London Business Angels
A GLE business

Glossary of Terms

Administration:
A procedure defined by the Insolvency Act 1986, providing a possible alternative to the liquidation or receivership of a company. Once an administration order is gained by a court, the claims of all creditors are frozen, giving the company protection against its creditors. The administrator then runs the company.

Administrative receivership:
The term for receivership in the UK. If a company is no longer financially viable, an administrative receiver may be appointed to run the company, probably with a view to selling it as a going concern. The company is then said to be in administrative receivership or, more commonly, in receivership.

AIM:
Alternative Investment Market. A stock market regulated by the London Stock Exchange and intended for smaller companies. AIM has grown rapidly since it was founded in Autumn 1995 and at April 2003 there were 705 companies quoted on AIM, capitalised at more than £10bn.

APR:
Annual Percentage Rate. The rate of interest, calculated by a set formula, to give a "true" rate of interest on a loan. All companies offering loans to the public are obliged to quote the APR on the loans or credit they are offering.

Asset backed:
An investment which is covered by assets, perhaps land or buildings, is said to be asset backed. If the business fails, the losses to the investor will be less, since the assets will be sold and the proceeds distributed to creditors, lenders and investors, so reducing or eliminating any losses.

Asset Value:
The value of the assets owned by a company. Net asset value is the value of the assets minus the value of any liabilities.

Break-even:
The level of sales necessary for a company to cover all it's fixed and variable costs. Above break-even sales, a company will be profitable.

Bridge financing:
Capital received by a company to cover a short term requirement e.g. to build a new factory before its existing factory is sold.

Burn rate:
The rate at which a company is consuming cash each month. A high technology start-up will often have a high burn rate while people are employed to develop the technology and before any sales are achieved.

Business angel:
An individual who invests capital in a small business, and who will often be actively involved in helping the business to grow.

Business Plan:
A plan written by the management of the company, usually for the purpose of raising capital, describing how the capital will be used to develop the business.

Buy – back:
The owner of a company who sells shares in his company may retain the right to buy – back some or all of the shares he sells, usually at a price which will show a good return to the investor.

BVCA:
British Venture Capital Association, association of providers of venture capital and investment capital.

Capital gains:
The difference between the price paid for shares (or other capital assets) and the prices at which they are sold..

Captive funds:
Venture capital funds which are owned by larger financial institutions.

Cash flow:
The flow of cash in and out of a company. A company may be profitable but still have negative cash flow and fail. A company may be loss making and, for a time, still have positive cash flow. First-time entrepreneurs should take care to understand the distinction between profit and loss and cash flow.

Company voluntary arrangement:
If a company is failing, its principals may make a voluntary negotiated settlement with its creditors. This is known as a CVA, and sometimes also a Corporate Voluntary Arrangement or Corporate Voluntary Agreement.

Compliance:
The process to ensure that the financial regulations are complied with. Many of the rules are designed to protect the public form misleading claims about returns they could receive from investments. Others outlaw insider trading.

Convertible:
Financial instruments which convert into others, usually ordinary shares. For example, a convertible preference share will convert into a certain number of ordinary shares in certain circumstances which are defined when the original deal is done.

Corporate venturing:
The practice of large, typically multinational, firms of providing funds to small firms to encourage a steady flow of new products, techniques and technologies and possibly, acquisitions.

Corporation tax:
The tax on company profits, currently 30% in the UK. The corporation tax starting rate is currently 0% for companies with taxable profits less than £10,000. The small companies rate is reduced from 20 to 19% for companies with taxable profits between £50,000 and £300,000. There is also relief available for companies making the transition between £10,000 and £50,000 and between £300,000 and £1,500,000.

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Cumulative shares:
As in cumulative preference share. A preference share is entitled to a dividend i.e. A first share of the profits of a company. A cumulative preference share is entitled to the first share of profits plus back payments on any such dividends which were missed in past years.

Current assets:
Assets of a company, such as cash, stock and debtors, which can be converted into cash in a few months.

Debt:
In terms of financing a business there is a distinction between debt and equity. Debt is money borrowed from a bank or other institution which is subject to interest paid at a specified rate. The total borrowed must be repaid either on a specified date or on demand.

Development capital:
Usually refers to equity capital raised to provide for the company to grow ambitiously. Also referred to as a growth capital.

Discounted Cash Flow (DCF):
An investment appraisal technique which takes into account both the time value of money and also the total profitability of a project over a project's life (see also Internal Rate of Return and Net Present Value).

Dividends:
When a company makes a profit, it pays part of these profits to its shareholders – those who provided its investment capital. Such payments are known as dividends.

Dividend Cover:
Calculated by dividing earnings after tax by the net dividend and expressed as a multiple. It shows how many times a company's dividends are covered by post-tax earnings.

Downside:
The negative risk and the consequent potential for failure, that an investor takes when making an investment. Contrast with "Upside".

Due diligence:
Before venture capitalists make an investment in a company, they will make detailed investigations about its market, competitors, management, track record, financial and legal status. This is known as due diligence.

Early stage:
Investments are sometimes categorised by the stage of investment. In general the earlier the stage the higher the risk. The stages are seed, start-up, early stage development and later stage development (or expansion).

Earn out:
Sometimes when a company is sold, part of the payment will be deferred. The seller will thus receive some cash now and some cash in each of the next few years. The amount of these deferred payments will often be linked to the profitability of the company in those years. This is known as earn out and is intended to reassure the buyer of the company's state at the time of exchange.

Enterprise Investment Scheme:
The aim of the EIS is to encourage wealthy individuals to invest in smaller unquoted companies and to play an active part in their management, thereby becoming "Business Angels". An EIS investor receives 20% tax relief on his investment up to a maximum of £150,000 p.a. There is no capital gains tax when these shares are sold, provided they have been held for three years. If the investment fails, further tax relief is available. Under the EIS a business angel investor may be paid a reasonable salary by the investee company and may become a director.

Enterprise Zone:
Geographical area which attracts tax benefits for businesses located in the area.

Entrepreneur:
Normally an owner of an independent business. Term used to describe an enterprising person, hence often related to the setting of a new or growing company. Those who are seeking venture capital.

Equity:
Equity or share capital is the risk of capital provided to finance a business. If the business fails the equity capital will usually be lost.

ESOP:
Employee Share Option Plan. A scheme, approved by the Inland Revenue to enable employees to acquire shares in the companies in which they work.

EVCA:
European Venture Capital Association. Association of providers of venture capital and investment capital across Europe.

Exclusivity Agreement:
This is often referred to as a lock-out agreement. During the agreed period of exclusivity the company and/or its existing shareholders agree not solicit or negotiate other for investment into their company. This will enable the investor to complete his due diligence at which time it may be incurring certain professional fees free from the interest of any competing party. Usually some form of confidentiality obligations will be imposed if they have not already been entered into.

Exit:
The realisation of an investment by way of sales or exchange for some sort of marketable commodity.

Exit Route:
Method by which an investor intends to, or has realised and investment. This could range from a trade sale through purchase by the directors to a floatation on a stock exchange.

Expansion Capital:
Capital provided for the growth and expansion of an stablished company. Funds may be used to finance increased production capacity, product development, provide additional working capital and/or for marketing.

Factoring:
A company which sells goods for £1,000 will issue an invoice for these goods at the date of sale, but the invoice may not be paid for several months, harming its cash flow. The company may take this invoice to a factoring company which will pay a percentage of the invoice immediately, perhaps £800 and the balance, less a fee, when the invoice is finally paid. There are many variations of detail on this basic idea.

Fees:
Investment companies earn their rewards in the form of a dividend or interest payments, but they may also be entitled to fees in connection with putting together the deal and for monitoring the progress of the investment.

Fixed Assets:
Assets such as land and buildings which are fixed, and which cannot easily be moved or sold quickly (cf. Current assets).

Financial structure:
The debt, equity and other financial instruments used to provide finance for a company.

Flotation:
When a company begins trading its shares on the Stock Exchange. This can either be on the London Stock Exchange or one of the other markets, like AIM. Flotation is a possible exit route from an investment.

FSA:
The Financial Services Authority. Under UK law, anyone involved with the management of financial assets must be a member of this Self Regulatory Organisation (SRO), which then monitors their activities to make sure they comply with the proper standards. The FSA monitors the activity of venture capital companies and organisations which invest capital on behalf of others. Organisations which fail to conduct their business legally and/or to the proper standards can be fined and/or disqualified from carrying on in business.

GAAP:
Generally Accepted Accounting Policies.

Gearing:
The ratio of debt (borrowing on which interest is due) to equity (long-term shares capital) of a company. In general, the higher the gearing, the higher the percentage of annual profits which must be used to pay interest and the greater the vulnerability of the company to events outside its control such as a rise in interest rates or a fall in sales. There is no precise and accepted definition of gearing, so beware of statements such as: Company A has.gearing of 50%. Always ask exactly how this figure is calculated and what is included in debt and equity. Long-term loans from founders, for example are often more like equity, although they may technically be classed as debt.

Hands-on/Hands-off:
An investor who plays an active part in the investee company is said to be a hands-on investor.

Holding Company:
A company which holds (i.e. owns) a number of subsidiary, usually trading, companies.

Hostile takeover:
The takeover of a company against the wishes of the incumbent management or board.

Hurdle:
The return on investment (sometimes an "IRR") that an investor needs to compensate for the risk involved in making that investment. The hurdle would be set at different levels depending on the type of company but would never reduce below a basic "hurdle rate".

Intangibles:
The non physical assets of a company that have a value examples of which could be brands or patents.

Internal rate of return (IRR):
Equivalent to the compound rate of return of an investment. Technically, the discount rate which, when applied to a set of cash flows, gives a net present value of zero (see also Internal Rate of Return and Discounted Cash Flow).

Intellectual Property:
A Company's intangible assets like patents, brand names etc.

Investment Agreement:
This is a summary of the main terms of the investment into the company. Typically it will describe the amounts and types of shares to be issued. It will set out the manner in which the investors' capital is to be returned and the way in which the investors are to be protected at such time as their money is at risk. It will also include warranties that certain states of affairs prevail in relation to the company

Initial Public Offering:
This is the first time that a company has tried to raise funds on a "public" market such as a stock exchange. Terms used to describe this are "flotation", "float", "going public", "listing" when a company obtains a quotation on a stock market. Stock markets include the Official List of the London Stock Exchange (where around 40% of trading company flotations are venture backed), the Alternative Investment Market (AIM), EASDAQ, NASDAQ and other overseas exchanges.

Later Stage Development:
An investment in a company which is mature and profitable to finance the development of the company.

Lead Investor:
Ina substantial investment, the whole risk is often shared among a syndicate. Normally, one investor will take the lead in negotiating the terms of the investment and has no responsibility for finding other syndicate investors.

Leaseback:
Sale and leaseback. To raise capital, a company may sell assets (e.g. a factory) which it owns and lease it back.

Leasing:
Payment for an asset by regular payments over a fixed period. An "off-balance sheet" method of financing capital expenditure.

Leverage:
The total borrowings of a company expressed as a percentage of shareholders' funds.

Leveraged buy-out:
Purchase of a business using largely debt on the back of a relatively small amount of equity. Some MBOs are conducted in this way.

Liquidation:
The sale of all of a company's assets, for distribution to creditors and shareholders in order of priority. This may be as a result of the failure of the company or by agreement amongst shareholders.

Listing:
When a company trades its shares on a stock market it is said to be "listed".

Loan capital:
Form of debt which has to be repaid at a specified time in the future (as distinct from a bank overdraft which may be called in at short notice).

Management buy-in (MBI):
Funds provided to enable a manger or group of managers from an outside company to buy in to it.

Management Buy-out (MBO):
Funds provide to enable operating management to acquire the existing product line or business they currently manage.

Mezzanine Finance:
A term which has caused confusion because it has been used by different people to mean different things. Originally it was used to describe bridging finance which companies would raise for working capital shortly before raising capital on a stock market. Latterly it has been used to describe a financing instrument which has elements of both debt and equity, e.g. Debt with rights to convert to equity, or a share in profits.

Multiple:
This refers to the multiple of earnings which would be used to estimate the value of a company. Similar to a price - earnings ratio.

NASDAQ:
The National Association of Security Dealers Automated Quotation, is the largest US stock market in terms of companies listed and shares traded. It was launched in 1971 and is operated by the Nasdaq Stock Market Inc.

Net Present Value (NPV):
The current value of future cash flows discounted back to today's date using a stated discount rate. (See also Internal Rate of Return and Discounted Cash Flow).

Non-executive director
"Part-time" directors who share all the legal responsibilities of their executive colleagues on the board of a company. The general view is that they can operate as an independent director able to take a long-term view of a company and protect the interests of shareholders. An investor will often appoint a non-executive to board as one way of monitoring its investment.

Ofex:
Launched in 1995, OFEX is a facility which enables companies to raise significant amounts of investment without obtaining a full listing on the purely public exchanges and at less cost. Amounts as small as £500,000 are possible on OFEX but shares are not as marketable as shares quoted on a full exchange (website: www.ofex.co.uk).

Options/Share options:
Financial instrument which gives the holder the right to buy an underlying instrument (e.g. Ordinary shares).

Payback:
A measurement of the time, usually years, that are required to payback and amount equivalent to the initial investment.

Placing:
The sale of a share holding or block of shares, through a broker, to other investors, usually institutions.

Preference shares:
Shares which hold preferential rights over ordinary shares, typically including a first right to dividends and any capital payment.

Price earnings (P/E) ratio:
The quoted market price per share divided by the earnings (profits after tax) per share. Stock market analysts use this ratio as an indicator of the expected future performance of a company.

Ratchets:
A structure whereby the eventual equity allocations between the groups of shareholders depends on either the future performance of the company or the rate of return achieved by the venture capital firm. This allows management shareholders to increase their stake if the company performs particularly well.

Receivership:
The common term for Administrative Receivership.

Redeemable shares:
Shares which can be repurchased by the company at a predetermined value.

Replacement capital:
Capital provided as a substitute for funds removed by a previous shareholder, such as a retiring director, who now wishes to realise his stake.

Restructure:
Usually involves fairly major changes in the organisation of a company. Possibly by changing the management and/or the share ownership structure.

ROI:
Return on investment.

Roll-over relief:
Tax relief or more precisely tax deferral, on capital gains which is granted if the gains are reinvested in an unquoted company.

Second round financings:
Finance made available to young companies which have already launched products on to the market but need more cash to realise their potential.

Seed Capital:
Capital provided to allow a business concept to be developed, perhaps involving the production of a business plan, prototypes and additional research, prior to bringing a product to market and commercial large scale manufacturing. (BVCA definition).

Sensitivity Analysis:
A financial analysis of projected profit and cash flows of an investment proposition which measures the sensitivity of those projects to increases or decreases in the underlying assumptions. In other words the analysis of "what if" situations.

Shareholders Agreement:
Many of the rights between shareholders in a company are set out in its Articles of Association. This is a public document that is filed at Companies House. In many cases shareholders will want to create rights and obligations between them that are better kept privileged between them. In such cases rather than bundle those rights and obligations into a public document they will enter into private contractual arrangements, in a document such as a shareholders agreement.

Silent Partner:
An investor who is not involved in the running or strategic direction of a company of which he is a shareholder.

Slippage:
Delay experienced by a company in achieving financial projections as forecast by the company's plan.

Spin-Out:
Emergence of a company in its own right from a larger business or university.

Start-Up Capital:
Financing provided to companies for use in product development and initial marketing. Companies may be in the process of being set up or may have been in business for a short period of time, but have not yet sold their product commercially.

Subscription Agreement:
A subscription agreement sets out the terms upon which an investor will subscribe for shares in a company. The term is often used to describe what is in effect an Investment Agreement. They may have similar structures and terms however a subscription agreement is likely to be a somewhat simpler form of agreement

Sweat Equity:
Equity (shares in a company) which is given to the founder of the company in recognition of the effort (sweat) which he has expended in getting the company started up.

Syndication:
An arrangement whereby a group of investors come together to invest in an investment proposition which they would not be prepared to consider individually whether because of risk or amount of funding required. There is however usually a "lead" investor.

Trade Sale:
Sale of a company to another company. As a form of exit, it is an alternative to flotation and more common.

Turnaround:
An investment in a company in trouble, which seeks to revive the company's fortunes, and set it on a profitable course.

Underwrite:
When a company raises capital there is always a possibility that all the money may not be forthcoming. This risk is often underwritten by an institution which, for a fee, will agree to make up any shortfall.

Upside:
The potential for a positive result from an investment which is usually deemed to contain some element of risk.

Valuation of Shares:
Shares of publicly quoted companies are valued daily according to flow of demand and supply. Valuation of private companies is more difficult because there is no market in their shares. It is often done by reference to p/e ratios in similar quoted companies, or by discounted the projected future cashflow of the business. It needs to be said that valuation can be done in a variety of ways, is more of an art than a science and at the end of the day is always a matter of negotiation between a willing buyer and a willing seller.

VCT:
Venture Capital Trust. A scheme established by the UK Government in 1995 to encourage investment in smaller companies. Individuals receive very generous tax reliefs on investments of up to a changing monetary amount per year in new VCT's (20% refund of income tax, deferral of capital gains tax of 40%). All dividends form the VCT are tax free, provided the share have been held for five years. The VCT can invest up to a maximum of £1M per investee company and can only invest in unquoted companies or companies quoted on AIM.

Venture Capital:
Originally, capital supplied to early stage, innovative businesses where the risks were high but so were the potential returns. The term in Europe has now come to encompass almost all types of investment in unquoted companies, and including management buy-outs.

Vulture Capital:
A description of venture capital used by those who believe that venture capitalists take too much and offer too little when they invest.

Warranties:
Assurances, which are given by a seller, verifying those statements that he has made about the company and the state of its finances are true.

White Knight:
An investor who rescues a company in distress. Also a bidder considered to be friendly to the interests of the management who is invited to bid for a company when the takeover target is facing a hostile bid.

Working Capital:
Capital which is required to finance the ordinary trading activities of a company, i.e. To purchase raw materials, to pay labour to convert raw materials to goods, and to finance debtors (or receivables). An accounting definition would be current assets less current liabilities. From a practical point of view, it is necessary to have an understanding of how a rise in sales will affect working capital. In some businesses, a rise in sales of 10% will require a significant increase in working capital required for a new business will be greater than the start-up capital required to purchase plant and equipment.

Yield:
Calculated by dividing the gross dividend by the share price and expressed as percentage. It shows the annual return on an investment from interest and dividends, excluding any capital gain element.