CS Mexico Market Report
Franchise Services Sector in Mexico

April 2009

Summary

Despite the challenging economic climate, last year the franchise industry in Mexico grew 14%. Conservative estimates indicate that this sector will grow at least 10 percent in 2009.

Mexico is a large and diverse country that offers excellent business opportunities throughout its multiple regions. U.S. Franchise concepts have been very successful due to the commercial ties between both countries and the recognition and acceptance of U.S. brands by the Mexican population.

In 2008, the World Franchise Council ranked Mexico as the 7th leading nation in franchise development. According to the Mexican Franchise Association, Mexico has 860 franchise concepts, including international brands, mainly from the United States.

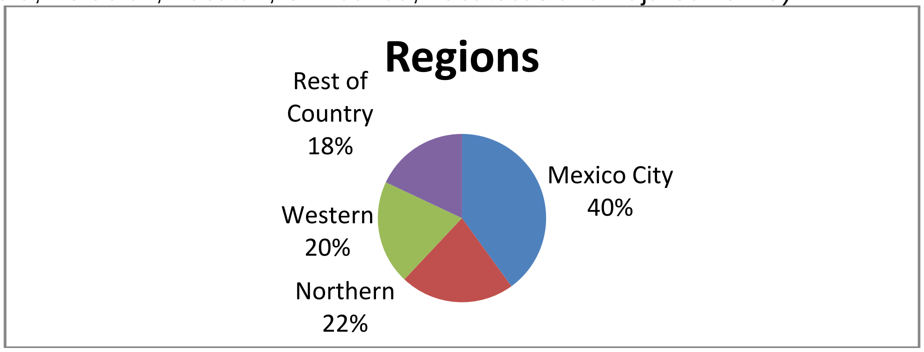
Market Demand

Although the food and restaurant sector in the franchise industry in Mexico has always been a very popular business model, in 2008 the services sub-sector showed significant growth. Services such as entertainment concepts for children, personal care services, and automotive services among others have a great potential in the Mexican market in the following years.

Traditionally, large cities like Mexico City, Monterrey and Guadalajara have been the first option to open a new franchise concept, but last year, smaller cities have been successful in the creation or development of franchise business opportunities. This trend is because their population is looking for new products or brands, including international concepts.

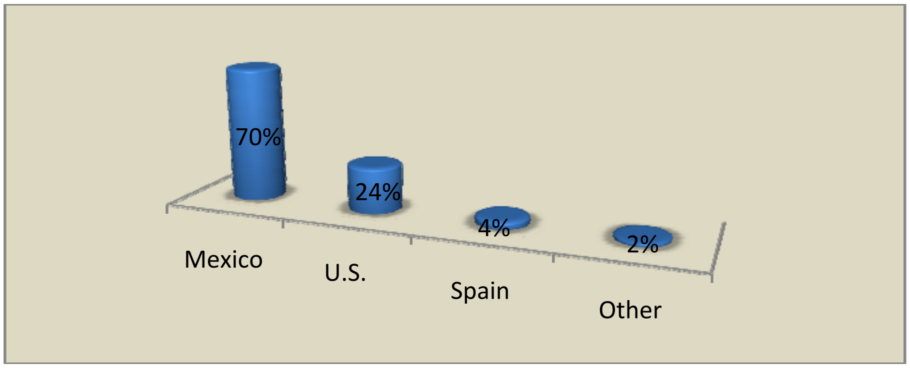
Market Data

In Mexico there are currently around 860 franchises registered in more than 70 different sectors. The regional distribution of the franchises is concentrated mainly in Mexico City, Northern Mexico (of which 10 % are located in Monterrey), Western region (Guadalajara 9 %), and 18% in the rest of the country – (Coahuila, Querétaro, Sonora, Veracruz, Yucatán, Chihuahua, Zacatecas and Baja California)



* Source: Mexican Franchise Association

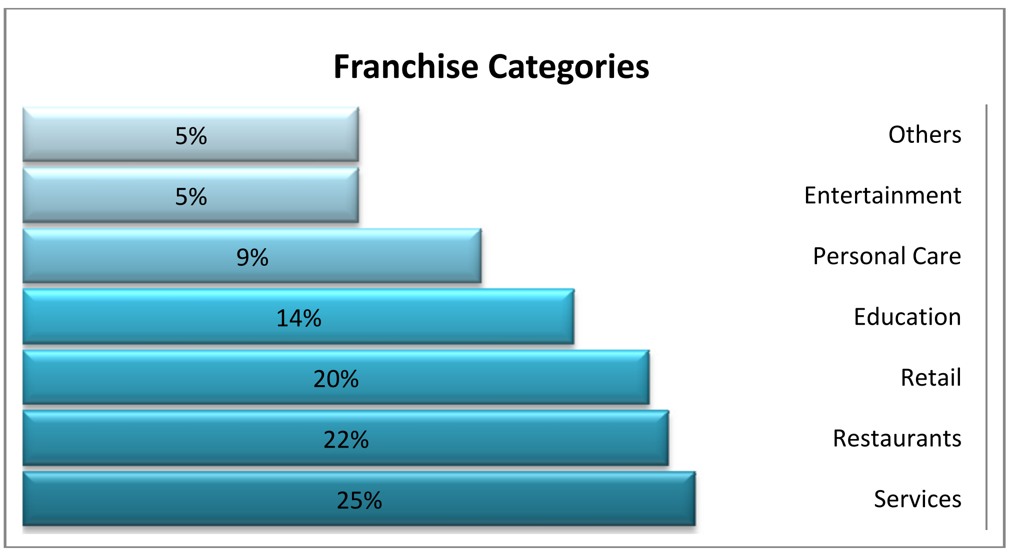
Statistics show that 70% percent of the franchises in Mexico are of Mexican origin, 24 percent are from the U.S., 4% from Spain, and Canada and Brazil have 1% of the market among other countries. Firms from other Latin American countries are finding Mexico as their best option to expand internationally, and are focused in exploring secondary markets such as Veracruz, Quintana Roo, Puebla and State of Mexico.



* Source: Mexican Franchise Association

Best Prospects

According to franchise specialists in Mexico, Education and Entertainment services for children, Personal Care Services (spas, beauty shops, health care centers), and Automotive services are considered as some of the best prospects for the next 5 years. Low investment concepts in any of these sectors will have more opportunities to grow in secondary markets.



* Source: Mexican Franchise Association

Prospective Buyers

The most important element for a franchise selection is the business sector and customers preference; so you will find serious and devoted investors looking for new business opportunities in the franchise sector which are basically high/middle income professionals that consider franchise opportunities as a medium-long-term life plan.

When the potential franchisee evaluates its possibilities takes in consideration the following factors:

a) Personal tastes and business type preferences
b) A well-known brand
c) Support offered to franchisees
d) Payback periods no longer than four years
e) Right concept and services suited to the Mexican culture

Among the states in Mexico with most opportunities in the services sectors are:

Aguascalientes	Puebla	Coahuila	Veracruz
San Luis Potosí	Baja California	Sonora	Yucatán

Central

Aguascalientes is home to just over 1 million people with a GDP per capita of $10,145. The economy is based on the automotive and auto parts, information and industrial technologies sectors. It is also certified by the World Bank as having the country's best business environment, measured by the possibilities of recovering investments, trial times, time needed to open a new business, costs of opening a business, and access to credit. Over 70 percent of the state's residents live in the capital city Aguascalientes.

San Luis Potosi has 2.4 million inhabitants and a GDP per capita of $6,599. GDP growth in the state has been one of Mexico's highest, and the introduction of new companies and investments should help this trend to continue. Its main population center is the metropolitan area of San Luis Potosi.

Puebla's large population of 5.4 million people, with a GDP of $5,795, makes it an attractive market. An industrial state with large automotive and autoparts segments, Puebla is also becoming involved in the growing aerospace industry. A large number of universities and students should bode well for the continued growth of the area. The principal cities include Puebla, Atlixco and Tehuacan.

Northern

Chihuahua contains about 3.2 million people and its GDP per capita is $11,739. Its proximity to the United States has made it a major supply route to the U.S. and to the other border-states in Mexico. The large manufacturing and commercial sectors have drawn significant foreign direct investment in recent years, making the state one of Mexico's most attractive economies. Chihuahua produces 4.4 percent of the nation's GDP and is one of 4 Mexican states that comprise 60 percent of the nation's commercial growth.

Coahuila is home to 2.5 million people with a GDP per capita of $11,869. Bordering Texas, this state is home to multiple industrial sectors, including a large automotive industry. The addition of strong commerce and service industries, and the new developments of aerospace, biotechnology and information technologies have led Coahuila to be one of the leading economies in Mexico. The main cities are Saltillo and Torreon.

Nuevo Leon is considered the industrial heart of Mexico; Monterrey controls more than half of Mexico's total industrial assets. Monterrey is the distribution center of Mexico due to its strategic location on the NAFTA Corridor. Monterrey is Mexico's leading city of U.S. franchises, and the most prominent sectors are food, automotive, hotel and restaurants.

Western

Baja California has a population of over 3 million people with a GDP per capita of $10,813. Its strategic position has made it a large port of entrance for products and services from both Asia and the USA. Important cities include Tijuana, Mexicali, and Ensenada. Baja California accounts for approximately 35 percent of the total aerospace industry in Mexico with 48 companies and 12,000 employees. There are 80 automotive companies employing around 30,000 people. Fifteen Original Equipment Manufacturers in the electronics industry, including Sony, Hitachi, JVC, Panasonic and Samsung, employ over 50,000 people. There are also almost 900 maquiladoras in the state, 31 percent of Mexico's total.

Sonora has a population of over 2.4 million and a GDP per capita of $9,834. Its location along the U.S. border has given Sonora many advantages, and its services, industrial, and agricultural industries have all benefitted. The recent growth of domestic tourism has recently added another dimension to the state economy. Main cities include Hermosillo, Ciudad Obregon, Guaymas, Nogales and Navojoa.

Jalisco has almost 7 million people with a GDP per capita of $8,631. Its main cities are Guadalajara, Zapopan and Puerto Vallarta. Jalisco's growth has long involved the information technology sector, and recently was selected as home to a new IBM plant.

South

Veracruz is a state of over 7 million people with a GDP per capita of $5,154. The port of Veracruz is the largest and most important in Mexico, and with plans of expansion the local economy should benefit with more jobs and a greater GDP. A new superhighway being constructed between Veracruz and Mexico City is expected to increase the already large tourist industry. The principal cities are the port city of Veracruz, Xalapa, and neighboring Cordoba and Orizaba.

Yucatan and Quintana Roo together have about 3 million people with respective GDP per capita of $6,812 and $12,695. With large tourism industries, these two states are located in the Yucatan Peninsula. The infrastructure in the area includes multiple international airports, large sea ports, and a large number of hotels. Recent investment in other economic sectors has diversified the economies to complement tourism, with Yucatan most prominently showing a large growth rate in industrial manufacturing. Cancun, Playa del Carmen, Cozumel, Chetumal and Mérida are the main cities in this area with a high tourism concentration.

Campeche has just over 750,000 inhabitants, with a GDP per capita of $14,436. Located at the base of the Yucatan Peninsula, it is home to most of Mexico's oil and natural gas industry, both of which would benefit from new service organizations. The need for in-rig hotels, security services, maintenance, and transportation offer market opportunities. The tourist, fishing, and forestry industries also offer opportunities. Pro-business development policies, like short business start-up times, make Campeche an attractive investment area. The metropolitan City of Campeche offers the best opportunities as well as a close proximity to Guatemala.

Market Entry

As Mexico is a big and diversified country, it is advisable to divide the territories into at least 3 regions (Northern, Central and South) to grant the Master franchise agreements and in order to have a better and quicker development of the brand.

Before entering the Mexican market it is important to take into consideration the following aspects:

1. Type of Franchise model appropriate for Mexico (Master vs. Regional Franchise Rights)
2. Level of Interest in the Mexican market for the products/services that you will be offering (Potential of the market, Product/Service acceptance)
3. Training / Support capabilities (Language, resources)
4. Product / Service tropicalization: U.S. concepts may not be as popular as in the United States for Mexican customers, be prepared to adapt your products/services to the Mexican culture.

Franchising in Mexico, as in any other country, requires a long-term commitment. U.S. franchisors must commit human and financial resources, patience and time to make their concept succeed in the Mexican market.

U.S. franchises must be aware that since the Mexican market is dominated by local franchises, a requirement for a successful franchise concept in Mexico is to adapt, or customize, the concept and characteristics to Mexican tastes. This practice, known as "tropicalization", includes not just translating into Spanish the company's promotional literature, manuals and supporting material, but changing the necessary elements to make it appropriate to Mexico.

When negotiating with an investor in Mexico to grant a Master or Regional Franchise, it is recommended to seek legal advice from a law firm with experience in franchise law and practices.

Competition

Although U.S. franchise concepts are very popular in Mexico, local concepts are the main competitors for U.S. franchisors. In recent years, Mexican entrepreneurs with successful concepts have adopted the franchise model to expand their business in country. As the investment fees and royalties are usually lower than from an international franchise concept, Mexican investors find it easier to invest in domestic brands. It is expected to see more international brands in Mexico, especially from Spain, and Central America mainly in the services and food sectors.

Market Issues & Obstacles

The Franchise sector in Mexico is regulated by Article 142 of the Industrial Property Law, and Article 65 of its Regulations. On January 26, 2006, an amendment to the Mexican Franchise Regulations (Article 142) was published in the Mexican Official Gazette, stating a new definition of franchise, mandating requirements for franchise agreements, and providing new standards for pre-sale franchise disclosure.

The amendment will mainly protect franchisees that report abuses from franchisers, either at the execution of the agreement or when terminating it, which was affecting the growth of the franchise sector. The Mexican Association of Franchises (AMF) lobbied for the change, demanding more legal security for the franchise sector in Mexico.

Remittance of royalties and fees: No restrictions apply on remittance of royalties and fees, apart from normal reporting requirements.

Tax consequences. Royalties and fees face withholding taxes at the following rates: 15% on payments for technical assistance; the use of models; plans; formulas; know-how; copyright; artistic, literary and scientific works; and the rights to use theatrical and television films and radio recordings; and 40% for the use of patents, trade names, trademarks and publicity.

In the case of payments made to residents of a tax haven jurisdiction, the 40% rate applies. Fees from construction activities are subject to a withholding tax of 30% if the projects do not give rise to a permanent establishment.

Deduction of fees from taxable income is possible, but with limits; only those that are indispensable or strictly related to the company's activity can be deducted without restrictions. Mexico has yet to place any limits on how much subsidiaries can deduct for payment of royalties and fees to parent companies, as long as those payments are not larger than those that would be paid to a third party.

Franchise agreements must be registered before the Mexican Institute of Industrial Property in order to be effective against third parties.

Financing

In an effort to continue supporting the development of the franchise industry in Mexico, the Mexican Franchise Association and the Ministry of Economy have created different finance programs to help existing franchise concepts expand in the Mexican market.

The **Programa Nacional de Franquicias (PNF)** was developed in 2007 with the support of the Ministry of Economy, to give more opportunities to Mexican entrepreneurials to create, re-engineer, develop or remodel a franchise concept. This program will benefit existing franchise concepts to grow or modernize their business, and will also support investors to acquire a franchise concept (either Mexican or international) to be developed in the country.

For more information about this financial opportunity please refer to: www.franquicia.org.mx

The Overseas Private Investment Corporation is able to provide financing to a variety of small business entities involved in international franchise relationships. OPIC may directly provide loans of up to $4 million either to the U.S. franchiser, on-lend to franchisees in eligible developing countries, or to its local franchisees in developing countries.

Trade Events

The Feria Internacional de Franquicias is the largest franchise event in Mexico. In 2009, the event attracted more than 30,000 investors from Mexico, Central and South America, all of them in search of opportunities to develop in their respective markets. The U.S. Commercial Service encourages U.S. Companies to participate in the USA Pavilion at this important event.

Feria de Franquicias – Guadalajara
June 25-27, 2009
Guadalajara, Jalisco

XXXII Mexico International Franchise Fair – USA Pavilion
March 4-6, 2010
Mexico City
World Trade Center

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www.franquiciasdemexico.org

Secretaría de Economía / Subsecretaría para la Pequeña y Mediana Empresa
www.franquicia.org.mx

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