

Capacity Utilization-

Capacity utilization refers to the manufacturing and production capabilities that are being utilized by a nation or [enterprise](#) at any given time. It is the relationship between the output produced with the given resources and the potential output that can be produced if capacity was fully used. Capacity utilization can also be defined as the metric used to calculate the rate at which the prospective levels of output are being met or used. The rate is displayed as a percentage and provides an insight into the total utilization of resources and how a company can increase its output without increasing the costs associated with production. The capacity utilization rate is also called the operating rate.

Formula for Capacity Utilization

The mathematical formula for calculating capacity utilization is:

$$\text{Capacity Utilization} = \frac{\text{Actual Level of Output}}{\text{Maximum Level of Output}} \times 100$$

Example of Capacity Utilization

Suppose XYZ Company is producing 20,000 and it is determined that the company can produce 40,000 units. The company's capacity utilization rate is 50% $[(20,000/40,000) * 100]$. If all the resources are utilized in production, the capacity rate is 100%, indicating full capacity. If the rate is low, it signifies a situation of "excess capacity" or "surplus capacity."

It is unlikely that an economy or company will function at a 100% capacity rate as there are always hurdles in the production process (such as the malfunction of equipment or unequal distribution of resources). A rate of 85% is considered the optimal rate for most companies. The capacity utilization rate is used by companies that manufacture physical products and not services because it is easier to quantify goods than services.

Economic Significance of Capacity Utilization-

If demand in the market increases, it will raise the capacity utilization rate, but if demand decreases, the rate will fall. Economists use the rate as an indicator of inflation pressures. A low capacity utilization rate will result in a decrease in price because there are excess capacity and insufficient demand for the output produced.

Economies with a capacity ratio of much less than 100% can significantly boost production without affecting the associated costs.

Many capitalist economies face high excess capacity rates, and economists use the rate as an argument against capitalism, stating that resources are not as well allocated as they could be. However, regardless of economic conditions, there will never be full capacity utilization as inefficiencies in resource allocation always exist in an economy.

Corporate Capacity

The capacity utilization rate is an important indicator for companies because it can be used to assess operating efficiency and provides an insight into cost structure. It can be used to determine the level at which costs per unit go up or fall. When there is a rise in output, the average cost of production will decrease.

It means that the higher the capacity utilization, the lower the cost per unit, allowing a business to gain an edge over its competitors. Many large companies aim to produce as close to the full capacity rate (100%) as possible.

Although attaining a full capacity rate is not possible, there are ways companies can increase their current utilization rate, including:

- Employing more staff and encouraging overtime to ensure that all production targets are being met
- Spending less time on the maintenance of equipment so that more time can be spent on the production of goods
- Subcontracting some of the production activities

Effects of Low Utilization

Low capacity utilization is a problem for fiscal and monetary policymakers who use such policies to stimulate the economy. In 2015 and 2016, many European economies such as France and Spain struggled with the consequences of low capacity utilization. Despite the governments' intervention through historically low interest rates, inflation remained significantly low with a threat of deflation.

The low capacity utilization led to high unemployment that created slack in the economy, making it hard for prices to react to monetary stimulus. With excess capacity, an increase in the production of goods did not require a significant investment in capital.

When a company faces an increase in demand for its goods, it is often able to meet the demand without raising the cost per unit. The company can optimize its output level with no additional cost for investment in better infrastructure.

foreign collaboration

Foreign collaboration **accelerates economic growth of the country**. Foreign collaboration fills up the technological gaps. This helps in increase in industrialisation. Due to foreign collaboration other resources such as capital, human and physical resources are mobilised.

The major features of foreign collaboration for the growth of business are as follows:

- Agreement: ...
- Government consent: ...
- World integration: ...
- Growth of industrial sector: ...
- Gives legal Identity: ...
- Helps to meet out requirements:
 - **Improve the financial growth of the collaborating entities.** Occupy a major market share for the collaborating entities. Reduce the higher operating cost of a non-resident entity. Make an optimum and effective use of resources available in the resident entity's country.

The following are the common characteristics of multinational corporations:

- Very high assets and turnover. ...
- Network of branches. ...
- Control. ...
- Continued growth. ...
- Sophisticated technology. ...
- Right skills. ...
- Forceful marketing and advertising. ...
- Good quality products.