

Chemical Executive Series

Succeeding in Challenging Times

accenture

High performance. Delivered.

Part of a series of papers
focusing on fresh ideas
in the chemical industry



• Consulting • Technology • Outsourcing

Chemical company executives are no strangers to cyclical downturns, but the current situation is a great deal more complicated than what the industry has seen in the past.

Since mid-2008, global demand has dropped dramatically, and prices have followed suit. To complicate matters, the industry was caught with high-value inventory due to the elevated cost of oil prior to the downturn, leaving companies to take significant write-offs of inventory when demand fell.

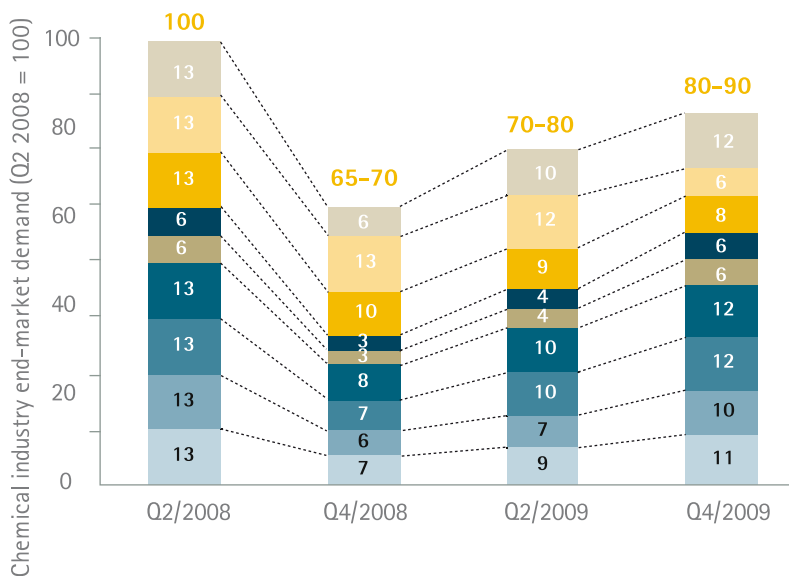
No one is able to predict when the downturn will end, and while many chemical companies may have enough cash to ride it out, recovery for the industry will be gradual and likely tied to developments in specific

end markets and regions. Many observers have suggested that an upswing could begin to take hold in late 2009. Accenture expects that there will be improvements—but also that there will be a differentiated, end-market-specific path to recovery (see Figure 1).

Nevertheless, the downturn will end and, as companies cope with the cost pressures of today, they also need to prepare for that economic upswing. Indeed, recent Accenture High Performance Business research shows that the way in which a company reacts to a downturn has a clear impact on its long-term success. Researchers analyzed the actions and financial results of hundreds of companies during and after a recession. Those companies identified as long-term winners tended to see

the downturn as an opportunity to improve and build, rather than just “hunker down.” They worked deliberately during these periods—not so much to establish a new strategic position, but to strengthen their current position. In today’s market, chemical companies can learn from that experience and take action to succeed during the downturn and beyond and ultimately achieve high performance.

Figure 1. Differentiated path to recovery.



Volume estimates

- Chemical end markets:
- Agriculture
- Construction
- Electrical and electronics
- Textile and dye stuff
- Personal care
- Food and feed
- Pharmaceutical
- Automotive
- Packaging

Against this background, it is clear that companies need to reconsider their positions and decide on their strategies for responding to changed circumstances.

Some companies will be necessarily focused on survival. Other, better-positioned companies should be thinking about how to turn events to their favor, using the downturn to improve their relative competitive position and establish a stronger platform for future growth.

Exploit the ordinary

Every company today is under intense scrutiny—from wary investors, debt holders, potential buyers, nervous boards, impatient regulators and concerned customers and employees. In these circumstances, management first must demonstrate the ability to run day-to-day operations more effectively than before. For leaders to manage the maximum effect in a downturn, they must exploit the ordinary levers at hand, maintaining flawless operations despite the need to tighten belts and deal with suppliers in crisis, customers lacking in confidence and ongoing post-merger integration challenges. Four operational imperatives will be critical to manage throughout the crisis: Rapid and sustained cost

management, customer acquisition and retention, operational excellence and effective mergers and acquisitions (M&A).

Rapid and sustained cost management

For many companies, this will be the most important imperative—but it must be done with a surgeon's dexterity. Costs, assets and investments must be rigorously scrutinized along the entire value chain, from research and development through the supply chain to customer service.

The key is to balance the speed of cost reduction and the delivery of cash to the bottom line with the retention of critical business capabilities and future sources of value. Indiscriminate cost-cutting or jettisoning of assets will leave companies unprepared to rebound during the upturn.

Customer acquisition and retention

Companies always want to keep good customers and sign up new ones, but this imperative takes on even greater meaning during a downturn.

Nervous customers may be tempted to stay on the sidelines until the economic outlook improves, which means that prudent, customer-centric investments in marketing, sales and distribution are essential.

Companies should focus on sustaining their customer bases; some may even be able to take share from weaker players in their home markets while building new markets elsewhere in the world. For example, exchange rate fluctuations on the order of 20 percent may provide an opportunity for companies to

exploit a new pricing strategy, as advantages over foreign competition are gained overnight.

Operational excellence

This imperative takes on added importance in companies that are truly global. When all aspects of an organization—manufacturing, customer service, sales, distribution, management, marketing and innovation—are spread throughout the world, operational excellence depends on the development and management of an effective global operating model to take all these activities into account.

Effective mergers and acquisitions (M&A)

While a focus on M&A may seem counterintuitive during an economic crisis, it is actually even more important during challenging times, when bargains suddenly become available.

But handle these opportunistic acquisitions with care: Cheap, troubled companies are likely to come with demoralized employees, processes in disarray and balance sheets in tatters—all of which make integration particularly challenging. And thorny problems such as balance-sheet integration, customer alignment, supply chain optimization and shared services

must still be resolved deftly—this includes mergers already in progress. In addition, the foundation for cultural alignment, especially in the context of cross-border acquisitions, must be laid carefully.

These imperatives require great focus and discipline on the part of management teams. No company can fail to attend to them and expect to make it through the current crisis and emerge equipped to take advantage of the upturn.

Companies should push through improvements that might have met with strong resistance in better times.



Manage the extraordinary

As leaders deal with the day-to-day operational challenges companies face during any downturn, they are also obliged to move quickly to manage the extraordinary. They must confront the challenges and threats unique to this crisis in real time—and they must do so at speeds that initially may feel uncomfortable or even impossible to reach and sustain. Companies that have not invested in organizational agility and quick decision making—creating effective top management teams and change processes—will find the tasks necessary for managing the extraordinary particularly daunting.

Based on an assessment of their companies' current situation, management teams must choose from among three core strategies, each with associated tactics. What is extraordinary about these strategies is not the tactics themselves but how they must be managed simultaneously alongside everyday operational goals and challenges.

The chosen strategy needs to be a priority for management, but not so much so that it risks overwhelming the business. The strategy cannot be allowed to cause significant interruptions in the current business that would signal distress (or greater distress than already observed by the market), and it must not be allowed to demoralize

employees—even members of the top-management team might be affected. Employee morale is critical to coming through a crisis in a stronger position, and management confidence and decisiveness in the face of challenges bolsters employee confidence.



Recession, strategy and transformation

For chemical companies, determining the right response to this recession is complex since it hits many industry segments in a time of consolidation and reorganization. For some time, many companies have been working to transform themselves in preparation for a more global future. Just where they are on that journey will have a significant bearing on the strategies and actions they need to pursue now.

To understand what steps a company should take, it is useful to consider two factors. The first factor is financial stability and ability to meet debt payments, or secure debt refinancing—key factors in defining a company's management agenda today. The second factor is to what extent a company has completed its strategic transformation, since in many cases a company's strategic—and not just financial—freedom has been seriously affected by this downturn. This analysis essentially classifies chemical companies into three broad categories, that Accenture calls “cash is king,” “build the global model,” and “grow against the tide” (see Figure 2).

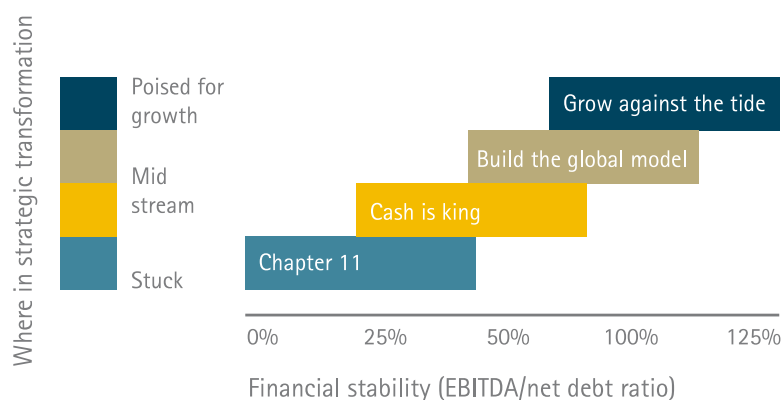
In a downturn, management focus likely is on the company's long-

term, strategic transformation journey, and the need to address short-term challenges.

Cash is king (survival)

A number of companies are midstream with their transformation efforts and have relatively high debt levels and, for the time being at least, do not have the cash needed to continue those efforts. Their high debt levels are due, in part, to their inability to make planned and strategically sound divestments. These companies will need to focus on strengthening their financial position and managing cash in order to meet debt and interest payments. They typically will need to decrease working capital, delay large investments, optimize

Figure 2. Emerging management focus in the chemical industry.



Where in strategic transformation—How far has company progressed toward achieving its target business model, in line with the three apparent models and their characteristics.

Financial stability—To what extent is current cash flow providing adequate coverage for net debt on balance sheet.

inventory levels and reduce the workforce. They also can pursue initiatives that will help them reduce costs and simultaneously prepare for the future, such as creating more robust demand-planning capabilities, outsourcing noncritical functions, locking in low commodity prices, and identifying and eliminating unprofitable customers, channels and products.

Build the global operating model and prepare for the upturn (reposition)

Companies in this category are fairly strong financially and have made significant progress in their transformation. They are more or less set to survive the current recession and should aspire to

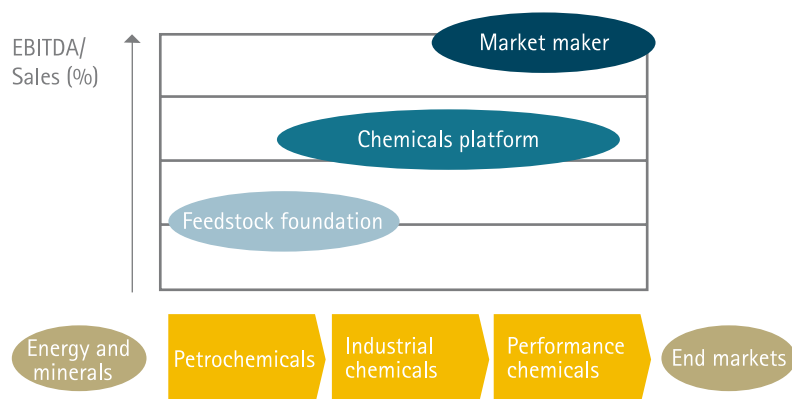
emerge from this period stronger than before the downturn. This implies they typically will need to address some structural issues and continue to build a global operating model. These steps might include the finalizing and integration of acquisitions under way, reducing complexity in product and customer base, the optimization of manufacturing and supply chain assets, right-sizing and reskilling the workforce, and simplifying processes across the organization. Such efforts will enable them to achieve high performance by improving productivity and selling, general and administrative expense (SG&A) cost performance, and delivering more global and scalable support processes in preparation for the upturn.

Grow against the tide (grow)

Accenture expects there are only a few companies able to grow against the current tide. Likely, these companies will be characterized by strong financial health and the complete or near complete transformation to the target business model. These companies are in position to look ahead and prepare—to sharpen and, where appropriate, accelerate plans, benefit from the development of new offerings and take market share. They essentially are ready to use the current business environment as a springboard for accelerating improvement and moving ahead of their competitors.

Figure 3. Emergence of chemical industry business models.

Value chain positioning and profitability



Business model-specific considerations

Accenture believes that in the coming years, chemical companies will have to adopt one of three emerging business models, which we call feedstock foundation, chemicals foundation and market maker¹ (see Figure 3). For the companies in the “grow against the tide” category, the appropriate strategy will depend on which of these models they are pursuing.

- **Feedstock foundation.** In this downturn, Accenture believes that companies adopting this model can make use of their superior cost position to expand their existing position. In a market suffering from overcapacity, this approach will be preferred to buying market share via acquisition. With low operating rates in the industry and the multitude of new plants coming online in the next two years, companies generally will not be interested in acquiring additional capacity—in particular when it is not “world-class.” However, they should remain alert to niche, “beachhead” acquisitions that can give them access to specific markets or technologies.

- **Chemicals platform.** Selective consolidation may be an attractive strategy because this is a fairly fragmented segment encompassing numerous large and small companies. And there are some “distressed” companies and assets in this area—companies that do not have sufficient scale, lack true leadership positions, or have problematic balanced sheets.

Given the challenges in the financial markets and the relatively high valuations of many potential target companies, acquirers pursuing deals should consider alternatives to traditional financing, such as entering into joint ventures or trading assets (“asset swaps”) with other companies, or considering equity-funded acquisitions.

1. Accenture point of view, “Sharpening business models helps chemical companies achieve high performance” (March 2009), http://www.accenture.com/Global/Services/By_Industry/Chemicals/R_and_I/ChemicalExecutiveSeries.htm



Such approaches may be attractive for chemical platform companies that are halfway through their transformation process and now find themselves unable to continue due to a lack of "bridge financing" for divestments and acquisitions.

- **Market maker.** Market maker companies will work to drive innovation based on an understanding of product performance and act on pervasive end-market trends, rather than just customer input. In the current environment, they need to focus on making sure that they sustain market growth—where possible, leveraging the downturn to drive market growth against other "legacy" solutions by focusing on better performance, lower cost or more sustainable solutions.

These efforts to innovate and grow will need to be combined with increased attention to the market maker's operating model. As these companies scale up to several times their original size, they will need to ensure the organization and their business processes can sustain performance in the face of greater size and complexity. As they expand, delivering nearly double-digit growth rates on an ongoing basis will be a growing challenge in terms of the management attention, resources and capital involved.

Opinions differ on the likely depth and duration of a downturn, but few would dispute that we are currently in a challenging economic environment that is unlikely to improve substantially in the coming 12 months. Risks may come from many sources—mapping these carefully and understanding how to mitigate them will be essential. Many companies will struggle to survive—and some will not make it. In these cases, rapid action to secure cash flow and minimize exposure to risk can make the difference.

High-performance businesses proactively use a downturn to improve their competitive position, taking advantage of shifting customer needs, upgrading talent, and acquiring capabilities and assets at a bargain price.

Region-specific considerations

As there are business model-specific considerations to the downturn, similarly there are region-specific ones. For mature regions such as North America and Europe, companies will need to carefully balance a cost and cash focus while maintaining an eye on medium- and long-term future opportunities. This balancing could mean capacity eliminations, but at the same time, investments in innovation and growth.

For growth economies and emerging markets, Accenture recommends staying focused on end-market trends, looking for opportunities to get closer to customers and capture value. Local players also will need to assess their competitiveness against what

is likely to be a more aggressive stance from resource-rich, export-oriented players and adjust their strategies and investment plans where appropriate.

Resource-rich, export-oriented countries and regions will need to take a hard look at their strategies and plans. As their investment strategies were predominantly predicated on the growth of export markets with limited volumes in protected home markets, these companies find themselves in a true squeeze. We expect these companies will need to enhance the value of their building blocks (such as through new routes and processes) and improve their presence in target markets.

The key question for management is:
Where will your company be in this new world?

Getting better in tough times

Meanwhile, chemical companies that are continuing transformation efforts will need to invest in strengthening those aspects of the business that support high performance, and in shedding those that hinder it. As discussed earlier, they may have to be creative in their search for funding due to tight credit markets. Accenture sees at least three vehicles that companies potentially can draw on to fund transformation. Joint ventures, for example, can be used to consolidate partner companies' subsidiaries with the same products or raw materials, or to create "greenfield" entities with local partners in resource-rich regions. Companies also may consider asset swaps, which

essentially involve the trading of complementary business lines or value-chain components to round out business portfolios.

Sovereign wealth funds (SWFs) also may be a source of capital in the downturn. These funds have been playing a growing role in M&A. At the end of 2008, SWFs were involved in 19 percent of pending acquisitions, up from virtually zero prior to 2005. In general, SWFs were created to ensure the future economic development and prosperity of the countries that own them—and most are in natural resource-rich countries, which means that many chemical producers are well positioned to tap into these funds.

Navigating the downturn: Key role for company leadership

Finally, a key factor in working through this downturn will be leadership—just as it is in any challenging time. Executives need to provide the vision, direction and decisiveness—and the optimism—that will help people stay focused and avoid uncertainty or inertia slowing down the organization. Effective leaders will use the downturn as a lever to respond and improve to meet today's immediate challenges—and to see beyond the downturn and work to create high-performance businesses that can deliver sustained results over the long term.

About the authors

Paul Bjacek is the Accenture Chemicals and Natural Resources research lead and has 22 years of experience in the chemical business. Previously associated with SRI Consulting and Chevron, he frequently writes, presents and consults on strategic industry issues.

paul.bjacek@accenture.com

James Bogues is a senior executive in the Accenture Chemicals industry group and the lead for process industries for the Accenture Pricing and Profit Optimization group. He has led extensive transformation programs in business-to-business marketing, supply chain, sales strategy and process development in large, complex businesses. He has worked with many of the world's leading chemical, oil, gas and other resource-intensive companies.

james.g.bogues@accenture.com

Copyright © 2009 Accenture
All rights reserved.

Accenture, its logo, and
High Performance Delivered
are trademarks of Accenture.

About Accenture

Accenture is a global management consulting, technology services and outsourcing company. Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. With approximately 177,000 people serving clients in more than 120 countries, the company generated net revenues of US\$21.58 billion for the fiscal year ended Aug. 31, 2009. Its home page is www.accenture.com.



1 2 4 5 8 1 6 8