

Taking into account inter-company differences in segment reporting formats, segment data analysis could also be used to analyse and benchmark comparable segments of peer companies within the same industry. This type of comparison probably makes more sense than comparing high-level, aggregated data of peer companies where similarities are usually much less evident than at operating segment level. But then again, one should keep in mind that segment reporting according to IFRS 8, *Operating Segments*, is entity-specific, not only with regard to information items reported, but also in respect of the measurement bases used.

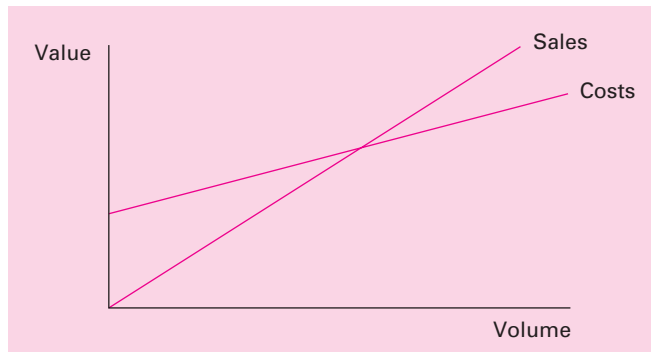
Operational gearing

Another aspect of a company's competitive position is the flexibility of its cost structure: companies with high fixed costs cannot react easily to downturns and generally need to seek high market share to maximize their fixed capacity. Companies in the same industry but which organize themselves with higher variable costs are more flexible, but may need to site themselves in a high price niche rather than look for large market share.

This can be illustrated graphically. The convention in management accounting is that a company's costs are either fixed or variable in the short to medium term (this is an oversimplification, but useful for analytical purposes). Thus a company with high fixed costs would have the relationship between volume and profit shown in Figure 17.2.

Figure 17.2

The relationship between volume and profit in a company with high fixed costs



Clearly, the higher the volume, the more profit, and such a company has some interest in reducing prices to gain market share, because that will lead to more than proportionately higher profits. Conversely, a company with low fixed costs and high variable costs is not very sensitive to volume changes and has much more interest in increasing prices. Such a company should therefore seek niche products, or highly differentiated products, where a small volume can be sold at high price.

Analytically, the concept of *operational gearing* refers to the volatility of profit as a function of changes in sales while taking into account the company's cost structure. Operational gearing can be interpreted as the percentage change in profit as sales changes 1 per cent. It can be measured as follows:

$$\text{Operational gearing} = \frac{\text{Sales} - \text{Variable costs}}{\text{Profit before tax}}$$