

June 2016



# *Mexico's Rising: Resilience and Reforms*

# *Introductions*

## Speakers



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Growth Markets Centre

# Agenda

Mexico  
overview

1

Key growth  
sectors

2

Convenience  
matters:  
Serving the  
new Mexican  
consumer

3

Mexico  
reforms -  
Tax and  
regulations

4

PwC in  
Mexico

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PwC's Growth  
Markets  
Centre

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# *Mexico Overview*

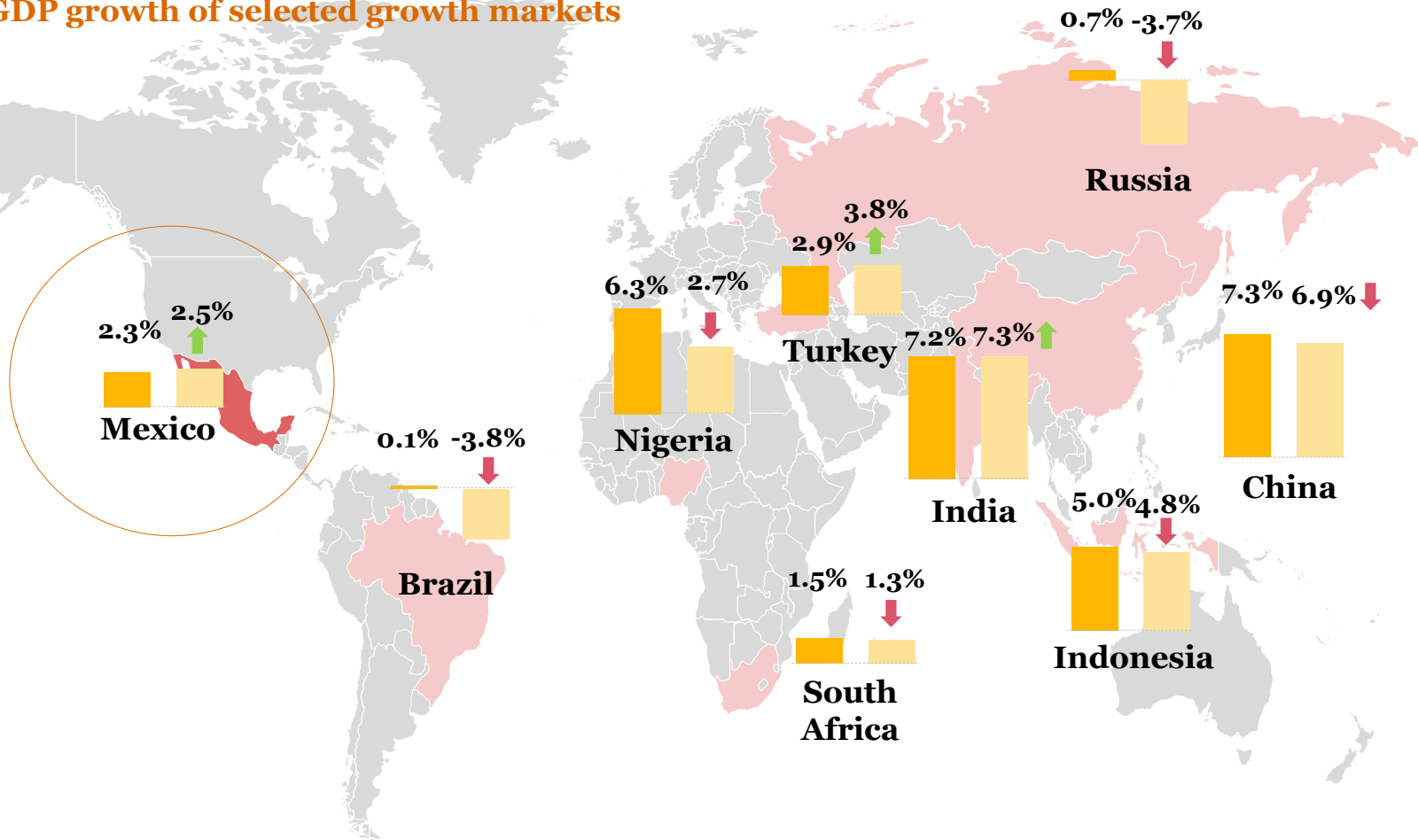
## *Key Indicators (2015)*

- Population size: 120 M
- GNI per capita: US \$9.9 k
- Inflation : 2.7%
- Growing middle class
- 45% of Mexicans are internet users

## *Mexico's performance stands out against uneven growth in other emerging markets*

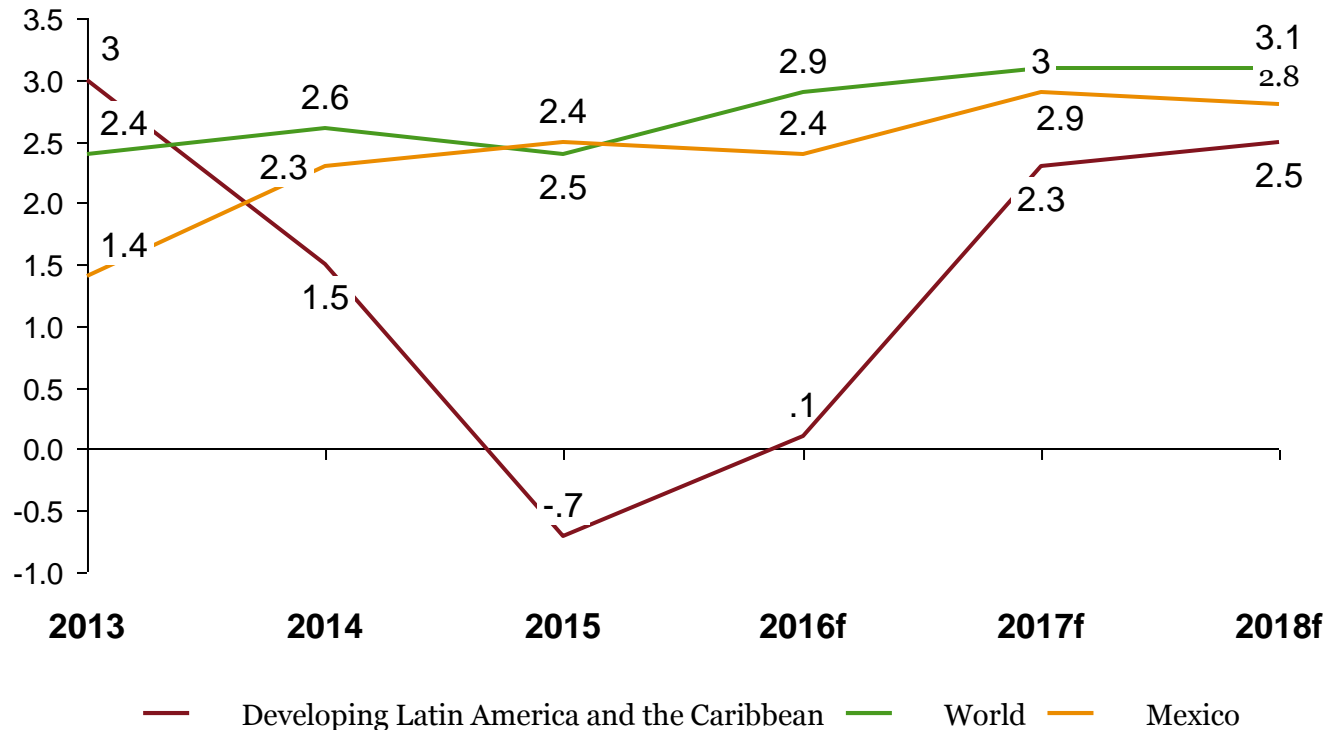
### Annual GDP growth of selected growth markets

2014  
2015



***The country stands out vis-à-vis other emerging markets with robust GDP growth over the past two years***

**GDP Real Growth**  
(Projections to 2018)\*

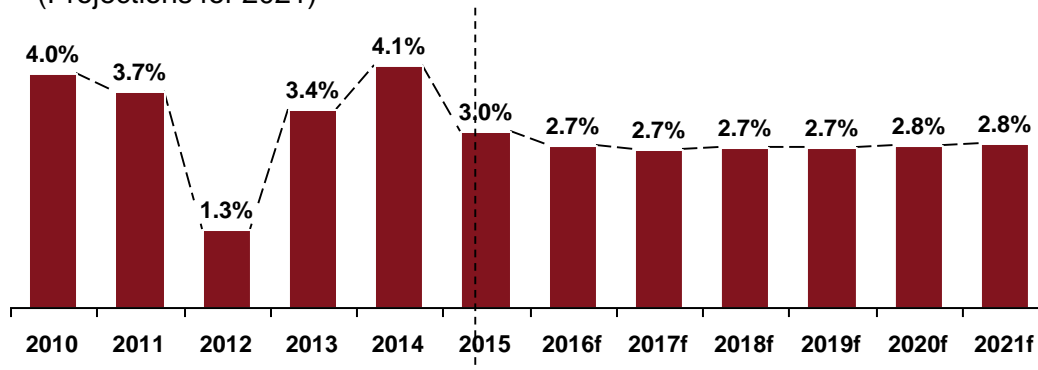


- **In terms GDP growth, Mexico has outperformed other Latin America and Caribbean countries**
- **This may result in a sizable pockets of opportunity in businesses such as *retail, consumer goods, telecom, education* and other segments**

***Going forward, this positive trend is expected to continue, with the GDP forecasted to increase over the next 5 years***

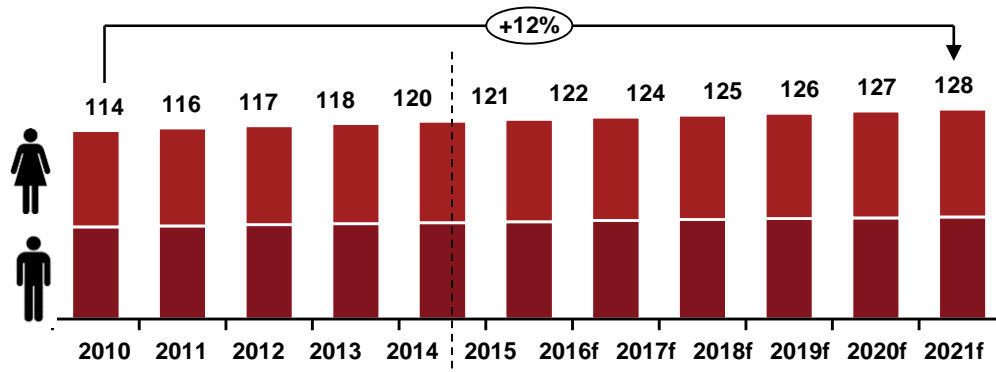
### GDP Per Capita

(Projections for 2021)\*



### Total Population

(Projections for 2021)\*



\*Millions of inhabitants divided by gender

### Mexico Outlook

- The Mexican market is recovering, expecting a steady growth of GDP
- GDP growth and its positive correlation with population growth, make Mexico an attractive market for new business opportunities
- Other factors favoring investment in Mexico are its geographical location, higher education levels and population growth

***Mexico is in a good position to enjoy demographic dividend, with a 20% increase in population in the age group between 15 - 59***

**Population by age group (millions)**

2015 2050 forecast

Economic benefit from a larger work force

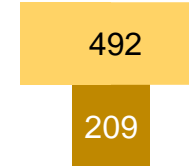
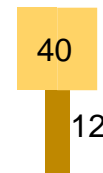
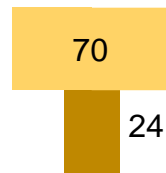
**Brazil**

**Mexico**

**China**

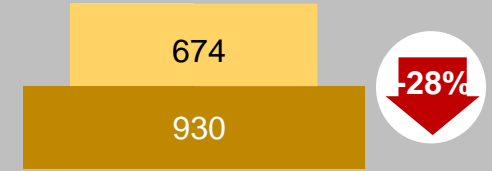
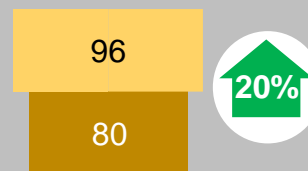
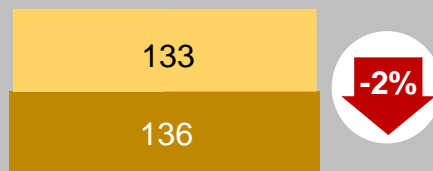
Age group

60+

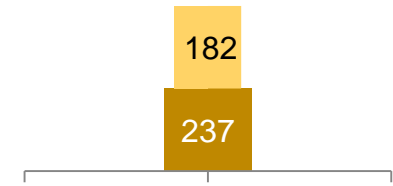
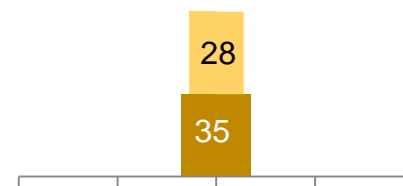
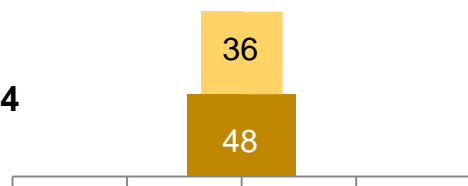


**Change in population from 2015 to 2050**

15 - 59



0 - 14

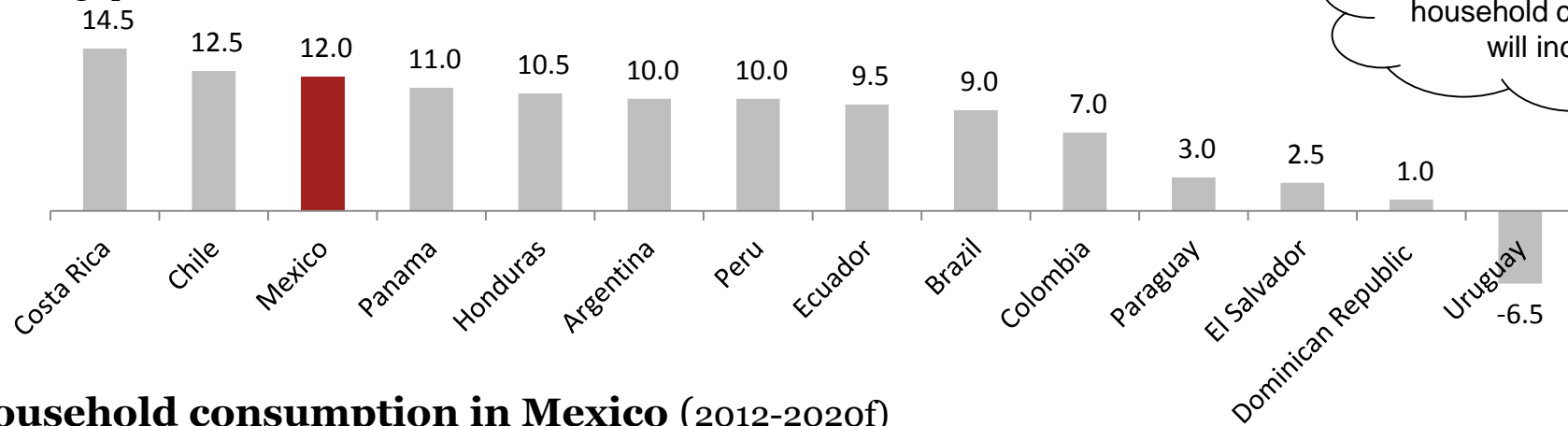




## Mexico overview

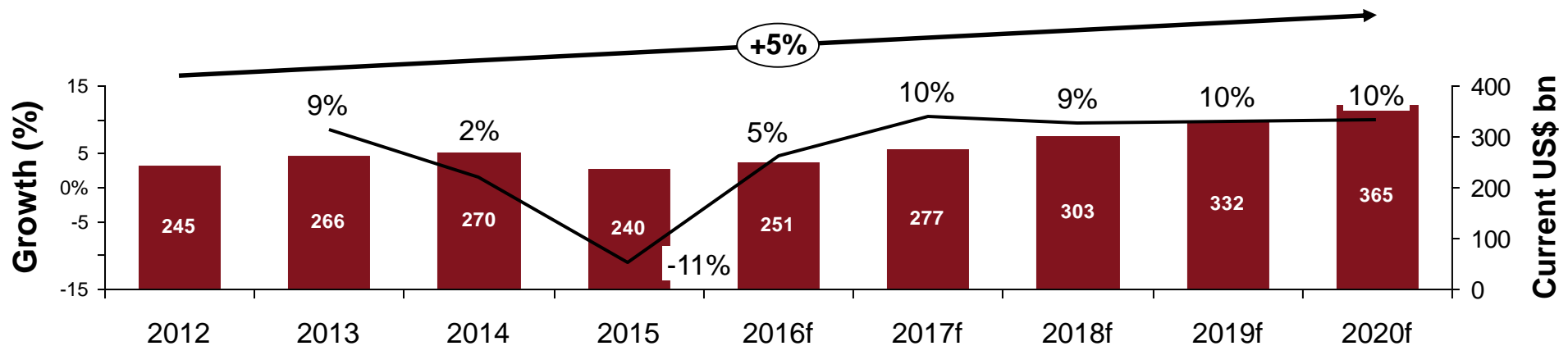
***The growth in Mexico's middle class is among the greatest in LatAm, which translates into an increase household consumption***

**Change in middle class as a percentage of population in LatAm**  
(percentage points), 1995 - 2010



As disposable income continues to grow, household consumption will increase

**Household consumption in Mexico (2012-2020f)**



***Moreover, a robust tax system and numerous exchange treaties make Mexico one of the most open economies in the world***

**Industry**

- Private investments is dominant in the manufacturing, constructions and hospitality industries, as in wholesale and retail trade operations

**Government**

- Mexico is a federal democratic republic divided into 32 states. The chief executive is the President, who is elected for a period of six years and may not be re-elected. There is a bicameral legislature as well as a judicial branch.

**Economy**

- Mexico has a mixed economy, with the government, its agencies and government-owned or controlled companies expected to reduce their traditionally dominant position in the areas of telecommunications, public utilities and petroleum.

**Population**

- The population estimated at approximately 120 million inhabitants, reflecting a net annual increase in recent years of about 1.4%. Mexico is the most populous country in Latin America after Brazil. The total population has more than tripled since 1940

**Inflation**

- The inflation rate dropped to one digit and may be considered comparable with Mexico's commercial partners (i.e. US and Canada).

**GDP Growth**

- GDP growth of 2.5% in 2015



***In the coming years, mayor trends will reshape the Mexican market towards a more connected and digital economy***



***Demographic shifts***



- Growing middle class
- Demographic dividend: Informal and Formal sectors
- Better educated workforce



***Accelerating urbanization***



- 78% of the population lived in urban areas in 2012
- GHG Emissions are becoming an issue in mayor cities
- In Mexico City, productive life of 40 years, Mexicans spend 3 years stuck in traffic



***Improved access to investors and capital***



- Investor-friendly environment
- Increased FDI for renewable energy



***Technological breakthroughs***



- Improving access to mobile and internet network
- Growth of entrepreneurship sector



***Resource scarcity and climate change***



- Increasing investments in renewable energy
- CO2 emissions expected to decrease clean energy sources increase

# Key growth sectors



**Retail and Consumer**



**Telecom**



**Financial Services**



**Energy**



# More pesos in the consumer's pockets translate into increased appetites for more goods and services

## Success Stories

**60%** of Mexico's economic output is **household spending**

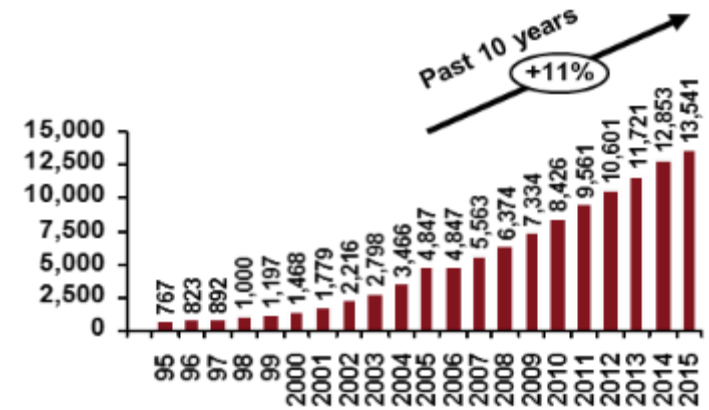
**12%** was the middle class growth from 1995 to 2010

**18 million** households are estimated to be in the **middle class** by 2030



- Strong logistics
- Network as a key capability
- Real state as a main growth engine
- "Rent" don't buy

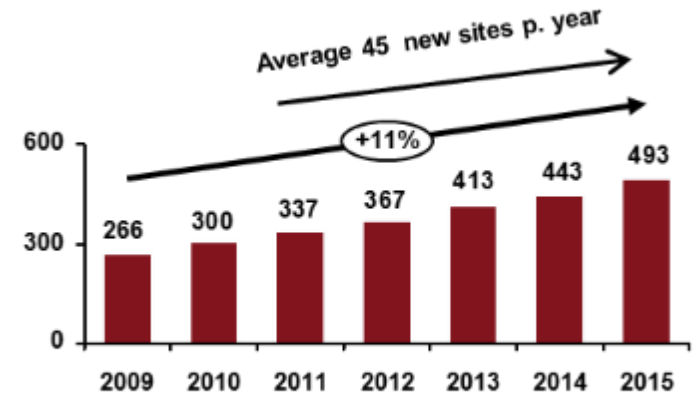
### OXO - Outlets



### STARBUCKS

- Industry know how
- Supply Chain Excellence
- Marketing plan
- Identity creation
- Consumer knowledge

### Starbucks - Stores





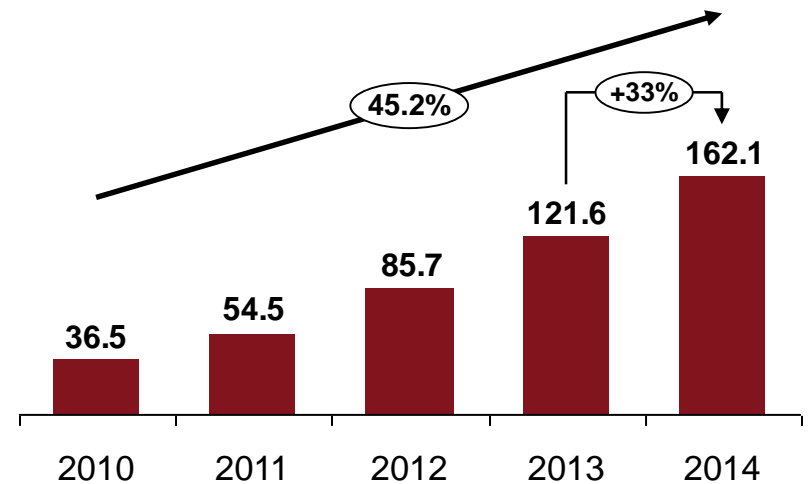
# E-Commerce in Mexico is booming, bringing new growth opportunities for the consumer goods and retail industries

## E-commerce is a growing trend

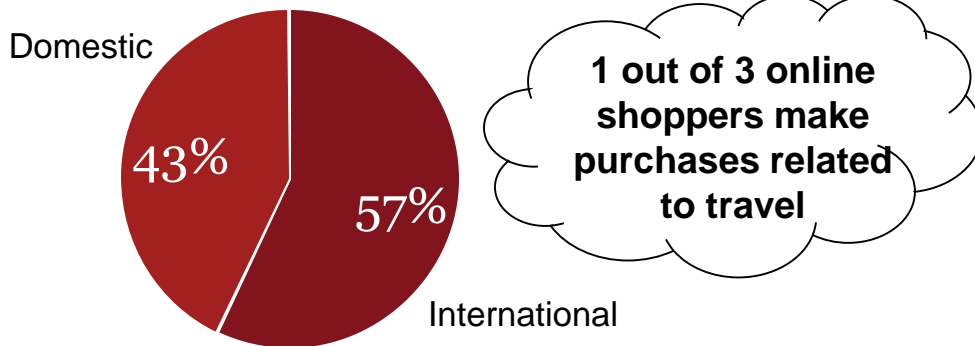
54 M Internet users  
 22 M e-shoppers (37%)  
 US \$31-\$77 is the average order  
 97% of e-shoppers want to buy again

## E-Commerce Volume and Growth in Mexico

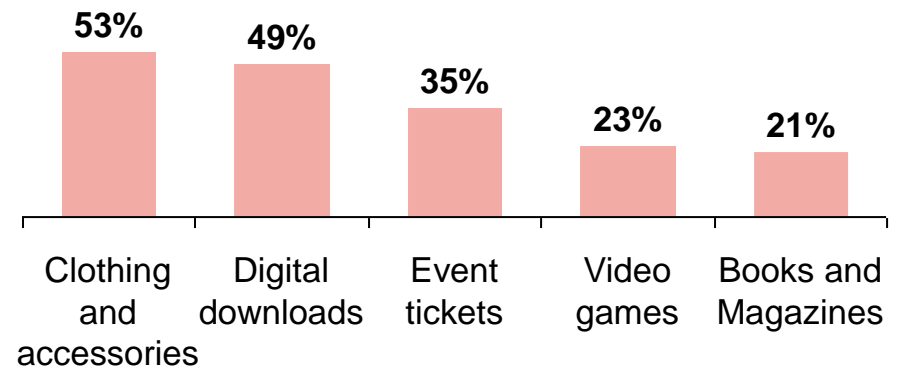
MM MXN and CAGR (2010-2013)



## International E-Commerce Purchases



## Purchase Incidence





## **Banking services, credit, and mobile banking are increasing in Mexico as the middle class continues to grow**

**91%** of the payment transactions are made in cash

**73%** of the population is unbanked (older 15 years old)

**49** ATM per 100,000 adults (2014)

**828** thousands of POS terminals in Mexico vs. +2.5 million formal, informal and food service outlets



### **Growth potential:**

Significant growth opportunity due to low penetration of banking services and government focus on improving financial access

- **Mobile:** Government campaigns promoting the use new mobile banking to expand access to financial services



### **Limited public trust:** Lack of trust in bank system

- **Financial Literacy:** Lack of financial education causes the decapitalization of households
- **Security:** Significant concern in the consumer finance industry as fraud techniques become more sophisticated

### **Major Developments**

- In 2014, Grupo Bimbo, Visa and Banamex partnered with Blue Label to help facilitate access to **card payment technology** for small businesses
- Co-branded **store cards** remain very popular (3.6 M users), Liverpool (retail) has more card holders than any other bank (except Banamex, BBVA)
- Parliament passed New Banking and Financial Institution Law in 2014 to strengthen the financial system and increase tax collection



***In recent years, telecom has shown an accelerated growth, with revenue representing an estimated 3.0-3.5% of total GDP***

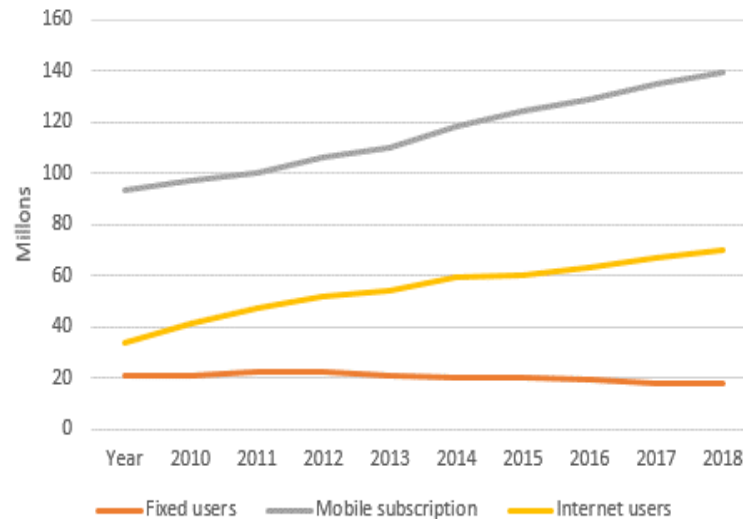
**12.7%** is the expected increase of users of satellite and cable television

**5.7%** is the expected growth for the mobile market in the coming years

**61.9%** is the **Smartphone penetration** estimate for 2020

**US 132 B** in Foreign Direct Investment from 1999 to 2014

**Number of Users for 2017**



- Broadband connections at home are still expensive
- Mexican internet services are highly priced

**Structural Reform: Telecom**

*In June 2013 the Telecom reform came into effect to ensure a **sustainable and efficient development** of the Telecom market that will benefit consumers, including those in rural areas.*

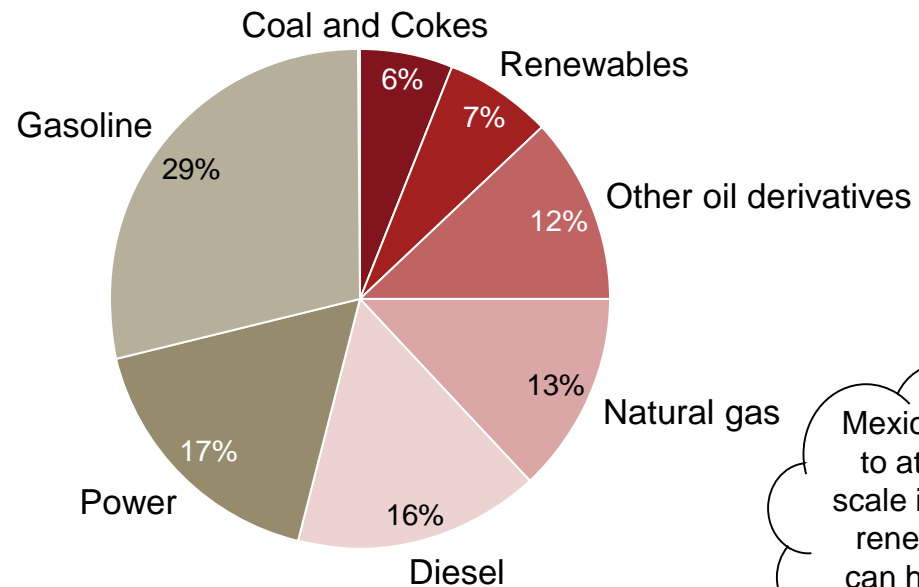


## ***Ambitious reforms in the energy sector are driving opportunities to provide cleaner and affordable services for all***

- Mexico accounts for **20%** of all the energy use in Latin America
- Mexico is the **10th largest** oil and gas producer
- By 2050 Mexico aims to reach a share of **50%** in power generation to zero or low emission energy types
- **Renewable energy** accounted for **22%** of installed capacity in the power system in 2013 (14 GW).
- Within the next decade, the Mexican government aims to provide electricity to the **40-50% of rural communities** that lack power access today

### **Total final energy consumption in Mexico**

(breakdown by energy carrier, 2013)



#### **Structural Reform: Energy**

Mexico is seeking to attract large-scale investment in renewables that can help diversify energy

*To boost oil and gas exploration and production which has been in decline for the past 10 years, Mexico ended the 75-year state oil monopoly by opening the sector to foreign investment in 2013. It was envisaged that this move would increase long-term oil production by 75% and attract US\$50 billion in investments by 2018.*

# Convenience matters: Serving the new Mexican consumer

The Retail and Consumer Industry in Mexico  
April 2016

## Convenience matters Serving the new Mexican consumer



### In this report

- 3 Mexico: Stability amidst global volatility
- 4 More than just a quickie: Significance of the retail and convenience sector
- 6 More power to the pocket: The sector takes off
- 12 Convenience matters
- 16 In the shadows: The over-the-counter market
- 22 Building capability muscles and aligning your operating model
- 29 The winning concoction: Local knowledge, global expertise
- 31 Unlocking the enablers for growth

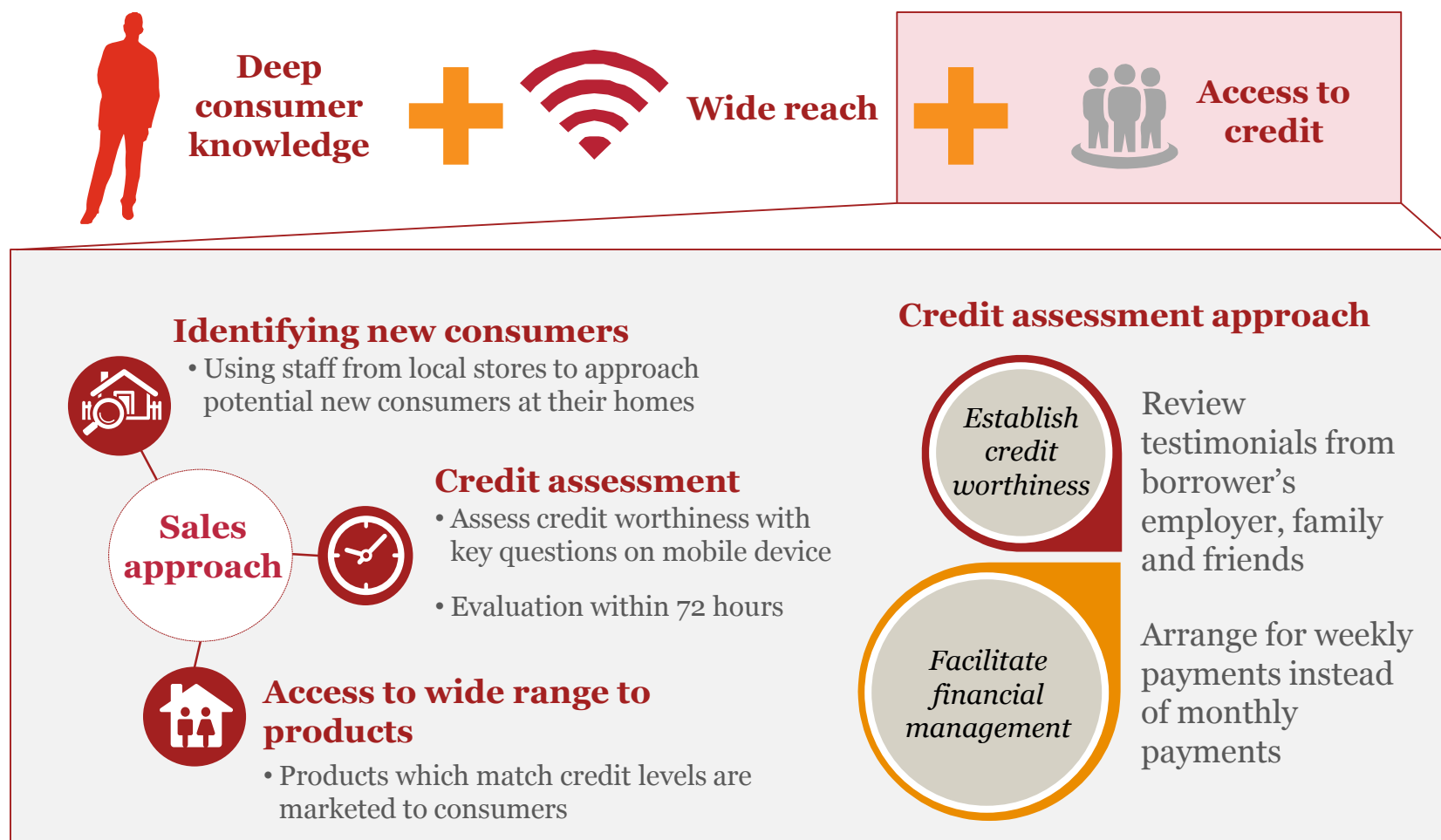


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## ***Companies can target Mexico's large informal segment by providing access to credit while managing risks effectively***



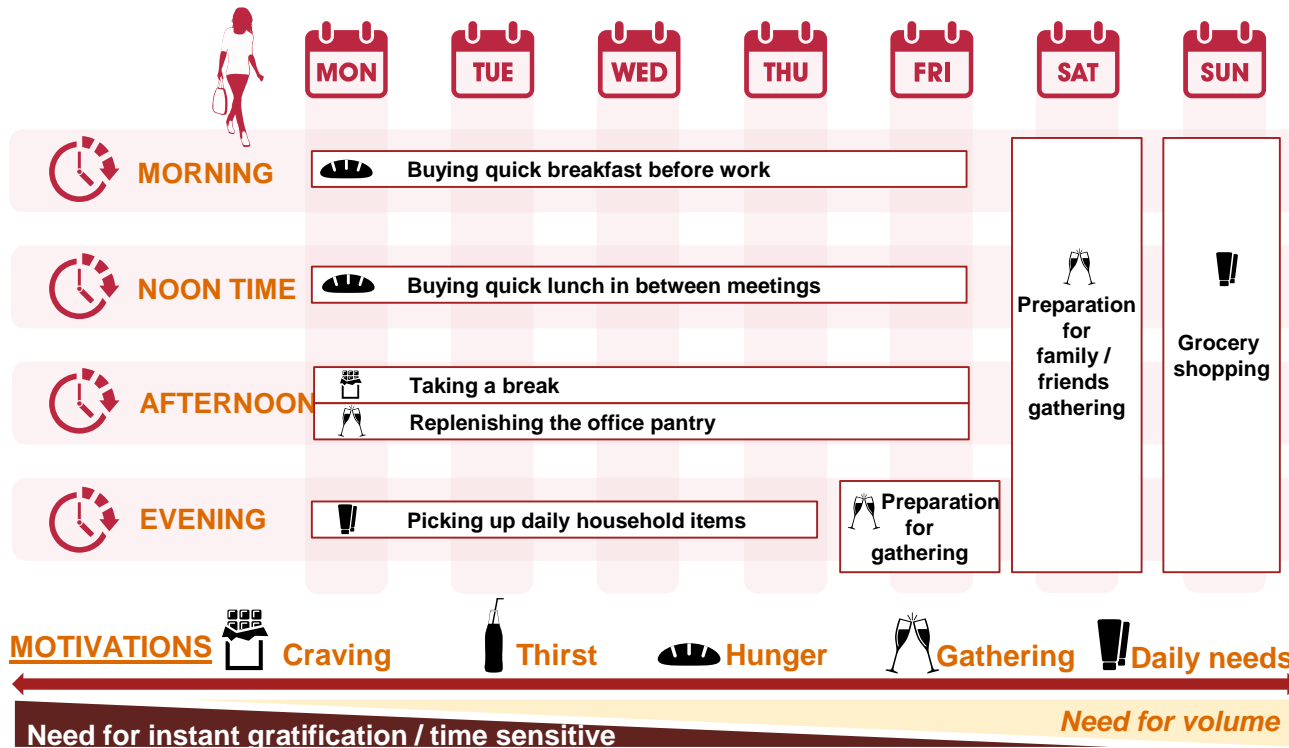
## Convenience matters: Serving the new Mexican consumer

# *Delivering customer convenience by serving varying needs is a critical differentiator in the retail and consumer sector*

### Varying needs of a Mexican consumer

### EXAMPLE

### Ways to deliver the value of convenience



#### Focus on buyer's motivation, not consumer groups



- Understand different drivers
- Customizing the product categories and size of the product to carry by motivations at each trip

#### Partnerships beyond the R&C industries



- Customer needs often lie across industries
- Deliver the end-to-end experience by partnerships across industries

## ***Mexican companies need to innovate and adopt flexible business models to address changing consumer needs***



**1**

Gain insights on customer motivation and innovate through partnerships to address the need for convenience

**2**

Tap into opportunities in the informal market, which can be potentially through providing access to credit

**3**

Understand the different motivations of a consumer at different times to better address their needs

**4**

Develop a flexible operating model that adapts to the Mexican market

**5**

Foreign companies need to be prepared to invest in capability enhancement in local partnerships to succeed in the market

# *Mexico reforms - Tax and regulatory environment*

## *Current and potential investors in the Mexico should consider a relevant topics in the tax system (1/2)*

### Overview of the Mexican tax legislation

- Mexico follows a management approach to **tax residency** rather than solely based on country of incorporation.
  - Companies are required to **pay income tax** (federal tax) on **worldwide income**, regardless of location or source.
  - Income is generally **recognized on an accrual basis** and the corporate income tax rate is 30%.
  - The main difference between the calculation of net income for book and tax purposes is that the procedure to **recognize inflation is different** (e.g. tax adjustments for inflation).
- **Deductible expenses** must comply with several general and specific requirements, e.g. to be “strictly indispensable” for the business activities of the taxpayer.
  - Tax losses are **subject to inflationary adjustment** and may be carried forward for a ten-year period. No carry backs are allowed.
  - Payments made to **overseas** group entities may be **subject to withholding tax** (ranging from 4.9 to 40%), or may be entitled to tax treaty relief.

## ***Current and potential investors in the Mexico should consider a relevant topics in the tax system (2/2)***

### **Overview of the Mexican tax legislation**

- Thin **capitalization rules** must be followed for interest paid to foreign related parties, with a 3-to-1 debt to equity ratio limit.
- **Interest payments** considered as non-deductible dividends, when such interest derives from back-to-back loans.
- **VAT** is administered by most entities that sell goods or render services and is calculated on a monthly basis, at 16% on a cash basis.
- The 3 most relevant local taxes in Mexico are: **payroll tax, annual property tax and real estate transfer tax.**

#### **Employees**

- Employers and employees are required to make contributions to the **social security system.**
- A company with employees is required to **distribute a portion of its annual profits** among all its employees. The amount distributable to the employees is 10% of the taxable income.

#### **Imports/ Exports**

- Mexican customs law establishes that all **imports and exports** to and from Mexico are subject to **pay custom duties, VAT and compensatory tariffs.**
- **Goods** can be **imported on a temporary** or on a permanent basis. A temporary importation may provide access to tax and customs benefits.



***The Mexican Tax System provides tax incentives, special regimes and advantages for foreign companies***

Research and development **cash grant**

**FIBRA** (Real Estate Investment Trust “REIT”),  
FIBRA-E

Zero rated VAT for **exports**

**Special Economic Zones**  
(currently in process)

Customs and VAT waived on temporary import programs to produce exports

Mexico has more than **fifty tax treaties**

**Maquila regime**

**Energy reform** (analyze tax consequences)

***There are a few trending topics in the Mexican Tax System that are relevant for investors***

**Electronic invoices**

- Mexican firms are allowed to use electronic accounting and issue electronic invoices

**Restrictions on related party transactions**

***Base Erosion and Profit Shifting “BEPS”***

- Tax treaty limitations on double non-taxation results
- Limitation on certain payments to non-Mexican residents
- Identification of relevant transactions

**Transfer information**

- New information is required by Mexican tax authorities: Master file, local file and country by country report.

**Corporate Audit Program**

- SAT has designated a Corporate Audit Program (Auditoría de Proyectos Especiales) to implement the OECD recommendations and discourage aggressive tax planning strategies
- The Mexican tax authority is not hesitant to attack structures if considered abusive, and the legislation and court cases are more recently weighted toward substance

# *PwC in Mexico*



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## Overview of PwC Mexico

*3,511 people*  
*18 offices*  
*15 states*

1. Mexico City
2. Chihuahua
3. Ciudad Juarez
4. Guadalajara
5. Hermosillo
6. León
7. Monterrey
8. Puebla
9. Villahermosa



## ***Key service offerings in advisory and tax***

### *Service Offerings*

1

#### **Advisory**

*PwC Mexico's Advisory team has more than 400 professionals across different specializations, such as:*

- Strategy Consulting
- Technology Consulting
- Risk Consulting
- Management Consulting
- Corporate Finance
- Deals
- Government & Public sector
- Digital Services
- Data & Analytics
- Cybersecurity

2

#### **Tax**

*PwC Mexico's Tax and Legal Services team is one of the largest in Mexico with approximately 600 colleagues that provide the clients a broad range of tax specialized services including:*

- Corporate tax
- International tax consultancy
- Transfer Pricing
- Corporate legal and tax legal services
- International trade
- International assignment services
- Tax compliance
- Human resources (payroll and social security contributions)
- Dispute Resolutions, etc.
- Merger and acquisitions

***PwC (including Strategy&) is best positioned to support clients on entry and expansion in Mexico, across a range of areas – from strategy to execution***

## Highlights of our recent experience



*Developing a comprehensive 3-year digital strategy for a retail pharmacy by designing a seamless digital Omni channel experience*



*Strategy for establishing a holding company to centralize operations and manage tax consequences for the shareholders, for a telecom group*



*Developing a Target Operating Model for the Ministry in charge of Communications*



*Assistance in establishing a new business, including incorporation of an entity in Mexico, for a power generation company. Also provided insights into the obligations from a tax and labor perspective*



*Business process transformation for one of the predominant Financial Institutions*



**pwc**



*Implementation of a financing transaction, tax planning around the Mexican special mining duty, creation of a shared service center for LatAm, and setting up an offshore trading company, for a mining client*



*Business transformation for a state owned Oil & Gas company*



*Assistance in business acquisition, including redesign and optimization of corporate structure, for retail and consumer companies*



*Assessment of the healthcare ecosystem to detail potential market entry plays for a leading health services provider*

# *PwC's Growth Markets Centre*



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## About PwC's Growth Market Centre

PwC's Growth Markets' teams are supported by the Growth Markets Centre (GMC), which is a global team bringing PwC's global expertise to help clients grow profitably in complex new markets

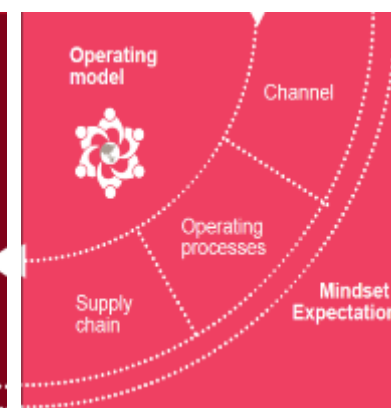
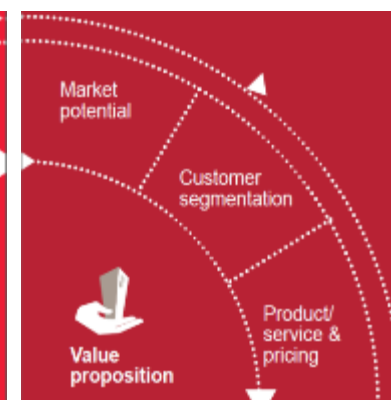
### How the GMC can help

- **Access to global expertise:** ensures clients receive the full benefit of PwC's global expertise and access to bespoke teams
- **Sector focused insights:** thought leadership on how the Growth Markets are evolving and what clients can do to ensure profitable growth
- **Growth Markets Framework :** our framework enable s our clients to assess and prioritize their entry and expansion needs by helping to:
  - Navigate the business environment
  - Enter the right market(s) with effective value proposition(s)
  - Build effective partnerships and teams
  - Develop operating model capabilities for growth

*Navigate the **business environment***



*Enter the right market with effective **value proposition***



*Build effective **partnerships and teams***

*Develop **operating model** capabilities for growth*



# Accessing our growth markets' point of view



**Annual GMC event: Emerging Markets Conference “Growing in the age of volatility”:** The GMC has partners with INSEAD to host an annual conference focused on key Growth Markets issues

*This year's Emerging Markets Conference is scheduled for October 20<sup>th</sup>, 2016 at INSEAD Asia Campus, Singapore*

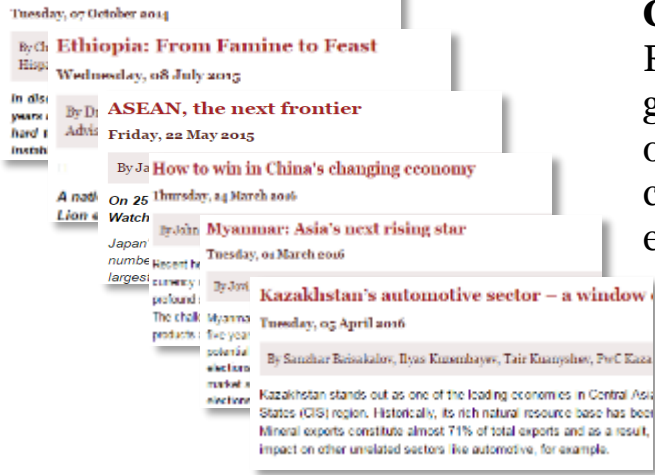


**GMC thought leadership:** Addressing key Growth Markets issues whilst highlighting PwC's expertise in the region



**Sector deep-dive analysis:** Insights on up and coming sectors across Growth Markets, e.g. *“Convenience matters: Serving the new Mexican consumer”*

**Underappreciated Hispanoamérica**



**GMC blogs:** Regular updates on growth opportunities and challenges in emerging markets

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 i [growth.markets.centre.sg@sg.pwc.com](mailto:growth.markets.centre.sg@sg.pwc.com)

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# Q&A



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