



International professional and executive search

Business in Mexico: Salary and Compensation Structures in Mexico

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INTRODUCTION

The involvement of foreign companies in Mexico over the past two decades has increased dramatically. Some are attracted by lower costs and others by the potential of a growing market in Latin America.

Even with news in recent years of populist governments in some Latin American countries, the two main economies Mexico and Brazil continue to thrive and maintain a steady growth of around 5% per year. The financial stability and growth coupled with reforming democratic governments has begun to transform social conditions. The middle class is emerging from poverty. Credit has returned and consumers have responded with purchases of cars, appliances and other goods. Most importantly, because of that strengthened middle class, the number of educated professionals continues to grow.

Even with a positive socioeconomic environment, legal and cultural differences exist. Employers and organizations are concerned about significant differences between labor laws in Mexico and the United States. There is always a cost concern associated with the potential financial obligations and liabilities that come with Mexican employees.

This white paper seeks to address concerns and provide insight about doing business in Mexico.

This document is not meant to provide a thorough breakdown of every practice in Mexico or serve as a legal guideline. It is only an outline of common practices to help managers gain a better understanding of Salary and Compensation Structures in Mexico. We strongly recommend you discuss your specific business requirements with Mexican legal counsel as well as compensation and tax professionals.

LEGAL FRAMEWORK

Unlike the United States where labor law is regulated at a state level, labor law in Mexico is Federal.

Most of the legal framework for labor law in Mexico comes from the Constitution established shortly after the Mexican Revolution in the early 1900's and officially adopted in 1917. One of the main drivers of the Mexican Revolution was a perceived abuse of workers, poor working conditions and exploitation of child labor. The late 1800's were a time of economic boom during a dictatorship that promoted foreign investment and a strong presence of foreign companies that helped build the infrastructure such as railroads. In many cases the foreign organizations were perceived as protected by the dictatorship and taking advantage of Mexican labor. This fact is a key in understanding why the Mexican Constitution, born from that revolution, includes so many rights and protections for workers. These provisions are much more specific than the ones provided to US workers under the American Constitution.

Those provisions in the Mexican Constitution are the basis for the two sources of legal rights for workers enacted by the Mexican Congress:

- 1) The Federal Labor Law. Dealing with issues such as minimum wage, employment conditions, benefits and rights of workers to organize.
- 2) The Federal Social Security and Housing Law. Dealing with issues such as health care, housing and retirement.

THE INFLEXIBLE WORK FORCE

The flexibility the employer has over working hours is one of the main differences between employment in Mexico and employment in the United States. An employer in Mexico is committed to paying the number of working hours per week that are established in an employment contract. The only way to reduce the number of working hours and not pay for them is to terminate the employment contract and create a new one. This can be more complicated than it sounds.

While most employment relationships in the United States are “at-will”, under Mexican law the presumption is that contracts of employment have an indefinite length. Laws are written to encourage employers to maintain the employment relationship. Even when a written contract is not in place, precedence establishes an implied contract of employment that will provide the employee with all the protections of the Federal Labor Law. These protections include severance if the employment relationship is terminated without cause. Severance benefits include 3 months of salary and depending on the circumstances, may also include 20 days pay for each year of service plus all other cash benefits that have been accrued during the year.

PAY RATE / UNIT OF PAY

Mexico’s Federal Labor Law establishes that an employer and employee can agree upon a rate or unit of pay. The common practice is to use the Daily Base Pay Rate (DBPR) known in Spanish as “Salario Diario Base de Cotizacion” in contracts and for all compensation related calculations. Benefits, social security contributions and most importantly the Federal Labor Law use the Daily Base Pay Rate (DBPR) as a base for calculating benefits. Even when calculating over time the hourly rate is based on the DBPR.

Unlike the U.S., where the minimum wage is expressed in dollars per hour, in Mexico it is expressed in pesos per day.

Even when the daily rate is the basis for calculating all compensation and benefits, Mexican employees will be familiar with what they see based on their pay period and will relate to weekly, bi-weekly, monthly or yearly amounts.

Conversions are straight forward:

Hourly rate (used to calculate over time) = DBPR / 8

Weekly pay = 7 X DBPR

Bi-weekly = 7 X DBPR X 2

Yearly = 7 X DBPR X 52

Monthly = Yearly / 12

It is common for an employee to NOT know his/her daily pay rate (DBPR). Since tax structures in Mexico can get very complicated, employees will often not even know (or care about knowing) what their gross pay is. When you discuss a Mexican employee's compensation make sure you ask if the amounts they are providing are gross (before taxes) or net (after taxes).

It is important to note that unlike an hourly wage in the United States (that is typically multiplied only by the number of hours worked) the Daily Base Pay Rate is considered within a 7 day week assuming the seventh day is a paid / non working day.

Example

An employee is hired for a call center help desk covering the desk two days a week (8 hours each day) and paid \$1000 pesos each week.

The DBPR for calculation purposes would be:

$$\text{\$142.85 Pesos} = \text{\$1,000.00} / 7$$

The DBPR will be used to calculate all benefits except benefits related to severance pay. The daily rate used to calculate severance pay is called the "Salario Diario Integrado",

Spanish for Integrated Daily Pay Rate (IDPR). The difference is that the IDPR includes all cash benefits including commissions and allowances in addition to the base salary that the DBPR considers.

PAY DAY

As in most states in the U.S., the Mexican Federal Labor Law regulates how often employees get paid. In Mexico direct labor employees must be paid at least every week and all others at least every two weeks. To simplify processing of payroll, most companies that have direct labor employees (such as manufacturing operations) will pay all of their employees on a weekly basis.

THE WORK SHIFT

The biggest difference between a work week in Mexico and a work week in the United States is the hours. While a work week in the US is typically 40 hours, per the Federal Labor Law a work week in Mexico is 48 hours. Spread in six eight hour shifts, working Monday through Saturday.

Most organizations in Mexico will distribute the 48 hours in five 9.6 hour shifts to limit the work week from Monday to Friday and provide employees with a full weekend. Under those circumstances Saturday becomes a paid day of rest.

OVERTIME

The Federal Labor Law in Mexico makes a very clear distinction between overtime and work on a day of rest.

Overtime is considered as time worked after a normal shift and must be paid as double or in some cases as triple the regular pay rate.

Work on a rest day is paid as mentioned above, double the regular pay rate.

There are two considerations to determine if overtime hours are considered double or triple paid hours:

- The total amount of overtime hours worked during the work week.
- The amount of hours worked during a single day after a regular shift.

The first nine overtime hours during the week are considered double, every hour after that is considered triple.

The first three hours after a regular shift are considered double hours, every hour after that is considered triple regardless of the number of overtime hours worked during the week.

Example 1

An employee with a Daily Base Pay Rate of \$142.85 pesos works two hours of overtime during five straight days in a single week for a total of 10 overtime hours. How much overtime pay will he get?

Because he never worked more than 2 hours of overtime on a single day the first 9 hours are paid as double and only the 10th hour as triple:

The employee is entitled to 21 hours of pay.

If the Daily Base Pay Rate of this employee is \$142.85 pesos his equivalent Hourly Rate is:

\$17.86 (\$142.85 8 divided by 8)

The employee's overtime pay will be:

\$375.06 (\$17.86 multiplied by 21)

Example 2

An employee works 4 hours of overtime on two days in a single week for a total of 8 overtime hours.

How many hours of pay is he entitled to?

Because he worked more than 3 hours on a single day the first 3 hours for each day are double and the fourth hour on each day is triple:

The employee is entitled to 18 hours of pay.

BENEFITS

Required by the Mexican Federal Labor Law:

Aguinaldo

An annual bonus to be paid no later than December 20 of each year. The Federal Labor Law requires that the bonus be no less than 15 days of pay regardless of the years of service. If an employee has been with the company for less than a year the amount is prorated based on the hire date.

Paid Holidays

There are 7 required paid holidays in Mexico

- January 1st – New Year's
- February 5th - The day the Mexican Constitution went into effect in 1917
- March 21st - Celebration of the birth of Benito Juarez. Mexican President who served 5 terms and resisted the French occupation, overthrew the Empire and restored the Republic.
- May 1st – Labor Day
- September 16 – Independence Day
- November 20 – Anniversary of the Mexican Revolution
- December 25 – Christmas Day

State and Federal Election days are also considered holidays as well as the Presidential Inauguration that takes place on the 1st day of December every 6 years.

Employees that are required to work on any of these days are entitled to double time.

Contrary to common belief in the United States “5 de Mayo”, commemorating the Battle of Puebla, where Mexico defeated the French on May 5th is not a commonly observed or celebrated holiday.

Other holidays that may be observed:

- February 24th – Flag Day
- Good Friday and Easter Sunday
- May 10th – Mothers Day
- September 1st – State of the Union
- October 12th – Celebrates the arrival of Columbus to the Americas
- November 1st – Day to honor the dead
- December 12th – Day of the Virgin of Guadalupe

Vacation Pay

Employees with at least one year of service are entitled to six days of paid vacation. Vacation time will increase by 2 additional days for each year of service up to the fifth year. After five years, employees are entitled to 2 additional days for each additional 5 years of service.

Day of Rest

Under Mexico’s Federal Labor Law, employees are entitled to one paid day of rest for each 6 days of work in addition to the required 7 paid holidays. This seventh day can fall on any day of the week. However, employees whose regularly scheduled work shift falls on a Sunday must be paid a premium of 25% above what they are paid on other days. This is known as the Sunday Premium (“Prima Dominical”).

Workers required to work on the 7th day, holiday or any other rest day are entitled to double pay. If that day falls on a Sunday, the worker is entitled to double pay plus the 25% premium.

Annual Profit Sharing

Federal Labor Law also requires that company-wide profits be shared with employees. The amount of profit required to be shared is determined by the National Profit Sharing Commission. The commission includes representation from workers, employers and government. In recent years the typical percentage of profits to be distributed among the employees has ranged from 8% to 10%. This percentage is not distributed equally. Distribution is weighted based on the employees Daily Base Pay Rate.

It's important to note that the employee is entitled to profit sharing of the legal entity that employs them, not the corporate organization. For foreign companies, the profit sharing is limited to the Mexican subsidiary or entity.

Social Security Benefits:

The social security system in Mexico provides, regulates and manages medical, retirement and housing benefits for workers. The system is managed by the Mexican Social Security Institute or IMSS (acronym for its name in Spanish). Contributions from employers account for most of the revenue to provide these benefits. Approximately 70% of the revenue comes from employers, 25% from employees and 5% from the government.

Employers provide the equivalent of approximately 28% of the employee's salary into several government managed funds that provide social security benefits. The contribution will vary depending on the work the employee is performing and the potential injury and health risks. The index is heavily affected by recordable incidents.

Retirement Savings Plans

Retirement savings plans are regulated but not managed by the IMSS. Current programs require employees to provide contributions into a privately managed government approved fund selected by the employee. The mechanism is similar to an IRA in the U.S. where the employee can move their account from one bank to another. However, the investment itself behaves more like a mutual fund where the employee chooses which bank will manage the money but leaves the responsibility of managing the investment to a fund manager.

Currently employers are required to contribute 2% of the employee's salary to their retirement fund. This contribution is capped at 25% of the prevailing minimum wage.

Housing Subsidies

Mexico has a national fund for subsidizing housing for workers. The subsidies are typically in the form of low interest loans or other credits.

Employers are required to contribute 5% of the employee's salary to the fund. The contribution is capped at the equivalent of 10 times the prevailing minimum wage.

Social Welfare Benefits

Social Welfare Benefits are considered non-cash benefits provided by the employer that promote better living conditions for the employee. These benefits are optional and tax exempt. However, the exemption is capped to benefit lower paid employees. As a result many companies cap the benefit to match the tax exemption cap.

A key element of a Social Welfare Benefit is that it must be provided to all employees regardless of salary, wage or rank. If the benefit is not across the board it will not be considered within the Social Welfare Benefit plan and the tax exemptions will be lost.

These benefits include:

Subsidized Cafeteria Service

This benefit is no different than the one provided by many companies in the United States.

Grocery / Food Coupons (“Vales de Despensa”)

These coupons are provided to employees with every paycheck and can be used in grocery stores.

Savings Fund (“Fondo de Ahorro”)

The savings fund is a very common and very popular benefit to promote short term savings. The employer deducts and matches a percentage of the employee’s salary for every paycheck and contributes both amounts to the fund. The employer’s and the employee’s contributions plus interest are paid back to the employee at the end of the 12 month period.

The fund is managed by an employee commission with company oversight and is commonly used to provide short term employee loans.

Payment of medical insurance and life insurance premiums

Life insurance plans in Mexico are pretty much identical to plans in the United States. Medical insurance is not.

Even while social security covers medical benefits most employees use private medical practices and seek private medical insurance. Coverage in Mexico is mostly for hospital visits and catastrophic events which dramatically reduces the premiums. Yearly premiums in Mexico will be close to two months of premiums in the United States.

It is not common for employees to share the cost with employers. It is common for companies to limit the coverage to the employee and allow the employee to pay the premium to include his/her family in the group plan.

When reviewing health insurance benefits employees will look at:

- a) The deductible;
- b) Overall cap in medical expenses that are covered by the plan;
- c) Geographical coverage;
- d) Specific hospitals that may be blacked out
- e) Coverage that will include their family.

Transportation

It is not uncommon for companies to provide private bus routes for their employees. It's a practice that began with direct labor to reduce tardiness and has expanded to all the ranks as traffic becomes a bigger issue in mayor cities.



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