So What?

Even though you might not have spent any money today, you still incurred expenses. What does this mean? Well, think about it. You woke up at home—someone pays the rent or mortgage for you to live there. Perhaps the heat or air-conditioning was running—someone pays for utilities, too. How a[illegible] the cereal you ate for breakfast or t[illegible] of jeans you threw on before leaving [illegible] school? Though you might not have purchased those items today, they sti[illegible] cost money.

The expenses that keep your life running on a day-to-day basis—housing, food, clothing, etc.— might be considered your personal “operating” costs. Businesses have operating costs as well. These expenses don’t directly relate to the business’s product(s), but they are still essential for success. Learn more about operating costs and their effects on business.

Look! Overhead!

Every business has **operating costs**. There are a few different terms that may be used to describe these costs, such as “overhead” or “OPEX” (operating expenses). No matter what they’re called, these are the ongoing, day-to-day expenses of running a business that are not directly related to production.

Operating costs are the opposite of **capital expenditures**. [illegible]xpenditures are one-time purchases that a company [illegible]erhaps a building or a piece of equipment. Operating [illegible] the other hand, relate to maintaining that building [illegible]orial services) or running that piece of equipment [illegible].g., electricity). For more on the difference between operating costs and capital expenditures, including a video, visit http://www.diffen.com/difference/Capex_vs_Opex.

The two main types of operating costs are fixed and variable. They are sometimes further subdivided into categories such as “selling expenses v. manufacturing expenses” or “administrative expenses v. manufacturing expenses.” For more on these distinctions, read Sam Ashe-Edmunds’ article “Selling Expenses v. Administrative Expenses” at http://smallbusiness.chron.com/selling-expenses-vs-administrative-expenses-57899.html.

Mix it up

Some operating costs may be considered partially variable and partially fixed. These are known as **semi-variable costs** (sometimes called **semi-fixed costs** or **mixed costs**). Semi-variable costs are fixed until the company reaches a certain level of production; after that, they become variable. Here are a few examples:

- A manufacturer has a fixed cost for its employees' wages, but when it decides to produce a greater number of products this month, its employees work more hours and earn overtime. The em[illegible]yees' base wages are still fixed, but the cost of paying thi[illegible]able, depending on how many extra hours are [illegible]
- This same manufacture[illegible]s electric bill, but with the increased productio[illegible]ectricity. The amount that is over and above the re[illegible] expense is variable.
- A company has a fixed cost for its salespeople's salaries, but when the company produces more, and salespeople sell more, their sales commissions increase. The salaries are fixed, but the commissions are variable. Considered together, they are a mixed cost.

▲ *Semi-variable costs are partially variable and partially fixed. Just think about what happens when an employee works overtime—the employee's base wages are fixed, but the overtime pay is variable.*

To see how companies calculate their semi-variable costs, go to http://www.variablecost.net/Semi-Variable-Costs.html.

One way for businesses to combat high operating costs is to create **economies of scale**. Economies of scale happen when a business creates enough of a product to spread out and "dilute" its fixed costs. Let's say that a manufacturer's monthly operating costs are $20,000. If it produces 10,000 products a month, each product carries $2 of operating costs into its total cost. However, if the company can manufacture 15,000 products in that same time period, that number is only about $1.33. This economy of scale allows the company to reduce the impact of its operating costs without actually lowering them at all. Read more about economies of scale at http://www.econo[...]de/12446567.

The bottom line

As you can see from our di[...]perating costs have a major impact on a business'[...]costs go up or down, profits fluctuate as well. More costs equal less profit, and fewer costs equal greater profit.

A company's **gross profit** is the revenue it makes after subtracting the costs of the products it has sold. For example, if a company made $1 million last quarter and spent $200,000 producing its goods, its gross profit is $800,000. Gross profit is a good indicator of how well a company keeps its costs under control. You see, a similar company may also have made $1 million in revenue during the same quarter; however, it spent $300,000 producing its goods. This company's gross profit is only $700,000. It is spending more money to make the same amount of revenue. Clearly, the first company is more efficient.

Learn more about gross profit at http://www.entrepreneur.com/article/226158.

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▲ *Operating costs have a major impact on a business's profits. More costs mean less profit, but fewer costs mean greater profit!*

