

# Glossary of Business Finance Terminology

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This glossary provides an alphabetical list of commonly used business finance terms, giving a brief explanation of each term.

**Accounting code:** Numbers or letters assigned to budget or cost centres within an organisation to help the allocation of income, expenditure and balance sheet headings.

**Accounting period:** The regular period (normally a year) for which a business accounts for its income, expenditure, assets and liabilities.

**Accounts:** The financial records of a business. These include an analysis of the profit and loss account and the balance sheet.

**Accounts payable:** Money that a business owes to suppliers for products and services bought on credit.

**Accruals:** A term used in accounts to describe income due or costs incurred during an accounting period, but which are not received or paid during that period.

**Added value:** The value of improvement made to goods or services at any particular stage in their production.

**Administration:** The process for a company in severe financial difficulty to apply to the court for protection from its creditors. The court appoints an administrator to take over the management of the company while a restructuring plan is implemented.

**Alternative finance:** Ways of raising finance outside the traditional channels of banking, venture capital, private equity or stock market listings. The main alternative finance sources for small businesses are crowdfunding and peer-to-peer lending.

**Amortisation:** An annual charge made in a business' profit and loss account to reduce the value of an intangible asset in the business balance sheet.

**Annual percentage rate (APR):** Where interest on loans is expressed as something other than a yearly rate (1.5% per month, for example), the APR is the equivalent rate over a year.

**Appropriation account:** The part of the profit and loss account that shows how the profit has been divided (or appropriated) into dividends and reserves.

**Asset finance:** The finance methods used to obtain new equipment or machinery. The main types of asset finance are hire purchase and leasing.

**Assets:** A business's goods, resources and property that have a monetary value.

**Audit:** An examination and verification of a business's financial and accounting records and supporting documents by a registered auditor.

**Authorised capital:** The maximum share capital a company is allowed to issue under its memorandum of association.

**Average collection period:** The average number of days it takes for a business to collect revenue from its credit sales.

**Bad debts:** Debts owed to a business that are unlikely to be repaid and should be written off.

**Balance sheet:** A statement providing a snapshot of everything a business owes and owns at a particular moment in time.

**Bankruptcy:** A legal procedure that arranges for creditors to be paid, in full or in part, when an individual has debts that exceed their assets.

**Base rate:** The rate of interest, set by the Bank of England, on which financial institutions base their lending and savings rates.

**Book-keeping:** Recording a business's financial transactions in its accounting records and keeping those accounts in order, either for internal management purposes or an external inspection.

**Book value:** Value of an asset as shown in the accounting records. Book value usually means original value less accumulated depreciation, though in the case of premises it may mean the latest valuation.

**Books:** A business's financial records: for example, its cash book, sales ledger, purchase ledger and payroll.

**Break-even point:** Point at which income from sales exactly equals the total costs for the business.

**Budget:** A plan for the allocation and use of resources, usually an itemised list of expected income and expenditure for a given future period.

**Capital:** Money brought into a business by way of share capital and loan capital, as well as retained earnings generated by the business.

**Capital employed:** The net worth of a business. Usually defined as capital introduced plus retained profit plus long-term loans.

**Capital gains tax:** A tax payable by individuals (including sole traders and partners in a partnership) based on the chargeable gains made from selling assets.

**Cash:** Money in hand or in a bank account.

**Cash book:** A record of all cash receipts and payments.

**Cash flow:** The money coming into and going out of a business in a given period. Cash flow is positive if more comes in than goes out, or negative if more goes out than comes in.

**Cash flow forecast:** A projection of what a business expects its cash income and cash payments to be over a given period of time in the future.

**Collateral:** An asset pledged as a guarantee to a lender until a loan is repaid. If the borrower defaults on their loan payments, the lender has a right to sell the collateral asset to recover the loan.

**Company voluntary arrangement:** A legally binding agreement between a company and its creditors, which allows the company to repay part of the debt that it owes each creditor, according to an agreed payment schedule, while it continues to trade.

**Consolidated accounts:** The accounts of a parent company or holding company. These combine the accounts of all companies in the group.

**Consumer credit:** Provision of credit to retail customers. An example is hire purchase or deferred payment.

**Contingent liability:** Possible future liabilities of a business that depend on the outcome of a forthcoming event, such as a court case, which may or may not happen.

**Contribution:** The difference between the price charged for a product and the direct costs involved in making it. This 'contributes' to covering the fixed costs or overheads and, once all the fixed costs are covered, contributes to the net profit.

**Corporation tax:** The tax on a company's trading profits, charged as a percentage of the taxable profits made during its accounting period.

**Credit:** In banking terms, credit is either a receipt that is paid into a bank account or a facility that allows a business to borrow money. In book-keeping terms, a credit is an accounting entry, and either increases the business' liabilities or reduces its assets.

**Credit limit:** A limit on borrowing from a bank, or a limit that a business imposes on how much its customers can purchase on account.

**Credit note:** A note issued to a person or business when goods are returned by them, which cancels or modifies the original invoice.

**Credit period:** The time allowed between the provision of goods or services and when they have to be paid for.

**Creditors:** People or businesses who are owed money. Suppliers who are owed money are described as 'trade creditors' to differentiate them from other creditors, such as banks.

**Creditors' turnover ratio:** A measure of how quickly a business pays its creditors. For suppliers this is calculated as total purchases divided by the average value owed to trade creditors (both excluding VAT)

in the year. Dividing 365 by the result gives the number of days that it takes for the business to pay its creditors, or the average payment period.

**Crowdfunding:** Funding a project or venture from a large number of individuals and organisation, typically online via specialist crowdfunding platforms.

**Current assets:** Assets in a cash or near-cash state, such as stock and money owed by debtors.

**Current liabilities:** Debts owed by a business that have to be paid back in less than 12 months.

**Current ratio:** A financial ratio that measures the ratio of current assets to current liabilities and indicates whether a business has sufficient working capital to operate. Also known as the 'working capital ratio'.

**Debenture loan:** A type of long-term loan, taken out by a company or limited liability partnership, which is registered at Companies House and gives the lender security over the borrower's assets.

**Debit:** In banking terms, debit is a payment made from a bank account. In book-keeping terms, a debit is an accounting entry that results in an increase in a business' assets or a drop in its liabilities.

**Debt:** Money that is owed to a person or business.

**Debtors:** Businesses or individuals who owe a business money, usually due to the purchase of goods or services.

**Debtors' turnover ratio:** A measure of how quickly debtors pay their debts. This is calculated as total sales divided by the average value of debtors (both excluding VAT) in the year. Dividing 365 by the result gives the number of days that it takes for a debtor to pay the business, or the average collection period.

**Depreciation:** The charge in a business's accounts that reflects the reduction in value of a tangible asset over time as its useable life is exhausted (see also 'Amortisation').

**Direct costs:** Sometimes known as cost of sales, these are the costs that can be directly attributed to the production of a particular product or service (for example, raw materials and direct labour).

**Disbursement:** Money paid out for incidental expenses.

**Discount:** A deduction from the recommended price of an item, or a bonus for prompt payment.

**Discounted cash flow:** A way of valuing a project to estimate its investment potential, taking account of the fact that money now is worth more than money in the future. Discounted cash flow is used to compare two projects that will generate income at different times.

**Dividend:** Payment made from net profits to the shareholders of a company.

**Double entry:** The standard method of book-keeping where every transaction is entered as a debit to one account and a credit to another account. The totals of debits and credits are always equal.

**Drawings:** Money that self-employed people take from their business to cover their monthly living costs. Drawings are regarded as an advance against the profits of a business, not as a business expense.

**Equity:** The capital that shareholders own in a company, equal to its assets less its liabilities.

**Expenses:** General term that can mean all the costs of a business, but is normally used to signify overhead expenses (as opposed to direct costs).

**Factoring:** A way for a business to fund cash flow by selling its invoices to a third party (a factor).

**Financial year:** The 12-month period that a business chooses for its accounting year.

**Finished goods:** Stocks of goods that are ready for sale.

**Fixed assets:** Assets with a life of longer than one year (such as buildings and machinery).

**Fixed charge:** A form of security taken by a lender over a specified asset, which cannot then be sold without the charge being released.

**Fixed costs:** Costs that are fixed for a business for a reasonable length of time, and not dependent on the number of units produced (such as rent, rates and salaries).

**Fixed rate:** A loan on which the interest rate does not change during its entire term.

**Floating charge:** A form of security taken by a lender (typically a bank) over all the assets of the business.

**Flotation:** The issue of shares by a company to the public on the stock market.

**Gearing:** A measure of debt as a proportion of total finance. It is usually expressed as the ratio of debt to capital employed.

**Goodwill:** The value of a business to a purchaser over and above its net asset value. It reflects the value of intangible assets like reputation, brand name, good customer relations, high employee morale and other factors that improve the firm's performance.

**Gross profit:** The difference between turnover and the direct costs of making a product or providing a service, before taking into account overheads, indirect salaries and interest payments.

**Gross profit margin:** Gross profit divided by sales, usually expressed as a percentage.

**Guarantor:** A person who commits to guarantee the debts of another. If, for example, an individual fails to meet their obligations on hire-purchase repayments, the guarantor will be obliged to make those repayments.

**Hire purchase:** An agreement to hire goods for a period of time, with the option of purchasing them at the end of the agreement for a small amount.

**Indirect costs:** Business costs that cannot be attributed directly to the production of a particular product or service (such as rent, salaries or bank charges).

**Input tax:** The VAT that a business pays on supplies (inputs) required for it to produce goods or services.

**Insolvency:** The situation in which a person or business is unable to meet debts when they fall due.

**Intangible assets:** Assets that are non-physical in form. Examples include patents, goodwill, trade marks and copyright.

**Interest:** The amount charged by a lender on borrowed money, usually expressed as an annual percentage.

**Interest cover:** Measure of the ease with which a business can meet its interest payments out of profit. It is calculated as profit before interest and tax (PBIT) divided by interest paid.

**Inventory:** Stock items or a list detailing them. In accounting, inventory is the sum of raw materials, components, work in progress and finished goods still not sold.

**Investment:** Putting money into, for example, assets, a project or a business, in the expectation of receiving income or a larger repayment in return.

**Investment appraisal:** Evaluation of any investments or potential investments to be made, usually in profit terms.

**Invoice:** A bill issued for products or services provided to a customer.

**Invoice discounting:** A commercial arrangement in which a third party (the discounter) pays an advance on the value of an invoice that is not yet due for payment. The discounter charges interest and fees for this service.

**Lease:** A contract in which the legal owner of an asset agrees to allow another person to use that asset in return for a regular specified payment (a lease charge, or rent) over a set term.

**Lease purchase:** A variation on leasing. At the end of the lease period the goods become the lessee's property.

**Leverage:** The ratio of total finance to equity.

**Liabilities:** Combined debts owed by a business, whether short-term or long-term.

**Liquid assets:** Cash or items such as debtors and finished stock that can readily be converted into cash.

**Liquidation:** Formal closure of a company. Any assets are sold and used to pay off some or all of the company's debts.

**Liquidity:** Measure of the working capital or cash available to a business to enable it to meet its liabilities as they fall due. Liquidity ratios include the current ratio and the quick ratio.

**Long-term liabilities:** Any bank loans, debentures and hire-purchase payments due more than 12 months after the balance sheet date.

**Loss:** The amount by which expenditure exceeds income in a given period.

**Management accounts:** Detailed financial accounts normally prepared monthly for internal use by a business.

**Margin of safety:** How far above break-even point a business is operating.

**Marginal cost:** The increase in total cost in producing one extra unit. Marginal costing compares the marginal revenue (the extra income) of selling the extra unit with the marginal cost.

**Markup:** The profit margin on goods or services, expressed as a percentage of the product's cost.

**Maturity:** The date on which a debt becomes due for payment.

**Negative cash flow:** Where more money is going out of a business than is coming in.

**Net current assets:** Current assets minus current liabilities.

**Net present value:** The value of a business's future trading, expressed in today's money.

**Net profit:** The gross profit of a business minus all expenses. In business accounts, the word 'net' is often dropped, with profit referred to as 'Profit before tax' or 'Profit after tax'.

**Net profit margin:** Measures trading profit relative to sales revenue. It is calculated as net profit divided by sales and expressed as a percentage.

**Net worth:** Total assets less total liabilities.

**Operating profit:** Actual profit made by a business after the deduction of all expenses.

**Output tax:** The amount of VAT a business adds to the price of its product or service.

**Overdraft:** A flexible form of bank lending on a current account, allowing the customer to overdraw money to a certain limit, often used as a short-term business finance facility although it can be cancelled by the bank at any time.

**Overheads:** All operating costs that are not directly linked to a product and which, generally speaking, are fixed costs (such as rent, utilities and insurance).

**Overtrading:** When a business is selling more products or services than its working capital facilities can cope with.

**Payroll:** The financial record of employees' salaries, wages, bonuses, net pay and deductions.

**Peer-to-peer lending:** Borrowing money through an online service that matches lenders with borrowers.

**Personal expenses:** Expenses incurred by an individual while on business, and normally reclaimable as business expenses.

**Petty cash:** A small amount of cash kept on hand by a business for incidental expenses.

**Positive cash flow:** Where more money is coming into a business than is going out of it.

**Profit:** Level by which income exceeds expenditure in a given period.

**Profit and loss account:** An account showing a company's income and expenses, usually prepared annually or monthly, which depicts its trading performance.

**Profit margin:** Ratio of profit to sales; calculated using either gross profit (gross profit margin) or profit before interest and tax (net profit margin). Often expressed as a percentage, it shows how profitable a business is.

**Purchase ledger:** Used to record all suppliers' invoices and payments to suppliers, and to show which invoices remain unpaid.

**Qualified accounts:** Audited company accounts where the auditor has expressed doubts or disagreement over the information shown in the accounts.

**Quick ratio:** A financial ratio that measures a firm's liquidity, or how readily it can pay off its debts. Also called the 'acid test ratio'.

**Ratio analysis:** A tool for assessing the financial performance of a business by calculating ratios from its accounts. These ratios can help to give a more in-depth picture of how the business is managing its resources. There are four main types of ratio: liquidity, solvency, efficiency and profitability.

**Reducing balance depreciation:** Where depreciation on a fixed asset is calculated by applying the depreciation rate to the net book value.

**Reserves:** The retained profits of a business that form part of its capital.

**Return on investment (ROI):** Amount of money generated by a capital investment in a given period of time expressed as a percentage of the total amount invested.

**Revenue:** Income generated by a business for a specific period.

**Salary:** The gross amount of money paid to an employee in return for their labour. It is usually paid monthly (unlike wages, which are usually paid weekly) and expressed as an annual sum.

**Sales ledger:** Record of every invoice issued, the amount of cash received and the amount owed to a business by its customers.

**Security:** An asset that is offered by a borrower to a lender to safeguard a loan.

**Shareholders:** Owners of a company's shares or stocks.

**Shares:** The ownership of a company is divided into shares, each representing a part of the equity capital invested in the business.

**Soft loan:** Loan made at an interest rate below the market rate or with lenient repayment terms.

**Solvency:** Measure of a business's ability to pay its bills as they fall due. If the business cannot pay, then it is insolvent.

**Staged payments:** Payment by instalments. This may be a normal condition in a contract or arranged as a way of improving cash flow where a customer cannot pay the full amount due in one payment.

**Stock:** An asset of a firm held for sale in the ordinary course of business. Raw materials, components and consumables may also be held in stock.

**Stock exchange:** A financial centre where shares in public companies are traded.

**Straight line depreciation:** Method of accounting for the depreciation of a fixed asset across its estimated useful life in equal, normally annual, instalments.

**Tangible assets:** Assets owned by a business that have a physical existence, for example stock and machinery.

**Taxable supplies:** Goods and services supplied to a customer that are liable for VAT (even if zero rated).

**Taxable turnover:** The total value of taxable sales for VAT purposes.

**Trade credit:** Allowing the customer to buy goods or services up to a certain value (the credit limit) and then pay for the items in accordance with the agreed credit terms.

**Trial balance:** In double entry book-keeping, a statement of all debits and credits in an accounting period. The totals of all debit and credit items should be the same.

**Turnover:** Total sales income. Net turnover is calculated by total sales income less returns. VAT is not included in turnover figures.

**Unsecured loan:** A loan under which the lender has no entitlement to any of the borrower's assets in the event of the borrower failing to make the loan repayments.

**Value Added Tax (VAT):** A tax on consumer expenditure, collected on business transactions. The VAT that businesses pay to HMRC is equal to their output tax minus their input tax.

**Variable costs:** Costs that change depending on the quantity of goods or services that a business produces. They rise as production increases and fall as production decreases. Examples of variable costs include raw materials, sales commissions and packaging.

**VAT registration:** A business whose annual turnover exceeds a certain threshold (currently £85,000) must register with HMRC to become a VAT vendor. Businesses with a lower turnover than the threshold can still register voluntarily.

**Venture capital:** Funding that may be made available to early-stage companies with good growth prospects that are unable to get funds from standard lenders such as banks. Venture capitalists supply capital to companies in return for an equity stake in the company.

**Wages:** Regular money payments to an employee in return for their labour. They are usually paid weekly and based on an hourly wage rate.

**Winding up:** Voluntary or compulsory liquidation of a company.

**Work in progress:** Raw materials, components and products that are within the production process but are not yet finished goods.

**Working capital:** The difference between current assets and current liabilities. This capital is used to run the business.

**Write off:** To reduce the value of an asset in the books to zero (for example, to record a debt as a bad debt).

**Written down value:** The value of an asset after deducting cumulative depreciation. Also called the net book value.

**Zero-based forecasting:** Forecasting that starts from a zero base rather than from the previous year's actual performance figures.

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