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Close, But Not Quite Home

Rising wages in China and a weak peso again make Mexico an increasingly attractive destination for manufacturing.

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The Trump Administration's contentious relationship with Mexico, possible changes to trade agreements and its public focus on American manufacturing has led some to reconsider moving jobs south-of-the-border. But what's often lost in the rhetoric and public relations arm wrestling is the growing trend of nearshoring.

As opposed to offshoring, where American jobs are moved to another country, or reshoring, where those jobs come back, nearshoring describes when an American manufacturer moves jobs from far overseas, typically China, to our North American neighbors in Mexico or Canada.

Rising wages in China, along with concerns over intellectual property rights, rising freight costs and the low value of the peso have made Mexico an increasingly attractive destination again for manufacturers looking to make labor-intensive products. Many of those new Mexican facilities come at the expense of American factories, for certain, but many will come at the expense of China's, or India's. And while President Trump's trade agenda has given some manufacturers pause, the nearshoring trend is likely to continue, says Harry Moser, founder and president of the Reshoring Initiative.

"Unambiguously, I'd rather have the work in the United States," Moser adds. "But there's some work that's so labor intensive, that no matter how much you automate it, it's a choice of China or Mexico. And the U.S. isn't possible because there are so many other competitors who will still be making it in China or Mexico, and you just can't do it."

Work coming to Mexico from China does have benefits for the American blue-collar worker, as well.

When a product is made in Mexico and shipped to the U.S., about 40% of the content of the product originated in the U.S., Moser says, because the supplier base isn't strong enough in Mexico to supply 80-90% of the components. As opposed to a product shipped from China, which contains only about 5% American components.

Moser says an ideal manufacturing relationship between the U.S. and Mexico would involve bringing the high-tech automation jobs back here to work in symbiosis with labor-intensive operations in Mexico.

"I think you could make all of North America dramatically stronger than it even is today," Moser adds. "If I were president, that's what I'd be doing, building a bridge instead of a wall, and working together for the benefit of all three countries."

Reasons for Nearshoring: Wages, Freight Costs and Proximity

The story is almost always the same when a company calls asking about nearshoring, says Source One Director and Head of Global Sourcing Diego De la Garza.

"They raise the fact that wages are increasing in China, that it's kind of hard to do business with Chinese companies for different reasons, including intellectual property concerns or even some of the labor conditions," he says. "Even things as simple as the time zone are a factor. For the most sophisticated companies, they were looking at options to increase the inventory turnover, to reduce the timelines, to be able to place orders a lot more frequently and have them turn around expeditiously. Sometimes that wasn't the case with a lot of Chinese companies that weren't flexible, or unwilling to accommodate."

Indeed, hourly manufacturing wages in China have risen by an average of 12% a year, according to The Economist. Those trending Chinese wages have eclipsed rates in Mexico, where hourly labor is now 40% lower, in dollar terms, than in China, according to a Bank of America Merrill Lynch study reported in Financial Times. It's a big reverse from 12 years ago, when labor costs in Mexico were about 183% higher than China's.

In addition to rising rates in China, manufacturers are also interested in bringing work to Mexico due to its geographical proximity. That leads to savings in freight and shipping, in addition to supply-chain efficiencies and reduced lead times.

"The main driver I see for why people are nearsourcing is really more towards customers, because customers are expecting more Amazon-like service," says Lisa Anderson, a manufacturing and supply chain consultant and president of LMA Consulting Group Inc. "It doesn't matter if they compete at all with Amazon, most of my clients do not. However, the Amazon-like service has become a standard. My manufacturing clients, whether they're in aerospace and have a really long lead-time—or in some cases they're in food or building products and their lead time is really short—regardless, their customers are expecting about a 50% reduction in lead time. They're expecting really rapid deliveries, they're expecting 24/7 types of service levels."

Safety Concerns in Mexico

Manufacturers still see Mexico as a desirable place to operate, but its perception as a dangerous place persists. In 2014, 55% of the senior-level, North American manufacturing executives surveyed by AlixPartners said they expect improvements in safety/security in Mexico. The following year, 2015, that percentage dropped to 42%.

"So, companies are still hesitant to send their managers and their own U.S. workers down there for extended periods, because of risk," Moser says.

De la Garza's experience talking with executives reflects the survey.

“A lot of the questions I get asked are related to the ‘state of the state,’ in other words: corruption and cartels,” he says. “When you talk about nearshoring, from a purely financial and supply-chain standpoint, it is a no-brainer. A lot of companies understand the values and appreciate the benefits that are associated with it and want to jump on it. But at the same time, they are raising legitimate concerns with safety. Do I have to bribe a government official so I can get my company properly set up in the system? Or, do I need to be concerned with my employees working late at our manufacturing plant because they’re going to get kidnapped? Or is a drug cartel going to come in and set the place on fire?”

De la Garza’s advice is the same no matter what country a manufacturer is considering: know your business.

“Do your due diligence as you proceed with identifying companies you want to partner with,” he says. “If you’re in contract manufacturing, due diligence is critical, because there are some areas in Mexico that are highly unsafe, but that probably equates to 5-10% of the entire territory. The rest of it is extremely competitive, and it’s thriving. “

Trump Factor

De la Garza, Anderson and Moser all expect the trend towards nearshoring to continue during the new administration.

“I think (manufacturers) might at this point be more worried about the bad publicity than anything else,” Anderson says.

When the reduced cost of shipping from Mexico versus China is considered, in addition to the low value of the peso, any tariffs or trade penalties enacted by the Trump Administration would likely be nullified.

“The exchange rate is much more competitive than it was a year and a half ago, which means it’s a lot cheaper for companies that want to buy from Mexico,” De la Garza says. “I would think (nearshoring) is going to grow at a very rapid pace, I think companies are going to move with a lot of confidence.”

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