

Could Intra-Firm Misalignment Explain Price-Setting Patters?

Inspere

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Victor Monteiro^a, Diogo Guillén^a

^a Department of Economics - Inspere, São Paulo, Brazil

^b Department of Economics - Inspere, São Paulo, Brazil

Introduction

Goal: Propose a simple model for large firm's pricing decision, based on the interplay between communication within the firm and the provision of incentives.

Theoretical Contributions:

- Derive a new Phillips curve where the misalignment of incentives and the number of divisions of a given firm drive the slope of the Phillips curve;
- Show that within-firm misalignment in the communication generates price stickiness and non-neutrality of money;

Empirical Contributions:

- Our intra-firm mechanism fits the small changes on prices and heterogeneity on price-setting;
- Our communication mechanism illustrates the gathering information-misalignment.

Data-Set

- We collected daily data from 2018 onwards from the six major supermarket chains;
- Our dataset covers supermarkets goods as well as appliances and durable goods in Brazil;
- Average products per day in each retailer on the range of 6,000 to 28,000;
- We implement a textual supervised learning algorithm method that matches the names of the products with the CPI structure as a **fuzzy string matching algorithm**;
- We have an hierarchy of 19 categories and 4 sectors across the retailers.

Within Firm Environment

Firm structure - Suppose a company with two sales departments, division A and division B, and a headquarters that decides the optimal price given the information provided by the departments a la Dessein et al (2009) as:

$$\text{Max } E_t \left[\sum_{t=0}^{\infty} \beta^t \pi_i (P_{it}, P_t, Y_t, Z_{it} | M_i) \right] \quad (1)$$

Optimal Price Equation - From that, price dynamic depends on:

$$p_{it} = p_t + \frac{\pi_{13}}{|\pi_{11}|} (1 + t_i)(1 + h)^{t_i} + \frac{\pi_{14}}{|\pi_{11}|} (1 + t)(1 + k)^t \quad (2)$$

- The Aggregate Misalignment $\frac{\pi_{13}}{|\pi_{11}|}$ and the Aggregate Partition t .
- The Idiosyncratic Misalignment $\frac{\pi_{14}}{|\pi_{11}|}$ and the Idiosyncratic Partition t_i .

The Phillips Curve

The dynamics of the sectoral Phillips curve illustrates that how revelation of the information matters to the firms when taking their pricing decisions:

$$\pi_{kt}^* = \alpha_j \pi_t - (1 - \alpha_j) E_t \pi_{t+1} + \gamma_j \Delta E_t y_{t+1} + \chi_j \pi_{kt} + E_t (\pi_{k,t+1}^* - \pi_{t+1}) \quad (3)$$

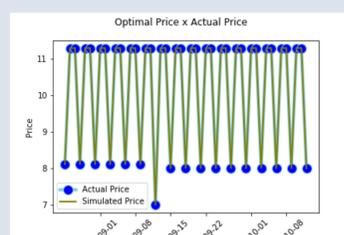
Where: $\alpha = \frac{\pi_{12}}{|\pi_{11}|}$, $\gamma = \frac{\pi_{13}}{|\pi_{11}|}$, $\chi = \frac{\pi_{15}}{|\pi_{11}|}$.

- Less informative communication (higher misalignment) induces higher inflation (through the distortions in the prices of the goods);
- Higher misalignment demands a hawkish Central Bank (in an environment with higher inflation cost);
- Misalignment enhances the persistence and size of monetary policy and disinflation output cost.

Do Retailers Match our Optimal Prices?

- Estimating optimal price equation we fit the following facts:

1. Small changes in prices
2. (Changes) Reference Price
3. Length of Price Spell
4. Sales Behavior
5. Temporal Stickiness



Apple



Rice

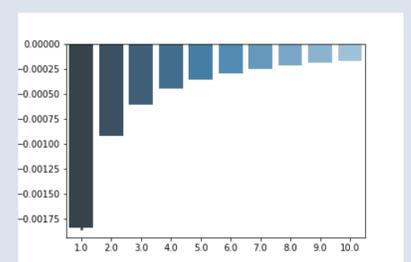


Soap Powder



Tomato Sauce

Misalignment x Partition



- The higher the number of partitions of a given good the lower is its misalignment, because:
 - \downarrow Misalignment $\rightarrow \downarrow$ noise in the communication $\rightarrow \uparrow$ informative is the communication $\rightarrow \downarrow$ intervals of each partition $\rightarrow \downarrow$ stickiness.

Main Take-Ways

- The endogenous communication mechanism, when empirically evaluated, matches the empirical prices and the gathering information-misalignment (both through the interplay partition-misalignment).
- Through the incentives provision of the firms we address the heterogeneity of price distribution; the reference/sales price behavior and the small changes on prices
- Through the Phillips curve, the within firm misalignment matters to fit the macro stylized facts as:
 - The inflation behavior;
 - The real effects of monetary policy;
 - Its interplay with both the number of sectors and the level of misalignment.

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Contact: victorecmonteiro@gmail.com / dguillen@gmail.com