

Financial Terms

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Assignment 1.1

Valuation

Valuation is the analytical process of determining the current (or projected) worth of an asset or a company. - James Chen, Investopedia

Valuation is the process of rating a company's total value. This is the basis for all investments either private or public via the stock market. The value of a company is calculated from a number of factors, such as the literal money the company has, the value of all its physical assets, the estimated value of the company's intellectual property and patents, and the company's place in the market and strength of the market sector. A company's true value is rarely accurately calculable, which is why the stock market exists, so most valuations rely on common models to calculate approximate values based on a relatable set of data in order to compare companies.

Liquidation

Liquidation in finance and economics is the process of bringing a business to an end and distributing its assets to claimants. - Will Kenton, Investopedia

Liquidation is the process by which a company's assets are sold or distributed to make up for losses and pay off debts. All of a company's assets are generally subject to liquidation when it is dissolved, including physical product, property, and intellectual property rights. There are generally multiple tiers of debt that are affected by a company's liquidation, with higher tiers being paid off before lower tiers receive anything. Liquidation is not always specifically used when a company is being completely shut down but is sometimes used when a company is restructured or goes through certain types of bankruptcy in order to settle certain debts and recoup losses on underperforming product lines.

SAFE Note

SAFE (simple agreement for future equity) notes are a simpler alternative to convertible notes ... created in 2013 by Y Combinator. - upcounsel

SAFE notes are a type of convertible note which is much simpler and more manageable. Like convertible notes, SAFE notes are an investment with the agreement to purchase future equity at an agreed price. Unlike convertible notes, SAFE notes are not loans and don't guarantee that an investor's money will be paid back if the startup fails, nor do they have a fixed deadline on repayment. These differences between a SAFE note and convertible note make SAFE notes an appealing option for founders, as they lack the looming deadline of repayment or conversion, and an appealing option for investors for their relative simplicity and ease of negotiation.

Convertible Note

A convertible note is a type of short-term debt financing that's used in early-stage capital raises. - Meredith Turits, Fundera

A convertible note is a type of loan given to startups by investors. They differ from standard bank loans in two major ways: they are based on the prediction of a future business valuation; and they can be paid back through equity instead of cash. Much like normal bank loans, convertible notes have deadlines, interest rates, and repayment options. Investors use these types of notes because they are a safer and potentially more profitable type of investment to make in a startup company than a direct equity investment. Safer in that if the startup is in the large percentage that completely fail the loan is still repayable, unlike equity which would be worthless. Profitable because due to valuation caps, discounts, and interest rates the investor is not only at a minimum making profits from the interest but also potentially converting both the capital and interest profit into heavily reduced share prices.

Angel Investor

An angel investor is a high-net-worth individual who provides financial backing for small startups or entrepreneurs, typically in exchange for ownership equity in the company. - Akhilesh Ganti, Investopedia

Angel Investors, or private investors, are generally wealthy individuals who invest their personal capital into startups in the early stages of growth in exchange for current or future equity. Angel Investors are often the only viable option for many startups, as securing bank loans can be impossible depending on the type of business and the entrepreneur. These investors are usually the first choice in funding startups, and angel investors frequently provide additional support to entrepreneurs aside from financial backing, such as a network of contacts and valuable experience.

Venture Capitalist

A venture capitalist (VC) is a private equity investor that provides capital to companies exhibiting high growth potential in exchange for an equity stake. -

Akhilesh Ganti, Investopedia

Venture Capitalists are generally groups of private investors which pool their money in order to invest in startups which look to have promising returns. VCs typically invest in startups that have proven their concept already and have a strong business plan and management team in place, hoping to fund the accelerated growth of bringing a successful product to market and then either cash out or use their ownership of a large portion of the company to guide its future direction. The high rate of failure in startups makes bank loans difficult or impossible to secure, which makes venture capitalists almost a necessity in bringing any startup to market.

Incubator

An incubator firm is an organization engaged in the business of fostering early-stage companies through the different developmental phases – Will Kenton, Investopedia

Incubators are groups which help take startups in their very early stages and guide them through the process of establishing and growing. Incubators typically target entrepreneurs which have an idea but have yet to establish a business plan or begin the work of bringing that idea to fruition. These groups offer access to a wide range of benefits to early startups such as industry contacts, guidance, and planning help. Incubators often either facilitate the investment in a startup by putting entrepreneurs in contact with investors or by investing in the startup directly, depending on how the incubator is setup and what its purpose is.

Financial Partner

Financial partners are any individual or organization that makes a financial investment into a startup or company in hopes of receiving a growth on their investment. Financial partners may be individual/angel investors or larger organizations like venture capital firms. Whoever they are, financial partners are integral parts of a startup as they help to provide the capital required to found or expand the business.

Cash Flow

Cash flow is the net amount of cash and cash-equivalents being transferred into and out of a business. - Alicia Tuovila, Investopedia

Cash flow is the net cash flowing through a business's accounts. A positive cash flow is a necessity for a successful business, but every startup begins with a negative cash flow until they start to make a profit. Cash flow is an important metric to track for any business, but especially for startups due to their general lack of other assets, investments, and sales.

Pro Forma

Pro forma... is a method of calculating financial results using certain projections or presumptions. - Alicia Tuovila, Investopedia.

Pro forma calculations are those done based on projected, estimated, or imagined values. In many cases, it may not be easy or possible for a company to get a concrete value for use in a financial calculation, so they use estimates or projections to calculate those values. The type of pro forma calculations used depends on which type of financial metric is being calculated for a business. For example, in some cases a pro forma calculation is used in order to calculate a company's earnings by excluding one-time costs and fees so that the company can do year-over-year comparisons easier. Pro forma calculations can be misleading if the estimates being used are too aggressive, and as such there are laws in place governing what types of pro forma calculations can be used in order to appeal to public investors.

Crowdfunding

Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business venture. - Tim Smith, Investopedia

Crowdfunding is the funding of a startup, business, or concept through the distributed investment by hundreds or thousands of investors, almost always with no equity attached. This type of investment can be done directly by the company, but a majority of crowdfunding investments are done through sites such as Kickstarter and Indiegogo which take a percentage of the money raised in exchange for hosting, publicity, and the ease of transactions. Generally, investors offer a small amount of money to support a company or project in exchange for early access to the products being developed, or for behind-the-scenes access or influence on the trajectory of the project. Crowdfunding has not only become a popular way for startups and businesses to access capital, but also for consumers to find products and services that they are interested in more easily. Crowdfunding is sadly also the home of countless grifters aiming to gather large investments with no real plan to execute on their proposal.

CAPEX

Capital expenditures are funds used by a company to acquire, upgrade, and maintain physical assets. - Jason Fernando, Investopedia

Capital expenditures are funds used by businesses outside of the normal flow of capital in order to manage physical asset. Building new warehouses, repairing old machinery, and replacing outdated technology are all types of capital expenditures. Capital expenditures are recorded separately from other profits and losses on a balance sheet as they serve a different role in the company's cash flow. Companies with proportionally higher capital expenditures are generally those that prioritize their continued improvement and not just on maintaining current operations.

IPO

An initial public offering refers to the process of offering shares of a private corporation to the public in a new stock issuance. - Jason Fernando, Investopedia.

An IPO (initial public offering) is the possible stage of a company's growth where they become publicly traded on the stock market. For many startups, the IPO stage is the end goal of the company and is where angel investors and venture capitalists hope to profit from their investments. Becoming a public company is a huge hurdle in the development of a business, and there are a lot of requirements for a company to be allowed to be publicly traded. But if a business does become publicly traded, it has far more options for funding their growth and expansion.