Understanding of AI Terms (2026 Edition)

A Practical Guide for Business Professionals, Managers & Everyday AI Users

Artificial Intelligence (AI) is rapidly becoming part of our daily work. Whether you're using ChatGPT, Microsoft Copilot, Google Gemini, Claude, or AI-powered business applications, understanding the language of AI helps you make smarter decisions and communicate more effectively.

This guide explains twelve essential AI concepts in simple language with practical business examples.

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1. LLM (Large Language Model)

What is an LLM?

A Large Language Model (LLM) is the "brain" behind generative AI systems like ChatGPT, Claude, Gemini, Copilot, DeepSeek and Qwen.

An LLM is trained using billions (sometimes trillions) of words collected from books, websites, articles, research papers and other publicly available information.

Instead of memorising answers, it predicts the most likely next word based on patterns it has learned.

Think of it as an incredibly knowledgeable assistant that has read millions of books.

Examples

- ChatGPT (OpenAI)
- Claude (Anthropic)
- Gemini (Google)
- Microsoft Copilot
- Alibaba Qwen
- Baidu ERNIE

Business Applications

- Writing emails
- Drafting reports
- Creating presentations

- Customer support
- Coding assistance
- Research
- Brainstorming ideas

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2. Hallucination

What is Hallucination?

Hallucination occurs when AI confidently provides information that is incorrect or completely made up.

The AI doesn't intentionally lie—it simply predicts text that appears convincing but isn't supported by facts.

Example

You ask:

"Who won the Nobel Prize in AI in 2023?"

The AI may invent a person because no such Nobel Prize exists.

Why It Happens

- Missing training data
- Ambiguous questions
- Lack of current information
- Weak prompting

How to Reduce Hallucinations

✓ Use trusted sources

✓ Verify important facts

✓ Ask AI to provide references

✓ Use Retrieval-Augmented Generation (RAG)

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3. Token

What is a Token?

AI doesn't read words.

It reads **tokens**.

A token may be:

- a word
- part of a word
- punctuation
- number
- symbol

For example:

"Unbelievable"

may become

Un + believ + able

Every prompt you type uses tokens.

Every AI response also consumes tokens.

Why Tokens Matter

More tokens mean:

- higher AI costs
- longer processing time
- larger context window

Businesses using AI APIs usually pay based on token usage.

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4. Training vs Inference

Training

Training is where AI learns.

Developers feed enormous datasets into powerful computers.

The model gradually adjusts billions of mathematical parameters (weights) until it becomes good at predicting language.

Training can take:

- weeks
- months

using thousands of GPUs.

Inference

Inference is when users interact with the trained AI.

When you type a prompt into ChatGPT, the model performs inference.

Inference is much faster than training.

Think of it like:

Training = Going to university

Inference = Doing your job

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5. Fine-Tuning

What is Fine-Tuning?

Fine-tuning takes an already-trained AI model and teaches it specialised knowledge.

Instead of building AI from scratch, organisations customise existing models.

Examples

Healthcare

Teach AI medical terminology.

Legal firms

Teach AI legal documents.

Manufacturing

Teach AI SOPs, quality manuals and engineering standards.

Banks

Train AI on compliance documents.

Benefits

- Higher accuracy
- Industry-specific knowledge
- Better responses
- Improved productivity

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6. Reinforcement Learning from Human Feedback (RLHF)

What is RLHF?

RLHF is how humans teach AI to behave better.

People review AI responses.

Good answers receive positive feedback.

Poor answers receive negative feedback.

The AI gradually improves over time.

Think about training a dog.

Good behaviour receives rewards.

Over time the behaviour improves.

Similarly, AI learns preferred responses through feedback.

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7. Distillation

What is Distillation?

Distillation means using a very large AI model to teach a smaller AI model.

Instead of requiring huge computing power, the smaller model learns most of the important knowledge.

Benefits

- Faster
- Cheaper
- Lower energy consumption
- Easier deployment on laptops and mobile devices

Many lightweight AI assistants use distilled models.

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8. Retrieval-Augmented Generation (RAG)

What is RAG?

RAG allows AI to search your company's documents before generating answers.

Instead of relying only on general knowledge, AI retrieves relevant information first.

Example

Without RAG

"What is our company's leave policy?"

AI guesses.

With RAG

AI searches:

- HR handbook
- Employee policies
- SOPs
- Knowledge base

Then produces an accurate answer.

Benefits

- Reduces hallucinations

- Improves accuracy
- Uses latest company documents
- Better enterprise AI

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9. Chain of Thought

What is Chain of Thought?

Complex problems become easier when broken into logical steps.

Rather than jumping straight to an answer, AI reasons through each stage.

Examples include:

- financial analysis
- troubleshooting
- engineering calculations
- business planning
- strategic decision making

Step-by-step reasoning often improves answer quality.

Note: Modern AI systems may use internal reasoning techniques, but users typically see only the final answer rather than the model's internal reasoning process.

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10. Weights

What are Weights?

Weights are the mathematical values inside an AI model.

They represent everything the model has learned.

During training, these numbers are adjusted billions of times.

Large AI models contain hundreds of billions of weights.

Think of weights as the AI's memory encoded in mathematics.

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11. Validation Loss

What is Validation Loss?

Validation Loss measures how well AI is learning during training.

A lower validation loss generally means the model is improving.

Developers monitor this number to prevent:

- overfitting
- poor generalisation
- unstable learning

It acts like a progress report during AI training.

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12. Coding Agent

What is a Coding Agent?

A Coding Agent goes beyond simple code suggestions.

It can:

- write code
- test code
- debug programs
- improve software
- create applications
- automate workflows

Examples include:

- GitHub Copilot
- OpenAI Codex
- Cursor AI
- Windsurf
- Claude Code

Modern coding agents are becoming valuable "AI software engineers" that work alongside human developers.

Key Takeaways

Understanding these AI terms helps you:

- Communicate confidently about AI
- Select the right AI tools
- Ask better prompts
- Reduce AI mistakes
- Improve productivity
- Make informed business decisions
- Prepare for AI transformation in your organisation

AI is no longer just for data scientists. Every professional can benefit from understanding these core concepts.

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