**What is Fixed Cost vs Variable Cost?**

Fixed cost vs variable cost is the difference in categorizing business costs as either static or fluctuating when there is a change in the activity and sales volume. Fixed cost includes expenses that remain constant for a period of time irrespective of the level of outputs, like rent, salaries, and loan payments, while variable costs are expenses that change directly and proportionally to the changes in business activity level or volume, like direct labor, taxes, and operational expenses.

**What Is Variable and Fixed Cost in Accounting?**

Fixed costs are predetermined expenses that remain the same throughout a specific period. These overhead costs do not vary with output or how the business is performing. To determine your fixed costs, consider the expenses you would incur if you temporarily closed your business. You would still continue to pay for rent, insurance and other overhead expenses.

**Some examples of fixed costs include:**

1. Rent
2. Telephone and internet costs
3. Insurance
4. Employee Salaries
5. Loan Payments

Any small business owner will have certain fixed costs regardless of whether or not there is any business activity. Since they stay the same throughout the financial year, fixed costs are easier to budget. They are also less controllable than variable costs because they’re not related to operations or volume.

Variable costs, however, change over a specified period and are associated directly to the business activity. These are based on the business performance and the volume of services the business generates.

**Some examples of variable costs include:**

1. Direct labor
2. Commissions
3. Taxes
4. Operational expenses

Since they are changing continuously and the amount you spend on them differs from month-to-month, variable expenses are harder to monitor and control. They can decrease or increase rapidly, cut your profit margins and result in a steep loss or a whirlwind profit for the business.

**What Is Fixed Cost and Variable Cost? Examples**

1. FIXED COSTS EXAMPLE

Fixed costs remain constant for a specific period. These costs are often time-related, such as the monthly salaries or the rent.For example, the rent of a building is a fixed cost that a small business owner negotiates with the landlord based the square footage needed for its operations. If the owner rents 10,000 square feet of space at $40 a square foot for ten years, the rent will be $40,000 per month for the next ten years, regardless of the profits or losses.

It is important to note that fixed costs are not constant in the long run. Take the example above. The rent will be the same till the business occupies the space or till the landlord decides to increase the rent after the end of the lease agreement. If the owner decides to move to a bigger facility or pay more, the business expense would obviously go up.

2. VARIABLE COSTS EXAMPLE

Variable costs change directly with the output – when output is zero, the variable cost will be zero. The total variable cost to a business is calculated by multiplying the total quantity of output with the variable cost per unit of output. A common example of variable costs is operational expenses that may increase or decrease based on the business activity. A growing business may incur more operating costs such as the wages of part-time staff hired for specific projects or a rise in the cost of utilities – such as electricity, gas or water. Unlike fixed expenses, you can control your variable expenses to leave room for profits.

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| --- | --- |
| Fixed Costs | Variable Cost |
| In accounting, fixed costs are expenses that remain constant for a period of time irrespective of the level of outputs | Variable costs are expenses that change directly and proportionally to the changes in business activity level or volume. |
| Even if the output is nil, fixed costs are incurred. | The cost increases/decreases based on the output |
| Fixed costs are also known as overhead costs, period costs or supplementary costs. | Variable costs are also referred to as prime costs or direct costs as it directly affects the output levels. |
| Fixed costs are time-related i.e. they remain constant for a period of time. | Variable costs are volume-related and change with the changes in output level. |
| Depreciation, interest paid on capital, rent, salary, property taxes, insurance premium, etc. | Commission on sales, credit card fees, wages of part-time staff, etc. |
|  |  |

**Why Is It Important to Distinguish Between Fixed Costs and Variable Costs?**

As a small business owner, it is vital to track and understand how the various costs change with the changes in the volume and output levels. The breakdown of these expenses determines the price level of the services and assists in many other aspects of the overall business strategy. These costs are also the primary ingredients to various costing methods employed by businesses including job order costing, activity-based costing and process costing.

1. BREAK-EVEN ANALYSIS

The knowledge of the fixed and variable expenses is essential for identifying a profitable price level for its services. This is done by performing the break-even analysis (dollars at which total revenues equal total costs)

Volume needed to break even = fixed costs / (price – variable costs)

The equation provides not only valuable information about pricing but can also be modified to answer other important questions such as the feasibility of a planned expansion. It can also give entrepreneurs, who are considering buying a small business, information about projected profits. The equation can help them calculate the number of units and the dollar volume that would be needed to make a profit and decide whether these numbers seem credible.

2. ECONOMIES OF SCALE

An understanding of the fixed and variable expenses can be used to identify economies of scale. This cost advantage is established in the fact that as output increases, fixed costs are spread over a larger number of output items.

Both fixed costs and variable costs contribute to providing a clear picture of the overall cost structure of the business. Understanding the difference between fixed costs and variable costs is important for making rational decisions about the business expenses which have a direct impact on profitability.

Fixed and variable costs for manufacturing (with examples)

In manufacturing, the total cost of direct labor, raw materials, and facility upkeep will take the biggest bite out of your revenue.

**Examples of fixed costs for manufacturing**

1. Depreciation or financing payments for equipment
2. Equipment maintenance
3. Indirect labor—supervisor and administrator wages
4. Insurance premiums
5. Business licenses

**Examples of variable costs for manufacturing**

1. Raw materials
2. Direct labor—wages for the people manufacturing goods hands on
3. Credit card and payment processing fees
4. Outgoing freight