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Mexico's Maquiladora Industry and Other Manufacturing Facilities in Mexico

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I. Introduction

This panel addresses the operation of Mexico's *maquiladora* industry as compared to other manufacturing facilities in Mexico. The panel discusses the details of starting and operating a *maquiladora*, as well as the relevant factors to consider in deciding between operating a *maquiladora* and a Mexican domestic manufacturing facility. In addition, the panel explores the relevant issues facing a corporation wishing to expand into Mexico with respect to labor laws and plant facilities. It then compares the real estate laws of the United States and Mexico, in addition to the type of markets present in each country, to help determine the feasibility of operating either type of manufacturing facility. Finally, the panel briefly discusses Japanese ownership of manufacturing facilities in Mexico.

II. The Incentive Management System in Mexican Manufacturing Facilities

FRED W. MACKENBACH:*

The simplest, yet still effective, form of management is known as the Incentive Management System. Under this system of management, salaries and bonuses are directly funneled from a company's profits, regardless of whether an employee starts out at the assembly line, sales, engineering, or management level. In other words, under the Incentive Management System, employees enjoy a profit-sharing bonus plan. This system takes into account each employee's rating, which is based on his guarantee of high work quality. Therefore, when an employee produces low quality work, his or her rating decreases, which consequently reduces the bonus.

The Incentive Management System has produced a very low turnover rate among companies' employees. At the same time, the overall costs of running the company, when compared with such

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profit sharing, is lower than that of other companies operating under different systems. Because the employees under this system work as a single cohesive group, their productivity level is four times the national average level. Furthermore, unions are nonexistent, although employees are guaranteed thirty hours of employment per week. The advantages of working under this system include achieving high levels of manufacturing activity and excellent product quality. Additionally, engineering skills, as well as overall sales, increase. Consequently, company finances are boosted.

A. Maquiladoras

Many companies are moving their operations to Mexico in order to take part in the Mexican domestic market and to protect their market shares. In addition, Mexico's PITEX program is a driving force to move operations down to Mexico. The move allows for smoother and more effective assembly operations, producing higher quality products.

One reason to have a *maquiladora* is to increase a company's market share, while simultaneously having high-paid employees who are qualified. In addition, all of those operating the company are Mexican citizens, with only one individual who is not Mexican. The essential ingredients of this type of structure are not related to labor, but are technology, attention to detail, and owners of the company who are involved in the day-to-day operations of the business. The owners must be accessible to the workers and feel comfortable in the production area.

Maquiladora systems often incorporate a "buddy system." This allows the employees access to the key department heads without going through a hierarchy or bureaucracy. In addition, *maquiladora* systems employ the task force approach, where a sales group of primarily Mexican employees heads the sale of products made in both Mexico and the United States. The employees are selected, trained, and then set loose to work independently. As a result, the quality of the products, financial stability of the company, maintenance production, purchasing, and sales increase.

A *maquiladora* may also utilize a piece work system, although it is not a common system in the Mexican industry. Under the piece work system, companies, while paying out attractive employee wages, can give a forty percent bonus to the employees at the end of the year due to the overall productivity of the company. In other words, the company may produce more without increasing the production staff. Such operations are possible without cutting back on the quality requirements of United States plants.

Before setting up a *maquiladora* plant in Mexico, four factors must be considered. First, one should proceed on the basis that it is easier to buy companies than to operate them. Second, one should thoroughly investigate the situation by talking with those who run successful plants, either in the United States or in Mexico. Third, one should realize that if a company is poorly managed in the United States, a *maquiladora* or a one hundred percent owned corporation in Mexico will not solve the problem of poor management. Fourth, the manager who is to be sent to Mexico to operate the plant must be special and must also be able to adapt to a different cultural environment. In other words, a plant cannot be expected to become successful solely by relocating in Mexico; key management factors must change accordingly. Additionally, if a company chooses to move to a country with high inflation, it may be important to have someone on the staff who understands the financial impact of high inflation on the company and what is necessary to stay profitable and minimize the impact of that inflation.

B. Additional Considerations Before Deciding to Move to Mexico

Mexico is almost European in some ways. The people are highly educated, and the business environment is very different from that on the border. When you are on the border, it is like having one foot on each border, one in Mexico, and one in the United States.

Reasons for doing business in Mexico depend on what business people intend to accomplish. The goal most often sought by businesses is economic advantage. A more important concept, however, is the concept of a capable and easily trained labor force with an established work ethic. The success of the *maquiladora* industry depends on the Mexican worker.

The planning involved in moving to Mexico is also important. An analysis of risks involved in dividing a company into unrelated subsidiaries is critical to making plans to move to Mexico. Furthermore, business owners should seek the right advice from consultants and other businessmen before making the move. Two major concerns arise with such situations. First, Mexico has never been an industrial country. Secondly, the owners must plan the moving of offices while on-site at the border, rather than planning it from the United States.

The reason for this is that a trip to Tijuana, for example, would expose potential investors to almost 500 operations that they would not otherwise be aware of. Many companies are flourishing in Tijuana and other parts of Mexico, and these companies can be a part of future investments.

Electronics, furniture, and wood-working companies, many of which came from California, are successful in Mexico. Many companies choose to work with groups in Mexico. Such foreign companies use these groups to provide for administration and paperwork, as well as the planning for the Mexican government. As a result, the foreign companies are free to be involved in manufacturing. The companies bring their own machinery and use their own technicians to set up the process. The specialized companies provide employees, and the original companies run the manufacturing. This approach has proven to be very successful. Many companies prefer this approach over starting a new subsidiary, which requires all of the planning involved in starting a new company.

Small and medium-sized companies can also adopt this approach. Having the administration done by a local company often accelerates the progress because original companies can concentrate on the manufacturing. Plant development, as a consequence, occurs quickly because these companies focus on training. In this way, a process that would normally take a year can take just three months to produce a finished, acceptable product.

Sometimes, older companies plan for a certain growth rate of the population, only to find that, after a year, it accelerated almost twice as fast. For example, a company originally planning to employ thirty workers at the end of the first year found itself with ninety workers. Another company planning to have seventy workers at the end of the second year actually employed over 250. Therefore, Mexico has proven it can support successful industrial businesses while providing businesses with lower labor costs and better workmanship.

RUSSELL BENNETT:

Another key ingredient to success for a company is contact with people who are in Mexico every day and who are well versed in local ways. These people can assess the needs of foreign businesses and help them make choices regarding equipment and business types. For example, they can help decide whether a system such as the shelter system, where the local contact supplies all the services, is appropriate and allows the parent company to focus on manufacturing without worries of personnel policies. Shelter companies originally sheltered United States and Japanese companies from having to understand and interpret legislation in Mexico.

ERNESTO BRAVO:*

Another reason why a United States firm should use a shelter system, rather than run a plant itself, is that a shelter service provides peace of mind as well as ease of entry to a new company in a short amount of time. Learning what it takes to start a new company takes much time, research, and direct involvement by management. Shelter companies shorten the period of time necessary to start a new operation and provide the needed experience for success.

RUSSELL BENNETT:

Another fundamental component of a successful business in Mexico is the element of cost sharing. Establishing a factory with twenty-five or thirty workers requires not only personnel, but customs and traffic managers to bring products back and forth across the border. The local shelter companies already have personnel departments, and provide these services to foreign companies who need them. They also have customs and traffic departments for the foreign companies to use. However, many companies that start in shelter move away from it after a few years. This process, called graduating, allows companies to hire personnel provided by the shelter company.

III. LABOR LAWS

FERNANDO CERVANTES:

Due to the way labor legislation has evolved in Mexico, some companies base their success on high technology, while others base it on their attention to human resources. The firms concentrating on human resources should receive the highest priority. The foreign investor must be particularly aware of how the United States-Mexican experience is affected by the NAFTA treaty. But the NAFTA treaty alone will not resolve problems.

In order to compete with Europe and Asia, the NAFTA parties must have a competitive labor force. This is particularly true in Mex-

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ico, where the focus is often on human resources rather than high technology. To achieve a competitive standard, both domestic and foreign controlled companies bear the responsibility for training and educating their Mexican work force. Before engaging in such an enterprise, however, it is especially important that foreign managers obtain a basic understanding of Mexican labor practices.

A. Federal Labor Law

Labor unions began in Mexico in the 1850s and 1860s but did not receive formal recognition until the late 1880s. Even then, the government only recognized labor unions whose requests were the least troublesome. After the Mexican Revolution in 1910, labor unions gained strength, largely because of the unions' alliance with the National Revolutionary Party ("PRN"), the precursor to the Institutional Revolutionary Party ("PRI"), the political party that has controlled the Mexican government for nearly sixty years. During the early days of PRI control, Mexico passed it first labor law. However, from the 1930s until the 1970s, the government maintained a laissez-faire attitude with respect to labor regulation. Beginning in the early 1970s, the government became more protective and exceedingly more regulatory. This new attitude resulted in the passage of the federal labor laws of 1970, which remain in effect today. These labor laws are far more favorable to the Mexican laborer than a foreign manager might realize. For example, a company cannot dismiss an employee without proving cause in a court of law. Since establishing cause can be difficult, dismissing an employee can prove to be an expensive proposition.

B. Administration of Mexican Labor Law

The Federal Labor Law is administered by Labor Boards at both the Federal and State level. The States do not have separate labor laws of their own. The Federal Labor Board deals with key industries such as mining or transportation. State Labor Boards deal with local labor issues. These Boards consist of three individuals representing the government, business, and labor sectors. A State Governor appoints the government representative who serves as President of a State's Labor Board. Because the business and labor representatives are frequently on opposite sides of a labor issue, the final decision is often left to the board President. For this reason, Mexican Labor Boards are politically oriented. As the governor's mouthpiece, the board President exercises very little independent discretion. This results in a variety of labor practices from State to State depending on how heavily a state government relies on labor for political support. Thus, if a foreign company is considering establishing a business in one of Mexico's border cities, it should familiarize itself with the Labor Board's political affiliation. For example, a company seeking to operate in Matamoros, Tamaulipas, which borders Brownsville, Texas, will have to befriend the unions in order to operate successfully. In contrast, Tijuana, Baja California Norte, which borders San Diego, California, is less closely linked to labor. Mexicali, Baja California Norte, which borders El Centro, California, also has a stronger private sector, which can aid companies in hiring middle management. The most effective method that a foreign company can use to familiarize itself with the prevailing labor conditions is to speak with others who have already established operations, talk with professional consultants, and, most importantly, travel to the area and obtain advice from people who will be truly familiar with the situation.

IV. Staffing and Company Philosophy

Once a foreign company has chosen its location, it should seek to find both a Mexican plant and personnel manager. It is extremely important to acquire strong local management. Although some companies start off with foreign management, converting to Mexican management is important to the continuity and stability of the plant.

A lack of continuity can spoil even the best laid plans. Often, foreign companies fail to establish either strong Mexican management or suitable foreign managers, leading to delay and confusion. One United States company, for example, had six managers from the United States in two years. When the time came to renegotiate the lease, the landlord found himself dealing with a new plant manager after all the plans had been negotiated with the previous one two months before. It took an additional six months to renegotiate the lease. Delays such as these obviously impair a plant's ability to succeed.

It is equally important to develop a company philosophy that fits the environment in which the plant operates. Many foreign companies, especially those that have established *maquiladoras*, have failed to develop a company philosophy, despite careful planning in all other areas. Still others have taken for granted that the company philosophy extant in Los Angeles or Chicago is equally applicable to their Mexican plant.

While some principles are universal and can be incorporated anywhere, others must fit the culture and circumstances in which they are to apply. Furthermore, once management adopts a company philosophy, the company must ensure it is properly communicated to every employee. Otherwise, it serves no purpose.

V. THE PHYSICAL FACILITIES

RUSSELL BENNETT:

Often, a United States company already owns the equipment that its Mexican operation will use. The equipment is usually located at an existing plant and the company merely moves it from the United States location to that in Mexico. Thus, the physical plant is usually the most expensive investment a foreign company will make when it establishes a Mexican operation. The physical plant consists of the leased or purchased factory or office buildings and the surrounding real estate. The considerations involved in selecting the physical plant include its proposed function, location, and financing.

VI. MEXICAN VERSUS UNITED STATES REAL ESTATE MARKETS

This section discusses the differences between the United States and Mexican real estate markets. The United States real estate market has an average vacancy rate of approximately twenty to thirty percent, depending on the market area. This percentage range holds true for most major United States cities such as Chicago, New York, and Los Angeles, depending on the particular area. A normal market vacancy rate is supposed to be ten percent. Thus, a twenty to thirty percent vacancy rate indicates a buyer's market.

The Mexican real estate market is quite different. There are basically no vacancies. This is especially true of the industrial real estate market. Because the market is so bare, there are no real estate brokers in Mexico like those in the United States. When an enterprise needs an industrial workspace, it typically builds a new facility. It does not concern itself with possible vacancies in the area.

The types of real estate investors also differ in the United States and in Mexico. In the United States, insurance companies and pension funds are predominant real estate investors. This is not so in Mexico. In Mexico, these companies have traditionally not put their funds into real estate, but, rather, have relied on other traditional non-real estate transactions. The difference has resulted from the different interest rates in the United States and Mexico.

Prior to a sharp rise in Mexico's interest rates, real estate investment was prevalent. However, when interest rates rose, money became scarce, and the real estate market dried up. Those who had previously invested in real estate were locked in, since no one could afford to get a loan. These factors have led to a dramatic difference in the United States and Mexican real estate markets.

In the United States, one can typically purchase real estate for less than its replacement cost. If a building costs $300 to $350 per square foot to build in the United States, that building could be bought for $200 to $300 per square foot today. Conversely, in Mexico, if the building costs $140 to $200 per square foot to build, it can immediately be sold for between $200 to $400. Supply in Mexico has not kept up with demand. Because of this, Mexican property values have a significant built-in premium.

When setting up an industrial plant in Mexico City, one must be particularly cautious. One must carefully examine the plant, building, and training facilities available in a given area. One must also be concerned with the area's location, stability, and reliability of a power supply. Another major concern is zoning within the city.

Since the 1985 earthquake, the government enacted a series of convoluted zoning laws. These laws can create a potential resale problem, especially if one purchases property that was not originally zoned adequately. One must be sure to properly plan for zoning changes. However, if the need should arise, re-zoning the property is not a difficult process. Since traffic is also a major concern in Mexico City, one must choose a property location that allows customers easy access to the property.

Phone service is another area of concern. Currently, telephone service in Mexico is substandard when compared to that of the United States. However, AT&T recently signed a contract with Electrico Mexico to install fiber optic lines throughout the country. Thus, within a few years, Mexican phone services will be on par with those in the United States. Currently, however, many sites restrict the number of phone lines allowed. Sites that allow an appropriate number of telephone lines can be extremely expensive.

A final concern is the availability of water in Mexico City. Since the city is surrounded by mountains, it is difficult to get water into the city. The cost could vary considerably depending on location. Given all of these factors, and the expense attributed to them, a prospective business venture must carefully consider and weigh its business needs.

One must determine which needs are absolutely critical to one's business, and find the most cost-effective location to fill those needs. Having done so, the business can profit from investing in Mexico.

VII. The Role of the *Maquiladora* After NAFTA

The *maquiladora* has been a protected special interest for the past twenty-five years. They have been protected and favored over Mexican companies because they have constantly been composed of 100% non-Mexican equity. They have been exempt from paying import duties on both simple and complex machinery. The reason for this exemption is that the *maquiladora* is found in almost completely export-oriented industries. Thus, these industries generate huge export incomes for Mexico.

With the arrival of NAFTA, the *maquiladora* will become obsolete. First, under NAFTA, import duties will drop from their current range of around ninety percent on imported machinery down to ten percent. Within several years, the import duty will disappear completely. Thus, the *maquiladora* will no longer have this competitive edge over Mexican-owned companies.

Furthermore, under the new foreign investment laws of Mexico, any company can be foreign-owned, regardless of whether it exports one hundred percent of its product. Given these two factors, any company in Mexico can become a *maquiladora*, and so the concept of a *maquiladora* will eventually become obsolete.

VIII. The Role of Asian Companies in Mexico

Many Japanese, Korean, and Taiwanese companies currently have manufacturing or assembly plants in Mexico. Some of these plants are utilized only for final assembly of products. The question remains, then, how these assembly plants and export products will be treated under NAFTA.

However, the laws regarding a product's origin are still unsettled. The current proposal is that a product will be considered to have Mexican "origin" if at least thirty-five percent of the final product was made in Mexico. Of course, products of Mexican origin will enter the United States under a generalized preference system, sometimes duty-free. These rules must prevent the possibility of railroading products through Mexico in order to avoid paying duties. Indeed, duties must still be paid on the portion of the goods that are not actually Mexican.