Nearshore Manufacturing ESOP Fund (NMEF)

Problem Statement

Income inequality in emerging and middle economies remains a massive global problem. Despite significant economic growth in recent decades, countries like Mexico (45.4 Gini index), Panama (50.9), and Belize (53.3) still exhibit pronounced levels of economic disparity.

A major driver of this inequality is the dynamic between labor and capital. Labor forces in these economies are not well positioned to participate in the full upside of economic growth, as they are traditionally locked out of long-term benefits that distribute wealth equitably (e.g., through retirement benefits) or through the ownership of their industry (e.g., stock options). Furthermore, traditional buyout structures transfer profits and control from owner-operators to private institutions, often abroad, capping domestic economic development.

This problem is especially pertinent for the industries that drive economic growth for these countries, such as manufacturing. However, these industries are often equipped with collateralizable hard assets and stable cash flows, which can be used to support innovative financial products.

Opportunity

As the US continues to shift its manufacturing needs away from China to neighbors like Mexico ("nearshoring"), a significant opportunity exists to utilize Employee Stock Ownership Plan (ESOP) buyouts that equitably distribute profitability upside to workers. This model could be replicated in other nearshore manufacturing hubs throughout LATAM.

Why Mexico?

The **manufacturing sector** represents 18.5% of Mexico's GDP - there are > 67K consumer goods and material products manufacturing enterprises in Mexico with ~1.4M employees*. The sector attracted 47.9% of foreign direct investment (FDI) from 2016-2021.

Mexico became the **top US trading partner** at the beginning of 2023, with total bilateral trade reaching $263B in the first four months of the year.

Furthermore, with an **average manufacturing wage of $4.00/hour**, many working-class Mexicans are ill-equipped for retirement.

**Statista, 2023*

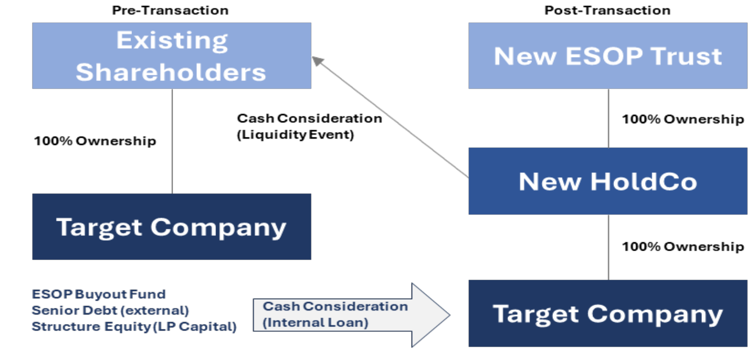
Solution

Investment Thesis:

We believe the Nearshore Manufacturing ESOP Fund (NMEF) structure has the power to attract more firm owners and outside investors to transfer wealth and equity participation to Mexican manufacturing workers. This instrument will help the working class capture the value creation inherent in their labor and lock-in long-term benefits through industry ownership.

NMEF brings ESOP buyouts to Mexico's growing manufacturing sector, giving low- to moderate-income Mexican employees an equitable distribution of wealth by providing them with a share of the capital growth of their employer. Investors are compensated for higher non-US market risk with higher returns (vs. US ESOP funds) via interest rates commensurate with market risk. At full fund deployment, underlying loans could be securitized to reduce risk exposure.

How It Works



In the NMEF buyout, the Fund Sponsor establishes a new "HoldCo" as the purchasing entity. Simultaneously, an "ESOP Trust" is created, subscribing to 100% of HoldCo's shares. Fund Sponsor secures financing through external debt and internal equity. Post-transaction, the ESOP Trust owns 100% of HoldCo, which, in turn, owns 100% of Target. Shares are released from the ESOP Trust for distribution among employees as the company repays loans with its cash flow . To attract external financing, Senior Debt takes precedence over Fund Sponsor's structured equity. Senior Debt is repaid through annual coupon payments and a final principal payment (either via refinancing or available firm cash), while structured equity received annual returns through cash or PIK interest, with final payback during a recapitalization event. The Fund charges a 2% annual management fee and a 20% fee on carried interest computed.

Structure

This Fund will operate akin to a traditional LP-GP structured Private Equity Fund, with the Fund Sponsor (e.g., Morgan Stanley) acting as the GP and outside investors as the LPs. The Fund will target a ~20% Gross IRR, a ~2x Gross MOIC and will use substantial outside debt financing (50-75%) to execute its deals.

Terms	
Fund Size	$300-500M
Fund Life	8-12 years
Target Investors	Institutional, Govt., ESG, Donor-Advised Funds
Target IRR	15%
Target MOIC	2x
Fee Structure	2% mgmt. fee (p.a.), 20% carry

Hypothetical Capital Stack	Target %	Target Terms
External Debt (Senior)	50-75%	SOFR + 350 bps
Sponsor Structured Equity	25-50%	18-22%

Rollout

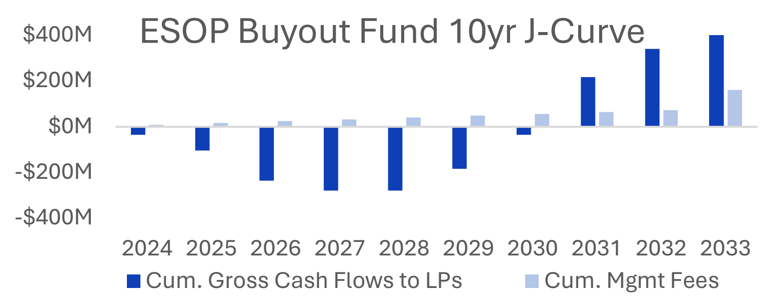
Pilot	Potential Extensions
Target 8-12 lower-to-middle market mfg. firms in Mexico with $15-30M in EBITDA and EBITDA interest coverage ratios >3x (post-purchase)	**Geographies:** Panama, other Central American countries with high income inequality & middle economic dev. **Industries**: Manufacturing, textiles, chemicals, commodities (e.g., steel)

Benefits

The NMEF represents a strategic alignment of economic incentives, social goals, and industry needs across Mexican manufacturing workers, current industry and government/NGO stakeholders, while providing investors with attractive risk-adjusted returns.

- **Lower income inequality:** Mexico faces significant income inequality (45.4 Gini coefficient, 2020) and the manufacturing sector employs a large portion of the workforce (18.5% of GDP), often at low wages ($4/hr). The NMEF addresses this issue by allowing manufacturing workers to benefit from the wealth generated by their labor. On average, employees at ESOP companies retire with 2.5x more wealth and earn 5-12% more wages, directly helping to correct income disparities in the sector.
- **Improved business outcomes:** ESOP-owned companies tend to have an average of 21% higher profitability, 3% higher sales, and are 25% more likely to stay open. These business outcomes are driven by more engaged employees, higher customer engagement, and 33% better employee retention.
- **An alternative to private credit/convertible debt:** Structured equity offers investors many of the benefits of private credit via higher yields with the option to convert to equity via warrants. The Fund can toggle the level of cash/PIK interest, giving firms additional flexibility and aligning the incentives of investors and firms.
- **Liquidity and aligned-interest for business owners:** Selling shareholders are offered compelling market-rate exits (liquidity event, strategic partner), coupled with powerful ESOP benefits (greater management ownership, aligned interest with employees). Equity roll-over stakes and earn-out incentives will be considered as-needed, to facilitate current management share in upside.

Financial Returns



Impact Metrics (KPIs)

Impact

Employee Ownership Percentage: Tracks the percentage of each portfolio company owned by employees through the ESOP, reflecting the degree of wealth and equity sharing.
Employee Net Wealth Increase: Measures the increase in financial wealth for employees participating in the ESOP, showing the impact on individual financial wellbeing.
Community Impact Score: Assesses the fund's & its portfolio companies' impact on communities through philanthropy, community engagement, & economic development.

Business Outcomes

Productivity: Evaluates changes in productivity levels within the portfolio companies, post-ESOP implementation, to gauge the impact of employee ownership on operational efficiency.
Employee Satisfaction: Through surveys and assessments, track how employee workplace perception, engagement, and job satisfaction evolve post-ESOP implementation.

Key Product Differentiators

VS. ESOPs in Mexico: Exist mostly within compensation packages, particularly for tech startups and multinational corps operating in MX – *limited upside and less applicability to working-class as often used to retain/attract "highly-skilled" workers.*

VS. Participacion de los Trabajadores en las Utilidades (PTU): Fixed share of profits, designed to benefit a wider range of workers – *limited upside and reduced performance alignment, which potentially handicaps business outcomes.*

SDGs Addressed

1 NO POVERTY	End poverty in all its forms everywhere	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	Deliver inclusive and sustainable industrialization
8 DECENT WORK AND ECONOMIC GROWTH	Drive inclusive & sustainable economic growth, full & productive employment	10 REDUCED INEQUALITIES	Reduce inequality in and among countries.

Potential Partners

Investment firms

LPs (e.g., endowments & Donor Advised Funds)

Relevant trade associations & unions

Middle-market Mexican manufacturers

Challenges & Risks

Challenge / Risk	Mitigant
Compliance with local and intl. tax, labor laws and financial regs.	US-based fund, Mexican and US legal counsel.
Sourcing private, profitable manufacturing companies.	Partnership local investment banks, trade show promotions.
Structuring the fund to manage foreign cash flows.	Mexican and US banking relationships, offshore HoldCo.
Implementing proper debt compliance.	Treasury & legal teams, financial covenants (e.g., reporting).
Market Risk: political & economic stability, pro-trade regulation.	Potential securitization once fund is fully deployed.
Currency Risk: fluctuations in USD/MXN exchange rate.	Hedging through FX instruments (i.e., forwards and swaps).
Credit Risk: sufficient free cash flow to pay principal and interest.	Diligence will prioritize bizs with stable FCF & high cov ratios.
Governance/Integration: leadership and strategic oversight; protecting ESOP structure at exit.	Employee ed programs, new GM & board seats for employee representatives.
Ecosystem: sufficient financial infrastructure for ESOPs (bankers, attorneys, banks, investors).	Leverage large global banks w/international relationships & ESOP experience.
Scalability: sufficient buyout targets that fit criteria.	Potential expansion across e.g., geography or industry.