China fever

Rex Features

Emerging markets, most notably China, are exerting a huge pull on Europe's specialty chemical companies – but there are risks and problems to overcome

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For Western companies seeking growth in these straightened economic times, it is hard to resist the attraction of China, with its rapidly expanding economy and booming consumer demand.

In China, it seems, things happen – and fast. Automotive manufacture is booming, aerospace is on its way, mining and construction markets are huge.

But how should companies manage their business and investments in China, and in Asia in general, come to that? How can they balance investment in today's fast-growing Chinese market with retention and expansion of their global footprint? And what are the implications for the shape of Western producers in times to come?

Leading executives met in Frankfurt, Germany in late October to discuss these questions and associated issues, at the third ICIS/Booz & Company CEO Roundtable on European Specialty Chemicals (see panel for participants' details).

The global economic downturn and expectations of sluggish growth in EU and US markets has highlighted the importance of having a position and investment strategy in emerging markets such as China, but also in India, Brazil and Southeast Asia.

Frank Aranzana of Cytec Industries summed up the general feeling around the table that, for the next decade at least, "emerging markets will contribute more growth than developed economies." He added: "The economic crisis created a sharp drop in chemicals demand and China was the first major economy to recover from the global recession and this with strong growth momentum.

"We have seen a shift of manufacturing to Asia and have had to adapt supply to demand in the US and the EU due to weaker demand. So, in future, when we need to add resources and people, we will look to emerging markets where we have a lower manufacturing base and huge growth prospects."

Aranzana saw great potential in the Asian region for Cytec's eco-friendly coating resins, mining chemicals, polymer additives and advanced composites. "We are determined to seize the opportunities," he said.

Bernard Boyer of Arkema reinforced this point by saying: "Because of the crisis, the underlying trends are now much clearer than a few years ago. The resilience of China, Brazil and India is going to be important for the global economy."

Rob Frohn of AkzoNobel, which has been active in China for about 15 years, said: "With China, you cannot afford to stand on the sidelines. You have to participate and take the risk."

AkzoNobel had been upping the pace of its investment in China in recent years, said Frohn, and he was enthusiastic about its operations there. "Our profitability there is in line with the company average," he noted. The company's 25 or so manufacturing units in China are seen as part of its overall global footprint.

Asia is already the biggest single market for US-based Dow Corning – and its fastest growing. The company's Klaus Hoffmann said China was playing an important role, "being the engine for that growth," adding: "This is obviously why we invest a lot in Asia."

Boyer confirmed the overall sentiment that the emerging markets had become the key to growth for the specialty sector. On its spin-off from Total four years ago, he said the company had been too EU-focused and its geo-footprint had needed modifying.

"We were not enough in emerging markets and felt we had a gap and needed to rebalance," said Boyer. "Now we have a significant increase in exposure to these markets, having decided to focus on China and grow our businesses in that country." This includes Arkema's fluorogas and polymers, acrylics, hydrogen peroxide, polyamides and functional chemicals.

"We took a step-by-step approach and are finding that profitability is attractive," he said. "We have a China focus and strategy, which brings some level of risk, but we are adapting to this and are happy with our position."

In terms of Europe and the US, said Boyer, growth would come only in very specific new areas, while the emerging economies would provide the most important volume growth. "Growth in China and India is resilient and self-sustaining, but we need to focus on the latest technology," he observed.

But Gunter von Au of Sud-Chemie said companies should not ignore their established businesses in developed markets. "Never underestimate the US, it is very resilient," he pointed out, adding: "If we want Europe to retain a manufacturing industry, we need to be careful we don't lose the success we have [here]."

GLOBAL STRATEGY

So, when considering investments, China had to be seen as part of a company's overall global strategy, said von Au. "You can consider it as a region, but it has to fit within the global field. Sud-Chemie has over 30 locations in Asia, with nine plants in China, so the region is very important for us."

This point was supported by several other participants. Hoffmann said Dow Corning was absolutely committed to investing in Asia, given its status as an engine of growth. "But, given the size of the EU and US economies, we will continue to be there for a long while," he stressed. Investment in Asia was beginning to free up capacity and resources in North America and Europe, which had previously been used to supply China, he said.

Frohn said AkzoNobel also took a global view of its supply chain, but markets were more rigid in the US and Europe, so it was harder to respond to demands. "The worry is that we need to ensure North America and Europe stay healthy," he said. "We need to keep plants going to supply local markets –

but we need to keep them competitive. A global network is the way to go for specialties."

One issue many specialty companies face when dealing with emerging markets is that they are generally organised along strategic business unit (SBU) lines and often lack regional oversight and regional champions to drive investment in these regions.

This situation appears to be receiving attention, with some companies refocusing their regional structures and adding matrix responsibilities for regional markets. Chris McNally from Booz & Company said some were even elevating their China operations into separate business units as their presence there grew.

REGIONAL STRUCTURE

Sud-Chemie, for instance, has a typical matrix structure, with businesses responsible for profit and loss accounts, plus a regional organization. Von Au said that for all important regions, a group board member sat on the local company board. Von Au himself is chairman of Sud-Chemie's China company.

At Dow Corning, China has high visibility in the company's regional structure, enjoying more direct contact with senior management and the CEO than other regions. A couple of years ago, said Hoffmann, the company expanded its regional structure from three areas – Europe, Americas and Asia – to seven, namely North America, western Europe, Latin America, southeast Asia, the Middle East and north Africa, central and eastern Europe and China.

The situation was similar at AkzoNobel, said Frohn. The company operates a matrix structure of SBUs and regional organizations, with the SBUs generally leading the way. "But China has become the first region to have its own financial targets and we have pulled all units together so they act as a single company," he said. "This helps the smaller units to grow in emerging markets."

AkzoNobel is now moving to overlay country-level structures on SBUs in Brazil, India and Russia. "We don't have a China or Brazil board member, but one day we may," said Frohn. Boyer said Arkema treated China objectives at company level, but the SBUs were still responsible for implementing strategy.

Participants at the roundtable also addressed another concern facing Western companies operating in emerging markets, and China especially – the significant differences in employee attitudes and expectations about loyalty, salary, even honesty, especially when it comes down to business ethics and intellectual property (IP) protection.

The latter point, they agreed, was of vital importance for specialty chemical companies and would determine the approach taken to product development and innovation in the country, as well as how much leading-edge technology they were prepared to transfer there.

> **"China does occasionally overbuild in certain areas once it has identified a need"**
>
> **CHRIS MCNALLY**
> Booz & Company, Beijing

Von Au asked: "How do you protect IP?" Frohn said being over-protectionist risked not being able to do business in the country. Hoffmann said companies had to find their own ways of dealing with the issue. The Chinese, as discussed above, do expect Western partners and investors to bring in the latest technology.

Aranzana said innovation was a key driver for specialty chemicals growth. He felt the risk of IP theft and copycat plants was lower for differentiated and patented specialty chemicals than commoditized products. There were plenty of bright people in China to do innovation, he said. "The challenge is to keep them."

This provoked further discussion about attracting and retaining employees. Expectations around salaries and career progression were now much higher, even "extreme," among skilled Chinese workers and managers, and keeping hold of good people was a real challenge. Making sure they did not run off with trade secrets and set up their own operations was another concern. And that did happen, said several participants.

Von Au said company loyalty was difficult to establish in China. He warned: "We have to learn how to train and develop people so they become part of the company. We need to develop retention programs."

But Hoffmann pointed out: "Perhaps we may just have to accept that higher staff turnover will be the norm in our Chinese operations." One approach was to create different hierarchy levels in China so there were more opportunities for career advancement, he added.

But a swing to Asia would inevitably cause tensions as investment and recruitment in the region grew in preference to investment in Europe and North America, said Frohn. "It is not a popular message. Even within Asia, other countries are complaining that the focus is all China, China, China. So even within the region, there is a tension."

One answer, he said, was to locate more senior managers in the emerging regions. At AkzoNobel, 90% of senior management was now located in the mature regions, he said. Eventually, the ratio would need to be close to 60:40 in favour of the fast-growing emerging markets, said Frohn. "Our target is to increase turnover in China from \$1.5m [€1.1m] to \$3.0bn over the next five years. It's a challenging target and we can't do it just by employing expatriate staff."

MARKET CONCERNS

Although China represents a vibrant opportunity for Western specialty chemicals, several concerns stem from China's politically directed economy. Von Au said the politicians who had overseen the country's industrialization were "dedicated and skilled".

But Booz's McNally noted: "China does occasionally overbuild capacity in certain areas once it has identified a need and obtained or developed the technology." This was especially so if the product was designated as strategic for the country's needs, said Booz's Marcus Morawietz. This could also lead to rapid commoditization of chemical products.

However, the conclusion to be drawn is that the Chinese market will, for some time, represent a great opportunity for specialty chemicals, but the market is set to become more competitive as new domestic producers edge their way into all sectors and levels. If Western companies bring leading-edge technology, they can stay in front while the market grows.

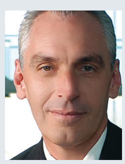
But there are risks, and China should be regarded as a part of an overall global strategy by companies doing business there. Other emerging markets are attractive, but perhaps not so exciting at the moment. ■

For more information on chemicals at Booz & Company, go to **booz.com/global/home/what_we_do/industries/chemicals**

TAKING PART IN THE ROUNDTABLE

Frank Aranzana, president of specialty chemicals, Cytec Industries

Bernard Boyer, executive vice president, strategy, Arkema



Klaus Hoffmann, regional president, western Europe, Dow Corning

Gunter von Au, CEO and chairman of the managing board, Sud-Chemie

Rob Frohn, board member for specialty chemicals, AkzoNobel

Also present:
John Baker, ICIS

Richard Verity, Booz & Co.
Marcus Morawietz, Booz & Co.
Chris McNally, Booz & Co.