



UNDERSTANDING: CAPEX VS OPEX

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Abstract

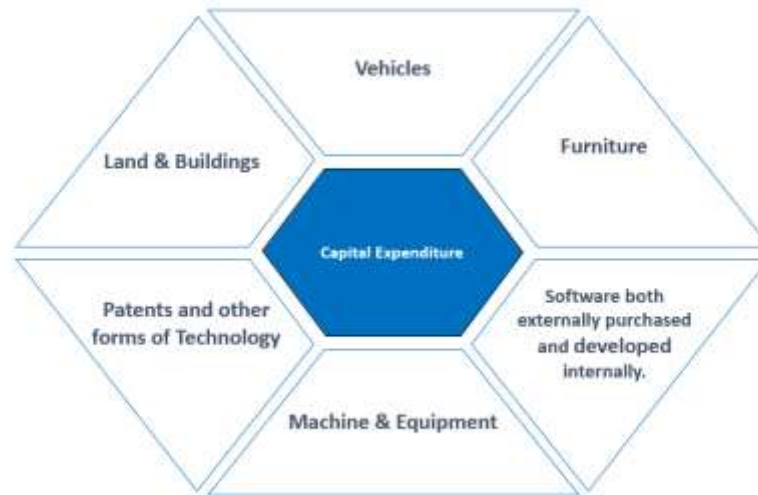
This article will be discussing the expenditures pertaining to the long-term investments (Capex) and certain expenses called (Opex) that is incurred and charged in the same accounting period. It will cover the meaning, significance, pros and cons of them for a business. It will also briefly explain what business expenses can fall in each category and the possible accounting treatment under each category. The point, idea, approach could differ by country, Industry, business etc.

Overview

Businesses have a variety of expenses that pertain to the overall costs of running and growing the business such as the rent and rates for their offices, cost of materials, Salaries, fixed assets, software, hardware, buildings, cars, marketing & advertising expenses. All these costs incurred by businesses are organized primarily under Capex and Opex.

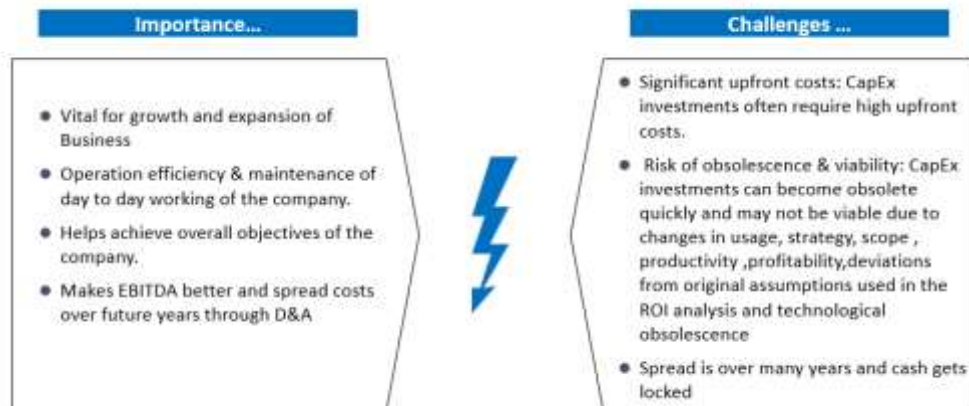
Capital Expenditures (Capex) are purchases of significant goods or services that will be used to improve a company's performance in the future. It is the money spent or invested by an organization to acquire, develop, or maintain assets for the future benefit to the organization. One of the defining characteristics of capital expenditures is longevity, meaning that the purchases benefit the company for longer period as the lifespan of these goods & services goes beyond the current financial year.

Below are few examples of Business spending that is considered as Capex:



Capex Benefits and Challenges for the Business

Although Capital expenditure is crucial as with everything in business there are benefits and challenges associated with capital expenditures. Some of them are summarized below:



Operational Expenditures (Opex) are the costs the company incurs for running its day-to-day operations. These are the ordinary and customary costs that are required for all commercial and operating activities.

Below are few examples of Business spending that is considered as Opex:



Accounting Treatment

Capex and Opex are treated differently for accounting purposes.

Capex is recorded on the balance sheet as a capitalized asset. Capital expenditures are not fully deducted in that accounting period but instead deducted over several years based on the useful life of the asset as depreciation or amortization. Opex is reported on the income statement as an expense and are fully deducted in the same accounting period this means they are charged in the P&L as an expense in the period they are incurred and are fully tax deductible. For example, some Corporations defer Software development and once the project is complete and start amortizing over several years depending on the life expectancy of the asset.

To calculate Capex, you can use the following formula:

$$\text{Capex} = \text{Current period PP\&E (plant, property, \& equipment)} - \text{prior period PP\&E} + \text{depreciation}$$

Conclusion

While both Capex and Opex both are essential parts of keeping a business running, growing and successful capex path can be a bit challenging and complex. Any new project or investment will have both these elements running hand in hand with one more than the other depending on which path the organization decide to choose based on various factors like budget, strategy, industry dynamics .Although the choice between Capex and Opex is not binary, but a well thought out

strategy to strike a correct balance between both the elements can be crucial for the success of a business.

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