

## Mexico in a nutshell

**Population:** 105 million

### Trade agreements:

Member of North American Free Trade Agreement (NAFTA) which grants reduced and zero tariffs between member nations, (US, Mexico, Canada). Sees complete tariff elimination by 2007.

Mexico-EU trade agreement since 2000.

### Main industries:

Include leather, footwear, chemicals, textiles, clothing, motor vehicles.

### Economic characteristics:

Highly export oriented, manufacturing driven economy, extremely reliant on US which is the destination for 87% of all exports. Competes with Asian economies, especially China. Economy currently in doldrums. Peso currently heavily devalued and unemployment rising. Manufacturing costs also rising giving some multinationals reason to look at

relocating to China (e.g. Delphi Electronics). Large clusters of manufacturing operations on US border, especially components for electronics, automobiles, aeronautical, engineering.

Leather and shoe industry mainly concentrated in the Guanajuato and Jalisco regions.

### Market advantages:

- Highly developed trade agencies.
- Highly export oriented economy; therefore lots of incentives, e.g. 'Sheltered Maquilas' for foreign owned export oriented businesses.
- Business-friendly government (National Action Party) under President Vicente Fox. Less bureaucracy than in China, less potential for product counterfeiting.
- Big market in own right (population of 105 million).
- Strong links to US market.
- Business opportunities presented by fast expanding infrastructure. Lots of opportunities for Public Private Partnerships.

### Market disadvantages:

- Dependence on US economy and therefore vulnerability to US trade policy (textiles).
- Peso tied to US dollar. Price of exports increases dramatically when dollar/peso rate strengthens. Conversely, vulnerability of goods sold in sizable domestic market in times of cheap Peso, like now.
- Social problems attached to the manufacturing shanty towns on US border.
- Smuggled and under-invoicing of imported goods a problem.
- Big environmental problems, lack of hazardous waste disposal facilities, natural fresh water resources scarce.

Mexico remains a good staging post for importing into US. Good for 'higher end' manufactured products such as auto and electronics components, also services into US and domestic market. Lower tech goods such as footwear and textiles can be manufactured much more cheaply in China.

# Mexico's leather industry in the current environment

The Mexican leather sector became important for the local economy when the footwear industry was born and, therefore, it is intimately linked to shoe production. Latterly local leather supplies have not been enough to serve the shoe industry due to a reduction in cattle numbers.

The leather industry has improved its chances of growth and, before the current stagnation of domestic demand, was reorienting its promotion and development efforts towards other countries, mainly Asian.

In general terms the leather and footwear sector contributes just 1.1% to manufacturing GDP. This is a reduction on previous years showing that the sector is falling behind compared with the rest of the Mexican economy.

In 2003 the reduction in exports continued due to lower foreign demand, mainly from the American market, the destination for 90% of Mexico's exports of leather and leather goods.

The Mexican leather industry is seeking solutions by trying to export footwear

leather to non-US markets including China, and by trying to diversify into non-footwear leather types. Based in Leon, CUINBA has done just that and is now one of the most important local suppliers of upholstery leather and leather seats to the motor industry.

### Looking ahead — prospects for 2006

According to the government of the State of Guanajuato, the leather industry is doing its best to:

- Achieve specialisation in two or three market sectors;
- Make the industry known as part of an entrepreneurial quality culture characterised by its market approach and its creativity;
- Raise environmental awareness within the sector;
- Generate high added value products in anticipation of market needs and exceeding all expectations;
- Specialise in working from wet blue or crust by having it contract tanned or bought in.

### Looking way ahead — prospects for 2025

- Position the industry in the local and international markets;
- Assure that companies operate without damaging the environment;
- Become leaders in two or three market niches.

### Challenges

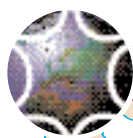
- The main challenge faced by the leather industry is to produce quality leather to supply the local shoe and leathergoods factories so that imports from Central and South America can be replaced by locally manufactured goods;
- To adopt non-polluting production processes.

### Strategies

- To increase productivity and quality through training and new technologies and production processes;
- To create modular groups of small companies to manage sales and purchases more efficiently;
- To support specialisation and generate high added value production.

### Acronyms used in this paper:

INEGI – National Institute of Statistics, Geography and Information Technology; SDS – Secretariat of Sustainable Economic Development; PROCIC – International Competitiveness Program for the Leather and Shoe Supply Cluster; KS – Key Step; CICEG – Chamber of the Footwear Industry of the State of Guanajuato; COFOCE – Foreign Trade Promotion Co-ordinating Division; BANCOMET – Foreign Trade Bank CIEEX – Centre for Innovation in Exports.



## Country Commentary: Mexico



### Footwear: recent evolution and prospects

The footwear industry will keep showing signs of weakness when it comes to increasing production and exporting.

| Description of the sector                                                      | Figures        |
|--------------------------------------------------------------------------------|----------------|
| Industrial added value - Textiles, Garments, Leather and Footwear (GDP%)       | 2.7%           |
| Number of shoe factories                                                       | 3,245          |
| Direct jobs                                                                    | 118,290        |
| Exports, data by COFOCE                                                        | \$66.5 million |
| % of total exports (Guanajuato State)                                          | 2.7%           |
| <i>*2000 data prepared by S.D.E.S. based on information supplied by INEGI.</i> |                |

This situation is due to the lack of vertical integration in the sector that puts it in a highly vulnerable position in terms of exchange rates, international competition

and the domestic economic environment.

However, it must be stressed that the Mexican footwear industry generates 100,000 direct jobs but if we look at the sector as a whole we will see that the leather and shoe production chain employs over 500,000 people. This explains why it has such a high social impact.

million in 2001. In the last few years, the average annual import growth rate has been 30%.

### Number of exporting companies

There are approximately 4,000 shoe factories in Mexico of which 82% are small or micro businesses. In the 1990s, there were around 1,000 exporting companies but numbers fell to 630 in 2001.

| Imports into Guanajuato State, January-September 2003 |                       | US \$ |
|-------------------------------------------------------|-----------------------|-------|
| USA                                                   | 121,872,812.26        |       |
| COLOMBIA                                              | 4,450,173.34          |       |
| ITALY                                                 | 4,290,157.65          |       |
| CHILE                                                 | 3,550,754.26          |       |
| URUGUAY                                               | 2,890,721.43          |       |
| SOUTH-AFRICA                                          | 2,492,360.64          |       |
| SINGAPORE                                             | 2,477,611.00          |       |
| SPAIN                                                 | 1,181,230.83          |       |
| CANADA                                                | 1,090,656.98          |       |
| BRAZIL                                                | 912,320.99            |       |
| GERMANY                                               | 774,670.84            |       |
| SWITZERLAND                                           | 667,920.68            |       |
| ARGENTINA                                             | 655,535.85            |       |
| INDIA                                                 | 557,787.54            |       |
| FRANCE                                                | 526,181.62            |       |
| NICARAGUA                                             | 486,945.61            |       |
| SOUTH KOREA                                           | 385,499.84            |       |
| TAIWAN                                                | 347,832.83            |       |
| AUSTRALIA                                             | 323,313.92            |       |
| THAILAND                                              | 295,532.05            |       |
| P.R. of CHINA                                         | 245,632.78            |       |
| THE NETHERLANDS                                       | 208,076.51            |       |
| OTHERS                                                | 896,483.04            |       |
| <b>TOTAL</b>                                          | <b>151,580,212.49</b> |       |

### Exportable offer

Mexico exports around 30 million pairs of shoes annually. It produces all sorts of footwear including safety shoes and cowboy boots but it is very competitive in the medium-high priced dress shoe sector.

### Mexican competitive position

According to the Competitiveness Ranking of Harvard University, Mexico fell from 42nd place in 2000 to 51st in 2001, putting the country well behind its main competitors of Spain, Italy, Brazil, Portugal and Korea.

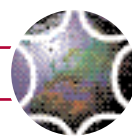
### Total imports and exports

In 2001, shoe exports generated a turnover of \$356.6 million, 11% less than in 2000 when exports reached \$404.9 million.

Mexico's main customer is the USA which imports 93% of its shoes, followed by Puerto Rico with 1.4%, Canada 1.0%, Cuba 0.7%, Guatemala 0.4%, Chile 0.4% and Costa Rica 0.3%, among others.

Imports have grown steadily from \$190.2 million in 2000 to \$271.2

| Leather exports from Guanajuato State, January-September 2003 |                      | US \$ |
|---------------------------------------------------------------|----------------------|-------|
| USA                                                           | 57,962,423.14        |       |
| CHINA                                                         | 7,374,192.09         |       |
| GERMANY                                                       | 4,073,131.71         |       |
| GUATEMALA                                                     | 1,820,693.06         |       |
| ITALY                                                         | 1,588,244.84         |       |
| SPAIN                                                         | 1,478,717.20         |       |
| TAIWAN                                                        | 1,041,745.92         |       |
| SOUTH-AFRICA                                                  | 1,012,697.96         |       |
| INDIA                                                         | 744,550.75           |       |
| CANADA                                                        | 535,608.36           |       |
| THAILAND                                                      | 490,673.87           |       |
| JAPAN                                                         | 466,542.82           |       |
| URUGUAY                                                       | 411,347.17           |       |
| CHILE                                                         | 305,242.10           |       |
| BRAZIL                                                        | 236,314.90           |       |
| PORTUGAL                                                      | 196,550.13           |       |
| SOUTH KOREA                                                   | 153,102.07           |       |
| AUSTRALIA                                                     | 111,566.20           |       |
| EL SALVADOR                                                   | 94,178.01            |       |
| PUERTO RICO                                                   | 77,014.38            |       |
| UK                                                            | 72,205.86            |       |
| OTHERS                                                        | 171,676.39           |       |
| <b>TOTAL:</b>                                                 | <b>80,418,418.89</b> |       |



# Mexico's international challenge

The world's main shoe importers grew 1% in 2001 but demand remained stable in 2002. Countries like China, India and Indonesia have consolidated their positions as large producers and their exports to European countries and the USA are drastically reducing export expectations of other countries such as Mexico.

China remains the world's largest footwear producer with exports reaching 3.1 billion pairs per year. On the other hand, Italy has reduced production but it still holds a prominent position as fashion leader and in the development of new materials and technologies.

## Main producers

In order of importance, China is the world's largest shoe producer with 5,500 million pairs per year. It is followed by India with 682 million pairs, Brazil with 520 million pairs; Italy with 425 million; Indonesia with 3.18 billion; Türkiye with 270 million and Mexico with 260 million pairs.

| Type of footwear | %   |
|------------------|-----|
| Ladies'          | 45% |
| Sports/athletic  | 19% |
| Teens'           | 17% |
| Mens'            | 13% |
| Leisure          | 4%  |
| Safety           | 2%  |

The USA, Mexico's main partner in international shoe trade, imported 1.4 billion pairs in 2001, of which 78% came from China, 7.8% from Brazil, 5.9% from Indonesia, 4.5 from Italy, 2.1% from Spain but just 2% from Mexico.

## The environment

ISO 14000 environmental management practices are a new competitive requirement in the shoe sector. Countries such as Brazil are quite advanced in ISO 14000 certification and practise implementation with good results in terms of sales in the leather and shoe industries alike.

## Current opportunities and recovery prospects

The situation of the shoe industry has remained very similar to that of 2002. China, India and Indonesia remain leaders in budget footwear production and, despite their excellent quality and impeccable finishing, countries like Italy and Spain have seen their growth expectations fluctuate in recent years.

In search of a place in the international market, CICEG – Chamber of the Footwear Industry of the State of Guanajuato has set up a pilot project for the development of exporting companies and international expert Peter Kern has been appointed to coordinate it. In a recent press conference, José Antonio Salim ➤ President of CICEG – presented the project and its coordinator.

Mr. Kern explained that 40 companies in the Guanajuato region are taking part in the international competitive quality pilot plan as of January 2004. The main aim of the project is for the participating companies to improve their skills exporting.

Mr. Kern added that the ➤ programme has the support of Bancomext and COFOCE – Foreign Trade Promotion Coordinating Division. He also said that the plan includes setting up a trade office in Germany and warehouses in the south of the United States.

According to Mr. Kern, the project is an initiative of the Mexican industry and does not depend on government funds. Over 100 companies were potential participants but, numbers were reduced considerably with 27 selected to take part in GDS. Participants in the plan have signed a commitment term and deposited the stipulated funds for kick-off.

There is no set deadline for the production of results but it is expected that 2004 will see some Mexican companies in the international scene.

Businessman Rubén Carmona appreciates the advantages of the plan: "Our company exports to the United States but we want to reach Europe as well and that is why we are participating in the project."

Engineer Salim Alle is quite satisfied that the Mexican industrial sector has shown slight recovery in the last few months, both in terms of production and employment. He added that, at the moment, expectations are more optimistic as the Federal Investigation Agency has managed to reduce the inflow of contraband footwear, leaving more room for Mexican goods in the local market.

Salim Alle recognises that international competition remains a challenge to overcome. "The answer to this and other challenges we currently face is to try and become more competitive in

the global market," he added. He also points out an increasing number of entrepreneurs are attaining higher productivity through PROCIC – International Competitiveness Program for the Leather and Shoe Supply Cluster.

The Mexican sports footwear sector is the one most hit by contraband from China. It is estimated that between 25 and 35 million pairs of Chinese sports shoes are smuggled into the country each year. This directly affects Mexican production which has been forced to reduce its output year on year.

At the end of the 1990s, overall Mexican shoe production was estimated at 200 million pairs per year. At present, it is believed to be approximately 175 million pairs.

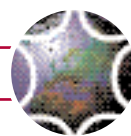
Figures supplied by the Mexican authorities show import numbers as follows:

In 2001 legal imports of footwear amounted to 18 million pairs, of which Taiwan accounted for 3 million and Brazil 2.6 million. By 2003 this had risen to 29 million pairs with Brazil rocketing to 9.2 million, Vietnam 5.6 million while Malaysia, Spain and Indonesia were each around 1.5 million. Taiwan had fallen to 1.5 million.

Despite being supplied by the Mexican Government, these figures do not reflect the current reality of the local shoe industry that is hit daily by the following problems:

- Contraband of 30+ million pairs per





year that must be added to official import figures;

- Contraband "in disguise" through underinvoicing;
- International sales by triangulation.

A well-known fact within the sector is that Chinese companies offer, in writing, to ship goods accompanied by Certificates of Origin issued by a country other than China in order to avoid the import quotas imposed by Mexico on Chinese goods at present and that will be valid through to 2006.

Prospects are that the Mexican shoe industry will see reduced production and increased imports over the next few years. If there were a gradual or full-scale border opening to Chinese legal imports the disaster would be even greater. However, the Government and the relevant sectors' chambers have put effective defence strategies in place and it seems unlikely that Mexico's borders will be opened easily.

It is public knowledge that China is putting pressure on the United States so that the shoe and textiles import agreements between China and the other two NAFTA members (USA and Canada) will be extended to Mexico that still limits imports from China through quotas. Peter Kern affirms that this has allowed Mexican companies to remain less efficient than

those in other countries with whom they are now competing directly.

Therefore, an indiscriminate opening of Mexican borders to Chinese goods in the short term is a very remote possibility, and especially as the textile sector is in an even worse state than leather and footwear. The main argument would be that it would cause a massive loss of jobs. Moreover, even the United States is starting to rethink the current broad opening of their market to Chinese goods.

The existing options are to select market niches for well-defined products favoured by the competitive advantages that are starting to emerge as well as trying to penetrate more select markets with higher purchasing power.

In the long term, the future of the Mexican leather and shoe industry is uncertain but the truth is that it has been going downhill for the last five years.

## Footwear: Guanajuato

Guanajuato is Mexico's main footwear manufacturing cluster but it is being threatened by its backwardness in some sectors.

The state of Guanajuato accounts for 55% of the national footwear industry. Prospects for the sector are as follows:

## Prospects for 2006

- To become one of the four main shoe exporters to the United States;
- The State of Guanajuato is to become Mexico's number one footwear manufacturing cluster and Mexico should rank between the first ten footwear exporters of a given product;
- The sector must be compact and specialised;
- Medium and small sized companies must have common targets;
- More local people must become involved in the shoe trade both in the domestic and international markets;
- To take advantage of market niches that require higher added value products.

## Prospects for 2025

- The State of Guanajuato should consolidate itself as one of the world's main producing and exporting regions of fashion shoes through a specialised sector;
- To identify forward-thinking entrepreneurs capable of adapting and reacting to market changes;
- To become leaders in at least one market sector.

## Challenges

- To detect market niches, sectors and

### 1. Conclusions of the Comparative Study Mexico-China, by Peter Kern and Ramón Ascencio

- Labour comprises less than the 2% of the cost of the product in China while in Mexico it is well above 12%.
- Even though there are no direct subsidies of the government for the firms, the conditions prevailing in the privileged zones provide them with certain advantages.
- In China, most footwear factory owners are Chinese that acquired experience in Taiwan and Korea. They are now effectively applying that knowledge and experience in mainland China.
- China was born as a manufacturer, with a know-how ad hoc to the world market demand and in just a decade has overtaken countries with a long shoe manufacturing tradition like Mexico.
- The technologies and interests of the international footwear world have been poured into China, such as Italian design, machinery and international advanced systems, brands and negotiations of the owners of the world market. All that has increasingly concentrated the manufacturing of parts and components in China and this may be irreversible for a long time.
- The American and European markets depend on Chinese footwear for popular consumption, so they have given up the manufacturing of low-priced products. Instead their companies have migrated towards high-value markets and products.
- It should be the same for Mexico. If the country wants to keep the domestic market as well as exporting, it should aim at manufacturing high added value products and in smaller quantities products for specialised markets as well as provide an excellent service.

### 2. Characteristics of the Mexican Entrepreneur

- He has relied on the protection of high import tariffs for too long and this has prevented him from achieving the same level of competitiveness as the rest of the world.
- He is geared to the product, not the market.

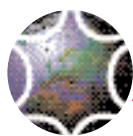
- He does not realise that he must change the culture and skills of the whole business, and that this means he himself must change as much as his employees.
- He does not travel nor is he really interested in what is going on in the outside world.
- He wants high profit margins while in the rest of the world the fight is on for margins below 6 percent on sale prices before tax.
- Usually his personal life lacks discipline.
- He lacks medium or long-term plans.
- He lacks passion for what he does.

### 3. Opportunities for the Mexican Footwear Industry

- There is only one and it is called export.
- If the country wants to keep the domestic market and continue exporting it must target high value-added products for niche markets, and accompany this offering with improved levels of service.
- Welted mens dress shoes in classical styles.
- Casual mens shoes.
- Kids shoes of all types except budget.
- Comfort shoes of all types.
- Safety shoes with various degrees of specialisation.
- Bowling, golf, climbing shoes and shoes for other specialised sports.
- Cowboy boots when fashion requires them.

Source: KS. The study proposes negotiating reductions to the import quotas of Chinese footwear and that Mexican companies start assembling components from the Far East in their factories straightaway. This policy might lead to a loss of jobs, but it should help prevent additional losses.

Peter Kern fears that, if there is not a favourable reaction from Mexican footwear manufacturers, within six years only 10 percent of the existing companies will remain.



## Country Commentary: Mexico

products that benefit from the strengths of the local industry and develop them in the next five years;

- To successfully face the competition posed by China, Brazil and Eastern-European countries by offering more competitive products;
- Available funds should only be channelled to parts of the value chain where they can add value, and be related to the timing and implementation on the various trade agreements to avoid "rowing against the current";
- Footwear sales are in the hands of trading companies and very few companies sell direct to their customers. The queries then are: will trading companies come to Mexico and buy market sectors? What are the chances of footwear sales remaining in Mexican hands?;
- To benefit from the competitive advantage of the proximity to the United States and put in place logistics systems that reduce the cost of transport into the American market.

### Strategies

- To improve productivity and quality through training and new technology integration;
- To create integration models for small and medium-sized companies in order to make them more flexible;
- To develop collaborative agreements with

the various sectors of the production chain, stressing the importance of strategic alliances, promotion, new market penetration, design, fashion and supply;

- To protect the sector by fighting unfair competition;
- To attract additional investment to the production chain;
- To use the services of CIEX. 

#### The Mexican footwear marketplace 2001

|                                                              | Pairs                                |
|--------------------------------------------------------------|--------------------------------------|
| Footwear production (pairs)                                  | 210 million<br>(175 million in 2003) |
| Exports (pairs)                                              | 16,211,382                           |
| Imports (pairs)                                              | 8,925,712                            |
| Domestic consumption (pairs)                                 | 202,714,330                          |
| % Share of Domestic Consumption<br>(Footwear made in Mexico) | 95.60%                               |

Source: Data prepared by S.D.E. based on information supplied by CICEG.

#### Description of the sector 2001

| Description of the sector 2001                           | Figures |
|----------------------------------------------------------|---------|
| Total gross production (millions of pesos)               | 9,326.8 |
| Gross Added Value (millions of pesos)                    | 2,885.5 |
| Gross Added Value (% of industry total)                  | 8.9%    |
| Number of factories                                      | 3,548   |
| % of total number of manufactured goods factories        | 17.1%   |
| Direct jobs                                              | 66,688  |
| % of total direct jobs in the manufactured goods sector  | 28.8%   |
| Exports in 2000 (millions of dollars)                    | 2.7%    |
| % of total Mexican exports in 2000 (State of Guanajuato) | 20%     |
| % of total exports / production (1998)                   | 20%     |

Source: Bancomext.