After the economic storm and chaos, are we returning to a period of stability and leadership confidence? ICIS and J&M Management Consulting asked ICIS readers and interviewed selected CEOs to understand what the chemical industry might look like after the storm

Confidence returns?

JOHN BAKER AND JAMES BLACK/LONDON

MUCH HAS been written about the global economic trauma and the precipitous fall in demand for chemicals at the end of 2008. This was amplified by the respondents to our survey and through the executive interviews.

CEOs, typically with experience of three to four previous downturns, talked in terms of "we fell off a cliff." They did not know where demand was going, day to day.

This should could as no surprise, as all the CEOs mentioned falls in demand during the fourth quarter (Q4) of 2008 and Q1 2009 of 20–80%. These were swings they had never seen before.

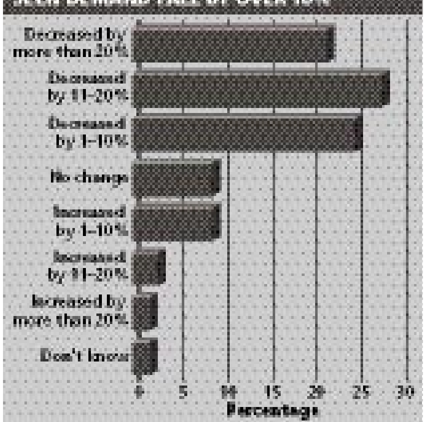
But the downturn may now be slowing. Half of respondents to the online survey indicated that demand in April, in comparison to the previous six-month level, had fallen by over 10%, with 22% seeing more than 20%.

The financial sector downturn and resulting impact on financing/debt cost was unanimously seen by the CEOs as the key trigger to the severity of the downturn. Most of them also associated the high energy and raw materials costs in mid-2008 as being contributory factors to the rapid collapse in demand and customer destocking.

"A lot of our customers had been building stock to hedge raw materials availability and prices," one commented. Another said: "Some of our customers where even destocking for financial reasons, irrespective of their own customer demand – in effect, shorting delivery to their customers to pull down cash costs." And another added: "For some of the sectors, we were already expecting a downturn due to the stage of sector cycle, and also due to lower-cost capacity coming on stream in the Middle East and Far East."

Most CEOs talked about being caught out by the speed of the downturn and not having the time to respond to the consequences and implement action plans. "We ended up fire-fighting for a while; our actions plans are really starting to take hold now," said one.

HALF OF ALL RESPONDENTS HAVE SEEN DEMAND FALL BY OVER 10%



SOURCE: ICIS

The majority of CEOs agreed that, though hindsight is 20:20, a gut feeling said that the financial bubble could not continue. The cliche "If it looks too good to be true – it probably is" was cited frequently.

The other insight from CEOs was that though most of them ran scenario planning and risk mitigation, they had not planned a scenario of such speed or severity – but most will include such a scenario from now on!

TOUGH YEAR AHEAD

Two-thirds of the responses to the survey expect the severe downturn to carry through into Q2 2009. The CEOs we interviewed were split into three groups – one or two believing they would see a slight drop in demand in Q2 versus Q1; the majority expecting to see a flat quarter in Q2, compared with Q1; and the final group expecting a slight upturn towards the end of Q2, which would fall away again in Q3 and Q4.

"The massive swings and shock we experienced in Q4 are behind us. We have a much more stable demand profile, which will swing within the 5–10% spreads we are well positioned to handle as business as usual," said one CEO. Another said: "We are starting to get a good view of 'real' customer demand, which we can manage."

Some 40% expect a 5–15% drop in demand in the next 12 months, while 43% expect the downturn to last until the end of 2009, and

39% expect it to last to mid or late 2010.

CEOs and company chairmen have expressed a split view during their Q1 reporting season. US major Dow Chemical, for example, reported net income 39% lower in Q1 compared with 2008. Presenting the figures in April, chairman and CEO Andrew Liveris, noted: “There are some signs that the pace of global economic decline is moderating…. It’s prudent to expect that 2009 will still be a recessionary year globally, and we are not counting on material improvements in economic conditions in the near term.”

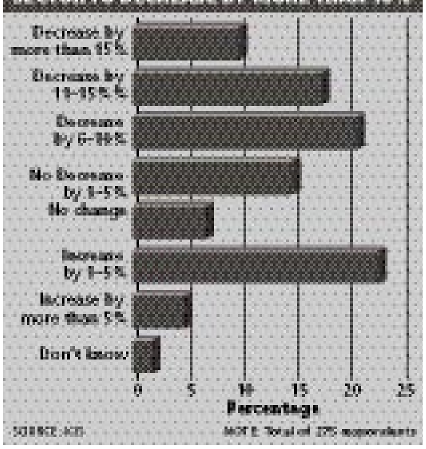
For the same quarter, US producer Huntsman reported a 33% decrease in revenue, with president and CEO Peter Huntsman commenting: “We did see positive order patterns within the first quarter, and left the quarter with stronger demand than we entered.”

German chemical producer Bayer MaterialScience reported a Q1 drop in demand of 33% compared with Q1 2008. Bayer chairman Werner Wenning noted: “This is an unprecedented development for Bayer…. The downturn seems to be bottoming out. The first signs of a modest recovery in demand are appearing.”

Compatriot BASF saw sales 23% lower in Q1, prompting chairman Jurgen Hambrecht to note that “there is currently no sign of a reversal of this trend, and we do not consider temporary topping up of inventories in some regions and industries to be signs of a sustainable upturn.”

In private, CEOs shared cautious views: “If 2007 was peak cycle, we likely won’t return to 10% down on that until 2011–2012, and get back up to peak cycle until 2015,” said one. Another said: “We’ll see the early signs of sustainable growth towards the end of Q4 2009.

EXPECTED DEMAND IN THE CHEMICAL SECTOR TO DECREASE BY MORE THAN 10%



These will continue slowly during 2010 and onward.” Several CEOs expect to see some kind of “false dawn” or “dead cat bounce” along the way – but this would be short and sharp, and they are prepared for it. Timing for this “blip” was varied and specific to their particular sectors.

CASH IS KING

Free cash flow and cash were at the forefront of most CEOs’ minds. The survey results also showed the increase in importance of cash and cash flow in key performance indicators. Many said: “Cash is king.”

> **“We do not consider temporary topping up of inventories… an upturn”**
>
> **Jurgen Hambrecht**, chairman, BASF

CEOs talked about cash and free cash flow as being more important than earnings before interest, tax, depreciation and amortization (EBITDA) at the moment. Said one: “This is all about conserving cash and keeping a healthy balance sheet to survive the downturn.” And another: “[Inventory has] moved from being an operational measure to be being a strategic issue, which is the consequence of several decisions across the value chain.”

Most of the CEOs said they had been preparing for some kind of downturn. They already had plans in place and the severity of the downturn meant they merely accelerated these plans. It was fortuitous that they had already mobilized somewhat, so they did not have to start from scratch. As one said: “Speed matters – this eventually snowballed quickly and the issue became how long do we wait, how fast should we and can we react.”

MANAGEMENT EXPERTISE

The chemical sector has been managing downturns for many years. As one CEO pointed out: “This isn’t rocket science – we unfortunately have experience of doing this before.” Experienced management teams have deployed this in the following areas:

- Reducing throughput and capacity, using a combination of short-term working, ad hoc/accelerated maintenance, mothballing plants and some permanent plant closures, but linked to accelerating strategic closure plans
- Stopping all discretionary spending, escalating and managing purchase authorizations to executive (chief financial officer/CEO) level, and cutting consulting and temporary-labor costs
- Reviewing and adjusting accounts payable and accounts receivable terms
- Accelerating price increases, moving from quarterly to monthly or weekly terms, and proactive margin management plans
- Reaching out to increase customer touches and prioritizing spend on these activities
- Research and development (R&D)/innovation – prioritizing projects/skills for innovation and growth and increasing velocity of new projects by doing fewer faster
- Stopping all nonessential capital expenditure and ring fencing critical asset builds
- Freezing recruitment
- Understanding and managing both supplier and customer risk
- Managing all aspects of cash on a day-to-day basis – at the executive level.

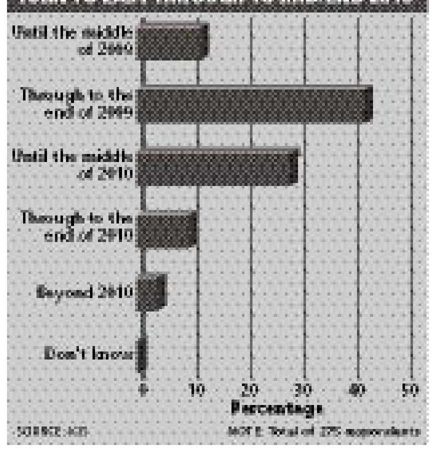
The one issue that CEOs were somewhat split on was protecting market share. One side of the view was: “We need to maintain our market share so that we have the foundation for growth when the upturn comes.”

The counter view was: “Market share isn’t so important at the moment – it’s all about survival and preserving cash – and if that means we reduce share or even bottom-slice our client base to survive, then so be it.” Others cautioned that “years of good work on restructuring could be lost by people chasing volume to fill assets and the margin impacts will be lost forever.”

FOCUS ON THE CORE

The industry has minimized fixed costs on an ongoing basis for several years and reduced in head count and labor costs. This time, com-

RESPONDENTS WHO EXPECT THE DOWNTURN TO LAST THROUGH TO MID/END 2010



HOW THE SURVEY WAS CONDUCTED

The study of chemical industry dynamics was carried out by ICIS and J&M Management Consulting using a three-stage approach.

Readers of *ICIS Chemical Business* were surveyed online in April 2009, with 275 responding to the questionnaire. The survey results were complemented with 10 face-to-face executive interviews carried out by J&M with CEO/business unit leaders of global chemical companies, to explore their personal feelings and beliefs and to enable a number of issues to be examined in more depth. Public statements of several chairmen and CEOs from their Q1 public financial reports were analyzed. The survey and face-to-face interviews were undertaken under a confidentiality agreement and all comments are therefore nonattributable. The full results of the survey can be seen at: **http://tinyurl.com/ogscmz**.

panies appear to have been adopting more focused approaches to protect core competences. The majority apply some kind of core competence-type of thinking and approach. Common activities were linked to protecting/ring fencing the following:

- People and key skill and capability
- R&D/innovation for future growth
- Key asset builds/projects in growth regions
- Sales and marketing/customer intimacy
- Safety and nurturing assets
- Values and ethics.

Most of these actions are recognized by the respondents, with 55% saying they are not scaling back R&D/innovation investment and with 59% saying they plan to bring new innovations/products to market faster.

The majority of respondents viewed the actions taken by their company as protecting the core competence and foundations for growth, and that the actions also supported long-term viability of their company.

SUMMARY

J&M Management Consulting chemicals practice leader James Black summarized the interviews and discussions: "It sounds like people, at least in private, believe we have bottomed out. They expect a long, slow, sustainable recovery and we probably won't get back to peak 2007 levels until 2012 or later. Europe and North America will grow more slowly than the likes of the Middle East and China.

"The stability of 'real' demand has brought back more feelings of confidence and predictability to leadership teams… but this will take a while to permeate the total business.

"We still face ongoing consequences in terms of downsizing, asset consolidations, and business failures – but it's been interesting how companies have been trying to protect future core competence for growth.

"The refreshing thing is that 92% of those who responded to the survey saw a positive future for their company and 89% saw a longer-term future for themselves in the industry, and all the CEOs interviewed believed the sector to be a dynamic industry for future employment and for new people to enter and grow their careers…. It would appear that there is real light at the end of the tunnel! ■

ABOUT ICIS AND J&M

This survey is part of a series of offerings from ICIS custom publishing, headed by global editor John Baker. For more details, contact: **john.baker@icis.com**

ICIS

J&M Management Consulting combines management consulting with IT consulting. By optimizing business processes and supporting their performance with modern IT solutions, it helps chemical companies achieve strategic goals faster and with sustained success. J&M's expertise includes supply chain management and its associated business processes, including distribution, marketing, purchasing, finance and controlling. The Hidden Champions Study 2009 named J&M the best management consultancy for supply chain management.

J&M MANAGEMENT CONSULTING

WHAT'S ON

A PICK OF THE BEST TOOLS, SERVICES AND EVENTS WORLDWIDE

www.icis.com ONLINE NOW

Read the news before it is printed

ICIS has a number of online news feeds that are free to subscribe to. You'll need a feed reader, though. We like Google reader in the ICIS office : www.icis.com/v2/staticpages/newsfeeds.htm

Editor's commentary blog

Read the editor's commentary ahead of publication. You can see what the editor is thinking, days ahead of receiving your copy of *ICIS Chemical Business*, by visiting the new *ICIS Chemical Business* editor's commentary blog. You can also comment on his views there. What are you waiting for?: www.icis.com/blogs/editorscommentary

Online at
www.icis.com/subscribe