

MBA- I semester, paper- Managerial Economics, MB 102, TOPIC- External Economies of scale.

External Economies of scale

External economies refer to gains accruing to all the firms in an industry due to the growth of that industry. All the firms in the industry irrespective of their size can enjoy external economies. The emergence of external economies is due to localization.

The main types of external economies are as follows:

1. Economies of Concentration

When a number of firms are located in one place, all the member firms reap some common economies. Firstly, skilled and trained labour becomes available to all the firms.

Secondly, banks and other financial institutions may set up their branches, so that all the firms in the area can obtain liberal credit facilities easily. Thirdly, the transport and communication facilities may get improved considerably. Further, the power requirements can be easily met by the electricity boards. Lastly, supplementary industries may emerge to assist the main industry.

2. Economies of Information

The economies of information may arise because of the collective efforts of the various firms. Firstly, an individual firm may not be in a position to spend enormous amounts on research. However, by pooling all their resources new inventions may become possible. The fruits of the invention can be shared by all the member firms. Secondly, publication of statistical, technical and marketing information will be of vital importance to increase output at lower costs.

3. Economies of Disintegration

When the industry grows, it becomes possible to split up production into several processes and leave some of the processes to be carried out more efficiently by specialized firms. This makes specialization possible and profitable. For example, in the cotton textile industry, some firms may specialize in manufacturing thread, some others in producing vests, some in knitting briefs, some in weaving t-shirts etc. The disintegration may be horizontal or vertical. Both will help the industry in avoiding duplication, and in saving time materials.

Relationship between Internal and External Economies

No watertight compartmental division can be made between internal and external economies. When a number of firms are combined into one, external economies will become internal economies. Internal economies are due to the expansion of individual firm while external economies arise due to the growth of the entire industry. External economies are a pre-requisite for the growth of backward regions.