

2nd IMMEX Outlook

Identify opportunities now



Foreword

Considering the concentration of IMMEX companies in the border states of Mexico, we are proud to present our **second IMMEX Outlook: Border Region study**, which represents an effort to understand the business climate and expectations of the maquiladoras in Mexico.

Without a doubt, Mexico continues to be one of the world's leading manufacturing countries. The 2013 Global Manufacturing Competitiveness Index published by Deloitte, listed Mexico along with Brazil, Canada and the United States among the top 15 manufacturing countries in America¹.

Considering this ranking, we researched the current conditions and expectations from this specific sector

of the industry, IMMEX, in order to assess their strengths and opportunity areas. In this second edition of our study, we surveyed business leaders and professionals from the states of Baja California, Chihuahua, and Sonora. We included a section with some of the challenges IMMEX are facing in this region, such as the situation related to the Federal Law on Protection of Personal Data held by Private Parties and Individuals, Infonavit audit requirements, the IMMEX verification process (NEEC Certification), and other relevant industry topics.

As in our last edition, we hope you'll find value added and relevant business industry information for your decision making.

Yours truly,

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¹ [http://www.deloitte.com/assets/Dcom-Mexico/Local%20Assets/Documents/mx\(en-mx\)Global_Manufacturing_Competitiveness2013.pdf](http://www.deloitte.com/assets/Dcom-Mexico/Local%20Assets/Documents/mx(en-mx)Global_Manufacturing_Competitiveness2013.pdf)

Methodology of the study and profile of the participants

The survey was applied during the last quarter of 2012 by email and phone. The survey responses correspond to 235 business professionals from different areas: administrative, financial, human resources, production and accounting from companies in Baja California, Sonora and Chihuahua registered as IMMEX in the Secretariat of Economy directory.

From the total respondents, 19% indicated they are Chief Accounting Officers (CAO), followed by Tax Managers (TM) with 17%, and Human Resources Manager (HRM) with 15% (Fig 1).

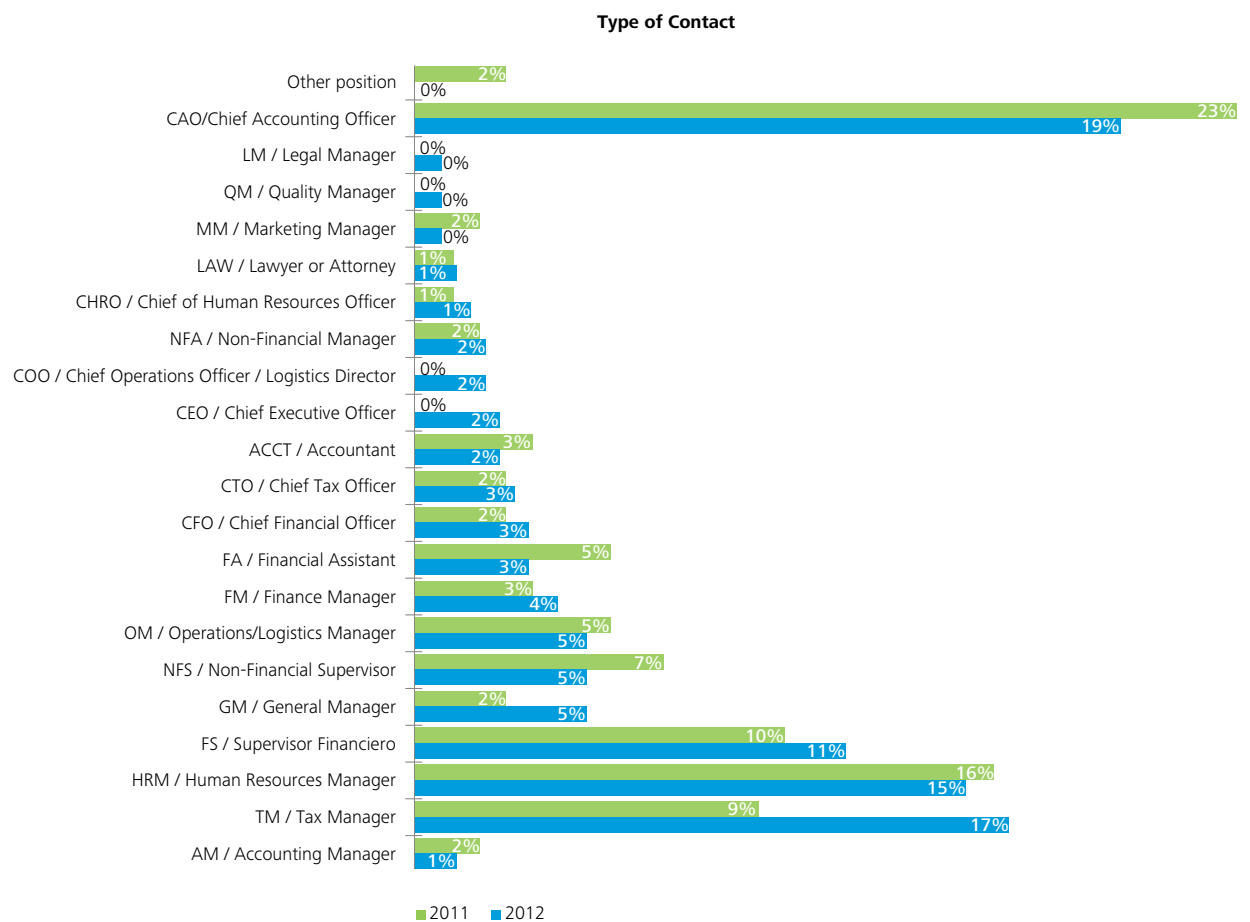


Figure 1. Respondent type and percentage participation in second the IMMEX Outlook Survey: Border Region

The electric and electronics sector was the largest business sector represented accounting for 20% of the total responses, followed by automobile manufacturing with 11%. An

additional 37% of respondents work in other diverse sectors, with fully 45% of these hailing from manufacturing (Fig 2.)

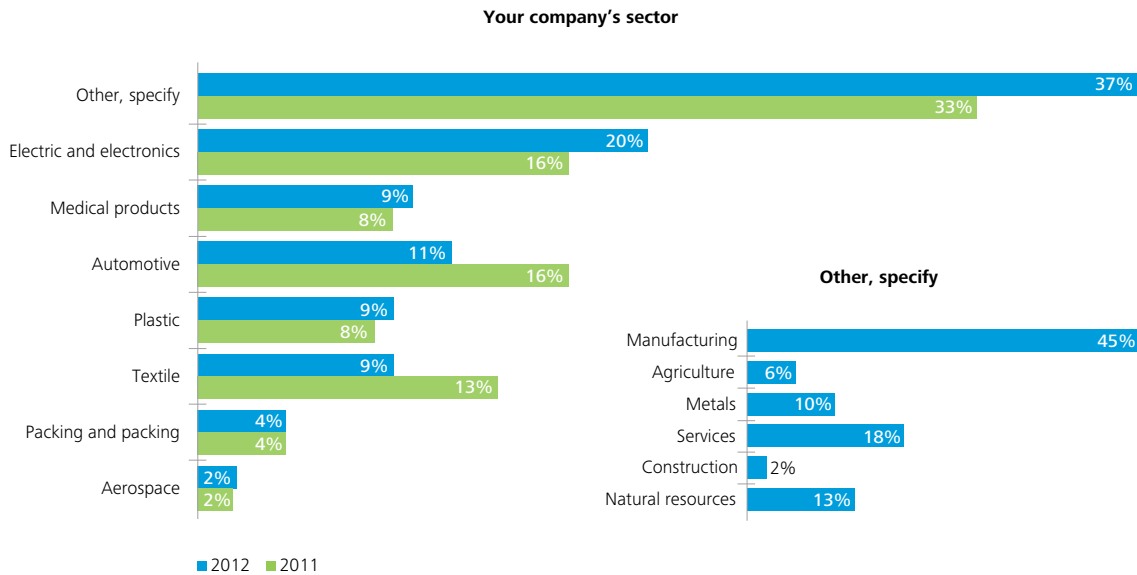


Figure 2. Classification of your company's sector

Diverse survey results

The majority of the respondents indicated the origin of the company's investment comes from United States, 73% (Figure 3). 93% of companies have a temporary import regime, out of which 87% are IMMEX (Figure 4). In terms of revenue, 51% did not provide a revenue range, 16%

indicated a range of 35 to 100 million pesos (fiscal year), 9% within the range of 101-300 million-pesos (Figure 5).

In terms of the number of employees, 53% of respondents reported less than 300 workers, followed by 23% reporting 301-500 and 12% indicating 501-1,000 employees (Figure 6).

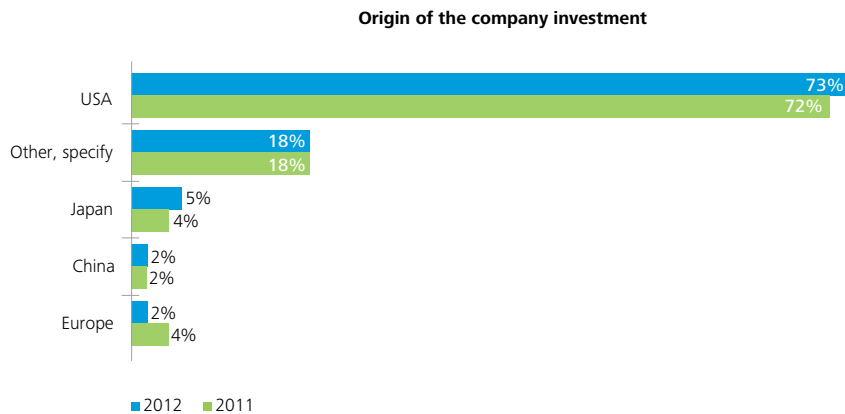


Figure 3. Origin of the company investment



Figure 4. Does your organization have a temporary import regime?

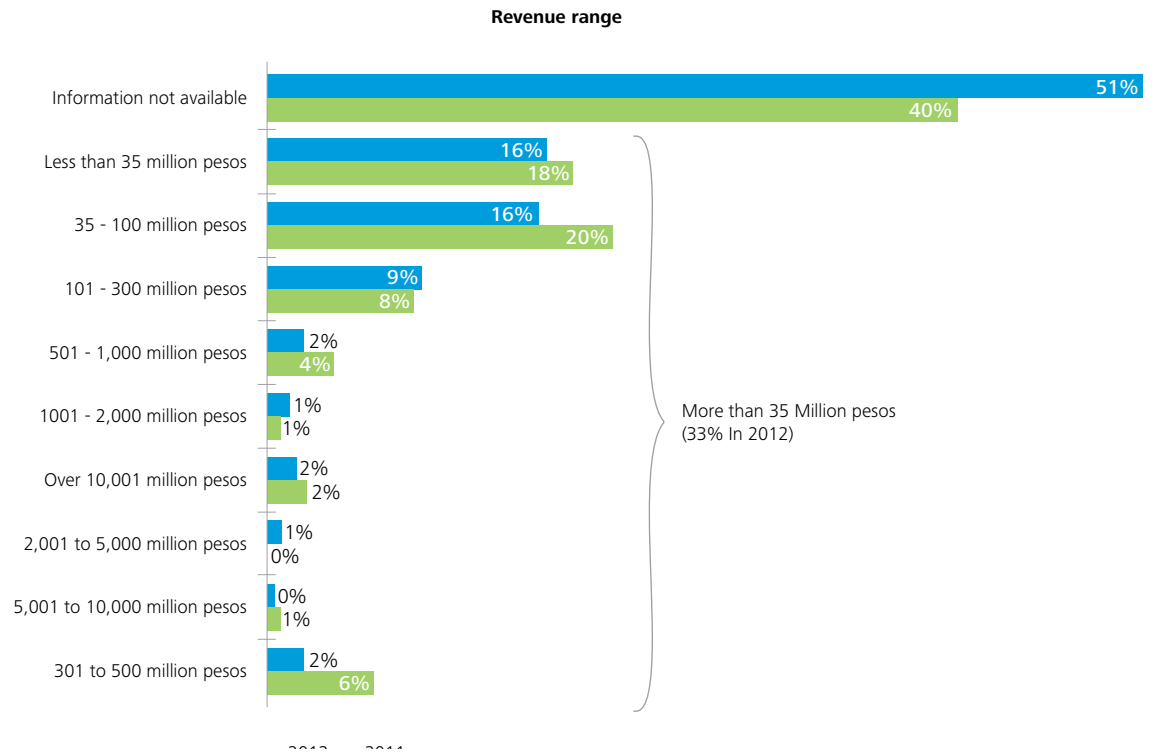


Figure 5. Revenue range

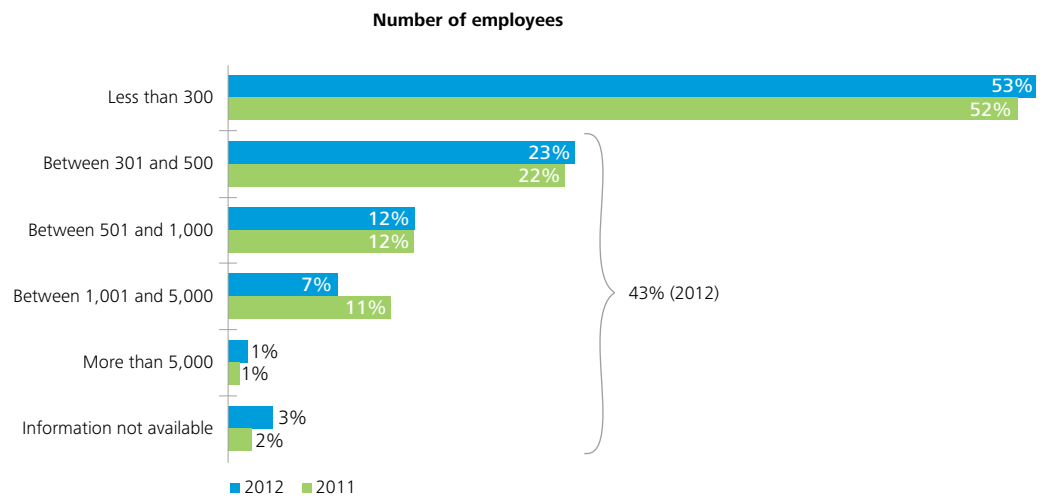


Figure 6. Number of employees

Business climate in the country and companies

During 2012, there were presidential elections for both the United States and Mexico. These political changes were just one part of the economic environment that caused some doubts and expectations among the business professionals surveyed.

In general terms, opinions came in on the side of optimism. The 24th edition of Deloitte Business Barometer Mexico (released at the end of 4Q-12)², revealed generally positive opinions related to an improving investment climate, in which the economic situation and security were the most favorable variables. Likewise, expectations of business leaders point to a favorable scenario in the business climate in the short term.

Moreover, Deloitte's Global Manufacturing Competitive Index has reported a dip in the competitiveness of Mexican manufacturing industry over the last two years, as Mexico moved down from sixth place in 2010 to thirteenth place 2012. Despite this slump, the outlook for the future remains upbeat, as can be seen in numbers released by the National Institute of Statistics, Geography and Informatics (INEGI, by its Spanish acronym) showing the growth of 2.4% in the in-bond sector, driven largely by foreign investment³.

At the global level, even as the greater America's region continues to exhibit agility in output, with the United States, Brazil, Canada and Mexico standing among the fifteen most competitive countries over the last five years; it seems, nonetheless, that many Asian countries are positioning to occupy ten of the top fifteen spots in the ranks of competitiveness within the next decade.

Finally, experts expect this year's manufacturing industry to provide a significant boost to the country's GDP on the strength of sustained expansion of external demand led by the United States, where Mexican products continue to gain market.

Overview of the regional context

Results of the 2012 survey show a recovery in the perception of the border region, 57% of respondents believe that 2012 was better than 2011 for their companies, while 31% reported no change (Figure 7). With regard to variables indicating the business climate, the economic situation

of the United States outperformed all others, as 39% of respondents gave the thumbs up for 2012, vs. only 15% in 2011 (Figure 8). These results coincide with opinions of diverse experts who have projected acceleration of the US economy driving modest growth of the global in the coming year⁴.

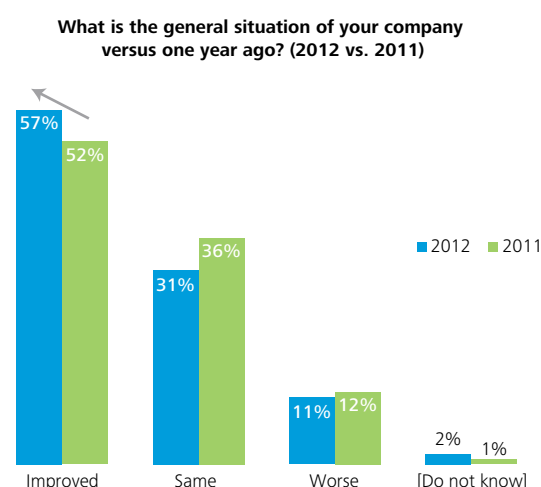


Figure 7. How does the general situation of your company compare to its position one year ago? (2012 vs. 2011)

In other matters, competitiveness of the IMMEX sector clearly improved in 2012 against 2011, with 43% of respondents giving 2012 a positive rating vs. 21% in 2011. Security also showed a significant gain of 27% in 2012 versus 13% in the previous year. The outlook for employment for this year also improved. (Figure 8).

With regard to variables describing the business climate, most respondents believe the situation in 2013 will be better. More than fifty percent of respondents called the following variables "better": the US economy, IMMEX competitiveness, availability of credit, employment, security, and the cost of materials and supplies. The economic situation of the country, however, did not improve significantly, with 43% believing it will remain unchanged vs. 2011, and 20% suggesting an improved performance in 2012.

Despite these numbers, we can generally assert that respondents in the border region still hold a positive outlook, which coincides with that of companies throughout Mexico.

² http://www.deloitte.com/view/es_MX/mx/sala-de-prensa/boletines-deprensa/3363a5b57c86c310VgnVCM2000003356f70aRCRD.htm

³ Idem

⁴ Global Powers of Retail 2013. Retail Beyond. Deloitte, p. 4. https://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Consumer%20Business/dtl_cb_GlobalPowersofRetailing2013.pdf

What is your current view of the following concepts vs. one year ago?

■ Improved
■ Same
■ Worse
■ [Do not know]

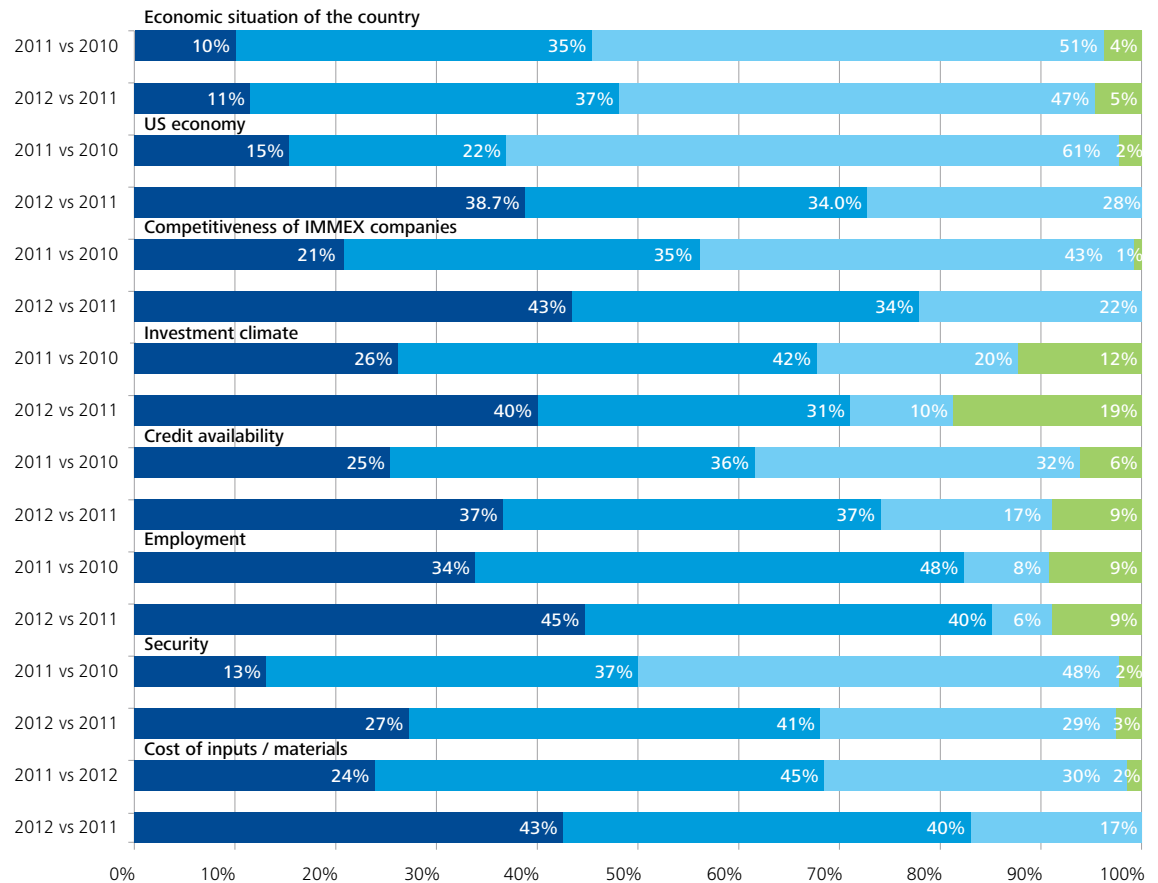


Figure 8.

How will the following concepts perform in the next year?

■ Improved
■ Same
■ Worse
■ [Do not know]

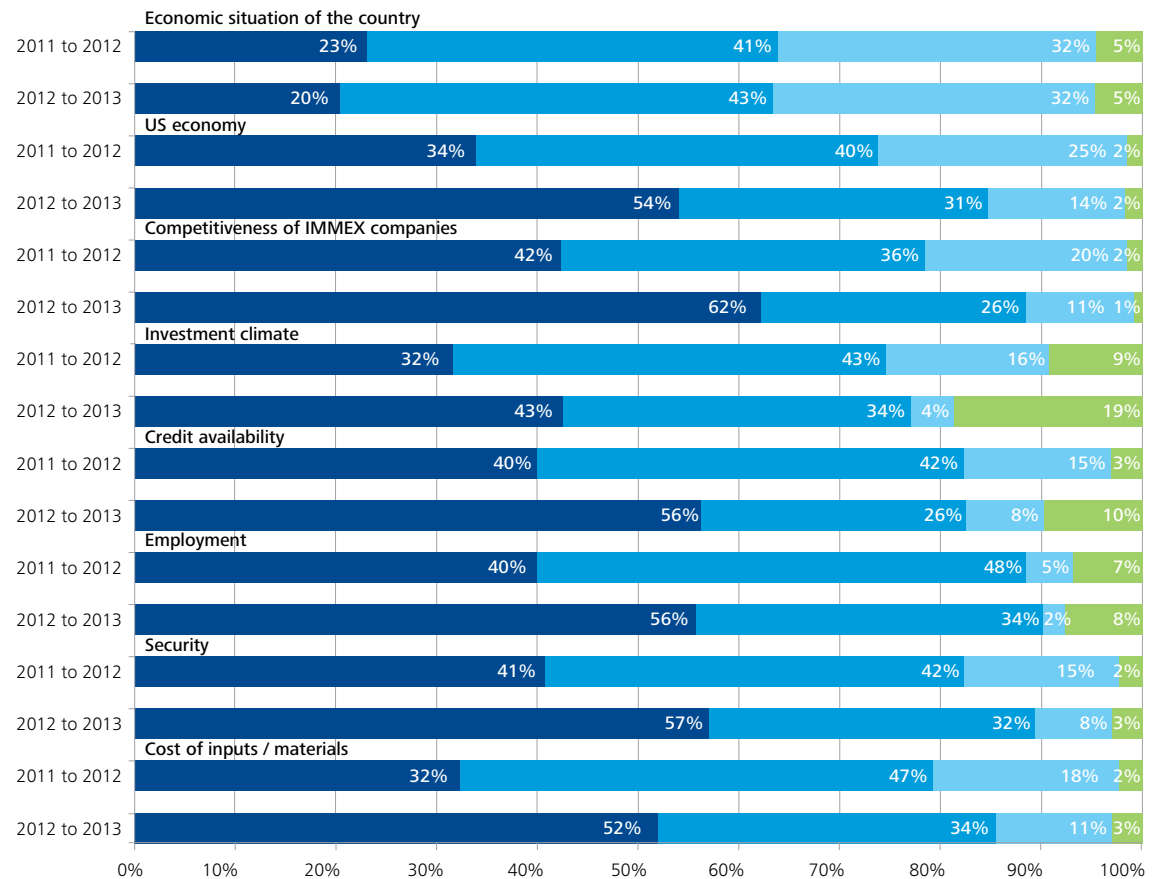


Figure 9.

General situation of companies in the region

The company variables evaluated in the study were rated in the normal-average situation, compared with the previous year (2011 vs. 2010), with the exception of the production demand and the IMSS audit / documentary /paperwork compliance load, these two concepts were rated as better. As such, the following variables remained largely unchanged

vs. last year (Figure 10): production demand (at 47%), inventory turnover (40%), personnel turnover (43%), reliability of inventory control system (41%), impact on income statement due to exchange rate volatility (39%), debt load (47%) and the use of warehouse, machinery and equipment (41%).

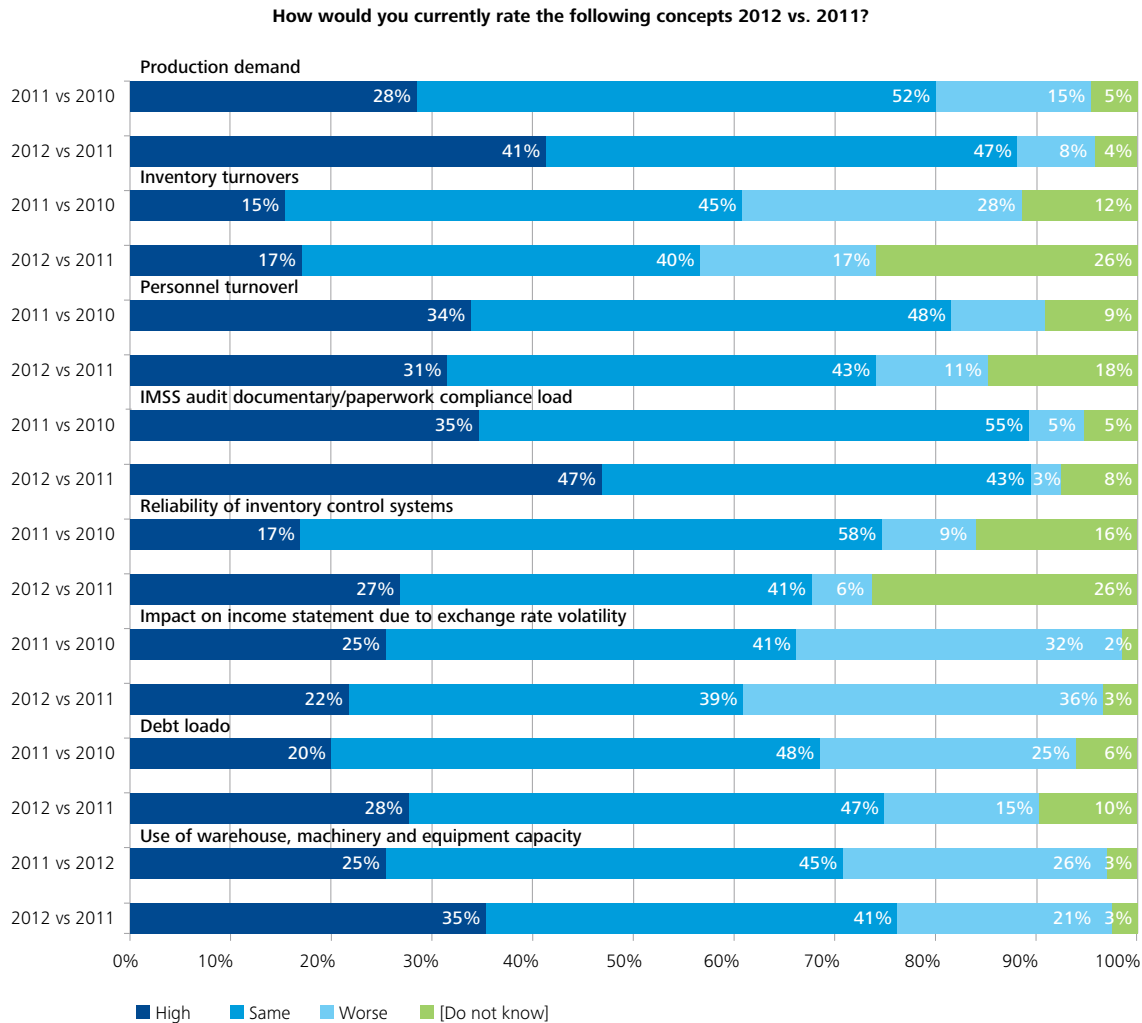


Figure 10. How would you currently rate the following concepts 2012 vs. 2011?

As for 2013 expectations, most respondents believe the situation shall remain largely normal or average. The variable for use of warehouse, machinery and equipment capacity were rated “high” with 53% for 2013, though inventory turnover will stay “normal” or average vs. 2012, according

to 41% of those respondents. With regard to SAT (Mexico’s Internal Revenue Service) compliance and producing information required for IMSS audits, fully 41% said this would be high (Figure 11).

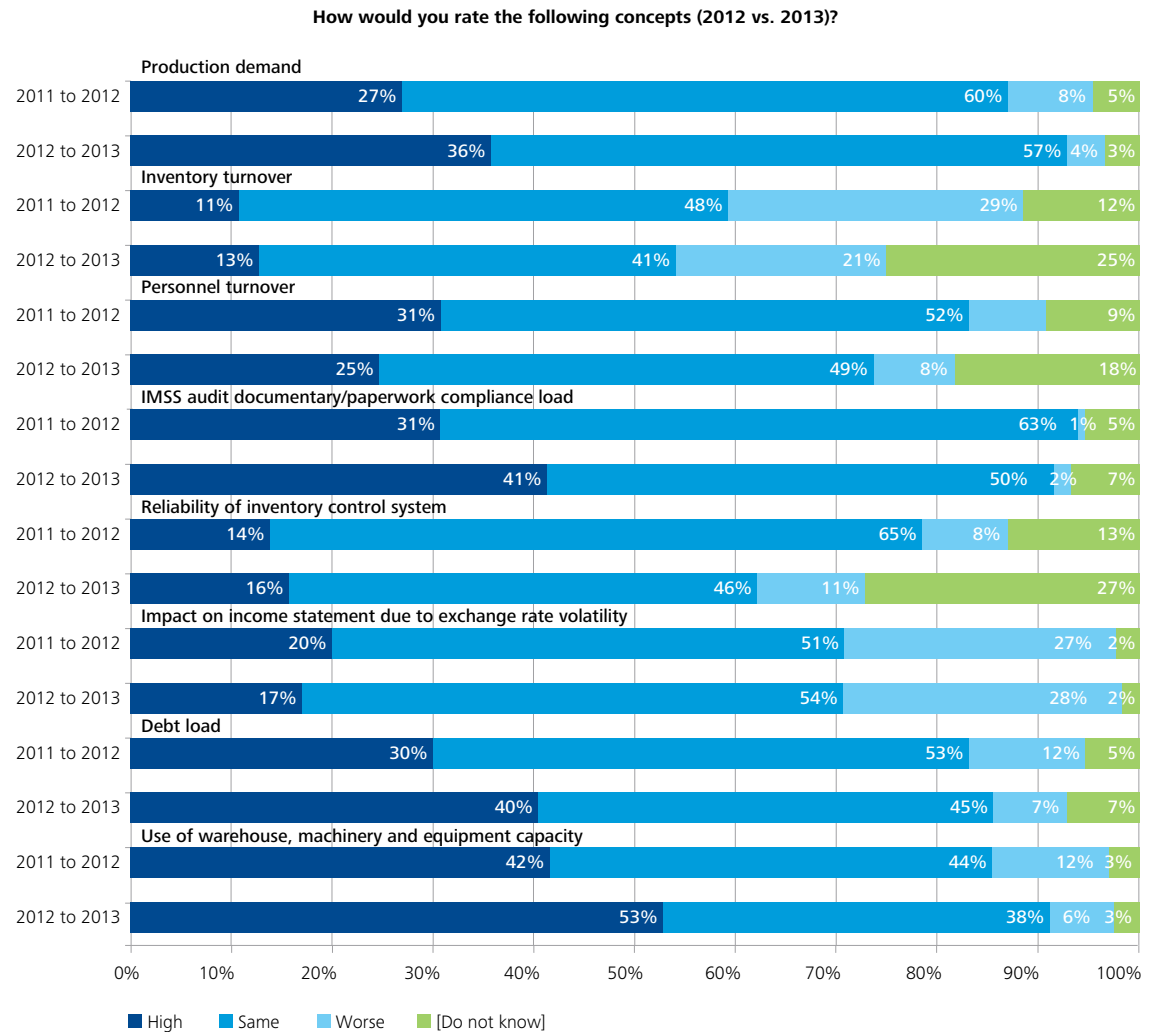


Figure 11. How would you rate the following concepts (2012 vs. 2013)?

Challenges, opportunities, value added

Value added for IMMEX companies

According to executive's responses, the implementation of cost reduction strategies (85%) resulted the first the value added alternative, such as presented in the first Outlook IMMEX study, with 75%. In view of the strength of the peso vs. the dollar, we can assume that cost reduction has become even more compelling.

73% of respondents indicated that the implementation of a human capital development plan was the second best alternative. This perception is important for IMMEX companies since having talented employees is one of the factors in measuring a country's competitiveness, none improvement or initiative could be implemented or proposed without the qualified talent resources.

The value added alternative of the New Scheme for Certified Companies (NEEC) resulted as the third option with 70%. By having registry as a certified company, companies are granted important customs benefits such as: reduction in the amount of "red lights" reviews at the moment of the customs clearance, streamline in the preparation of pedimentos, flexibility in auto-corrections even if under an audit by part of the customs authorities, use of "express" lanes within the ports of entry, transfers by part of companies with IMMEX Program through virtual

pedimentos of its manufactured products to national companies, and fast track in the refund of favorable VAT, among many others.

Other variables were the implementation of sustainability and environmental programs (69%), security and guarantee in the handling of information by means of implementation of a model that responds to the requirements of the LFPDPPP and fiscal benchmarking, the analysis of trends, best practices and predictive models both with 59%. Obtaining economic funds for the development and innovation of processes and technology to adjust new production lines or improve existing ones resulted with 46%.

Though doubtless there are several areas of opportunity for organizations, these areas are the key for driving the competitiveness of the sector. On one hand, fiscal benchmarking offers the industry an excellent opportunity to deal with the challenges of taxation and compliance, as it provides companies with a more accurate vision of their position in the Mexican market in terms of the fiscal indicators that serve to signal both opportunities and risks. On the other hand, access to economic funds can help companies to work on research and development projects toward enhancing efficiency of manufacturing processes and producing ever more sophisticated products.

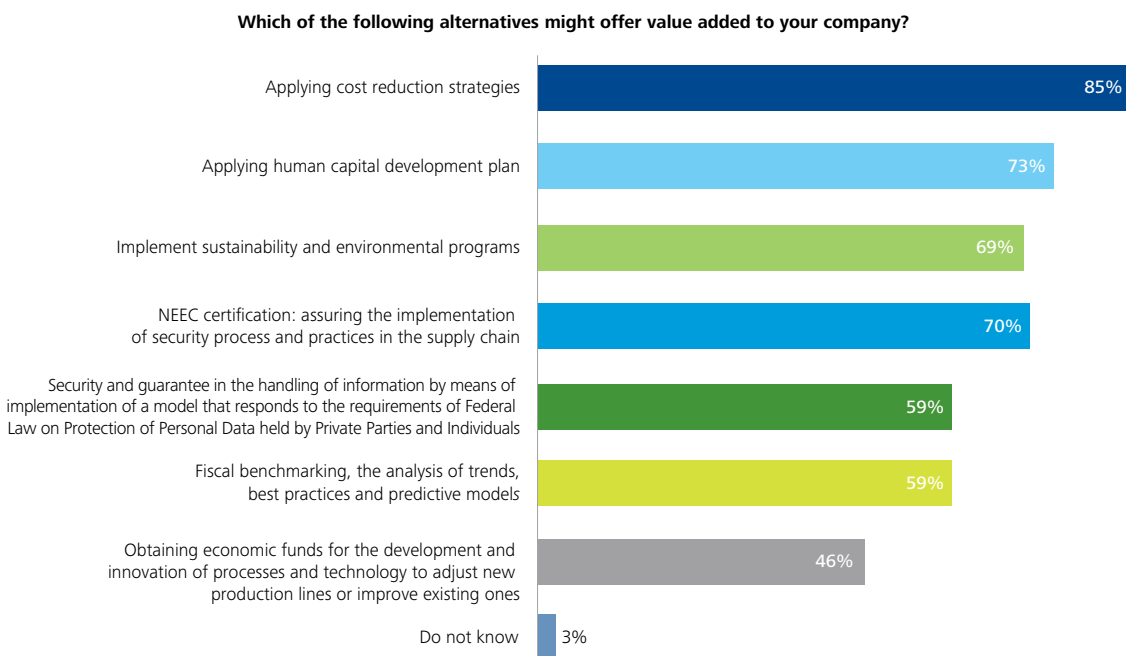


Figure 12. Which of the following alternatives might offer value added to your company?

Challenges

Considering the current situation, professionals were asked about some of the variables that could represent a challenge to their organizations. 69% indicated that the

cost of raw materials and suppliers is the biggest challenge, while 66% pointed to the constantly shifting foreign trade market. The challenge of compliance with tax / regulations was cited by 60% of respondents.

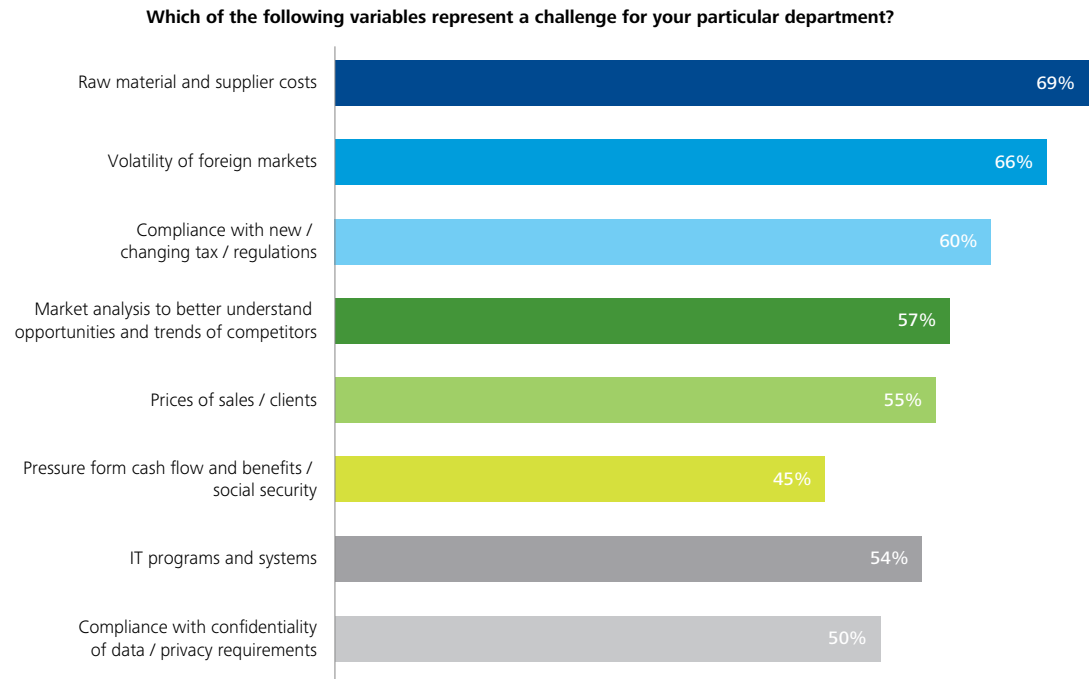


Figure 13. Which of the following variables represent a challenge for your particular department?

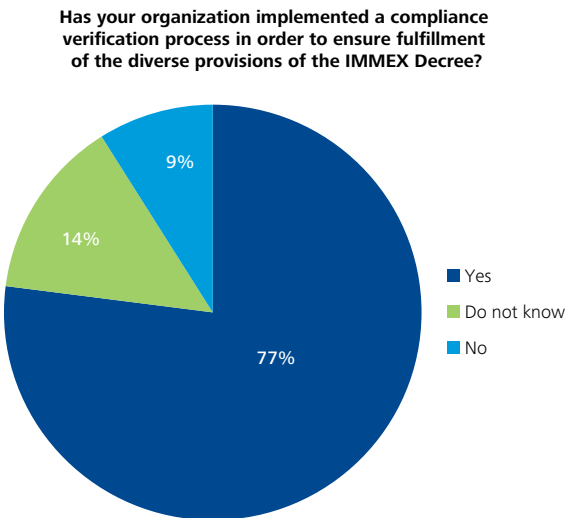


Figure 14. Has your organization implemented a compliance verification process in order to ensure fulfillment of the diverse provisions of the IMMEX Decree?

IMMEX verification process

A company registered as IMMEX has a series of tax and operative advantages that are important for any enterprise with international operations. 77% of respondents indicated their companies currently have IMMEX verification procedures in place, which allows them to not only to remain in the program but also to receive the IETU (flat tax) tax credit authorized for this sector. In contrast, 14% of respondents are unaware of IMMEX verification procedures in their organizations and 9% indicated that there are no such procedures in place. As can be seen in these figures, no fewer than 23% of respondents still have the opportunity to improve the efficiency of their processes and enjoy the benefits offered by the IMMEX program.

INFONAVIT Opinion

This program is called Bimonthly Auditor's Opinion for INFONAVIT (Bi-monthly –Bi-monthly audited). The goal is to provide benefits to employers who adhere to this program, which basically consist of a waiver for the employer not

to be notified with bonds of differences for the periods (bimonthly) audited. This Bi-monthly audit report does not replace the annual voluntary audit report and those who submit the notice for annual report must comply with the obligations and deadlines established for these purposes. As for the current year, the program applies only to companies that are within the pilot program.

Those employers adhering to the program, will not be subject to notifications of differences for the periods audited, furthermore, they will have the certainty of reasonably complying with the various obligations with the Institute, thus eliminating payment risk surcharges and interests. It is important to take into consideration the benefits contained in the program, otherwise, these benefits are allowed by submitting the annual report a year after and not immediately as started in the program.

65% of respondents reported that their respective companies are audit for INFONAVIT, while 19% indicated that their company does not. 16% had no knowledge of the situation. Of the 65% in the audited group, more than half (34%) reported that their companies take advantage of Bi-monthly –Bi-monthly audited report, while 29% stated that their company has opted for the INFONAVIT voluntary audit report. The balance of 37% of respondents said they had no knowledge of these procedures.

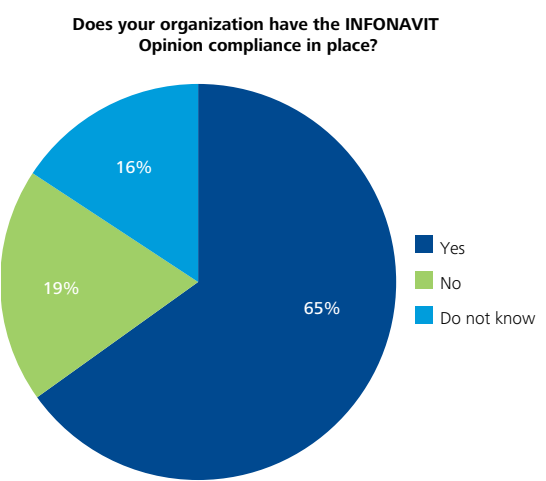


Figure 15. Does your organization have the INFONAVIT Opinion compliance in place?

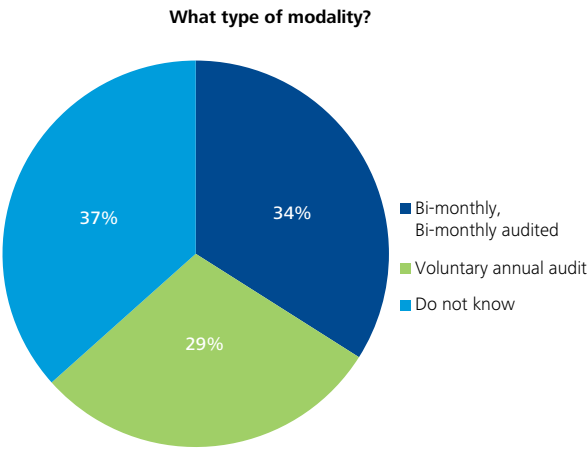


Figure 16. What type of modality?

Federal Law on Protection of Personal Data held by Private Parties and Individuals, (LFPDPPP, by its Spanish acronym) for IMMEX companies

Since publication of the Federal Law on Protection of Personal Data held by Private Parties and Individuals in the Mexico’s Federal Official Gazette on July 5, 2010, individuals and entities must comply with the applicable provisions derived from this legislation. The new law provides flexible, faster, and easier mechanisms for citizens to exercise their rights before those responsible for the databases. The law also provides the citizens the Right of **A**ccess, **R**ectification, **C**ancellation and **O**mission of their personal data (ARCO Rights, by its Spanish acronym).

It is important to keep in mind that the approaches of LFPDPPP do not involve only the protection of data, but also a number of processes and procedures that support the exercise of rights of the information’s owners. To achieve the balance between protection and efficiency, it is necessary to use a risk-bases approach that allows the design and implementation of optimal processes and controls, and thus, achieving the appropriate balance between cost and benefit.

Related with the LFPDPPP, 51% of the respondents ignore the implication of the Law (Figure 17), while only 33% indicated that their departments have taken actions to

comply with it. Noncompliance of this Law results in sanctions.

Are you aware of the implications of the Federal Law on Protection of Personal Data held by Private Parties and Individuals (LFPDPPP) issued on July 5, 2010, that took effect in 2012, applicable for all areas in the organizations that handle personal data?

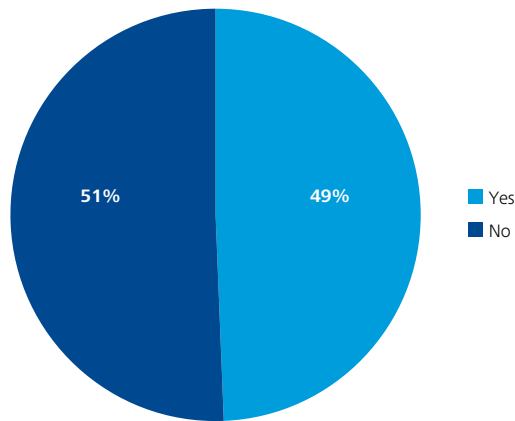


Figure 17. Are you aware of the implications of the Federal Law on Protection of Personal Data held by Private Parties and Individuals (LFPDPPP) issued on July 5, 2010, that took effect in 2012, applicable for all areas in the organizations that handle personal data?

Has your department taken some action to ensure compliance with the Federal Law on Protection of Personal Data held by Private Parties and Individuals?

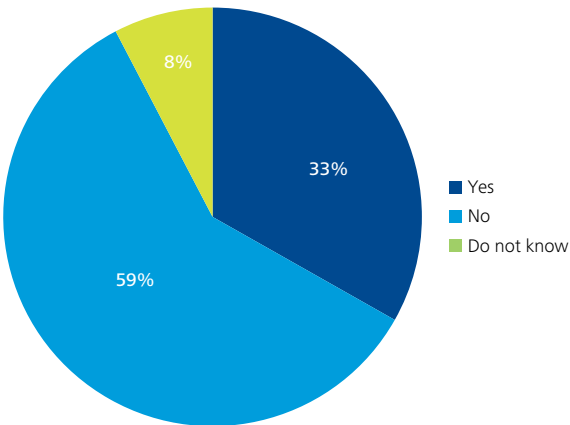


Figure 18. Has your department taken some action to ensure compliance with the Federal Law on Protection of Personal Data held by Private Parties and Individuals?



Conclusions

- The panorama for 2012, according to the respondents, was much improved over 2011 compared with 2012. Variables describing the US economy (the main investor for IMMEX) advanced significantly, while security and employment were also rated in a better scenario. The local economy, however, still did not provide signs of recovery according to the business leaders queried. This is probably because the survey was carried out during the presidential election season that may have caused some uncertainty. It will be interesting to see if the next survey can detect the positive effects of recent reforms.
- While Mexico is still rated among the world top 15 countries for the manufacturing industry; still needs to work on areas of improvement to keep a competitive edge. In order to improve its position among manufacturing economies, Mexico needs to work in the following areas: innovation, taxes, cost of raw materials, market attraction and the health system. Failing to do so, brings the risk of lagging behind competitors in emerging markets, especially those in Asia.
- The outlook for this year is positive and showed significant signs of recovery across all variables according to the respondent's opinions; however, at the time of the survey there was still considerable doubt about the direction of the Mexican economy. Nonetheless, as mentioned before, Mexico is currently going through a period of reform that doubtless will exert significant positive impacts on the overall performance of the economy.
- IMSS compliance requiring vast amounts of information, so is still one of the factors undergoing the most growth in company operations. This situation is expected to continue next year. A good approach for companies could be to outsource these functions, so that companies can focus on the critical areas of business operation and strategy.
- Companies in the region still have areas of opportunity in the areas of strategy and operation. On one hand, there is still a significant portion (23%) of companies that has not yet taken advantage the many IMMEX provisions, and more than half are not even aware of the implications of recent personal data protection legislation. Moreover, funds for research and development were not rated among the top three alternatives for value added for IMMEX, though this is one key factor for innovation and competitiveness.

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