Factors influencing Optimum Size of firm:

The following are the factors that influence the optimum size of a firm:

a. Technical forces
b. Managerial forces
c. Financial forces
d. Marketing forces
e. Forces of risk and fluctuations

1. Technical forces influence size of a firm

Technical forces which influence the optimum size of firm are degree of specialization (division of labour), mechanization and integration of work processes. In the case of division of labor, a job is split into small functions and each function is assigned to a specific workman. When a workman performs a specific operation over a long period of time, the skill of the workman, speed of performance, quality of work etc improve.

Division of labor facilitates mechanization. A firm has to be fairly large enough to go in for mechanization. A large firm producing standardized products can go for assembly line manufacturing which increases output and results in lower cost of output. Another advantage is a large scale firm can go in for integration of processes. Manual labor can be replaced by machines. Technical factors favor expansion of an organization. The size of the optimum firm will be large if

1. the product or machinery used for manufacturing is large in size (e.g. ship building, aircraft manufacturing, iron and steel plants, heavy machinery etc)
2. the industry is a public utility (power generation and distribution, railways etc.)
3. the industry produces intricate, complex products (computer chips, semi conductors, watches etc).

In case then industry produces products of a small size or the machinery used in Manufacturing is small in size, the optimum size would be small (e.g. small machine tools etc).

2. Managerial forces influence size of business units

Managing an organization today is a complex task. The services of qualified, experienced, professionals are required to run the organization in an efficient manner. Therefore businesses which desire to maximize their sales and profitability need to appoint a competent management team. To appoint such personnel, high amounts of remuneration and benefits have to be paid. Only large organizations would be able to offer such high remuneration levels. The expert managers using their ability and skills can ensure the growth of the business in various spheres. But there is a limit to which expert management can grow the organization.

3. Financial forces influence size of a business unit

Investors have more confidence in large and established firms. They prefer to invest their money in large firms because of the possibility of earning high returns. Investors generally do not prefer to invest in new or small firms because they feel that such investment is risky and the possibility of earning high returns is also less. Therefore large firms are able to raise required financial resources easily. Banks also come forward to lend loans at cheaper rates of interest and therefore cost of funds is also less for large firms.

In case of financial difficulties they can transfer funds from one division to another. Though a large firm is able to raise resources from outside resources, there is also a limitation. There may be interference in the management of the firm by outsiders. The Board of directors are answerable to shareholders, and financial institution such as IFCI, ICICI or IDBI which advance loans might require that their representative should be in the Board of directors. This sort of interference will result in management losing its independence, delayed decisions, disharmony and loss of efficiency.

4. Marketing forces influence size of business

A large firm can enjoy economies of buying and selling. Since it buys raw materials in bulk quantities it can enjoy the benefits of quantity discounts. It can employ experts for purchase. They would be able to source quality raw materials at cheaper prices. Similarly experts can be employed for marketing their products. In case a large firm has multiple products the sales force can market the entire range of products.

Advertisement time in media can be bought in bulk at cheaper rates. The organization can employ reputed market research agencies to know the changing needs and preference of consumers and produce products accordingly. But the large firm cannot have close contact with the customers and understand their requirements whereas a small firm can do so. Any mistake done by a large firm would result in huge losses. Suppose a large firm buys raw material and later find is unsuitable, it would find it very difficult to dispose it because of the bulk quantity.

5. Forces of risks and fluctuations influence size of business

Business enterprises face risks from different sources. Risks may arise due to the following reasons:

- changes in customers preferences (textiles to ready-made, typewriters to computers etc.)
- changes in fashions (jeans to cotton casuals etc.)
- increased competition (in all industries)
- changes in government policies (reservation to De-reservation in SSI’s, ban on lottery sales in Tamil Nadu, from protection to local industry to liberalization, globalization and privatization etc.)
- fluctuations in currency rates. (1$ = Rs.30 in 1980’s to 1$ = 68 in 2016)
- difficulty in getting production inputs (power shortages in many states etc)
- loss of key employees.
- development in technology (pagers to mobile phones, floppies to CD’s)
- theft, pilferage and embezzlement of organizations resources natural calamities (earthquakes, tsunami, floods, etc)

In case of risks, a small firm would be able to adjust its operations and business much faster when compared to a large firm. A large firm would find it difficult to change its business and way of working in a quick manner. Sometimes large firms may combine with other firms to adjust itself to the new changes.