# 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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