Economies and diseconomies of scale

Economies of scale refer to lower average costs of production as a firm operates on a larger scale due to gains in productive efficiency. Average fixed costs decline continuously with larger levels of output.

Diseconomies of scale are the cost disadvantages of growth. Unit costs are likely to eventually rise as a firm grows due to a lack of control, coordination and communication.

Internal economies of scale

- Technical economies: better machinery
- Financial economies: borrow more money
- Managerial economies: allocating business functions
- Specialisation economies: division of labour
- Marketing economies: selling in bulk
- Purchasing economies: buying in bulk
- Risk-bearing: diversified product portfolio

External economies of scale

- Technological progress
- Improved transportation networks
- Skilled labour
- Regional specialisation: location reputation

Internal diseconomies of scale

- Lack of control and coordination
- Poorer working relationships
- Slack and procrastination
- Bureaucracy
- Complacency

External diseconomies of scale

- Too many businesses in one area

Small versus large organisations

- Market share - a firm's sales revenue as a percentage of the industry's total revenue
- Total revenue - value of a firm's annual sales turnover per time period
- Size of workforce - total number of employees hired
- Profit - value of a firm's profits per time period
- Capital employed - the value of the firm's capital investment for the business to function

Increase in the above = growing firm

Benefits of being small

- Cost control
- Financial risk
- Government aid
- Local monopoly power
- Personalised services
- Flexibility
- Small market size

Benefits of being large

- Brand recognition
- Brand reputation
- Value-added services
- Lower price
- Greater choice
- Customer loyalty

Internal (organic) **growth**

Internal growth occurs when a business grows using its own capabilities and resources to increase the scale of its operations and sales revenue:

- Changing price
- Effective promotion
- Producing improved or better products
- Sell through better placement
- Increased capital expenditure
- Improved training and development

External (inorganic) **growth**

External growth occurs when a business grows by collaborating with, buying up or merging with another firm:

- Faster way to grow
- Quick way to reduce competition
- Greater market share
- Working with other businesses means sharing of ideas
- External growth can help firms evolve