Sage ERP | White Paper

Strategic Partnering in the Speciality Chemicals Industry

Prepared exclusively for Sage by Cambashi, Inc.
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A Restructuring that Changes the Chemical Industry

Specialty chemical companies are in the midst of an industry-wide restructuring that threatens their role as independent innovators. This has been further hastened by the global recession (Figure 1).

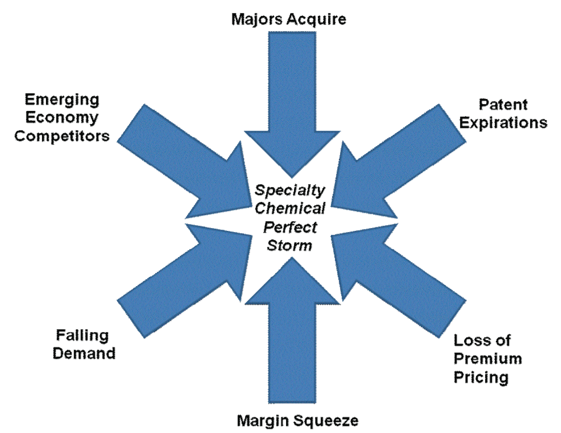

Figure 1: Specialty chemical has many factors contributing to restructure the entire industry.

For the past decade, basic chemical giants and a new breed of holding companies have been strategically acquiring and integrating specialty chemical businesses to establish strong portfolios targeting specific end markets. Specialty chemical makers with focused niches are the target for chemical leaders, holding companies, other specialty producers, and even chemical distributors. The result is a consolidated playing field of diversified and specialty power houses that can afford to sell specialties in volume as "light" commodities.

During this same period, many specialty technologies reached patent expiration, hit the peak of their lifecycle, and lost their premium pricing advantage. To create a perfect storm, after the oil crisis that justified higher pricing came pressure from customers to cut prices, squeezing margins. Specialty pricing took another hit as demand fell and customers looked for lower-priced alternatives during the economic crisis.

Furthermore, chemical breakthroughs are harder to find. That change has resulted in fewer innovations that can command premium prices and changes the game across the industry.

The chemical majors out of India, China, and the Middle East are also actively trying to capture the demand of their growing economies while leveraging their access to feedstocks and local investors.

Sizing Up the New Normal Paradigm

What is emerging is a separation of two camps. In one camp are the top-tier chemical powerhouses that are diversifying and strengthening their portfolios and positioning themselves to respond to global megatrends with commoditized technology offerings. In the other camp are smaller specialty chemical companies in narrow niches, developing higher-margin innovations and services to capture profit and share in their core markets. (See Figure 2.)

Diversified Chemical Giants	Specialty Chemical Players
Emphasis on high growth and margins	Emphasis on value-driven growth
Diversification and specialty M&A	Focus on core competences and niches
High-volume specialty commoditization	Lower volume value chain solutions
Leveraging access to feedstocks	Leveraging customer relationships
Focus: Megatrend global solutions	Focus: Value-add innovations
Multitechnology capabilities	Multidiscipline capabilities
Global presence and local facilities	Regional presence and global partners
Well positioned for emerging markets	Well positioned for emerging solutions
Leadership role in eco-sustainability	Innovation role in customer sustainability

Figure 2: The industry is separating itself into two distinct types of businesses, with the large commodity firms moving into specialties and the specialties becoming more niche-oriented. As a result, their business strategies and focuses are vastly different.

The diversified heavyweights are focused on higher growth and margins along with less exposure to cyclic market risk. These objectives have been the driver of Dow's transformation strategy as a high-value earnings-growth company, which led to its acquisition of Rohm and Haas. Today, Dow and its peers have sophisticated market strategies, multi-technology capabilities, and global reach to pursue megatrends with high growth opportunities in infrastructure, agriculture, energy, electronic materials, coatings, health and wellness, personal care, water solutions, and packaging materials. They are also becoming well positioned to lead in emerging markets across Asia and Latin America.

Specialty chemical players are revising their strategies to further differentiate themselves from the diversified conglomerates and new entrants coming out of emerging regions. This is a time for focusing on leading core competencies that aren't easily duplicated and divesting operations that aren't number one or two in market share or don't generate enough value creation in their targeted niche markets. This exercise is particularly challenging, since most market sectors have yet to recover from the global recession and it is unclear if some of these segments will attain previous demand levels or normalized growth rates. In some cases, executives are still uncertain if their specific end-markets are in a V- or W- shaped recession and when a second dip may occur. As a result, they are being cautious in their decisions and still maintaining tight control on expenses.

There are a number of specialty chemical firms in a strong position coming out of the recession because of their established expertise in specialty niches that are not easily replicated by outsiders. Yet even these well positioned specialty businesses face considerable challenges in generating significant growth or achieving historical margins. During the downturn, many companies closed plants or reduced their fixed assets, leaving them with less capacity and fewer resources. Customers cause challenges with new specifications, sourcing strategies, and parent companies. Furthermore, smaller specialty companies can't easily make technology acquisitions or conduct high growth innovation efforts that take years before there is a return on investment.

Specialties Turn to a Value-Driven Approach

Opportunities exist for specialty chemical companies in creating value through strong portfolio and innovation management. As chemical technology breakthroughs become harder to achieve, innovation has taken on new meaning and is moving beyond traditional R&D thinking into the business model.

Companies are zeroing in on focused innovation across the value chain that enhances competitiveness for themselves and their customers. This requires deep understanding of the customers' business opportunities and challenges. This isn't as simple as turning to sales and marketing to provide direction. It is a much broader and deeper challenge. This customer intimacy, or deep relationship fostered by frequent interactions across the organization, is necessary to understand and support a customer's business.

What is typically required is a more structured and systematic business research process to uncover the "voice of the customer." The outcome is a clearer view of what does and does not add value across the value chain. That knowledge and subsequent vision provides a unique advantage in developing innovative strategies, solutions, and services that fit customers' needs, solve their problems, and add competitive value to their offerings.

Ciba Specialty Chemicals was an early role model of this approach back in 2001, when it focused on textiles and developed integrated solutions in product chemistry, processes, and technical support. It was then able to add value throughout the textile chain at a global and local level—from fiber production to weaving, dying, and finishing and on to retail and end-customer marketing. Ciba's approach to specialties was a primary factor in BASF's interest and eventual takeover bid.

What these companies understood is the importance of a value-driven model to develop a mix of product and service solutions. Instead of focusing strictly on the chemical value chain for innovations, they moved into adjacent areas such as equipment and services. It is in the adjacent value chains and new business models where the greatest opportunities for innovation and growth can be found for specialty chemicals.

Strategic Partnerships are Key to Sustainable Value-Driven Growth

An underutilized, yet critical success factor for this new normal paradigm is strategic partnerships. As a result of the economic shakeup and changing nature of innovation, partnerships will become a vital strategic factor for chemical makers. There are a number of sound partnering options for value-driven growth, as shown in Figure 3, including:

- **Teaming up with other chemical companies.** After having made severe reductions in assets and resources, many in the chemical industry will need certain technologies, assets, and expertise to serve a valued customer or specific market niche. Others will be looking for joint venture partners to share in the expense of developing more risky innovations, such as sustainability technologies and new market expansions. For example, MeadWestvaco Specialty Chemicals and Albemarle recently formed a strategic alliance to enter the mercury emissions control market.
- **Forming alliances with specialty distributors.** Some global distributors have already transformed their businesses into sales and marketing organizations. They have a long history of being close to their customers and already see the potential of value-added support, field services, and adjacent applications in growing their businesses. These partners can accelerate a specialty chemical's value in a given sector and provide greater global presence.

- **Bridging the capacity gap with toll manufacturers.** Toll contractors or outsourced manufacturers are an efficient, responsive, and flexible option to capture demand as it picks up. The toll manufacturers may be looking for joint venture partners and customers seeking multiyear contracts to share in the expense of rebuilding their capacities. Tollers can also be development partners or other specialty chemical providers.
- **Creating joint solution agreements with equipment makers or service providers.** When companies explore a broader solution footprint beyond the confines of the chemical value chain, they will find opportunities to establish marketing agreements with the providers of these adjacent components (selling equipment, hardware, services, or anything else that adds value to the solution). A recent example is the partnership between Hexion Specialty Chemicals and Telke Technical Services to develop green building products for the construction industry.
- **Developing strategic ventures with customers.** Developing stronger relationships with the customer base can lead to strategic partnerships for longer term projects. This can lead to the development of a breakthrough industry solution or opportunities to jointly offer new solutions to the customers' markets.

Partnership Options

- Chemical Makers
- Specialty Distributors
- Toll Manufacturers
- Nonchemical Firms
- Customers

Figure 3: There are a number of partnering options for developing and supporting value-driven innovations and customers.

Streamlining and Integrating the Value-Driven Business Model

Chemical companies have long been R&D driven, developing chemistries and selling them as products in volume. The new value-driven business model will reorient the business processes around customer solutions, sales and marketing, and value-added activities. This is a major change and for many companies will require new information systems to support this restructuring, much like Air Products, which implemented an ERP system to integrate its streamlined actives with one common system across its global organization.

What Air Products understood was the need for corporatewide adoption of common business processes and the means to measure them to achieve a value-driven business. A single common platform that eliminates specialized subsystems and goes across all locations provides uniform processes, integrated data, and consistent metrics. Some of the core functional requirements of such a system are shown in Figure 4.

Enterprise IT Functionality

- Sales, Marketing, and Customer Mgmt
- R&D—Product and Compliance Mgmt
- Product Lifecycle Mgmt
- Technology Portfolio Mgmt
- Supplier Relationship Mgmt
- Contract Lifecycle Mgmt
- Supply Chain Mgmt
- Production Planning and Execution
- Distribution Mgmt and Services
- Environment, Health, and Safety Mgmt
- Asset Performance and Safety Mgmt
- Technical and Field Services Mgmt
- HR and Financial Mgmt
- Value-add Activity Costing
- Financial and Performance Analytics
- Sustainability and Compliance Mgmt

Figure 4: The business IT functionality needed by value-driven chemical companies to manage operations, growth and risk.

Conclusion

While the economic crisis sped up the inevitable changes in the chemical industry, it also forced companies to face these changes and pare down their businesses to core capabilities. This provides a cleaner sheet from which to build a new corporate vision and value-driven infrastructure. It also put companies in the position of fewer in-house resources and assets, which will drive the need and opportunity for strategic partnerships. While these may have been the worst of times, they may in turn produce the best of times in years to come for specialty chemical survivors.

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