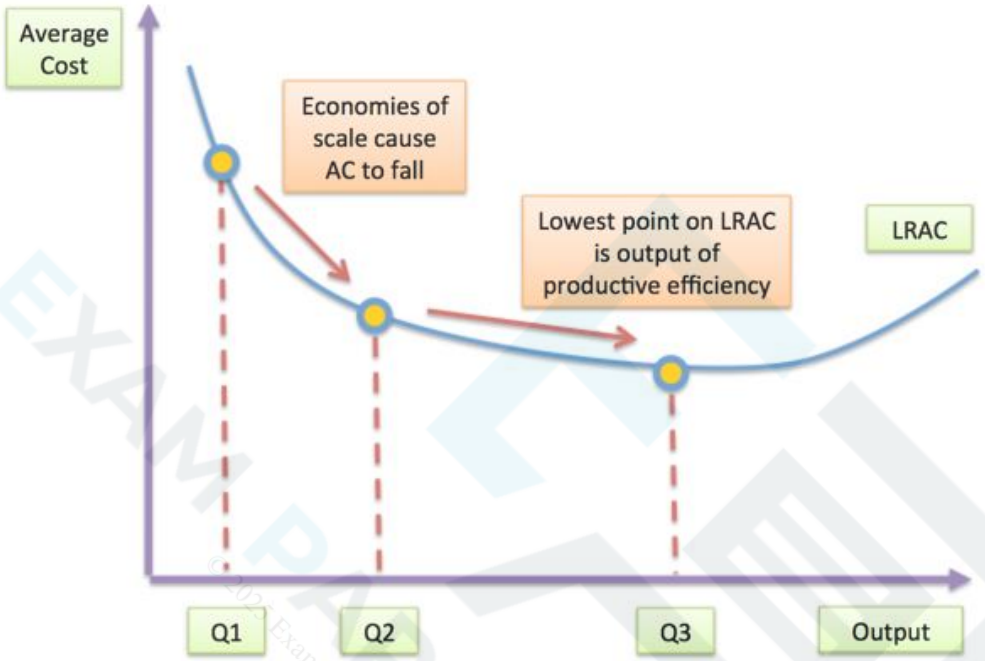
3.3.3 Economies and diseconomies of scale

- *Types of economies and diseconomies of scale*
- *Minimum efficient scale*
- *Distinction between internal and external economies of scale*

- Economies of scale are where average costs of production fall as output increases
- Total costs are spread over a greater quantity of output
- The AC curve can be altered in the long term by changing its scale of production and changing a fixed factor
- Internal economies of scale occur within a firm
- External economies of scale occur within an industry:
    - Improved infrastructure
    - More training facilities
    - More R&D
    - Agglomeration economics: the clustering of businesses
- Examples of internal economies of scale:
    - Risk-bearing: a firm can expand their product range to spread the cost of uncertainty; if one part fails, they have other parts to fall back on
    - Financial: banks are willing to lend more cheaply because they are less risky
    - Managerial: they can specialise and divide their labour which includes employing specialist managers and supervisors
    - Technological: they can afford to invest in more advanced and productive machinery and capital
        - Indivisibility of machines: some factors can be broken up such as large machines (blast furnace); there is no smaller alternative
        - Principles of multiples: large firms can afford to make us of multiple machines to achieve a high utilisation rate
        - Increased dimensions: cheaper to increase building volume than surface area
    - Marketing: they can divide marketing budgets across larger outputs
    - Purchasing: they can bulk buy, which means each unit costs them less
- Network economies of scale:
    - Gains from the expansion of ecommerce which allows large online show to cheap add extra goods
- Diseconomies of scale: when output passes a certain point and average costs start to increase per extra unit of output produced
- Examples of diseconomies of scale:
    - Control: It becomes harder to monitor how productive the workforce is, as the firm becomes larger.
    - Coordination: It is harder and complicated to coordination every worker, when there are thousands of employees.

- Communication: Workers may start to feel alienated and excluded as the firm grows. This could lead to falls in productivity and increases in average costs, as they lose their motivation

- The lowest point on the LRAC diagram is the minimum efficient scale where the optimum level of output is reached since costs are lowest and the economies of scale have been fully utilised.



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