



Costs: Fixed Costs, Variable Costs, and Volume

An Addendum to the "Controlling Costs" Session in MOBI's Quick Start Entrepreneur Course

Managing costs is one of your most important jobs as a business owner. There are two kinds of costs, fixed and variable. Fixed and variable costs impact the business in different ways but both are important in making the business profitable.

In the discussion of costs, it will be useful to define the word volume. Production volume is the number of units that your business produces in a week, month, or year. Sales volume is the number of units your business sells in a week, month, or year. In general, if you are selling a service, then production volume and sales volume are the same -- you make it and sell it at the same time. If you are selling a product, you can make more than you sell (and sell more than you make if you have inventory) so production volume and sales volume can be different.

Fixed costs are costs that are independent of volume. Fixed costs tend to be costs that are based on time rather than the quantity produced or sold by your business. Examples of fixed costs are rent and lease costs, salaries, utility bills, insurance, and loan repayments. Some kinds of taxes, like business licenses, are also fixed costs. Since you have to pay fixed costs regardless of how much you sell, you should be careful about adding fixed costs to your small business. Fixed cost is often called overhead.

Variable costs are costs that change as the volume changes. Examples of variable costs are raw materials, piece-rate labor, production supplies, commissions, delivery costs, packaging supplies, and credit card fees. In some accounting statements, the Variable costs of production are called the "Cost of Goods Sold."

It is possible for a cost to be fixed for some kinds of businesses, but variable in other kinds of businesses. For example, for a food truck, fuel is probably a fixed cost (it takes the same amount of fuel to move the food truck regardless of how much food the business sells) but fuel would be a variable cost for a delivery service like UPS (more packages delivered means more fuel).