The passage of Mexico’s energy reforms in late 2013 signaled that the government understands competition as well as foreign capital and expertise are required to reverse Mexico’s declining oil and gas production and tap both deepwater and unconventional plays. However, many Mexicans continue to express skepticism about the government’s ability to ensure that local benefits from the oil and gas industry are realized through the “Apertura”—the opening of the industry—particularly with the reentry of international oil companies (IOCs). In response, the energy reform included strict local content provisions.

In the recent Round 1 Call for Bids for shallow-water blocks, model production-sharing contracts (PSCs) included requirements for 13% local content during the exploration period and 25% during the first year of development, increasing 1% per year up to 35%. The definitions and metrics for national/local content are as yet unclear, but IOCs should remain aware of these as the National Hydrocarbons Commission (CNH) has authority to penalize those that do not comply.

Maximizing local content is an increasingly important and complex challenge for IOCs in many emerging market countries. While Mexico offers a foundation of industry infrastructure, goods, services and workforce, meeting local content challenges in the Apertura will be exacerbated due to a number of special considerations, especially labor laws and relations, worker training, corruption, and access to finance.

Complex labor laws, relations
As indicated by Diego Rivera’s mural on the National Palace, Mexico’s constitution and other legislation provide strong worker protections. The Federal Labor Law of 1970 “establishes the minimum benefits to which employees are entitled as well as employees’ and employers’ rights and obligations.” Local laws and workplace standards/norms define specific protections for employees and contractors.

New entrants in the Mexican oil and gas sector will encounter powerful labor unions supported by strong parties that oppose the Apertura.

While PEMEX, unions and well-established supply chain “grupos” have learned to work together over the years, newcomers will need to quickly develop the local labor relations knowledge and skills needed to minimize the risk of work stoppages, project delays and/or increasing labor costs.

Fostering good relations with labor leaders and developing mastery of labor codes will be critical. Partnering with locally established industry peers, service providers and other multinationals (e.g., automotive or mining) will help companies capture lessons learned.

Just as important will be the commitment to “unlearn” past practices for working around labor requirements. IOCs are likely to encounter practices that do not meet emerging corporate and international social responsibil-
Ity norms or that harm a company’s reputation as a partner of choice to workers and host communities.

**Workforce capacity, training**

IOC employment standards and quality requirements may be significant hurdles for many local workers and suppliers. IOCs will need to develop and start implementing clear local content development strategies early to meet local content targets.

While identifying well-trained local oil and gas workers will certainly be easier in Mexico than in other countries with strong local content laws (e.g., Angola), IOCs should plan to dedicate significant effort to verify that each has the requisite skills and training required and help workers adjust to the specific standards expected among IOCs.

This will be particularly important for finding truly local workers—those from communities near company operations—rather than personnel from other areas in Mexico. Use of non-local national workers may optimize national content but may do little to reduce risk from fence line community opposition. Sourcing workers from host communities will be more challenging but much more likely to generate community support.

To help support local businesses vs. individual employees, the industry as a whole should consider collaborating in one or more joint-sponsored training centers. This approach is supported by the CEO of PEMEX and has been used with success in other countries with local content laws. Applying a similar approach in Mexico may help IOCs build credibility as good partners to those opposed to or wary of the Apertura.

**Corruption**

Combating corruption remains a massive challenge in Mexico and is cited in the World Economic Forum Global Competitiveness Report 2013-14 as the most difficult factor for doing business in Mexico. Mexico ranks 103rd out of 174 in Transparency International’s 2014 Corruption Perception Index, with a rank of 1 being the least corrupt.

With regard to local content, corruption is a key concern around the award of contracts. Companies entering Mexico will need to implement and enforce strict protocols with workers to maintain compliance with local and international anticorruption laws (e.g., the U.S. Foreign Corrupt Practices Act). Corruption is of particular concern in onshore areas where violence is prevalent (e.g., in the Burgos Basin near the U.S. border) because governance is particularly weak and corruption prevalent in these regions.

**Access to finance**

Many support industries in the oil and gas supply chain have high technical and financial barriers of entry. While capacity-building and training can help overcome technical barriers, access to finance is a key challenge for many suppliers, especially small- and medium-size enterprises that often have no/little formal credit record, insufficient record-keeping and low levels of formality in past business practices, and/or face macroeconomic headwinds (e.g., high inflation rates and unstable currencies). This results in companies either taking on high interest debt or deferring growth until they have saved enough to self-finance expansion.

IOCs cannot and should not be held solely responsible for overcoming this challenge, but they can play a positive role in facilitating solutions that will ultimately result in cost savings and well-developed local (not just national, but host-community or regional) supply chains. To do this will require proactively engaging with local and regional governments to develop smart policies that enable supply chain development. These could include, for example, developing lists of products exempt from customs duties, promoting linkages along the oil and gas supply chain to other industries and leveraging matching funds to support capacity building.

At the individual level, IOCs also can help develop their local supply chain by:

- Prefinancing or prepurchasing raw materials;
- Providing a significant upfront payment/mobilization fee;
- Expediting payment of invoices (i.e., net 15 day);
- Requiring major contractors to pay local subcontracts immediately;
- Engaging with banks to reduce perceived risk of suppliers (i.e., by providing proof of contracts); and
- Making targeted equity investments in key suppliers to fund capital expansion.

Maximizing local content will be critical to assuaging public concerns over the opening of Mexico’s oil and gas industry to international companies. Those that manage the many associated challenges well are more likely to be the partner of choice for future opportunities in the country. Unfortunately, programs to facilitate local content development are typically underresourced and focus on short-term impacts rather than the structural issues that inhibit optimization of local content. IOCs entering Mexico will need to start developing and implementing clear local content development strategies early to manage this unusually important and complex risk of doing business in an exciting new arena.

*References available*