Definitions and key terms

Term	Meaning
Amortisation	Most commonly refers to the process of paying off a debt over time through regular payments. Can also be a term used to describe depreciation of an intangible (nonphysical) asset such as goodwill or internally developed software.
Capital	Capital refers to items which benefit the business over more than the current year, e.g. land, buildings or equipment. Capital expenditure or capital cost refers to the one-time expenses for the purchase of these items.
CPI	The **C**onsumer **P**rice **I**ndex is an internationally comparable index which measures changes in the price level of a basket of consumer goods and services purchased by households. It is the most commonly used inflation index.
Depreciation	A reduction in the value of an asset over its lifetime e.g. public sector equipment is often assessed to have useful life of five years, its costs are therefore charged (spread) over this five year period rather than when it is initially bought. These regular charges which spread out the costs of the asset are referred to as depreciation.
EBITDA	**E**arnings **b**efore **i**nterest, **t**axation, **d**epreciation and **a**mortisation. EBITDA provides a comparable measure between organisations which removes the distorting effects of financing decisions (e.g. interest paid), investment decisions (depreciation and amortisation) and taxation from the company profits. It provides a proxy measure of the amount of earnings which is due to the company through its operations in a particular period.
EBITDAR(M)	**E**arnings **b**efore **i**nterest, **t**axation, **d**epreciation, **a**mortisation, **r**ent (and **m**anagement). EBITDAR and EBITDARM are measures equivalent to EBITDA which seek to provide good comparisons between care providers overall financial health, by removing the impact of rentals and in the case of EBITDARM, company management charges.
Financing costs	Costs associated with paying for the assets of the business. These costs are incurred as charges resulting from accessing funds. The most common example is bank interest.

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Goodwill	The value placed on a company beyond what could be sold separately, such as property, products, patents or brand names: effectively, the intangible asset of the company's reputation.
Oncosts	A cost incurred by an employer has when they employ someone, in addition to the cost of paying the person's salary or wages. Oncosts include pension contributions and employers' National Insurance contributions.

Important terms to understand are the acronyms EBITDA and EBITDARM. EDITDA stands for Earnings before interest, taxation, depreciation and amortisation, and is a measure designed to ensure sensible comparisons between organisations' operational success by removing the distorting effects of financing decisions (e.g. interest paid), investment decisions (depreciation and amortisation) and taxation from the company profits. It provides a proxy measure of the amount of earnings which is attributable to the company operations in a period. In the residential sector, EBITDARM is often used. This stands for Earnings before interest, taxation, depreciation, amortisation, rent and management fees. Again, the aim is to remove 'distortions' to enable comparisons between organisations. These measures are often used as a proxy measure to compare different companies' profit levels.

To commission for sustainability it is also important to have a basic understanding of financing costs. To enter the social care market a provider needs to obtain the necessary assets. In residential care in particular, where a building is required to deliver the service, the investment needed can be significant. In order to fund this, providers have a range of financing options available to them. A basic understanding of these and the differences between them, is helpful when it comes to understanding both providers' ongoing costs (e.g. interest on borrowings) and the investment made on which they will seek a return.

Financing method	Loan, debt or mortgage	Equity or investment	Lease or rental
Funding source	Bank/financial institution	Individual, group of individuals (e.g. shareholders), investment fund (e.g. pension fund)	Leasing company

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‘Payment’ or ‘return’ to the lender	Interest (may be fixed or variable)	Dividend (share of profit, variable)	Rental/lease charges (usually fixed)
Asset ownership	Lender often has rights over asset until loan is fully repaid	Asset owned by the business, but with some obligations to equity providers	Lease company owns the asset, the business may have the option to buy

The key point for commissioners to note is that there is always a cost for finance, whether equity, loan or lease. EBITDA(RM) is the best way to compare profitability or surplus between organisations as it represents the fairest comparison between organisations using different financing methods.

Commissioners need to ensure that the overall market is sustainable, with provision that meets local need remaining in place. If fee levels are negotiated that do not allow for financing costs or reasonable rate of return, it will be more likely that business owners will sell their businesses and invest elsewhere, or owners will not enter the market, thus reducing the supply of care available. Effective commissioning should seek to understand the financing costs which relate to a major contract, including the point at which any loans or lease payments come to an end.

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