Unit 40

Economies and diseconomies of scale

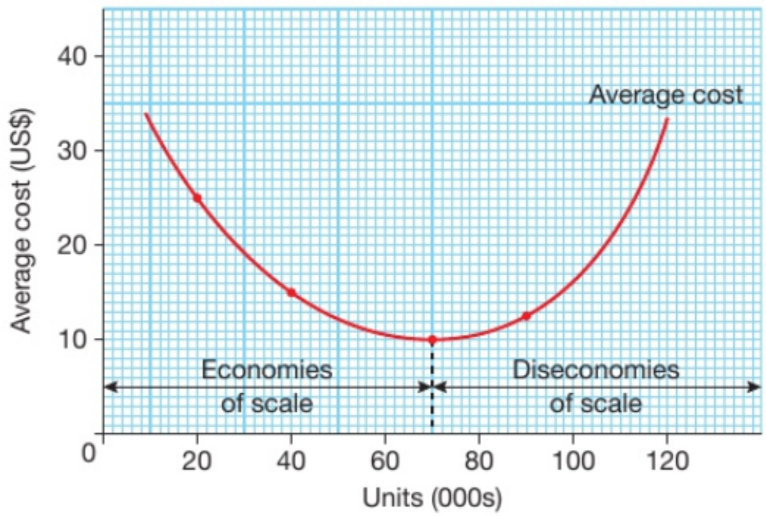
1. **Economies of scale**

: Financial advantages of producing something in very large quantities. (Falling average cost when producing more goods)

2. **Diseconomies of scale**

: Rising average costs when a firm becomes too big.

Diagram



3. Internal economies of scale

: the cost benefits that an individual firm can enjoy when it grows. The reasons why costs fall are summarised

3.1 Purchasing economies

: Large firms that buy lots of resources get cheaper rates. Suppliers offer discounts to firm that buy raw material and components in bulk.

3.2 Marketing economies

: Marketing economies can occur because some marketing costs, such as producing a television advert, are fixed. These costs can be spread over more units of output for a larger firm.

3.3 Technical economies

: There can be more specialisation and more investment in machinery and therefore its average cost will fall.

3.4 Financial economies

: Larger firms can get cheaper money. They also have a wider variety of sources to choose from. For example, a large limited company can raise money by selling shares.

3.5 Managerial economies

: As firms expand they can afford specialist managers. As a result, efficiency is likely to improve and average costs fall.

3.6 Risk-bearing economies

: Larger firms are more likely to have wider product ranges and sell into a wider variety of markets. This reduces the risk in business.

4. External economies of scale

: the cost benefits that all firms in the industry can enjoy when the industry expands

4.1 Skilled labour

: As a result, training costs will be lower when workers are recruited.

4.2 Infrastructure

: If a particular industry dominates a region, the roads, railways, ports will be shaped to suit that industry's needs.

4.3 Ancillary and commercial services

: An established industry in a region will encourage ancillary supplier in that industry to set up close by.

4.4 Cooperation

: When firms in the same industry are located close to each other they are likely to cooperate with each other so that they can call gain.

5. Diseconomies of scale

5.1 Bureaucracy

: Larger business rely more on bureaucracy (system of administration that uses a large number of departments and officials)

5.2 Labour relations

: If a firm becomes too big, relations between workers and managers may deteriorate. Management may fail to understand workers and they may become demotivated.

5.3 Control and coordination

: A very large business may be difficult to control and coordinate.

6. Other limits to growth

6.1 Lack of finance

: Some businesses would like to grow but are not able to raise the finance needed to expand.

6.2 Nature of the market

: Some markets are too small to sustain very large companies.

6.3 Lack of managerial skills

: Some businesses may be prevented from growing because the owners do not have the managerial skills required to run a large business operation.

6.4 Lack of motivation

: Some business owners do not want to grow business. They may be happy running a small business.