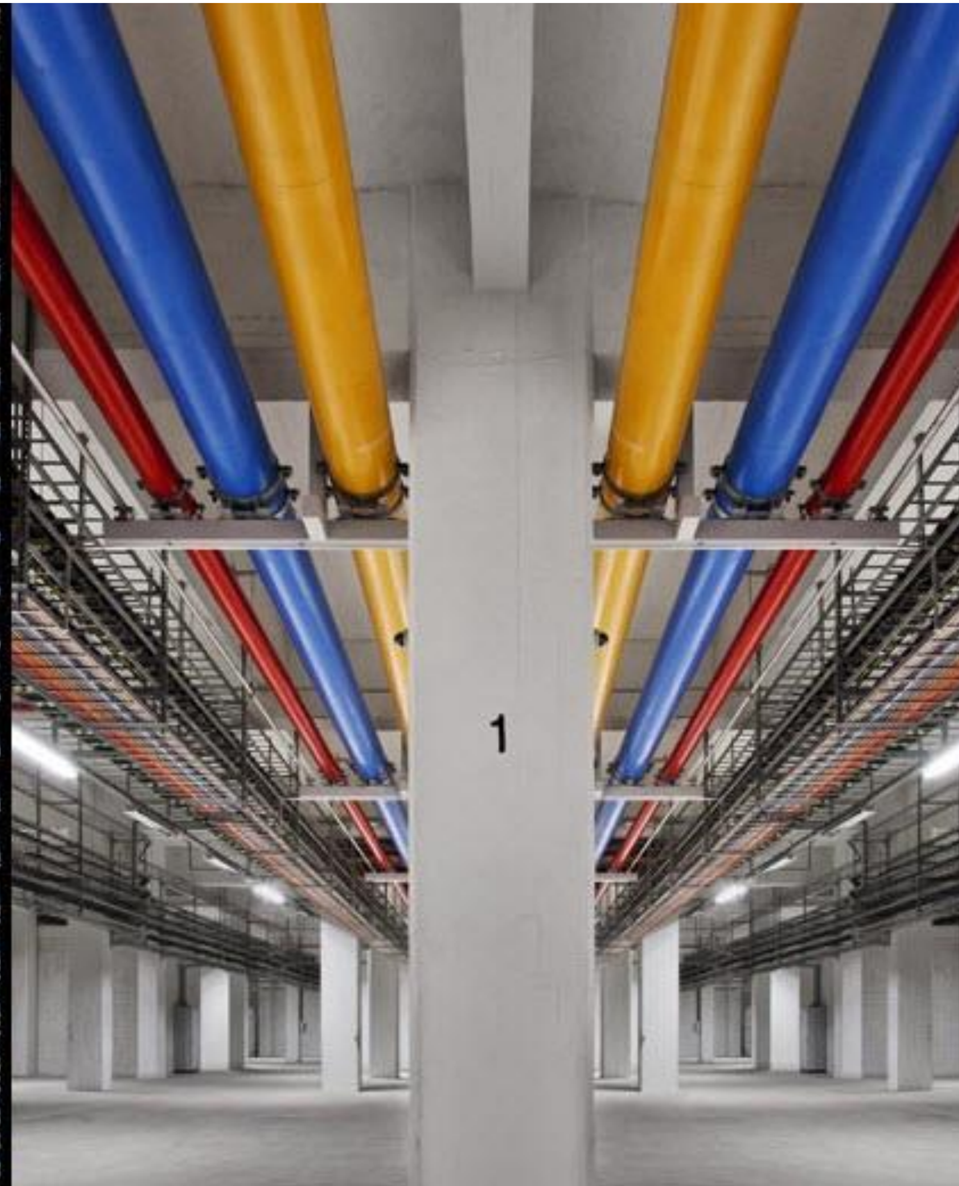
Economies and Diseconomies of Scale

Internal Economies of Scale

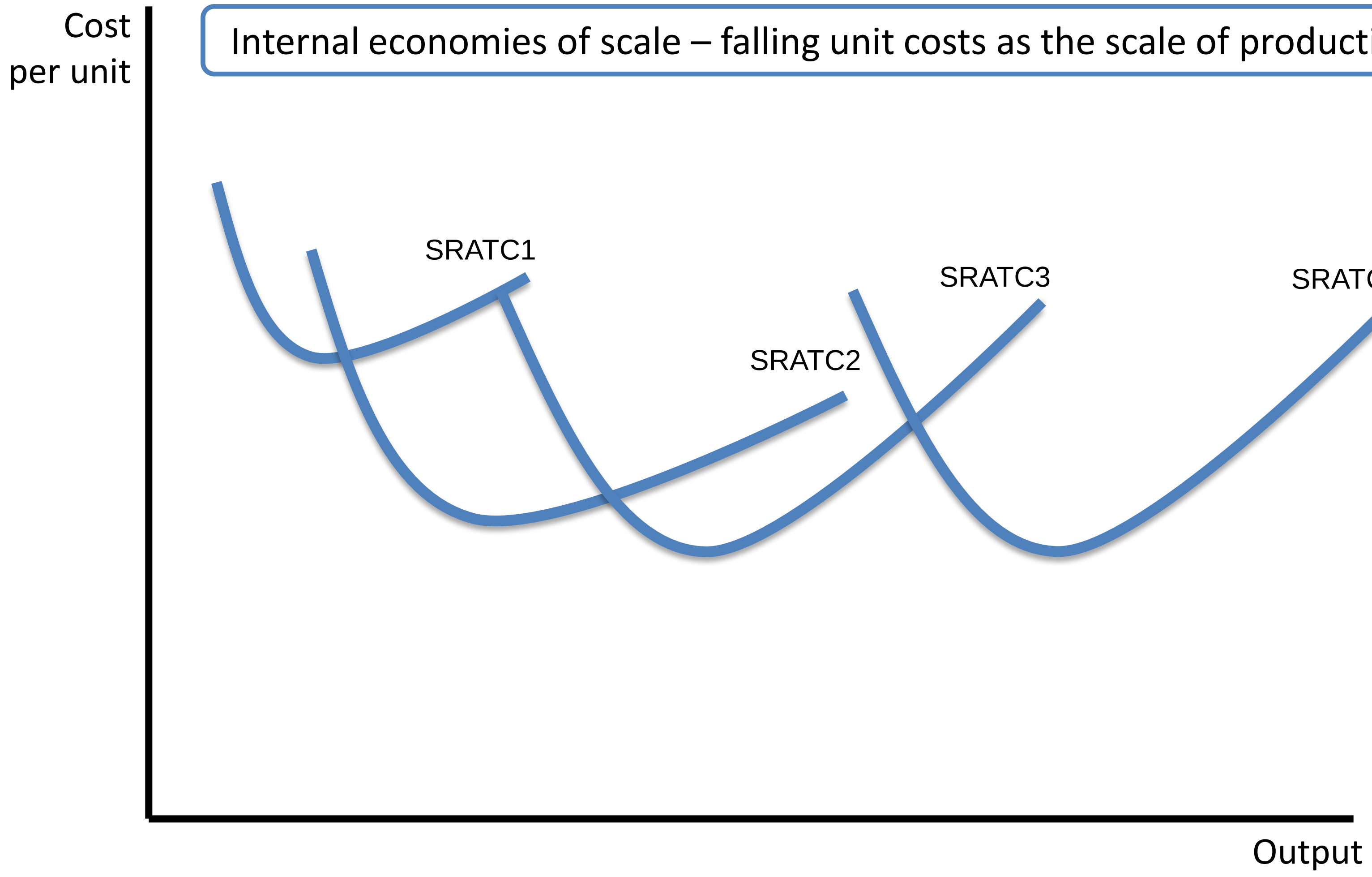
Buying economies	Buying in greater quantities usually results in a lower price (bulk-buying)
Technical	Use of specialist equipment / bulky units of capital or specialist processes to boost productivity
Risk-bearing	Grow a wider range of products and customer markets through diversification to lower market risk for investors
Marketing	Spreading a fixed marketing spend over a larger range of products, markets and customers
Network	Adding extra customers or users to a network that is already established (e.g. mobile phones)
Financial	Larger firms benefit from access to cheaper finance; smaller businesses are often credit constrained
Industry	An external economy – all competitors benefit – e.g. specialist businesses grouped close together

Servers at Google



Long Run Cost Per Unit

Internal economies of scale – falling unit costs as the scale of production grows



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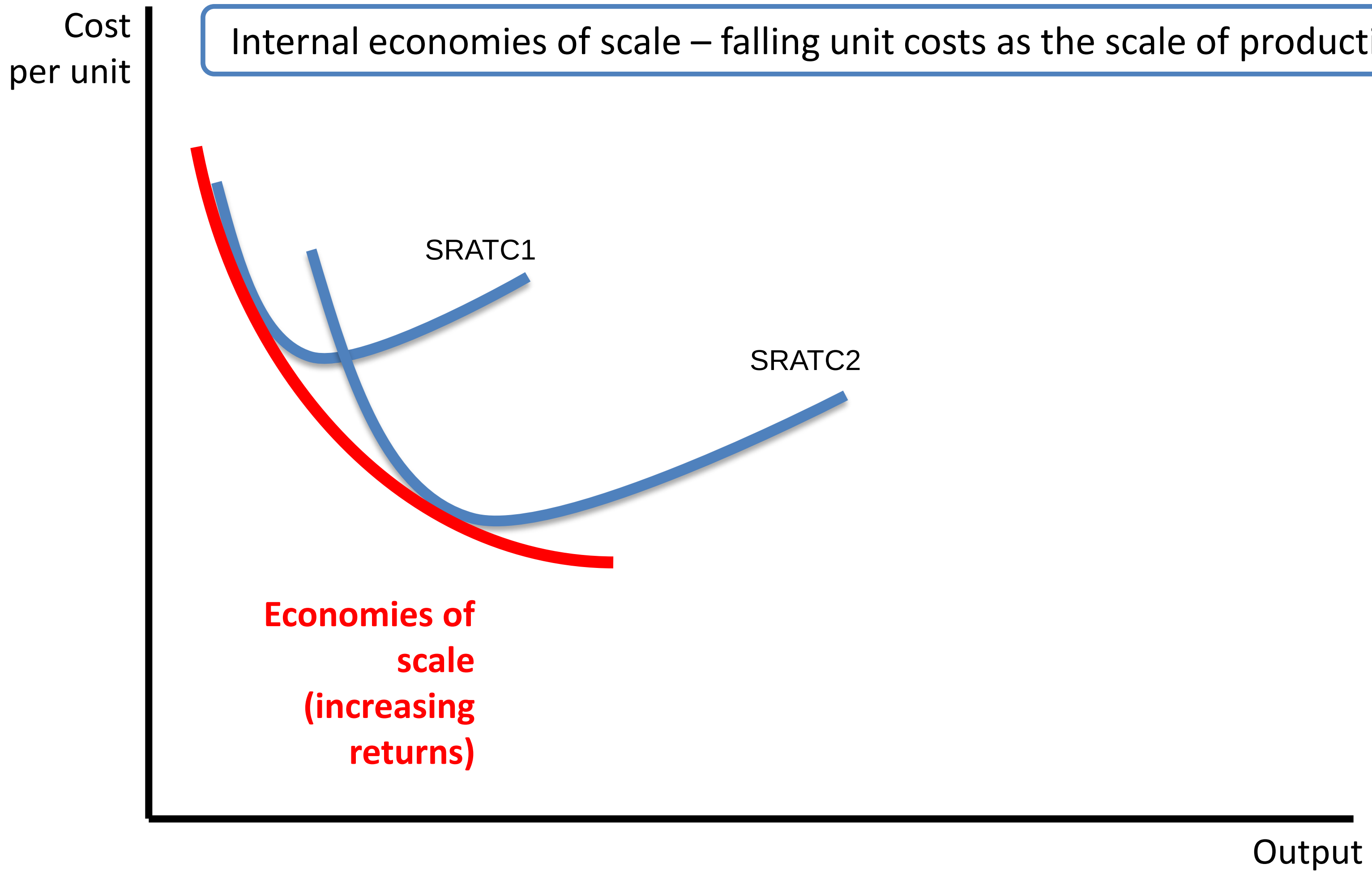
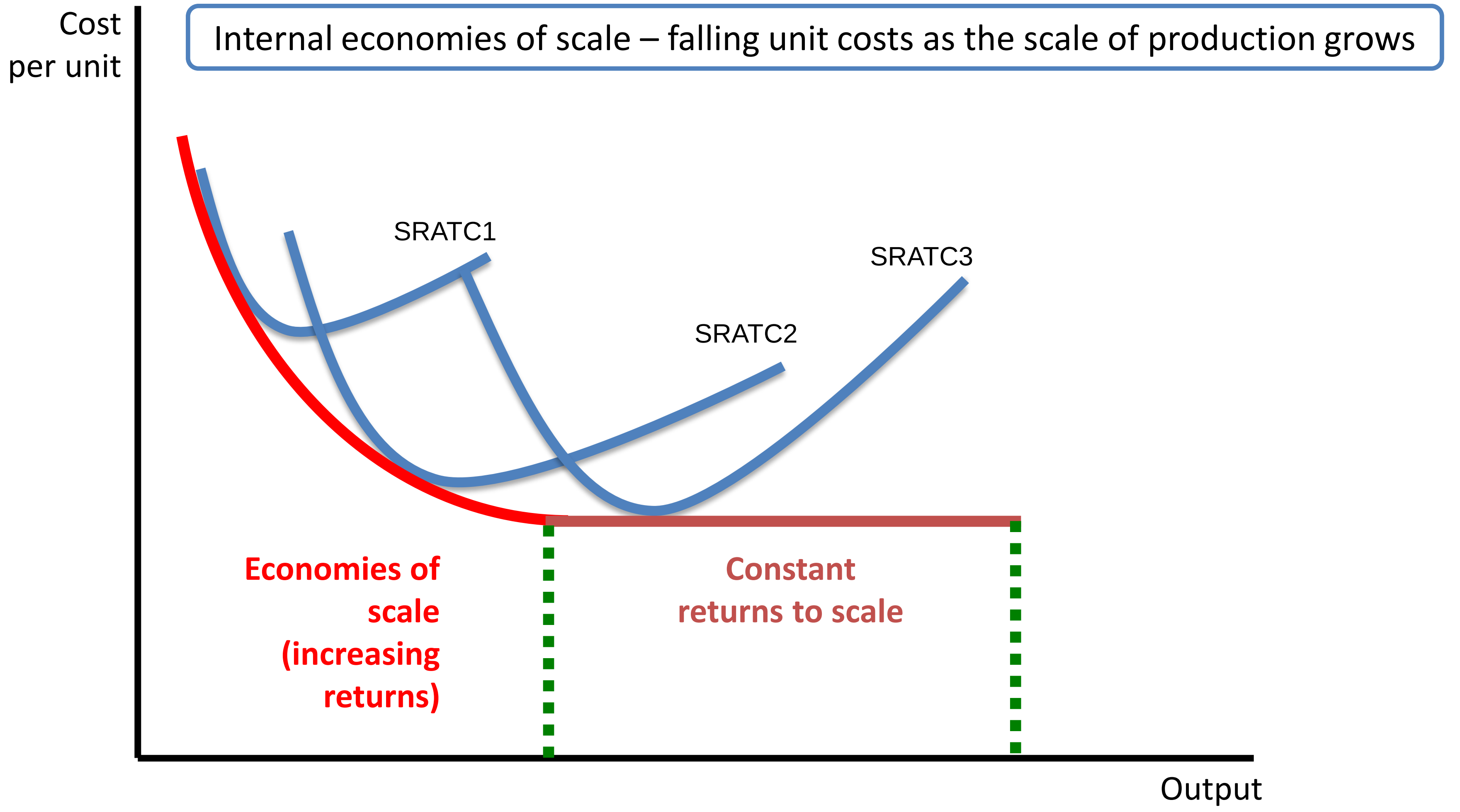
Internal economies of scale – falling unit costs as the scale of production grows



Long Run Cost Per Unit



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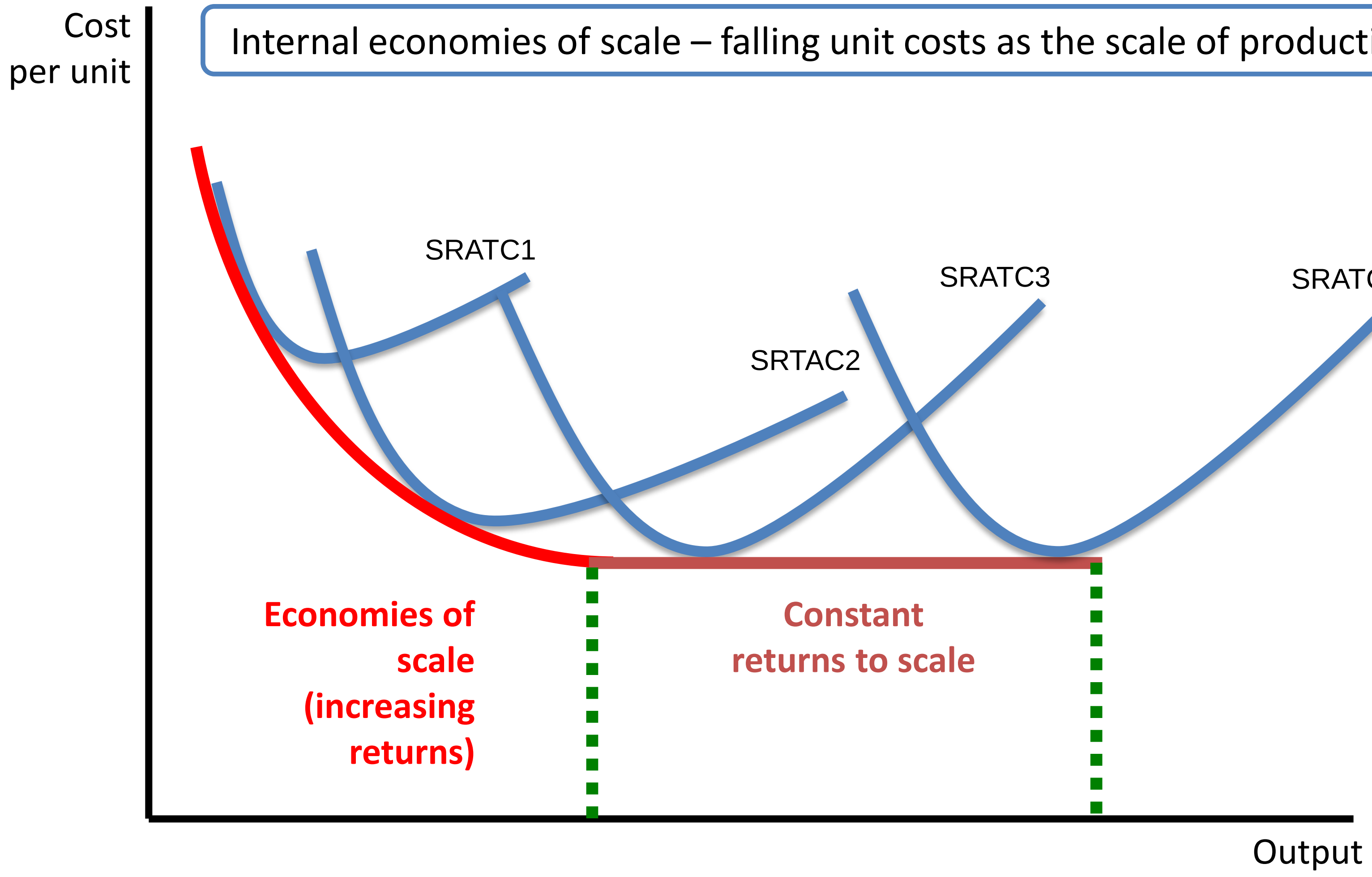

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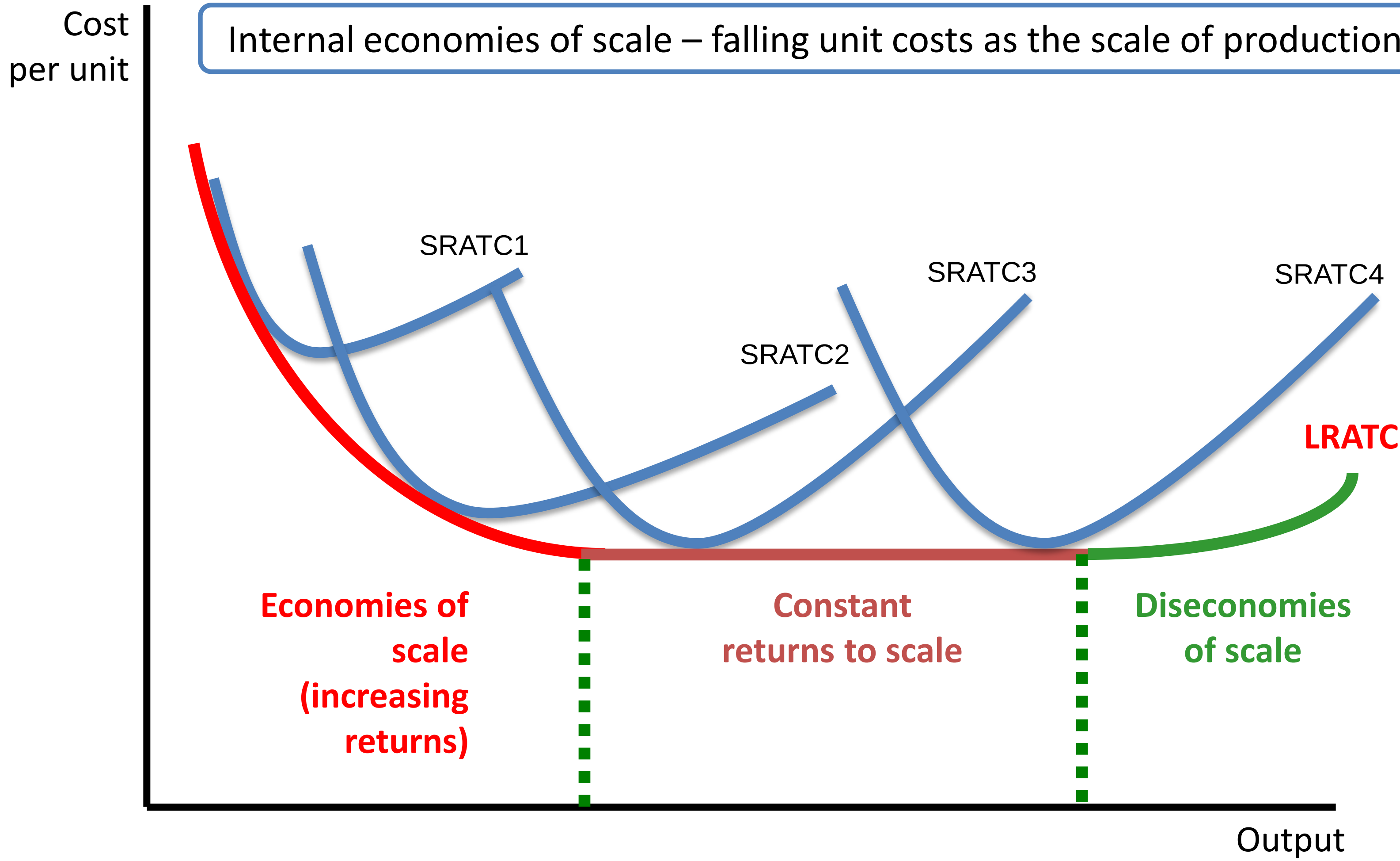
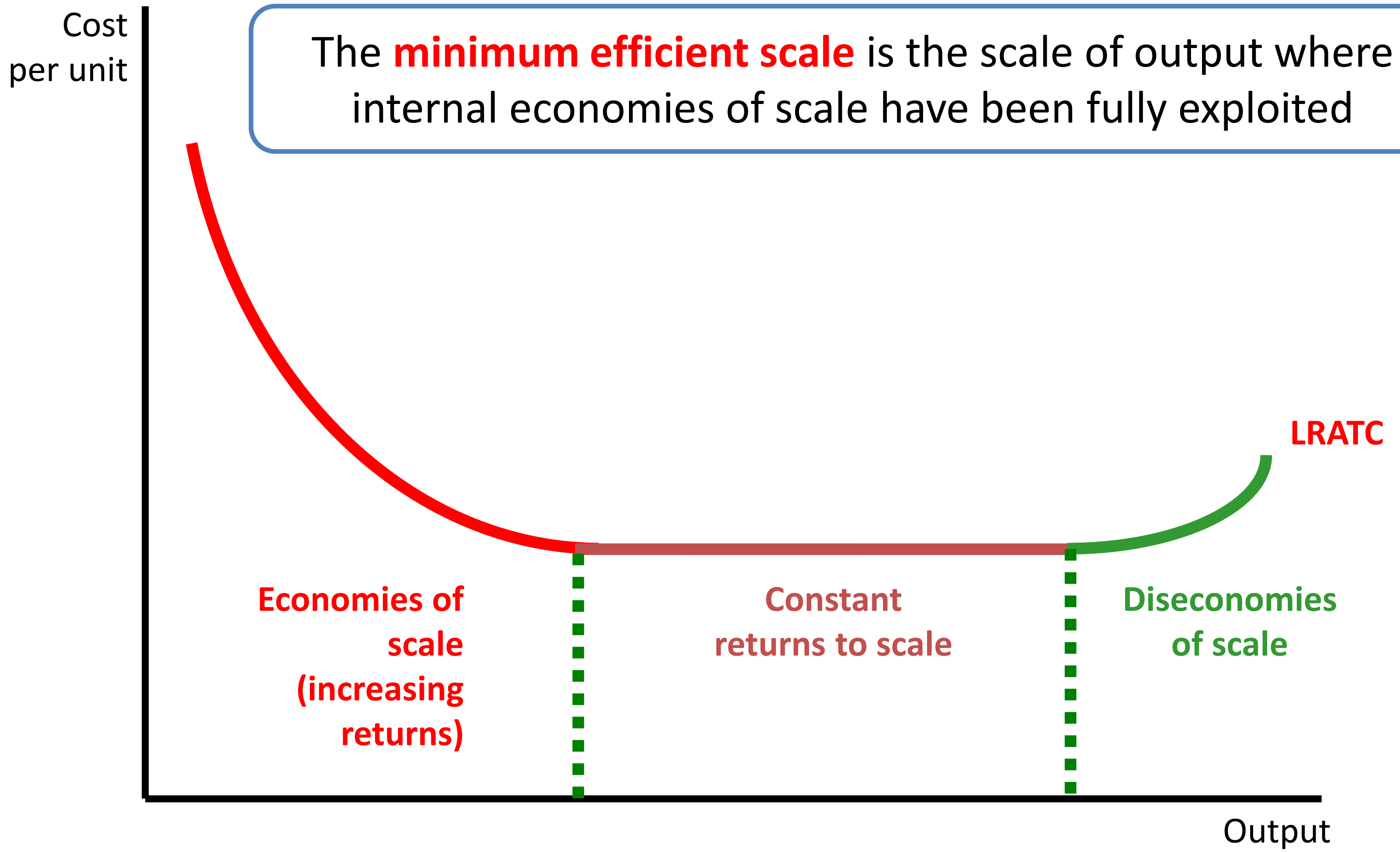
Internal economies of scale – falling unit costs as the scale of production grows

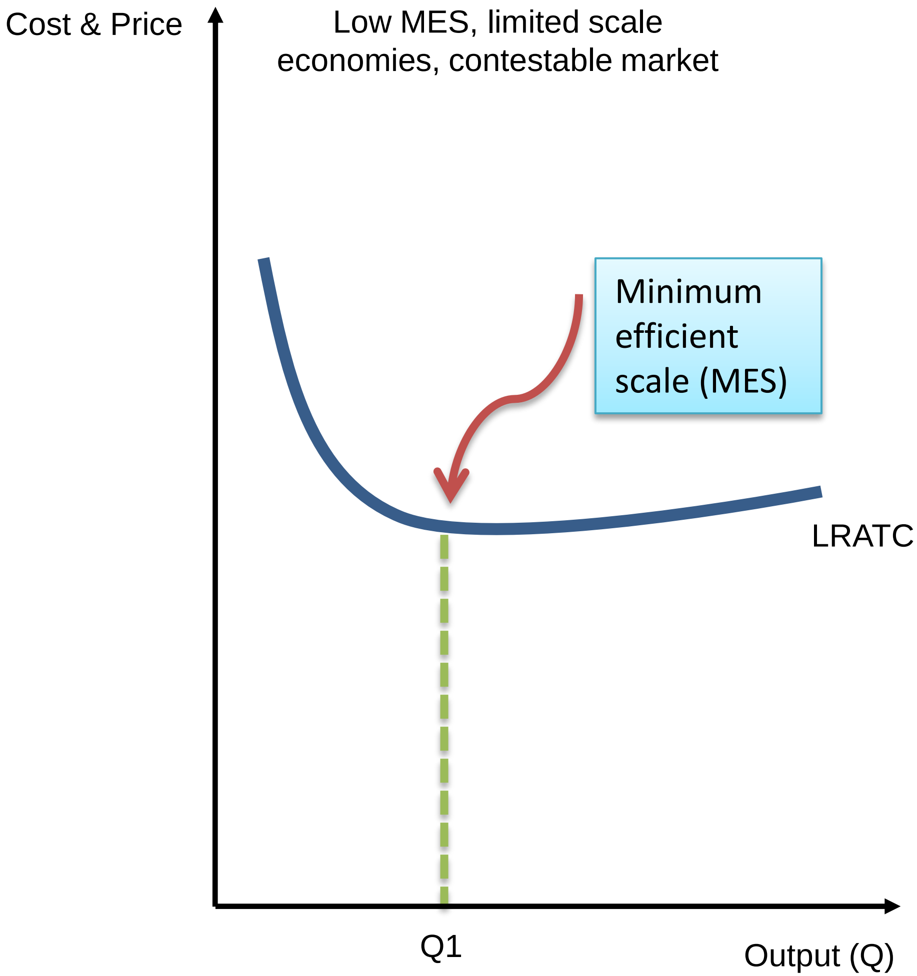


Minimum Efficient Scale (MES)

The **minimum efficient scale** is the scale of output where internal economies of scale have been fully exploited

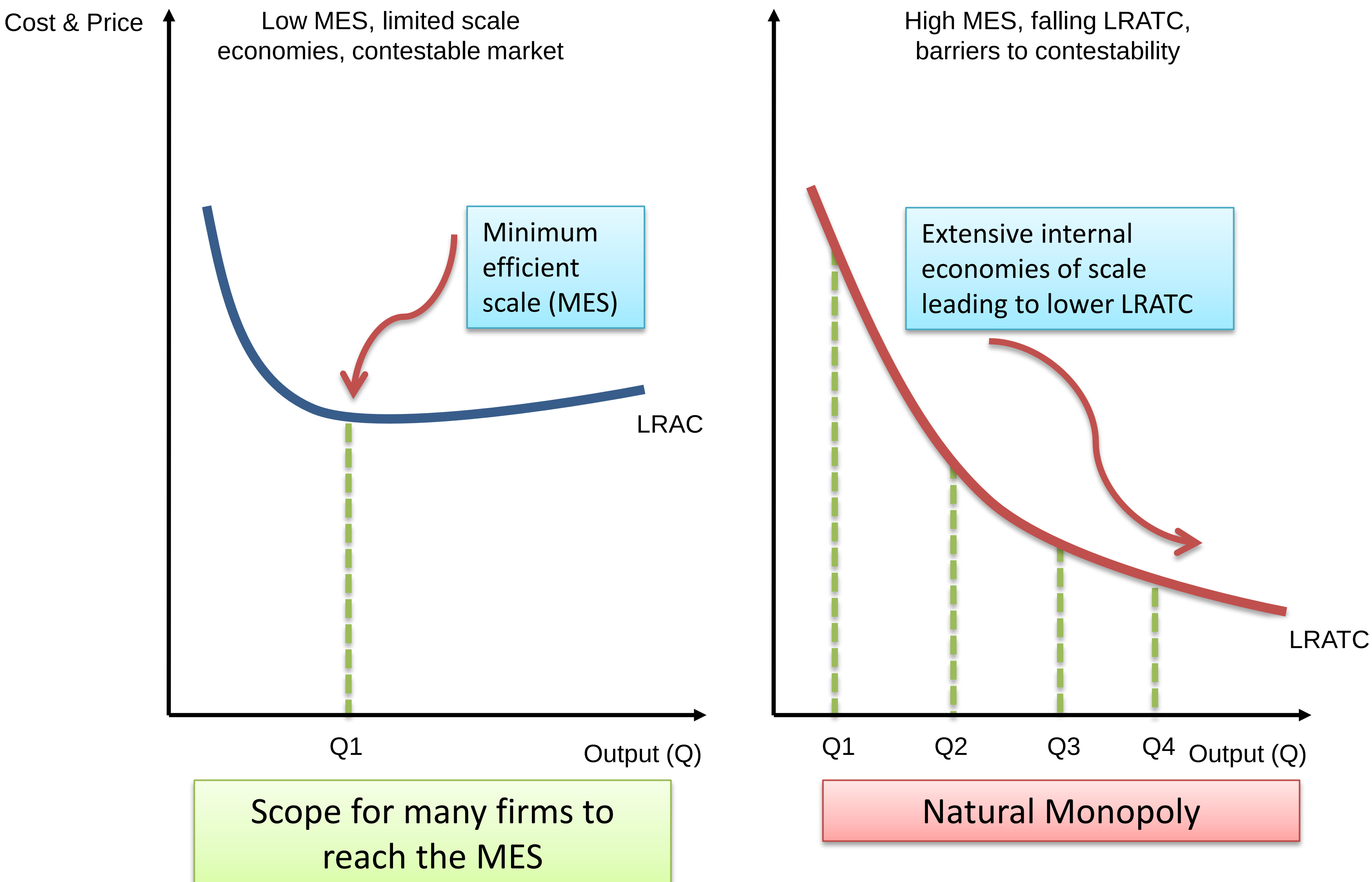


Different Shapes of Long Run Average Cost Curves

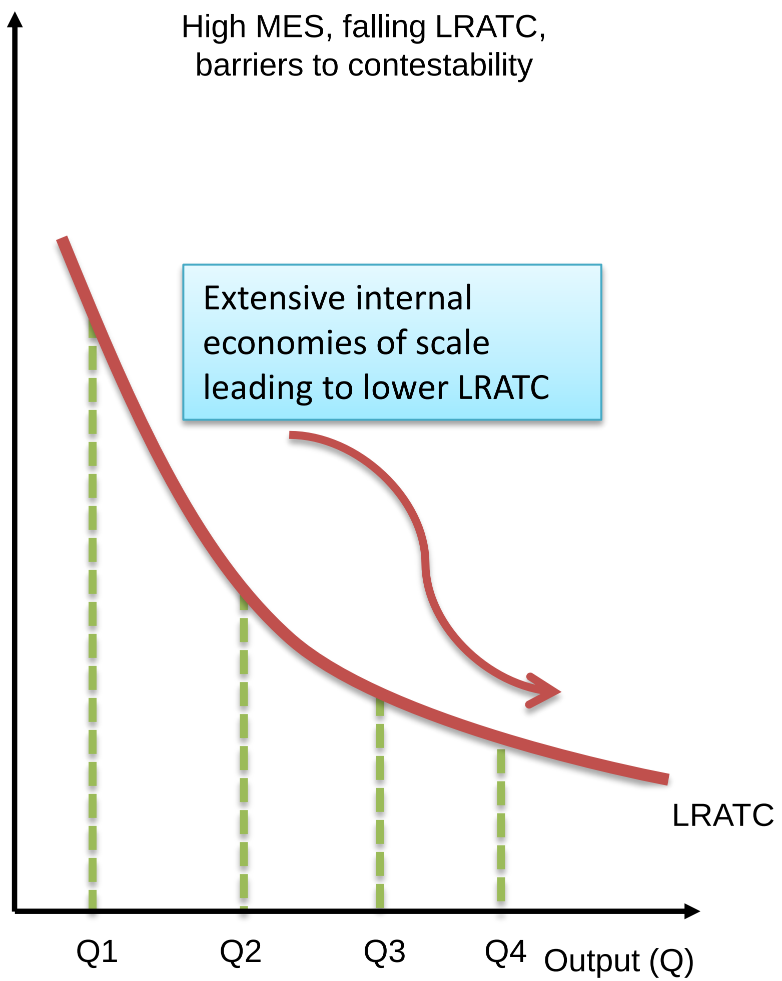


Scope for many firms to reach the MES

Different Shapes of Long Run Average Cost Curves



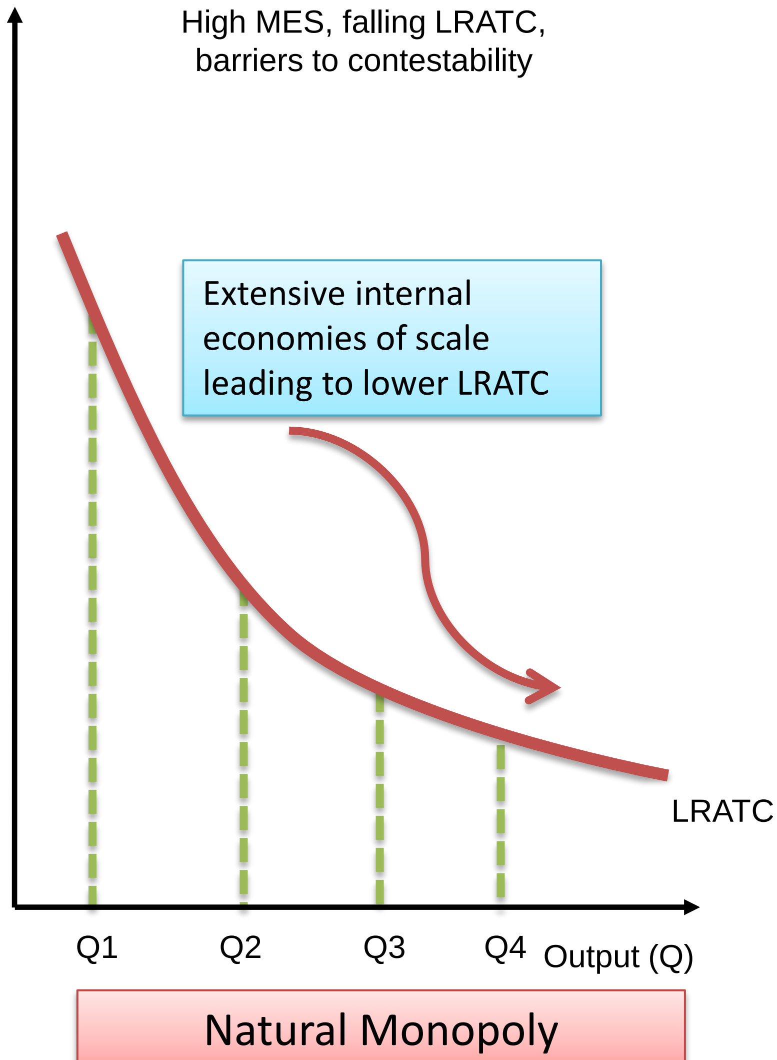
Falling LRATC for a natural monopoly



Natural Monopoly

London Underground

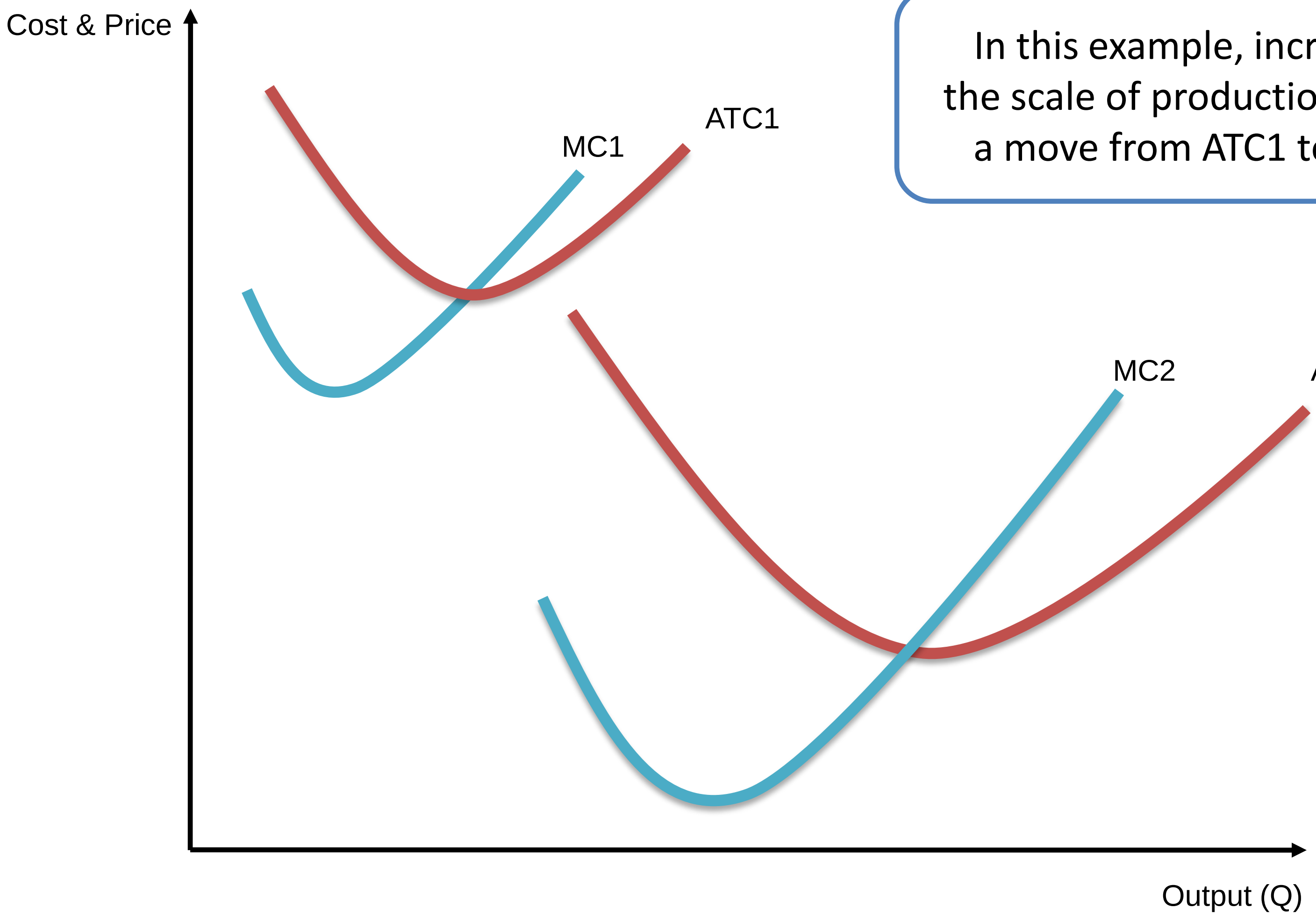
Falling LRATC for a natural monopoly



London Underground

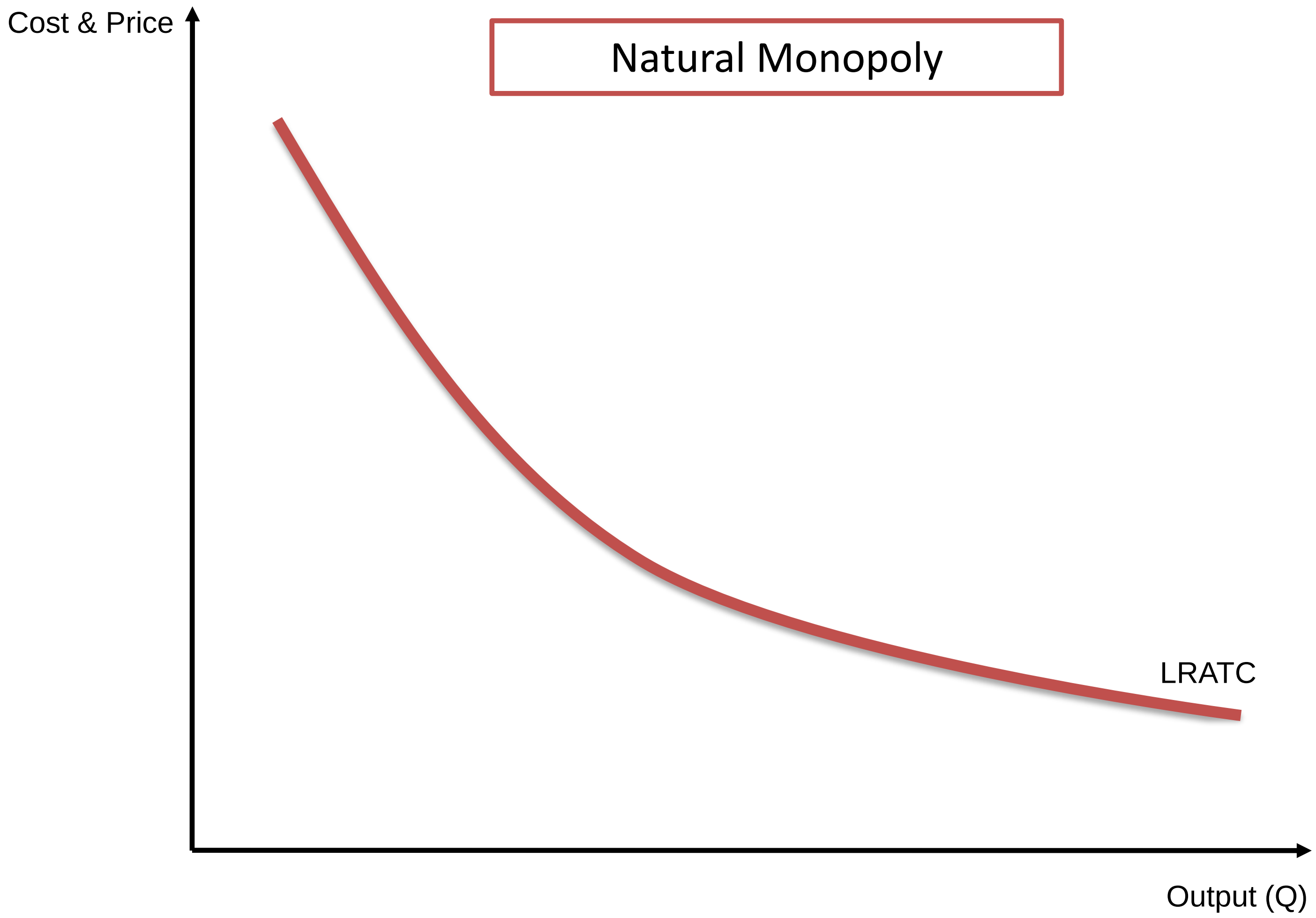
Water and Sewage Networks

Economies of Scale – Prices, Profit and Welfare

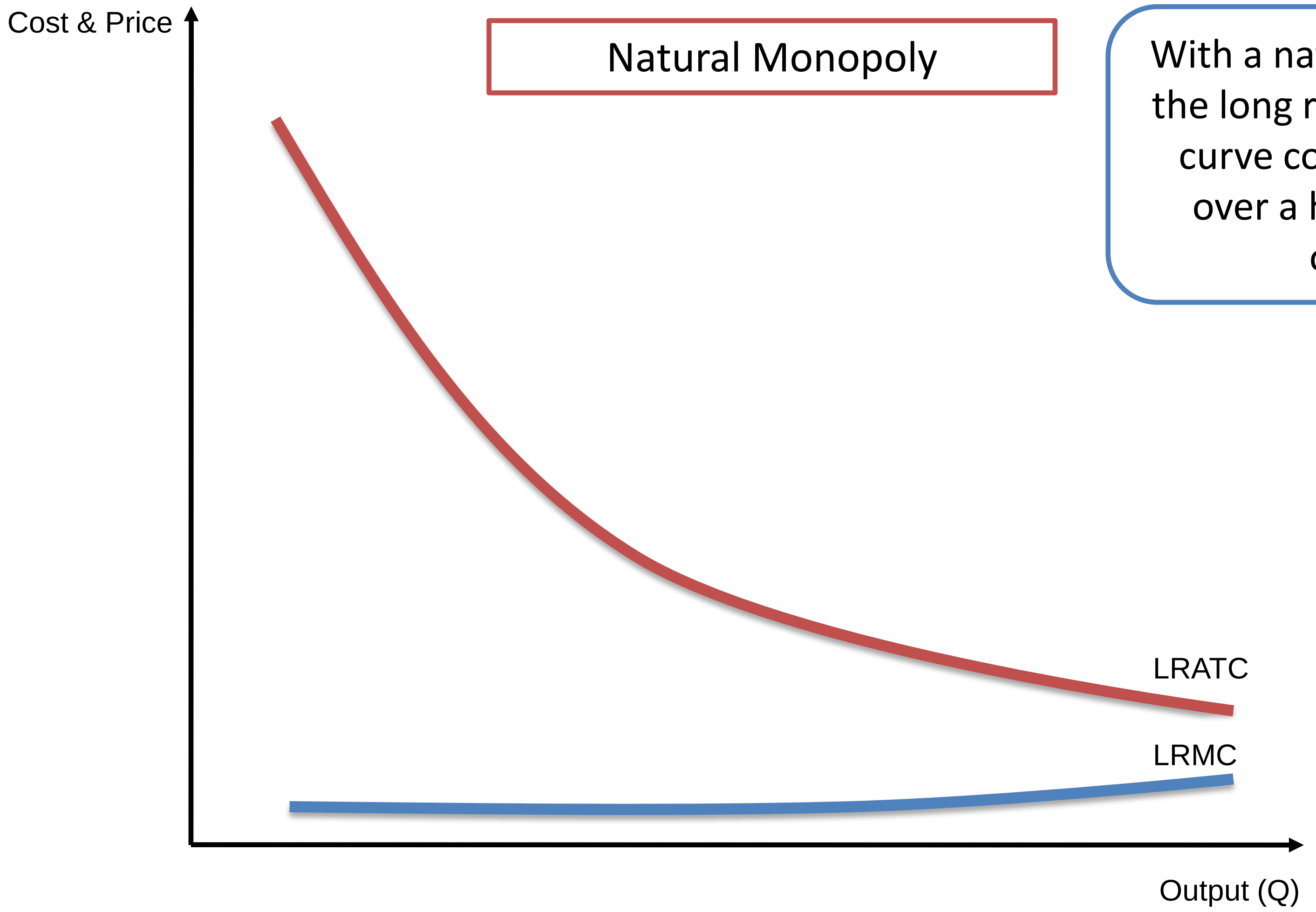


In this example, increasing the scale of production allows a move from ATC1 to ATC2

Falling LRATC for a natural monopoly

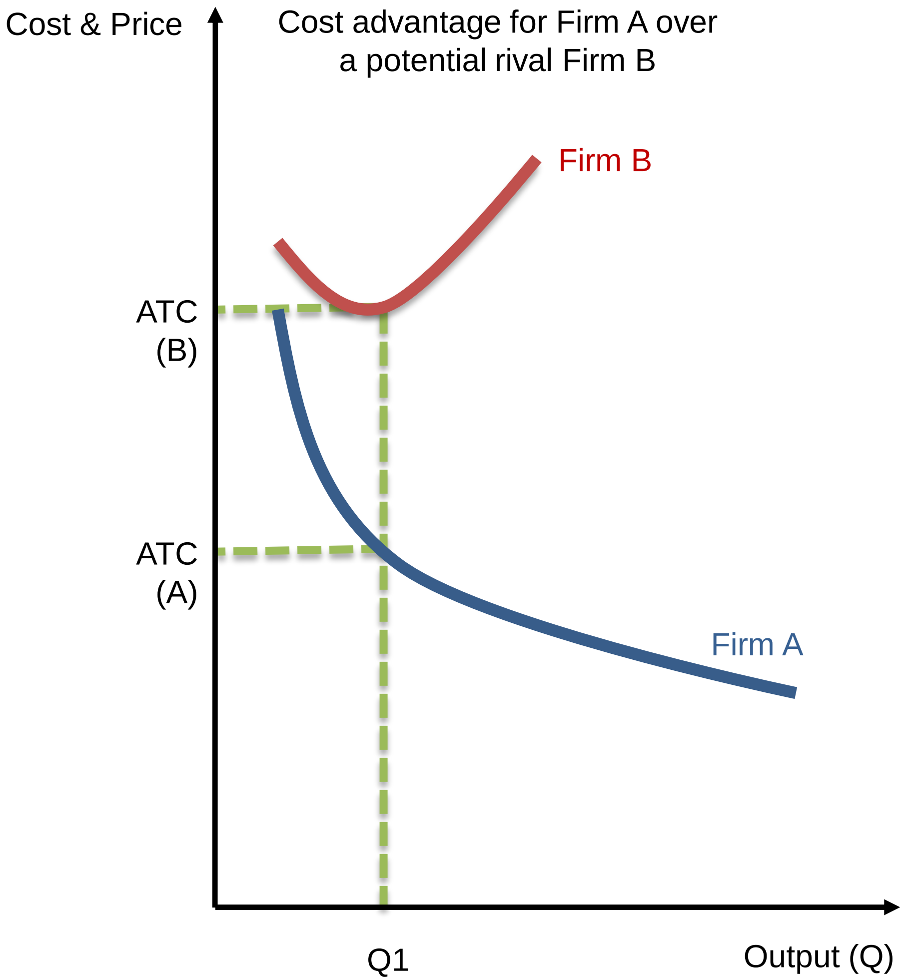


Falling LRATC for a natural monopoly



With a natural monopoly, the long run average cost curve continues to fall over a huge range of output

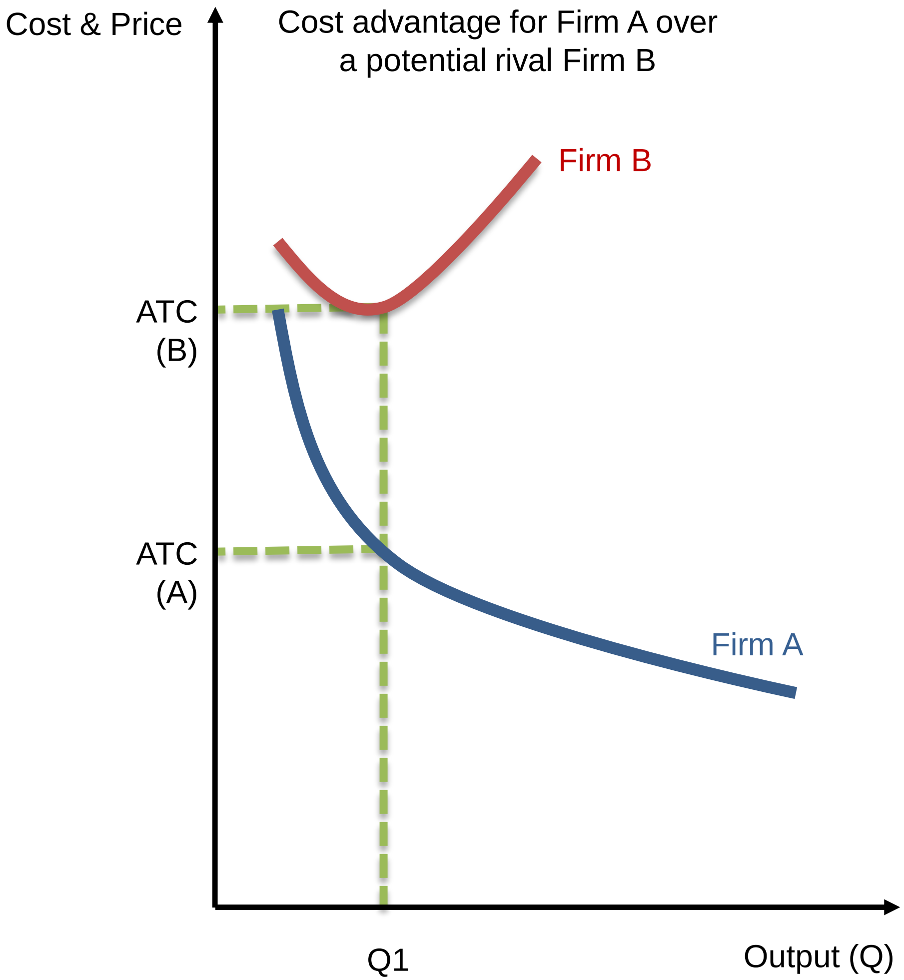
Long Run Cost Advantages for Existing / Established Businesses



At output Q1 – firm A has a big **cost advantage** over a potential rival firm B

Reasons?

Long Run Cost Advantages for Existing / Established Businesses



At output Q1 – firm A has a big **cost advantage** over a potential rival firm B

1. Learning economies
2. Vertical integration
3. Lower customer churn
4. Monopsony power

Internal Diseconomies of Scale – Rising LRATC

Factors which cause the average production cost per unit of a business to increase above the efficient level … for example

Poor communication within businesses

More difficult to control a larger, more complex business

More frequent machinery and employee breakdown if output and capacity utilization is too high

Loss of management focus, greater risk of industrial relations problems and possible strikes