ECONOMIES OF SCALE

Economies of scale are the cost advantages that a business obtains due to expansion. When economists are talking about economies of scale, they are usually talking about internal economies of scale. These are the advantages gained by an individual firm by increasing its size i.e having larger or more plants.

DISECONOMIES OF SCALE

- Diseconomies of scale are the disadvantages of being too large. A firm that increases its scale of operation to a point where it encounters rising long run average costs is said to be experiencing internal diseconomies of scale

Internal and External economies of scale

- Internal economies of scale :- lower long run average costs resulting from a firm growing in size.
- External economies of scale :- lower long run average costs resulting from an industry growing in size.

Internal and external diseconomies of scale

- Internal diseconomies of scale :-higher long run average cost arising from a firm growing too large.
- External diseconomies of scale:- higher long run average costs resulting from an industry growing too large

- **Prof. Koutsoyannis has divided the internal economies into two parts:**
- A. Real Economies
- B. Pecuniary Economies

- Real economies are those which are associated with the reduction of physical quantity of inputs, raw materials, various types of labour and capital etc.

These economies are of the following types:

1. Technical Economies:

- Technical economies have their influence on the size of the firm. Generally, these economies accrue to large firms which enjoy higher efficiency from capital goods or machinery. Bigger firms having more resources at their disposal are able to install the most suitable machinery.
- Therefore, a firm producing on large scale can enjoy economies by the use of superior techniques.

Technical economies are of three kinds:

(i) Economies of Dimension:

- A firm by increasing the scale of production can enjoy the technical economies. When a firm increases its scale of production, average cost of production falls but its average return will be more.

(ii) Economies of Linked Process:

- A big firm can also enjoy the economies of linked process. A big firm carries all productive activities. These activities get economies. These linked activities save time and transport costs to the firm.

(iii) Economies of the Use of By-Products:

- All the large sized firms are in a position to use its by-products and waste-material to produce another material and thus, supplement to their income. For instance, sugar industries make power, alcohol out of the molasses.

2. Marketing Economies:

- When the scale of production of a firm is increased, it enjoys numerous selling or marketing economies.
- In the marketing economies, we include advertisement economies, opening up of show rooms, appointment of sole distributors etc.
- Moreover, a large firm can conduct its own research to effect improvement in the quality of the product and to reduce the cost of production.
- The other economies of scale are advertising economies, economies from special arrangements with exclusive dealers. In this way, all these acts lead to economies of large scale production.

3. Labour Economies:

- As the scale of production is expanded there accrue many labour economies, like new inventions, specialization, time saving production etc.
- A large firm employs large number of workers.
- Each worker is given the kind of job he is fit for.
- The personnel officer evaluates the working efficiency of the labour if possible.
- Workers are skilled in their operations which save production, time and simultaneously encourage new ideas.

4.Managerial Economies:

- Managerial economies refer to reduction in managerial costs and proper management of large scale firm.
- Under this, work is divided and subdivided into different departments.
- Each department is headed by an expert who keeps a vigil on the minute details of his department.
- A small firm cannot afford this specialisation.
- Experts are able to reduce the costs of production under their supervision.
- These also arise due to specialization of management and mechanisation of managerial functions.

5. Economies of Transport and Storage:

- A firm producing on large scale enjoys the economies of transport and storage.
- A big firm can have its own means of transportation to carry finished as well as raw material from one place to another.
- Moreover, big firms also enjoy the economies of storage facilities.
- The big firm also has its own storage and go down facilities.
- Therefore, these firms can store their products when prices are unfavorable in the market.

B. PECUNIARY ECONOMIES:

- Pecuniary economies are those which can be had after paying less prices for the factors used in the process of production and distribution.
- Big firms can get raw material at the low price because they buy the same in the large bulk.
- In the same way, they enjoy a lot of concessions in bank borrowing and advertisements.

These economies occur to a large firm in the following:

- (i) The firms producing output on a large scale purchase raw material in bulk quantity. As a result of this, the firms get a special discount from suppliers. This is a monetary gain to the firms.
- (ii) The large-scale firms are offered loans by the banks at a low interest rate and other favourable terms.
- (iii) The large-scale firms are offered concessional transportation facilities by the transport companies because of the large-scale transportation handling.
- (iv) The large-scale firms advertise their products on large scales and they are offered advertising facilities at lower prices by advertising firms and newspapers.

External Economies:

- External economies refer to all those benefits which accrue to all the firms operating in a given industry.
- Generally, these economies accrue due to the expansion of industry and other facilities expanded by the Government.
- According to Cairncross, “External economies are those benefits which are shared in by a number of firms or industries when the scale of production in any industry increases.”
- A good example is that of coal mines in a locality.

Prof. Cairncross has divided the external economies into the following parts as:

1. Economies of Concentration:

- As the number of firms in an area increases each firm enjoys some benefits like, transport and communication, availability of raw materials, research and invention etc. Further, financial assistance from banks and non-bank institutions easily accrue to firm.
- We can, therefore, conclude that concentration of industries lead to economies of concentration.

2. Economies of Information:

- When the number of firms in an industry expands they become mutually dependent on each other.
- In other words, they do not feel the need of independent research on individual basis.
- Many scientific and trade journals are published.
- These journals provide information to all the firms which relates to new markets, sources of raw materials, latest techniques of production etc.

3. Economies of Disintegration:

- As an industry develops, all the firms engaged in it decide to divide and sub-divide the process of production among themselves. Each firm specializes in its own process. For instance, in case of moped industry, some firms specialize in rims, hubs and still others in chains, pedals, tires etc. It is of two types- horizontal disintegration and vertical disintegration.
- In case of horizontal disintegration each firm in the industry tries to specialize in one particular item whereas, under vertical disintegration every firm endeavors to specialize in different types of items. Material of one firm may be available and useable as raw materials in the other firms. Thus, wastes are converted into by-products.
- The selling firms reduce their costs of production by realizing something for their wastes. The buying firms gain by getting other firms' wastes as raw materials at cheaper rates. As a result of this, the average cost of production declines.

Significance of Economies of Scale:

(a). Nature of the Industry:

- The foremost significance of economies of scale is that it plays an important role in determining the nature of the industry i.e. increasing cost industry, constant cost industry or decreasing cost industry.

(b). Analysis of Cost of Production:

- When an industry expands in response to an increase in demand for its products, it experiences some external economies as well as some external diseconomies.
- The external economies tend to reduce the costs of production and thereby causing an upward shift in the long period average cost curve, whereas the external diseconomies tend to raise the costs and thereby causing an upward shift in the long period average cost curve.
- If external diseconomies outweigh the external economies, that is, when there are net external diseconomies, the industry would be an Increasing cost industry.