

THE DISECONOMIES OF SCALE:

Recalling A Forgotten Marketing Approach

By Alan Hallett JP, B.Ed(Hons) , M.Ed

When I was taught Economics nearly 40 years ago, the concept of the economies of scale was an accepted tenet for all economists: it probably still is today. My premise for this paper is that the economies of scale can sometimes be seen as the primary determinant when considering the success of an organisation. I believe this presents only part of the argument: this is not a new topic and this ground has been covered before, but in the age of globalisation and the 'mega-corporation' it seems we have rather forgotten one of the fundamentals of all business practice: to provide a service that the customer wants.

The Received Wisdom

What are we taught about the economies of scale?

That **big is beautiful**. Of course savings can be made when buying in bulk or undertaking a nationwide advertising campaign. The problem is, perhaps, that economies of scale mean exactly that: economies. It does not necessarily mean an efficiency of operation or service

Efficiency. A co-ordinated and cost efficient operation can result as a consequence of efficient use of resources in a large operation

Large organisations can make significant **cost savings** by avoiding duplication, buying or selling in bulk, developing specialist skills, lowering unit costs and having greater access to capital

Large organisations can provide a **co-ordinated and comprehensive service**. They have access to the **best facilities** and the most developed information and distribution networks..

Best management. Large companies pay the biggest salaries so it is presumed they must have the most accomplished senior management.

They can provide the **best resources**, because they can buy in bulk and have the available capital.

The Reality

Large organisations are **inefficient** in their management, procedures, operations, distribution and customer service.

Layered management, procedures and operations that do not take account of local circumstances and are determined from the centre, distribution that is often sub-contracted to another commercial organisation, customer service that is all too often impersonal and dismissive: these features are found all too often in the large company.

Duplication of resource in terms of management, servicing

Constrained by regulation. The large company must comply with the extensive – and often complex – health and safety, employment and environmental laws. It must negotiate with trade unions, be aware of its cultural and physical impact on the local community and work within the corporate laws and social mores of its particular community

Politicised organisation. Large companies are of considerable significance in any community: they provide employment for the residents, bring wealth to the area and have an important impact on the reputation and status of that area, thus determining whether other companies move in. As such, it is inevitable that governments will take a keen interest and make every effort to influence decisions to suit their particular political needs.

Impersonal. Large organisations become enveloped in their own bureaucracy: the bigger they become the greater the bureaucracy. There is a tendency, therefore, for every aspect of the company's operation to become depersonalised: staffing, product, customer.

The result of all this is that companies become **insensitive to customer needs**. They are unable to respond in a flexible way because the company is not built to respond to individual need. For a large company to be profitable it must maintain a high turnover and good profit margins: thus mass production.

Large organisations require a **complex infrastructure** to survive. This can add significantly to the unit cost whilst denying the employee an opportunity to act with imagination and drive: the bureaucracy stifles the creativity.

One size fits all. High business costs mean that the large company must produce and sell in quantity in order to fund its activities and reward its shareholders. This inevitably means large scale production of a limited number of items, thus limiting choice and effectively prescribing which products are available to the consumer.

Of course some large companies seek to negate these diseconomies by developing a *sustainable competitive advantage* (Porter). This might take the form of emphasising their lower costs as a means of attracting and retaining customers, or it might be in differentiation where they seek to distance themselves from their large rivals by, for instance, creating structures that imitate small businesses. Thus we see the appearance of personal customer assistants, who 'adopt' particular customers and service their needs on a regular basis. Large conglomerate food companies often retain the brand names of companies and products many years after they have taken over that particular organisation: customers tend to trust brands that are long-established. In some cases, differentiation can actually lead to lower costs, such as the crisp manufacturers who use a distinctively coarser (and cheaper) paper for their crisp bags.

There is risk in this approach, however. If more than one differentiation ploy is adopted, or if differentiation and low cost are attempted in unison, then difficulties might ensue. The danger is that the company might dissipate its efforts by trying to achieve too many goals or reach too many markets, with a consequent loss of focus – and to the detriment of its competitive advantage. The company must therefore be very careful when deciding its favoured approach

The Solution

Small Organisations provide

Personal service. Every customer matters because each and every one helps to provide your income and your livelihood!

Customer Knowledge. Because you have a limited number of customers, you get to know their interests and requirements in great detail. Nothing is appreciated more than personal knowledge of the customer's needs.

Quick response. The large company often finds it difficult to respond to particular customer needs: its structure does not accommodate the need for quick turn-around or specific customer requests

The customer matters. Every sale/deal/contract is of vital importance if a small company is to survive and prosper. Consequently, care is taken to 'look after' the customer and every employee is aware of the significance of the relationship between the business and the customer.

A small company is more likely to be **independent of outside influences**. It is usually outside the political arena and, unless it is tied to a single large distributor/outlet, can be concerned only with its own wellbeing.

In a small company, **efficiency must be maintained if survival is to be assured**. In a large organisation, the employee often feels very far removed from the 'sharp end' of business. As a result, waste, inactivity and indifference are commonly found.

The **personal relationship** between customer and company – and between employee and company – is of prime importance. If the customer/employee is recognised as being of importance to the company, then success is more likely to be assured. It is also likely to lead to enhanced **loyalty**, on the part of both the customer and the employee. The customer is usually quick to recognise that every effort is being made to fulfil a contract – and values that application. Similarly, if the employee knows that his employer is making every effort to improve the working situation, he will be more willing to strive on the company's behalf.

Of course if a small company is successful by providing these enhanced services, it is likely to experience significant growth. Does that mean it must lose all the advantages we have mentioned? Not necessarily.

Franchising can allow large companies to develop the advantages of the small business whilst still benefiting from the recognised economies of scale normally only available to the large monolithic organisation. This type of cellular structure allows the organisation to market itself as local, accessible and personal, with significant management decisions being made with regard to the local customer base.

As an alternative, one of Britain's most famous retail outlets, the John Lewis Organisation, is **owned by its workforce**, so that employees feel they belong to - and are part of - the business. As a result, service, involvement and commitment are enhanced to the benefit of the company, the employees and the customers.

We should therefore be looking to rediscover an unfashionable marketing approach: to extol the virtues of the 'small' over the 'large'; to emphasise the benefits of the local instead of the global; to stress the advantages of service, value and personal attention. What has apparently been forgotten needs to be relearned: that small can, when properly managed, be beautiful.

These are uncertain times in business and banking. Large organisations are threatened by ruin or takeover, seemingly on the whim of the money markets: perhaps we are now entering the post-industrial age where the small independent operator, unhindered by the tangled international traumas currently affecting much of the world, can actually come to the fore. If a company can

provide a service at a competitive price, stay close to its customers and foster loyalty with customers and employees alike, then maybe that points the way to a different, but successful future.

Bibliography

- J.L.Hanson A Textbook of Economics Macdonald & Evans, 1961
- M.E.Porter Competitive Advantage: Harvard Business School, 1985
Creating and Sustaining Superior Performance