GLOBAL NETWORK FOR ADVANCED MANAGEMENT

Yale SCHOOL OF MANAGEMENT

ECONOMIES OF SCOPE

Suppose that Firm ABC is an on-line retailer of books, video, and music. We infer that Firm ABC's total cost of selling these three product lines is *lower* than the total costs of three separate firms each selling one product category. Firm ABC has thereby realized *economies of scope*.

Economies of scope are relevant to many different situations:

1. Korean *conglomerates* ("Chaebols") such as LG, Samsung, and SK account for a large share of national GDP by leveraging their governance capabilities, management skills, relationships with the government, and financial capacities across multiple lines of business.
2. Huawei produces many of the inputs going into their smart devices and also provides comprehensive end-to-end communication technologies.[1] Apple, by contrast, focuses on design of their smart devices and a small subset of inputs.
3. Indonesia's largest ride-sharing company, Gojek, has launched a successful video streaming service.
4. Along with its original messaging / chat services, Tencent offers a range of services, including gaming, payments, and financial services.

Examples 3 and 4 raise a fundamental strategic question: What opportunities exist for successful high-tech platforms to organize its users and suppliers across additional lines of business? One might expect that a successful platform can offer its users additional products and services. Indeed, this strategic narrative of adding more products and services is common.

You should be skeptical about claims that economies of scope are always available for high-tech firms. [2] Major bike-sharing firms in Europe did not have any advantages in marketing hotel rooms to their customers (https://www.donkey.bike). Leveraging their customer bases has not worked out so well for Chinese bike-sharing companies. (See photo on next page.)

Readings:

1. Robert J. Graham, "Introduction to Economies of Scope" https://www.dummies.com/education/economics/introduction-to-economies-of-scope/
2. Ronald Coase, "The Nature of the Firm," *Economica* 4 (16): 386-405 (1937).

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[1] Economies of scope influence the scope of firms' activities and, hence, the extent to which they are *vertically integrated*. Ronald Coase (1937) explained that the extent of *vertical integration* depends on the costs of organizing economic activity within the firm versus the transactions costs of using outside suppliers. Using outside suppliers requires contracts that minimize opportunistic behavior and encourage suppliers to make relationship-specific investments. For these and other insights, Ronal Coase innovations that are specific to the downstream buyer. Rf., Coase (1937).

[2] https://www.economist.com/business/2019/01/26/lessons-from-the-fall-of-chinas-bike-sharing-pioneer, The *Economist*.

Source: Projectgus