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Out of the woods?

After 18 months grappling with the chemical downturn, what have executives learned and how is the future shaping up? An ICIS/J&M survey conducted earlier this year offers some insights

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LOOKING BACK on 2009, the view from the top evidently depends on just where you were standing. But in general, last year as a whole turned out much as people were expecting by the end of the first quarter (Q1). In some cases, the outcome was even slightly better than had been expected.

Just over two-fifths of *ICIS Chemical Business* readers surveyed indicated that the year performed more or less as expected, with one-quarter saying 2009 was better than expected. This was generally supported by face-to-face discussions with chief financial officers (CFOs) after the 2010 online survey.

As one CFO put it: "2009 turned out sig-

nificantly better than our best dreams during the dark days of Q4 2008 and more in line with our Q1 2009 feelings." Another mentioned: "Human behavior is always to expect that something will normalize much faster than it does. So the start of 2009 probably didn't match this over-optimistic expectation, but then the back end of the year caught up, so that overall, we did as expected."

The magnitude of the demand downturn in 2009 also depended on the sector you stood in, with agrochemicals looking at 8–12% reductions, integrated petrochemicals and base chemicals typically seeing a 15–25% drop, and specialty chemicals typically falling somewhere in between.

All these comments and feelings were also

clearly reflected in the 2009 financial results of the likes of UK-based INEOS, Johnson Matthey, Croda International and Yule Catto; US-based Dow Chemical and Huntsman, Germany's BASF and Bayer MaterialScience, the global Borealis, Swiss producer Clariant and France's Arkema, among others.

As one CFO pointed out: "Eventually, some normality returned. For us, the downturn started to be over when our clients' expectations flicked over from being pessimistic to being optimistic about the future..., which was probably mid-year for us."

Another CFO noted: "The bottoming-out process and belief in business returning [to normal] was quite fragile. It was difficult to recognize real demand versus rebuilding of

inventory in the pipeline so we were always worried about, and prepared for, a mid-term blip down in [2009] demand.”

One interesting observation was that most CFOs and the majority of survey respondents thought the downturn to be more severe across the overall chemical industry compared with their own sector or company.

One CFO commented that “as we went from struggling to understand the consequences for our business to some normality, we had even less information on the wider industry and so expected the worst. Or maybe we wanted to believe that though it had been tough for us, we did a good job versus the rest of the industry.”

MATURE APPROACH

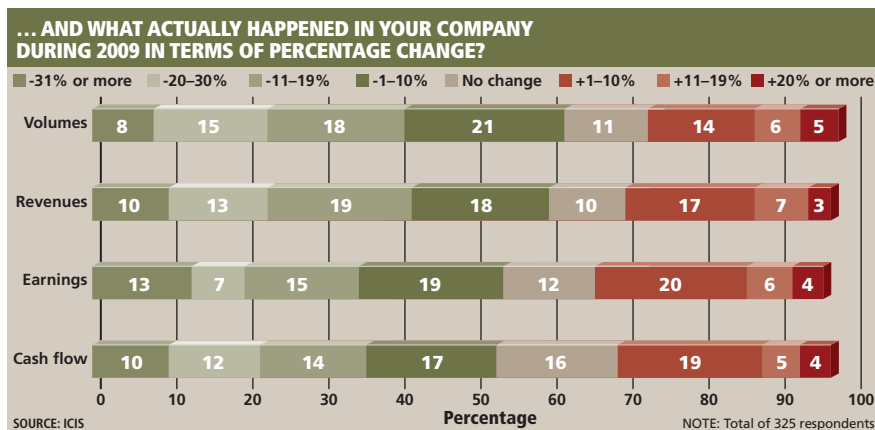
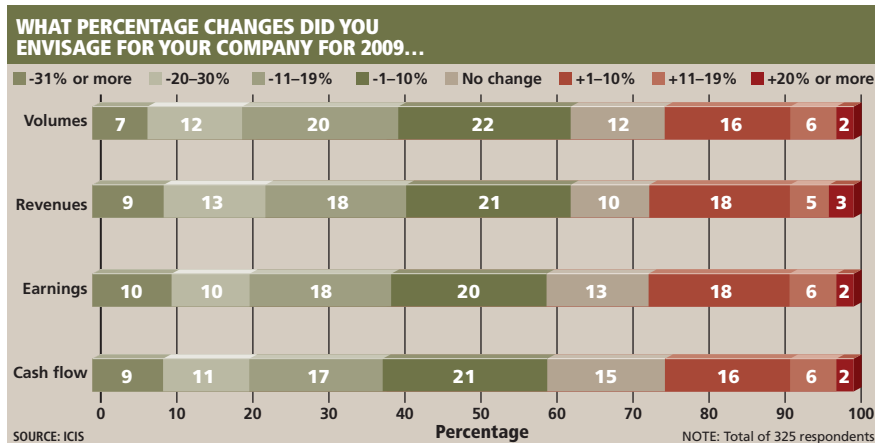
The chemical industry is well versed in managing cyclicity and downturns. But this time we also saw mature behaviors in the market around pricing and margin management. The 2010 survey results were consistent with those reported in the 2009 survey (see *ICIS Chemicals Business* June 8, 2009, pages 31–33). In 2010, respondents revealed that most companies pro-actively addressed cash management, out-of-pocket cost control, pricing control, downsizing/restructuring, some mothballing/idling, capex management, focused research and development investment and inventory reductions.

The majority of CFOs shared a common view along the lines of “we saw really mature market behaviors in terms of our largest meltdown scenario – that prices would collapse as people started chasing volume with price wars. This pricing collapse didn’t materialize and margins were managed closely.”

Other CFOs pointed out just how much inventory and cash they and the industry freed up. “Once cash was highlighted and elevated for close executive attention, it was amazing how much could be freed up through the value chain. The trick for all of us now is not to regress and become belligerent about it ever again.”

An interesting contrast to the 2009 survey was that, while CEOs and the majority of respondents believed then that they did not have the best information, key performance indicators and processes to manage the rapid downturn during the end 2008/Q1 2009 period, in 2010, the majority (more than 70%) of respondents and all the CFOs we talked to believed they had more than adequate business information and processes to manage effectively in 2009.

One hypothesis could be that the shock



of feeling out of control at the end of 2008 gave way to more normalized business and management confidence during 2009.

People again featured widely, as in 2009, with 59% of respondents talking about their company ring-fencing critical skills and competencies, 43% already foreseeing skill gaps developing further in the future, and 36% reporting ongoing recruitment freezes for another 12 months or so. CFOs generally mentioned that “once the worst of the downturn passed we spent significant management and leadership time reassuring employees about the future and our business model.”

Other comments included: “Our executive had the best available view of what was going on and the trick was to reassure while also being pragmatic that the future was in no way guaranteed.” And “as the general economics in the wider world were bleak, it was possibly easier in that context for us to be practical and straightforward about reality short term and hope longer term.”

The relative importance of sales and marketing, supply chain and finance were judged

by respondents to have increased since the downturn. This was echoed in our CFO conversations. Finance, by the very nature of the downturn, increased in importance. Thus, 47% of respondents saw the CFO role increasing in importance because of the financial impacts of the downturn, with 39% viewing the CFO and CEO roles as becoming more closely linked.

The CFOs we met reinforced this: “It was a natural consequence that the CFO ended up in more critical discussions and fronting more important meetings,” commented one. Another said: “Financial understanding, control, and risk management became increasing important fundamentals of the business – this reinforced both the financial team’s roles in our business teams and project teams, and also the increase in financial understanding and experience in our business unit leaders.”

WHAT ABOUT THE FUTURE?

Volumes for 2010 are starting to look more normalized but expectations remain cautious and the recovery fragile. A total of 84% »

» of respondents expected growth in 2010 compared with 2009, with 55% expecting growth of 1–10% and 30% expecting 10% growth or more.

As expected in the 2009 survey and CEOs views at that time, respondents this time reiterated their expectation of slow to moderate growth in Europe and North America (at typically 1–3%/year) and more significant in Asia and China (typically 8–12%/year or more). The interesting region mentioned by quite a few was Latin America, with a typical comment being: “We didn’t see much downturn during 2008–2009 in Latin America and growth this year will continue moderately year on year.... This compares to slow growth in Europe and North America from a large downturn and similarly strong growth in China and Asia from a significant downturn.”

One CFO noted: “We totally underestimated the rate of recovery in 2009 and growth above 10% still appears realistic for this year.”

Again, surprisingly, both the majority of our survey respondents and most CFOs we talked to reflected on the expectation that the chemical industry overall would have slower growth in 2010 than their own companies. Half of respondents expected their company to get back to peak 2007–2008 demand levels in about 2011–2012 or 2013, with the remainder looking five or more years out.

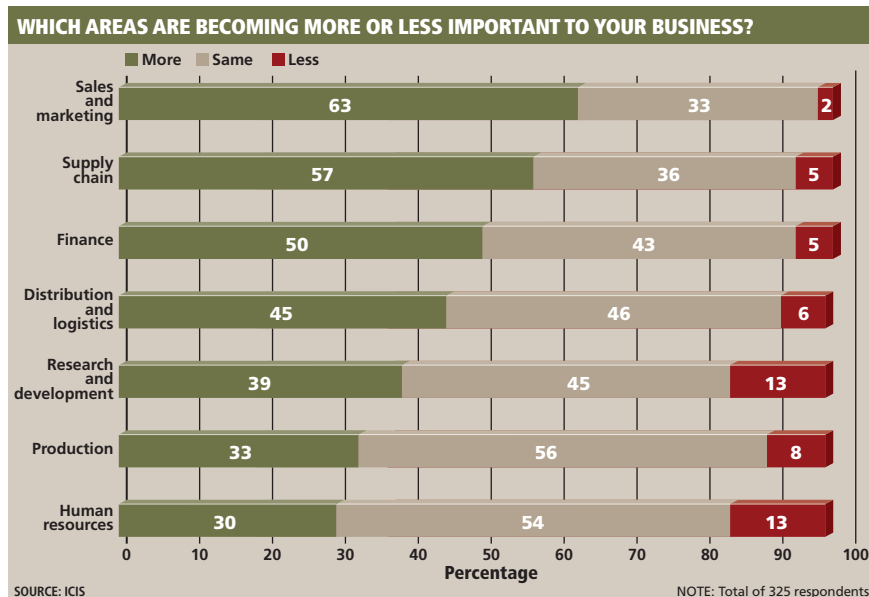
The bias of expectation for the overall sector to return to 2007–2008 peaks was more toward the five year or more timeframe – specifically pointing out that the regional splits within this will probably never be the same again.

These expectations perfectly mirrored our CFOs responses. “We expect to see peak volume demand reflected in 2011–2012 and, if the rest of 2010 continues as strongly as Q1 this year, then that will look more like 2011.”

These CFO sentiments for 2010 have been reflected in companies’ Q1 reporting this year. BASF noted that it expected a “slow and uneven recovery of the global economy... [with] favorable business development.” While Bayer saw “recovery so far further than expected.... The global economic recovery is likely to continue this year,” adding that it was “confident about the future.”

Borealis “remains alert and cautious as we expect the second half of [the] year to be more difficult.” And Dow saw “demand growth continuing” with it “maintaining operational and financial discipline.”

So companies were cautious, but clearly not as pessimistic as 12 months ago. Future



worries and unknowns were linked to the euro exchange rate; the European sovereign debt crisis and emerging concerns regarding the evolving BP Gulf of Mexico ecological disaster. On top of these, there is big uncertainty on how energy-rich and large energy-consuming regions choose to prioritize what they do with their energy, introducing interesting political risks to consider.

It is fair to say that the CFOs we talked to were not taking their eyes off the ball and were looking into new scenarios and risk. Most CFOs still talked about some kind of long-term recovery and stable growth in 12 months – so this will be a long road to recovery.

As one CFO aptly put it: “So far in 2010, we are still taking a week-by-week view,

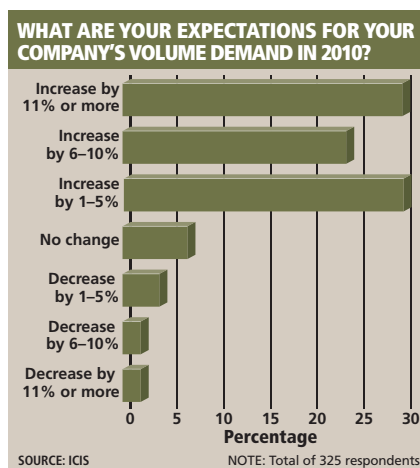
not months, and not looking too far back either – it’s dynamic and fragile.” Another concluded: “We took a deep breath and held our breath in 2008–2009 to see what happened...., while in 2010, we have started to take a couple of small breaths again.”

A couple of CFOs mentioned that “in hindsight, it might have been better for [the] longer-term health of the industry if the dramatic parts of the downturn had lasted one or two more quarters, just to straighten out some of the structural issues in various sectors and [encourage] healthy consolidation.”

LESSONS TO DRAW

So what were some of the personal lessons learned, as mentioned during our CFO discussions? These included:

- Do not be unconcerned – you should have respect for the complications of trying to project what the future of the world will be. Only one or two people very occasionally get it right first time.
- Understand the real risk profile for the company and recognize it is dynamic – if you drew a risk matrix before the downturn, then it would be totally different now.
- Manage the balance sheet sensibly – it should always be on the agenda. What about your corporate debt?
- Supply chains – volume and price. Remember the importance day to day of managing cash and working capital.... There was a lot slushing around before the downturn – look how much we all managed to free up.... Let’s not regress.



HOW THE SURVEY WAS CONDUCTED

This study of chemical industry dynamics was carried out by ICIS and J&M Management Consulting (J&M) using a three-stage approach and follows on from a similar survey in 2009 (see *ICIS Chemical Business* June 8, 2009).

First, readers of *ICIS Chemical Business* were surveyed online in March and April this year, with 325 responding to a detailed questionnaire. Senior managers and industry leaders made up 55% of respondents (typically at board level), with another 27% in senior leadership roles.

The majority of respondents (71%) had in excess of 10 years' experience in the industry. Half of the respondents came from companies with global revenues of up to \$500m (€407m) and half from companies with global revenues of above that figure; 30% were working for publicly

listed organizations, 48% privately owned and 18% family owned. Sector cover was 35% from petrochemicals and 30% from specialty chemicals, with the remainder split equally across pharma/fine chemicals, agrochemicals and inorganics.

Second, the survey results were complemented with seven face-to-face executive interviews carried out by J&M with CFOs of global chemical companies. These explored their personal feelings and beliefs and enabled a number of issues to be examined in more depth.

And third, we analyzed the public statements of several chairmen and CEOs in their Q1 2010 financial reports. The survey and face-to-face interviews were undertaken under a confidentiality agreement and all comments are therefore unattributable.

- Plan for the worst case – have scenarios well thought out.
- We had to balance having bold/dramatic scenarios and plans with having the patience to act responsibly – if we had knee jerked into some scenarios, we could have done untold structural damage to our current growth plans.
- Margins held up – we can act responsibly – or maybe the sector is more mature and acts responsibly on price now.
- You cannot really do everything at once – you must focus on the few key things quickly.
- Really dig deep into priorities and complete/execute your next steps – do not get distracted.
- Do not overreact – knee jerks cost a fortune – apply measured business thinking.

- Do not rely on experience based on history – look at reality in front of you. It also helps a lot if someone in the team has not been in the industry for 30 years.
- It is all about people.... Leadership was important.... At the start of 2009, it was more drastic.... We were all naked and people could not hide anyway.... [You need to] trust your gut feeling. Spot leaders.
- Not a typical business situation.... It revealed a lot [and was a] time for capabilities.... We hire for capabilities and fire for personality. We need to understand more about the whole people side of the business and how people behave under stress, as well as in the steady state.
- We really learnt some unique stuff about our people – who are the real potential

ABOUT ICIS AND J&M MANAGEMENT CONSULTING

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** custom publishing

J&M Management Consulting (J&M) combines management consulting with IT consulting. By optimizing business processes and supporting their performance with modern IT solutions, it helps chem-

ical 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.



J&M MANAGEMENT CONSULTING

future leaders who can handle pressure and lead in difficult times.

So did people still see the industry as an exciting place to work? Our CFOs now, just like the CEOs in 2009, think so. More than 80% of respondents also think this is a dynamic industry to work in and over 90% of respondents and all CFOs expected to still be working in it themselves in three to five years.

As one of our CFOs said: "If you want to work in a truly dynamic global sector – you could do a lot worse than chemicals. Make sure you select a truly global player and it could be really exciting." Others added: "Most of the chemical sectors have contributed above their industrial weight in terms of value creation in the last 10 years.... Go and check how many chemical companies are in the top halves of their respective bourses. What other career choices would you take – banking?"

CONCLUSION

James Black, chemical practice leader for J&M Management Consulting, who handled all the CFO discussions, reflects that "compared to 12 months ago, when talking to CEOs, we definitely see more personal and business confidence in the future. One of the interesting dimensions was how personally both CEOs and CFOs felt the downturn and thought about the future."

"There appear to be two or three situations that played out during 2009. One group of companies had transformation plans and performance programs underway and accelerated them and focused on leveraging results. The second group had plans being formulated for the future over time and they took the chance to move the plans forward. The final group quickly did the basics well based on previous experience.

"This time, we saw more balanced thinking considering not only cost control/reduction but also commercial excellence with strong proactive pricing and margin management – and few examples of market prices collapsing. This market maturity is always a good sign of a sector in control even in a downturn. The downturn reminded us that people are the hidden asset – nurturing them and developing them globally will be one of the fundamental foundations for growth in the future and a real competitive advantage."

» For the full results of the survey, go to www.icis.com/icisjmsurvey2010