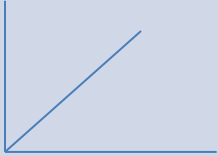
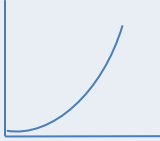
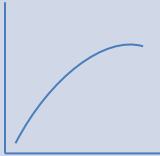
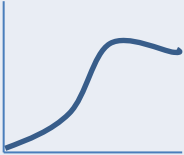


Returns to Scale - Costs

Praveen Malla

Law of Returns to Scale

Type	Curve (X: Input Factors; Y: Output)	Description	Example (MEC case)
Constant Returns to Scale		Proportional increase in all inputs = proportional increase in output	10% increase in manpower and facilities = 10% increase in admissions
Increasing Returns to Scale		Proportional increase in output > Proportional increase in inputs	10% increase in manpower and facilities = 15% increase in admissions
Decreasing Return to Scale		Proportional increase in output < Proportional increase in inputs	10% increase in manpower and facilities = 5% decrease in admissions
Variable Returns t Scale		First increase and then decrease in output (Most typical case)	10% increase in manpower and facilities = 15% increase in admissions and probably 5% dropouts

Cost

Type of Cost	Meaning	Example
Actual and Opportunity Costs	Actual: Those that are recorded in the books of account	Wages Paid
	Opportunity: Revenue that could have been earned by employing a good/service in some other alternative use	Businessman taking employment else where for salary
Incremental (Differential) and Sunk Costs	Incremental: Additional cost due to a change in the level or nature of business activity	Establishing a new office; adding a new product line; purchase of additional warranty
	Sunk: Cost incurred once that cannot be retrieved	Non-refundable security deposit; Cost incurred on setting up say 'meat shop' that becomes irretrievable when meat sale is banned

Cost

Type of Cost	Meaning	Example
Short-run and Long-run Costs	SRC: Costs that vary with output when fixed plant and capital equipment remain the same	Firm decides not to increase production in the near future. So firm manages with existing plant and equipment.
	LRC: Costs that vary with output when all input factors including fixed plant and equipment vary	Firm decides to increase production and therefore adds capital resources
Fixed and Variable Costs	Fixed: Fixed. Not impacted by the changes in volume of production	Salary for professors
	Variable: Varies with changes in volume of production	Fuel costs (cab fare – distance and wear and tear determine costs)

Cost

Type of Cost	Meaning	Example
Urgent and Postpone-able Costs	Urgent: Costs that are incurred to continue operations of the firm	Raw material
	Postpone-able: Costs that can be deferred without impacting the operations of the firm	Maintenance
Escapable and Unavoidable Costs	Escapable: Costs that can be reduced when business contracts. Can be controlled and are discretionary	Closing a branch; firing some manpower
	Unavoidable: Costs that are incurred irrespective of the business conditions	Say housekeeping in a movie hall or a college or a hotel

Cost

Type of Cost	Meaning	Example
Abandonment and Shutdown Costs	Abandonment: Cost of retiring a plant/asset etc permanently from service/use	Cessation/closure of say Begumpet airport
	Shutdown: Cost incurred in the event of suspension of plant operations. These costs could have been saved had the plant continued its operations	Re-recruitment costs when operations re-commence

Cost

Type of Cost	Meaning	Example
Past and Future Costs	Past: Cost incurred in the past. Can be found in financial statements of the firm	Fees paid for your 10+2 studies
	Future: Costs to be incurred in the future. Can be found in the budget statements or cost forecasts of the firm	Fees to be paid for your second year Engineering studies
Direct and Indirect Costs	Direct: Traceable cost	Salary or costs incurred by a certain department
	Indirect: Cannot be traced	HR and Admin departments conduct a joint programme and incur costs. If the costing unit is not clear.