25 Essential Financial Terms to Know - Indeed

The field of finance can be complex, but learning about common financial terms can help you understand economic concepts and apply them to your life. Having a clear understanding of such terms may also aid your financial decision-making. When you take the time to study these concepts, it can also help you discuss financial topics with your coworkers, clients and investors more effectively.

Why is it important to know financial terms?

Knowing finance terms is important because it can help you understand and manage your financial situation. For example, you can utilize this knowledge to make significant financial decisions, such as taking out loans, renting or buying property and planning for retirement. It can also help you stay up-to-date and aware of current economic news and events.

The following list consists of essential financial terms and their definitions:

1. Loan

A loan is a sum of money or an item that one entity lets another entity borrow. The borrower repays their debt to the lender within a specified period and may pay interest on it and potentially extra fees. To take out a loan, an individual usually needs to provide a reason and financial information to the lender, such as their credit score and proof of employment. Sometimes lenders require collateral, which means that the lender and borrower agree that if the borrower does not pay back the loan — known as defaulting — the lender can seize property instead.

2. Interest

Interest is the additional money individuals must pay when borrowing money. Institutions that loan money to an entity typically charge interest at a rate that is a percentage of the loan. For example, if an individual secures a $30,000 loan for a car, they may need to pay an additional 5% of the loan back, or $1,500 in interest. Interest rates can also vary based on other factors, such as an individual's credit score and how long it takes them to repay the money. Individuals can also earn interest when investing or saving money.

3. Compound interest

Compound interest is the amount of interest earned on a loan or deposit based on the initial amount plus the interest accumulated over time. While banks and lenders calculate simple interest as a percentage of the initial or principal amount of the loan or deposit, they calculate compound interest as a percentage of the new loan or deposit amount every year. As a result, a debt or deposit with compound interest grows at a faster rate than simple interest.

4. Credit

Credit is a contractual agreement in which a lender loans money to a borrower, understanding that the borrower will repay it later. A borrower can demonstrate their trustworthiness in numerous ways, such as paying back their credit in full and on time consistently. Credit cards represent the most common example of buying on credit.

5. FICO score

A FICO score is a three-digit number that measures an individual's trustworthiness to pay back loans or debts. This concept, also called a credit score, demonstrates the individual's creditworthiness. Banks, lenders and other financial institutions calculate credit scores based on factors such as payment history, length of credit history and debts. The higher the score, the better an individual's chances of getting favorable terms on a loan or credit card.

6. Asset

An asset is an item with economic value that an entity owns and appears on businesses' balance sheets. Current assets, also called liquid assets, represent assets that owners can easily and quickly convert into cash, often within a year. Examples include checking or savings account balances, inventory and short-term investments. Non-current assets, also called fixed assets, take longer to liquidate. Examples include property, machinery and equipment. Assets may be tangible, meaning material items such as cash or equipment. Intangible assets are not physical objects but still incur value, such as trademarks, patents, copyrights and franchise agreements.

7. Liability

A liability is a debt or amount of money that an entity owes to another entity. Examples of liabilities include bank loans, accounts payable and credit card debts. Current liabilities are due within a year, while non-current liabilities are more long-term, such as mortgages and leases. Much like assets, liabilities appear on businesses' balance sheets.

8. Net worth

Net worth is the total value of what an individual or business owns minus the amount owed in debts. As a result, it represents the difference between an entity's assets and liabilities. Individuals can determine net worth by adding up the value of all their assets and subtracting their debt from that total.

9. Income

Income is the amount of money an entity earns for work or from investments. For example, a salesperson can generate income by selling products to customers. While revenue is the total income an entity receives from its typical activities, the net income or net profit is the amount of money an entity receives after subtracting expenses or costs.

10. Expenses

Expenses are the costs of operating a business and are related to generating revenue. Common examples of expenses include rent, utilities, employee wages and marketing costs. Businesses track expenses for profit and loss statements and can write off some expenses on their income tax returns, though such write-offs must adhere to IRS rules.

11. Budget

A budget is a financial plan developed by an entity that determines how much money they will spend over a particular period. When creating budgets, individuals and businesses often consider factors such as income, assets and liabilities. A budget can help entities compare how much money they make to how much they spend, allowing them to make financial decisions or plans for the future.

Advanced Terms

12. Accounts receivable

Accounts receivable is the money that clients or customers owe a business for products or services provided to them. It means that the business has made a sale but has not yet received payment for it. Businesses typically provide invoices to customers that display the amount owed and list accounts receivable as assets on balance sheets.

13. Accounts payable

Accounts payable is the money that a business owes to other entities for provided goods or services. This concept represents when a business has received a good or service, often bought on credit, but has not yet paid for it. Businesses display accounts payable as short-term debts or liabilities on balance sheets.

14. Balance sheet

A balance sheet is one of the three core financial documents created by businesses. It represents an organization's financial position at a certain point in time by displaying its assets, liabilities and shareholders' equity. This financial statement lists assets on one side and liabilities and shareholders' equity on the other, and the two sides must equal each other.

15. Income statement

An income statement, also known as a profit and loss statement, is another core financial document for businesses. This document reports a company's earnings and losses or expenses over a particular period, often monthly. This financial statement helps measure a company's ability to earn money and its growth potential.

16. Cash flow statement

A cash flow statement is the third core financial document for businesses. This document reflects the movement of money in and out of a business over a particular period. A cash flow statement measures solvency, meaning an organization's ability to pay its bills and expenses. If more money flows into the business than out of it, the business is cash-flow positive.

17. Investment

An investment is an allocation of money with the expectation of a profit or material benefit in return. With an investment, individuals do not intend to use the good they purchased but hold onto it to create value or more money. Many people invest money into the stock market, aiming to use their investments to generate more money. Individuals can also purchase real estate properties or other assets that increase in value over time.

18. Asset allocation

Asset allocation is an organization's decision about the assets in which it plans to invest. The three main types of assets or asset classes are cash, stocks and bonds. When making these investment decisions, organizations typically consider the potential risks and profits. Eventually, organizations may adjust their asset allocation, known as rebalancing, to align with business needs or increase profits.

19. Stocks

Stocks, also called equities, are portions or shares of ownership in a company. Companies sell shares or stocks to raise money for developing products, paying debts and growing their business. When individuals or entities buy a company's stock, they are investing in that company. Because the value of stocks can increase over time, investors may sell them later to make a profit. They can also profit if the stock pays dividends or portions of the company's revenue.

20. Bonds

Bonds are investments in debt, representing a type of fixed-income securities. Buying a bond means that an individual lets an entity, often a corporation or government, borrow their money for a certain period. The entity repays the investor, often with interest, in periodic payments.

21. Capital gains

Capital gains are the increase in value of an asset or investment above its initial purchase price. It represents the difference between how much something is currently worth and how much it was worth when purchased. Realized capital gain occurs when an entity sells the asset or investment. A capital loss occurs when the asset or investment loses value since its purchase.

22. Mortgage

A mortgage is a loan used to buy property. Individuals repay their mortgages to banks or financial lenders in regular payments with interest over a specified period. The property serves as collateral, so the lender can seize it if an individual cannot make their payments.

23. Amortization

Amortization is the process of repaying debt in regular installments over a specified period. Lenders or other entities calculate amortization based on the total amount of the loan and the agreed-upon interest rate. Typically paid monthly, the payment represents a combination of the interest costs and the loan balance.

24. Taxes

Taxes are fees paid by individuals or entities to governments that fund government spending and public programs. For example, governments can use the money from taxes for national defense, police and firefighting forces, community development and paying off the national debt.

25. AGI

Adjusted gross income (AGI) is the total income earned from wages or investments minus IRS-approved income adjustments. These adjustments may include interest on student loans, retirement account contributions or work expenses. The IRS uses individuals' AGI to identify their taxable income and determine whether they qualify for certain tax deductions or credits.