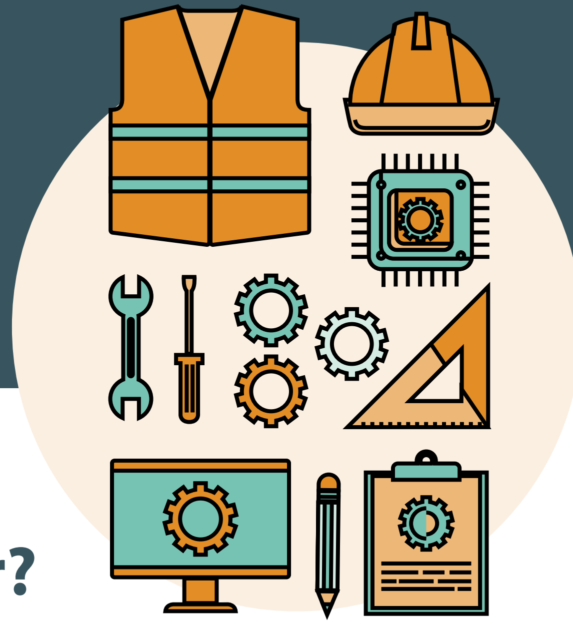
Entrada Group

WHITEPAPER



Are You Ready for the Next Crisis Around the Corner?

As the first headlines came in about a new illness sweeping through China, few could have predicted the global shockwaves that would be the Coronavirus. As case numbers rose dramatically, what started as a few days of nationwide disruption turned into months of quarantine. Things shut down in China first, with other nations close behind. Manufacturing practically ground to a halt in nearly every corner of the planet: Production slowed to a trickle, supply chains all but froze, and distribution and retail significantly decreased.

This global pandemic was unprecedented and swift, and the resulting supply chain delays were practically unavoidable. While nearly every player in nearly every industry was affected, companies that had invested in a globally diverse production base were in an infinitely better position than those that relied on manufacturing in a single region.

The pandemic reinforces a valuable lesson: operational diversification is not just a "nice to have;" it's a necessity. While no location is immune from a truly global pandemic like Covid-19, the tragedy exposed the vulnerability of companies that rely exclusively or largely on production in a single region or country. The next crisis on the horizon may affect a more limited geographical area, and companies with a diverse operational footprint will be in a better position to adapt quickly. There are a lot of reasons Mexico makes sense as part of such an agile manufacturing strategy, as this paper explores.

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Thinking Beyond Your Own Backyard

What type of existential or macro-level crises could potentially be most harmful to a company? Before addressing that question, it's important to distinguish between macro-level issues (such as political unrest, tariffs or an aging workforce) and those more operational in scope (including facility fires, power outages or union strikes). While both can be utterly debilitating to a company, most manufacturers have established contingencies for more operational crises.

This paper focuses on the more nuanced macro-level issues, of which many are beyond the immediate control of the manufacturer. For example, a company cannot solve a trade war. Additionally, the rapid advancement of globalization has pushed these issues to the forefront more than ever before, resulting in gaps and risks. While a company cannot prevent a tariff from being imposed, it can prioritize a presence in alternative low- or zero-tariff production locations.

According to Deloitte's whitepaper *Footprint 2020: Expansion and Optimization Approaches for US Manufacturers*, "many manufacturers expanded rapidly and deployed geographic assets in pursuit of singular objectives – to either increase revenues, or reduce costs, mitigate risk, gain access to talent,"[1] in recent years. As the aftermath of the global pandemic has proven, no country is completely devoid of risk, which means no matter how confident a company might be in its production platform, there are always impending dangers around the corner.

For Entrada Group's clients that produce at one of our Mexico manufacturing campuses, Mexico has proven to be a great complement to their operations, both in and out of a crisis. For example, companies with multiple manufacturing locations have the flexibility of quoting on projects from more than one facility, as well as the option of shifting production from one region to another, should a crisis emerge, whether a natural disaster, labor issue, or newly imposed tariff.

While Mexico is the most cost-competitive production location within the USMCA region, it has a lot of other strengths as part of a global production footprint, including a youthful workforce, proximity to the US and Canada, an open trade philosophy and outstanding logistics (for more detail on competitive advantages, see the "Mexico's Strengths as a Global Production Location" section, below).

Crisis Preparedness – A Matter of Survival

When an emergency strikes, small and midsized manufacturers have traditionally been more vulnerable than their larger counterparts, as many rely on production in a single location or region. "[Small and midsized enterprise] management teams don't have the bandwidth that large companies have in core functional areas to manage commercial pressures,"[2] according a 2020 McKinsey report. "This lack of capacity manifests itself in an inability to quickly adapt their supply chain and production processes."

[1] Deloitte Development: "Footprint 2020: Expansion and optimization approaches for US manufacturers," 2015.
[2] McKinsey & Company: "Setting Up Small and Medium-Size Enterprises for Restart and Recovery," 2020.

Reliance on a single production region or location exposes manufacturers to greater risk, with fewer options should a natural disaster or civil unrest, to give just two examples, occur. With crises in today's global world more frequent than ever, many companies are finding that level of risk too much to bear.

In a July 2020 survey of nearly 1,300 leaders from global manufacturing, 59 percent of respondents indicated they believe geographic diversification is the best way to prevent supply chain disruptions in the future.[3] Multiple production locations provide companies the needed agility to adapt to crises old and new.

TRADITIONAL RISKS

For the past two decades, manufacturing has changed considerably, largely due to globalization. Here are some of the most common and pervasive challenges manufacturers have been facing over that time:

ACCESS TO LABOR

In developed nations, manufacturing jobs are not as sought after as they once were, which means fewer young, skilled workers are entering the workforce in North America, Europe and elsewhere. By 2030, there could be a deficit of 7.9 million manufacturing workers,[4] according to a report from consulting firm Korn Ferry.

RISING COSTS AND TIGHTER MARGINS

Manufacturers must constantly respond to demands from their customers to sharpen their pencil and offer more for lower cost. In response, companies are turning to more automation (which requires capital investment) and/or to cost-effective production in faraway lands (which are further away from customers). Both of these solutions can be problematic for small-to-midsized manufacturers.

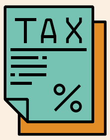
CHINA AS THE SOLUTION

In the past, China production helped solve the above two challenges. But over time, China's cost advantage over other countries has dissipated. Intellectual property theft in China is still a major threat to manufacturers too. Finally, consumers in many parts of the world are expressing a weariness to "Made in China," expressing concerns about Beijing's commitment to trust, transparency and human rights.

[3] 3D Hubs: "Supply Chain Resilience Report." 2020.
[4] Korn Ferry: "Future of Work: The Global Talent Crunch," 2018.

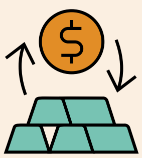
NEW DANGERS

In addition to the traditional issues, some newer risks have arisen that manufacturers now have to consider as well:



TARIFFS

Taxes have become a primary weapon in many developed countries' arsenal, hurting manufacturers in particular. In 2019, 69 percent of manufacturing leaders said they were affected by 2018 tariffs, compared to a global average of 54 percent,[5] according to Kroll's annual *Fraud and Risk Report*.

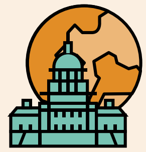


CURRENCY FLUCTUATIONS

Since abandoning the gold standard[7], many countries are at a higher risk of experiencing greater fluctuations in their currency, which can have detrimental effects on import and export pricing for manufacturers.

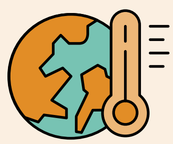
REGIME CHANGE

As political groups become more partisan, the shifts in economic policies from leader to leader have become more turbulent, resulting in larger shifts in financial burdens for manufacturing entities. This can include changes in taxes, minimum wage laws or newly enacted environmental policies.



GEOPOLITICAL ISSUES

A rise in populism and widespread access to social media platforms that greatly enable political organization has dramatically increased geopolitical risk across industries,[6] according to a study conducted by Ernst & Young. This can be incredibly disruptive, as these issues potentially lead to heavy regulation, expropriation of resources and uncertainty.



CLIMATE CHANGE

The effects of this danger occur on two fronts: rising rate of geographical disasters, and new consumer expectations for responsible manufacturing.

Rise in Natural Disasters:

Climate change has caused a dramatic rise in frequency of catastrophic weather events, increasing the danger for supply chain disruption. Between 2016 and 2019, the US experienced an annual average of 14 disasters causing $1 billion or more in damage,[8] more than double the annual rate of occurrence between 1980 and 2019, when adjusted for inflation.

The 2011 tsunami in Japan was a catastrophic event that damaged Japan's economy to the tune of $200 billion, according to the country's government. Interestingly, Nissan at the time was the only major Japanese auto OEM with operations in Mexico. Following the tsunami, Toyota, Honda and Mazda all announced the launch of assembly facilities in Mexico, to limit future supply chain disruption from the next natural disaster on the horizon.

Corporate Social Responsibility:

A heightened awareness about climate change from consumers and political figures has created a rising demand for companies to improve sustainability measures.[9] To risk alienating customers, companies are re-examining a raft of factors, including their carbon footprint, sustainability practices and supply chain infrastructure.

[5] Duff & Phelps, Kroll Division: "Global Fraud and Risk Report 2019/2020," 2019
[6] Ernst & Young: "Why You Need a Strategic Approach to Political Risk," 2019.
[7] Investopedia: "What is the Gold Standard," 2019.
[8] National Oceanic and Atmospheric Administration: "2010-2019: A Landmark Decade of U.S. Billion-Dollar Weather and Climate Disasters," 2020.
[9] WeThinkItMatters: "The Demand for Corporate Social Responsibility (CSR) in Today's Economy," 2019.

Mexico's Strengths as a Global Production Location

Mexico offers global manufacturers a lot more than just a counterbalance against production in China or issues in other parts of the world. Here are some of the superlatives of Mexico manufacturing:

• **Supply Base Diversity:** When Coronavirus first hit Asia, companies relying largely or solely on components or input from China had few production options. Many had to slow down or cease production lines. Mexico attracts suppliers, OEMs and raw materials suppliers from all over the world, however. This diversity provides companies already in Mexico the luxury of a range of sourcing alternatives, should a regional slowdown occur.

• **An Adaptive Currency:** The Mexican Peso has steadily devalued over decades, creating a situation that is both predictable and beneficial to overseas-based manufacturers. Since the spread of the Coronavirus pandemic, for example, Mexico's Peso has decreased as much as 30% in value,[10] which benefits companies investing in US or Canadian dollars, or Euros, and paying locally in Pesos. (Access our whitepaper about the benefits for manufacturers of Mexico's currency, on our website).

• **Track Record of Quick Recovery:** Entrada's Mexico-based clients have shown a track record of bouncing back from economic hardship rather quickly in the past, such as after the 2008-09 Great Recession. Due to its competitive operating costs, Mexico is a natural choice for restarting operations in more challenging economic environments.

• **Educated and Hardworking Workforce:** According to UNESCO, Mexico ranks eighth in the world with 114,000 annual graduates from the fields of engineering, construction and manufacturing. Further, the typical workweek in Mexico for an employee in manufacturing is 48 hours, versus the more standard 40-hour work week in much of the world.

• **Cost Competitiveness:** Labor costs in Mexico are on par with, or lower than, costs in China. In fact, in according to a Boston Consulting Group study,[11] Mexico is the second-most cost-competitive manufacturing export nation.

• **Proximity:** For US and Canadian companies, the ability to produce closer to their consumer market offers greater flexibility, insight and control. With shorter delivery times, companies can cut production lag time and be more responsive to changes in consumer tastes or seasonality, as well as reduce delivery costs. Also, Mexico is ultra-convenient for maintenance, support or engineering visits from the US or Canada. If a machine goes down or a replacement part is needed, an engineer can be in Mexico for repairs the next day. That isn't possible from Asia.

• **Free trade within USMCA:** One of the greatest assets Mexico can offer is its longtime status as a signatory to NAFTA (and now USMCA). Mexico-produced goods qualify for zero-tariff trade status (when rules of origin guidelines are met) with the US and Canada, two of the world's largest consumer economies. In addition, Mexico offers free trade with over 40 countries around the world.

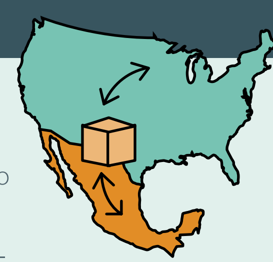
CHINA/MEXICO – NOT AN EITHER/OR EQUATION

A move to Mexico does not necessitate shutting down operations in China. In fact, by using both countries in tandem, manufacturers are better positioned to offer more for their clients and further mitigate risk.

Mexico manufacturing provides unbeatable proximity for companies that export to North America. That equates to greater consumer responsiveness and faster shipping times, which are essential in the "Amazon Era." Plus, companies can significantly

lower their own costs related to transportation, utilities, or many of the other 28 costs listed in the Reshoring Initiative's Total Cost of Ownership Estimator.[12]

From a strategic operational perspective, Mexico offers a great hedge against any issues a manufacturer may face with a facility in China. No matter the issue on the horizon in China -- whether rising landed costs, US tariffs, or extended delivery times due to rising demand – short- or long-term issues can quickly be mitigated by a facility in Mexico.



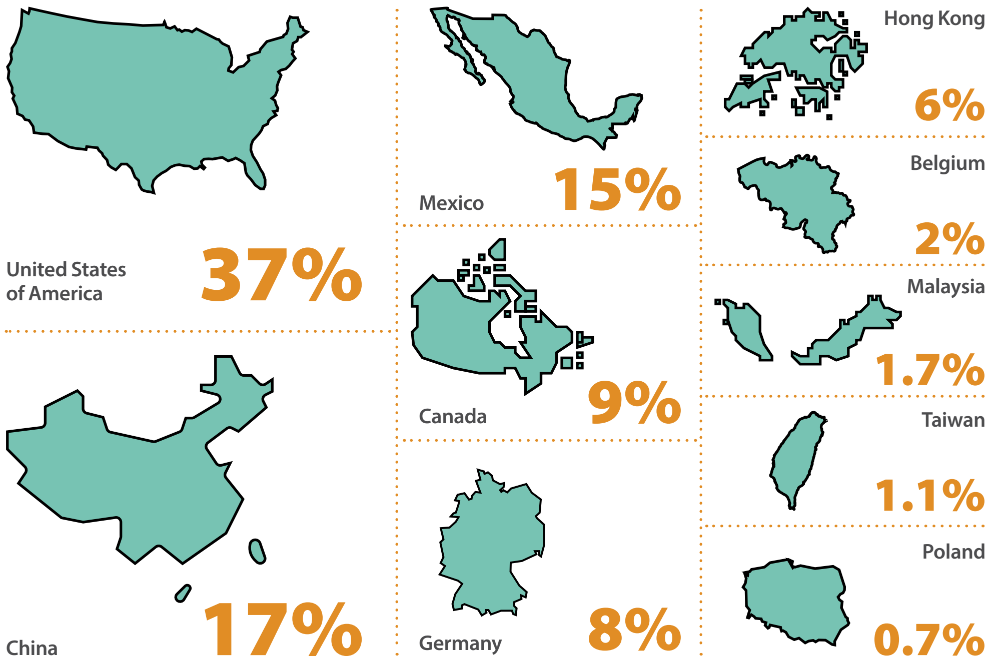
An example of one of Entrada's longtime clients, Premium Sound Solutions (PSS), illustrates an additional advantage of Mexico operations as a complement to production in China: Potential for new growth. Belgium-based PSS produces acoustics for automotive sector clients all over the world. PSS initially had manufacturing facilities in China, Malaysia and Europe. One of PSS's clients in the U.S., BMW, mandated that PSS establish operations in North America to be closer to the OEM.

To satisfy its important customer, PSS established its own Mexico operations at Entrada's manufacturing campus in Zacatecas, Mexico, as opposed to launching operations in the U.S. Not only did this footprint in Mexico enable PSS to produce speakers nearby BMW's U.S. operations, it also led to new opportunities. PSS in Mexico now produces for Volkswagen, Audi, Tesla and BMW, having grown to more than 700 employees in the facility, 650 more than at initial launch.

[10] Reuters: "Mexico's Weak Peso May Buffer Battered Economy, Lift Exports," 2020.
[11] Boston Consulting Group: "How Shifting Costs are Altering the Math of Global Manufacturing," 2018.
[12] Reshoring Initiative: "Total Cost of Ownership Estimator," 2020.

SUPPLY BASE DIVERSITY

2019 year-end breakdown of imports by nation to Entrada's clients in Mexico.



Entrada's Support Platform – Crisis Proven

Two concrete examples illustrate the added-value Entrada's clients realize during crises or in recovery periods following economic downturns (which are often triggered by crises). Without the full scope and economies of scale of Entrada's manufacturing support platform, it would be cost-prohibitive for our clients to take these actions on their own.

As part of its response at the outset of the Coronavirus pandemic, the Mexican government mandated that all workers be sent home from work with full pay. For small- and mid-sized manufacturers in Mexico, paying workers when the facility is idle represents a significant cost. So Entrada Group, which has a strong and longstanding relationship with the labor unions in the country, negotiated an alternative solution under which employees would be sent home and receive half their salary. This represented a cost savings for our clients of hundreds of thousands of dollars, during a time when production in the facility was either significantly slowed or halted altogether.

The 2008-09 Great Recession also showcases the scalability and flexibility that Entrada's clients appreciate as a hallmark of our manufacturing campuses. When the downturn initially hit, many clients experienced fewer orders and a slowdown, resulting in headcount reductions. Typically, manufacturing workers in Mexico are entitled to a severance package (which can be costly, depending on seniority) if they are let go by their employer. But our clients have a fallback: if a laid-off worker can be hired by another company within our manufacturing facility, no severance package is necessary. Companies were affected in different ways in 2008-09, and many laid-off workers were quickly rehired by other manufacturers on the campus.

Similarly, in 2009 when hiring picked up again, companies needed to staff up in a hurry or risk losing orders. As the economy improved, Entrada group was able to hire as many as 200 people per week during the height of the recovery. Small companies on their own would have a hard time processing headcount changes at that volume.

Advantages of The Entrada Platform, At Any Time

No country is risk-free and Mexico certainly has its share of dangers and impediments to growth. For small and midsized manufacturers in particular, adding a production location in Mexico makes a lot of sense strategically but it may seem too risky, costly or unattainable. This is where Entrada's manufacturing support platform comes in, as we take full responsibility of all non-production related (General & Administrative) support required in Mexico.

Clients at either of our Mexico manufacturing campuses (over one million square feet of manufacturing space in Zacatecas and Celaya) are able to avoid the hurdles and hassles other companies would have to endure if they were to establish and run a Mexico facility on their own. For example, our clients can be operational in Mexico in as little as 90 days, compared to companies that opt to setup Mexico operations on their own, and require years to complete all the requirements, from site selection to compliance to workforce development, and on and on.

Through Entrada's manufacturing support platform, our clients bypass the obligation of establishing a legal entity of record in Mexico. The time-consuming requirements to optimize import/export? Our clients don't have any of those hassles, because Entrada takes care of everything. Triple A certifications, IMMEX licensing, OEA obligations…all are already established and operational when our clients join the fold. And our decades of expertise in Mexico mean our clients don't have to worry about the hefty fines or delays often incurred by overseas manufacturers new to Mexico, that inevitably make mistakes in compliance management.

Our clients have access to over 100 subject matter experts with deep knowledge in numerous areas of Mexico manufacturing, from continuous improvement and government relations, to community relations and finance. We even handle human resources, sourcing the best direct and indirect talent our clients require to optimize their production. With a labor force of more than 6,000 people, Entrada is an employer of choice in the local community. That means our clients are able to tap into the same excellent reputation and brand recognition. Finally, our manufacturing support platform offers complete adaptability and flexibility, as clients can scale their footprint up or down as production needs fluctuate.

While there may not be a crisis like the Coronavirus pandemic again in our lifetime, there are sure to be more disruptions that will affect production at a global scale. Whether a hurricane, tariff or political unrest, it is important to be have contingencies in place that will better position your company to face an emergency. Mexico is the smartest and most cost-competitive production location in the Western hemisphere. When combined with the additional strengths and flexibility of Entrada Group's manufacturing support platform, it gives companies optimal agility in the face of any crisis.

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