Glossary

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"A" round ("Series A") – formerly the first "institutional" capital raised by a Company, the "A" round is now typically the second institutional round of financing for a young company where venture capitalists are sufficiently interested in a company to invest a larger amount of capital after the "Seed" round to fund the company to the next stage of its development. Subsequent rounds of financing are called "B," "C," "D," etc.

Accredited investor – a person or legal entity, such as a company or trust fund, that meets certain net worth and income qualifications and is considered to be sufficiently sophisticated to make investment decisions in private offerings. Regulation D of the Securities Act of 1933 exempts accredited investors from protection of the Securities Act. The Securities and Exchange Commission has proposed revisions to the accredited investor qualifying rules, which may or may not result in changes for venture investors. The current criteria for a natural person are: $1 million net worth (excluding the value of a primary residence) or annual income exceeding $200,000 individually or $300,000 with a spouse. Directors, general partners and executive officers of the issuer are considered to be accredited investors. See Rule 501 of Regulation D of the SEC for current details.

Alpha – a term derived from statistics and finance theory that is used to describe the return produced by a fund manager in excess of the return of a benchmark index. Manager returns and benchmark returns are measured net of the risk-free rate. In addition, manager returns are adjusted for the risk of the manager's portfolio relative to the risk of the benchmark index. Alpha is a proxy for manager skill.

Alternative asset class – a class of investments that includes venture capital, leverage buyouts, hedge funds, real estate, and oil and gas, but excludes publicly traded securities. Pension plans, college endowments and other relatively large institutional investors typically allocate a certain percentage of their investments to alternative assets with an objective to diversify their portfolios.

American Investment Council (AIC) – an advocacy, communications and research organization for the private equity industry in the United States. Previously known as Private Equity Growth Capital Council (PEGCC).

Angel – a wealthy individual who invests in companies in relatively early stages of development.

Angel Groups – groups of individual angels who invest together, individually or through a pooled vehicle, enabling them to share deal flow with each other.

Anti-dilution – a contract clause that protects an investor from a substantial reduction in percentage ownership in a company due to the issuance by the company of additional shares to other entities. The mechanism for making an adjustment that maintains the same percentage ownership is called a Full Ratchet. The most commonly used adjustment provides partial protection and is called Weighted Average.

ASC Topic 820 – FASB Accounting Standards Codification (ASC) Topic 820 (formerly known as FAS 157) is the accounting standard that dictates how to measure and disclose fair value for financial reporting purposes. FASB ASC Topic 946 (Investment Companies) dictates that all investments should be reported at fair value.

"B" round ("Series B") – a financing event whereby venture capital investors who are sufficiently interested in a company provide a next round of funding after the "A" round of financing. Subsequent rounds are called "C," "D," and so on.

Basis point ("bp") – one one-hundredth (1/100) of a percentage unit. For example, 50 basis points equals one half of one percent. Banks quote variable loan rates in terms of an index plus a margin and the margin is often described in basis points, such as LIBOR plus 400 basis points (or, as the experts say, "bips").

Beta – a measure of volatility of a public stock relative to an index or a composite of all stocks in a market or geographical region. A beta of more than one indicates the stock has higher volatility than the index (or composite) and a beta of one indicates volatility equivalent to the index (or composite). For example, the price of a stock with a beta of 1.5 will change by 1.5% if the index value changes by 1%. Typically, the S&P 500 index is used in calculating the beta of a stock.

Beta product – a product that is being tested by potential customers prior to being formally launched into the marketplace.

Blockchain – a distributed ledger that uses advanced cryptography to create a "chain" of "blocks" of information that are unalterable and verifiable. Useful for recording any number of transactions or sets of data in a verifiable way that is extremely difficult to modify.

Blank Check Company – See SPAC.

Board of directors – a group of individuals, typically composed of managers, investors and experts who have a fiduciary responsibility for the well-being and proper guidance of a corporation. The board is typically elected by the shareholders.

Book – see Private placement memorandum.

Bootstrapping – the actions of a startup to minimize expenses and build cash flow, thereby reducing or eliminating the need for outside investors.

Bp – see Basis point.

Bridge financing – temporary funding that will eventually be replaced by permanent capital from equity investors or debt lenders. In venture capital, a bridge is usually a short-term note (6 to 12 months) that converts to preferred stock. Typically, the bridge lender has the right to convert the note to preferred stock at a price that is a 20% to 25% discount from the price of the preferred stock in the next financing round. See Mezzanine and Wipeout bridge.

Broad-based weighted average anti-dilution – A weighted average anti-dilution method adjusts downward the price per share of the preferred stock of investor A due to the issuance of new preferred shares to new investor B at a price lower than the price investor A originally received. Investor A's preferred stock is repriced to a weighted average of investor A's price and investor B's price. A broad-based anti-dilution method uses all common stock outstanding on a fully diluted basis (including all convertible securities, warrants and options) in the denominator of the formula for determining the new weighted average price. See Narrow-based weighted average anti-dilution.

Burn rate – the rate at which a startup uses available cash to cover expenses in excess of revenue. Usually expressed on a monthly or weekly basis.

Business Development Company (BDC) – a publicly traded company that invests in private companies and is required by law to provide meaningful support and assistance to its portfolio companies.

Business plan – a document that describes a new concept for a business opportunity. A business plan typically includes the following sections: executive summary, market need, solution, technology, competition, marketing, management, operations, exit strategy, and financials (including cash flow projections). For most venture capital funds, fewer than 10 of every 100 business plans eventually receive funding.

Buyout – a sector of the private equity industry. Also, the purchase of a controlling interest of a company by an outside investor using substantial debt (in a leveraged buyout) or a management team (in a management buyout).

Buy-sell agreement – a contract that sets forth the conditions under which a shareholder must first offer his or her shares for sale to the other shareholders before being allowed to sell to entities outside the company.

C Corporation – an ownership structure that allows any number of individuals or companies to own shares. A C corporation is a stand-alone legal entity so it offers some protection to its owners, managers and investors from liability resulting from its actions.

Capital Asset Pricing Model (CAPM) – a method of estimating the cost of equity capital of a company. The cost of equity capital is equal to the return of a risk-free investment plus a premium that reflects the risk of the company's equity.

Capital call – when a private equity fund manager (usually a "general partner" in a partnership) requests that an investor in the fund (a "limited partner") provide previously committed capital. Usually a limited partner will agree to a maximum investment amount and the general partner will make a series of capital calls over time to the limited partner as opportunities arise to finance startups and buyouts.

Capital gap – the difficulty faced by some entrepreneurs in trying to raise between $2 million and $5 million. Friends, family and angel investors are typically good sources for financing rounds of less than $2 million, while many venture capital funds have become so large that investments in this size range are difficult.

Capitalization table (or Cap Table) – a table showing the owners of a company's shares and their ownership percentages as well as the debt holders. It also lists the forms of ownership, such as common stock, preferred stock, warrants, options, senior debt, and subordinated debt.

Capital gains – a tax classification of investment earnings resulting from the purchase and sale of assets. Typically, a company's investors and founders have earnings classified as long-term capital gains (held for a year or longer), which are often taxed at a lower rate than ordinary income.

Capital stock – a description of stock that applies when there is only one class of shares. This class is known as "common stock."

Capital Under Management – A frequently used metric for sizing total funds managed by a venture capital or private equity firm. In practice, there are several ways of calculating this. In the US, this is the total committed capital for all funds managed by a firm on which it collects management fees. This calculation ignores whether portions of the committed capital have not yet been called and whether portions of the fund have been liquidated and distributed. It typically does not include aging funds in their "out years" on which fees are not being collected. For purposes of this book in calculating capital managed, because direct data is not available, the last eight vintage years of capital commitments is considered a proxy for the industry's total capital under management.

Capped participating preferred stock – preferred stock whose participating feature is limited so that an investor cannot receive more than a specified amount. See Participating preferred stock.

Carried interest capital gains – the share in the capital gains of a venture capital fund that is allocated to the General Partner. Typically, a fund must return the capital given to it by limited partners plus any preferential rate of return before the general partner can share in the profits of the fund. The general partner will typically receive a 20% carried interest, although some successful firms receive 25%–30%. Also known as "carry" or "promote."

Clawback – a clause in the agreement between the general partner and the limited partners of a private equity fund. The clawback gives limited partners the right to reclaim a portion of disbursements to a general partner for profitable investments based on significant losses from later investments in a portfolio.

Closing – the conclusion of a financing round whereby all necessary legal documents are signed and capital has been transferred.

Co-investment – the direct investment by a limited partner alongside a general partner in a portfolio company.

Collateral – hard assets of the borrower, such as real estate or equipment, for which a lender has a legal interest until a loan obligation is fully paid off.

Commitment – an obligation, typically the maximum amount that a limited partner agrees to invest in a fund. See Capital call.

Common stock – a type of security representing ownership rights in a company. Usually, company founders, management and employees own common stock while outside investors own preferred stock. In the event of a liquidation of the company, the claims of secured and unsecured creditors, bondholders and preferred stockholders take precedence over common stockholders. See Preferred stock.

Comparable – a private or public company with similar characteristics to a private or public company that is being valued. For example, a telecommunications equipment manufacturer whose market value is 2 times revenues can be used to estimate the value of a similar and relatively new company with a new product in the same industry. See Liquidity discount.

Control – the authority of an individual or entity that owns more than 50% of equity in a company or owns the largest block of shares compared to other shareholders. Control can also be granted through special voting rights and protective provisions in a company's organizing documents.

Consolidation – see Rollup.

Conversion – the right of an investor or lender to force a company to replace the investor's preferred shares or the lender's debt with common shares at a preset conversion ratio. A conversion feature was first used in railroad bonds in the 1800's.

Convertible debt – a loan that allows the lender to exchange the debt for common shares in a company at a preset conversion ratio. Also known as a "convertible note."

Convertible preferred stock – a type of stock that gives an owner the right to convert preferred shares to common shares of stock. Usually, preferred stock has certain rights that common stock doesn't have, such as decision-making management control, a promised return on investment (dividend), or senior priority in receiving proceeds from a sale or liquidation of the company. Typically, convertible preferred stock automatically converts to common stock if the company makes an initial public offering (IPO). Convertible preferred is the most common tool for private equity funds to invest in companies.

Co-sale right – a contractual right of an investor to sell some of the investor's stock along with the founder's or majority shareholder's stock if either the founder or majority shareholder elects to sell stock to a third-party. Also known as Tag-along right.

Cost of capital – see weighted average cost of capital (WACC).

Cost of revenue – the expenses generated by the core operations delivering the product or services of a company.

Covenant – a legal promise to do or not do a certain thing. For example, in a financing arrangement, company management may agree to a negative covenant, whereby it promises not to incur additional debt. The penalties for violation of a covenant may vary from repairing the mistake to losing control of the company.

Coverage ratio – describes a company's ability to pay debt from cash flow or profits. Typical measures are EBITDA/Interest, (EBITDA minus Capital Expenditures)/Interest, and EBIT/Interest.

Cram down round – a financing event upon which new investors with substantial capital are able to demand and receive contractual terms that effectively cause the issuance of sufficient new shares by the startup company to significantly reduce ("dilute") the ownership percentage of previous investors.

Cryptocurrency – a natively-digital currency using encryption techniques to regulate the creation of units of currency and verify transfer of funds. Usually created and managed independently of a central bank.

Cumulative dividends – the owner of preferred stock with cumulative dividends has the right to receive accrued (previously unpaid) dividends in full before dividends are paid to any other classes of stock.

Current ratio – the ratio of current assets to current liabilities.

Data room – a specific location where potential buyers / investors can review confidential information about a target company. This information may include detailed financial statements, client contracts, intellectual property, property leases, and compensation agreements.

Deal flow – a measure of the number of potential investments that a fund reviews in any given period.

Defined benefit plan – a company retirement plan in which the benefits are typically based on an employee's salary and number of years worked. Fixed benefits are paid after the employee retires. The employer bears the investment risk and is committed to providing the benefits to the employee. Defined benefit plan managers can invest in private equity funds.

Defined contribution plan – a company retirement plan in which the employee elects to contribute some portion of his or her salary into a retirement plan, such as a 401(k) or 403(b). The employer may also contribute to the employee's plan. With this type of plan, the employee bears the investment risk. The benefits depend solely on the amount of money made from investing the employee's contributions.

Demand rights – a type of registration right. Demand rights give an investor the right to force a startup to register its shares with the SEC and prepare for a public sale of stock (IPO).

Dilution – the reduction in the ownership percentage of current investors, founders and employees caused by the issuance of new shares (for example to investors in follow on rounds, employees by increasing the stock option pool, debt providers in the form or warrants, etc.).

Dilution protection – see Anti-dilution and Full ratchet.

Direct Listing – also known as a DPO (Direct Public Offering), a Direct Listing is a listing on an exchange, such as the NYSE or NASDAQ, where a company offers its securities directly to the public and self-underwrites its securities without the use of intermediaries such as investment banks, broker-dealers, and underwriters as would be the case in an IPO. Cutting out the intermediaries from a public offering materially lowers the cost of a public offering. Spotify completed the first-ever Direct Listing on the NYSE on April 3, 2018.

Direct secondary transaction – a transaction in which the buyer purchases shares of an operating company from an existing seller. While the transaction is a secondary sale of shares, the transacted interest is a primary issue purchase directly into an operating company. Sellers are often venture capitalists selling their ownership stake in a portfolio company. Buyers are often funds that specialize in such investments.

Discount rate – the interest rate used to determine the present value of a series of future cash flows.

Discounted cash flow (DCF) – a valuation methodology whereby the present value of all future cash flows expected from a company or investment is calculated.

Distressed debt – the bonds of a company that is either in or approaching bankruptcy. Some private equity funds specialize in purchasing such debt at deep discounts with the expectation of exerting influence in the restructuring of the company and then selling the debt once the company has meaningfully recovered.

Distribution – the transfer of cash or securities to a limited partner resulting from the sale, liquidation or IPO of one or more portfolio companies in which a general partner chose to invest.

Dividends – payments made by a company to the owners of certain securities.

Down round – a round of financing whereby the valuation of the company is lower than the value determined by investors in an earlier round.

DPO (Direct Public Offering) – see Direct Listing

Drag-along rights – the contractual right of an investor in a company to force all other investors to agree to a specific action, such as the sale of the company.

Drawdown schedule – an estimate of the gradual transfer of committed investment funds from the limited partners of a private equity fund to the general partners.

Due diligence – the investigatory process performed by investors to assess the viability of a potential investment and the accuracy of the information provided by the target company.

Dutch auction – a method of conducting an IPO whereby newly issued shares of stock are committed to the highest bidder, then, if any shares remain, to the next highest bidder, and so on until all the shares are committed. Note that the price per share paid by all buyers is the price commitment of the buyer of the last share.

Early stage – the state of a company after the seed (formation) stage but before middle stage (generating revenues). Typically, a company in early stage will have a core management team and a proven concept or product, but no positive cash flow.

Earnings before interest and taxes (EBIT) – a measurement of the operating profit of a company. One possible valuation methodology is based on a comparison of private and public companies' value as a multiple of EBIT.

Earnings before interest, taxes, depreciation, and amortization (EBITDA) – a measurement of the cash flow of a company. One possible valuation methodology is based on a comparison of private and public companies' value as a multiple of EBITDA.

Earn out – an arrangement in which sellers of a business receive additional future payments, usually based on financial performance metrics such as revenue or net income.

Elevator pitch – a concise presentation, lasting only a few minutes (an elevator ride), by an entrepreneur to a potential investor about an investment opportunity.

Employee Stock Ownership Program (ESOP) – a plan established by a company to reserve shares for employees.

Entrepreneur – an individual who starts their own business.

Entrepreneurship – the application of innovative leadership to limited resources in order to create exceptional value.

Enterprise Value (EV) – the sum of the market values of the common stock and long-term debt of a company, minus excess cash.

Equity – the ownership structure of a company represented by common shares, preferred shares, or unit interests. Equity = Assets - Liabilities.

ESOP – see Employee Stock Ownership Program.

Evergreen fund – a fund that reinvests its profits in order to ensure the availability of capital for future investments.

Exit strategy – the plan for generating profits for owners and investors of a company. Typically, the options are to merge, be acquired, or make an initial public offering (IPO). An alternative is to recapitalize (releverage the company and then pay dividends to shareholders).

Expansion stage – the stage of a company characterized by a complete management team and a substantial increase in revenues.

Fair value – a financial reporting principle for valuing assets and liabilities, for example, portfolio companies in venture capital fund portfolios. In 2007, more defined rules took effect. See ASC Topic 820.

Fairness opinion – a letter issued by an investment bank that charges a fee to assess the fairness of a negotiated price for a merger or acquisition.

FAS 157 – see ASC Topic 820 entry.

First refusal – the right of a privately owned company to purchase any shares that employees would like to sell before they are offered to outside buyers.

Founders stock – nominally priced common stock issued to founders, officers, employees, directors, and consultants.

Free cash flow to equity (FCFE) – the cash flow available after operating expenses, interest payments on debt, taxes, net principal repayments, preferred stock dividends, reinvestment needs, and changes in working capital. In a discounted cash flow model to determine the value of the equity of a firm using FCFE, the discount rate used is the cost of equity.

Free cash flow to the firm (FCFF) – the operating cash flow available after operating expenses, taxes, reinvestment needs, and changes in working capital, but before any interest payments on debt are made. In a discounted cash flow model to determine the enterprise value of a firm using FCFF, the discount rate used is the weighted average cost of capital (WACC).

Friends and family financing – capital provided by the friends and family of founders of an early-stage company. Friends and family financings may also include individual angel investors known to or introduced to the founders. Friends and family financing rounds are typically structured as notes convertible into a Seed or Series A round of financing. Founders should be careful not to create an ownership structure that may hinder the participation of professional investors once the company begins to achieve success.

Full ratchet – an anti-dilution protection mechanism to protect earlier investors from dilution when a new round is raised at a lower price. In the case of a full ratchet for a Series A followed by a Series B at a lower price per share, additional shares would be issued to the Series A preferred investors so that their resulting cost per share is equal to the price per share paid by the Series B preferred investors. Often as a result of the implementation of a ratchet, company management and employees who own a fixed number of common shares suffer significant dilution. See Narrow-based weighted average anti-dilution and Broad-based weighted average anti-dilution.

Fully diluted basis – a methodology for calculating any per share ratios whereby the denominator is the total number of shares, both preferred and common, issued by the company on the assumption that all warrants and options are exercised.

Fund-of-funds – a fund created to invest in other funds (e.g. VC Funds, PE funds, etc.). Typically, individual investors and relatively small institutional investors participate in a fund-of-funds to minimize their portfolio management efforts and leverage the size and scale of the fund-of-funds.

Gatekeepers – intermediaries which endowments, pension funds, and other institutional investors use as advisors regarding private equity investments.

General partner (GP) – a class of partner in a partnership. The general partner retains liability for the actions of the partnership. Historically, venture capital and buyout funds have been structured as limited partnerships, with the venture firm as the GP and limited partners (LPs) being the institutional and high net worth investors that provide most of the capital in the partnership. The GP earns a management fee and a percentage of gains (see Carried interest).

GP – see General partner.

GP for hire – in a spin-out or a synthetic secondary, a GP for hire refers to the professional investor who may be hired by a purchasing firm to manage the new fund created from the orphaned assets purchased. In past cases, the GP has often expanded its role to fundraise for and run new funds alongside the initial fund.

Going-private transaction – when a public company chooses to pay off all public investors, delist from all stock exchanges, and become owned by management, employees, and select private investors.

Golden handcuffs – financial incentives that discourage founders and/or important employees from leaving a company before a predetermined date or important milestone.

Growth stage – the stage of a company when it has received one or more rounds of financing and is generating revenue from its product or service. Also known as "middle stage."

Hart-Scott-Rodino (HSR) Act – a law requiring entities that acquire certain amounts of stock or assets of a company to inform the Federal Trade Commission and the Department of Justice and to observe a waiting period before completing the transaction to allow the agencies to assess whether there will be any anti-competitive implications as a result of the transaction.

Hedge fund – an investment fund that has the ability to use leverage, take short positions in securities, or use a variety of derivative instruments in order to achieve a return that is relatively less correlated to the performance of typical indices (such as the S&P 500) than traditional long-only funds. Hedge fund managers are typically compensated based on assets under management as well as fund performance.

High yield debt – debt issued via public offering or public placement (Rule 144A) that is rated below investment grade by S&P or Moody's. This means that the debt is rated below the top four rating categories (i.e. S&P BB+, Moody's Ba2 or below). The lower rating is indicative of higher risk of default, and therefore the debt carries a higher coupon or yield than investment grade debt. Also referred to as Junk bonds or Sub-investment grade debt.

Hockey stick – the general shape and form of a chart showing revenue, customers, cash, or some other financial or operational measure that increases dramatically at some point in the future. Entrepreneurs often develop business plans with hockey stick charts to impress potential investors.

Holding period – amount of time an investment remains in a portfolio.

Hot issue – stock in an initial public offering that is in high demand.

Hot money – capital from investors that have no tolerance for lack of results by the investment manager and move quickly to withdraw at the first sign of trouble.

Hurdle rate – a minimum rate of return required before an investor will make an investment.

Incorporation – the process by which a business receives a state charter, allowing it to become a corporation. Many corporations choose Delaware because its laws are business-friendly and up to date.

Incubator – a company or facility designed to host startup companies. Incubators help startups grow while controlling costs by offering networks of contacts and shared back office resources.

Indenture – the terms and conditions between a bond issuer and bond buyers.

Initial coin offering (ICO) – an offering of units of a new cryptocurrency or crypto-token, usually in exchange for existing cryptocurrencies such as Bitcoin or Ether, as a presale against a future blockchain project, i.e., the new coins or tokens sold will be the "currency" for transactions in a new or future blockchain project.

Initial public offering (IPO) – the first offering of stock by a company to the public. New public offerings must be registered with the Securities and Exchange Commission. An IPO is one of the methods that a startup that has achieved significant success can use to raise additional capital for further growth. See Qualified IPO.

In-kind distribution – a distribution to limited partners of a private equity fund that is in the form of publicly traded shares rather than cash.

Inside round – a round of financing in which the investors are the same investors as the previous round. An inside round raises liability issues since the valuation of the company has no third-party verification in the form of an outside investor. In addition, the terms of the inside round may be considered self-dealing if they are onerous to any set of shareholders or if the investors give themselves additional preferential rights.

Institutional investor – professional entities that invest capital on behalf of companies or individuals. Examples are pension plans, insurance companies, and university endowments.

Intellectual property (IP) – knowledge, techniques, writings, and images that are intangible but often protected by law via patents, copyrights, and trademarks.

Interest coverage ratio – earnings before interest and taxes (EBIT) divided by interest expense. This is a key ratio used by lenders to assess the ability of a company to produce sufficient cash to service its debt obligation.

Internal rate of return (IRR) – the interest rate at which a certain amount of capital today would have to be invested in order to grow to a specific value at a specific time in the future.

Investment thesis/Investment philosophy – the fundamental ideas which determine the types of investments that an investment fund will choose in order to achieve its financial goals.

IPEV – stands for International Private Equity Valuation guidelines group. This group is made up of representatives of the international and US venture capital industry and has published guidelines for applying US GAAP and international IFRS valuation rules. See www.privateequityvaluation.com. Widely regarded in the US as the global successor to the US-focused PEIGG group.

IPO – see Initial public offering.

IRR – see Internal rate of return.

J curve – a concept that during the first few years of a private equity fund, cash flow or returns are negative due to investments, losses, and expenses, but as investments produce results the cash flow or returns trend upward. A graph of cash flow or returns versus time would then resemble the letter "J."

Later stage – the state of a company that has proven its concept, achieved significant revenues compared to its competition, and is approaching cash flow break even or positive net income. Typically, a later stage company is about 6 to 12 months away from a liquidity event such as an IPO or buyout. The rate of return for venture capitalists that invest in later stage, less risky ventures is lower than in earlier stage ventures.

LBO – see Leveraged buyout.

Lead investor – the outside investor that makes the largest investment in a financing round and manages the documentation and closing of that round. The lead investor sets the price per share of the financing round, thereby determining the valuation of the company.

Letter of intent – a document confirming the intent of an investor to participate in a round of financing for a company. By signing this document, the subject company agrees to begin the legal and due diligence process prior to the closing of the transaction. Also known as a "Term Sheet."

Leverage – the use of debt to acquire assets, build operations, and increase revenues. By using debt, a company is attempting to achieve results faster than if it only used its cash available from pre-leverage operations. The risk is that the increase in assets and revenues does not generate sufficient net income and cash flow to pay the interest costs of the debt.

Leveraged buyout (LBO) – the purchase of a company or a business unit of a company by an outside investor using mostly borrowed capital.

Leveraged recapitalization – the reorganization of a company's capital structure resulting in more debt added to the balance sheet. Private equity funds can recapitalize a portfolio company and then direct the company to issue a one-time dividend to equity investors. This is often done when the company is performing well financially and the debt markets are expanding.

Leverage ratios – measurements of a company's debt as a multiple of cash flow. Typical leverage ratios include Total Debt/EBITDA, Total Debt/(EBITDA minus Capital Expenditures), and Senior Debt/EBITDA.

L.I.B.O.R. – see The London Interbank Offered Rate.

License – a contract in which a patent owner grants to a company the right to make, use, or sell an invention under certain circumstances and for compensation.

Limited liability company (LLC) – an ownership structure designed to limit the founders' losses to the amount of their investment. An LLC itself does not pay taxes, rather its owners pay taxes on their proportion of the LLC profits at their individual tax rates.

Limited partnership – a legal entity composed of a general partner and various limited partners. The general partner manages the investments and is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment. The general partner collects a management fee and earns a percentage of capital gains (see Carried interest), while the limited partners receive income, capital gains, and tax benefits.

Limited partner (LP) – an investor in a limited partnership. The general partner is liable for the actions of the partnership while the limited partners are generally protected from legal actions and any losses beyond their original investment. The limited partner receives income, capital gains, and tax benefits.

Liquidation – the sale of a company. This may occur in the context of an acquisition by a larger company or in the context of selling off all assets prior to cessation of operations (Chapter 7 bankruptcy). In a liquidation, the claims of secured and unsecured creditors, bondholders, and preferred stockholders take precedence over common stockholders.

Liquidation preference – the contractual right of an investor to priority in receiving the proceeds from the liquidation of a company. For example, a venture capital investor with a "2x liquidation preference" has the right to receive two times its original investment upon liquidation before other more junior forms of equity share in the liquidation proceeds.

Liquidity discount – a decrease in the value of a private company compared to the value of a similar but publicly traded company. Since an investor in a private company cannot readily sell his or her investment, the shares in the private company must be valued less than a comparable public company.

Liquidity event – a transaction whereby owners of a significant portion of the shares of a private company sell their shares in exchange for cash, in the case of an IPO or cash-based M&A transaction, or shares of an acquiring company.

Lock-up agreement – investors, management, and employees often agree not to sell their shares for a specific time period after an IPO, usually 6 to 12 months. By avoiding large sales of its stock, the company has time to build interest among potential buyers of its shares.

London Interbank Offered Rate (L.I.B.O.R.) – the average rate charged by large banks in London for loans to each other. LIBOR is a relatively volatile rate and is typically quoted in maturities of one month, three months, six months, and one year.

Management buyout (MBO) – a leveraged buyout controlled by the members of the management team of a company or a division. Often an MBO is conducted in partnership with a buyout fund.

Management fee – a fee charged to the limited partners in a fund by the general partner. Management fees in a private equity fund usually range from 0.75% to 3% of capital under management, depending on the type and size of fund. For venture capital funds, 2% is typical.

Management rights – the rights often required by a venture capitalist as part of the agreement to invest in a company. The venture capitalist has the right to consult with management on key operational issues, attend board meetings, and review information about the company's financial situation.

Market capitalization – the value of a publicly traded company as determined by multiplying the number of shares outstanding by the current price per share.

MBO – see Management buyout.

Mezzanine – a layer of financing that has intermediate priority (seniority) in the capital structure of a company. For example, mezzanine debt has lower priority than senior debt but usually has a higher interest rate and often includes warrants. In venture capital, a mezzanine round is generally the round of financing that is designed to help a company have enough resources to reach an IPO. See Bridge financing.

Multiples – a valuation methodology that compares public and private companies in terms of a ratio of value to an operations figure such as revenue or net income. For example, if several publicly traded computer hardware companies are valued at approximately 2 times revenues, then it is reasonable to assume that a startup computer hardware company that is growing fast has the potential to achieve a valuation of 2 times its revenues. Before the startup company issues its IPO, it will likely be valued at less than 2 times revenue because of the lack of liquidity of its shares. See Liquidity discount.

Narrow-based weighted average anti-dilution – a type of anti-dilution mechanism. A weighted average anti-dilution method adjusts downward the price per share of the preferred stock of investor A (by issuing new additional shares) due to the issuance of new preferred shares to new investor B at a price lower than the price investor A originally received. Investor A is issued enough preferred stock to replicate a weighed average of investor A's price and investor B's price. A narrow-based anti-dilution uses only common stock outstanding in the denominator of the formula for determining the new weighted average price.

National Venture Capital Association (NVCA) – the trade organization that empowers the next generation of American companies that will fuel the economy of tomorrow. As the voice of the US venture capital and startup community, NVCA advocates for public policy that supports the American entrepreneurial ecosystem. Serving the venture community as the preeminent trade association, NVCA arms the venture community for success, serving as the leading resource for venture capital data, practical education, peer-led initiatives, and networking.

NDA – see Non-disclosure agreement.

Non-cumulative dividends – dividends that are payable to owners of preferred stock at a specific point in time only if there is sufficient cash flow available after all company expenses have been paid. If cash flow is insufficient, the owners of the preferred stock will not receive the dividends owed for that time period and will have to wait until the board of directors declares another set of dividends.

Non-disclosure agreement (NDA) – an agreement issued by entrepreneurs to protect the privacy of their ideas when disclosing those ideas to third parties.

Non-interference – an agreement often signed by employees and management whereby they agree not to interfere with the company's relationships with employees, clients, suppliers, and sub-contractors within a certain time period after termination of employment.

No-shop clause – a section of an agreement to purchase or invest in a company whereby the seller agrees not to market the company to other potential buyers or investors for a specific time period.

Non-solicitation – an agreement often signed by employees and management whereby they agree not to solicit other employees of the company regarding job opportunities.

NVCA – see National Venture Capital Association.

Offering memorandum – a legal document that provides details of an investment to potential investors. See Private placement memorandum.

Operating cash flow – the cash flow produced from the operation of a business, not from investing activities (such as selling assets) or financing activities (such as issuing debt). Calculated as net operating income (NOI) plus depreciation.

Option pool – a group of options set aside for long term, phased compensation to management and employees.

Outstanding shares – the total amount of common shares of a company, not including treasury stock, convertible preferred stock, warrants, and options.

Pay to play – a clause in a financing agreement whereby any investor that does not participate in a future round agrees to suffer significant dilution compared to other investors. The most onerous version of "pay to play" is automatic conversion to common shares, which in essence ends any preferential rights of an investor.

Pari passu – a legal term referring to the equal treatment of two or more parties in an agreement. For example, a venture capitalist may agree to have registration rights that are pari passu with the other investors in a financing round.

Participating dividends – the right of holders of certain preferred stock to receive dividends and participate in additional distributions of cash, stock, or other assets.

Participating preferred stock – a unit of ownership composed of preferred stock and common stock. The preferred stock entitles the owner to receive a predetermined sum of cash (usually the original investment plus accrued dividends) if the company is sold or has an IPO. The common stock represents additional continued ownership in the company.

PEIGG – acronym for Private Equity Industry Guidelines Group, an ad hoc group of individuals and firms involved in the private equity industry for the purpose of establishing valuation and reporting guidelines. With the implementation of FAS 157 in 2007, the group's mission was essentially complete. Several of its members then joined IPEV, which is viewed by US VCs as the international successor to PEIGG.

Piggyback rights – rights of an investor to have his or her shares included in a registration of a startup's shares in preparation for an IPO.

PIK dividend – a dividend paid to the holder of a stock, usually preferred stock, in the form of additional stock rather than cash. PIK refers to payment in kind.

PIPEs – see Private investment in public equity.

Placement agent – a company that specializes in finding institutional investors that are willing and able to invest in a private equity fund. Sometimes a private equity fund will hire a placement agent so the fund partners can focus on making and managing investments in companies rather than on raising capital.

Portfolio company – a company that has received an investment from a private equity fund.

Post-money valuation – the valuation of a company including the capital provided by the current round of financing. For example, a venture capitalist may invest $5 million in a company valued at $2 million "pre-money" (before the investment was made). As a result, the startup will have a post-money valuation of $7 million.

PPM – see Private placement memorandum.

Preemptive rights – the rights of shareholders to maintain their percentage ownership of a company by buying shares sold by the company in future financing rounds.

Preference – seniority, usually with respect to dividends and proceeds from a sale or dissolution of a company.

Preferred return – a minimum return per annum that must be generated for limited partners of a private equity fund before the general partner can begin receiving a percentage of profits from investments.

Preferred stock – a type of stock that has certain rights that common stock does not have. These special rights may include dividends, participation, liquidity preference, anti-dilution protection, and veto provisions, among others. Private equity investors usually purchase preferred stock when they make investments in companies.

Pre-money valuation – the valuation of a company prior to the current round of financing. For example, a venture capitalist may invest $5 million in a company valued at $2 million pre-money. As a result, the startup will have a "pre-money" valuation of $2 million.

Pre-Seed round ("Series Pre-Seed") - a financing event whereby angels, angel groups, professionally managed Seed funds, and early stage venture capital funds become involved in a young start-up company that was previously financed by founders, their friends and family, and individual angel investors in a friends and family financing. Pre-Seed rounds are uncommon but have begun to emerge as Seed rounds have grown larger in size and investor expectations for company progress before a Seed round has increased. Pre-Seed rounds can be priced rounds or can be structured as notes convertible into a "Series Seed" financing round. The size of Pre-Seed rounds can often be similar to the size of Seed rounds only a few years ago.

Pre-Seed stage - the state of a company when it has just been incorporated and its founders are developing their product or service.

Primary shares – shares sold by a corporation (not by individual shareholders).

Private Equity Growth Capital Council (PEGCC) – See American Investment Council (AIC).

Private equity – equity investments in non-public companies, usually defined as being made up of venture capital, growth equity, and buyout funds. Real estate, oil and gas, and other such partnerships are sometimes included in the definition.

Private investment in public equity (PIPEs) – investments by a private equity fund in a publicly traded company, usually at a discount and in the form of preferred stock.

Private placement – the sale of a security directly to a limited number of institutional and qualified individual investors. If structured correctly, a private placement avoids registration with the Securities and Exchange Commission.

Private placement memorandum (PPM) – a document explaining the details of an investment to potential investors. For example, a private equity fund will issue a PPM when it is raising capital from institutional investors. Also, a startup may issue a PPM when it needs growth capital. Also known as "Offering Memorandum."

Private securities – securities that are not registered with the Securities and Exchange Commission and do not trade on any exchanges. The price per share is negotiated between the buyer and the seller (the "issuer").

Qualified IPO – a public offering of securities valued at or above a total amount specified in a financing agreement. This amount is usually specified to be sufficiently large to guarantee that the IPO shares will trade in a major exchange (NASDAQ or New York Stock Exchange). Usually upon a qualified IPO, preferred stock is forced to convert to common stock.

Quartile – one fourth of the data points in a data set. Often, private equity investors are measured by the results of their investments during a particular period of time. Institutional investors often prefer to invest in private equity funds that demonstrate consistent results over time, placing in the upper quartile of the investment results for all funds.

Realization ratio – the ratio of cumulative distributions to paid-in capital. The realization ratio is used as a measure of the distributions from investment results of a private equity partnership compared to the capital under management.

Recapitalization – the reorganization of a company's capital structure.

Red herring – a preliminary prospectus filed with the Securities and Exchange Commission and containing the details of an IPO offering. The name refers to the disclosure warning printed in red letters on the cover of each preliminary prospectus advising potential investors of the risks involved.

Redemption rights – the right of an investor to force the startup company to buy back the shares issued as a result of the investment. In effect, the investor has the right to take back his/her investment and may even negotiate a right to receive an additional sum in excess of the original investment.

Registration – the process whereby shares of a company are registered with the Securities and Exchange Commission under the Securities Act of 1933 in preparation for a sale of the shares to the public.

Regulation D – often referred to as simply "Reg D," an SEC regulation that governs private placements. Private placements are investment offerings for institutional and accredited individual investors, but not the general public.

Restricted shares – shares that cannot be traded in the public markets.

Return on investment (ROI) – the proceeds from an investment, during a specific time period, calculated as a percentage of the original investment. Also, net profit after taxes divided by average total assets.

Rights offering – an offering of stock to current shareholders that entitles them to purchase the new issue.

Rights of co-sale with founders – a clause in venture capital investment agreements that allows the VC fund to sell shares at the same time that the founders of a startup choose to sell.

Risk-free rate – a term used in finance theory to describe the return from investing in a riskless security. In practice, this is often taken to be the return on US Treasury Bills.

Road show – presentations made in several cities to potential investors and other interested parties. For example, a company will often make a road show to generate interest among institutional investors prior to its IPO.

ROI – see Return on investment.

Rolling fund – a new type of investment vehicle, structured as a series of limited partnerships, which allows fund managers to share deal flow with fund investors on a quarterly subscription basis while netting carried interest over a multi-year period. With this fund structure, funds are open to new investors every quarter vs. only being open when a new fund is closed.

Rollup – the purchase of relatively smaller companies in a sector by a rapidly growing company in the same sector. The strategy is to create economies of scale. For example, the movie theater industry underwent significant consolidation via rollups in the 1960's and 1970's.

Round – a financing event usually involving several private equity investors.

Royalties – payments made to patent or copyright owners in exchange for the use of their intellectual property.

Rule 144 – a rule of the Securities and Exchange Commission that specifies the conditions under which the holder of shares acquired in a private transaction may sell those shares in the public markets.

S corporation – an ownership structure that limits its number of owners to 100. An S corporation does not pay taxes. Rather, its owners pay taxes on their proportion of the corporation's profits at their individual tax rates.

SBIC – see Small Business Investment Company.

SPV (Special Purpose Vehicle) – an entity created by an investor, or by private equity or venture capital fund management company, to invest in one company, or a small group of companies. In the case of an individual investor, an SPV enables that investor to raise capital to invest in one company or one small group of companies without forming a fund management company and raising a traditional fund. In the case of private equity and venture capital fund management companies, an SPV is often used to put more capital into a portfolio company or a small group of companies than would be prudent for the fund itself given diversification requirements and portfolio concentration limits. SPVs raised by private equity and venture capital funds will typically have lower management fees and carried interest than the main funds.

SPAC (Special Purpose Acquisition Company) – a company with no commercial operations formed strictly to raise capital through an IPO for the purpose of acquiring an existing company. Also known as "blank check companies," SPACs have been used for decades, but until recently were generally used for acquisitions of small companies. In recent years, however, SPACs, have become extremely popular, attracting high profile executives, private equity firms, and underwriters. In 2020, SPACs raised more than $84B, a six-fold increase from a record-setting year just one year earlier in 2019, and accounted for over one-half of all IPO volume for the year.

Scalability – a characteristic of a new business concept that entails the growth of sales and revenues with a much slower growth of organizational complexity and expenses. Venture capitalists look for scalability in the startups they select to finance.

Scale-down – a schedule for phased decreases in management fees for general partners in a limited partnership as the fund reduces its investment activities toward the end of its term.

Scale-up – the process of a company growing quickly while maintaining operational and financial controls in place. Also, a schedule for phased increases in management fees for general partners in a limited partnership as the fund increases its investment activities over time.

Secondary market – a market for the sale of limited partnership interests in private equity funds. Sometimes limited partners choose to sell their interest in a partnership, typically to raise cash or because they cannot meet their obligation to invest more capital according to the takedown schedule. Certain investment companies specialize in buying these partnership interests at a discount.

Secondary shares – shares sold by a shareholder (not by the corporation).

Securities and Exchange Commission (SEC) – the regulatory body that enforces federal securities laws such as the Securities Act of 1933 and the Securities Exchange Act of 1934.

Seed capital – investment provided by professional seed funds, angels and angel groups, and friends and family of the founders of a startup in the seed stage of its development.

Seed round ("Series Seed") - a financing event whereby angels, angel groups, professionally managed Seed funds, and early stage venture capital funds become involved in a young start-up company that was previously financed by founders, their friends and family, and individual angel investors in a friends and family financing. Seed rounds can be priced rounds or can be structured as notes convertible into a "Series A" financing round. The Seed round is now typically the first "institutional" financing of a company, although Pre-Seed rounds have begun to emerge drawing earlier institutional capital (See Pre-Seed round.) The size of Seed rounds in recent years has grown to resemble what formerly would have been a small "Series A" round.

Seed stage – formerly, the state of a company when it has just been incorporated and its founders are developing their product or service.More typically today, the stage of a company following material product development and often commercial launch, but before raising larger amounts of capital for investments in growth.

Senior debt – a loan that has a higher priority in case of a liquidation of the asset or company.

Seniority – higher priority.

Series A preferred stock – preferred stock issued by a fast growth company in exchange for capital from investors in the "A" round of financing. This preferred stock is usually convertible to common shares upon an IPO.

Shareholder agreement – a contract that sets out the basis on which the company will be operated and the shareholders' rights and obligations. It provides rights and privileges to preferred and major shareholders and protections to minority shareholders.

Sharpe Ratio – a method of calculating the risk-adjusted return of an investment. The Sharpe Ratio is calculated by subtracting the risk-free rate from the return on a specific investment for a time period (usually one year) and then dividing the resulting figure by the standard deviation of the historical (annual) returns for that investment. The higher the Sharpe Ratio, the better.

Small Business Investment Company (SBIC) – a company licensed by the Small Business Administration to receive government capital in the form of debt or equity for use in private equity investing.

Stock option – a right to purchase or sell a share of stock at a specific price within a specific period of time. Stock purchase options are commonly used as long term incentive compensation for employees and management of fast growth companies.

Strategic investor – a relatively large corporation that agrees to invest in a young or a smaller company in order to have access to its proprietary technology, product, or service.

Subordinated debt – a loan that has a lower priority than a senior loan in case of a liquidation of the asset or company. Also known as "junior debt."

Sweat equity – ownership of shares in a company resulting primarily from work rather than investment of capital.

Syndicate – a group of investors that agree to participate in a round of funding for a company. Alternatively, a syndicate can refer to a group of investment banks that agree to participate in the sale of stock to the public as part of an IPO.

Synthetic secondary – a popular method of completing a direct secondary transaction in which the buyer becomes a limited partner (LP) in a special purpose vehicle (SPV) or similar entity that has been set up out of the underlying investments in order to create a limited partnership interest. The term arose because of the synthetic nature of the direct purchase through the LP secondary transaction.

Tag-along right – the right of a minority investor to receive the same benefits as a majority investor. Usually applies to a sale of securities by investors. Also known as Co-sale right.

Takedown – a schedule of the transfer of capital in phases in order to complete a commitment of funds. Typically, a takedown is used by a general partner of a private equity fund to plan the transfer of capital from the limited partners.

Tender offer – an offer to public shareholders of a company to purchase their shares.

Term loan – a bank loan for a specific period of time, usually up to ten years in leveraged buyout structures.

Term sheet – a document confirming the intent of an investor to participate in a round of financing for a company. By signing this document, the subject company agrees to begin the legal and due diligence process prior to the closing of the transaction. Also known as "Letter of Intent."

Tranche – a portion of a set of securities. Each tranche may have different rights or risk characteristics. When venture capital firms finance a company, a round may be disbursed in two or three tranches, each of which is paid when the company attains one or more milestones.

Turnaround – a process performed at a struggling company resulting in a substantial increase in a company's revenues, profits, and reputation.

Under water option – an option is said to be under water if the current fair market value of a stock is less than the option exercise price.

Underwriter – an investment bank that chooses to be responsible for the process of selling new securities to the public. An underwriter usually chooses to work with a syndicate of investment banks in order to maximize the distribution of the securities.

Venture capital – a segment of the private equity industry which focuses on investing in new companies with high growth potential and accompanying high risk.

Venture capital method – a pricing valuation method whereby an estimate of the future value of a company is discounted by a certain interest rate and adjusted for future anticipated dilution in order to determine the current value. Usually, discount rates for the venture capital method are considerably higher than public stock return rates, representing the fact that venture capitalists must achieve significant returns on investment in order to compensate for the risks they take in funding unproven companies.

Venture Monitor – officially known as the PitchBook-National Venture Capital Association (NVCA) Venture Monitor. Jointly produced by PitchBook and NVCA, it serves as the authoritative quarterly report on venture capital activity in the entrepreneurial ecosystem. The Venture Monitor provides a complete look at venture capital activity, reporting on fundraising, investments, exits, and other relevant industry analysis in one comprehensive report each quarter.

Vesting – a schedule by which employees gain ownership over time of a previously agreed upon amount of retirement funding or stock options.

Vintage – the year that a private equity fund begins making investments. Venture funds are generally benchmarked to funds of the same vintage year.

Voting rights – the rights of holders of preferred and common stock in a company to vote on certain acts affecting the company. These matters may include payment of dividends, issuance of a new class of stock, mergers, or liquidation.

Warrant – a security which gives the holder the right to purchase shares in a company at a pre-determined price. A warrant is a long-term option, usually valid for several years or indefinitely. Typically, warrants are issued concurrently with preferred stocks or bonds in order to increase the appeal of the stocks or bonds to potential investors.

Washout round – a financing round whereby previous investors, the founders, and management suffer significant dilution. Usually as a result of a washout round, the new investor gains majority ownership and control of the company.

Weighted average cost of capital (WACC) – the average of the cost of equity and the after-tax cost of debt. This average is determined using weight factors based on the ratio of equity to debt plus equity and the ratio of debt to debt plus equity.

Weighted average anti-dilution – an anti-dilution protection mechanism whereby the conversion rate of preferred stock is adjusted in order to reduce an investor's loss due to an increase in the number of shares in a company. Without anti-dilution protection, an investor would suffer from a reduction of his or her percentage ownership. Usually as a result of the implementation of a weighted average anti-dilution, company management and employees who own a fixed number of common shares suffer significant dilution, but not as badly as in the case of a full ratchet.

Write-down – a decrease in the reported value of an asset or a company.

Write-off – a decrease in the reported value of an asset or a company to zero.

Write-up – an increase in the reported value of an asset or a company.

Zombie – a company that has received capital from investors but has only generated sufficient revenues and cash flow to maintain its operations without significant growth. Sometimes referred to as "walking dead." Typically, a venture capitalist has to make a difficult decision as to whether to liquidate a zombie or continue to invest funds in the hopes that the zombie will become a winner.