# Financial glossary
for entrepreneurs

## A

**Accelerated payment**

When the borrower requests to reduce his loan amortization period by increasing the amount or frequency of payments so the loan is paid off earlier.

**Accounting Standards for Private Enterprises (ASPE)**

A set of accounting standards applicable to Canadian private enterprises.

**Accounts payable**

Money owed by a company to its suppliers or other parties for services or goods. It is a current liability on the balance sheet.

**Accounts receivable**

Money owed to a company by its customers for services or goods that have been delivered. It is a current asset on the balance sheet.

**Acid test ratio**

See cash ratio.

**Amortization period**

Total length of time that it takes to pay a debt in full.

Under accounting principles, the amortization period usually refers to the useful economic life of an intangible asset.

See also depreciation and depreciation expense.

**Angel investor**

A wealthy individual who invests in companies typically in the early stages of development.

**Asset**

Any tangible (e.g. inventory, machinery, building, etc.) or intangible (e.g. intellectual property, goodwill, etc.) resource that is owned by a person, group of persons or business and is perceived by others to have value.

**Asset-backed securities (ABS)**

Financial securities (tradable assets) that are backed by loans, leases or receivables against assets, such as vehicles and equipment. These securities are issued under a securitization operation.

**Asset-based financing**

Lending that is based solely on the assets in the business.

**Average days payable**

A financial indicator that measures the average number of days it takes for a company to pay its suppliers.

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**Average collection period**

A financial indicator that measures the average number of days it takes for a company to receive payments from its customers.

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# B

**Balance sheet**

Also called *Statement of Financial Position*.

A summary of a business's financial situation at a given date. It lists the company's assets (machinery, buildings, inventory, cash, etc.), its liabilities (what it owes), and the amount invested by its shareholders (shareholder's equity). The total assets must equal the total liabilities plus the shareholder's equity.

**Balloon loan**

A type of loan that doesn't fully amortize over its life and requires a balloon payment at the end in order to be fully paid.

**Balloon payment**

A large payment due at the end of the term of a loan. The name comes from the fact that the debt becomes inflated like a balloon as a result of the fact that the loan amount hasn't been fully amortized over the life of the loan.

**Blended payment**

A loan repayment method where the loan is repaid in equal instalments, which include both principal and interest.

**Bottom line**

See net profit.

**Breakeven analysis**

Financial analysis that determines when a company's revenues will equal all the costs associated with those revenues.

**Breakeven point**

When a company's revenues will equal all the costs associated with those revenues.

See also breakeven analysis.

**Bridge capital**

Also called *bridge funding or bridge financing*.

Temporary funding to cover a period of time until permanent capital is secured from equity investors or debt lenders.

**Bridge financing**

See bridge capital.

**Bridge funding**

See bridge capital.

**Business accelerators**

Programs that support and accelerate the growth of early stage or established companies through mentorship, access to investors, logistical and technical resources as well as shared office space. Accelerators usually last for three to four months. They generally focus on the high-tech sector.

**Business incubators**

Programs that support the growth of start-up companies through mentorship, access to investors, logistical and technical resources as well as shared office space. They generally focus on the high-tech sector. Companies can spend from several months to a year or two in a business incubator.

**Business net worth**

See shareholder's equity.

**Business plan**

A written document detailing a business's goals and the steps that will be taken to achieve these goals. It includes a description of the company's products or services, its market potential and competitors, as well as a detailed description of the current and planned financial situation of the business, its marketing, production and human resources strategy.

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**Buy in management buyout (BIMBO)**

A form of acquisition whereby an external group of investors joins forces with the existing management team and they buy together into the business.

See also leveraged management buyout (LMBO), management buyout (MBO) and employee buyout.

## C

**Cash flow**

The net change in cash position during a period.

It is calculated as the difference between the amount of cash injected in or generated by the business (sources or inflows of cash) and the cash withdrawn from or used by the business (uses or outflows of cash).

Check out BDC's free cash flow eBook.

**Cash flow statement**

Document presenting the company's cash flow over a period of time (months or years). For each period, it shows the amount of cash injected in or generated by the business (sources or inflows of cash) versus the cash withdrawn from or used by the business (uses or outflows of cash).

**Cash ratio**

Also called *quick ratio or acid test ratio*.

A financial ratio indicating a company's ability to pay immediate creditor demands, using its most liquid assets (cash or assets that are easily converted into cash), also called quick assets. It's similar to the working capital ratio, except that it does not include inventory and prepaid items for which cash cannot be obtained immediately.

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**Collateral**

The security held by your bank in the event you default on your loan.

**Costs of goods sold**

Costs that are a direct result of producing the product or providing a service, such as materials, direct labour, utilities, etc.

See also gross profit.

**Current assets**

Assets that can be converted into cash within the next 12 months or operating cycle, such as inventory and accounts receivable. The value of current assets is used to calculate the working capital ratio.

See also quick assets.

**Current liabilities**

A company's financial obligations that are due over the next 12 months or operating cycle, such as short-term debt and accounts payable.

The value of current liabilities is used to calculate the working capital ratio.

**Current ratio**

See working capital ratio.

## D

**Debt-service coverage ratio**

A financial ratio measuring a business's capacity to generate adequate earning to repay its debt. It is typically calculated by dividing the business's operating profit before interest and depreciation by the annual principal and interest payments on its debt.

**Debt-to-asset ratio**

A financial ratio showing the percentage of a company's assets financed by creditors. A high ratio indicates a substantial dependence on debt and could be a sign of financial weakness.

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**Debt-to-equity ratio**

A financial ratio measuring how much debt a business is carrying as compared to the amount invested by its owners. This indicator is closely watched by bankers as a measure of a business's capacity to repay its debts.

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**Default**

Failure to repay a loan when term is due or failure to respect other conditions in the Loan Agreement that are defined as "incidents of default."

**Depreciation**

A decrease in value of an asset. For accounting purposes, depreciation indicates how much of a tangible asset's value has been used up. Amortization and depreciation are often used interchangeably, but this is an incorrect practice because amortization refers to intangible assets and depreciation refers to tangible assets.

**Depreciation expense**

This is when you allocate the cost of an asset over a period of time, usually over its useful life. For instance, a computer costing $1,000 that has a useful life of 5 years would have a depreciation expense of $200 each year.

See also amortization period.

**Depreciation period**

Chosen period of time for allocating the cost of an asset over its useful life.

**Dilution**

Also called *equity dilution*.

When the percentage of a business owned by current investors, founders and employees is reduced by the issuance of new shares to new investors. Dilution can also occur when holders of stock options or other similar securities exercise their options.

**Dividends**

A portion of the net profit that is distributed by a company to its shareholders.

## E

**Early-stage company**

A company that is already formed (when it first starts is referred to as the seed stage) but is not yet generating revenues. Typically, a company in early stage will have a core management team and a proven concept or product, and a negative cash flow.

**Earnings Before Taxes (EBT)**

See operating profit.

**Earnings Before Interest and Taxes (EBIT)** See net operating profit.

**EBITDA** Acronym for Earnings Before Interest, Taxes, Depreciation and Amortization.

It's a fairly standard indicator of a company's general financial performance.

**Employee buyout** A form of acquisition whereby employees acquire all or part of the company they work at.

See also leveraged management buyout (LMBO), management buyout (MBO) and buy in management buyout (BIMBO).

**Equity dilution** See dilution.

**Equity financing** Raising money to finance a company's activities by selling stock or stock options to a new investor.

**Exit** When the investors in a company (owner or outside investors) sell part or all of their ownership in order to have a return on their investment and typically achieve some liquidity. Typical exit options are to merge with another company, have it acquired or make an initial public offering (IPO).

## F

**Financial ratios** The number that is obtained by dividing one financial statement (or account) line item by another to facilitate the analysis of a company's financial condition and its profitability.

Financial ratios are used to evaluate the performance of a company. By comparing the ratios to industry standards, potential problems can be identified.

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**Financial statements** A formal record of the financial situation of a company including the income statement, balance sheet, statements of retained earnings and cash flow.

**Fixed assets** An accounting term to describe tangible assets such as land, buildings, and equipment that the company owns or uses during the normal of business.

**Fixed costs** Overhead costs that generally do not change, such as office expenses, rent, etc.

See also gross profit.

**Fixed-rate loan** A loan for which the interest rate is fixed for a specified period of time.

**Floating interest loan** See variable-rate loan.

## G

**General Partner (GP)**

A term commonly used in the venture capital industry. Typically, a venture capital fund is structured as a limited partnership, with the venture capital firm that manages (invests or divests in companies) the fund called the general partner (GP). Limited partners (LPs) are investors that provide most of the capital in the partnership. The GP manages the fund on behalf of the LPs and retains liability for the actions of the partnership.

**Gross margin**

See gross profit.

**Gross profit**

Also *gross margin and gross profit margi*n.

It is the difference between a company's revenues and the cost of goods sold (the costs that are a direct result of producing the product or providing a service, such as materials, direct labour, utilities, etc.). It does NOT include fixed costs (overhead costs that generally do not change, such as office expenses, rent, etc.), taxes and interest payments.

See also operating expenses and net profit.

**Gross profit margin**

See gross profit.

## H

**Hedging**

A risk management technique used to insulate financial results from market, interest rate or foreign currency exchange risk (exposure) arising from normal banking operations

## I

**Illiquid assets**

Assets that cannot be easily converted into cash.

**Income statement**

A summary of a business's operating results over a specific period, including all revenues and expenses, including taxes, resulting in a net income or loss.

**Initial public offering (IPO)**

The first offering of stock by a company to the public. An IPO is one way for a successful company to obtain additional capital for further growth. Early investors may take this opportunity to sell their investments in the company.

**Intangible assets**

Assets that lacks physical substance. They cannot be used for payments of debts and include goodwill, patent, trademark, incorporations costs. They may produce income and can be sold, that is why they are listed under assets.

**International Financial**

A set of international accounting standards aiming to provide common guidelines for the way public companies prepare and disclose their financial statements.

**Inventory turnover**

A ratio indicating how often a company has sold and replaced its inventory over an accounting period. It is a common operational efficiency ratio.

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## J

**Joint venture**

A legal business entity created by two or more companies that agree to pool their resources and work together on a specific business project and share profits or losses.

## L

**Late-stage company**

Term usually used in venture capital.

When a company has a product or service in the market and has achieved some commercial success, usually with significant revenue growth. However, it is not necessarily profitable. Late-stage companies backed by venture capital may be 12-to-24 months away from an exit event, such as an initial public offering or an acquisition.

**Letter of credit**

Also called *letter of guarantee*.

Document issued by a financial institution guaranteeing payment to a seller if certain conditions are met. The letter of credit serves as a payment guarantee for the seller regardless of whether the buyer ultimately pays or not.

**Letter of guarantee**

See letter of credit.

**Leveraged management buyout (LMBO)**

A form of acquisition whereby the management team pools its resources to acquire all or part of the business they manage, using the company's assets as collateral to secure financing.

Also see employee buyout, management buyout (MBO) and Buy-In-Management-Buyout (BIMBO).

**Liabilities**

A company's debt or other financial obligations, such as loans, accounts payable and mortgages.

**Limited partner (LP)**

In the case of venture capital, a Limited Partner is an investor (it can be an institutional or private investment firm) that will provide funds for investment in companies by a general partner (GP). The GP is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment.

**Limited partnership**

See limited partner and general partner.

**Line of credit**

See operating loan.

**Liquidity**

The ability of a company to pay current liabilities, using cash or assets that are easily converted into cash.

**Loan acceptance**

When a company has agreed to the authorized financing terms and conditions offered by the financial institution. Loan acceptance follows loan authorization.

**Loan authorization** — When the financial institution has completed its due diligence and approved the financing request. Authorization precedes loan acceptance.

**Loan maturity date** — The date on which the loan ends and the last payment is due.

**Loan syndication** — A type of loan in which several banks provide a portion of the financing and share in the risk. Typically, one bank ("the agent") administers the loan on behalf of the other banks ("the participants"). Loan syndication is typically used for large loans to large companies.

**Long-term assets** — Assets that are not intended to be turned into cash or be consumed within the next 12 months or operating cycle, such as property and equipment.

**Long-term liabilities** — Debts or obligations that are not due within the next 12 months or operating cycle.

**Love money** — Money loaned by family or friends. Bankers consider this "patient capital"—that is money that will be repaid as the company's profits increase.

## M

**Mergers & Acquisitions (M&A)** — The financial strategy and process involved in buying, selling and combining companies.

**Management buyout (MBO)** — A form of acquisition whereby the management team pools its resources to acquire all or part of the business they manage.

Also see employee buyout, leveraged management buyout (LMBO) and Buy-In-Management-Buyout (BIMBO).

**Market capitalization** — The value of a publicly traded company which is calculated by multiplying the number of outstanding shares by the current price per share.

## N

**Net earnings** — See net profit.

**Net income** — See net profit.

**Net profit** — Also called *bottom line, net income or net earnings*.

A company's total income minus all the expenses, including taxes, interest, depreciation and amortization, or operating expenses for a determined period of time.

**Net operating income** — See net operating profit.

**Net operating profit** — Also called *net operating income or Earnings Before Interest and Taxes (EBIT)*.

A company's operating profit minus the operating expenses, but before income taxes and interest are deducted.

**Net profit margin ratio**

Also called *return on sales ratio*.

A financial ratio showing the net profit generated by each dollar of sales. It measures the percentage of sales revenue retained by the company after operating expenses, interest and taxes have been paid.

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## O

**Operating expenses**

Expenses associated with a company's day-to-day business operations, including administrative (overhead) costs, depreciation and amortization, and all costs associated with producing and selling products or services.

It excludes any costs that are not associated with the core of the business, such as one-time costs related to a lawsuit or a business reorganization, or currency exchange costs.

**Operating loan**

Also called *line of credit*.

Short-term, flexible loan that a company uses as required—borrowing as much as it needs up to a determined amount. It is usually secured by inventory and accounts receivable and the bank can require full repayment at any time.

**Operating profit**

Also called *Earnings Before Taxes (EBT)*.

The difference between gross profit and operating expenses.

## P

**Pari-passu**

A way of structuring loan security (the assets that would be taken over by creditors if the borrower defaulted on the loan) where creditors are said to be equal in terms of who gets paid first. This means that in the event of a loan default, distribution of the assets will occur proportionate to the amount owed to each creditor with no other preference. This allows for the risk exposure of each institution to be reduced.

**Patient capital**

See love money.

**Peer lending for Aboriginal Banking**

A lending concept developed by BDC for the Aboriginal community based on the principle of group borrowing. If one person in the group defaults on the loan (does not pay), the entire group is penalized.

**Personal loan**

Money loaned to a person, not to a business, and secured by the borrower's personal assets. Many banks offer this type of loan to start-up businesses or to those with few fixed assets (land, building or equipment).

## Q

**Quick assets**

Highly liquid assets that can be rapidly turned into cash. They include the available cash in the business and accounts receivable. Inventory and prepaid items for which cash cannot be obtained immediately are excluded.

Used when calculating the cash ratio.

See also current assets.

**Quick ratio**

See cash ratio.

## R

**Regular payment**

See straight-line payment.

**Retained earnings**

The portion of a company's net income that is reinvested in the business instead of distributed to shareholders as dividends.

**Return on investment**

See return on total assets ratio.

**Return on sales ratio**

See net profit margin ratio.

**Return on shareholder's equity ratio**

A financial ratio indicating the amount of after-tax profit generated for each dollar of equity. It measures the rate of return the shareholders receive on their investment.

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**Return on total assets ratio**

Also called *return on investment*.

A financial ratio measuring how profitable a company is relative to its total assets, i.e. how much profit (excluding income taxes and financing charges) is generated compared to how much a company has invested to generate those profits.

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## S

**Seasonal payment**

A loan payment schedule that is adapted to the company's cash flow availability. For example, a business in the tourism industry will have lower payments during its off-season months and higher payments during high-season period.

**Secured loan**

Financing where assets such as machinery or property are pledged as collateral in the event the borrower defaults on the loan; if this were to happen, the financial institution takes possession of the assets used as collateral.

See also unsecured loan.

**Securitization**

A specialized form of financing for independent finance and leasing companies. They bring together some of their financial assets (e.g. leases and loans) and negotiate a selling price to investors. By doing this, they can access funding on potentially better financial terms that those of more typical commercial lending. The finance and leasing companies can then pass these terms on to their customers – usually small and medium-sized enterprises that buy vehicles and equipment.

**Seed capital**

The initial capital used to start a business. The money often is provided by angel investors, friends and family members.

**Senior debt**

Debt that gives its holder a priority right over other debts.

**Shareholders' equity**

Also called *business net worth*.

The difference between what a company owns (assets) and what it owes (liabilities) at a certain point in time.

Used to calculate the return on shareholder's equity ratio.

**Sole proprietorship**

A business that is owned and operated by one individual. The owner of the sole proprietorship is responsible for all business liabilities and his personal assets can be used to pay for these liabilities.

**Start-up**

A business that is being established for the first time. Existing companies that have not yet had 12 consecutive months of sales are also included in this category.

**Statement of Financial Position**

See balance sheet.

**Stepped payment**

Type of payment in which lower payments are allowed for the first few years, followed by increased or "stepped up" payments later in the life of the loan.

**Straight-line payment**

Also called r*egular payment*.

It's the simplest type of amortization, whereby the principal payments are spread out equally over the life of the loan.

**Subordinate financing**

A blend of debt and equity financing used to finance the growth of existing companies. It is financing that is subordinate in priority of payment to secured debt, and senior to common stock or equity.

**Syndicated loan**

See loan syndication.

## T

**Tangible assets**

Assets that have a physical form such as real estate, equipment, vehicles, furniture or inventory. Tangible assets are usually required as collateral by conventional lenders when considering a loan request.

See also fixed assets.

**Term loan**

A loan that is intended to be fully disbursed and then repaid in regular installments (usually monthly) over a set period of time. Term loans are most often used to finance fixed assets such as equipment and buildings.

## U

**Unsecured loan**

A loan for which the lender does not have any tangible assets (equipment, real estate, cash) as collateral. The lender relies solely on the financial capacity and creditworthiness of the borrower to repay the loan.

## V

**Variable-rate loan**

Also called *floating interest loan*.

A loan where the interest fluctuates depending on market interest rate changes.

**Venture capital (VC)**

Financing capital provided to businesses with high-growth potential in exchange for equity (shares) in the business.

**Venture Capital Action Plan (VCAP)**

A Government of Canada initiative launched in early 2013 to improve access to venture capital financing through the creation of four large Funds of Funds.

BDC has been asked to provide support and advice to the Government (Ministry of Finance, Ministry of Industry and the Expert Panel) as it implements VCAP.

**Venture capital fund**

An investment fund that manages money from investors providing capital to early stage, high-potential growth companies.

See also general partner (GP).

## W

**Working capital loan**

Financing to finance everyday operations in a company, such as marketing, developing or launching new products, etc.

**Working capital ratio**

Also called *current ratio*.

It's the difference between current assets and current liabilities. This financial ratio indicates whether a business has sufficient cash flow to meet short-term obligations, take advantage of opportunities and attract favourable credit terms.

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## Financial glossary disclaimer

The Business Development Bank of Canada (BDC) has prepared this glossary to help entrepreneurs better understand some of the most common financial terms associated with running a business. This glossary is not exhaustive and shouldn't be regarded as professional advice. Users can expect different terms in contracts or when dealing with financial institutions.

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