

Issue 5  
Summer 2011  
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## MEXICO WATER REPORT



### **Channel Market Strategies in the Mexican Water Segment (PART II)**

In the past edition of the Mexico Water Report, we discussed selling direct, through a local distributor, or via a local representative. Here we will analyze the pros and cons of selling through integrators, strategic alliances, and subsidiary offices.

#### **Integrators**

The use of local integrators for the sale of water products to the Mexican public sector is important and is becoming even more important for two reasons. First, a foreign manufacturer trying to sell into a Mexican public project must use a locally-based company, either a manufacturer, distributor, or integrator, in order to participate. Second, with the new national content regulation for government purchases, foreign products without significant (60%) local content cannot meet national requirements for direct sales. However, if these foreign products are incorporated into an integrated project, where local content in materials, services, and labor are viable/plentiful and where national content requirements drop from 60% to 40%, they can meet the regulations.

NAFTA supposedly protects U.S. and Canadian companies from this type of discrimination but many Mexican federal entities use this new regulation to create a de facto “Buy Mexico” policy for government procurement sales. It is also important to mention that if any federal funds are used for municipal and state purchases (probably 90% or more of all water segment purchases), national content requirements apply. The Mexican federal government is aggressively enforcing these new content provisions at the national level.

However, many Mexican distributors have had success convincing municipal water authorities to avoid formal bid processes when sourcing replacement parts and instead buying under the simplified process called “adjudicación directa”. Likewise, LGA Consulting is seeing that some municipalities are not enforcing the new national content regulations and thus allowing 100% foreign made products to satisfy their procurement needs of replacement parts. Nonetheless, while replacement parts might appear to be a better fit for distributors than integrators, integrators have begun to diversify their product and service mix so that they are capturing more and more of the service and replacement part business that used to be the domain of Mexican distributors.

With no national content requirements and no restrictions requiring Mexican-based company sales, sales of water-related products to private sector customers are wide open. In these cases, integrators

have some advantages in larger projects. However, private sector companies often are less interested in an integrated solution and more interested in price and functionality. Likewise, larger private sector companies are generally more capable of dealing with technology challenges in implementation and with multiple vendors for more cost effective solutions. While integrators can and are used for larger projects, medium and small projects or product purchases are more likely to be handled by local distributors, local representatives, or even direct sales from foreign-based companies.

The key to successfully working with an integrator is to not rely exclusively on the integrator to market and promote your products in the market. Integrators too often reach for the least expensive, functional product to put into the mix of their integrated system or project in order to provide the client with the most cost effective solution. Unless your product happens to be the lowest cost, functionally viable product in the market, either your direct sales force in the United States or local independent reps is going to have to help drive sales and marketing efforts in country. This is the only way to ensure that the end-user is fully aware of your product's cost-benefit and that your product is duly pulled through by the integrator. With this support, it is really just a matter of time before your integrator is talking with your lower cost competitors.

### **Strategic Alliance Partner**

Working with a local Mexican partner can be beneficial for two important reasons. First, these types of companies can sell your product and related aftermarket parts and service to the private sector without discrimination as your de facto distributor. These types of relationships are more likely to generate true business development and not just order taking as so often is the case with distributors. For larger projects, where an integrated approach is needed or prudent, the alliance partner can also provide this type of support in-house, or work with other local partners to provide the needed synergies and support.

Sales and market development assistance is often not the driving force behind a strategic alliance. Market viability is often determined by the ability of the foreign company to include local content, either for regulatory reasons (as mentioned above) or to remain price competitive with other local manufacturers. The ability to combine foreign products with local fabrication and assembly capabilities to create a cost effective product offering that your fellow, foreign competitors probably cannot match offers a company a pronounced market advantage. In a market like Mexico where price is unfortunately king, these types of synergies can be the difference between success and failure.

### **Subsidiary Office**

If clients will not buy product sold direct from the United States, if reps are hard to find, if distributor margins threaten your viability and their order taking mentality are not getting your product into market niches, if strategic alliance partners and integrators become tiresome and

distracting and too demanding, AND if the market potential is clear, it might be time to open up a sales office in Mexico.

Independent local intermediaries offer certain benefits that are especially evident in new, smaller, or less dynamic markets. However, relying on them for promotion, marketing, business development and even sales outreach in primary international markets generally leads to frustration. Also, too often trying to perform this function in these types of markets from abroad can be distracting and therefore even more frustrating.

Some U.S. companies with less international experience wrongly believe that a joint venture or strategic alliance is the most viable way for them to enter the market with local presence without the headaches of opening and operating a full fledged subsidiary. However, it has been our experience that if a company is unable to handle the responsibilities and support needed for a Mexican subsidiary office, it is probably even less prepared to deal with a joint venture with local ownership interests.

Subsidiary operations can be structured in a number of ways. Some companies want the visible in-country presence, employee base, and perhaps on-the-ground service that current and future clients require without running the business through the Mexican entity, effectively creating a Mexican cost center and a service agreement between the U.S. manufacturer and its Mexican subsidiary. Others want to run all or almost all of the business through the Mexican subsidiary, creating the capability of warehousing product and parts and/or giving Mexican clients the local invoices they want.

In the next edition of the Report, we will analyze the important exclusivity issue, the effectiveness of incentives, and suggestions about the best mixture of carrots and sticks to use in Mexico and specifically in the Mexican water segment.