

Financing Options and Terms for Business

BUSINESS FINANCE

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Purpose

The purpose of this guide is to help readers become more aware of various financing options, as well as commonly used financial terminology needed when raising funds for business.

There are three parts to this guide:

- Financing Options - definitions of various types of financing available to business.
- Financing Terms - a list of common terms used by financial institutions.
- Key Financial Ratios - an explanation of common financial ratios that are used as guidelines at financial institutions to assess the state of your business

Financing Options

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| Accounts Receivable Financing | Obtaining a loan from a financial institution, factor or commercial finance company to finance day-to-day operation. The accounts receivable of the business are pledged as security on the loan. |
| Angels | Private individuals with capital to invest in business enterprises. |
| Bridge financing | An interim loan made for a short period during which the borrower is arranging long-term financing. |
| Business Improvement Loans | Government-guaranteed loans within specific limits to businesses engaged in designated lines of endeavor. |
| Equipment Financing | Borrowing from a financial institution, finance or acceptance company to purchase machinery or equipment, and using that equipment as collateral. |
| Equipment Leasing | Obtaining the use of machinery, vehicles or other equipment on a rental basis. This avoids the need to invest capital in equipment. Ownership rests in the hands of the financial institution or leasing company, while the business has the actual use of it. |
| Export financing | In addition to the commercial banks, export financial assistance may also be accessed from other agencies, including the Canadian Commercial Corporation (CCC), the Canadian International Development Agency (CIDA), and the Export Development Corporation (EDC). |
| Floor Financing | Usually used by car dealers, agricultural dealers, as well as piano, furniture and large appliance dealers to finance their floor stock. The lender maintains legal ownership of the floor items while the retailer displays them for sale. |
| Factoring | Selling trade accounts receivable for cash on a non-recourse basis to |

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| | a factoring company, which assumes responsibility for credit and collection. The factor charges a discount rate and pays the balance to the vendor. The amount advanced as a percentage of approved receivable will vary depending on the factoring company. |
| Inventory Financing | Inventory is used in two ways: (1) to support a loan; or (2) to obtain additional credit to increase inventory. In the case of a manufacturer, a financial institution may take a debenture or security under Section 88 of the <i>Bank Act</i> . If the goods are kept in a public warehouse, the financial institution may make advances under Section 80 of the <i>Bank Act</i> . Other lender advance funds to businesses against warehouse receipts or debenture security. |
| Junior Capital Pool | Is an offering by an issuer, which has no significant assets and/or business, and has (1) no specific plan for the acquisition of any asset or business, or (2) a specific plan, but such plan is not at the stage of an enforceable agreement, for the acquisition of an asset or business. Accordingly, it is one in which the investor is invited to rely primarily on the issuer's promoters, directors and officers. |
| Venture Capital | Is often referred to as risk capital. It is capital invested by an outside party in a business, either as equity, or as a form of secondary debt. These funds rank behind all other secured creditors. |

Financing Terms

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| Acceleration Clause | A provision in a security agreement, mortgage note, bond, trust deed or credit agreement stipulating that the debt secured thereby, together with accrued interest, may become due and payable upon breach of some condition. |
| Aging | The process of analyzing receivables and payables by classification according to the length of time they have been outstanding. |
| Amortization | The gradual reduction of a debt by periodic payments over the term of the loan. |
| Appraised Value | An estimate of the current market value used in evaluating the assets pledged as security for a loan. |
| Arm's Length | A situation in which the parties to a transaction are not related or closely connected with each other. |
| Assignment | A transfer by one part (the assignor) of his rights or title in property to another (the assignee or assign). An assignment may take the form of a separate document or a clause in a mortgage, security agreement or other arrangement. |

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| Balance Sheet | The financial statement that shows the net worth of a company. |
| Back-to-Back Credit | Credit opened by a finance house or bank on the strength of another credit and used in foreign trade. The foreign importer provides the finance house with the relevant documents, on the strength of which a credit is opened in favour of the exporter. This can then be used to back another credit for the exporter (i.e. the first credit backs the second). |
| Balloon Note | A note calling for periodic payments which are not large enough to pay off the face amount of the note prior to maturity, so that a large final payment known as the “balloon” is due when the note matures. |
| Bankruptcy | Proceedings under the <i>Bankruptcy Act</i> whereby the property of an insolvent person is taken over by a receiver or a trustee for distribution among the bankrupt’s creditors, and by which the bankrupt is relieved of the unpaid balance of liabilities. |
| Benchmark | A measurement by which others are compared. |
| Bill of Lading | A document executed by common carriers acknowledging the receipt of goods and which serves as a document of title to the consigned goods. |
| Bonded Warehouse | A warehouse in which goods are stored without excise or customs duties being paid until they are removed from the warehouse. |
| Break-Even Point | Point where revenue equals expenses. |
| Business Plan | An overview in words and numbers of the history of a business and its owners, the aims and objectives of a business, and proposals to achieve business goals. |
| Capacity | An assessment of your ability and willingness to repay a loan from anticipated future cash flow or other sources. |
| Capital Cost Allowance | The income tax term for depreciation. |
| Capital Investments | Money used to purchase permanent fixed assets for a business, for example, machinery, land or buildings, as opposed to day-to-day operating expenses. |
| Capital Lease | A lease with a residual value at the end of the lease term and a buy out option. The equipment shows as an asset and the balance outstanding shows as a liability. |
| Cash Flow Forecast | An estimate of when and how much money will be received and paid out of a business. It usually records cash flow on a month-by-month basis, for a period of two years. |

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| Cash Flow | The difference between cash inflows and cash outflows. |
| Character | An assessment of your dependability as a person. |
| Chattel Mortgage | A pledge of business or personal property other than real estate - for example, equipment, automobiles, or other supplies required to operate a business - in exchanged for a loan to purchase the property in question. |
| Collateral | Property (real, personal or otherwise) pledged as security for a loan. Also, any supplementary promise of payment, such as a guarantee. |
| Comfort Letter | A letter by which the writer conveys assurance that something is or is not so, to the best of the writer's knowledge. |
| Commitment Fee | Amount paid to a lender by a borrower (in addition to interest) as a fee for committing to make a loan. |
| Commitment Letter | A document by which the lender agrees to provide financing within a specified time and according to terms and conditions contained therein. |
| Comparative Statement | A form of financial-statement presentation in which current period results and positions are presented with corresponding figures for previous periods. |
| Conditional Sales Agreement | A contract of sale under which the transfer of title does not take place until specified payments have been made. |
| Conditions | The limits written into an agreement between a borrower and a lender specifying exactly what each party is expected to do in exchange for the benefits each will receive. |
| Consignment | A shipment of goods under an agreement whereby the receiving party undertakes to sell them as an agent for the shipper. The shipper retains title to the goods until they are sold. |
| Consortium | An association of independent organizations usually formed to undertake a specific project that requires skill and resources that are not possessed by any of the participants individually. |
| Creditworthy | A person or persons with no judgments, delinquent accounts or late payments on their record. |
| Cross-Collateralization | The process by which several loans advanced by one lender on different properties are secured by charges against each of the properties. A default on one loan normally constitutes default on another. |
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| Debenture | A written instrument evidencing indebtedness, which is a direct obligation of the issuer, which is either secured or unsecured, and which may be negotiable. |
| Default | Failure to comply with the terms or covenants in an agreement, or occurrence of any event which makes a loan document enforceable. |
| Demand for Payment | Describes an action that may be taken by a lender when a borrower is in default of the loan terms as established in the commitment letter. The demand is usually a formal request for repayment of the outstanding balance in full, within a certain time frame. |
| Demand Loan | A loan that must be repaid in full, on demand. |
| Discount Rate | A discount rate is the percentage by which a fixed amount is decreased upon fulfillment of a specific transaction. e.g. If a receivable of \$100 is sold at a 9% discount, the seller receives \$91. |
| Due Diligence | The process of checking the numbers and facts contained in a finance report for accuracy and truth. |
| Equity | The value of a business after all debts and other claims are settled. Also, the amount of cash a business owner invests in a business and/or the difference between the price for which a property could be sold and the total debts registered against it. |
| Escrow | The holding in trust of a written agreement or other property (including money) by a third party until specified conditions are fulfilled. |
| Exit Strategy | The way you plan to leave your business once you want to move to something else or retire. Examples would be, sell, go public, pass down to children etc. |
| Financier | A person who lends money. |
| Fixed Charge | A charge presently attaching property (commonly given, for example, in a debenture), which may be contrasted with a floating charge. |
| Floating Charge | A continuing charge on the assets of the grantor of the floating charge (usually in a debenture), but permitting the grantor to deal freely with the property in the usual course of business until the security holder intervenes to enforce its security or until there has been an event of default. |
| Fundee | The person who receives the proceeds of a funding transaction. |
| Fundor | The person who provides the funds used in the funding transaction. |
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| Indemnify | To make good a loss which one person has suffered in consequence of the act or default of another. |
| Indemnity | A collateral contract, security or assurance by which one party agrees to indemnify another. |
| Issued Capital | Proportion of authorized capital stock for which subscriptions have been received and the stock allotted. |
| Joint and Several Liability | A liability which allows the plaintiff to sue one or more of the parties to such liability separately, or together with all other such parties, at the plaintiff's option. |
| Joint Venture | A business undertaking entered into by two or more parties which is intended to terminate upon the completion of a specific project. |
| Key Man Insurance | Life insurance on a key employee, partner or proprietor. The business is the beneficiary under the policy. |
| Leasing | The process by which assets are acquired on a rental basis, ownership does not pass until the last payment and any payout amounts are received by the leasing company. |
| Lending Limit | The maximum amount a person is allowed to lend without having to ask a higher authority for permission. |
| Letter of Credit | A letter issued by a bank authorizing the person named therein to draw money up to a specified amount from the bank's branches or correspondents, providing the conditions set out in the letter are met. |
| Limited Partnership | An unincorporated association (i.e. partnership) formed by two or more persons whereby the general partner is liable for the obligations of, and management of, the partnership, with the limited partners having no liability beyond the amounts contributed or agreed to be contributed by them as capital, and no management responsibilities. |
| Line of Credit | An agreement negotiated between a borrower and a lender establishing the maximum amount of money against which a borrower may draw. The agreement also sets out other conditions, for example, how and when the money is to be repaid. |
| Marketing Plan | An integral part of the business plan stating in words and numbers how, where and to whom a business proposes to sell its product and/or services. |
| Net Lease | A lease under which the tenant agrees to pay, in addition to the rent, expenses such as taxes, insurance, maintenance and other costs of the leased property. |
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| Net Worth Statement | The difference between what an individual owns and what the individual owes is that person's net worth. |
| Non Recourse | In a non recourse transaction the buyer has no right to request compensation in the event of non payment. |
| Operating Loan | A loan intended for short-term financing, supplying cash flow support or to cover day-to-day operating expenses. It is part of a Line of Credit. |
| Operating Lease: | An operating lease is one with no buy out clause and no residual value. It is treated just like rent and written off against expenses. |
| Performance Bond | Instrument aimed at ensuring a service or contract is completed correctly. If this is not the case, then the bank issuing or guaranteeing the bond will be required to make a compensatory payment. |
| Personal Guarantee: | A legal promise to pay personally should your company default on its obligations. A personal guarantee puts all your personal assets at risk. |
| Personal Liability | The kind of responsibility for the payment or performance of an obligation that exposes the personal assets of the responsible person to payment of the obligation. |
| Prepayment | Payment of all or part of the debt before its maturity date. |
| Prime Rate | The interest rate charged by banks to its preferential borrowers. It is the lowest rate of interest available to borrowers. |
| Promissory Note | A signed promise to pay a certain amount of money on demand or on a fixed date. |
| Proposal | Under the <i>Bankruptcy Act</i> , the proposal made by a debtor to his creditors for the orderly payment of debts, without the debtor going into bankruptcy. |
| Prospectus | A complex document issued by a corporation or promoter in connection with the offering of security or other investment opportunities containing specific information about the promoter's business, the type of investment, financial data and other pertinent facts in conformity with security regulations. |
| Ratio | Comparison of two figures used to evaluate business performance. Examples of key ratios are the Debt/Equity Ratio and Return on Investment. |
| Receiver | A person appointed by the court or pursuant to a debt instrument, to take charge of the assets of an insolvent person or business and |

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| | preserve them for sale and distribution to creditors. A receiver may also be appointed to take charge of property while that property is the subject of ongoing litigation. |
| Receivership | The state or condition of a corporation, partnership or individual over whom a receiver has been appointed for protection of assets for the benefit of creditors. |
| Receiving Order | A court order from which a court-appointed receiver takes authority respecting the property subject to the receivership. |
| Recourse: | Recourse means that if the client does not pay, the holder of the obligation has the right to ask you for repayment of money advanced in full. |
| Reverse Takeover | A term usually applies to a situation where ownership of a larger company is acquired by a smaller company. It usually requires an extensive reorganization of the acquiring company's capitalization. |
| Revolving Credit | An arrangement that permits a purchaser to charge purchases against an account every month provided the balance does not exceed a predetermined credit limit. Monthly payments must be made on the account. |
| Right of First Refusal | Right to have first opportunity to purchase when such becomes available, or right to meet any offer. |
| Risk Averse: | To dislike risk and be uncomfortable in risky situations. |
| Sale and Leaseback | The sale of an asset with the vendor immediately renting the asset from the purchaser for long-term use. |
| Secured Creditors | Those creditors who hold security for a debt, for the duration of the debt. |
| Senior Debt | Debt that has a higher priority of claims than other debts. |
| Shrinkage | The theft of assets. More commonly used in retail operations to mean shoplifting. |
| Spread | The difference between what a bank pays for the money it lends and what it gets paid for the money it lends. |
| Standby Commitment | A commitment from a lender to make a loan in a specified period of time on specified terms, but without specific intent as to whether funds will be drawn down, or, if drawn, the time or times at which drawdown is to occur. |

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| Standby Fee | A sum of money (normally non-refundable) given by the borrower to the lender to keep a loan commitment effective for a specified period of time. |
| Subordinate Debt | Debt that has a lower priority of claims than other debts. |
| Term Loan | A loan intended for medium-term or long-term financing to supply cash to purchase fixed assets, such as machinery, land or buildings, or to renovate business premises. |
| Title | The valid, registered owner of an asset. |
| Turnover | The number of times the wholesale value of the inventory is sold each year. |
| Unsecured Creditor | A creditor who does not hold security from his or her debtor. |
| Venture Capital | High risk money advanced by a company or individual to a business in return for some future consideration, usually ownership in the business. |
| Winding Up | Settlement of the accounts and liquidation of the assets of a partnership or corporation, for the purpose of making distribution and dissolving the concern. |
| Without Recourse | Giving the lender no right to seek payment or seize assets in the event of non-payment from anyone other than the party specified in the debt contract |
| Working Capital | The excess of current assets over current liabilities. |
| Work-in-Progress | Partly finished goods or contracts that are in the process of manufacture or completion at the end of an accounting period or at any particular time. |

Key Financial Ratios

Ratios are the most commonly used method for analyzing financial statements. These ratios are meaningful only when they are compared over time, or with other companies, or within particular industries.

Ratios can provide an indication of financial health to both the business owner and the financial institution. While no single ratio is all encompassing, ratios can provide a basis on which to form a judgment.

Some Definitions and Terms used in Financial Ratios:

- Cash Flow: Net profit after tax plus depreciation/amortization, deferred taxes and other non-cash expenses.

- Current Assets: Total of cash, deposits, trade receivables, inventory and other assets due within one year.
- Current Liabilities: Total of trade accounts payable, bank operating loans and other debt due within one year.
- Tangible Net Worth: Net worth less intangible assets, for example, goodwill.

Some Key Ratios:

| Ratio | Calculation | Principle |
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| Current ratio (or working capital ratio) | $\frac{\text{Current assets (due under 1 yr)}}{\text{Current liabilities}}$ | A high or rising ratio indicates more current assets are free from debt claims of creditors. |
| Age of receivables | $\frac{\text{Trade account receivables} \times 365 \text{ days}}{\text{Sales/revenues}}$ | A long period may indicate the company's credit policies and collection procedures need attention. |
| Inventory turnover | $\frac{\text{Inventory} \times 365 \text{ days}}{\text{Sales/revenues}}$ | A long period indicates ineffective investment of funds. A rising trend may indicate a buildup of unsaleable goods. |
| Debt-to-equity | $\frac{\text{Total liabilities}}{\text{Tangible net worth}}$ | A low ratio indicates a cushion against loss to creditors. |
| Gross profit to sales | $\frac{\text{Gross profit}}{\text{Sales / Revenue}}$ | Indicates company's markup. A reducing percentage may show company is not increasing prices in relation to costs. |
| Net profit to net worth | $\frac{\text{Net profit after tax}}{\text{Tangible net worth}}$ | Measure return on owner investment. An indication of the marketability of the company. A return of 100% or more is desirable. |
| Sales growth | $\frac{\text{Current yr sales} - \text{Prev yr sales}}{\text{Previous yr sales}} \times 100\%$ | A check to see if the business is keeping pace with inflation. |
| Net profit after tax growth | $\frac{\text{Current yr profit} - \text{Prev yr profit}}{\text{Previous yr profit}} \times 100\%$ | Indicates whether profit margins are being maintained year-to-year, and whether any profits are being "siphoned off." |

Industry Development Branch

The Industry Development Branch accelerates Alberta's industrial diversification, growth and competitiveness, and actively attracts industry to the province. This is accomplished through partnerships between business and government.

The business of the branch is industry development and industry attraction. This is accomplished by providing specific services to the private sector including assistance with:

- Alliances and joint ventures
- Business and competitiveness audit
- Business retention
- Business site locations
- Flexible business networks
- Investment attraction
- Supplier development
- Sector expertise in:
 - (a) Aerospace and defence
 - (b) Agrifood
 - (c) Architecture, engineering, and construction
 - (d) building products
 - (e) Chemical and petrochemical
 - (f) Energy resources
 - (g) Environmental products and services
 - (h) Financial services
 - (i) Information and communication technologies
 - (j) Life sciences
 - (k) Metal fabrication and machinery manufacturing
 - (l) Oil and gas technology and services
 - (m) Tourism
 - (o) Transportation and logistics

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