Business and Finance Terms to Know

Running a business involves a constant learning curve. And that applies whether you're a rookie entrepreneur just starting out with a great idea for a new business or a more established small business owner with a quickly growing business that needs to expand. You *should* always be learning as a business owner, no matter where you are in your career—there's always a new tool to master, new problems to solve, and new vocabulary to understand.

In order to not get totally overwhelmed, it's helpful to take things one segment at a time. For instance, feeling confident when discussing the business's financial needs should be a priority for every small business owner. After all, you represent the heart and soul of your business in the marketplace. So knowing the "language" of business finance is an integral part of your job as the owner.

The good news is that you don't have to be an accountant or a financial planner to negotiate in the world of business finance. Here are some business terms and finance terms that will help you find your way to successful small business funding.

From accounting, to business loans, to general business financial operations, this booklet contains the ultimate list to all the business finance terms and definitions you need to know!

1. Accounts Payable

Accounts payable is a business finance 101 term. This represents your small business's obligations to pay debts owed to lenders, suppliers, and creditors. Sometimes referred to as A/P or AP for short, accounts payable can be short or long term depending upon the type of credit provided to the business by the lender.

2. Accounts Receivable

Also known as A/R (or AR, good guess), accounts receivables is another business finance 101 term that means the money owed to your small business by others for goods or services rendered. These accounts are labeled as assets because they represent a legal obligation for the customer to pay you cash for their short-term debt.

3. Accrual Basis

The accrual basis of accounting is an accounting method of recording income when it's actually earned and expenses when they actually occur. Accrual basis accounting is the most common approach used by larger businesses to record and maintain financial transactions.

4. Accruals

A business finance term and definition referring to expenses that have been incurred but haven't yet been recorded in the business books. Wages and payroll taxes are common examples.

5. Asset

This business finance key term is anything that has value—whether tangible or intangible—and is owned by the business is considered an asset. Typical items listed as business assets are cash on hand, accounts receivable, buildings, equipment, inventory, and anything else that can be turned into cash.

6. Balance Sheet

Along with three other reports relating to the financial health of your small business, the balance sheet is essential information that gives a “snapshot” of the company’s net worth at any given time. The report is a summary of the business assets and liabilities.

7. Bookkeeping

A method of accounting that involves the timely recording of all financial transactions for the business.

8. Capital

Refers to the overall wealth of a business as demonstrated by its cash accounts, assets, and investments. Often called “fixed capital,” it refers to the long-term worth of the business. Capital can be tangible, like durable goods, buildings, and equipment, or intangible such as intellectual property.

9. Working Capital

Not to be confused with fixed capital, working capital is another business finance 101 term. It consists of the financial resources necessary for maintaining the day-to-day operation of the business. Working capital, by definition, is the business's cash on hand or instruments that you can convert to cash quickly.

10. Cash Flow

Every business needs cash to operate. The business finance term and definition cash flow refers to the amount of operating cash that "flows" through the business and affects the business's liquidity. Cash flow reports reflect activity for a specified period of time, usually one accounting period or one month. Maintaining tight control of cash flow is especially important if your small business is new, since ready cash can be limited until the business begins to grow and produce more working capital.

11. Cash Flow Projections

Future business decisions will depend on your educated cash flow projections. To plan ahead for upcoming expenditures and working capital, you need to depend on previous cash flow patterns. These patterns will give you a comprehensive look at how and when you receive and spend your cash. This info is the key to unlock informed, accurate cash flow projections.

12. Depreciation

The value of any asset can be said to depreciate when it loses some of that value in increments over time. Depreciation occurs due to wear and tear. Various methods of depreciation are used by businesses to decrease the recorded value of assets.

13. Fixed Asset

A tangible, long-term asset used for the business and not expected to be sold or otherwise converted into cash during the current or upcoming fiscal year is called a fixed asset. Fixed assets are items like furniture, computer equipment, equipment, and real estate.

14. Gross Profit

This business finance term and definition can be calculated as total sales (income) less the costs (expenses) directly related to those sales. Raw materials, manufacturing expenses, labor costs, marketing, and transportation of goods are all included in expenses.

15. Income Statement

Here is one of the four most important reports lenders and investors want to see when evaluating the viability of your small business. It is also called a profit and loss statement, and it addresses the business's bottom line, reporting how much the business has earned and spent over a given period of time. The result will be either a net gain or a net loss.

16. Intangible Asset

A business asset that is non-physical is considered intangible. These assets can be items like patents, goodwill, and intellectual property.

17. Liability

This business finance key term is a legal obligation to repay or otherwise settle a debt. Liabilities are considered either current (payable within one year or less) or long-term (payable after one year) and are listed on a business's balance sheet. A business's accounts payable, wages, taxes, and accrued expenses are all considered liabilities.

18. Liquidity

Liquidity is an indicator of how quickly an asset can be turned into cash for full market value. The more liquid your assets, the more financial flexibility you have.

19. Profit & Loss Statement

See "Income Statement" above.

20. Statement of Cash Flow

One of the important documents required by lenders and investors that shows a summary of the actual collection of revenue and payment of expenses for your business. The statement of cash flow should reflect activity in the areas of operating, investing, and financing and should be an integral part of your financial statement package.

21. Statement of Shareholders' Equity

If you have chosen to fund your small business with equity financing and you have established shares and shareholders as part of the controlling interests, you are obligated to provide a financial report that shows changes in the equity section of your balance sheet.

22. Annual Percentage Rate

The business finance term and definition APR represents the yearly real cost of a loan including all interest and fees. The total amount of interest to be paid is based on the original amount loaned, or the principal, and is represented in percentage form. When shopping for the right loan for your small business, you should know the APR for the loan in question. This figure can be very helpful in comparing one financial tool with another since it represents the actual cost of borrowing.

23. Appraisal

Just like your real estate appraisal when buying a house, an appraisal is a professional opinion of market value. When closing a loan for your small business, you will probably need one or more of the three types of appraisals: real estate, equipment, and business value.

24. Balloon Loan

A loan that is structured so that the small business owner makes regular repayments on a predetermined schedule and one much larger payment, or balloon payment, at the end. These can be attractive to new businesses because the payments are smaller at the outset when the business is more likely to be facing strict financial constraints. However, be sure that your business will be capable of making that last balloon payment since it will be a large one.

25. Bankruptcy

This federal law is used as a tool for businesses or individuals who are having severe financial challenges. It provides a plan for reduction and repayment of debts over time or an opportunity to completely eliminate the majority of the outstanding debts. Turning to bankruptcy should be given careful thought because it will have a negative effect on the business credit score.

26. Bootstrapping

Using your own money to finance the start-up and growth of your small business. Think of it as being your own investor. Once the business is up and running successfully, the business finance term and definition bootstrapping refers to the use of profits earned to reinvest in the business.

27. Business Credit Report

Just like you have a personal credit report that lenders look at to determine risk factors for making personal loans, businesses also generate credit reports. These are maintained by credit bureaus that record information about a business's financial history.

Items like how large the company is, how long has it been in business, amount and type of credit issued to the business, how credit has been managed, and any legal filings (i.e., bankruptcy) are all questions addressed by the business credit report. Lenders, investors, and insurance companies use these reports to evaluate risk exposure and financial health of a business.

28. Business Credit Score

A business credit score is calculated based on the information found in the business credit report. Using a specialized algorithm, business credit scoring companies take into account all the information found on your credit report and give your small business a credit score. Also called a commercial credit score, this number is used by various lenders and suppliers to evaluate your creditworthiness.

29. Collateral

Any asset that you pledge as security for a loan instrument is called collateral. Lenders often require collateral as a way to make sure they won't lose money if your business defaults on the loan. When you pledge an asset for collateral, it becomes subject to seizure by the lender if you fail to meet the requirements of the loan documents.

30. Credit Limit

When a lender offers a business line of credit it usually comes with a credit limit, or a maximum amount that you can use at any given time. It is said that you reach your credit limit or "max out" your credit when you borrow up to or exceed that number. A business line of credit can be especially useful if your business is seasonal or if the income is extremely unpredictable. It is one of the fastest ways to access cash for emergencies.

31. Debt Consolidation

If your small business has several loans with various payments, you might want to consider a business debt consolidation loan. It is a process that lets you combine multiple loans into a single loan. The advantages are possibly reducing the interest rates on the borrowed funds as well as lowering the total amount you repay each month. Businesses use this tool to help improve cash flow.

32. Debt Service Coverage Ratio

The business finance term and definition debt service coverage ratio (DSCR) is the ratio of cash your small business has available for paying or servicing its debt. Debt payments include making principal and interest payments on the loan you are requesting. Generally speaking, if your DSCR is above 1, your business has enough income to meet its debt requirements.

33. Debt Financing

When you borrow money from a lender and agree to repay the principal with interest in regular payments for a specified period of time, you're using debt financing. Traditionally, it has been the most common form of funding for small businesses.

Debt financing can include borrowing from banks, business credit cards, lines of credit, personal loans, merchant cash advances, and invoice financing. This method creates a debt that must be repaid but lets you maintain sole control of your business.

34. Equity Financing

The act of using investor funds in exchange for a piece or ”share” of your business is another way to raise capital. These funds can come from friends, family, angel investors, or venture capitalists.

Before deciding to use equity financing to raise the cash necessary for your business, decide how much control you are willing to share when it comes to decision-making and philosophy. Some investors will also want voting rights.

35. FICO Score

A FICO score is another type of credit score used by potential lenders for evaluating the wisdom of entering a contract with you and your business. FICO scores comprise a substantial part of the credit report that lenders use to assess credit risk. It was created by the Fair Isaac Corporation, hence the name FICO.

36. Financial Statements

An integral part of the loan application process is furnishing information that shows your business is a good credit risk. The standard financial statementpacket includes four main reports: the income statement, the balance sheet, the statement of cash flow, and the statement of shareholders' equity, if you have shareholders.

Lenders and investors want to see that your business is well-balanced with assets and liabilities, has positive cash flow, and will have capital to make expected repayments.

37. Fixed Interest Rate

The interest rate on a loan that is established in the beginning and does not change for the lifetime of the loan is said to be fixed. Loans with fixed interest rates are appealing to small business owners because the repayment amounts are consistent and easier to budget for in the future.

38. Floating Interest Rate

In contrast to the business finance term and definition fixed rate, the floating interest rate will change with market fluctuations. Also referred to as variable rates or adjustable rates, these amounts may often start out lower than the fixed rate percentages. This makes them more appealing in the short term if the market is trending down.

39. Guarantor

When starting a new small business, lenders might want you to provide a guarantor. This is an individual who guarantees to cover the balance owed on a debt if you or your business cannot meet the repayment obligation.

40. Interest Rate

All loans and other lending instruments are assigned the business finance key term interest rates. This is a percentage of the principal amount charged by the lender for the use of its money. Interest rates represent the current cost of borrowing.

41. Invoice Factoring or Financing

If your business has a significant amount of open invoices outstanding, you may contact a factoring company and have them purchase the invoices at a discount. By raising capital this way, there is no debt, and the factoring company assumes the financial responsibility for collecting the invoice debts.

42. Lien

This business finance term and definition is a creditor's legal claim to the collateral pledged as security for a loan is called a lien.

43. Line of Credit

A lender may offer you an unsecured amount of funds available for your business to draw on when capital is needed. This line of credit is considered a short-term funding option, with a maximum amount available. This pre-approved pool of money is appealing because it gives you quick access to the cash.

44. Loan-to-Value

The LTV comparison is a ratio of the fair-market value of an asset compared to the amount of the loan that will fund it. This is another important number for lenders who need to know if the value of the asset will cover the loan repayment if your business defaults and fails to pay.

45. Long-Term Debt

Any loan product with a total repayment schedule lasting longer than one year is considered a long-term debt.

46. Merchant Cash Advance

A merchant may offer a funding method through a loan based on the business's monthly sales volume. Repayment is made with a percentage of the daily or weekly sales. These tend to be short-term loans and are one of the costliest ways to fund your small business.

47. Microloan

Microloans are loans made through nonprofit, community-based organizations and they are most often for amounts under $50,000.

48. Personal Guarantee

If you're seeking financing for a very new business and don't have a high value asset to offer as collateral, you may be asked by the lender to sign a statement of personal guarantee. In effect, this statement affirms that you as an individual will act as guarantor for the business's debt, making you personally liable for the balance of the loan even in the event that your business fails.

49. Principal

Any loan instrument is made of three parts—the principal, the interest, and the fees. The principal is a business finance key term and is the original amount that is borrowed or the outstanding balance to be repaid less interest. It is used to calculate the total interest and fees charged.

50. Revolving Line of Credit

This business finance term and definition is a funding option is similar to a standard line of credit. However, the agreement is to lend a specific amount of money, and once that sum is repaid, it can be borrowed again.

51. Secured Loan

Many lenders will require some form of security when loaning money. When this happens, this business finance term and definition is a secured loan. The asset being used as collateral for the loan is said to be "securing" the loan. In the event that your small business defaults on the loan, the lender can then claim the collateral and use its fair-market value to offset the unpaid balance.

52. Term Loan

These are debt financing tools used to raise needed funds for your small business. Term loans provide the business with a lump sum of cash up front in exchange for a promise to repay the principal and interest at specified intervals over a set period of time. These are typically longer term, one-time loans for start-up expenses or costs for established business expansion.

53. Unsecured Loans

Loans that are not backed by collateral are called unsecured loans. These types of loans represent a higher risk for the lender, so you can expect to pay higher interest rates and have shorter repayment time frames. Credit cards are an excellent example of unsecured loans that are a good option for small business funding when combined with other financing options.

54. Articles of Incorporation

This is legal documentation of the business's creation, including name, type of business, and type of business structure or incorporation. This paperwork is one of the first tasks you will complete when you officially start your business. Once submitted, your articles of incorporation are kept on file with the appropriate governmental agencies.

55. Business Plan

Here is your tool for demonstrating how you want to establish your small business and how you plan to grow it into good financial health. When writing a business plan, it should include financial, operational, and marketing goals as well as how you plan to get there. The more specific you are with your business plan, the better prepared you will be in the long run.

56. Employer Identification Number (EIN) Certificate

In order to be more easily identified by the Internal Revenue Service, every business entity is assigned a unique number called an EIN. When you start your small business, an EIN will be assigned and mailed to the business address. This number never changes, and you will be asked to furnish it for many reasons.

57. Franchise Agreement

For a small business entrepreneur, entering into a franchise agreement with a larger company can be a way to enter the marketplace. The agreement made between you and the larger company gives you the right to operate as a satellite of the larger company in a certain territory for a given period of time. This lets you, the business owner, take advantage of a brand name that's already familiar in the marketplace and a process or operation that has already been tested.

58. Net Worth

This business finance term and definition is an expression of your business's total value, as determined by your total current assets less the total liabilities currently owed by the business. With your business's most recent balance sheet in hand, you can calculate the net worth using a simple formula: Assets – Liabilities = Net Worth.

59. Retained Earnings

Just like it sounds, this term represents any profits earned that are retained in the business. This can also be referred to as bootstrapping.

60. Tax Lien

If your business fails to pay taxes owed to the designated government entity, namely the IRS, you may find your assets seized by the claim of a tax lien. The government can not only seize your assets for liquidation to resolve the tax debt, but they can also charge you penalties on the amount you owe.

Don't Be Overwhelmed

As a small business owner, you will be required to wear many different hats—often including that of chief financial officer or bookkeeper. Before you let yourself get intimidated by all the business terms and definitions, just remember that knowledge is power.

You can serve your small business most effectively by becoming familiar with terms used in business finance and how they will affect your business's financial health. Armed with a basic understanding of business finance key terms, you will be prepared to face the financial challenges that go along with being a small business owner.