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# RABOBANK INTERNATIONAL – MEXICO

*Ken Shwedel*

Why do firms want to invest? Probably one of the main drivers of investment in Mexico is the mature domestic markets in Canada and the United States. If you look at some of the things propelling the stock market, it is a necessity to firms to continue growing and that growth is in foreign investment.

### **Tax and Capital Policies are Important**

What do companies look for in direct foreign investment? This has already been presented in the Handy/Bamford paper. One of the things that should be emphasized is that tax and capital policies are very important. Tax and capital policies determine the mobility and flow of capital, and the ease of importing and exporting capital. The name of the game is profit and the ability to move monies out of the country as needed is an important criterion.

My particular belief is that the NAFTA document, from the Mexican point of view, is also an investment document. The free trade agreement protects foreign investment in Mexico and the ability to take that money out of Mexico. I would strongly argue that the concept of tax and capital policies is underrated in the analysis of business decisions.

### **The Relationship of Concentration to Market Power**

It was mentioned in the Handy/Bamford paper that the 100 largest companies control one-third of the foreign direct investment. Researchers analyze closely the concept of concentration and control. For example, when studying the Mexican and United States cattle industries, everyone looks at the size – the daily slaughter rates of the largest companies. The U.S. company, IBP, has a daily slaughter rate that in two days is more than the capacity of the largest company in Mexico. I believe that the important issue is the relationship of concentration to market power. The largest company in Mexico, in this case, has only 7 percent of the market. The concept of market power and concentration, and how they interact, are relationships which we need to look at as we go on.

There is a lot of structural change occurring in Mexico as exemplified by the opening up of the economy and increased competition. Structural change is an important part of the process in Mexico, and in other developing countries. Developed and the developing countries have to be viewed in a different context in relation to structural adjustment.

## **Direct Foreign Investment, Portfolio Investment and Privatization**

One of the issues which was not discussed in the Handy/Bamford paper is the relationship between portfolio investment and direct foreign investment. In 1995, when the devaluation of the peso occurred, portfolio investment left Mexico. At the same time, direct foreign investment stayed in country. This indicates that macroeconomic stability is one of the effects of direct foreign investment.

Another point mentioned in the paper is the necessity to attract direct foreign investment. Currently, in Mexico, there is a debate about the privatization of the electric utility industry. Foreign investors are saying that Mexico has to privatize because it needs to send a signal that the country is still privatizing and that structural change is still occurring. I ask the question, "Are we getting on a structural change/privatization merry-go-round?" There becomes a need to do more privatization to attract more direct foreign investment because of the need for more macroeconomic stability and before you know it, there is nothing left to privatize or change. The result may be an economy which is much more open, liberal and market driven that even the countries from which the direct foreign investment is coming.

### **Companies Have Three Choices**

In today's environment for a Mexican company with all of the changes taking place there are essentially three basic choices:

- It can go out of business.
- It can entrench, looking to be a strong player in a regional or niche market.
- It can grow into a national player.

Concerning the latter two choices, direct foreign investment can play an important role whether it be in terms of strategic alliances or joint ventures.

Something that needs more study and analysis is how companies choose strategic alliances versus joint ventures in the NAFTA context. Joint ventures I define as a marriage, and strategic alliances I understand as something like "living together." With strategic alliances, you try it out and see if it works and if it does not, you can walk away.

The Mexican food industry needs assistance in specialization, technology, financing, economies of scale, merchandising and management support. The concept of merchandising and management support was not discussed in the Handy/Bamford paper. Management support is a key area in countries such as Mexico which are moving away from a closed economy to an open economy. The knowledge of competition and how you compete is lacking in these countries.

Another area which is important is financing. One the errors of looking at credit policy is to compare the real interest rates in Mexico with real interest rates around the world. I believe that in an open economy, you cannot compare real peso

interest rates with real dollar interest rates. You have to adjust the peso rate to a dollar rate. Looking at the cost of domestic credit in dollar terms, Mexican companies' cost of money on the local market is two and a half to three times more than in the U.S. market. At the same time, financing is scarce, especially in certain segments of the economy. Under these circumstances access to financial resources becomes a significant factor in the decision by a Mexican to enter into an arrangement with a foreign company or investor.

In Mexico, there was an opening up of the economy which was not consistent across sectors; some sectors opened up faster than others. Few banks in Mexico have a track record in agribusiness. Although the Mexican financial sector is being opened up and banks are coming in, few banks are coming in with agribusiness expertise.

There is also a political cost for Mexico in direct foreign investment. The decision to allow direct foreign investment is a political decision with political costs. There is also a cultural cost.

## THE ALLIANCE PROCESS

*David Heilig*

In two years of studying business in Mexico and trying to identify new opportunities, I have gone through "the alliance process." It starts with examining previous alliances – people known to be doing business in Mexico. I give them a call and tell them I am coming down, and seek advice. That leads to another phone call and another meeting, and so on. It is no different than doing business in your own country. It is all about relationships; that is nothing new. People buy from people. During this development time, there should be a dedicated period of discovery and relationship building. These relationships and investigations should be done face to face.

The next step is education. Companies are often ill informed about other countries. My approach is to return to the United States and inform a company about what is available in Mexico, what was observed there, how forward thinking the contacts were, and how technically advanced, the businesses were. For example, many of the packing houses are more technologically advanced in terms of food hygiene and food safety than those of the United States.

The "alliance process" continues with achieving a thorough understanding of what goals are to be achieved. Business ventures must be guided by clearly defined objectives. If the objective is to make money, then the firm must have a strategy.