



Mexico at a crossroads: Is it missing out on its opportunity for nearshoring?

Maximizing the value of nearshoring and accelerating Mexico's growth and development requires overcoming critical challenges in infrastructure, services, and security.

By Jordi Ciuró and Armando Flores

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At a Glance

- ▶ Nearshoring¹ could significantly drive Mexico's economic growth, increasing its exports and creating qualified jobs.
- ▶ It seems Mexico hasn't been able to seize the full potential of nearshoring, for neither Foreign Direct Investment (FDI) nor exports have accelerated their growth in real terms, while emerging Asian economies have outpaced Mexico as nearshoring destinations.
- ▶ Mexico has the potential to accelerate the growth and increase the value of its exports by over 500 billion dollars by 2030.
- ▶ To take full advantage of this opportunity, Mexico needs to address major challenges in sector-wide ecosystems, infrastructure, power and water supply, talent, cost competitiveness, and security.

Mexico's nearshoring situation and potential

As a result of recent global disruptions, the dynamics of traditional value chains have been deeply altered. Geopolitical tensions, commercial tensions between China and the US, the COVID-19 pandemic, and the semiconductor crisis, among others, have exposed and accelerated supply chain vulnerabilities, driving companies to seek for more resilient alternatives.

In this context, business leaders in multiple industries are applying what they have learned managing these turbulences, focusing on reinventing their supply chains to make them shorter, closer to the client, more flexible, transparent, and sustainable. For instance, a global study by Bain & Company shows that over 50% of those in charge of supply chains plan to increase their nearshoring and onshoring operations in the near future, deprioritizing cost reduction.

Thereby, nearshoring represents a unique opportunity for Mexico, for it can drive economic growth, industrial activity, and the country's relevance in the commercial ecosystem even further thanks to its proximity to the US, its solid manufacturing base, and the existing trade agreements. Some examples of the potential impact of said acceleration on export manufacturing activity include better job opportunities for Mexicans, the formalization of S&MEs, growth in the demand for export-associated services (i.e., logistics, insurance, industrial real estate), and strengthening of local economy in relocation hubs, among others.

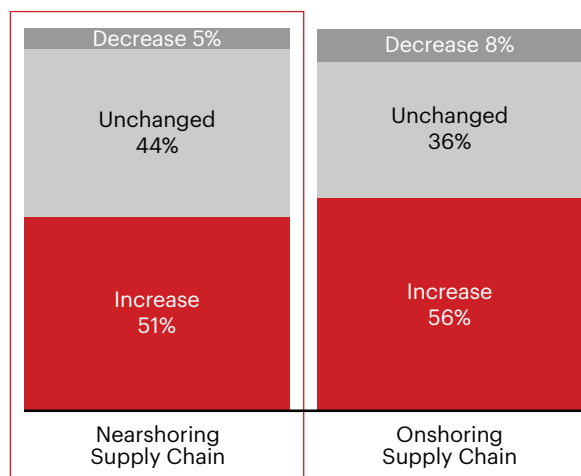
This supply chain reformulation, along with the relocation of manufacturing centers near consumption hubs, has already led to an increase of over \$130 billion dollars in the value of Mexican exports since 2019, reaching \$593 billion dollars in 2023. Thus, Mexico becomes the United States' biggest trading partner as of 2023, with over 15% of its imports total value.

¹ By nearshoring, we understand the phenomenon of relocation of production processes to geographies closer to the centers of demand. In particular for Mexico, the relocation of production chains from Asia to North America.

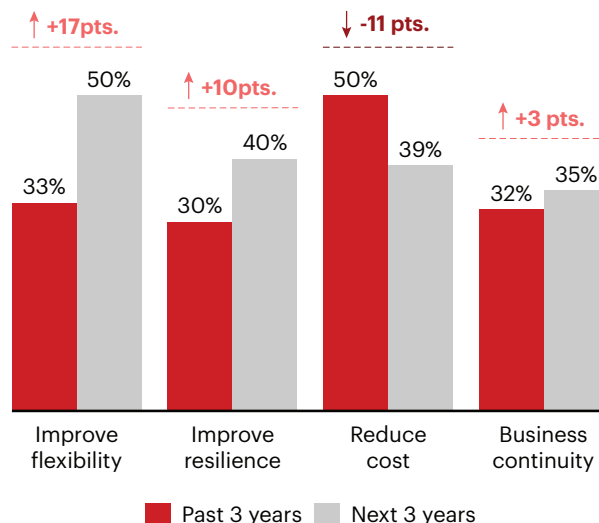
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Figure 1: Increase in nearshoring and onshoring decisions in the near future in situations where flexibility and resilience gain importance

Supply chain location decisions in the next 3 years
(survey respondents %)



Supply chain investment goals, past 3 years vs next 3 years
(survey respondents %)



Source: Bain survey on the supply chain industry's resilience. September 2022 (n=275)

This rise in exports is mainly seen in the electric equipment industry, derived from growth in renewable energies and investment in power infrastructure improvement in the United States. Another benefited industry is the automotive industry, light vehicles in particular. As for the geography, most of this growth is concentrated in the Bajío, Northeast and Northwest regions, which since 1990 have witnessed the increase of consumer purchasing power by 1.3%, 0.7% and 0.4%, respectively, reflecting the positive impact from nearshoring in local economy.

It seems Mexico hasn't been able to seize the full potential of nearshoring, for neither Foreign Direct Investment (FDI) nor the country's exports have accelerated its growth in real terms since 2019.

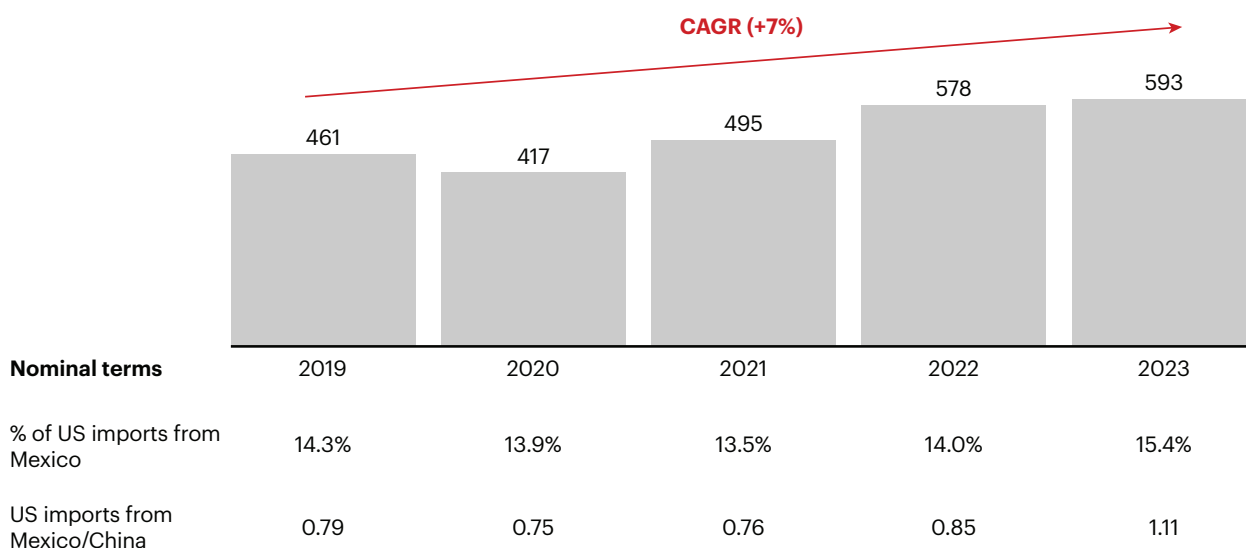
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Figure 2: 2019-2023 value of Mexico’s exports in nominal terms

Mexico’s exports

(Billion dollars, nominal terms)



Source: Banxico, International Trade Administration

since 2019. This dynamic contrasts with what is experienced in Asian developing countries, where exports to the United States have grown more rapidly during the same period:

- First, although FDI has recovered in the past two years reaching over \$36 billion dollars in total investment, it has not experienced an acceleration, and the arrival of new capital in recent years has not increased at all.
- By isolating the effects of inflation, Mexico’s real exports growth has decelerated, going from 17% real growth during the 2015-2019 5-year period to only 12% during the 2019-2023 5-year period (precisely when it would’ve been expected for them to have accelerated).
- Lastly, Mexico has been surpassed by several Asian countries, such as Vietnam, Thailand, India, Malaysia, and Indonesia, which have seized greater trade participation from the United States since 2019. The value of imports from said Asian countries has grown over 50% since 2019, compared to only 35% growth of US imports from Mexico. In addition, when we analyze US imports from these Asian countries, we find that more than half of the growth (equivalent to \$54 billion dollars) has been in products for which Mexico was already a top exporting country to the United States in 2019.

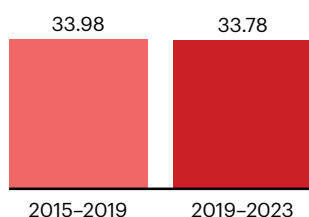
Consolidating and accelerating the value and relevance of nearshoring could transform Mexico’s economic outlook, leading to more than doubling the total value of foreign trade by 2030 and

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Figure 3: Mexico hasn't seized the full potential of nearshoring, therefore it hasn't been able to accelerate its real growth

FDI has not substantially grown and there is less arrival of new capitals

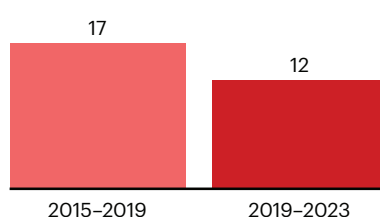
Foreign Direct Investment (FDI) average
(Billion dollars)



New investments average	12.3	11.8
% of new investments out of total	36%	35%

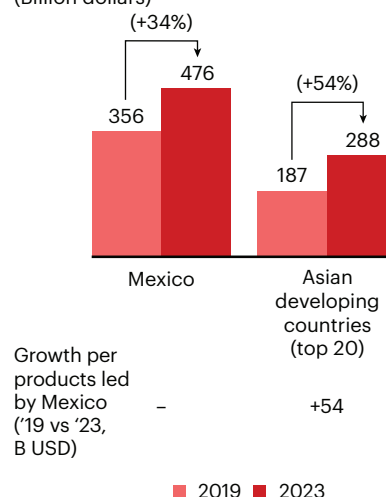
The real growth of Mexico's exports has decelerated

Growth of Mexico's exports in real terms
(%)



Asian developing countries have grown more rapidly than Mexico

US imports per country
(Billion dollars)



Growth per products led by Mexico ('19 vs '23, B USD)

■ 2019 ■ 2023

Source: Banxico, US Bureau of Labor Statistics, International Trade Administration, EIA, Capital IQ, Bain Analysis

reaching up to \$1,100 billion dollars in total exports value. The implicit growth in this maximum potential scenario is greater than the growth experienced by Mexico in the past years and it would involve maintaining or even increasing its share in some of the industries where Mexico is already relevant. This potential would first imply maintaining the past years' trend growth, which would be equal to adding \$300 billion dollars to its exports value by 2030. However, by taking full advantage of relocation opportunities, Mexico could attract a greater investment and accelerate exports by over an additional \$200 billion dollars in the same period, equivalent to creating four export hubs the size of what Nuevo León is today.

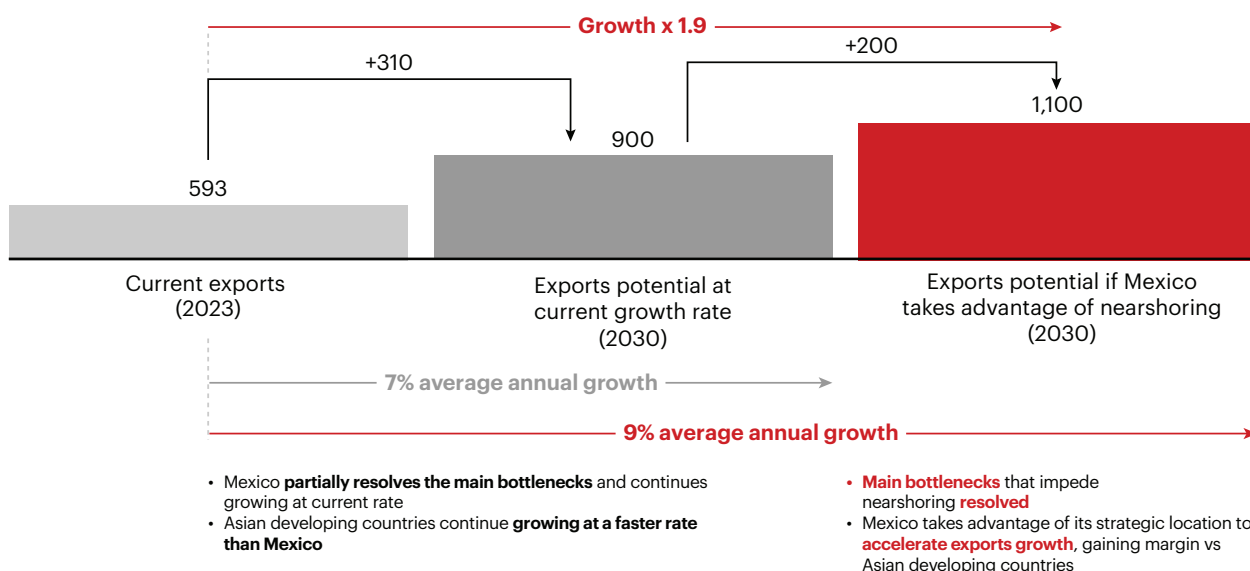
If we look at the niches where Mexico already has a strong presence and is in a position to benefit from the reduction of Chinese exports to the US, the industries with a greater opportunity to contribute to this maximum potential scenario include Electric Equipment, Mechanics/Machinery, Metals and Plastics.

Mexico's unique opportunity to more than double its total value of exports accentuates its urgent need to accelerate its efforts to resolve the struggles and challenges of nearshoring and thus unblock growth.

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Figure 4: Mexico has the potential to almost double its exports

Mexican exports
(Billion dollars)



Source: International Trade Administration, Banxico, Capital IQ, Bain Analysis

Struggles and Challenges of Nearshoring

The struggles and challenges faced by already-settled companies or those that wish to relocate to this country highlight the areas where Mexico should focus to seize the maximum potential of nearshoring:

1. Sector-wide Ecosystems

One of the first aspects companies assess before relocating their production centers is the availability of an adequate supplier ecosystem. Encouraging and developing comprehensive ecosystems is fundamental in supporting the growth of new product manufacturing in the country. An example of a successful strategy is the support to cluster development led by Nuevo León since 2000s, combining efforts by the government, companies, and academia to develop eight strategic industries, namely manufacturing, automotive, information technologies, health, among others. This participation has placed Nuevo León’s export growth 2 p.p. above Mexico’s nationwide growth reaching \$56 billion dollars in 2023.

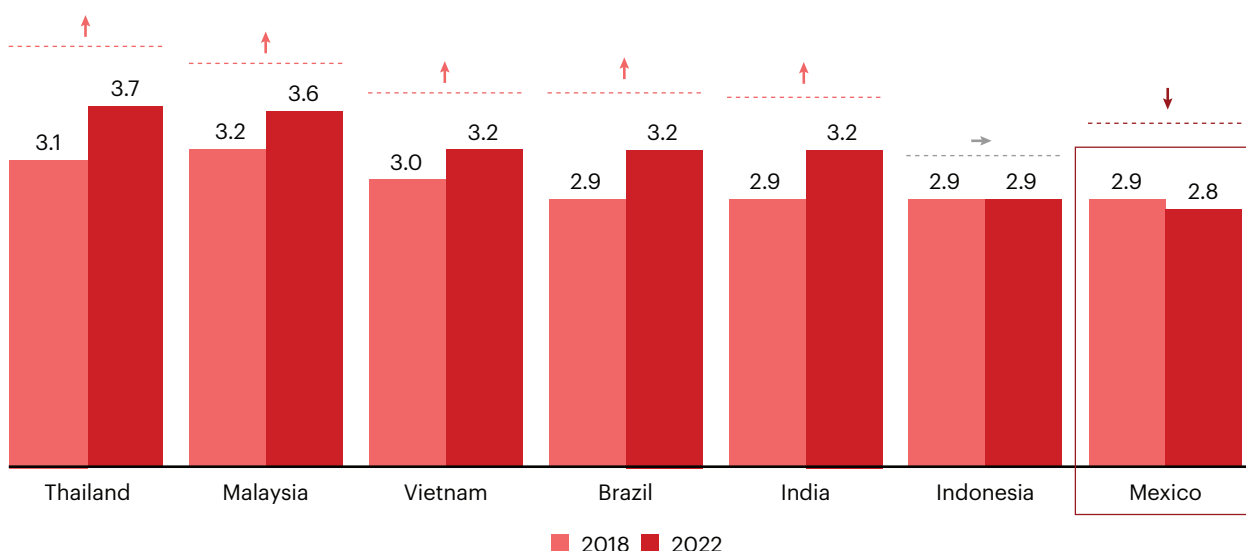
2. Infrastructure and Logistics

One of the main obstacles to realize the nearshoring potential in Mexico is its infrastructure. Despite its strategic location, the country’s logistics and transport infrastructure is lagging

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Figure 5: Mexico is lagging behind in transport infrastructure compared to other US trade partners

Quality of trade and transport-related infrastructure
(1=low to 5=high)



Source: World Bank

behind compared to other countries and has even deteriorated since 2018. Roads, ports, and railways, especially intermodal connectivity, require significant investment to satisfy the demands of an ever-growing manufacturing activity, particularly in northern states.

On the other hand, the efficiency of customs processes in Mexico has dwindled versus competing countries, affecting trade fluidity and increasing crossing times and costs. This is mainly due to congestion in customs warehouses, obsolete technology at ports, and the lack of adequate logistics infrastructure. To address these problems, the current customs capacity will need to be strengthened with additional qualified staff, infrastructure, and innovative technology to achieve a better efficiency.

3. Power and Water Supply

The generation of an adequate and reliable power supply, especially access to renewable energy sources, as well as water supply, are paramount for industrial operations. Specifically, in the past years, Mexico has had limited growth in its generation capacity, particularly from renewable sources, as well as in expanding its transmission grid.

Securing sufficient electricity and water supply will require coordinated efforts between the government and the private sector, as well as investment, both in generation (including clean energies) and in transmission, to achieve a supply that is reliable, green, and with reduced costs.

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4. Talent and Workforce

Companies that seek to settle in Mexico, especially in high growth industries such as automotive, electric equipment, and machinery, lean towards advanced manufacturing with a high degree of automation and tend to avoid basic in-bond assembly. This trend, driven by the increase in labor cost and the need for more efficient processes, requires personnel with advanced skills such as technicians and engineers. Currently, the difficulty to cover vacancies and the shortage of qualified workers are two of the main challenges faced by most companies in Mexico, according to recent analyses by the IMCO.

To address this, it is crucial to promote collaboration between the government, universities, and the private sector in developing technical education opportunities and professional training programs, improving the educational infrastructure, and conducting awareness and career guidance campaigns.

5. Competitiveness

In spite of the fact Mexico is currently cost competitive versus other US trade partners, a number of factors will increase the pressure on costs, and if they are not compensated with improvements in productivity, this would significantly affect the country's competitiveness as a manufacturing and exports hub. These factors include a possible labor reform, the constant increase to minimum salary, the continuity of a strong Mexican peso, and the increase in the cost of financing if the country credit risk deteriorates. In addition, the review to the United States-Mexico-Canada Agreement generates uncertainty about its possible impacts.

An approach in significantly improving productivity and reducing costs, together with the acceleration of digitalization and process automation through technology and artificial intelligence, is crucial to offer services, raw material, and competitive products to new companies seeking to relocate to Mexico.

6. Security

The perceptions of Mexico as a dangerous country pose a significant barrier in attracting foreign investment and the high-level talent necessary to grow in industries with a greater added value. Improving the security conditions is crucial to make Mexico a more attractive nearshoring destination. In addition, security also has big impacts in costs and logistic certainty, contributing to investment remaining concentrated in the current main hubs.

Mexico needs to seek actions to fight the crime rate and thus allow the growth of its FDI, reduce associated costs, and facilitate the attraction of highly-qualified workers.

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Conclusion

Nearshoring offers an extraordinary transforming opportunity for Mexico, promising economic growth, the creation of employment, and a greater global competitiveness. However, to seize this opportunity's maximum potential, it is crucial to address challenges in infrastructure, public services, talent, security, cost competitiveness and supplier development. Failing to do so could leave Mexico lagging behind its Asian competitors.

With strategic planning, adequate investments, and collaboration between the public and private sectors, Mexico can position itself as a leading nearshoring destination, driving long-term prosperity for its economy and population. The moment to act is now, before this opportunity fades away and is not fully exploited.

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