Economies of Scale – When Bigger Really Is Better



Procurement and Supply Chain Management Made Simple.

Foreword – The Advantage of Being Bigger

Growth has long been associated with commercial success, financial strength and competitive advantage. Larger organisations can negotiate substantial purchasing agreements, invest in specialist technology, consolidate distribution networks and spread operating expenditure across far greater volumes of activity. These opportunities help explain why businesses pursue expansion, acquisitions, and market share gains. However, rising turnover, employment, or geographical coverage does not automatically improve efficiency, particularly when additional scale creates costs that outweigh the benefits.

Scale is unevenly distributed across the United Kingdom (UK) economy. The Department for Business and Trade estimated that 5.7 million private sector businesses existed at the start of 2025, of which only 8,335 employed 250 or more people. Those large businesses represented only 0.15% of the business population, yet accounted for 40% of private sector employment and 49% of turnover. Small and medium-sized enterprises (SMEs) generated the remaining 51%, around £2.8 trillion.

The economic attraction of size is considerable. A manufacturer producing one million components can spread machinery, property and management costs across ten times as many units as a competitor producing 100,000. A national retailer may secure purchasing terms unavailable to smaller businesses, while a major logistics provider can consolidate deliveries across established routes. Nevertheless, these advantages depend on operational conditions, commercial discipline and the ability to convert purchasing power and capacity into measurable savings.

The difficulties become apparent when expansion adds management layers, fragments accountability, complicates technology and increases coordination demands. A business may negotiate lower material prices while simultaneously increasing warehousing expenditure, transport distances and administrative overheads. Similarly, centralising services may remove duplication but slow decision-making and reduce responsiveness. The apparent advantages of growth can therefore conceal inefficiencies that only disciplined financial and operational analysis reveals, which is why size and genuine efficiency must always be assessed separately.

The central question is not whether bigger organisations have more resources, but whether those resources deliver better economic results. Genuine economies of scale reduce the average cost of comparable output while maintaining appropriate quality, service and resilience. Sustainable growth requires organisations to identify where additional volume creates value, recognise when efficiency gains begin to diminish, and understand when further expansion adds more cost than commercial benefit.

What Are Economies of Scale?

Economies of scale arise when an organisation increases output and reduces the average cost of producing each unit of goods or delivering each unit of service. The underlying principle is that greater operational volume spreads fixed costs, improves resource utilisation and supports more efficient working methods. However, these advantages depend on how an organisation plans, manages, and finances additional activity, not simply on its size.

The distinction between economies of scale and business growth is fundamental. An organisation may increase turnover from £20 million to £30 million without becoming more efficient if operating expenditure rises proportionately or faster. Equally, higher profits may result from increased selling prices rather than improved productivity. Genuine economies of scale occur when producing comparable output becomes less expensive over the long run, once capacity and operating arrangements have been allowed to adjust.

Consider a manufacturer producing 100,000 components annually at a total cost of £2 million, or £20 per component. If production increases to 150,000 components while total expenditure rises to £2.7 million, average cost falls to £18. Although overall spending has increased by £700,000, the manufacturer achieves a 10% reduction in unit cost. This illustrative calculation shows why absolute expenditure alone provides an incomplete assessment of operational efficiency.

Organisational size is therefore an unreliable substitute for measuring economic performance. A large retailer may have extensive purchasing resources yet operate inefficient distribution arrangements, while a smaller competitor achieves higher productivity through careful stock management and focused operations. Meaningful comparisons require consistent measures of cost per unit, service quality, product specification and capacity utilisation. The decisive question is whether additional scale improves economic performance after accounting for all the resources required to achieve it.

Reading the Numbers – Profits, Savings, Synergies and Forecasts

Evidence of economies of scale takes several forms that must be distinguished carefully. Reported financial performance describes revenue, profit and margins under particular accounting measures. Cash-releasing savings reduce expenditure or funding requirements, while non-cash-releasing efficiencies allow existing resources to support additional activity without equivalent cost increases. Recurring synergies are ongoing benefits from integration or restructuring, whereas forecast efficiencies remain projections until delivered. Each measure answers a different question, and combining them without explanation can materially overstate the economic benefits of organisational scale.

Reported profit can differ considerably depending on the accounting measure used. Ocado Group's 2025 results provide a revealing example. Revenue reached £1.36 billion and adjusted earnings before interest, taxation, depreciation and amortisation (EBITDA) were £178 million. However, adjusted loss before tax was £353.1 million, while statutory profit before tax reached £402.9 million. The statutory result included a £782.6 million accounting gain from valuing its investment in Ocado Retail after deconsolidation, while underlying cash flow remained negative at £213 million. Consequently, reported statutory profitability should not be confused with operational efficiency or cash generation.

The following case studies are labelled accordingly. Tesco reports adjusted operating profit, Rolls-Royce reports underlying operating profit, Lloyds Banking Group quoted annual run-rate savings, the Tesco and Booker merger was justified by forecast synergies, and Crown Commercial Service (CCS) measured commercial benefits against market price comparators. None of these measures is wrong, but each must be read on its own terms before drawing any conclusion about economies of scale.

Internal and External Economies of Scale

Internal economies of scale originate within an organisation as its operations expand.

Purchasing economies arise through larger orders and stronger negotiating positions, while technical economies result from specialised equipment, automation and efficient production systems. Both depend on volume because a production line or automated warehouse becomes cheaper per unit only when it stays busy. Without sufficient throughput, the same investments raise average costs rather than lowering them.

Managerial and financial economies complete the internal picture. Larger organisations can employ specialists whose expertise supports far greater activity than any single department could justify. They may borrow on better terms because lenders often view diversified revenue as lower risk. Technology expenditure can likewise be spread across more transactions, reducing the average processing cost. Each of these advantages is examined in detail below, together with the conditions under which it fails to materialise.

External economies develop beyond an individual organisation through the concentration of related industries, suppliers, infrastructure and skilled employees. The UK automotive industry illustrates the point. The Society of Motor Manufacturers and Traders (SMMT) reported that manufacturers built 717,371 cars and 47,344 commercial vehicles in 2025, supported by more than 2,500 component providers nationwide. That shared supplier base allows each manufacturer to draw on capabilities it would otherwise need to develop and fund itself.

Industrial clusters and shared research infrastructure can give smaller organisations access to capabilities that would otherwise require substantial independent investment. The High Value Manufacturing Catapult, which links manufacturers with researchers and technology specialists, reported in its 2025 annual review that it worked with 5,810 companies, 3,496 of which were SMEs. Arrangements of this kind reduce barriers to innovation without requiring every participant to expand independently to reach an efficient scale.

Fixed Costs, Variable Costs and the Economics of Volume

Understanding economies of scale requires separating fixed costs from variable costs. Fixed costs, such as factory rent, insurance and certain management salaries, remain broadly unchanged across a relevant range of output. Variable costs, including materials, packaging and some production labour, generally change with activity. As output rises, fixed expenditure spreads across more units and average fixed cost falls, provided additional production stays within existing operational capacity.

Consider a distribution centre with annual fixed operating expenditure of £3 million. Processing three million parcels allocates £1 of fixed cost to each parcel, while processing five million reduces that allocation to £0.60. The operator has cut average fixed cost by 40% without reducing its £3 million commitment. However, the calculation excludes variable handling costs, additional labour, maintenance and any deterioration in service performance as throughput increases.

Contribution margin provides another perspective. If a manufacturer sells a product for £50 and incurs £30 in variable costs, each additional sale contributes £20 towards fixed expenditure and subsequent profit. With annual fixed costs of £2 million, the organisation must sell 100,000 units to break even. Higher volumes can strengthen profitability considerably, but only where demand, production capacity and contribution margins remain commercially sustainable over time.

The same arithmetic works in reverse. High fixed costs create operating leverage, meaning that profits rise quickly when volumes grow but fall just as quickly when demand weakens. If the manufacturer above sold 150,000 units, it would earn £1 million of profit, whereas at 80,000 units it would lose £400,000. Organisations pursuing scale through heavy fixed investment therefore accept greater exposure to volatile demand, a risk that smaller, more flexible competitors may avoid.

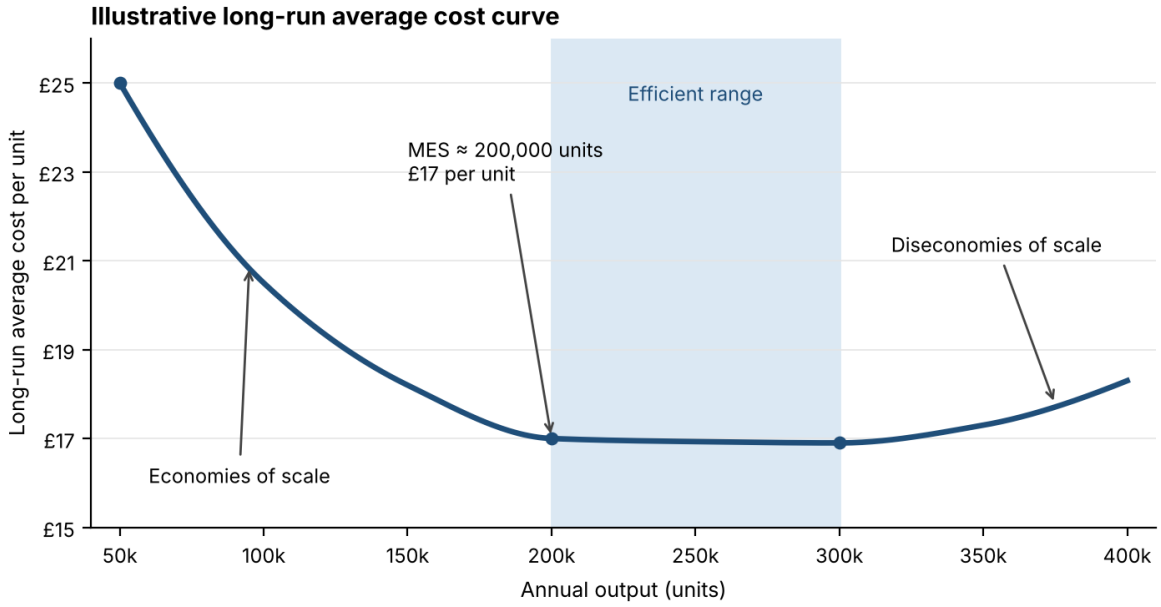
Fixed expenditure is not permanently fixed as organisations expand. A manufacturer operating near maximum capacity may require another production line, additional premises or a second

management team. These investments create step changes in fixed costs that can temporarily increase average expenditure. Effective capacity planning therefore examines whether projected demand justifies the next investment, rather than assuming that every increase in output automatically improves financial performance.

The Minimum Efficient Scale – How Big Is Big Enough?

Minimum efficient scale (MES) describes the lowest output level at which an organisation achieves its minimum long-run average cost (LRAC), or enters a range where average costs remain close to that minimum. Before reaching this point, higher production can create substantial efficiencies through improved utilisation, specialisation, and fixed-cost absorption. Beyond it, further expansion delivers limited financial advantage because the principal benefits of scale have already been realised.

The LRAC curve explains why. It shows the lowest achievable cost per unit at each output level once an organisation can adjust all its inputs, including premises, equipment, and workforce. Typically, the curve falls steeply at low volumes as fixed costs are spread and specialisation increases, flattens across an efficient range, and may eventually rise as coordination, complexity and management costs grow faster than output. The illustrative curve below shows this pattern.



Illustrative values only; not observed UK business data. The approximately efficient range begins at 200,000 units. Lowest illustrated average cost: £16.90 at 300,000 units.

Consider a manufacturer whose average production cost declines from £25 to £17 as annual output increases from 50,000 to 200,000 units. Further expansion to 300,000 units reduces average cost to £16.90, demonstrating that the remaining economies are marginal. The organisation has entered an approximately minimum-cost operating range, although the lowest illustrated cost occurs at 300,000 units. Beyond that level, average costs begin to rise, indicating emerging diseconomies of scale. Further investment must therefore be justified against increasingly limited additional savings and the possibility of higher operating costs.

Minimum efficient scale is not necessarily the production level that maximises total profit. An organisation may achieve its lowest average cost at 300,000 units yet face demand for only 150,000 units at commercially acceptable prices. Producing beyond that demand could create surplus inventory or require selling price reductions. Conversely, strong demand and favourable contribution margins may justify operating beyond the minimum-cost range. The most profitable output depends on the relationship between marginal revenue, marginal cost,

investment requirements and market conditions, rather than average production cost alone.

The appropriate operating scale varies considerably between industries. A semiconductor fabrication facility may require very high volumes to justify expensive equipment and technical infrastructure, while a specialist engineering workshop can operate efficiently at much lower volumes. Food manufacturers benefit from continuous processing and standardised packaging, whereas professional service providers may face rising coordination costs as their workforce expands. Consequently, turnover or employee numbers alone cannot determine the minimum efficient scale.

Understanding MES has practical consequences for procurement and capacity planning. Where an industry's MES is large relative to total market demand, only a few producers can operate efficiently, which helps explain concentrated supply markets such as large aero engines. Buyers in those markets should expect limited competition and plan sourcing strategies accordingly. Where MES is small, many suppliers can compete on broadly equal terms, and aggregating demand delivers less additional advantage to the purchasing organisation.

Purchasing Power – Turning Volume into Commercial Advantage

Purchasing economies arise when organisations consolidate demand sufficiently to negotiate better commercial arrangements. Larger volumes can support lower unit prices, better payment terms, reduced transport charges and preferential access to production capacity. Suppliers may benefit through greater order certainty, longer production runs and lower sales administration costs. However, successful purchasing leverage requires accurate demand forecasts, disciplined contract management and an understanding of supplier economics, not aggressive negotiation alone.

The public sector offers a substantial example of aggregated purchasing. During 2024/25, £33 billion of direct public sector spend passed through CCS commercial agreements, with reported spend-related commercial benefits of £4.6 billion and an average commercial benefit rate of 10.49%. These benefits are calculated by sampling spend and comparing prices with current market comparators, so they represent estimated value rather than confirmed cash savings within every participating organisation's budget.

CCS became part of the Government Commercial Agency on 1 April 2026, combining it with central commercial teams previously operating within the Cabinet Office. Under the Procurement Act 2023, in force since 24 February 2025, contracting authorities may award contracts through frameworks, subject to the Act's requirements. Such arrangements aggregate demand and reduce repeated procurement activity, but authorities must still assess value for money, competition, and the suitability of each requirement.

A discounted purchase price can become commercially unattractive when achieving it requires excessive order quantities. Suppose a supplier offers a 5% reduction on components costing £2 million annually, creating an apparent £100,000 saving. If additional storage, financing, insurance, obsolescence and handling costs total £120,000, the organisation is £20,000 worse off. Therefore, evaluate purchasing economies through total cost of ownership (TCO), including inventory exposure, operational flexibility, and contractual commitments.

Supplier Relationships – When Bigger Customers Have Greater Influence

Organisations placing substantial, predictable orders can become strategically important customers within their suppliers' businesses. That position may improve access to senior management, technical expertise, production capacity and collaborative development. Suppliers may also prioritise investment where significant demand is contractually secured. However, influence should not be confused with unrestricted power, because excessive commercial pressure can undermine supplier profitability, discourage innovation and ultimately threaten continuity of supply.

The British grocery sector shows why supplier protection balances purchasing influence. The

Groceries Supply Code of Practice governs specified dealings between designated large grocery retailers and their direct suppliers, and is enforced by the Groceries Code Adjudicator. Retailers become eligible for designation when their annual UK grocery turnover exceeds £1 billion. The code addresses identified unfair trading practices rather than preventing retailers from negotiating competitive commercial terms with their suppliers.

Commercial scale also creates responsibilities when a major customer suffers disruption. Following the cyber incident that began on 31 August 2025, Jaguar Land Rover (JLR) halted manufacturing for several weeks, leaving businesses throughout its supply chain without orders. JLR subsequently fast-tracked a £500 million financing solution allowing qualifying suppliers to receive cash when production was scheduled. The financial stability of many smaller suppliers had become closely tied to one much larger customer.

Dependency works in both directions. A supplier earning a large share of its revenue from one customer gains volume and planning certainty but loses negotiating independence. In contrast, the customer gains preferential attention but becomes exposed if that supplier fails. Procurement teams should therefore monitor the proportion of each critical supplier's turnover their organisation represents, because a share that looks advantageous in normal conditions can become a shared vulnerability during disruption.

Effective supplier relationships therefore require more than competitive prices and substantial volumes. Organisations should examine supplier financial resilience, production constraints, their own payment performance, contractual risk allocation and the availability of alternative sources. Sustainable economies emerge when increased purchasing volume supports both operational efficiency and a commercially viable supply base, so that savings secured by the larger party do not simply transfer risk to organisations least able to absorb it.

Production Efficiency – Making More at a Lower Unit Cost

Production economies develop when higher output improves the utilisation of machinery, buildings, technical expertise and labour. Specialist equipment performs repetitive operations more consistently, while longer production runs reduce the frequency of changeovers, cleaning and recalibration. Workforce specialisation also improves productivity through accumulated experience. However, the economic benefit depends on maintaining sufficient demand to justify the investment and on avoiding unnecessary downtime, excess production and quality failures.

British automotive manufacturing demonstrates both the opportunity and its limits. SMMT's 2026 industry facts record automotive manufacturing turnover of £85 billion, value added of £18 billion and more than 183,000 manufacturing employees, with 1.60 million engines built in 2025. Yet total vehicle output fell by 15.5% to 764,715 units that year, a 73-year low, as tariffs, plant restructuring and cyber disruption reduced utilisation across expensive production facilities.

JLR shows how concentrated production capacity creates exposure when output stops. Its revenue for the quarter to September 2025 fell by 24% year on year to £4.9 billion, and it recorded £196 million of cyber-related exceptional costs. A high-volume production system carries fixed costs that continue throughout a shutdown. The figures underline the importance of maintenance, cybersecurity, contingency planning and capacity management wherever output depends on interconnected systems.

Standardisation – The Hidden Economy of Repetition

Standardisation creates economies by reducing unnecessary variation in components, materials, specifications and operating processes. When organisations apply common requirements across multiple products or facilities, purchasing becomes simpler, production planning improves, and employees need fewer specialised procedures. Standardisation also supports repeatable quality assurance and more predictable maintenance. The benefits often emerge gradually through reduced administrative expenditure, fewer errors, faster training and

more efficient utilisation of shared resources.

Consider a housing provider managing 20,000 properties, each potentially with different plumbing fittings, electrical components, and replacement fixtures. Agreeing suitable standard specifications could reduce the number of stocked items, simplify contractor training and support more competitive purchasing arrangements. However, standardisation must accommodate differing property conditions, statutory requirements, accessibility needs and technical compatibility. A uniform specification is not economical if it creates unnecessary replacement costs or leads to unsuitable outcomes for residents.

Manufacturing offers another important example, because component commonality reduces purchasing complexity and production disruption. Automotive manufacturers frequently use shared platforms, components and engineering systems across different vehicle models, spreading development costs across higher combined volumes while simplifying supplier arrangements. However, common components can also concentrate quality or supply risks, since a single defective part or unavailable material may affect several products at once and multiply the cost of any recall.

Successful standardisation therefore distinguishes between eliminating unnecessary variation and removing valuable choice. Procurement specifications should define essential performance outcomes without imposing arbitrary uniformity or excluding suitable suppliers. The Procurement Act 2023 includes rules on technical specifications intended to prevent unnecessary barriers to competition, including restrictions on referring to particular brands or trademarks. The strongest approach combines common technical standards with enough flexibility to accommodate operational differences, innovation and whole-life cost considerations.

Logistics and Distribution – The Value of Network Density

Distribution economies emerge when organisations move greater volumes through established transport routes, warehouses and delivery networks without proportionate cost increases. Higher vehicle utilisation spreads fuel, driver expenditure, insurance, and depreciation across more deliveries, while consolidating consignments and improving route planning further reduce costs. However, the greatest benefits usually come from concentrated demand within an operating area rather than simply expanding a distribution network's geographical boundaries.

Consider two delivery operations serving different areas. One delivers 120 parcels across a compact urban route at a cost of £240, or £2 per parcel. Another incurs the same operating expenditure but delivers only 40 parcels across a dispersed rural route, producing a unit cost of £6. Although illustrative, the comparison demonstrates why delivery density, distance between stops and the proportion of successful first-time deliveries materially influence logistics economics.

Royal Mail provides a substantial British example of network scale and utilisation. During 2024/25, it handled around 1.35 billion parcels, up 6%, alongside 6.33 billion addressed letters, down 4%, generating reported revenue of £8.23 billion. Its nationwide infrastructure allows parcels to share established delivery routes. Nevertheless, the continuing decline in letter volumes shows how reduced throughput erodes the economics of a network built for much higher traffic and fixed costs.

Distribution network design also involves balancing centralisation against responsiveness. A single large distribution centre may reduce property costs, consolidate inventory and improve automation utilisation, but it lengthens outbound transport distances and increases exposure to disruption. Multiple regional facilities may enable faster deliveries and lower final-mile costs, although duplicated infrastructure and stockholding are more expensive. Efficient networks require evaluating transport expenditure, warehouse operating costs, inventory requirements, and customer service commitments together.

Backhauling, route optimisation and load consolidation can deliver additional savings without expanding the physical network. Vehicles returning from customer deliveries may collect goods from suppliers, reducing empty mileage and improving asset utilisation. Digital planning systems can identify opportunities to combine journeys, match vehicle capacity with demand and remove unnecessary movements. The ultimate measure is not the number of vehicles, warehouses or deliveries, but the cost of providing reliable distribution services at the required standard.

Warehousing and Inventory – Spreading Infrastructure Costs

Warehousing economies arise when higher throughput allows organisations to spread infrastructure and operating costs across greater volumes of goods. Buildings, racking, material handling equipment, security systems and software often involve substantial investment before operations begin. Higher throughput can reduce the average cost of receiving, storing and dispatching products, provided additional activity does not create disproportionate labour requirements, congestion, maintenance costs or a deterioration in service standards.

Automated storage and retrieval systems improve productivity by reducing travel distances, speeding up order picking and using available space more effectively. Amazon's £500 million robotics fulfilment centre in Leeds, launched in August 2024, illustrates the investment involved. Spread across three floors, it was expected to employ more than 2,000 people by November 2024, showing how automation and human expertise work together, and how only very high throughput can justify capital commitments at this scale.

Inventory pooling provides another important economy by consolidating stock previously held across multiple locations. Under the square root law, consolidating five equivalent stockholding locations into one could theoretically reduce aggregate safety stock by approximately 55%, assuming independent and comparable demand variability, consistent replenishment conditions and unchanged service requirements. Actual savings depend on the inventory network's characteristics and may be considerably smaller. However, fewer locations increase delivery distances and replenishment times, so the working capital released must outweigh additional transport costs and any loss of availability.

Warehouse management systems (WMS) strengthen these benefits by improving stock visibility, location control, replenishment planning and labour allocation. Shared facilities may also allow several organisations to access infrastructure that would be uneconomical individually. Nevertheless, centralisation is not automatically superior to regional distribution. Successful network design balances warehouse throughput, inventory investment, transport costs, customer proximity and service resilience, measuring overall distribution performance rather than concentrating exclusively on storage expenditure.

Technology and Automation – The Economics of Greater Utilisation

Technology can generate economies of scale by spreading implementation and development costs across increasing transaction volumes. Enterprise resource planning (ERP) systems, robotic equipment, artificial intelligence (AI), and analytical platforms often involve high upfront costs, including integration, configuration, employee training, and cybersecurity. Once established, these systems can process additional transactions relatively cheaply, which is why digital operations frequently display stronger economies of scale than physical ones.

Consider an organisation investing £2 million in technology implementation, with annual running costs of £400,000 and an assumed five-year economic life. Using straight-line allocation, annual expenditure would amount to £800,000 before financing and other adjustments. Processing one million transactions yields an illustrative technology cost of £0.80 each, while two million reduces it to £0.40. These savings, however, depend on available system capacity and genuinely comparable transaction requirements.

Ocado Retail provides a measurable British example of technology utilisation. In the 52 weeks

to 30 March 2025, average units processed per labour hour across its customer fulfilment centres rose 11.9% to 225, up from 201 the previous year, while its newest centre at Luton peaked at 286. These are operational productivity measures rather than profit figures, but they show how robotic picking improves output from each hour of labour.

Not every technology cost falls as volume grows. Software licences are frequently priced per user or per transaction, cloud computing charges rise with consumption, and larger data volumes demand more storage, security monitoring and specialist support. AI services may be charged by usage, so greater reliance increases expenditure directly. Organisations should therefore model how each technology cost component behaves at higher volumes, rather than assuming the entire investment is fixed.

Automation must therefore start with a commercially justified operational requirement, not the assumption that advanced equipment guarantees efficiency. Organisations should examine transaction volumes, labour availability, system integration, maintenance, utilisation and expected asset life before committing expenditure. A poorly configured ERP platform can increase administrative burden, while underutilised robotics incur substantial depreciation. The key question is whether technology measurably improves productivity, service quality and total operating expenditure over its useful life.

Shared Services – Reducing the Cost of Supporting Operations

Shared services aim to reduce administrative duplication by consolidating activities previously performed separately across departments, divisions or organisations. Finance, payroll, human resources, procurement and information technology are particularly suitable where processes can be standardised without undermining operational requirements. Centralised teams can achieve economies through specialist staff, shared systems and higher transaction volumes, spreading operating expenditure across a broader service population while strengthening professional oversight and control.

Within the National Health Service (NHS), the NHS Business Services Authority delivers specialist business functions at national scale. In 2024/25, it made 69 million payments worth £97.6 billion, including prescription reimbursements, pensions, and payroll-related transactions. The authority reported approximately £668 million in savings and efficiencies for the wider health and care system during 2024/25, generated through activities including medicines optimisation, provider assurance and service delivery improvements. These benefits should be distinguished from the authority's own operating expenditure and should not be interpreted solely as cash savings arising from centralisation.

Central government has pursued similar arrangements. A National Audit Office (NAO) report published on 6 March 2026 examined the Shared Services Strategy, under which five departmental clusters are expected to deliver £1.0 billion of net lifetime benefits. HM Treasury has committed £1.15 billion since 2021, and has incurred £459 million since 2020. The NAO found no clear owner with the levers to deliver the strategy and concluded that full benefits would not be achieved.

Effective shared services require clear service-level agreements (SLAs), consistent performance standards and transparent charging arrangements. Measures should include transaction costs, processing accuracy, response times, system availability and customer satisfaction. Otherwise, consolidation can conceal inefficiency by shifting departmental expenditure into central corporate budgets. An organisation may reduce local staffing while creating additional management, technology and supplier costs elsewhere, producing an apparent departmental saving without any corresponding improvement in total expenditure.

Management and Specialist Expertise – The Benefits of Organisational Depth

Larger organisations can achieve managerial economies by employing specialists whose expertise supports substantial operational activity. Procurement professionals, engineers, financial analysts, legal advisers and technology specialists may each influence expenditure

far exceeding their employment costs. Rather than expecting general managers to take on complex technical responsibilities, organisations can deploy specialist knowledge across multiple departments or locations, strengthening decision-making, improving compliance, and reducing the average cost of professional support.

Consider a manufacturing organisation employing a specialist procurement analyst at a total annual employment cost of £75,000. If improved expenditure analysis, specification reviews and supplier negotiations generate independently verified annual savings of £300,000, the gross benefit is four times the employment cost. However, the assessment must exclude benefits that would have occurred anyway and account for implementation expenditure. Specialist appointments create economic value through measurable contributions, not professional titles alone.

Organisational learning can reinforce these advantages when knowledge developed in one location transfers effectively across the wider business. Standard operating procedures, engineering improvements, supplier performance information and financial controls can support multiple operations without complete reinvention. Large organisations may also offer structured career development and technical training. However, knowledge sharing requires accessible systems, clear responsibilities, and management commitment, rather than assuming information will naturally move between departments.

The consolidation of NHS England, NHS Digital and Health Education England illustrates savings from removing duplicated management capacity. NHS England's 2024/25 annual report recorded a 35% reduction in organisational size following the merger, resulting in £490 million of savings, with a further £306 million achieved through additional efficiencies in central costs. These are reported savings from becoming smaller and less duplicated, and they do not establish the contribution of any individual specialist function.

Nevertheless, increasing organisational depth can produce diseconomies when specialist functions become fragmented, or management hierarchies expand unnecessarily. Additional approval stages, departmental boundaries and reporting requirements may slow decisions and distance managers from operational realities. The objective should be sufficient expertise to improve performance without creating disproportionate administrative expenditure. Effective structures balance professional specialisation with clear accountability, accessible communication and the authority needed to resolve operational problems promptly.

Financial Economies – Access to Capital and Lower Financing Costs

Financial economies of scale arise when larger or financially stronger organisations can access capital on more advantageous terms. Established trading records, diversified revenue, substantial assets and predictable cash flows may reduce lenders' assessment of credit risk. Larger borrowers can sometimes access corporate bond markets, negotiate substantial credit facilities or spread financing administration costs across larger borrowing volumes. However, financial strength and creditworthiness matter far more than organisational size alone.

Consider two organisations each requiring £20 million to finance operational investment. If one secures borrowing at 5% annually and the other pays 8%, their annual interest expenditure would be £1 million and £1.6 million respectively, before fees and other financing adjustments. The £600,000 difference can materially affect investment returns and competitive pricing. These illustrative rates show the importance of financing costs but do not imply that larger borrowers automatically qualify for preferential terms.

Thames Water demonstrates why substantial operational scale does not guarantee inexpensive or readily available finance. In July 2024, Moody's and S&P Global Ratings downgraded the company's senior debt below investment grade, citing liquidity concerns. Losing investment-grade ratings placed Thames Water in breach of its licence, and the Water Services Regulation Authority (Ofwat) responded by appointing an independent monitor. Millions of customers could not offset the consequences of excessive borrowing and weak financial resilience.

Financial economies should therefore be assessed through the overall cost and availability of capital, not merely the interest rate attached to individual loans. Arrangement fees, security requirements, financial covenants, refinancing exposure and shareholder expectations all affect financing decisions. An organisation pursuing rapid expansion through excessive borrowing may sacrifice resilience to achieve operational scale. Sustainable advantages depend on sound governance, manageable debt, and investments that generate returns sufficient to justify the financing commitments.

Scale and Competitive Pricing – Who Receives the Savings?

Economies of scale can strengthen competitive advantage by reducing the cost of producing or delivering comparable goods and services. Organisations may use these savings to lower selling prices, increase operating margins, invest in technology or improve service quality. The distribution of benefits depends on competitive conditions, commercial strategy and customer expectations. Lower unit expenditure creates the capacity to offer better value, but it does not determine how that financial advantage will ultimately be shared.

Consider a retailer purchasing a product for £8 and selling it for £12 before accounting for other operating costs. If greater purchasing volumes reduce the acquisition cost to £7.20, the retailer gains £0.80 per unit. It could reduce the selling price, retain additional margin or divide the benefit between customers and shareholders. The decision depends on demand, competitor pricing, market conditions and the retailer's wider commercial objectives, rather than on the saving itself.

The proposed merger between Sainsbury's and Asda illustrates why increased market scale does not necessarily benefit consumers. In April 2019, the Competition and Markets Authority (CMA) prohibited the transaction, concluding that reduced competition would likely lead to higher prices, reduced choice, and poorer service. Although the businesses argued that the merger would generate efficiencies enabling lower prices, the CMA determined that the overall effects would harm shoppers across the UK.

The CMA's merger assessment guidelines recognise that efficiencies can strengthen competition when they lower costs or support innovation. However, merging parties must support claimed benefits with credible evidence, and the CMA weighs those benefits against potential competitive harm. Where market concentration reduces competitive pressure, organisations may have less incentive to pass savings to customers. Consequently, economies of scale and competitive markets are related considerations, but neither guarantees the other, and procurement professionals should recognise the difference.

Commercially sustainable pricing requires understanding both unit costs and the value delivered to customers. Aggressive discounting may increase sales volumes but undermine profitability if contribution margins become inadequate or service expenditure rises disproportionately. Conversely, retaining every efficiency gain may weaken market positioning where competitors offer better value. The strongest pricing strategies consider cost advantages, demand sensitivity, service differentiation and long-term financial resilience, rather than relying solely on purchasing leverage or market share.

Economies of Scope – When Sharing Resources Matters More Than Volume

Economies of scope occur when producing several products or services together costs less than producing them independently. Unlike economies of scale, which arise through greater volumes of comparable output, economies of scope result from sharing resources across different activities. Common distribution networks, procurement teams, technology platforms and specialist employees can support multiple product categories. The advantage depends on whether combining activities creates genuine cost efficiencies or adds organisational complexity.

A retailer operating grocery, clothing and household product categories may share purchasing expertise, distribution infrastructure, property and administrative systems. If these activities

ran independently, each would require separate management, technology, and logistical arrangements. Shared facilities can reduce duplication and improve resource utilisation. However, different handling requirements, storage conditions, and supplier markets may limit how far individual operating activities can be combined economically before complexity outweighs the savings.

Tesco's merger with Booker Group, completed in March 2018 for around £3.7 billion, provides a relevant British example of complementary activities. The transaction combined Tesco's retail capabilities with Booker's food wholesale and distribution operations. Tesco forecast pre-tax synergies of at least £200 million a year by the end of the third year after completion, drawn from procurement, distribution and central functions. These were forecast benefits at announcement, not independently established savings.

Economies of scope are particularly relevant to organisations considering diversification, shared infrastructure or additional service offerings. However, diversification should not justify combining activities with incompatible operating requirements. Shared management may reduce overheads but increase decision-making complexity, and common technology becomes expensive when it requires extensive modification. Genuine scope economies exist only when combined provision delivers lower total expenditure or superior value compared with efficiently managed separate operations.

Growth, Mergers and Acquisitions – The Promise of Synergy

Mergers and acquisitions are frequently justified by the expectation that combining organisations will generate economies of scale and scope. Consolidated purchasing, integrated distribution networks, shared technology and reduced administrative duplication can create substantial financial opportunities. However, projected synergies must be distinguished from actual savings. Integration requires investment, management attention and operational change, while incompatible systems, overlapping contracts and cultural differences can delay or eliminate anticipated benefits.

Lloyds Banking Group's acquisition of HBOS provides a significant British example of realised integration savings. Its 2011 results reported that, by 31 December 2011, the integration programme had delivered annual run-rate savings of £2,054 million, exceeding £2 billion a year in cost synergies. The programme spanned procurement, technology rationalisation, property and workforce changes, and it included migrating millions of HBOS customer accounts onto a single banking platform during 2011.

Achieving those benefits required substantial expenditure. Lloyds reported aggregate expensed integration costs of £3,846 million by the end of 2011, including £1,097 million incurred that year for severance, technology, and implementation. Annual run-rate savings represent the estimated recurring benefit at a particular point, not the total cash realised during preceding periods. Assessing acquisition performance therefore requires considering implementation costs, the timing of benefits, and financing arrangements together.

Mergers can also create unexpected operational challenges when organisations try to combine different technologies, employment arrangements, supplier contracts and management cultures. Integration may require redundancy expenditure, software replacement, property rationalisation and extensive process redesign. Customer relationships can deteriorate when consolidation disrupts established services. These risks become particularly significant when anticipated savings depend on rapid implementation, leaving insufficient time to properly resolve complex operational or contractual dependencies.

The commercial case for acquisition must therefore establish which efficiencies are achievable, when benefits will arise and how implementation risks will be managed. Regulatory approval is a separate consideration, particularly where consolidation may substantially lessen competition. Under the Enterprise Act 2002, qualifying mergers can be reviewed by the CMA, which assesses potential competitive harm alongside substantiated efficiencies. Greater organisational scale is not sufficient justification where customers,

suppliers or competition would suffer unacceptable consequences.

Economies of Scale in the Public Sector

Public sector economies of scale arise when public bodies coordinate purchasing, infrastructure, technology and administrative resources to improve value for money. Centralised procurement and collaborative commissioning can reduce duplicated activity, strengthen technical expertise and increase negotiating leverage. However, public sector efficiency must also account for statutory responsibilities, accessibility, service quality and wider economic considerations. The lowest unit purchase price does not necessarily represent the most advantageous outcome for taxpayers or service users.

NHS Supply Chain demonstrates both the opportunities and limitations of national purchasing aggregation. The National Audit Office reported in January 2024 that approximately £4.5 billion of relevant NHS purchasing passed through Supply Chain arrangements, while at least £3.4 billion was spent through alternative routes. Its reported market share was 57%, below the 62% target. Some NHS organisations identified product availability and competitive local pricing as reasons for purchasing elsewhere. The NAO also questioned the reliability of reported efficiency savings, noting that benefits from previous years had been counted again. The findings demonstrate why aggregated expenditure should not automatically be treated as evidence of improved value for money.

Social housing offers comparable opportunities through collaborative procurement of repairs, maintenance, materials and specialist services. The Regulator of Social Housing (RSH) reported 4.5 million social homes owned by registered providers in England at 31 March 2025, comprising 2.9 million owned by private providers and 1.6 million by local authorities. Its 2025 value-for-money analysis found median headline social housing costs had risen 11% to £5,690 per unit, increasing pressure on aggregate demand.

Public procurement aggregation must also preserve competition, transparency and supplier accessibility. Under Section 12 of the Procurement Act 2023, contracting authorities carrying out covered procurement must have regard to the importance of delivering value for money, maximising public benefit, sharing relevant information and acting, and being seen to act, with integrity. They must also treat suppliers equally unless different treatment is justified and consider whether barriers affecting small and medium-sized enterprises can be reduced or removed. Centralised purchasing should therefore deliver clear commercial benefits without unnecessarily restricting market participation, weakening competition, or compromising the quality and accessibility of public services.

Economies of Scale in Practice – UK Business Examples

Tesco demonstrates how purchasing volume, distribution infrastructure and coordinated operations can support economies of scale. For 2025/26, it reported group sales of £66.6 billion and adjusted operating profit of £3.15 billion on a 52-week basis, while statutory operating profit, measured over 53 weeks, was £2.99 billion. Common purchasing, shared systems and consolidated deliveries across thousands of stores all contribute, but these results cannot isolate how much profit derives specifically from scale.

More direct evidence appears in Tesco's Save to Invest programme, which delivered approximately £535 million in savings during 2025/26, ahead of its target, and set a new £500 million target for 2026/27. The programme optimises store, transport, and distribution infrastructure, reinvesting savings in lower prices and colleague pay. These are company-reported programme benefits, reflecting operational improvement rather than economies attributable to purchasing volume or organisational size alone.

Rolls-Royce provides a contrasting engineering example. In 2025, it reported underlying revenue of £20.1 billion, underlying operating profit of £3.46 billion and an underlying operating margin of 17.3%, up from 13.8% in 2024. Statutory operating profit was £4.47 billion and free cash flow £3.27 billion. The company attributed much of its Civil Aerospace improvement to

stronger large-engine aftermarket performance, contractual margin improvements, and an efficiency and simplification programme.

These examples show why financial improvement should be traced to three distinct sources. Genuine scale-related efficiencies lower unit costs because volume spreads fixed expenditure, as with route density in parcel networks. Productivity improvements independent of scale, such as process redesign, automation and simplification, can be achieved at almost any size. Commercial changes, including pricing, contract terms and product mix, raise margins without altering underlying cost efficiency. Each requires different evidence and different management action.

These distinctions matter most when interpreting the results of large British organisations. Tesco's reported Save to Invest savings reflect operational improvements, some of which may benefit from its existing scale, but their precise attribution requires more detailed evidence. Rolls-Royce's margin improvements reflect a combination of operational efficiency, commercial arrangements and aftermarket performance. Royal Mail's extensive delivery network creates opportunities for distribution economies, although declining letter volumes also affect its underlying cost structure. Organisational size may support all three forms of improvement, but reported financial performance alone cannot establish each contribution.

Diseconomies of Scale – When Growth Increases Unit Costs

Diseconomies of scale occur when increasing organisational output raises long-run average costs rather than lowering them. Greater size can create management complexity, communication difficulties, duplicated responsibilities and excessive administrative expenditure. Decisions requiring approval from several departments slow down, while employees become increasingly removed from senior management. The financial consequences can remain hidden when expanding sales volumes create an impression of success despite deteriorating productivity and rising unit costs.

Consider a manufacturer whose annual output increases from 200,000 to 300,000 units while operating expenditure rises from £4 million to £6.6 million. Average production cost increases from £20 to £22 per unit, a 10% deterioration despite a 50% increase in output. The additional expenditure may reflect management appointments, inefficient capacity expansion, overtime, quality failures or logistical complexity. Higher production has increased activity without meaningfully improving economic efficiency.

Government's earlier attempts at consolidation provide measurable evidence. In March 2012, the NAO examined five of the shared service centres established across central government between 2004 and 2011. Together they had cost £1.4 billion to build and operate, 56% more than the £0.9 billion predicted, while estimated savings by the end of 2010/11 were only £159 million. Two centres had around 50% spare capacity, and three failed to attract the customers expected.

Social housing provides further evidence that size does not automatically lower costs. In June 2016, the Homes and Communities Agency analysed unit costs across larger housing associations and found no significant evidence that provider scale reduced costs once other factors were controlled for. Median headline social housing costs were £3,550 per unit in 2015, and no measured factor explained about half of the variation between providers.

The Post Office Horizon scandal shows how centralisation, poor information and inadequate challenge can magnify failure across a national network. A single accounting system, trusted without effective scrutiny, generated shortfalls attributed to subpostmasters across hundreds of branches, while hierarchical reassurance suppressed warning signs. As at 30 September 2026, the organisation had paid approximately £1,731 million in financial redress to more than 14,000 claimants, arising from injustice rather than economies of scale.

The lesson is that common systems and centralised management do not automatically deliver sound governance or operational effectiveness. Larger organisations require reliable

information, accountable decision-making, and effective mechanisms to challenge errors. When managers rely too heavily on established procedures or hierarchical reassurance, problems can persist across multiple locations at once. The resulting financial, legal and reputational consequences may overwhelm any savings originally anticipated from centralising activities and standardising organisational processes.

The Hidden Cost of Complexity

Operational complexity increases when organisations expand product ranges, customer requirements, supplier relationships, geographical coverage and internal management structures. Each additional variation may require different specifications, stockholding arrangements, contracts, training or quality controls. Although individual changes may seem commercially attractive, their combined effects can disproportionately increase administrative and operational expenditure. Growth becomes economically questionable when supporting additional activity requires progressively greater resources without corresponding improvements in contribution margins or productivity.

A manufacturer supplying 100 standardised components may operate efficiently through common materials, established production schedules and straightforward quality procedures. Expanding to 500 product variations could require additional tooling, specialist inventory, more complex scheduling and more frequent machine changeovers. Even with substantial increases in turnover, the resulting complexity may reduce equipment utilisation and increase waste. Commercial managers must therefore distinguish profitable product diversification from unnecessary variation that consumes disproportionate resources.

Marks and Spencer provides a clear example of the risks within interconnected retail technology and operating systems. Its 2025 cyber incident disrupted online trading, product availability, and wider operations, and the company estimated the impact on operating profit at about £300 million before mitigation. Although a cyberattack caused the disruption rather than complexity itself, the incident showed how tightly integrated processes can transmit operational problems across an entire large-scale retail business.

Complexity also emerges when mergers bring together incompatible information systems, contractual arrangements and management practices. Organisations may initially retain separate platforms to maintain business continuity, creating duplicated software expenditure and fragmented reporting. Integrating those systems generates implementation costs, disrupts employees and temporarily reduces productivity. Therefore, assess the anticipated benefits of consolidation against the resources required to harmonise operations and maintain acceptable service standards throughout implementation.

Effective complexity management requires organisations to understand the cost of serving different products, customers and operating locations. Product profitability should include procurement, production, warehousing, distribution, returns and administrative expenditure, not just direct material costs. Managers should periodically challenge unnecessary specifications, low-volume product variations and inefficient operating arrangements. Simplification can generate substantial benefits without additional growth, especially when existing resources are sufficient but poorly coordinated.

Economies of Scale Versus Flexibility and Responsiveness

Large organisations gain advantages through standardised processes, purchasing volumes and specialist infrastructure, but smaller businesses may respond more effectively to changing customer requirements. Shorter reporting lines, direct management involvement and fewer approvals can accelerate decision-making. Smaller organisations may also develop specialist products or personalised services that would be uneconomical within highly standardised operations. Competitive performance therefore depends on matching organisational capabilities to customer expectations rather than pursuing size for its own sake.

Halma shows how specialist manufacturing can combine group scale with small-company

responsiveness. The safety, environmental and healthcare technology group operates dozens of autonomous businesses serving niche markets, describing its decentralised model as empowering leaders to respond with agility. For the year to 31 March 2026, it reported revenue of £2,582.3 million, adjusted earnings before interest and taxation of £594.5 million and a 23rd consecutive year of adjusted profit growth.

The collapse of Britishvolt in January 2023 illustrates the opposite risk: planned scale replacing proven demand. The company proposed a £3.8 billion battery gigafactory in Northumberland with around 3,000 jobs, supported by a conditional government funding commitment of £100 million. Without secured customers or sufficient financing, it entered administration before production began. Capacity planned for economies of scale could not replace established demand and adequate funding.

Flexibility becomes especially valuable when market conditions change unexpectedly. Smaller organisations may adjust production schedules, supplier arrangements or service offerings without extensive internal consultation. However, they may also face higher purchase prices, limited financial reserves and dependence on a small number of employees or customers. The strongest competitive position arises when organisations combine efficient operations with the responsiveness their markets require, regardless of their overall size.

Concentration, Dependency and Supply Chain Resilience

Concentrating production, suppliers, warehouses and technology infrastructure can reduce operating expenditure by eliminating duplication and improving resource utilisation. However, the same arrangements increase exposure to disruption when essential activities depend on a limited number of facilities or suppliers. A single distribution centre may offer lower storage costs than several regional warehouses, but a fire, system failure or transport interruption could affect every customer it serves at the same time.

The JLR cyber incident demonstrates the wider economic consequences of concentrated and interconnected operations. The independent Cyber Monitoring Centre estimated the cost to the UK economy at around £1.9 billion, within a modelled range of £1.6 billion to £2.1 billion, with more than 5,000 organisations affected. It classified the event as the most economically damaging cyber incident to hit the UK to date, although these remain modelled estimates rather than confirmed final losses.

The incident highlights how operational dependency extends well beyond an organisation's own facilities. Component suppliers, logistics providers and dealerships can experience severe financial pressure when a major manufacturer stops production. Organisations with substantial purchasing power may unintentionally create systemic vulnerabilities when suppliers become dependent on their demand. Effective resilience planning should therefore examine supplier financial stability, alternative production capacity, cybersecurity, inventory buffers and the consequences of a prolonged interruption.

Resilience measures involve financial trade-offs because alternative suppliers, additional inventory and spare capacity increase expenditure during normal operations. Consider a distributor choosing between one central warehouse costing £4 million annually and two regional facilities costing £4.6 million. If a major disruption has an estimated annual probability of 10% and would cause £8 million in losses under the centralised arrangement, the expected annual disruption loss is £800,000.

On these illustrative assumptions, the additional £600,000 investment could be economically justified if regionalisation materially reduces that exposure. However, management must also consider differences in transport costs, disruption severity, recovery capability and the possibility of simultaneous failures affecting both facilities.

Sustainable economies of scale should therefore be measured against risk-adjusted operating costs rather than minimum expenditure under ideal conditions. Organisations should examine concentration exposure, recovery times, insurance limitations and the availability of substitute

suppliers or facilities. Some operational redundancy may be commercially justified when service interruptions would cause substantial losses. The objective is not to eliminate every risk, but to balance efficiency, resilience, and financial sustainability.

Measuring Economies of Scale – Proving That Bigger Is Better

To establish whether economies of scale have genuinely been achieved, use consistent performance measures before and after expansion. Cost per unit is the starting point, supported by cost-to-serve, employee productivity, capacity utilisation, inventory performance and distribution expenditure. Comparisons must use equivalent products, service standards and accounting treatments. Otherwise, apparent improvements may reflect inflation, changing product specifications, or accounting allocations rather than genuine improvements in underlying operational efficiency.

Consider a manufacturer increasing annual output from 500,000 to 750,000 units while expenditure rises from £8 million to £10.5 million. Average cost falls from £16 to £14, a 12.5% reduction. However, management should also examine quality defects, production downtime, inventory investment and capital expenditure. If the additional machinery costs £5 million, the investment must generate sufficient sustainable benefits to justify its financing costs and expected economic life.

Return on capital employed (ROCE) is another important measure, comparing operating profit with the capital required to generate it. A business reporting operating profit of £4 million against capital employed of £40 million achieves ROCE of 10%. If expansion raises operating profit to £5 million but requires £60 million of capital, ROCE falls to about 8.3%, despite higher absolute earnings. In this case, growth has not improved capital efficiency.

TCO offers a broader procurement and operational perspective by incorporating acquisition, implementation, operation, maintenance and disposal costs. Managers should also monitor stock turn, deliveries per vehicle, warehouse cost per order and output per employee. Crucially, reporting must separate improvements attributable to greater scale from those arising through technology, pricing, workforce productivity or product mix, and must state whether figures are statutory, adjusted, cash, run-rate or forecast.

Summary – Scale Is an Advantage Only When It Delivers Efficiency

Economies of scale can strengthen organisations through purchasing leverage, efficient production, shared infrastructure, specialist expertise and better technology utilisation. These advantages can lower average costs, support competitive pricing, and free up resources for further investment. However, greater size does not guarantee superior economic performance. Expansion can also increase complexity, management costs, financial exposure and supply chain dependence, particularly when growth proceeds without effective planning, measurement or accountability.

The experiences of Tesco, Rolls-Royce, Royal Mail, Lloyds Banking Group and public bodies from the NHS to central government show that scale creates different opportunities across industries. Purchasing coordination, engineering specialisation and distribution density can improve performance, but their benefits depend on market conditions and management effectiveness. Conversely, operational disruption, excessive centralisation and unsuitable investment can erode anticipated savings, sometimes entirely, as the government's earlier shared service centres demonstrated.

Ultimately, the objective should be the most economically effective operating scale, not maximum size. Larger organisations must retain flexibility, maintain effective governance and protect operational resilience, while smaller competitors can succeed through specialisation and responsiveness. Purchasing power, production capacity, technology and shared services create lasting advantages only when they deliver measurable improvements in cost, quality and customer value. Bigger is better only when it genuinely makes the organisation more efficient.

Additional articles can be found at Procurement and Supply Chain Management Made Simple. This site looks at procurement and supply chain management issues to assist organisations and people in increasing the quality, efficiency, and effectiveness of their product and service supply to the customers' delight. *© Procurement and Supply Chain Management Made Simple. All rights reserved.*

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