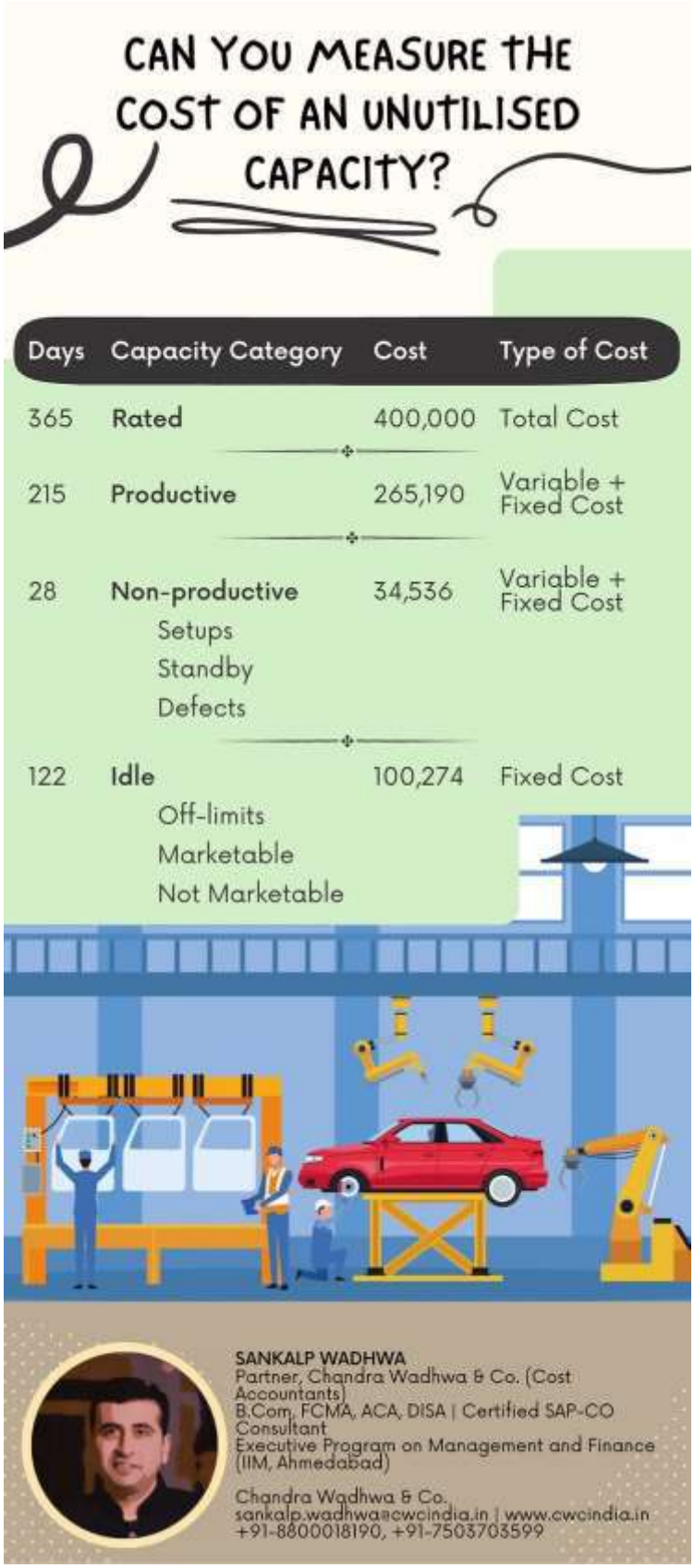
Can you measure the cost of an unutilised capacity?



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THE INTRODUCTION:
The client in question is a joint venture public limited listed company that is the leading manufacturer of thermal products for automotive applications in India.

THE PROBLEM:
As a manufacturing concern, we want to know how much of the capacity is utilised for production and how much capacity is wasted or unutilised or kept idle. In a capacity-aware model, the allocation of costs follows the usage of capacity.
A company's measurement of available capacity and utilisation is an essential ingredient. Therefore, it becomes imperative to analyse capacity planning thoroughly, including the planning for quantity produced or the scale of output.

Therefore, the client needs to ensure whether the capacity is planned rationally or not. They want to inspect capacity management more holistically, not missing out on any material information that might impact their business. Some of these considerations are:

- Proper demand forecasting
- Identifying throughput bottlenecks
- Appropriate material requirement planning (MRP)
- Incorporating actual capacity
- Accurate capacity measurement
- Common framework for all manufacturing facilities in PAN India, including its unit of measurement (UOM)

THE SOLUTION:
To develop a capacity measurement model that addresses the management’s concerns and can be universally adopted for manufacturing facilities across the country. To this end, the following accurate cost capacity measurement model should be generated on a real-time basis:

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Summary Model	Industry Specific Model
Idle	• Not Marketable • Off Limits • Marketable
Non - productive	• **Standby** • Waste • Maintenance • **Setups**
Productive	• Process Development • Product Development • Good Products

THE RESULTS:
After in-depth deliberations and continuous collaboration with the client for over three months, our team at Chandra Wadhwa & Co. developed a detailed-oriented capacity measurement model, which helped the client address the capacity management-related challenges.

The detailed model with an illustrative example can be accessed here. [1].

The model not only helped us to derive the capacity cost for the above-mentioned key metrics but also assisted in achieving excellent results in the following domains:

- Increased resource utilization
- Leaner operations
- More on-time delivery
- Full visibility
- Higher margins
- Assurance on available capacity and capacity utilised numbers
- More efficient capacity planning
- Fact-based ‘cost of capacity’ allocations

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FOOTNOTES:

1. ^ *Footnote 1_Capacity cost*

FREQUENTLY ASKED QUESTIONS:

Q. What is unutilised capacity?

A. Unutilized capacity refers to a company or facility's unused production or operational capacity. This can include equipment, labour, or other resources that need to be fully utilised to produce goods or provide services.

Q. Why is measuring the cost of unutilised capacity important?

A. Measuring the cost of unutilised capacity is important because it can help companies identify areas where they can improve efficiency, reduce costs, and increase profitability. By understanding the cost of unutilised capacity, companies can make informed decisions about resource allocation, pricing strategies, and production planning.

Q. How can companies measure the cost of unutilised capacity?

A. Companies can measure the cost of unutilised capacity by calculating the fixed and variable costs associated with maintaining the unused capacity. Fixed costs include expenses such as rent, depreciation, and insurance, while variable costs include expenses such as utilities, maintenance, and labour. By calculating these costs, companies can determine the actual cost of unutilised capacity and identify opportunities to reduce costs and increase productivity.

Q. What are some common causes of unutilised capacity?

A. Some common causes of unutilised capacity include changes in demand or production schedules, equipment breakdowns or maintenance, inefficient processes, and lack of skilled labour. Additionally, seasonal fluctuations in demand or unexpected changes in market conditions can lead to unutilised capacity.

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Q. How can companies reduce the cost of unutilised capacity?

A. Companies can reduce the cost of unutilised capacity by implementing strategies such as outsourcing, subleasing excess space or equipment, implementing just-in-time inventory systems, and cross-training employees to perform multiple functions. Additionally, companies can invest in technology and process improvements to increase efficiency and reduce downtime.

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