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**Business Terms & Definitions**

**Accounts Payable (AP)** – Bills to be paid as part of the normal course of business. This is a standard accounting term, one of the most common liabilities, which normally appears in the Balance Sheet listing of liabilities. Businesses receive goods or services from a vendor, receive an invoice, and until that invoice is paid the amount are recorded as part of “Accounts Payable.”

**Accounts Receivable (AR)** – Debts owed to your company, usually from sales on credit. Accounts receivable is business asset, the sum of the money owed to you by customers who haven’t paid. The standard procedure in business-to-business sales is that when goods or services are delivered the come with an invoice, which is to be paid later. Business customers expect to be invoiced and to pay later. The money involved goes onto the seller’s books as accounts receivable, and onto the buyer’s books as accounts payable.

**Assets** – Property that a business owns, including cash and receivables, inventory, etc. Assets are any possessions that have value in an exchange. The more formal definition is the entire property of a person, association, corporation, or estate applicable or subject to the payment of debts. What most people understand as business assets are cash and investments, accounts receivable, inventory, office equipment, plant and equipment, etc. Assets can be long-term or short-term, and the distinction between these two categories might be whether they last three years, five years, 10 years, or whatever; normally the accountants decide for each company and what’s important is consistency. The government also has a say in defining assets, because it has to do with tax treatment; when you buy a piece of equipment, if you call that purchase an expense then you can deduct it from taxable income. If you call it an asset you can’t deduct it, but you can list it on your financial statement among the assets. The tax code controls how businesses decide to categorize spending into assets or expenses

**Benchmark** – A benchmark is a standard or guideline used to compare some aspect of a business to some objective or external standard measure. For example, when a banker compares a business’ profitability to standard financial ratios for that type of business, the process is sometimes referred to as “benchmarking.”

**[Break-even analysis](http://articles.bplans.com/writing-a-business-plan/break-even-analysis/131%22%20%5Co%20%22break-even%20analysis)** – A technique commonly used to assess expected profitability of a company or a single product. The process determines at what point revenues equal expenditures based on fixed and variable. Breakeven is usually expressed in terms of the number of units sold or in total revenue. The break-even analysis is a standard financial analysis that measures general risk for a company by showing the sales level needed to cover both fixed and variable costs. That level of sales is called the break-even point, which can be stated as either unit sales volume or sales as dollar (or other currency) sales. The break-even analysis uses three assumptions to determine a break-even point: fixed costs, variable costs, and unit price. Fixed costs and variable costs are both included in this glossary, and unit price is the average revenue per unit of sales. The formula for break-even point in sales amount is: =fixed costs/(1-(Unit Variable Cost/Unit Price)) The break-even analysis is often confused with payback period, because many people interpret breaking even as paying back the initial investment. However, this is not what the break-even analysis actually does. Despite the common and more general use of the term “break even,” the financial analysis has an exact definition as explained above. One important disadvantage of the break-even analysis is that it requires estimating a single per-unit variable cost, and a single per-unit price or revenue, for the entire business. That is a hard concept to estimate in a normal business that has a collection of products or services to sell. Another problem that comes up with break-even is its preference for talking about sales and variable cost of sales in units. Many businesses, especially service businesses, don’t think of sales in unit, but rather as sales in money. In those cases, the break-even analysis should think of the dollar as the unit, and state variable costs per unit as variable costs per dollar of sales.

**Break-even point** – The output of the standard break-even analysis. The unit sales volumes or actual sales amounts that a company needs to equal its running expense rate and not lose or make money in a given month. This should not be confused with the recovering initial investment through the regular operation of a business. That concept, often confused with break-even, is called the payback period. See break-even analysis for more background.

**Business plan** – The written document that details a proposed or existing venture. It seeks to capture the vision, current status, expected needs, defined markets, and projected results of the business. A business plan “tells the entrepreneur’s story” by describing the purpose, basis, reason and future of the venture.

**Buy-sell agreement** – An agreement designed to address situations in which one or more of the entrepreneurs wants to sell their interest in the venture.

**C Corporation (C Corp)** – Corporations are either the standard C corporation or the small business S corporation. The C Corporation is the classic legal entity of the vast majority of successful companies in the United States. Most lawyers would agree that the C Corporation is the structure that provides the best shielding from personal liability for owners, and provides the best non-tax benefits to owners. This is a separate legal entity, different from its owners, which pays its own taxes. Most lawyers would also probably agree that for a company that has ambitions of raising major investment capital and eventually going public; the C Corporation is the standard form of legal entity. The S corporation is used for family companies and smaller ownership groups. The clearest distinction from C is that the S corporation’s profits or losses go straight through to the S corporation’s owners, without being taxed separately first. In practical terms, this means that the owners of the corporation can take their profits home without first paying the corporation’s separate tax on profits, so those profits are taxed once for the S owner, and twice for the C owner. In practical terms the C Corporation doesn’t send its profits home to its owners as much as the S corporation does, because it usually has different goals and objectives. It often wants to grow and go public, or it already is public. In most states an S corporation is owned by a limited number (25 is a common maximum) of private owners, and corporations can’t hold stock in S corporations, just individuals. Corporations can switch from C to S and back again, but not often. The IRS has strict rules for when and how those switches are made. You’ll almost always want to have your CPA and in some cases your attorney guides you through the legal requirements for switching.

**Cash** – Cash normally means bills and coins, as in paying in cash. However, the term is used in a business plan to represent the bank balance, or checking account balance plus other liquid securities used to bolster the checking account.

**Cash basis** – An accounting system that doesn’t use the standard accrual accounting. It records only cash receipts and cash spending, without assuming sales on credit (Sales made on account; shipments against invoices to be paid later) or Accounts payable (Bills to be paid as part of the normal course of business).

**Cash flow** – The cash flow in a business plan is the change in the cash balance. For example, the cash flow for a month would be a positive $10,000 if the balance was $10,000 at the beginning of the month and $20,000 at the end of the month. It is important to distinguish cash flow, which is the change in the balance, from cash or cash balance, which is the resulting ending balance. More formally, cash flow is an assessment and understanding of cash coming into and flowing out of the venture in specific periods of time. This can be based on projections or actual cash flow.

**Cash flow statement** – One of the three main financial statements (along with Income Statement and Balance Sheet), the Cash Flow shows actual cash inflows and outflows of the business over a specified period of time. The Cash Flow Statement reconciles the Income Statement (Profit and Loss) with the Balance Sheet.

**Cost of Goods Sold (COGS)** – The cost of goods sold is traditionally the costs of materials and production of the goods a business sells. For a manufacturing company this is materials, labor, and factory overhead. For a retail shop it would be what it pays to buy the goods that it sells to its customers. For service businesses, that don’t sell goods, the same concept is normally called “cost of sales,” which shouldn’t be confused with “sales and marketing expenses.” The cost of sales in this case is directly analogous to cost of goods sold. For a consulting company, for example, the cost of sales would be the compensation paid to the consultants plus costs of research, photocopying, and production of reports and presentations. In standard accounting, costs of sales or costs of goods sold are subtracted from sales to calculate gross margin. These costs are distinguished from operating expenses, because gross profit is gross margin less operating expenses. Costs are not expenses.

**Doing Business As (DBA)** – DBA stands for “Doing Business As,” which is a company name, also commonly called a “Fictitious business name.” When a sole proprietor operates a company using any name except his or her own given name, then the DBA or fictitious business name registration establishes the legal ownership to satisfy banks, local authorities, and customers. So when you start the Acme Restaurant, unless you are named Acme, you need your DBA to open a bank account in that name, pay employees, and do business.

**Depreciation** – An accounting and tax concept used to estimate the loss of value of assets over time. For example, cars depreciate with use.

**Entrepreneur** – Someone who starts a new business venture; someone who recognizes and pursues opportunities others may not see as clearly, and finds the resources necessary to accomplish his or her goals.

**Expense** – Webster’s calls it “a spending or consuming; disbursement, expenditure”. What’s important about expenses for the purpose of business accounting is that expenses are deductible against taxable income. Common expenses are rent, salaries, advertising, travel, etc. Questions arise because some businesses have trouble distinguishing between expenses and purchase of assets, especially with development expenses. When your business purchases office equipment, if you call that an expense then you can deduct that amount from taxable income, so it reduces taxes.

**Fixed cost** – Running costs that take time to wind down: usually rent, overhead, some salaries. Technically, fixed costs are those that the business would continue to pay even if it went bankrupt. In practice, fixed costs are usually considered the running costs. These are static expenses that do not fluctuate with output volume and become progressively smaller per unit of output as volume increases. Fixed costs are an important assumption for developing a [break-even analysis](http://articles.bplans.com/writing-a-business-plan/break-even-analysis/131). The standard break-even formula estimates a break-even point of sales based on per-unit price or revenue, per-unit variable costs, and fixed costs.

**Goodwill** – When a company purchases another company for more than the value of its assets — which is quite common — the difference is recorded as an asset named “Goodwill.” This is not a general term for the value of a brand, for example, but a very specific accounting term. For example, if one business buys another business for $1 million then it needs to show the $1 million spent as an asset. If there are only $500 thousand in real assets, the accounting result should be $500,000 in real assets purchased and another $500,000 in “Goodwill.”

**Gross margin** – The difference between total sales revenue and total cost of goods sold (also called total cost of sales). This can also be expressed on a per unit basis, as the difference between unit selling price and unit cost of goods sold. Gross margin can be expressed in dollar or percentage terms.

**Income statement** – Also called Profit and Loss statement. An income statement is a financial statement that shows sales, cost of sales, gross margin, operating expenses, and profits or losses. Gross margin is sales less cost of sales, and profit (or loss) is gross margin less operating expenses and taxes. The result is profit if it’s positive, loss if it’s negative.

**Interest expense** – Interest is paid on debts, and interest expense is deducted from profits as expenses. Interest expense is either long-term or short-term interest.

**Inventory** – Goods in stock, either finished goods or materials to be used to manufacture goods

**Inventory turnover** – Total cost of sales divided by inventory. Usually calculated using the average inventory over an accounting period, not an ending-inventory value.

**Inventory turns – Inventory turnover (above).** Total cost of sales divided by inventory. Usually calculated using the average inventory over an accounting period, not an ending-inventory value.

**Labor** – The labor costs associated with making goods to be sold. This labor is part of the cost of sales, part of the manufacturing and assembly. The row heading refers to fulfillment costs as well, for service companies.

**Liabilities** – Debts; money that must be paid. Usually debt on terms of less than five years is called short-term liabilities and debt for longer than five years in long-term liabilities.

**Limited Liability Company (LLC)** – The LLC form is different for different states, with some real advantages in some states that aren’t relevant in others. An LLC is usually a lot like an S corporation, a combination of some limitation on legal liability and some favorable tax treatment for profits and transfer of assets. This is a newer form of legal entity. Why would you establish an LLC instead of a corporation? That’s a tough legal question, not one we can answer here. In general, the LLC has to be missing two of the four characteristics of a corporation (limited liability, centralized management, continuity of life, and free transferability of ownership interest). Still, with the advisability and advantages varying from state to state, here again, this is a question to take to a good local attorney with small business experience.

**Long-term assets** – Assets like plant and equipment that are depreciated over terms of more than five years, and are likely to last that long, too.

**Loss** – Loss is an accounting concept, the exact opposite of profit, normally the bottom line of the Income Statement, which is also called Profit or Loss statement. Start with sales, subtract all costs of sales and all expenses, and that produces profit before tax. Subtract tax to get net profit. If the end result is negative, then instead of profit it is called loss.

**Market share** – Total sales of an organization divided by the sales of the market they serve.

**Marketing** – The set of planned activities designed to positively influence the perceptions and purchase choices of individuals and organizations.

**[Marketing plan](http://www.mplans.com/sample_marketing_plans.php%22%20%5Co%20%22marketing%20plan)** – A written document containing description and guidelines for an organization’s or a product’s marketing strategies, tactics and programs for offering their products and services over the defined planning period, often one year.

**[Mission statement](http://articles.bplans.com/writing-a-business-plan/writing-a-mission-statement%22%20%5Co%20%22mission%20statement)** – A statement that captures an organization’s purpose, customer orientation and business philosophy.

**Net** [**cash flow**](http://www.bplans.com/business_calculators/cash_flow_calculator) – This is the projected change in cash position, an increase or decrease in cash balance.

**Net profit** – The operating income less taxes and interest. The same as earnings, or net income.

**Net worth** – This is the same as assets minus liabilities, and the same as total equity. Other short-term assets these might be securities, business equipment, etc.

**Operating expenses** – Expenses incurred in conducting normal business operations. Operating expenses may include wages, salaries, administrative and research and development costs, but excludes interest, depreciation, and taxes.

**Partnership** – Partnerships are harder to describe because they change so much. They are governed by state laws, but a Uniform Partnership Act that has become the law in most states. That act, however, mostly sets the specific partnership agreement as the real legal core of the partnership, so the legal details can vary widely. Usually the income or loss from partnerships passes through to the partners, without any partnership tax. The agreements can define different levels of risk, which is why you’ll read about some partnerships that have general partners and limited partners, with different levels of risk for each. The agreement should also define what happens if a partner withdraws, buy and sell arrangements for partners, and liquidation arrangements if that becomes necessary. If you think a partnership might work for your business, make sure you do this right. Find an attorney with experience in partnerships, and check for references of present and past clients. This is a complicated area and a mistake in the agreement will cause a lot of problems.

**Payables** – Short for Account Payables; Bills to be paid as part of the normal course of business. This is a standard accounting term, one of the most common liabilities, which normally appears in the Balance Sheet listing of liabilities. Businesses receive goods or services from a supplier, receive an invoice, and until that invoice is paid the amount is recorded as part of “Accounts Payable.”

**Payroll** – Wages, salaries, employee compensation

**Pro forma income statement** – A projected Income Statement. Pro forma in this context means projected. An income statement is the same as a profit and loss statement, a financial statement that shows sales, cost of sales, gross margin, operating expenses, and profits.

**Pro forma statements** – Financial statements that project the results of future business operations. Examples include a pro forma balance sheet, a pro forma income statement, and a pro forma [cash flow](http://www.bplans.com/business_calculators/cash_flow_calculator) statement.

**Profit** – Profit is an accounting concept, normally the bottom line of the Income Statement, which is also called Profit or Loss statement. Start with sales, subtract all costs of sales and all expenses, and that produces profit before tax. Subtract tax to get net profit.

**Profit or loss** – Also called Profit and Loss statement. An income statement is a financial statement that shows sales, cost of sales, gross margin, operating expenses, and profits or losses. Gross margin is sales less cost of sales, and profit (or loss) is gross margin less operating expenses and taxes. The result is profit if it’s positive, loss if it’s negative.

**Receivables** – Short for Account Receivables; Debts owed to your company, usually from sales on credit. Accounts receivable is a business asset, the sum of the money owed to you by customers who haven’t paid. The standard procedure in business-to-business sales is that when goods or services are delivered they come with an invoice, which is to be paid later. Business customers expect to be invoiced and to pay later. The money involved goes onto the seller’s books as accounts receivable, and onto the buyer’s books as accounts payable.

**Retained earnings** – Earnings (or losses) that have been reinvested into the company not paid out as dividends to the owners. When retained earnings are negative, the company has accumulated losses.

**S Corporation (S Corp)** – Corporations are either the standard C corporation or the small business S corporation. The C Corporation is the classic legal entity of the vast majority of successful companies in the United States. Most lawyers would agree that the C Corporation is the structure that provides the best shielding from personal liability for owners, and provides the best non-tax benefits to owners. This is a separate legal entity, different from its owners, which pays its own taxes. Most lawyers would also probably agree that for a company that has ambitions of raising major investment capital and eventually going public; the C Corporation is the standard form of legal entity. The S corporation is used for family companies and smaller ownership groups. The clearest distinction from C is that the S corporation’s profits or losses go straight through to the S corporation’s owners, without being taxed separately first. In practical terms, this means that the owners of the corporation can take their profits home without first paying the corporation’s separate tax on profits, so those profits are taxed once for the S owner, and twice for the C owner. In practical terms the C Corporation doesn’t send its profits home to its owners as much as the S corporation does, because it usually has different goals and objectives. It often wants to grow and go public, or it already is public. In most states an S corporation is owned by a limited number (25 is a common maximum) of private owners, and corporations can’t hold stock in S corporations, just individuals. Corporations can switch from C to S and back again, but not often. The IRS has strict rules for when and how those switches are made. You’ll almost always want to have your CPA and in some cases your attorney guides you through the legal requirements for switching.

**Short-term assets** – Cash, securities, bank accounts, accounts receivable, inventory, business equipment, assets that last less than five years or are depreciated over terms of less than five years. Also called Current Assets.

**Sole proprietorship** – The simplest form is the sole proprietorship. Simply put, your business is a sole proprietorship if you don’t create a separate legal entity for it. This is true whether you operate it in your own name, or under a trade name. If it isn’t your own name, then you register a company name as a “Fictitious business name,” also called a DBA (“Doing Business As”).

**SWOT analysis** – A formal framework of identifying and framing organizational growth opportunities. SWOT is an acronym for an organization’s internal Strengths and Weaknesses and external Opportunities and Threats.

**Target market** – The target market is a defined segment of the market that is the strategic focus of a business or a [marketing plan](http://www.mplans.com/sample_marketing_plans.php). Normally the members of this segment possess common characteristics and a relative high propensity to purchase a particular product or service. Because of this, the member of this segment represents the greatest potential for sales volume and frequency. The target market is often defined in terms of geographic, demographic, and psychographic characteristics.

**Venture capitalists (VC)** – Venture capitalists are thought of in two ways, first, some people think of any wealthy individual who invests in young companies as a venture capitalist. Second, within the more informed investors, analysts, and entrepreneurs, a venture capitalist is a manager of a mainstream venture capital fund.

**Venture capital** – Venture capital nowadays is used two ways, first, people often take venture capital as any investment capital obtained through private investment or public investment funds directed to high-risk and high-potential enterprises. Second, within the more informed and sophisticated business circles, venture capital is defined more narrowly as investment money coming from the mainstream venture capital firms, a few hundred major firms, different from investment money from other private investors, angels, etc. For example, the www.bplans.com web tool that recommends investment strategies treats venture capital in this second way, mainstream venture capital investors, as opposed to angel investors, SBIC companies, banks, or friends and family. A venture capitalist is a professional manager of a venture capital fund.

**Working capital** – The accessible resources needed to support the day-to-day operations of an organization. Working Capital is commonly in the form of cash and current (short-term) assets, including Accounts Receivable, prepaid expenses, Accounts Payable for goods and services, and current unpaid income taxes.

