Economies of scope

- Economies of scope is a term that refers to the reduction of per-unit costs through the production of a wider variety of goods or services.
- In economies of scope, firms try to take cost advantages by providing a variety of related products to make full use of the inputs rather than specializing in the delivery of a single product. Sharing or joint utilization of inputs among similar products are the main reason for economies of scale.

- ECONOMIES OF SCOPE are present when the joint output of a single firm is greater than the output that could be achieved by 2 different firms each producing a single product
- DISECONOMIES OF SCOPE are present when the joint output of a single firm is less than the output that could be achieved by 2 different firms each producing a single product

- Economies of scope play an important role in firms decisions of what combination of goods to produce.
- Globalization has made economies of scope even more important to firms in their production decisions.

- Eg of economies of scope ;
- McDonalds can produce both hamburgers and French fries at a lower average cost than what it would cost two separate firms to produce the same goods. This is because McDonalds hamburgers and French fries share the use of food storage, preparation facilities, and so forth during production.

- Economies of scope means diversifying or expanding the product line which will result in more unit of output and profit with use of certain amount of fixed cost and resources.
- when done correctly, economies of scope can help companies gain a significant competitive advantage.

- If a single firm can **jointly** produce goods X and Y more cheaply that any combination of firms could produce them *separately*, then the production of X and Y is characterized by *economies of scope*
- **This is an extension of the concept of economies of scale to the multi product case**

- The extent to which the economies of scope can be determined by studying a firm's costs
- If a combination of inputs used by one firm generates more output than two independent firm would produce, then it costs less for a single firm to produce both products than it would cost the independent firms.
- To measure the degree to which there are economies of scope, we have to find the percentage of cost of production that is saved when two products are produced jointly rather than individually
- Degree of economies of scope is the percentage of cost savings resulting when two or more products are produced jointly rather than individually

Economies of scope can be measured by as follows:

$$SC = \frac{C(Q_1) + C(Q_2) - C(Q_1, Q_2)}{C(Q_1) + C(Q_2)}$$

Where $C(Q_1,Q_2)$ is the cost of jointly producing goods 1 and 2 in the respective quantities; $C(Q_1)$ is is the cost of producing good 1 alone, and similarly for $C(Q_2)$.

Example: Let $C(Q_1)$ = \$12 million; $C(Q_2)$ = \$8 million; and $C(Q_1,Q_2)$ = \$17 million. Thus:

$$SC = \frac{\$12 + \$8 - \$17}{\$12 + \$8} = \frac{\$3}{\$20} = .15$$

Thus joint production of goods 1 and 2 would result in a 15 percent reduction in total costs

Economies of Scope v/s Economies of Scale

Economies of Scope	Economies of Scale
Economies of scope" is relatively a new approach to business strategy, and is heavily based on the development of high technology.	"Economies of scale" has been known for long time as a major factor in increasing profitability and contributing to a firm's other financial and operational ratios.
Economies of scope is linked to benefits gained by producing a wide variety of products by efficiently utilizing the same Operations.	Economies of scale is about the benefits gained by the production of large volume of a product

Economies of scope

- COST ADVANTAGE FROM VARIETY
- PRODUCT DIVERSIFICATION WITHN SAME SCALE OF PLANT.
- SAME PLANT OR EQUIPMENT PRODUCING MULTIPLE PRODUCTS.

Economies of scale

- COST ADVANTAGE FROM VOLUME
- STANDARDISATION
- LARGER PLANT