

# Chemical Customer Connectivity

## Knowing what matters to your customers— The European experience

*Recession in developed markets, unpredictable exchange rates, volatile prices for oil and other commodities.... It is no surprise that the European Chemical Industry Council lowered its growth forecast for the 2008 financial year to 2 percent. Yet when the going gets tough, the tough get going. The fast-growing market of the past few years has hidden a lot of sloppy behavior—the worst of which is not truly addressing what your customers need or want. Winners—survivors—in this market have already realized that the time has come for a change.*

As the European chemical industry begins to struggle through more difficult economic times, it is more important than ever to focus on long-term growth and activities such as innovation. Companies are dusting off their business strategies and product portfolios and improving their operational efficiencies in preparation for better days ahead. What's most important in tough times, however, is to stay focused on meeting customers' needs. Connect with customers now or risk losing a competitive edge (*see sidebar: Know Your Customers*).

These are among the major findings in a recent study performed by A.T. Kearney and CHEManager Europe, as the two joined forces to survey senior-level executives from the leading players in the chemical industry. Called the Chemical Customer Connectivity Index (C3X), our objec-

tive was to analyze the industry from the vantage points of chemical companies (manufacturers) and their customers.<sup>1</sup> We found that while companies are still largely optimistic about how the industry will fare over the next year (in terms of volume), most expected further short-term price increases for chemical raw materials as a consequence of the general rise in raw material costs (*see figure 1 on the following page*).

In this paper, we use the survey findings to answer two key questions: What issues are at the very top of chemical customers' agendas? Which areas should be given the highest priority by chemical company executives?

### What Customers Want

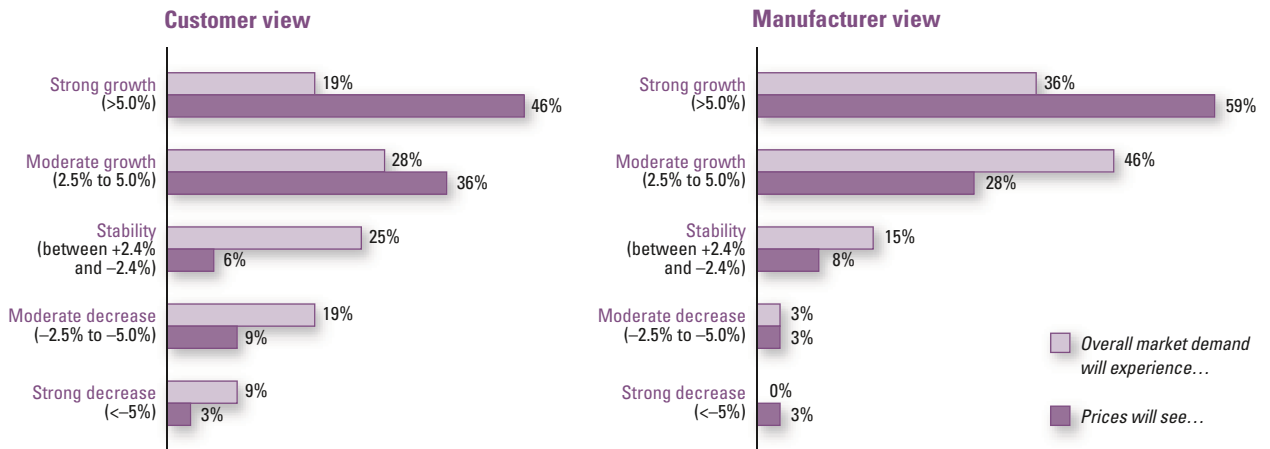
Pricing excellence tops the agenda for 88 percent of chemical customers, followed by process excellence



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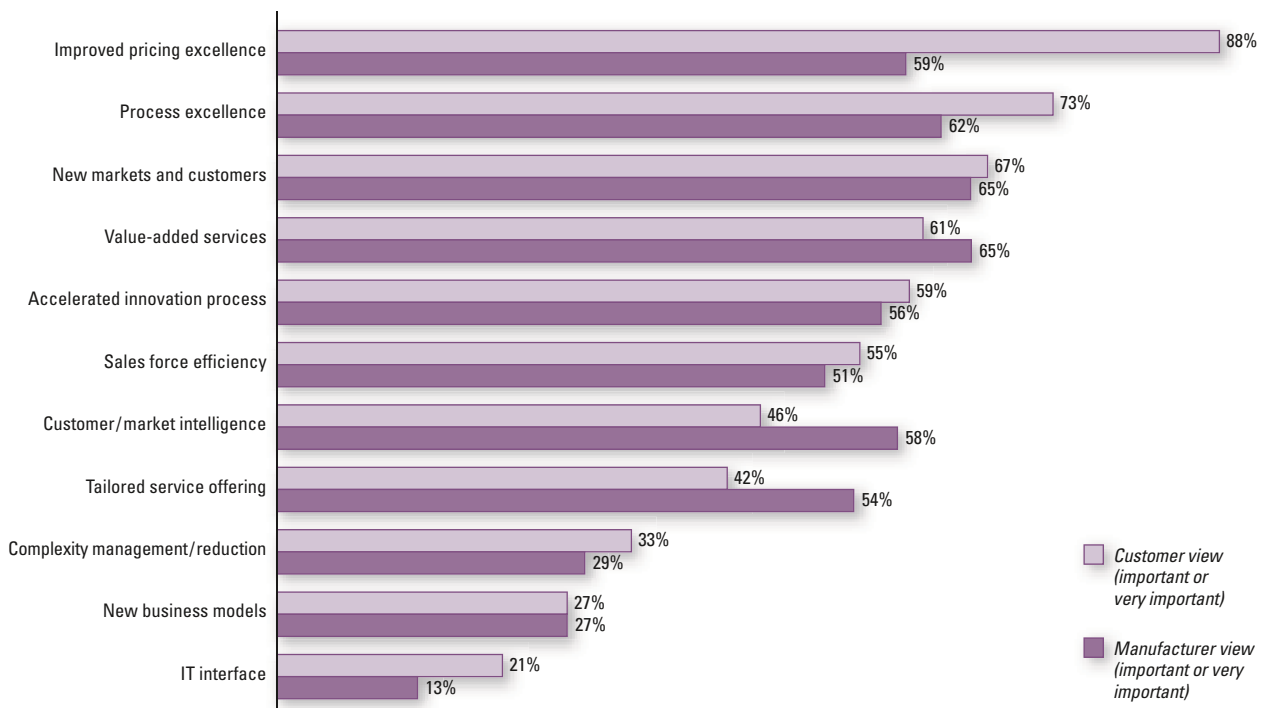
<sup>1</sup> Participants in the C3X survey, which took place from June to August, included executives from 10 European countries, representing an equal number of chemical firms and client companies, for a total of 80 executives. Chemical customers comprised 10 different industry sectors, ranging from automotive and food to cosmetics.

**FIGURE 1: The outlook for growth**



Source: A.T. Kearney

**FIGURE 2: Major topics for chemical manufacturers**



Source: A.T. Kearney

(73 percent) and new customers and markets (67 percent). Figure 2 outlines the major topics.

**Pricing excellence.** Chemical companies frequently misjudge the significance to their customers of a sensible price-performance ratio. Because production performance depends on chemicals, customers

want price mechanisms to be more in line with performance improvements achieved. Today, 56 percent of pricing arrangements are fixed prices and 39 percent are based on price formulas. When questioned about future contract structures, most executives anticipate a change in the next year. And in a clear sign that

customers are preparing for a possible downturn, making their contract structures more flexible, 63 percent of survey participants think contracts with index-based price formulas will soon be the agreement of choice. Chemical companies that address the pricing issue with more differentiated and tailored pricing concepts have a better chance of staying in this game.

**Process excellence.** Smooth supply-chain management, including product availability and reliable delivery, is considered a “given” by almost all chemical customers, matching the chemical companies’ own beliefs. Customers perceive inventory management and packaging flexibility as “nice to have” but not really necessary. They think by eliminating these non-differentiating services they can cut costs. Criteria such as the relationship between the buyer and seller and the financial stability of the chemical company are also of secondary importance.

**New markets and customers.** Chemical customers in emerging markets, primarily Brazil, Russia, India and China, want to buy existing products and services tailored to meet their needs. Roughly 67 percent of customers list this among their top priorities in the next year. The findings point specifically to adapting products to meet the requirements in new industry value chains and the needs of new markets and end consumers. For example, some chemical companies are exploiting opportunities in new supply chains, such as for lithium batteries, to capture more value, while others are moving beyond selling pure products to acting as full

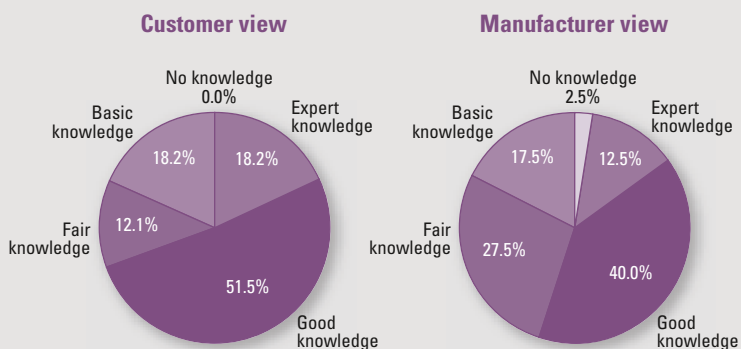
## Know Your Customers

A key finding of the C3X survey is that chemical companies address their customers’ concerns best when they understand the requirements of their customers’ customers. For approximately two-thirds of executives such knowledge is fundamental to defining their customers’ needs. Executives attribute a significantly smaller role to technical aspects, commercialization and the end consumer.

Most customers credit chemical companies with a better overall understanding of customer requirements than chemical company executives claim to have. Nearly three-quarters of chemical customers say they are excellently or well understood by their suppliers while only about half of chemical firms’ claim such customer knowledge (*see figure*).

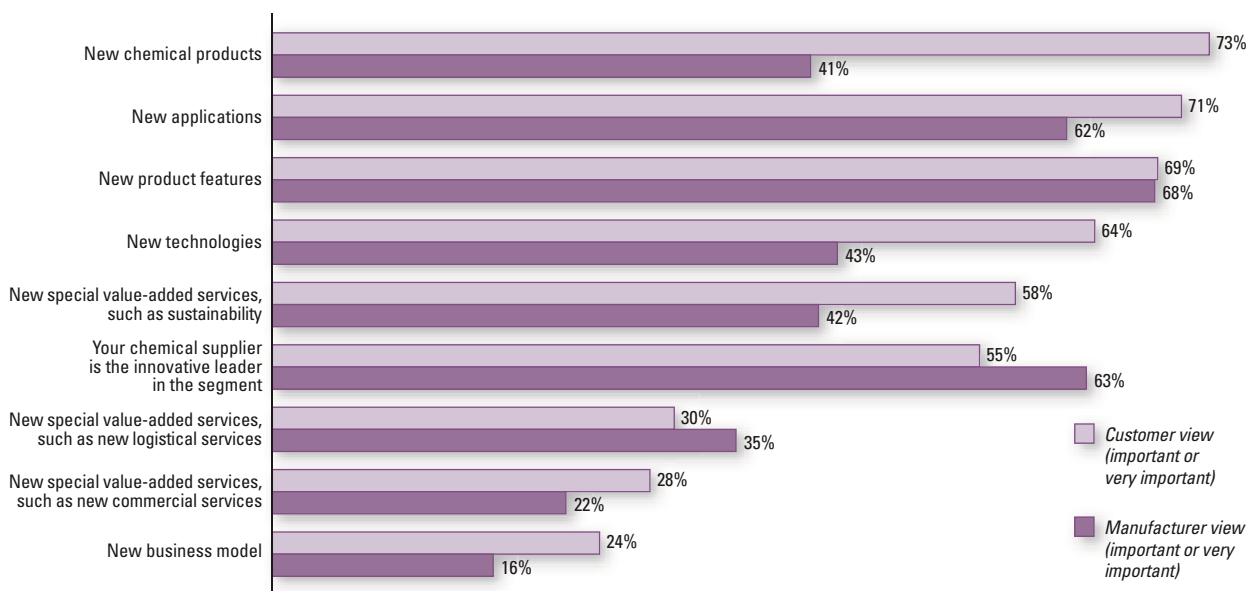
Are chemical company executives too self-critical? Other than in a few areas, their general understanding of their customers’ requirements is actually pretty good. Now their focus should be on leveraging this know-how more effectively and triggering innovative activities that deliver products and services that more precisely match customers’ needs. The focus and the result should be on achieving growth. While chemical companies might know what their customers want, they are often not in a position to think creatively and convert this knowledge into new offerings.

**FIGURE:** How well do chemical manufacturers know their customers?



Source: A.T. Kearney

**FIGURE 3:** Customers' innovation expectations



Source: A.T. Kearney

service providers; they are taking over the management of entire processes, such as waste water treatment facilities and coating plants. Also on chemical customers' radar screens is adapting existing products and services for completely new applications.

By comparison, chemical companies view their customers' priorities somewhat differently, citing value-added services, new markets and customers and process excellence among the top three areas. Surprisingly, the chemical regulation REACH did not feature highly in the list of internal issues of concern.<sup>2</sup>

### Innovation: Delivering Game Changers

Expectations are high when it comes to innovation. Customers expect

chemical companies to be creative and innovative, hoping for both "incremental innovation" and genuine "game changing" ideas. Indeed, 73 percent of customers believe they expect new products, 71 percent say they expect new applications, and 69 percent of customers expect new product features (see figure 3 on the following page).

Chemical companies, on the other hand, consider innovation in terms of their existing product portfolios—either changing or further developing current products in existing and completely new applications. This should not be a surprise as, in some cases, game changing innovations are associated with decades of research and enormous up-front

investments; these investments (both costs and risks) are often not equally shared between chemical companies and their customers.

Our findings confirm that the chemical industry is still very scientifically focused and, in many cases, still does not consider marketing and sales as an integral part of the innovation process. An issue that becomes increasingly apparent is the lack of sales competence at the customer interface.

### The Closer the Better

When asked what they think of *collaborative innovation* between chemical companies and their customers, about two-thirds of survey participants ranked it as important or very important.

<sup>2</sup> REACH is a European Community regulation on chemicals and their safe use. It deals with the Registration, Evaluation, Authorization and Restriction of Chemical substances. The new law entered into force on 1 June 2007.

Chemical firms rank collaborative innovation even a little higher than their customers do. They know that by involving the customer at an early stage, they can better align expectations and therefore preemptively manage the risks associated with innovation. Chemical companies also try to share the burden of the high costs of research and development (R&D) with their customers. This, however, is not always in the interest of the customer, which could be why a considerable proportion of customers score collaborative innovation as unimportant. The extent to which the customer is involved in the innovation process also varies from one customer industry to the other. For instance, close collaboration is particularly widespread in the automotive industry.

Close collaboration with customers also helps chemical companies increase revenues, particularly in the market-entry phase of new products. For nearly half of all chemical companies, 10 to 20 percent of revenues are from products younger than three years. This high percentage highlights how working collaboratively with customers can accelerate the acceptance of new products. The earlier customers become involved in new product development, the higher the chances for a successful launch and the faster time to market and revenues.

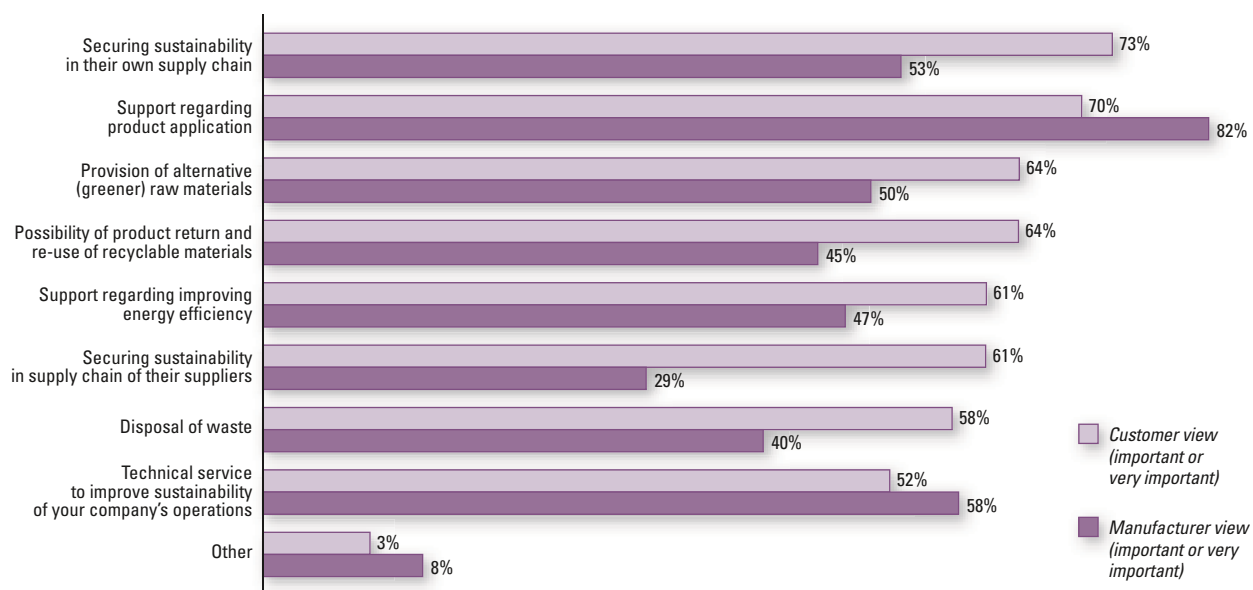
When asked about annual investments in innovation, chemical companies on average invest around 2 to 4 percent of revenues in innovation projects. The share is closer to 8 percent or more for more innovation-oriented companies. What is striking,

however, is that “innovation management efficiency” is still very poor in many cases. In well over a third of the companies surveyed, only 40 percent of the innovation budget is assigned to defined projects. This makes the absolute investment into innovation rather difficult to compare as there is no direct link between the investment and the resulting innovations.

### It's Not Easy Being Green

Chemical companies tend to underestimate the importance of environmental protection and sustainability to their customers. Almost 35 percentage points more customers than chemical companies rate environmental protection as important or very important and for sustainability the difference is 22 percentage points. In this respect, are chemical firms

**FIGURE 4:** Helping customers become more sustainable



Source: A.T. Kearney

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losing opportunities to differentiate their companies from competitors? The short answer is yes or, at least, maybe. The issue of sustainability is one that the customers' customers have very much taken to heart. More than 60 percent of customers say they would consider support in this area as helpful. In the next 12 months, customers indicate that social responsibility and a positive environmental track record will be key requirements for doing business with a chemical company.

Their expectations are fairly straightforward. Customers would like the chemical companies to support them where possible, especially in areas such as supply chain management (see figure 4 on the previous page). They want the chemical companies to consider sustainability all along the value chain—starting

with the supply chain processes of their suppliers and ending with the supply chains of their customers' customers.

Yet, chemical companies still largely view sustainability defensively—as something linked to plant efficiency, technology and raw materials. Less than 30 percent think sustainability is of interest to their customers. And, so far, few have identified sustainability as an opportunity to further expand their offerings, differentiate against competition or align their own portfolio with customers' requirements.

Chemical companies that take on sustainability—addressing it fully and correctly—will be in a better position to develop a holistic understanding of the customer-industry value-added chain. A glance to the future suggests that over the next

year, offering customers such value-added services as sustainability will be a good way to differentiate from competitors—especially when such services are offered at an attractive price.

## Think Long Term

Long-term thinking is a fundamental building block in a sustainable customer-supplier relationship. Those who understand the interface to their customers and address the relevant issues of today, tomorrow and beyond are well prepared and have a clear advantage. In reality, however, it is apparent that there are still significant opportunities that can be exploited by better fulfilling customer requirements. Offering real value-added services—for example, in the area of sustainability—are good opportunities for raising a company's profile.

## Authors

**Dr. Tobias Lewe** is a vice president in the Dusseldorf office. He can be reached at [tobias.lewe@atkearney.com](mailto:tobias.lewe@atkearney.com).

**Thomas Rings** is a vice president in the Munich office. He can be reached at [thomas.rings@atkearney.com](mailto:thomas.rings@atkearney.com).

**Dr. Marc Vathauer** is a manager in the Frankfurt office. He can be reached at [marc.vathauer@atkearney.com](mailto:marc.vathauer@atkearney.com).

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A.T. Kearney, Inc.  
Marketing & Communications  
222 West Adams Street  
Chicago, Illinois 60606 U.S.A.

1 312 648 0111  
email: [insight@atkearney.com](mailto:insight@atkearney.com)  
[www.atkearney.com](http://www.atkearney.com)