Harnessing Mexico's Cost Advantage For You

whitepaper

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## White Paper - Why An Accurate Cost Model Could be the Difference between Success and Failure in Mexico

Every time we are in contact with a manufacturer considering Mexico, one of the first exercises we conduct with them is a cost model. It occurs early in the site selection process and is, understandably, one of the most important questions to answer – How much does everything cost?

Entrada Group estimates we can save clients between **25-50%** in overall operating costs.

Unfortunately, many companies contemplating a new manufacturing location (particularly in a foreign country) either don't run through a sufficiently comprehensive cost model or they lack insight into all the costs they will encounter in an unfamiliar location. This can lead to hidden costs that will only be identified further down the road, after it is too late. Entrada Group has compiled this FAQ to help manufacturers who are considering their first step toward Mexican manufacturing and need some insight into how to best complete a cost model. We added some typical questions at the end about growth, as we hear these a lot.

### *Manufacturing Cost Models – Frequently asked questions*

#### *Q: What does Entrada Group include in a manufacturing cost model?*

A: A thorough cost model must include all costs associated with doing business in Mexico, except for raw materials. It's important to remember that a cost model is not a startup model; a cost model must include all ongoing Mexican costs. A startup model is useful, but only for the initial phase. To be accurate, the cost model must include complete operational costs the manufacturer incurs in the course of production. From there, Entrada Group adds all the local Mexican costs (more on these below).

#### *Q: What are some of the types of costs manufacturers need to plan for in Mexico?*

A: In a nutshell, you will need to account for everything except for the cost of raw materials. These include costs that are unique to Mexico that the vast majority of foreign manufacturers will not be aware of.

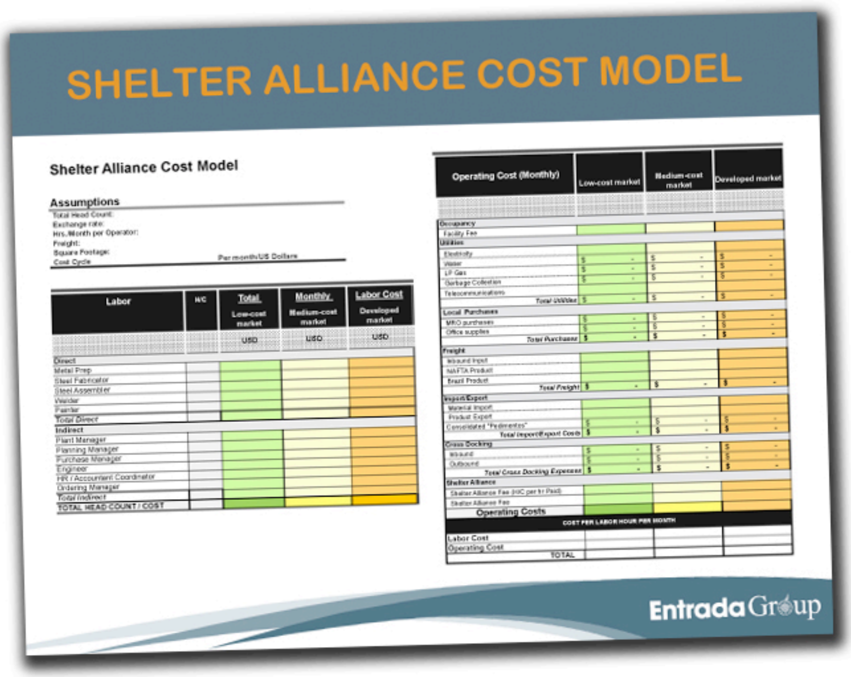
Here is a non-exhaustive list:

- Rent
- Service provider fees
- National/foreign freight
- Customs taxes
- Crossing in/crossing out
- Maintenance, repair and operations (MRO)
- Outside processing
- Utilities
- Direct material
- Waste
- Travel expenses
- Overnight shipping costs
- Installation
- Insurance
- Cleaning supplies
- Equipment rental
- Tax burden of non-deductible costs
- Uniforms
- Security equipment
- Gasoline and fuel
- Training
- Taxes and rights
- First aid supplies
- Software

### *Q: Which costs are direct manufacturer costs versus Entrada's costs?*

A: The costs borne by Entrada Group, as the local operator and entity of record, as opposed to those borne directly by the manufacturer, are "pass-through" costs. Many of the costs listed above fall under this category. They include all of the non-production-related costs (also known as general and administrative support costs). In addition, Entrada's services include everything your company needs in order to successfully launch a new facility in Mexico – guidance, experience, relationships with local government officials and suppliers.

To derive your overall operating costs in Mexico, you would divide this total figure by the number of employees in the operation and the number of hours worked in order to calculate your hourly operating cost.



***Q: What is the benefit of performing a cost model analysis?***

A: An accurate cost model allows you to compare costs between, say, your current operation and an alternative manufacturing facility you may be considering. It also allows you to compare costs at two locations in the same country or region, taking into account all costs that will be associated with production and support, except for raw materials costs. It can also give you a sense of the costs of your competitors.

***Q: How can Entrada develop an accurate cost model when every company has different operations and processes?***

A: We need extensive input from company management in order to develop an accurate cost model for prospective Mexican operations. First, we would discuss with the prospect the setup of their Mexican facility, or they would give us cost details on their existing operation and we would develop the corresponding costs for Mexico.

Next, we would examine the operating costs of a similar company already present in our industrial facility in Zacatecas, Mexico. We would analyze some recent monthly snapshots of their operating costs. We want to look at average months, rather than atypical months, to develop an accurate benchmark. Then we look at assumptions we might need to modify based on differences from the prospective company.

***Q: What would be an average total operating cost for a manufacturing facility in Mexico?***

A: It's essential to remember that prices vary tremendously across Mexico. For example, total operating costs at our industrial park in Fresnillo, Zacatecas may be as much as 40% lower than corresponding operating costs manufacturers would find near the US border.

Looking specifically at central Mexico, based on our years of experience here, total operating costs will vary based on the nature of a company's processes and the type of production they engage in. For example, for some of our clients with labor-intensive production, total operating costs in Mexico are as low as $5 per hour. Others have more sophisticated processes like machining, and they might pay as much as $15 per hour.

Based on years of working with numerous clients across a wide range of industries, Entrada Group estimates we can save clients between 25-50% in overall operating costs.

***Q: Why is Mexico so much cheaper?***

A: Operating costs are defined to include those Mexico-related costs commencing from the staging facility of the manufacturer's home nation, inclusive of all wages, salary, benefits, supplies and transportation. For manufacturers in the US and Canada, that includes all costs incurred up to the point of arrival at the Mexico border. For manufacturers in Asia and Europe, it includes parallel costs incurred for goods to arrive at port in Mexico.

Operating cost differentials realized in Mexico are due to decreased costs. For example, a 2014 Boston Consulting Group study found that Mexico has lower average manufacturing costs than China, thanks to stable wage growth, sustained productivity gains and steady exchange rates.

The high labor-cost differential in Mexico allows companies to save on wage and fringe benefit costs (e.g., healthcare, etc.). In addition, the actual indirect costs themselves are significantly lower in Mexico than in the US, Canada or the EU, leading to even greater savings.

***Q: How can a Mexico manufacturing location contribute to an overall long-term growth strategy?***

A: The Mexican government has clearly made free trade a priority, with 12 free trade agreements in place with 44 countries around the world. This makes Mexico arguably one of the most open trading partners in the world. So while NAFTA gets much of the attention due to the importance of the nearby US and Canadian markets, Mexico also gives foreign manufacturers access to key markets in Central America, South America, Europe and even Asia. But capitalizing on Mexico's free trade status with countries in those regions requires an in-country Mexico presence.

***Q: What is the track record of growth for Entrada's clients in Mexico?***

A: Over the past 15+ years, our clients in central Mexico have consistently demonstrated a pattern of long-term, sustainable growth. It is common for our clients to launch their Mexico operations, only to expand their footprint once, twice or three times over, during the course of a few years. They typically do this after gaining a better understanding of the productivity of the Mexican workforce and seeing firsthand the growth opportunity Mexico affords. They also appreciate that our unique campus platform enables flexibility and scalability to support such growth.

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***About Entrada Group***

Entrada Group guides manufacturers in establishing and running their own cost-effective Mexico operations, enhancing their global competitiveness. Our proprietary business platform reduces cost and risk, giving small- and medium-sized foreign companies a production footprint in Mexico, and empowering them to anticipate needs and deliver solutions to their clients, in an accelerated way.

On behalf of the manufacturer, Entrada Group assists with the strategic, legal and practical requirements of setting up operations in Mexico ; we also provide all ongoing non-production-related support (General & Administrative) services, which leaves our clients free to focus fully on their key competency: manufacturing great products.