Basic Business Terms

Following is a list of basic terms you will need to become acquainted with:

Accounts Payable: These are your outstanding business obligations that are owed to others.

Accounts Payable Turnover: Cost of goods divided by accounts payable.

Accounts Receivable: Outstanding invoices or obligations owed to your business by others. They result from products or services that are sold on terms that allow delivery prior to the collection of cash. After the inventory is shipped, an invoice is sent to the customer and later cash is collected.

Accounts Receivable Turnover: Sales divided by accounts receivable.

Asset Turnover: Sales divided by total assets.

Assets: Resources owned by a company. Assets are shown at net book or net realizable value and generally do not reflect any appreciated value. Assets are broken down into three categories.

- Current Assets
- Fixed Assets
- Intangibles.

Current Assets include Cash, Accounts Receivable (A/R), Inventory, Notes Receivable (N/R), Prepaid Expenses, and Other Current Assets.

Fixed Assets include Land, Building, Machinery and Equipment, Furniture and Fixtures, and Leasehold Improvements.

Intangibles include Research and Development, Patents, Market Research, and Goodwill.

Balance Sheet: A list of company assets, liabilities, and owner's equity at a given point in time. The balance sheet is a snapshot of the company's financial standing at an instant in time. It is also known as the Statement of Financial Condition. The "bottom line" of the balance sheet must always balance in this way. Assets will always equal Liabilities + Owner's Equity. The balance sheet provides a summary of owner equity at any given point in time. It is value of the assets that belong to the owner. The income statement and balance sheet have a close relationship. Owner's equity on the beginning of the balance sheet, plus the profit (or loss) from the income sheet equals your equity for that period.

Business Expenses: Outflows of resources required to generate a revenue stream.

Budget: This is a forecast of all sources of cash and all expenditures in a given period. Typically a twelve-month period, recorded monthly.

Cash Flow Statement: Over a period of time, a picture of all cash inflows and outflows.

Current Ratio: Current assets divided by current liabilities.

Depreciation: The degraded value of fixed assets. This is not a cash expenditure. It is an ongoing expense of the business as assets like equipment wear down.

Financial Leverage: Total assets divided by owner's equity.

Fixed Costs: Overhead of the business and expenses that continue regardless of the amount of sales revenue. Among other things, it would include salaried labor costs, rent, utilities, insurance expenses, etc.

Gross Profit: This is the percentage of your business income that the company realizes *before* administrative expenses.

Income Statement: The matching of company sales with the expenses used to generate those sales. It is also known at the profit and loss statement. It shows all income over a period of time and how profitable a company is. Read from the top down, it summarizes the revenue and related expenses with the net result at the bottom. It does not reveal hidden problems such as insufficient cash flow.

Inventory Turnover: Cost of goods sold divided by inventory

Liabilities: Assets that are committed to creditors. Liabilities represent the obligations of a company to its creditors. Both creditors and owners are "investors" in the company at any given time. Liabilities are listed in order of maturity, with those that must be paid within a twelve-month period listed under Current Liabilities. After that are any Accrued Expenses. Then comes Notes Payable, with a short-term maturity of twelve months or less. After that is listed the Current Portion of Long-Term Debt. On the Balance Sheet, after the Current Liabilities, comes the Non-Current Liabilities. This includes the Non-Current Portion of Long-Term Debt (LTD), Officer Loans and Contingent Liabilities, which are potential liabilities from lawsuits, warranties, etc. The Total Liabilities represent the sum of all monetary obligations of a business and all claims on its assets.

Net Profit: The amount of income left after deducting all costs of doing business.

Net Worth: The total value of the business after deducting all liabilities from total assets.

Operating Efficiency: Net income divided by sales.

Owner's Equity: This represents the owner's investment in the business.

Payroll Taxes: As employers, businesses are required to withhold taxes from the paychecks of its employees and send them to the proper government agency. This includes Social Security, Medicare, Federal Unemployment Tax, State Unemployment Tax, State Income Tax, and Federal Income Tax. Other local taxes may also be withheld. Generally companies hire a payroll service to handle the details.

Pro Forma Statement: A statement of financial condition that details the predictions of company management. These statements are based on projected *future* performance, not on actual historical data.

Quick Ratio: Current assets minus inventory: this number divided by current liabilities.

Return on Assets: Net income divided by owner's equity.

Return on Owner's Equity: Net income divided by total assets.

Solvency: The company's ability to meet its cash obligations and needs.

In addition to the above terms, there are many more financial terms and ratios that you will eventually want to become familiar with.