

strategy&

AN OVERVIEW OF STARTUPS IN MEXICO

Mexican startup ecosystem



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Why is this report relevant?

1

Investors

- In this report, we analyze Mexico's startup ecosystem situation by identifying **key players, startups, and most popular investing sectors**
- PwC/Strategy& interviewed various stakeholders such as investors, startups, and supporting platforms, allowing us to **pinpoint incentives and drivers, including COVID-19 impacts**

2

Supporting platforms

- Based on stakeholder interviews, PwC/Strategy& identified **critical gaps & barriers, including the most relevant incentives** singled out in Mexico
- We present an overview of the key sectors and **incubating programs**, as well as accelerating platforms issues
- We also present sector trends and **main changes** in view of the **COVID-19 pandemic**

3

Startups

- We identified **key stakeholders in the Mexican startup ecosystem**, including supporting platforms, investors, and outstanding startups
- This report includes an analysis of the most relevant sectors as well as **relevant gaps and barriers in the entrepreneurship ecosystem**

INTRODUCTION

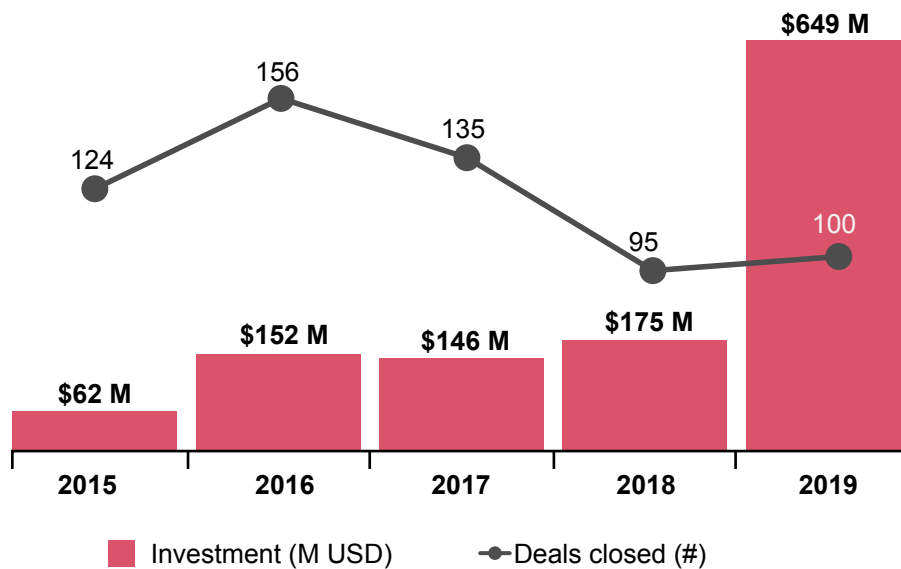
Mexico is the second-largest startup market in Latin America, only behind Brazil. Innovation is an excellent solution for the challenges that the country faces.

Mexico is one of the most attractive markets in Latin America. Venture capital investment has grown 4x since 2017, while the number of new companies has shown notable growth, especially in the financial services sector. Additionally, foreign investors such as QED Investors and General Atlantic actively invest in new Mexican companies. As shown in Graph 1, venture capital investment increased significantly from 2018 to 2019; meanwhile, the number of agreements closed has risen marginally.

EXHIBIT 1

Investment in Mexico

Historic Venture Capital (VC) Investment in Mexico



Source: Startupeable, LAVCA

1. Top cities

The cities with the highest startup, investors, and supporting platforms concentration are the following:

- **Mexico City:**

Mexico’s capital and most populated city in the country. It has been the home to most Fintech and transportation startups. Several international and local investment funds have offices in Mexico City, making it attractive for startups to begin operations there. Additionally, most international corporations have HQ located in the city, growing the number of corporate venture capitals.

- **Guadalajara:**

Located in Jalisco, one of the states with the highest growth of technology that enables businesses. Historically, it was the hub for several US tech players who wanted to develop in Latin America. It is also a region with several universities with incubators for their students, promoting innovation and startups.

- **Monterrey:**

Several startups with innovative solutions in the manufacturing and electronic commerce sectors established their headquarters in Monterrey, the capital of Nuevo León, as well as several investment funds that seek possible investments in startups with local operations. Monterrey is also home to several major industrial corporations such as Cemex and Xignux. Nuevo León -the second largest contributor to the national GDP- has a high industrial activity and is located on the border with the United States. The wide array of universities within the state enriches the region with many accelerators and incubators.

EXHIBIT 2
Startup HQs by state in Mexico



Additionally, Puebla, Querétaro, and Hidalgo are considered innovation hubs. These states have a significant number of universities promoting startups and innovation through incubating and accelerating programs.

2. Top investors

Different types of investors depend on various characteristics such as origin, historical investments, participation in Mexico, and others. The primary kind of investors in the Mexican startup ecosystem is shown in Exhibit 3. Most corporate investors focus on startups that add value to their current business, while Venture Capital and Angel Investors focus on startups past the proof of concept that have a fast growth potential. On the other hand, Multilateral Finance Institutions tend to invest in startups with an Environmental, Social, and Governance (ESG) focus.

EXHIBIT 3
Investors in Mexico

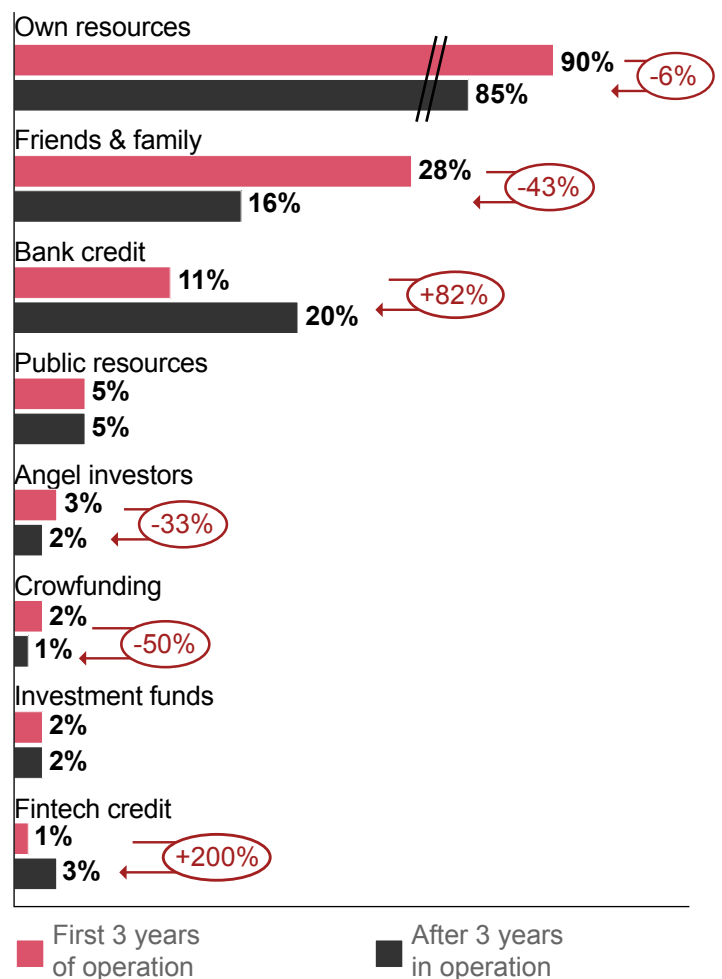


Type of investor	Description	Examples
Corporate investors	Corporate companies with shares in various startups	BIMBO, ENGIE, FEMSA, IBERDROLA
Venture Capital	Investment fund that participates in high risk transactions in startups	ALLVP, ANGEL VENTURES, Combinator
Angel Investors	High-net-worth individual that provides financial backing for startups and entrepreneurs	Juan Lopez Salaberry, Sergio Romo, Jose Galvez Esteban, Jose Vielma, Jorge González Gasque
Gov. & Multilateral Finance Institutions	International institution that invests in small companies and startups	national Financiera, IFC, BANCOMBRAS

Source: CNTXTO, crunchbase

Even though investment in Mexico has grown since 2017, a survey held by the Entrepreneurship Association in Mexico (ASEM) indicates that most startups rely heavily on their family, friends, and own investments.

EXHIBIT 4
Sources of financing for startups in Mexico



Note: Surveyed entities could answer more than one choice
Source: ASEM

Outstanding sectors in the Mexican startup ecosystem

The number of startups in Mexico has grown by 16% annually since 2010. The sectors with the highest growth in the number of startups are:

- **Beauty and wellness**, with a growth rate of **31%**
- **Transportation and mobility**, with a growth rate of **22%**
- **Agriculture**, with a growth rate of **18%**

Additionally, the sectors with the highest number of startups in Mexico as of 2020 are:

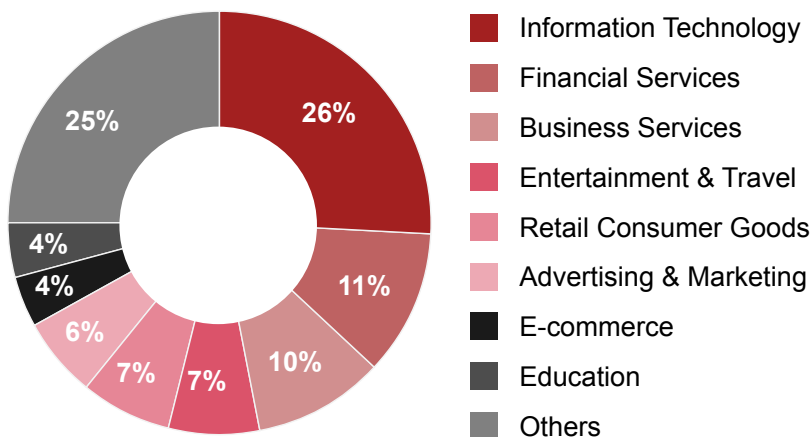
- **Information Technology**, with over **600 startups**
- **Financial Services**, with over **300 startups**
- **Business services**, with over **250 startups**

In late 2020, Mexico announced its first unicorn Kavak, with a valuation of 1,160 million USD. Kavak received funding from several international funds such as Softbank and General Atlantic, including some local Venture Capital funds such as Mountain Nazca. Since then, three more startups have followed its steps, expanding the total number of unicorns in Mexico to four: Bitso, the country's first Bitcoin exchange platform; Clip, leading digital payment platform; and Konfío, financial technology firm.

In Mexico's current ecosystem, various companies received an investment of between 100 million and 1,000 million USD. These startups are considered "centaurs" and include companies such as Credijusto, Albo, and Stori.

Companies valued at a range between 10 and 100 million USD are called "ponies". These startups in Mexico are focused in many sectors, but several on the financial services such as Minu, Fondeadora, Conekta, and Kueski. Other pony startups belong to the e-commerce and retail sectors, such as Jüsto, GAIA, and Homie.

EXHIBIT 5
Startup distribution in Mexico by sector



Note: Others includes energy & environment, agriculture, manufacturing, communication, art & design, healthcare, real estate, transport, and social sectors
Source: crunchbase

Current gaps & barriers for entrepreneurs

A similar point of view on current gaps and barriers to the startup ecosystem was collected from various stakeholders. The top mentioned are stated below:

Lack of attractive funding sources

Lack of funding alternatives (high-risk aversion from Mexican investors), **a limited offer of government support programs** (the main national government support program for entrepreneurs: INADEM, closed in 2019), and **scarce regulatory incentives** (limited offer of tax incentives to new businesses)

Tax schemes

High bureaucracy for creating and registering companies, as well as **complicated tax schemes** that require much time to understand & comply with

Fear of failure

The **high-risk aversion from entrepreneurs and their basic preparation** on business pitches limits their ability to grow business ideas

Client payment delay

Delay on client payments in Mexico, derived from economic and cultural factors, is a significant problem for companies with **limited cash flow or that are capital intensive**

Scarce mentorship alternatives

Lack of entrepreneurial network with experts that have already developed successful startups and opportunities to develop public relationships to get people to know their business

Corruption & insecurity risks

Corruption and insecurity are a central challenge for entrepreneurs that work closely with **government entities** (e.g., in the Energy and Environment sector) or that operate in sectors that have high contact with drug cartels (e.g., Agriculture)

Incentives and drivers

We could say the most important incentive to the startup ecosystem is the growing need for at-hand solutions, digital tools, and automation processes for Mexican consumers to leverage opportunities while remaining secure. Although **COVID-19** has negatively impacted analog businesses, the reality is that the boost on tech-enabled ones has become noticeable.

INCENTIVES AND DRIVERS FOR STARTUP CREATION

Digital era

The growth of a **digital & software-enabled economy** offers “one click away” solutions to clients, forcing companies to **streamline processes and digitalize databases** to adapt to a fast-changing **market and demand**. The need for collaboration and productivity when doing remote work is also one of the main drivers of digitalization.

IA & Data Analytics

Development in the 5G network will **enable IoT and IA startups** to grow further. The need for **engaging in online learning** for schools during the COVID-19 pandemic enabled IA and digital solutions in startups.

Making processes and supply chains more agile requires AI solutions and data analysis. These requirements promote the development of more IA startups.

ESG startups

The world's current situation is pushing us to react. We need to **address the pressing issues of environment, society, and governance**. Corporations and startups are noticing the added value that ESG initiatives and startups have to offer. Startups in these sectors are growing, including **healthcare access for all and clean solutions**, among others.

Cybersecurity needs

The digitization of information and the new “paperless” trend are promoting the development of online documentation, which needs to be safe from **cyber-attacks and hacks**. Big corporations require a cybersecurity strategy, and small and medium enterprises are reaching out to **cybersecurity startups to protect their information in a better way**.

“Mexico’s startup ecosystem is going to be significantly affected by COVID-19. It will mean the end to several non-digitalized businesses while others seize the opportunity of a new digital era ”

- Mexican Venture Capital Founder

Startup ecosystem outlook



There are several trends expected to grow in the following years among startups. We identified some of them, including the impact of COVID-19 in the industry tendencies.

Overall, the startup ecosystem is expected to grow. The digitalization of services and the elimination of intermediaries will be led by startups. There are several sectors with a high growth expectation, including cybersecurity services, digitalization of financial services, online healthcare (teleconsultations), and the insurance industry. These industries are favored because they are solving most problems people are currently facing.

Mexico was the cradle of several internationally recognized startups, such as Rappi and Cornershop. Even if these are not Mexican, they developed their business model and grew within the Mexican market. There is a general expectation for businesses to achieve a unicorn or centaur status in the following years, enticing international funds to invest in Mexico or Latin American startups.

On the other hand, some stakeholders in the startup ecosystem believe the Fintech “boom” that occurred in the past few years will cease to grow exponentially.

Trends and opportunities

Global trends heavily influence market trends in the startup ecosystem in Mexico. As mentioned before, one of the biggest trends includes the growth of digital services. Companies or services that are not traditionally digital are trying to find alternatives that help consumers access these services through a digital or technology-based solution.

GLOBAL TRENDS:

Digitalization of services

Several trends and opportunities result from the need to go digital. The imminent development of a 5G network will improve access to the Internet in remote places, growing the reach and accessibility to more people. For example, virtual care and medical teleconsultations will be accessible to a higher number of people, increasing the potential market size.

Startup expansion

One of the key trends that startups are following is expanding to other countries. The key is to take advantage of the similarities between countries. Nowadays, many startups have a short-term expansion plan. Internationalization makes them more interesting for global funds and increases their odds to become unicorns or high valued companies.

Process and service automation

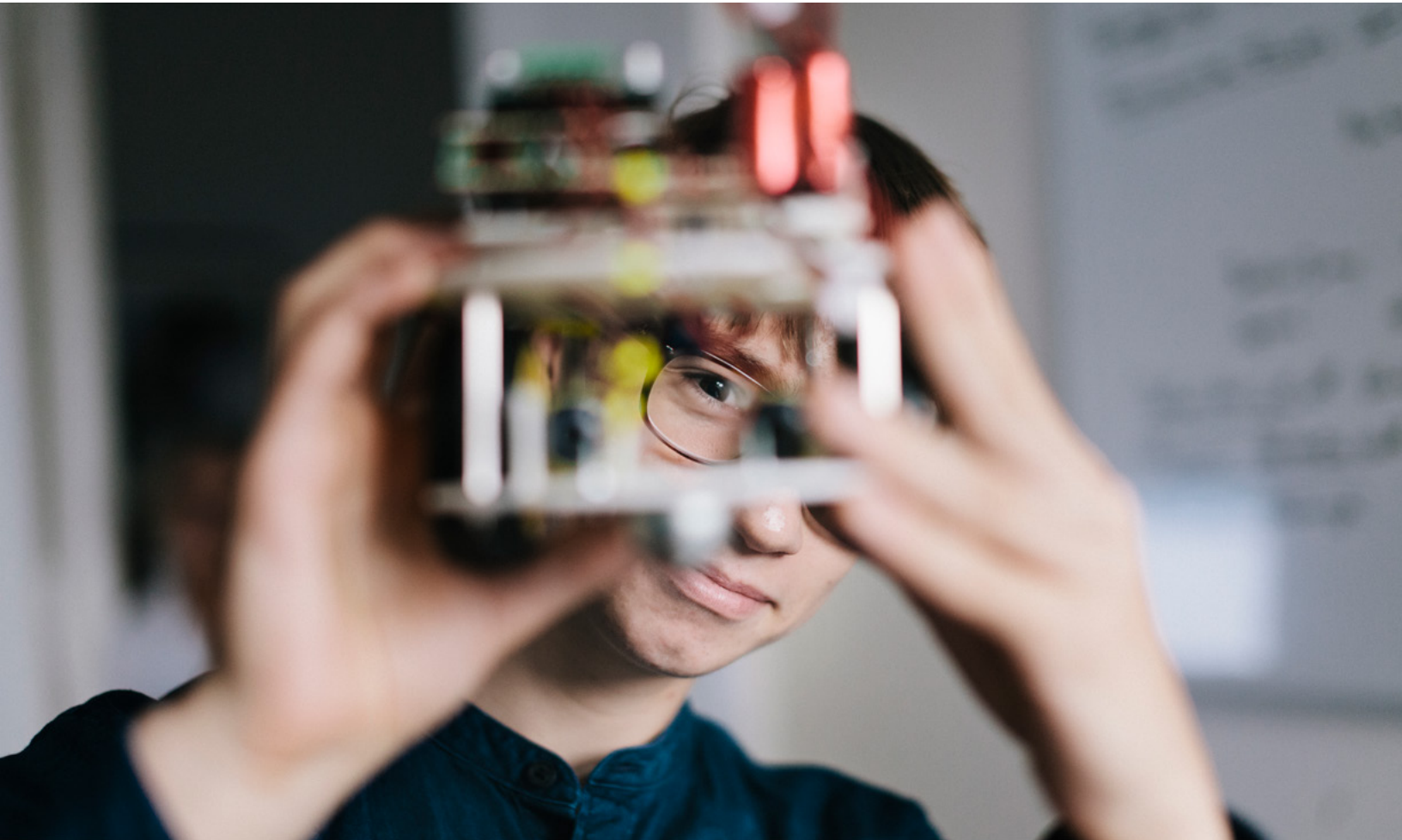
Companies with manual systems will have to change to AI or automatic solutions. There is a need to speed processes and digitize their operations to succeed in a new era of technological transformation. This trend of using chatbots and developing digital and automatic databases is essential in the following years. This change also applies to payment methods which are expected to be automated and centralized through e-wallets and online payment methods.

ESG sectors

For startup sectors, there are several industries with high growth expectations at an international level. Among them is healthcare, especially with tech-enabled solutions. Also, agriculture and food, enabled with technology, and the energy and environment sector, as there is a governmental and social push for startups that promote a more sustainable world. *ven un mundo más sostenible.*

Resilience in unexpected times

Another trend that developed after COVID-19 was the resiliency of different business models. There are several companies that relied on mass activities such as concerts or transportation that had to adjust their business models to survive during the pandemic. For example, a company that provided payment platforms for mass events had to pivot into home delivery services to thrive. This is becoming more common among newly created startups, which must develop skills that will allow them to act on their feet in the face of new and unexpected situations.



LOCAL TRENDS:

Difficulty funding pre-seed startups

Additionally, there are trends that are local to the Mexican market. Since the closure of INADEM (National Institute of the Entrepreneur), there has been a lack of government-led supporting platforms, which has also decreased the amount invested in startups in the pre-seed stages. Startups in this stage have a tough time attaining capital since they require all of it to proceed from private funding. Additionally, the venture capital firms that invest in pre-seed stages are not willing to invest full capital requirements since they cannot take such high risks.

Lack of accelerators and incubators

A key opportunity is incubating and accelerating new businesses. Even if many international incubators support startups in Mexico and university-owned incubators, there is still room for local accelerators to play a fundamental role in their development.

COVID-19 impact

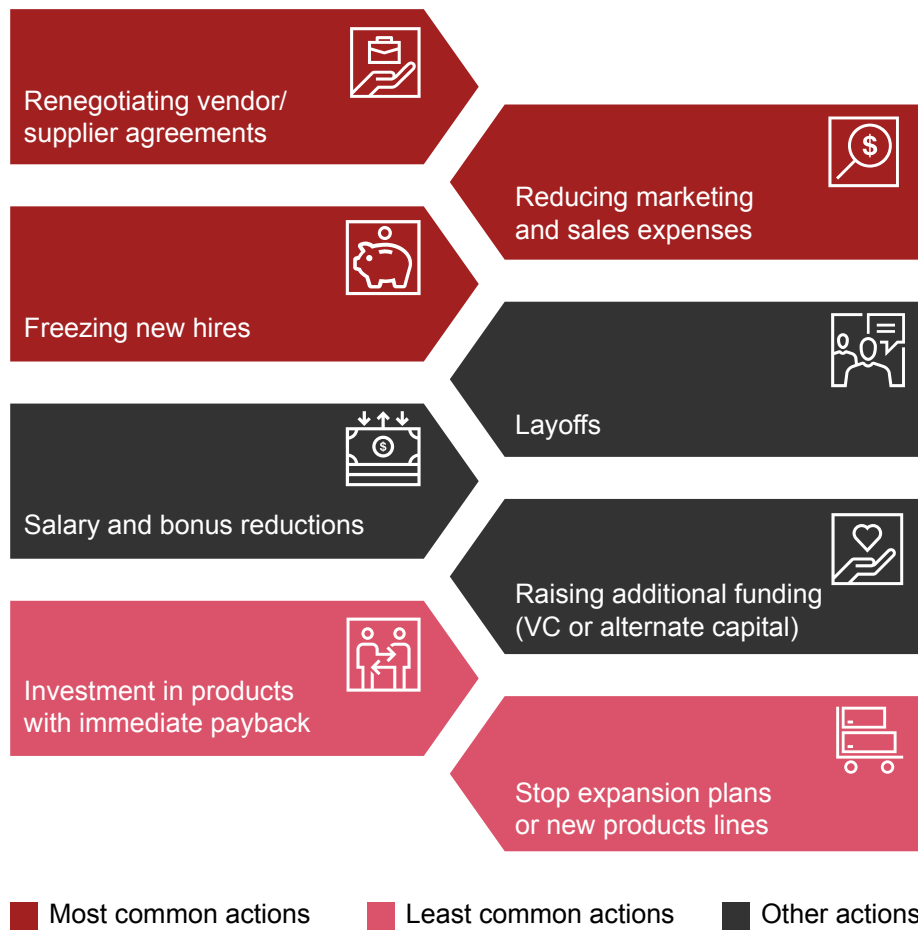
As the global economy has been affected by the COVID-19 pandemic, startups are currently analyzing how to face these impacts, still trying to understand whether they are favorable or not:

- High-profile investment funds and VCs are interested and still investing in Mexico despite COVID-19, but they are being more selective and focused on startups that were accelerated by the pandemic
- The current Mexican administration actions and the COVID-19 pandemic drove the outflow of capital, increased the cost of financing, and led to a depreciation of the exchange rate, especially affecting entrepreneurs in the seed and pre-seed stages
- The increased demand for assorted products and services is forcing startups to increase collaboration between them (especially B2C with B2B) to develop sophisticated synergies and be able to streamline processes, reduce costs, satisfy demand, and increase sales
- The accelerated transition to online platforms and digitized remote services in view of the COVID-19 pandemic resulted in more clients willing to use more tools that are “one click away”
- Health organizations are working on alternatives to lower healthcare costs. The industry is going through an innovation phase in which medical practitioners are working together to provide a high-quality but low-cost solution
- Solving missing or inefficient links in the medical device/drug supply chain. The industry is currently rethinking processes to have a more efficient and resilient regulatory process
- Insurance companies are starting to use drones in the assessment of damage on real estate property, which is making their services more efficient in time and cost
- Current energy demand and the high penetration of renewable energy generation assets have promoted one of the lowest coal dependency periods in decades, which paves the way to a zero-carbon emission power sector
- Utility services suppliers are leveraging the current high levels of customers trust and in-home working arrangements to offer digitally enabled supply solutions to end-users, with the goal of differentiating from their competition

In terms of the most common actions that startups had to take in view of the COVID-19 pandemic, we identified the most common ones, which include freezing new hires and reducing their short-term marketing expenses:

EXHIBIT 6
Startup actions in view of Covid-19 pandemic

What actions are startups taking in face of Covid-19?



Source: ASEM radiografía del emprendimiento

Overall insights

Mexico's startup ecosystem is growing. Kavak's rise as the country's first unicorn is proof of the belief investment funds and venture capitals are having in Mexican innovation. Mexico is viewed as one of Latin America's most interesting countries.

The participation of US accelerators and investment funds in startups increased significantly in the past few years. In order to keep the interest in this sector, local startups should have more local support, not only from government entities but also from consumers. The recent and accelerated digitalization will be crucial to the development of a higher number of startups in the short term. Industries such as "insurtech" (combination of insurance and technology) are transforming how transactions and insurance policies are being handled. Nowadays, people are looking for fast and online solutions, where they don't have to wait physically in line to submit an incident.

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