Navigating Latin American Shared Services opportunities

Mexico

Latin America is becoming increasingly attractive as a location for Shared Service centers. Given the very different—and rapidly shifting—political, regulatory, and economic landscapes across Latin American countries, there is no "one-size-fits-all" approach to the region. Companies looking to enter the Latin America Shared Services market must carefully assess their short- and long-term service needs, strategic priorities, and risk tolerance before choosing a location. This series provides Deloitte's perspective on the strengths and opportunities for the most common Shared Services markets in Latin America. This series highlights the insights Deloitte believes will shape the potential of Latin American countries to be successful destinations for Shared Services operations today and into the future.

Recent instability shouldn't shake Mexico's Shared Service reputation

Despite slowed growth, Mexico's Shared Services outlook remains positive

Over the past few years, forecasts for Mexico's economic prospects have turned from euphoria to disappointment. Analysts from the IMF to the *Wall Street Journal* had forecast Mexico's economy to grow anywhere between 3.2-4.2% from 2012-2015. President Peña Nieto's administration predicted 5% target growth when he took office in 2012. The reality has been a stark contrast to these projections, with an average annual growth closer to 2% over the last few years.[1] This has been, in large part, due to a variety of complications including Public Sector spending cuts, a large drop in oil prices, and geopolitical instability due to corruption and drug cartel violence. These issues have overshadowed Mexico's inherent strengths as a location for establishing Shared Service centers, potentially putting Mexico "on sale" for companies looking to set up shop in Latin America.

A new land of opportunity

Mexico presents an enticing case for companies looking to open a Shared Services center in Latin America. There is a large availability of capital relative to other competing Shared Services markets in Latin America and Mexico's economy is diversified, with strengths in consumer business, retail, manufacturing, technology, and finance.

Manufacturing has historically been an area of investment for the Mexican government, with significant effort spent on establishing Maquiladoras to spur manufacturing growth. However, manufacturing growth has held at 18% of GDP[2] over the last three years despite these investments. This, together with oil prices hovering below $30 per barrel, is increasing pressure on the Mexican government to further diversify its economy in an effort to stabilize tax revenues.

Deloitte believes that this turn of events could greatly benefit the services sector as the government will shift incentives to encourage foreign investment there. The sinking peso, currently hovering around 18:1 relative to the dollar, and shifting incentives would create an outstanding opportunity for companies looking to establish Shared Services centers in Mexico.

Geography. Mexico's geography also could be an advantage for companies looking to establish Shared Service centers. Mexico's shared border with the United States allows for direct access to the Western world's largest economy. This close proximity decreases asset transportation costs, travel time, time zone parity and ultimately reduces business disruption for companies with cross-border operations. Additionally, Mexico is centrally located in the Americas, with all major North and South American countries and economic hubs a maximum of nine hours away by air.

Talent. Mexico's workforce is potentially another strong competitive advantage. Mexico has an educated workforce, with high secondary and graduate education levels, particularly in technical fields. The Mexican labor pool has strong English skills, particularly in the northern bordering states, yet commands lower wages than other Latin American markets with similar talent profiles.

Incentives. Mexico's government has already established several tax and legal incentives which may be leveraged by companies looking to establish Shared Service centers. The tax incentives include a 55% payroll decrease for the first year of operations for new high-tech businesses, with an annualized 20% payroll tax deduction each year the workforce increases by 25%. New entrants may also be able to take advantage of a 30% property tax discount and an 80% real estate tax discount.[3] Legal advantages, including MexicoFIRST, IMMEX, and PROSOFT also tip the scales in Mexico's favor (see figure 1 for detail).[4,5,6]

Figure 1. Three legal advantages that may be leveraged by Shared Services entrants.

Tax. Mexico has the most active tax treaties of any Latin American country with 55. Other top countries in the region lag behind, with the next closest having 35 tax treaties. A multi-national setting up a Shared Service center could potentially pay a lower withholding tax in Mexico than in a neighboring country, generating significant savings.[7]

The look before the leap

While Mexico clearly makes a strong case for being one of the top Latin American Shared Services destinations, it is also important to consider some potential drawbacks. First, growth prospects have slowed recently as a result of the sharp drop in the price of oil, resulting in a decline in international investments as market players wait out rough conditions.[8] Second, the threat of natural disasters cannot be overlooked as Mexico City is located in a seismic hotbed and violent tropical storms regularly threaten both coasts. Finally, the threat of violence, particularly in Mexico's northern cities, reduces worker safety and lowers the quality of life for local and expat employees alike.

These risks, while ever-present, have been greatly mitigated by government regulations related to infrastructure, with newer buildings such as Torre Mayor in Mexico City built to withstand an earthquake measuring up to 9 on the Richter scale. As a result of such measures, geographical risks have not stopped numerous global companies from opening Shared Service centers in Mexico over the past decade[9] (today, one in every three Shared Service centers in Latin America is located in Mexico).[10] Despite the current stretch of economic and political challenges, Mexico should be front of mind for any organization looking to make the leap to Latin America.

Endnotes

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7 Deloitte International Tax Source. "Mexico Highlights 2016." HYPERLINK "http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-mexicohighlights-2016.pdf" http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-mexicohighlights-2016.pdf.

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For more information, please contact:

Francisco Silva
Partner
Deloitte MX – Mexico
Email: fsilva@deloittemx.com
Phone: +52.55.5080.6310

Kort Syverson
Principal
Deloitte Consulting LLP
Email: ksyverson@deloitte.com
Phone: +1.213.553.1275