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microNOTE # 6

AMAP BDS Knowledge and Practice Task Order

Lexicon

This lexicon is created to have a common language for key value chain concepts.

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Agglomeration strategy

Any approach for increasing the horizontal coordination of firms' activities or outputs, in order to generate one or more of the following: transaction cost savings, collective economic efficiencies, learning, and/or economies of scale. Examples include a trader organizing the collection of outputs from multiple firms or, alternatively, the collection of outputs being organized by a producer cooperative or an exporter.

Asymmetric information

Information that is available to one or more individuals or firms but not to others.

Capital

Money or assets put to economic use. Includes fixed capital (machinery, buildings, etc.), working capital (raw materials, partially finished products, cash on hand, etc.), financial capital (money, bonds, shares), human capital (knowledge, skills, capabilities), and social capital.

Cluster

A group of geographically linked firms generating external economies. Clusters include firms in one or more core value chains, along with the firms providing services to them. Clusters also include organizations such as trade associations, universities and vocational schools, financial institutions, and local and national government agencies.

Competitiveness

The ability of a firm or value chain to achieve or maintain an edge over market rivals. This edge can be based on price, efficiency, quality, quantity, asymmetric access to information, uniqueness, branding, advertising, good service, and/or other environmentally or socially valued standards (e.g., social marketing, fair trade practices).

Competitive strategy

An approach for improving or maintaining firm and/or value chain competitiveness over the long run.

Critical success factors

Firm or value chain characteristics that underlie competitiveness. Examples of these characteristics include price, quality, uniqueness, delivery reliability, and the presence of inter-firm cooperation.

Divisibility of capital

The smallest unit of financial or physical capital at which economies of scale can be achieved.

Economies of scale

Reduction in the average cost of each unit of production as total output increases. Economies of scale often result from the ability to spread overhead and fixed costs over more units of output. Diseconomies of scale occur when an increase in the total units of production results in higher average costs per unit.

Expected returns

Projected profits under conditions of uncertainty; calculated as the sum of the net returns from each possible outcome multiplied by the probability each outcome will occur (i.e., the sum of the weighted net returns from each possible outcome).

External economies

A type of externality in which some of the benefits generated by a firm's actions accrue to outside firms and individuals. In this situation, the marginal social cost of an activity is less than its marginal social benefit.

Factors of production

The ingredients of economic activity: land, labor, capital, and enterprise. Payments to the four factors of production are rent, wages, interest, and profit, respectively.

Governance

A description of the dynamic distribution of power, learning, and benefits among firms in a value chain. Governance can be characterized along a continuum of four types of relationships:

1. **Market relationship**: arms-length transactions in which there are many buyers and many suppliers; repeat transactions are possible, but little information is exchanged between firms; interactions are limited and no technical assistance is provided.

2. **Balanced relationship**: both buyers and suppliers have alternatives; supplier has various buyers; if supplier has few buyers, then buyer has few suppliers; extensive information flow in both directions, with buyer often defining the product (design and technical specification); both sides have capabilities that are hard to substitute; both sides are committed to solving problems through negotiation rather than threat or exit.

3. **Directed relationship:** main buyer takes at least 50 percent of supplier's output; buyer defines the product (design and technical specification) and monitors the supplier's performance; buyer provides technical assistance; buyer knows more about supplier's costs and capabilities than supplier knows about buyer's; supplier's exit options are more restricted than buyer's.

4. **Hierarchical relationship:** vertical integration of value-added functions within a single firm; supplier is owned by buyer or vice versa; limited autonomy to make decisions at the local level.

Horizontal linkages

Market and non-market interactions and relationships between firms performing the same function (i.e., operating at the same level) in the value chain.

Inter-firm cooperation

Joint action between two or more firms in a value chain. Includes horizontal and vertical linkages between firms and can be formal or informal. Examples include bulk purchasing of inputs, subcontract farming, and industry branding campaigns.

Intermediary (a.k.a. middleman)

An individual or firm connecting the buyer and seller of a product.

Learning

The ongoing acquisition of information, skills, and capabilities by firms and value chains in order to improve or maintain competitiveness.

Market channel

A single branch of a value chain, normally defined by similarities at the final retail level.

Market power

When one firm in a market has the ability to exert significant influence over the quantity of goods and services traded or the price at which they are sold.

Net returns (a.k.a. net benefits)

Most narrowly, a firm's profits from engaging in an economic activity: total revenues minus total costs. More broadly, net returns encompassing non-profit objectives such as income stability, long-run economic security, cultural integrity, community status, job satisfaction, etc.

Relationships between terms: market channel, value chain, subsector and industry

A market channel is a subset of a value chain, which is a subset of a sector, which is a subset of an economy (market channel < value chain < sector < economy). The following terms are used synonymously: value chain, subsector, industry.

Rents (a.k.a. economic rents)

The difference between what a factor of production is paid and how much it would need to be paid to remain in its current use. The existence of rents indicates market power, since there are no persistent rents in perfect competition. (Rent also has a second definition: payments to land as a factor of production.)

Risks

A loss or the chance of a loss. The chance of things not turning out as expected.

Social capital

The level of trust and/or obligation generated by operating within the norms and networks that govern market and non-market interactions between people. Examples include the trust generated by consistently meeting delivery and quality requirements, the trust and obligation between members of a family or ethnic group, and the trust group members place in their leaders.

Transaction costs

Costs incurred during a transaction in addition to the price of the product that is changing hands. These include the costs of gathering information, the costs of negotiating a contract, and the costs of enforcing the terms of a contract.

Upgrading

Innovation that increases firm and/or value chain competitiveness. There are five categories:

1. Process upgrading: increasing efficiency (i.e., more output for same level of inputs; or same output for lower level of inputs).

2. Product upgrading: improving product quality.

3. Functional upgrading: operating at a new level in the value chain.

4. Intra-sectoral upgrading: operating in a new market channel within the same value chain.

5. Inter-sectoral upgrading: producing a completely different product in a completely different value chain.

Value added

The value of the firm's output minus the value of all its inputs purchased from other firms. It is therefore a measure of the profit earned by a particular firm plus the wages it has paid.

Value chain

The full range of activities that are required to bring a product from its conception to its end use. These include design, production, marketing, distribution, and support to get the product to the final consumer. The activities that comprise a value chain can be contained within a single firm or many firms.

Vertical linkages

Market and non-market interactions and relationships between firms performing different functions (i.e., operating at different levels) in the value chain.