DP Business Management (FE2024) – Unit 3: Finance and accounts key terms

Key terms from HL topis in **red**

- **Accounting rate of return (ARR)** - Also referred to as the average rate of return, this method of investment appraisal calculates the average annual profit of an investment project expressed as a percentage of the amount of invested.
- **Acid test ratio** - Also known as the quick ratio, this short-term liquidity ratio measures an organization's ability to pay its short-term debts without having to sell any stock (inventories).
- **Accumulated depreciation** - This refers to the accrued value of non-current assets, most of which fall in value over time du e to depreciation.
- **Assets** - The possessions owned by a business, which have a monetary value, e.g., buildings, land, machinery, equipment, inventories, and cash.
- **Average costs** - This is the cost per unit of output. It is calculated by the formula: AC = TC ÷ Q where: AC = Average cost TC = Total cost, and Q = Quantity of output
- **Average revenue** - This is the amount a business receives from its customers per unit of a good or service sold. Mathematically, AR = TR ÷ Q = P where: AR = Average revenue TR = Total revenue Q = Quantity of output, and P = Price
- **Bad debt** - This occurs when a debtor is unable to pay outstanding invoices to the business. The result is it reduces the cash inflows for the vendor (seller).
- **Balance sheet** - Also known as the statement of financial position, this set of final accounts shows the value of a firm's assets, liabilities, and the owners' investment (or equity) in the business, at a particular point in time.
- **Bankruptcy** - Sometimes referred to as receivership or corporate liquidation, this means a situation when a person or business declares that they can no longer pay back their debts, so the entity collapses (fails).
- **Break-even** - This condition exists when a firm's sales revenues cover all of its production costs.
- **Break-even analysis** - This is a business management tool used to determine the level of sales volume needed to cover all the costs associated with the output of a particular good or service.
- **Break-even chart** - This is a graphical illustration of an organization's production costs, sales revenues, and profits (or loss) at given levels of output.
- **Break-even point (BEP)** - This is the point on a break-even chart where the firm's total costs equal its total revenue, shown by the intersection of the TR and TC curves.
- **Break-even quantity (BEQ)** - The quantity of sales (sales volume) required for a firm to reach break-even. It is found by using the formula: BEQ = Fixed costs / (Price – Average variable cost).
- **Break-even revenue** - This is the value of the output needed to break-even.

- **Capital expenditure** - Refers to business spending on fixed assets or capital equipment of a business.
- **Capital employed** - The value of all sources of finance for a business, including internal and external finance.
- **Capital expenditure** - A business organization’s spending on the purchase or acquisition of fixed assets, e.g. spending on buildings (premises), machinery, equipment and tools.
- **Cash** - This refers to the money an organization has either “in hand” (at its premises) and/or “at bank” (i.e., in its bank account). It is the most liquid type of current assets.
- **Cash flow** - The movement of an organization’s cash inflows (cash received from the sale of goods and services) and cash outflows (used to pay for the costs of running the business).
- **Cash flow forecasting** - A quantitative technique used to predict how cash is likely to flow into and out of the business for a particular period of time.
- **Cash flow problems** - These are liquidity issues that arise when an organization has insufficient funds to run its business, i.e., when net cash flow is negative.
- **Cash inflow** - Refers to the money coming into a business from earnings (sales revenue) and other sources of finance, such as crowdfunding.
- **Cash outflow** - Refers to the money going out of a business to pay for its costs, such as the purchase of raw materials or the payment of wages and salaries.
- **Closing balance** - Found in a cash flow forecast, this refers to the value of cash held by a business at the end of a trading period (usually on the last trading day of the month).
- **Cost centre** - A section or division of a business that has responsibility for its own operational costs. It is held accountable for its departmental expenditure.
- **Costs** - The charges that an organization incurs from its operations, e.g., rent, wages, salaries, and insurance.
- **Creditor days ratio** - The efficiency ratio that measures the average number of days an organization takes to repay its creditors (suppliers who the business has bought products from using trade credit, so have yet to pay for these).
- **Crowdfunding** - Rising finance for a business venture or project by getting small amounts of money from a large number of people, usually through online platforms.
- **Creditors** - Also known as trade creditors, this refers to the suppliers that allow a business to purchase goods and/or services on trade credit.
- **Credit control** - The process of monitoring and management of debtors, such as ensuring only suitable customers are given trade credit and that customers do not exceed the credit period.
- **Cumulative net cash flow** - The sum of an investment project’s net cash flows for a particular year plus the net cash flows of all previous years.

- **Current assets** - Short-term assets belonging to an organization which will last in the business for up to 12 months, e.g., cash, debtors, and stock (inventory).
- **Current ratio** - A short-term liquidity ratio used to calculate the ability of an organization to meet its short-term debts (within the next twelve months of the balance sheet date).
- **Current liabilities** - These are the short-term debts of a business, which need to be repaid within twelve months of the balance sheet date. Examples include bank overdrafts, trade creditors, and other short-term loans.
- **Debtors** - A type of current asset, referring to individual or business customers that owe money to the organization as they have bought goods or services on trade credit, i.e., they need to pay within 30 and 60 days.
- **Debtor days ratio** - The efficiency ratio that measures the average number of days an organization takes to collect debts from its customers (as they have bought goods and services on trade credit but have yet to pay for these).
- **Depreciation** - The fall in the value of a fixed asset over time, mainly due to wear and tear (usage) and obsolescence.
- **Discount rate** - Also known as a discount factor, this is the figure used to reduce the future value of money. It is used to establish the present value of cash that is yet to be received by the business.
- **Discounted cash flow** - This method of investment appraisal uses a discount rate (the inverse of compound interest) to reduce the value of money received in future years because money loses its value over time.
- **Direct costs** - Costs that are clearly associated with the output or sale of a certain good, service or business operation, e.g., raw materials.
- **Dividends** - The payments from a company's profit (after interest and tax) paid to the shareholders (owners) of the company. The amount of dividends paid to an individual shareholder depends on the number of shares held by the individual.
- **Efficiency ratio** - Financial planning and decision-making tool to measure how well the resources of a business are used in order to generate income from the firm's capital.
- **Equity** - Refers to the value of the owners' stake in the business, i.e., what the business is worth at the time of reporting the balance sheet.
- **External sources of finance** - Finance that comes from outside the organization, usually with the help of a third-party provider, such as a bank, business angel, venture capitalist or government.
- **Favourable variance** - This discrepancy in the budget occurs when profits are higher than expected, due to lower than expected costs and/or higher than predicted revenues.
- **Finance** - Refers to the various available money that an organization has to fund its business activities.
- **Finance and accounts** - Function of an organization responsible for ensuring that the business has sufficient funds in order to conduct its daily operations.

- **Financiers** - Financial institutions (such as banks) and individual investors who provide source of finance for businesses. They are interested in the organization's ability to generate profits and to repay debts.
- **Final accounts** - These are the published accounts of an organization, made available to and used by different stakeholders, e.g., managers, employees, shareholders, sponsors, financiers, and investors.
- **Fixed assets** - The long-term assets (possessions) of an organization that have a monetary value and are used repeatedly but are not intended for resale within the next twelve months, e.g. property and equipment.
- **Fixed costs** - Costs that do not change with the level of output, e.g., loan repayments and management salaries.
- **Gearing ratio** - The efficiency ratio that measures the extent to which an organization is financed by external sources of finance (i.e. loan capital as a percentage of the firm's total capital employed).
- **Gross profit** - This refers to the profit from a firm's everyday trading activities. It is calculated by the formula: Sales revenue – Cost of sales.
- **Gross profit margin (GPM)** - A profitability ratio that measures an organization's gross profit expressed as a percentage of its sales revenue. It is also an indicator of how well a business can manage its direct costs of production.
- **Illiquid assets** - These items of value, owned by the business, cannot be sold quickly, are difficult to sell, and/or cannot be sold easily without incurring a significant loss in value.
- **Initial public offering (IPO)** - An IPO occurs when an organization sells all or part of its business to shareholders on a public stock exchange for the first time. This changes the legal status of the business to a publicly held company.
- **Insolvency** - Refers to the situation where a person or a business is unable to meet their bill and other debt obligations. The debts (liabilities) of the individual or organization exceed their assets.
- **Intangible assets** - Non-physical fixed assets that are valuable to a firm's survival and success, such as brand value, goodwill, copyrights, trademarks, and patents.
- **Intellectual property rights** - Abbreviated as IPRs, and also known as **intellectual property protection**, these are a firm's fixed, intangible assets with a monetary value, comprised of goodwill, patents, copyrights and trademarks.
- **Intellectual property protection** - Also known as intellectual property rights (IPRs), this refers to the lawful and private ownership of certain creations, inventions, or works, namely copyrights, patents, and trademarks.
- **Internal sources of finance** - Finance that come from within the organization, from its own resources and assets without the help of a third-party provider.

- **Investment** - Capital expenditure with the intention of a financial return on this spending at some point in the future.
- **Investment appraisal** - The formal process of quantifying the financial risks of an investment decision, in order to establish whether the expenditure can be justified from a financial perspective.
- **Leasing** - This financial service enables businesses to have access to fixed assets, by hiring these assets, but without the high costs of capital expenditure.
- **Liabilities** - The debts of a business, i.e., the money owed to others, e.g., money owed to financiers, trade creditors, and the government (for tax).
- **Liquidity** - Refers to the ease with which a business can convert its assets into cash without affecting its market value, i.e., it measures a firm's ability to repay short-term liabilities without having to use external sources of finance.
- **Liquidity crisis** - A situation that arises when a business is unable to pay its short-term debts. This can eventually lead to bankruptcy.
- **Liquidity position** - This is a measure of the extent to which a business has sufficient liquidity to continue its operations and activities.
- **Liquidity problem** - Also known as a cash flow problem, this issue occurs when there is a lack of cash in the organization because its cash inflows are less than its cash outflows, i.e., it experiences negative net cash flow.
- **Liquidity ratios** - These are financial ratios that examine an organization's ability to pay its short-term liabilities and debts, namely the current and acid test ratios.
- **Loan capital** - Also known as debt capital, this refers to borrowed funds from financial lenders, such as commercial banks.
- **Long-term finance** - Refers to sources of finance of more than five years, for the purchase of long-term fixed assets or to fund the growth of a business in overseas markets.
- **Microfinance -** An external source of finance provided by financier who support entrepreneurs of small businesses, especially females and those on low incomes who are ordinarily unable to secure loans from commercial banks.
- **Payback period (PBP)** - The investment appraisal method that considers the time it takes for the amount of money invested in a project to be repaid using the proceeds generated from the investment.
- **Personal funds** - Internal source of finance, with entrepreneurs using their own savings, usually to finance their start-up business.
- **Profit** - The financial surplus after all costs, including expenses, have been paid (formerly referred to as "net profit").
- **Profit and loss account** - Also known as the income statement, this shows a firm's profit (or loss) after all production costs have been subtracted from the organization's

revenues, each year. It is also known as the statement of profit or loss or income statement.

- **Profit margin ratio** - A profitability ratio that measures a firm's overall profit (after all costs of production have been deducted) as a percentage of its sales revenue. It is also an indicator of how well a business can manage its indirect costs (overhead expenses).
- **Profit after interest and tax** - This section of the P&L account shows the actual value of profit earned by the business after all costs have been accounted for.
- **Profit before interest and tax** - This section of the P&L account shows the value of a firm's profit (or loss) before deducting interest payments on loans and taxes on corporate profits.
- **Profit centre** - A section or division of a business that has responsibility for both costs and revenues generated within the department. It is held accountable for the amount of profit generated.
- **Qualitative investment appraisal** - Method of investment appraisal used to determine whether a project is worth investing in by using non-numerical techniques, e.g., whether the project aligns with the organization's mission.
- **Quantitative investment appraisal** - Method of investment appraisal used to determine whether an investment project is worthwhile based on financial analysis, namely, PBP, ARR, and NPV.
- **Ratio analysis** - A quantitative management planning and decision-making tool, used to analyse and evaluate the financial performance of a business. These can be further categorised as profitability, liquidity, and efficiency ratio analysis
- **Residual value** - Also known as the scrap value, this is the value of a fixed asset at the end of its useful life before it is replaced.
- **Retained profit** - Also referred to as retained earnings, this refers to the value of a firm's earnings after all costs are paid (including interest and tax) and shareholders have been compensated (dividends).
- **Return on capital employed (ROCE)** - A profitability ratio that measures a firm's efficiency and profitability in relation to its size (as measured by the value of the organization's capital employed).
- **Revenue** - The money (income) received by a business from the sale of goods and/or services.
- **Revenue expenditure** - Refers to business spending on its everyday and regular operations.
- **Revenue stream** - The different sources of revenue (or income) for a business, e.g., revenue from sponsorship deals, merchandise sales, membership fees and royalties.
- **Share capital** - Also known as equity capital, this is finance raised through the issuing of shares via a stock exchange (or stock market).
- **Share issue** - The process involving a public limited company selling additional shares in order to raise finance.

- **Shareholders (stockholders)** - The people or organizations that have shares in a company. Their interest is financial, i.e. regular dividends and a higher share price.
- **Short-term finance** - Refers to sources of finance needed for the day-to-day running of the business, i.e., revenue expenditure.
- **Short-term loans** - These are advances (loans) from a financial lender, such as a commercial bank, that needs to be repaid within 12 months of the balance sheet date.
- **Sources of finance** - Refers to where a firm obtains its money to fund its business activities and operations, such as from personal savings, loan capital, crowdfunding, and share capital.
- **Straight line depreciation** - A method of depreciation that spreads the depreciation of a fixed asset evenly over its useful life, i.e., the value of the asset falls by the same amount each year.
- **Stock exchange** - This is any marketplace where the general public and other companies can buy and/or sell shares
- **Total assets** - The sum of a firm's non-current assets and its current assets.
- **Trade credit** - Financial service that enables a business customer to purchase and obtain goods and services but to pay for these at a later date.
- **Trade creditors** - Suppliers may give trade credit, which needs to be repaid at a future date (typically 30 to 60 days).
- **Variance** - Refers to a discrepancy between the planned (budgeted) item of expenditure or revenue and the actual amount.
- **Variance analysis** - This is the management process of comparing planned and actual costs and revenues, in order to measure and compare the degree of budgetary success.
- **Working capital** - The money available for the day-to-day running of a business. It is calculated by subtracting current liabilities from current assets.
- **Working capital cycle** - Also referred to as net current assets, this refers to the duration between a business paying for its production costs of a good or service and receiving the cash from customers purchasing the product.
- **Zero budgeting** - A method of budgeting that requires all budget holders to justify each dollar of spending subject to management approved before the funds are released.