

Unit 3 Supply Analysis and Production Function.

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Supply Meaning, Law of Supply, Elasticity of Supply, Meaning and Types with Diagram.

Production Function, Meaning Short Run and Long Run Production Function Law of Returns, Law of Variable Proportion, Economies and Diseconomies of Scale.

Ques. What do you mean by supply?

Ans. Supply of a commodity refers to the quantity of a commodity which producers or sellers are willing to produce and offer for sale at a particular time over a particular period of time.

Ques. Define the term supply?

Ans. "Supply refers to the quantity of a commodity offered for sale at a given price in a given market at a given time."

-Murad Anatol

"The supply of goods is the quantity offered for sale in a given market at a given time at various prices".

-Prof. Thomas

Ques. Give the difference between Stock and supply.

Ans. Supply refers to the quantity of goods offered for sale, whereas stock is the excess of goods available in the market over the quantity of goods offered for sale.

Supply may be termed as the part of stock available in the market for sale at a certain time. Stock is always more than supply, that is, supply is the part of stock.

Ques. What is meant by supply function?

Ans. The supply function in economics is a mathematical formula that depicts the relationship between quantity supplied of commodity X and its determinants. In other words, supply of commodity X is the function of determinants of X.

The function helps businesses and governments to study and monitor an economy's demand/supply situation.

$$S_x = f(P_x, P_f, T, G, N, T_p, \dots \text{etc})$$

Wherein, S_x is supply of commodity X, P_f is price of factors of production, T is change in technology, G is goals of the firm, N is natural factors, T_p is taxation policy.

Ques. What are the determinants of supply?

Ans. The determinants of supply are:

1. The price of the commodity (P_x): The supply of a commodity very much depends on its price. There is a direct and positive relationship between the price of a commodity and its supply.
2. The price of related commodities (P_r): The supply of a particular commodity is inversely related with the price of other commodities, such as the supply of wheat will fall with the rise in the price of rice. This is due to the fact that a rise in the price of rice will encourage producers to produce more rice.
3. The price of factors of production (P_f): With the rise in the price of factors, the cost of production also rises, which results in decrease of supply and vice-a-versa.
4. Change in technology (T): If the change in technology or new discoveries bring reduction in costs and increase in production, this will increase the level of supply also.
5. Goals of the firm (G): In general, the goals of the firm are maximizing profit, sales, output or employment. These goals and any changes in them affects the supply of the commodity. Sometimes, simply to build their image and prestige in the society, the producers continue supply of the commodity ignoring profits.
6. Expected change in price (E): In case producers expect an increase in the price, they will retain or withdraw goods from the market. Consequently, supply will reduce. If price is expected to fall in future the supply will naturally increase.
7. Natural factors (N): Supply of goods is the part of goods produced. Production of goods depends upon various natural factors. For example, agricultural production depends upon rain, fertility, climatic conditions etc.
8. Means of transportation and communication (C): Adequate supply of commodities is maintained, if the means of transport and communication are developed. Scarcity of goods will be experienced in the domestic market, if the means of transport and communication are not properly developed.
9. Taxation policy (T_p): The production of the commodity is discouraged, if heavy duty on its production is imposed. In the same way, tax concessions encourage producers to increase supply.
10. Agreement among producers (A): Sometimes all the firms producing the same commodity form an association, a pool or a syndicate and regulate supply of the goods in such a way, so that they may earn maximum profit.

Ques. Explain the law of supply with the help of a diagram and a schedule.

Ans.

- ❖ Meaning of the law of supply: Law of supply establishes the direct relationship between price and quantity of goods supplied. According to this law, supply of the commodity will

increase with increase in price and decrease with decrease in price, other things remaining the same.

- ❖ Definition: "The law of supply states that other things remain the same, higher the price, the greater the quantity supplied or lower the price, the smaller the quantity supplied".

-Prof. Dooley

Point to be noted: The price cannot fall below a certain point. In case the price falls too much, the supply of the goods may be stopped. The price below which the producer will not be willing to sell is known as the reserved price. The amount of the reserved price depends upon: Durability of the commodity, Estimated price, Storage charges, Transportation costs etc.

The supply of goods cannot be withheld for too long, because the producer would like immediate return on his investment.

- ❖ Assumptions of the law of supply:

1. There is no change in the prices of related goods,
2. There is no change in the technique of production,
3. There is no change in the prices of the factors of production,
4. There is no change in the goal of firm,
5. There is no expectation of change in the price of the commodity.

- ❖ Presentation of law through:

- A. Supply schedule: A supply schedule is a tabular presentation that gives a full account of supply of a particular commodity at different prices, at a certain time in a specified market. The following hypothetical supply schedule illustrates the law of supply that is, the relationship between the price of commodity X and its supply.

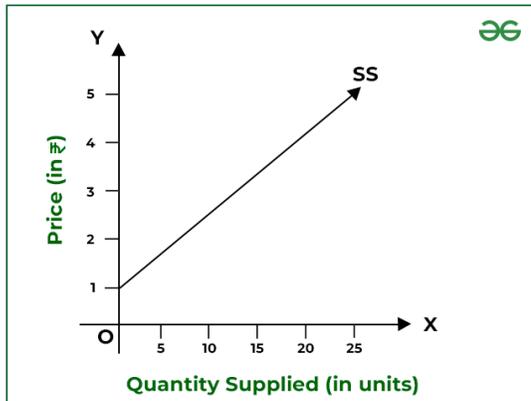
Schedule showing relationship between price and supply of the commodity:

Supply Schedule

Price (in ₹)	Quantity (in ₹)
1	0
2	5
3	10
4	15
5	20

From the above given schedule it can be seen that when the price of product 'X' is Rs. 1 the supply is 00 units and as the price increases from Rs. 2 to 3, 4, 5, the supply of X also increases from units 5 to 10, 15, and 20 respectively.

- A. Supply curve: The graphical presentation of the supply schedule is supply curve. The supply curve is shown in the following diagram.



From the above given diagram it is clear that the slope of the supply curve is upward towards the right. The upward slope of the supply curve shows that with an increase in the price of commodity X, there is an increase in the supply of it.

❖ Exceptions to the law of supply:

The law of supply does not apply in the following cases:

- The law does not apply in agricultural products, whose supply is affected by natural factors.
- The law may not apply in case of perishable goods. In the case of these goods sellers may be willing to sell more units at a declining price.
- The law may not apply in case of goods having social distinction. The supply of these goods will remain limited even if their prices are high.

Ques. What is meant by Elasticity of supply? Explain the types of it with the help of a diagram.

Ans. Meaning-

- The concept of elasticity of supply helps in measuring the percentage change in quantity supplied of commodity 'X', due to a percentage change in price of commodity 'X'.

$$E_s = \frac{\text{Percentage change in quantity supplied of commodity 'X'}}{\text{Percentage change in price of commodity 'X'}}$$

$$E_s = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in price}}$$

$$\text{or } = \frac{\text{Proportional change in quantity supplied}}{\text{Proportional change in price}}$$

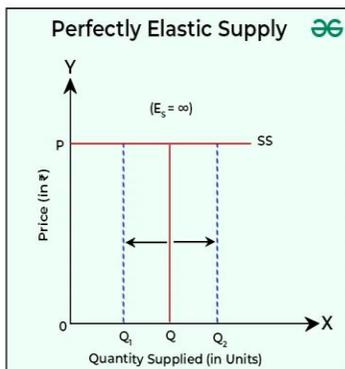
$$\text{or } E_s = \frac{\Delta Q_s / Q_s}{\Delta P / P} = \frac{\Delta Q_s}{Q_s} \times \frac{P}{\Delta P} = \frac{\Delta Q_s}{\Delta P} \times \frac{P}{Q_s}$$

- **Types of Elasticity of supply**

There are five types of elasticity of supply

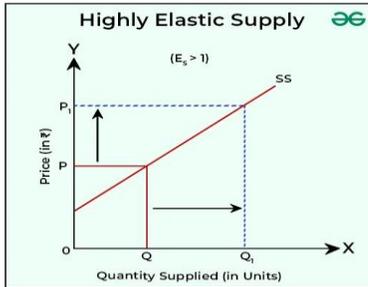
1. Perfectly elastic supply or Infinite elastic supply ($E_s = \infty$)
2. Relatively elastic supply or More elastic supply ($E_s > 1$)
3. Unitary elastic supply or Elasticity equals to one ($E_s = 1$)
4. Relatively inelastic supply or less elastic supply ($E_s < 1$)
5. Perfectly inelastic supply or Zero elastic supply ($E_s = 0$)

1. Perfectly elastic supply or Infinite elastic supply ($E_s = \infty$)-



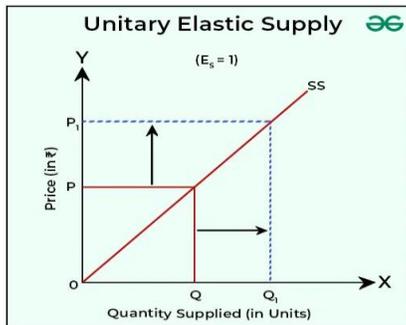
When the supply of a product changes (increases or decreases) even when there is no change in price, it is known as Perfectly elastic supply. Here the supply curve is a horizontal line, that is, parallel to the X axis.

2. Relatively elastic supply or More elastic supply ($E_s > 1$)



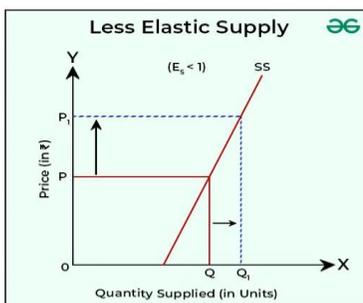
When the proportionate change in supply is more than the proportionate change in price, it is known as relatively/ highly elastic supply. Here the supply curve is upward sloping towards the right and is more elastic.

3. Unitary elastic supply or Elasticity equals to one ($E_s = 1$)



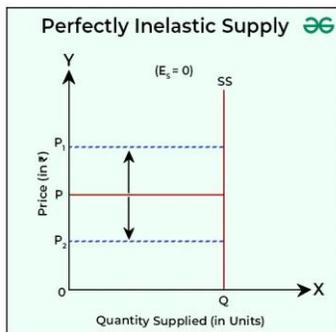
When the proportionate change in supply is equal to the proportionate change in price, it is known as relatively/ highly elastic supply. Here the supply curve is upward sloping towards the right and unitary elastic.

4. Relatively inelastic supply or less elastic supply ($E_s < 1$)



When the proportionate change in supply is less than the proportionate change in price, it is known as relatively/ highly elastic supply. Here the supply curve is upward sloping towards the right and unitary elastic.

5. Perfectly inelastic supply or Zero elastic supply ($E_s = 0$)



When there is no change in quantity supplied, even though there is change (increase, decrease) in price. Here the supply curve is a vertical line or parallel to the Y axis and is zero elastic.

Ques. What do you mean by production function?

Ans. Meaning: Production function explains the relationship between factor inputs and output under given technology.

"Production function is the name of relation between physical inputs and physical output of a firm

By-Prof. Watson

In simple words, production is the function of factor inputs. In other words, the production function expresses the functional relationship between output and factor inputs.

That is, change in output is the result of change in factor inputs. Here, output is dependent and factor inputs are independent variables.

Symbolically,

$$Q = f(L, I, C, r, \dots \text{etc.})$$

Where, Q- Output, F= function of, L=Land, I= labour, C=Capital, r= raw material.

Production function explains in what proportion factor inputs should be combined to increase the production.

Assumptions of production function:

1. There is perfect divisibility of both inputs and output.
2. There is limited substitution of one factor for the other,

3. State of technology remains the same during a given period of time.
4. There is inelastic supply of fixed factors in the short run,
5. It is assumed that firms utilize their inputs at the maximum levels of efficiency.

- Forms of production function:
 - A. Short run and Long run production function
 - B. Cobb-Douglas production function,
 - C. Linear Homogeneous production function,
 - D. The Constant Elasticity of Substitution production function.

Ques. What is the difference between returns to a variable factor and returns to scale?

Ans. In case of returns to a variable factor (law of returns), returns are the result of changes in variable factors. Under returns to scale all factors are treated as variables and these factors are proportionately increased to obtain increased output.

Ques. Write a note on Short run and Long run production function.

Ans. Before explaining the short run and long run production function of a firm we will know the meaning of short run and long run period of a firm.

- Meaning of short run and long run period of a firm:
 1. Short run period of a firm. There is a difference between market period (very short period) and short period of a firm:
 - a. Market period or very short period. It is a very short period, wherein factors of production and costs remain fixed. This is due to the fact that the producer does not have sufficient time to make the fresh adjustment of the factors of production. In this way, he can neither increase the production nor decrease it. In such a period supply remains fixed and the demand plays a very important role in the fixation of price.
 - b. Short period of a firm: It is a period, in which every factor of production cannot be changed as per the desire of the producers. Change in skilled labor, machines, organization and scale of production cannot be made. Change in unskilled labor, raw material, fuel and number of shifts can be made. We have fixed and variable factors and also fixed and variable costs in this period. In the case of production, the law of variable proportion applies.
 - c. Long period of a firm: in a long period the producer has sufficient time, so he can effect change in every factor of production. All the factors of production are variable, so the cost also remains variable. Production in the long period is made on a large scale, so the production units enjoy the economies of large scale production. It should be noted that, after achieving the ideal combination of factors of production these economies may change into losses.

In a long period, the law of returns to scale applies. In the beginning, law of increasing returns, afterwards law of constant returns and finally law of diminishing returns is applicable.

- A. **Short run production function:** The short run production function is also known as 'Single variable production function'. Here the quantity of some inputs say, labor is varied. It can be expressed as follows:

$$Q = f(L, R),$$

where, Q quantity of output, f = function of, L is labor and R is capital as a fixed factor.

The study of short run production function is the subject matter of the law of diminishing returns which is also known as the law of variable proportions.

- B. **Long run production function:** In the long run production function all inputs are variable. Production can be increased by changing one or more of the inputs. The firm can change the size of its plant as also its scale of operation. This can be expressed as follows,

$$Q = f(L, L, C)$$

Where, Q is the quantity of output. L is labor; L_i stands for land and C for capital.

The study of long run production functions forms the subject matter of law of returns to scale.

Ques. What do you mean by total product, average product and marginal product? Explain the relationship between them with the help of a diagram.

Ans.

1. Total product or total physical product (TP or TPP): It refers to the total volume of goods and services produced during a specified period of time generally, a year. It is the total physical output corresponding to each set of inputs. In other words, it is the sum total of marginal products.

$$TP \text{ or } TPP = \sum MP \text{ or } \sum MPP$$

2. Average product or average physical product (AP or APP): Per unit production of the variable factor is known as average product. When we divide total output by the quantities of a variable factor, we get an average product.

$$AP = \frac{\text{Total product}}{\text{Units of a variable factor}}$$

or. $\frac{TP}{L}$

Where, L is labor i.e., units of variable factor.

3. Marginal product or marginal physical product (MP or MPP): The change in the total product due to the application of one more or one less unit of variable factor is known as marginal product. Marginal product is the addition to total product by the employment of an additional unit of a factor.

$$MP = TP_{n+1} - TP_n$$

or

$$\frac{\Delta TP}{\Delta L}$$

Here, MP Marginal product, TP total product, n units of a factor, L = labor, Δ change

Ques. Explain the law of variable proportion with the help of a diagram.

Law of Variable Proportions (With Diagrams)

“As the proportion of the factor in a combination of factors is increased after a point, first the marginal and then the average product of that factor will diminish.”

Prof. Benham

Assumptions:

Law of variable proportions is based on following assumptions:

1. Constant Technology: The state of technology is assumed to be given and constant. If there is an improvement in technology the production function will move upward.

2. Factor Proportions are Variable:

The law assumes that factor proportions are variable. If factors of production are to be combined in a fixed proportion, the law has no validity.

3. Homogeneous Factor Units:

The units of variable factor are homogeneous. Each unit is identical in quality and amount with every other unit.

4. Short-Run: The law operates in the short-run when it is not possible to vary all factor inputs.

- Explanation of the Law: In order to understand the law of variable proportions we take the example of agriculture. Suppose land and labour are the only two factors of production. By keeping land as a fixed factor, the production of variable factor i.e., labour can be shown with the help of the following table:

Table 1.

Units of Land	Units of Labour	Total Production	Average Production	Marginal Production
10 Acres	0	—	—	—
"	1	20	20	20
"	2	50	25	30
"	3	90	30	40
"	4	120	30	30
"	5	140	28	20
"	6	150	25	10
"	7	150	21.3	0
"	8	140	17.5	-10

} 1st stage
 } MP > AP
 } AP = MP
 } 2nd stage
 } MP=0 and TP Maximum
 } 3rd stage MP < 0

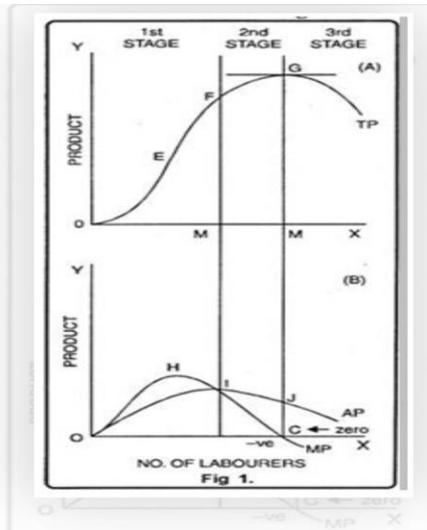
From table 1 it is clear that there are three stages of the law of variable proportion. In the first stage average production increases as there are more and more doses of labour and capital employed with fixed factors (land). We see that total product, average product, and marginal product increases but average product and marginal product increases up to 40 units. Later on, both started decreasing because the proportion of workers to land was sufficient and land is not properly used. This is the end of the first stage.

The second stage starts from where the first stage ends or where AP=MP. In this stage, average product and marginal product start falling. We should note that marginal products fall at a faster rate than the average product. Here, total product increases at a diminishing rate. It is also maximum at 70 units of labour where marginal product becomes zero while average product is never zero or negative.

The third stage begins where the second stage ends. This starts from the 8th unit. Here, marginal product is negative and total product falls but average product is still positive. At this stage, any additional dose leads to positive nuisance because additional dose leads to negative marginal product.

Graphic Presentation:

In fig. 1, on the OX axis, we have measured the number of labourers while quantity of product is shown on the OY axis. TP is the total product curve. Up to point 'E', total product is increasing at an increasing rate. Between points E and G it is increasing at the decreasing rate. Here marginal products have started falling. At point 'G' i.e., when 7 units of labourers are employed, total product is maximum while marginal product is zero. Thereafter, it begins to diminish corresponding to negative marginal products. In the lower part of the figure MP is marginal product curve.



Up to point 'H' marginal product increases. At point 'H', i.e., when 3 units of labourers are employed, it is maximum. After that, the marginal product begins to decrease. Before point 'I' marginal product becomes zero at point C and it turns negative. The AP curve represents the average product. Before point 'I', average product is less than marginal product. At point 'I' the average product is maximum. Up to point T, average product increases but after that it starts to diminish.

Three Stages of the Law:

1. First Stage:

First stage starts from point 'O' and ends up to point F. At point F average product is maximum and is equal to the marginal product. In this stage, total product increases initially at increasing rate up to point E. between 'E' and 'F' it increases at diminishing rate. Similarly marginal product also increases initially and reaches its maximum at point 'H'. Later on, it begins to diminish and becomes equal to average product at point T. In this stage, marginal product exceeds average product ($MP > AP$).

2. Second Stage:

It begins from the point F. In this stage, total product increases at diminishing rate and is at its maximum at point 'G' correspondingly marginal product diminishes rapidly and becomes 'zero' at point 'C'. Average product is maximum at point 'I' and thereafter it begins to decrease. In this stage, the marginal product is less than average product ($MP < AP$).

3. Third Stage:

This stage begins beyond point 'G'. Here the total product starts diminishing. Average product also declines. Marginal product turns negative. Law of diminishing returns firmly manifests itself. In this stage, no firm will produce anything. This happens because the marginal product of the labour becomes negative. The employer will suffer losses by employing more units of labourers. However, of the three stages, a firm will like to produce up to any given point in the second stage only.

in the second stage only.

Total Product	Marginal Product	Average Product
Stage I First increases at increasing rate then at diminishing rate.	Increases in the beginning then reaches a maximum and begins to decrease.	First increases, continues to increase and becomes maximum.
Stage II Continues to increase at diminishing rate and becomes maximum.	Continues to diminish and becomes equal to zero.	Becomes equal to MP and then begins to diminish.
Stage III Diminishes	Becomes negative.	Continues to diminish but will always be greater than zero.

Optimum Production:

After making the optimum use of a fixed factor, then the marginal return of such a variable factor begins to diminish. The simple reason is that after the optimum use, the ratio of fixed and variable factors become defective. Let us suppose a machine is a fixed factor of production. It is put to optimum use when 4 labourers are employed on it. If 5 labourers are put on it, then total production increases very little and the marginal product diminishes.

Ques. Explain the law of returns to scale.

Ans. In the long run all factors of production are variable. No factor is fixed. Accordingly, the scale of production can be changed by changing the quantity of all factors of production.

Definition:

“The term returns to scale refers to the changes in output as all factors change by the same proportion.” Koutsoyiannis

“Returns to scale relates to the behaviour of total output as all inputs are varied and is a long run concept”. Leibhafsky

Returns to scale are of the following three types:

1. Increasing Returns to scale.
2. Constant Returns to Scale
3. Diminishing Returns to Scale

Explanation:

In the long run, output can be increased by increasing all factors in the same proportion. Generally, laws of returns to scale refer to an increase in output due to increase in all factors in the same proportion. Such an increase is called returns to scale.

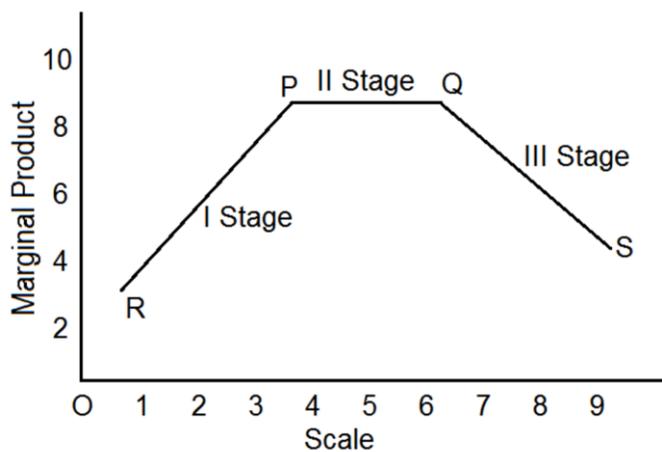
Diagram showing stages of returns:

Table 8. Showing different stages of return to scale

Units of Labour	Units of capital	%age increase in Labour & Capital	Total Product	%age increase in TP	Returns to scale
1	3	–	10	–	Increasing
2	9	100%	30	200%	
3	9	50%	60	100%	
4	12	33%	80	33%	Constant
5	15	25%	100	25%	
6	18	20%	120	10%	Decreasing
7	21	16.6%	130	8.3%	

stages of returns to scale:

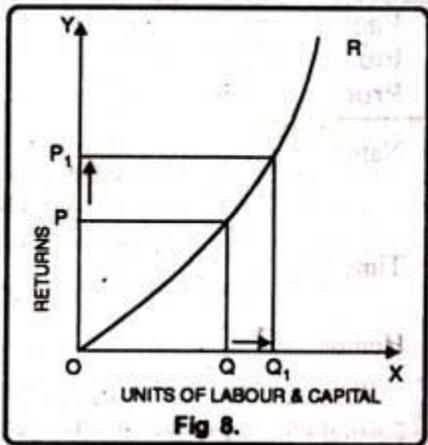
Figure 1



The above stated table explains the following three stages of returns to scale:

1. Increasing Returns to Scale:

Increasing returns to scale or diminishing cost refers to a situation when all factors of production are increased, output increases at a higher rate. It means if all inputs are doubled, output will also increase at a faster rate than double. Hence, it is said to be increasing returns to scale. This increase is due to many reasons like division of external economies of scale. Increasing returns to scale can be illustrated with the help of a diagram 8.

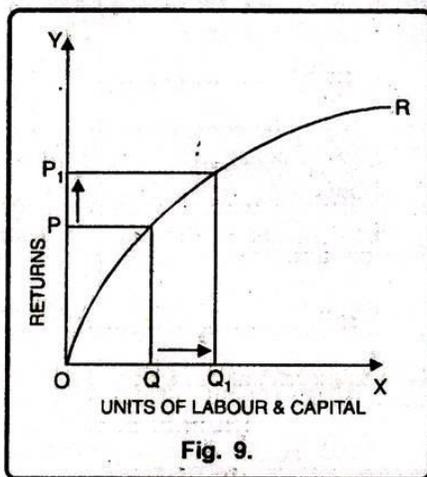


In figure 8, the OX axis represents increase in labour and capital while the OY axis shows increase in output. When labour and capital increases from Q to Q_1 , output also increases from P to P_1 which is higher than the factors of production i.e. labour and capital.

2. Diminishing Returns to Scale:

Diminishing returns or increasing costs refer to that production situation, where if all the factors of production are increased in a given proportion, output increases in a smaller proportion. It means, if inputs are doubled, output will be less than doubled. If 20 percent increase in labour and capital is followed by 10 percent increase in output, then it is an instance of diminishing returns to scale.

The main cause of the operation of diminishing returns to scale is that internal and external economies are less than internal and external diseconomies. It is clear from diagram 9.

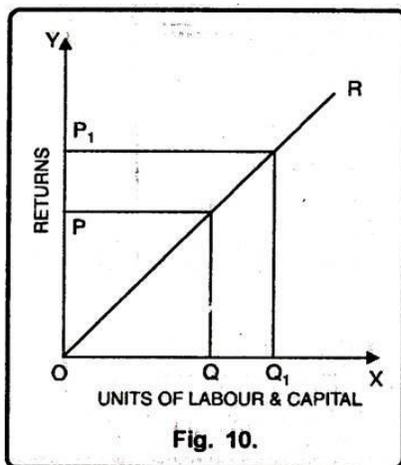


In this diagram 9, diminishing returns to scale has been shown. On the OX axis, labour and capital are given while on the OY axis, output. When factors of production increase from Q to Q_1 (more quantity) but as a result increase in output, i.e. P to P_1 is less. We see that the increase in factors of production is more and increase in production is comparatively less, thus diminishing returns to scale apply.

3. Constant Returns to Scale:

Constant returns to scale or constant cost refers to the production situation in which output increases exactly in the same proportion in which factors of production are increased. In simple terms, if factors of production are doubled output will also be doubled.

In this case internal and external economies are exactly equal to internal and external diseconomies. This situation arises when after reaching a certain level of production, economies of scale are balanced by diseconomies of scale. This is known as a homogeneous production function. Cobb-Douglas linear homogeneous production function is a good example of this kind. This is shown in diagram 10. In figure 10, we see that the increase in factors of production i.e. labour and capital are equal to the proportion of output increase. Therefore, the result is constant returns to scale.



Ques. Explain the Economies and Diseconomies of Scale in detail.

Ans.

- ❖ Meaning: Economies of scale are defined as the cost advantages that an organization can achieve by expanding its production in the long run.
- ❖ In other words, these are the advantages of large scale production of the organization. The cost advantages are achieved in the form of lower average costs per unit.

It is a long term concept. Economies of scale are achieved when there is an increase in the sales of an organization. As a result, the savings of the organization increases, which further enables the organization to obtain raw materials in bulk. This helps the organization to enjoy discounts. These benefits are called economies of scale.

- ❖ **The economies of scale are divided in to internal economies and external economies discussed as follows:**

i. Internal Economies:

Refer to real economies which arise from the expansion of the plant size of the organization. These economies arise from the growth of the organization itself.

The examples of internal economies of scale are as follows:

a. Technical economies of scale:

Occur when organizations invest in expensive and advanced technology. This helps in lowering and controlling the costs of production of organizations. These economies are enjoyed because of the technical efficiency gained by the organizations. The advanced technology enables an organization to produce a large number of goods in a short time. Thus, production costs per unit falls leading to economies of scale.

b. Marketing economies of scale:

Occur when large organizations spread their marketing budget over the large output. The marketing economies of scale are achieved in case of bulk buying, branding, and advertising. For instance, large organizations enjoy benefits on advertising costs as they cover larger audiences. On the other hand, small organizations pay equal advertising expenses as large organizations, but do not enjoy such benefits on advertising costs.

c. Financial economies of scale:

Take place when large organizations borrow money at a lower rate of interest. These organizations have good credibility in the market. Generally, banks prefer to grant loans to those organizations that have a strong foothold in the market and have good repaying capacity.

d. Managerial economies of scale:

Occur when large organizations employ specialized workers for performing different tasks. These workers are experts in their fields and use their knowledge and experience to maximize the profits of the organization. For instance, in an organization, accounts and research departments are created and managed by experienced individuals, SO that all costs and profits of the organization can be estimated properly.

e. Commercial economies:

Refer to economies in which organizations enjoy benefits of buying raw materials and selling finished goods at lower cost. Large organizations buy raw materials in bulk; therefore, enjoy

benefits in transportation charges, easy credit from banks, and prompt delivery of products to customers.

ii. External economies:

Occur outside the organization. These economies occur within the industries which benefit organizations. When an industry expands, organizations may benefit from better transportation networks, infrastructure, and other facilities. This helps in decreasing the cost of an organization.

Some of the examples of external economies of scale are discussed as follows:

a. Economies of Concentration:

Refer to economies that arise from the availability of skilled labor, better credit, and transportation facilities.

b. Economies of Information:

Imply advantages that are derived from publication related to trade and business. The central research institutions are the source of information for organizations.

c. Economies of Disintegration:

Refer to the economies that arise when organizations split their processes into different processes.

❖ Diseconomies of scale

Meaning- Diseconomies of scale occur when the long run average costs of the organization increases. It may happen when an organization grows excessively large. In other words, the diseconomies of scale cause larger organizations to produce goods and services at increased costs.

There are two types of diseconomies of scale, namely, internal diseconomies and external diseconomies, discussed as follows:

i. Internal diseconomies of scale:

Refer to diseconomies that raise the cost of production of an organization. The main factors that influence the cost of production of an organization include the lack of decision, supervision, and technical difficulties.

ii. External diseconomies of scale:

Refer to diseconomies that limit the expansion of an organization or industry. The factors that act as restraint to expansion include increased cost of production, scarcity of raw materials, and low supply of skilled laborers.

There are a number of causes for diseconomies of scale.

Some of the causes which lead to diseconomies of scale are as follows:

i. Poor Communication:

Act as a major reason for diseconomies of scale. If production goals and objectives of an organization are not properly communicated to employees within the organization, it may lead to overproduction or production. This may lead to diseconomies of scale.

Apart from this, if the communication process of the organization is not strong then the employees would not get adequate feedback. As a result, there would be less face-to-face interaction among employees- thus the production process would be affected.

ii. Lack of Motivation:

Leads to fall in productivity levels. In case of a large organization, workers may feel isolated and are less appreciated for their work, thus their motivation diminishes. Due to poor communication networks, it is harder for employers to interact with the employees and build a sense of belongingness. This leads to a fall in the productivity levels of output owing to lack of motivation. This further leads to an increase in costs of the organization.

iii. Loss of Control:

Acts as the main problem of large organizations. Monitoring and controlling the work of every employee in a large organization becomes impossible and costly. It is harder to make out that all the employees of an organization are working towards the same goal. It becomes difficult for managers to supervise the sub-ordinates in large organizations.

iv. Cannibalization:

Implies a situation when an organization faces competition from its own product. A small organization faces competition from products of other organizations, whereas sometimes large organizations find that their own products are competing with each other.