BZT Dictionary

The missing business glossary

BZT (Bizness Talk) Dictionary contains financial and legal concepts which are used in transactions, in the financial sector, among owners and entrepreneurs, in the Board room, and in the management of businesses.

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Enjoy the reading!
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A

Accruals

Accruals are the balance sheet accounts that show accrued charges and revenue. Those accounts include among others trade payables, receivables, tax liabilities and interest.
Example:

- "Accrued payables" are accrued unpaid debts, for ex. rent, that are recorded as debt in the balance sheet.
- "Accrued receivables" are accrued claims that have not yet been paid, for ex. trade payables, and are recorded as assets in the balance sheet.
- "Accrued revenues" are revenues that have not yet been invoiced or paid. They are recorded as assets in the balance sheet.

See also:

- Accrual accounting

Acid test ratio

A measure of a company's cash position. Also called "Quick Assets Ratio" or "Liquid ratio". This measure measures the company's capacity to pay short term liabilities.

See also:

- Liquid ratio
- Quick assets ratio

Accrual accounting

A device within accounting the purpose of which is to distribute receipts and costs over time so as to obtain as accurate a picture as possible of the company's financial position.
Before starting using accrual accounting business events were reported as cash transactions. But these do not always provide a true and fair view of the financial position of the company since the future income on credit or future commitments and liabilities were not recognized. Accrual accounting allows a company to show what they are required to pay and what future revenues to expect. It also makes it possible to in a fair manner show intangible assets - such as goodwill.

Rents are a cost which is usually distributed (periodized) over a period of time. If a company pays rent for three months in advance, the evaluation of the cost of rent will not be accurate if the whole payment is taken as a cost, and burdens the results, only in the month in which the rent is paid. Periodizing, in this example, means that the cost of the rent will be spread over the three months to which the payment of rent relates, with 1/3 recorded in each of those months.

Another type of accrual accounting is depreciation of machinery and equipment. Assume that a company buys a new car for €25,000. In order to obtain an accurate picture of the cost of the car, it is decided that the total cost is to be taken (depreciated) over five years. The annual cost will then be €5,000 per year (€417 per month), which gives a more accurate picture of the cost of the car.

Revenues can be distributed the same way. Assume that a company will be paid a fixed price for a project which will run for 6 months. Assume further that the company will receive 30% of the project's price in advance. If the company reports the whole advance in the month the payment is made, that will not give an accurate picture of the company's sales. Therefore, the revenue is periodized (and recognized) over the time to which the payment in advance relates. The remaining 70% of the project's revenues will be invoiced and periodized in phase with the project's level of completion.

In connection with accrual accounting it is important to have control over the cash flow, since revenues and costs per month do not show what incoming and outgoing payments are being made.

See also:

- Cash flow
- Cost
- Revenues

Adjusted EBITA

EBITA which has been adjusted for comparison-destroying entries.

See also:

- EBITA
- Comparison destroying items

Adjusted EBITDA

EBITDA which has been adjusted for comparison-destroying entries.

See also:

- EBITDA
- Comparison destroying items

Advisor

An "Advisor" is a person who gives advice and who is engaged in connection with making investments, business developments or transactions. An Advisor may be a professional advisor, for instance an investment bank, a lawyer, or an accountant. The term Advisor is also used as a title for experienced persons who assist Venture Capitalists and Private Equity in making investments or in the development of portfolio companies.
Many growing companies may have several external advisors who are called "Senior Advisors" on an "Advisory Board".

See also:

- DD
- VDD
- Exit process
- Success Fee

Agreement to issue shares

An agreement prepared in connection with the financing of a business. This is an agreement between the existing owners, and potentially also others who will become owners, which will govern the terms and conditions of a new issuance of shares.

See also:

- New issuance

Anchor investor

An Anchor investor is someone who guarantees to invest a significant amount in connection with a rights issue of financial instruments, e.g. buying a large number of shares in an initial public offering (IPO).
Anchor investors can be both an advantage and disadvantage for small investors. Professional, well-respected anchor investors give confidence that an issue of financial instruments (e.g. shares) is market priced and give a parallel guarantee that a certain number of shares are traded. However, if the anchor investor takes most of an interesting IPO, for example, a small investor may get a tiny allocation and, therefore, a disadvantage.

Angle

An investor would most like to have a unique perspective (an angle, an insight) for an investment, which means that the investor can offer a higher price and better terms for a company than those which other purchasers can. Perhaps the investor has already invested in a similar company and has experience in the business area.
The investor may also know the management well or have a valuable network of advisors knowledgeable in the business area.

Arm's length

A transaction at "arm's length" is a transaction between unaffiliated parties which act independently and in their own interest. An example of a transaction that is *not* at arm's length is a business transaction between persons who are related to each other.

See more:

- Bona fide

Asset Class

An asset class is a collection of securities of the same class with similar characteristics and behaviour in the market. Risk profile and return expectation are comparable within the same asset class. Examples are:

- Shares
- Bonds
- Liquid assets
- Raw materials
- Real Estate
- Private Equity and Venture Capital

See more:

- Private Equity

Average Joe and Jane

Average Joe (male) or Jane (woman) is primarily used in North America to refer to an ordinary, average American person.
Compare Joe and Jane with:

- Sweden: Medelsvensson
- UK: John Smith
- Germany: Max Mustermann and Erika Mustermann
- France: Monsieur Durand and Madame Michu
- Italy: Mario Rossi.

B

Back to basics

Means that a company concentrates on its principal business, or on those business areas in which it is particularly competitive.
Most companies, when times are good, have a tendency to expand their activities into new business areas and markets. Costs and investments increase.
When times are bad, the Board of Directors and the management have to cut back on activities and reduce costs. "Back to basics" may then mean that the company will close down, or sell, those parts of the business which are not part of its core activities.

See also:

- Core business
- Focusing

Bail

Bail means to provide a guarantee for somebody else's debt, *i.e.* to guarantee to pay in case the person to whom one provides a guarantee cannot or doesn't want to pay his debt.
The term is traditionally used when someone deposits the money to the court or repledges other assets so that the court can release the suspect from prison. The pledge guarantees that the suspect will arrive to the court for the trial – if not the one who provided the guarantee is going to lose the pledged asset.

Baisse

Downturn on a securities exchange, fall in stock prices. From the French word "baisse" which means reduction. The opposite of "baisse" is "hausse". See also "Bear market".

See also:

- Bear market
- Downturn
- Hausse

Bear market

Downturn on a securities exchange, fall in stock prices and pessimism as to future developments in stock prices. The opposite of "bear market" is "bull market". It is said that the bull holds its head and horns pointing upwards while the bear goes about with its head bowed down.

See also:

- Baisse
- Downturn

Beauty contest

When competing providers, for example in connection with the purchase of consulting services, are given an opportunity to introduce themselves to the purchaser and to describe what they can offer and why they rather than others should be chosen.
Usually the client has given the providers a specification as to what is to be covered and instructions as to how the presentation is to be made.

See also:

- Pitch
- Elevator pitch
- Beauty parade

Beauty parade

When competing providers, for example in connection with the purchase of consulting services, are given an opportunity to introduce themselves to the purchaser and to describe what they can offer and why they rather than others should be chosen. Synonym of "beauty contest".
Usually the client has given the providers a specification as to what is to be covered and instructions as to how the presentation is to be made.

See also:

- Pitch
- Elevator pitch
- Beauty contest

BIMBO

This is an abbreviation of the expression "Buy In Management Buy Out" which describes a situation where an external company management, together with the company's present management, buy out a company (or a business) from its present owner. A BIMBO can be a situation which requires financing, and which is an attractive investment for a venture capitalist and Private Equity.

See also:

- MBI
- MBO

BINGO

Abbreviation of "Buy In Growth Opportunity" which is used when an external company management buys into a company with great growth potential. BINGO can be a situation which requires financing and is an attractive investment for a venture capitalist and Private Equity.

Black knight

An undesirable investor in, or buyer of, a company who intends to change the company's direction and is prepared to make all the changes necessary to accomplish that, both in the board of directors and in the management.
The owners, the Board of Directors, and the management will do all they can to defend themselves against the "black knight" and to avoid its obtaining control of the company.

See also:

- Corporate raiders
- White knight

Blue-chip

Blue-chip is a term used for financially stable companies with a good reputation, and who are well established in their industry. A blue-chip company is expected to be non-cyclical and should deliver attractive profits in good as well as in bad times. Typically, the company is among the top three in its industry with a well-respected brand. The term, as such, originates from poker.

It is complex to define what is a blue-chip company. The Dow Jones index may be a guidance since it is supposed to include US blue-chip companies, such as Apple, Coca-Cola, Intel, and Microsoft.

Shares in blue-chip companies are considered to have a lower risk compared to non-blue-chip. They should have solid profitability and regularly pay dividends to their shareholders. Common investors in blue-chip shares are institutional investors managing public money, such as pension funds.
The opposite of blue-chip is the so-called penny stocks, which typically have lower and less stable share price. Penny stock companies will regularly not pay dividends to their shareholders.
Shares in blue-chip companies are, of course, not unaffected by major, adverse events impacting the stock market - for example, during a stock market crash.
Of course, a blue-chip company can suffer from challenges other than a general stock market decline, make losses, and in the worst case, go bankrupt. There are several well-known examples where reputable businesses have experienced severe problems during disruptive market changes. An example is digitalization and its impact on industries such as Kodak and Agfa. The shift in technology opened up for devastating competition from brand new companies.

See also:

- Penny stock

Board of Directors

"The Board of Directors" is the company's ruling body (sometimes abbreviated BoD). The Board of Directors is the company's highest decision-making body for strategic and tactical issues, if we exclude the meetings of shareholders. It is charged with the duty of managing and developing the company in the best possible way so as to create value, in the first instance for the owners but also for other interests.

The Board of Directors is selected by the shareholders, and the independence of the members of the Board of Directors varies depending on business tradition and regulatory structure. In some jurisdictions it is considered that the members of the Board of Directors must be independent of the owners and not be employed in the company. It can happen that not even the Chief Executive Officer is a formally elected, regular member of the company's Board of Directors. In other jurisdictions (e.g., in some Anglo-Saxon countries) it is considered to be an advantage for the members of the Board of Directors to be close to the company and its situation. Here large parts of the Board of Directors may consist of the directors (the top management) in the company top management -- from which the name "Board of Directors" derives.

The Board of Directors must follow the rules and laws which are in force in the country involved and be responsible for the company's organization and the management of the company's business. But the Board of Directors must also, based upon directives from the owners, see to it that the business plan is implemented at the same time as they take into account what is best for the company in the situation in which the company finds itself. The principal tasks of the Board of Director are, among other things, to:

- Continually keep track of the company's financial situation.
- See to it that the organization is structured so that bookkeeping, asset management and financial circumstances are monitored in a satisfactory way.
- Provide written instructions as to when and how reporting to the Board of Directors is to be done.
- Develop policies and guidance for the work of the Board of Directors.
- Appoint the CEO and develop instructions and guidance for the work of the CEO, which will govern the division of responsibility between the CEO and the Board of Directors.

Another important role which the Board of Directors has in many jurisdictions is to see to it that taxes and fees are paid on time. The Board of Directors must also see to it that the annual financial statements are prepared and are provided in a timely fashion to the relevant governmental authorities.

It is an undertaking of high responsibility to be elected to a company's Board of Directors. In many jurisdiction decisions of the Board of Directors are taken by majority vote, but each member of the Board of Directors also has an individual responsibility for the decisions that director agrees with and makes. In other words, as a member of a Board of Directors you will have joint and several liability in many cases.

Having the right Board of Directors is utterly decisive for the development of the business. The Board should be composed of persons with different experience, competence and personality who are suited to the situation and phase in which the company finds itself. It is the combined strengths of the Board of Directors which is decisive for successful Board work. The atmosphere in the board must be open and respectful and allow all questions to be asked!

See also:

- Shareholders' meeting

Bona fide

A "bona fide transaction" is a transaction with honest, reliable parties, acting in good faith, and on terms and conditions customary in the market. Compare with "Arm's length" distance.

See also:

- Arm's length

Book building

A process for creating a demand and a price picture, for example during an issuance of shares or a listing on a securities exchange. Ordinarily an investment bank functions as coordinator (broker) in the process. Book building is also used in connection with the issuance of other securities. The broker builds a book with investors who are interested in the transaction.
It is an offering process in which the investors state how many shares they are interested in, and at what price. The auction proceeds confidentially, and outside of a securities exchange if a listed company is involved.

Boot Camp

Boot Camp (bootcamp) is a term used in some business situations to describe various types of gatherings involving education and in combination with some kind of physical exercise. It may, for example, refer to an event where participants get an intensive course on how to use social media for their marketing while exercising with physical exercise, and healthy food.
Boot Camp originates from the US military, where it is a term for an intensive physical training camp for young recruits in the army. The name is also used as a term for rehabilitation programs for young criminals instead of imprisonment.
A completely different meaning of Boot Camp is as the brand of the Apple software to enable the use of Windows operating systems on Apple computers (in addition to MAC OS).

Branding

It is difficult to give a precise definition of "branding" since it can embrace a great number of widely disparate activities. In brief one can say that it is a long, persistent process to build an honest and positive picture (image) of the company in the customer's consciousness. A good brand must evoke positive feelings and promise the customer satisfaction and quality.

Examples of well-known brands are Coca Cola, Apple, IKEA and BMW. See also "Intangible Assets".

It is not only businesses which build and maintain strong brands. Examples of this are the Red Cross, the UN and Save the Children. Even political parties build the brands under which they market their ideologies, for example Liberals and Conservatives.

Sometimes brand is said to be the same as trademark, which is a somewhat limited definition. A trademark is a sign (symbol, word, letter combination etc.) that you recognize and associate with the company. The trademark must, however, be in harmony with the image the branding is creating.

What, then, is the business point of branding? The goal of a strong brand is to be able to have higher prices than one's competitors, and thus also higher margins and profits. And higher profits are needed since significant investments are necessary to build, develop and maintain a strong brand.

A strong brand is a valuable element in the company's balance sheet -- an intangible asset. In turn, this can provide substantial goodwill assets, which are sometimes difficult to define the value of, in connection with acquisitions of companies.

See also:

- Intangible assets

Break-even point, BEP

The point where "plus" and "minus" are equal. An example is when revenues and costs balance, that is that the revenues are the same as the costs during the measuring period. Break-even can also be the point where profits and losses balance or the company reaches a positive cash flow so that what is received in payment is equal to what is paid out. This may mean that the business begins to make a profit above break-even. This point is sometimes called "ground zero".

See also:

- Burn rate

Bridge financing

Financing for the purpose of bridging a gap in the company's finances for a relatively short period of time, for example in connection with an acquisition or in the event of temporarily strained liquidity. It is also possible to use a bridge in order to finance a growth company which is planning a securities exchange listing and a new issuance of securities.

Bubble

A financial bubble is a rapid increase in the price of an asset, which, after a certain period, turns into a rapid price drop (the bubble bursts). Bubbles often occur in a particular industry and may include a rapid increase in the share price of certain companies, the price of real estate, or the price of a particular commodity.

A bubble is a speculative, upward spiral caused by good access to capital and exaggerated expectations of future value growth. More and more investors pay an increasingly high price, which quickly exceeds the real value of the asset. At the start of the bubble, investors may make huge profits by selling the asset in an upward spiral, which, in turn, attracts new investors and financiers.

However, sooner or later, the financial bubble will burst. When and how the turnaround will come is impossible to predict. The shift is triggered by some unforeseen event--big or small--that creates uncertainty about the real value of the asset. When the financial bubble bursts, the price of the asset will decrease in a rapid downward spiral. The financiers are no longer willing to provide capital for investments and, instead, demand repayments. Investors now sell their assets in a panic, trying to cut their losses and repay any debts. As the price falls, there are more and more sellers and less buyers, which in turn increases the downward spiral. If an investor has borrowed against the investment and assets were used as collateral, the lender may force a sale -– even at a loss. But at a certain price level and time, the decline of the price stops. New investors begin to believe that the asset is undervalued. This is the time to buy; the price slowly increases and is normalized.

The winners in the bubble are those who bought early at a low price and sold at a high price, just before the bubble burst. The losers are those investors who came in late. They paid a high price and did not have time to sell, or did not want to sell, before the downturn began. Late investors usually wait too long to sell; they hope the price will turn so they can avoid or reduce their loss.
How can you recognize a bubble? It's probably impossible to understand if a rapid price increase in an asset is based on an underlying real value growth or if it's a speculative bubble. Generally speaking, you should be careful and observant if the price of an asset rises suddenly and quickly without an apparent change in the asset's real return.

What then are the consequences of a financial bubble? If the bubble involves only a particular asset, such as shares in a small company, the economy in general is largely unaffected. But if the bubble covers the entire stock market or significant and large companies, the burst can lead to a stock market crash and a recession for an entire country. The financial bubble will then impact the real economy, and the effects are extensive.

There have been a number of famous bubbles throughout history. One very well-known bubble was the tulip bubble in Holland (1630). Speculation in tulip bulbs drove values to extremes. During the bubble of the South Sea Company in England (1720), there was speculation in the stock of the South Sea Company, which was trading in the South Sea and other parts of America. The stock exchange crash in the US (October 1929), also known as Black Tuesday, was the most disastrous stock market crash in the history of the United States so far. It led to the Great Depression, which spread to all Western industrialized countries. Black Monday refers to Monday, October 19, 1987, when stock markets around the world crashed after a huge share price increase in a very short time. The IT crash (March 2000), or the dot.com bubble had to do with speculation in assets related to IT and the

Internet. The financial crisis of 2008 (September 2008) refers to speculation in various assets, e.g., the housing market, real estate, and subprime mortgages. It led to the loss of confidence in banks, finical institutions, and to the bankruptcy of the Lehman Brothers.

Bull market

Upturn on a securities exchange, increased market prices and an optimistic belief about the future development of market prices. "Bull market" is the opposite of "bear market". It is said that the bull holds its head and horns pointing upwards while the bear goes about with hits head bowed down (?).

See also:

- Hausse

Burn rate

Is a measure which describes the capital (cash) which is being used (burned) in a company which does not have its own positive cash flow.
Burn rate shows the company's current costs and necessary investments and is often measured in €/month. If the company has cash of €10m and its "Burn rate" is €2m/months the cash will last for 5 months. Unless break-even is reached during this period, the owners or the bank will have to provide more capital within 5 months, or else the company will not survive.

See also:

- Cash flow
- Negative cash flow
- Positive cash flow
- Break-even point, BEP

Business angels

Business angels, also called angel investors, are private individuals who invest their own money in enterprises -- often newly started ones (start-ups). The name comes from these investors being regarded more as charitable donors than as rational capitalists.
A typical business angel is a successful entrepreneur who has previously built up a business, sold it and now shares his capital, his experience and his network with a young management team which has started its first business.

The motive behind the investment is thought to be principally the interest and pleasure derived from helping newly started companies to succeed. But there is obviously also a financial motive.

See also:

- Seed capital

Business as usual

"Business as Usual" (BAU) means that the business –-or organization-- is conducted in a normal, usual way. The term is used in conjunction with a business that is subjected to extensive external events that may affect the business positively or negatively. However, we do not know yet when and how. The business is run in a normal manner until we know with certainty that the business is affected and how it is affected.

See also:

- Exit
- Exit process

BAU is sometimes confused with the status quo, which is misleading. The status quo means that no changes are made at all while BAU includes normal, planned changes.

Example: In connection with the sale of the company (in an exit process), the management is given the task to operate business as usual until the sale is negotiated and completed. It means that business activities are conducted normally not to be affected by the ongoing sales process. All information about the planned sale is kept secret and disclosed only to those directly involved as there are large uncertainties in the sales process. The intention is not to create uncertainty and anxiety among its stakeholders, e.g., employees, customers, suppliers. If buyers and sellers cannot agree on price and terms, then the deal will be off. In addition, the management does not know what plans a potential new owner has for the business and how a transfer of ownership will affect its stakeholders.

For the management, business as usual means to run the business normally and, in parallel, be active in the sales process. This may include producing financial information, writing reports, and to make company presentations. The management must also, as much as possible, prepare the company for the situation after the sale. This fragmented focus is obviously a very difficult and tedious task! Even if the intention is to operate normally, you cannot make long-term commitments or major strategic decisions. It is, therefore, important to keep the period with business as usual as short as possible -- with respect to both the management's focus and the company's strategic development.

Business card on the table

Introducing yourself to a desirable customer or business partner with hopes of business in the future. You give your business card to the potential customer or leave it on the customer's meeting table.

Business Plan

A business plan is a description of a company's business that is both wide-ranging and detailed. The plan will contain a description of the company's business concept, strategies for various business areas, activity plans, resource needs, and financial plans. You may start with a marketing plan which is then included as part of the business plan.

A business plan may contain the following headings:

- Market and market development.

- Business idea (concept), vision, mission.
- Market segment and positioning that has been chosen.
- Products and services.
- Competition - direct, indirect, substitutes.
- Competitive advantages.
- A SWOT-analysis (strengths, weaknesses, opportunities and threats).
- Values, ethics, culture and morale.
- CSR
- Team, competence, resources, partners, networks.
- Sales, management, production, logistics, deliveries.
- Profits/losses, balance sheet, cash flows.
- Financing.
- Short-term and long-term objectives.

The plan will often cover a rolling 3-5-year period and be revised at least once each year.

See also:

- CSR
- SWOT

Bust, going bust

An expression for a company going into bankruptcy. Sometimes the term "Belly up" is used.

Buy and build

Investing in one (1) company with the intention of building a larger company by the acquisition of companies which complement the business or increase market share. "Buy and Build" is an investment strategy which Private Equity investors, for example, avail themselves of.
An example is an investment which is made in a company in UK and which later buys up competitors in Germany, France, Spain and Italy. By means of the acquisitions, the market is consolidated, and a larger European company is created. A company with a broader geographic platform is generally seen as having higher value for a purchaser than a company which is only active in one domestic market.

See also:

- Buy-out transaction
- Consolidation

Buy-out transaction

When an external buyer, for example a Private Equity investor, buys out a business (e.g. a subsidiary) from a company or an ownership group. In a so-called "leveraged buy-out" the financing of the acquisition has great significance.

See also:
- Private Equity
- LBO
- Partial Buy-Out

C

CAO
Abbreviation of "Chief Administrative Officer", the management person who is responsible for the administration in a company or a business. This is a wide-ranging position and one in which the area of responsibility depends on the size and type of the business. The CAO is responsible for a variety of administrative (business support) processes, which may include the finance department, the human relations department, the reception of visitors, the purchasing of office equipment, IT/telephone, lease agreements, etc.
The CAO usually reports to the CEO.

See also:
- C-suite

Carry
Carry is a term for the part of the profits in a fund which is distributed to a venture capital or Private Equity management company (the so-called General Partner).

In order for carry to be distributed, however, the profits must exceed a specific level (hurdle). When and how distribution of profits is to be made is partly the result of negotiations and partly dependent on international market practice. The investors in a Private Equity fund may, for example, be willing to distribute 10% of the profits in carry, but only after the fund has reached a total of 20% in annual return.

See also:
- Private Equity
- Fund

Cash cow
A successful product, or a part of a business, which generates large cash flows (and profits). This is often a fully developed product with no growth, and which does not need further investments.

The profits from a Cash cow are therefore reinvested in new products and services.

Cash flow
The company's internally generated funds, that is, the liquidity (cash) which has been created or is being used during a particular period in the business.

In order to obtain a complete picture of how the business is developing, it is not enough to analyse and understand the profit and loss statement and the balance sheet. To understand to the business's need for financing, it is also necessary to report and understand the company's cash flow.

The reported net cash flow is affected by all of the company's revenues and costs, excluding items which do not affect cash flow (write-offs and balance sheet allocations).

See also:

- Burn rate

Cash rich

A term for a company, or a business, which is financially very strong. The company has significantly positive cash flow and a larger cash position than the business requires. Another term is a business that is "over liquid" or "overcapitalized".

CCO

Can have several meanings:

- Chief Commercial Officer: Head of marketing, responsible for marketing, market development, sales, etc., with the goal of increasing the company's market share.
- Chief Compliance Officer: Head of regulatory compliance, responsible for the company complying with regulatory requirements, for instance environmental requirements, ISO 9000, etc.
- Chief Communications Officer: Head of information services, with responsibility for the business's external communications and for PR.
- Chief Content Officer: Head of content, with overall responsibility for the content of the media channels which the company uses -- web, text, video, sound, animations, etc.
- Chief Creative Officer: Head of creative services, whose areas of responsibility depend upon the type of business -- for example with responsibility for "branding" and for the company's image which its marketing creates. The title may also encompass creative directors, art directors, designers, copywriters, etc. within an advertising agency.

The CCO usually reports to the CEO. See also "C-suite".

See also:

- C-suite

CEO

The executive director. Abbreviation of "Chief Executive Officer". Sometimes also called President.

See also:

- C-suite

CFO

Director of finance. Abbreviation of Chief Financial Officer. The CFO usually reports to the CEO.

See also:

- C-suite

CHRO

Chief Human Resources Officer (Head of Personnel) has the overall, strategic responsibility for the HR function (Human Resources) and for all issues related to personnel. This may, for example, encompass policies for the management of recruiting, development of personnel, discharging, and issues of succession and compensation. The CHRO usually reports to the CEO.

See also:

- C-suite

CIO

Chief Information Officer is the one who has responsibility for the company's internal information systems and who most often also covers both the telephone and the data communication. An earlier term was Head of IT. The CIO usually reports to the CEO.
See also:

- C-suite

C-level

Synonym to C-suite. The abbreviations in the so-called C-level are equivalent to positions of the top managers in a corporation who report to the CEO - the so-called 2nd tier.

See also:

- C-suite

Closing

When a business transaction ”close”. "Signing" is the event when the seller and the buyer of an asset (e.g. a company) are agreed on price and terms and conditions, and the purchase and sale agreement ("SPA") is signed. In many cases the transaction cannot be concluded at the same time; the companies may, for example, need approval from specific governmental authorities. It is then necessary to wait (weeks, months) so that all the formalities can be in place before it is possible to close the transaction. Only then are shares and money exchanged at the same time as the formal change of ownership occurs.

See also:

- Signing

Coaching

Coaching is a supportive activity which is intended to help a person or a group of people (a team) achieve particular goals. Coaching usually exists within the world of sports, but in recent years has been used in many other contexts, for example among those who work with career guidance and leadership.

Coaching of business leaders may be carried out in many different ways. Usually goals and partial goals are established jointly, and the coach gives encouragement and asks questions.

COB

COB is short for Chairman of the Board. The abbreviations in the so-called C-suite are equivalent to positions of the top managers in a corporation who report to the CEO - the so-called 2nd tier. Here COB is an exception.

See also:

- C-suite

COLOMBO

Abbreviation of "Colossally Over-priced MBO", that is, a greatly overpriced buyout transaction. In the years 2006-2007, just before the financial crisis, many COLOMBOs were carried out.

See also:

- MBO

Comfort factor

Investing in a company is always risky and an investor wants to feel as comfortable as possible about his or her investment. It is possible to increase the comfort factor by making a penetrating investigation of the enterprise.

Another way of increasing the comfort factor is to go through various scenarios for the development of the investment (the company). Both positive and negative. You want to be able to live and sleep well with the worst case, that is, even if the worst-case scenario happens.

When there is a big gap between your base case and worst-case scenario the comfort factor is considered to be high.

See also:

- Worst-case scenario

Comparison-destroying items

Entries on balance sheets and profit and loss statements which are not related to the company's normal business. Usually these are revenues or costs which are of a one-time character or which will not recur annually. In order to obtain a picture of the company's normal business, these entries are excluded.

An example of a comparison-destroying item is the disposition of a subsidiary which has produced a large profit on its sale and a large addition to cash. Another example is the cost of closing down a factory.

See also:

- Adjusted EBITDA
- Adjusted EBITA

Completion

When a transaction becomes legally binding. This normally occurs when all agreements, including appendices, are completed and signed.

See also

- Closing

Compliance

A business's obedience to (compliance with) a regulatory structure. As an example, the financial sector must comply with and obey a significant number of requirements and regulations which are principally designed to protect external investors and the general public from misleading information which affects the value of an asset.

Companies must comply with a regulatory structure for bookkeeping, auditing and reporting. Other regulatory structures which must be complied with (if the company is subject to them) are rules for quality (ISO 9000), environment (ISO 14000) and CSR (ISO 26000, Corporate Social Responsibility).

Conditions Precedent, CP

Entails that a transaction is conditioned upon the fulfilment of a number of factors for the transaction finally to be carried out (to be closed). A common condition precedent is that the transaction is conditioned upon approval by governmental authorities, for instance, the competition authorities in the affected countries.

See also:

- Closing

- SPA

Consolidation
Consolidation means fusion. The word can be defined and used in various ways depending on context. If what is involved is a fusion of several businesses in a single industry in order to build a larger, stronger business, it is said that an industry has been consolidated. Consolidation can also mean that the profit and loss statements and the balance sheets of the subsidiaries in a group are consolidated (calculated together) so as to obtain a consolidated result.

See also:
- Buy and build

Contributions in kind
A business can use its own shares as payment for assets. Upon an issuance against contributions in kind new shares are exchanged for assets, for example where a machine is appraised and is contributed (is exchanged) for an ownership share. It is also common for shares in an acquired company to be contributed (to be exchanged) for shares in the acquiring company.

A prerequisite for a contribution in kind is that the assets, the property to be contributed, are of use to the company. The assets which are contributed must be appraised at market value.

Convertible debenture
A convertible debenture (loan) is a debt instrument issued by a company to finance the business. It is regarded as a hybrid security since it is an ordinary, unsecured, loan with a convertibility option. The option gives the lender the right after a certain time, but not an obligation, to convert the loan to shares in the company. The lender gets interest on the loan but no repayment during the term. The company usually pays a lower interest rate on the loan compared to if there were no option to convert to shares.

The number of shares that corresponds to the amount of the loan is settled in advance. The value of the option is determined with an option-pricing model such as the Black-Scholes valuation formula. When the loan matures, the lender can choose to get the loan repaid in cash or to be converted into shares in the company.

Example: Assume you lend 10,000 Euro to a company with a term of three years. When the loan matures, you have the right to convert the loan to shares valued at 120% of the current share price €10. The interest rate, paid annually, is set to 5%. If the share price exceeds €12 on the due date, you choose to convert to shares. If the price is below €12, you will choose to get the loan repaid in cash. Let assume that the share price is €10. It is of course then better to get the loan repaid and use the cash to buy shares directly. During the term, you also received interest to the amount of €1,500.

The risk of an investment in a convertible debenture is regarded as lower when compared with an investment in shares. In addition to the flexibility, a convertible debenture gives the lender a downside protection. If the company is unable to repay the loan in cash at maturity, the lender may try to negotiate an extension with a new, lower conversion rate -- one that may even be lower than the current share price. The convertible debenture also has a preference before shares if assets are distributed, e.g., in a liquidation or bankruptcy situation. Convertible debentures, however, are subordinated loans secured in the assets of the company.

See also:

- Downside protection

COO

Chief Operating Officer is the person who is finally responsible for the operations in a company or a business (operations manager). The COO usually reports to the CEO.

See also:

- C-suite

Cost

It is necessary in accounting to separate costs so as to obtain as accurate a picture as possible of a company's financial position. An example is rental costs, which usually are periodized. If a company pays rent (makes a payment) for three months in advance, the classification of the rental cost will not be correct if the entire payment is taken as a cost, and impacts the profit and loss statement, only in the month in which the rent was paid. Cost accounting in this example means that the rental cost will be divided into thirds over the three months to which the rental payment relates.

See also:

- Accrual accounting
- Revenues

Core business

The nucleus of a company's business, that is, those areas in which the company has special competence and is competitive as compared with its competitors.

See also:

- Back to basics

Corporates

A term for large companies and their key management personnel. Sometimes the term "large corporates" is also used. Large export companies and nationwide banks are good examples.

Corporate finance

A concept for professional advisory services to companies. A company (or its owner) will use the corporate finance department of an investment bank or a large accounting firm if it needs qualified financial advice.

This may involve advice or help relating to:

- Company financing, for example new securities issuances.
- Purchase or merger of companies.
- Disposition of companies or businesses.
- Locating appropriate acquisition objects.
- Valuation of companies.
- Incentive programs.
- Etc...

In many developed countries there is a good infrastructure for corporate finance and financial advisory services. There are small, medium-sized and large firms which offer these services, all depending on the size and complexity of the transaction.

See also:

- New issuance
- Investment bank
- M&A
- Raise a fund

Corporate raiders

"Corporate raiders" are investors who buy significant shares (controlling positions) in a business without certain large owners, the Board of Directors or the management having consented. This is then regarded as a hostile takeover. The investors' intention is often to take advantage of hidden values of the business, for instance by dividing it up and then selling the parts individually. The hypothesis is that 1+1 equals more than 2.

Corporate raiders are regarded by some as being short-sighted, greedy investors while others think that they liberate values in sleepy businesses.

See also:

- Pirates
- Black knight
- Overcapitalized

Corporate turn-around

Measures for turning around developments in a company which has fallen into serious difficulties. Very comprehensive measures are almost always needed to convert loss into profit.

See also:

- Back to basics

Corporate venture, CV

A venture capital company which is within a large, established business (for instance, Intel or Ericsson) and which invests in closely related new ideas and technologies which are of interest for the long-term development of the business. The capital which is invested comes from the balance sheet of the CV, i.e. not from a typical Venture Capital fund.

The advantages for the company (the target company) which CV invests in are that it obtains access to expertise in the industry, and often its first customer. The disadvantage for other shareholders in the target company is that there may be only one (1) possible buyer in the event of a sale of the company, that is, of the parent company which owns the Corporate Venture company. A potential buyer may for instance be a competitor to the CV's parent, which would make the transaction impossible. A CV with a controlling position may thus be able to dictate the price and the terms and conditions.

Cost of capital

The cost which the company/the business has for the capital which it uses. The cost of capital can be divided up into two principal groups:

- The cost of the capital which the owners have invested, that is, the company's equity capital on its balance sheet. The cost of the equity capital corresponds to the owners' requirements for return and is dependent on alternative, comparable possible investments.
- The cost of borrowed capital, that is, interest-bearing debt to banks or other lenders. The interest on loans varies partly with the risk in the company and partly with the level of market interest rates.

The cost of the two sources of capital varies from company to company, in that both operational and financial risks are considered. The cost of capital in a young company without a history is higher than in a company which has shown good results and a positive cash flow for many years. Companies with low equity to debt ratios (a large share of loans in relation to equity capital) in general have higher capital costs that those with high equity to debt ratios.

Most companies strive to achieve an optimal balance between equity capital and borrowed capital. The cost of capital for a business as a whole will therefore be a weighted middle value of requirements for return on equity capital and on loans. The average cost of capital is called WACC (Weighted Average Cost of Capital) – or "the wacc" as economists often say.

See also:

- WACC

CPI

CPI is an abbreviation of "Consumer Price Index" and is a statistic measure of the average change over time in consumer prices. In calculating the Consumer Price Index, a comprehensive, mixed basket of goods for private consumption is used. The basket is divided into twelve principal groups, and some 90 subordinate groups, in conformity with an international classification (COICOP = Classification of Individual Consumption by Purpose).

The usual price groups within a consumer price index are:

- Food and non-alcoholic drinks.
- Alcoholic drinks and tobacco.
- Clothes and shoes.
- Residences.
- Equipment and household goods.
- Health care and medical services.
- Transport.
- Postal and telephone communications.
- Recreation and culture.
- Education.
- Restaurants and hotels.
- Sundry goods and services.

The CPI is used, for example, for:

- Compensation purposes and as a general measure of the development of the cost of living of households. It can bear on adjusting pensions and social support services, as well as on adjustments of prices in agreements (e.g., in lease contracts).
- Conversion of nominal consumption numbers into numbers in fixed prices in national accounts and in calculation of developments in real wages.
- Stabilization policies such as a basis for a Central Bank's monetary policy and the development of the domestic purchasing power of the domestic currency.
- Measuring changes in inflation and in prices in connection with economic analyses.
- Determination of the base price amount.

See also:

- Inflation
- Index

CRO

Chief Risk Officer (CRO) is responsible for analyzing risks and managing conduct in order to minimize the company's essential risks, for example its financial, operational, product-related and PR risks. The CRO usually reports to the CEO.

See also:

- C-suite

Creditor

A creditor – is someone who has a claim against someone else. A synonym is claimant. A person or a firm that the creditor has a claim against is called debtor. In other words, the debtor has a debt to the creditor.

See also:

- Debtor

Crossover investor

A crossover investor is an investor who invests in several stages of a company's life cycle, e.g. before, during and after a company's IPO. The aim is to maximize the return. Crossover investors are common in young technology and biotechnology companies.

Crowd funding

"Crowd funding", or grass roots financing, is a method of financing a company, or a project, in which many private investors each make a relatively small investment. Usually these investments are coupled with high risk and are used, for example, to finance the start-up phase of a new business. But crowd funding is also used to finance other types of projects, for example a website, a new film, or a new music project.

One of the advantages of this method is that a project can find capital willing to take risks in situations where institutional investors and banks consider the risk entirely too large or the upside entirely too small. Among the disadvantages is that there will be a large number of investors to take into consideration and to keep informed.

There are a number of internet-based services in case it is desired to use crowd funding. In any case, it is important to describe, and to be clear about, both the possibilities and the risks in the investment.

CSR

An abbreviation of "Corporate Social Responsibility". The concept CSR began to be used as early as the 1960s and has been used all the more often in recent years. It has even become a modern buzzword. ISO 26000 is the international standard which is used for guidance and certification of a company's CSR work.

The idea is that a company must not only maximize the value of the shares for its owners. CSR is intended to be a self-regulating process which entails that the company will consistently have regard to all stakeholders and their interests so as to positively affect ethics, morale, the environment and social circumstances. The processes must at the same time minimize the risk of improprieties (e.g., bribes).

In the long term, CSR is thought to create increased profitability by more efficient use of all of the company's resources, and thereby also to create increased value for the owners. Failure to satisfy adequately the society's expectations for the company's CSR will create bad-will, and damage the trademark and the company's image, which will in turn diminish the value of the company.

We can anticipate increasing regulation of and legislation relating to companies' CSR processes, from both local and international authorities.

See also:

- Shareholder value

C-suite

Abbreviations, which originally derive from the USA, of the authority and position in a business of its top managers. In addition to the CEO, officers who report directly to the CEO, the so-called "second tier", are included. A synonym is C-level. Their position (title) is usually shortened to three letters which start with a C and end with an O. Examples are:

- Chief Administrative Officer (CAO).
- Chief Creative Officer (CCO).
- Chief Executive Officer (CEO).
- Chief Financial Officer (CFO).
- Chief Human Resources Officer (CHRO).
- Chief Information Officer (CIO).
- Chairman of the Board (COB).
- Chief Operations Officer (COO).
- Chief Risk Officer (CRO).
- Chief Technology Officer (CTO).
- and so on...

See also:

- TLA

CSO

Chief Science Officer (Head of Research) is responsible for research within the company, for example in a pharmaceutical company. The CSO usually reports to the CEO.

See also:

- C-suite

CTO

Chief Technical Officer (Technical Director) is responsible for the company's research and technological development. The CTO usually reports to the CEO.

See also:

- C-suite

Customer Experience

Customer Experience (CX) – is a concept that encompasses all the contacts that you as a customer have with a company. The CX includes your overall experience as a customer of the company, its products and services.

The experience may include your observations from only one purchase occasion or during a longer time with repeated purchases. CX reflects the feeling you have as a customer after all interactions with the company.

CX is sometimes confused with the UX (user experience) which, however, is a narrower concept than the CX. CX is measured using e.g. NPS method (Net Promoter Score), which means that you need to answer whether you would recommend the company to a friend.

See also:

- User experience, UX

D

DCF

"DCF" is an abbreviation of "Discounted Cash Flow" and is a method for calculating what a future payment is worth today (present value).

An example: Assume that you have been promised €100 in a year. If the rate of interest (the discount interest rate) is set at 10%, the value today is €90.90.
The method is really a "backwards calculation" of interest. You can compare the reverse situation. If you invest €90.90 today and get 10% annual interest you will have €100 in a year.

DCF calculations are used, for example, in connection with the valuation of enterprises.
See also:

- NPV
- Discounted cash flow
- Pay-back

Deal

A synonym for transaction or agreement. It can encompass both complex transactions and simple agreements.

Deal flow

The flow of business opportunities (investment proposals) which reach an investor.

Debt

A debt (or liability) is a commitment to pay back a sum of money. The repayment often must be made within a specified time. Amortization is a step-wise repayment of a debt. Examples of debt or liability items on a balance sheet are bank loans, accounts payable and taxes.
The balance sheet item Equity capital is seen as a debt or liability to the shareholders, but without a time for repayment being determined. Dividends can be regarded as interest to the owners.

See also:

- Debtor
- Equity

Debt-free company

The term debt-free company means that the market value of the company's shares (the equity capital) plus interesting-bearing loans is equal to the total cost which an investor would have to pay to acquire the company and repay the company's loans. The company is then considered to be "debt-free".

An interesting reflection is that the company's value (compare "Enterprise Value") increases if the debts increase. But it must be noted that the value of the shares (the equity) is unchanged, or perhaps declines if increased debt means that risk in the company increases.

See also:

- Enterprise Value, EV
- Equity value

Debtor

A debtor is the term for someone who has a debt to someone else. The person to whom the debtor has a debt is called creditor. In other words, a creditor has a claim against a debtor.

See also:

- Creditor

Deflation

The term "deflation" means the percentage decline in the general price level from one point in time to another. In order to get an understanding of the price level, the changes in a large number of products (a basket with some 90 products and services) are measured over a specific period of time, which may be months, quarters, or years. Changes in the general price level can be translated into a consumer price index (CPI) and is used, among other things, to adjust agreements, rents, allowances, etc. Read more under "Inflation".

Deflation is the opposite of inflation and means that growth in the country's economy has stopped and is negative. Long periods of deflation are unusual, but after the financial crisis of 2008 the USA and several countries in Europe were affected by persistent deflation. Central banks can to some extent counteract deflation by lowering their lending interest rates (discount rates) and increasing the quantity of money (printing new bills).
In periods of deflation, those who save and those who wait to make investments and purchases are the winners, since prices and the value of assets decline. Cash is king and it is best to wait until prices have hit bottom.

Deflation for an extended period of time is damaging for the economy, especially if the value of important assets such as real estate, residences and shares declines. In the downward spiral which deflation entails, both investors and consumers hold off on larger investments and purchases -- which further drives the deflation. A persistent deflation will lead to inequalities in wealth, to unemployment, lower wages and increased political unrest. Periods of deflation are characterized by generalized pessimism and negative views of future opportunities.

See also:

- CPI
- Inflation

- Lowflation
- GNP
- GDP

Derivative

A "derivative" is a complicated financial instrument whose value is based on the value of one or more underlying assets. For example, derivatives may be tied to interest rates, currencies, shares or raw materials. Share options are an example of a derivative.

An investor, or a fund manager, can use derivatives partly defensively to minimize risk in a portfolio and partly offensively to increase return. Companies, too, use derivatives, for example to minimize exchange rate risks in customer receivables invoiced in foreign currencies or as a protection against interest rate increases on loans.

A derivative is a complicated (risky) investment alternative which is built to some extent on speculation. It is essential to know what you are doing and to be well informed about trading in securities. The derivative provides an opportunity for increased return or reduced risk -- you just have to choose. An investor can obtain growth in the value of her or his portfolio but at the same time be exposed to new risks, e.g., market risks (if the underlying value "goes in the wrong direction") or credit risks (if the counterparty cannot pay).

The two most common types of derivatives are:

- Futures: A buyer and a seller agreed on price, terms and conditions for payment and delivery of a specific asset on a specific day in the future.
- Options: There are two main types of options. The "offeror" (i.e. person or company) who grants an option can either sell an opportunity to purchase or buy an opportunity to sell an asset. The former is commonly named "call option" and the latter a "put option". The buyer of the option pays a fee (a premium) for the right to buy or sell the asset. The buyer obtains the right, but not the obligation, to purchase or sell the asset on terms and conditions agreed upon in advance, at an agreed price, and with delivery at a specific point in time. The person who sells and gets the premium for the option, by contrast, is forced to sell or to purchase the asset if the option is exercised.

How does this work? Derivatives can be as complex as you wish, but in brief the derivative gives an investor an opportunity to manage risks, that is, to choose if she or he wants to increase or to reduce the risk in her or his securities portfolio. For example, by purchasing a put option an investor in shares can sell the shares on a specific day at a price determined today and thereby obtain protection against a downturn on the securities exchange which she or he fears may occur.

Similarly, an investor can obtain a lever on her or his holdings by purchasing a call option to buy a specific share on a specific day at a price determined today. The option will be exercised if the exchange goes up and the price exceeds the price the investor has the right to purchase the share for. If the stock exchange goes to the wrong direction, the investor in these two examples will not exercise the option and will hence lose the capital which was used for purchasing the options.

Derivatives are purchased and sold in precisely the same way as other liquid securities. The derivatives market is a large, global market which performs an important function in the financial system. The opportunities for combining protection and a lever are in reality very much more complicated than in the examples above.

Trade in derivatives takes place partly on regulated securities exchanges and partly OTC (over the counter). OTC means that the buyer and the seller carry out the transaction directly between themselves and determine the price and terms and conditions without oversight from a securities exchange. On a securities exchange the trading is transparent, with known prices, terms and conditions, and delivery dates. Generally speaking, the liquidity is better on a securities exchange, that is it is easier for find a buyer/seller and to make a deal.

See also:

- Option
- Securities exchange
- OTC

Development capital

Capital for the development of a company or a business. Synonyms are "Growth capital" and "Expansion capital".

See also:

- Growth Capital

Dilution

When a company issues new shares, the percentage ownership of every existing share is diminished. The shares and the owners become diluted. If, for example, a company has a total of 1,000 shares and issues 300 new shares, the dilution will be 30%.

See also:

- New issue
- Pro rata

DINGO

A warning! An abbreviation which means: "Don't Invest – No Growth Opportunity"!

DINKY
Is an acronym that stands for "Dual Income No Kids Yet." It describes couples with high earnings potential who do not have kids and are between 25-40 years old. They are certainly planning to have children, but not yet. They take the advantage of a freer lifestyle and are, therefore, a very interesting target for the more expensive and exclusive consumer products and services.

They have the time and can afford everything from frequent restaurant visits and expensive cars to exclusive clothing and travel.

DINK (Dual Income No Kids) is a similar expression but refers to childless couples with high incomes of all ages - up to retirement. Products and services are adapted and expanded for those people with a more mature lifestyle. For couples without children, in middle age and older, investments in real estate, living abroad and exclusive experiences are examples of products and services likely to be of interest.

Discounted cash flow
Current calculated value of future cash flow. See more under "DCF".

See also:

- DCF

Dividend cover
A key ratio which measures the number of times a dividend can be paid from the year's profits and is stated as €/share or $/share (depending of local currency).

A low ratio may mean that too much of the profit is being paid out to the owners. A high ratio provides security that the company has capacity to dispense the capital, which is being paid out and, if the profit level is maintained, is a good sign for future dividends and direct return on the shares.

Dog
An expression for a very bad investment, product or business. A dog is an investment with a return which is much lower than expected and lower than comparable investments.

Double-digit
An expression for describing a powerful change in a company parameter (new orders, receipts, costs, etc.). For example, if a company has a double-digit growth in sales, this means that growth during the measuring period increased by a double-digit percentage number between 10% and 99%. This most often involves a change of 10%-20%.

Downside protection

A collective name for contractual devices which an investor can use to protect itself against losses if an investment declines in value. For example, an investor may have the right to free shares if the company does not live up to expectations or if a future new issuance of securities is made at a lower company valuation than when the investor came in as an owner.

Another example of downside protection is convertible loans. Partly the nominal value of the loan amount is independent of the valuation of the shares and partly the option portion (the right to convert to shares) is protected against a decline in value provided that the conversion price can be adjusted downwards if the company does not meet expectations or cannot repay the loan.

See also:

- Second round

Downturn

Downturn on a securities exchange, fall in stock prices. Another expression which is used is the French word "baisse" which means reduction. The opposites of downturn and baisse are upturn and boom (French: hausse).

See also:

- Bear market
- Baisse
- Upturn

Drag along

A device to "drag along" all owners in the event of a sale of the company. This is a contractual provision in a shareholders' agreement by which one (or several) principal owners can require that all shareholders sell their shares if an offer for the company is received which the principal owners accept.

The contract paragraph "Drag along" gives the principal owner, in a sell situation, control over all shares in the company. This is valuable for the principal owner since a buyer of the company can require that the principal owner deliver 100% of the shares.

A "Drag along" is particularly important in certain cases if the minority shareholders own more than 10% of the company. A buyer who gets more than 90% of the shares in a company may, with support from legislation (in some jurisdictions) compel the surrender of the rest of the shares. This right disappears if one or several of the minority owners have more than 10% of the shares and are not willing to sell.

See also:

- Shareholders' agreement
- Tag along

Drawdown

An example of a "drawdown" is when a company (its owner or Board of Directors) has a right to pull down financing for the company from an amount already set aside by the investors.
In some cases, an investor does not want to pay out the whole amount but instead commits itself to do so in stages whenever the company needs the financing. If the financing relates to a young company, in a start-up phase, this is sometimes called "spoon feeding".
Another example is venture capital and Private Equity funds which are financed in stages, where capital can be drawn down from the funds' investors whenever investments in various companies are made.

See also:

- Spoon-feeding
- Tranche
- Raise a fund

Due diligence, DD

A structured, detailed and penetrating review of a business or a company which new investors make before an acquisition or an investment. The inspection is made with "due diligence" -- hence the name. The investor develops an understanding of the company's strengths, weaknesses, risks and opportunities.

The DD is a check on whether the description of the business which the investor has received agrees with reality. The design and extent of a DD is situation specific and depends on the business's industry and size. It may contain sections for:

- Legal issues.
- Financial information.
- Commercial issues.
- The company's management and personnel.
- Morale, ethics, CSR.
- Tax issues.
- Pension commitments.
- External and internal environment.

The investor usually engages independent advisors to carry out the review of selected parts of the enterprise.

See also:

- Vendors DD, VDD
- Advisor
- Exit process
- Red flag

E

Early Stage

The early stage in a company's development. In this stage the company has no or only modest sales, is making a loss, has negative cash flow and must be financed with external capital.

See also:

- Seed capital
- Incubator

Earnings per share, EPS

An earnings measure which gives "earnings per share" -- abbreviated EPS. The measure is an indicator of a company's profitability and is based on earnings after taxes (usually adjusted for possible dividends) divided by the number of outstanding shares:

- EPS = (Net income – Dividends)/Number of shares in the company.

Assume that a company has a net income after tax of €100m and pays €25m in dividends. If the company has 15 million outstanding shares the earnings per share is:

- EPS= (100-25)/15= €5.00.

Earn out

Means a supplemental purchase price and is provided for in the sale agreement (SPA) between the seller and the buyer. As an example, an earn-out may give the seller a right to additional payment if the company it has sold reaches certain specified levels of sales or profits.

See also:

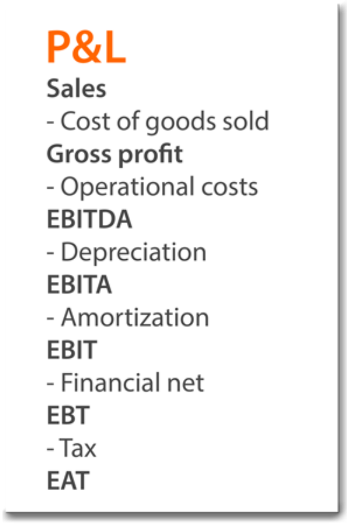
- SPA

EBITA

"Earnings Before Interest, Taxes and Amortizations", that is, the result of operations before interest, taxes, and write-offs of goodwill and of other excessive values.

This is a measure of results which permits comparisons over time and which is independent of financing costs, and of write-offs of goodwill and of excessive values which impact the company.

The figure below shows where in the P&L-statement you will find the EIBTA.



See also:

- EBITA margin
- Adjusted EBITA
- EBITDA

EBITA margin

A measure of results which is based on the result of operations before interest, taxes, write-offs of goodwill and of other excessive values (EBITA) in relation to net sales, expressed in percent. Calculated as follows: EBITA/net sales and stated in percent (%).

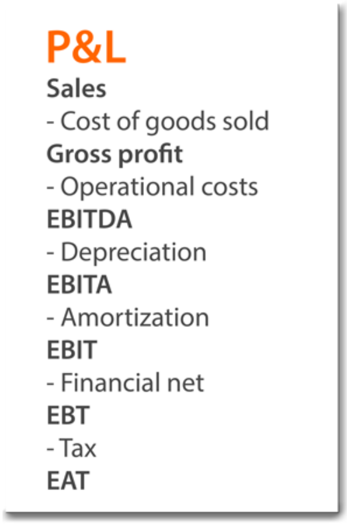
See also:

- EBITA

EBITDA

"Earnings Before Interest, Taxes, Depreciations and Amortizations", that is the result of operations before interest, taxes, depreciation, write-offs of goodwill and of other excessive values.

The figure below shows where in the P&L-statement you will find the EIBTDA.



This is a measure of results which permits comparisons over time and which is independent of financing costs, and of write-offs of goodwill and of excessive values which impact the company.

EBITDA is also used as an approximate measure of the company's cash flow as derived by calculation from its profit and loss statement.

See also:

- EBITDA margin
- Adjusted EBITDA
- EBITA

EBITDA margin

A measure of results which is based on the result of operations before interest, taxes, depreciation, write -offs of goodwill and of other excessive values (EBITDA) in relation to net sales, expressed in percent. Calculated as follows: EBITDA/net sales and stated in percent (%).

See also:

- EBITDA

Elevator Pitch

A very short presentation of oneself, one's company or product. The idea is to be able to make a short and interesting presentation in the course of a ride in an elevator. Preferably between two floors!

The goal is to get a follow-up meeting where it will be possible to provide more comprehensive information about oneself and one's offer.

See also:

- Beauty contest
- Pitch

Emerging business

A young company, or business, which has started selling and has great potential.

Enterprise incubator

A centre for newly-started enterprises, start-ups. The incubator offers an infrastructure with office space, reception for visitors, telephone and data networks, etc.

See also:

- Incubator

Enterprise value (EV)

Enterprise Value, or debt-free company value, is defined as the market value of the company's equity capital plus interest-bearing liabilities, as reduced by its liquid assets (cash). One way to calculate EV is to multiply the operating profit (e.g., EBITDA) by a multiple which is set by the market (the so-called EV-multiple).

Example: If the company's operating profit (e.g. EBITDA or EBITA) is €100M and the multiple is set at 7, the company's enterprise value will be EV= €700M. An estimate of the "market value" of the shares (the equity capital) can then be obtained by deducting the company's interest-bearing liabilities.

See also:

- Debt free
- EBITDA
- EBITA
- EV multiple
- Equity value
- Price mechanism
- Transaction value

Entrepreneur

Usually this means an energetic and ambitious person who takes the initiative and sees possibilities where others see problems. The entrepreneur is often the founder, or a significant owner, of a growth company.

Some examples of successful entrepreneurs are Ingvar Kamprad (IKEA), Bill Gates (Microsoft) and Steve Jobs (Apple).

If a person has started several successful enterprises, that person is called a serial entrepreneur.

See also:
- Serial entrepreneur

Equity

Shareholders' equity:	This year	Last year
Common stock and paid-in capital	**33 750**	32 500
Retained earnings	**5 000**	4 000
Accumulated other income	**800**	700
Total shareholders' equity	**39 550**	**37 200**

Equity (Capital) is the element on the balance sheet which constitutes the difference between the company's assets and its liabilities. In a corporation, equity is the shareholders' capital (or stockholders' capital) and is therefore booked as indebtedness to the owners.

The equity consists in part of the capital which the owners have contributed (the share capital) and in part of the profits which the company has generated (retained earnings).

Even if the equity is the shareholders' capital, it cannot be paid out in whatever way the shareholders or the company may want. The country's legislation (The Companies Act) governs when and how the owners' capital may be taken out. Regard must also be had to the company's capacity to pay dividends and to its financial situation.
Equity can be divided into "Restricted Equity" and "Unrestricted Equity".
Restricted Equity:
- Consists of the "share capital" and of restricted reserves (for example a share premium reserve).
- May not be paid out to the owners (except upon the dissolution and liquidation of the entire company).
- May be considered as a "capital guarantee" to creditors.

Unrestricted Equity:
- Consists of profits carried forward (accumulated profits and retained earnings) as well as the profits of the current year.
- May be paid out to the shareholders, but only if the Board of Directors considers that the company will be able to pay a dividend taking into consideration the financial needs and the commitments the company has.

Sometimes the concept "adjusted equity capital" (AEC) is used, which entails the reported equity being adjusted by various items on the balance sheet. As an example, any excessive values of assets (e.g., real estate) and other reserves on the balance sheet may be added (net after taxes). Possible negative items should also be taken into account. The adjusted equity capital, however, is usually higher than the reported equity capital.

See also:

- Share capital
- Debt

Equity/Assets ratio

A term for the relationship between equity capital in the company and the total assets on the company's balance sheet. The equity/assets ratio is measured in percent and is a measure of the company's capital structure, i.e., the division of the total capital between equity capital (the shareholders' capital) and debts (loans).

The ratio is calculated as:

- Equity/asset ratio= Equity capital/Total assets.

The equity/assets ratio shows how large a share of the total capital is made up of the equity capital. An equity/assets ratio of 25% shows that the company's financing is 25% equity and 75% loans. An equity capital/assets ratio of 50% thus means that the company's financing is equally divided between equity capital and loans.

The equity/assets ratio is a measure of the financial risk in a company. A high ratio entails a lower risk -- and vice versa. How high should the equity/assets ratio be? It depends on the industry and on the phase in the life cycle in which the company finds itself. Many larger, mature companies have a goal of having a ratio greater than 30%. If a company is growing powerfully, or is in an acquisition situation, a much lower ratio may be defensible.

Too high an equity/assets ratio is not optimal either. It may be a sign that the company is overcapitalized and could increase the dividends to its owners -- unless the company plans an expansion or a substantial acquisition.

An alternative measure of the company's capital structure is the debt ratio, which gives the relationship between debts and equity capital.

See also:

- Lever
- Overcapitalized
- Solidity

Equity ratio

A term for the relationship between equity capital in the company and the total assets on the company's balance sheet. Synonyms are "Solidity" and "Equity/Assets ratio".

See also:

- Equity/Assets ratio
- Lever

Equity value

The value of all shares in the company. There may, however, be a difference between the book value and the market value of equity. One method for estimating the market value is to take the company's total value (Enterprise Value) and reduce it by interest-bearing net liabilities (taking liquid assets/cash into account). Equity Value is sometimes abbreviated "EqV".

Calculated as follows:

- EqV= EV - interest-bearing debts + cash= market value of the equity.

See also:

- Enterprise Value

Escrow

An escrow is a financial instrument held by a third party on behalf of two or more other parties in a business transaction. One example is the payment for a property deposited into an escrow account (a blocked account, a trust) in a bank waiting for the outcome of the final inspection.

The parties to a contract (escrow contract) have agreed on the terms for how and when the payments from the escrow can be done.

An escrow gives the seller the security that the buyer can complete the purchase while waiting for the outcome of the inspection. At the same time, the buyer gets a security to get back all or part of the payment if the property is not of the quality that the seller promised. The blocked funds are transferred to the seller only when the conditions of the sale are met.

Another example is that parts of the purchase during acquisition are deposited into an escrow account as security for the guarantees that the seller of the company gives to the buyer. It can be a commitment from the seller that lasts over a number of years, and where instalments from the escrow account to the buyer take place if the buyer makes no warranty claims.
Suppose a company is sold for 100 million and 10 % (10 million) is deposited in an escrow on a blocked bank account as security for the three-year guarantees that the seller gave the buyer. The funds on the escrow account are also the seller's maximum commitment to cover any warranty claims.

The parties have also agreed that the guarantee commitment fades with time, and that one third should therefore be paid to the seller every year, that is, 3.3 million per year, unless the buyer has warranty claims.

If, however, it turns out that the company's inventories were valued at a price 2 million too high and the seller accepts the buyer's claims, a payment from the escrow account of 2 million is transferred to the buyer as a compensation for the inadequacy.

The party (for ex. a bank) that offers and is responsible for an escrow will take a fee of some percentage to cover the costs of administering the account and manage the payments.

EVCA

An abbreviation of European Private Equity & Venture Capital Association. EVCA was founded in 1983 and is an industrial association for persons active in the European venture capital market. The principal office is in Brussels.

Members are investors/venture capital companies and advisors who participate in business transactions (corporate finance, legal advisors and accounting firms). EVCA has more than 1,200 members.

You can search the membership on EVCA's home page to find advisors and investors suitable for various types of financing, situations and amounts.

Many countries have their own domestic Private Equity & Venture Capital Association, e.g. BVK (Germany), NVCA (USA) or BVCA (Britain).

EV-multiple

This is a multiple (a constant) which, when multiplied by the operating profit (e.g. EBITDA), gives the company's so-called "Enterprise Value" (EV). The EV multiple varies with the company's industry and over time (the business cycle).

A mature company, sensitive to the business cycle, may be valued by a multiple of five (5), while a growth company, not sensitive to the business cycle, may be valued by a multiple of 10.

The multiple is also affected by the market's tolerance for risk. A good economy and a positive view of the business climate raises the EV multiple.

See also:

- Enterprise Value
- EBITDA
- EBITA

Exit

A change of ownership when the old owners dispose of/sell their shares (exit) and new owners come into the company. This is a term which is often used by investors, especially Venture Capitalists and Private Equity, who are known for their exits. They invest and create value as owners in businesses for a limited time in order later to profit from their investment in an exit. An exit can be made in various ways, for example by a sale within the industry or through a listing of the company's shares on a securities exchange.

If there are several owners who together own the company, an exit is usually governed by a shareholders’ agreement (the SHA).

Exit is a word which is sometimes associated with great drama. But it must be remembered that it only involves a change of ownership and that not everyone who works in the company actually exits. The management and all other employees remain and work there after an exit. And to put in in perspective, one should also remember that there are continual exits on the securities exchange, when listed shares are sold and bought.

See also:
- Shareholders' agreement
- Exit process
- Listing on a securities exchange

Exit process

Exit (sale) of a company may be accomplished in a number of different ways, for example through a:

- Structured auction process with many potential buyers.
- Negotiated process with a few interested buyers, so-called "bilateral process".
- Listing on a securities exchange

In all of these processes the goal is to create a competitive situation where several buyers make offers for the company in a more or less structured auction. The intention is to get the best possible price and the best possible terms and conditions.

A structured exit process, which is not a listing on a securities exchange, may be divided into the following phases:

- Choice of an M&A advisor (investment bank).
- Choice of process.
- Scheduling.
- Analysis and selection of which buyers may be interested.
- Preparation of a "Teaser".
- Performance of the sellers' review of the company, a Vendor's Due Diligence (VDD).
- Setting up of a data room.
- Preparation of an Information Memorandum (IM).
- First round of bidding, with non-binding, indicative bids.
- Preparation of a sale and purchase agreement (SPA).
- Selection of which buyers have qualified for a "second" round of bidding or a negotiation.
- The buyer's due diligence (DD).
- Final and binding bids.
- Final negotiations.
- Signing.
- Closing.

A structured exit process takes some 6-12 months to carry out and is very demanding of work by the owners, the company's management and the advisors who lead the process. It is a challenge, and a difficult balancing act, to carry out an exit process and at the same time focus on the company's day-to-day business, transactions and customers -- on "business as usual".

See also:

- Vendors DD, VDD
- Advisor
- Teaser
- IM
- SPA
- DD
- Signing
- Closing
- M&A
- Exit

Expansion capital/financing

A financing of a company which needs capital in order to expand and grow its business. The financing may be done with loans, new issuances of securities, or owner contributions.
As an example, the capital may be used for investment in building up inventory in connection with increasing sales, in production equipment, or in order to finance new services and market channels.

See also:

- Growth capital

F

Fee

A collective term for the remuneration of, among others, advisors. It can also relate to remuneration which investors receive from the companies in which they invest (so-called management fees or monitoring fees) to cover their direct costs for administration of an investment.

See also:

- Success fee
- Management fee
- Monitoring fee

Financial buyer

A buyer which is not an industrial business, an entrepreneur or a business angel. The purchase may involve an entire company or a significant part of it. Among examples of financial buyers are investment companies and venture capitalists.

Financial buyers are usually not experts in the company's operational activities but contribute capital and strategic advice and share their networks of influential, experienced people.

See also:

- Trade sale

Flip

A very short-term investment, in which the investor's exit (the time for sale) has already been decided upon before the completion of the investment.

First round financing

The financing of a young company is usually divided into a number of rounds. The first round is the one which is associated with the greatest risk since the company has perhaps not yet managed to launch its products and start its sales.

See also:

- Downside protection
- Second round financing
- Spoon feeding

Focusing
Relates to a concentration on those businesses where the company has special advantages as compared with its competitors. Focusing entails at the same time saying no to more remote or new transactions and avoiding the allocation of competence and resources over many businesses. An appropriate choice of words is "less is more".

See also:

- Back to basics

Fund
A fund is a gathering of capital which is owned by several investors together (fund unit owners) and, depending on its orientation, makes investments in various types of securities.

The fund provides the individual fund unit owner both with an opportunity for larger transactions and greater spreading of risk. An example is a diversified share fund which spreads its capital over a range of industrial and geographic areas and may have tens of thousands of fund unit owners. The fund will have a Fund Manager with responsibility for investments and management of the fund's capital.

The capital of Venture Capitalists and Private Equity comes from funds, in which a number of institutional investors are given the opportunity via the fund to invest indirectly in unlisted companies. See more under "Raise a fund".

See also:

- Raise a fund
- Venture Capital
- Private Equity

Fund raising

The process by which an investment fund is raised (created) and investors are invited to invest in a mutual fund. Read further under "Raise a fund".

See also:

- Fund
- Raise a fund

Future, futures
A "future" is a binding agreement to buy or sell an asset at an agreed price and with delivery on a specified day. An example is a so-called "currency future" which is an agreement to buy or sell a specific currency.

Currency futures are used, for example, by a company which wants to guard (to secure itself) against currency risks.

For example, if a French company has a large purchase in USD, a bank can offer the company a futures contract in USD with a right to purchase Euros on a specific day in the future at the rate of exchange established today.
Currency futures are a way of hedging.

See also:

- Hedge

G

Guaranties

When a business is sold, the buyer often requires the principal owners (or the owners who have substantial influence in the company) to guarantee that the description of the company and its business agrees with reality.

For example, the guaranties may be that the parent company owns the shares in the subsidiaries, that the value of the inventory on the balance sheet is correct, that there is no known important agreement which is in the process of being terminated, etc. If it later appears that the inventory was too highly valued in the informational material provided to the buyer, those who provided the guaranty will be liable to compensate the buyer for the difference in amount.

In the sale agreement between the seller and the buyer, the guaranties are often specified in what is called "the guaranty catalogue", which is a special part of the agreement. What guaranties are given and how large the compensation is to be for any breach of the guaranties are often the most complicated parts of the negotiation between seller and buyer.

See also:

- R&W
- SPA

GDP

"GDP" (Gross Domestic Product) is a measure of the total production of goods and services within a country. Compare this with GNP/GNI (gross national product/gross national income) which also includes what is produced outside of the country by businesses which are owned by the country's citizens. The measuring period is usually one year (e.g., rolling 12 months), but may also encompass one or several quarters.

It is important to distinguish between nominal GDP and GDP measured in fixed prices. Assume that a country produces only two goods: mobile telephones and cars. During the first year 1 million telephones and 200,000 cars are produced. One telephone cost €200 and one car costs €30,000. This means that GDP for year 1 will be:

- 1,000,000 telephones @ €200 + 200,000 cars @ €30,000= €200M + €6,000M= €6,200M.

Nominal GDP for the year will thus be 6.2 billion Euros.

Assume that during the second year 1.2 million telephones and 210,000 cars are produced. At the same time, the price of a telephone increases to €220 and of a car to €33,000. GDP for year two will then be:

- 1,200,000 telephones @ €220 + 210,000 cars @ €33,000= €264M+€6,930M= €7,1940M.

Nominal GDP for year two will thus be nearly 7.2 billion Euros, which is an increase of over 16%. But this increase depends partly on an increase in volume and partly on an increase in price. Calculating GDP with fixed prices will correct for the price increase between the two years.

We take the volumes from year two and the prices from year one. GDP with fixed prices will be:

- 1,200,000 telephones @ €200+210,000 cars @ €30,000= €240M+ €6,300M = €6,540M.

GDP for the second year will instead now be approximately 6.5 billion Euros. This is an increase of 5.5%, which shows a significantly lower growth as compared with the increase in nominal GDP. The difference also shows that the manufacturers have succeeded in increasing their prices in parallel with the increase in volume -- inflation-driven growth.

GDP is used principally to see the growth in a specific country from one period of time to another. But GDP per capita is also used to compare growth and living standards between countries.

Measuring by comparing numbers between countries has its deficiencies, however, and is subject to a great deal of criticism. The most important objection is that not all production is included in GDP -- e.g., all "do-it-yourself-jobs", unpaid, non-profit or black-market work is not included.

Another deficiency is that it is difficult to determine the value of the public sector's production. This is taken at what it costs, not at the value it delivers. But despite these deficiencies GDP is an accepted, established and much used measure.

See also:

- Inflation
- Deflation
- GNP

Gearing

The term describes the relationship between a company's equity capital and its liabilities and is usually expressed in percent (%). Another relationship which is often used is operating profit before financial items in relation to net indebtedness (for example EBITDA/net debt).

Gearing serves to increase the return on equity capital, that is, the owners' contributions, by a supplementary financing with loans at lower interest than what the company pays on equity capital.

A good balance between equity capital and borrowed capital is healthy for the business, but a highly geared (borrowed) company means higher financial risk. If the enterprise loses profitability the gearing will act as negative lever on the return.

See also:

- Lever
- Leverage
- Leverage buy-out, LBO

GNP

"GNP" (Gross National Product) or GNI (Gross National Income) is a measure of the country's total production of goods and services. As distinguished from GDP, GNP also includes production based outside of the country's borders (offshoring) in businesses owned by the country's citizens. See also "GDP".

See also:

- Offshoring
- GDP

Golden parachute

A golden parachute is a contract between a company and a key employee. The agreement gives the key person right to a substantial compensation if the employment is terminated by the company. Usually it is the CEO and certain members of management group that are covered by a contract with the right to a golden parachute.

The purpose of such contract is to provide certain key employees security when major changes occur. A common situation where the parachute clause is used is when the management board of a company decides to dismiss the CEO. The compensation can for example consist of a cash payment, a severance grant during a fixed period of time, retirement benefits or share-based instruments.

Another example is in case of acquisition. If the management of the company that is bought feels that their jobs are threatened after the acquisition, they may decide to leave the company before the buyer makes the evaluation about which key persons they would like to keep. It may go so far that the managers try to prevent a takeover if they think they will be dismissed when the acquisition is completed.

A golden parachute gives these key persons a financial security in case they lose their jobs and it means they can await the buyer's plans and decisions regarding business activities. It also indirectly gives the buyer of the company some certainty that the key employees would remain in the company after the acquisition.

Even high-ranking state or municipal officials and politicians may have some kind of golden parachute that can be used if they are fired or lose their political mandate. In this case it is often an intention to give an official, who has perhaps limited his career to one (1) employer, the financial security to be able to overcome a change.

Goodwill
A term for the values (item on the balance sheet) which exceed the booked value of the company's assets. In conjunction with a purchase of a company or a business, goodwill may consist of established trademarks, patents, know-how, etc.

If the company has a goodwill item on its balance sheet, that item may be re-valued every year, which can lead to write-downs or write-ups of its value which can affect the profit and loss statement.

See also:
- Intangible assets

Grass roots financing
"Grass roots financing" is a method of financing a company, or a project, in which many (private) investors each make a relatively small investment. Usually these investments are coupled with high risk and are used, for example, to finance the start-up phase of a new business.
See also:
- Crowd funding

Growth capital
A term for the capital a company or an enterprise needs so as to be able to grow in a goal-oriented and consistent fashion.

A company in a growth phase may encounter problems with liquidity (cash) since the business must expand in several directions simultaneously. For example, this may involve financing of product development, new product lines, start-up of a sales company, or build-up of inventory.

The financing can be done through new loans or a new securities issuance, which will in addition increase the equity capital and strengthen the balance sheet.
A synonym is "Expansion capital".

See also:
- Expansion financing
- Private Equity

H

Hamster wheel

A company which finds itself in a "hamster wheel" has ended up in a vicious circle. Perhaps it does not have the characteristics that are essential to enable it to compete in a market, or opportunities to develop. The owners, the Board of Directors and the management keep running, and at last end up running around in circles, not finding any quick solutions, and becoming more and more frustrated.

See also:

- Vicious circle

Hands-on, hands-off

These concepts are used, as an example, by an investor or a company's Board of Directors to describe how active they are in the day-to-day operations of the business.

"Hands-on" means that they are active in the management of the business -- sometimes even in operational issues -- while "hands-off" means that they let the company's management run the business. The concepts can also describe how a supervisor runs his or her business area and that person's methods of giving orders to those who report to her/him.

Hausse

Upturn on a securities exchange, the market prices rise. From the French "hausse" which means increase. Opposite of "baisse" (downturn).

See also:

- Bull market
- Baisse
- Upturn

Hedge

Means to reduce risk and protect an investment with the help of another, counteracting financial instrument. The concept "hedge" is said to derive from the time when farmers in the English countryside protected their crops by planting hedges around their fields.

There are a number of devices for hedging, for instance derivatives, options, and futures. An investor (for example a hedge fund) can protect its investments in shares from a general downturn in the securities market by using "short selling" (see link below). If the market price goes down, the investor loses on its initial shareholding but makes a profit on the shares which have been shorted.

An export-oriented business with customer receivables in, say, USD, can hedge by using currency futures contracts by which the company obtains a right to sell USD on a specific day and at a specific price set in advance.

Example:
A French company sells a production machine to the USA for $2M (two million dollars) with a 60-day credit period for the customer. The rate of exchange at the time of delivery is €1.30/USD, which means that the customer receivable is worth €2.6M (2.6 million Euro). The company's bank offers the company a futures assurance which provides protection against a weakening in the USD by providing that it will buy USD in 60 days at €1.28. Since this is a significant customer receivable, the company chooses to hedge 50%. The futures contract means that the company will be forced to sell and the bank forced to buy, in 60 days, 1 MUSD (50% of the total) at the exchange rate of €1.28/USD.

Assume that the exchange rate falls to €1.21/USD by the time that the customer pays. The company now sells half of the 2MUSD that it was paid for €1.28/USD. The rest is exchanged at the rate of €1.21/USD. In total the company receives €1.28M + €1.21M = €2.49M. If the company had not hedged and had instead exchanged the 1 MUSD at €1.21, the company would have received €2.42M. The company thus profited to the extent of €70,000 by means of the currency futures contract (leaving aside fees to the bank).

In this example, the company chooses not to hedge the whole amount. It is desirable to have an upside in case the USD strengthens against the Euro. If the company hedges the whole amount of 2 MUSD and the exchange rate of the USD rises to €1.32/USD, the company will have to sell at an exchange rate of €1.28. The company will thus lose €2.64M - €2.56M or €80,000.

See also:
- Futures
- Short selling

Hockey stick

A "hockey stick" is a prediction in which the sales curve in a business follows the blade of a hockey stick so that in a near future the curve will radically turn upwards and follow the shaft of the stick. Hockey stick predictions are most common in start-up companies which do not have any historical sales to look at.

The optimistic prediction is made so as to sell the company's future more than its past, with the aim of increasing the company's value, for instance in conjunction with a new issuance in which new owners will be offered an opportunity to buy shares in the company.

In start-up phases, the owners, the Board of Directors and the management are often altogether too optimistic about the potential sales growth. But experienced investors are very sceptical about optimistic predictions and would rather value the company as following a stick which is lying down, where the increase in sales follows the shaft and not the blade.

Holding Company

A Holding Company is a company whose purpose is to hold shares in one or more subsidiaries. Another name for it is "management company". A holding company most often owns more than 50% of the shares in its subsidiaries to have majority influence and control. The holding company is usually not an operational company directly involved in the operation of the business, but there is no obstacle to prevent it running its own businesses.

Venture Capitalists and Private Equity investors usually establish a new holding company when making an investment. It is the holding company which is financed in order to buy the operating company and which formally appears as the new owner. This means that a Venture Capital company and its funds do not directly own the shares in the operating (target) company, but instead that ownership is accomplished via a holding company.

See also:

- Investment company
- Partial buy-out
- Buy-out transaction

Hostile takeover

A hostile acquisition of an enterprise which is not approved of by the owners, the Board of Directors or the management. It is experienced as particularly hostile if an aggressive competitor is the buyer.

See also:

- Corporate raiders

I

In between jobs
"I'm in between jobs" is a way of saying "I was fired," or "I quit". It is a more positive way of seeing the situation than saying "I am unemployed"; you see opportunities and believe in your own capacity to control your future.

Independent director, ID
Anglo-Saxon Boards of Directors consist in large part of members who are in management positions in the company, for example the CEO and heads of departments (2nd tier) reporting to the CEO.

The concept of Independent Director (ID) means a member of the Board of Directors who is independent of the management of the company and of the owners, a person who is not part of the company's executive management or closely allied with an ownership group.

See also:
- NXD

Index, Indices
An index is a fictional (imaginary) measure of a change in the economy. It is a statistical measure, and measures in percent. Examples are a securities exchange index (Dow Jones), an interest rate index (3-month Stibor), a raw materials index (Aluminium) or a currency exchange index (EUR/USD). Another common index is CPI (Consumer Price Index), which measure price changes over a specific period of time.

Indices are calculated from a base time period which is given the index 100. If a stock exchange index increases from 100 to 110 after a year this means that the shares on the exchange have gone up by an average of 10% during the year.

See also:
- Relative return
- CPI

Industrial takeover
When one industrial enterprise buys another enterprise so as to strengthen its position, expand its business, take advantage of synergies, etc.

Another type of acquisition is a financial takeover, when a financial investor (Venture Capitalist, investment company) acquires a company without industrial connections or advantages.

See also:

- Venture Capital
- Private Equity
- Trade sale
- Synergy

Inflation

The term "inflation" means the percentage increase of the general price level from one point in time to another. In order to get an understanding of the price level, the changes in a large number of products (a basket with some 90 products and services) are measured over a specific period of time, which may be months, quarters, or years. The general price level is translated into a consumer price index (CPI) and is used, among other things, to adjust agreements, rents, support levels, etc.

High inflation usually means that the money supply in the country increases. The country's central bank prints new bills and increases its lending to the banks so as to facilitate investment and consumption. Increased money supply promotes inflation in that the purchasing power per currency unit (e.g., Euro) decreases.

Central banks can to some extent control the rate of inflation by increasing or decreasing the money supply and changing their lending rates (discount rates). A certain amount of inflation is considered healthy since it implies a positive confidence in future opportunities and growth in the economy. This is particularly true if price increases depend on increasing demand more than on the supply of products and services. Many central banks in developed countries aim for an inflation target of 2% per year.

Inflation means that the value of money decreases and that the purchasing power per currency unit is lower. In periods of high inflation, everyone with loans is a winner, since inflation makes the value of the loan decrease and helps to amortize the loan. In order to compensate for the decreases in value in times of high inflation, lenders demand ever higher interest rates. Therefore interest rate levels are higher in periods of high inflation as compared with interest rates in periods with low levels of inflation. Low inflation, by contrast, is an advantage for those who save, since the purchasing power of the saved capital is relatively constant.

Inflation is an important measure for assessing the condition of a country's or a region's economy as a whole. Most decision-makers and economists watch for changes in the rate of inflation. Increasing inflation is generally seen as meaning that the state of the economy is on the way up. Low inflation may imply a poor economy, low growth and in extreme cases a crisis situation. Changes in inflation are thus well-correlated with the country's GNP (Gross National Product).

The causes of swings in the economy and in inflation are, of course, many. Economists collect data, analyze it and try to understand what macro-economic connections affect and drive the swings. The goal is to be able to foresee changes so as to be able to reduce their extent and their consequences in a timely manner. The ever more global and complex economy makes it more difficult to make predictions. There can be a boom in one part of the world at the same time as there is a bust, deflation and negative growth in another part. Compare, for example, the situation in Asia with Europe and the USA after the financial crash of 2008.

See also:
- Inflation
- Lowflation
- GNP
- Real interest rate
- CPI

Information memorandum (IM)

An "Information Memorandum" (IM) is a document which gives a detailed description of a possible investment. An example is the IM which is prepared for a company in connection with a sale process (exit process) or a new securities issuance.

The IM will describe the company's business, markets, customers, management, financial position, future plans and current ownership. It will also describe why an investment in the company is a good investment (the "investment rationale"). The IM can be seen as a fact-based sales brochure the purpose of which is to attract potential investors/buyers and give them a basis on which to evaluate the possible investment.

In a structured sale of an entire company, with several potential buyers, the IM will also constitute a basis for the first indicative bid. It is the chosen financial advisor which, together with the company's management, Board of Directors and owners, will prepare the IM.
It is a very extensive job to produce an IM, and it will contain the following parts:
- Summary.
- The possible investment -- the investment rationale.
- Invitation to the exit process or subscription for shares.
- Background.
- The market and the industry.
- Competitors.
- Vision, strategies and targets.
- The company's business, products and services.
- Historical profit and loss statement, balance sheet, cash flow analysis.
- Comparison-destroying items.
- Intangible assets and intellectual property.
- Business plan 3-5 years into the future (with financial information).
- Comments on the business and the financial position.
- Current ownership.
- Opportunities, strengths, threats and risks.
- Description of the management and key personnel.
- Legal issues.

- Appendices.
- Etc...

See also:
- Teaser
- Exit process
- New issuance
- Comparison destroying items

Incubator

An incubator is a centre for newly started enterprises, start-ups, which offers an infrastructure with office space, reception for visitors, and telephone and data networks. Also called "enterprise incubator". The purpose is to help an entrepreneur to get his or her enterprise started or to develop an idea into a first saleable product.

An incubator may therefore contain professional help for:
1. Product development and business development.
2. Creation of business plans.
3. Financing.
4. Business law.
5. Marketing.
6. Bookkeeping and accounting.

An important part of an incubator is contact with the other enterprises in the incubator and the building of a personal network. Many technical universities have started incubators (so-called "technology parks") where the results of research and innovations from the university can be developed towards commercial use.

See also:
- Enterprise incubator
- Early stage
- Seed capital

Instrument

Devices (financial instruments) for financing an enterprise, e.g., via a bank loan, shares, convertible securities, etc.

Intangible assets

Intangible assets or intellectual property, sometimes called invisible assets, that is, assets which cannot be physically touched. For example, these may be patents, trademarks, know-how or capitalized product development.

Intellectual property is particularly important in service enterprises, while in manufacturing companies the fixed assets (for example, machines, production facilities, inventories) are still regarded as the most important assets.
Even in industrial companies, however, intellectual property is becoming ever more important since the physical products are becoming ever more alike. Businesses must thus build other values so as to be able to differentiate themselves, for example by their trademarks, product designs, etc.

See also:

- Goodwill
- Branding

Intermediary

Middleman in a financial transaction, e.g., an investment bank.

Internal interest

An investment's "internal" annual return. The interest for each year is added to the capital which has been invested and the annualized capital (the original investment plus interest) is then the basis for the interest calculation for the next year. One thus calculates interest on the interest.

Example: If you invest €100 and receive interest of 10% you will have €110 after the first year. The second year's interest will then be calculated on the amount of €110 and will produce a new total amount of €121, which will in turn constitute the basis for year three. Equivalently, the calculations can be done backwards. Assume that you invest €100 in year one and have €121 after year two. You have had internal interest of 10%. Compare "IRR" (Internal Rate of Return).

See also:

- IRR

Investment bank

A financial advisor which helps enterprises with financing, conveyance of businesses, listing on securities exchanges, and so on. The investment bank may be either free-standing or part of a commercial bank. The investment bank often has its own analytics department for evaluating businesses, and also close contact with affluent clients to whom it offers potential investments.

See also:

- Corporate finance

Investment committee

The committee which, for example in a Venture Capital or Private Equity company, is to make the formal decision on an investment, a supplementary investment or if a sale (divestment) is to be made.
The committee is often composed of external, independent persons with experience in a variety of business areas.

Investment company

The general purpose of an "investment company" is the financial management of investments which are made in a number of companies. Investment companies often do not have a majority interest in the companies in which they invest, and buy and sell shares for the purpose of earning money. The investments are principally in shares listed on securities exchanges.

The business concept of some investment companies is only to obtain the highest possible return and growth of value on their shares long-term. Their ownership share only amounts to a couple of percent. Other investment companies want to have a control position in the companies they invest in and therefore have so large an ownership share (often more than 10%) that they can affect the composition of the Board of Directors.

In some jurisdictions, companies which are classified as "investment companies" may have a tax advantage in that profits on the sales of shares may be tax-free income.

See also:

- Holding company

Investor

An "investor" in a company usually means someone who invests his or her capital (buys shares) in order to obtain part of the company's return through owning part of it. Expected return is divided up partly into dividends and partly into price increases in the shares (value growth). But a lender to the company may, of course, also be seen as an investor.

An investor in shares has no security in the company's assets, which a lender often has. The company's lenders receive interest and also repayments (amortization) on their loans even if the company is operating at a loss and does not pay dividends to its shareholders. The owners, moreover, come last in line in the event of a distribution of the assets of a company (in liquidation, bankruptcy, etc.). The investors' capital is thus exposed to higher risk, a risk which must be compensated for by a higher return as compared with a lender's capital. Unless the risk is compensated for by a higher return, it is of course better simply to be a lender.

See also:

- Private Equity
- Venture Capital

IPO

An abbreviation of "Initial Public Offering". IPO means that an enterprise will be listed on a stock exchange or on some other regulated market place. See further under "Listing on an exchange".

See also:

- New issuance
- Liquid share
- Listing on a securities exchange
- Quoted company

IRR

IRR is an abbreviation of "Internal Rate of Return" and relates to an investment's internal annual return. Read more under "Internal interest".

See also:

- Internal interest

J

JIC

JIC (Just In Case) means good to have and is the opposite of JIT (Just In Time). The JIC philosophy means that you must build and hold inventories of products so as to be able to deliver IN CASE they are needed, and not WHEN and IF they are needed.

Jokingly one can say that JIC means "sloppy", or no management of the production or of the logistical flow, which in turn leads to large inventories and large commitments of capital. Frequently, too, the "wrong" product is in inventory when the customer places an order. But, more seriously, production and an inventory of spare parts is an example of what is embraced in the JIC philosophy.

See also:

- JIT
- Kanban

JIT

JIT (Just In Time) is a term for a planning philosophy which entails producing goods at the right point in time and in the right quantity, exactly when the customer wants to have them. At bottom, JIT is a Japanese production and planning philosophy. The JIT philosophy affects not only production and delivery of the final products, but also the entire logistical flow. All component parts in turn must be delivered JIT in the right quantity and at the point in time when they are needed.

The aim of the philosophy is to minimize all inventory buffers in the whole chain of logistics, and thereby minimize the commitment of capital in the business. JIT is used today not only in manufacturing industries but also in all businesses with large flows of goods.

JIT is often combined with KANBAN, which is a way of managing production.

See also:

- JIC
- Kanban

Joint Venture

When two or more parties form a company (a shared-risk enterprise) in order to develop a project, provide combined resources and share risk.

KANBAN

KABNAN is a Japanese JIT production philosophy for planning and managing both labor operations and the flow of goods in a production process. It is said that products and components are to be pulled through the chain of production, that is, that customer orders determine the need for deliveries and final assembly which in turn determines how component parts are produced in earlier stages. The opposite is "traditional" planning where components are pushed through the supply chain -- from planning of purchases to completed items in inventory.

The KANBAN philosophy is used today not only in manufacturing industries but also in other businesses, for example, in health care and software development, to which it has been adapted. Used correctly, the business becomes more efficient in that bottle necks are made visible and eliminated, which in turn leads to shorter lead times.

See also:

- JIC
- JIT
- Lean

Key issues

Important questions and areas of investigation, for example in the assessment or the development of a company or in an analysis of a possible investment. See also "DD".

See also:

- Due diligence, DD

L

Lead investor
The investor who leads a round of investment (e.g., in conjunction with a new issuance of securities) and who will be the dominant owner among the other investors. It is customary to say that the other investors piggyback on the lead investor.

Leads
In general means "business opportunities". They may be investment proposals which come to an investor, or customers who have shown an interest in the company's products.

Leakage
Means that capital is "leaking out" of the company, for example to the owners through dividends or repayment of other shareholder contributions. In certain situations, for example, banks will not allow any leakage from the company before interest and amortization have been paid on the bank loans.

It is also important that leakage to existing owners be controlled in connection with an exit process. An example is by means of the so-called "Locked box" method.

See also:
- Locked box

Lean
LEAN is a Japanese management philosophy which entails doing the right thing at the right time and thereby reducing all loss of time and resources. LEAN is applied both in manufacturing industries and in the service businesses.

This point of view has as its starting point the valuation of all activities in a business based on the values they contribute to the business. Those activities which do not add value are thereafter systematically eliminated.

LEAN's value concept is based not only on maximized share value but also on the consistent creation of value for all interests.

LEAN has been criticized for leading to inadequate staffing and to stress. But correctly used it will lead to the opposite, by evening out the burdens of work and eliminating waste of time and resources.

See also:
- JIT
- Kanban

Lemons

Used to describe "sour" investments. Lemons ripen relatively quickly and become sour. Investments in companies which have developed all too quickly can produce a sour aftertaste, especially if the business is not based on a solid foundation or does not stand on stable ground.

Letter of Intent (LoI)

An agreement between two or more parties which describes their intention relating to a more extensive business relationship or transaction. For example, it may relate to a partnership, an investment, or a disposition.

An LoI is a first step towards the real negotiations and a final agreement. The declaration of intent contains important, agreed-upon terms and conditions for continued negotiation. It can therefore be seen as a first test of whether the conditions necessary for a more comprehensive agreement exist.

The contract will contain provisions which make the agreement non-binding on the parties, but with certain exceptions (for instance as to confidentiality).
Compare also "Term Sheet", which is usually a more developed contract with more detailed terms and conditions and the prerequisites for a transaction.

See also:
- Term sheet

Lever

With a good balance between equity capital and borrowed capital a company can get an extra push, a financial lever, for the return on equity capital on its balance sheet. If the return on the company's total capital is higher than the rate of interest which the company pays on its loans an increased level of indebtedness gives an increased return on equity capital (i.e., the owners' capital).

When the company uses the level of indebtedness as a lever for the return on equity capital, it must at the same time understand the consequences of the increased financial risk. If the interest rate on loans is higher than the return on total capital, there will be the opposite effect and increased indebtedness will have a negative effect on equity capital. In other words, the lever work in both directions.

Example:
In order to analyze and show the effect of a lever on indebtedness, the so-called "lever formula" is used:
- Re= Rt + (Rt-Rd)x(D/E)
- Re: Return on equity capital.
- Rt: Return on total capital.

- Rd: The company's average interest cost.
- D/E: Level of indebtedness.

The lever formula is sometimes called the "Johansson formula" after Professor Sven-Erik Johansson at the Stockholm School of Economics in Stockholm, Sweden.

Assume that the company has a stable profit equivalent to a 10% return on total capital, that the average interest rate on loans is 4%, and that the company's total capital consists of 60% loans and 40% equity capital. If we put these values into the lever formula we obtain a return on equity capital (Re):

- Re=Rt+(Rt-Rd)*(D/E)=10+(10-4)*(60/40)=10+6*1,5=19%.

The level of indebtedness of 1.5 thus provides an addition of 9% on equity capital. Assume that the company increases the indebtedness level to 75% loans and 25% equity capital. The return on equity capital now becomes:

- Re=10+(10-3)*(75/25)=10+6*3=10+18=28%.

The increased level of indebtedness thus provides an addition of 18% on equity capital. But now assume that the company's result is worsened and delivers a return on total capital of only 2%, i.e., lower that the 4% cost of loans. The company still has 75% loans and 25% equity capital. The return on equity capital becomes:

- Re=2+(2-4)*(75/25)=2+(-2)*3=2-6=-4%.

The level of indebtedness now makes a negative contribution of -6% which results in a -4% return on equity capital, i.e., 4% of the owners' capital is being used up in one year. This example shows the effect (and the risk) of a lever when the company's total return (Rt) is less than the rate of interest on its loans.

See also:

- Leverage
- Leverage buy-out
- Profitability

Leverage

By mixing equity capital and loans it is possible to obtain a lever and the growth of an investment (equity capital) if the business provides a higher return than the interest on loans.

See also:

- Lever
- Gearing

Leveraged Buy-out, LBO

An abbreviation for "Leveraged Buy-out". An LBO is an investment in a company where the investment is financed by a mix of equity capital and loans. You need to find good balance between these two forms of finance in order to achieve an optimal lever for the investment.

See also:

- Buy-out transaction
- Lever
- Gearing

Liquid ratio

A measure of a company's cash position. Also called "Quick Assets Ratio" or "Acid-test ratio". This measure measures the company's capacity to pay short term liabilities and is calculated: Cash position = (current assets - inventory)/short-term liabilities.

Of course, the higher the quotient the better the company's cash position is. A quotient of 2 thus means that the company has €2 (if the report is done in Euros) available to cover €1 of its short-term liabilities. See also "Quick Assets Ratio".

See also:

- Acid test ratio
- Lever
- Quick asset ratio

Liquid share

A liquid share is a share which can relatively easily be converted to cash. An example is listed shares, which usually can be sold immediately and with cash coming directly into your account. Of course, the more liquid a company's shares are the easier it is to buy and sell those shares.

Shares in a company which is not listed on a securities exchange, by contrast, are difficult to sell (and to value). It is then said that the shares are illiquid. Even listed shares can be difficult to convert to cash if there is little trading (i.e., shallow market depth) in the shares, for instance in a smaller company which is listed on a smaller securities exchange.
Illiquid shares are coupled with a higher risk in that they cannot be sold if the owner no longer believes in the company. Thus, all else being equal, liquid shares will be valued more highly than illiquid shares.

See also:

- IPO
- Listing

Listing

"Listing" usually means that a company's shares are listed on a "regulated market" -- a "securities exchange" or "stock exchange". The name of the shares (abbreviated), price and trading volume are noted on the market place's summary (list) of trading in shares during a specific time period (hours, days, weeks, etc.). A listing also means that sellers and buyers can trade in the shares.

In the public press, there is sometimes a certain amount of confusion about what is meant by the concept when it is said that a company's shares are to be listed. It may not be clear whether the company's shares are to start being traded on a regulated market or an alternative market.

A "securities exchange" is an enterprise which has received permission from a governmental authority to conduct trading in securities in a regulated market place. It is usually the regulating authority which has oversight over securities exchanges and trading platforms. If a company chooses listing on a regulated market the company must be approved by the securities exchange to which the listing relates, which is a very comprehensive process. Common to all regulated market places is that they operate under strict laws and rules which regulate the trading in securities. The requirements for listing a company's shares and how the listings will appear vary among various market places and geographical locations. All companies must prepare a prospectus when shares (or other securities) in the company are offered to the public for trading. The prospectus describes the company, the business, financial facts, risks and opportunities.

An alternative, simpler market place for trading in securities is called a trading platform or MTF (Multilateral Trading Facility). A securities company can obtain permission to operate an MTF, but a regulated securities exchange may also operate an MTF. In addition to regulated securities exchanges and MTFs, there are a number of smaller, unregulated (local) stock markets for trading in securities where buyers and sellers can meet.

With the final goal of listing on a securities exchange, the strategy for a smaller company may be first to introduce the company's shares on an MTF (an exchange lite) and then later change the listing to a regulated market. The Board of Directors and the management can thus practice for a certain time on the simpler market.

As an investor in shares, you must be pay attention to the market on which the company's shares are listed. A listing on a regulated exchange is an assurance that the company fulfils the extensive requirements of that securities exchange, which is to be seen as a stamp of quality. Even companies whose shares are traded on other markets may voluntarily meet many of the requirements which the listed companies must satisfy, but they don't need to and thus the risk in the shares is greater. If you invest in shares which are not listed on a regulated market it is especially important that you understand both the opportunities and the risks with which the purchase of the shares is associated.

See also:

- IPO
- Listing on a securities exchange

Listing on a securities exchange

Means that a company's shares are listed (are introduced) on to a regulated market. There are authorized governmental authorities in a country which give a company (a securities exchange) permission to operate a regulated marketplace. A place for trading which is not as fully regulated is called a "trading platform" or an MTF (Multilateral Trading Facility). Read more under "Listing".

A securities exchange introduction and listing are done principally in order, if it is necessary, to finance the company through a new issuance of shares or other securities. Another important purpose is to offer existing owners a marketplace where they can sell their shares and at the same time give new owners an opportunity to buy shares in the company. After a listing the shares are "liquid", i.e., can be converted to cash.

Liquid shares are associated with lower risk as compared with unlisted shares, since the shareholder can more easily sell the shares if she or he does not like the developments in the company -- you can "vote with your feet". When the risk is diminished, the share's price ought to rise after a listing -- which is not always the case.

When a company chooses to list its shares on a securities exchange, the requirements for information disclosure increase. The company must accept the rules of the securities exchange in some form of listing agreement. The intention of these rules which the companies must follow is to protect investors, e.g., by requiring correct information and, to the extent possible, preventing insider trading in the shares.

Circumstances and changes which affect the share's market price must be made public, including, among other things, financial information, information on material changes in ownership, and changes in key-management. No one is supposed to be able to profit by trading in shares based on information which is not public or which is misleading.
A listing on a securities exchange is a very extensive and demanding process.

It takes at least a year to prepare a company for a securities exchange, to make the company "exchange ready" and to effectuate the listing. What is absolutely the most important thing is to understand and determine the purpose of the listing, for example:

- The company needs capital and will make a new issuance of securities at the same time as the listing.
- The company already has a large number of owners and must arrange for regulated trading in its shares.
- The main owners want to make an "exit", i.e., to sell their shares to new owners in conjunction with the listing.
- The company wants to facilitate part-ownership for key persons and employees.
- To make the company better known, to increase attention and to strengthen the trademark.

A listing process contains a large number of activities, among other things to:

- Select financial advisors.
- Develop a time plan and a budget.

- Select a securities exchange and register for listing.
- Update the company's business plan, adapt it to the prospectus.
- Adapt the certificate or articles of incorporation, terminate any shareholders agreements, etc.
- Carry out a Due Diligence (DD).
- Overhaul the Board of Directors and the management so that these satisfy the exchange's requirements for exchange-related experience.
- Go through financial information, capital needs, reporting structure and adapt financial goals.
- Develop and adapt reporting for external information (quarterly reports, press releases, etc.).
- Hold the shareholders meetings which are needed to adapt the company to compliance with the rules of the securities exchange that has been chosen.
- Establish goals for ownership structure, investors and expansion (number of owners).
- Value the company and set the price of the shares.
- Make application for listing.
- Do a "road show" in order to meet investors and analysts so as to sell the shares.
- Prepare a prospectus and get it approved by the relevant governmental authorities and the securities exchange that has been chosen.
- Information to employees, customers, suppliers.
- Strategy for PR and media.
- Update the homepage -- don't wait till the last minute for this!
- Etc.

A conclusion is that the preparations must be begun in good time before the target date for the listing. An effective project leader and project management are needed in order to coordinate activities among the owners, the Board of Directors, the company, advisors, governmental authorities, and the securities exchange that has been chosen. Last but not least, all costs must be monitored throughout the entire process -- the total cost of the listing is going to be a significant item for the company.

See also:

- IPO
- Listing
- Quoted company
- Exit
- Road show

Living dead

A designation for an investment in a company which is not developing in a satisfactory way and where growth has stagnated.
If, in addition, an owner cannot sell her or his holdings and get out of the investment, then the owner is locked into a living dead investment, which is among the worst things that can happen to an active investor.

Locked box

This is a device for regulating the price in conjunction with an acquisition of a business, especially when the annual financial statements cannot be used as a basis for the valuation. Early in the selling process, the seller and the buyer will agree that the price which the buyer is to pay is based on the company's status at a specifically designated point in time, the so-called locked box date.

The device means that the business's profit and loss statement and balance sheet are locked as from the agreed point in time. The valuation is then based on the company's financial position and business status at the locked box date. This means in turn that the price of the company and of the shares is also locked. The purpose is to simplify the process and the negotiations by locking important, variable parameters.

The consequences are that the seller loses any possible upside if the company does better than expected in the period between the locked box date and the point in time when the transaction closes (which can be several months later). The buyer, on the other hand, loses if the company performs worse.

If a long time passes between the locked box date and the closing of the transaction, the price (the total price) may be corrected by application of a market interest rate.
The device presupposes that there will not be any leakage to the existing owners, e.g., that there won't be any dividends or any repayments of loans or of other supplemental contributions the shareholders may have made.

See also:

- Closing
- Leakage
- Price mechanism

Lock up agreement

A contractual arrangement in which owners in a company agree not to sell their shares. An owner thus becomes locked in for a specific period. This can relate, for example, to the first three years in a new investment where there has been agreement not to sell the shares and to work together to create value in the company. An owner then cannot rock the boat!

It is also common to have a lock up in conjunction with a listing on a securities exchange. Existing owners then cannot sell their shares during, for instance, the first half year that the company is listed on the exchange. The purpose is to protect the market price so that earlier owners do not all sell out at the same time, which would lead to a strong initial sell pressure and thus to a lower price for the shares.

Lowball

A lowball offer is a price bid that is significantly lower than the price at which the seller expects to sell an asset. There is, of course, no definite numerical level for a lowball bid; it depends on the situation. In some cases, it is 90%, while in other cases, it may have to be 50% of the expected price to be regarded as a lowball bid.

A lowball offer is often a tactical negotiating gambit to find the absolute lowest possible price for an asset, and there is space for the seller to negotiate the price up. However, in some cases, the purchaser may find the asset severely overvalued and, therefore, unwilling to raise the price.

A lowball offer has its risks. Negotiations will become more complex, and it will take a longer time to reach a common understanding and successful agreement.

If the offer is too low and outside the ZOPA, the seller may find it frivolous and be offended. When trust is broken, there is no basis for further negotiations, and the potential deal is off.

See also:
- ZOPA

Lowflation
The term "lowflation" means a very low level of inflation at the border of deflation (~0-1%). See also "Inflation" och "Deflation".

Times of lowflation are in-between situations with an uncertain future and high risk. Investors and consumers wait and see before investing or making large purchases. This in turn leads to a continued downturn in the economic situation, even lower inflation and increased risk of deflation.

See also:
- Inflation
- Deflation

M

M&A

Stands for "Mergers and Acquisitions" and is an expression which covers purchases, sales and mergers of companies. In connection with large acquisitions of enterprises, the seller and the buyer each engage their own so-called M&A advisor. Examples of these can be an investment bank or an accounting firm which offers M&A services.

Larger corporates often have their own M&A departments which continually look for and analyze possible acquisitions.

See also:

- Corporate finance
- Exit process

Management fee

There are several possible meanings for the concept "Management fee", but it usually means the compensation which the investor (or the investor's investment company) receives from the investors (unit owners) in a fund to cover costs related to the investment activity. The size of the compensation may be as large as a couple of percent of the fund's total size.

A portfolio company in a Private Equity corporate structure may also pay a fee to cover certain of an investor's day-to-day expenses related to the company. The condition, however, is that the services to which the compensation relates are of use to the company.

See also:

- Fee
- Monitoring fee
- Private Equity
- Raise a fund

Management walk-out

A serious situation for owners and the Board of Directors! The management and key personnel in an enterprise decide to create a new, sometimes a competing, business, resign and start their own company. This may also describe the situation in which large parts of the management go over to a competitor, which is even more serious.

The people who do a management walk-out must see to it that they do not take along trade secrets or client lists, or utilize other intellectual property which belongs to the company they are leaving. It is also a very sensitive matter to try to recruit former colleagues.

MBI, Management Buy-in

When external business management buys a controlling position in a business. The management most often has knowledge about the business, the products and the market before the acquisition. The management which is buying in may even come from a competitor.

Financing of the acquisition may be made together with some financially strong party, for example a Private Equity investor or a Venture Capitalist.

See also:

- BIMBO

Management Buy-out, MBO

A management buy-out (MBO) is a transaction in which one or more investors, together with the existing management of the business, acquire a company acquire a company (or a business). The investors say that they are backing an ambitious management team in buying out and running "their" business. Examples of situations in which an MBO is possible are:

- When a large company sells one of its non-core businesses in a restructuring.
- If a small, profitable subsidiary in a large group does not receive the priority which it needs from the group's management. The management in the subsidiary which has been side-tracked may then itself take the initiative for a buy-out. In order to finance the buy-out, the management will get in touch with external investors, for example a PE investor (venture capitalist).
- In conjunction with a generation change in a family business.

An MBO situation is an attractive investment opportunity for Private Equity.

See also:

- BIMBO
- COLOMBO
- RAMBO
- Private Equity

Mezzanine finance

This is a financial instrument with a half-way position (hybrid) in a company's capital structure. Mezzanine stands between equity capital and those bank loans which are secured in some way by the company's assets.

In connection with larger business acquisitions, financing is structured in an optimal way with a variety of different financing forms (instruments) which supplement each other, and in which mezzanine financing plays a major role. The investors (the new owners) want to balance equity capital and loans in order to achieve the best return in relation to risk and financing costs.

Mezzanine financing bridges the gap between the loans which the bank offers and the equity capital which the investors have available. In order to make mezzanine loans attractive, both a higher interest rate than the interest rates which are offered on bank loans, and better priority rights than the shareholders have, are offered. The loan may even, in some situations, be convertible to shares.

The word mezzanine derives from the Italian word "mezzano" (middle) and is used for, among other things, an extra floor in a building.

Momentum

In a transaction, "momentum" means that the parties have the will, the enthusiasm and the tempo which drives a transaction forward towards a conclusion. If momentum disappears, the transaction also disappears!

Monitoring fee

The compensation an investor receives from the companies (portfolio companies) which that investor has invested in. The compensation is to cover the administrative costs which the investor has.

See also:

- Fee
- Management fee

Monopoly

Monopoly is a market situation where a single company or group of companies controls the whole or almost the whole market for a certain type of product or service. Monopoly is characterised by lack of competition, which may result in high prices and lower quality products.

Many companies strive to get a monopoly position in order to determine pricing and supply without having to pay attention to competitors. But it is a short-sighted and narrow view. In a longer perspective the competition is seen as a key driver of innovation in new products, range of services and pricing.

In many countries there are competition laws (antitrust laws) to protect free markets from being dominated by one company. This, for ex., includes rules that an acquiring company, if there is a risk for a dominant position post acquisition, must receive approval from the competition authorities in the countries concerned before a purchase can be completed.

See also:

- Oligopoly

MTF

An abbreviation of "Multilateral Trading Facility" which is a term for a trading platform for securities which is not a regulated securities exchange. Read more under "Listing on an exchange".

See also:

- Listing on a securities exchange

N

NATO

Short for: No Action Talk Only!

NDA

NDA is an abbreviation of "Non-Disclosure Agreement" and means secrecy agreement or confidentiality agreement. The agreement governs how the parties must deal with the confidential information which they share with one another during a business negotiation or in the process of a transaction.

An NDA will contain:

- Who the parties are.
- A definition of what type of confidential information is covered, for instance, all business secrets.
- A definition of what is not confidential information, for instance, what is generally known to the public.
- When and how the confidentiality is applicable.
- Exceptions from confidentiality.
- When and confidential information must be returned.
- Penalties for breach of contract.
- Etc...

Confidentiality clauses are also common in other business agreements, consultancy agreements and employment agreements.

There are a lot of other designations and abbreviations for secrecy agreements, for example "Confidentiality Agreement" (CA), "Confidential disclosure agreement" (CDA) or "Secrecy agreement". You just need to choose!

See also:

- Secrecy agreement

Newco

A "Newco" is a newly-formed company (New Company) and is a legal entity in the form of a corporation. There are usually already-registered, empty Newco to purchase if you are in a great hurry. The new company may have a registered name such as "Shelf company 123 Ltd (Inc.)".

An example of a situation in which a Newco is used is in connection with a larger enterprise acquisition. It is then the newly-formed company which is the legal entity which obtains financing in order to carry through the purchase itself and which is presented as the formal new owner. The Newco, in turn, is owned by those who are responsible for the financing, for example an investment company, an industrial company or a venture capitalist. After the transaction has been carried out, the owners of the Newco will decide upon a new, suitable company name.

Negative cash flow

A company which does not itself, through its own business, create sufficient cash in order to be able to cover its costs and make its investments has negative cash flow. If the situation is temporary, the company must obtain new, external financing via a new issuance, other owner contributions, or loans.

This can be acceptable in a start-up phase but is not a sustainable situation long-term. If the situation is not temporary, more comprehensive restructuring measures are needed.

See also:

- Cash flow

Net debt

Defined as the company's long-term and short-term debt (loans) minus cash (liquid assets).

Network

This means a "network" of experienced persons who can provide advice and help as well as sharing their own networks.

Investors (Private Equity, Venture Capitalists) often have very well developed, active networks of advisors for a variety of business situations and frequently arrange so-called network meetings to have an exchange or experience and contacts. A more descriptive designation is "Business Network".

See also:

- Advisor

New issuance

In a new issuance, a corporation issues new shares. The company issues shares to existing, and sometimes also to new, owners. A new issuance is a way of financing the company. The company may need capital for growth (expansion) or for an acquisition. A new issuance of shares may also be needed in a crisis situation to strengthen the liquidity and the balance sheet.

Issuance of new shares means that the quantity of the company's outstanding shares increases and thus that existing owners risk being diluted, that is, holding a lower percentage share of the company if they do not participate in the issuance.

In order for shareholders to avoid being diluted, it is common for there to be preference issuances. In these the existing shareholders have preferential rights and are offered the opportunity to subscribe for new share in proportion to their existing holdings (pro rata). If a shareholder has 10% of the company's shares, she or he has a right to subscribe for 10% of the new shares.

See also:

- IPO
- Corporate finance
- Agreement to issue shares
- Information memorandum, IM
- Underwrite
- Post-money
- Pre-money

Niche company

An enterprise which focuses its business on a limited part of the market. The total marked is divided up into appropriate segments and the enterprise then chooses a segment, a niche, within which it has competitive advantages and can differentiate itself.

Many new companies are started because there is a niche that is not well provided for by existing companies. There may even be an entirely new, niche need which comes in to being and in which the established businesses do not move quickly enough to adapt to customer demand.

Non–executive director

A member of the Board of Directors who is not employed in the company. Compare also "Independent Director".

See also:

- Independent director

Not invented here, NIHS

NIHS stands for Not Invented Here Syndrome. It is a term for the tendency to reject appropriate external solutions to problems.

NIHS may include individuals, an organization, or an entire business. It occurs in a variety of situations, such as strategic planning, new product development, or organizational changes. Those who are set to solve a problem choose to develop their proprietary solution, although an available external solution is superior to the proprietary.

Causes of NIHS are often uncertainty and fear. The staff are afraid that the external solution will threaten their positions, which in some cases is a legitimate fear.

Example: A company chooses to purchase a product component from a sub-contractor instead of making it in house. The engineers responsible for the in-house development may then become redundant and lose their jobs. Hence, they will do everything possible to show that the external solution is inferior to the proprietary — even if it is superior and costs less. A similar situation may arise, for example, in a reorganization when an external service provider is chosen to deliver office services. The employees recognize that the service provider will take over their tasks. They will now try to show that the service provider is inferior and in total more costly than the in-house-produced services. Unless the affected employees are offered new tasks within the organization, the fear and the uncertainty over their positions are justified.

Chronic NIHS, however, is a dangerous syndrome because it leads to stagnation. The business may not keep up with the development of new technologies, work processes, markets, business models, and customer behaviours. The company is in danger of losing its competitive advantage, which in a changing world goes very fast. The Board of Directors, and the management of the business must be observant and not allow chronic NIHS to develop.

NPV

NPV stands for "Net Present Value" and describes the current value of future cash flows in investments. NPV is calculated with the help of the future, unencumbered net cash flow which is discounted at a chosen rate of interest (WACC). The term "net cash flow" means the difference between what is paid in and what is paid out as generated by the investment.

NPV calculations are used to evaluate and prioritize investments within a company, for instance in a new product line or machine. The net cash flows which the investment generates are calculated to present value using an interest rate which corresponds to the company's average cost of capital (WACC).

NPV is also used as one device (among many) to value an entire company, where the calculations are based on the enterprise's free cash flow (more or less the cash flow which could be distributed to the owners). An investor in the company, who evaluates various alternative investments, would use a discount rate of interest which corresponds to the alternative return from investments of equal value.

Compare with the DCF calculation, which gives the same result as an NPV when net cash flow is used in the calculations.

See also:

- DCF
- WACC
- Pay-back

NXC

Non-Executive Chairman is a Chairman independent of (not employed by) the company.

See also:

- Independent director

NXD

An abbreviation of "Non-Executive Director", which means a member of the Board of Directors who is not employed in the company. Compare also "Independent Director".

See also:

- Independent director

O

Offshoring

This means that a company moves all or part of its production of goods or services to another country. Offshoring can be said to be outsourcing to suppliers outside of a country's borders. Since the beginning of the 1990s, European businesses have moved a great deal of their production to Asia.

Offshoring happens to the greatest extent from high-cost countries to low-cost countries. A prerequisite is the ever more globalized economy which makes it ever easier to move capital, products and services between countries. Globalization has also brought about increased cost and price pressure from low-cost countries, and the principal purpose of offshoring has been, and still is, to lower costs in order to meet increased price competition. But offshoring is driven more and more by the possibility of also establishing R&D and sales in the country to which the production is moved. Especially interesting countries are the rapidly growing markets in Asia, where China, India, Indonesia and Vietnam are some examples.
Clearly, the advantages of offshoring are not only financial ones. It also leads to increased contacts, collaboration and cultural exchanges between countries. The receiving countries get to share know-how, investments and opportunities for work, which in turns leads to growth and increased well-bring. But there are also of course disadvantages and risks with offshoring, for example:

- Increased logistical complexity.
- Increased costs for inventory maintenance, quality control, travel, etc.
- Cultural and language barriers.
- Risks of copying and "theft" of intellectual property, e.g., know-how, patents and trademarks.
- Export of employment opportunities.
- CSR risks - e.g., bribery and child labour.

In principle, all manufacturing of clothing today is done outside of industrialized countries. Here the global trademarks Nike (US) and H&M (Sweden) have been pioneers and have built up production using partners in a large number of developing countries. But offshoring of electronics and software is also of great importance and where currently China and India are large recipient countries.

See also:

- Outsourcing
- GNP

Oligopoly

Oligopoly is a market situation where a small number of companies control the market for a particular product or service. An oligopoly situation typically occurs in markets with high entry barriers, such as energy and commodity markets.

Companies in an oligopolistic market avoid price competition in order not to compete each other to bankruptcy. They are therefore investing more in product differentiation, development of extra services and advertising to appear as the best option. There may also be higher risk of cartels in oligopolistic markets compared to markets with many players in the open competition.

See also:

- Monopoly

Option

An option is a contractual arrangement between two parties -- a granter of an option and a holder of an option. There are two main types of options -- "call options" and "put options". If it is a call option the person/company who has the option (the option holder) has the right, but not an obligation, to purchase in the future the underlying asset which is the subject of the option. If it is a put option the option holder has the right, but not an obligation to sell the asset.

The price which is paid for the option is called a premium. The value and the purchase price of the underlying asset are determined in advance, for example by valuation or negotiation.

A share (stock) call option gives the option holder the right, after an agreed time, to purchase a number of shares at a pre-determined price. Example: For a premium of €0.5 per option the option holder receives the right to acquire 100 shares in Company X in three years for €50 per share. If the market price of shares in the company in year three exceeds €50 the option holder will exercise the option and purchase 100 shares for €50 each. If the market price is less than €50 the option will not be exercised since it is cheaper to directly buy the share on the stock exchange. In this case, the option holder will have suffered a loss amounting to €0.5x100= €50. The granter of the option, by contrast, will have a corresponding profit and in addition will still have her or his 100 shares.

Options transactions between existing shareholders have no effect on the number of outstanding shares and do not result in dilution. But if a company issues subscription options (rights to subscribe for newly issued shares) the number of the company's outstanding shares will increase and that will result in a dilution for existing shareholders if the options are exercised. Subscription options are a common way of offering management and employees a chance to become owners in the business. Options with the rights to subscribe for new shares are also called warrants.

What, then, is an option good for? An option gives the option holder a chance to acquire the underlying asset with a more limited capital investment. Assume that the closing price in the example above is €60. If the option holder then exercises the option and purchases 100 shares for €50 per share, he or she will make a profit of €10 - €0.5 = €9.50 per option. For the grantor of the option the option provides both premium income which increases direct return and also protection in case the asset's value declines. If the grantor of the option in the example above had purchased the shares for €30 per share and the shares had declined to €29.50 the grantor of the option would have made neither a profit nor a loss (€29.50 + €0.5 for the premium).

The "Black-Scholes" model is a common model for valuing and calculating the premium for an option, and there are several other calculators on the net which you can use.

See also:

- Synthetic option
- Warrant
- Derivate

OTC

"OTC" stands for "over the counter" or "outside the exchange". OTC trading means that the buyer and the seller engage in a securities transaction (e.g., a derivative) and determine the price and terms and conditions without the involvement of an exchange.

See also:

- Derivate

Outsourcing

"Outsourcing" means that a company, or an organization, delegates all or parts of its production of goods or services to another company. But it can also be a public business which delegates production. Compare offshoring which means outsourcing to suppliers outside of the country.

Initially businesses began to outsource activities non-critical to the business, e.g., wage administration, cleaning and reception of visitors. But today everything is delegated which someone else can do better or cheaper. Many production companies have all manufacturing of component parts outsourced and only do final assembly and quality control of the finished product in-house. Closely related expressions are "contract manufacturing" and "subcontractor" (the one who does the production).

The advantage for the company which outsources the production is in reducing its costs and in more easily being able to adapt its capacity to variations in demand. So-called buy/make calculations are done in order to determine what is to be done in-house and what is to be outsourced. The subcontractor to which the outsourcing is made gets larger volumes and must adapt costs, prices and its capacity to the requirements of the customer making the order. The risks for the company which outsources its production lies, among other things, in that it cannot control the production at the subcontractor and that it gives up know-how that may be critical to the business. What is particularly to be avoided is becoming dependent on one supplier (a so-called single source) for a critical component.

For the company which takes over the production, outsourcing means greater volume over which to spread fixed costs, which should in turn lead to increased profitability. But it can also lead to heavy pressure on prices and margins if it is necessary to compete for attractive customers and orders. The supplier, too, must ensure that it does not become unduly dependent on one large customer. If the customer chooses to change to another supplier, that can produce large adjustment problems under great time pressure.

See also:

- Offshoring

Overcapitalized

An overcapitalized company has a balance sheet which is stronger than the business requires. This is seen in a high equity/debt ratio or large cash holdings. An overcapitalized company is considered not to provide an optimal return on capital. One alternative the company has is to increase investments in new products, services or markets. Another alternative is to make a complementary acquisition.
Unless the company's Board of Directors or management sees opportunities for the company to utilize the capital for growth, the only alternative is to increase dividends to the shareholders.
An overcapitalized company is an attractive prey for a hostile takeover by corporate raiders.

See also:

- Cash rich
- Corporate raiders
- Solidity

Owner directive

An owner directive is a well-designed document that defines the owners' intention with their ownership in the company—both in the short- and long-term. The owner directive is primarily aimed at the company's Board of Directors and its CEO, but it obviously has an impact on the entire company, its operations, staff, and other stakeholders.

Owner directives are particularly important in all companies with more than one owner. All owners will have different objectives and intentions with their ownership in the company. One owner may want to create and build a company to be taken over by the next generation. Another owner may value cash and want as quickly as possible to sell the company to realize created values.

Owner directives are even more important in companies where there are different types of owners, such as private individuals, venture capitalists, and state (public) owners.
In listed companies, there is usually no owner directive. The scattered ownership makes it difficult to establish one for all shareholders' common view of the ownership, and hence a joint directive to the Board.
In the process of producing the directive, the owners should agree on some important issues, e.g.:

- Is it a growth or a livelihood business the owners intend to build?
- Should the company invest the profits in developing the business, or should the profits be distributed to the owners?

- What financial structure and financial risk should the company have, for example, in the balance between equity and debt?
- Will the growth target require the owners from time to time to inject new capital in the company, e.g., in share issues or by shareholder loans? Share issues, for example, will have an impact on long-term ownership since owners who can't or do not want to participate will over time become diluted when their share of the company decreases.
- Do the owners aim to exit the ownership in the company within a foreseeable time span (3-5 years), i.e., cash-out? Or, should the company be taken over by the next generation?
- What is the perception of "value"? Is "value" equal to the price of the stock, or is it measured in more soft parameters such as jobs created and recognized (prized) entrepreneurship.
- How much time should each owner devote to the company – full-time or part-time?
- What management positions in the company should the owners have – if any?
- In case owners are involved in the operations, who supervises whom? Important positions to agree on are the CEO; CFO; and directors for sales, marketing, and R&D.

In addition to the direct business objectives, the owners should, in the process, also share intentions and agree on goals of a more personal matter. What drives an individual to be an active owner in the company? If there are several private owners, personal goals with ownership may essentially differ.

An updated owner directive is necessary if the Board of an owner-led company is expanded to also include external, independent Board members as well. Potential new Board members of owner-led companies should ask for an owner directive before deciding to join the company's Board of Directors. The Board should be in no doubt about the owners' intentions with the company. The directive lays the foundation for the Board's and management's strategy work. The company's business plan should reflect the owners' intentions.

An owner directive should not be confused with a shareholder's agreement (SHA), which is a legally binding agreement between major owners. The SHA includes the essential corporate governance issues relating to the governance of the company. Examples are the articles of association, the company's field of activity, how the Board of Directors will be appointed, how shareholders may sell shares, and needed votes for major strategic decisions. Hence, there is an overlap in some issues, which means that adjustments may be needed if one of the documents is changed.

An owner directive may be developed in various ways, e.g., through an internal process between the owners. However, it is recommended for an external and independent adviser to be brought in to lead and structure the process. An external advisor, whom the owners trust, can usually facilitate discussions of more personal and sensitive matters of ownership. There are numerous professional advisers and consultants who specialize in the development of owner directives.

See also:

- SHA

P

Partial buy-out

When the previous (selling) principal owner of a company participates in a "buy-out" of a significant ownership interest in the new, purchasing entity.

In a buy-out transaction it is usual that a new holding company is created and financed and makes the acquisition of the target company which is to be bought out. In a partial buy-out the previous owner continues to be an owner, but in the new holding company.

The previous owner gets new shares in the holding company as payment for its shares in the company which is being sold. A share exchange transaction may in some jurisdictions be efficient from a tax standpoint if the seller is entitled to postpone capital gains tax on any eventual profit on the shares which are exchanged.

See also:

- Holding company
- Buy-out transaction

Pay-back

"Pay-back" is a simple device for calculating the profitability of an investment and for establishing priority among alternative investments. The device is sometimes called "pay-off". The calculation of pay-back is done so that the total invested amount is divided into the annual payment surplus which the investment generates.

The company's Board of Directors will usually have established goals for the maximum time for pay-back of an investment.
Example: A company makes an investment of €10M (ten million Euros) in a new machine. The machine is expected to provide a payment surplus of €3M per year. A straight pay-back will give a payment period of 10/3 = 3.3 years (that is, the investment will have been paid back in 3.3 years). If the requirement is at most a 4-year pay-back, the investment in the example above could be made.
The disadvantage of a simple, straight pay-back is that it does not take into account the company's cost of capital and the fact that the future payments will have a lower present value. The "Pay-back" device can therefore be supplemented with a present value calculation of the future payment surpluses. The discount interest rate which is used must correspond at least to the company's average cost of capital, WACC. If, in the example above, we assume that the company's WACC is 10%, the current value of the annual cash flow will be:

- Year 1: €3M x 0.91= €2.73M
- Year 2: €3M x 0.83= €2.49M
- Year 3: €3M x 0.75= €2.25M
- Year 4: €3M x 0.68= €2.04M
- Year 5: €3M x 0.62= €1.86M

The diagram above shows the accumulated cash flows as calculated to present value. As appears from the diagram, the investment of €10M will only be repaid after 4.2 years if the cost of capital is included. With a goal for pay-back of at most 4 years, the investment will not be made.

Even if a simple, straight pay-back calculation has its deficiencies, it is a good device for making a quick and simple judgment about whether an investment will meet the company's goal for pay-back time. It is also a good device for prioritizing investments -- the quicker the pay-back the more profitable the investment is. But in order to obtain a more complete picture of the investment it is necessary to use supplemental devices, e.g., DCF and NPV, to determine whether it is profitable or not.

See also:

- DCF
- NPV

Pay-off

"Pay-off" is a simple device for calculating the profitability of an investment and prioritizing among investment alternatives. Another name for "pay-back".

See also:

- Pay-back

Peer group

A comparison group of similar enterprises in the same industry. In order to be able to compare and evaluate the efficiency of a company it is important to compare its key numbers with those of similar enterprises in the same industry. Competitors' key numbers are especially interesting. Among the important key numbers are profit margin, return on equity capital, R&D costs, and personnel costs in relation to turnover.

Another important measure is the P/E ratio which gives the share's price in relation to the earnings per share.

See also:

- P/E-ratio

Penny stock

The term originates from the United States and corresponds to shares that have a relatively low price (below $5) and associated with high risk.

Penny stocks offer a relatively low starting investment since the price per share is low and allows higher returns compared to investments in more stable shares, e.g., in blue-chip companies.

Trading volumes are often weak, and when a decline occurs in the stock price, it can be challenging to divest and to get out of the investment. Since the risk is high and the share price volatile, the investor must be aware that the entire invested capital can be lost.

- General rules are:
- Be careful and do not invest too much
- You should know the industry
- Chose the right company
- Mitigate the risk and invest in more than one company
- Be prepared of the worst case

See also:

- Blue-chip

P/E ratio

The share priced divided by the earnings per share (price/earnings). The P/E ratio is a very common measure for evaluating the company's market value relative to that of other similar companies.

See also:

- Peers

Pirates

Investors who buy significant shares (controlling positions) in a business without certain large owners, the Board of Directors or the management having consented. This is then regarded as a hostile takeover. The investors' intention is often to take advantage of hidden values in the business, for instance by dividing it up and then selling the parts individually. The hypothesis is that 1+1 equals more than 2.

Pirates are regarded by some as being short-sighted, greedy investors while others think that they liberate values in sleepy businesses. See also "Corporate raiders".

See also:
- Black knight
- Corporate raiders
- Hostile takeover

Pitch
When competing suppliers get to introduce themselves to the buyer and to tell about what they can offer and why they rather than others should be chosen. A pitch is a short presentation in which everyone has the same, very limited, time to say why they rather than others should be chosen.

See also:
- Beauty contest
- Elevator pitch

Poison pill
A poison pill is a method to make a hostile takeover of a corporation more difficult and expensive. Poison pills give the board of a company the opportunity to give the existing owners, or management, special rights that will complicate an unwanted buyer's acquisition of the company.

It is a common practice used in the US but is difficult - or impossible - to apply in countries and jurisdictions where all shareholders must be treated equally. The poison pill method can be regulated in the articles of association to allow the Board to make a rights issue to existing shareholders at a very favourable price. The intention is to increase the number of shares in the company and dilute the new owner to a level that an acquisition becomes unprofitable.

Critics argue that poison pills reduce the efficiency of the market when they prevent necessary acquisitions and restructurings. The term is also sometimes used to refer to a clause in a contract. For example, an unexpected situation can turn out to be a big disadvantage to certain parties of the agreement while giving other parties a great advantage.

The term poison pill is a term taken from the spy world. By taking a poison pill, an outed spy - with death as a resort - avoids interrogation and torture.

Positive cash flow

A company has positive cash flow if it creates sufficient cash (liquid assets) with its own business to cover its costs and investments. If the case flow, i.e. the unrestricted cash, is not needed for the development of the business it can be paid out to the shareholders.

See also:

- Burn rate
- Negative cash flow

Portfolio

Is used as a collective concept for the businesses in which an investor has invested. A "portfolio" consists of a number of businesses, and the investor who has the overall responsibility is called the Portfolio manager or something similar.

The businesses in the portfolio usually have no business relationship with each other and are not part of any common group. An individual company is called a portfolio company.

Post-money

The term "post-money" means the situation in a company after a new issuance of securities. Assume that a company is valued at €10M (ten million Euros) before an addition to capital through a new issuance of securities. The valuation after the new issuance will then be €10 + €5 = €15M, which is the value post-money. The value (€10M) before the new issuance is called pre-money.

Assume that you own 10% of the company before the new issuance, which means that your shares are worth €1M. If you do not subscribe for your share (10% of €5M) you will be diluted by 33%. This means that your share of the company post-money will be 6.67%. Note, however, that your shares are still worth €1M since the company's new value after the contribution will be €15M.

See also:

- Pre-money
- New issuance

Pre-emption

A pre-emption clause is a kind of a right of first refusal clause, usually in the certificate or articles of incorporation.

See more:

- Pre-emptive rights

Pre-emptive rights

Pre-emptive rights are similar to the rights of first refusal and may be governed either in the certificate or articles of incorporation or in an agreement (shareholders agreement) among the existing shareholders. The intention is to have control over who may come in as a new owner if one of the owners wants to sell her or his shares.

The difference from a right of first refusal is that the person who wants to sell shares must, before the sale occurs, notify the Board of Directors that he or she wants to sell shares. Usually there is already a potential buyer who has stated a price and terms and conditions. The existing owners then have an opportunity to acquire the shares before they are sold to a new owner.

Price and terms and conditions must be the same as in the offer the potential buyer has made. The offer must correspond to a market price and be at arm's length, i.e., where the buyer is not related to or a close friend of the seller. If there is no bid with price information, an effort will be made to find a device for determining the market price. See "Price mechanism".

How a pre-emption rights clause is exercised varies depending on the jurisdiction. But it is common that the communication between the new and the old shareholders will occur through the company's Board of Directors. When the Board of Directors has obtained approval for a new subscription or received information that a sale to a new owner has taken place, the Board of Directors must inform every existing shareholder who is entitled to subscribe or purchase shares as a result of the pre-emptive rights. If no owner responds to the offer, the transaction can go through with the new owner.

See also:

- Arm’s length
- Shareholders’ agreement
- Right of first refusal
- Price mechanism

Preferred shares

Preferred shares give the holder special rights ahead of other shareholders. The most common is that such a shareholder has priority with respect to dividends, which means that the holder of preferred shares will get dividends before other shareholders. Preferred shares can also have priority in the event of liquidation of a company (a liquidation preference). The preference is usually governed by the certificate or articles of incorporation.

Shareholders may also agree by means of an agreement (a shareholders’ agreement) that certain shares are to have preference with respect to the purchase price which a buyer pays for the company in the event of a future sale. This is called a contractual preference. The preference may also be so designed that certain investors in the company get back the amounts they invested before other owners receive part of the purchase price.

See also:

- Shareholders’ agreement

Premium

Compensation or price for an asset, for example for insurance or an option.

Pre-money

The term "pre-money" means the situation in a company before a new issuance of securities. Assume that a company has a pre-money valuation of €10M (ten million Euros) before a €5M addition to capital through a new issuance of shares. The valuation after the new issuance then will be €10 + €5 = €15M, which is the value post-money.

Assume that you own 10% of the company before the new issuance, which means that your shares "pre-money" are worth €1M. If you do not subscribe for your share (10% of €5M) you will be diluted by 33%, and your share of the company post-money will be 6.67%. Note, however, that your shares are still worth €1M since the company's new value after the contribution will be €15M.

See also:

- Post-money
- New issuance

Price mechanism

At the start of the process for a large share transaction or the sale of a company, it is usual that the price of the company and the shares will be determined by some agreed method. The price mechanism may consist of the value of the company being determined by multiplying its profit by a constant (compare Enterprise Value).

Another method may be that two accountants who are independent of one another provide their respective views as to the value, and the seller and the buyer then agree that the value midway between the accountants' valuations determines the value of the company.

The methods for determine the price of a company are often supplemented by a price adjustment mechanism which will adjust the price if the result, assets or debts on the balance sheet change before the transaction closes. These adjustments may relate to dividends paid to the owners or to changes in cash, inventory or receivables.
Compare also "" which is another example of a price mechanism.

See also:

- Locked box
- Enterprise Value
- SPA

Private Equity

"Private Equity" (PE) is a comprehensive term for investments in unlisted businesses. The concept can have somewhat different meanings depending on context, for example:

- Investor: PE investor.
- Industry: PE industry.
- Investment type (asset class) for investors in funds: PE asset, PE fund.

PE investments may be divided in relation to the development state of the company:

- Venture Capital (investing in young companies).
- Growth Capital (investing for growth and expansion expansion).
- Buy-out (large buy-out transactions).

The investments are usually majority investments which provide a dispositive influence over decisions in the company. The exception is Venture Capital, which often is a minority investment made through a syndicate with other Venture Capitalists and founders.
PE investors are very active owners in the company in which they have invested. They take seats on the Board of Directors and work strategically together with the company's Board of Directors and management to consistently increase the value of the company.

The capital PE invests comes principally from PE funds. Through these funds, institutional investors are offered an opportunity to invest by means of the fund in unlisted companies. Typical fund investors are pension funds, insurance companies, public institutions, foundations, and mutual funds. The investors in PE funds may be both local and international investors. The funds often have a term of ten years, which means that the PE investor must manage to invest, develop and realize the investments (sell the companies) within the stated time.

PE investors are often criticized for being short-sighted. The average holding period for an investment, however, is determined by the requirement of the fund investors for repayment within the term of the fund. Since the funds often have a term of ten years, it means that the holding period will typically be five to seven years. PE investors must sell all its investments in order to be able to pay back the capital plus profit to the investors, and must thus manage to invest, develop and realize the investments (sell the companies) within the stated time.

See also:

- Venture Capital
- Growth capital
- Buy-out transaction
- Raise a fund

Profitability

Profitability is measured in percent and is a measure in which the profit is placed in relation to the capital which has been invested. As a private person, for example, the profitability of your savings accounts at a bank is measured by dividing the annual interest by the amount of the accounts. For example, if you have saved €1,000 and receive €50 (your profit) in interest, the profitability of your savings is 5% per year.

In a company, profitability is measured by placing the profit in relation to the capital the company uses.

Profit and profitability are two concepts which are often confused. But as appears from the foregoing, profit is not a measure of profitability. Assume that you have two savings accounts, in which you have saved €1,000 in one and €5,000 in the other. The first account pays interest of €50 and the second €100. The profit (the interest) in the latter account is twice the size and it would be easy to believe that the profitability is higher too. But if the profit is placed in relation to the amount saved, we see that the profitability is 2.5%, that is, only half as large compared with the first account -- which pays 5%.
In a similar fashion, we can look at the profitability in a company. If company A shows a profit of €200M and company B a profit of €400M, this does not necessarily mean that company B, with its higher profit, is more profitable. In order to measure profitability in a company, the profit must be placed in relationship to the capital which the company uses, i.e., the capital which is invested in the company.

We can thus define profitability in a company as:

- Profitability=profit/invested capital.

The profit in a company can be seen as the interest" on the capital which has been invested in the company. Sometimes the concept of return on capital is used as a synonym for profitability in a company. The different profitability measures used are:

Return on total assets

$$R_T = \frac{\text{profit before financial costs}}{\text{total assets (capital)}}$$

Return on capital employed

$$R_{CE} = \frac{\text{profit before financial costs}}{\text{average capital employed}}$$

Return on equity

$$R_E = \frac{\text{profit after financial costs}}{\text{adjusted equity}}$$

Return on equity after taxes

$$R_{EaT} = \frac{\text{profit for the year after taxes}}{\text{adjusted equity}}$$

The term "adjusted equity" capital (AEC) includes that part of the untaxed reserves which belongs to the company and the shareholders after taxes have been paid. In the calculation of the adjusted equity capital regard may also be taken to the average equity capital during the year. Therefore, AEC is usually higher than what is reported on the balance sheet as equity capital.

What, then, is sufficient profitability? The answer, of course, is it depends. In a simplified model of the pricing of capital, it is assumed that the market (lenders, investors, banks and so on) determine what profitability (return) they expect in order to offer capital. The profitability which the market expects determines in turn the price of capital. The interest rate which a bank wants in order to lend you money is thus the market price you have to pay to borrow money from the bank.

The market price of capital varies with the risk, mainly dependent on whether a borrower can re-pay the amount used. For example, in order to get access to capital loan and obtain the market price, you are expected to pay the required interest and amortization. In the same way, it is expected that a company will be able to pay interest and amortization to the bank as well as dividends to its owners.
Of course, the lower the risk that a borrower cannot make its payments to a lender, the lower the price of the loan will be. If there is no uncertainty at all, for instance when the state borrows, it is common to speak of a risk-free investment and a risk-free interest rate. Since the state is usually seen as a very safe payer, the interest rate on government bonds is often used as a measure of a risk-free interest rate. Loans to private persons and businesses therefore include a certain risk premium in addition to the risk-free interest rate.

The price of capital is, however, not only affected by the ability to re-pay capital. It is also affected by the market's willingness to take risk. In good, positive times, lenders and investors are willing to take greater risks and offer capital for lower compensation, and in uncertain times they are asking for a higher price.

How, then, is the market price of equity capital (the owners' capital) to be determined, that is, the capital which is often called risk capital? Basically, the price of equity capital is the return which an investor expects in order to be willing to put capital into a company or to buy shares on a securities exchange.

An investor's requirement as to the return on capital of her or his investments is the sum of risk-free interest plus a risk premium for the unavoidable, systematic business risk, that is, for the risk which cannot be eliminated through the use of a diversified investment portfolio. The size of the risk premium cannot be determined with certainty; it varies with the business, over time and is based to some extent on subjective expectations about the future. The risk is naturally greater with a newly started, unlisted company as compared with a large, listed company, the shares of which can be sold if the investor is not pleased with the developments in the company.

Example:
Assume that the risk-free interest rate, at a particular point in time, is 2%. Assume, further, that the average risk premium, at the same point in time, for large companies on a securities exchange is 5.6%. The total required return (and the price) for securities exchange listed ownership capital here will be 7.6%.

Since the business and financial risk in smaller companies is greater, the risk premium will be affected also. We will assume that a small listed company (e.g., market value less than €50 million) at the same point in time has a risk premium supplement of 3.7%. This gives a total risk premium of 9.3% and a required return of 11.3%.

In an equivalent way, investors will make judgments about risk premiums and return requirements for unlisted companies. It is not uncommon for an investor to require twice the risk premium in order to contribute capital to an unlisted smaller company, which would mean a total return requirement (and price) for equity capital in the company exceeding 20%. A contributing cause of the materially higher risk premium in this case is that the shares can be very difficult to sell (the shares are not liquid) if the investor is not pleased with the developments in the company.

See also:
- Lever

Promissory note
A type of document which shows that there is a debt. It is a written agreement between two or more parties which is prepared in connection with a loan.

The promissory note states who the parties are, the borrower/debtor and the lender/creditor, as well as the terms and conditions of the loan. A promissory note is usually held by the creditor. When the debt has been paid, it will be cancelled and returned to the maker (debtor).

Proposal
Investment proposals, leads.

Pro rata
The proportion of an owner's share of the company (the number of shares owned divided by the total number of shares), often measured in percent.

See also:
- Share allocation

Q

Q&A

"Q&A" is an abbreviation of "questions and answers". In connection with a presentation, it is usual to set aside time for a Q&A session at the end of the presentation.

In conjunction with a road show, where the management gives a presentation on the company, analysts and investors will have a chance to put questions to the CEO and the company's management. Those who are going to make the presentation, together with their financial advisor among others, will have gone through all of the questions which they think may be asked. They then prepare and practice the answers in a so-called "dry run", that is, a practice presentation. It is also decided in advance who will answer which questions.

Another situation with a well-prepared Q&A session is in connection with media practice before a press conference and meetings with journalists.

See also:

- Road show

Quant

This is a quantitative analyst who uses mathematical and statistical models in her or his evaluations. A quant tries to understand developments with the help of complex models based on historical data, statistical measurements and research.

An "exchange quant" tries to predict the developments on the securities exchange and to utilize both key numbers and advanced mathematical models. Quantitative analyses seldom give a completely nuanced picture -- for that, supplementary qualitative analyses are also needed.

See also:

- DCF
- Spreadsheet jockey

Quick Assets Ratio

Quick Assets Ratio (QAR) is a measure of a company's short-term capacity to pay. Also called "Quick Ratio". The measure shows the company's capacity to pay short-term liabilities and is calculated:

- QAR = (current assets - inventories)/short-term debts.

The higher the ratio the better the company's cash position. A ratio of two (2) thus means that the company has €2 available to cover €1 of short-term debts.
Inventories are excluded since they cannot quickly be converted to liquid assets. If a company is forced to sell inventory, it is assumed that this will be done at a lower value than the booked value.

Whether receivables should be included is also a subject for discussion, since the value of receivables depends on the customers' capacity to pay. If the company wants the customers to pay in cash, or earlier than when payment is due, it must be assumed that the payment will be made with a discount.

See also:

- Liquid ration
- Acid test ratio

Quotation

A bid or an offer.

Quoted Company

The term for a listed company, that is, the company's shares can be bought and sold in a marketplace which is available to the general public.

See also:

- Listing

R

Raise a fund

To a large extent, Private Equity (PE) invests other people's money. PE offers large local and international investors the opportunity to invest in unlisted companies by creating and raising a fund. Typical fund investors are pension funds, insurance companies, public institutions, foundations and mutual funds. "Private Equity" is an "asset class" in the entire portfolio of fund investors.

The PE investor collects several institutional investors into a single fund in order to obtain advantages of scale, and thereby also spread risk by being able to invest in many companies in different industries. An individual fund investor commits himself or herself to invest a certain portion of the total fund capital and then contributes his or her capital share as and when investments are made.

The fund investor is a part owner (LP, Limited Partner) in the fund and the PE's management company (GP, General Partner) is responsible for the management of the fund and for regular reports to the fund unit owners. The PE investors invest the capital of the fund in a number of companies and work actively for the creation of value during the time they hold the investment. The fund has a limited term, usually ten years. The fund capital plus profits must be repaid within the fund's term. The fund investors pay an annual management fee (1-2% of the fund capital) to the PE investor's management company.

A PE fund may have a specific orientation, for instance towards a certain geographical area (Europe, Asia), industry (Telecoms), development phase (expansion), or situation (turn-around). The fund will also have limitations on how much of the total fund capital may be invested in any individual investment, for example a maximum of 10% of the fund's capital in any single company.

See also:

- Advisor
- Draw down
- Corporate finance
- Private Equity

RAMBO

An abbreviation of "Rescue After an MBO". Sometimes a Management buy-out (MBO) fails and the owners must start a restructuring or a turn-around of the business. The causes of the failure can be many. Perhaps the investors paid too high a price just before a downturn in the economy and the company's management has not been able to move the company away from a negative development. Under such circumstances a RAMBO may be necessary.

See also:

- MBO

Ratchet effect

When a variable quantity typically only moves in one direction. The expression can have different, specific meanings depending on context. One example is when the consumption levels does not fall as much as income in an business cycle down-turn.

A ratchet effect can also mean a provision which is sometimes included in an acquisition agreement for a transaction (a MBO-transaction) in which a business' management will become part owners. The agreement may give the management an increasing ownership share if the company achieves certain profitability targets.

R&D

Abbreviation of Research and Development, that is, the function in the company which is responsible for development of new products.

Real interest rate

A real interest rate is the rate of interest which has been corrected for inflation. If the nominal annual interest rate is 5% and inflation is 3% during the year, the real interest rate will be 5% - 3% = 2%. This means that if you have saved €100 you will have €105 in the account after a year, but the purchasing power will only have increased by 2%, that is, €2.

See also:

- Inflation

Redemption program

A "redemption program" is a modified repurchase program for shares in a corporation. In the first stage, the company gives out free shares (redemption shares) to its owners in proportion to their holdings -- for example, a shareholder may receive one (1) redemption share for each existing share. In the second stage, the company then buys back the redemption shares at a pre-determined price which in principle corresponds to what a dividend per share would have been. The direct return per share before taxes is thus the same.

A redemption program does not diminish the number of outstanding shares and, just as with a share repurchase, can be an advantage for those investors who have different tax rates on dividends and repurchases. As an example, the repurchase of redemption shares may, in certain jurisdictions, be taxed as a tax-free sales profit while an ordinary dividend is taxed as a financial receipt.

A redemption program can also be an advantage for private investors since shares that are sold receive part of the initial value (cost) of existing shares.

Example: Assume that you have purchased 100 shares for €5 per share. The company now creates a repurchase program with redemption shares and you receive a new share for every existing share, i.e., 100 shares. In the next stage the company redeems the new shares for €0.5 each and you receive a total of €50.

The tax authorities in the country now decide that 5% of the initial value of €5 of your previously purchased shares will be attributed to the redemption shares, i.e., €0.25/share. This means that you will be taxed for the sale profit of €0.5-0.25= €0.25 per share and your total sale profit will be €25 instead of €50.

In practice this means that your tax on the sale profit will be pushed forward into the future, since the initial value of your remaining 100 shares will be reduced by €0.25/share from €5 to €4.75/share (in total from €50 to €47.50). You will thus obtain a correspondingly higher sale profit when you sell these shares in the future.

See also:

- Share repurchase

Red flag

A warning flag of a serious deficiency or drawback in the company in advance of an acquisition. In connection with due diligence (DD) of a business, a red flag report is a report which describes problems and risks in the target company. Among other things, this may relate to legal, financial or environmental risks.

A red flag will definitely lead to efforts to haggle about the acquisition price, even if the buyer can remedy the deficiencies after the acquisition. Too many difficult and unexpected "red flags" may lead the buyer to withdraw and not go through with the acquisition.

See also:

- DD
- VDD

Relative return

An investor will compare an investment's return with an "index". The relative return shows how capable the investor is at creating value in the portfolio (or the fund) as compared with the market's general developments. The goal is to do better than a comparable index.

If, for example, the value of the shares in the portfolio increased by 8% while the share index for comparable shares rose by 5%, the relative return is 3%. Well done! But if the index increased by 10% the relative return will be -2%. Not such a good job!

See also:

- Index

Rescue
When a company in crisis, perhaps on the way towards bankruptcy, is moved from loss to profit by means of a comprehensive rescue. A rescue usually involves capital contributions, restructuring of the business, change of management, and always a "fight against the clock".

Restructure
Means very large, comprehensive changes in a company's organization and business. The intention is to increase the pace of decision making, execution and necessary changes in working methods while adapting the company to a new situation. It can involve selling businesses, changing top management or introducing an entirely new organizational structure with new assignments and reporting channels.

See also:

- Back to basics

Return
Return in a company is measured by the ratio between profit and invested capital and is expressed in a percentage. The measurement of return can be based on parts of or on the whole of the invested capital.
Examples are "return on equity" (ROE) or on "capital employed" (ROCE).
The "return" on your own private savings account is the interest rate you receive from the bank.

See also:

- Profitability

Return on capital
The profit in a company can be seen as the "interest" on the capital which has been invested in the company. Often the concept "return on capital" is used as a synonym for profitability.

See also:

- Profitability

Revenues
It is necessary to distinguish among payment, income and revenues or receivables.
Payment means, as an example, that a customer pays for goods or services and the money arrives in a bank account or the company's cash account.

Income comes into existence when a company sells goods or services. When the company sends an invoice, the income is booked.

Receivables are income, which is periodized, that is divided over the periods during which performance by the company is made and delivered. Assume that the company sells a project and receives an advance for a project that will go on for three months. The income is then booked as a receivable in the profit and loss statement and reported one-third each month.

See also:

- Accrual accounting
- Cost

Reverse take-over

When a smaller company acquires a larger company. Usually it is the larger company which acquires and integrates a smaller company. It is naturally associated with greater risks when a smaller company acquires a larger one, for example:

- Does the smaller company have sufficient financial and management resources to integrate the larger company?
- If the cultures of the enterprises differ -- whose culture will win out?
- Can the smaller company's organization and reporting structure be developed so as to deal with a business which is twice as large?
- Etc...

Sometimes the end result after the integration is that the management of the purchased company "takes over" the purchasing company!

Right of first Refusal, ROFR

Generally, "right of first refusal" (ROFR) is a contractual right -- but not an obligation --for a person/business to enter into a transaction (purchase, lease etc.) with a person/business ahead of anyone else. See also "Option".
In the case of shares and ownership in a company, there may be a right of first refusal clause in the certificate or articles of incorporation (depending upon the jurisdiction) or in a shareholders' agreement. A seller of shares in the company must then first offer her/his shares to the existing owners who are covered by the right of first refusal. See also "Pre-emptive rights".

How a right of first refusal is exercised varies depending on the type of asset and on the jurisdiction. Regarding shares in a company, it is common that the communication between the new and the old shareholders will go through the company's Board of Directors. When the Board of Directors has received information that a sale to a new owner has taken place, the Board of Directors must inform every existing owner who is entitled to purchase.

See also:

- Option
- Pre-emption rights
- Shareholders' agreement

Risk credits

"Risk-assuming credits" are defined as loans and grants from governmental institutions. They are also called soft loans. This is a form of financing which is appropriate for the start-up of a new company. Combined with financing from an active business angel, this type of credit can be the optimal financing (and ownership) for a newly started company so that in its next stage it can take in "Venture Capital". Repayment of risk-assuming credits and soft loans may be conditioned on the company/business generating a profit.

See also:

- Business angels
- Spoon-feeding

Road show

A "road show" is a trip to a variety of places made by the top management of a company, often accompanied by a financial advisor, to meet analysts and investors. Most often this occurs in connection with the closing of the books, and for a relatively long period. But it can also happen in connection with a listing on an exchange or with a new issuance of shares or other securities.

The purpose is to inform the market, create a positive interest in the company and sell the shares. The management and the advisors will have carefully prepared the presentation and the responses to the questions which may be asked during the Q&A session.

In conjunction with a relatively large exchange listing, this may be a time-consuming international trip to various financial centres, often with several meetings a day for a couple of weeks.

See also:

- Listing on a securities exchange
- Q&A

R&W

Abbreviation of "Representations and Warranties", that is, commitments as to specific facts and guaranties. The concept relates to guaranties which existing owners (sellers) give to new, incoming owners (buyers) in connection with a transaction relating to an asset, for instance a share transaction.

See also:

- Warranties and indemnities

S

Second round financing

The financing of a young company is usually divided into a number of rounds. The first round (first round financing) is the one which is associated with the greatest risk since the company has perhaps not yet managed to launch its products and start its sales. In the second round (second round financing) the company has come a bit of the way along the road and the risk is therefore lower. A third round is called "third round financing", and so on.

Early investors usually ask for some type of compensation (downside protection) in case the valuation in the following rounds do not meet the value expectations from the previous round. The value of the company may have declined. The compensation may consist of free shares so that the price of the "old" shares corresponds to the price that is set for the new issuance.

See also:

- Downside protection
- Spoon-feeding

Securities exchange

A "securities exchange" is a company which has obtained permission from an authorized governmental authority to operate so-called regulated markets for trading in securities, for example in shares. A synonym often used is Stock exchange.

The extensive rules which securities exchanges must comply with are intended to protect investors, for example by seeing to it that trading and the setting of prices is efficient as well as, to the extent possible, preventing insider trading.
Examples of major stock markets are:

- New York Stock Exchange,
- NASDAQ,
- London Stock Exchange,
- Deutsche Börse
- Tokyo Stock Exchange, and
- Shanghai Stock Exchange.

See also:

- Listing on a securities exchange
- Bear market
- Bull market

Secrecy agreement

The agreement governs how the parties must deal with the confidential information which they share with one another for example during a business negotiation or in the process of a transaction.

See also:

- NDA

Seed capital

A form of financing for a very early stage financing. Seed capital makes it possible for an idea to begin to be developed into a product or for a research project to be made into a company. Enterprise incubators, or business angels, can help with seed capital in a first round of financing.

"Risk credits/capital" is a type of seed capital.

See also:

- Early stage
- Business angels
- Incubator
- Risk credits
- Spoon-feeding

Sellers' knowledge

In the warranty section of a share purchase agreement (SPA), the sellers are required to provide warranties regarding essential circumstances in the company and its operations. The warranties are generally made on the date when the seller and buyer sign the SPA (signing).

If the closing of the transaction (the point in time when the shares change owners and the proceeds are paid) takes place at a later date than the signing date, it is often a hot topic to agree whether the warranties are made on the date of signing only or at signing and also at closing. Notably, in case there is an extended period between signing and closing, it is reasonable to require the seller to renew its warranties at closing.

It should be noted, however, that sellers never should agree to provide forward-looking warranties, i.e., not give warranties relating to events that may happen in the future. Further, sellers' warranties should be made by each seller individually and severally, and not jointly and severally.

Examples of typical and fundamental warranties are sellers' full ownership of the shares in the company and that the shares are not subject to any encumbrances, the accuracy of financial information, tax payments, material agreements, salaries and remuneration, and the company's compliance with relevant laws, regulations and policies.

Some warranties state positive facts such as that the company owns real estate, production facilities, material rights such as trademarks patents – all listed in an appendix to the agreement. Other warranties may state negative facts, e.g., the company is not involved in any legal disputes or that no ongoing customer contracts exceeding 5% of sales are terminated or has expired. An important matter when negotiating the warranty clauses is whether the warranties should only relate to the current situation of the business or should it also refer to past circumstances.

In some instances, the seller knows that a specific warranty is true and fact-based – for example, that none of the company's ten largest suppliers have terminated their supplier agreement. However, in other cases, the seller may not be entirely sure if the warranty can be fact-based or not, e.g., "no key supplier intends to terminate its contract with the company." The warranty, in such a case, becomes a matter of risk allocation. If the seller provides the warranty, the seller will be responsible for the cost the buyer receives if a critical supplier will terminate the agreement. If the seller does not give the warranty, any damages will be borne by the buyer.

The sellers may still need to provide warranties even if the sellers do not know for a fact if a warranty statement is entirely accurate or not. One way of dealing with this tricky situation is by using the phrasing "seller's knowledge." Then, only the circumstances that a seller knew about applies when the warranties were provided. An example of wording is "insofar as the seller knows, none of the company's ten largest suppliers intend to terminate an agreement with the company." Note that "seller's knowledge" does not include what the management or an employee of the company know about a circumstance – provided that the seller was not informed.

See also:

- Closing
- Signing
- SPA

Serial entrepreneur

An entrepreneur who, after having successfully sold his first enterprise, invests anew and starts another enterprise. Many successful entrepreneurs who have built up an enterprise and sold it don't want to just play golf. They are eager to go further and to seek out challenges in building new enterprises.

Investors are positively disposed towards investing in parallel with and supporting serial entrepreneurs. They have experience and have shown that they can start, develop and sell enterprises at a profit.

See also:

- Entrepreneur

SHA

SHA is short for "shareholders' agreement". It is an agreement among the largest owners in a company where the parties agree on what rules are to govern important ownership decisions, decisions at meetings of the shareholders and of the board of directors.

See also:

- Shareholders’ agreement
- SHA
- Drag along
- Tag along
- Exit
- Pre-emptive rights
- Syndication

Share allocation

After the existing and new shareholders have subscribed for shares in a new issuance, the company's board of directors decides to whom the newly issued shares are to be issued (who will be allowed to purchase them). The board of directors also decides how many shares shall be allocated to each subscriber.

In the event of over-subscription, i.e., when there are more subscribers who want to purchase shares than there are shares available to be purchased, the allocation will be made in accordance with specific principles. Common principles for allocation are that no one may receive more shares than a certain proportion per subscriber or the number which corresponds to that person's current proportion of the total number of shares, i.e., pro-rata.

See also:

- Pro rata

Share capital

That part of the shareholders' equity capital on the balance sheet which corresponds to the face or par or nominal value of the issued shares.

See also:

- Equity

Shareholders’ agreement, SHA

An agreement among the largest owners in a company where the parties agree on what rules are to govern important ownership decisions, decisions at meetings of the shareholders and of the board of directors. Customary clauses which regulate joint ownership are clauses which govern rights of first refusal, consents, and pre-emptive rights.

- Among other things, the agreement will regulate:
- Identity of the contracting parties.
- Background, purpose, with the cooperation.
- The company's business.
- Issues which will require unanimity, for example, the annual budget, acquisitions, dispositions.
- The composition of the board of directors.

- The company's top management (CEO, CFO, etc.).
- Allocation of profits, dividends.
- Any continued, future, financing, e.g. how a new subscription of shares will be carried out.
- If, how and when a shareholder may sell her or his shares.
- Pre-emptive rights and/or rights of first refusal for shares.
- How the company is to be appraised in conjunction with sales of shares.
- If, how and when shareholders may make any joint sale (exit).
- If the shares of natural persons are to be "separate property".
- Confidentiality.
- Any prohibition of competition.
- Governing law.

How and where disputes are to be resolved, for example by means of arbitration or in the courts.

See also:

- SHA
- Drag along
- Tag along
- Exit
- Pre-emptive rights
- Preferred shares
- Syndication

Shareholders' meeting

The shareholder (owner) meeting is the highest decision-making body in a corporation, and the meeting when *all* shareholders meet. If a shareholder cannot be present at the meeting, a proxy can be given to some other legally competent person. At the meeting, the shareholders make the basic decisions on the company's direction and management in conformity with the Companies Act and the certificate or articles of incorporation.
When and how shareholders hold a shareholders', meeting varies depending on business tradition, jurisdiction, and type of company (large, small, listed, closely held, etc.). Also, what questions are considered and what decisions the meeting makes varies.

We will try here to give a general description and to illuminate certain questions with generalized examples.

A shareholder may vote the shares she or he owns. Ordinarily, the rule is one vote per share, but in certain countries legal rules may permit, and the certificate or articles of incorporation may prescribe, that different classes of shares have different voting rights (for example, one A-share has ten votes and one B-share has only one vote per share).

If the country's laws and the company's certificate or articles of incorporation so provide, the company must hold a regular annual meeting each year (often abbreviated as AGM, i.e., Annual General Meeting). This must often be held within a specified time (for example, six months) after the end of the fiscal year. Here the owners select the Board of Directors and make decisions on the disposition of the profits or losses from the company's operations. In some countries the shareholders meeting also appoints the company's auditors.
The owners also make decisions on amendments to the certificate or articles of incorporation, changes to the share capital, and incentive programs for the management and the Board of Directors which may affect the number of shares in the company (*e.g.*, options, convertible securities). In some jurisdictions, the shareholders meeting may also decide upon compensation for the Board of Directors and the auditors and provide guidelines for compensation for the principal members of management.

Where shareholders' meetings are to be held varies, but it is common for them to be held in the place where the Board of Directors has its seat (*e.g.*, the place which is specified in the paragraph on principal place of business in the certificate or articles of incorporation and which is recorded in the register of companies). It is commonly the Board of Directors which calls the shareholders meeting and in the manner which is provided in the certificate or articles of incorporation. In some cases auditors, or a minority of at least 10% of the shareholders, can request the Board of Directors to call a special, or non- ordinary or extra shareholders meeting.

1. Election of a chairperson for the meeting.
2. Approval of the list of attending shareholders and qualified voters.
3. Election of a person to take the minutes, and one or two persons to verify the minutes.
4. Determination that the meeting has been properly called.
5. Approval of the agenda.
6. Presentation of the annual financial reports and, when required, the auditors' report.
7. Decisions on:
    - approval of the profit and loss statement and the balance sheet,
    - dispositions of the corporation's profit or loss in conformity with the approved balance sheet,
    - granting of a release from liability (for the previous fiscal year) for the members of the Board of Directors and the chief executive officer.
8. Election of the Board of Directors and in appropriate cases of the auditors.
9. Approval of the fees of the Board of Directors and of the auditors.

In larger companies, it is common for the company's CEO to provide her or his views on the year just past, on the conditions in the market, and on the company's more significant strategic efforts. "Other matters" added to the agenda before the meeting may also be taken up if that is established by law or in the certificate or articles of incorporation.

See also:

- Board of Directors

Shareholder value

Focusing on "Shareholder value" is an investment and management philosophy which gives priority to the interests of the shareholders and in which the company is operated so as to maximize the value of the shares (the price of the shares).

There are divided opinions as to whether it is optimal (for the business) always to put maximizing the value of the shares first on the list, especially if the temporal horizon is short. Listed companies have been criticized for not having a longer temporal horizon for the creation of value than the next quarter -- the "quarterly view" of company finances.
In any case, a long-term, sustainable increase in "shareholder value" is an important guiding principle in the development of a company.

See also:

- CSR

Share repurchase

A share repurchase means that a company buys its own shares. The method is mainly used as an alternative to a dividend or to distribute cash when retained earnings can't be invested to get sufficient returns. But it can also be used as an attempt to control the company's share price if the price is undervalued. A repurchase reduces the number of outstanding shares which means that profit and net worth per share increase, and the share price need to be reassessed. If the share price is undervalued it may thus increase the share's price. Note, however, that the company's profits remain the same.

A share repurchase may also be an advantage for certain investors who have different tax rates on dividends as compared to a repurchase. For example, in certain cases a repurchase can be seen as a tax-free sale while an ordinary dividend would be taxed as financial income.

See also:

- Redemption program

Short selling, Shorting

Short selling (Selling short, Shorting or Short sale) means taking "a short position" in a financial investment and is a way of making money when a share's market price falls. If you think that the market price of a particular share is going to fall, you borrow those shares with a promise to return them within an agreed period of time. In the next step you sell the shares at that day's market price. If the share's market price falls, you buy back the same number of shares at a lower price and then return the shares you have borrowed. You have now made a profit equal to the difference between the value you sold for and the cost of buying back the shares.

Selling short thus gives protection against a downturn in a securities exchange, but it is also associated with a significant risk. If the market price of the shares goes up, you will be obliged to buy them back at a higher price than what you sold them for. You will then suffer a loss which corresponds to the difference between the price you sold the shares for and the cost of buying them back. The loss can quickly become substantial and may even be greater than your initial investment for borrowing and shorting the shares. It is especially risky to short shares in a company which is a candidate for a takeover or a buy-out.

In theory the loss can be unlimited. Compare that with the alternative of your buying shares and in the worst case they become valueless. In this case, your loss is limited to your investment - there is thus an upper limit for losses in ordinary share transactions.
In order both to monitor the profit and to minimize the risk, you should choose a share with high turnover (liquidity). You want to be able both to sell and to buy the shares quickly. Shares with low turnover increases the risk, since it can be difficult to buy back the shares if the price rises rapidly.

You cannot short all of the shares that are traded on a securities exchange. Only certain selected shares can be shorted, most often shares in larger listed companies with large turnover (high market liquidity). Examples of those who lend out shares are mutual funds run by the banks, insurance companies and pension funds. Shorting of shares is accomplished through brokers in the same way as with trading in shares generally. Large "borrowers" are, among others, hedge funds, asset managers, mutual funds and, to some extent, even individual persons.

Example
Assume that you have €10,000 to invest in shares. You can choose to buy shares for €10,000 or to "short" for €10,000 (costs for commissions, fees and interest to the lender of the shares). You choose to short (since you believe that the market price of the shares is going to fall) and your €10,000 is sufficient to borrow 10,000 shares. Later you sell the borrowed shares on the securities exchange at that day's market price of €5 per share, which gives you an income of €50,000.
Your judgment proves to be correct and the share price falls to €3 per share. Now you choose to buy back the 10,000 shares for €30,000 and return the shares to the lender. Your profit on the "short sale" is €50,000 –€ 30,000= €20,000 before any taxes that may be involved. You have thus invested €10,000 and made a profit which is twice as large as your investment.

But if you are wrong and the share's market price instead goes up to €8 your cost to buy back the shares will be €80,000. Now you will suffer a loss of €30,000, which is three times more than your initial investment of €10,000. By selling short you can thus lose more than what you invested. You must thus be on your guard and quickly buy back the borrowed shares if the market price rises. Compare this with the alternative where you buy shares for €10,000 and the shares, in the worst case become worthless, then your loss is limited to your investment, that is, to €10,000.

Advantages of selling short:
- You can profit if the securities exchange goes down or the market price of a particular share falls.
- You can, with not much capital, increase your return on investment since it is cheaper to borrow shares than it is to purchase shares.

Disadvantages of selling short:

- If the share's price goes up you will suffer a loss, and you may even lose a larger amount than you invested.
- You must be very alert, experienced and know the financial markets, since the risk in your investment portfolio rapidly increases.

As said, with short selling you can balance your risk and earn money also even if the market price for a particular share goes down. But there are many critics of short selling. But there are many critics of short selling. Some think that short selling results in larger price downturns and increases the uncertainty (volatility) in the share's market price. They also think that hedge funds with large capital can create a sell pressure on the share's market price by means of short selling and thereby push the market price down before the buy back. When the shares are then bought back the share's market price increases again. The device of first selling and then buying large volumes produces increased swings in the share's market price without the company's underlying value having changed.
Proponents, for their part, maintain that the advantages outweigh the disadvantages and that short selling is an important device for increasing the average return on the investors' total capital. They also think that the volatility (the market swings) in the portfolio can be minimized by the investors to some extent being able to protect themselves to some extent against securities exchange downturns.

See also:
- Hedge

Signing
The occasion when the agreements which govern a business arrangement are signed by the parties.

See also:
- Closing
- Exit process

Silent partner
A passive investor (shareholder) who is "hands-off", does not sit on the Board of Directors and is not involved in the operational management of, or the strategic decisions in, the company.

Solidity
A term for the relationship between equity capital in the company and the total assets on the company's balance sheet. The equity capital/assets ratio is measured in percent and is a measure of the company's capital structure, i.e., the division of the total capital between equity capital (the shareholders' capital) and debts (loans). Synonyms are "Equity capital/Assets ratio" and "Equity ratio".

See also:

- Equity capital/Assets ratio
- Lever
- Overcapitalized

Soft loans

"Soft loans" usually are defined as loans and grants from governmental institutions. They may also be called "Risk-assuming credits". This is a form of financing which is appropriate for the start-up of a new company. Combined with financing from an active business angel, this type of credit can be the optimal financing (and ownership) for a newly-started company so that in its next stage it can take in venture capital. Repayment of "Soft loans" may be conditioned on the company/business generating a profit.

See also:

- Business angels
- Spoon-feeding

SPA

An abbreviation of "Sales and Purchase Agreement", which is a term for an agreement governing the sale and purchase of an asset, for instance shares in a company or a piece of real estate.
In the "SPA" the seller commits itself to sell and the buyer commits itself to buy the assets which are involved at the price and on the terms and conditions which have been agreed upon between them in the agreement. Important parts of the agreement are the so-called price mechanism, which governs how the price is to be determined, as well as terms and conditions and limitations on the guarantees which may be given.

The SPA will govern the following areas:

- Which parties will be included?
- Definitions of important concepts which are used in the agreement.
- Background.
- What transaction the agreement covers, *e.g.*, sale and purchase of shares.
- Price and price mechanism.
- Important terms and conditions for the transaction (conditions precedent).
- The buyers and the seller's guaranties (representations and warranties, R&W).
- Undertakings (liabilities).
- Confidentiality.
- When and where the agreement is to be signed and the transaction closed (closing).
- How any disputes are to be dealt with.

Apart from discussions of price, questions relating to guarantees and to the amounts of damages are the most complicated parts both of the negotiations and of the agreement between the parties.

Interpretation of the SPA concept may sometimes lead to painful misunderstandings, for instance if one party comes to the discussion about "the SPA agreement" thinking that it is an agreement about going to a spa for a swim and a shower.

See also:

- Price mechanism
- Exit process
- R&W
- Closing
- Conditions precedent
- Earn out

Spin-off

When a part of an enterprise, for example a subsidiary, a division or a product line, is sold. Is also called "spin-out".

Spin-out

A term for the process by which a subsidiary or a part of the activities of a large business is sold to a new owner. Also called "spin off".

Spoon feeding

Is a form of financing by stages. In connection with investments in a company which is in a start-up phase (early stage), an investor will often not pay out the whole amount which is required to take the company to positive cash flow.

The investor may commit himself or herself for the whole amount but make payments in stages according to when the company needs the financing. The payments are often conditioned on milestones which the management has promised to meet.

The purpose is partly to diminish the risk for the investor and partly not to give the company and its management more financing than is needed for a given situation.

See also:

- Draw down
- Seed capital

Spreadsheet jockey

A person who likes to build theoretical, financial scenarios of the future with the help of computers and spreadsheets (excel). These can involve altogether too many and too complex alternatives which are not always entirely realistic.

See also:

- Quant

Star

A very successful enterprise, investment or product. A real star!

Start-up

A new, young enterprise in a first start-up phase. The company's size really plays no role, but usually a small, newly-established company is meant.

See also:

- Unicorn

Structuring a transaction

A transaction divided into appropriate parts which may even be carried out in temporal stages. A structured transaction will include finding appropriate financial instruments (e.g., loans, shares), both so as to produce a good mix of instruments in the financing and so as to make the transaction possible for all the parties which are involved.

See also:

- Mezzanine finance
- Tranche

Success fee

Advisors involved in a business transaction may receive the whole or part of their compensation as a "success fee". This means that the advisors' compensation is based on the value of the transaction and is only paid if the transaction is brought to a successful conclusion. The intention is that the advisors are to have the same interest as the seller, so that given their exposure to the transactional risk (the risk that the transaction will not come off) they will work hard to obtain as high a price as possible.

An investment bank, for example, may be entitled to a success fee of 3% of the value of the transaction. If the company is sold for €100 million, the investment bank will receive compensation of €3 million.

The converse of a success fee is a fixed fee which is to say a fixed amount determined in advance, and sometimes paid even if the transaction is not brought to a successful conclusion. A success fee will potentially result in a larger compensation since the advisor is taking a risk, partly relating to the final value and partly relating to whether the transaction is brought to a successful conclusion at all.

See also:

- Fees
- Advisor

SWOT

SWOT is an abbreviation of "Strengths - Weaknesses - Opportunities - Threats". It is a well-established and is a structured method of analysis for evaluating strengths, weaknesses, opportunities and threats in relation to a business and its environment. Strengths and weaknesses are internal factors, while opportunities and threats are external factors. SWOT analyses are often made in connection with strategic planning and business development and may be made for an entire enterprise, a business, or a product.

In the analysis of a company, a SWOT analysis may cover:

- Strengths: Describes the strengths the company has and which provide advantages in relation to competitors. For example, financial strength, a strong trademark, or unique know-how.
- Weaknesses: Describes the weaknesses which the company has and which are a disadvantage in comparison with competitors. For example, weaknesses may be high costs, antiquated products, or poor profitability.
- Opportunities: Describes external positive factors and events which are an advantage for the company. For example, new opportunities may be that new markets are opening, that a large competitor is discontinuing its competitive business, or that a complementary acquisition is possible.
- Threats: Describes external negative factors and events which may cause problems and threaten the company's business. For example, these may relate to a downturn in the economy, a rapid technology change, exchange rate changes which reduce competitiveness, or that a key supplier has financial problems.
-

Too often only an isolated SWOT analysis is made, which then has limited value and no connection to the actions to be taken and resources to be allocated in accordance with the business plan. In the next stage of the continued analysis, it is essential to describe the actions which are necessary in order to:

- Counteract weaknesses.
- Utilize and develop strengths.
- Take advantage of opportunities.
- Avoid and parry threats -- or how a threat can be converted into an opportunity.
-

It is important in the analysis to limit the number of opportunities and to try to find the absolutely most important (top five) factors which affect the company. With too long a list of strengths, weaknesses, opportunities and threats, without direct connection to an action plan, the SWOT analysis will become a theoretical exercise without real practical significance.

See also:

- Business plan

Syndication

Syndication means that two or more investors invest in an enterprise jointly. The intention is to spread risk as well as to coordinate resources, competence and business networks. In conjunction with syndication, a dominant investor (lead investor) often takes on the principal responsibility for coordination among the investors and the development of the company. All investors together are often called "the consortium".

Syndication is especially common in investments at early states -- among Venture capital investors. The investors usually prepare a "shareholders agreement" which governs their collaboration and the ownership and governance of the company.

See also:

- Shareholders' agreement
- Venture Capital

Synergy

Synergy happens when 1+1 is more than 2. The combination of two businesses is most often done so as to receive and benefit from synergies. This may relate to synergies for reducing costs or increasing receipts.

What is optimal is if both sales and cost synergies are obtained at the same time. Cost synergies, for example, arise if the combined business obtains larger volumes in its manufacturing facility and can spread fixed costs over more units. Sales and market synergies arise if it is possible to offer common customers more products without increasing the cost of sales.

Retrospective calculations of many acquisitions have shown, however, that the synergies anticipated before the combination are not wholly satisfied. The causes are obviously many and different depending on the situation. One simple, overriding explanation is that in reality it is not possible to fully integrate businesses. There is always some little detail which was overlooked in the planning and which carries with it a doubling of costs in some areas of the combined business.

See also:

- Trade sale

Synthetic option

This is an imaginary option which does not give a right to acquire shares in the company, and therefore does not produce any dilution for the shareholders. A "synthetic" option is designed in the same way as a real subscription stock option (which gives a right to subscribe for newly issued shares). Usually, the synthetic options are issued by the company and offered to personnel in the company. The intention is to give key personnel a part of the value created and of the increase in the value of the shares, but without the existing shareholders being diluted.

The risk for the synthetic option holder should be the same as that with a subscription option. Valuation and the setting of the prices of synthetic options must be done in the same way as with subscription options. Instead of shares synthetic options give the holder a right to cash compensation from the company which corresponds to the compensation which a subscription option would have given.

The profit on the option may be taxed as a capital gain (depending on the jurisdiction) if the valuation and terms and conditions are made and designed in a manner which is compatible with market practice.

See also:

- Option

Systematic risk

Systematic risk is the inherent risk of an entire market or an entire market segment. Other terms are "volatility" or "market risk". This risk cannot be reduced through diversification within the same market.

The systematic risk is both unpredictable and impossible to completely avoid. One way for an investor to reduce systematic risk in the portfolio is through hedging. Another way is to divide their investments among different types of assets, for ex. by buying shares, debt securities and real estate. Systematic risk in a market is affected by changes in interest rates, inflation, recessions, oil price changes and political events.

Systematic risk of a security, a fund or investment portfolio is measured by the so-called beta ratio (β). A beta greater than 1 means that the investment faces higher systematic risk than the market, a beta less than 1 means lower systematic risk than the market and a beta that equals to 1 means the same systematic risk as the market.

See also:

- Unsystematic risk

T

Tag along

A contractual connection between shareholders. It entails that if a buyer offers to buy a shareholder's shares, the buyer must make the same offer to the other shareholders who are parties to the agreement. The other shareholders then have the right but not the obligation to "tag along" in the transaction.
Tag along is a protection for minority owners in case a majority owner sells her or his shares to an undesirable new owner. It also gives a minority owner an opportunity to sell his or her shares if there is a good offer.

See also:

- Drag along
- Right of first refusal
- Shareholders' agreement

Teaser

A simplified, summary description of an investment opportunity. One example is a company teaser in combination with a sales process. It contains a short description of the investment opportunity, the company, its business and financial status. In this early stage the name of the company is not given. The teaser is given to potential buyers and investors in the company in an early, preparatory phase of the sales process and without their needing to sign a confidentiality agreement (NDA).
If the buyers/investors are tempted by the opportunity and thinks that the company and the investment opportunity are interesting, they can receive the more complete description in an "Information memorandum" (IM) in the next phase.

See also:

- IM
- Exit
- Exit process

Term sheet

A first agreement in which the parties agree on the fundamental terms and conditions for a transaction. A term sheet contains important, agreed terms and conditions for continued negotiation. This early agreement is also a first (acid) test which suggests whether or not there are conditions for a more comprehensive agreement. Compare with "Letter of intent" (LOI).

See also:

- LOI

Texas shoot-out

A Texas shoot-out can have different meanings depending on the situation. It is said to have its origin from dealings in cattle in Texas in the Wild West, and was then used with real firearms. In the business context it is a contractual arrangement the purpose of which is to loosen up a locked ownership situation with several owners. But no pistols of course!

A Texas shoot-out can start with one of the shareholders offering to buy the other owners' shares at a specified price. If those who receive the offer do not accept it, they must purchase the shares of the shareholder who first made an offer to buy their shares (who "drew first") at the same price and on the same terms and conditions.

The device leads to the offer (share price) being balanced, in that the owner who makes an offer to buy may be forced to sell her or his shares at the price she or he had offered to buy the shares for. It is thus not a good idea to make a "low ball" offer!

TLA

The abbreviation TLA can clearly have many different meanings. Within the language of business TLA is used (with humour) as a collective designation for all "Three Letter Abbreviations" which are used.

It is very common to create new words which are abbreviations of some longer, more descriptive English concept -- sometimes altogether too often and too hard to understand. Among the most common TLAs are words from "the C-suite", i.e., CEO, CFO, and CTO. Other examples are M&A, GNP, B2B. Even CBS (Corporate Bullshit) is a TLA.

See also:

- C-suit

Top line

The first line in the profit and loss statement, i.e., sales during a defined period.

Track record

An informal list of qualifications which shows previous earnings by a company and its management. In recruiting processes, key persons with a good track record are sought. Investors look for companies with very good, improving earnings over a series of years and in which the management can show a good track record.

Trademark

A trademark is a sign (symbol, word, letter combination etc.) that you recognize and associate with a company. The trademark must be in harmony with the image the branding is creating.

A trademark is designated by the letters TM (non-registered) or a ® for a registered and legally protected trademark.

See also:

- Branding

Trade sale

"Trade sale" is a sale of a company to a purchaser within its industry. Often the buyer is a larger company, which will obtain synergies from the combined business.

See also:

- Financial buyer
- Synergy

Tranche

Tranche is the French word for slice or divide up. The term is used to describe a structured financing of a company where the capital contribution is divided upon into parts (tranches). In a business context, tranches may involve different types of financial instruments (loans, mezzanine, shares, etc.) with different terms and conditions and durations. It can also relate to capital contributions which are provided to the company in tranches as needed or when specific milestones are reached.
See also:

- Drawdown
- Mezzanine finance
- Spoon-feeding

Transaction value

The value of the entire transaction. Compare "Enterprise value".

See also:

- Enterprise Value

Turn-around

Measures for turning around developments in a company which has fallen into serious difficulties. Very comprehensive measures are almost always needed to convert loss into profit.

See also:

- Restructure

U

Underwrite

"Underwrite" has somewhat different meanings depending on context. In conjunction with financing of companies, the term means that some financially strong party guarantees a transaction.

Assume that a company is in need of at least €100M (one hundred million Euros) as a capital contribution. The company chooses to make a new issuance of shares. Since shares for at least €100M must be subscribed for, there is a risk of a Catch 22 situation -- all of the investors waiting to see if the entire necessary amount will be subscribed for before subscribing themselves.

In the example above, an investor is ready to invest but only upon condition that the issuance is fully subscribed and that at least €100M will come into the company. In order to create security for all of the investors, an investment bank or a relatively large owner may guarantee (underwrite) all or part of the necessary capital amount.

The party which provides the guaranty goes in and, in exchange for a fee, subscribes for any difference that may come into existence between the capital which is subscribed for in the new issuance and the total capital which the company needs. Suppose that in the example above shares for €85M are subscribed for. The guarantor then goes in and subscribes for shares corresponding to the remaining €15M.

See also:

- New issuance

Unicorn

A Unicorn is a term for start-up companies that are valued at more than a billion dollars. Usually these companies are funded by venture capitalists (Venture Capital). The valuation reflects the company value in the latest round of funding and is principally based on future expectations. A "Super Unicorn" is a start-up company that is valued at ten billion dollars.

See also:

- Start – up
- Venture Capital, VC

Unsystematic risk

Unsystematic risk is the risk that is specific to a particular company - or a particular industry. It can also be called "corporate risk".

A company that is in a start-up phase, that makes losses or faces risk going bankrupt has a higher unsystematic risk compared with a company that has stable profits and is financially sound. An investor can reduce the unsystematic risk through diversification, i. e. the investment is spread over several companies.

See also:
- Systematic risk

Upturn
Upturn on a securities exchange, the market prices rise. Another used expression is the French word "hausse" which means increase. Opposite of "downturn" or "baisse".

See also:
- Bull market
- Downturn
- Hausse

User Experience (UX)
User Experience (UX) is a concept that includes the experience you have as a customer when you directly use a company's product (or service). UX is measured by quantitative measures, such as reliability, failure rate, simplicity, usability, change frequency and time to complete a task.

A website's UX can be measured by how many clicks it takes to complete a task.
UX is sometimes confused with CX (Customer Experience) which, however, is a broader concept than the UX.

See also:
- Customer Experience

V

Value uplift

When the value of an enterprise increases -- perhaps on the basis of some specific action or event. If the company gets a large, new and profitable customer the transaction will generate a "value uplift".

Vendors due diligence, VDD

"Vendors due diligence" is the seller's DD before a planned sale of a company. It is a structured, detailed and penetrating review of the business. The intention is to find weaknesses and risks which may affect valuation and price so that there is time to deal with the problems. The weaknesses which cannot be remedied, or which remain, must be made visible and disclosed so that an offer of the company includes them.
The seller wants to avoid a situation in which the buyer, in its own DD, finds weaknesses which can be used to justify price reductions or changes in terms and conditions at the end of the selling process.

The design and extent of a VDD is specific to the situation and depends on the company's industry and size. A VDD is similar to a buyer's DD, but is usually somewhat more limited to those areas where the seller and the management suspect that there may be deficiencies. It may, for example, contain sections for:

- Legal issues, contracts, patents.
- Financial information.
- Commercial issues.
- Tax issues.
- Key employment agreements.
- Pension obligations.
- The company's management and personnel.
- External and internal environments.

The seller will usually engage external advisors so as to obtain an independent review of selected parts of the enterprise.

See also:

- DD
- Advisor
- Exit process
- Red flag

Vendor note

A vendor note is a type of debt instrument when a seller of an asset gives buyer a loan to finance the purchase (promissory note). A vendor note is used to enable or facilitate a deal. As seller gives buyer a loan increases the seller's risk in the deal - a risk that is usually compensated with a higher sales price. The loan can be secured, for example, by making the asset that is being sold a collateral. It can also be called "seller note".

Venture Capital, VC

A classic "Venture Capital" investment is a time-limited, usually a minority, investment in an unlisted company. Often the enterprise is a young company which is in an early phase (early stage) of its life cycle.

The venture capitalist will be active in his or her ownership, will take a seat on the Board of Directors, and will work on the company's strategic development in between Board of Directors meetings.

The concept venture is said to be an abbreviation of adventure which means that a direct translation would be adventurous or adventuresome capital.

See also:

- Private Equity
- Syndication

Vicious circle

A company which finds itself in a vicious circle has ended up in a difficult situation. Perhaps it does not have the characteristics that are essential to enable it to compete in a market, or opportunities to develop. The owners, the Board of Directors and the management keep running, and at last end up running around in circles, not finding any quick solutions, and becoming more and more frustrated.

See also:

- Hamster Wheel

Volatility

Volatility is a measure of risk which shows how much the price of a financial asset (e.g., a share) will vary. The measure is based on the standard deviation over one year's daily history. The more a share's price varies up and down the greater the volatility. The volatility is used as a measure of the share's market risk but provides no information as to whether a share is on the way up or the way down. The word derives from volatile, which means fleeting or unstable.

VUCA

VUCA is an abbreviation for Volatility, Uncertainty, Complexity and Ambiguity. It is used to describe a situation that is rapidly changing, which leads to volatility, uncertainty, complexity and ambiguity. It was originally a military term for a very uncertain situation. The general use of the term VUCA began in the 1990s.

It is used in the context of strategic planning to describe and explain a specific situation. The management in a company may try to avoid responsibility for mistakes by claiming that it is not possible to prepare and plan activities in a VUCA world. But this is misleading. Instead, you should ask the question: If we live in a VUCA world; how should we act to adapt and take advantage of the uncertainties?

However, VUCA takes into account that some decisions are very complex. It brings together four different types of challenges that require four different set of actions - one for each letter of the acronym.

An overarching issue is how much we know about each challenge and how much we can impact the outcome. But it keeps on your toes, and forces you to be well prepared, flexible, responsive and innovative.

WACC

"WACC" is an abbreviation of "Weighted Average Cost of Capital". The cost of the capital a company uses is divided into two principal types:

- The cost of equity capital (the owner's/shareholders' capital), and
- the cost of borrowed capital (e.g. the bank's capital).
-

A business must strive for an optimal mix of equity and borrowed capital. But how the optimal balance will look will depend on the company's situation and will vary over time. A young company without a history will often find it hard to obtain bank loans and will therefore be financed mainly with the shareholders' equity, while a more mature company with strong cash flow can increase the share of loans.

The cost of bank loans is usually lower than that for equity capital. This depends in part on the lender often taking security in the company's assets and requiring payment of interest and amortization even in periods when the owners do not receive dividends. The shareholders' contributions to the equity capital are not secured by the assets and cannot be taken out whenever a shareholder wants. The company must have sufficient financial strength and unrestricted means (unrestricted equity capital and liquidity) in order to be able to pay dividends to the shareholders. In addition, the company's shareholders come last in the line of creditors in the event of a liquidation or bankruptcy. The shareholders therefore require a higher return (interest) on their capital than a bank does.
Assume that the cost of bank interest (after taxes) is 3% and that the shareholders require 10% (risk-free interest + risk compensation). Assume further that the company is financed 40% loans and 60% equity capital. The average cost of capital WACC is then (0.4x3%) + (0.6x10%) = 7.2%.
The return on all investments which the company makes must exceed the WACC in order for the company's profitability with its existing capital structure to be maintained. For that reason, the WACC is included as an interest rate (discount rate) in assessment of the company's investments, e.g., in calculations of NPV and DCF.

See also:

- Cost of capital

- DCF
- NPV

Warranties and indemnities

The concept covers legal undertakings which a buyer requires from a seller of an asset, for instance shares in a company. The buyer's intention is to minimize risk and compensate itself for negative surprises. The buyer requires that the seller guarantee certain important facts about the company and also assume liability for any deficiencies in the guaranties (breach of warranty).

The seller must then cover the loss (damage) which the buyer suffers on the basis of the facts about the company not turning out to be what the seller had guaranteed. But in order to obtain compensation, the buyer must be able to show that a deficiency led to a loss and that the deficiency is covered by the guaranties.

Warrant

There is no strict definition of the difference between an option and a warrant, but you may say a warrant is a call option with the rights to subscribe for new shares (or other securities). A warrant's lifetime (before expiration date) is usually longer (years) than for options (months).

See also:

- Option
- Derivative

White knight

A friendly, desirable investor in, or buyer of, a company. In conjunction with a threat of a hostile takeover, some owners will look for a white knight which can come in with an attractive alternative for those shareholders who are prepared to sell to an undesirable, new owner. The white knight will then come as a saviour and the company will avoid a hostile takeover.
Even the Board of Directors and the management will prefer the white knight as a new owner since it most often will not intend to change direction, strategy, Board of Directors or management.

See also:

- Black knight

Worst case scenario

The worst imaginable scenario! In connection with the assessment of an investment, the investor develops a number of alternative possible outcomes (e.g., high, likely and low). As a last complement to these alternatives, a worst-case scenario is also imagined and analyzed.

The same thing is true for a company management which is evaluating a significant transaction or business deal.

It is customary to say that one must not take greater risks that those with which one can live and sleep well with the worst-case scenario!

See also:

- Comfort factor

Y

Yardstick
Measuring stick. The concept is used, for example, in conjunction with comparisons of companies, products and production processes. But it is also used in conjunction with comparisons of the performance of (leading) persons. The level of performance against which measurement is made, and compared, is more or less the new standard level.

YTD
Year To Date (YTD) in its strict meaning is the period of time from the beginning of the current year up to the day's date. But in a company's financial reporting it means the time from the start of the fiscal year to the end of the latest calendar period (assessment period). If, for example, the fiscal year starts 1 January and one looks at the financial position in May after the outcome of April, the result YTD is the same as the cumulative result during the year up to 30 April.

Yield
Return, return on capital, on different financial instruments (shares, bonds, etc.). For example, the return can be calculated as the relationship between interest and invested capital over time with an IRR calculation.

See also:

- IRR

Yoyo
A yo-yo market is a slang term for a very volatile (variable) securities market. The name comes from the movement of the toy yo-yo. In a yo-yo market the price of the securities fluctuates a lot and is usually not following the general movements (index) on an established exchange.

Investments in a yo-yo market entail therefore very high risks and are very stressful for investors. You must have strong mind if you want to be active on a yo-yo market. On the other hand, a yo-yo market can also be very profitable - if you can buy and sell at the right time. In a true yo-yo market after a downturn there will always be an upturn, sooner or later.

Z

Zero base

Zero base calculation - the examination starts at zero and revenues and costs in the order of priority.

In budgeting, zero based budgeting is sometimes used. This is a budgeting method in which each expenditure item is examined systematically. All costs are valued and prioritized according to the utility they have in the business. Sometimes called bottom-up budgeting.

Zillion

A very, very large number of millions.

Zombie

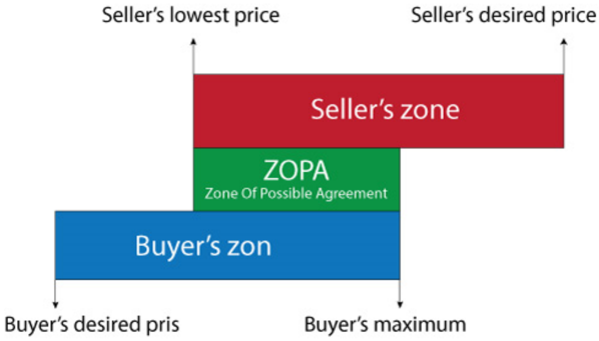
A Zombie is a company that continues its activity even though it is insolvent or close to bankruptcy. A typical zombie has very high operating costs, for example because of the extensive research and development.

The development of a zombie is very unpredictable - the company may go bankrupt or may become a great success. Investment in a zombie is therefore extremely risky and not suitable for investors who do not understand the risk.
Example of a zombie could be a small biotech company with small funds that is attempting to create a blockbuster drug by concentrating its investments to research and development. Drug development is known to be a very expensive affair and it takes long time. If the development of the drug fails, the company can go bankrupt, but if the development is successful, it can make high profits by either selling the drug or license to a large well-established pharmaceutical company.

Expectations of return in case of success are usually very high as investors in zombies in the worst case can lose all the invested capital. The high risk must therefore be compensated with possible high returns.

ZOPA

ZOPA stands for "Zone Of Potential Agreement" and describes the areas of negotiation (the zone) within which two parties may come together and reach an agreement. If the parties are outside of the zone, and cannot come together, it is not possible to reach an agreement. In conjunction with a negotiation it is important early on both to understand one's own ZOPA and to try to position oneself within the counterparty's ZOPA. Successful negotiations require an understanding of both hard and soft terms and conditions, and of specific interests and values. If the parties' ZOPAs overlap each other, there is a chance of negotiating an agreement which the parties will accept.



Example: Assume that you want to sell your business and think that it is worth €100M – €150M. A buyer is prepared to pay €80M – 120M. Here there is a positive ZOPA. Another buyer is prepared to pay a maximum of €95M. If that buyer is not willing to move into the area of €100M - €150M, or you are not willing to change the lower boundary from €100M to €95M, there is no ZOPA. A soft factor in your ZOPA may be that, in addition to the price, you will insist that regard has to be taken to the employees in the company and that the offices and production must therefore not be moved from its existing location.

Understanding and analysis of the parties' ZOPAs can of course be used in different types of negotiations -- not just in business transactions. And if there are more than two parties, the analysis, understanding and acceptance of the various parties' ZOPAs is even more complicated.

An alternative way of expressing "ZOPA" is to say that it is necessary to understand and accept the counterparty's agenda in order to be able to reach an agreement.

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