

## Corporate Finance

### CORONAVIRUS: THE CURRENT BUSINESS CHALLENGE

The so called “Break-even point” is a relevant concept in business economy. Simply speaking, a company is in break-even point when the number of product units sold equals its Total Fixed Cost, divided by the respective Contribution Margin per Unit (i.e., the difference between the product price and its variable unit cost) In other words, said number of sold products is the minimum the company needs to remain “indifferent”, having neither loss nor profits: higher sales will imply benefits and, on the contrary, lower sales will imply losses.

This means that should there be a drop in the Quantity of Units Sold and assuming that the Contribution Margin per Unit is constant in the short term, the Total Fixed Cost will have to be reduced in order to maintain the break-even point. Theoretically, such Cost consists of a set of invariable expenses despite any changes in the quantity manufactured and sold: the typical examples include rents, fixed asset depreciation and several services. Labor payments (salaries) are generally classified as a variable cost, however, they may be considered a fixed cost in the short term even in the event of decrease in the manufactured quantities and the sales. This is so, not only because there are always some staff members who are key to ensure the continuity of the business, but also because there are economic factors which advise against laying staff off (in the first place, compensation costs, and then the selection and training costs in relation to new recruits), apart from all the legal obstacles involved. Obviously, the decision to keep the number of staff or not will ultimately depend on whether the situation is transient or permanent.

The current situation, as a consequence of the COVID-19 pandemic, confronts us with a major dilemma. Forecasts from reliable sources show significant drops in the economic activity for several quarters, as well as an uncertain recovery of the pre-crisis level during 2021. The “immobility” under the assumption of a quick recovery turns out to be a highly risky option: many small and medium sized companies may not have enough reserves to withstand a more or less extended reduction in sales (without even considering the situation of severely affected sectors such as commercial air transport, tourism, hotel industry and their respective value chains).

So, with “immobility” ruled out, the only alternative is to change our operating procedures in order to face the crisis. These changes may take shape from three basic vectors:

- continuing with the usual activities under a different productive modality:
- incorporating new activities; or
- implementing a combination of both.

It is evident that some of the already verified changes as a result of the emergency are permanent. For example, there is almost no return from teleworking, either totally or partially.

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Many companies that had not adopted this operating modality before have already incorporated it, and for different reasons, they are unlikely to go back to the pre-crisis situation (not only as regards costs but also due to the possibility of repeated emergencies in the future). Remote work, which is suitable for the fulfillment of a great number of tasks (in areas such as planning, administration and finance, marketing, training, etc.) will become part of the usual work environment from now on. Adopting this change will have an impact on many markets, from office purchase, sale and lease transactions to information technology services. On the other hand, it is worth pointing out that those industrial sectors which, due to the nature of their activities, are not capable of using teleworking extensively will also incorporate several changes to their operations, both in the short term (new hygiene measures, distancing among workers, health monitoring, etc.) and in the medium and long term (automation and remote operation).

Another possible change lies in the modification of the goods/services combinations that are produced so as to respond to the demand more accordingly and thus, to prevent or mitigate the drop in sales. A company in the cosmetic industry, for example, has cut down the production of perfumes and makeup and increased soap manufacture during the crisis without having to make any substantial investments (probably this type of circumstantial changes in consumption will become long lasting tendencies). In other cases, the circumstances will impose new realities (the increasing demand in e-books and audiobooks will unlikely be met by the traditional bookshops open to the public, whose survival is currently under threat as a result of the emergency).

As we all know, a company needs a specific combination of factors (traditionally: land, work and capital) given its “production function” in order to reach a certain number of goods/services produced. Owing to the economic impact of this emergency, the entire company needs to review its own “function” so as to return to the lost balance. In a few words, this is the business challenge these days.

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