Exporting Considerations Using Mexico as an Example

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Elements of doing business with Mexico (import, export, strategic alliance:

What is your objective?

- Export/import/joint venture
- Excess production
- Mature product
- Developing a new market according to your business plan
- Hype

The development of a strategic plan before delving into Mexico:

"The building block for your success in a foreign market such as Mexico."

Food for thought:

- Does doing business with Mexico fit into your overall business plan?
- Are you successful in the U.S? If not, what makes you think that things will be different in Mexico?
- Why Mexico? Why not Texas or California?
- What is driving you towards Mexico?
- Are you willing to spend the time and money required to break into the Mexican market?
- Will you have patience?

Identifying Your Market

- Market feasibility: both in the import/export and strategic alliance sense

- Does the product have a market?

- Will this be profitable?

Doing Your Homework and Conducting Research

- Can prioritize markets based on their potential
- Can evaluate the market and avoid costly errors
- Can make decisions based on data not just guesswork
- Can understand the environment in which you will be working
- Many sources of research are free or low cost
- Can determine what the customer wants, why they want it and how they go about filling their needs
- Can learn how the competition is doing

Primary vs. Secondary Research

- Primary: first-hand market research such as observations, surveys, and interviews, usually for specific research purposes or to address specific questions. Can be time consuming and expensive.

- Secondary Market Research: Utilizing existing information such as reports, statistics, and studies.

Secondary market research is conducted in 4 general ways:

- Examining closely the local competitors with similar products who are successfully exporting. Determining the specific foreign marketplaces where these competitors are exporting.
- Keeping abreast of world events that influence the international marketplace.
- Analysis of trade and economic statistics. Trade statistics are generally compiled by product category (usually NAICS code) and by country. These statistics provide U.S. firms with information concerning shipments of its products over specified periods of time. Demographic and general economic statistics, such as population size and composition, per capita income, and production levels by industry can be important indicators of the market potential for a company's products.
- Obtaining the advice of experts:
  - Government trade specialists.
  - Seminars, workshops, and trade shows.
  - International marketing consultants
  - Contacting trade and industry association staffs.
- ***The trick is to obtain as much information as you can for free!***

Informational Sources

- export.gov
- <u>National Institute of Standards and Technology (NIST):</u>
  - DOC bureau where you can access international product standards information
  - *http://www.nist.gov/*
- <u>U.S. Department of Commerce Export Assistance Center in El Paso:</u>
  - Robert Queen, Senior Trade Specialist: covers El Paso and New Mexico
- U.S. Department of Commerce: www.commerce.gov
- <u>Commercial Officials in U.S. Embassies</u>
  - "Hit or Miss" – these officials are rotated regularly and their market knowledge varies
  - Many locals are enlisted in this service and can be valuable resources
  - Greater information and knowledge exists for larger trade partners of the U.S.

Other Resources:

- United States Department of Agriculture
  - Foreign Agriculture Services (FAS)
  - FAS posts in embassies and consulates worldwide
  - *www.fas.usda.gov*
- U.S. Department of State
  - Political information
  - Travel conditions in foreign countries
  - *www.state.gov*
- World Bank
  - Economic and various statistical information
  - *www.worldbank.org*
- International Monetary Fund
  - World financial information
  - *www.imf.org*

- United Nations
  - Social statistics and treaties
  - *www.un.org*

- Central Intelligence Agency
  - World Fact Book
  - Factbook on Intelligence
  - http://www.odci.gov/index.html

- Organization for Economic Cooperation and Development
  - Economic Statistics
  - *http://www.oecd.fr/*

- U.S.-Mexico Chamber of Commerce
- American Chamber of Commerce
- Mexican Consulate (Albuquerque and El Paso)
  - Commercial specialists in the consulates tend to focus on getting their nation’s products into U.S. markets
  - Very helpful if you approach the situation from a joint venture or strategic alliance standpoint

In Mexico:

- INEGI
- Secretariat of the Economy
- Canaco
- Canacintra
- Promexico
- Chihuahua:
  - Secretariat of the Economy
  - COPARMEX Juarez and Chihuahua City
  - City of Juarez (Fomento Economico)
  - Desarrollo Economico Juarez and Chihuahua City
  - Maquila Associations: AMAC and AMEAC
- ITESM

Specific Steps:

- Research and understand your market.
- Involve all of the free assistance possible.
- Identify the HS (Harmonized Commodity Description and Coding System).
- Set time aside for a prospect visit or trade mission
- Determine NAFTA content of your product

Harmonized Tariff System Code

•The Harmonized System Code (HS) is an international standardized numerical method of classifying traded products. The identifying number assigned to each product is used by customs officials around the world to determine the duties, taxes and regulations that apply to the product.

•Developed through the active participation of 60 countries, 23 public and private international organizations and 2 national trade facilitation organizations.

• HS has replaced the old Tariff Schedule of the U.S. Annotated and the old Schedule B U.S. Export Code. HS number must appear on the SED and other documents in order for exports to leave the country.

•Organized into 22 sections with 99 chapters. Each section generally covers an industry and the chapters cover the various products and materials of the industry: Section XI is Textiles and Textile Products.

•Organized in a ten-digit numbering system. HS code contains a 4-digit heading and a 6-digit subheading that builds upon the previous digits.

HS Example:

*Using silk as an example, the HS code **5003.10.00** is "silk waste not carded or combed"*

• 50 represents the chapter, "silk"

• 5003 is the heading, "silk waste"

• 5003.10 is the subheading, "not carded or combed"

Note: Digits seven though ten vary from country to country and are purely for statistical and tariff purposes. Sometimes an eleventh digit (a "check digit") is added as a protection measure. It ensures that the code is an authentic HS code. The first six digits are universal.

To find your Schedule B Export Code number in the Harmonized System, call the Bureau of the Census Foreign Trade Division at (301) 457-4100; or call your local customs broker.

Basic Import/Export Documentation:

- Bill of Lading
- Certificate of Origin
- Commercial Invoice
- Consular Invoice
- Destination Control Statement
- Export Packing List
- Inspection Certificate
- Insurance Certificate
- Shipper's Export Declaration (SED)

It's a good idea if you are exporting to importing to immediately involve a customs broker.

The Strategic Alliance

- Often the best way for a smaller company with limited resources to enter Mexico.
- Reduces the learning curve
- Have to conduct due diligence on your potential business partner

North American Free Trade Agreement (NAFTA)

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- NAFTA is a comprehensive trade agreement that improves virtually all aspects of doing business within North America.
- NAFTA has eliminated most tariffs completely, and removes many of the non- tariff barriers, such as import licenses, that have helped to exclude U.S. goods from the other two markets, especially Mexico.
- NAFTA ensures that investment will not be coerced by restrictive government policies, and that U.S. investors receive treatment equal to domestic investors in Mexico and Canada.
- At the same time, NAFTA's extensive easing of cross-border services rules ensures that if U.S. companies do not wish to invest in another country to provide their service, they do not have to.
- The best intellectual property provisions ever negotiated by the United States ensure that the U.S. competitive advantage in high technology is fully protected. NAFTA provides for guaranteed access to lucrative government procurement contracts in Canada and Mexico.

NAFTA Chronology

- Within 10 years of the January 1, 1994 implementation of NAFTA, all tariffs were eliminated on North American industrial products traded between Canada, Mexico and the United States.
- A few tariffs on U.S. exports of agricultural products to Mexico were phased out over 15 years.
- As provided in the U.S.-Canada Free Trade Agreement (CFTA), all trade between the United States and Canada was duty-free by 1998.
- Prior to NAFTA, Mexican tariffs, which ranged from 0 to 25 percent, were 2.5 times U.S. tariff rates -- and about the same as (pre-CFTA)
- On January 1, 1994, Mexico eliminated tariffs on nearly 50 percent of all industrial goods imported from the United States, including some of our most competitive products such as machine tools, medical devices, semiconductors and computer equipment, and telecommunications and electronic equipment.

Elimination of Non-Tariff Barriers

- In addition to elimination of tariffs, Mexico has eliminated non-tariff barriers and other trade- distorting restrictions.

- Upon implementation, U.S. exporters started to reap the benefits from the removal of most import licenses, which had acted as quotas, essentially limiting the importation of products into the Mexican market. The benefits are two-fold:

  1) Exporters are able to ship more of their products into Mexico

  2) Exporting is more cost effective since exporters will no longer have to deal with the uncertainty and administrative burden associated with obtaining an import permit.

Other Barriers:

NAFTA also eliminated a host of other Mexican barriers, such as:

- local content
- local production
- export performance requirements

=> These acted to limit U.S. exports to Mexico.

Local content requirements are a conditional permission to sell a product on the incorporation of a mandatory percentage of local parts or labor.

In other cases, companies had to produce locally if they wanted to sell to the domestic market, or they must export a certain percentage of production.

NAFTA eliminates all these requirements.

NAFTA Rules of Origin:

- NAFTA reduces tariffs only for goods made in North America. Tough rules of origin determine whether a good qualifies for preferential tariff treatment under NAFTA.
- Strong rules benefit U.S. workers and firms.
- Goods traded duty-free under NAFTA must contain substantial North American content. Rules of origin reward companies using North American parts and labor. As duties are phased out, the incentive to use North American goods increases.
- Rules of origin prevent "free riders" from benefiting through minor processing or transhipment of non-NAFTA goods. Mexico and Canada cannot be used as export platforms into the U.S. market.

NAFTA Investment Considerations

- NAFTA Removes Investment Barriers
- Prior to NAFTA implementation, Mexico could review all investment proposals to determine if they were in the national interest. Under NAFTA, Mexico could review acquisitions above an initial threshold of $25 million, phased-up to $150 million over nine years (adjusted for inflation and economic growth). Mexico will continue to prohibit foreign investment in certain "Constitutional" activities (i.e., energy).
- NAFTA gives U.S. companies the right to establish firms in Mexico and Canada or acquire existing firms, but it does not encourage U.S. firms to go abroad.
- NAFTA provides, at the option of the investor, for binding international arbitration of disputes between host governments and foreign investors that involve monetary damages or restitution of property that may arise if NAFTA rights are denied. This is an important development in U.S. trade relations with Latin America, as certain countries in that region have denied foreign investors such protection.

Cultural Issues:

- Relationship building
- Concept of time
- Language
- Mexico is a nation of different cultures: (i.e. border vs. Mexico City vs. Monterrey vs. Guadalajara

Translations:

- Is the person doing the translation a native speaker or expert in the Mexican dialect of Spanish?
- Ask for references or samples of past work.
- Two or more Spanish speakers should review the translation–the context is extremely important
- Costs vary – good translations can run between US$15 to US$30 per page depending on the nature of the translation.
- A lot of companies try to save money on translations, but this can be a tremendous risk.

Do not skimp in this area – it will come back to haunt you.

Legal Considerations:

- Common/case vs. civil/code law
- Forming a business relationship is like "getting married"
- To establish a formal Mexican S.A. de C.V. or not?
- What happens when things go wrong?

U.N. Convention on the International Sale of Goods (CISG):

- Entered into force in the United States on January 1, 1988.
- If applicable to a given transaction, the CISG supplies "gap filling" rules that govern contract formation and set forth the rights and obligations of the buyer and seller.
- The CISG provides, however, that express contractual provisions take precedence over the default provisions of the CISG.
- Thus, contracting parties remain free to specify whatever law or terms they wish to apply to their transaction, and may exclude altogether the application of the CISG to their contractual relationship.

The CISG only applies to international commercial sales of goods:

- First, the sale must be international in character:
  - A sale is considered "international" if it involves "parties whose places of business are in different States." In ratifying the CISG, the United States stipulated that, absent express agreement to the contrary, the CISG would not apply to contracts between a U.S. party and a party whose place of business is in a state that has yet to adopt the CISG.

- Second, the CISG covers the sale of goods, and does not automatically apply to services contracts:
  - Where a contract includes both goods and services elements, the CISG will apply when the sale of goods constitutes the "preponderant part of the [seller's] obligations... ." Contracting parties are free to apply the CISG to services (or predominantly-services) contracts, so long as this choice of law is made explicit in the contract itself.

- Finally, the CISG only applies to commercial transactions, i.e., sales between merchants of goods. Among other limitations, it does not cover consumer sales; auction sales; sales of negotiable instruments or securities; or sales of ships, vessels, or aircraft.

Adoption of the CISG by the United States provides important benefits to U.S. exporters. Parties negotiating international sales contracts often find the "choice of law" issue to be among the most contentious. Each party is familiar with its own domestic sales law, and prefers that its local rules apply to the transaction.

The CISG enables the parties to avoid difficulties in negotiating "whose law will govern" by putting into place internationally accepted substantive rules on which contracting parties, courts, and arbitrators may rely.

Lawyers/Accountants:

Lawyers:

- Choose an attorney that has specific knowledge of the Mexican commercial sector

- Choose an attorney that has some type of association with a Mexican law firm.

Accountants:

- Get your accountant involved immediately in your Mexican efforts, not only for commercial purposes, but also for personal purposes.

- A lot of companies prefer the larger accounting firms such as KPMG. These companies have a presence in many countries and their clients comfortable with their presence and experience.

- However, sometimes smaller is better—especially if the bigger firms cannot devote the attention which a smaller business needs.

Pricing Your Product:

Simple scenario of how your product could be affected by price mark-ups:

Domestic:
From factory
Local transport
Insurance
Financing
Retailer

Transit/Overseas:
From factory
Local transport (home country)
Cross border transport
Importer
Tariffs/permits/non-tariff barriers
Local transport (foreign country)
Wholesaler
Retailer
Other intermediary
Insurance
Financing (or the cost of getting paid – i.e. letters of credit)

In each of the above steps, you must recognize the role of tariffs, taxes, duties, and other costs such as marketing. Be cognizant of profit margin and what intermediaries are tacking on to the cost.

Getting Paid

- **Advance Payment:** No risk to the seller. The buyer pays up front. Not a very attractive offer to the buyer and many will refuse.

- **Letter of Credit:** Low risk to the seller. The L/C is issued by the buyer's bank to the seller's bank verifying payment to be made immediately upon the shipment of goods. With this method, both buyer and seller are happy: the buyer is assured of the shipment of goods prior to releasing payment; seller is assured of prompt payment when releasing goods.

- **Credit Cards:** Low risk to the seller. By accepting a charge payment, payment barriers are avoided and currency fluctuations are monitored by the credit card company (usually on an hourly basis).

- **Foreign Bank Checks:** Medium risk to seller. A check can be drawn on either a U.S. or foreign bank. Usually a fee is involved in processing foreign checks. Cashing a foreign check may involve waiting for check to clear.

- **Open Account:** High risk to the seller. The buyer is not required to pay until goods are received. This arrangement is good for the customer but bad for the U.S. business, because there is no guarantee of payment.

- **Direct Debit:** Low risk to the seller. The seller directly debits the buyer's account without prior notification as long as the buyer receives the lowest price possible at the moment. Direct debit requires the seller to open a bank account in the foreign country.

- **Bank Transfers:** Low risk to the seller. The foreign buyer transfers funds directly to the seller's bank. These may be difficult with multiple order and reorder payments.

- **Consignment:** High risk to the seller. Seller doesn't receive payment until goods are actually sold. Control considerations.

Financial Background Check of Potential Partner, Marketer, or Prospect:

1) Ask them to directly provide you with information on their company.
2) Trade associations and chambers of commerce.
3) If credit agencies exist, use them.
4) Ask for bank and trade contacts.
5) U.S. D.O.C. and/or Embassy personnel
6) Eximbank
7) Domestic Private Credit Information Sources (although there are a handful that specialize in foreign firms)

Consultants:

- Do as much homework as you can before you resort to contracting a consultant.
- Use consultants when you do not have the time or resources to internally do the work at hand.
- Not everybody who claims to be an expert is indeed and expert.
- Areas of specialization (i.e. industries and/or markets).
- How much experience do they have in the country?
- How often do they travel to Mexico?
- Are they fluent in Spanish?
- What is their fee based upon?: flat fee, commission, portion of the business, etc.
- Do they have a presence in Mexico (i.e. an associate there)?
- Check with local trade officials.

Thank You !

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