Chapter 4. Financing the Venture

Costing and Strategy

Estimating costs is a prerequisite for financial planning and for securing financing, if required. For this, a company needs to develop a sense of its likely costs over the course of a transaction. Once this has been done, a cashflow assessment can be prepared. These costs, however, will vary from one entry strategy to another.

For example, in the case of direct exports to Mexico, cost calculations are relatively simple. They will include the costs of production in Canada and the additional costs of delivering the goods to Mexico, including packing, transportation, export documentation, insurance, tariffs, customs fees if they apply, licences and permits, and the costs of distribution, marketing and sales in Mexico. They may also include the fees and commissions paid out to brokers, agents and distributors. Finally, there may also be special costs incurred to modify the product for the Mexican market, changes to packaging and labelling, and any additional costs of service or repairs to products sold in the Mexican market.

Franchising is an entry strategy that is relatively easy to cost. In this case, estimates should include the costs associated with the sale, such as travel, executive time and other expenses, including research and possibly translation.

Producing in Mexico will involve a set of cost calculations similar to those for the domestic market, but with the addition of items that may be unique to the Mexican market. This might include distinct package design, preparation of customized instructions or other materials, and translation. There may also be costs associated with meeting local standards such as health and safety and environmental rules. Certain components may have to be sourced externally, however, and this will create additional transportation costs as well as supply risks.

Joint ventures represent another level of complexity. If inputs are being shipped from Canada for processing or assembly in Mexico, costs associated with both exporting and local investment will have to be combined. On the other hand, some deductions will have to be made to represent the contributions of the partners.

North-Man Engineering Inc.

Effective partnering has been key to the success of North-Man Engineering Inc., of Winnipeg, Manitoba. The company has focussed its environmental expertise on the engineering, water and wastewater treatment sectors in Mexico. In 1991, North-Man concluded a deal with Mexican partners to establish a Mexican subsidiary. The joint venture, *North-Man Zaltech* consumed the partners' combined resources for some 18 months before it landed a first contract. By the end of 1992, Mexican sales accounted for 15 percent of the Canadian company's revenues. The implementation of the North American Free Trade Agreement (NAFTA), and the so-called environmental "side agreement," elevated environmental enforcement to a new level in Mexico and is expected to boost sales substantially. Also, the Mexican government's emphasis on infrastructure expansion, including new potable water and wastewater treatment facilities, will also contribute to long-term success.

Notwithstanding these long-run growth factors, environmental opportunities were severely curtailed by the devaluation of the peso at the end of 1994. The government was faced with the prospect of severe job losses if plants were closed for environmental infractions. Small- to medium-sized manufacturers are considered most vulnerable, and they have cut environmental expenditures as enforcement efforts have been relaxed. Some environmental projects were stopped mid-stream because of the increased price of imported inputs. On the other hand, enforcement has continued for multinational corporations.

North-Man has not changed its strategy as a result of these difficulties, and maintains its service-oriented stance. Equipment purchases for current projects were already final before the devaluation. The most important problem was the difficult time experienced by the staff of the company's Mexico City office, who are all Mexicans. The company is optimistic about the future and expects Mexico to contribute a larger share of consolidated profits as it continues to expand.