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Small Firms' Slow Recovery amidst Economic Revival

What is the issue?

- The difference between headline wholesale inflation and retail inflation is being seen as an indicator of the economy opening up closer to full potential.
- However, there is slow pace of recovery of smaller companies, even as a few big companies are commanding a higher pricing power. Here is why.

What is the current inflation scenario?

- Headline retail inflation [Consumer Price Index (CPI)] eased to a 16-month low of 4.06% in January 2021.
- This was well within the RBI's medium-term target of 4%±2% and lower than the projection of 5.2% for the January-March quarter.
- Core inflation (non-food, non-fuel segment) remained sticky at 5.65% in January 2021, the same level as December 2020.
- Wholesale inflation [WPI] rate rose to an 11-month high of 2.03% in January.
- The WPI – CPI development is being seen as an indicator of the economy opening up closer to full potential.
    - The WPI is now trending up even as CPI is moderating.
    - This is a sharp reversal of the post-pandemic trend of sluggish WPI print and scorching CPI estimates.

What is the contention though?

- The key contention is turning out to be the sticky core retail inflation (prices rise in the non-food, non-fuel segment).
    - Sticky inflation is an undesirable economic situation where there is a combination of stubbornly high inflation, and often stagnant growth.
- This reflects the slow pace of recovery of smaller companies at the peripheries of sectors.
- This remains the case even as a few big companies are commanding a higher pricing power.
- All these happen at a time when demand continues to remain subdued.
- Services sector inflation is yet another cause for worry, going forward.

What are the factors behind?

- Supplies have now eased up and logistical constraints have become less.
- So, the supply to the final consumer has improved.
- Thus, it is a good sign with WPI picking up.
- But, few big companies have now better pricing power on the back of a faster recovery after the pandemic.
- This, in a way, is fuelling core inflation and inflationary expectations, even as headline inflation remains within the comfort zone of the RBI.

- On the other hand, smaller companies and traders are struggling with working capital issues.
    - This is resulting in lower capacity utilisation and lower margins for these firms.

What does the Monetary Policy Committee report show?

- [Oligopoly is a market structure with a small number of firms, none of which can keep the others from having significant influence; small group of large sellers.]
- The oligopolistic core in the economy is starting to exercise pricing power aided by –
    i. rising profits and profit margins
    ii. improving capacity utilisation and lack of new capacity additions
- In several sectors which are characterized by an oligopolistic core and a competitive periphery, the oligopolistic core has dealt with the pandemic well.
- On the other hand, it is the competitive periphery, smaller firms in other words, that has been affected.
- The big firms (in the oligopolistic core) are also the enterprises that are benefiting from borrowing at rates below the policy corridor through commercial paper issuance.

What is the challenge with supply of goods?

- The inherent core inflation is still high because available supply of goods and services is perhaps falling even short of the weak demand.
- The argument essentially is that during the lockdown and post-lockdown, a lot of companies had to shut shop; they laid off people.
- So, even if the plant and machinery is the same, their capacity to produce is seriously down, and that comes from the unemployment figures.
- It is generally presumed that if the physical capacity exists, supply should happen. But that is not fully correct.

- For supply to happen, the firms would need to get working capital and hire labour back.
- If not, then effective supply becomes lower.
- Also, most manufacturing sectors have long-tail distribution i.e. 4-5 large companies and a huge number of small ones.
- But the small ones seem to have gone out of business.
- So whatever competition the large companies were facing, that level of competition has gone down.
- To move further, companies would need some amount of inflation to recover a part of what they have lost.

Source: The Indian Express

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