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Economies of scale

Key points:

- Economies of scale occur when a company’s production increases, leading to lower fixed costs.
- Internal economies of scale can be because of technical improvements, managerial efficiency, financial ability, monopsony power, or access to large networks.
- External economies are ones where companies can influence economic priorities, often leading to preferential treatment by governments.
- Diseconomies of scale can occur when a company becomes too big, lowering its production.

Types:

There are two main types of economies of scale:

1. internal
2. external.

Internal economies of scale

Internal economies result from a larger volume of production.

For example, large companies can buy in bulk. This economy lowers the cost per unit of the materials they need to make their products. They can use the savings to increase profits . Or they can pass the savings to consumers and compete on price.

There are five main types of internal economies of scale.

- **Technical** economies of scale result from efficiencies in the production process itself. For example: Large shipping companies cut costs by using super-tankers.
- **Monopsony power** is when a company buys so much of a product that it can reduce its per-unit costs. For example, Wal-Mart's "everyday low prices" are due to its huge buying power.
- **Managerial** economies of scale occur when large firms can afford specialists. For example, a seasoned sales executive has the skill and experience to get the big orders. They demand a high salary, but they're worth it.

- **Financial** economies of scale mean the company has cheaper access to capital .
- **Network** economies of scale occur primarily in online businesses. It costs almost nothing to support each additional customer with existing infrastructure. So, any revenue from the new customer is all profit for the business. A great example is eBay.

External economies of scale

- A company has external economies of scale if its size creates preferential treatment. That most often occurs with governments.For example, a state often reduces taxes to attract the companies that provide the most jobs.
- Small companies can cluster similar businesses in a small area. That allows them to take advantage of geographic economies of scale. For example, artist lofts, galleries, and restaurants benefit by being together in a downtown art district.

Diseconomies of scale

- Sometimes a company chases economies of scale so much that it becomes too large. This overgrowth is called a diseconomy of scale.
- For example, it might take longer to make decisions, making the company less flexible. Miscommunication could occur, especially if the company becomes global. Acquiring new companies could result in a clash of corporate cultures. This clash will slow progress if they don't learn to manage cultural diversity.