

Run the Factory Full

Idea In Short

If your business carries significant fixed costs, maximize asset utilization to drive down per-unit costs. Avoid taking on fixed costs unless necessary, and recognize that heavy fixed-cost structures create barriers to exit that handcuff strategic flexibility.

Fixed Costs Are Everywhere

What do airplanes, hospital equipment and full-time employees have in common? They are all fixed costs. These are costs a business incurs regardless of how many passengers it carries, patients it treats or products it sells. Fixed costs represent the structural backbone of most operations, and they shape pricing, capacity and competitive strategy.

The clearest examples are big, physical and expensive. A sports stadium costs the same whether it hosts one game or fifty. Magnetic resonance imaging equipment might cost \$3 million regardless of how many scans are performed. An airplane is expensive whether it sits on the ground or flies through the air. The principle holds across industries, and understanding it is essential for executives making investment and pricing decisions.

Empty Assets Mean Waste

You rent an apartment with a year-long lease. You go on vacation for three weeks, and the landlord does not refund your rent. Whether you got full value from the apartment is not her problem. The same logic applies to a gym membership you rarely use or a car that sits in the garage. A house full of unused things is not great. An empty vacation home is a waste of money.

The lesson is straightforward. If you have something valuable, use it. Idle assets drain resources without generating returns. This principle extends beyond physical assets to people, technology and intellectual property. Underutilized investments represent capital that could be deployed elsewhere.

Asset-Lite Is Advantageous

One of the biggest changes over the last 30 years is how easy it has become to start a business with minimal fixed-cost investment. You can work remotely without an office. You can use free software for collaboration. You can build a website for a nominal fee, outsource design, outsource manufacturing and ship directly to customers. The barriers to entry have collapsed for asset-light models.

Decades ago, companies maintained email servers on their own premises. The infrastructure investment was substantial. Today, cloud services and software-as-a-service platforms have eliminated most of that fixed cost burden. Going asset-lite reduces risk and increases flexibility, which is why entrepreneurs and investors favor this approach.

Run the Factory Full

If you were the vice president of a factory, you would want to keep it running smoothly. More production makes planning easier. More production makes staffing more predictable. More production reduces variability and improves profitability percentages. The logic is simple and powerful.

Consider a t-shirt printing machine that costs \$5,000 and lasts one year. Whether you produce 1,000 shirts or 75,000 shirts, you will not get that \$5,000 back. It makes sense to produce more because the same investment gets divided across more units. If you produce 50,000 shirts, the fixed cost per unit drops to 10 cents. 1 If you have to pay for the factory anyway, you might as well run at full production.

Economies of Scale

Executives love this phrase, and for good reason. Getting bigger lets you spread fixed costs over more units. Getting bigger can lower your relative cost structure and improve margins. This dynamic has driven mergers and acquisitions for decades, as companies seek scale advantages in purchasing, operations and distribution. 2

Scale advantages compound over time. A larger company negotiates better terms with suppliers. A larger company invests in better technology. A larger company attracts stronger talent. These advantages create a self-reinforcing cycle where incumbents grow stronger

and challengers struggle to compete on cost.

Marginal Revenue Equals Marginal Cost

In the short run, you should produce more product until your marginal revenue equals your marginal cost. This sounds technical, but the logic is practical. As long as you are covering your marginal costs, keep going. Your fixed costs are sunk and should not factor into your production decisions. 3

Consider an oil producer who invested heavily in oil fields, equipment and distribution. The marginal cost to pull a barrel from the ground is modest. In the short term, as long as the selling price exceeds that marginal cost by even one dollar, production is worthwhile. Consider a movie theater where licensing rights and building costs are expensive. The additional cost of air conditioning and popcorn is small. It makes sense to stay open even during weekday mornings with sparse attendance. Consider a teacher with 10 empty seats. Selling those seats at a discount is advantageous because the marginal cost of 10 extra students is minimal.

Fixed Costs Create Exit Barriers

All fixed costs are not sunk. If you have a long-term lease on a building or carry debt payments, stopping production does not eliminate those obligations. You still need to service your debts even if you stop pumping oil, showing movies or teaching classes. These costs create impediments to exiting a business.

Leaders often find themselves trapped. A shop may not be profitable, but the contract runs for three more years. The company must keep the lights on until the lease expires. Beyond contractual obligations, executives must consider brand impact and customer promises. Exiting a business segment can signal weakness to the market and erode trust with remaining customers.

Utilization Matters for People

Any consultant knows the word utilization. For those outside professional services, this concept can seem slightly robotic. Why are we trying to use people like machines? For those in consulting, law or accounting, the logic is obvious. Human capital is the biggest

asset in these firms, and in professional services it can represent up to 80 percent of total costs.

A roofing business with 25 employees needs them busy. A restaurant needs the right number of cooks and servers for excellent service. A school needs the right number of faculty for great student outcomes. Lots of idle people means wasted talent and budget. People are an economic asset, and their utilization directly affects the bottom line.

Individuals Want to Create Value

New hires want to quickly demonstrate their value. Go-getters want to accomplish meaningful work. Recruiting is enormous effort, and companies want to see returns on that investment. Matching the right people to the right work is difficult, which is why it remains an enormously valuable business.

Billable work offers clear benefits for professionals. It provides a simple way to track the profitability of time. A consultant with 2,000 hours in a year can directly measure the revenue generated. Client work is real work that impacts lives, budgets and careers. Professionals want to add value, and bigger impact brings bigger recognition and bigger compensation.

Companies Want Leaders

Companies need to win in the market, make money and meet payroll. It is the role of managers to get the most from their people through vision, direction, staffing, training, incentives and organizational design. Peter Drucker observed that the productivity of work is not the responsibility of the worker but of the manager. He also noted that managers are paid to be uncomfortable.

Leadership is critical for a reason. Choose any great company, and it would not be great without brave leaders, competent decision makers and thoughtful risk-takers. Leaders are rare and valuable resources. They are difficult to find, which is why founders keep returning to their companies and why chief executives get recruited from one organization to another. The best leaders are valuable, rare, hard to imitate and deeply embedded in the organizations they serve.

- 1Economies of Scale
- 2Economies of Scale: Definition, Types, and Strategies
- 3Profit maximization

Summary

Fixed costs are everywhere, from airplanes to employees. Going asset-lite reduces risk, while heavy fixed costs demand full utilization. Leaders must understand how marginal economics, exit barriers and human capital utilization drive profitability and competitive advantage.