Mexico Must Rise To The Challenge of Nearshoring

What China Did And What Mexico Must Do To Join The 'Factory Of The World' Club

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In the 30 years since the fall of communism, marked by the 1991 collapse of the Soviet Union and economic reforms in the People's Republic Of China, global poverty has plummeted to once unimaginable lows. According to the World Bank,[1] in 1820 94% of humanity lived in extreme poverty. By 1980, after 160 years of progress, that number dropped to 50%. Impressive. But by 2015 only 9.6% lived in extreme poverty, and that was achieved while the global population grew by 2 billion people. That means in only 30 or so years the human existence for the common man was transformed on a scale greater than the impact of both the industrial revolution (1760-1840) and great migration to the United States (1880-1920) combined.

A major contributor to this remarkable progress was China reopening its doors to the outside world in 1978 after a near total social, academic and economic self-imposed exile. When China emerged on the global scene, she was a bizarre conformity-cult on par with North Korea today, traumatized by 3 decades of successive tragedies. In the 1950s, under the new rule of the Chinese Communist Party (CCP), China simultaneously destroyed its industries and agriculture through preposterous socialist experiments under "The Great Leap Forward." This led to "The Great Chinese Famine," the largest famine in human history with estimates of up to 45 million people having starved to death in just 3 years (1959-1961). China's suffering culminated in yet another lost decade of vicious political infighting during the Cultural Revolution: a civil war stoked by rival CCP factions that pitted neighbor against neighbor. This 3-decade debacle only came to an end when Deng Xiaoping, the leader who succeeded Chairman Mao, announced to his people: "Black cat, white cat. If it catches mice, it's a good cat," meaning: the era of mindless and deadly posture-politics was over, to be replaced with results-oriented pragmatism.

Unwinding a society built on total control—from what you wore, to what you planted, to where you lived, to what you bought, to who you married—without mass displacement was no easy task. Facing this unprecedented challenge, Deng Xiaoping assured the people of China: "We shall cross the river by feeling for the stones with our feet."

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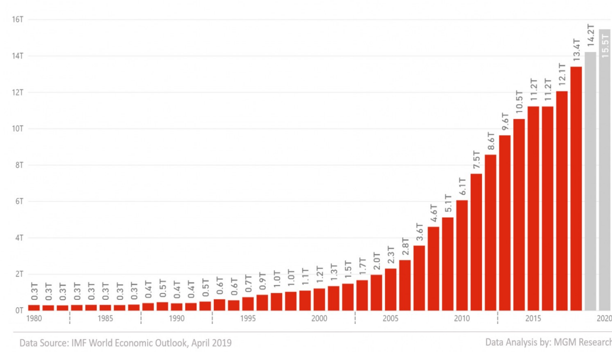
UNMATCHED SUCCESS

Two years after China opened its doors it had a GDP of around \$300 Billion, and after a long slow 20-year climb it reached the trillion-dollar mark only in 1998.[2] But a mere 7 years later, in 2004, China doubled its GDP to \$2 trillion. Rising to \$4.6 trillion in 2008. And in 2011 China's GDP surpassed Japan's making China the world's 2nd largest economy with a GDP of \$7.5 Trillion. Today, China's GDP stands in excess of \$18 trillion. The World Bank estimates that in the year 2020 China was responsible for approximately 28.5% of global manufacturing output.[3] Breaking this down, statista.com estimates that China makes 57% of the world's footwear, half of all plastic toys, 66% of Christmas lights and 90% of Christmas decorations. It also became the largest car market in the world in 2009, surpassing the USA in sales. 23.6 million passenger cars were sold in China in 2022, while US sales were just under 14 million vehicles.

China GDP 1980-2020

GDP in current prices (Trillions of US dollars)



At the same time Russia, a relatively well-educated and technologically and militarily advanced country, well ahead of China, also spent the 1990s sluffing off the shackles of statism and central planning. However, Russia has had nowhere near the exponentially greater economic success of China—even to this day. Why?

OVERSEAS CHINESE

A series of Chinese diasporas across southeast Asia, and to separated Chinese territories (British colony Hong Kong, Portuguese colony Macau, and Republic of China on Taiwan), that occurred over centuries created what is known as the Bamboo Network, consisting of ethnically Chinese-owned businesses across the region. It is a supernational society of often related wealthy ethnic Chinese, successful manufacturers and exporters, many with market access to the US and EU customers. To a large degree, these people initially brought opportunities through China's newly opened door in the form of manufacturing knowhow, funding and a route to market: open orders from western retailers. Russia, on the other hand, had no overseas Russians to lead the way out of communism with order books in hand. Consequently, Russia's transition from communist command economy to free market economy lagged far behind.

PUBLIC AND PRIVATE INFRASTRUCTURE INVESTMENT

Given the state in which the 3 lost decades left China, its economy had to be largely built from scratch. On into the 1990s the Chinese government was systematically breaking down the barriers left by the old communist structure, deftly managing to attract and steer infrastructure investment from abroad into basic systems: toll expressways, power plants, modern ports, railways, new airports and similar foundational infrastructure, much of it built by foreign investors and experts—and quickly. For its part, China invested growing tax revenue into things like economic zones, its banking system and relevant tertiary education, all under a more reliable and predictable administrative and legal structure.

This cleared the way for China's entrepreneurial class to step up and become a primary driver of

China’s exponential growth, which quickly surpassed the once monopoly government sector. According to Katharina Buchholz’s June 2021 Statistia article entitled *Private Sector is China's Main Economic Driver*: “Data gathered by McKinsey & Company shows that just in the past 20 to 25 years, the share of Chinese urban employment supported by private enterprises more than quadrupled from just 18 percent in 1995 to 87 percent in 2018.”

CHINA’S ENTREPRENEURIAL CLASS

Prior to opening its doors to business in 1978, you could expect a beating and imprisonment for setting up a food cart on a street corner in China, charged with being a “capitalist roader” and engaging in “counterrevolutionary activities.” The general consensus among China watchers is that the defining moment when China’s people first felt safe, that things wouldn’t revert back to the bad old days, was in 1992 when, backdropped by Shenzhen City’s many rotating construction tower cranes and high-rise buildings under construction Deng Xiaoping announced: “This is correct.” And no one objected. Over those intervening 14 years there was a lot that had been done to restore trust among the Chinese people.

Shenzhen China Under Construction

While the Chinese Government and big foreign-expert companies took care of the large-scale industries such as major infrastructure, strategic heavy industries and prestige priority projects, it was up to China’s entrepreneurs to take the lead with light manufacturing. Learning from the overseas Chinese, they began building upon that early success by starting their own factories, creating factory towns such as Shenzhen, Dongguan, Fujian and Suzhou, to name a few. They became vertically integrated towns where components for making anything from hair dryers to coffee makers were being made just down the street. And if you didn’t know a nearby component supplier, one of your other suppliers did. Consequently, China’s light manufacturing sector became a nimble, finely tuned machine where you could lay a product on a conference table at a final assembler and within a short period of time have a bill of materials, identifying the specific components and their suppliers, a delivery date, and all under the “China price.”

THE BUSINESS CYCLE FINALLY ARRIVES IN CHINA

China’s 40 years of continuous economic growth was a remarkable achievement that brought nearly a billion of its 1.4 billion people out of grinding 19th century hand-to-mouth rural agrarian poverty into the 20th and even 21st century standards of living. But China’s economic miracle has been facing significant headwinds both internal and external. One key internal factor (among many) is China’s one child policy that has inverted the population pyramid and will result in 200 million fewer working age adults by 2050. For perspective, when China entered WTO there were 10 workers for every retiree. By 2050 they’ll be only 2 workers for every retiree.[4]

An important external factor (in addition to others, such as the emergence of other low-cost competitors) is the impact of geopolitics. These range from an overdependence on volatile imported energy, to the ripple effect of essential Personal Protection Equipment (PPE) being held up during the Covid-19 crisis, to tariffs designed to decouple the USA from its dependence on China. All have conspired to incentivize factories to leave China, moving a significant amount of production into the Bamboo Network countries including Vietnam and Indonesia, and even non-network countries such as India and Bangladesh. But with Mexico having lower effective labor rates than China[5] and the USA being

China's single largest customer, why hasn't a much larger percentage of factories been relocated to Mexico?

THE CASE FOR MEXICO

Of the change in US imports from China 2017 to 2022, so far Mexico has picked up only about 5% of the business that moved out of China.[6] Why? One reason is that potential customers need a way to easily find Mexican manufacturers. In 1999, China's multi-billionaire Jack Ma co-founded Alibaba Group, a B2B e-commerce marketplace website. Until then, the only ways to find Chinese manufacturers was to attend trade shows such as the bi-annual Canton Trade Fair, or to hire a well-connected Hong Kong or Taiwanese pathfinder to navigate buyers to potential suppliers. If the Mexican government, or a smart private entity, wanted to do only one thing to accelerate Mexican manufacturing's integration into the global supply chain, creating a digital Mexican Thomas Register [7] would be it.

In the 1990s the mantra was: "Think global, act local," as multinational companies accessed customers in new international markets. But in the 21st century it is now: "Think global, act global." Mexican companies need to do their homework and own their supply chain—even across multiple continents.

But that is only half the job. There also needs to be a change of mindset amongst Mexican manufacturers themselves. They need to be ready to receive and respond to inquiries at "China speed." Speed to market is an essential element to putting forward winning quotes. Responsiveness to the customer's inquiries have to be a priority, and proposals need to be flexible and willing to modify manufacturing set-ups to be competitive on a worldwide basis.

Success in this area is about being nimble, agile and taking the initiative. In the 1990s the mantra was: "Think global, act local," as multinational companies accessed customers in new international markets. But in the 21st century it is now: "Think global, act global." Mexican companies need to do their homework and own their supply chain—even across multiple continents. They need to develop a supplier knowledge database and experience with raw material and component markets in Mexico. In doing so, they will develop an "ecosystem" of raw materials and components from Mexico. And if not Mexico, sources from Latin America. And if not Latin America (or in addition to), alternative sources from Asia…including China. The US customers are not going to do this for them. Only once they've mastered their "supply chain backwards," and are able to ensure raw material costs are optimized, can they consistently and repeatably beat the China price, win customers' confidence and deliver customer satisfaction.

Another reason Mexico isn't winning more China manufacturing is they also need to be more proactive in seeking out international customers. The factories may be in China, but their customers are north of the US-Mexico border. Mexico's competitive advantages with US customers is proximity, cultural similarity and membership in the USMCA. Manufacturers determined to win US business need to make a plan, add capabilities and meet these customers where *they* are. The fact, for example, that small DC motors that go into a whole host of electrical products aren't readily available from Mexican manufacturers isn't the customer's problem: it's Mexico's problem. If they want to win the business, these factories need to provide end-to-end supply chain solutions to these customers, not give the customer more problems while waiting for a purchase order. Being in a position to work with these US customers through all the issues of nearshoring will be the hurdle to clear that puts Mexico in a position to join the factory of the world club.

FEDERAL AND STATE GOVERNMENT'S ROLE

Like China's government once did, the Mexican government can do a great deal to enable Mexico's transformation from order taker to globally capable manufacturing powerhouse. They need to aggressively promote Mexico as an attractive investment destination by sponsoring more trade fairs in Mexico and represent Mexico in more commercial trade fairs around the world. State and federal government incentives need to be collaborative and coordinated to help competitively position Mexico for the global supply chain. And, perhaps most importantly Mexico must deal with its chronic security issues. The US State Department has issued "do not travel" advisories for 6 states in Mexico, for 7 states "reconsider travel," and for 17 states "exercise increased caution." Buyers, indeed, international expats who would accompany their company's investments into Mexico don't want to have to consider the costs of armed guards taking their executives and engineers to work and back every day, nor their kids to school. And where overseas Mexicans are concerned, family safety is among the top reasons for not moving back to Mexico to take advantage of this once-in-a-generation opportunity. This amounts to a brain drain that will inhibit Mexico's progress every bit as much as the lack of overseas Russians did for Russia.

Industrial Park In Mexico

In 2024 we're coming off a very successful 40-year global race to the lowest cost manufacturing around the world that has delivered unprecedented global prosperity. But with the lower-hanging fruit largely picked with that business model, and with the aforementioned nearshoring factors taking hold, the momentum has now shifted to the reliability of regionalization and the benefits of shortened supply chains. With interest in the US market at an all-time high driven by an energy crisis in Western Europe[8] from war in Eastern Europe, and the politicization and unpredictably of China supply looming, Mexico has a golden opportunity to quickly capture the title of "factory of the Americas" right next door to the US market—25% of global GDP. But like China's journey, it is going to take nothing less than a transformation in the way things are done. This transformation will not be achieved by a slow, deliberate, incremental approach, it will be achieved by greater speed, some risk taking, and re-imagining the future, and thus establishing Mexico as the factory of the world rather than a supplier of traditional products to the United States.

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Lawrence Allen spent 20 years leading consumer product businesses in the Greater China Region for the likes of Hershey and Nestlé. He formed **SA^{USA} Market Entry Services** (singaporeacademyusa.com/market-entry) in September 2020, and is a partner at **Mexico Strategic Sourcing Alliance** (mxstrategicsourcing.com). In 2010 he published ***Chocolate Fortunes: The Battle For The Hearts, Minds and Taste Buds Of China's Consumers*** (lawrenceallenauthor.com/chocolatefortunes) a market-entry China business book that chronicles the quarter-century battle between the world's chocolate companies for the hearts, minds and taste buds of China's emerging consumers.

END NOTES

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