# Glossary of
# Raising Finance Terms

*Expert knowledge means success*

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# Introduction

We have compiled this glossary of terms to assist you to understand the “jargon” which is used in business and investment. This glossary is limited to Raising Finance Terms but we publish several other glossaries as well – check our website or call us for details.

# Raising Finance Terms

- **APR -** the annual percentage rate is a rate of interest that every financier must quote and must calculate in the same way, so that meaningful comparisons can be made.
- **Balloon repayment** - when the majority of the repayment of a loan is made at or near the maturity date, with the final payment substantially larger than the earlier payments. Used in the funding of fixed assets in a growing business.
- **Base rate** -the rate of interest which forms the basis for the charges for bank loans and overdrafts or deposit rates for commercial banks. Rates of interest charged by the banks on much of their lending to customers are set at margins over their own base rate - the size of the margin depends on the nature and status of the customer. A change in the base rate normally signifies a marked change in the level of short-term market interest rates hence the base rate is widely used as an indicator of the broad level of interest rates.
- **Bill of exchange** - a trade finance tool consisting of a written order that binds one party to pay a fixed sum of money to another party at a predetermined future date. However, the most common form bill of exchange is a cheque being a bill drawn on a bank and payable on demand.
- **Bullet -** a single repayment on a loan paid at maturity.
- **Business plan** – a plan setting out the objectives of the business and how they are to be achieved.
- **Capital repayment moratorium** - a period of time in which the interest accruing on the loan is covered, but no capital is repaid. Also sometimes referred to as a capital repayment holiday.
- **Cap** - example of a derivative (see below). A contract which effectively imposes a maximum on the interest rate payable where the rate is variable. It protects against increases in the bank's cost of funds, and is not concerned with the margin charged above this. A premium is charged, much as in an insurance policy.
- **Collar** - example of a derivative where the maximum and minimum effective rates payable are determined for a specified period.
- **Collateral** - asset pledged to a lender until a loan is repaid. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to pay off the loan.
- **Confidential invoice discounting** - a tool whereby invoices can be turned into cash. Invoices are sent to the lender, who will normally agree a cash injection of up to 85% of the outstanding invoices. The responsibility for collection remains with the client. This facility tends to be used when there is a growing demand for working capital.
- **Convertible** - in this context, a form of preference share, which can be converted into ordinary shares at a set future date. The expression can also be used in connection with a debt instrument that can be 'converted'.
- **Covenant -** a promise made in a formal legal agreement, that certain activities will or will not be carried out. Financial covenants agree the minimum financial performance ratios the borrower will achieve. Breach of covenants will constitute an event of default. Covenants are an integral part of all term commitments.
- **Covenant-lite loan (also called cov-lite loan)** – this is a loan with very light covenants or even no covenants at all. Their development usually goes in hand with increase leverage and an overheating of the loan markets as in 2007 when banks seems so keen to lend to private equity firms that they are dispensing with their usual covenants and safeguards.
- **Debt Service** - cash required in a given period, usually one year, for payments of interest and current maturities of principal on outstanding debt.
- **Derivative** - a 'stand-alone' contract to 'hedge' or protect a borrower's exposure to movements in financial markets, including interest rates, exchange rates, commodity prices etc.
- **Discounted -** using a bill of exchange, a lender may discount the bill by paying the borrower the amount of the bill, less the costs of funding and a percentage to reflect the interest charged.
- **Enterprise Capital Fund** - under the Enterprise Capital Fund (ECF) scheme the Government will match Venture Capital funding pound for pound to help small and medium sized businesses grow.

- **Event of default** - within a facility letter (see below), there will be a list of the lender's rights if the borrower fails to meet its obligations, or if a specified event occurs. The rights will typically include the cancellation of any further drawdowns under the facility, the liability becoming repayable on demand, and other conditions.
- **Facility letter** - the formal document setting out the mutual rights and obligations of lender and borrower.
- **Factoring** - there are many different types of factoring arrangements. An arrangement can be either confidential or disclosed to customers. Typically it involves the purchase of the trade debts owed to a business by a factoring company. This provides short term financing and may include the administration of the business' sales ledger by the factor who will be responsible for credit control and the despatch of statements. Because factoring involves the sale of the business' debtors it is only suitable for financing working capital and is normally most suitable for growing businesses. The cost will be more than an overdraft but your business may save money, for instance by not having to employ a credit controller. (See also invoice discounting).
- **Fixed rate** - an interest rate management tool, where the rate on a loan is agreed at drawdown for the life of the loan. Early repayment will involve meeting the bank's costs in 'breaking the fixture'.
- **Forward rate agreement** - a hedging tool which allows both the lender and the borrower to agree a rate of interest at a future date.
- **Gearing** - a fundamental analysis ratio of a company's level of long-term debt to its equity capital expressed in percentage form. Also referred to as leverage.
- **Grants** - whether or not grant finance is available will depend on factors such as where the business is located, whether it will create jobs and the purpose of the investment. Grants are normally preferable to other forms of finance. However there can be costs ill complying with the terms and conditions of the grant and you should research these carefully.
- **Hedge** - the term for protecting oneself from market movements. When raising finance, it is advisable to hedge against adverse interest rate movements.
- **Hire purchase** - a form of asset finance whereby the asset is acquired in the name of the borrower, but is generally charged as security to the lender. Effectively, a loan against the asset. The asset and the borrowing appear on the balance sheet, and tax treatment will reflect this. Every hire purchase contract has a peppercorn option payment at the end by which the borrower acquires unfettered legal title to the asset.
- **Invoice discounting** - a similar arrangement to factoring, but confidential - the customer should be unaware that the invoice has been discounted. The business usually retains responsibility for running the sales ledger and collecting debts.
- **IPO (Initial public offering)** - the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPO's can be risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.
- **Joint and Several Liability** - an undertaking by two or more people to be responsible, either individually or jointly, for any liability which may exist after any member or members have failed to meet their obligations. For example if a group of four people enter into a joint and several liability on a bank loan then, in the event of two of the members failing to meet their obligations, the remaining two members become fully responsible for the repayment of the loan.
- **Leasing** - An alternative means of asset finance, with the user (lessee) paying the lessor a rental for the use of the asset for a defined period. The two principal types of lease are Finance Leases and Operating Leases, and there are differences in accounting and tax treatment between the two. Unlike hire purchase financing, leasing contracts do not have a peppercorn option payment at the end by which the borrower acquires unfettered legal title to the asset.
- **Mezzanine debt -** a class of debt that ranks behind the senior debt. The pricing and/or terms reflect the higher risk to the lender.
- **Overdraft** - the simplest and most flexible method of borrowing money. An agreed line of finance, repayable on demand by the lender, but usually reviewable at least annually. A 'committed' overdraft is not repayable on demand, but is available for a period up to 364 days, usually subject to conditions and/or covenants.
- **Overtrading** - term used when a business is growing its sales faster than it can finance them, leading to insufficient cash being available to meet outgoings.

- **Participating preferred stock** - a type of preference share that, under certain conditions, gives holders the right to receive earnings payouts over and above the specified dividend rate.
- **Preference shares** - a type of share that has preference to ordinary shares by a fixed dividend (provided the company has distributable reserves), and over assets in the event of liquidation.
- **Private placement** - a way of raising capital by issuing shares to known clients of the advisers.
- **Prospectus** - a formal legal document describing details of a corporation, generally created for a public fund raising offering.
- **Redeemable -** a type of preference share which can be bought back by the company, usually at their option, at or over a specified period.
- **Retention of title** - the retention by a seller of goods of legal title to the goods until they have been paid for, even though possession of the goods is given to the buyer before that time.
- **Revolving credit facility** - a line of credit similar to an overdraft, but committed for longer than a year. Subject to meeting covenants, the line may be drawn and repaid at will.
- **Rights issue** - any share issue that will dilute the ownership of a given class of shareholder must be offered to that class in proportion to their existing shareholdings. This is known as a 'rights' issue.
- **Senior debt** - debt whose terms require it to be repaid before subordinated debt receives any payment.
- **Sensitivity analysis** - analysis of the sensitivity of predicted results to changes in the underlying assumptions.
- **Side letter** - as situations change, the terms of a loan may need to be altered. These changes will be explained in a side letter.
- **Syndication** - the process whereby a group of venture capitalists will each invest a portion of the amount of money required to finance a business.
- **Term loan** - a loan for a fixed amount with a fixed repayment schedule normally from a bank. It is most suitable for funding fixed assets and core borrowing. Although the interest rate may he slightly less than on an overdraft there is no opportunity to flex the amount of financing. When the level of financing required is likely to go up and down it is important to choose a form of finance which does not require you to pay for funds you are not using. Therefore a term loan is suitable for fixed assets, but not for working capital. The key advantages of a term loan are that you know when the repayments are and can budget accordingly and the APR may be lower.
- **Trade finance** - a term generally used to cover the multitude of means of financing international trade, using the instruments of that style of trade.

# Further Information

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www.glossarist.com/glossaries/business/

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