

BUSINESS CLOSURE

*The other
unstoppable epidemic*



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BUSINESS CLOSURE

the other unstoppable epidemic



SYNTHESIS

More than 451 thousand companies in Mexico are in a technical stoppage: they have not opened their doors during the confinement or have made any other effort to continue operating because of different reasons. It is the closest thing to bankruptcy. There are still 47% of companies (especially SMEs) that have a probability greater than 50% of closing their doors permanently in the coming months, a percentage that represents approximately 60,283 companies.

At least two direct effects of company bankruptcy are identified in the short and medium-term: job losses and company insolvency.

The impact on the past due portfolio¹ has already begun to show itself in the SME delinquency index, which shows an upward trend, increasing from 5.9% to 6.4% from February to May of this year. For its part, formal and informal employment has fallen to its lowest rates in recorded history.

¹ The National Banking and Securities Commission (CNBV) for its acronym in Spanish, defines the past due portfolio as: all credits that have been granted by any financial entity and that have not been paid by the borrowers in the terms originally agreed.

IMPACT OF COVID-19 IN COMPANIES IN MEXICO

The consequences of COVID-19 on the Mexican economy has had a direct impact on its real sector.

The massive closure of businesses² has brought with it a drop in economic activity in an unprecedented way in the modern history of this country.

The effects of this fall are just starting to be noticed and felt. The forecast is that thousands of companies will be severely affected, which will also generate an impact on employment.

According to the 2019 Economic Censuses, most of the economic units in Mexico employ less than 250 people.

² It is extremely important to clarify that we adhere to the definition of closure presented by the National Institute of Statistics and Geography INEGI, for its acronym in Spanish, in recent days (technical stoppage and temporary closure). Since this definition allows us to have a clear overview of the depth of the economic crisis, its eventual recovery, as well as the effects generated by the closure of businesses.

Those considered as micro, small and medium-sized enterprises (MiSMEs) represent 99.8% of the total economic units. These units in turn concentrate 70.9% of the employed population, the remaining 29% is employed by large companies (with more than 250 people). Also, the sales value of the first group is 3.3 billion pesos, while for large companies it is six billion pesos a year³, which is equivalent to 42% of GDP.

According to the economic activity they carry out, 49.5% of the companies can be considered essential⁴ economic activities, and the other 50.5%.

³ The 2018 National Survey on Productivity and Competitiveness of Micro, Small and Medium Enterprises (ENAPROCE) for its acronym in Spanish, considers the value of sales of the three main goods or services.

⁴ The 2018 National Survey on Productivity and Competitiveness of Micro, Small and Medium Enterprises (ENAPROCE) for its acronym in Spanish, considers the value of sales of the three main goods or services. Gazette of the Federation and / or the National Statistical Directory of Economic Units (DENUE) for its acronym in Spanish of INEGI: <https://tinyurl.com/udwrzgm>, <https://tinyurl.com/ydymo64q>, <https://tinyurl.com/y4dza1qk>, <https://tinyurl.com/y5906mqk>.

As non-essential in such a way that the Mexican economy is lucky to keep a certain type of balance. Therefore, from the first moment in which the declaration of confinement and the closure of businesses in Mexico was made official (March 31st) and the subsequent stages of reopening, it could be said that about half of the companies in the country have not stopped operating. However, there is information from the Survey on the Economic Impact Generated by COVID-19 in Companies (ECOVIND-IE) 2020, where it mentioned that this in reality applies only to 40.4% of companies in Mexico.

The rest have had to implement closures (some longer than others) or different measures that allow them to continue operating.

With the agreements issued by the federal executive branch on April 6th and 8th, other activities were included and with them the opening of more businesses. These activities include 926 thousand 502 companies, but as mentioned, not all were in operation.

Subsequently, with the arrival of the epidemiological semaphore in Mexico (of a federal nature), various economic sectors have been gradually reopened; however, under certain restrictions, such as timetables, geographic location, or limited to a portion of

the total established clientele, in addition, local governments have established various guidelines in order to control the spread of SARS-CoV-2.

ACTIVIDADES	ROJO	NARANJA	AMARILLO	VERDE
 MEDIDAS DE SALUD	En todos los niveles se mantienen las medidas de salud pública			
 LABORAL	Sólo esenciales	Esenciales y 30% no esenciales	Se reanudan actividades esenciales y no esenciales	
 ESPACIOS PÚBLICOS	No permitido	30% de espacios abiertos	70% de espacios abiertos y 30% espacios cerrados	Apertura de espacios abiertos y cerrados
 PERSONAS VULNERABLES	No permitido	Cuidado Máximo	Cuidado Medio	Cuidado de control
 ESCOLAR	No se permite el reinicio de clases			Reinicio de clases

Image: How does the traffic light for the reopening of work centers work? En <https://tinyurl.com/yymzx8da>.

Even with the partial reopening of the economy, there are still a large number of companies that remain closed. The big question that arises from here is, how many of these companies will stop operating after the economic reopening applies to entire regions (such as states) or economic sectors?

If the reopening continues to be postponed due to the health contingency, we will likely see the unleashing of an economic crisis of greater proportions.

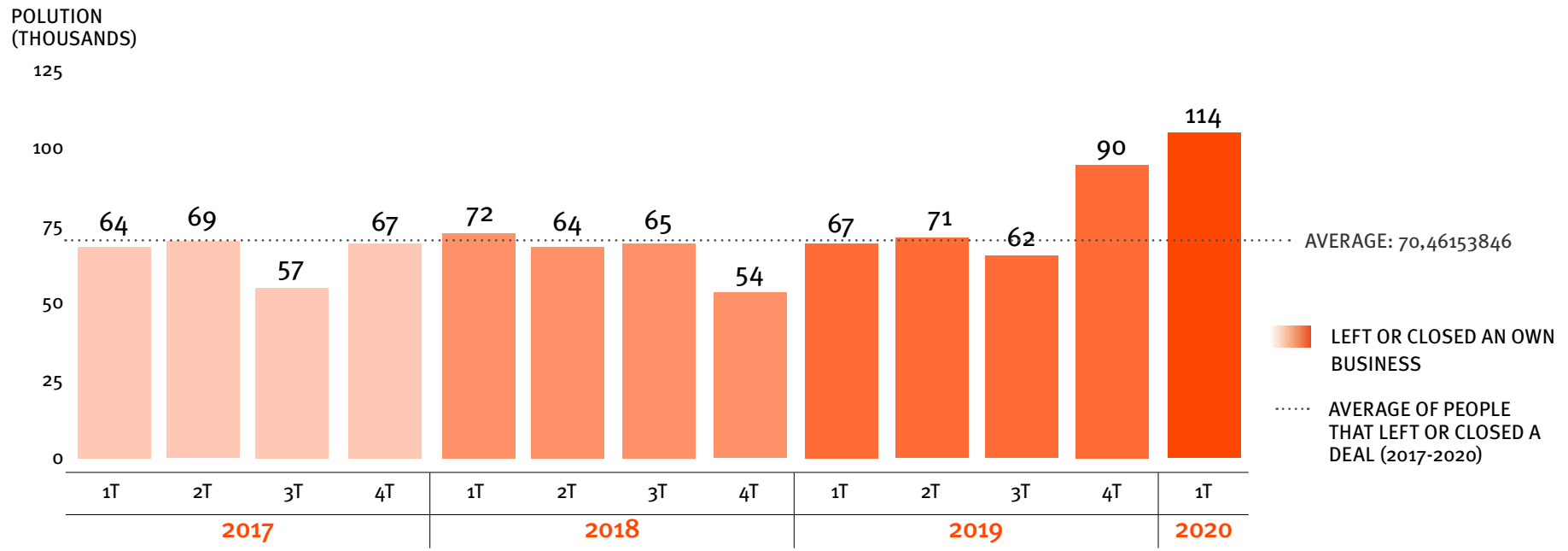
The loss of employment that will generate a consequent reduction in consumption due to the loss of income, as well as the risk that the financial system may be infected by the lack of liquidity of Mexican businesses to face the payment of their respective credits, can spread and significantly prolong the economic crisis.

BUSINESS IN THE RUN-UP TO THE HEALTH AND ECONOMIC CRISIS

Based on the National Occupation and Employment Survey (ENOE) for its acronym in Spanish, we can observe that the number of people who were unemployed due to leaving or closing their own business in March 2020 was 113 thousand 532 people, a figure not seen since the first quarter of 2014 when it was 115 thousand 470 people. This implies an increase in unemployment due to the increase in company closings of 25.5% compared to the previous quarter and 70.5% compared to the first quarter of 2019, a figure that expresses the severity in which the Mexican economy found itself. Given that the ENOE does not record the number of people who are employed due to the opening of its businesses, this figure does not correspond to the net variation (openings minus closings) of the number of businesses in Mexico, therefore the sum of the partials (between January and March) is not equal to the total number of closings (or openings).

In March 2020, 113,532 people left or closed their own business.

CHART 1. UNEMPLOYED POPULATION DUE TO LEAVING OR CLOSING THEIR OWN BUSINESS



Source: In-house elaboration with information from ENOE.

However, the statistics show the adverse situation faced by people who started a business prior to the health crisis. The sudden reduction in employment in the first quarter of 2020, when it increased by 70.3 thousand unemployed compared to the average of the first quarter of 2017-2020, meant 61.4% more, as can be seen in graph 1. The depletion of the economy had become increasingly evident since before the health crisis.

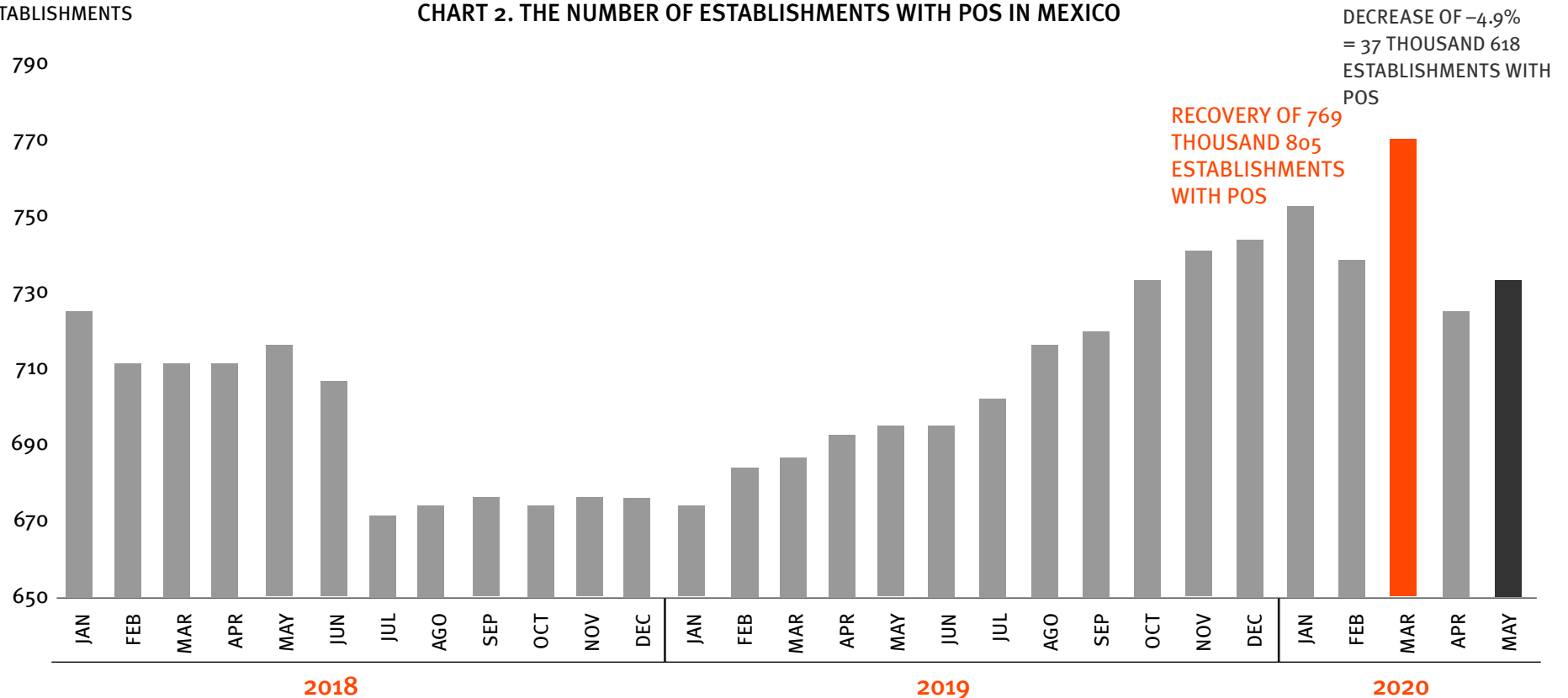
Another measurement that allows us to know the magnitude of the problem are transactions through the point of sale terminals (POS) in businesses. Although it is recognized that such variation expresses the situation of a certain set of businesses (especially SMEs) and not the totality gave the scarce financial penetration, it is an indicator of the permanence of the companies.

After recovering from the fall in the number of establishments with POS between June and July 2018, to reach a historical maximum in March 2020 (769 thousand 805 establishments with POS), the presence of POS has decreased again in May. Said decrease between March and May is -4.9%, an absolute difference of 37 thousand 618 establishments.

It is extremely important to clarify that, according to ENAPROCE 2018, 69.4% of SMEs in the country accept credit, debit cards, or checks as a means of payment versus only 16.7% of microenterprises. This implies that, based on the POS statistics, we can obtain more robust conclusions for SMEs.

THOUSANDS OF ESTABLISHMENTS

CHART 2. THE NUMBER OF ESTABLISHMENTS WITH POS IN MEXICO



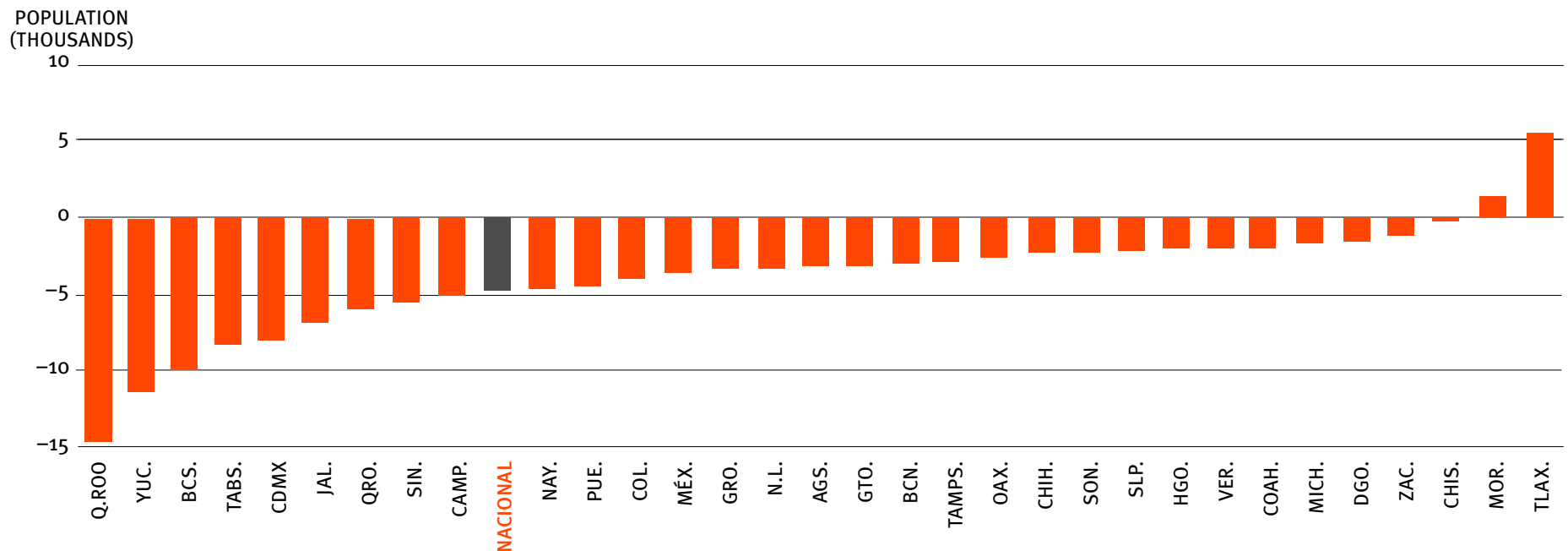
Source: In-house elaboration with information from Banco de México

The contraction in the number of establishments with POS is exacerbated when the relative variation is taken into account by state and even by regions of the country. In the southeast, Quintana Roo and Yucatán lead the loss; For their part, Tabasco and Campeche are above what's nationally registered. On the other hand, this reduction is consistent with the decrease in the number of formal jobs by state. Consequently, it is not surprising that Baja California Sur is also among the states with the greatest reduction.

The foregoing due to the vocation of such states to tourism services. Now, concerning the total loss in the said period, only four states accumulate 56.1%, namely: Mexico City, Jalisco, Quintana Roo, and the State of Mexico.

The greatest loss of establishments with POS belongs to the states dedicated to tourist services.

CHART 3. VARIATION (MARCH-MAY) IN THE NUMBER OF ESTABLISHMENTS WITH POS / FEDERAL ENTITY



Source: In-house elaboration with information from Banco de México.

According to this survey, 93.5% of small businesses consider that the main reasons for the bankruptcy are: drop in sales, high cost of utilities and services (electricity and gasoline), lack of working capital and a reduction in suppliers repayment terms, public safety (armed robbery and petty theft), rent and salaries.



Image: in <https://latitudmegalopolis.com/2020/07/29/pequenos-comercios-en-quebra-por-covid-19-en-mexico/>.

HOW MANY COMPANIES HAVE BEEN AFFECTED IN MEXICO?

A figure that clarifies the panorama in the rest of the country is the one offered by the Covid-19 Impact on Small Business⁵ survey –which is representative for small businesses in the Valley of Mexico, Veracruz, and Oaxaca–, which tells us that for July 150 thousand micro-businesses (the well-known “small store at the intersection”) have declared bankruptcy.

⁵ <https://tinyurl.com/y4489hrb>.

According to ECOVID-IE, 59.6% of companies implemented technical stoppages or temporary closures. However, by company size, the said technical stoppage or closure was 44.1% for large companies, 51.5% for small and medium-sized companies, and 60.3% for micro-companies. By type of business activity, essential and non-essential, 42.1%, and 57.9% respectively. However, within those companies that carried out such stoppages or closures, an important part



Image: in <https://heraldodepuebla.com/2020/05/03/comida-solo-para-llevar-o-a-domicilio-decreta-barbosa/>.



Image: in <https://expansion.mx/empresas/2020/07/28/el-covid-19-causa-el-cierre-de-150-000-pequenos-comercios-en-el-pais/>.

implemented operational actions (59.6%), among which the following stand out home delivery (15%), special promotions such as discounts, rebates, deferred payments, 2 for 1, among others (12.8%) and Home office (12.8%).

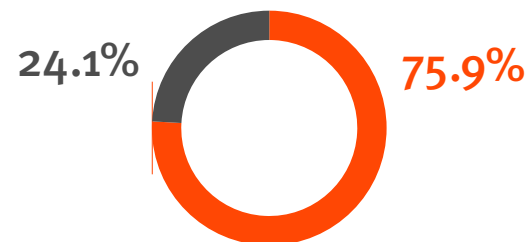
The foregoing implies that regardless of the regulation not allowing non-essential businesses to be kept open, they have had to implement various mechanisms that allow them to continue operating. In other words, companies have closed their doors and do not imply that they have stopped offering their products or services.

Therefore, those that did not implement stoppages and closings, plus those that did close but did implement operational actions such as those described above, can bring us closer to the number of companies that are in operation.

Thus, the companies that continued in operation in one way or another are 75.9% of companies, while the remaining 24.1% of companies have completely stopped their activities.



Image: in <https://politica.expansion.mx/cdmx/2020/04/02/enfotos-por-covid-19-colocan-vallas-en-el-zocalo-y-cierran-madero#pid=slide-1>.



This 24.1% corresponds to 451,070 companies that kept their doors closed and also did not take any action to stay in operation.

Now, of those companies that stopped their activities, 97.3% presented some type of ill effect. The most common ill effects are:

1. 93.2% of the companies presented a decrease in their income by 62.6%.
2. 76% faced a decrease in demand of 59.6%.
3. 46.4% has lower availability of cash flow and shortage of supplies, raw materials, finished goods, or materials acquired for resale, with a drop of 61.6%.

By company size, the main impacts were the following:

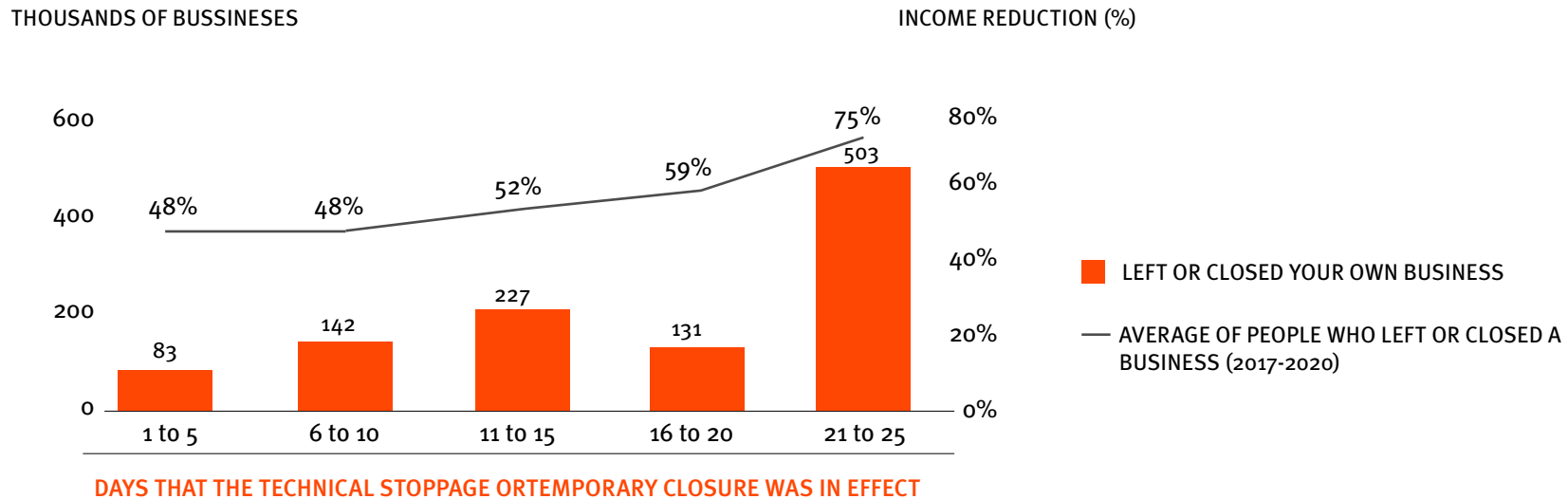
1. 92.7% of large companies have implemented operational actions, 73.3% of SMEs, and only 58.9% of microenterprises.
2. Working from home has a higher prevalence among larger companies; 87.7% of large companies have implemented this action, instead, it was only like this for 44.5% of SMEs and 17.1% for the case of micro-companies.

3. By type of ill effect, the decrease in income is the one with the greatest presence, but with different impacts. 85.9% of micro-companies have this type of ill effect, 80.7% of SMEs and 33.5% of large companies. In turn, microenterprises saw their income affected by 56.6% on average, SMEs showed a 52% decrease and large companies had a 27.7% decrease.

In general, it is observed that the longer the technical stoppage or temporary closure lasts, the loss of income is affected in a greater proportion. So much so that 47% of companies that have implemented any type of closure have had a decrease in their income of 75% on average; This is because they have had to extend said closure for at least three weeks.

What's more, just closing between one and five days has implied a loss of income of almost 50% for 83,000 companies.

CHART 4. COMPANIES THAT IMPLEMENTED A TECHNICAL STOPPAGE OR TEMPORARY CLOSURE AND THE IMPACT ON INCOME BY DAYS ELAPSED



Source: Prepared by the author with information from ECOVID-IE.

For its part, the evidence shows us that by type of activity the differences are minimal between the essential and the non-essential –a totally different case when analyzing by company size–, whether as a proportion of the total or due to the impact that has had COVID-19 on them, as shown in the following table.

Imagen: en <https://www.eleconomista.com.mx/estados/Negocios-de-Jalis>



TABLA 1. PRINCIPALES AFECTACIONES EN LAS EMPRESAS POR TIPO DE ACTIVIDAD* (%)

TYPE OF ACTIVITIES	TOTAL OF COMPANIES WITH SOME TYPE OF ILL EFFECT	REDUCTION OF THE TOTAL AMOUNT OF SALARIES AND / OR STAFF BENEFITS		SHORTAGE OF SUPPLIES, RAW MATERIALS, FINISHED GOODS, OR MATERIALS ACQUIRED FOR RESALE		DECREASE IN INCOME		THE DECREASE IN DEMAND AND CANCELLATION OF ORDERS		LOWER AVAILABILITY OF CASH FLOW	
		YES	THE AVERAGE PERCENTAGE OF VARIATION	YES	THE AVERAGE PERCENTAGE OF VARIATION	YES	THE AVERAGE PERCENTAGE OF VARIATION	YES	THE AVERAGE PERCENTAGE OF VARIATION	YES	THE AVERAGE PERCENTAGE OF VARIATION
TOTAL	93	18	50	32	44	85	56	68	55	43	56
ESSENTIAL ACTIVITIES	93	17	48	33	41	85	54	67	52	41	52
NON- ESSENTIAL ACTIVITIES	94	19	52	30	47	86	59	68	57	44	59

Source: In-house elaboration with information from ECOVID-IE. *Figures are rounded to integers.

THE EXPECTATIONS OF SMES IN MEXICO

At the time of carrying out this survey, other studies have been prepared at the international level that may well enrich the analysis, such as the COVID-19 International Small Business Study⁶, which reveals that 47% of Small and medium-sized enterprises (SMEs) in Mexico, has a probability of bankruptcy greater than 50% in the next six months, or what is equal to 60,283 SMEs⁷. The aforementioned study yields three other results of great importance, such as:

1. 53% of SMEs in Mexico has laid off at least one employee due to the health crisis, compared to 55% of companies of the same size in Latin America.
2. 65% of SMEs in our country think that they will have to lay off an employee in the next 60 days, three percentage points more than the rest of Latin America.
3. 80% of these companies think that their business will fully recover in the next two years, only one percentage point above that declared by SMEs in the rest of the region, but 9% higher than the expectations of SMEs in the United States.

⁶ <https://tinyurl.com/yx8u69xr>.

⁷ <https://tinyurl.com/y4489hrb>.

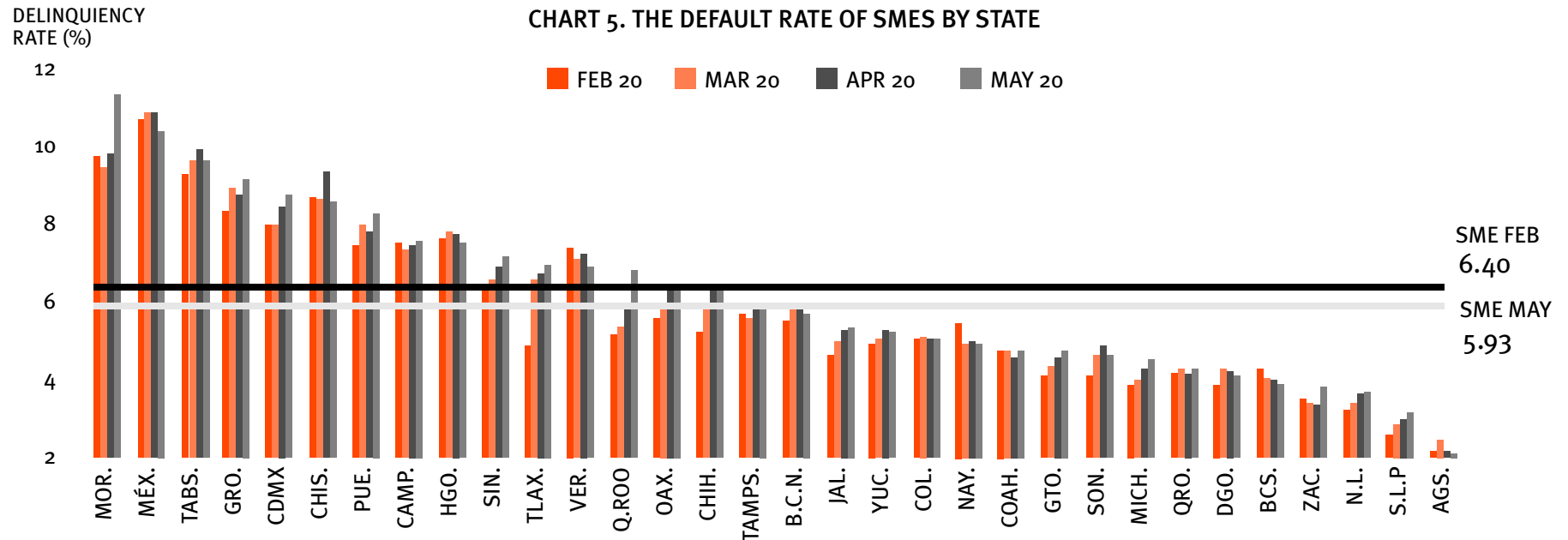


Image: in <https://canalc.com.ar/advierten-que-20-mil-comercios-corren-peligro-de-cierre/>

ECONOMIC CRISIS, BANKRUPTCY AND ITS IMPLICATIONS FOR THE FINANCIAL SYSTEM

The economic crisis reveals one of the great problems of small businesses, the high dependence of total income on constant cash flow. Such income is destined to the payment of salaries, suppliers, and credits, mostly. So, the effects of the drop in demand and the consequent decrease in income have led to an increase in the overdue portfolio, especially for

SMEs, which have a higher delinquency rate, which is also constantly growing. As of May, the overdue portfolio amounts to 27.2 billion pesos, which implies that, in the case of SMEs, 6.4 pesos out of 100 are not paid at the time of maturity, but things get worse depending on the state.



Source: Prepared by the author with information from the CNBV.

By state, the cases that stand out for being above the national average and also maintaining an upward trend are Morelos, Guerrero, CDMX, Puebla, Sinaloa, Tlaxcala, and Quintana Roo. However, the State of Mexico continues to be concerning for being one of the states whose SMEs accumulate a high amount of debt compared to the total, together with the previous ones.

FINAL COMMENTS

The Mexican economy faces various challenges, especially the companies related to the economic sectors most affected by the health crisis and those of smaller size. Faced with the postponement of generalized openings of subnational economies, the scarce use of acceptance of different means of payment other than cash, and the limited use of different marketing channels, growth and economic recovery after a phase of confinement is restricted.

On the other hand, these conditions limit the liquidity of the MSMEs as they face an unprecedented reduction in demand, which directly affects their current income. This in turn reduces the availability of

resources to meet their liabilities. The foregoing is generating a vicious cycle of reduction in demand, decreased income, and cutbacks in personnel, and the non-payment of debt.

The figures provided by the Economic Commission for Latin America and the Caribbean (ECLAC), where its mentioned that around 500,000 companies are closing, are not far from what is stated here; however, a difference will have to be made between partial and permanent closures. Permanent closures are an extremely serious symptom of the weakness of the economic structure in our country, and circumstantial and contextual factors are undermining this condition even more. The outlook is that the number of permanent company closures will exceed those 500 thousand closures. Companies face a race against time, as they face amortizations to be due, suppliers and wages to pay, and families to feed.

In addition, the decrease in the number of businesses in Mexico may have serious effects on the growth track in the medium and long term, and affect the potential GDP of our country.

For its part, the first measurements on the matter at the international level indicate that Italy reported a confirmed closing of businesses of 7.2%, and between confirmed closings and those that are assumed to be permanently closed, the figure rises to 18.3%¹. It should be remembered that Mexico is the fourth most affected economy in the world at an annual rate -only after Spain, the United Kingdom, and France-, Italy occupies fifth place.

On May 7, 2020, the President of the Republic said: “If there is a company bankruptcy... then let it be the businessman who assumes responsibility ...”. Indeed, 93% of companies in Mexico have not received any type of support from the government in any of its three orders² and at least 24% are on the verge of collapse.

On May 7, 2020, the President of the Republic said: “If there is a bankruptcy of a company ... then let it be the employer who assumes responsibility ...”.

¹ <https://tinyurl.com/y6bpxkuk>.

² It is worth mentioning that a 0.9% of the companies have received assistance from some chambers and business organizations or other sources.

A photograph of Andrés Bello López, the President of Mexico, speaking at a podium during a press conference. He is wearing a dark suit and a striped tie, and has his hands raised in a gesture. The podium features the Mexican coat of arms. In the background, a red banner displays the text "GOBIERNO DE MÉXICO" in white capital letters, with a faint image of the Mexican coat of arms above it.

GOBIERNO DE
MÉXICO

Indeed, 93% of companies in Mexico have not received any type of support from the government in any of its three orders and at least 24% are on the verge of collapse.

Image: The President at his press conference / Omar Franco en <https://www.milenio.com/politica/los-temas-de-amlo-en-la-mañanera-de-hoy-7-de-mayo>.



