Business Finance Glossary

A full break down of all the key financial terms you need to know to run a busines or work as a freelancer.

Business model:
This is a term used by investors and lenders. It is asking “who has your money in their pockets and how are you going to get it into your pocket”. In the excitement of creating a new product/service, this part is often overlooked. For more info on this, a fantastic read is “Getting to Plan B” by John Mullins. The main proposition is that your journey to success will include a revision (or more) to your initial business model!

Profit and loss report:
Also known as ‘Income Statement’. This is the name of the report that sets out income and expenses. It is prepared by matching income and related expenses in the same period.

Sales/Turnover/Revenue:
The measurable success of any business. Sales do not include VAT which is collected on behalf of the government, nor do they include sales of shares or loans. Grants are included in sales as they are not repayable and in a sense a business is having to do something for them. They would be recorded as “other sales”. Sales are recorded in the profit & loss when goods are dispatched and invoiced, not when the cash is received.

Cost:
A distinction between cost of goods sold and overheads (also known as indirect costs).

Cost of goods sold:
These are the “direct” costs of producing your good or service. If it creates your product or service, then it is part of cost of goods sold and is known as a direct cost. For example, for a skirt company, this is the cost of the skirt, plus any stickers, customisation, and the shopping bag.

Gross profit:
Means Sales less Cost of Goods Sold. It effectively represents the value that has been created. For example, you took the material, applied a customisation, which turned it into a higher value product. This is the numerical representation of your value proposition. The numbers start to help create the story. Does the business move up market/down market, opt for organic ingredients? How is the value split between the business and the customer?

Overheads:
These are the costs of running or administering the business. The key point to know is that they are by nature, fairly fixed. Think of them as housekeeping costs.

Operating profit:
This is Gross Profit less overheads. It is the profit before interest on any loans and before tax. This allows you to compare profits without the impact of interest (which varies with the amount borrowed and interest rates) and taxation. Operating profit

is also known as EBIT (earnings before interest and tax).

Advanced information:
You should be aware of EBITDA. It is EBIT + depreciation + amortisation. It is used as an approximation for cash flow on the basis that depreciation and amortisation are non-cash accounting entries. Amortisation is writing off intangible assets, such as 'goodwill'.

Gross profit margin:
It is not the absolute value of business numbers that is important, but rather the trend and relationships. Expressing numbers as a percentage (%), usually of sales, is useful to see trends and consumer patterns. When gross profit is divided by sales, it is known as the gross profit margin.

Break even:
This is a crucial number you need to have at all times. It is the point at which the business moves from loss to profit, i.e. the level of sales either in £ or units sold where all costs are covered. If you are selling T-shirts for £30, and the cost of goods sold is £10, then each T-shirt "makes" £20. If your fixed costs like the premises, marketing etc are £20,000, then to break even you need to sell 1,000 T-shirts (£20,000/£20 = £1000.)

Sensitivities:
The only certainty with sales forecasts is that actual will be different. To manage this uncertainty, prepare an upside and downside forecast, typically plus and minus 10 - 15%. It is essential to have these prepared before any meeting with funders. If you are able to produce these, it will prove that you are prepared for a variety of outcomes.

Accruals Accounting:
This is one of the biggest reasons entrepreneurs don't understand finance people. Viability is selling for more than your costs. To assess viability, you need to match income and costs in the same period. For example, if sales made in January aren't paid until March, it wouldn't be fair to wait until producing the March accounts to record the sale. This process of accounting for things when they happen, and matching income and expenses is called accruals accounting. Of course, sometimes activity and cash occur in the same period e.g. cash sales on a market, but this does not happen often.

Cash Flow:
This report sets out the monthly flows into and out of the business bank account. It needs to be regularly updated and forecasted at least 6 - 9 months into the future, to give enough time to raise finance. Money Folk hate last minute requests for finance. However, if it appears in the bank that is how it should appear on the cashflow.

Burn rate:

A jargon word used by investors. How much cash is being used up by the business each month?

Runway:
More jargon, meaning how long before the money runs out.

Working Capital:
Working capital is the amount of money tied up in customers owing you money and stock minus what is owed to suppliers. Lack of working capital explains why fast growing and profitable businesses can go bust.

Stock:
This is the value of raw materials and unsold goods at the end of an accounting period. The value is deducted from purchases to give a value for “cost of goods” actually sold in the period.

Debt Finance:
In simpler terms, this is loan finance. You don’t give away any ownership of the business, but you have to repay the loan with interest every month. Failure to do this will mean the bank “calling in the loan” and taking your business away with it. Frequently and invariably the bank will require security.

Equity Finance:
This is when an investor puts money into a business in exchange for a share of the ownership. No interest is paid, and no monthly repayments are made. They make their money by selling the shares. For smaller businesses, this money is frequently provided by wealthy entrepreneurs, also known as “business angels”.

Debtors:
Money owed by customers.

Creditors:
Money owed to suppliers.