necessarily the same as the cash actually spent in the period in view of adjustments for depreciation, accruals and prepayments.
- **Cost Centre** - a physical location within an organisation such as a department or section where costs are accumulated.
- **Cost Code** - a numbering system used to describe the type, source and purpose of all costs and revenues.
- **Cost of Capital** - the return required by the providers of finance – lenders and shareholders – to reflect the risks they face. The weighted average cost of capital (WACC) is the required rate of return reflecting the relative proportions of funding provided by lenders and shareholders. The cost of capital is also referred to as the hurdle rate, the discount rate or the test discount rate.
- **Cost of Equity** - the return required by shareholders. It is expressed on an after-tax basis.
- **Cost of Sales or Cost of Goods Sold (COGS) -** the directly attributable costs of products or services sold, (usually materials, labour, and direct production costs). Sales less COGS = gross profit. Effectively the same as cost of sales (COS) which is commonly arrived at via the formula: opening stock + stock purchased - closing stock.
- **Cost Unit** - any product or service to which costs can be charged.
- **Coupon** - the interest payable on a bond and the dividend payable on Preference Shares.
- **Covenant** - a requirement imposed by a lender as part of a funding agreement. For example, a company's operating profit may have to be at least four times greater than the interest charge in order to provide the lender

with an appropriate level of financial security. The relationship between the operating profit and the interest charge is called the interest cover.

- **Credit** - a term in double entry bookkeeping – for every credit, there must be a debit.
- **Credit Rating** - an assessment of a company's creditworthiness – the ability and willingness to repay its short and long-term debts. The two best known credit rating agencies are Moodys and Standard and Poors. For Standard and Poors, the highest rating is AAA. The lowest is CCC.
- **Creditors (also called Accounts Payable)** - any person or organisation to whom a company has a commitment apart from shareholders. For example, suppliers of goods for whom unpaid bills are outstanding (trade creditors) and bank borrowings. It is a legal requirement to distinguish between short-term creditors (due to be paid within 12 months of the balance sheet date) called current liabilities, and long-term creditors (amounts due to be paid after one year).
- **Creditors, Long** - these are liabilities payable more than one year after the Balance Sheet date. This includes provisions and deferred taxation, loans and debt, including convertible debt, repayable more than one year after the Balance Sheet date.
- **Cum Dividend** - the purchaser of shares receives the right to receive the next dividend.
- **Cumulative Preference Shares** - these are preference shares with the condition that if any preference dividends have not been paid in previous years then they must be paid in full before a dividend can be paid to the ordinary shareholders.
- **Current Assets** - the value of the assets held at the Balance Sheet date that are represented by cash, or can be expected to be converted into cash within the next 12 months.
- **Current Liabilities** - short-term liabilities payable on demand or within one year of the Balance Sheet date.
- **Current Ratio** - the ratio of Current Assets divided by Current Liabilities. It is a broad measure of the ability of a business to meet its short-term commitments. The Acid-Test (or Quick Ratio or Liquid Ratio) however, is a more sensitive measure.
- **Debentures** - these are IOUs issued by a company in the form of a Bond or Note issued with redemption dates a number of years into the future. Debentures are usually secured against specific assets (mortgage debentures) or through a floating charge on the company's assets.
- **Debit** - a term in double-entry bookkeeping. There are at least two entries – a debit and a credit.
- **Debt** - interest-bearing liabilities such as short and long-term bank loans.
- **Debt: Equity Ratio** - the relationship between debt (interest-bearing liabilities or borrowings, including lease obligations) and equity shareholders' funds. It is also known as the gearing or leverage ratio. A common definition is net debt (total borrowings less short-term deposits and cash balances) expressed as a percentage of equity. The debt-equity ratio can also be defined as net debt expressed as a percentage of net debt plus equity. Net debt plus equity is the total financing available to a business.
- **Debtors (or Receivables)** - amounts owing to the company, including the value of sales made under credit, where settlement from the customer is still awaited.
- **Deferred Taxation** - this is caused by the timing differences which arise when a transaction is recognised for accounting purposes and when it is recognised for corporation tax purposes. One of the main factors is the difference in the timing of depreciation and the permitted allowances claimed against taxable profits. These tax allowances are called capital allowances.
- **Depreciation** - as a fixed asset such as plant and machinery is used, its value falls. This is recognised as a charge in the Profit and Loss Account and as a deduction from the cost of the asset concerned in the Balance Sheet. The aim is to write down the cost, less any salvage value, of a fixed asset over its estimated useful life. It is a bookkeeping entry and does not represent any cash outlay. The most common method is either straight line depreciation whereby a fixed asset is reduced in value in equal annual instalments or by instalments on a reducing balance basis.
- **Derivative** - this is a financial instrument that a company uses to reduce or remove ('hedge') non-essential risks such as interest rate changes, foreign exchange rate movements and commodity price fluctuations.
- **Differential or Incremental Costs and Revenues** - the costs and/or revenues of different options which are then compared to identify the differences between them.
- **Discounted Cash Flow (DCF)** - a method used to calculate the present value of cash flows from operations taking into account the time value of money. The time value of money

recognises that cash received today is worth more than cash received in the future because, in the meantime, it can earn a return.

- **Dividend or Distribution** - the discretionary (except on fixed coupon shares such as Preference Shares) payment recommended by the board of directors and approved by the shareholders to be distributed pro rata among the shares outstanding. On preferred/preference shares, it is generally a fixed amount. On ordinary shares, the dividend varies with the fortunes of the company and the amount of cash available. It may be reduced or omitted if performance is poor or cash is retained to finance acquisitions and to invest in new projects. Sometimes a company will pay a dividend based on past earnings even if it is not profitable; the dividend is then said to be 'uncovered'. Dividends are sometimes paid in two instalments – an interim dividend paid during the financial year and a final dividend paid after the end of the financial year.
- **Dividend Cover** - the profit attributable to the ordinary shareholders (the earnings), divided by the total dividend. It is a measure of the security of the dividend. The higher the dividend cover, the more secure the dividend since, if earnings fall, the less likely it will be that the dividend will be reduced. An uncovered dividend will have a dividend cover of less than one. Such a situation may lead to future dividends being reduced or passed (no dividend being paid at all). An alternative to dividend cover is the payout ratio. This is the annual dividend expressed as a percentage of the earnings. For example, a dividend cover of two is equivalent to a payout ratio of 50%.
- **Dividend Yield** - the annual dividend per share expressed as a percentage of the share price. A relatively low dividend yield implies that an investor is prepared to accept a low dividend income today. The expectation is that the share price will rise since the earnings prospects of the company are perceived to be good. The expectation of an appreciation in the share price is compensation for the relatively low dividend income. A relatively high dividend yield implies that an investor is not prepared to wait for an appreciation in the share price because the outlook for earnings growth is perceived to be poor and/or the risk of holding the company's shares is perceived to be high. In both cases, an investor wants a relatively high dividend income as compensation for the uncertain future prospects.
- **Double Entry Bookkeeping** - the method of recording financial transactions whereby every item is entered as a debit or credit in one account and a corresponding credit or debit in another.
- **Due Diligence** - an independent review of a company's business and financial position before a merger or take-over deal is finalised. It covers such issues as the terms of property leases, contracts with customers and the circumstances under which lenders can call in their loans.
- **Earnings** - the profit after all costs including taxation less preference dividends and the minority interest. It is the profit attributable to the ordinary shareholders - the 'bottom line'. The US expression for earnings is 'net income'. The term 'net profit' is also used.
- **Earnings Per Share (EPS)** - the earnings divided by the number of issued ordinary shares. Growth in EPS is an important financial performance indicator. Fully diluted earnings per share is worked out after allowing for the extra shares that may be issued in the future, for example, from employee share option schemes.
- **Earnings Yield** - the earnings per share expressed as a percentage of the market price of an ordinary share. The reciprocal of the earnings yield is the price-earnings ratio (P/E ratio).
- **EBITDA** - this stands for earnings before interest, tax, depreciation and amortisation. It is equivalent to revenues less cash costs including the cost of sales. Depreciation and amortisation are non-cash charges and are, therefore, excluded from cash costs. EBITDA also equivalent to operating profit plus depreciation and amortisation. EBITDA is both a measure of profitability and an indicator of the ability of a business to generate cash from its own activities. In this context, EBITDA is sometimes referred to as 'operating cash flow'.
- **Economic Value Added (Eva) or Economic Profit** - the operating profit after tax less a capital or financial charge for the capital employed used in the business.
- **Enterprise Value** - the total value of a business. It is equal to its market capitalisation (the market value of the equity) plus the market value of its long and short term debt.
- **Equity** - the ownership interest of ordinary shareholders in a company. It is equal to total assets less short and long term creditors. It is also referred to as net assets, net worth, share capital and reserves, shareholders' funds, the shareholders' interest, or equity shareholders' funds. Equity is equivalent to share capital plus retained profit/earnings plus other reserves, for

example, a revaluation reserve.

- **EV/EBIT ratio (Enterprise value to earnings before interest and tax)** - this valuation ratio is similar to, but somewhat simpler than EV/EBITDA, with which it shares the advantage of valuing a company regardless of its capital structure. The ratio is: *EV ÷ EBIT.* The ratio is not used much in practice. EV/EBITDA is generally preferable, but sometimes the information needed is not available: for example, when doing a sum-of-parts valuation and divisional/subsidiary depreciation and amortisation numbers are not available. The EV/EBIT ratio indicates how many times the market values the operational result of the company. A low ratio suggests poorly efficient use of a company's resources, even if its profit margin is high.
- **Exceptional Items** - unusual items in an income statement such as re-organisation and restructuring costs and significant write-downs or write-offs in the value of assets and investments. Results are often shown both before and after exceptional items.
- **Ex Dividend** - the purchaser of shares does not receive the right to receive the next dividend.
- **Expenditure or Expense** - see capital expenditure and revenue expenditure.
- **Factoring / Invoice Discounting** - the receipt of cash immediately from a specialist financing company. This is arranged against the security of approved sales invoices for a fee. In the case of factoring, the finance company runs the sales ledger and collects the cash from customers. In the case of invoice discounting, the finance company does not run the sales ledger. Instead, the client company collects cash from customers which is then banked for the account of the finance company.
- **FIFO (First-in first-out) -** a method of stock (Inventory) valuation based on the assumption that the items remaining in stock are those which were purchased most recently. This means that the oldest stock is assumed to be used first.
- **Fixed Assets** - assets used in the operation of the business and will include all tangible assets such as plant and machinery, computer equipment, land and buildings. It also includes intangible assets such as goodwill, patents and trade marks.
- **Fixed Cost -** a cost which does not vary with changing sales or production volumes, such as: property rent, permanent staff wages, and depreciation of fixed assets.
- **Fixed Charge** - a type of security for a lender. The charge is on specific assets such as buildings and machinery.
- **Fixed Investments** - investments held for long term business or investment purposes. Taken in conjunction with fixed assets, they provide the tangible asset backing for the company's liabilities and debt.
- **Flexible Budget** - a budget that changes according to the actual level of activity or output achieved.
- **Floating Charge** - a type of security for a lender. A floating charge applies to all the assets of a business.
- **Forecast** - the best assessment of what is likely to be the result for a period taking into account actual performance so far, additional information not included in the budget and other future actions that will have an impact during the financial period. By contrast, the budget is the financial plan for a period and remains unchanged.
- **GAAP -** Generally Accepted Accounting Principles. They represent the common set of standards and procedures by which audited financial statements are prepared, for example, historical cost accounting.
- **Gearing (Debt to Equity)** - the percentage that borrowings represent to shareholders funds (less intangibles) at the end of the latest and preceding financial period. The expression “Negative Equity” or "neg equity" indicates that there are actual borrowings but a negative equity base.
- **Going Concern** - the assumption on which the financial statements of a company are prepared and audited. It means the company is financially viable and can meet its commitments for the foreseeable future. If the auditors mention that the going concern principle is questionable then the company may not be financially viable. This may be the case when it is difficult to renew borrowing facilities. Specific reference to going concern is required in a company’s annual report.
- **Goodwill** - this is the money paid to acquire a company that exceeds its net tangible assets value. It is also the value of a company in excess of its net assets shown in its balance sheet.
- **Gross** - usually means "before deduction of tax".
- **Gross Profit (or gross profit margin)** - this is sales less cost of goods or services sold.
- **Group Accounts (or Consolidated Accounts)** - the annual financial statements of a company and its subsidiaries.
- **Historical Cost** - this is the traditional way of valuing assets in a balance sheet and costs in the profit and loss account

or income statement. The criterion for valuation is the cost at the time of purchase. This system of accounting is known as historical cost accounting (HCA). Some financial statements are prepared under HCA modified by the revaluation of certain assets, usually property, to their current value.

- **Holding Company** - the parent company which owns a controlling interest in one or more subsidiaries. See minority interest.
- **Income** - the US term for profit. Net Income is the profit after tax on earnings.
- **Income Statement** - see the Profit and Loss account.
- **Initial Public Offering (IPO)** - The first time a company offers its shares to the financial markets and to the general public.
- **Insolvent** - Unable to meet commitments as they fall due. This will happen when a company does not have enough cash to pay its cash costs and/or when a company's liabilities exceed its assets. It is an offence for a company to trade when it is insolvent.
- **Intangible Assets (Intangibles)** - the company assets that are without physical form but which represent a right or expected future benefit. Examples are Goodwill on acquisition (being the value placed on the acquired company's reputation and market presence), Brands, Patents, Intellectual Property.
- **Interest Cover** - an indicator of solvency. It is calculated by expressing profit before interest and taxation (the operating or trading profit) as a multiple of the interest charge. It is a measure of the ability of a business to service its financing costs from the profit it earns from its trading activities.
- **Internal Rate Of Return (IRR)** - the rate of return or discount rate used in the financial appraisal of a project which produces a net present value of cash flows equal to zero. It is a measure of a project's profitability. The IRR should exceed the cost of capital.
- **Inventory** - the US word for stocks of raw materials, work-in-progress and finished goods.
- **Investments** - long term investments are investments in other businesses such as in an Associated Company, a Subsidiary or a Joint Venture. They will appear under fixed assets in the balance sheet. Short term investments refer to cash balances that are placed on deposit to earn a return. They will appear under current assets in the balance sheet.
- **Joint Venture** - a long-term investment – an investor shares control with one or more other parties under a contractual arrangement. The arrangement is referred to as a joint venture.
- **Journal Entry** - transferring an item from one account to another. For example, correcting an error by transferring an amount for insurance premiums to salaries if the figure for insurance premiums has been overstated and the amount for salaries has been understated.
- **Lease** - the hire of a fixed asset such as plant and machinery from a leasing company - the lessor. There are two sorts of leases. An operating lease is a short-term contract. At the end of the period, the asset concerned is returned to the lessor by the lessee. The leasing costs are charged to the profit and loss account for the appropriate period. A finance lease is a long-term contract. The value of the leased asset is shown or 'capitalised' in the lessee's balance sheet (unlike an operating lease). The commitment to the lessor is split between short and long-term liabilities. The asset concerned is depreciated each year by the amount of the capital repayments. Interest charges on the lease agreement are charged to the profit and loss account when they are incurred.
- **Liability Amounts -** monies owed by a business or company. Its usage varies: 'total liabilities' can mean equity plus amounts due to creditors. But, it may mean amounts owed to third parties or creditors only such as banks and suppliers.
- **LIFO (Last In First Out)** - a method of stock (Inventory) valuation which assumes that the last item delivered to stock is the first to be used. The cost charged in the Profit and Loss Account is, therefore, the most recent cost and, in times of inflation, will be higher than under FIFO (First In First Out). It is not accepted as a method by the HMRC in the UK but it is sometimes used in management accounts to maintain up-to-date costs.
- **Limited Company** - a company is a separate legal entity belonging to the Shareholders who own it. Limited means that the liability of the Shareholders is limited to the amount they have invested in the company. A public limited company (legally abbreviated to plc or PLC) is a type of limited liability company in the United Kingdom (and other jurisdictions where company is law is derived from English law) which is permitted to offer its shares to the public and has a certain minimum issued share capital. A public limited company may not necessarily be a 'quoted' company (that is, a company whose shares are listed on a Stock Exchange). A 'quoted' company is

also referred to as a 'listed' company. All other companies are 'private' companies.

- **Limited Liability Partnership (or LLP)** - a special type of company with limited liability protection but which is treated for tax purposes as if it were a partnership. It has "Members" rather than "Shareholders".
- **Liquid Assets or Liquid Resources** - the value at the balance sheet date of all assets that are either represented by cash or are transferable into cash at short notice.
- **Liquidity** - the extent to which a business has access to cash. Therefore, it is a measure of the ability of a business to meet its short-term commitments. If a company expands too quickly, capital expenditure, trade debtors and stocks may increase so fast that creditors cannot be paid promptly because cash flow is inadequate. This is called 'overtrading'.
- **Margin of Safety** - the difference in activity or output between a company's current level of activity or output and the level producing a break-even result. At break-even, a company's revenues are equal to its total costs.
- **Marginal Cost and Marginal Costing** - marginal cost is the extra or incremental cost of producing/selling an extra unit of output. Marginal costing is a system of costing used for decision-making purposes that focuses on the recovery of direct, incremental or variable costs only. The system should be used with caution.
- **Market Capitalisation** - the stock market value of a company calculated by multiplying the price per share by the number of issued shares.
- **Market To Book Ratio** - the market capitalisation divided by the book value of a company's equity in its balance sheet.
- **Minority Interest** - a non-controlling ownership of less than 50% of a company's voting shares by either an investor or another company.
- **Mortgage** - a form of long-term borrowing secured against a specific asset such as a building.
- **Net Assets** - this is total Assets (fixed and current) less Current Liabilities and long-term liabilities.
- **Net Current Assets** - this is current assets less current liabilities.
- **Net Present Cost** - the sum of the annual negative cash flows from operations for a project discounted at the cost of capital.
- **Net Present Value (NPV)** - the sum of all the annual negative and positive present values of future cash flows from operations. The present values are calculated by discounting the cash flows at the cost of capital. The NPV at the cost of capital is equivalent to the shareholder value created by the project.
- **Net Profit** - net profit normally means profit after deduction of all operating expenses, including both fixed costs and overheads as well as variable costs, depreciation and amortisation. It is normally the profit before deduction of tax, in which cased it is often referred to as 'net profit before tax' or PBT.
- **Net Realisable Value** - the value that could be obtained by disposing of assets. It is not normally used in financial statements, except in the valuation of stocks. If the realisable value is less than cost, then net realisable value should be the basis of stock valuation. In the UK, property companies revalue their property investments to market or realisable value.
- **Net Worth** - synonymous with net assets and equity.
- **Nominal Value** - the face value of a security. In the case of Share Capital it is also known as the Par Value, and may reflect the price at which shares were originally issued. However, a new share issued later may be issued at a price well above the nominal value (see Share Premium). The nominal value normally has no significance for the market value at which a share is traded.
- **Notes Payable** - the US term for short-term borrowings.
- **Off-Balance Sheet Financing** - potential liabilities which do not appear on the balance sheet of the company concerned. Examples include the borrowings of a Joint Venture and Associated Company.
- **Operating Costs 0r Operating Expenses**- all costs excluding the cost of sales, interest charges and taxation. Revenues less the cost of sales and operating costs equals operating or trading profit. The abbreviation, PBIT, (Profit Before Interest and Taxation) is the same as operating profit. Operating income, EBIT (earnings before interest and tax) and trading profit are other terms used for operating profit.
- **Operating Margin** - see profit margin.
- **Operating Profit** - revenues less the cost of sales and operating costs. Other descriptions for operating profit are profit before interest and taxation (PBIT), earnings before interest and taxation (EBIT), operating income and trading profit.
- **Opportunity Cost** - the sacrifice involved in pursuing one course of action rather than another or making a

particular decision rather than another. For example, if a new factory is built on land that could otherwise be sold and the factory is built then the opportunity cost is the potential sales proceeds from the land if it had been disposed of. This opportunity cost should be included in the financial evaluation of the new factory project.

- **Ordinary Shares** - these are the most common form of shares. Holders of these shares are the voting and risk bearing owners of the company. They receive dividends that vary in amount, being subject to the company's underlying profitability and the directors' recommendations. The US term for ordinary shares is common stock.
- **Over-Trading** - see Liquidity.
- **Overdraft** - money owed on a bank current account. A form of short-term borrowing. It is repayable on demand.
- **Par Value** - the face, or nominal, value attributed to each of the company's shares. This has no relationship to either the value of the company or to the quoted price.
- **Payback Period (strictly speaking: The Discounted Payback Period)** - the length of time before the present value of the cumulative cash flows from operations for an investment project reaches zero. This is equivalent to the length of time before a project recovers the present value of the initial cash outflows. It is the 'break-even' time and is a measure of capital efficiency and risk.
- **Preference Shares** - dividends on preference shares must be paid before Dividends are paid on Ordinary Shares hence the word 'preferred'. They are paid at a set percentage of the nominal or par value of the preferred share. For Cumulative Preference Shares, all past unpaid preference dividends must be paid before an ordinary share dividend is paid. Preference Shares are not part of a company's equity and, on a winding up of a company, are normally paid out before Ordinary Shares.
- **Prepayment** - a payment made during the current accounting period for a cost relevant to a later period. This means that the cost is charged as an expense in the future period's Profit and Loss Account even though the cash outflow takes place in the current period. Examples are insurance premiums and rent and business rates paid in advance.
- **Present Value** - the value today of cash receivable from operations at some time in the future. It is calculated by multiplying future cash flows from operations by discount factors which depend on when the cash flows are expected to be received.
- **Pre-tax profit** - the figure reported by the company in its Profit & Loss Account reflecting the results of all business activities and decisions for the financial period.
- **Price-Earnings Ratio (P/E Ratio)** - the market price of a share divided by the earnings per share to give the number of years' earnings per share represented by the current share price. It is a financial status symbol. The higher the P/E ratio, the more attractive a company's earnings prospects are perceived to be. The historic P/E ratio is based on the latest reported earnings per share. The forward or prospective P/E ratio is based on the forecast earnings per share.
- **Profit** - the difference between Revenues, Sales or turnover and the costs incurred for an accounting period. In view of the 'matching' principle, earning a 'profit' is not the same as generating cash since sales are recognised in the Profit and Loss Account, when goods or services are supplied (rather than when they are paid for by the customer). Costs are incurred during the time period to which they relate (which may not be when they are paid for in cash) and some costs, such as Depreciation or Amortisation, do not involve cash outlays at all. It is important to note that there are a number of different measures of profit.
- **Profit Before Taxation** - the profit after all costs, including financing costs or interest charges, but before taxation and dividends.
- **Profitability Index** - the net present value of future cash flows is divided by the present value of future cash outflows or cash outlays. It is a measure of capital efficiency which ranks projects according to the net present value they generate per £ of investment. The profitability index can also be defined as the present value of future cash inflows divided by the present value of future cash outflows. Project rankings are unchanged regardless of which definition is used. The profitability index is used when the cash available for capital expenditure is limited. This situation is referred to as capital rationing.
- **Profit and Loss Account (P&L)** - a key reporting and measuring tool (along with the Balance Sheet and Cashflow or Cashflow Statement). The P&L typically shows sales revenues, cost of sales/cost of goods sold, generally a Gross Profit margin (sometimes called 'contribution'), fixed overheads and or operating expenses, and then a profit before tax figure (PBT).

- **Profit Margin** - a measure of the profitability of Sales. It is defined as the profit before or after interest and taxation expressed as a percentage of Sales. The operating or trading margin is the profit before interest and taxation expressed as a percentage of Sales. The net margin is the profit after taxation divided by Sales expressed as a percentage.
- **Pro-Forma Results** - financial results before taking into account unusual, exceptional or 'one-off' items such as acquisition and merger transactions, asset write-downs and rationalisation costs.
- **Provisions** - the amounts set aside in a Balance Sheet for prospective, future, liabilities that can not yet be fully quantified. Similar to Accruals and Accrued Charges. It is an additional allowance for a cost or charge incurred during a period but not paid by the end of period balance sheet date. Examples of provisions are the estimated cost of redundancies and the costs of reorganising a business. Provisions may be disclosed separately as exceptional items if they are significant. A provision is included as a cost in the Profit and Loss Account and as a liability in the Balance Sheet. A distinction is drawn sometimes between Accrued Charges (the precise amount is known) and a provision (an estimate).
- **Quick Ratio** - current assets, excluding stocks, as a multiple of current liabilities. It is a measure of the ability of a business to meet its short term commitments (within 12 months).
- **Realisable Asset Value** - the price at which an asset, a group of assets or a business could be sold.
- **Real Return** - the return earned by a business or project after allowing for inflation.
- **Receivables** - the same as Trade Debtors.
- **Replacement Cost or Current Cost** - assets may be valued at their replacement cost rather than their historic cost. This is sometimes done in management accounts so that a business is charged with current rather than historic levels of cost.
- **Replacement Cost Operating Profit** - the profit after allowing for the extra or reduced cost of replacing stocks and before interest and taxation. It is used, for example, by oil companies as an important measure of performance since their results are affected by the impact of changes in the input cost of crude oil.
- **Reserves**- the realised and unrealised gains which have added value to the business, and which form part of the equity. Realised gains produce profit. Unrealised gains arise from the revaluations of assets such as property. A third form of gain is the share premium paid over and above the nominal or par value of issued new shares.
- **Retained Profit or Retained Earnings** - the profit for the year after all charges and the distribution of dividends to shareholders. The figure for retained profit in the balance sheet will be the accumulated retained profit since the business started to trade. It may be shown as the revenue reserve, the profit and loss account reserve, retained earnings or retained profit.
- **Return on Capital Employed (ROCE)** - operating or trading profit (profit before interest and taxation) expressed as a percentage of capital employed. This is the pre-tax return on capital employed. A more rigorous measure is the 'after tax' ROCE - the profit before interest after tax expressed as a percentage of capital employed. ROCE is the most important measure of profitability. The ROCE measures the return earned by a business from its trading activities. This return is then compared with the return required by the shareholders and lenders financing the business. The return required by investors and lenders is called the cost of capital. For a business to create value the ROCE should exceed the cost of capital.
- **Return on Equity** - profit after taxation (earnings) divided by equity expressed as a percentage.
- **Return on Sales** - the operating profit divided by sales expressed as a percentage. It is also called the operating margin.
- **Revaluation Reserve** - the difference between the original cost of an asset, usually property, and its current market value. The difference is added to the original cost of the property and added to equity as a revaluation reserve.
- **Revenue** - see Sales.
- **Revenue Expenditure** - Expenditure charged to the Profit and Loss Account or income statement in the period in which it is incurred.
- **Revenue Reserve** - see Retained Profit.
- **Rights Issue** - the issue of additional shares by a company to its existing shareholders (in proportion to their existing holdings) normally at a discount to the prevailing stock market price in order to ensure a successful issue.
- **Sales** - the invoiced value of the goods and services provided to customers during an accounting period. It is also called revenue or turnover. It excludes VAT (or, in some jurisdictions, sales taxes).

- **Scrip Issue** - a free or bonus issues of new shares to existing shareholders in proportion to their current holding. No monies from the new Share Capital are received and no extra cash is raised. A company converts some or all of its retained profit into shares. Since the number of Ordinary Shares will increase, the share price will fall pro rata.
- **Secured Loan** - a loan against which a certain asset or assets is pledged. If the borrower with the loan falls into default, the lender will obtain the available proceeds from the sale of these assets before any payment to unsecured creditors such as suppliers.
- **Securitisation** - the placing of a collection of assets (such as a chain of pubs or a portfolio of mortgages) into a special purpose vehicle (SPV). The SPV then borrows against the security of its assets. The borrowings are repaid from the cash flows generated by the SPV. One of the aims of securitisation is to separate the creditworthiness of the SPV from the general credit standing of the company that set up the SPV.
- **Sensitivity Analysis** - a technique used in investment appraisal. It assesses the effects on the net present value, the internal rate of return, the discounted payback period and the profitability index of changes in the assumptions supporting the estimated future cash flows from operations. Sensitivity analysis asks the 'what if' question.
- **Share Buy-Backs** - the purchase of shares by a company from its own shareholders. It has the effect of reducing equity and increasing earnings per share and can boost the share price.
- **Share Capital** - the permanent capital contributed directly by the owners of a business (the shareholders) both at the start of trading and, subsequently, when additional capital is required to finance expansion. Issued share capital is the amount of capital contributed by shareholders and received by the company. Authorised share capital is the total amount of share capital which the directors are empowered to issue. Any premium on issue of shares above par value is shown as "Share Premium".
- **Share Dividend** - a Dividend paid in the form of an issue of extra shares rather than in cash.
- **Shareholders' Interest or Shareholders' Funds** - the sum of share capital plus retained profit plus other reserves at the balance sheet date. Synonymous with equity, net worth, net assets and share capital and reserves.
- **Share Premium** - the difference between the issue price and the nominal or par value of a share. When a premium is paid for new shares, a share premium reserve is created or increased.
- **Shareholder Return** - the total wealth returned to a shareholder by a company during a specific time period. It is calculated by adding together the appreciation (or fall) in the share price and the Dividend per share received and expressing the result as a percentage of the opening share price. For example; the share price was 100p at the start of a 12 month period and 110p at the end; the dividend per share received during the year was 5p. The total gain was, therefore, 110p less 100p plus 5p to give 15p. 15p expressed as a percentage of the opening share price (100p) is 15%. 15% is the annual rate of shareholder return. When shareholder return is calculated over a period of several years, it is assumed that dividends are reinvested to purchase additional shares.
- **Solvency** - the ability of a business to meet its longer-term commitments. See also Debt: Equity Ratio and Interest Cover.
- **Standard Costing** - a system of costing – predetermined costs are compared with actual costs to highlight differences or variances which are then investigated.
- **Stocks (or Inventory)** - the combined value of raw materials, work in progress or under construction, and finished goods held. They are normally valued at cost or net realisable value, whichever is lower. The US equivalent term for Stocks is Inventory.
- **Stock Turnover Rate** - the average number of times each year that stocks are 'turned over' or used in the course of trading activity. It is calculated by dividing the cost of sales by average or closing stocks. (When computing the ratio from published accounts, the cost of sales may not be known; in such cases, the sales figure is normally substituted).
- **Subsidiary Company** - a company where more than 50% of the voting shares are owned by another company.
- **Sunk Cost** - a cost that has been incurred already, for example, market research and product development costs. Sunk costs should be excluded from future cash flows from operations since they are 'spilt milk' – they are past expenditures which exist regardless of future project decisions.
- **Trade Creditors** - amounts due to suppliers for goods and services received but not yet paid for. They are normally due for payment within 12

months of the balance sheet date, and are part of current liabilities. A capital creditor refers to unpaid amounts for capital rather than revenue expenditure, for example, unpaid bills for new plant and machinery. The American term for trade creditors is accounts payable.

- **Trade Debtors** - the amount due from customers in respect of goods and services supplied but not yet paid for. Usually reported under current assets, but a note may disclose that some trade debtors are not expected to pay within the coming year. The American term for trade debtors is accounts receivable.
- **Trading Or Operating Profit** - profit before interest and taxation (PBIT). It is also referred to as EBIT (earnings before interest and taxation) and operating income.
- **Trial Balance** - a list of debit and credit balances in individual accounts in the accounting records of a business from which a Profit and Loss Account and a Balance Sheet are prepared.
- **Turnover** - the sales, or gross revenue, of the company during the financial period.
- **UK GAAP** - UK General Accepted Accounting Principles being a widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board.
- **Value Added** - the difference between sales and the cost of bought-in materials and services. It is the wealth created by the activities of a business.
- **Variable Cost** - a cost which varies according to the volume of production: for example, raw material and packaging costs. Semi-variable costs are partly fixed and partly variable: for example, utility charges such as electricity and gas include a fixed charge plus a variable charge dependent on usage.
- **Variance** - the difference between a budgeted or standard figure and the actual result. There are a number of different kinds of variances including material price and usage variances; labour rate and efficiency variances; variable overhead rate and efficiency variances’ fixed overhead spending, volume and efficiency variances.
- **Working Capital or Net Current Assets** - current assets (such as trade debtors, cash and stocks) less current liabilities (such as trade creditors, bank overdraft and accrued charges). Trading working capital is current assets excluding cash balances less current liabilities excluding short-term borrowings. Working capital is the net investment in short-term assets giving a company the resources it needs to trade on a day-to-day basis. It is likely to fluctuate according to the needs of the business, for example, seasonal requirements.
- **Zero Based Budget** - a budget compiled without reference to the previous year’s budget. It challenges the status quo.

Investment and Financial Terms

- **The Association of British Insurers (ABI)** - this is the trade association to which most UK insurance companies belong. One of its functions is to monitor quality and decide common areas of interest so that minimum standards of customer service can be maintained.
- **ACC Accumulation Units -** a unit type designed for growth. Income is used to raise the value of units rather than purchasing new units.
- **Account Managers –** management companies which deal with the administration of investment holdings. In the past this role would normally be the responsibility of the same company that ran the fund.
- **Active Investment Management** - the management of an investment portfolio that involves active trading of securities in an attempt to produce above-average returns on a risk-adjusted basis. Active management is predicated on the belief that it is possible to beat the market averages consistently.
- **Actuary** - Actuaries are professional people employed, usually, by insurance companies because they have special skills in calculating insurance rates by reference to the mathematical laws of probability to measure potential risks. In England, these people are members of the Institute of Actuaries, in Scotland of the Faculty of Actuaries.
- **Additional voluntary contributions (AVCs)** - these are extra amounts of money which you may choose to save in order to enhance the pension you will receive on retirement.
- **Affinity Card** - Affinity cards are credit cards linked to a particular cause, which may or may not be charitable. Some charities offer credit cards (the schemes are run by card issuers on the charities' behalf) that make small percentage payments towards charity funds each time you use the card.
- **Allocation rate** - this is the percentage of your investment payment that is actually invested (e.g. 75%) after initial charges have been taken into account.
- **Allonge** – derived from the French word *allonger*, which means to draw out, an allonge is a sheet of paper attached to a bill of exchange for the purpose of documenting endorsements. The need for an allonge arises as a result of a lack of space on the bill itself. For example, as a bill of exchange is transferable through endorsement, it may be exchanged among so many parties that these parties don't all fit on the bill. In this case, a separate piece of paper (the allonge) is attached to the bill, acting as a legal extension of the document. An allonge is more usually used in those countries where the Code Napoléon is in force, as that code requires every endorsement to express the consideration. Under English law, as the simple signature of the endorser on the bill, without additional words, is sufficient to operate as a negotiation, an allonge is seldom necessary. With the decline in the use of bills of exchange, it is now rarely needed.
- **Alpha (and Alpha Coefficient)** - a mathematical estimate of the amount of return expected from the inherent values of an investment. It measures the portion of an investment's return from specific (non-market) risk. It is the difference between an asset's actual performance over a specified period of time and the performance that might have been expected using its volatility relative to "the market" (the beta coefficient). It measures risk-adjusted performance, factoring in the risk due to the specific security, rather than the overall market. A high value for alpha implies that the asset has performed better than would have been expected given its beta (volatility).
- **Alternative Investment Market (AIM)** - this is an official Stock Exchange market for investors seeking investment opportunities in smaller, and usually, higher risk entities.
- **Annual Equivalent Rate (AER)** - this is a notional rate that is generally quoted on interest paid on savings and investments. It is intended to demonstrate what your interest return would be if the interest was compounded and paid annually instead of monthly (or any other period). The gross AER is the contractual rate of interest payable before the deduction of income tax. Net AER is the amount of interest payable after allowing for the deduction of basic rate tax.
- **Annual General Meeting (AGM)** - this is the annual shareholder meeting. All companies, except those with an elective resolution in place, are required by law to hold this meeting. This meeting is normally held 21 days after publication of the annual report. It must be held within 18 months of the previous AGM. The accounts are presented and various resolutions are put forward at these meetings.
- **APCIMS (Association of Private Client Stockbrokers and Investment Managers)** - the official body of Stockbrokers and fund managers specialising in the provision of investment services for private clients.

- **AITC (Association of Investment Trust Companies)** - the AITC is the trade body for investment trust companies.
- **Annuity** - this usually refers to an insurance related investment product that guarantees or aims to pay a stated amount to the holder every year. The payments may be at a fixed interest rate (Fixed Annuity) or a variable rate (Variable Annuity). The insurance annuity usually offers tax deferral benefits as well.
- **Arbitrage** - buying securities in one country, currency or market, and selling in another simultaneously to take advantage of price differences.
- **Association of Residential Lettings Agents (ARLA)** - ARLA was formed in 1981 as the professional and regulatory body for letting agents in the UK.
- **Authorised person -** a firm or person authorised under the Financial Services and Markets Act to carry on investment business.
- **Backwardation** - a futures market term: the situation in which, and the amount by which, the price of a commodity for future delivery is lower than the spot price or a far future delivery price lower than a nearer future delivery. One says that the forward curve is "in backwardation" (or sometimes: "backwardated"). Backwardation is a situation where the cash price of a commodity is pregnant with a premium a buyer is willing to pay for the immediate delivery of the commodity. Formally, backwardation means a downward sloping forward curve (as in an inverted yield curve). A backwardation starts when the difference between the future price and the cash price is less than the cost of carry. The opposite market condition to backwardation is known as *contango*.
- **Base Rate** - the base interest rate determined usually by a country's central bank (such as the Bank of England) upon which all other lending or savings interest rates are based.
- **Basel Accord (or Basel Capital Accord)** – the agreement adopted by the Basel Committee on Banking Supervision in 1988, and amended in 1996. It is an internationally (among the G-10 central banks) agreed set of supervisory regulations governing the capital adequacy of international banks. Capital is measured in relation to the perceived credit and market risk of the assets owned by the banks. The standards are almost entirely addressed to credit risk, the main risk incurred by banks.
- **Bear** - this is an investor who is negative towards shares, believing prices will fall. A Bear market is one where share prices across the entire market are generally, and consistently, falling.
- **Bearer Security** - this is a bond or a share for which there is no other proof of ownership other than the physical possession of the security. Since no official record or register of ownership is kept, the owner is the "bearer" of the share or bond certificate and they are easily traded without formality.
- **Bell Curve -** This is statistically a large and random sample when measured will produce a bell curve on a bar chart where the scale measurement is along the x-axis and the total occurrences within the sample up the y-axis.
- **Benchmarking** - the analysis of selected activities and processes, and their comparison with similar analyses for other organisations.
- **Beneficial Owner -** in stockmarket usage as a result of the growing importance of nominee accounts, it is a term used to identify the actual owner of an asset although the asset may not be recorded in their name.
- **Beta (or Beta Coefficient)** – this is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. The Beta Coefficient is a concept taken from the popular Capital Asset Pricing Model that describes an individual asset's risk as compared to the overall market. It measures how much the particular asset moves in relation to a broader index. A beta of 1.0 indicates that an asset closely follows the market. A beta greater than 1.0 indicates greater volatility than the market. Those below 1 tell us that the security moves less than the overall market index. The Financial Times all-share index or the Dow-Jones index are usually taken as proxy measurements for general market movements.
- **Bid Price -** the price the market maker will pay you for your shares when you sell. The opposite of Offer Price (the price you have to pay if you want to buy shares).
- **Bid Offer Spread -** this is the difference between the bid price (at which you can sell shares) and the offer price (at which you can buy shares). Many unit trusts also have a bid-offer spread and effectively this amounts to an extra exit charge when the investor sells.
- **Boiler Rooms** – these are offices, often overseas, set up to sell shares to UK investors. They are not authorised by the FSA and act illegally by selling and promoting the sale of shares in the UK.

The shares are often sold by telemarketing by stock brokerage firms operating out of inexpensive, low-rent offices (hence the term "boiler room") and use high-pressure sales tactics to sell shares that are unsuitable, over priced, extremely risky and possibly even non-existent.

- **British Insurance Brokers' Association (BIBA)** - BIBA is the UK's leading independent insurance body representing insurance brokers, intermediaries and consumers.
- **Blue Chip** - a term used to define the shares of a company regarded as being a solid, and consequently safe, investment. The company will almost certainly be large, well established and profitable, but be conservatively managed.
- **Bonds** - a bond is simply an IOU. It is an agreement under which a sum is repaid to an investor after an agreed period of time. A bond can be issued by anyone but is, generally, a certificate issued by governments and companies as a means of raising capital which generally entitle the holder to a fixed-rate of interest during their life and repayment of the amount of the bond at maturity.
- **Bonus issue** - the issue by a company of new shares which do not require any payment to be made by the shareholder. This has the effect of making the company's shares more marketable because of the increased number available and the lower market price.
- **Building Societies Association (BSA)** - this is the trade Association representing interests of building societies who are members of it.
- **Bull** - this is an investor who is positive towards shares, believing prices will rise. A Bull market is one where share prices across the entire market are generally, and consistently, rising.
- **Bundesbank** - this is the German central bank which was set up in 1957 and given full independence to set interest rates.
- **Call** - this is the demand by a company or any other issuer of shares for payment. It may be the demand for full payment on the due date, such as, for example, with a rights issue. The calls are usually made several months apart by call letter and the shares are said to be paid-up when the shares are fully paid.
- **Call Option** - this is the right, but not the obligation, to purchase shares at a specified price on a specified future date.
- **Call (covered warrant)** - a warrant that gives the holder the right, but not the obligation, to buy the underlying at a future date and specified price.
- **Call (warrant) -** a call warrant allows the holder to benefit from a rising market. It rises in value when the underlying asset rises in value.
- **Cap and Collar Rate** - a mortgage which guarantees the interest rate charged will remain sandwiched between two specified levels.
- **Capital Assets Pricing Model (CAPM)** – this is an economic model for valuing stocks and securities as well as derivatives (see Derivatives Market) by relating risk and expected return. The model says that the expected return investors would demand is equal to the rate on a risk free security plus a risk premium. The model is used in finance to determine a theoretically appropriate required rate of return (and thus the price if expected cash flows can be estimated) of an asset, if that asset is to be added to an already well-diversified portfolio, given that asset's non-diversifiable risk. The CAPM formula takes into account the asset's sensitivity to non-diversifiable risk (also known as systematic risk or market risk), in a number often referred to as beta (β) in the financial industry, as well as the expected return of the market and the expected return of a theoretical risk-free asset.
- **Capital Fulcrum Point (CFP)** - the CFP measures the annual percentage growth rate required from the underlying instrument to do equally well in terms of capital appreciation from its associated warrant.
- **Capitalisation** - money from a company's reserves is converted into issued capital, which is then distributed to shareholders as additional shares in place of a cash dividend. This is also known as a Scrip Issue.
- **Capital Ratios** – the use of capital ratios is a valuable tool for assessing the safety and soundness of banks. The regulatory framework for determining bank capital adequacy is under review by the Basel Committee on Banking Supervision (see Basel Accord).
- **Carpetbagger** - someone who becomes an account holder with a building society or other mutual in the hope that they will benefit from a windfall handout when the building society demutualises (turns itself into a public company).
- **Carry Trade** - a speculation strategy involving borrowing at one interest rate, then investing the acquired funds into a different asset that generates a higher interest rate yield.
- **Cash Market -** this is a term used on futures markets to describe the underlying currency market or stockmarket in which deals are carried

out in the currencies or shares to which the futures contracts relate. Also known as the Spot Market.

- **Cash Settled Warrants** - these are warrants which are not exercised in exchange for a physical asset, but for a cash amount equal to their intrinsic value.
- **CAT** - CAT stands for Charges, Access and Terms. CAT standards are designed to identify savings products that are simple, clear and fair, so that savers will feel confident about choosing them. However, it doesn't mean they're suitable for all savers. Nor does it guarantee performance.
- **Caveat Emptor** - this is Latin for 'let the buyer beware'. It implies a buyer must ensure that goods about to be purchased are free from defects and that he/she bears the risk. It is particularly relevant in property transactions, where the seller is legally obliged not to mislead the buyer, but other than that the onus is on the buyer to satisfy himself that the property is in the condition he wants.
- **Chapter 11** - the term for corporate bankruptcy protection in the US, similar to company voluntary arrangements (CVAs) in the UK. It postpones a company's obligations to its creditors, giving it time to reorganise its debts or sell parts of the business.
- **Chartered Insurance Institute (CII)** - the body controlling professional standards (educational, ethical etc) in the insurance industry.
- **Chinese Wall** - an internal 'wall' between two departments of a bank or other financial institution which is meant to ensure that conflicts of interest do not arise. For instance, a bank might have a corporate finance department which advises on takeovers and mergers, and a fund management division which invests client money in shares. If the fund managers were to hear in the canteen about an impending deal, that would be insider dealing. Chinese walls, 'enforced by a bank's compliance department, are meant to ensure that the corporate financiers don't talk to the fund managers about their work.
- **Closed-End Fund** - these funds have a fixed number of shares, which are listed on the London Stock Exchange (LSE). The market price of the shares is determined by demand and supply factors. Investment trusts are closed-end funds.
- **Closed Period** - The two months before a company announces its results in which directors are prohibited from dealings in its shares.
- **CoCo Bonds (also known as Contingent Convertible Bonds)** – these are bonds which are only convertible into stock if the share price achieves a specified level.
- **Collar (also called a fence)** - a protective options strategy in which a written call and a long put are taken against a previously owned long stock position. The options may have the same strike price or different strike prices and the expiration months may or may not be the same.
- **Collateralised Debt Obligations (CDOs)** - A collateralised debt obligation is a financial structure that groups together individual loans, bonds or assets in a portfolio, which can then be traded. In theory, CDOs attract a stronger credit rating than individual assets due to the risk being more diversified. But, as the performance of some assets has fallen, the value of many CDOs have also been reduced.
- **Collective Investment** - a collective investment is a pooled fund, which gives a professional fund manager control of the investments on behalf of private investors. Collective investments include products such as Unit Trusts, Investment Trusts and Open Ended Investment Company (OEIC) and most are usually geographical or thematical such as UK Smaller Companies or American Equity.
- **Consolidations** – this occurs when a company reduces the number of shares it has in circulation by consolidating its share capita; for example, shareholders would receive 2, 50p shares for every 1, £1 share held.
- **Consols** – these are British bonds that have no specified maturity date and pay a coupon for ever.
- **Contagion (or to be more precise, Financial Contagion) –** this is the transmission of economic shocks from one country to others, through trade or other economic connections. Financial interdependence can transmit a crisis from one country to another, for example if countries borrow from the same creditors. Faced with a crisis in one country, banks and other lenders may lose their nerve and start recalling loans made to borrowers in the region, creating a credit crunch - a shortage of cash - in debtor countries. Contagion can take place both during "good" times and "bad" times and does not need to be related to crises. However, contagion tends to be emphasised only during times of crisis times.
- **Contango** - a term used in the futures market to describe an upward sloping forward curve (as in the normal yield curve). One says that such a forward curve is "in contango" (or sometimes "contangoed"). It is the situation

where, and the amount by which, the price of a commodity for future delivery is higher than the spot price, or a far future delivery price higher than a nearer future delivery. For stocks and shares, Contango is the carry-over of the settlement of an account on a stock exchange to a future period. Such postponement requires payment of interest on the amount carried over. The opposite market condition to contango is known as Backwardation.

- **Contract For Difference** - a contract designed to make a profit or avoid a loss by reference to movements in the price of an underlying item. The underlying item is not bought or sold itself. Similar to spread betting. Increasingly popular as an alternative to actual share trading as it allows margin deposit trading and legally avoids stamp duties or similar taxes. Typically, a quoted CFD price will track the underlying share price quite closely.
- **Convertible Bond** - these bonds can be converted into a specified number of shares of the issuing company at a pre-determined price.
- **Convertible Preference Shares** - these shares can be converted into ordinary shares at a given price at a future date.
- **Correlation** – this is more an economic function rather than an investment one. Two random variables are said to be positively correlated if high values of one are likely to be associated with high values of the other. They are negatively correlated if high values of one are likely to be associated with low values of the other. A number of different coefficients are used for different situations - the best known correlation coefficient is the *Pearson product-moment correlation coefficient*, which is obtained by dividing the covariance of the two variables by the product of their standard deviations.
- **Corporate Governance** - the term used, following recent Government sponsored reports, to describe the policies and procedures that the company's directors' employ in their conduct of the company's affairs, and their relationships with shareholders to whom they are responsible as managers of the shareholders interests in the company, and of its assets.
- **Co-operative** - a business owned and operated by its members.
- **Covered Bonds** – these are senior debt instruments secured by a cover pool of mortgage loans (property as collateral) or public-sector debt to which investors have a preferential claim in the event of default. Covered bonds have a higher risk weighting than mortgage-backed securities because the holder is exposed not only to the non-repayment of the mortgages but also to the financial health of the issuer.
- **Covered Warrants** – these are a recent addition to the range of stock market related investments that an investor can buy. These products provide the ability to make a profit from a fall in the value of a company's shares, as well as a rise. They provide investors with the opportunity to gain exposure to other instruments that are not normally available on the stock market. Covered warrants, which can be bought for as little as £50, do this by giving you the right, but not the obligation, to buy or sell a share at a specific price and at a specific time. You could, for example, take the view that a company's share was going to fall in price over the next six months and make money if they did. This is known as 'shorting' a share. You are free to sell the warrants you have bought at any time through a stockbroker, just like ordinary shares. Covered warrants, which are issued by investment banks, can be used as an insurance policy as well as for betting on share price falls. If, for example, you hold ordinary shares in a company you are hoping the shares will go up in value. But you could hedge your bets by buying a warrant that would pay out if its share price fell. You can also use them to take bigger bets on the market. When you buy shares in a company, the amount you gain is limited to the rise in the share price: if it rises by 20%, you make 20%. But if, for example, you believe a share is set to bounce, you could buy a covered warrant that gives you ten times its gain. So, if the share were to rise 20%, your investment would rise 200%.
- **Coupon** - a regular payment received by the bondholder over the lifetime of the bond. The coupon rate is expressed as a percentage of the face value of the bond.
- **Creative Accounting** - the term used to indicate accounting and financial reporting practices which, whilst not illegal, are intended to convey a circumstance or position that is either misleading or illusory, creating a position of profitability or soundness that may not be totally valid.
- **Credit Crunch** - the situation created when banks hugely reduced their lending to each other because they were uncertain about how much money each of them had. This in turn resulted in more expensive loans and mortgages for ordinary people.
- **Credit Default Swap** – this is a specific kind of counterparty agreement allowing the transfer of third party credit risk from one party to the other. One party in the swap is a lender and faces credit risk from a third party, and

the counterparty in the credit default swap agrees to insure this risk in exchange of regular periodic payments (essentially an insurance premium). If the third party defaults, the party providing insurance will have to purchase from the insured party the defaulted asset. In turn, the insurer pays the insured the remaining interest on the debt, as well as the principal. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap. Unlike insurance, however, CDSs are unregulated. This means that, when the bond defaults, there is no regulator to make sure the seller of the CDS actually has the money to pay the holder.

- **Credit Event** – an event under a credit derivative agreement that leaves an obligor unable to fulfil its financial obligations. Particularly in credit derivatives transactions, these events are carefully specified and will usually arise from: failure to pay, insolvency, cross-default, restructuring, repudiation, merger and downgrade. A credit event is effectively an insurance to cover a third party default.
- **Credit Spreads** - this is the difference between the yields on riskier bonds and on safer Government securities (Gilt-Edged Securities or Gilts). Gilts offer a low rate of return as the risk of default is almost negligible whereas companies that borrow by issuing bonds have to offer a higher yield due to the potentially higher risk of default. The difference between the corporate bond rate and the rate on a government bond is known as the "spread".
- **CREST** - CREST is the UK's electronic (paperless) registration and settlement system for equity share trading. In other words it is the book entry transfer system for UK and Irish registered equity and corporate stocks.
- **Cum** - when appended to the share price, this means "including". Thus a share price quoted cum dividend (or cum div.), means that you will receive the next, and announced, dividend if you buy the shares.
- **Cumulative Preference Shares** - these preference shares accumulate unpaid dividend, which is then paid out when the company next declares it or is able to pay Dividends.
- **Currency Peg** - A commitment by a government to maintain its currency at a fixed value in relation to another currency. Typically this is done by the government buying its own currency to force the value up, or selling its own currency to lower the value. An example of a peg was the fixing of the exchange rate of the Chinese Yuan against the US Dollar.
- **Cyclical Stocks –** these are stocks the market performance of which is heavily influenced by changes in economic activity. Their price will rise when the economy turns up, and will fall when the economy turns down. Examples are (a) house builders which have done well in the 10 years from 1997 with low interest rates and high demand for houses. Non-cyclical stocks (also called "counter cyclical or defensive stocks"), such as stocks within the food and hospital industries, are not directly affected by economic changes.
- **Dark Pools of Liquidity** (also **Dark Pools** or **Dark Liquidity**) – these are electronic "crossing networks" that provide liquidity that is not displayed on order books. They offer institutional investors and larger hedge funds many of the same benefits associated with making trades on the stock exchanges' public limit order books - without tipping their hands to others, meaning publicly quoted prices aren't affected. Dark pools range from completely opaque to semi-transparent and their order flow can range from transient to stationary. Opaqueness impacts fairness, as the more-transparent the liquidity pool, the easier it is to be manipulated. More-transparent crossing networks (such as Liquidnet Inc., Pipeline, or the SIGMA X unit of Goldman Sachs) solve this problem by not letting brokers or more-active traders onto the platform and by policing their community and evicting poachers. Other crossing engines with some transparency, such as Pipeline or Posit, give away such limited information that is difficult to use. These "pools" are growing rapidly, both in number and in volume of trades and account for around 12% of all US stock trades (Source: August 2008, Tabb Group).
- **Day Trader** - a US Term. Day traders are in and out of the market many times during the course of one trading session and may not even hold a position in any securities overnight. This approach tends to generate a lot of expenses in the form of commissions and denies the day trader the ability to participate in the long-term creation of wealth through compounding which is possible if you own the shares of a quality business.
- **DAX -** German Stock Exchange Index.
- **Dead Cat Bounce** - a phrase long used on trading floors to describe a short-lived recovery of share prices in a falling stock market.
- **Debt for Equity Swap** – this is a way in which a company can swap some of

the money it owes to a bank or other creditor in exchange for shares and, in doing this, the debt is reduced accordingly. There are many possible reasons why a company would wish to restructure its finances – such as the need to meet certain contractual obligations (for example) maintaining a debt/equity ratio below a certain number. A debt for equity swap can help a company that is in financial trouble by cancelling some of its outstanding debt.

- **Deferred Ordinary Shares** - these are shares that rank below preferred ordinary shares for dividends.
- **Dematerialisation** - traditionally the evidence of financial security ownership is by written statements on paper (e.g. share certificates). Increasingly such information is being placed on electronic records (called dematerialisation) and paper evidence is being abandoned.
- **Demutualisation** - the process by which building societies and mutual insurers convert themselves from mutual organisations (owned by their members/customers) to profit-making companies with share capital and which distribute profits to their shareholders.
- **Depository Receipts** - these are certificates, representing evidence of ownership of a company's shares held by a depository. They can be bought and sold. American Depository Receipt (ADR) is a document giving the owner rights to UK shares which have been lodged in a US Depository. They are effectively bearer documents. They are issued by US banks to give American investors access to UK shares. (see also Global Depositary Receipts (GDRs) and European Depositary Receipts (EDRs))
- **Depression** - a depression is a sustained, long-term downturn in economic activity in one or more economies. It is a more severe downturn in the economy than a recession, which is seen as part of a normal business cycle. The word “depression” is often used to refer to the worldwide economic depression from the late 1920s through the 1930s. In the United States, it began with the stock market crash in October, 1929.
- **Derivative Market** - the Market on which futures, such as derivatives are sold. Sales are made on the basis of a guaranteed future sale at a current price, which is known as the "underlying". The terms "contracts" or "products" are often applied to denote the traded instrument.
- **Discounted Cash Flow** - a way of estimating the value of an investment in today's money by adjusting future returns to get their present value.
- **Discount Rate** – the rate used for adjusting the total present value of future income from an investment, projected over a given period of time after taking into account the declining value of money.
- **Div per share** - dividends are regarded as a crucial investment measure. It is the declared net dividend per share payable to registered shareholders for the financial period. This is the income a shareholder receives on each share invested in the company.
- **Dividends** - the sum paid by the company to its shareholders as their direct financial reward from holding the company’s shares. It is the income received from an investment in the company’s shares. A company can choose to pay a dividend from reserves following a loss-making year, and conversely a company can choose to pay no dividend after a profit-making year, depending on what is believed to be in the best interests of the company. However, a company cannot make dividend payments except out of distributable reserves.
- **Dividend cover** - the indicator as to the rate that the company may be paying its dividends out of its earnings, and its ability to continue to pay dividends at that rate.
- **Dow Jones** - a US index which is the oldest and most widely used measure of the overall condition of the stock market. Each of the four averages is price-weighted and includes a few dozen widely held stocks. There are four Dow Jones Averages: Industrial, Transportation, Utilities, and Composite (the other three together).
- **"Earnings before…"** - There are several 'Earnings Before..' ratios such as: EBT = Earnings Before Taxes; EBIT = Earnings Before Interest and Taxes; EBIAT = Earnings Before Interest after Taxes; EBITD = Earnings Before Interest, Taxes and Depreciation; and EBITDA = Earnings Before Interest, Taxes, Depreciation, and Amortisation.
- **Earnings Per Share (EPS)** - the relationship of the profit, after tax, attributable to each share in issue. It is the key component of company performance featured in the price earnings ratio (P/E ratio or PER). The main subject of broker research on future corporate performance and a key factor in arriving at share and corporate value. "This value is displayed in pence (p)".
- **EASDAQ** - a Europe-wide stock exchange aimed at innovative, young and fast growing companies.
- **Economic Indicators** - statistical data showing general trends in the economy. Those with predictive value are leading

indicators (they anticipate the direction in which the economy is going – such as movements on the stock exchange reflecting investor confidence or sentiment as well as interest rate movements); those occurring at the same time as the related economic activity are coincident indicators; and those that only become apparent after the activity has occurred are lagging indicators which confirm long-term trends and happen after an event.

- **Elliott Wave Theory -** A technical analysis technique published by Ralph Elliott, which claims that stockmarkets follow a pattern of five waves up and three waves down (or sometimes, five up and three down in a bull market, and three up and five down in a bear market). According to Elliott, stockmarket movements conform to specific patterns, consisting of a series of waves – because people tend to think and behave in a herd-like way (i.e., people's response to price changes isn't reasoned or random, but is determined by "shared mood trends"). Every wave consists of a number of smaller waves conforming to the same pattern, so it is possible to discern Elliott Waves in price movements during an hour or a century.
- **Equity** - that part of the company's share capital represented by ordinary, or voting, shares. The risk-sharing aspect of the company's invested capital.
- **Ethical Investments (also known as Socially Responsible Investment (SRI))** - these are investments where the fund manager will take an ethical or environmental view on companies before deciding to include them in the portfolio.
- **Eurobond (also called "global bond")** - an international bond issued and traded outside the country in whose currency it is denominated and outside the regulations of a single country. Multinational companies and national governments use Eurobonds to raise capital in international markets. Eurobonds are attractive methods of financing as they give issuers the flexibility to choose the country in which to offer their bond according to the country's regulatory constraints. In addition, they may denominate their Eurobond in their preferred currency. Eurobonds are attractive to investors as they have small par values and high liquidity.
- **Euro Depositary Receipts (EDRs)** - as with other depositary receipts (see American Depositary Receipts and Global Depositary Receipts), the EDR is a certificate representing ownership of the issuer's underlying shares. Prices of EDRs are quoted in euros and are often close to values of related shares, but they are traded and settled independently of the underlying shares.
- **EV/EBIT ratio (Enterprise value to earnings before interest and tax)** - this valuation ratio is similar to, but somewhat simpler than EV/EBITDA, with which it shares the advantage of valuing a company regardless of its capital structure. The ratio is: *EV ÷ EBIT.* The ratio is not used much in practice. EV/EBITDA is generally preferable, but sometimes the information needed is not available: for example, when doing a sum-of-parts valuation and divisional/subsidiary depreciation and amortisation numbers are not available. The EV/EBIT ratio indicates how many times the market values the operational result of the company. A low ratio suggests poorly efficient use of a company's resources, even if its profit margin is high.
- **Ex** - when appended to the share price, means "excluding". Thus a share price quoted ex dividend (xd or ex div.), means that you will not receive the announced dividend when you buy the shares. Conversely, you will still receive the dividend when you sell the shares xd, even though you do not hold the shares at the actual time of the dividend payment.
- **Exchange Traded Fund (ETF)** - an ETF provides an investor with the opportunity to own a theoretical investment. Instead of owning individual equities, the investor buys a share in the index. A single tradable instrument thus effectively allows investment in the performance of all of the constituent stocks. This is similar in concept to investing in an index-tracking fund but an ETF can be traded throughout the day with no tracking errors. The ETF market started in the USA and has now crossed to Europe. In index calculation terms there is little or no difference between ETF and non-traded indexes and thus demand has increased for index calculation systems, albeit for use in another field. Perhaps the best way to think about an ETN is like a bond whose return to the investor depends on the performance of an exchange traded fund.
- **Execution Only** - the service provided by a broker who buys and sells shares (or transacts insurance business) on the instructions of clients but who offers no advice about what to buy and sell.
- **Federal Reserve System** - the central banking system of the United States - comprised of the Federal Reserve Board, the 12 Federal Reserve Banks, and the national and state member banks. Its primary purpose is to regulate the flow of money and credit in the country. The Federal Reserve was established in 1913 to maintain a sound and stable banking system throughout the United States and to promote a strong economy.

- **Financial Adviser** - there are two main types of financial advisers, Independent Financial Advisers and Tied Agents (Company Representatives). Independent Financial Advisers have access to the entire market place to choose the most suitable products and services for their clients whereby a Tied Agent is restricted to the products of their sponsor company.
- **Financial Services Compensation Scheme (FSCS)** – the FSCS is the compensation fund of last resort for customers of authorised financial services firms. The FSCS deals with claims against authorised firms (those regulated by the Financial Services Authority (FSA)) that are unable, or likely to be unable, to pay claims against them. The maximum level of compensation for claims against firms declared in default on or after 1 January 2010 is £50,000 per person per firm. The maximum level of compensation for claims against firms declared in default before 1 January 2010 is 100% of the first £30,000 and 90% of the next £20,000 up to £48,000 per person per firm.
- **Fiscal Policy** - the government's decisions about the amount of money it spends and collects in taxes to achieve full employment and a non-inflationary economy capable of maintaining economic growth.
- **Flat Yield (also called Running Yield or Interest Yield)** - it is the income you earn in a year per £100 market value of a bond. The figure is calculated by dividing the coupon by the market price and multiplying by 100.
- **Fractionalised Reserve Banking** - a system in which banks keep only a fraction of their deposits on reserve as cash and deposits at the Central Bank. In a 100 percent reserve banking system, banks would be unable to create money by making loans. However, holding less than 100 percent allows banks to make loans and, in turn, create money in the economy.
- **Franked Income or Franked Investment Income** – this is Dividends and other distributions from UK companies that are received by other companies. The principle of UK corporate taxation is that once one company has paid corporation tax, any dividends it pays can pass through any number of other companies without carrying a further corporation-tax charge, hence the term 'franked'. Thus franked investment is exempt from corporation tax in the hands of the recipient company.
- **Free Cash Flow –** this is the amount of cash generated by the business after meeting all its operating obligations for interest, tax and dividends and after all capital investment. It shows how much money the company could pay out to shareholders without expanding and without running down its existing operations The higher a company's free cash flow yield, the better.
- **Free Float** – that part of the share capital of a Company that is actively traded on the stock exchange that are not held by large owners and which have no sales restrictions. It is thus a measure of how many shares are reasonably liquid. The free float or a public float is usually defined as being all shares held by investors other than:
  - shares held by owners owning more than 5% of all shares (those could be institutional investors, "strategic shareholders," founders, executives, and other insiders' holdings)
  - restricted stocks (granted to executives that can be, but don't have to be, registered insiders)
  - insider holdings (it is assumed that insiders hold stock for the very long term.
- **FTSE** - Financial Times Stock Exchange, the joint operation for compilation and maintenance of the indices used as the key performance benchmarks for the UK Stock Market.
- **FTSE Index** - three indices comprise the FTSE All Share index - FTSE 100, FTSE Mid 250 & FTSE Small Cap. A fourth index, the FTSE Fledgling, covers newly listed and other listed companies not included in the other indices.
- **Fundamentals** - these determine a company, currency or security's value. A company's fundamentals include its assets, debt, revenue, earnings and growth.
- **Fund Manager** - the person or people responsible for deciding on asset and stock allocation in a collective investment.
- **Futures** – a tradeable contract committing you to take delivery (if you are the buyer) or to make delivery (if you are the seller) of an agreed amount of something such as shares, commodities or currency.
- **Gilt-Edged Securities (or Gilts)** - UK Government bonds or other securities or instruments issued by the Government paying, usually, a fixed rate of interest and regarded, because of its Government backing, as the safest long-term investment.
- **Global Deposit Receipts (GDRs)** - these are negotiable certificates issued by depositary banks which represent ownership of a given number of a company's shares which can be listed and traded independently from the the underlying shares and typically used by companies from emerging markets. GDRs can be listed on either

the Main Market or the Professional Securities Market. A GDR will be used to access two or more markets, usually London and the US. They are often launched for capital raising purposes, so the US element is generally either a Rule 144(a) ADR or a Level III ADR, depending on whether the issuer aims to tap the private placement or public US markets. These securities are quoted and traded in US dollars on the International Order Book and the associated dividends are paid to investors in US dollars. GDRs are settled in either DTC or Euroclear Bank enhancing their cross border liquidity. GDRs allow purchasers to gain exposure to companies which are listed on foreign markets without having to purchase the shares directly in the market in which they are listed.

- **Gross Domestic Product (GDP)** - this is the standard wealth measure for the economy in a country, namely of all the services and goods produced in a year. There are three main ways of calculating GDP - through output, through income and through expenditure.
- **Growth Companies** - those companies that are expected to have continual growth, year on year, in their earnings per share.
- **Home Income Plan** - this is a way of a person (usually having reached retirement age) to raise money or an income by giving up ownership (or part ownership) of their house in exchange.
- **Horizontal Ratio Analysis** - using financial ratios to provide comparison of a company's performance across a series of different financial periods (years).
- **Indices** – indices are benchmarks based on a "basket" of currencies or shares which show the movement in value from one period to another, for example: the FTSE 100 is an index of the largest 100 companies traded on the London Stock Exchange and includes shares such as GlaxoSmithKline, Royal Dutch Shell, Tesco and Vodafone.
- **Initial Public Offering (IPO)** - an IPO is the first sale of stock (shares) by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPOs can be risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.
- **Insider Dealing -** under the Criminal Justice Act (1993) Insider Dealing or as it is sometimes called Insider Trading is a crime, committed when an individual in possession of unpublished price sensitive information (that is, not in the public domain) and/or knowingly connected with a company attempts to, or actually deals in its shares; or when that information is communicated to a third party with the purpose that the third party may use it to trade unfairly.
- **Interest coverage ratio (also called interest coverage or times interest earned)** – this is arrived at by taking income before interest expenses and taxes (EBIT) and dividing it by the amount of interest that a company pays on its debt. The ratio indicates how well the company's earnings are able to cover the company's debt. The calculation shows a company's ability to meet its interest payments on outstanding debt. The lower the interest coverage ratio, the larger the debt burden is on the company. The lower the ratio, the more the company is burdened by debt expense. When a company's interest coverage ratio is 1.5 or lower, its ability to meet interest expenses may be questionable. An interest coverage ratio below 1 indicates the company is not generating sufficient revenues to satisfy interest expenses.
- **Interest Rate Spread** – this the gap between the interest rate a bank pays on deposits and the higher rate it charges for loans. The yield the lender charges over a specific index that is commensurate with the risk of a given transaction. Usually, the "spread" is quoted in the terms of basis points. It shows the extent to which interest earning capacity of an entity exceeds or falls short of its interest cost obligations. The formula is: (Interest earned ÷ Interest-earning assets) less (Interest paid ÷ Interest-costing liabilities).
- **Interest Rate Swap** - a transaction in which two counterparties exchange interest payment streams of differing character based on an underlying notional principal amount. More simply, interest rate swaps are simply the exchange of one set of cash flows (based on interest rate specifications) for another. The advantage to this is that one company may have access to lower fixed rates and another company may have access to lower floating rates. The three main types of swap are coupon swaps (fixed rate to floating rate in the same currency), basis swaps (one floating rate index to another floating rate index in the same currency) and cross-currency interest rate swaps (fixed rate in one currency to floating rate in another). Often, an interest rate swap involves exchanging a fixed amount per payment period for a payment that is not fixed (the floating side of the swap would usually be linked to another interest rate, often the LIBOR). In an interest rate swap, the

principal amount is never exchanged: it is just a notional principal amount. Also, on a payment date, it is normally the case that only the difference between the two payment amounts is turned over to the party that is entitled to it, as opposed to exchanging the full interest amounts. Thus, an interest rate swap usually involves very little cash outlay.

- **Interims (int)** - the company's results for, normally, the first six months of its reporting period (usually its financial year). Also the identification of the dividend declared and paid on the results for this period.
- **Investment Trust** - a closed-end investment fund which is a company listed on the Stock Exchange and whose purpose is to invest in other shares, often specialising in specific types of company, geographical area or industrial sector.
- **Kondratiev Cycles** - the discovery of cyclic phenomena of long duration in economic activity is attributed to the Russian economist Nikolai. D Kondratiev (1892 to 1938) who, in the 1920s, described the existence of long waves in the world economy. He based his theory on the observation of trends in the fluctuation of 19th-century economic indicators (mainly prices), and he explained the occurrence of long waves in terms of the durability and production period of and amount invested in, particular types of capital goods. The specific source of the long wave was the tendency of investment in these basic capital goods to occur in clusters. The notion of long waves (or Kondratiev cycles) is a 50-60 year cycle in prices, interest rates and other economic variables. Kondratiev cycles are most readily apparent in monetary data such as prices and interest rates.
- **Individual Savings Account (ISA)** – Individual Savings Account, the replacement for PEPS and TESSAS launched in April 1999. Maxi-ISAs can include cash and stocks and shares in a single ISA with one manager. Mini-ISAs enable you to have separate ISAs with different managers for cash and stocks and shares.
- **Inflation** – inflation is caused by an increase in the amount of money or credit available in relation to the amount of goods or services available, which causes an increase in the general price level of goods and services. Over time, inflation reduces the purchasing power of a unit of currency making it worth less.
- **Internal Rate of Return (IRR)** - this is the return which can be earned on the capital invested in the project, i.e. the discount rate which gives a Net Present Value (NPV) of zero. This is equivalent to the yield on the investment. A project is a good investment proposition if its IRR is greater than the rate of interest, including an appropriate risk premium.
- **Junk Bond** - a bond (or loan to a company) with a high interest rate to reward the lender for a high risk of default.
- **Keynesian Economics** - the economics of John Maynard Keynes. In modern political parlance, it is the belief that the state can directly stimulate demand in a stagnating economy: for example, by borrowing money to spend on public works projects like roads, schools and hospitals.
- **Lamfalussy Process –** this is an approach to the development of financial service industry regulations used by the European Union. Originally developed in March of 2001, it is named after the chair of the EU advisory committee that created it, Alexandre Lamfalussy. It is composed of four "levels," each focusing on a specific stage of the implementation of legislation. At the first level, the European Parliament and Council of the European Union adopt a piece of legislation, establishing the core values of a law and building guidelines on its implementation. The law then progresses to the second level, where sector-specific committees and regulators advise on technical details, then bring it to a vote in front of member-state representatives. At the third level, national regulators work on coordinating new regulations with other nations. The fourth level involves compliance and enforcement of the new rules and laws. The Lamfalussy Process provides several benefits over traditional lawmaking, including more-consistent interpretation, convergence in national supervisory practices, and a general boost in the quality of legislation on financial services. This has been demonstrated best in the development of the Markets in Financial Instruments Directive.
- **Letters of Credit -** these are used by exporters and importers, and usually provided by the importing company's bank to the exporter to safeguard the contractual expectations and particularly financial exposure of the exporter of the goods or services.
- **LIBOR (The London InterBank Offered Rate)** - this is an interest-rate benchmark gauging how much banks and other finance houses charge each other to borrow money. BBA LIBOR fixing evolved in the early 1980s with the growth of syndicated lending and early developments in the derivatives markets. Since then it has assumed an increasing importance as well over 20% of all international bank lending and

more than 30% of all FX transactions take place in London. BBA LIBOR is now used to calculate the interest rates applying to a wide range of contracts. In April 2008, Banks were calling for alternatives to the use of LIBOR due to fears that it may be distorted. The distortion can arise because LIBOR is based on quotes from banks as to the rate of interest they are prepared to lend unsecured funds to other banks but it is difficult to check whether trades are actually conducted at the quoted rates.

- **Liquidity** - the portion of an investment portfolio that is not fully invested, but is represented by cash holdings.
- **Loan-to-Own (or Distressed-Debt Strategy / Rescue Financing)** – a strategy used by private equity and other investors to purchase companies as an alternative to conventional asset, stock or merger transactions. In applying these strategies, creditors use their debt positions to take ownership of troubled companies which agree with their lenders and shareholders to dramatically strengthen their balance sheet by swapping the majority of their debt for equity. It provides an opportunity for investors to take control of a company without buying it outright, providing capital to a business that needs money to continue operating. The strategy can also be applied by Hedge Funds and Private Equity investors to acquire debt, and sometimes certain amounts of equity or management control, such as voting power or board seats, from a lender of a distressed company.
- **Managing Investments** - the business of arranging for investments to be bought and sold on behalf of clients. This is a regulated activity under the Financial Services and Markets Act.
- **Mkt cap / Market capitalisation** - Market capitalisation is the number of shares in issue multiplied by the share price at the time the market capitalisation was calculated.
- **Margin Call** - a demand from a broker to the client asking for additional funds to be deposited in a margin account to meet margin requirements because of adverse price movements. This arises when derivatives (such as a spreadbet) are bought, for example with an initial deposit of say 10% of the value of the underlying shares, and the share value falls when you expected it to rise.
- **Market Maker** - a Stock Exchange member firm that is obliged to make a continuous two-way price in the shares it follows. This is a commitment to offer to buy and sell the securities it trades in.
- **Market Neutral Funds** - a hedge fund strategy that seeks to exploit differences in stock prices by being long and short in stocks within the same sector, industry, market capitalisation, country, etc. This strategy creates a hedge against market factors. Market neutral funds aim to deliver above market returns with lower risk by hedging bullish stock picks (buys) with an equivalent number of short bets (sells). The strategy attempts to profit from the current direction of the market. A person using the strategy will take both long and short positions at the same time by holding a market neutral position to exploit any momentum in the market. Hedge funds commonly take a market neutral position as they are focused on absolute return as opposed to relative return. On top of investing, some income is also generated from the interest earned by placing the cash proceeds of the short sales in savings accounts. The goal is to deliver consistent returns, ranging anywhere from 3% to 6% above Treasury bills or gilts, after fees, whether the market is going up or down. However, not all market neutral funds are lower risk.
- **Marking to Market** – (also called mark to market or marked to market) this is the process by which changes in the value of futures contracts are settled daily. The losses or gains on this type of derivative contract are assessed daily in reference to the value of the underlying price. The term "Marking to Market" can also refer to the practice of reporting the value of assets on a market rather than book value basis.
- **Mean reversion** - This is a tendency for individual stocks or entire asset classes to revert to their long-term averages after periods of relative under- or over-performance. It is thus based on the mathematical premise that all prices will eventually move back towards the mean or average return. If there is a change in prices (unexpected jump, either up or down), prices will return or revert eventually to the level before the change. The time it takes to revert is often referred to as the time to reversion.
- **Mid Price** - the mid point of the buying and selling spread (bid/offer spread) quoted by the market makers. It is the price shown in the share price pages and market reports in the financial media, but it is not the price at which you could necessarily expect to buy or sell.
- **MiFID** – this stands for the Markets in Financial Instruments Directive which introduced a single market and regulatory regime for investment services across the 30 member states in the EU. It came into effect on 1

November 2007, and replaced the Investment Services Directive (ISD).

- **Modigliani & Millers (MM) Capital Structure Theories** - (i) MM-no tax, which proves that no optimal capital structure exists, and that the WACC is invariant to debt / equity ratio; or (ii) MM-with tax which suggests that the tax shield should be exploited up to the point of almost 100 per cent debt financing.
- **Monoline –** a company specialising in a single type of financial business, such as credit cards, home mortgages or a sole class of insurance and which may use direct marketing practices and statistical models to target specific customers.
- **Mutual Fund** - a US term for collective investments. They are pooled investments and are the equivalent of UK Unit Trusts and Open Ended Investments Companies.
- **Naked Shorting** - the illegal practice of short selling shares that have not been affirmatively determined to exist. It is illegal because it allows manipulators a chance to force stock prices down without regard for normal stock supply/demand patterns. Ordinarily, traders must borrow a stock, or determine that it can be borrowed, before they sell it short. However, some professional investors and hedge funds take advantage of loopholes in the rules to sell shares without making any attempt to borrow the stock.
- **National Association of Securities Dealers Automatic Quotation System (Nasdaq)** - an electronic quotation system that provides price quotations to market participants about the more actively traded common stock issues in the OTC market. About 4000 common stock issues are included in the Nasdaq system.
- **OFEX** – this was a UK unregulated, off exchange, alternative to the official Stock Market, organised by JP Jenkins Ltd., and targeted at smaller companies, with a potentially higher risk, but consequent prospects of greater reward (this market is now the PLUS market).
- **Offer Price** - the price you have to pay to the Market Maker to buy shares you want.
- **Open Ended Investment Company (OEIC)** - an OEIC is a pooled collective investment vehicle, in company form. OEICs first became available in May 1997 and were introduced as a more flexible alternative to established unit trusts. An OEIC may have an 'umbrella' fund structure, allowing for many 'sub-funds' with different investment objectives. This means you can invest for income and growth in the same fund without having to worry about purchasing different types of shares. OEICs may also offer different share classes for the same fund. Being "open ended", OEICs can expand and contract in response to demand - just like unit trusts. The share price of an OEIC is the value of all the underlying investments, divided by the number of shares in issue. As an 'open-ended fund' the fund gets bigger and more shares are created as more people invest. The fund shrinks and shares are cancelled as people withdraw their money.
- **Operating Leverage** – this is a measure of how revenue growth translates into growth in operating income. Operating leverage is the extent to which a firm uses fixed costs in producing its goods or offering its services. As a measure of leverage, it tells you how risky (variable) a company's operating income is. A business that makes few sales, with each sale providing a very high gross margin, is said to be highly leveraged. A business that makes many sales, with each sale contributing a very slight margin, is said to be less leveraged. As the volume of sales in a business increases, each new sale contributes less to fixed costs and more to profitability. A business that has a higher proportion of fixed costs and a lower proportion of variable costs is said to have used more operating leverage. Those businesses with lower fixed costs and higher variable costs are said to employ less operating leverage: the higher the degree of operating leverage, the greater the potential danger from forecasting risk.
- **Option** - a derivative that gives the option-holder the right to buy or sell a commodity at a specified price at a certain time or within a certain period of time. Options differ from futures in that with a future the future holder is obliged to go ahead with the transaction whereas the option is simply an option to take that up if they wish.
- **Option Premium** – this is the price the buyer of an options contract pays for the right to buy or sell a security at a specified price in the future. It is a non-refundable, full payment (not a deposit) for the rights specified in the stock option contract. The option premium is paid regardless of whether or not the option is actually exercised. The option premium often changes, due to fluctuating market conditions and economic variables. The total value of an option consists of intrinsic value, which is simply how far in-the-money an option is, and time value, which is the difference between the price paid and the intrinsic value. The time value approaches zero as the expiration date approaches.

- **P/E ratio (price per earnings)** - the P/E ratio is an important indicator as to how the investing market views the health, performance, prospects and investment risk of a public company listed on a stock exchange (a listed company). The P/E ratio is arrived at by dividing the stock or share price by the earnings per share (profit after tax and interest divided by the number of ordinary shares in issue).
- **PEG Factor** - The Price/Earnings to Earnings Growth, or PEG ratio or Factor is used as a rule-of-thumb measure to consider basic value while taking earnings into account. The factor is used to indicate the relative attraction, and consequent value enhancing potential, from investing in a growth company. It indicates the relationship between the P/E Ratio and the earnings per share growth rate. A PER of 15, with an earnings growth rate for the company of 30%, gives a PEG factor of 0.5 (15/30). The lower a PEG the better because it means a stock is cheap relative to its earnings growth potential. The formula for Peg Factor is P/E Ratio divided by estimated future earnings per share growth rate.
- **Penny Share** - the term usually applied to companies whose shares have a very low price, normally under 50p per share. Companies, whose shares have speculative appeal, represent greater risk and are often issued by former, high riding companies, now deemed to be on harder times.
- **Performance Spread** - the percentage difference between the actual rate of return on an investment and the required rate given its risk class.
- **Piotroski (or F) Score -** a method of evaluating stocks devised by Joseph Piotroski, an Accounting Professor at the University of Chicago. He reasoned that because value stocks are troubled companies by definition, many are financially distressed and won't have the financial resources to recover. Pondering on whether he could improve the performance of a value portfolio by throwing out the financially weakest stocks. Piotroski devised a simple nine-criteria stock-scoring system for evaluating a stock's financial strength that could be determined using data solely from financial statements. One point was awarded for each test that a stock passed. Piotroski classed any stocks that scored eight or nine points as being the strongest stocks. His findings were that these strong stocks as a group outperformed a portfolio of all value stocks by 7.5% annually over a 20-year test period. Piotroski also found that weak stocks, scoring two points or fewer, were five times more likely to either go bankrupt or delist due to financial problems.
- **Ponzi Scheme** – this is an investment scam that appears to pay high returns within a short period of time and at little risk. However, it does so by paying the supposed returns out of the victims' own capital. It's the name given to fraudulent "make money fast" schemes promoted through the Internet and elsewhere. It only generates returns only by recruiting new investors and the money collected from them is used to pay the return. The scam is named after Carlo (Charles Ponzi), a clerk in Boston, USA, who first used the scheme in 1919.
- **Portfolio** - the total investments held in different companies or investment trusts by an individual investor or organisation.
- **Pound Cost Average (or Averaging)** – for £s, this is the regular investing of fixed amounts over regular periods, typically monthly, in order to accumulate holdings in securities such as shares, unit trusts and investment trusts. When for example a unit trust price or investment trust price has fallen, more units or shares can be purchased for that month. Similarly when the price rises then fewer units or shares can be purchased. Over a period of a few years, the average price paid will be lower than the average share price for that period since more shares are bought at the lower price and fewer at the higher price. For $s (when it is called a *Constant Dollar Plan*), this is the same in that it is a plan enabling investors to accumulate shares in a mutual fund by purchasing them on a regular basis (for example monthly) with a fixed dollar amount. The dollar amount buys more shares when the price is low than when it is high, and over time the investor will have accumulated shares at a cost which is neither high nor low, but average for the period in question.
- **Preference Shares** - dividends on preference shares must be paid before Dividends are paid on Ordinary Shares hence the word 'preferred'. They are paid at a set percentage of the nominal or par value of the preferred share. For Cumulative Preference Shares, all past unpaid preference dividends must be paid before an ordinary share dividend is paid. Preference Shares are not part of a company's equity and, on a winding up of a company, are normally paid out before Ordinary Shares.
- **Prelim / Preliminary Statement** - the announcement made by the company to the Stock Exchange on its annual or interim results, earnings and proposed dividend and made prior to the publication and release of the full Report.

- **Price Sensitive** - price sensitive information is information or data related to a company's trading or any other affairs which is likely, if generally known, to have an influence on its share price. Use of such information prior to general release could lead to criminal charges of Insider Trading.
- **Prime Broker** - a prime broker is a large bank or securities firm that give one-stop shop administrative and back office support including professional services to hedge funds, large institutional customers and other professional investors.
- **Profit-participating Deferred Shares (PPDS)** - Profit-participating deferred shares are capital instruments that building societies will be able to issue to strengthen their balance sheets. This will help building societies that are suffering from a lack of access to capital as they face losses amid plunging property values. Unlike banks, building societies cannot raise new equity to offset losses. Like bonds, the instruments will pay interest, but like a stock, their value will fluctuate along with the company's profitability. PPDS will not be protected deposits for the purposes of the Financial Services Compensation Scheme.
- **Promissory Note** – this is an unconditional promise made by one person to another to pay a fixed amount on demand or at a specified future date. It contains an unconditional promise to pay a certain sum to the order of a specifically named person or to bearer—that is, to any individual presenting the note. A promissory note can be either payable on demand or at a specific time.
- **PROSHARE** - the organisation set up to encourage, and support, investment in the stock market by private individuals.
- **Prospectus** - the formal document issued by, or on behalf of, a company when it first seeks entry to, for example, the Stock Exchange's Official List (and also at other times when an unquoted company wishes to issues shares). It describes the company's business background, assets and financial performance and often, an official forecast on future performance expectations. Prospectuses will also be published for any subsequent issues of new shares, such as a rights issue.
- **Quant Fund** - a mutual fund that makes investment decisions by quantitative analysis. In such funds, the managers build computer-based models to determine whether or not an investment is attractive.
- **Quantitative Easing -** Quantitative easing was first used as a tool of monetary policy by the Bank of Japan to fight domestic deflation in the early 2000s. It's a term used when a central bank creates money out of 'thin air' to inject into the banking system. The aim is to increase the amount of deposits in private banks so that, by way of deposit multiplication, they can increase the money supply by increasing debt (lending). *'Quantitative'* refers to the money supply; *'easing'* refers to reducing the pressure on banks. A central bank can do this by buying government bonds (treasury securities in the US) in the open market, or by lending money to deposit-taking institutions, or by buying assets from banks in exchange for currency, or any combination of these actions. These have the effects of reducing interest yields on government bonds, and reducing inter-bank overnight interest rates, and thereby encourage banks to loan money to higher interest-paying bodies. In layman's terms, the central bank creates more money (a liability for the central bank) and uses this money to buy securities in the open market (an asset).
- **Quoted Company** - a company whose shares are listed on an official Stock Exchange.
- **Rappaport's Value Drivers** - pioneered by Alfred Rappaport, the shareholder value approach is by definition forward looking, cash based, long term, and risk adjusted. Rappaport says there are seven key factors which determine value. They are: 1. Sales growth rate. 2. Operating profit margin. 3. Tax rate. 4. Incremental fixed capital investment. 5. Incremental working capital investment. 6. The planning horizon. 7. The required rate of return.
- **Real Rate of Return** - the rate that would be required in the absence of inflation.
- **Recession** – Recession is a significant decline in activity spread across the economy, lasting longer than a few months. It is seen in industrial production, employment, income, and wholesale-retail trade. Recession usually follows a boom, and precedes a depression. It is characterised by rising unemployment and falling levels of output and investment. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's GDP. (GDP stands for "gross domestic product" and is the standard wealth measure for the economy). A recession is a national or world event, by definition.
- **Redemption Yield** - any one of several methods of calculating what interest rate is necessary for the market price of a bond to equal the net present value of the remaining interest payments and redemption value.

- **Relative Strength** - this is regarded as one of the most important technical analysis indicators. The relative strength, for a given period, indicates the performance status of the company's share price, relative to the performance of an underlying, benchmark index, for the market over the same period.
- **Repo** - a repurchase agreement (also known as a Sale and Repurchase Agreement or Buyback) which allows a borrower to use a financial security (such as Treasury Bills) as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell immediately a security to a lender and also agrees to buy the same security from the lender at a fixed (higher) price at some later date.
- **Reverse Acquisition (or Reverse Take Over)** - a technique used by a private company to go public without jumping through all the regulatory hoops that going public usually requires. The private company acquires majority ownership in a publicly listed company that has no assets or liabilities (called a shell), changes the company's name, and installs its management and board of directors.
- **Rights Issue** - An additional issue of shares by the company to existing share holders and at an advantageous, discounted, price. A means for the company to raise new funds for further development or to finance a new acquisition for cash. A 2 for 5 rights at 145p means that the existing share holder has the right to acquire a further 2 shares for every 5 currently held at a new cost of 145p per share acquired.
- **Scrip Issue (Bonus Issue)** - shares issued to shareholders, in proportion to existing holdings, to increase the number of shares to make them easier to sell in smaller denominations.
- **Securities** - the general name for stocks, shares and bonds issued by the company to investors.
- **Shadow Banking** - the "shadow banking system" or the "shadow financial system" is largely formed by non-bank financial institutions that (just as banks do), borrow short and in liquid forms and lend or invest long in more illiquid assets. They are able to do this via the use of credit derivative instruments which allow them to evade normal banking regulations such as those related to specifying ratios of capital reserves to debt - as they are not depositary institutions, these entities do not have direct or indirect access to the central bank's lender-of-last-resort support. In conditions of market illiquidity, they could go bankrupt if unable to refinance their short-term liabilities. These financial institutions are subject to market risk, credit risk and especially liquidity risk, since their liabilities are short-term while their assets are more long term and illiquid. The term "shadow banking system" is attributed to Paul McCulley of PIMCO.
- **Shorting** - short selling or "shorting" is the practice of selling things the seller does not own, (often financial instruments), in the hope of repurchasing them later at a lower price. Often, the sold item is 'borrowed' or 'rented' for the period of sale and re-purchase. Short-sellers attempt to profit from an expected decline in price (in contrast to the ordinary investment practice, where an investor *"goes long,"* purchasing a security in the hope the price will rise).
- **Short Selling: Regulatory Developments** - on 19 September 2008, the UK's Financial Services Authority (FSA) published Short Selling (No 2) Instrument 2008. It prohibits short selling in relation to UK financial sector companies, defined as a company that is a UK bank, UK insurer or a UK incorporated parent undertaking of either of these. The FSA has published a list of the UK incorporated banks and insurers to which the Instrument applies.
- **Slump (or Economic Slump) -** a period in which a country's economy is greatly affected by unemployment, low and low levels of trade and investment and resulting in poverty. It is the sudden falling off or decline in economic activity, prices, or business (associated with "Depression" and "Recession" although perhaps lasting shorter than these).
- **Sovereign Wealth Funds (or SWFs) -** in broad terms, SWFs are investment funds created and owned by governments to invest in foreign assets (such as property, shares, bonds or other financial instruments) for the purpose of generating long term investment returns. SWFs encompass a wide range of funds and a variety of investment strategies and management, but share common characteristics.
- **Split Capital Investment Trusts** - some investment trusts issue more than one type of share. They are called Split Capital Investment Trusts and form about 10% of the whole market. The simplest "Split" is divided between capital and income shares. The capital shares receive no dividends over the life of the trust, while the income shares receive all the income generated by the whole fund. This creative financial marketing is valuable because it enables private investors to select precisely the sort of investment they need.

- **Spread** - this is the difference between the Market makers buying (offer) and selling (bid) prices.
- **Spread Betting** - a form of gambling on the outcome of any event where the more accurate the gamble, the more that is won and conversely the less accurate the more that is lost.
- **Standard and Poors** - a US credit rating organisation, awarding ratings of AAA (triple A) to D. Anything below BB is purportedly a doubtful proposition for investment purposes.
- **Stagflation** – put simply, stagflation is an economic state in which inflation combines with a downturn in the economy – "stagnation with inflation". It is an economic downturn characterised by the simultaneous existence of stagnation and persistent and intractable inflation. Stagflation occurs when the economy isn't growing but prices are - not a good situation for any country.
- **Standard Deviation** - this is a statistical measure of the distance a quantity is likely to be from the average value. In finance, standard deviation is applied to the annual rate of return of an investment, to measure the investment's volatility, or "risk".
- **Stamp Duty** - the tax on the purchase of shares and property. Stamp Duty is not paid by sellers.
- **Status** - this indicates the market on which the company's equity capital is traded. "Full" means fully listed on the main London Stock Market. "AIM" means that the company is a member of the Alternative Investment Market.
- **Stock Exchange** - a market where stocks and shares are bought and sold.
- **Structured Investment Vehicles (SIVs) -** these are usually created by investment banks to raise "off-balance sheet finance". The investment vehicle holds mainly highly rated asset-backed securities and funds itself using the short-term commercial paper market as well as the medium-term note (MTN) market. Because of the rolling nature of its funding, an SIV is highly dependent on maintaining the highest possible short-term and long-term credit ratings. The first SIVs were founded in the mid-1980s as bankruptcy-remote entities and were sponsored by large banks or investment managers for the purpose of generating leveraged returns by exploiting the differences in yields between the longer-dated assets managed and the short-term liabilities issued.
- **Stock Splitting -** a stock split increases the number of a company's issued shares by dividing each existing share. The stock's market capitalisation remains the same, and the value of the stock in aggregate is the same, but there are more shares available and thus each share is worth proportionately less. For example, with a 2-for-1 stock split, each shareholder receives an additional share for each share held, but the value of each share is reduced by half: two shares now equal the original value of one share before the split. The most logical reason for stock splitting is to increase a stock's liquidity and can bring the share price down to a more attractive level for investors.
- **Stop Loss** - an order placed with a broker to sell a security when it reaches a certain price. It is designed to limit an investor's loss on a security position. It can also be known as a "stop order" or "stop-market order". For example, setting a stop-loss order for 10% below the price you paid for a share would limit your loss to 10%.
- **Subordinated Loans** - often an unsecured loan and one which would only be repaid after secured loans had been repaid.
- **Sub-Prime Mortgages and Loans** - the phrase 'sub-prime' in relation to mortgages, sometimes also referred to as "non conforming mortgages", generally refers to those mortgages targeted at consumers with impaired or low credit ratings (with payment delinquencies and possibly county court judgments, and bankruptcies) who may find it difficult to obtain finance from traditional sources. These mortgages are also often used to consolidate existing secured and non-secured debts. These borrowers may also show reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. These loans have a higher risk of default than loans to prime borrowers and this is reflected in high interest and other penal terms. Some sub-prime lenders are independent, but increasingly they are affiliates of mainstream lenders operating under different brand names.
- **Swap** - exchanging one thing for another and used in the financial arena e.g. currency swap, for trading purposes, or interest rate swap, where borrowers swap fixed rate for variable rate investments.
- **Synthetic(s) (and Synthetic Security)** - a financial instrument that is created artificially by simulating another instrument with the combined features of a collection of other assets with different characteristics than could otherwise be achieved, for example, higher yield, better liquidity, or interest rate protection. These securities mimic or simulate conventional financial instruments that may or may not be available to investors. Most such deals are Private Placements involving two investors, and usually are created through Interest Rate Swaps, for example, creating a synthetic Floating

Rate Note by matching a fixed rate bond and an interest rate swap. An investment firm might create a synthetic index that seeks to outperform a particular index by purchasing options contracts rather than the equities the actual index owns, and using the money it saves to buy cash equivalents or other debt securities to enhance its return on the derivatives.

- **Tangible Assets** - the combined total of fixed assets and long term investments.
- **Tap Stock** - a gilt edged security, not issued through the stock exchange, issued at a predetermined price.
- **TechMARK** - a grouping together of technology companies from a wide range of FTSE sectors into a market with its own identity and its own FTSE indices.
- **Tier 1 Capital** - a calculation of the strength of a bank in terms of its capital, defined by the Basel Accords, typically comprising ordinary shares, disclosed reserves, retained earnings and some preference shares.
- **Tobin's Q Ratio** – this is assets divided by replacement value: the market value of a company's assets divided by the replacement value of the company's assets. Tobin's Q is a ratio comparing the value of the stocks of a company listed in the financial market with the value of a company's equity book value. Another use for Q is to determine the valuation of the market as a whole. The formula for this is: value of shares on stock market/corporate net worth. The ratio was developed by James Tobin (Tobin 1969). Tobin's Q is calculated by dividing the market value of a company by the replacement value of the book equity: EMV+LBV divided by EBV+LBV (Where EMV = Equity Market Value, LBV = Liabilities Book Value and EBV = Equity Book Value).
- **Toxic Debts** - Debts that are very unlikely to be recovered from borrowers. Most lenders expect that some customers cannot repay; toxic debt describes a whole package of loans where it is now unlikely that it will be repaid.
- **Tracker Funds** - a fund which aims to achieve the same returns as a chosen share index, and which does this by investing in all the companies in the index according to a market value weighting. Mathematically, this ensures that the fund achieves its aims.
- **Tracking stocks -** Tracking stocks are securities that are designed to have a value that reflects the value of a division of a company. Issuing a tracker is an alternative to a demerger or partial demerger. A separate listing for a subsidiary should cause the market to separately value that subsidiary. This often increases the sum of parts valuations of the parent company. A tracking stock allows a company to both retain full control and have the benefits of the separate valuation of a division. A security is created that shares in the profits of a division, but that has reduced or no voting rights.
- **Treasury Bills** - a short term bill of exchange, depending on discount to give it value, as it does not pay interest.
- **Treasury Stock** - loans to the government for an initial period exceeding 90 days.
- **Umbrella Fund** - a collective fund containing several sub-funds, each of which invests in a different market or country. The umbrella fund structure makes it cheaper for savers to move from one sub-fund to another.
- **Undated Stocks** – these are fixed interest stocks which have no redemption date.
- **Unitisation** – this is the conversion of an investment trust into unit trust.
- **Unit Trust** - an open ended collective investment vehicle, not quoted on the Stock Exchange, but investing in stock market listed securities. Units can be redeemed at will, thereby reducing the pool of funds available for investment by the investment managers of the trust.
- **Valuation Method** - the policy guidelines an investment management team uses to value the holdings in a funds portfolio.
- **Value at Risk (VaR)** - a technique used to estimate the probability of portfolio losses based on the statistical analysis of historical price trends and volatilities. In practice, it is the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. Although VaR is a very general concept that has broad applications, it is most commonly used by security firms or investment banks to measure the market risk of their asset portfolios (market value at risk). VaR is widely applied in finance for quantitative risk management for many types of risk. VaR does not give any information about the severity of loss by which it is exceeded. Other measures of risk include *volatility/standard deviation*, *semi-variance* (or *downside* risk) and *expected shortfall*.
- **Vega** - a measure of the sensitivity of an option or warrant price to changes in the volatility of the underlying asset.
- **Venture Capital Trust (VCT)** - a type of investment trust which invests in small unquoted companies including AIM and OFEX companies, and which is designed to attract risk capital from higher rate taxpayers by giving them tax

concessions. VCTs are quoted on the London Stock Exchange.

- **Volatility / Standard Deviation** – this is the speed and magnitude of price changes measured over a certain period of time. A price that frequently moves sharply will be considered to have a high degree of volatility.
- **Warrant** - a tradable security providing the holder with the right to buy specific shares at a set price on a future date.
- **White Knight** - A company which comes to the rescue of another listed company which is under siege from an unwelcome bidder. The White Knight may make an improved offer, or it may just be a more acceptable predator than the first bidder, as far as the management are concerned.
- **Wholesale Money** - funds that are borrowed by financial institutions in large quantities rather than from investors in small quantities. Wholesale banking is banking services for other financial institutions.
- **Wrap Account** - an account in which a brokerage manages an investor's portfolio for a flat quarterly or annual fee. This fee covers all administrative, commission, and management expenses. Sometimes this also includes funds of funds.
- **Xa** - another way of writing ex all. This means that shares bought in a company are without entitlement to current dividends, rights issues or scrip issues. Such entitlement remains with the seller of the shares.
- **Xc** - another way of writing ex scrip or ex capitalisation. Shares bought in a company are without entitlement to current scrip issues. Such entitlement remains with the seller of the shares.
- **Xd** - another way of writing ex dividend. Shares bought in a company are without entitlement to current dividends. Such entitlement remains with the seller of the shares.
- **Xr** - another way of writing ex rights. Shares bought in a company are without entitlement to current rights issues. Such entitlement remains with the seller of the shares.
- **Xw** - another way of writing ex warrants meaning that shares bought in a company are without entitlement to warrants.
- **Yankee** - in the US, a Yankee is a dollar denominated bond issued in the USA by a foreign bank.
- **Yearling** - a local authority bond normally issued for one year.
- **Yellow Strip** - the yellow band on a SEAQ or SETS screen which displays the highest bid and the lowest offered prices that competing market makers are offering in a security. They are known colloquially as the 'touch' or 'yellow strip' prices.
- **Yield** - the annual dividend or interest income relative to the value of the underlying security on which it is received. This is expressed as the percentage the income per share bears to the share price.
- **Yield Curve** – a curve which plots current yields of fixed interest securities against their times to redemption (maturity). This enables investors to compare the yields of short, medium and long term securities at a given time.
- **Yield Gap** - a comparison between the average yield from shares (dividend yield) and the average current yield from long dated gilts (15 years or more to redemption).
- **Yield to Maturity (YTM)** - this is the rate of return anticipated on a bond if it is held until the maturity date.
- **Zero-Coupon Bonds** - these are securities which do not pay interest. They are issued at a deep discount to the redemption price so that the investor receives the return in the form of capital gain rather than income.
- **Zero-Coupon Convertible -** a zero-coupon bond issued by a company can be converted into common stock at a certain price; one issued by a government can be converted into an interest-bearing bond.
- **Zero Dividend Preference Shares** - these Preference Shares are issued by split capital investment and pay no income but promise to repay the shares at a higher level at a fixed date. The shares are very tax efficient and have been used for school fees planning.
- **Zero-Minus Tick -** in stock markets, a price which is the same as that for the previous transaction, but less than that of the trade before that. Also known as a zero-downtick.
- **Zero-Plus Tick -** In stock markets, a price which is the same as that for the previous transaction, but greater than that of the trade before that. Also known as a zero-uptick.

Islamic Financial and Investment Terms

Guiding Principles

Broadly, three Sharia rules set Islamic finance apart. First is a bar on involvement with industries considered sinful, such as gambling and alcohol. Second is a strict ban on Riba, which means that Muslims are prohibited from taking or giving interest. Third, there is an injunction to avoid Gharar, meaning excessive risk-taking and uncertainty.

- **Al-'Aariyah -** Al-`Aariyah means the loan of a particular piece of property, the substance of which is not consumed by its use, without anything taken in exchange, In other words, it is the gift of usufruct (this means the right of enjoying all the advantages derivable from the use of something that belongs to another, as far as is compatible with the substance of the thing not being destroyed or injured) of a property or commodity that is not consumed on use. It is different from Qard in that it is the loan of fungible objects which are consumed on use and in which the similar and not the same commodity has to be returned. It is also a virtuous act like Qard. The borrowed commodity is treated as liability of the borrower who is bound to return it to its owner.
- **Al Ghunm bil Ghurm -** This provides the rationale and the principle of profit sharing in Shirkah arrangements (a contract between two or more persons who launch a business or financial enterprise to make profits). In the conventional books of Fiqh (Islamic law, the science of the Shariah, an important source of Islamic economics), the partnership business has been discussed under the option of Shirkah that, broadly, may include both Musharakah and Mudarabah. Earning a profit is legitimised only by engaging in an economic venture, applying risk sharing principles and thereby contributing to the economy.
- **Al-Kafalah -** Literally, Kafalah means responsibility, amenability or suretyship. Legally in Kafalah, a third party become surety for the payment of a debt. It is a pledge given to a creditor that the debtor will pay the debt, fine etc. Suretyship in Islamic law is the creation of an additional liability with regard to the claim, not to the debt or assumption only of the liability and not of the debt.
- **Al- Rahn -** means pledge or collateral. Legally, Rahn means to pledge or lodge a real or corporeal property of material value, in accordance with the law, as security, for a debt or pecuniary obligation so as to make it possible for the creditor to recover the debt or some portion of the goods or property. In the pre-Islamic contracts, Rahn implied a type of earnest money which was lodged as a guarantee and material evidence or proof of a contract, especially when there was no scribe available to put it into writing. The institution of earnest money was not accepted in Islamic law and the common Islamic doctrine recognised Rahn only as a security for the payment of a debt.
- **Al-Sarf -** Basically, in pre-Islamic times this was the exchange of gold for gold, silver for silver and gold for silver or vice versa. In Islamic law such an exchange is regarded as 'sale of price for price' (Bai al Thaman bil Thaman), and each price is consideration of the other. It also means sale of monetary value for monetary value – currency exchange.
- **Amanah -** Trust, with associated meanings of trustworthiness, faithfulness and honesty. As an important secondary meaning, the term also identifies a transaction where one party keeps another's funds or property in trust. By extension, the term can also be used to describe different financial or commercial activities such as deposit-taking, custody or goods on consignment. Amanah entails an absence of liability for loss except in breach of duty. Current accounts are regarded as Amanah (trust). If the bank gets authority to use current account funds in its business, Amanah transforms into a loan. As every loan has to be repaid, banks are liable to repay the full amount of the current accounts.
- **Arbun -** Earnest money/Down payment; a non-refundable deposit paid by the client (buyer) to the seller upon concluding a contract of sale, with the provision that the contract will be completed during the prescribed period.
- **Bai' Muajjal -** Literally this means a credit sale. Technically it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the seller earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in instalments. The bank has to expressly mention the cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price.
- **Bai' Salam -** Salam means a contract in which advance payment is made for goods to be delivered later. The seller undertakes to supply some specific goods to the buyer at a future date in exchange for being paid in advance a

price fully paid at the time of contract. According to the normal rules of the Shariah, no sale can be made unless the goods are in existence at the time of the bargain, but a Salam sale forms an accepted exception to the general rule provided the goods are defined and the date of delivery is fixed. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to potential disputes. The objects of this sale are goods and cannot be gold, silver or currencies because these are regarded as monetary values exchange of which is covered under rules of Bai al Sarf, i.e. mutual exchange which must be hand to hand without delay. Except for this, Bai' Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship.

- **Bai' bil Wafa -** Bai' bil Wafa is a sale with a right in the seller, having the effect of a condition, to repurchase (redeem) the property by refunding the purchase price. According to the majority of Fuqaha (experts) this is not permissible.
- **Daman** - This is 1) Contract of guarantee, security or collateral; 2) Responsibility of entrepreneur/manager of a business; one of two basic relationships toward property, entailing bearing the risk of its loss.
- **Dayn -** Dayn means Debt. A Dayn comes into existence as a result of any contract or credit transaction. It is incurred either by way of rent or sale or purchase or in any other way which leaves it as a debt to another.
- **Diminishing Musharaka** - A structure used in place of conventional mortgages – both residential and commercial. The buyer and the banker jointly buy the property with the buyer occupying 100% of it, paying rent to the bank for the percentage the bank owns. Over time, the buyer will acquire the bank's share of ownership and as this happens, the rent is reduced to reflect the bank's diminishing ownership percentage.
- **Duyun -** This means debts and ought to be returned without any profit since they are advanced to help the needy and meet their demands and, therefore, the lender should not impose on the borrower more than what he had given on credit.
- **Falah -** Falah means to thrive, to become happy or to have luck and success. Technically it implies success both in this world and in the Akhirah (the Hereafter). The Falah presumes belief in one God, the apostlehood of Prophet Muhammad, Akhirah and conformity to the Shariah in behaviour.
- **Fiqh -** This means Islamic law and the science of the Shariah.
- **Gharar -** This means any element of absolute or excessive uncertainty in any business or a contract about the subject of contract or its price, or mere speculative risk. It is one of three fundamental prohibitions in Islamic finance (the other two being Riba and Maysir). Gharar is a sophisticated concept that covers certain types of uncertainty or contingency in a contract. It has the potential to lead to undue loss to a party and unjustified enrichment of the other, which is prohibited. The prohibition on Gharar is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.
- **Hawalah** - Literally, this means a transfer. Legally, it is an agreement by which a debtor is freed from a debt by another becoming responsible for it or the transfer of a claim of a debt by shifting the responsibility from one person to another, ie, a contract of assignment of debt. It also refers to the document by which the transfer takes place.
- **Hibah -** this means a gift.
- **Ijara -** An Islamic lease agreement. Instead of lending money and earning interest, it allows the bank to earn profits by charging rentals on the asset leased to the customer. The duration of the lease, as well as the basis for rental, are set and agreed in advance. The bank retains ownership of the item throughout the arrangement and takes back the item at the end.
- **Ijara-wa-iktana -** Ijara-wa-iktana is similar to Ijara, except that included in the contract is a promise from the customer to buy the equipment at the end of the lease period, at a pre-agreed price – in other words, it is a hire purchase agreement. Rentals paid during the period of the lease constitute part of the purchase price. Often, as a result, the final sale will be for a token sum.
- **Ijara with diminishing Musharaka -** The principle of Ijara with diminishing Musharaka can be used for home-buying services. Diminishing Musharaka means that the bank reduces its equity in an asset with any additional capital payment the customer makes, over and above the rental payments. The customer's ownership in the asset increases and the bank's ownership decreases by a similar amount each time an additional capital payment is made. Ultimately, the bank transfers ownership of the asset entirely over to the customer.
- **'Inah -** (A kind of Bai) this is a double sale by which the borrower and the

lender sell and then resell an object between them, once for cash and once for a higher price on credit, with the net result being a loan with interest.

- **'Inan -** (A type of Shrikah) a form of partnership in which each partner contributes capital and has a right to work for the business but not necessarily in equal shares.
- **Islamic banking (also called Islamic finance or Islamic financial services) -** Financial services that meet the requirements of the Shariah, or Islamic law. While designed to meet the specific religious requirements of Muslim customers, Islamic banking is not restricted to Muslims: both the financial services provider and the customer can be non-Muslim as well as Muslim.
- **Istihsan -** this is a doctrine of Islamic law that allows exception to strict legal reasoning, or guiding choice among possible legal outcomes, when considerations of human welfare so demand.
- **Istisna'a -** this is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. Istisna'a can be used for financing the manufacture or construction of houses, plant, projects, and the building of bridges, roads and highways.
- **Jahala -** this means ignorance, lack of knowledge; indefiniteness in a contract, sometime leading to Gharar.
- **Kali bil-Kali -** The term Kali refers to something that is delayed. It appears in a maxim forbidding the sale of al-Kali bil-Kali i.e. the exchange of a delayed counter value for another delayed counter value.
- **Kharaj bi-al-Daman** - this means that a gain accompanies liability for loss. This is a Hadith (what was transmitted on the authority of the Prophet) forming a legal maxim and is a basic principle of Islamic finance.
- **Khiyar -** means an option or the power to annul or cancel a contract.
- **Khiyar al-Majlis -** means the power to annul a contract possessed by both contracting parties as long as they do not separate.
- **Khiyar al-Shart** - this is a right, stipulated by one or both of the parties to a contract, to cancel the contract for any reason for a fixed period of time.
- **Mal-e-Mutaqawam -** Things the use of which is lawful under the Shariah; or wealth that has a commercial value. Legal tender of the modern age that carries monetary value is included in Mal-e-Mutaqawam. It is possible that certain wealth has no commercial value for Muslims. Examples would be pork or wine.
- **Maysir -** Gambling. One of three fundamental prohibitions in Islamic finance (the other two being riba and gharar). The prohibition on maysir is often used as the grounds for criticism of conventional financial practices such as speculation, conventional insurance and derivatives.
- **Mithli -** (Fungible goods): Goods that can be returned in kind, i.e. gold for gold, silver for silver, US $ for US $, wheat for wheat, etc.
- **Mubah -** means an object that is lawful (i.e. something which is permissible to use or trade in).
- **Mudaraba(h) -** A Mudarabah is an investment partnership, whereby the investor (the Rab ul Mal) provides capital to another party/entrepreneur (the Mudarib) in order to undertake a business/investment activity. It is a contract between two parties, one who provides the funds and the other who provides the expertise and they agree to the division of any profits made in advance. While profits are shared on a pre-agreed ratio, loss of investment is borne by the investor only. The Mudarib loses its share of the expected income.
- **Mudarib -** The Mudarib is the entrepreneur or investment manager (ie, the expert) in a Mudarabah who invests the investor's funds in a project or portfolio in exchange for a share of the profits. For example, a mudarabah is essentially similar to a diversified pool of assets held in a Discretionary Asset Management Portfolio.
- **Murabaha -** Murabaha is a contract for purchase and resale and allows the customer to make purchases without having to take out a loan and pay interest. Instead of lending out money, the capital provider purchases the desired commodity (for which the loan would have been taken out) from a third party and resells it at a predetermined higher price to the capital user. It involves an unconditional sale contract where pre-approved and pre-agreed goods are sold at a cost-price plus mark-up for which the sale date is clearly defined and agreed. The concept of a Murabaha involves trading in goods or commodities and making profit through their purchase and sale in a way that conforms to Islamic guidelines. The customer pays the sale price for the goods over instalments, effectively

obtaining credit without paying interest.

- **Musawamah** - Musawamah is a general kind of sale in which the price of the commodity to be traded is bargained between seller and the purchaser without any reference to the price paid or cost incurred by the former.
- **Musharaka(h)** - This is a partnership where profits are shared as per an agreed ratio whereas the losses are shared in proportion to the capital/investment of each partner. In a Musharakah, all partners to a business undertaking contribute funds and have the right, but not the obligation, to exercise executive powers in that project, which is similar to a conventional partnership structure and the holding of voting stock in a limited company. This equity financing arrangement is widely regarded as the purest form of Islamic financing. The difference between Musharaka arrangements and normal banking is that you can set any kind of profit sharing ratio, but losses must be proportionate to the amount invested.
- **Qabul -** Acceptance, in a contract.
- **Qard -** A Qard is a loan, free of profit. Banks use this arrangement for current accounts. In essence, it means that a customer's current account is a loan to the bank, which is used by the bank for investment and other purposes. It has to be paid back to the customer, in full, on demand. Legally, Qard means to give anything having value in the ownership of the other by way of virtue so that the latter could avail of the same for his benefit with the condition that same or similar amount of that thing would be paid back on demand or at the settled time.
- **Qimar -** Qimar means gambling. Technically, it is an arrangement in which possession of a property is contingent upon the happening of an uncertain event. By implication it applies to a situation in which there is a loss for one party and a gain for the other without specifying which party will lose and which will gain.
- **Qiyas -** Literally this means measure, example, comparison or analogy. Technically, it means a derivation of the law on the analogy of an existing law if the basis of the two is the same. It is one of the sources of Islamic law.
- **Riba -** Riba means interest, which is prohibited in Islamic law. Technically, it means an increase over the principal in a loan transaction or in exchange for a commodity accrued to the owner (lender) without giving an equivalent counter-value or recompense in return to the other party. Any risk-free or guaranteed interest on a loan is considered to be usury. The legal notion extends beyond just interest, but in simple terms Riba covers any return of money on money - whether the interest is fixed or floating, simple or compounded, and at whatever the rate.
- **Riba Al-Fadl -** Riba Al-Fadl (excess) is the quality premium in exchanging low quality with better quality goods e.g. dates for dates, wheat for wheat, etc. The concept of Riba Al-Fadl refers to sale transactions while Riba Al-Nasiah (see below) refers to loan transactions.
- **Riba Al-Nasiah -** Riba Al-Nasiah or Riba of delay is due to an exchange not being immediate with or without excess in one of the counter values. It is an increment on principal of a loan or debt payable. It refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of the period the amount originally lent together with an increase on it, in consideration of the lender having granted him time to pay. Interest, in all modern banking transactions, falls under the purview of Riba Al-Nasiah. As money in the present banking system is exchanged for money with excess and delay, it falls, under the definition of Riba.
- **Ribawi -** Goods subject to Fiqh rules on Riba in sales, variously defined by the schools of Islamic Law: items sold by weight and by measure, foods, etc.
- **Salaf -** means loan/debt .The word Salaf literally means a loan which draws forth no profit for the creditor. In wider sense, it includes loans for specified periods, i.e. short, intermediate and long-term loans. Salaf is another name for Salam (see below) as well wherein the price of the commodity is paid in advance while the commodity or the counter value is supplied in future; thus the contract creates a liability for the seller. Amount given as Salaf cannot be called back, unlike Qard, before it is due.
- **Salam -** A Salam is primarily a deferred delivery sale contract usually used for commodity finance. It is similar to a forward contract where delivery is in the future in exchange for spot payment.
- **Shariah -** Islamic law. A Shariah compliant product meets the requirements of Islamic law. A Shariah board is the committee of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of Shariah compliant products.
- **Shariah advisor -** An independent professional, usually a classically trained Islamic legal scholar, that advises an Islamic bank on the

compliance of its products and services with the Shariah, or Islamic law. While some Islamic banks consult individual Shariah advisors, most establish a committee of Shariah advisors (often know as a Shariah board or Shariah committee).

- **Shariah compliant -** An act or activity that complies with the requirements of the Shariah, or Islamic law. The term is often used in the Islamic banking industry as a synonym for "Islamic" — for example, Shariah compliant financing or Shariah compliant investment.
- **Shirkah** - means a contract between two or more persons who launch a business or financial enterprise to make profits. In the conventional books of Fiqh, the partnership business is discussed under the option of Shirkah and that may include both Musharakah and Mudarabah.
- **Sukuk -** Similar characteristics to that of a conventional bond with the difference being that they are asset backed, a Sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.
- **Tabzir -** Spending wastefully on objects which have been explicitly prohibited by the Shariah irrespective of the quantum of expenditure.
- **Takaful -** Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance, Takaful schemes are designed to avoid the elements of conventional insurance (i.e., interest and gambling) that are problematic for Muslims.
- **Tawarruq -** Reverse Murabahah or Commodity Murabaha. As used in personal financing, a customer with a genuine need buys something on credit from the bank on a deferred payment basis and then immediately resells it for cash to a third party. In this way, the customer can obtain cash without taking an interest-based loan.
- **Ujrah -** A contract of agency in which one person appoints someone else to perform a certain task on his behalf, usually against a certain fee.
- **Wakala -** This is an agency contract, which usually includes in its terms a fee for the expertise of the agent. Banks may use it for their large Deposit accounts: the customer owns the capital invested and appoints the bank as agent and pays a fee for their expertise.

Insolvency Terms

- **Administration Order -** an administration order is a Court Order placing a company that is, or is likely to become, insolvent under the control of an administrator following a petition by the company, its directors or a creditor. The purpose of the order is to preserve the company's business, allow a reorganisation or ensure the most advantageous realisation of its assets whilst protecting it from action of its creditors.
- **Administrative Receiver -** appointed by the holder of a floating charge covering the whole, or substantially the whole, of a company's property. He can carry on the company's business and sell the business and other assets comprised in the charge to repay the secured and preferential creditors. Sometimes, this is abbreviated to "receiver".
- **Administrative Receivership** - the term applied to the legal state of a company when a person is appointed as an administrative receiver over its assets.
- **Administrator - a** licensed insolvency practitioner appointed by the Court under an administration order to achieve the purposes set out in the order. The administrator will need to produce a plan, known as his proposals for approval by the creditors to achieve this.
- **Agricultural Receivership** - a specialist remedy to take control of the assets of a farmer under the Agricultural Credits Act 1928.
- **Associates** - Associates of an individual include family members, relatives, partners and their relatives, employees, employers, trustees in certain trust relationships, and companies which the individual controls. Associates of companies include other companies under common control (see also connected persons).
- **Bankrupt** - a bankrupt is an individual against whom a bankruptcy order has been made by the Court. The order signifies that the individual is unable to pay his/her debts and deprives him/her of his/her property, which is then realised for distribution amongst his creditors.
- **Bankruptcy -** the process of dealing with the estate of a bankrupt. A bankrupt is an individual against whom a bankruptcy order has been made by the Court. The order signifies that the individual is unable to pay his/her debts and deprives him/her of his/her property, which is then realised for distribution amongst his creditors.
- **Bond - i**nsurance cover, to protect the uncharged assets of an estate needed by a person who acts as a licensed insolvency practitioner.
- **Break-up sale** - dismantling of a business. Trading ceases and the assets are sold off piecemeal. Insolvency practitioners prefer to sell as a going concern if possible.
- **Charge** - a right given to the creditor to have a designated asset of the debtor appropriated to the discharge of the indebtedness, but not involving any transfer either of possession or ownership.
- **Charging Order** – a Court order placing restrictions on the disposal of certain assets, such as property or securities, and gives priority of payment over other creditors.
- **Company Directors Disqualification Act (1986)** - the Consolidation Act on the disqualification of persons from being directors or otherwise concerned with a company's affairs.
- **Company Voluntary Arrangement (CVA)** – this is a voluntary arrangement for a company is a procedure whereby a plan of reorganisation or composition in satisfaction of its debts, is put forward to creditors and shareholders. There is a limited involvement by the Court and the scheme is under the control of a supervisor.
- **Composition** – this is an agreement between debtor and his creditors whereby the compounding creditors agree with the debtor and between themselves to accept from the debtor payment of less than the amounts due to them in full satisfaction of their claim.
- **Compulsory Liquidation** - a compulsory liquidation of a company is a liquidation ordered by the Court. This is usually as a result of a petition presented to the Court by a creditor and is the only method by which a creditor can bring about a liquidation of its debtor company.
- **Connected Persons** – these are directors or shadow directors and their associates, and associates of a company.
- **Court-appointed Receiver** - a person, not necessarily a licensed insolvency practitioner, appointed to take charge of assets usually where they are subject to some legal dispute. Not strictly an insolvency process, the procedure may be used other than for a limited company, e.g. to settle a partnership dispute.

- **Creditors' Committee** - a creditors' committee is formed to represent the interests of all creditors in supervising the activities of an administrator or trustee in bankruptcy, or receiving reports from an administrative receiver (cf Liquidation Committee).
- **Creditors' Voluntary Liquidation (CVL)** - this relates to an insolvent company. It is commenced by resolution of the shareholders, but is under the effective control of creditors, who can choose the liquidator.
- **Debenture** - this is a document stating the terms of a loan, usually to a company. Debentures may be secured on part or all of a company's assets, or they may be unsecured. Often also referred to as floating charge and the lender is often referred to as a floating charge, and the lender is often referred to as the debenture holder.
- **Disqualification of Directors** - a director found to have conducted the affairs of an insolvent company in an "unfit" manner will be disqualified, on application to the Court by the DTI, from holding any management position in a company between 2 and 15 years.
- **Extortionate Credit Transaction** - transaction by which credit is provided on terms that are exorbitant or grossly unfair compared with the risk accepted by the creditor. Such a transaction may be challenged by an administrator, liquidator or trustee in bankruptcy.
- **Fixed Charge** - form of security granted over specific assets, preventing the debtor dealing with those assets without the consent of the secured creditor. It gives the secured creditor a first claim on the proceeds of sale, and the creditor can usually appoint a receiver to realise the assets in the event of default.
- **Floating Charge** - a floating charge is a form of security granted to a creditor over general assets of the company which may change from time to time in the normal course of business (e.g. stock). The company can continue to use the assets in its business until an event of default occurs and the charge crystallises. If this happens, the secured creditor can realise the assets to recover his debt, usually by appointing an administrative receiver, and obtain the net proceeds of sale subject to the prior claims of the preferential creditors.
- **Fraudulent Trading** - where a company has carried on business with intent to defraud creditors, or for any fraudulent purpose. It is a criminal offence and those involved can be made personally liable for the company's liabilities.
- **Going Concern Sale** – this is the basis on which insolvency practitioners prefer to sell a business. Effectively, it means the business continues, jobs are saved, and a higher price is obtained.
- **Guarantee** - legal commitment to repay a debt if the original borrower fails to do so. Directors may give guarantees to banks in return for the bank giving finance to their companies.
- **Individual Voluntary Arrangement (IVA)** - voluntary arrangement for an individual is a procedure whereby a scheme of arrangement of his affairs or composition in satisfaction of his debts is put forward to creditors. Such a scheme requires the approval of the Court and is under the control of a supervisor.
- **Insolvency –** this is defined as the state of having insufficient assets to meet all debts, or being unable to pay debts as and when they are due. If a creditor can establish either test, he will be able to present a winding-up petition. For a bankruptcy petition, inability to pay is the only available ground.
- **Insolvency Act 1986** - this is the primary legislation governing insolvency law and practice. Nevertheless, many other statutes and statutory instruments are also relevant.
- **Insolvent Liquidation** - a company goes into insolvent liquidation if its goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of liquidation.
- **Insolvency Partnership Order 1994 (IPO) -** an Order setting out the procedures for dealing with insolvent partnerships. The Order provides for winding up an insolvent partnership as an unregistered company, with or without concurrent insolvency proceedings against individual partners; for the joint bankruptcy of individual partnerships, without winding up the partnership as an unregistered company; and for the application of the administration and company voluntary arrangement procedures to insolvent partnerships.
- **Insolvency Practitioner (IP)** - see Licensed Insolvency Practitioner.
- **Insolvency Rules** - The Insolvency Rules 1986, as amended, provide the detailed working procedures for the provisions of the Insolvency Act 1986.
- **Insolvency Services Account** An account maintained at the Bank of England by the Department of Trade and Industry, through which funds must be passed in liquidations and bankruptcies.

- **Insolvent Liquidation** -a liquidation in which the company is unable to pay all it creditors.
- **Interim Order** - an individual who intends to propose a voluntary arrangement to his creditors may apply to the Court for an interim order which, if granted, precludes bankruptcy and other legal proceedings whilst the order is in force.
- **Judgement** – this is: (1) Recognition of a debt by a Court or (2) Decision given by a Court at the conclusion of a trial
- **Law of Property Act 1925** – this governs transactions in law and property. Contains statutory powers of receivers appointed under a fixed charge.
- **LPA Receiver** - Law of Property Act 1925 receiver: a person (not necessarily an insolvency practitioner) appointed to take charge of a mortgaged property by a lender whose loan is in default, usually with a view to sale or to collect rental income for the lender. This is common in the case of the failure of a property developer, whose borrowings will largely be secured on specific properties.
- **Licensed Insolvency Practitioner (IP)** - a person licensed by one of the Chartered Accountancy bodies, the Law Societies, the Insolvency Practitioners' Association or the Department of Trade. An IP is the only person who may act as an office holder in an insolvency.
- **Lien** – the legal right to retain possession of assets or documents in settlement of a debt.
- **Liquidation** - liquidation is a process whereby a company has its assets realised and distributed to satisfy, insofar as it is able, its liabilities and to repay its shareholders. The term winding-up is also used. Liquidation is a terminal process and is followed by the dissolution of the company.
- **Liquidation Committee** – a committee of creditors who receive information from the liquidator and sanction some of his actions (c.f. Creditors' Committee).
- **Liquidator** - a licensed insolvency practitioner appointed to wind-up a company.
- **Mareva injunction** - a Court order preventing the disposal of assets.
- **Members' Voluntary Liquidation (MVL)** - a solvent liquidation where the shareholders appoint the liquidator to realise assets and settle all the company's debts, plus interest, in full within 12 months.
- **Misfeasance** - breach of duty in relation to the funds or property of a company by its directors or managers.
- **Mortgage** - a transfer of an interest in land or other property by way of security redeemable upon performing the condition of paying a given sum of money.
- **Nominee** - an insolvency practitioner appointed to consider proposals of a debtor in an individual, company or partnership voluntary arrangement.
- **Office Holder** – a liquidator, provisional liquidator, administrator, administrative receiver, supervisor of a voluntary arrangement, or trustee in bankruptcy.
- **Official Receiver (OR)** - an Officer of the Court, civil servant, member of the Department of Trade Insolvency Service, deals with bankruptcies and compulsory liquidations.
- **Onerous Property**
  The term onerous property in the content of a liquidation or bankruptcy applies to unprofitable contracts and to property that is unsaleable or not easily saleable or that might give rise to a continuing liability. Such property can be disclaimed by a liquidator or a trustee in bankruptcy.
- **Partnership Voluntary Arrangement** - a voluntary arrangement (under the provision of The Insolvent Partnerships Order 1994) for a partnership (PVA) is a procedure whereby a proposal is put forward to creditors for a composition in satisfaction of its debts or a scheme of arrangement. Such a scheme requires the approval of the court and may be proposed in conjunction with individual voluntary arrangements in respect of each of the partners.
- **Petition** - a written application to Court for relief or remedy.
- **Preference** - payment or other transaction made by an insolvent company or individual which places a creditor in a better position than they would have been otherwise. A liquidator, administrator or trustee in bankruptcy may recover sums which are found to be preferences. If the transactions took place within a period of either two years (where the creditor is a connected person) or six months (in other cases) of the insolvency.
- **Preferential Creditor** - defined in Schedule 6 of The Insolvency Act 1986. Has priority over creditors whose debts are secured by a floating charge and unsecured creditors, when funds are distributed by a liquidator, administrative receiver or trustee in bankruptcy.
- **Pre-Pack –**a technique devised by insolvency practitioners to rescue a company in distress. It is used where a company is placed into administration (or a company voluntary arrangement

(CVA)) and then immediately sold pursuant to a sale arranged before the administrator (or the supervisor of a company subject to a company voluntary arrangement) was appointed.

- **Proof of Debt** - the document submitted by a creditor to the licensed insolvency practitioner giving evidence of the amount of the debt. Only used in compulsory liquidations.
- **Provisional Liquidator** - the name usually given to a licensed insolvency practitioner appointed to safeguard a company's assets after presentation of a winding-up petition but before a winding-up order is made.
- **Proxy** – the document whereby a creditor authorises another person to represent him at a meeting of creditors. The proxy may be a general proxy, giving the proxy holder discretion as to how he votes, or a special proxy requiring him to vote as directed by the creditor. A body corporate can only be represented by a proxy.
- **Proxy holder** – the person who attends a meeting on behalf of someone else.
- **Public examination** - when a company is being wound up or in bankruptcy proceedings, the Official Receiver may at any time apply to the court to question the company's director(s) or any other person who has taken part in the promotion, formation or management of the company or the bankrupt.
- **Receiver**- this term is often used to describe an administrative receiver, who may be appointed by a secured creditor holding a floating charge over a company's assets. More accurately, a receiver is the person appointed by a secured creditor holding a fixed charge over specific assets of a company in order to take control of those assets for the benefit of the secured creditor.
- **Receivership** - the general term applied when a person is appointed as a receiver or administrative receiver.
- **Recognised Professional Body** - an organisation approved by the Secretary of State as being able to authorise its members to act as insolvency practitioners.
- **Reservation of Title (or Retention of Title)** – a provision under a contract for the supply of goods which purports to reserve ownership of the goods with the supplier until the goods have been paid for. This is a complex and continually evolving area of law.
- **Scheme of Arrangement** – this is a term normally used to describe a compromise or arrangement between a company and its creditors or members or any class of them under section 425 of the Companies Act 1985, which may involve a scheme for the reconstruction of the company. If a majority in number representing three-fourths in value of the creditors or members or any class of them agree to compromise or arrangement it is binding if sanctioned by the court. Section 425 may be invoked where there is an administration order in force in relation to the company where there is a liquidator or provisional liquidator in office, or where the company is not subject to any insolvency proceedings. The term is also used in section 1 of the Insolvency Act 1986 in relation to company voluntary arrangements.
- **Secured Creditor** – a creditor with specific rights over some or all of the debtor's assets. A secured creditor gets paid first out of the proceeds of sale of the security.
- **Security** - charge or mortgage over assets taken to secure payments of a debt. If the debt is not paid, the lender has a right to sell the charged assets. Security documents can be very complex. The commonest example is a mortgage over a property.
- **Shadow Director** – a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not a shadow director merely because the directors act on advice given by him in a professional capacity.
- **Special Manager** - a special manager is a person appointed by the Court in a compulsory liquidation or bankruptcy to assist the liquidator, official receiver or trustee in managing the insolvent's business. He does not need to be an insolvency practitioner.
- **Statutory Demand** - a formal notice requiring payment of a debt exceeding £750 within 21 days, in default of which bankruptcy or liquidation proceedings may be commenced without further notice. A statutory demand cannot be used where the debt is disputed.
- **Supervisor** - the licensed insolvency practitioner appointed by creditors to supervise the way in which an approved voluntary arrangement is put into effect.
- **Transaction at an Undervalue** - a transaction at an undervalue can describe either a gift or a transaction in which the consideration received is significantly less than that given. In certain circumstances such a transaction can be challenged by an administrator, a liquidator or a trustee in bankruptcy.

- **Trustee -** quite apart from its common usage (e.g. under the Trustee Act 1925) this is a term used for a variety of insolvency appointments, including the licensed insolvency practitioner appointed in an English bankruptcy; a Scottish sequestration; a deed of arrangement; a Scottish trust deed and an administration order (of the affairs of a deceased director).
- **Unsecured Creditor** - strictly, this is any creditor who does not hold security. More commonly used to refer to any ordinary creditor who has no preferential rights, although, in fact preferential creditors will almost always also be unsecured.
- **VAT Bad Debt Relief** - the relief obtained in respect of the VAT element of an unpaid debt. Previously available only when the debtor became insolvent, relief is now available where debt is 6 months old at the relevant date.
- **Voluntary Arrangement** - see Individual Voluntary Arrangement (IVA), Company Voluntary Arrangement (CVA) and Partnership Voluntary Arrangement (PVA).
- **Voluntary Liquidation** - see creditors' voluntary liquidation and members' voluntary liquidation.
- **Winding-up -** see liquidation.
- **Winding-up Order** – the order made by the Court for a company to be placed in compulsory liquidation.
- **Winding-up Petition** - a petition presented to the Court seeking an order that a company be put into compulsory liquidation.
- **Wrongful Trading** - applied to companies in liquidation where a director allowed the company to continue trading in circumstances where he should have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. The directors involved may be made personally liable to make a contribution to the company's assets.

Business Financial Ratios

Financial ratio analysis is a business tool. It uses the power of comparison - either with the same business in previous trading periods or with others in the industry. Sometimes, when using benchmarking techniques, it's useful to make a comparison with "best in world" whether in the same industry or not.

The ratios that are used come from one or more pieces of information in a company's financial statements (their "annual accounts"). The level and historical trends of these ratios can be used to draw conclusions about a company's performance, its financial condition, its operations and attractiveness as an investment.

The advantage of ratio analysis is that it uses comparison to other data and standards. It creates a level playing field of comparing like with like to see how a business has performed.

One of the simplest ratios used is that of gross margin (or gross profit) percentage - this is the gross margin (before overheads and business expenses) that a business earns on its sales.

Example:

A Sales are £500,000
B Cost of Sales is £350,000
C Gross margin is £150,000 (A less B)
D The gross margin percentage is 30% (C as a percentage of A)

Note: Sales and Cost of Sales should always quoted as net of VAT for a VAT-registered business

On its own, a financial ratio has little value - but in context (i.e. by comparing it with something else) it can give a reader of financial statements an excellent picture of a company's situation and the trends that are developing.

In the above example, a gross margin of 30% doesn't mean very much but if most competitors of the business have margins of 20%, it's clear that this business is much more profitable at the gross margin level than its industry peers. This is a good sign and if we also know that the margin has been increasing steadily for the last few years, this would also be a favourable sign that management of the business has implemented both effective business policies and strategies.

Ratio Categories

An overview of some of the categories of ratios is given below:

- **Leverage Ratios** - the extent that debt (borrowings) is used in a company's financing structure.
- **Liquidity Ratios** - showing the short-term financial situation or solvency of a company.
- **Operational Ratios** - using sales turnover measures to show how effective a company is in its operations and use of assets.
- **Profitability Ratios** - using margin analysis (the most popular ratio being the gross margin percentage) to show the return on sales and capital employed.
- **Solvency Ratios** - indicating a company's ability to generate cashflow and meet its debts.

Ratio Focus

Bankers and others, who interpret financial ratios, focus on the "downside" risk since they gain none of the upside from an improvement in operations. The best they can expect is that the money they advance will be repaid and to ascertain a company's financial risk, they pay great attention to liquidity and leverage ratios.

Investors and their analysts look more to the operational and profitability ratios, to see what future profits will accrue for the benefit of shareholders.

When analysing the financial results of a company, or comparing several companies it is tempting to become so involved in calculating a wide variety of financial ratios that the original purpose is lost. Remember that the key questions to ask are:

- Is the business profitable?
- Can the business pay its bills?
- Is the Company Solvent?
- How is the business financed?
- How does this year compare to last year?
- How does our performance compare to our competitors?
- How does the business compare to the industry norms?
- Are the Products Selling?

These key questions indicate that the financial health of a company is dependent on a combination of profitability, short-term liquidity and long-term liquidity. In the past, most emphasis was placed on profitability but today liquidity has increased in importance.

Some of these questions are dealt with below:

Is the Company Solvent?

Current Ratio = Current Assets Divided by Current Liabilities
A measure of the ability to pay short-term debts. A current ratio of current assets to current liabilities of less than 2 to 1 is generally considered to be unsatisfactory.

Quick Ratio = Cash + Marketable Securities + Receivables divided by Current Liabilities
A measure of the immediate ability to pay short-term debt. A ratio of quick assets to current liabilities of at least 1 to 1 is considered desirable.

Are the Products Selling?

Stock (Inventory) Turnover = Cost of Sales Divided by Average Stock Held
A measure of the appropriateness of inventory levels in terms of time required to sell or "turn overstock/ inventory".

Are Receivables Being Collected on Time?

Receivables Turnover = Sales Divided by Average Accounts Receivable
A measure of the receivable position and approximate average collection time.

Can the Company Cover its Interest Payments?

Times Interest Earned = Income Before Taxes + Interest Expense Divided by Interest Expense
A measure of the ability to cover interest payments.

How Efficient are the Operations?

Rate Earned on Total Assets = Net Income Divided by Average Total Assets
A measure of the effectiveness of asset utilisation.

How's Management Doing?

Return on Equity = Net Income Divided by Average Owners' Equity
A measure of the return earned on owners' equity.

Has the Company Borrowed Wisely?

Total Debt to Equity = Total Liabilities Divided by Owners' Equity
A measure of the use of debt to finance operations. The higher the ratio, the higher the leverage the entity has used to fund operations.

Long-Term Debt to Equity = Long-Term Debt Divided by Owners' Equity
A measure of the extent to which long-term debt is used to finance operations.

Total Debt to Total Assets = Total Debt Divided by Total Assets
A measure of asset funding provided by creditors.

Equity to Total Assets = Owners' Equity Divided by Total Assets
A measure of funding provided by owners which reflects financial strength and cover for creditors.

Measuring Liquidity

In considering the liquidity of a business, people often refer to its "Working Capital position". This can be called the short-term credit analysis. Working Capital is the excess of Current Assets over Current Liabilities.

Other Liquidity and Efficiency Ratios

Cost/income ratio is an efficiency measure similar to operating margin. It is most commonly used in the financial sector in giving investors a clear view of how efficiently a company is being run - unlike the operating margin, lower is better.
Formula: Operating costs (administrative and fixed costs) divided by operating income.
Current ratio - establishes the relationship between current assets and current liabilities. It measures a company's ability to meet its current obligations.
Formula: Current Assets Divided by Current Liabilities
Quick ratio - sometimes analysts calculate the ratio between the liquid (quick) assets and current liabilities. Quick current assets are cash, marketable securities and debtors (receivables). It may provide a better reading on a firm's ability to meet current obligations than the current ratio.
Formula: (Total of: Current Assets less Stock and Prepaid Assets) Divided by Current Liabilities
Stock or Inventory Turnover - calculated by dividing average stock/inventory into cost of goods sold. This allows a measurement of any disproportionate amount of inventory.
Formula: Average Inventory Divided by Cost of Goods Sold

Average collection period - calculated by dividing the year's sales into trade debtors (receivables) and multiplying this times 365. This average collection period tends to measure if the recovery is adequate, slow or past due.
Formula: (Trade Receivables / Sales) multiplied by 365 days.

On this and the next few pages, you will find the usual ratios used in the analysis of a business by bankers, investors, business analysts and, most importantly, by good business managers. These ratios will help you to understand your business better and hopefully improve your margins, operating efficiency and profitability.

RATIO	HOW IS IT CALCULATED?	WHAT DOES IT MEAN?
Acid Test (or Quick Ratio)	This is arrived at by dividing the liquid assets of the business (cash plus immediately disposable, investments, debtors and bills receivable) by the current liabilities.	This ratio shows how many times liquid assets cover current liabilities and indicates the ability to pay current debts from cash and "near cash" assets. Unfortunately, this ratio can be misleading since it doesn't take into account the timing of collectability of receivables.
Asset cover	This is arrived at by taking current and fixed assets and dividing them by all liabilities.	This shows how many times the total tangible assets of the business (intangible assets are ignored from the calculation) cover total external liabilities. The higher the figure then the greater the degree of safety to creditors and the providers of debt finance. Where group and related company loans or directors' loans are viewed as quasi-capital, it may be appropriate to exclude these funds from liabilities because they may really be tantamount to the fixed capital of the business.
Asset Turnover	Sales revenue divided by total assets (less current liabilities)	Measure of operational efficiency - shows how much revenue is produced per £ of assets available to the business.
Cost of Debt Ratio (average cost of debt ratio)	Cost of interest divided by average outstanding debt in a period.	Despite the different variations used for this term (cost of debt, cost of debt ratio, average cost of debt ratio, etc) the term normally and simply refers to the interest expense over a given period as a percentage of the average outstanding debt over the same period, ie., cost of interest divided by average outstanding debt.
Credit Given	The total of the debtors and bills receivable of the business are divided by the turnover and multiplied by the number of days in the accounting period.	This represents the number of day's credit given to customers or clients of the business. Where the business trades substantially for cash, care should be exercised in interpreting the outcome but the trend is nevertheless important. Remember that the longer a receivable remains uncollected, the greater is the risk that it will be irrecoverable.

RATIO	HOW IS IT CALCULATED?	WHAT DOES IT MEAN?
Credit Taken	This is arrived at by taking the creditors and bills payable of the business and dividing it by the cost of sales and multiplying that answer by the number of days in the accounting period. Alternatively the denominator can be the turnover or sales of the business.	This shows how quickly the business pays its creditors. In the event that the purchases figure is not available the alternative use of turnover or sales may provide a useful indication but it is a less technically accurate method of assessment and care should be exercised in interpreting the outcome. Where the figure for trade creditors as opposed to total creditors is separately identifiable from the accounts, that figure should be used rather than total creditors and bills payable.
Current ratio (also known as the Liquidity Ratio)	This ratio is determined by taking the total of the current assets of the business and dividing them by the total of the current liabilities, (creditors of the business that fall due within 12 months of the balance sheet date). The ratio is often expressed against a measurement of 1 – e.g. 3:1.	This shows how many times current liabilities are covered by current assets and gives an indication of the ability to pay current debts without having to liquidate fixed assets or raise longer-term funds. The inherent dangers within this ratio are that it shows the position only at a particular point in time and also that it ignores asset quality and convertibility into cash.
Debt to assets employed	This is calculated by taking total liabilities as a percentage of total assets.	This ratio shows the degree to which assets are funded by external creditors. The lower the ratio, the greater is the degree of comfort for creditors against loss in the event of liquidation.
Debt to Equity	This takes the loans and external finance of the business (as opposed to creditors) and divides the total by the net assets or total of capital reserves. The answer is expressed against the figure of 1 - for example, 5:1.	This measures the gross level of debt finance against shareholders' equity. Depending upon their nature, it may be appropriate to ignore such items as hire purchase, intra-group loans, directors' loans etc. so as to reflect "outside" debt to equity. Equally there may be a case for including these "inside" debts with the net assets and shareholders' equity as they may be regarded as effectively the same.
Gross Profit Margin	This is calculated by expressing the difference between the sales and cost of sales (the gross profit) as a percentage of sales or turnover.	This ratio measures the performance of the business at its prime level of operations and is therefore of crucial importance. It indicates the contribution that the sales activity makes to the operating costs of the business. An increasing ratio may mean that there is better control of buying or manufacturing costs but it could also mean that sales prices have risen either because the market can bear higher sales prices or inflation temporarily allows advantage to be taken. A decreasing ratio may mean that there are problems with cost or production control or that sales prices have been cut as a result of competitive pressure. Sometimes a gross loss is suffered in which case the margin will be negative and it will contribute to the overall loss.

RATIO	HOW IS IT CALCULATED?	WHAT DOES IT MEAN?
Interest cover	This is taken by expressing profit before tax and interest as a percentage of the interest cost.	This ratio measures the degree of certainty that interest will be covered by earnings and the amount of decline that can take place without impinging on the ability to pay the annual interest cost.
Profit Margin	This is calculated by expressing the difference between the sales and cost of sales (the gross profit) as a percentage of sales or turnover.	This ratio measures the performance of the business at its prime level of operations and is therefore of crucial importance. It indicates the contribution that the sales activity makes to the operating costs of the business. An increasing ratio may mean that there is better control of buying or manufacturing costs but it could also mean that sales prices have risen either because the market can bear higher sales prices or inflation temporarily allows advantage to be taken. A decreasing ratio may mean that there are problems with cost or production control or that sales prices have been cut as a result of competitive pressure. Sometimes a gross loss is suffered in which case the margin will be negative and it will contribute to the overall loss.
Repayment Commitments	This is arrived at by taking the cost of interest and other finance charges which appear in the accounts and adding to it the capital repayments in an accounting period and dividing the total by the profit of the business before tax and depreciation and expressing the total as a percentage.	This measures the percentage of funds generated from ordinary activities before tax and depreciation, which are committed to servicing the interest on and repayment of debt. The lower the percentage then the greater degree of safety for the lender.
Return on shareholder's funds	This is calculated by taking profit (after tax) and expressing it as a percentage return on shareholder's funds.	This should show management's ability to operate a profitable business providing adequate or high returns to shareholders.
Return on Investment (ROI)	It is relatively simple to calculate return on investment: % ROI = (benefits / costs) x 100	ROI tells you the percentage return you have made over a specified period as a result of a business investment or business decision. It is a fundamental financial and business performance measure. It means different things to different people (often depending on perspective and what is actually being judged). Many business managers and owners use the term in a general sense as a means of assessing the merit of an investment or business decision. 'Return' generally means profit before tax.

RATIO	HOW IS IT CALCULATED?	WHAT DOES IT MEAN?
Return on Capital Employed (ROCE)	Profit before interest and tax divided by capital employed x 100	A fundamental financial performance measure. A percentage figure representing profit before interest against the money that is invested in the business. It is important to take profit before interest and tax so as to eliminate the distorting effects of variable interest and tax rates.
Sales to assets	This is taken by expressing sales over total assets employed	It shows management's ability to manage and control assets - to gain value from this ratio, you need to analyse figures in greater detail, ie by evaluating sales against receivables, stock and fixed assets.
Stock Turn	This is arrived at by taking the total of the stock of raw materials, finished goods and work in progress and dividing them by the total of the cost of sales of the business and multiplying the answer by the number of trading days in the accounting period.	This ratio is expressed in number of days and indicates the speed of stock turnover expressed as the number of days' sales invested in stock and work in progress. An increase may indicate management inefficiency or perhaps a deliberate policy to cope with an expected sales surge or as a hedge against stock supplies. Watch out for work in progress included in this calculation - stocks are easier to dispose of than work in progress in a distress situation.
Trading Overheads	This ratio is arrived at by taking the totals of the trading and operating overheads and expressing them as a percentage of turnover. It can also be calculated for individual items of overhead such as labour, interest, marketing and so on.	This measures the percentage of turnover that is used up by operating costs that are more fixed than variable in nature. It is possible to arrive at a rough break-even level of sales by calculating the exact level of sales and the contribution from it, which will exactly meet the operating expenses.

INDICES	HOW IS IT CALCULATED?	WHAT DOES IT MEAN?
Index of Sustainable Growth Developed by Robert L. Higgins	This uses the following formula: G (for sustainable growth) = (X1 (1 - X2) (1 + X3)) / (X4 - (X1 (1 - X2) (1 + X3))) Where: **X1** = Profit Margin = (Income before Taxes / Sales) multiplied by 100 **X2** = Dividend Payout Ratio = Total Dividends / Net Income **X3** = Leverage = Liabilities / Equity **X4** = (Assets / Sales) multiplied by 100	This index helps determine the level of growth of sales beyond which external capital will be needed. In other words, when planning for a specific growth in sales, one must be aware of whether external financing will be needed. If Sales growth forecast are above G: - External financing (equity or debt) should be sought after, - Or the profit margin should be improved, - Or the distribution of dividends should be lower, - Or the level of assets should be lower (lease instead of buy).
Bankruptcy Index Developed by Edward I. Altman	Z = 1.2 (X1) +1.4 (X2) +3.3 (X3) +0.6 (X4) +1.0 (X5) Where: X1 = (Working capital = Current assets - Current Liabilities) / total assets X2 = Retained earnings / total assets X3 = EBIT / total assets X4 = (Market value of equity = Market Price per share multiplied by number of stocks) / total debt X5 = Asset turnover = Sales / Total Assets	This is a formula used to predict a company's likelihood of going bankrupt within one or two years. The Z-score is reputed (not surprisingly) for becoming more accurate as a firm nears bankruptcy. As a general rule, a score below 1.81 is worrying while a score above 2.99 is comfortable. Edward Altman developed the "ALTMAN Z-SCORE" by examining 85 manufacturing companies. Later, additional "Z-Scores" were developed for private manufacturing companies (Z-Score - Model A) and another for general/service firms (Z-Score - Model B). A "Z-Score" is only as valid as the data from which it was derived i.e. if a company has altered or falsified their financial records/books, a "Z-Score" derived from those "cooked books" is of lesser use.

Disaster Management Terms

The following terms are drawn from information supplied by members of the BCI, industry experts and from other published glossaries. We acknowledge the conditions of BCI for reproduction. www.thebci.org/

- **Activation** - the implementation of recovery procedures, activities and plans in response to an emergency or disaster declaration.
- **Alternative site** - an alternative operating location for the usual business functions (i.e. support departments, information systems and manufacturing operations) when the primary facilities are inaccessible. (Associated term: back-up site)
- **Alert** - a formal notification that an incident has occurred which may develop into a disaster.
- **Backlog trap** - the effect on the business of a backlog of work that develops when a system or process is unavailable for a long period, and which may take a considerable length of time to reduce.
- **BS7799** - a UK BSI Standard for information security management.
- **Building Denial** - any damage, failure or other condition which causes denial of access to the building or the working area within the building, e.g. fire, flood, contamination, loss of services, air conditioning failure, and forensics.
- **Business Continuity** - A pro-active process which identifies the key functions of an organisation and the likely threats to those functions. From this information, plans and procedures can be developed thus ensuring key functions continue whatever the circumstances.
- **Business Continuity Co-ordinator** - a member of the recovery management team who is assigned the overall responsibility for co-ordinator of the recovery planning programme including team member training, testing and maintenance of recovery plans. (Associated terms: business recovery planner, disaster recovery planner, business recovery co-ordinator, disaster recovery administrator)
- **Business Continuity Management -** those management disciplines, processes and techniques which seek to provide the means for continuous operation of the essential business functions under all circumstances.
- **Business Continuity Plan -** a collection of procedures and information which is developed, compiled and maintained in readiness for use in the event of an emergency or disaster. (Associated terms: business recovery plan, disaster recovery plan, recovery plan)
- **Business Continuity Planning -** the advance planning and preparations which are necessary to identify the impact of potential losses; to formulate and implement viable recovery strategies; to develop recovery plan(s) which ensure continuity of organisational services in the event of an emergency or disaster; and to administer a comprehensive training, testing and maintenance programme. (Associated terms: contingency planning, disaster recovery planning, business recovery planning)
- **Business Continuity Programme -** the ongoing process supported by senior management and funded to ensure that the necessary steps are taken to identify the impact of potential losses, maintain viable recovery strategies and recovery plans, and ensure continuity services through personnel training, plan testing and maintenance. (Associated terms: disaster recovery programme, business recovery programme, contingency planning programme)
- **Business Critical Point -** the latest moment at which the business can afford to be without a critical function or process.
- **Business impact analysis (BIA)** - a management level analysis which identifies the impacts of losing company resources. The BIA measures the effect of resource loss and escalating losses over time in order to provide senior management with reliable data upon which to base decisions on risk mitigation and continuity planning. (Associated terms: business impact assessment, business impact analysis assessment)
- **Cold Site -** one or more data centres or office space facilities equipped with sufficient pre-qualified environmental conditioning, electrical connectivity, communications access, configurable space and access to accommodate the installation and operation of equipment by critical staff required to resume business operations.
- **Contingency Fund -** an operating expense that exists as a result of an interruption or disaster which seriously affects the financial position of the organisation. (Associated term: extraordinary expense)
- **Contingency plan -** actions to be followed in the event of a disaster or emergency occurring which threatens to disrupt or destroy the continuity of normal business activities and which seeks to restore operational capabilities. Now largely incorporated within Business Continuity Plan.

- **Crisis -** an abnormal situation, or perception, which threatens the operations, staff, customers or reputation of an enterprise.
- **Crisis Management Team (CMT) -** a group of executives who direct the recovery operations whilst taking responsibility for the survival and the image of the enterprise.
- **Crisis Plan or Crisis Management Plan -** a plan of action designed to support the crisis management team when dealing with a specific emergency situation which might threaten the operations, staff, customers or reputation of an enterprise.
- **Critical Service -** any service which is essential to support the survival of the enterprise.
- **Critical Data Point -** the point to which data must be restored in order to achieve recovery objectives.
- **Decision Point** - the latest moment at which the decision to invoke emergency procedures has to be taken in order to ensure the continued viability of the enterprise.
- **Declaration (of disaster)** - a formal statement that a state of disaster exists.
- **Disaster -** any accidental, natural or malicious event which threatens or disrupts normal operations, or services, for sufficient time to affect significantly, or to cause failure of, the enterprise.
- **Disaster Recovery -** the process of returning a business function to a state of normal operations at an interim minimal survival level and/or re-establishing full scale operations.
- **Disaster Recovery Plan (DRP) -** a plan to resume, or recover, a specific essential operation, function or process of an enterprise.
- **Emergency -** an actual or impending situation that may cause injury, loss of life, disruption of property or interfere with business operations to such an extent to pose a threat of disaster.
- **Emergency Control Centre -** the location from which disaster recovery is directed and tracked; it may also serve as a reporting point for deliveries, services, press and all external contacts.
- **Emergency Data Services -** remote capture and storage of electronic data, such as journalling, electronic vaulting and database shadowing.
- **Emergency Management Team -** the group of staff who command the resources needed to recover the enterprise's operations.
- **Emergency Plan (or Emergency Management Plan) -** a plan which supports the emergency management team by providing them with information and guidelines.
- **Enterprise -** an organisation, a corporate entity; a firm, an establishment, a public or government body, department or agency; a business or a charity.
- **Enterprise (large scale or super) -** an enterprise that is large and complex, in the sense that it could absorb the impact of losing a complete location or business unit. The normal terminology, and perspective, needs to be scaled down by regarding individual locations or business units as self-sustaining entities.
- **Financial Impact -** an operating expense that continues following an interruption or disaster, which as a result of the event cannot be offset by income and directly affects the financial position of the organisation.
- **Hot site -** a data centre facility or office facility with sufficient hardware, communications interfaces and environmentally controlled space capable of providing relatively immediate back-up data processing support. (Associated terms: warm-site, cold-site)
- **Human Resource Disaster Recovery -** a specific strategy for dealing with risk assessment, prevention, control and business recovery for critical (key) personnel.
- **Immediate Recovery Team -** the team with responsibility for implementing the business continuity plan and formulating the organisation's initial recovery strategy.
- **Impact -** Impact is the cost to the enterprise, which may or may not be measured in purely financial terms.
- **Incident -** any event that may be or may lead to a disaster.
- **Invocation -** a formal notification to a service provider that its services will be required.
- **Information Security -** the securing or safeguarding of all sensitive information, electronic or otherwise, which is owned by an organisation.
- **Logistics/Transportation team -** a team comprised of various members of departments associated with supply acquisition and material transportation, responsible for ensuring the most effective acquisition and mobilisation of hardware, supplies and support materials.
- **Minimum Resource Requirement (MRR)** – used in undertaking BIAs (Business Impact Analysis) by identifying the absolute minimum people, infrastructure, desks/space, applications and supply of materials required to perform a particular

process. The result is then put in the BCP (Business Continuity Plan) as a shopping list of the "must have" items to recover the process.

- **Mobile Standby -** a transportable operating environment, usually complete with accommodation and equipment, which can be transported and set up at a suitable site at short notice.
- **Mobilisation -** the activation of the recovery organisation in response to an emergency or disaster declaration.
- **Off-Site Location -** a storage facility at a safe distance from the primary facility which is used for housing recovery supplies, equipment, vital records etc.
- **Operational Impact -** an impact which is not quantifiable in financial terms but its effects may be among the most severe in determining the survival of an organisation following a disaster.
- **Outage -** the interruption of automated processing systems, support services or essential business operations which may result in the organisation's inability to provide a service for some period of time.
- **Period of Tolerance -** the period of time in which an incident can escalate to a potential disaster.
- **Pre-positional resource -** material (i.e. equipment, forms and supplies) stored at an off-site location to be used in business resumption and recovery operations. (Associated terms. pre-positioned inventory)
- **Reciprocal Agreement -** An agreement in which two parties agree to allow the other to use their site, resources or facilities during a disaster.
- **Recovery -** see system recovery.
- **Recovery Exercise -** an announced or unannounced execution of business continuity plans intended to implement existing plans and / or highlight the need for additional plan development. (Associated terms: disaster recovery test, disaster recovery exercise, recovery test, recovery exercise)
- **Recovery Management Team -** A team of people, assembled in an emergency, who are charged with recovering an aspect of the enterprise, or obtaining the resources required for the recovery.
- **Recovery Plan -** A plan to resume a specific essential operation, function or process of an enterprise. Traditionally referred to as a disaster recovery plan (DRP).
- **Recovery Site -** a designated site for the recovery of computer or other operations, which are critical to the enterprise.
- **Recovery Strategy -** a pre-defined, pre-tested, management approved course of action to be employed in response to a business disruption, interruption or disaster.
- **Recovery Team -** a group of individuals given responsibility for the co-ordination and response to an emergency or recovering a process or function in the event of a disaster.
- **Recovery Window -** The time scale within which time sensitive function or business units must be restored, usually determined by means of a business impact analysis.
- **Resilience -** the ability of a system or process to absorb the impact of component failure and continue to provide an acceptable level of service.
- **Response -** the reaction to an incident or emergency in order to assess the level of containment and control activity required.
- **Restart -** the procedure or procedures that return applications and data to a known start point. Application restart is dependent upon having an operable system.
- **Restoration -** the process of planning for and implementing full scale business operations which allow the organisation to return to a normal service level.
- **Resumption -** the process of planning for and / or implementing the recovery of critical business operations immediately following an interruption or disaster.
- **Risk Assessment & Management -** the identification and evaluation of operational risks that particularly affect the enterprise's ability to function and addressing the consequences.
- **Risk Reduction or Mitigation -** the implementation of the preventative measures which risk assessment has identified.
- **Scenario -** a pre-defined set of events and conditions which describe an interruption, disruption or disaster related to some aspect(s) of an organisation's business for purposes of exercising a recovery plan(s).
- **Security Review -** a periodic review of the security of tangible and intangible assets which should cover security policy, effectiveness of policy implementation, restriction of access to the assets, accountability for access and basic safety.
- **Service Level Agreement (SLA) -** an agreement between a service provider and service user as to the nature, quality, availability and scope of the service to be provided.
- **Site Access Denial -** any disturbance or activity within the area surrounding

the site which renders the site unavailable, e.g. fire, flood, riot, strike, loss of services, forensics. The site itself may be undamaged.

- **Social Impact -** any incident or happening that affects the well-being of a population and which is often not financially quantifiable.
- **Standby Service -** the provision of the relevant recovery facilities, such as cold-site, warm-site, hot-site and mobile standby.
- **Stand Down -** formal notification that the alert may be called off or that the state of disaster is over.
- **Structured Walk-Through -** an exercise in which team members verbally review each step of a plan to assess its effectiveness, identify enhancements, constraints and deficiencies. (Associated term: bench test).
- **System Denial -** a failure of the computer system for a protracted period, which may impact an enterprise's ability to sustain its normal business activities.
- **System Recovery -** the procedures for rebuilding a computer system to the condition where it is ready to accept data and applications. System recovery depends on having access to suitable hardware.
- **System Restore -** the procedures that are necessary to get a system into an operable condition where it is possible to run the application software against the available data. System restore depends upon having a live system available.
- **Table Top Exercise -** the exercising and testing of a BCP, using a range of scenarios whist not effecting the enterprise's normal operation.
- **Tolerance Threshold -** the maximum period of time which the business can afford to be without a critical function or process.
- **Vendor -** an individual or company providing a service to a department or the organisation as a whole. (Associated terms: supplier, third party vendor).
- **Vital Record -** a record that it is essential for preserving, continuing or reconstructing the operations of the organisation and protecting the rights of the organisation, its employees, its customers and its stockholders.
- **Warm Site -** a data centre or office facility which is partially equipped with hardware, communications interfaces, electricity and environmental conditioning capable of providing backup operating support. (Associated terms: hot site, cold site).
- **Work Area Standby -** a permanent or transportable office environment, complete with appropriate office infrastructure.

Further Information

If what you were looking for isn't here, try the business dictionary and business glossary directory at:
www.glossarist.com/glossaries/business/

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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Important Notice

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