# Notes 2012 Topic 9: Cost of Production

## List of Main Definitions and Concept

### Short Run

* + - The firm is constrained by a fixed maximum capacity, which means that it can only increases the variable factors of production to increase its production while one of its factors of production is held fixed.

### Long Run

* + - All the factors of production used by the firms can be changed to increase production.

### Marginal Product (MP)

* + - MP is the additional change in output as a result of additional increase in the variable factor of production.

### Average Product (AP)

* + - AP is derived from the total number of products produced divided by the total number of variable factors of production.

### Total Product (TP)

* + - TP refers to the total number of outputs produced by the total number of variable factors of production.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Fixed Factors | Variable factors | Marginal Product | Total  Product | Average Product |
| 1 | 1 | 3 | 3 | 3 |
| 1 | 2 | 5 | 8 | 4 |
| 1 | 3 | 7 | 15 | 5 |
| 1 | 4 | 9 | 24 | 6 |
| 1 | 5 | 6 | 30 | 6 |
| 1 | 6 | 0 | 30 | 5 |
| 1 | 7 | -2 | 28 | 4 |

### Factors of Production

* + - The resources used for production are known as factors of production which can be classified as land (rent), labour (wage), capital (interest) and entrepreneurship (profit).

### Fixed Factors of Production

* + - These are factors of production which cannot be varied during short run to increase production.

### Variable Factors of Production

* + - These are factors of production which can be valued during short-run to increase production.

### Fixed Cost

* + - Cost of production that is incurred due to the use of fixed factors and they do not vary with the level of output of the firm.  
      Example: interest payment of borrowing to finance business operation

### Variable Costs

* + - Cost that incurred due to the use of variable factors and the cost will vary with the level of output. Example: Wages.

### Total cost of Production

The total cost production are costs of production incurred due to the utilization of fixed and variable factors of production of goods and services.

### Long run average cost of production

The total cost of production are costs of production incurred due to the utilization of resources for the production of goods and services in the long run.

**How Production Condition Varies During Short Run**

* + - The efficiency of production during short run is measured by the law of diminishing return or law of variable proportion which is based on the change in marginal production.
    - In this production law for short run, the focus is to see how efficiency can be developed from the understanding of the combination of the fixed factors to variable factors so as to derive an optimal combination of these factors.
    - Thus, the measurement of efficiency in short run is based on the change in the value of marginal product (MP or MPPL) which is determined by the source of efficiency based on the rate of utilization of the fixed factor of production by the variable factor of production.
    - When marginal product (MP) increases, the production condition is efficient and thus experiences **increasing returns due to better utilization of the fixed factors by the variable factors of production.** As a result, the marginal cost (MC) decreases which will lead to the rise in the total cost at decreasing rate and the sharp fall in average fixed cost (AFC) and the fall in the average variable cost(AVC) which will contribute to the reduction in average total cost (ATC).
    - When marginal product (MP) decreases, the production condition is less efficient and thus, experiences **diminishing returns due to over-utilization of the fixed factors by variable factors.** As a result, the marginal cost (MC) rises which will lead to the rise in the total cost at an increasing rate and a gentle fall in average fixed cost (AFC) and a rise in average variable cost (AVC) which will contribute to a rise in average total cost (ATC).
    - When marginal product becomes negative, the production condition is inefficient and thus, experiences negative returns due to negative utilization of the variable factors. As a result, the marginal cost (MC) rises extensively which will lead to the rise in the total cost at an increasing rate and a very gentle fall in average fixed cost (AFC) and a sharp rise in average variable cost (AVC) which will contribute to a sharp rise in average total cost.
    - Production condition during **short-run**:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Production Law** | **Measurement of Efficiency** | **Basis of efficiency** | **Impact on output** | **Impact on Cost Condition** |
| Short run | Law of diminishing returns / Law of Variable proportion  Inputs are increased on a variable proportional basis where the fixed factor of production is held constant while the variable factors are allowed to increase.  In this production law for short run, the focus is to see how efficiency can be developed from the understanding of the combination of the fixed factors to variable factors so as to derive an optimal combination of these factors. | Marginal Product  Efficient as MP increases  (increasing Return)  Less efficient as MP decreases (Diminishing Return)  Inefficient as MP becomes negative  (negative Return) | Rate of utilization of capacity of fixed factors by the variable factors  Better utilization of capacity of fixed factors by variable factors  Over-utilization of capacity of fixed factor by variable factors  (use it to explain why MC rises)  Negative utilization of fixed factors by variable factors | Increase in MP – TP increase at increasing rate  Decrease in MP – TP increase at decreasing rate  MP becomes negative – TP decreases | MC decreases – TC increases at decreasing rate, AFC decreases, AVC decreases. ATC decreases  MC increases – TC increases at increasing rate, AFC decreases gently, AVC increases. ATC will increase after AVC is equal to ATC  MC rises sharply, TC increases sharply, AFC falls very marginally, AVC rises sharply,  ATC rises sharply |

## How Production Condition Varies During the Long Run

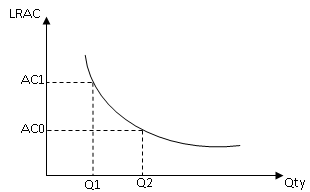
* + - The scale of production in the long run is increased on a fixed proportion basis which means that all the factors of production have to be increased at a similar proportion based on the most efficient level of capital/labour ratio in the short run.
* The production law measures the efficiency of production which shows how the scale of production will influence the rate of change in output in relation to change in input based on the influence from the economies and diseconomies of scale.
* The measurement of the efficiency of production is measured on the scale of return, based on the percentage change in output in relation to the percentage change in input, termed as **scale of return.** The source of efficiency is seen from the experience of **economies and diseconomies of scale** as scale of production increases.
* When the production level **is efficient, the firm is experiencing increasing return to scale** where the percentage increase in output is greater than the percentage increase in inputs, **made possible by economies of scale.**
  + - When the production level **is constant rate of efficiency, the firm is experiencing constant return to scale** where the percentage increase in output is same as the percentage increase in inputs, with no any influence by **economies of scale.**
    - When the production level **is inefficient, the firm is experiencing decreasing return to scale** where the percentage increase in output is lesser than the percentage increase in inputs, negatively affected **by diseconomies of scale.**
    - Table for production condition in the **long run**:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Time Period | Production Law | Measurement of Efficiency | Basis of efficiency | Impact on output | Impact on Cost Condition |
| Long Run | Return to Scale as affected by economies and diseconomies of scale  All inputs can be increased on a fixed proportional basis, implying that the percentage change in the capital and labour is of the same percentage.  The production law measures the efficiency of production how the scale of production will influence the rate of change in output in relation to change in input based on the influence from the economies and diseconomies of scale. | % change in output in relation to % change in inputs  IRTS -% increase in output > % increase inputs  CRTS - % change in outputs = % change in inputs  DRTS - % change in outputs < % change in inputs | Economies and diseconomies of scale  Economies of Scale  Neutral gain in EOS    Diseconomies of Scale | TP increases at increasing rate  TP increases at constant rate  TP increases at increasing rate | TC increases at decreasing rate  LRAC decreases  TC increases at constant rate  LRAC remains constant  TC increases at increasing rate  LRAC rises |

## 🞹Sources of Internal Economies of Scale

### 3.1 Internal Economies of Scale

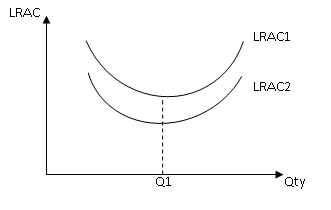
* + - Cost savings that are accrued from large scale production of the firm, contributing to the fall of the LRAC due to the firm's expansion of its output.
    - The cost saving is attained by the spread of the total cost of production over a larger number of output or the cost saving gained by lowering the rate of increase in the total cost due to lower cost of inputs. **As seen from the diagram, the average cost will fall from AC1 to Ac2 as the output increases from Q1 to Q2**

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3.2 External Economies of Scale

* + - Cost savings that are accrued to the firm as a result of the expansion of the industry that will raise the efficiency of the firm, contributing to the fall in the LRAC without any change in the production for the firm.

## The cost saving is attained by the gain of efficiency from the use of the infrastructures and facilities provided by the government and integrated activities within the industry which will lower the cost of production. As seen from the diagram, the LRAC will lower down from LRAC1 to LRAC2 as output remains at Q1.

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AC1

AC2

## Sources of Internal Economies of Scale

### 4.1 Technical Economies of Scale

* + - Can be attained as a result of technical improvement achieved in the production process due to the increase in plant size. The cost saving can be seen in these areas:
    - Greater specialization of work to reap the advantage of division of labour, increasing the productivity of the workers and hence, increase in production
    - Better process of production by linking processes so as to reduce wastage of goods and cut down the time period and increase production with the given resources
    - Enhance the capacity of machinery production to allow greater production
    - Allow the use of bigger machinery overcoming the problem of indivisibility of machinery
    - Recycling of waste product to cut down cost

### 4.2 Managerial Economies of Scale

* + - Attained by the employment of specialized workers to raise the efficiency of the firm without increasing the unit cost of production. This is achieved when the specialized staffs manage to increase the production scale allowing the spread of the total cost of production over a large quantity of output.

### 4.3 Commercial Economies of Scale

* + - Attained when the firm manages to reduce the cost of inputs by buying in bulk at favourable rates and through cost saving of advertising cost due to large scale production.

### 4.4 Financial Economies of Scale

* + - Attained when the firm is able to have cheaper source of fund to finance their business due to the size of their operation, enabling them to obtain lower interest rate in their borrowing or the issue of shares to obtain more fund.

### 4.5 Risk Bearing Economies of Scale

* + - Attained when the large firm spread risks, eliminates them though diversification in production, making the firm less vulnerable to changes in market conditions.

***It is important to explain the sources of the economies of scale based on the context of the industries such as supermarket, banking, petrol retailing stations, hospitals and others.***

**Qn: How EOS can be attained by the supermarket?**

1. **Technical EOS**

-Division of labour

-Use of machinery (point of sales system)

1. **Managerial EOS**

-Buyer-select the right product for sale in supermarket 🡪 increased sales 🡪cost of rental for production ↓

1. **Commercial EOS**

-Successful advertising

-↑sales🡪cost of goods sold↓

1. **Financial EOS**

-Borrow directly from retail market – incur low cost of borrowing for business

1. **Risk-bearing EOS**

-Different types of products for sale

-↑TR – sustain business operation

**Qn: Explain the advantage of large firm in the particular industry**

a. EOS (How LRAC is lowered)

b. Mkt adv

(Market power/forms of efficiency)

Explain how the concept of EOS affect the price and output decision.

Reap EOS – cost saving – decrease in AC and MC – decrease price and increase in output – raise competitiveness and create BTEs

## Sources of External Economies of Scale

* + - Sources of cost reductions, which accrue to the firm from the growth in the size of the industry.
    - The firm's cost per unit of output decreases as the size of the whole industry grows. Firms, regardless of size, benefits from expansion of the industry.

### 5.1 Economies of Concentration (Network system – CTE,PIE)

* + - When an industry is concentrated, firms benefit from the concentration of resources, facilities and infrastructures. All these facilities will help the firm increases its efficiency and lower cost of production for the whole industry.

### 5.2 Economies of Information (R&D)

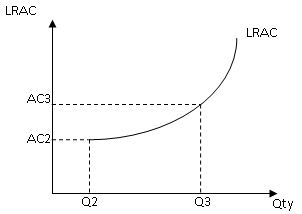
* + - Derived from the publication of trade and technical journals, central research institutions. These efforts will help the firm gain greater knowledge to raise its efficiency and improves its productivity in many aspects, lowering cost of production.

### 5.3 Economies of Disintegration (Outsourcing - handphones)

* + - Allows the firms to split certain parts of production and source for inputs, which can be produced by the common suppliers. The supplier of these inputs can gather the total production and concentrate the production to bring down the cost of these inputs.

## Sources of Internal Diseconomies of Scale

* + - Internal diseconomies of scale occur as the firm becomes inefficient of production when it exceeds certain level of production beyond its efficiency level of production. This will lead to a rise of the average cost of production as seen from the diagram as the average cost rises from AC2 to C3 as output increases from Q2 to Q3.



### 6.1 Administrative Diseconomies of Scale

* + - Occur due to weak coordination as there are too many departments in the firm. This will create weak control and coordination in the organization, leading the rise of inefficiency and average cost of production too.
    - Too many operational procedure – waste time and incur more manpower cost

### 6.2 Managerial Diseconomies of Scale

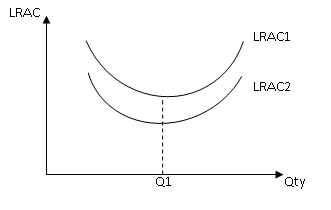
* + - Conflicts due to different organization cultures
    - Occur due to the complexity of decision-making and frictions among the various departments due to the size of the firm. The various departments have different perspectives, and conflicting aims and thus this undermines the efficiency of the organization. This will lead to the rise of the average cost of production.

### 6.3 Low labour morale

### As the firm grows too big, hierarchy alienation is seen as the lower level workers feel a sense of loss. The absence of a sense of belonging undermines the morale of the workers and interest in their work. Consequently, the productivity of the organization will decrease. Workers trapped in a repetitive, mundane job with limited interests in success of firm, decrease quality and increased cost in quality control.

## Sources of External Diseconomies of Scale

* + - It occurs when the industry is over-stretched in term of resources and facilities; the cost of production will rise throughout the industry as the inefficiency will affect the productivity of the firm. **As seen from the diagram, the LRAC will rise from LRAC1 to LRAC2 without any change in the output of the firm.**

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7.1 Excessive use of resources

* + - Increasing demand for factors of production creates stress on the availability of resources, demanding the cost of resources to rise, such as labour cost as the issue of scarcity arises.

7.2 Rise of externalities

* + - Third party effects
    - Stress on facilities will lead to the rise of externalities, raising the cost of production for the society and the industries For example, pollution and traffic congestion

7.3 Excessive Competition

* + - Increase wage cost of workers
    - Greater competition will mean the there will be greater wastage in the form of excessive advertising which will only increase the cost of production but no increase in the demand

## 🞹Reasons for the Survival of Small Firms

### 8.1 Nature of Product (niche market) – raise consumer satisfaction

* + - Some services require personal attention, such as a haircut, tailoring, shops selling accessories, etc. Individual attention is required to cater to the needs of the customers. In most cases, such services cannot be handled by machines as the goods cannot be standardized, i.e. mass production is not possible. Craftsmanship is vital, e.g. ladies' fashion, costume, watches and jewellery, hand-printed batik, etc.

### 8.2 Skills of the Entrepreneur – improve adaptation to changes

* + - If the entrepreneur is highly educated, knowledgeable and skilful, he would be able to improve the productivity of the organization. He will ensure the survival of the small firm.

### 8.3 Geographical Location

* + - The small firm will be able to provide the consumer convenience as it will locate itself near to the consumer.

### 8.4 Adaptability and Flexibility

* + - The adaptability and flexibility of small firms make it attractive for small firms to remain small. The firm can adapt easily to changing economic conditions. Their factors of production are not specialized as in the case of the larger firms, like the blast furnace of an iron and steel mill which cannot be used for other purpose.

However, firms can still be big despite the need of personal services🡪can standardize services – can conduct mass sales

### 8.5 Disadvantages of Large Firms

* + - Development of a bureaucratic organization
    - Extensive division of labour (will lead to lower productivity)
    - High wages for professionals
    - Intense and hence expensive competition
    - increasing risks (unwillingness to undertake risks can also deter expansion)

**Qn: Explain why small firms can proliferate despite the challenges of big organization**

**Explain why monopolistic competitive form of market structure prevails despite its inefficiency** (adv of small firms)

**Explain why small firms can proliferate despite the challenges of big organization**

Introduction – features of small firms / state that the advantages of small firm will help them overcome the competition from large firms

Main body

approach 1 –identify all possible challenges of bid firms (1 para)

* how small firms will react to overcome the challenges (advantages of small firms) ( 3 or 4 points)

approach 2 – identify one source of challenges / identify and explain how small firm overcome the challenges due to its advantage

Conclusion

### **10.2.1 How the Increase in Fixed Cost will Affect the Cost Condition in the Short Run**

* + - Increase in the use of fixed factors will induce an increase in the fixed cost of production and thus, an increase in cost of production in the short run.
    - If the increase in fixed cost is in terms of capital expenditure, it will raise the productivity of the variable factors of production, the marginal product will increase, contributing to the fall in the average fixed cost of production and average variable cost of production and average variable cost of production which means that the average total cost will fall too.
    - However, if the increase in fixed cost is in terms of expenditure like advertising, the impact on the average cost condition will depend on the success of the advertising campaign. In the case when it fails to achieve success where the demand does not increase, the total number of production will not increase. Hence, average fixed cost and average variable cost will rise and thus, contributing to the rise in average cost of production.

R&D

↑productivity🡪MP↑🡪↓AC

AC=AFC+AVC

↑ Advertising

a. Not successful

-output will not ↑

-AFC will not ↓ extensively

b. Successful

-output ↑, ATC ↓

-↓ATC = TFC/Q

## 11. Distinguish Between Short-Run and Long-Run

Note: the comparison must be made on the basis of a variable that allows the differentiation of the two types of production periods

### Definition

In the short run, the firm is constrained by a fixed maximum capacity, which means that it can only increases the variable factors of production to increase its production while one of its factors of production is held fixed. As for the long run, it is the production time period in the production process whereby all the factors of production used by the firms can be changed to increase production.

The time period is not definitely defined but it is based on the nature of the economy.

### How the Production Capacity will Vary (How will input vary in SR/LR)

In the short run, the firm can only increase the variable factors of production while keeping the quantity of the fixed factors of production constant when it increases the production capacity. In doing so, the production is increased at a variable proportion. As for the long run, the firm can increase the production by changing all the factors of production but the rate of variation must be changed at a fixed scale of production, implying that both the labour and capital employed must be changed at a similar percentage.

### The Production Law that Influence the Efficiency in the Two Time Periods (How efficiency is measured in the 2 time periods)

In the short run, the law of diminishing return will be the production law that explains how the production efficiency is measured by the variation of marginal product as production is increased with the use of more variable factors of production. As for long run, the return to scale will be the production law that explains how the production efficiency is measured by examining the percentage change in the level of output in comparison to the percentage change in the level of inputs.

As MP increases, the production in the short-run is considered efficient while the MP decreases or becomes negative, it is considered less efficient and inefficient respectively. As for the long run, the production is considered efficient when the percentage change in the output is greater than the percentage change in input while the production is considered inefficient when the percentage change in output is less than the percentage change in input.

### The Source of Efficiency that Influences the Law of Production in Short Run and Long Run

In the short run, the efficiency is based on the rate of utilization of fixed factors by the variable factors. There is better utilization of resources when the production is efficient, over-utilization when the production is less efficient and negative utilization when the production is efficient. As for the long run, the source of efficiency in derived from the economies of scale which is the cost saving and gain in production attained as a result of large scale production. There are economies of scale to be gained when the firm is efficient and there are diseconomies of scale when the firm is inefficient as production increases.

## 12. Distinguish between Internal and External Economies of Scale

Note: the comparison must be made on the basis of a variable that allows the differentiation of the two types of economies of scale.

### Definition of Economies of Scale

It refers to cost savings and gained in production accrued to a firm in the production of output resulting in returns to scale.

### The Difference in Definition between Internal and External Economies of Scale

Internal economies of scale are cost savings that are accrued from large scale production of the firm which will contribute to the fall of the LRAC as result of the firm’s expansion of its output. The cost saving is attained by the spread of the total cost of production over a larger number of output or the cost saving gained by lowering the rate of increase in the total cost due to lower cost of inputs. As for the external economies of scale, there are sources of cost reductions, which are accrued to the firm from the growth in the size of the industry. The firm’s cost per unit of output decreases as the size of the whole industry grows. Firms, regardless of size, benefit from expansion of the industry.

However, when the firm exceeds a certain production level, the diseconomies of scale will set in. Similarly, the diseconomies of scale will set in when the industry’s resources capacity is over-stretched and thus contributes to inefficiency.

### Sources of Internal and External Economies of Scale

The sources of internal economies of scale can be classified as technical economies of scale, managerial economies of scale, financial economies of scale, commercial economies of scale and risk-bearing economies of scale while the external economies of scale can be seen from the gain from the concentration of facilities and resources, concentration of information and disintegration of industries.

### Impact on the Cost of Production

When internal economies of scale occur, the production level of the firm will increase which will allow the total cost to be spread over a larger number of outputs and this will contribute to the fall in long run average cost of production. As for external economies of scale, it will occur when there is greater efficiency in the industry as whole and there is a reduction in the long run average cost while the firm’s production level remained unchanged.

### Reasons for the Merger and Acquisition of Firms

1. To reap the advantages of economies of scale – only possible under certain situation (business which are of the same nature)
2. To raise the profile of the organization when a firm takes over the brand name of another company – Lenovo buy over IBM
3. To attain rationalization of capacity of production - ↑pdn to lowest AC level
4. Increase market share by taking over the share of the market of the competitors when there is horizontal integration.
5. To provide greater control over the consumer market when there is vertical forward integration
6. To provide greater control of the supplier of goods and resources for backward integration
7. To create greater stability for the company when it is more diversified.
8. To spread risk over products, market and sources of supply to cut down loss due to the instability of the market.

### 12.6 Possible Problems Encountered during Mergers and Acquisition

1. Possible intervention by the government as it creates social problems due to consumer exploitation (charging at higher price) as there is the development of market power and the impact of retrenchment.
2. May not be able to attain economies of scale due to complexity of the organization and differences in the production and distribution channel
3. May experience diseconomies of scale when the firm expands beyond the optimum level of production.
4. Over-stretch the firm’s resource capacity and thus leading to possibility of business failures. (↓availability of business resources)

12.7 🞹Is merger beneficial to the society?

* It is beneficial because:
  + - Provide greater stability to the economy as it may provide essential resources or services and employment to the economy
    - Improve quality of products 🡪 ensure supply of goods
* It is detrimental to the economy because:
  + - May create market power that will undermine the interest of the consumer as market power promotes consumer exploitation in term of higher price setting and compromise in the quality of product
    - Higher degree of market power will mean a higher level of allocative and production inefficiency as the firm produces at the level of excess capacity when it set production equilibrium at profit-maximizing level.
    - May lead to inequity as the shareholders of the firm will enjoy supernormal profit that will widen the income disparity
    - Possible high level of retrenchment as a result of the need to rationalize the capacity of production to optimal level
* **Allocative inefficiency** refers to the presence of welfare loss termed as deadweight loss when the firm is selling the good at a price above the marginal cost (additional cost needed to produce the additional cost) – P>MC, implying a condition of consumer exploitation
* **Production inefficiency** refers to the condition when the firm is unable to produce the good at the minimum average cost of production (production @ Q≠min AC)

**12.8 Impact of Merger** (Firm, Society, Consumer)

12.8.1 Impact on the Firm

a) Benefits to the Firm

* Firms can reap Economies of Scale to lower average cost of production, enabling the firm to raise profitability
* Expand the size of market as a result of a larger market share
* provide sizeable market demand which will provide the incentive for the firm to engage in research and development to raise product innovation and productivity
* enable the firm to control the market share to raise market power by decreasing price or controls the administrative process
* The firm can reduce the risks of their business as it has a greater market share to diversify their sources of market demand
* They can create greater fund and gather more resources to compete more effectively against foreign firms and to compete in the international market

b) Detriments to the firm

* May stretch out the resources of the firm (cash-stripped/lack of staff) as the size of the production expands too extensively
* May experience diseconomies of scale which leads to rise in average cost of production
* May incite regulation from the government as firm may gain excessive market power such as the violation of the anti-trust law or the regulation in the aspect of retrenchment from mergers

**Qn: To what extent will mergers and acquisition be beneficial?**

a. Effects – lower price and improvement of quality of products

🡪limitations – will not pass cost savings to consumers & improve their R&D

12.8.2 Impact on the Consumers

a) Benefits to the consumers

* May be able to buy the goods at lower price level as the cost saving gained by the firm is passed onto the consumers
* May be able to enjoy the benefit of quality products and a greater variety of goods and services by the R&D made by the firm

b) Detriments to the consumers (Merger tends to greater market power)

* Consumer exploitation may occur as the firm with greater market power is likely to raise price and reduce output to conduct profit maximization
* Reduce consumer choices if the firm has extensive market power whereby the firm can only provide a few

12.8.3 Impact on the society

a) Benefit to the society

* Provide greater stability to the economy as the firms can develop a key industry to provide economic growth which will provide more employment and tax revenue for the society
* Raise the growth of the economy as the merger will allow the firm to engage in R&D and compete in the international market which will help the economy to raise export demand, leading to greater national income and employment

b) Detriments to the society

* The firm will experience production inefficiency and allocative inefficiency as the production level as the production is where the price level does not equal to minimum average cost of production and does equal to marginal cost. Consequently, the production will experience inefficiency in production and there will be welfare loss for the industry (deadweight loss) and thus the society does not attain social optimization in resource allocation (The firm is unable to attain production and allocation efficiency as the production equilibrium level attained at the profit-maximization level where MC=MR is at the excess capacity of production where the production does not equal minimum average cost of production or marginal cost)
* Greater inequality will surface, creating social dissatisfaction as the firm will gain supernormal profit due to market power which will undermine the majority of the market
* The economy may experience higher incidence of unemployment in the initial part of the merger as the firm will try to cut down duplication of operation and excessive production procedure to raise the efficiency of the merger

12.9.1 Why merger or acquisition is more beneficial than direct expansion of the firm?

* + - Mergers can eradicate competition and expand market share as the competitors has become part of the firm if the merger is based on horizontal integration
    - Can provide greater access to the consumers if the merger is based on vertical forward integration as seen from the acquisition of the distribution network
    - Can provide greater access to the source of supply of resources and goods if the merger is based on vertical backward integration
    - Provide greater stability to the firm as the firm can seek for more opportunity to diversify to reduce the risk of over-reliance on a particular source of supply or market.

12.9.2 Why direct expansion is more beneficial than merger or acquisition of the firm?

* Direct expansion by the firm will raise the competitiveness of the firm as the staff will be given opportunity for development
* Avoid the conflict of cultural complexity due to mergers of the different firms
* May not over-stretch the resources of the company as the expansion programme within the firm is made within the understanding of the firm’s capacity