Food Processing in Mexico Attracts U.S. Investment

Charles R. Handy and Suchada Langley
(202) 219-0866 (202) 219-0689

Spurred by a growing economy and population, Mexico has created a favorable environment for foreign firms to sell and invest in. The U.S. food processing industry is responding to the opportunity. Exports to Mexico by U.S. food processing firms and sales by their Mexican affiliates now total nearly $7 billion annually.

Reforms Stimulate Trade and Investment

Mexico has opened the door wider to foreign investors and traders by unilaterally liberalizing its trade, foreign investment, and domestic policies.

Since its accession to the General Agreement on Tariffs and Trade (GATT) in 1986, Mexico has reduced its maximum tariff rate from 100 percent to 20 percent. Mexico has also substituted tariffs for nontariff barriers, such as import licenses and quotas, and has dropped import licensing requirements on several agricultural and processed food items.

Rules governing foreign investment have been liberalized. Under certain conditions, Mexico now permits 100-percent foreign ownership of firms in most sectors of the economy.

Maquiladoras are a prime example. Maquiladoras are firms in Mexico that primarily specialize in production for export. The Mexican maquiladora program is one of the world's largest export processing zones with special import and export duty rates. That is, imports from other countries used in processing or assembling finished products for export enter Mexico duty-free. If the finished product is re-exported to the United States, only the non-U.S. share is charged a duty.

Mexico is the third largest market for U.S. processed food exports, following Japan and Canada. While the climate is ripe for increased exports, there are several advantages for using direct investment strategies over exports to access the Mexican market.

The authors are agricultural economists. Handy is with the Commodity Economics Division, and Langley is with the Agriculture and Trade Analysis Division, Economic Research Service, USDA.

The maquiladora program is being liberalized. When established in 1965, maquiladoras had to be located within a 20-kilometer strip along the U.S. border. Now maquiladoras can be located anywhere except in major urban areas of Mexico City, Guadalajara, and Monterrey. These firms may now sell a third of their output in the domestic market. Licensing is also easier, and investors from all over the world may establish plants. The United States remains the major investor.

These reforms have stimulated the Mexican economy to achieve an average annual real growth of 3.8 percent during the past 3 years. Exports from maquiladoras have grown over 20 percent. These plants number 1,699 and employ over 400,000 workers. Wages are up too. Wages (in U.S. dollar terms) doubled between 1983 and 1990, but were still lower than in the United States or Canada.

U.S. Food Exports to Mexico Increase

Mexico's population is growing, and is expected to expand from 89 million in 1991 to about 109 million by the year 2000. With an expanding economy and growing population, Mexico's demand for food products is increasing.

Mexico is the third largest market for U.S. processed food exports, following Japan and Canada. Mexico accounted for 8.5 percent of U.S. processed food exports in 1992, and that share is growing. Such exports to Mexico grew from $991 million in 1988 to over $1.9 billion in 1992—an average annual growth rate over 22 percent (fig. 1).

Meat and poultry products, including hides and skins, are by far the largest U.S. export category, accounting for 41 percent of total U.S. processed food exports to Mexico (fig. 2). The plant and animal fats and oils group constituted 15 percent. Grain mill products (including prepared feeds and pet foods) accounted for 12 percent of total processed food exports to Mexico, followed by dairy, sugar and confections, beverages, processed fruit and vegetables, and miscellaneous foods.

Figure 2

Meat and Poultry Products Are by Far the Major U.S. Processed Food Exports to Mexico

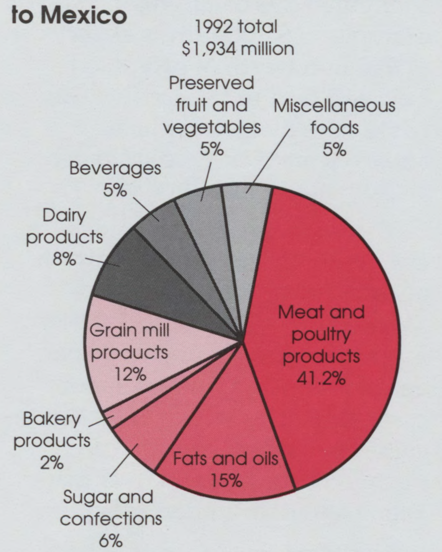
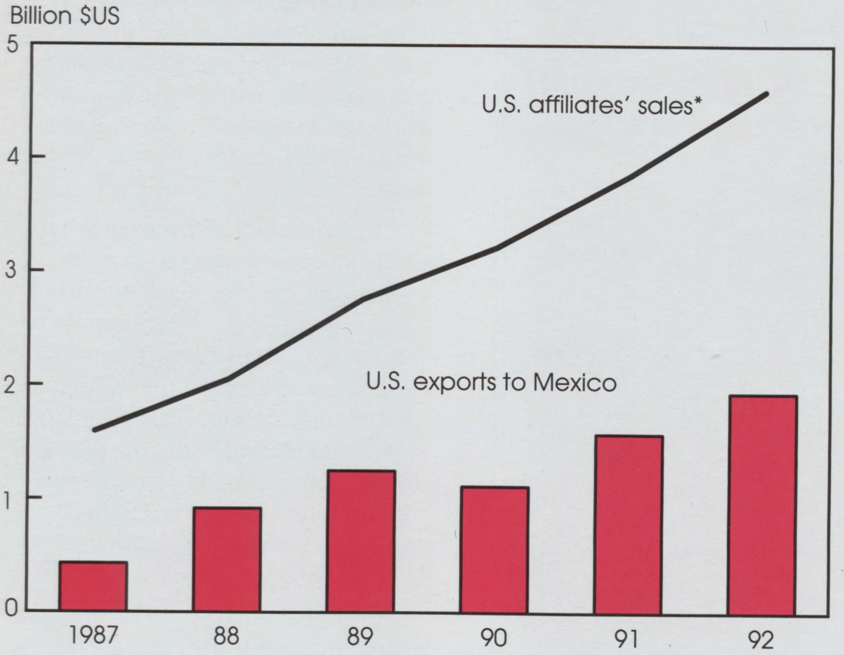


Figure 1

Processed Food Sales in Mexico by U.S. Affiliates Dwarf the Near18-Percent Annual Increase in Like U.S. Exports to Mexico



*1991-92 estimated.

Among individual processed food and feed industries, meatpackers are the most important U.S. exporters to Mexico. The poultry and egg processing industry ranks second, followed by soybean oil production, wet-corn milling, condensed and evaporated milk, and the animal and marine fats and oils industry.

Direct Investment Preferred Over Exports

Although U.S. exports of processed food to Mexico have increased markedly, many U.S. food firms are concentrating on direct investment strategies to increase their presence in the Mexican market. The proposed North American Free Trade Agreement (known as NAFTA), which would further improve Mexico's incomes and the investment climate, would likely strengthen this commitment. For example, U.S. food firms exported $1.9 billion worth of processed food and feed to Mexico in 1992, while sales by their affiliates in Mexico were over twice as much—an estimated $4.6 billion (fig. 1).

There are several advantages to U.S. food processors using direct investment strategies to access Mexico and other foreign markets. In addition to avoiding trade barriers and reducing transportation costs, U.S. firms with production facilities in the host country can maintain better control over marketing and distribution activities.

The Mexican Government now actively encourages foreign investment from the United States and other countries. The Mexican Investment Board, a joint project of the Mexican Government and the private financial community, provides information on labor, advises on viability of projects, refers investors to bankers, helps cut red tape, and sets up meetings with government authorities. With liberalized foreign investment laws, lower trade barriers, and good prospects for a trade agreement, Mexico has become far more attractive to U.S. and other foreign investors.

U.S. Affiliates' Sales Rising High and Fast

Sales by U.S. food processing affiliates in Mexico are rapidly growing. For example, U.S. affiliates' sales in Mexico increased 34 percent between 1988 and 1989, compared with increases of 8 percent in Canada, 20 percent in Europe, and 15 percent overall. Affiliate sales in Mexico continued to grow 17 percent in 1990 and an estimated 20 percent in 1991 and 1992. Such increases have resulted in Mexico ranking as the eighth largest host country for U.S. affiliates. Among the top 10 host countries for U.S. affiliates, Mexico is the only developing economy.

In 1990, U.S. firms maintained 30 food processing affiliates in Mexico, each with sales of at least $3 million. Average sales per U.S. affiliate increased from $55.4 million in 1988 to $107.3 million in 1990. Of the 30 U.S. affiliates, 8 were fruit and vegetable processors, 6 in the grain milling sector, 5 in beverages, 1 in dairy, 1 in meat processing, 1 in baking, and 8 in "all other," which includes sugar, confections, fats and oils, snacks, seafood, and other food preparations. These affiliates employed 48,100 people in 1990, up slightly from 48,000 in 1987.

Typically, U.S. parent companies hold the majority share in ownership of their food processing affiliates. Across all countries, 73 percent of U.S. affiliates are majority owned. This percentage drops significantly for Mexico, where only 56 percent of U.S. affiliates are majority owned. This share should increase given Mexico's recent liberalization of foreign investment regulations.

U.S. Affiliates Produce for the Mexican Market

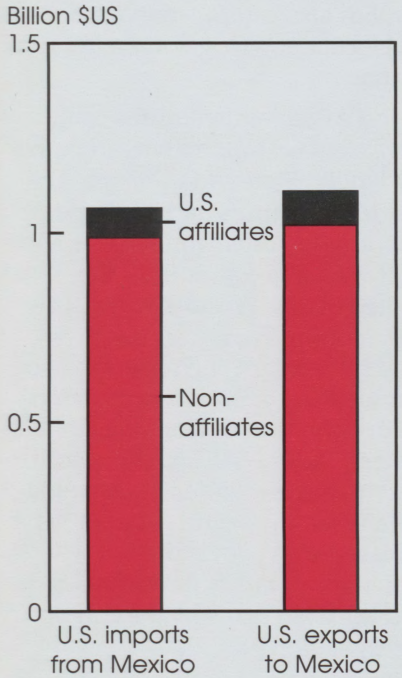
With a few notable exceptions, U.S. affiliates in Mexico produce primarily for the domestic market rather than for export to the United States. U.S. firms are transferring some production, marketing, and technology resources to their Mexican affiliates and joint-venture operations. These firms generally are more interested in Mexico as a rapidly growing market than as an export platform.

Merchandise trade between the United States and Mexican affiliates is surprisingly small. In 1990, U.S. imports of processed food from Mexico totaled $1.063 billion. Of this amount, only $74 million, or 7 percent, came from U.S.-owned Mexican affiliates (fig. 3). The same holds true for other countries. U.S. processed food imports from U.S.-owned affiliates worldwide totaled $1.289 billion in 1990, which accounted for only 6 percent of all processed food imports.

Likewise, U.S. firms export relatively small amounts to their foreign affiliates. U.S. firms exported $87 million worth of processed food to their Mexican affiliates in 1990. This accounted for 7.8 percent of total processed food exports to Mexico. Worldwide, the percentage is higher. About 9 percent of the total $19 billion in U.S. processed food exports in 1990 went to U.S. affiliates.

An obvious exception to this pattern of limited trade between affiliates and their U.S. parent compan-

Figure 3
U.S. Trade with Food Processing Affiliates in Mexico Is Small



Note: 1990 data.

ies are the maquiladora plants. Food and feed products exported to the United States from maquiladoras totaled just $145,000 in 1989 but rose to $490,000 in 1990. The duty-free U.S. portion also expanded—from 35 percent in 1989 to 62 percent in 1990. Products exported include canned, frozen, and dehydrated fruit and vegetables; meats (including sausage casings); seafood; candy; and salty snack foods.

Major U.S. Food Firms Have Affiliates in Mexico

Data from various company reports show that in 1992, 19 large U.S. food processing firms had 45 affiliates or joint ventures in Mexico's food and feed processing sector (table 1). Some U.S. food processors have operated in Mexico for many years; others have just recently entered. Several small U.S. food processors also have ownership interests in food processing plants in Mexico.

Ralston Purina has operated prepared feed and pet food plants in Mexico for several years and has just built a new plant to manufacture ready-to-eat cereal. CPC International operates a corn refining plant and consumer products plants producing salad dressings, oils, margarine, and other products. Kraft General Foods, owned by Philip Morris, manufactures a variety of frozen foods, dairy products, and other packaged foods at its three affiliates in Mexico.

Pilgrim's Pride Corporation, headquartered in Texas, is the second-largest chicken processor in Mexico. Pilgrim's Mexican operations include three feed mills and three chicken processing plants, as well as breeding, hatching, and grow-out facilities.

In 1990, PepsiCo greatly increased its investment in Mexican food processing plants. In addition to owning a concentrate syrup plant, PepsiCo is Mexico's largest salty-snack processor and cookie manufacturer. Total sales from PepsiCo's food processing affiliates in Mexico substantially exceed $1 billion.

Campbell Soup operates two plants in Mexico, which produce a variety of canned and frozen vegetables and other food ingredients. Campbell exports tomato paste and other ingredients from its Mexican affiliates for use in its U.S. operations. Universal Foods owns two food flavoring and coloring plants. Quaker Oats operates a cereal and a chocolate products plant and is expanding its sports drink operations. RJR Nabisco re-entered Mexico in 1992 by acquiring Lance, a Mexico City-based manufacturer of biscuits, pasta, flour, and cake mixes.

U.S.-owned companies dominate maquiladora food processing firms. In 1991, 37 U.S. food processing companies operated under

Table 1
Ralston Purina Is the Leading U.S. Food Processing Firm With Affiliates in Mexico

U.S. company	Number of Mexican affiliates or joint ventures
Ralston Purina	10
Pilgrim's Pride	6
CPC International	5
Philip Morris (Kraft General Foods)	3
Campbell Soup	2
PepsiCo	3
Quaker Oats	2
Universal Foods	2
Coca Cola	1
Bordon	1
Kellogg	1
Hershey Foods	1
McCormick & Co.	1
Gerber Products	1
Tyson Foods	2
Sara Lee	1
RJR Nabisco	1
Cargiel/Excell	1
J.R. Simplot	1

maquiladora programs. Most of these companies are small. Larger companies with maquiladora food processing firms include Campbell Soup, Kraft General Foods, and Frito Lay (part of PepsiCo).

Several large foreign-owned food processors in the United States have food processing affiliates in Mexico. These firms include Green Giant/Pillsbury, owned by Grand Metropolitan (United Kingdom); A.E. Staley, owned by Tate & Lyle (United Kingdom); and Central Soya, owned by Gruppo Ferruzzi (Italy).

U.S. Firms Also Concentrate on Joint Ventures

Some firms participate in joint ventures with Mexican companies. McCormick has a longstanding joint venture with a Mexican firm that produces McCormick-brand mayonnaise and spices. Gerber also has a joint venture that produces its baby food products for the Mexican market.

Tyson Foods developed an innovative joint venture with the Mexican firm Corporacion Citra and with C. Itoh & Co., Ltd. of Japan. Tyson exports whole broilers from its U.S. plants to Citra, where the broilers are deboned and further processed. Citra then exports the finished product to Japan, where it is distributed by C. Itoh. Tyson provided technological assistance to Citra to develop new deboning and further-processed poultry processing plants.

Tyson recently expanded its Mexican operations by entering into a second joint venture with Trasgo SA de CV, a major Mexican poultry producer/processor. Tyson's joint ventures augment rather than supplant its U.S.-based deboning and further processing operations.

Other food processors are entering the Mexican market by developing joint ventures for distribution, rather than by investing in foreign production facilities. For example, Sara Lee recently signed a joint venture with Grupo Industrial Bimbo, Mexico's largest bread and bakery manufacturer. Bimbo is one of the few firms in Mexico with its own national distribution network. Bimbo will help Sara Lee distribute its many bakery and processed meat products in Mexico, while Sara Lee will help Bimbo distribute its bakery products in the United States.

U.S. food wholesalers, such as McLane Company (owned by Wal-Mart) and Labatt Food Service, are opening modern wholesale distribution centers in Mexico. Rykoff-Sexton, a leading U.S. foodservice distributor, formed a joint venture with Organizacion Imperial SA de CV. The company, called Foodservice SA de CV, will distribute processed foods, foodservice equipment, and nonfood supplies to foodservice firms in Mexico. Fleming Companies, the second largest U.S. grocery wholesaler, also recently signed a joint venture with Grupo Gigante, a leading Mexican supermarket firm. The joint venture, called Gigante-Fleming SA de CV, plans to open four to six large supermarkets in Mexico during 1992-93.

Entry by these and other firms will pressure Mexican distribution firms to modernize and reduce costs. Having access to more efficient wholesalers will help U.S. food processors penetrate Mexican markets, whether from their U.S. operations or from their Mexican affiliates. In addition, Wal-Mart and The Price Company have both formed joint ventures with Mexican firms to open several membership wholesale clubs in Mexico. These stores will be similar to the Sam's Clubs and the Price Clubs in the United States. The Wal-Mart-CIFRA, SA joint venture also plans to open 11 large supermarkets in Mexico by mid-1993.

Several U.S. restaurant chains have expanded into Mexico—mostly by franchises or joint ventures. KFC (owned by PepsiCo) is leading the way, with over 70 outlets in Mexico. Domino's Pizza has 45 units in Mexico, followed by McDonald's 35 restaurants. Also in Mexico, but on a smaller scale, are Subway, Arby's, Carl's Jr., Chili's, T.G.I. Friday's, Jack in the Box, Sirloin Stockade, and Taco Bell.

Increased Partnerships Benefit Both Countries

More U.S.-Mexico joint ventures may occur. U.S. investors currently provide capital, technical expertise, and, in most cases, management, while Mexico supplies mostly labor, but also capital, management, and local knowledge of market conditions.

Increased joint ventures could increase economic activity in both the United States and Mexico. The majority of inputs and equipment imported by the maquiladoras and joint ventures comes from the United States. Without increasing U.S. investment, other countries may fill the gap. Such firms may be less inclined to import raw materials or components from the United States. Under NAFTA, the special duty treatment under the maquiladora program would eventually be replaced by a provision that will eliminate all tariffs faced by U.S. and Mexican firms by the end of the transition period.

Small Direct U.S. Investment From Mexico

While U.S. firms are rapidly expanding into Mexico, Mexican direct investment in the U.S. food industry is very small. In 1989, sales from Mexican-owned affiliates in the United States were below $50 million.

A notable exception is Grupo Industrial Maseca SA de CV. Maseca controls over 60 percent of the Mexican corn flour market, and has recently expanded into Central America and the United States. Maseca now produces corn flour in at least three plants in the United States. It also produces tortillas in 12 plants in 5 U.S. States, and is looking to expand into several additional U.S. cities. ■