Source: https://www.investopedia.com/ask/answers/033015/what-difference-between-economic-profit-and-accounting-profit.asp#:~:text=Economic%20profit%20is%20money%20earned,investment's%20total%20revenue%20or%20return.

**Economic Profit vs. Accounting Profit: What's the Difference?**

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**Economic Profit vs. Accounting Profit: An Overview**

Profit is one of the most widely watched financial metrics in evaluating the financial health of a company. It is the [financial gain or revenue](https://www.investopedia.com/terms/p/profit.asp) generated from any business or investment activity in excess of any expenses, taxes, and any other costs. However, economic profits and accounting profits are two types of profits. Economic profit refers to total [revenue from sales minus opportunity costs](https://www.investopedia.com/ask/answers/06/economicvsmarketvalueadded.asp) from all inputs. Accounting profit, on the other hand, represents the total earnings of a company, which includes explicit costs.

KEY TAKEAWAYS

* Profit is the financial metric that indicates an entity's financial gain or revenue from any business or investment activity.
* Economic profit is money earned after taking explicit and implicit costs into account.
* Accounting profit is the net income for a company or revenue minus expenses.
* You can determine economic profit by subtracting total costs from a company or investment's total revenue or return.
* Companies report their accounting profits to investors on their income statements and to the IRS for tax purposes.

**Economic Profit**

[Economic profit](https://www.investopedia.com/terms/e/economicprofit.asp) is a form of profit that is derived from producing goods and services while factoring in the alternative uses of a company's resources. It deducts explicit costs from revenue and includes the [opportunity costs](https://www.investopedia.com/terms/o/opportunitycost.asp) incurred during that period of time. [Implicit costs](https://www.investopedia.com/terms/i/implicitcost.asp), which are typically the costs of a company's resources, are also part of the equation.

You can calculate economic profit as long as you know the total amount of revenue earned and the total cost involved using the following formula:

*Economic Profit = Total Revenue - (Total Explicit Costs + Total Implicit Costs)*

For example, the implicit costs could be the [market price](https://www.investopedia.com/terms/m/market-price.asp) a company could sell a natural resource for versus using that resource. A paper company owns a forest of trees. They cut down trees and create paper products. Their implicit costs are the timber, which they could sell for market prices.

Here's another way to think about it. A company may choose Project A over Project B. The profit from Project A after deducting expenses and costs would be the accounting profit. The economic profit would include the opportunity cost of choosing Project A versus Project B. In other words; the economic profit would consider how much more or less profit would have been generated (by using the company's resources) had management chosen Project B.

Economic profit is based on theoretical principles while accounting profit uses accounting principles. As such, accounting profit is the true form of profitability while economic profit is derived from assumptions and estimates.

**Accounting Profit**

[Accounting profit](https://www.investopedia.com/terms/a/accountingprofit.asp) is also known as a company's earned profit, net income, or [bottom line](https://www.investopedia.com/terms/b/bottomline.asp). Unlike economic profit, accounting profit is reported on a company's income statement. It's the profit earned after various costs and expenses are subtracted from total revenue or total sales, as stipulated by [generally accepted accounting principles](https://www.investopedia.com/terms/g/gaap.asp) (GAAP). Those costs include:

* Labor costs, such as wages and salaries
* Any inventory needed for production
* [Raw materials](https://www.investopedia.com/terms/r/rawmaterials.asp)
* Transportation and storage costs
* Production costs and overhead
* Sales and marketing costs

Accounting profit is the amount of money left over after deducting the [explicit costs](https://www.investopedia.com/terms/e/explicitcost.asp) of running the business. Explicit costs are merely the specific amounts that a company pays for those costs in that period—for example, wages. Typically, accounting profit or net income is reported on a quarterly and annual basis and is used to measure the [financial performance](https://www.investopedia.com/terms/f/financialperformance.asp) of a company.

**Key Differences**

Economic profit is more of a theoretical calculation based on alternative actions that could have been taken. Accounting profit, on the other hand, calculates what actually occurred and the measurable results for the period.

Here's another way to think about it. Accounting profit is the profit after subtracting explicit costs (such as wages and rents). Economic profit includes explicit costs as well as implicit costs (what the company gives up to pursue a certain path). As such, accounting profit represents a company's true [profitability](https://www.investopedia.com/ask/answers/012715/what-difference-between-profitability-and-profit.asp) while economic profit is indicative of its efficiency.

Companies are only required to report one form of profit to the [Internal Revenue Service](https://www.investopedia.com/terms/i/irs.asp) (IRS) for tax purposes: accounting profit. Economic profit is generally only meant for internal uses. For instance, businesses can use it to determine whether to enter or stay in a particular market. Economic profit also shows how efficiently companies are operating, including whether they're allocating their resources to the best of their ability.

| **Major Differences Between Economic Profit and Accounting Profit** | |
| --- | --- |
| **Economic Profit** | **Accounting Profit** |
| Earnings after deducting explicit and implicit costs from total revenue | Earnings after deducting explicit costs of running a business |
| Derived from assumptions and estimates | Measurable and calculated as per GAAP |
| Not reported | Reported on corporate income statements and to the IRS |

**Economic Profit vs. Accounting Profit Example**

Let's use a hypothetical example to show how economic and accounting principles work in the corporate world. Remember that economic profit is based on estimates and assumptions while accounting profit is the figure that companies report for tax purposes and to investors.

Accounting profits are easy to determine since we already know that this figure can be found on a company's income statement. As noted above, it is reported as a company's net income. For instance, NVIDIA ([NVDA](https://www.investopedia.com/markets/quote?tvwidgetsymbol=NVDA)) reported total [net income](https://www.investopedia.com/terms/n/netincome.asp) or accounting profit of $9,75 billion for the 2022 [fiscal year](https://www.investopedia.com/terms/f/fiscalyear.asp) compared to the $4.33 billion it earned in 2021.1

Now let's take a look at an example of economic profit. Unlike accounting profit, you can't get this figure from a corporate financial or [income statement](https://www.investopedia.com/terms/i/incomestatement.asp). Instead, it requires some calculation. Let's say a company earns revenue of $10,000 on sales of stuffed animals. Explicit costs amount to $5,000. In addition, the company could have produced a different product; by foregoing that opportunity, it declined $2,000 of income. Using the formula above, we can determine that the economic profit of producing these toys is $3,000 ($10,000 - $5,000 - $2,000). The $2,000 is included as an implicit cost that is otherwise not recorded on the financial statements.

What Is the Difference Between Zero Accounting Profit and Zero Economic Profit?

Zero economic profit is also known as normal profit. Like economic profit, this figure also accounts for explicit and implicit costs. When a company makes a normal profit, its costs are equal to its revenue, resulting in no economic profit. Competitive companies whose total expenses are covered by their total revenue end up earning zero economic profit. Zero accounting profit, though, means that a company is running at a loss. This means that its expenses are higher than its revenue.

How Do You Calculate Economic Profit?

In order to calculate economic profit, add together both explicit and implicit costs. Then subtract that figure from the total amount of revenue earned. Explicit costs include wages, leases, utilities, and the cost of raw materials while implicit costs include any opportunity costs, such as the loss of interest on an investment.

How Do You Calculate Accounting Profit?

You can calculate accounting profit by subtracting explicit costs or expenses from the total amount of revenue earned. Explicit costs include things like raw materials, wages, lease payments, and utilities. Management calculates accounting profit as part of its financial statements, though it may use different approaches for internal analysis.

Is Accounting Profit More Than Economic Profit?

In most cases, accounting profit will be more than economic profit. This is because companies often incur opportunity cost for activities foregone in favor of other activities. For example, imagine a company has $100,000 to invest. If it declines one opportunity for another, the potential income from the declined opportunity is factored into economic profit but not accounting profit. In other words, accounting profit usually has less expenses, though it is possible for an opportunity cost to be a cost avoidance measurement that results in lower accounting profit.

Why Is Economic Profit Better Than Accounting Profit?

Economic profit may be seen as better than accounting profit because it is not restricted by accounting rules. Economic profit reflects all of the decisions of a company, regardless of whether they comply with GAAP or IFRS. Economic profit considers decisions not made or choices foregone, so it is a broader, more encompassing depiction of the positioning of a company.

**The Bottom Line**

There are a few ways to calculate profit. Most analysts use accounting profit which reflects the revenue less expenses of a company based on accounting rules. These costs are often explicitly defined. On the other hand, economic profit incorporates implicit costs that sometimes not recorded on a general ledger but still impact the net profitability of a decision.