



pwc



Nearshoring:

**A strategy to enhance
competitiveness and resilience
in the supply chain**

Change in the offshoring paradigm

For decades, the *offshoring* practice has been the operational paradigm of supply chains around the world. The goal of this strategy is to reduce costs by migrating manufacturing and supply operations to countries with a lower manufacturing cost, mainly the ones located in Asia.

The COVID-19 pandemic generated disruptions in the supply chains that broadly depended on Asia and especially on China. This evidenced the vulnerability of *offshoring*, which was imperceptible before given the regularity that the world experienced.

The localization of manufacturing operations and suppliers, only from a cost perspective, has resulted in a natural consolidation at a regional or country level. However, from a risk management perspective, it is no longer an acceptable practice for a company seeking to lead in its market.

In a future where pandemics, natural disasters, geopolitical conflicts, or other eventualities of similar impact may take place, the concept of competitiveness cannot exist without resilience.

In the organizations' supply chain, resilience involves more flexibility or a bigger capacity to adapt, especially from the manufacturing and supply point of view. This goes strictly hand in hand with the diversification of operations at a geographical level, in order to mitigate risk and guarantee sustainability in the event of a contingency.

Therefore, from now on, the key for all companies will be to find a balance between competitiveness and resilience. For that reason, *nearshoring* becomes the right strategy to diversify operations, and Mexico can offer relevant opportunities for the companies that provide for the North American market.



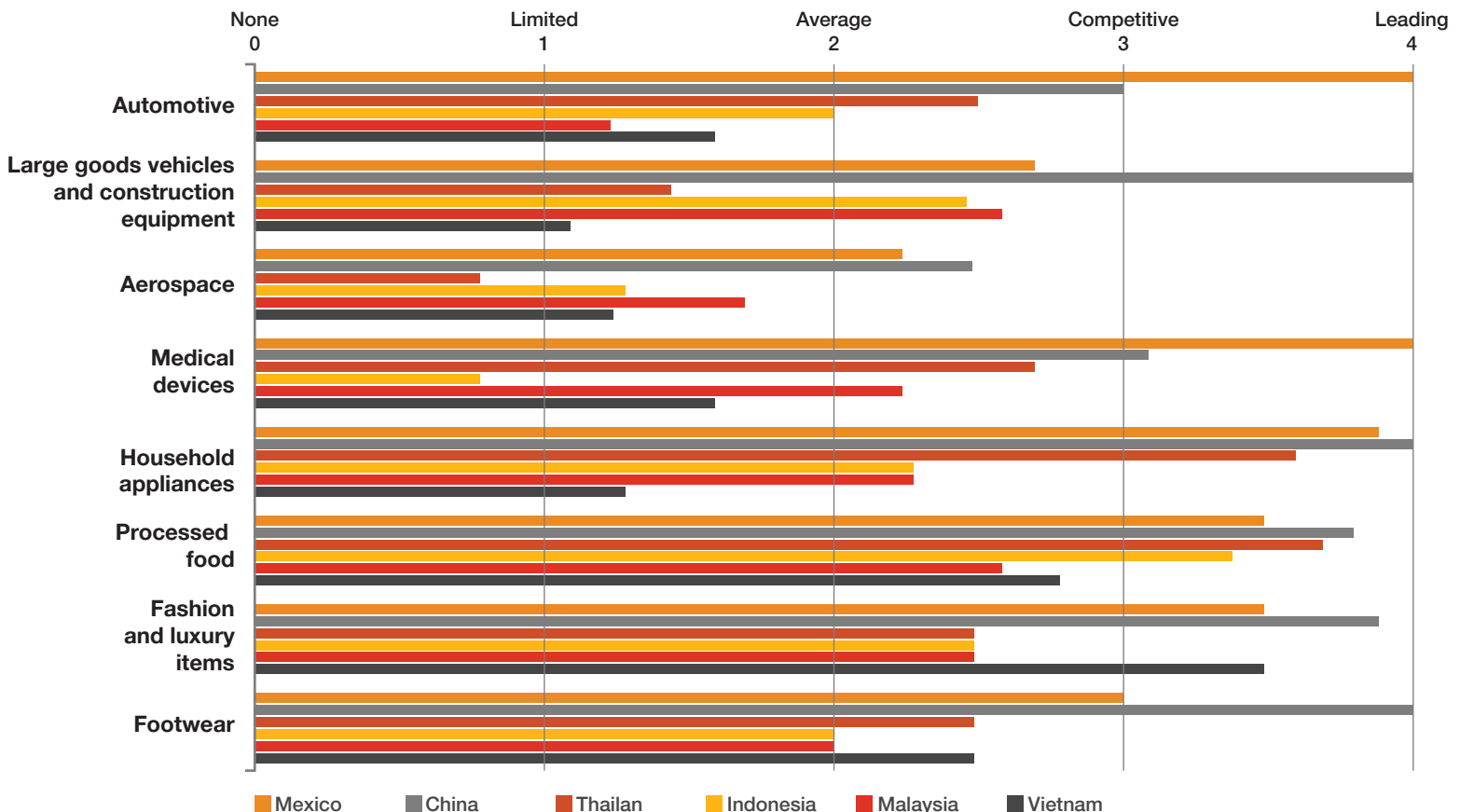
Nearshoring: opportunities in Mexico

Nearshoring is a strategy that not only looks to capitalize the operating, logistical, and commercial benefits of relocating manufacture and supply to countries that are closer to the source of the demand, but also calls for a geographical diversification to mitigate risks. This strategy has become increasingly important in the past years due to the impact of the pandemic and the commercial tension between China and the United States.

Mexico is an attractive alternative in relation to other low-cost locations in the world, as it offers diverse benefits among which we can highlight:

- **Specialized labor at a lower cost.**¹ As of 2015, the labor cost in China has been higher than in Mexico. In 2019, it was 50% higher.
- **Developed supply** in diverse industries throughout the country. Mexico is one of the low-cost territories with higher growth in the specialized processes manufacturing sectors.
- **Easiness to begin operations.** Mexico has been one of the low-cost countries with highest score in the *World Bank's Ease of Doing Business* ranking during 2020.
- **Quick access to the North American market.** This entails lower logistical costs, shorter times of delivery, and higher capacity to respond to disruptions in demand.
- **United States-Mexico-Canada Agreement (USMCA).** Represents a competitive advantage regarding fees/duties in North America. In addition, Mexico is part of 13 commercial treaties allowing free commerce with 46 countries, among other commercial agreements.

Manufacturing capacities per industry: Mexico versus low-cost Asian countries



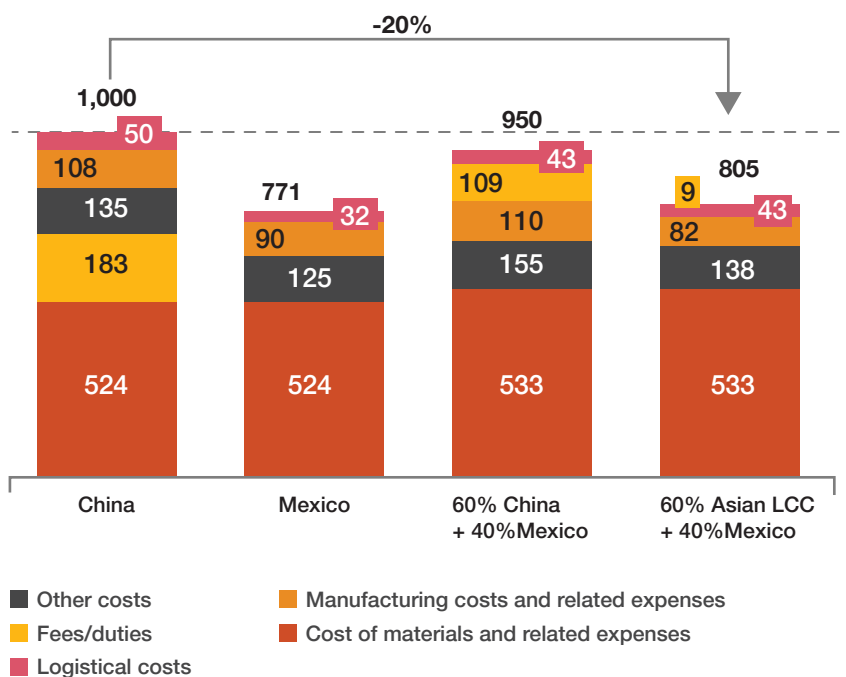
Source¹: IBIS World, Government Institutions, International Labor Organization, United Nations Industrial Development Organization, Global Business Guide, Mordor Intelligence, Fitch Solutions, Textile Infomedia, PwC analysis



Nearshoring strategies

PwC identifies three options to capitalize the advantages offered by Mexico in a *nearshoring* strategy:

- 1** **Dual operation (China + Mexico):** involves migrating operations gradually from China to Mexico.
- 2** **Dual operation (Asian LCC + Mexico):** considers migrating operations completely from China to a low-cost country (LCC) in Asia and to Mexico.
- 3** **Consolidated operation (Mexico):** proposes to migrate operations completely from China to Mexico.



	China	Mexico	60% China + 40% Mexico	60% Asian LCC + 40% Mexico
Pros	<ul style="list-style-type: none"> No need to invest in capital expenditure Continuous connection with the chain Experienced collaborators 	<ul style="list-style-type: none"> Lead time reduction Labor costs reduction Lower duties Low logistical costs 	<ul style="list-style-type: none"> Improvement in supply chain resilience through diversification Possibility to increase response capacity 	<ul style="list-style-type: none"> Improvement in supply chain resilience through diversification Decrease in duties
Cons	<ul style="list-style-type: none"> Risk of increase in duties Little supply chain resilience 	<ul style="list-style-type: none"> Uncertain labor availability Availability of materials Exchange rate fluctuation Supply chain resilience does not improve 	<ul style="list-style-type: none"> Expenses increase and limited cost savings 	<ul style="list-style-type: none"> Higher capital requirements Higher transition/production risk – ramp up

PwC guiding your nearshoring strategy

PwC offers different best practices settled solutions and experience to advise clients who are looking to relocate their operations to Mexico. Some of those are listed below:

Supply chain and operations transformation

- **Site location**
 - Operational perspective: Analysis of costs and availability related with Land, Talent, Services, Logistics
 - Socioeconomic perspective: Analysis of variables such as public security, socio-economic landscape, industry context, among others
- **Sourcing**
 - Suppliers' readiness assessment
 - Search and selection of suppliers
 - Strategy for development of new suppliers
- **Manufacturing Operating Model**
 - Maturity level assessment of current manufacturing operations
 - Manufacturing optimization program
 - Target operating model design (Workforce, Processes, Technology)
- **Distribution and Logistics**
 - Distribution network optimization
 - Search and selection of logistics partners

Legal, direct and indirect tax, and foreign trade consulting

- **Legal perspective**
 - Analysis of fiscal incentives per state
 - Legal entity set up
 - Support in foreign investment rules and real estate
 - Contracts development
- **Indirect tax and foreign trade perspective**
 - Customs operations feasibility
 - Support in securing general and sectorial Import Registrations
 - Support in acquiring IMMEX and PROSEC programs and CIVA and OEA certifications
 - Support with free trade agreements
- **Direct tax and transfer pricing**
 - Analysis of tax obligations and operations implications in Mexico
 - Analysis of applicable operational structure models (e.g., maquila)
 - Assistance in the evaluation and negotiation of Advance Pricing Agreements (APA's)
 - Support with the application of international tax rules and double taxation treaties

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