

## Finance Speedy Study Guides Academic

**Speedy Study Guides FINANCE** Here's a quick review of the terms you need to know:

There are a few basic finance terms that every entrepreneur should fully understand. They represent the costs of understanding how business development works across all stages in the life of a venture, so it's important you understand their meaning.

**Return on Investment (ROI)**  
The only way to think about your business is with an ROI perspective. The entrepreneur has committed capital investment into a certain combination of assets, from which the company generates sales. Those sales cover the costs of operations and hopefully produce a profit. That profit, divided by the total funds invested in the company (the assets), equals the ROI to the entrepreneur. Think of it this way: Would you work all those hours and take on all that responsibility if your ROI was only 6 percent annually? The stronger the profit picture compared to the total funds employed in the enterprise, the higher the ROI.

**Internal Rate of Return (IRR)**  
Every decision enacted by the entrepreneur must be viewed in terms of its internally generated return to the company. Unlike the simple division used to find the ROI, the IRR compares the net expected returns over the useful life of a project being reviewed by management to the funds spent on that decision (or projects). All projects must meet a certain IRR in order to be acceptable for investment by the company. If a project cannot meet a minimum IRR, then don't invest in it.

**Fixed asset base**  
This is the long-term base of the company's operation strategy, represented by all the equipment, machinery, vehicles, facilities, IT infrastructure and long-term contracts the firm has invested in to conduct business. From a finance perspective, these assets are the revenue generators. When the entrepreneur decides to invest in a certain fixed asset configuration, that becomes the base from which the company functions week in and week out, doing business and serving its customers.

**Cost of capital**  
This is the true cost of securing the funds that the business uses to pay for its asset base. Some funds are from debt (less risky to the creditors, so it has a lower cost of capital to the firm), and some funds come from equity (more risky to the investors, so these have a higher cost of capital). The combination of lower-cost debt capital with higher-cost equity capital produces the next item in this list.

**Working capital**  
Current assets are those short-term funds represented by cash in the bank, funds parked in near-term instruments earning interest, funds tied up in inventory, and all those accounts receivable waiting to be collected. Subtracting the company's current liabilities from these current assets shows how much working capital (your firm's truest measure of liquidity) is on hand and its ability to pay for decisions in the short-term. For example, if the firm has \$500,000 in current assets and \$250,000 in current liabilities, then \$250,000 is free and clear as working capital, available for spending on new things as needed by the company.

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