Hot growth markets in the spotlight

Poised for growth: Mexico
The story of globalization unfolds in complex ways. But it has, at its core, a single theme: business success hinges on seizing opportunities in rapid-growth markets. This series, *Hot growth markets in the spotlight*, offers quick perspectives on countries that are emerging as the world's most dynamic places to do business.

More than 70% of world growth over the next few years will come from emerging markets. Billions of new middle-class consumers represent new markets for companies based in both rapid-growth and developed countries. Yet navigating these markets involves having a keen understanding of their substantial risks as well as their payoffs. This series provides an at-a-glance overview of both.

Each spotlight offers a snapshot of Ernst & Young’s viewpoints on a specific rapid-growth country. It complements our more detailed offerings, approaching each market from the vantage point of where it stands in relation to globalization, innovation and talent – what we believe are the top three defining issues for businesses today and tomorrow. You’ll benefit from a unique combination of data, case studies and the real-life experiences and recommendations of our top country practice leaders.

**Each spotlight contains four key elements:**

- An overview of where the country stands in relation to globalization, innovation and talent, along with real-world case studies and examples
- A section entitled “In practice,” consisting of interviews with local Ernst & Young practice leaders and offering practical tips on opportunities for investing in the country, as well as an analysis of risk areas
- A data section offering a quick roundup of statistical information such as economic growth rates, size and age of the labor force, level of foreign direct investment and other key indicators, derived from our own research as well as external sources
- A comprehensive list of resources, including contact information for our local practice leaders and links to other Ernst & Young sites that provide in-depth information about the country
What’s the story?

Mexico may not get the press of the BRIC countries, but it’s a market that should not be overlooked. Already the 12th largest economy in the world, according to International Monetary Fund figures, it’s bigger than South Korea, Canada, or Indonesia. In 2011, the country grew approximately 3.5%, and in 2012 the growth is supposed to be 4%. As an energy exporter, the current high oil prices should also boost growth. At this rate, by 2040 some forecasters predict it will crack the top 10.

Among the advantages Mexico offers investors:

- Free trade agreements with 44 countries and counting, giving it direct access to more than 60 percent of global GDP.
- A much friendlier business environment than most hard-charging growth markets. The World Bank ranks it 53rd in the world, compared to 91 for China, and 132 for India. It’s also far ahead of the Latin and Caribbean average, which the bank ranks at 95th.
- A young and increasingly educated population. A total of 48% of the population is under 25, and many of them — over 1 million students — are now studying engineering and other technical subjects.
- Rising incomes. With average per capita income at $15,121 in terms of purchasing power parity, according to the International Monetary Fund, Mexico is a consumer market with vast potential.

Of course, enormous challenges remain. As is true of many developing counties, Mexico needs better infrastructure and an improved regulatory regime. But the biggest challenge faced now by this country of 112 million are the drug wars that have killed more than 47,000 in the last five years, according to government statistics — more people than the US lost in Vietnam.

Although the violence continues, shunning the market would be a mistake. The degree of danger varies wildly between states, and as the experience of such formerly war-torn countries as Colombia suggests, when the war does wind down, the peace dividend will be high. Indeed, the fact that the country is still able to grow respectably despite the mayhem suggests an underlying strength investors should not discount.
What’s in it for companies entering Mexico?

With easy access to global markets, a young labor force and regulatory structures that are more favorable than those of many other Latin American economies, Mexico is an increasingly important market. Alberto Tiburcio, our Sub-Area Managing Partner for Mexico & Central America, argues that the country is poised for growth in both the short term and the long run.

**A great market opportunity**

Mexico is the second-largest economy in Latin America, Alberto points out. Its 44 free trade agreements give it access to 60% of global GDP and roughly 1 billion consumers. Mexico has been an important receiver of foreign investment and it is expected that it will increase significantly once structural reforms in regulation are passed.

**Reasonable tax laws**

The tax regime is much more reasonable than that of many other emerging markets, Alberto notes. The filing requirements tend to be simpler. Corporate and income tax rates also tend to be lower than similar countries. This is one area where Mexico is very competitive.

**Future growth**

After the 2012 presidential election, two important sectors – oil and utilities – are likely to more open to private investors for the first time. Alberto says the liberalization of these sectors should create many opportunities for outside investors and private investment in oil exploration, energy infrastructure and energy utilities, likely enabling Mexico to grow faster.
“Mexico’s 44 free trade agreements give it access to 60% of global GDP and roughly 1 billion consumers.”

— Alberto Tiburcio, Sub-Area Managing Partner, Mexico & Central America
Tax challenges

The risks of emerging markets are well known and even a savvy global company can stumble with complex regulations; local political and cultural nuances; bureaucratic obstacles; and unclear business processes. In this spotlight, we focus on Mexico's tax system, which can be quite favorable to foreign investors but has nuances that should not be underestimated. We caught up with Manuel Solano, our Tax Managing Partner in Mexico & Central America, to discuss the most important tax features of the market.

Does Mexico offer any special tax advantages to investors?
“On the tax end, really what Mexico has the most to offer is the ‘maquila’ program,” says Manuel. Created in the 1970s to attract manufacturers to Mexico, the maquila or maquiladora program, which refers to free-trade-zone manufacturing operations, gives foreign manufacturers a 17% corporate tax rate on manufacturing activities. Outside the program, Mexico's statutory corporate tax rate stands at a fairly competitive 30% of corporate earnings.

What are the biggest tax risks?
“Over the last few years, the tax administration has become fairly aggressive, and it is constantly challenging transactions engaged by taxpayers which they consider to be aggressive. Thus far, this has been largely confined to supply chain structures with a foreign principle in place, debt push-downs, IP migrations and headquarter charges”, says Manuel.

Are there any particular issues companies should be watching closely?
“If I had to pinpoint where taxpayers are most vulnerable, it would be in transfer pricing. The government has identified transfer pricing as basically an area where there is low-hanging fruit and they're very keen on focusing on that aspect,” Manuel says.

“Largely, Mexico follows OECD principles, so basically on the transfer pricing front you would look to pretty much what I guess you're looking at in continental Europe and the US. Probably the most notable difference is that Mexico takes a transaction-type approach and not a profit-based approach, and also the legal formalities related to contemporaneous documentation, the filing of information or returns on related-party transactions, and payments abroad.”
How does Mexico’s tax regime compare to others in Latin America?
“Mexico has by far the most developed tax system in the region,” says Manuel. “It’s sort of the exporter of tax legislation. Largely this has to do with historical reasons. Dating back to the Aztecs, Mexico already had a tax system, and again also its proximity to the US has basically in many respects enabled Mexico to be at the forefront of tax legislation.”

“If you look at Mexico, Mexico is among the pioneers in the world when it comes to transfer pricing, CFC legislation, foreign tax credits, the filing of consolidated returns,” Manuel says. “Clearly in the income tax arena, it probably has the most sophisticated tax system in the region, and then on the VAT front, it’s the only country in the region that has a European-type system of value added tax.” Yet taxation is only at the federal level, he adds, so in this respect, the system is quite simple.

“Mexico has by far the most developed tax system in the region.”
— Manuel Solano, Tax Managing Partner, Mexico & Central America

How do I find out more?

**Tax policy and controversy outlook**
For a deep analysis of the perspectives of policy in Mexico and other markets in the Americas, click here.

**TradeWatch**
To read about the most important updates in Mexico’s customs and international trade policy, click here.
As with most emerging markets, market sophistication is not uniform in Mexico. For instance, while our models suggest that the finance function is fairly mature in many Mexican companies, benchmarking data is still hard to find. Logistics are quite advanced, particularly near the US border, yet corporate risk management is unevenly developed. Of course, at the same time, all those shortcomings are also opportunities. We talked to Fernando Garrido, our Advisory Leader in Mexico & Central America, about what foreign investors should expect.

**Limited access to benchmarked information**
The high percentage of private, family-owned companies can make benchmarking information difficult to come by, says Fernando. “Access to information is very restricted due to the fact that the management of private companies are not always open to sharing information either internally or externally, even when companies have hired firms to assess this type of maturity assessment,” he says.

**A leader in logistics**
“Mexico has a privileged location,” says Fernando. “Mexico is the portal to Latin American markets because of its geographical location, but also because of the more than 44 free trade agreement signed with the most important economies.”

Some aspects could be improved. Mexico is working to enhance its infrastructure, not only building new roads, but also enhancing the customs procedures and better logistics in railroads and seaports.
Savvy customers
Not all the opportunities are export-focused. The fast-growing domestic market is also of increasing interest to global markets. However, these new consumers aren’t naive: the Mexican consumer should not be underestimated, Fernando warns. “Customers are demanding more from the companies that they interact with,” he explains.

“They are more informed and have more choices than ever before. They want you to know them better, interact with them more effectively, and provide superior customer experience. Improving information quality and accessibility for decision-making is a competitive advantage, a competitive necessity.”

“A recent survey led by the World Bank ranked Mexico 50th of 155 countries in its Logistics Performance Index, just after Argentina and Chile.”
— Fernando Garrido, Advisory Leader, Mexico & Central America
In most respects, Mexico’s financial reporting is not very different from most countries. “I don’t think there are really any significant issues or problems different from any other country,” says Francisco Álvarez, our Assurance Services Managing Partner in Mexico & Central America.

Mexico has its own financial standards but public companies are now obliged to make their reports according to the International Financial Reporting Standards (IFRS), according to Francisco.

The commitment to IFRS is deep-seated, he says. “Local financial regulators are working hard towards making the Mexican information of the different public companies comparable worldwide. That is why they’re pushing strongly for IFRS and they are very serious in making sure that everybody is adopting the same rules. I think it is a process for their people that you can talk to and finally you can work with to make a common goal.”

Although little is changing with respect to conventional financial reporting, as with a number of other countries, the trend of reporting over additional topics such as social responsibility and sustainability is growing. “Currently we have no regulations regarding sustainability. However, the Mexican stock exchange is now requesting information towards producing a sustainability index. I think that we were moving towards a green accounting system in the future that will require more and more of this type of regulation,” Francisco says.

The fact that mandatory sustainability reporting is now being considered suggests how far Mexican regulation has come in recent years. “Mexico has come way ahead of the old days in which the market was very difficult to penetrate. I think it’s open, I think it’s easy to get registered, I think it’s easy to trade, and I would encourage most companies to come and try our markets,” Francisco says.

The regulatory clarity also makes debt and equity offerings relatively easy to organize – a serious job, but comparable to any advanced market. “I would encourage a lot more companies to come and try the different options available in the Mexican market, such as debt offerings or stock offerings. It’s open and it’s available,” Francisco says.
“I would encourage a lot more companies to come and try the different options available in the Mexican market, such as debt offerings or stock offerings. It’s open and it’s available.”

— Francisco Álvarez, Assurance Services Managing Partner, Mexico & Central America
How do I find out more?

Ernst & Young offers a wealth of in-depth information on Mexico. Check out the following links for more insights.

**Emerging Markets Center**
For your unique connection to the world's newest and most promising markets, [click here](#).

**Rapid-Growth Markets Forecast**
To find Mexico in our April 2012 Rapid Growth Market Forecast, [click here](#).

**M&A maturity index**
For interactive high-level insights into 175 countries, including Mexico, [click here](#).

**Doing business in Mexico**
For the most detailed view of everything you need to consider if planning to have expand into this market, [click here](#).

**Entrepreneurs speak out (Mexico)**
To learn about the most interest insights of entrepreneurs from Mexico, [click here](#).
We are a global organization with 152,000 talented people who have a shared way of working and a commitment to quality. This allows us to put together a team that can give you the seamless service you need, wherever you are in the world. We have an important presence in all the rapid-growth markets and provide global services in Assurance, Tax, Transactions and Advisory, as well as Strategic Growth Markets.

Through these services, we can help you retain the confidence of investors, manage your risk, strengthen your controls and achieve your potential. Our country practice teams have hands-on experience and in-depth knowledge of both local and global corporate environments.
## Facts at a glance

### Mexico – general facts

<table>
<thead>
<tr>
<th>Category</th>
<th>Details</th>
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</thead>
<tbody>
<tr>
<td>Total country area</td>
<td>1,964,375 sq km</td>
</tr>
<tr>
<td>Comparative size</td>
<td>12th largest in the world</td>
</tr>
<tr>
<td>Natural resources</td>
<td>Petroleum, silver, copper, gold, lead, zinc, natural gas, timber</td>
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<tr>
<td>Current population</td>
<td>115 million</td>
</tr>
<tr>
<td>Population rank in the world</td>
<td>11th</td>
</tr>
<tr>
<td>Mobile phone lines</td>
<td>(approximately) 97 million</td>
</tr>
<tr>
<td>Internet users</td>
<td>(approximately) 34.8 million</td>
</tr>
<tr>
<td>Major cities</td>
<td>Mexico City (capital) 19.32 million, Guadalajara 4.34 million, Monterrey 3.84 million, Puebla 2.28 million, Tijuana 1.63 million (2009)</td>
</tr>
<tr>
<td>Languages</td>
<td>Spanish (official language); English (used for international business)</td>
</tr>
<tr>
<td>Corruption Perceptions Index 2011 - country position</td>
<td>Mexico has the 100th position in the ranking based on the public perception of corruption in 182 countries. For more information on this index <a href="http://cpi.transparency.org">click here</a>.</td>
</tr>
<tr>
<td>Main industries</td>
<td>Food and beverages, tobacco, chemicals, iron and steel, petroleum, mining, textiles, clothing, motor vehicles, consumer durables, tourism</td>
</tr>
<tr>
<td>Country debt ratings</td>
<td>Standard &amp; Poor's (8 April 2011) BBB</td>
</tr>
<tr>
<td></td>
<td>Moody's (18 January 2012) Baa1</td>
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<tr>
<td></td>
<td>Fitch (15 December 2011) BBB</td>
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### Footnotes:
Growing Beyond

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Note: All data on this page comes from the Ernst & Young Rapid Growth Markets Forecast, except for the "Unemployment rate" graph data which comes from WEO Database.

Globalization and population indicators

Ernst & Young has collaborated for three years with the Economist Intelligence Unit on a series of reports that explore the business implications of globalization. The series includes the Globalization Index, which measures the performance of the world’s 60 largest economies. The following table shows the scores for the major economies in Latin America. For more information, please visit www.ey.com/globalization.

Simply by virtue of its vast natural resources, young population, and relatively steady GDP growth, Mexico would be a country to watch. But factor in some of its legal and infrastructure advantages, and it becomes truly formidable. In movement of labor and movement of capital, in particular, and the Mexican opportunity compares favorably to most Latin American countries.

### Globalization indicators

<table>
<thead>
<tr>
<th></th>
<th>Chile</th>
<th>Mexico</th>
<th>Peru</th>
<th>Colombia</th>
<th>Brazil</th>
<th>Argentina</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall score</strong></td>
<td>4.27</td>
<td>3.73</td>
<td>3.44</td>
<td>3.43</td>
<td>3.24</td>
<td>3.13</td>
</tr>
<tr>
<td><strong>Overall rank</strong></td>
<td>25</td>
<td>36</td>
<td>41</td>
<td>43</td>
<td>47</td>
<td>50</td>
</tr>
<tr>
<td>Movement of goods and services</td>
<td>4.89</td>
<td>4.77</td>
<td>4.32</td>
<td>3.30</td>
<td>3.48</td>
<td>3.12</td>
</tr>
<tr>
<td>Movement of capital and finance</td>
<td>6.24</td>
<td>4.79</td>
<td>4.43</td>
<td>4.56</td>
<td>4.64</td>
<td>3.38</td>
</tr>
<tr>
<td>Movement of labor</td>
<td>3.98</td>
<td>3.04</td>
<td>3.14</td>
<td>3.46</td>
<td>2.56</td>
<td>3.21</td>
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<tr>
<td>Exchange of technology and ideas</td>
<td>2.66</td>
<td>2.47</td>
<td>1.93</td>
<td>2.49</td>
<td>2.18</td>
<td>2.67</td>
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<tr>
<td>Cultural integration</td>
<td>3.36</td>
<td>3.40</td>
<td>3.30</td>
<td>3.31</td>
<td>3.27</td>
<td>3.30</td>
</tr>
</tbody>
</table>

Source: Ernst & Young Globalization Index, November 2011