

Business Services - Common Problems:

Underutilised assets

The return on capital invested in fixed/non-current assets is not satisfactory because the assets are not being used to their full potential.

Indicators

- There are surplus items of machinery or equipment which are either not used or are not used to their full capacity.
- The ratio of fixed/non-current assets to gross profit is rising.
- There is excess office/storage/factory space which will not be utilised through expansion.
- There is insufficient cash to support the steady flow of working capital.

Causes of the problem

- Production has not been properly scheduled.
- Forecasted growth was incorrect so assets which were not needed were purchased.
- Production and sales have decreased and are unlikely to regain their former levels for some time.
- Too much money has been applied to fixed/non-current assets.

Short term solutions

- Examine the current utilisation of all machinery and equipment. Determine the expected growth of production and sales over future periods. If there is a large disparity between the supply and the needs, consider selling some of the assets.
- Consider hiring the equipment out to third parties or alternatively renting the time usage on the machinery (eg hire out use of photocopier, fax machine, board room etc).
- Sell and lease back fixed/non-current assets to make more cash available for other assets/investments which have a greater return.

Long term solutions

- Determine future requirements for fixed/non-current assets and implement an asset replacement program in line with the expected growth.



- Always ensure there are sufficient funds available for an efficient flow of working capital.
- For every proposed asset purchase an expected rate of return on capital should be calculated to ensure the greatest use is being made of the funds. A common way of calculating this rate of return is the employment of the discounted cash flow technique.

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