MBA- I semester, paper- Managerial Economics, MB 102, TOPIC-Types of Economies of Scale.

The scale of production has an important bearing on the cost of production. It is a common experience of every producer that costs can be reduced by increased production. That is why the producers are keener on expanding the size or scale of production. In the process of expansion, the producer may benefit from the emergence of economies of scale. These economies are broadly classified into two types:

1. Internal Economies
2. External Economies

Internal Economies

When a firm expands its scale of production, the economies, which accrue to this firm, are known as internal economies.

According to Cairn cross, "Internal economies are those which are open to a single factory or a single firm independently of the action of other firms. They result from an increase in the scale of output of the firm, and cannot be achieved unless output increases. They are not the result of inventions of any kind, but are due to the use of known methods of production which a small firm does not find worthwhile."

Internal economies may be of the following types:

1. Technical Economies

Technical economies are those, which accrue to a firm from the use of better machines and techniques of production. As a result, production increases and cost per unit of production decreases.

Following Prof. Cairncross, we may classify the various kinds of technical economies as follows:

a) Economies of Increased Dimensions

Certain technical economies may arise because of increased dimensions. For example, a double decker bus is more economical than a single decker. One driver and one conductor may be needed, whether it is a double decker or a single decker bus.

(b) Economies of Linked Processes

As a firm increases its scale of operations, it can properly be linked to various production processes more efficiently. For example, in order to obtain the advantage in a linkage process, both editing and printing of newspapers are generally carried out in the same premises.

In the words of Prof. Cairn cross, "There is generally a saving in time and a saving in transport costs, when the two departments of the same factory are brought closer together than two separate factories."

c) Economies of the Use of By-products

A large firm is in a better position to utilize the by-products efficiently and attempt to produce another new product. For example, in a large sugar factory, the molasses left over after the manufacture of sugar from out of the sugarcane can be used for producing power alcohol by installing a small plant.

(d) Economies in Power

Large sized machines without continuous running are often more economical than small sized machines running continuously in respect of power consumption. For example, a big boiler consumes more or less the same power as that of a small boiler but gives more heat.

(e) Economies of Increased Specialization

A large firm can divide the work into various sub-processes. Therefore, division of labor and specialization become possible. At one stroke, all the advantages of division of labor can be achieved. For example, only well-established big school can have specialized teachers.

2. Economies of Continuation

Technical economy is also realized due to al long-run continuation of the production process. For example, composing and printing of 1000 copies may cost $200; but if we increase the number of copies to 2000 it may cost only $250, because the same sheet plate which has been composed previously can be utilized for the increased number of copies also.

3. Labor Economies

A large firm employs a large number of laborers. Therefore, each person can be employed in the job to which he is most suited. Moreover, a large firm is in a better position to attract specialized experts into the industry. Likewise, specialization saves time and encourages new inventions. All these advantages result in lower costs of production.

4. Marketing Economies

Economies are achieved by a large firm both in buying raw materials as also in selling its finished products. Since the large firm purchases its requirements in bulk, it can bargain on its purchases on favorable terms. It can ensure continuous supply of raw materials. It is eligible for preferential treatment. The special treatment may be in the form of freight concessions from transport companies, adequate credit from banks and other financial treatments etc

5. Financial Economies

The credit requirements of the big firms can be met from banks and other financial institutions easily. A large firm is able to mobilize much credit at cheaper rates. Firstly, investors have more confidence in investing money in the well-established large firms. Secondly, the shares and debentures of a large firm can be disbursed or sold easily and quickly in the share market.

6. Managerial Economies

On the managerial side also, economies can be achieved; when output increases, specialists can be more fully employed. A large firm can divide its big departments into various sub-departments and each department may be placed under the control of an expert. A brilliant organizer can devote himself wholly to the work of organizing while the routine jobs can be left to relatively low paid workers.

7. Economies of Research

A large sized firm can spend more money on its research activities. It can spend huge sums of money in order to innovate varieties of products or improve the quality of the existing products. In cases of innovation, it will become an asset of the firm. Innovations or new methods of producing a product may help to reduce its average cost.

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