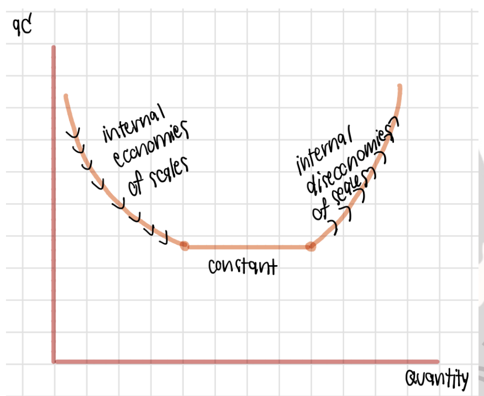
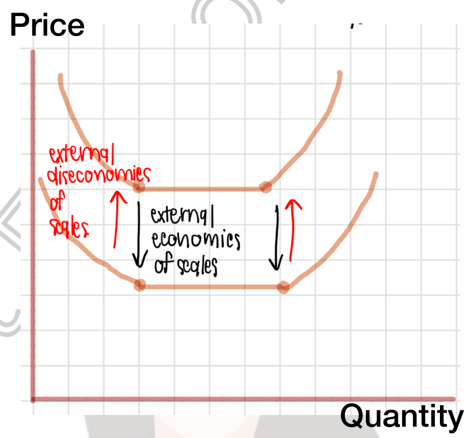
CHAPTER 6: Economies and diseconomies of scale

Key terms

1. Diseconomies of scale : a rise in the long-run average costs of production as output rises
2. Economies of scale : A fall in the long run average costs of production as output rises
3. External economies of scale : falling average costs of production, shown by a downward shift in the average cost curve, which result from a growth in the size of the industry within which a firm operates
4. Internal economies of scale : economies of scale which arise because of the growth in the scale of production within a firm
5. Minimum efficient sale (MES) of production : the lowest level of output at which long-run average cost is minimised

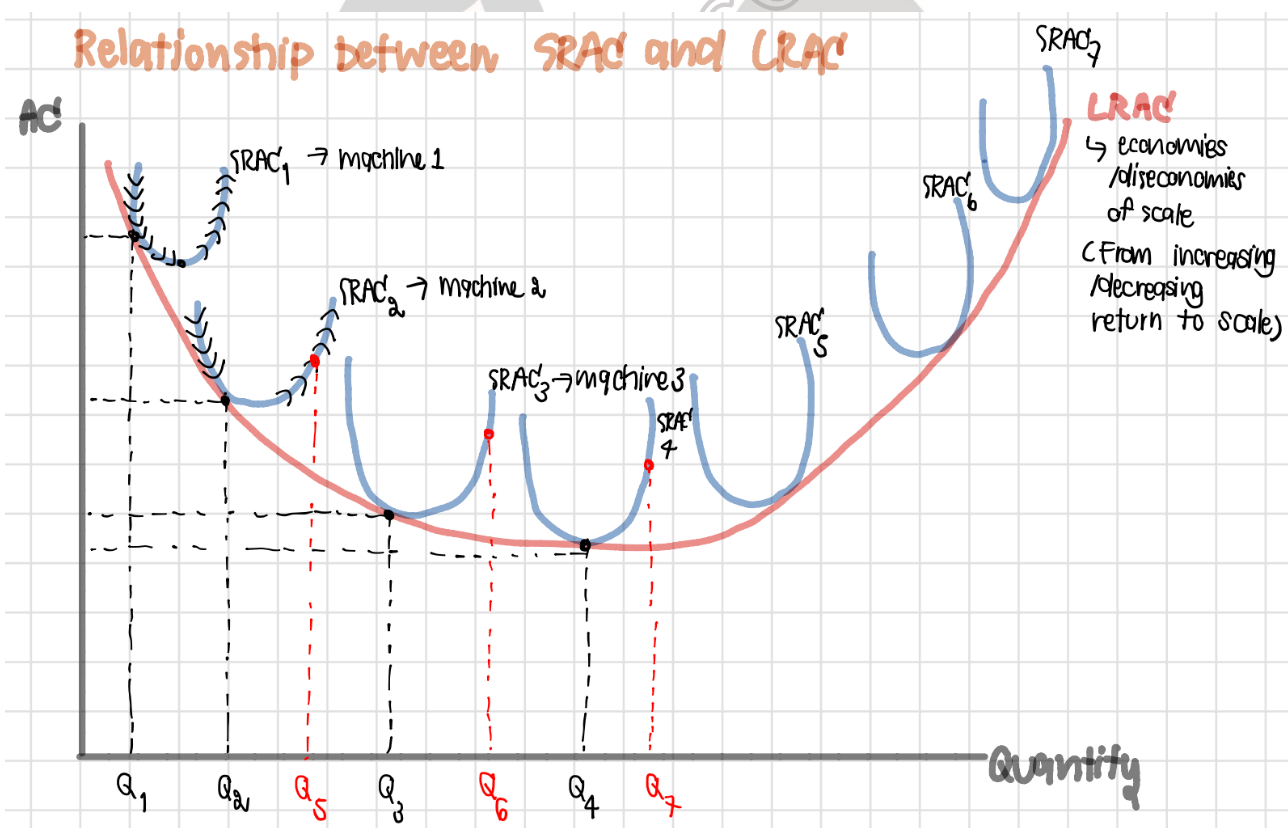
1. Economies of scale : occur when long-run average costs fall with increasing output

Internal EOS	External EOS
: Average cost lower when firms become larger	: Average cost lower when industries become larger
	
• Purchasing economies of scale • Managerial economies of scale • Technological economies of scale • Risk bearing • Marketing economies of scale • Financial economies of scale	• If car industry becomes bigger, all car firms will benefit from better infrastructure and access specialised labour

2. Diseconomies of scale : occur when long-run average costs increase with increasing output

- Poor communication : more labour enlarger firms, difficult to communicate and slow in decision making
- Alienation : Workers feel less important and less productivity
- Lack of control : when there are a large number of workers. It is easier to escape with not working very hard and productivity could suffer as a result
- External diseconomies of scale : when whole industries get too big and suffer issues such as congestion and duplication of routes

3. Relationship between SRAC and LRAC



- The slope of LRAC derived from series of SRAC
- At Q1,Q2,Q3,Q4 : SRAC = LRAC and Q5, Q6,Q7 where in short run, diminishing return to scales (SRAC > LRAC)
- Overall, In industries with economies of scale, we will become more efficient with higher output eg. Moving to Q1 to Q2 lead to lower average cost

- A bigger firm will get improved return to scales

- In short run, we get diminishing return, but overtime we can increase capital and shirt SRAC1 to SRAC2