2012 Chemicals Industry Perspective, Part 2

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We would like to offer our thoughts on the current business environment for chemical companies, what the future holds and which specific capabilities they need to enjoy the greatest success.

To read Part 1, please click here *[1].*

A Capabilities Strategy

Although the industry landscape is so clearly risky and may be difficult to navigate, chemical companies are facing a set of real opportunities. But to take advantage of them, chemical outfits need to revisit the capabilities they already have and should have -- to differentiate themselves from competitors in the race for profitability and improved performance.

These capabilities are sets of tools, processes, systems or skills that combine to drive a company toward its strategic goals. In our view, the following capabilities should be the main priorities for chemical companies in 2012 and beyond:

Choose the Right Business & Operating Models

Tailored business streams (TBS), in which distinctive management approaches are designed for products and regions, depending on customer preferences and product

life-cycle status, are already essential today, but will become even more critical as commoditization escalates in the chemical industry. By adopting TBS, a company would, for example, dedicate direct sales teams for selling specialty chemicals to key customers. These teams would, in essence, serve as embedded experts to help customize the chemicals to meet specific client product needs and to up-sell other specialty chemicals that may fit the parameters of future products that the client is developing.

The goal would be to earmark the lion's share of the chemical company's expenditures for driving higher volume and market longevity for specialty products that command a premium price. At the same time, this chemical company may opt for a far different business model for its commodity products, selling them through third-party distributors and devoting just a sliver of the overall R&D budget to advancing these low-margin items.

Regional differences should also be taken into account when choosing the right business model. Uppermost in mind should be emerging economies with their potentially large markets. Companies need to develop plans not merely to grow in these countries, but also to outpace the rate of growth in local markets. Consequently, tailored business streams should be developed to target unique aspects of the local business environment, and customer behavior and buying patterns.

In all cases, business requirements and management approaches chosen under the TBS umbrella must also be translated into operating models that support the tailored business streams.

Embrace Natural Supply Chains

There are certain things that chemical companies can't change about their supply chains to any significant degree: for example, where your customers are, and where you buy your raw materials. And external forces determine the cost of fuel for shipments. But it is possible to control logistics, and storage or inventory costs. In fact, the best way to do that is through an approach we call natural supply chains: a combination of rigorous market-back and product-forward supply chain strategies.

Under this approach, chemical companies segment their product and customer base into organic categories -- specialties, commodities and petrochemicals -- and then further by their value to the company, and then design their supply chains to best suit each of these individual buckets.

The goal is to leverage and scale common supply chain elements across the enterprise when market requirements allow -- for example, when there are long lead times, and standard designs and supply volumes. Alternatively, special supply chain services can be applied to products that have unique requirements -- shorter lead times, plenty of variability, smaller volume, order flexibility and numerous potential configurations, depending on customer needs.

Natural supply chains have consistently been shown to better support business

requirements and drive increased value through lower operational costs. For example, after implementing natural supply chains, one large chemical company improved lead time fulfillment by 20 percent, reduced inventory by 40 percent and slashed operating costs by about 20 percent.

Provide Solutions & Services

As a growth lever, this capability involves using a company's deep knowledge of its customers, and of chemical applications and technology to develop new offerings that go beyond the basic chemical value chain, including solutions based on performance-driven pricing.

Companies that implement this strategy successfully can enjoy the types of sustainable and stable revenue returns that the so-called razor-blade model offers; that is, after the initial sale, customers are likely to keep coming back for refills over a long period of time. Pricing and promotions management is critical, however, to make this strategy work. Products must be offered at prices that customers perceive as on par with the value of these new solutions and materials.

Overall, a move into providing solutions and services requires a significant upgrade of a company's go-to-market capabilities -- it's critical to identify the markets in which you can gain and sustain leadership -- as well as prolific idea generation, cross-functional and regional cooperation, a disciplined process that holds project managers responsible for strategy execution and ruthless portfolio management. While most companies are good at some of these dimensions, very few actually attempt real portfolio management -- to their detriment.

Enhance M&A Management

With acquisitions and partnerships certain to play more a prominent role in the chemical industry, particularly for expanding operations in emerging nations and for increasing the specialty chemical presence in a portfolio, effective post-merger integration or joint venture management is increasingly essential. Strategies for manufacturing, R&D, staff recruitment, talent development and customer service must be developed that take into account the combination of multiple organizations into an efficient, seamless operation.

In addition, chemical companies need to develop proficiency in valuing potential acquisitions or joint ventures, based on accurate readings of the dynamics of emerging markets, and on credible forecasts of demand and pricing for individual products and raw materials.

Design a Robust Innovation Strategy

As the chemical industry becomes more challenging globally, innovation as a core capability is increasingly a determinant of success. However, innovation is much more than R&D; it is a company-wide strategic thrust driven by a culture that encourages and rewards new ideas in all aspects of the business, from design to marketing, from manufacturing to talent development.

Indeed, according to the Booz & Co. Global Innovation 1000 annual study, the firms in all industries voted the 10 most innovative by global corporate executives outperformed the 10 companies with the largest R&D budgets by 33 percent in revenue and 20 percent in EBITDA margin averaged over five years. In fact, only three of the top 10 innovators were among the 10 biggest R&D spenders.

At the heart of a successful innovation strategy is well-developed and insightful knowledge about what customers need and want, along with a process for using this information to lead market-back product development. The result of this exercise may be to provide unique offerings for specific regions or niche segments.

To support turning customer ideas and preferences into products, there must be highly visible leadership commitment for innovation, including investment pools for novel ideas and ambitious targets for innovation-driven growth across the organization to encourage entrepreneurialism. Moreover, direct exposure of business managers, including the CEO, to markets and customers is critical, as is establishing application development, and production facilities and customer relations centers in the areas (such as emerging nations) where market growth is expected to be strongest and where proximity to customers can be a significant advantage.

We hope this letter stimulates your thinking about the capabilities your organization should develop or strengthen to compete in a period of volatility and change. We would welcome the opportunity to hear your thoughts about the year ahead and to discuss how you might create a more prosperous 2012.

In case you missed the first part in this series, please click here *[1]. For more information, please email Cassidy via* dennis.cassidy@booz.com *[2] or visit* www.booz.com *[3].*

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