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Chemicals industry summary

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Recent events have clearly demonstrated the extent to which the world is interconnected. The crisis which began in the US banking system has spread through the global economy as a whole – and no region has emerged unscathed. This historic moment provides an unprecedented opportunity for companies, governments and individuals to think more deeply about the sophisticated eco-systems of which we are all a part.

The current crisis has highlighted the need for new institutions, new mechanisms, new strategies and – most critically, perhaps – a different mindset among those leading the world's most important institutions and companies. Every CEO will have to make tough decisions about what actions are required to ensure his or her company's short-term survival. Yet none can afford to ignore the need to build a business that is agile enough to respond to new situations as they emerge, durable enough to grow over the long term and responsive to the requirements of all its stakeholders.

Redefining success, the PricewaterhouseCoopers 12th Annual Global CEO Survey, explores how CEOs are reconsidering the fundamentals of business in response to extreme operating conditions and assuming responsibility for issues that were once considered outside the scope of industry. We interviewed 1,124 CEOs around the world between September 10 and December 2, 2008. Our findings show that they are collaborating more extensively to balance the interests of increasingly influential stakeholders. They are also seeking new kinds of information to help them anticipate changes in critical business drivers.

Here, we look specifically at what the 48 CEOs in the chemicals industry think, and how they are dealing with a combination of challenges such as mankind has never seen before.

The business environment

'Bad news comes in threes.' The chemicals industry is currently contending with the fallout from hurricanes Gustav and Ike (which struck the US Gulf Coast in September), a rapidly deteriorating credit market and the threat of a deep global recession. Moreover, two of its key groups of customers, the automotive and construction sectors, are among those likely to be most severely affected by the downturn. So it is not surprising that chemical CEOs are less confident about the prospects for growth than in previous years; only 17% are very confident that they can increase revenues over the next 12 months, compared with 39% in 2008.

Chemical CEOs are particularly worried about the impact of the recent problems in the global banking system. Seventy-seven percent are somewhat or extremely concerned about the disruption of the capital markets, and 65% believe that this will affect their own plans for expanding (a result that is in line with the average for the entire survey). More than two-thirds of chemical CEOs anticipate that financing costs will increase and that they will have to delay some of their investments, while just over half believe that they will have to reduce their growth expectations.

But though these numbers are substantial, chemical CEOs are actually less pessimistic than their peers in the overall survey sample. They are also much less likely to be planning a reduction in the development of new products and services. In prior years, we noted the central role chemical CEOs

attributed to innovation as a driver of future growth. This year, many CEOs are maintaining their focus on R&D despite the challenging environment – evidence that they see new products or services as absolutely critical to the long-term viability of their companies.

Some 33% of chemical CEOs are also planning to complete a cross-border merger or acquisition over the next 12 months, compared with just 25% of the total survey population. Volker Fitzner, Global Chemicals Advisory Leader, PricewaterhouseCoopers, explains: 'While the economic downturn has significantly affected the large deal market, the small to mid-sized deal market remains relatively strong, as companies look for bolt-on acquisitions to strengthen their existing positions and dispose of assets that do not meet their internal performance levels.'

He adds: 'We expect to see additional deal activity driven by distressed companies requiring capital in order to restructure or continue operating during the bankruptcy process. Private equity capital from funds specialising in restructuring is a likely source of capital for distressed companies that are unable to obtain traditional financing. The reduced valuation level in the markets could also be seen as a chance for Chinese and Middle Eastern chemical conglomerates to expand into speciality chemicals and pick up entire companies or minority stakes.'

At least one Chinese chemical CEO is clearly poised to capitalise on any such opportunities that emerge. In one of the in-depth

interviews we conducted to supplement our quantitative research, Ren Jianxin, President of ChemChina, said: 'In a recession, we may have the chance to acquire some assets that might have otherwise been too expensive. But we shall not go bottom-fishing; we are an industry investor, not a financial investor. We keep our eye on the long term. This crisis is like the winter. Spring is not too far [away].'

Balancing the short and long term

Executives in the chemicals industry tend to take a longer-term perspective than those in many other sectors – partly, perhaps, because the chemicals industry is very capital-intensive and has quite long product lifecycles. In our experience, chemical CEOs typically respond to periods of economic difficulty by reassessing the timing and allocation of capital investments, rather than changing their business models.

We anticipate that this pattern will continue and that many companies will adapt their plans, as the medium – and long-term effects of the economic downturn become more apparent. Companies in some sub-sectors may experience fundamental changes in the regional supply/demand balance, because the downturn could influence the timing of plant closures and capacity additions. Many may also need to reassess their plans to capitalise on any opportunities for purchasing troubled operations.

Tactically, we expect that companies will try to conserve cash during this period, by optimising their working capital management and paying close attention to pricing, as they come under pressure from customers to pass on the savings from lower raw materials costs. The strongest companies will probably adopt short-term measures to cope with the recession without jeopardising their long-term interests, but weaker companies may be forced to focus on short-term issues merely to survive.

Addressing global risks

Proactively collaborating to address global and systemic risks is nothing new for the chemicals industry. It has already made considerable efforts to improve its environmental profile through initiatives like ResponsibleCare, where chemical companies have voluntarily committed to producing chemicals in a sustainable manner. But many companies are now taking steps to reduce their dependence on carbon-based energy sources, too. Fifty-eight percent of chemical CEOs report that they are making strategic investments in response to the threat of climate change.

The industry is also making active efforts to improve its energy efficiency and the sustainability of its energy supply. Ninety-four

percent of chemical CEOs are trying to reduce their energy consumption through improvements in operating efficiency, while 63% are investigating alternative energy sources and 58% are investing in new technologies to reduce their dependence on energy. More than half the chemical CEOs we surveyed are securing future supplies of energy as well – a response that is entirely logical, since carbon-based fuels are not only an important source of energy for chemicals production, they are also a key raw material for many chemicals.

However, energy is not the only resource about which chemical CEOs are concerned. Thirty-seven percent believe that scarcity of raw materials, water and other such natural resources may pose a threat to their companies' long-term growth – and, like their peers in other industries, most of them think that the pressure on natural resources will continue to increase.

Collaboration with government to achieve regulatory stability

The chemicals industry is a highly regulated sector that must comply with a wide range of rules regarding the production, transportation, storage and disposal of its products. These regulations often pose substantial challenges and are likely to continue evolving. Some three-fifths of chemical CEOs are therefore concerned that over-regulation may be a threat to the growth of their businesses in the future.

Chemical companies have already demonstrated a strong commitment to collaborating with regulators, customers, competitors and peers to achieve common goals. In response to the Registration, Evaluation, and Authorisation of Chemicals (REACH) directive, for example, industry trade organisations facilitated the development of 'SIEFreach', an electronic portal enabling industry players to share information on individual substances. The industry leaders also worked closely with their customers to ensure that the pre-registration process proceeded according to plan. But continued collaboration will be essential to establish stable guidelines and minimise the administrative and financial burden of compliance.

Cultivating key skills

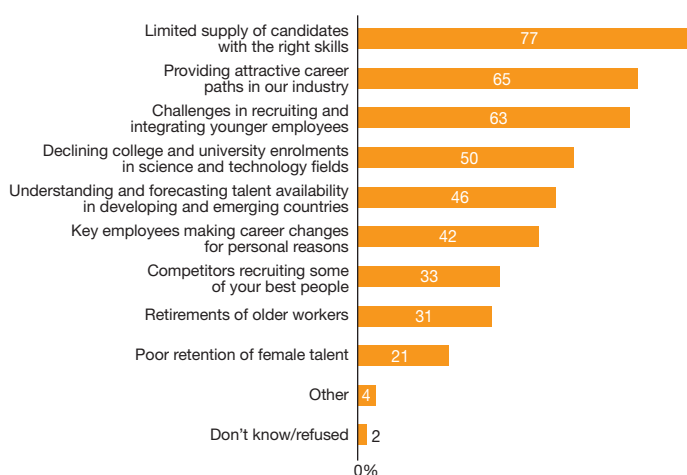
In a tough economic environment, companies generally need to pay greater attention to ensuring that they have the skills base they require to succeed, and that they develop, motivate and retain key talent. However, 35% of chemical CEOs anticipate that they will have to reduce the number of people they employ over the next 12 months (versus 26% of the total survey population).

The chemicals industry is heavily reliant on the development of new products and ideas – and it is people, not systems or processes, who generate innovation – so these CEOs will have to be very careful about how they implement such reductions. Retaining the right skills to deliver long-term business growth is essential, and companies that cut back too far now may struggle to take advantage of the economic recovery, when it occurs.

That said, headcount cuts in developed countries may provide opportunities for growing companies in developing markets like China. As Ren Jianxin, President of ChemChina, notes: ‘We see many enterprises around the world cutting jobs because of the financial crisis, and we work with leading human resource consultancies to recruit more Western professionals. We recently hired new directors for two of our factories – one from the UK and another from the US.’

The industry as a whole will also have to invest more effort in recruiting new staff in the longer term. Seventy-seven percent of the chemical CEOs we surveyed told us that they are concerned about the limited supply of candidates with the right skills, while 63% say that they find it hard to attract and integrate young workers (see figure 1).

Figure 1
The talent shortage remains the top concern



Q: Considering the talent required for the success of your business, what are the key challenges you face?
Base: 48

Source: PricewaterhouseCoopers 12th Annual Global CEO Survey 2009

Many chemical companies may therefore need to analyse how they engage with the ‘millennial’ generation, which has different expectations from those of previous generations. Other research conducted by PricewaterhouseCoopers shows, for example, that a substantial number of new joiners value training and development as much as, or more than, cash. They also regard the opportunity to work with strong coaches and mentors, and corporate commitment to the environment, as vital.¹

One way of attracting and motivating this new generation of workers would be to offer them the benefits and incentives they really want. But chemical companies should also promote the industry’s efforts to help solve the climate change challenge more strongly and continue to focus on corporate responsibility in order to appeal to candidates eager to work for employers that share their core values.

Looking forward

Chemical CEOs will have to ensure that they are addressing not only short-term risks, but also long-term systemic risks such as climate change and shrinking natural resources. As PricewaterhouseCoopers’ Global Chemicals Leader Saverio Fato notes, ‘Business models in the industry will need to evolve. Commodity chemical companies will follow speciality manufacturers by getting even closer to their clients; Chinese and Middle Eastern companies will buy into new markets or technologies; and almost all companies will need to adopt sustainable business solutions.’

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¹ PricewaterhouseCoopers, ‘Millennials at work: Perspectives from a new generation’ (2008), available at www.pwc.com/managingpeople2020

Full findings of the PricewaterhouseCoopers 12th Annual Global CEO Survey are available at www.pwc.com/ceosurvey

For additional information regarding PricewaterhouseCoopers’ chemicals sector practice, please visit www.pwc.com/chemicals