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Mexico Nearshoring: Opportunity for Manufacturers in China and the U.S.

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Nearshoring to Mexico has become more and more popular among businesses during the last two years mainly due to supply chain challenges for manufacturers of goods in countries outside of North America, such as China and others in the Asia-Pacific region. About 88 percent of U.S.-based small and medium-sized businesses will shift their supply chains towards using suppliers from Mexico or the U.S., with 45 percent of them planning to move all operations fully. The recent nearshoring trend has increased Mexico manufacturing sector, positioning Mexico as a key player in North America´s supply chain[1].

Mexico is the second largest commercial partner of the United States, after Canada, and it boasts the second largest economy in Latin America. Mexico has a vibrant economy where more than 90 percent of its international trade is protected by free trade agreements, and direct foreign investment from 2021 to 2022 surged by 12 percent for a total of $35.29 billion USD.

Outside of North America, China has become Mexico's second-largest import partner after the U.S. China has also become Mexico's largest trading partner in the Asia-Pacific region and its third largest export market. In terms of investment, it is estimated that there are approximately 1,289 Chinese companies doing business in Mexico.

Moreover, investment by Chinese companies in Mexican industrial parks continues to increase[2]. There are published plans of expansion from Chinese companies into the Mexican states of Jalisco, Nuevo Leon and Guanajuato, all demonstrating the realization that company managers have regarding the advantages of nearshoring in Mexico, as well as the states, push to obtain more investments from Chinese companies[3]. The Mexican border state of Nuevo León already is benefitting from Chinese investments – in fact, since October 2021, nearly $7 billion in foreign investment has poured into Nuevo León. In 2021, Chinese companies were responsible for 30 percent of foreign investment in Nuevo León, second only to the United States at 47 percent[4].

Manufacturing has been and will always be an essential pillar of Mexico's economy. This sector represents 18.5 percent of the country's economy, and it is a powerful magnet for foreign investment, accounting for 47.9 percent of direct foreign investment in the last five years. Mexico is strong in the automotive, auto parts, electronic components, aerospace, chemical, food, medical devices, beverages and tobacco sectors.

Although setting up manufacturing operations in Mexico can be a golden opportunity for some companies, the following are several key legal issues that companies need to consider to properly set up operations and take advantage of nearshoring opportunities:

[1] https://www.freightwaves.com/news/report-nearshoring-to-mexico-happening-faster-than-expected
[2] https://www.eleconomista.com.mx/econohabitat/China-lidera-la-inversion-en-espacios-industriales-para-nearshoring-en-Mexico-20221124-0133.html
[3] https://mexiconewsdaily.com/news/chinese-investment-manufacturing-mexico
[4] https://www.nytimes.com/2023/02/03/business/china-mexico-trade.html

1. Foreign Investment

The general rule is that foreign investment is allowed in Mexico. There are, however, certain activities subject to restrictions where foreign investment is limited to a maximum percentage of foreign investment participation (ranging from 10 to 49 percent limitation depending on the activity). Some other activities require governmental approval to exceed 49 percent of foreign investment participation. Finally, there are some activities reserved to Mexican nationals or Mexican entities without foreign investment, as well as activities reserved to the State.

Manufacturing, in general, is not subject to foreign investment restrictions except for a few areas, such as firearms and explosives.

The law requires registration of Mexican entities with foreign investment in the National Registry of Foreign Investment. This is a straightforward registration process that is done once a Mexican entity is formed.

2. Mexican Entities

Although there are various types of business organizations in Mexico, the most common is the *Sociedad Anónima*, commonly referred to as an S.A., which provides limited liability to its shareholders. There is also a *Sociedad de Responsabilidad Limitada*, also referred to as S. de R.L., which is analogous to a limited liability company. Both types of entities limit the liability of the shareholders and members, respectively.

A more sophisticated form of an S.A. is a *Sociedad Anónima Promotora de Inversiones* or S.A.P.I., which has a more modern corporate governance framework than the S.A. and is widely used when foreign companies decide to form a corporation in Mexico.

It is common that wholly-owned subsidiaries are formed as a S.A. or S. de R.L., while joint venture entities are formed as a S.A.P.I. Ownership of corporations (S.A. and S.A.P.I.) is evidenced by share certificates, while membership interests in the S. de R.L. are not certified.

The relationship among owners is governed by a single document, the *Estatutos* (charter by-laws) of the entity. The *Estatutos* are registered with the government at the Public Registry of Commerce of the domicile of the entity. The *Estatutos* usually include the name of the entity, its duration (unless it is for indefinite period of time), corporate purpose (which includes a laundry list of potential activities), minimum capital, ownership structure, rules for shareholder/member meetings and resolutions, management of the company (board or single director), rules for management meetings and resolutions, statutory examiner (who oversees management, if applicable), dissolution and liquidation rules, and powers of attorney granted by the entity, among others.

The formation process of these entities is virtually the same. They require at least two shareholders or members. The organizational documents are formalized with a notary public in Mexico. Shareholders or members may designate legal representatives in Mexico via formal powers of attorney to appear on their behalf before a notary public in Mexico to form the entity.

Under Mexican law, notary publics are lawyers authorized by the States to carry out specific legal acts (entity formation, wills, transfer of real estate title, etc.).

Generally, the process to incorporate may take from one to four weeks depending on the specific circumstances.

Commercial entities are regulated by federal law, and once formed, they can do business nationwide.

3. Labor Laws

Labor regulations are unique in Mexico compared to other countries. This is an important area of compliance for manufacturing companies in Mexico. The Federal Labor Law (FLL) governs all aspects of the employer-employee relationship, including collective bargaining agreements, right to call for strikes, minimum wages, shifts, statutory severance, compensation and occupational health and safety.

In 2023, the general minimum daily wage in Mexico is $207.44 Mexican pesos (approximately $10.37 USD at an exchange rate of $20.00 Mexican pesos per $1.00 USD). In the free zone of the northern border, the daily wage is $312.41 Mexican Pesos (approximately $15.62 USD at the same exchange rate above). Minimum wages are usually increased every year.

Under the FLL, any individual rendering services in subordination to another individual or entity is deemed to be an employee and has the rights provided by the FLL.

The FLL provides great protection to employees. For example, dismissal of employees must be done with just cause; otherwise, employees are entitled to statutory severance of three months of salary plus additional amounts that are determined in the FLL.

Also, there were recent amendments to the FLL that prohibit general outsourcing. However, FLL allows a limited subcontracting (*subcontratación*). There are very specific rules that must be followed to be able to have limited subcontracting in Mexico (e.g. considering the type of specialized services, value added provided, and mandatory registration of service provider, among others).

Navigating through labor regulations in Mexico has proven to be one of the more challenging areas for foreign companies doing business in Mexico. It is important to have a solid understanding of the regulations before the investment is deployed in the country.

4. Manufacturing and Special Programs

Mexico has created different programs to promote and expand its manufacturing industry. These programs intend to facilitate international trade operations, create economic incentives, and provide legal security for exports. At the same time, international trade programs have contributed significantly and positively to the Mexican economy, attracting foreign investment, creating industrial clusters, and jobs.

Various programs are available, and one of the most popular ones is known as IMMEX (its acronym in Spanish) which is a program that promotes Mexican exports. The program requires authorization from the Ministry of Economy. A Mexican entity with an IMMEX program authorization can temporarily import goods into Mexico for industrial transformation (which includes production, transformation or repair), so the end product obtained is exported. It also applies to certain export services provided to goods that are going to be exported. In such cases, there are no import taxes or customs duties applicable to such imported goods. In essence, the IMMEX program provides administrative simplification and tariff incentives to manufacturers and foreign-owned companies operating in Mexico for purposes of exporting end products.

A certification to obtain exemption from value added tax is also required. Such authorization is granted by the Ministry of Finance.

The IMMEX Program is only granted to Mexican entities and there are five categories in this program:

1. IMMEX Holding Company Program. This program is applicable to the manufacturing operations of a certified holding company and one or more of its subsidiaries in the same program. This is used for more complex manufacturing operations to be carried out by various entities of the same group in Mexico.

2. IMMEX Industrial Program. This program is applicable to a Mexican entity engaged in the manufacturing or transformation of goods in an industrial process for export. This is the most common IMMEX program.

3. IMMEX Services Program. This program is applicable to a Mexican entity which provides export services to other foreign companies with products in Mexico for export (e.g., storage, labeling, etc.). There is a specific list of "authorized services" that may be provided under the program. The list is issued by the Ministry of Economy.

4. IMMEX Shelter Program: This program is applicable to Mexican entities which obtain this authorization to provide manufacturing to non-affiliated foreign companies in Mexico for a fee. There are several companies in Mexico that have an authorized IMMEX Shelter Program (the "Shelter Company"). This scheme allows foreign companies to manufacture in Mexico without having to form a subsidiary. The Shelter Company takes the administrative burden of the operation (e.g., authorizations, management, hiring employees, importing raw materials, operating the manufacturing process, and exporting end products, etc.) for a fee. The foreign entities engaging a Shelter Company are required to provide technology and the production material for manufacturing. This scheme requires the foreign entity to comply with some tax obligations with the Mexican authorities, but such obligations are complied with through the Shelter Company. This program facilitates the administrative burden for foreign companies desiring to manufacture in Mexico, but it is usually more expensive than direct manufacturing.

5. IMMEX Outsourcing Program. This program is applicable to Mexican entities that obtain the IMMEX authorization but do not have the facilities to manufacture by themselves, so they carry it out through non-IMMEX third-party companies.

PROSEC (its acronym in Spanish) is another program available to manufacturing companies in some sectors (e.g., electrical, electronics, mining, metallurgical, chemical, automotive, auto parts, pharmaceuticals, drugs and medical equipment sectors). PROSEC allows companies to import inputs to manufacture products in a specific sector subject to preferential tariffs regardless of whether the products are exported or used in Mexico.

A Mexican entity may apply for IMMEX and PROSEC programs simultaneously. Both programs are authorized by the Ministry of Economy.

Finally, Mexico has executed many free trade agreements with several countries and economic regions, including North America (USMCA), European Union, European Free Trade Association, Trans-Pacific Partnership (CPTPP), Costa Rica, Nicaragua, Chile, Israel, El Salvador, Guatemala, Honduras, Uruguay, Panama and Peru, as well economic complementation agreements with other Latin American countries. To the extent that products manufactured in Mexico comply with the rules of origin and other requirements set forth in such free trade agreements, such products will receive the beneficial treatment of those treaties from a customs and duties perspective.

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China MIIT Releases Data Security Management Measures for Industrial and Information Technology Sectors, February 20, 2023

A New Guideline Added to China's Data Protection Framework, August 17, 2022

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China Releases Judicial Interpretation of Anti-Unfair Competition Law, April 28, 2022

Select Proposed Changes to the Company Law of the People's Republic of China, March 22, 2022

A Snapshot of China's Cyberspace Administration and Data Protection Framework, February 9, 2022

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China's Amended Administrative Penalty Law Took Effect on July 15, October 8, 2021

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China Patent Law Fourth Amendment—Impact on Foreign Companies, January 26, 2021

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China Adopts Interim Provisions on the Review of Concentrations of Business Operators for the AntiMonopoly Law, November 30, 2020

China Releases Draft Personal Data Protection Law for Comments, November 12, 2020

China Adopts Export Control Law, November 5, 2020

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China Releases Provisions on Strengthening the Supervision of Private Equity Investment Funds (Draft), October 15, 2020

China Releases Provisions on the Unreliable Entity List, October 5, 2020

China Releases Revised Measures on Handling Complaints of Foreign-Invested Enterprises, September 23, 2020
China Releases Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies, September 10, 2020

China Releases Draft Data Security Law, September 8, 2020

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Additional questions? Please contact Haynes and Boone lawyers Liza L.S. Mark and Alberto de la Peña