

An aerial night photograph of a city skyline, likely Mexico City, showing numerous illuminated skyscrapers and a complex highway interchange in the foreground. The city lights create a vibrant, glowing effect against the dark night sky. A prominent yellow vertical bar is located on the left side of the image.

MAYER | BROWN

NEARSHORING IN MEXICO

Table of Contents

- Executive Summary 1
- I. Background 2
 - a. *What Is Nearshoring?* 2
 - b. *Advantages* 2
 - c. *What drove companies to pursue resilience in their supply chains?* 2
 - d. *factors that have contributed to the trend of nearshoring* 3
- II. Why Mexico and What Makes Mexico a Good Candidate for the Relocation of a Supply Chain? 3
 - a. *Nearshoring in Mexico* 3
- III. When did Nearshoring Really Start Picking UP? 8
- IV. What are the main regions in Mexico where nearshoring is taking place or is expected to take place? 8
 - a. *What are the main regions where nearshoring is taking place in Mexico?* 8
 - b. *Isthmus initiatives and port improvements* 9
- V. What are the potential benefits for companies and for Mexico? 10
 - a. *Potential benefits for companies* 10
 - b. *Potential benefits for Mexico* 11
- VI. Market opportunities 12
 - a. *How does Mayer Brown see this phenomenon evolving into key market opportunities?* 12
- VII. Challenges 13
 - a. *Standardization of customs process* 13
 - b. *Deficit of industrial parks* 14
 - c. *Bureaucracy and corruption* 14
 - d. *Security* 15
 - e. *Rule of Law* 15
 - f. *ESG Policies* 16
 - g. *Infrastructure* 17
- VIII. Nearshoring and banking 17
- IX. E-commerce 18
- X. How is Mayer Brown suited to assist clients in the needs for legal services? 19

Executive Summary

Nearshoring is an economic trend which consists of relocating business operations to a nearby country or region, often with the intention of reducing costs and improving efficiency. This approach has become increasingly popular in recent years, particularly in the context of e-commerce, as companies seek to gain a competitive edge in a rapidly evolving marketplace.

One of the primary benefits of nearshoring is cost reduction. By moving operations to a nearby country with lower labor and overhead costs, companies can reduce their operational expenses and become more competitive in the marketplace. Additionally, the proximity of the new location can lead to improved efficiency in the supply chain, as shorter delivery times and lower shipping costs allow for better coordination and inventory management.

Another key advantage of nearshoring is the potential to improve the customer experience. With shorter delivery times and lower shipping costs, companies can offer faster and more affordable shipping options, leading to higher customer satisfaction and loyalty. This can be particularly important in the e-commerce industry, where customers expect fast and reliable shipping.

However, there are also potential downsides to nearshoring. For example, the relocation process can be expensive and time-consuming, and there may be challenges associated with cultural and language differences. In addition, there may be concerns about the displacement of local workers in the country of origin, as jobs are moved to the new location.

Despite these challenges, nearshoring has become an increasingly popular strategy for businesses seeking to improve their competitiveness. By carefully weighing the benefits and risks of nearshoring, companies can determine whether this approach is the right choice for their specific needs and goals.

In the context of Mexico, nearshoring has the potential to provide significant economic benefits. For example, if companies relocate operations to Mexico, this can create jobs and economic opportunities for the local community, leading to increased demand for goods and services and stimulating economic growth in the region. Additionally, nearshoring can attract direct foreign investment, which can have positive effects on economic growth and technology transfer to the Mexican economy. It can also improve Mexico's competitiveness in the global market by offering lower labor and production costs than other countries, making it an attractive location for companies to establish operations.

Mexico is a great option for nearshoring for several reasons:

- i. Geographic proximity: Mexico is located in close proximity to the United States, making it easier and more cost-effective to travel between the two countries. This can help facilitate communication and collaboration between teams.
- ii. Cultural compatibility: Mexico shares many cultural similarities with the United States, including language, work ethic, and business practices. This makes it easier for companies to work together and reduces the potential for misunderstandings.
- iii. Skilled workforce: Mexico has a large and growing pool of skilled workers, particularly in the technology and manufacturing sectors. This means that companies can find the talent they need to succeed in a competitive global market.
- iv. Competitive costs: Compared to other countries, Mexico offers a competitive cost structure for nearshoring. Labor costs are generally lower than in the United States, while infrastructure and real estate costs are also relatively affordable.

I. Background

A. WHAT IS NEARSHORING?

Nearshoring is an economic trend which consists of relocating business operations to a nearby country or region, often with the intention of reducing costs and improving efficiency. This approach has become increasingly popular in recent years, particularly in the context of e-commerce, as companies seek to gain a competitive edge in a rapidly evolving marketplace.

B. ADVANTAGES

One of the main advantages of nearshoring is the reduced cost of labor compared to domestic operations. By outsourcing to nearby countries, companies can take advantage of lower labor costs while still benefiting from similar time zones, cultural similarities, and easier communication. This can also lead to a reduction in transportation and logistics costs.

Another advantage of nearshoring is the ability to tap into a wider pool of skilled talent. Companies can leverage the expertise and experience of workers in nearby countries, who may have similar language and cultural backgrounds, as well as access to advanced education and training programs.

Nearshoring can also help companies improve their supply chain efficiency, as it reduces the time and costs associated with shipping goods and materials over long distances. This can help to streamline production and reduce lead times, enabling companies to be more responsive

C. WHAT DROVE COMPANIES TO PURSUE RESILIENCE IN THEIR SUPPLY CHAINS?

- i. Commercial tensions between China and the United States: In 2018, trade tensions arose between these two countries, resulting in the imposition of tariffs. This has resulted in increased costs of more than US\$700 billion.

- ii. COVID-19 pandemic: In 2020, the pandemic caused the closure of various borders and supply chain disruption, which interfered with global trade and ultimately resulted in a 10% annual drop in trade flows.
- iii. War between Russia and Ukraine: As a result of Russia's invasion of Ukraine, some trade routes were changed and, therefore, so were costs. The prices of raw materials such as oil and wheat were affected.

D. FACTORS THAT HAVE CONTRIBUTED TO THE TREND OF NEARSHORING

- i. Cost savings: One of the primary drivers of nearshoring is the ability to reduce labor costs while still maintaining a close proximity to operations. Companies can take advantage of lower wages in nearby countries, as well as reduced transportation and logistics costs.
- ii. Access to talent: Nearshoring allows companies to tap into a wider pool of skilled talent in nearby countries. This can be particularly important for companies that require specialized skills or expertise that may not be readily available in their home country.
- iii. Time zone proximity: Nearshoring to nearby countries can allow companies to operate in similar time zones, which can help to improve communication and collaboration with suppliers, partners, and customers. The difference in time zones has always been a significant issue with offshoring. In today's environment, managing a three-hour maximum time difference, including less travelling time and good connectivity between countries, seems more attractive.
 - iv. Cultural and language similarities: Nearshoring to nearby countries can also help to reduce cultural and language barriers, as there may be greater similarities in language, customs, and business practices.

II. Why Mexico and What Makes Mexico a Good Candidate for the Relocation of a Supply Chain?

A. NEARSHORING IN MEXICO¹

Mexico is a popular destination for nearshoring and relocation of production chains due to several factors, including:

- i. Proximity to the United States: Mexico shares a long border with the United States, which makes it an attractive location for companies looking to maintain a close proximity to their operations in North America.
- ii. Free trade agreements: Mexico has a network of free trade agreements with over 50 countries, including the United States, Canada, and the European Union. This makes it an

¹ Source: Banco de Mexico, The Boston Consulting Group in de la Madrid (2014), GMB Global Value Chain Disruption

ideal location for companies looking to access these markets. Free trade in North America is guaranteed with the USMCA (an update to the older NAFTA), with clear rules and a deeper integration among partners.

iii. Gateway to worldwide markets: Besides USMCA, Mexico has 12 other Free Trade Agreements with 48 countries, which connect the Mexican economy to more than 1.3 billion consumers (60% of the world's GDP).²

iv. Skilled, young labor force: Mexico has a large and highly skilled labor force, particularly in the areas of manufacturing, engineering, and technology. This makes it an attractive location for companies that require specialized skills and expertise. Between 2014 and 2021, real wages in our country increased 0.2% on average, while in China they increased 6.1% and in Vietnam 5.9%.

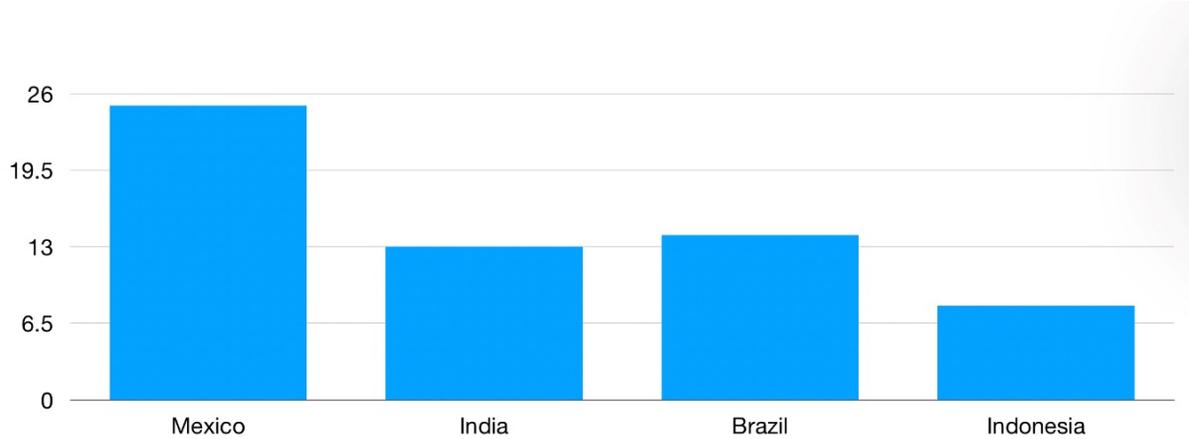


² Source: Mexico Ministry Economy

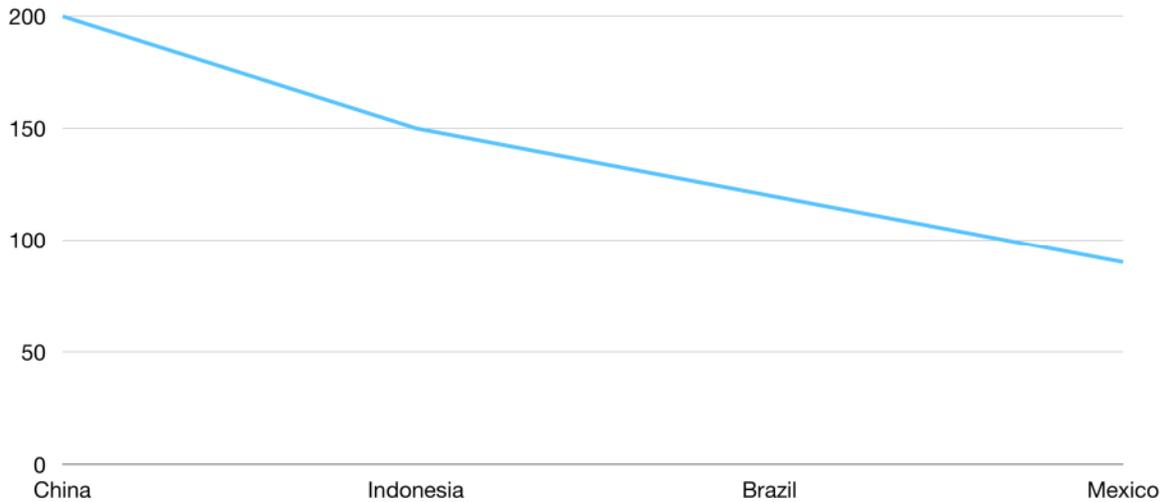
SHARE OF GRADUATES FORM ENGINEERING PROGRAMS

Source: OECwbD

- v. Competitive labor costs: While labor costs in Mexico have been rising in recent years, they are still lower than in many other developed countries. This can help companies to reduce production costs while still maintaining a high level of quality.



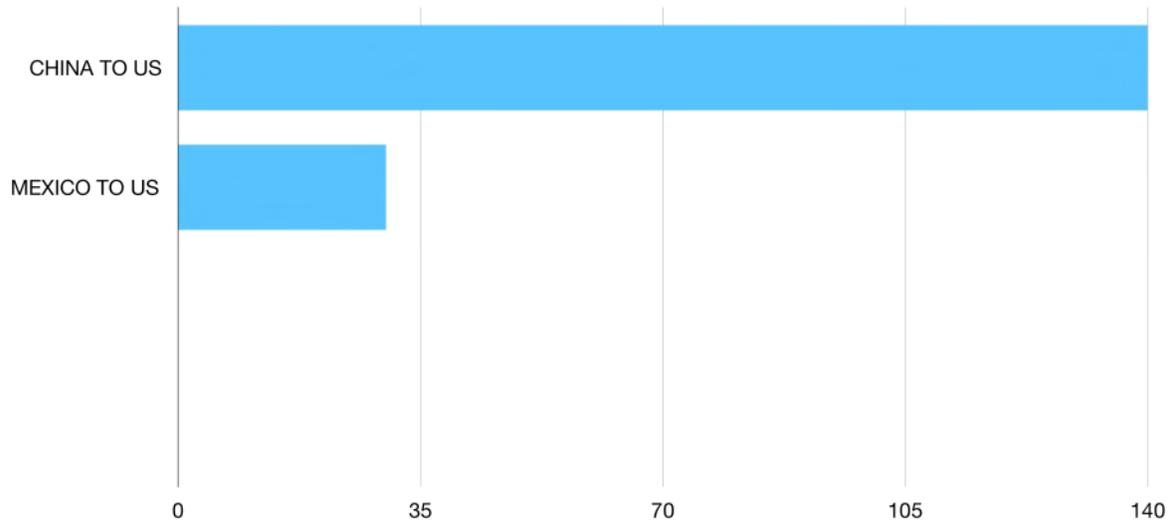
AVERAGE REAL WAGE INDEX FOR EMERGING G20 COUNTRIES, 2008-21



- vi. Stable political environment: Mexico has a relatively stable political environment, which makes it a safer location for foreign investment compared to some other countries in the region.
- vii. Low time and transportation costs: In March 2022, taking a container from China to the United States cost more than \$16,000, while from Mexico to the United States was only \$800.

LOW SHIPPING COST

Source: GMB Global Value Chains Disruptions



viii. Supply Chain Strategy: Quick shipping, efficient logistic services, and fleet management in a better geographical location allows all types of products to reach your clients faster.

MARITIME DAY TO SELECTED DESTINATIONS

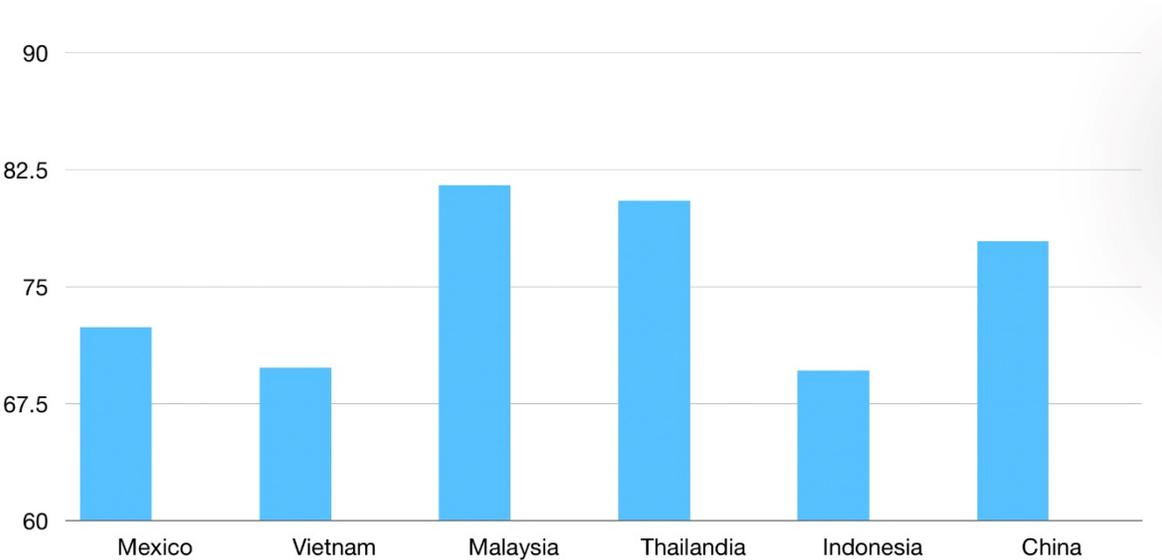
Source: The Boston consulting Group in De La Madrid (2014)

DESTINATION	MEXICO	CHINA	INDIA
NYC	5	32	25
L.A.	4	18	31
ROTTERDAM	16	32	20
YOKOHAMA	19	4	17

ix. Ease of doing business: Rankings published by The Boston Consulting Group, PwC and Savills. Tells United States that Mexico has a good position on competitiveness. Considering the low input costs, quality infrastructure and reliable services.

EASE OF DOING BUSINESS INDEX

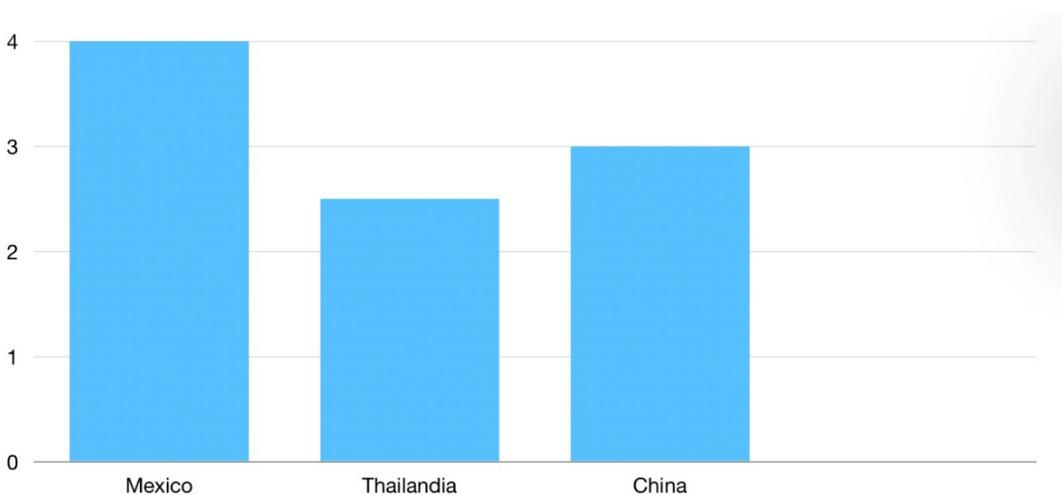
Source: PwC Analysis with data from The World Bank, Trading Economics and official statistics



x. A groundbreaking, well-developed and diversified industrial sector: Mexico is a world leader in manufacturing sectors such as Automotive (4th global exporter), Aerospace (6th largest supplier of aircraft parts to the United States) and Medical Devices (8th largest exporter worldwide).

MANUFACTURING CAPACITY, AUTOMOTIVE SECTOR

Source: PwC Analysis with data from The World Bank, Trading Economics and official statistics



xi. Double taxation treaties: Double taxation treaties are agreements between countries that aim to avoid double taxation of income or profits earned by individuals or

businesses operating in both countries. Mexico has signed double taxation treaties with various countries, including many that are popular destinations for nearshoring, such as the United States, Canada, and European countries.

These treaties can provide a benefit to nearshoring by reducing the tax burden on businesses operating in Mexico. Without such treaties, businesses may be subject to taxation in both their home country and in Mexico, resulting in a higher tax burden and reduced profitability.

III. When did Nearshoring Really Start Picking UP?

Nearshoring has been picking up steam over the last decade or so, with many companies beginning to look for alternative locations for their production and operations. This trend has been driven by a variety of factors, including rising labor costs in traditional offshore locations, political instability in some countries, and a desire to improve supply chain resilience and agility.

In particular, the COVID-19 pandemic has highlighted the risks and vulnerabilities of global supply chains, and has accelerated the trend towards nearshoring and regionalization. Many companies have been rethinking their supply chain strategies, and have been looking for ways to reduce their reliance on distant suppliers and to increase their proximity to customers and operations.

It is likely that the trend towards nearshoring will continue to pick up steam in the coming years, as companies seek to reduce risk, improve agility, and take advantage of new technologies and business models. However, the pace and scope of this trend will depend on a variety of factors, including geopolitical developments, changes in labor costs, and shifts in consumer preferences and demand.

IV. What are the main regions in Mexico where nearshoring is taking place or is expected to take place?

A. WHAT ARE THE MAIN REGIONS WHERE NEARSHORING IS TAKING PLACE IN MEXICO?

The main regions where nearshoring is taking place and will probably continue to take place in Mexico include:

- i. Nuevo León: Located in northeastern Mexico, Nuevo León is one of the most industrialized states in the country and is home to many manufacturing facilities that produce products for the automotive, aerospace, and energy industries.
- ii. Chihuahua: Located in northern Mexico, Chihuahua is known for its skilled workforce and is home to many manufacturing facilities that produce products for the automotive, electronics, and aerospace industries.

- iii. Baja California: Located in the northwestern part of Mexico, Baja California is home to a number of manufacturing facilities that produce products for the aerospace, automotive, and medical device industries.
- iv. Jalisco: Located in western Mexico, Jalisco is home to many manufacturing facilities that produce products for the information technology, electronics, and aerospace industries.
- v. Querétaro: Located in central Mexico, Querétaro is home to many manufacturing facilities that produce products for the aerospace, automotive, and electronics industries.
- vi. Tamaulipas: Located in northeastern Mexico, Tamaulipas is known for its low labor costs and is home to many manufacturing facilities that produce products for the automotive, electronics, and medical device industries.

These regions offer a number of benefits to companies that are looking to nearshore their operations, including competitive labor costs, a skilled workforce, and proximity to major markets such as the United States.

During 2022, 13 states captured 99% of the relocation of production centers in Mexico. The north of the country, due to its proximity to the United States, seems to be the region most likely to benefit from nearshoring. However, the central region is also gradually becoming attractive for international companies.³

B. ISTHMUS INITIATIVES AND PORT IMPROVEMENTS

Mexico has various initiatives and projects aimed at improving transportation infrastructure and driving economic growth, particularly through improvements to its ports and isthmus connections. Examples of these include the Trans-Isthmus Corridor, which seeks to connect the Gulf of Mexico and the Pacific Ocean through the construction of a rail line linking Coatzacoalcos and Salina Cruz, reducing transportation costs and improving efficiency. Another initiative is the Tehuantepec Isthmus Interoceanic Corridor, which aims to create a logistics hub between the two oceans by constructing a new port in Salina Cruz and upgrading facilities in Coatzacoalcos. The Port of Veracruz, Mexico's largest port and a crucial trade gateway with the United States and other countries, is undergoing expansion with the construction of new terminals and deepening of its access channel to accommodate larger ships. Similarly, the Port of Manzanillo, Mexico's second-largest port located on the Pacific coast, is also undergoing expansion with new terminals and channel deepening to accommodate larger vessels.⁴

These initiatives and port improvement projects are expected to create new economic opportunities for Mexico by improving the country's transportation infrastructure and making it easier for businesses to access global markets. They will also provide significant benefits to

³ Source: GBM Global Value Chain Disruption

⁴ Source: Government of Mexico. (n.d.). Programa de Desarrollo del Istmo de Tehuantepec. Retrieved from <https://www.gob.mx/programaistmo>

Mexico's logistics and supply chain industries by increasing the efficiency and reliability of cargo transportation.

The National Development Plan (*Plan Nacional de Desarrollo*) set forth among its regional projects the program for the Development of the Isthmus of Tehuantepec, whose objective is to promote the growth of the regional economy with full respect for the history and culture of the region. Its axis will be the Interoceanic Multimodal Corridor, which will take advantage of the Isthmus's position to compete in world markets for the mobilization of goods, through the combined use of various means of transportation. Within this framework, the Isthmus of Tehuantepec railroad and the ports of Coatzacoalcos, Veracruz, and Salina Cruz, Oaxaca will be modernized to offer cargo, transportation, storage, packaging, and various logistics services; highway and rural road infrastructure and the airport network will be strengthened; and a gas pipeline will be built to supply companies and domestic consumers.

In the 76 Oaxacan and Veracruz municipalities involved in this program, VAT and income tax will be reduced and fuel will be offered at reduced prices. Urban infrastructure will be built and educational services and human capital formation, housing, mobility, and infrastructure for research and technological development will be provided.

It is important to mention that we have not seen any investment from either the federal or state governments concerning this initiative. So we will have to wait and see if the next administration will invest in this initiative.

V. What are the potential benefits for companies and for Mexico?

A. POTENTIAL BENEFITS FOR COMPANIES

Nearshoring, which involves relocating business operations to a nearby country, offers several potential benefits to companies. Some of these benefits include:

- i. **Cost savings:** Nearshoring can offer cost savings compared to onshoring or offshoring, as it allows companies to tap into lower labor costs in nearby countries while maintaining cultural and geographical proximity.
- ii. **Improved communication:** With nearshoring, companies can work with teams in the same or similar time zones, reducing the challenges of communication and collaboration that can arise with offshoring to distant countries with large time zone differences.
- iii. **Cultural alignment:** Companies that nearshore often benefit from shared cultural values and business practices, leading to improved communication, collaboration, and understanding of each other's perspectives.
- iv. **Improved quality control:** Nearshoring allows companies to maintain greater control over the quality of their products or services, as they can more easily monitor and manage operations in nearby locations.

- v. **Reduced risk:** Nearshoring can reduce the risks associated with offshore outsourcing, such as language barriers, geopolitical instability, and intellectual property concerns.
- vi. **Flexibility:** Nearshoring can offer greater flexibility in terms of project timelines and requirements, as companies can more easily adjust to changing business needs and market conditions.
- vii. **Change from 'Just in Time' to 'Just in Case':** Just in Case (JIC) is a model of inventory management in which large quantities of products are accumulated and stored to avoid the risk of stock-outs that could affect the production process. Just in Time (JIT) is the opposite, where materials, products and even labor must arrive or be replenished exactly when they are needed in the production process, eliminating the need for stock and associated costs.

Overall, nearshoring can provide companies with several potential benefits, allowing them to reduce costs, improve communication and cultural alignment, maintain quality control, reduce risk, and increase flexibility.

B. POTENTIAL BENEFITS FOR MEXICO

Mexico is a popular nearshoring destination due to its geographical proximity, cultural alignment with the United States, and skilled workforce. Nearshoring to Mexico can provide several benefits to companies, as well as the Mexican economy. Some of these potential benefits include:

- i. **Job creation:** Nearshoring can create new jobs in Mexico, particularly in the manufacturing and services sectors, contributing to economic growth and reducing unemployment.
- ii. **Increased foreign investment:** Nearshoring can attract foreign investment to Mexico, as companies seek to take advantage of the country's lower labor costs and strategic location.
- iii. **Technology transfer:** Nearshoring can help transfer knowledge and technology from the United States to Mexico, leading to improvements in the Mexican workforce's skills and capabilities.
- iv. **Economic growth:** Nearshoring can contribute to the growth of Mexico's economy by increasing export revenues and expanding the country's manufacturing and services sectors.
- v. **Improved infrastructure:** Nearshoring can help drive improvements in Mexico's transportation, logistics, and communications infrastructure, benefiting both companies and the broader economy.

- vi. Cultural exchange: Nearshoring can facilitate cultural exchange between Mexico and the United States, leading to greater understanding and cooperation between the two countries.

It is estimated that for every 5% of exports in which Mexico replaces Asian countries, the GDP will grow by 2%.⁵

Companies from China represent 40% of the relocations to Mexico, followed by the United States with 20%, Japan with 11%, Germany with 9%, Korea with 8%, and other countries with 12%.⁶

VI. Market opportunities

A. HOW DOES MAYER BROWN SEE THIS PHENOMENON EVOLVING INTO KEY MARKET OPPORTUNITIES?

i. Sectors and Industries

Mexico offers a wide range of sectors and industries that are suitable for nearshoring. Some of the most popular sectors for nearshoring in Mexico include:

- i. Manufacturing: Mexico is a major manufacturing hub, with a strong tradition of producing high-quality goods for export. Some of the most popular industries for nearshoring in Mexico include automotive, aerospace, electronics, and medical devices.
- ii. IT and software development: Mexico has a rapidly growing technology industry, with a highly skilled workforce that is proficient in a variety of programming languages and software development tools. Nearshoring IT and software development to Mexico can provide cost savings while maintaining high levels of quality and expertise.
- iii. Business process outsourcing (BPO): Mexico is also an ideal destination for BPO services such as customer service, technical support, and back-office operations. The country has a large pool of bilingual and multilingual talent, making it an attractive option for companies looking to provide customer support in North America.

In addition to the sectors and industries mentioned earlier, transportation, real estate, materials, and automotive sectors are also suitable for nearshoring in Mexico. Here are some examples:

- i. Transportation: Mexico has a well-developed transportation sector, with a strong logistics infrastructure, making it an attractive option for nearshoring in this industry. Companies can take advantage of Mexico's strategic location to

⁵ Source: GBM Global Value Chain Disruption

⁶ Source: GBM Global Value Chain Disruption

access North American markets, as well as its skilled workforce to manage transportation and logistics operations.

ii. Real estate: The real estate sector in Mexico has experienced significant growth in recent years, with a booming construction industry and a growing demand for property. Nearshoring in this sector can provide access to a skilled workforce and lower labor costs, while taking advantage of the growing demand for property in the country.

iii. Materials: Mexico has abundant natural resources, including minerals and metals, making it an attractive location for nearshoring in the materials sector. Companies can take advantage of Mexico's skilled labor force and favorable regulatory environment to extract, refine, and export raw materials.

iv. Automotive: Mexico is one of the largest producers of automobiles in the world, with a highly skilled workforce and a competitive cost structure. Nearshoring in the automotive sector can provide access to this expertise and help companies take advantage of Mexico's proximity to the United States, which is one of the largest automotive markets in the world.

ii. IMMEX Program

The IMMEX program (*Industria Manufacturera, Maquiladora y de Servicios de Exportación*) is a Mexican government initiative that aims to promote exports by providing tax incentives and other benefits to manufacturing and exporting companies. Nearshoring can be an important part of the IMMEX program, as it allows companies to take advantage of Mexico's proximity to the United States and other markets, while also benefiting from the program's tax incentives.

Companies that participate in the IMMEX program can benefit from a range of tax incentives, including exemption from import duties and value-added tax (VAT) on raw materials and other inputs that are used in the production of goods that are ultimately exported. The program also allows companies to temporarily import machinery, equipment, and other goods without paying import duties, as long as they are used for production and export purposes.

VII. Challenges

A. STANDARDIZATION OF CUSTOMS PROCESS

In order for nearshoring to be successful, it is important to standardize and simplify customs procedures. This includes harmonizing customs regulations, implementing modern technologies, reducing bureaucratic procedures, and training customs personnel. Standardizing customs procedures can improve efficiency, reduce costs and processing time, increase transparency, and reduce corruption. Additionally, it can improve security in the supply chain and facilitate cooperation between customs authorities in different countries. Standardizing

customs procedures can be a critical factor for the success of nearshoring, as it facilitates logistics and transportation of goods between nearby countries, contributing to cost reduction and efficiency improvement in international trade.

B. DEFICIT OF INDUSTRIAL PARKS

Mexico has made significant progress in its industrial development over the years, but there is still a deficit of industrial parks in the country. Industrial parks are vital to the growth of the manufacturing sector because they provide the necessary infrastructure and support services for companies to operate efficiently.

The deficit of industrial parks in Mexico can be attributed to various factors, including limited access to financing for developers, lack of coordination between government agencies, inadequate planning and zoning regulations, and the high cost of land. Additionally, there have been issues with corruption and bureaucratic red tape, which have hindered the development of industrial parks.

The shortage of industrial parks has had several negative effects on Mexico's economy, including increased transportation costs, limited access to skilled labor, and decreased foreign investment. Moreover, the absence of adequate industrial infrastructure has also led to significant environmental problems, such as air pollution and water contamination, which have further slowed the country's economic growth.

To address this issue, the Mexican government has been working to improve the country's infrastructure, streamline regulatory processes, and offer incentives to encourage the development of industrial parks. Additionally, private sector investors have been stepping up to help fill the gap by financing and developing their own industrial parks.

C. BUREAUCRACY AND CORRUPTION

Bureaucracy and corruption have been persistent problems in Mexico for many years, and they continue to hinder the country's economic and social development. Bureaucracy refers to the complex and time-consuming administrative procedures that individuals and businesses must navigate to access public services and conduct transactions with the government. Corruption, on the other hand, involves the abuse of power by public officials for personal gain, often through the solicitation of bribes or other illicit means.

Bureaucracy and corruption in Mexico have had a range of negative effects on the country. For example, the excessive red tape and delays caused by bureaucracy can discourage foreign investment, reduce productivity, and increase costs for businesses. Corruption, on the other hand, undermines public trust in government institutions, exacerbates social inequalities, and siphons off public resources that could be used for social programs or infrastructure development.

The Mexican government has implemented several initiatives to tackle bureaucracy and corruption. For example, it has created an online platform called "Gobierno Digital" to streamline administrative procedures and reduce red tape. Additionally, it has established a special

prosecutor's office, the *Fiscalía Especializada en Combate a la Corrupción* (FECC), to investigate and prosecute corruption cases.

Despite these efforts, bureaucracy and corruption continue to be significant challenges in Mexico. According to Transparency International's 2021 Corruption Perception Index, Mexico ranked 124 out of 180 countries assessed, indicating that corruption remains a serious problem in the country. To address these issues, it will require a sustained effort from the government, civil society, and private sector to improve transparency, accountability, and the rule of law.

D. SECURITY

Security is a major concern in Mexico, and the issue of organized crime, particularly drug trafficking, has been a significant contributor to the country's security challenges. The drug cartels in Mexico are known for their involvement in a wide range of criminal activities, including drug trafficking, money laundering, extortion, and kidnapping. The activities of these groups have led to high levels of violence and insecurity in many parts of the country, including many of the regions where nearshoring is expected to take place.

Drug trafficking organizations (DTOs) have been active in Mexico for several decades, but their power and influence grew significantly in the 1990s and early 2000s. The drug trade is a lucrative business, and Mexico's proximity to the United States, the world's largest consumer of illegal drugs, has made it a key transit point for drug trafficking organizations.

Despite the government's efforts to combat organized crime, the DTOs continue to operate and exert significant control over many areas of the country. The violence associated with the drug trade has had a devastating impact on Mexico's communities, resulting in thousands of deaths, disappearances, and displacements.

To address this issue, the Mexican government has implemented several measures, including increased cooperation with international partners, such as the United States, and the deployment of military forces to areas affected by violence. The government has also established specialized police units, such as the National Guard, to combat organized crime and improve public safety.

The issue of narco-trafficking and its impact on Mexico's security will require a sustained, multi-faceted approach involving a range of stakeholders, including government agencies, civil society organizations, and the private sector, to address the root causes of violence and insecurity, promote the rule of law, and improve socio-economic conditions in affected areas.

E. RULE OF LAW

The rule of law is a fundamental principle of democracy that requires that all individuals and institutions, including government officials, be subject to and abide by the law. The rule of law is essential for promoting social stability, economic growth, and human rights. However, the rule of law has been a persistent challenge in Mexico, and the country has struggled to implement and enforce legal frameworks that ensure justice and equality for all.

One of the main challenges to the rule of law in Mexico is the high level of corruption within the government and law enforcement institutions. Corruption has undermined the trust of citizens in the justice system and led to impunity for crimes committed by powerful individuals and criminal organizations.

Additionally, the legal system is often slow and bureaucratic, leading to a lack of access to justice for many people, especially the poor and marginalized.

Another challenge to the rule of law in Mexico is the prevalence of violence and organized crime. Drug cartels and other criminal organizations have undermined the authority of the state and contributed to high levels of violence and insecurity in many parts of the country. The government's response to this violence has been criticized for being heavy-handed and ineffective, with reports of human rights abuses by security forces.

To address these challenges, the Mexican government has implemented several initiatives, including the creation of new legal frameworks, such as the National Anti-Corruption System, and the establishment of specialized units within the justice system to prosecute corruption and organized crime cases. Additionally, the government has increased investment in social programs and economic development to address the underlying socio-economic conditions that contribute to crime and violence.

Despite these efforts, the rule of law remains a significant challenge in Mexico, and more needs to be done to ensure that all individuals, regardless of their social or economic status, have access to justice and are subject to the law. This will require a sustained commitment from the government and society as a whole to promote transparency, accountability, and respect for the law.

F. ESG POLICIES

Environmental, social, and governance (ESG) policies have become increasingly important for companies and investors around the world, as they seek to balance financial performance with sustainability and social responsibility. However, implementing ESG policies in Mexico can be challenging due to a range of factors.

One of the main challenges facing ESG policies in Mexico is a lack of transparency and accountability in many sectors of the economy. Corruption and collusion between businesses and government officials can undermine the implementation and enforcement of ESG policies, as well as limit the availability of reliable data on environmental and social impacts.

Another challenge is the limited availability of capital and resources for sustainable investments, particularly in areas such as renewable energy, sustainable agriculture, and low-carbon transportation. This can make it difficult for companies to finance ESG initiatives and meet investor expectations.

Mexico also faces significant environmental challenges, such as air and water pollution, deforestation, and biodiversity loss. These environmental problems require significant investments and coordinated efforts from government, businesses, and civil society to address them effectively.

Additionally, social challenges, such as inequality, poverty, and access to education and healthcare, can also hinder the implementation of ESG policies. Companies operating in Mexico need to prioritize social issues and work with local communities to ensure that their operations are sustainable and socially responsible.

Despite these challenges, there are also opportunities for companies and investors to implement ESG policies in Mexico. For example, Mexico has significant potential for renewable energy development, and there is a growing market for sustainable products and services. Additionally, the Mexican government has implemented several initiatives to promote sustainable development.

G. INFRASTRUCTURE

Mexico's infrastructure has been identified as a key challenge for nearshoring. The country's infrastructure has been underdeveloped, particularly in terms of transportation, logistics, and telecommunications. This lack of infrastructure can lead to delays, increased costs, and reduced competitiveness for businesses operating in Mexico.

One major issue is transportation. Mexico's highways and railways are often outdated and poorly maintained, leading to longer travel times and higher transportation costs. This can also impact the delivery of goods and services, reducing the reliability of supply chains.

Another issue is the lack of investment in telecommunications infrastructure. Mexico has relatively low internet speeds and limited broadband coverage, which can be a major obstacle for companies that require high-speed and reliable connectivity for their operations.

Finally, there is also a shortage of skilled labor, particularly in industries that require specialized technical skills. This can make it difficult for companies to find the talent they need to operate effectively and efficiently.

To address these challenges, Mexico has been working to improve its infrastructure, including investments in transportation, telecommunications, and education and training programs to develop the skills of its workforce. However, these improvements will take time and continued investment to fully address the infrastructure challenges facing the country.

VIII. Nearshoring and banking

Nearshoring can have a significant impact on the financial industry in Mexico, particularly on non-bank lenders and industry leaders. As companies move their operations closer to their target markets, there is likely to be an increased demand for financing to support these operations.

Non-bank lenders, such as private equity firms, hedge funds, and specialty finance companies, are well-positioned to benefit from nearshoring. These lenders are typically more flexible and innovative than traditional banks, allowing them to respond more quickly to the changing needs of businesses. They can also offer financing solutions tailored to specific industries or supply

chains, which may be particularly valuable for companies that are reconfiguring their operations in response to nearshoring.

In addition, industry leaders in Mexico are also likely to benefit from nearshoring. As companies relocate their operations to Mexico, they will need to partner with local firms that can provide expertise on local regulations, customs procedures, and supply chain logistics. Industry leaders in Mexico are well positioned to provide these services, which could lead to new business opportunities and partnerships.

Overall, nearshoring is likely to create new opportunities for non-bank lenders and industry leaders in Mexico. However, these firms will need to be proactive in adapting their services and offerings to meet the changing needs of businesses as they relocate their operations to Mexico.

IX. E-commerce

E-commerce and nearshoring are two separate concepts, but they are increasingly becoming intertwined as businesses look for ways to improve their supply chains and logistics.

E-commerce refers to the buying and selling of goods and services online. With the rise of e-commerce, businesses are able to reach a larger customer base and operate on a global scale. However, e-commerce also presents challenges in terms of logistics, including shipping, warehousing, and inventory management.

Nearshoring, on the other hand, refers to the practice of outsourcing business processes or services to a nearby country or region rather than to a more distant location. Nearshoring can help businesses reduce costs and improve efficiency by leveraging the advantages of a nearby location, such as lower labor costs, reduced transportation time and costs, and similar time zones and cultural backgrounds.

When it comes to e-commerce, nearshoring can help businesses overcome some of the logistical challenges they face. By outsourcing certain parts of their supply chain to a nearby country, businesses can reduce transportation time and costs and improve their inventory management. This can result in faster delivery times and a more streamlined supply chain overall.

For example, a business based in the United States may choose to nearshore its warehousing and distribution operations to Mexico, where labor costs are lower and the location is more convenient for shipping to customers in the United States. By doing so, the business can improve its logistics and reduce costs, which can ultimately lead to a better customer experience.

Nearshoring is important in e-commerce for several reasons:

- i. **Cost reduction:** By using the practice of nearshoring, companies can take advantage of lower costs in nearby countries. This is because labor and overhead costs are generally lower in these countries. Additionally, transportation and logistics are more economical due to geographical proximity. All of this results in an overall reduction in operating costs.

- ii. Improved efficiency: Geographical proximity leads to greater efficiency in the supply chain. This is because delivery times are shorter and shipping costs are lower. Proximity also allows for better coordination in terms of production, transportation, and delivery. Improved efficiency also means better inventory management, which can lead to a reduction in storage-related costs.
- iii. Improved customer experience: The reduction in delivery times and resulting shipping costs from the practice of nearshoring can significantly improve the customer experience. Customers are more likely to buy from companies that offer fast and economical deliveries.
- iv. Risk reduction: In situations of political or economic uncertainty, the practice of nearshoring can reduce risk. If a company has a presence close to its target market, it is easier to adapt to changing market conditions and government regulations.

In summary, nearshoring is important in e-commerce because it helps companies reduce costs, improve efficiency, improve the customer experience, and reduce risk. These advantages can be especially important for companies looking to compete in an increasingly competitive global market.

X. How is Mayer Brown suited to assist clients in the needs for legal services?

Mayer Brown is a global law firm with a history dating back to 1863. The firm has over 1,600 lawyers in offices located throughout the Americas, Europe, Asia, and the Middle East. Mayer Brown provides legal services to clients in a wide range of industries, including banking and finance, corporate and securities, litigation and dispute resolution, and real estate.

Mayer Brown is known for its expertise in cross-border transactions, and its lawyers are experienced in navigating the complexities of international business. The firm's clients include multinational corporations, financial institutions, and governments, and it has been involved in some of the largest and most complex transactions and disputes around the world.

Some alternative investment structures that Mayer Brown offers are:

- i. CKDs (*Certificados Bursátiles Fiduciarios de Desarrollo*) are securities issued and publicly placed (i.e., listed on a Mexican stock exchange) by closed-ended investment vehicles designed for real estate, venture capital, growth and late-stage equity-style investments. CKDs are generally suitable for institutional investors but may also target retail investors.
- ii. FIBRAs (*Fideicomisos de Inversión en Bienes Raíces*) are open-ended structures designed for real estate investments through the listing of CBFIs (*Certificados Bursátiles Fiduciarios Inmobiliarios*). FIBRAs are generally suitable for both retail and institutional investors.

iii. CERPIs (*Certificados Bursátiles Fiduciarios de Proyectos de Inversión*) are closed-ended structures similar to CKDs but with greater flexibility. However, CERPIs are only suitable for institutional investors (or other qualified persons). CERPIs have generally been used in the past as feeder funds to make investments outside of Mexico.

iv. Private funds, generally set up in the form of Mexican trusts (*fideicomiso*), are generally used as co-investing vehicles alongside listed vehicles—CKDs, FIBRAs and CERPIs. Private funds have the benefit of being offered through private placements; thus, their corporate governance and reporting obligations are generally more investor-friendly compared to listed vehicles.

From a legal perspective, all of these listed local vehicles are trusts (*fideicomisos*), and their issuances are akin to capital market transactions in which the interests of the trusts are listed on a Mexican stock exchange—either the *Bolsa Mexicana de Valores* (BMV) or the *Bolsa Institucional de Valores* (BIVA). Mexican pension funds (*Administradoras de Fondos para el Retiro*, “AFORES”) are the main institutional investors that purchase these interests.

Meanwhile, fund sponsors looking to invest in Mexico generally use limited partnerships for their offshore capital sourcing platforms. Ontario, Canada is typically the jurisdiction of choice for these limited partnerships for a variety of reasons.

The challenge in raising both local and offshore capital is that limited partnerships and the local vehicles may be somewhat incompatible with each other. The parallel vehicles may also be denominated in different currencies. Furthermore, certain terms that are market for offshore vehicles (e.g., the United States and Europe) may not be market for local Mexican vehicles (or vice versa). However, the opportunity to market the fund to a larger investor base may far outweigh these challenges. Additionally, fund complexes with a local investor base may offer certain competitive advantages given their local knowledge and economic and political influence in Mexico, which may prove useful when executing the fund’s investment strategy.

Governance

Local-listed Mexican vehicles (i.e., CERPIs, FIBRAs and CKDs) generally have strict governance structures set out by statute. Limited partnerships, such as Ontario limited partnerships, on the other hand, are generally quite flexible. The corporate governance of limited partnerships can be structured in a variety of ways without running afoul of applicable laws. For instance, certain general partner minimum liability-related provisions are prescribed by statute in Mexico. Additionally, CKDs, FIBRAs and CERPIs require a technical committee (*comite técnico*).

Currency

A Mexican vehicle being denominated in pesos may present a set of challenges when drafting the governing documents for both the onshore and offshore platforms. For example, the distribution waterfall for the two parallel vehicles will be returning cash at different rates for investors because the preferred return rates, or hurdle rates, will be different. Local investors typically expect higher hurdle rates than their offshore counterparts because their capital

contributions are made in pesos. Second, because drawdowns are generally based on investor commitments or available commitments, discrepancies may arise in the drawable amounts for each parallel vehicle if the exchange rates for the parallel vehicles diverge. For instance, if the United States dollar appreciates over the Mexican peso, the drawable amount from the Mexican vehicle will be less than what was originally determined at the initial closing. Furthermore, to the extent the vehicles admit investors over a certain period of time after the initial closing, the difference in currencies and their corresponding fluctuations could create additional structural issues for fund sponsors when attempting to rebalance the entire fund complex following each closing or each investment. Therefore, mechanisms need to be put in place to address these issues or to at least disclose these issues to both investor bases to avoid misunderstandings.

Market Terms

In addition to facing governance and currency issues, market terms can be quite different between the offshore and onshore markets. For example, local investors generally expect rather simple investor-friendly indemnification terms; meanwhile, offshore investors expect rather broad indemnification provisions benefiting the sponsor, given the relatively litigious environment in offshore jurisdictions. Another point of contention is expense caps. Local investors expect expense caps for the entire fund, while expense caps are not market in offshore vehicles. Lastly, to align interests, offshore investors typically expect fund sponsor commitments to be made within the same vehicle in which they are investing and not outside the fund. However, in Mexico, it is quite common for fund sponsors to make their commitments outside fund complexes.

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