

# Operating Leverage

Operating leverage refers to the degree of risk inherent in a firm's operations (i.e. independent of how a firm finances its operations). Firms that operate with a great deal of fixed costs relative to variable costs are said to be operating with a great deal of operating leverage.

A firm with a high proportion of fixed costs will have relatively volatile operating profits. A slight increase in sales will lead to a dramatic increase in profits; a slight decrease in sales will lead to a dramatic decrease in profits.

Examples of capital intensive industries with high fixed costs and high operating leverage include the steel, glass and oil exploration industries. Examples of industries with low fixed costs and low operating leverage include the wholesale and retail industries.