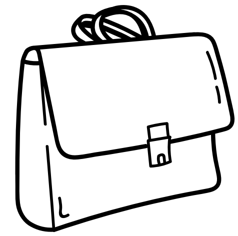
NCEO NATIONAL CENTER FOR **EMPLOYEE OWNERSHIP**

Business Literacy Basics



Business has its own vocabulary. Understanding a few basic terms can help you on your way to financial literacy.

Capital: Money or assets available to a company, including real estate, machinery, and buildings. "Working capital" refers to money available now to pay salaries, buy inventory, or pay bills. "Debt capital" refers to borrowed money. "Capitalization" is the amount of capital owned by a company. In your personal finances, capital can include a home, car, or other assets that you can sell.

Corporation: A business chartered by a state government and recognized as a separate legal entity from its owners. A corporation has its own rights, privileges, and liabilities. Typically, owners of a corporation are not personally responsible for any of the company's debts or other financial obligations, unless they personally guaranteed a loan, for example. This is called "limited liability." In the US, there are two types of for-profit corporations: C corps and S corps. C corps pay tax on their income. S corps pass tax obligations on to their owners, but have limited liability. Only some companies can meet the requirements to be an S corp.

Gross Income: The total amount of income a company has, both from sales and investments.

Net Income: The total amount of income a company has left (both from sales and investments) after all of its costs are subtracted. “Net income” is the same as “profit” and “earnings.” Generally, earnings are only a small percentage of revenues, usually from 1% to 10%.

Equity: The value of the company if it was sold, minus debts the company owes to others. Investments tend to increase the value of the company. Companies with a high “debt-to-equity” ratio have more borrowed money than equity. An easy comparison is buying a house. Your “equity” in the house is the current value (which could be more or less than you paid, depending on the market) minus what you still owe on the mortgage.

Leveraged: Another word for “borrowed,” so a “leveraged ESOP” is an ESOP that uses borrowed money. In theory, borrowed money will be put into an investment (new machinery, new employees, or even the company itself) that generates enough new revenue to pay back the loan and hopefully have profit left over. If your company is making money, but doesn’t have time to save before it needs to buy other things, it borrows money by promising to use its assets and future earnings to pay back the loan. Leverage allows companies to act quickly to take advantage of business opportunities.

Tax Deductions and Credits: To oversimplify, businesses (or their owners, in the case of S corporations) pay tax on their net income. Since expenses reduce net income, expenses reduce a company’s tax bill. Most business expenses, including contributions to employee ownership plans, yield tax deductions for the company. For instance, a company that contributes $5 million to an ESOP would have $5 million less in taxable income. If that company has a combined state and federal tax rate of 40%, it avoids $2 million in taxes by deducting the ESOP contribution from its income. A deduction, then, covers only part of the cost. A tax credit, on the other hand, gives the business back the same amount of money it spent, or some legally specified percentage.